



Featured Stock in March's Safest Dividend Yields Model Portfolio

17 new stocks make our [Safest Dividend Yields Model Portfolio](#) this month, which was made available to members on March 20, 2020.

Recap from February's Picks

Our Safest Dividend Yields Model Portfolio underperformed the S&P 500 from February 20, 2020 through March 18, 2020. The Model Portfolio fell 41.1% on a price return basis and 40.8% on a total return basis. The S&P 500 fell 28.8% on a price return and total return basis. The best performing large cap stock was up 7%, and the best performing small cap stock was down 27%. Overall, seven out of the 16 Safest Dividend Yield stocks outperformed the S&P 500 and Russell 2000 from February 20, 2020 through March 18, 2020.

Get the best fundamental research

Only our research utilizes the superior data and earnings adjustments featured by the HBS & MIT Sloan paper, "[Core Earnings: New Data and Evidence](#)." This Model Portfolio leverages our [Robo-Analyst technology](#)¹, which scales our forensic accounting expertise ([featured in Barron's](#)) across thousands of stocks.²

This Model Portfolio only includes stocks that earn an [Attractive or Very Attractive](#) rating, have positive free cash flow and [economic earnings](#), and offer a dividend yield greater than 3%. Companies with strong [free cash flow](#) provide higher quality and safer dividend yields because we know they have the cash to support the dividend. We think this portfolio provides a uniquely well-screened group of stocks that can help clients outperform.

Featured Stock for March: McDonald's Corporation (MCD: \$162/share)

McDonald's Corporation (MCD), is the featured stock in March's Safest Dividend Yields Model Portfolio.

We first featured MCD in [November 2012](#) and more recently made the stock a [Long Idea](#) in [November 2019](#). The stock has underperformed the S&P 500 since both reports were published, but given its strong fundamentals, MCD remains undervalued.

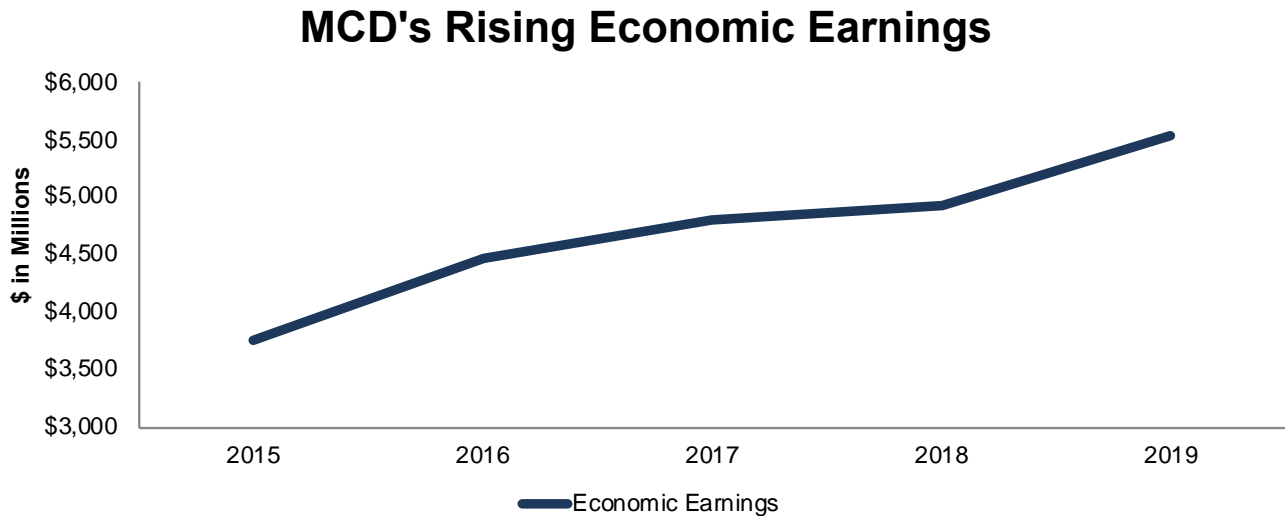
MCD has grown net operating profit after-tax ([NOPAT](#)) by 8% compounded annually since 2015 and by 4% compounded annually over the past decade. The firm's NOPAT margin increased from 21% in 2015 to 35% in 2019 while return on invested capital (ROIC) improved from 12% to 16% over the same period. Most importantly, MCD's [economic earnings](#), the true cash flows of the business, have grown from \$3.8 billion in 2015 to \$5.5 billion in 2019, or 10% compounded annually.

¹ Harvard Business School features the powerful impact of our research automation technology in the case [New Constructs: Disrupting Fundamental Analysis with Robo-Analysts](#).

² This [paper](#) compares our analytics on a mega cap company to Bloomberg and Capital IQ (SPGI) in a detailed appendix.



