



Featured Stock in July's Dividend Growth Model Portfolio

Six new stocks make our [Dividend Growth Stocks Model Portfolio](#) this month, which was made available to members on July 29, 2020.

Recap from June's Picks

On a price return basis, our Dividend Growth Stocks Model Portfolio (+3.1%) underperformed the S&P 500 (+4.8%) by 1.7% from June 30, 2020 through July 27, 2020. On a total return basis, the Model Portfolio (+3.2%) underperformed the S&P 500 (+4.8%) by 1.6% over the same time. The best performing stock was up 12%. Overall, 11 out of the 30 Dividend Growth Stocks outperformed the S&P 500 from June 30, 2020 through July 27, 2020.

[Learn more about 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](#)." The long-term success of our model portfolio strategies highlights the value of our [Robo-Analyst technology](#)¹, which scales our forensic accounting expertise ([featured in Barron's](#)) across thousands of stocks².

The methodology for this model portfolio mimics an All-Cap Blend style with a focus on dividend growth. Selected stocks earn an [Attractive or Very Attractive rating](#), generate positive free cash flow ([ECF](#)) and [economic earnings](#), offer a current dividend yield >1%, and have a 5+ year track record of consecutive dividend growth. This model portfolio is designed for investors who are more focused on long-term capital appreciation than current income, but still appreciate the power of dividends, especially growing dividends.

Featured Stock from July: Cisco Systems, Inc. (CSCO: \$47/share)

Cisco Systems, Inc. (CSCO) is the featured stock from July's Dividend Growth Stocks Model Portfolio.

We made Cisco Systems a [Long Idea](#) in [November 2014](#) and closed the position in [October 2018](#) for a 62% gain (vs. 32% for the S&P 500). The stock now presents a much more favorable risk/reward than when we closed the position.

Cisco Systems has grown revenue by 4% compounded annually and net operating profit after-tax ([NOPAT](#)) by 6% compounded annually over the past decade. Longer term, Cisco Systems has grown NOPAT by 12% compounded annually over the past two decades. The firm's NOPAT margin has increased from 17% in 2009 to 23% over the trailing twelve months (TTM), while return on invested capital ([ROIC](#)) has improved from 15% to 17% over the same time.

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 Compare our analytics on a mega cap company to Bloomberg and Capital IQ's (SPGI) analytics in the [detailed appendix of this paper](#).



Figure 1: Cisco Systems' Revenue & NOPAT Since 2009



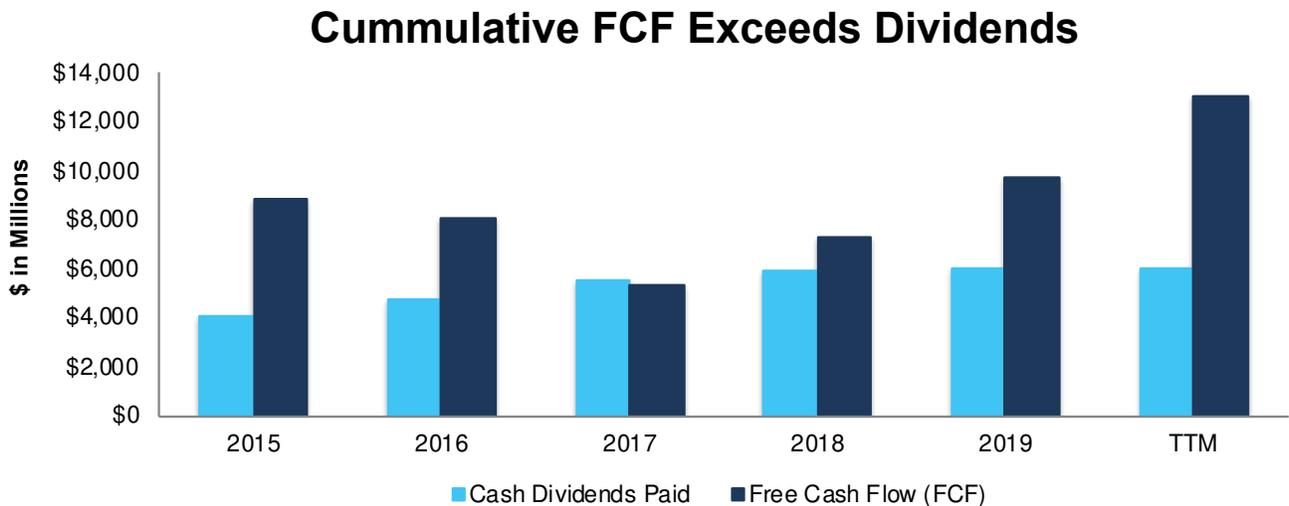
Sources: New Constructs, LLC and company filings

Steady Dividend Growth Supported by FCF

Cisco Systems has increased its dividend for nine consecutive years and from \$0.80/share in 2015 to \$1.36/share in 2019, or 14% compounded annually. The current quarterly dividend, when annualized, equals \$1.44/share and provides a 3% dividend yield.

More importantly, Cisco Systems' strong free cash flow (FCF) supports the firm's dividend payment. Cisco Systems generated \$39.3 billion (20% of current market cap) in FCF while paying \$26.3 billion in dividends from 2015 to 2019, per Figure 2. Over the TTM period, Cisco Systems generated \$13.1 billion in FCF and paid out \$6 billion in dividends.

Figure 2: Free Cash Flow (FCF) vs. Regular Dividend Payments



Sources: New Constructs, LLC and company filings

Companies with FCF well in excess of dividend payments provide higher quality dividend growth opportunities because we know the firm generates the cash to support a higher dividend. On the other hand, the dividend of a company where FCF falls short of the dividend payment over time cannot be trusted to grow or even maintain its dividend because of inadequate free cash flow.



CSCO Has Upside Potential

At its current price of \$47/share, CSCO has a price-to-economic book value ([PEBV](#)) ratio of 1.0. This ratio means the market expects Cisco Systems' NOPAT to never meaningfully grow over its remaining corporate life. This expectation seems overly pessimistic given that Cisco Systems has grown NOPAT by 7% compounded annually over the past five years and 6% compounded annually over the past decade.

If Cisco Systems maintains TTM NOPAT margins of 23%, grows NOPAT by just 4% compounded annually for the next decade, the stock is worth \$61/share today – a 30% 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 Cisco Systems' 2019 10-K:

Income Statement: we made \$3.2 billion of adjustments with a net effect of removing \$384 million in [non-operating income](#) (1% of revenue). See all adjustments made to Cisco Systems' income statement [here](#).

Balance Sheet: we made \$79 billion of adjustments to calculate invested capital with a net increase of \$2.4 billion. The most notable adjustment was \$19.1 billion (29% of reported net assets) related to [goodwill](#). See all adjustments to Cisco Systems' balance sheet [here](#).

Valuation: we made \$46.9 billion of adjustments with a net effect of increasing shareholder value by \$8.2 billion. Apart from [total debt](#), one of the most notable adjustments to shareholder value was \$27.6 billion in [excess cash](#). This adjustment represents 14% of Cisco Systems' market value. See all adjustments to Cisco Systems' valuation [here](#).

This article originally published on [August 10, 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.

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



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