Featured Stock in April's Safest Dividend Yields Model Portfolio

13 new stocks make our Safest Dividend Yields Model Portfolio this month, which was made available to members on April 22, 2020.

Recap from March's Picks

On a price return basis, our Safest Dividend Yields Model Portfolio (+18.7%) underperformed the S&P 500 (+23.1%) by 4.4% from March 20, 2020 through April 20, 2020. On a total return basis, the Model Portfolio (+19.2%) underperformed the S&P 500 (+23.4%) by 4.2% over the same time. The best performing large cap stock was up 40%, and the best performing small cap stock was up 48%. Overall, five out of the 20 Safest Dividend Yield stocks outperformed the S&P and Russell 2000 from March 20, 2020 through April 20, 2020.

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.

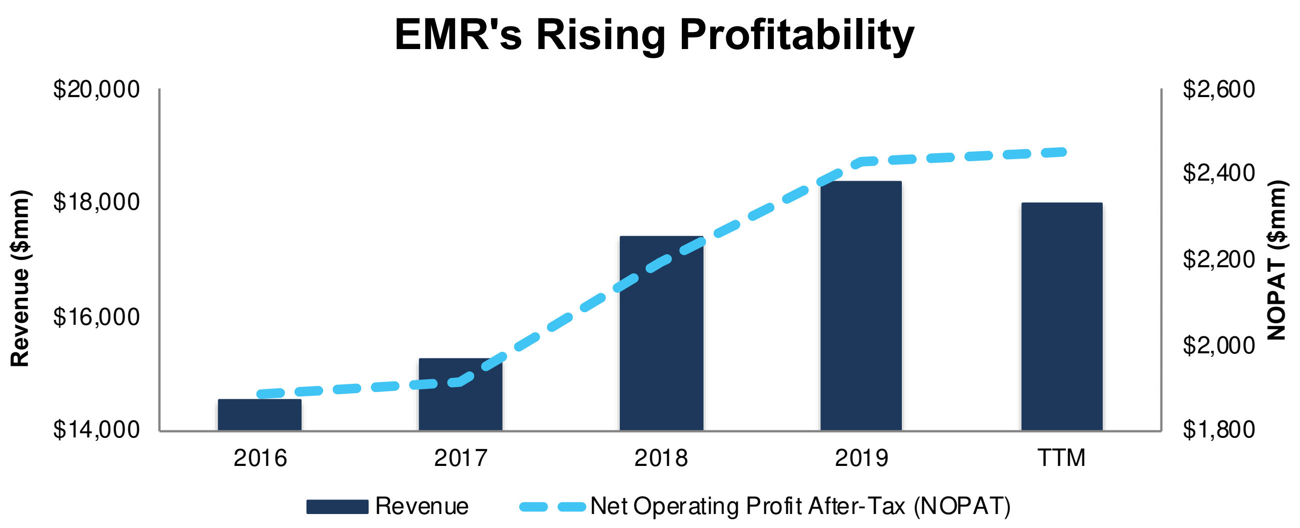
Featured Stock for April: Emerson Electric Company (EMR: $57/share)

Emerson Electric Company (EMR) is the featured stock in April's Safest Dividend Yields Model Portfolio.

EMR has grown net operating profit after-tax (NOPAT) by 9% compounded annually since 2016 and 3% compounded annually over the past two decades. The firm's NOPAT margin has increased from 13.0% in 2016 to 13.7% over the trailing-twelve-month (TTM), while invested capital turns have improved from 0.74 to 0.83 over the same period. The combination of rising NOPAT margin and invested capital turns drives the firm's return on invested capital (ROIC) from 10% in 2016 to 11% over the TTM.