Figure 1: MCD's Economic Earnings Since 2015

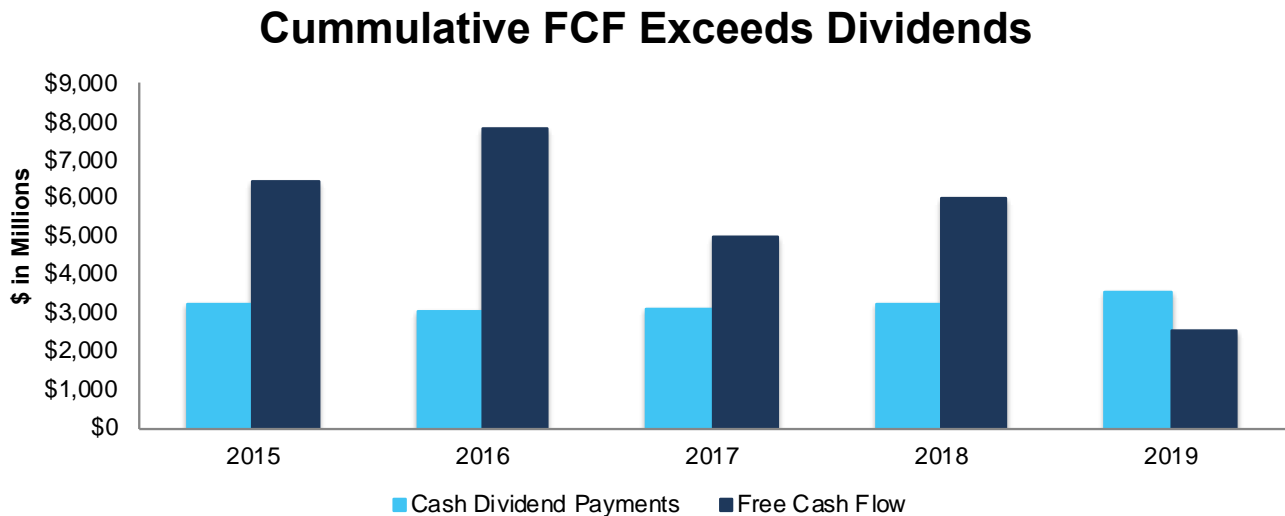


Sources: New Constructs, LLC and company filings

Cash Flow Supports Dividend Payments

MCD has increased its dividend for 43 consecutive years and the company [recently noted](#) it will not be making changes to its dividend, going so far as calling it a “priority.” MCD increased its annual dividend from \$3.44/share in 2015 to \$4.73/share in 2019, or 8% compounded annually. The current quarterly dividend, when annualized, equals \$5.00/share. MCD’s dividend payment has been supported by the firm’s strong free cash flow (FCF). MCD has generated \$27.8 billion (25% of current market cap) in FCF while paying \$16.2 billion in dividends since 2015, per Figure 2.

Figure 2: MCD's FCF Vs. Dividends Since 2015



Sources: New Constructs, LLC and company filings

Companies with strong FCF provide higher quality dividend yields because we know the firm has the cash to support its dividend. On the other hand, dividends from companies with low or negative FCF cannot be trusted as much because the company may not be able to sustain paying dividends.



MCD is Undervalued

At its current price of \$162/share, MCD has a price-to-economic book value (PEBV) ratio of 0.8. This ratio means the market expects MCD's NOPAT to permanently decline by 20%. This expectation seems overly pessimistic given that MCD has grown NOPAT by 4% compounded annually over the past decade and 6% compounded annually over the past two decades.

Even if MCD's NOPAT margin falls to 34% (compared to 35% in 2019) and it grows NOPAT by just 2% compounded annually for the next decade, the stock is worth \$240/share today – a 48% upside. [See the math behind this reverse DCF scenario.](#)

Critical Details Found in Financial Filings by Our [Robo-Analyst Technology](#)

As investors [focus more](#) on fundamental research, research automation technology is needed to analyze all the critical financial [details in financial filings](#) as shown in the Harvard Business School and MIT Sloan paper, "[Core Earnings: New Data and Evidence](#)".

Below are specifics on the adjustments we make based on Robo-Analyst findings in McDonald's Corporation's 2019 10-K:

Income Statement: we made \$2.4 billion of adjustments with a net effect of removing \$1.3 billion in [non-operating expenses](#) (6% of revenue). See all adjustments made to MCD's income statement [here](#).

Balance Sheet: we made \$21.5 billion of adjustments to calculate invested capital with a net increase of \$13.5 billion. The most notable adjustment was \$12.2 billion (28% of reported net assets) related to [operating leases](#). See all adjustments to MCD's balance sheet [here](#).

Valuation: we made \$51.2 billion of adjustments with a net effect of decreasing shareholder value by \$50.3 billion. Apart from [total debt](#), which includes the operating leases noted above, one of the most notable adjustments to shareholder value was \$477 million in [underfunded pensions](#). This adjustment represents <1% of MCD's market value. See all adjustments to MCD's valuation [here](#).

This article originally published on [March 25, 2020](#).

Disclosure: David Trainer, Kyle Guske II, and Matt Shuler receive no compensation to write about any specific stock, style, or theme.

Follow us on [Twitter](#), [Facebook](#), [LinkedIn](#), and [StockTwits](#) for real-time alerts on all our research.



