



Featured Stock in March's Dividend Growth Model Portfolio

19 new stocks make our [Dividend Growth Stocks Model Portfolio](#) this month, which was made available to members on March 26, 2020.

Recap from February's Picks

Our Dividend Growth Stocks Model Portfolio underperformed the S&P 500 from February 27, 2020 through March 24, 2020. The Model Portfolio fell 24.0% on a price return basis and 23.8% on a total return basis. The S&P 500 fell 18.3% on a price return basis and 17.8% on a total return basis. Overall, 11 out of the 30 Dividend Growth Stocks outperformed the S&P from February 27, 2020 through March 24, 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](#)." 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 ([FCF](#)) 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.

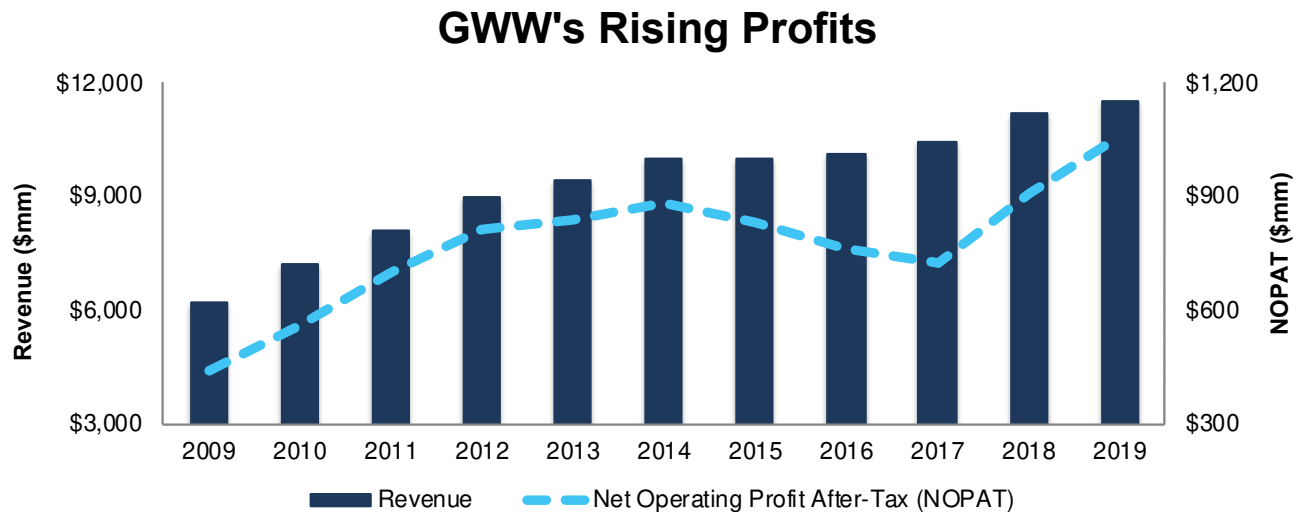
Featured Stock from March: W.W. Grainger (GWW: \$249/share)

W.W. Grainger, Inc. (GWW) is the featured stock from March's Dividend Growth Stocks Model Portfolio.

GWW has grown revenue by 6% compounded annually and net operating profit after-tax ([NOPAT](#)) by 9% compounded annually over the past decade. Longer-term, GWW has also grown NOPAT by 9% compounded annually over the past two decades. GWW's NOPAT margin increased from 7% in 2009 to 9% in 2019 while its ROIC improved from 13% to 18% over the same time. [Economic earnings](#), the true cash flows of a business, increased from \$236 million in 2009 to \$719 million in 2019, or 12% 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.