[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: EMR's Revenue & NOPAT Since 2016

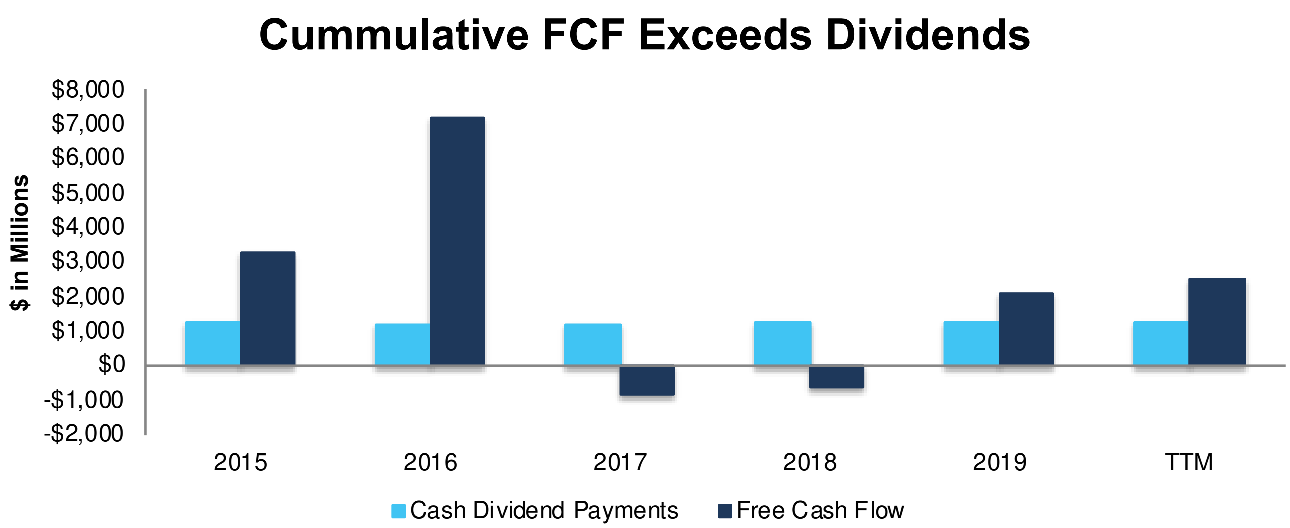


Sources: New Constructs, LLC and company filings

Cash Flow Supports Dividend Payments

EMR has increased its dividend for 63 consecutive years and stated in the most recent earnings call that it would not cut its dividend. The firm increased its annual dividend from $1.88/share in 2015 to $1.96/share in 2019, or 1% compounded annually. The current quarterly dividend, when annualized, equals $2.00/share and provides a 3.5% dividend yield. EMR's dividend payment has been supported by the firm's strong free cash flow (FCF). EMR generated $11 billion (32% of current market cap) in FCF while paying $6.2 billion in dividends from 2015 to 2019, per Figure 2. Over the TTM period, EMR has generated $2.5 billion in FCF and paid out $1.2 billion in dividends.

Figure 2: EMR'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.

EMR is Undervalued

At its current price of $57/share, EMR has a price-to-economic book value (PEBV) ratio of 1.1. This ratio means the market expects EMR's NOPAT to grow by no more than 10% over the remainder of its corporate life. This expectation seems overly pessimistic given that EMR has grown NOPAT by 9% compounded annually since 2016.

If EMR maintains TTM NOPAT margins of 13% and grows NOPAT by just 4% compounded annually for the next decade, the stock is worth $69/share today – a 21% 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 Emerson Electric Company's 2019 10-K:

Income Statement: we made $502 million of adjustments with a net effect of removing $125 million in non-operating expenses (1% of revenue). See all adjustments made to EMR's income statement here.

Balance Sheet: we made $8.4 billion of adjustments to calculate invested capital with a net increase of $7.1 billion. The most notable adjustment was $2.9 billion (20% of reported net assets) in asset write-downs. See all adjustments to EMR's balance sheet here.

Valuation: we made $10.4 billion of adjustments with a net effect of decreasing shareholder value by $7.1 billion. Apart from total debt, one of the most notable adjustments to shareholder value was $649 million in underfunded pensions. This adjustment represents 2% of EMR's market value. See all adjustments to EMR's valuation here.

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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.

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.**
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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

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