Footnotes adjustments matter. We are the ONLY source.

We provide ratings, models, reports & screeners on U.S. 3,000 stocks, 700 ETFs and 7,000 mutual funds.

HBS & MIT Sloan research reveals that:

- **Markets are inefficiently assessing earnings because no one reads the footnotes.**
- **Corporate managers hide gains/losses in footnotes to manage earnings.**
- **Our technology brings the material footnotes data to market for the first time ever.**

Combining human expertise with NLP/ML/AI technologies ([featured by Harvard Business School](#)), we shine a light in the dark corners (e.g. footnotes) of hundreds of thousands of financial filings to unearth critical details.

The HBS & MIT Sloan paper, [Core Earnings: New Data and Evidence](#), shows how our superior data drives uniquely comprehensive and independent debt and equity research.

This [paper](#) compares our analytics on a mega cap company to other major providers. The Appendix details exactly how we stack up.

Learn [more](#).

Quotes from HBS & MIT Sloan professors on our research:

Get better research:

“...the NC dataset provides a novel opportunity to study the properties of non-operating items disclosed in 10-Ks, and to examine the extent to which the market impounds their implications.” – page 20

Pick better stocks:

“Trading strategies that exploit cross-sectional differences in firms’ transitory earnings produce abnormal returns of 7-to-10% per year.” – Abstract

Avoid losses from using other firms’ data:

“...many of the income-statement-relevant quantitative disclosures collected by NC do not appear to be easily identifiable in Compustat...” – page 14

Build better models:

“Core Earnings [calculated using New Constructs’ novel dataset] provides predictive power for various measures of one-year-ahead performance...that is incremental to their current-period counterparts.” – page 4

Exploit market inefficiencies:

“These results ... suggest that the adjustments made by analysts and Compustat to better capture core earnings are incomplete. Moreover, the non-core items identified by NC produce a measure of core earnings that is incremental to alternative measures of operating performance in predicting an array of future income measures.” – page 26

Fulfill fiduciary duties:

“An appropriate measure of accounting performance for purposes of forecasting future performance requires detailed analysis of all quantitative performance disclosures detailed in the annual report, including those reported only in the footnotes and in the MD&A.” – page 33-34



DISCLOSURES

New Constructs®, LLC (together with any subsidiaries and/or affiliates, "New Constructs") is an independent organization with no management ties to the companies it covers. None of the members of New Constructs' management team or the management team of any New Constructs' affiliate holds a seat on the Board of Directors of any of the companies New Constructs covers. New Constructs does not perform any investment or merchant banking functions and does not operate a trading desk.

New Constructs' Stock Ownership Policy prevents any of its employees or managers from engaging in Insider Trading and restricts any trading whereby an employee may exploit inside information regarding our stock research. In addition, employees and managers of the company are bound by a code of ethics that restricts them from purchasing or selling a security that they know or should have known was under consideration for inclusion in a New Constructs report nor may they purchase or sell a security for the first 15 days after New Constructs issues a report on that security.

DISCLAIMERS

The information and opinions presented in this report are provided to you for information purposes only and are not to be used or considered as an offer or solicitation of an offer to buy or sell securities or other financial instruments. New Constructs has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor and nothing in this report constitutes investment, legal, accounting or tax advice. This report includes general information that does not take into account your individual circumstance, financial situation or needs, nor does it represent a personal recommendation to you. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about any such investments or investment services.

Information and opinions presented in this report have been obtained or derived from sources believed by New Constructs to be reliable, but New Constructs makes no representation as to their accuracy, authority, usefulness, reliability, timeliness or completeness. New Constructs accepts no liability for loss arising from the use of the information presented in this report, and New Constructs makes no warranty as to results that may be obtained from the information presented in this report. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information and opinions contained in this report reflect a judgment at its original date of publication by New Constructs and are subject to change without notice. New Constructs may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and New Constructs is under no obligation to insure that such other reports are brought to the attention of any recipient of this report.

New Constructs' reports are intended for distribution to its professional and institutional investor customers. Recipients who are not professionals or institutional investor customers of New Constructs should seek the advice of their independent financial advisor prior to making any investment decision or for any necessary explanation of its contents.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would be subject New Constructs to any registration or licensing requirement within such jurisdiction.

This report may provide the addresses of websites. Except to the extent to which the report refers to New Constructs own website material, New Constructs has not reviewed the linked site and takes no responsibility for the content therein. Such address or hyperlink (including addresses or hyperlinks to New Constructs own website material) is provided solely for your convenience and the information and content of the linked site do not in any way form part of this report. Accessing such websites or following such hyperlink through this report shall be at your own risk.

All material in this report is the property of, and under copyright, of New Constructs. None of the contents, nor any copy of it, may be altered in any way, copied, or distributed or transmitted to any other party without the prior express written consent of New Constructs. All trademarks, service marks and logos used in this report are trademarks or service marks or registered trademarks or service marks of New Constructs. Copyright New Constructs, LLC 2003 through the present date. All rights reserved.