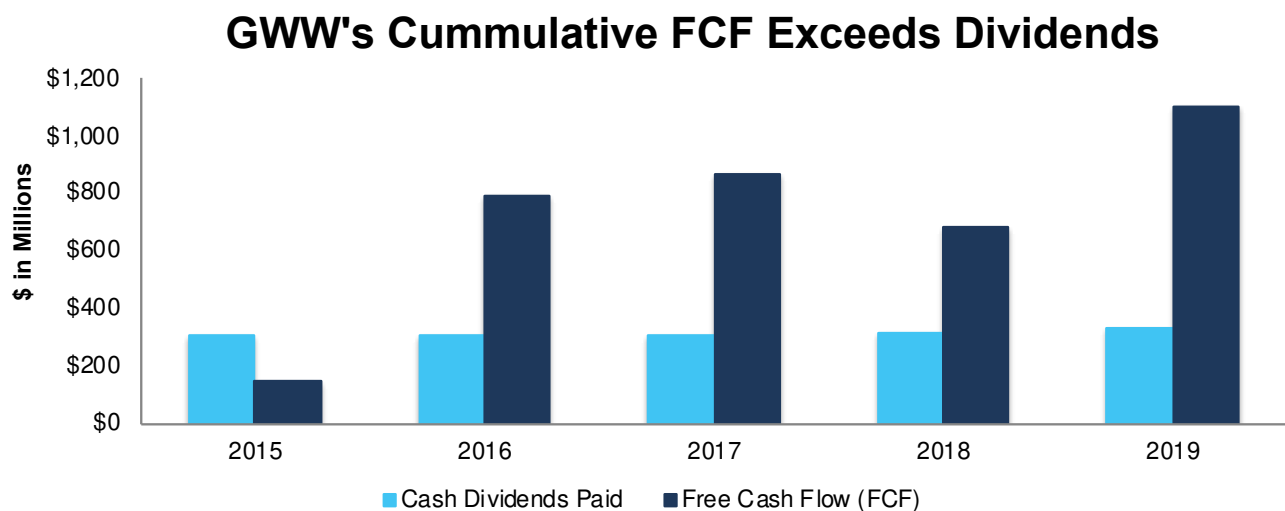
**Figure 1: GWW's Revenue & NOPAT Since 2009**

Sources: New Constructs, LLC and company filings

Steady Dividend Growth Supported by FCF

GWW has increased its dividend on common stock in each of the past 48 years. The company increased its annualized dividend from \$4.59/share in 2015 to \$5.68/share in 2019, or 5% compounded annually. Its current quarterly dividend, \$1.44/share equates to \$5.76/share annually. More importantly, GWW easily generates the cash flow needed to continue paying and growing its dividend. Over the past five years, GWW has generated a cumulative \$3.6 billion in FCF (27% of market cap) while paying \$1.6 billion in dividends.

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.

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

Sources: New Constructs, LLC and company filings

**GWW Is Undervalued**

At its current price of \$249/share, GWW has a price-to-economic book value ([PEBV](#)) ratio of 0.8. This ratio means the market expects GWW's NOPAT to permanently decline by 20% over its remaining corporate life. This expectation seems overly pessimistic for a firm that grew NOPAT by 17% year-over-year (YoY) in 2019 and 9% compounded annually over the past decade.

If GWW maintains its 2019 NOPAT margin of 9% and grows NOPAT by just 5% compounded annually over the next decade, the stock is worth \$419/share today – a 68% upside. [See the math behind this reverse DCF scenario.](#)

Add in GWW's 2.3% dividend yield and history of dividend growth, and it's clear why this stock is in March's Dividend Growth Stocks Model Portfolio.

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 W.W. Grainger's 2019 10-K:

Income Statement: we made \$376 million of adjustments with a net effect of removing \$211 million in [non-operating expenses](#) (2% of revenue). See all adjustments made to GWW's income statement [here](#).

Balance Sheet: we made \$1.7 billion of adjustments to calculate invested capital with a net increase of \$1.5 billion. The most notable adjustment was \$426 million (10% of reported net assets) related to [total reserves](#). See all adjustments to GWW's balance sheet [here](#).

Valuation: we made \$3.0 billion of adjustments with a net effect of decreasing shareholder value by \$3.0 billion. There were no adjustments that increased shareholder value. The largest adjustment to shareholder value was \$2.7 billion in [total debt](#), which includes \$207 million in [operating leases](#). This lease adjustment represents 2% of GWW's market value. See all adjustments to GWW's valuation [here](#). Despite these subtractions from shareholder value, GWW remains undervalued.

This article originally published on [April 1, 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.**
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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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