



Featured Stock in October's Safest Dividend Yields Model Portfolio

Six new stocks make our [Safest Dividend Yields Model Portfolio](#) this month, which was made available to members on October 21, 2020.

Recap from September's Picks

On a price return basis, our Safest Dividend Yields Model Portfolio (+8.3%) outperformed the S&P 500 (+6.0%) by 2.3% from September 23, 2020 through October 19, 2020. On a total return basis, the Model Portfolio (+8.6%) outperformed the S&P 500 (+6.0%) by 2.6% over the same time. The best performing large cap stock was up 22%, and the best performing small cap stock was up 23%. Overall, nine out of the 20 Safest Dividend Yield stocks outperformed their respective benchmarks (S&P 500 and Russell 2000) from September 23, 2020 through October 19, 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](#)." 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 October: Western Union Co. (WU: \$20/share)

Western Union Co. (WU), is the featured stock in October's Safest Dividend Yields Model Portfolio.

We made first Western Union a [Long Idea](#) in [September 2018](#) and reiterated it in [October 2019](#). Since our first report, WU is up 5% while the S&P 500 is up 13%. Despite this underperformance, the stock provides excellent risk/reward going forward.

Western Union has grown net operating profit after-tax (NOPAT) by 1% compounded annually since 2016. The firm's NOPAT margin increased from 15.0% in 2016 to 15.5% TTM, while its [invested capital turns](#) improved from 1.2 to 1.5 over the same time.

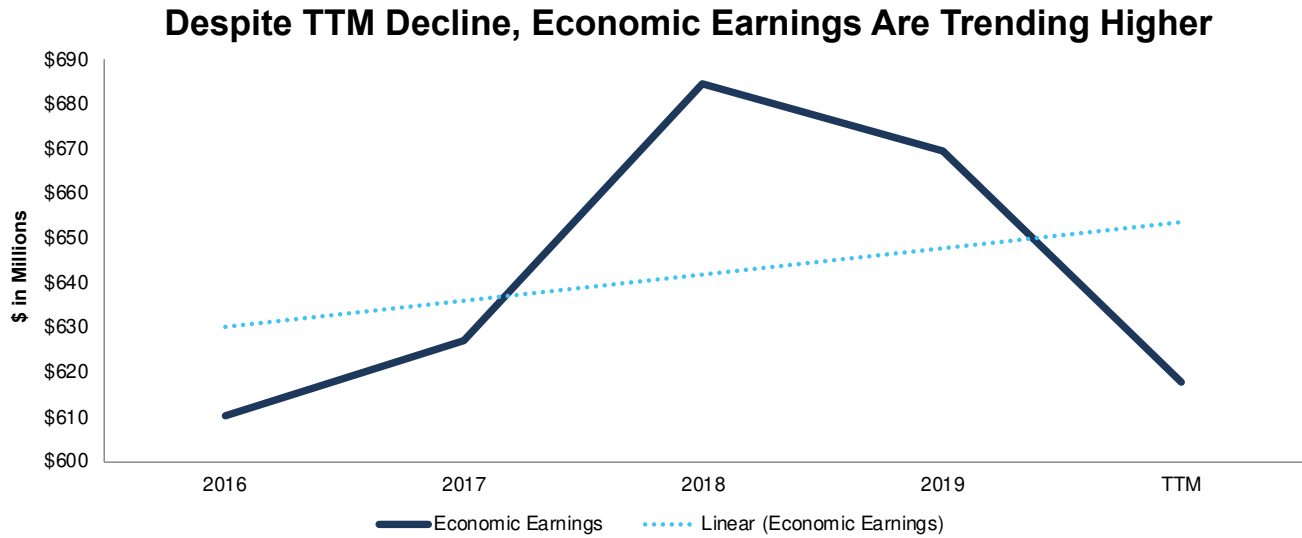
Rising margins and invested capital turns drive Western Union's return on invested capital (ROIC) from 19% in 2016 to 24% TTM. Most importantly, Western Union's [economic earnings](#), the true cash flows of the business, grew from \$610 million in 2016 to \$669 million in 2019, or 3% compounded annually. Over the TTM, COVID-19-induced disruption to the firm's [retail business](#) has contributed to driving economic earnings lower to \$618 million.

