



## 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](#)<sup>1</sup>, which scales our forensic accounting expertise ([featured in Barron's](#)) across thousands of stocks.<sup>2</sup>

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)

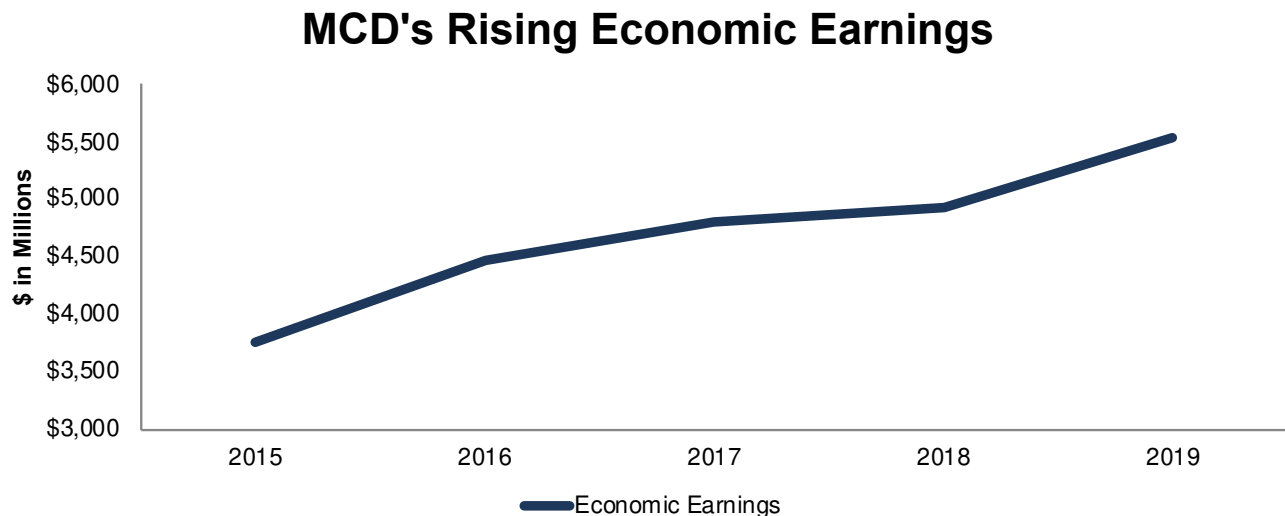
McDonald's Corporation (MCD), is the featured stock in March's Safest Dividend Yields Model Portfolio.

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.

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

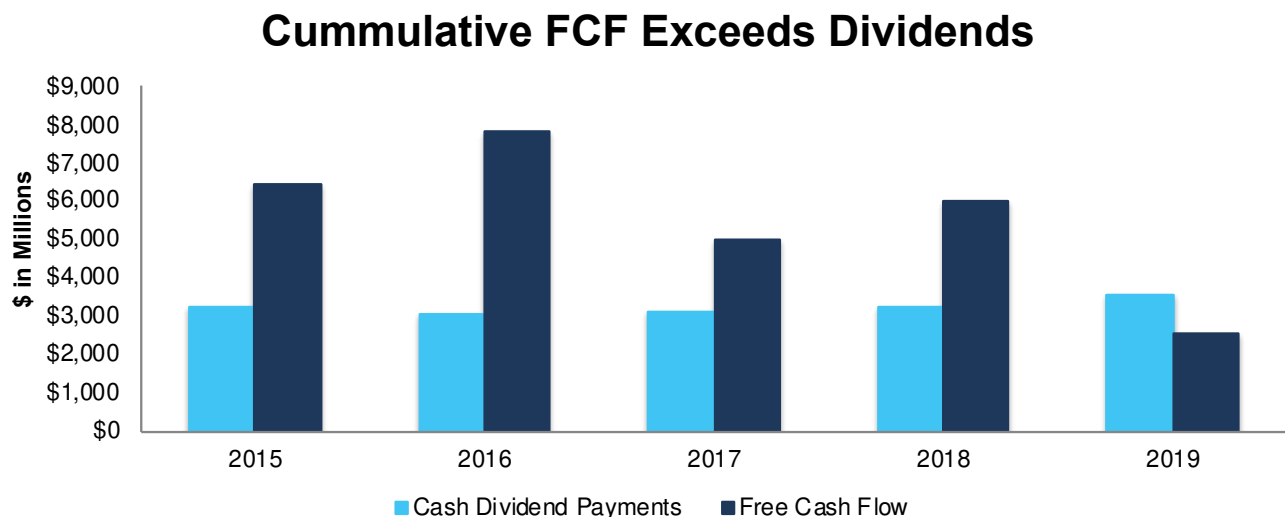
<sup>2</sup> This [paper](#) compares our analytics on a mega cap company to Bloomberg and Capital IQ (SPGI) in a detailed appendix.

**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.*

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## ***Footnotes adjustments matter. We are the ONLY source.***

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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**

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