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: Economic Earnings Since 2016



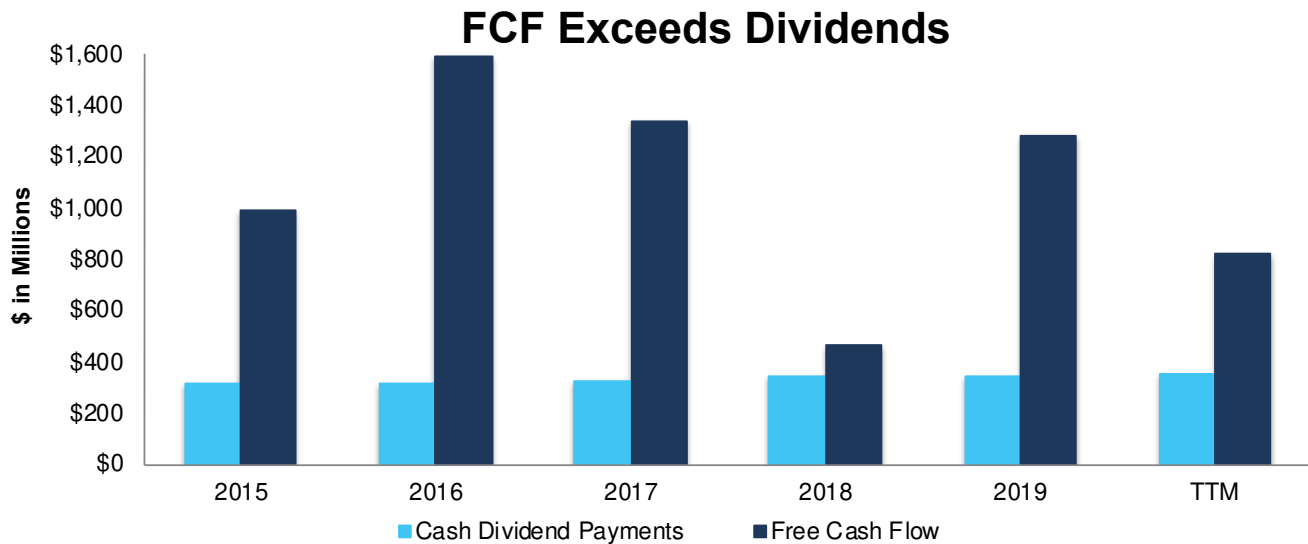
Sources: New Constructs, LLC and company filings

Cash Flow Supports Dividend Payments

Western Union has paid a dividend in each of the past 14 years. The firm increased its dividend payments from \$0.62/share in 2015 to \$0.80/share in 2019, or 7% compounded annually. The current quarterly dividend, when annualized provides a 4.4% dividend yield.

Western Union's dividend payment is supported by the firm's strong free cash flow (FCF). Western Union generated \$5.7 billion (69% of current market cap) in FCF while paying \$1.6 billion in dividends from 2015 to 2019, per Figure 2. Over the TTM, Western Union has generated \$827 million in FCF and paid out \$353 million in dividends.

Figure 2: Western Union'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.



WU Is Undervalued

At its current price of \$20/share, WU has a price-to-economic book value ([PEBV](#)) ratio of 0.5. This ratio means the market expects Western Union's NOPAT to permanently decline by 50%. This expectation seems overly pessimistic given that Western Union has grown NOPAT by 1% compounded annually since 2016.

Even if Western Union's margin falls to 12% (below all-time low of 15% and 16% in 2019) and the firm grows revenue by less than 1% compounded annually, which results in NOPAT falling by 2% compounded annually over the next decade, the stock is worth \$33/share today – a 65% 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 Western Union's 10-Q's and 10-K:

Income Statement: we made \$860 million of adjustments with a net effect of removing \$218 million in [non-operating income](#) (4% of revenue). See all adjustments made to Western Union's income statement [here](#).

Balance Sheet: we made \$2.6 billion of adjustments to calculate invested capital with a net decrease of \$625 million. The most notable adjustment was \$374 million (10% of reported net assets) in [asset write-downs](#). See all adjustments to Western Union's balance sheet [here](#).

Valuation: we made \$4.7 billion of adjustments with a net effect of decreasing shareholder value by \$2.6 billion. Apart from [total debt](#), one of the most notable adjustments to shareholder value was \$1.1 billion in [excess cash](#). This adjustment represents 13% of Western Union's market value. See all adjustments to Western Union's valuation [here](#).

This article originally published on [October 29, 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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