Featured Stock in March'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 March 19, 2021.

Recap from February's Picks

On a price return basis, our Safest Dividend Yields Model Portfolio (+8.5%) outperformed the S&P 500 (+1.7%) by 6.8% from February 18, 2021 through March 17, 2021. On a total return basis, the Model Portfolio (+8.9%) outperformed the S&P 500 (+1.7%) by 7.2% over the same time. The best performing large cap stock was up 20% and the best performing small cap stock was up 23%. Overall, 16 out of the 18 Safest Dividend Yield stocks outperformed their respective benchmarks (S&P 500 and Russell 2000) from February 18, 2021 through March 17, 2021.

More reliable & proprietary fundamental data, proven in The Journal of Financial Economics, drives our research. Our proprietary Robo-Analyst technology[1] scales our forensic accounting expertise (featured in Barron's) across thousands of stocks[2] to produce an unrivaled database of fundamental data.

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: Verizon Communications Inc. (VZ: $56/share)

Verizon Communications Inc. (VZ) is the featured stock in March's Safest Dividend Yields Model Portfolio.

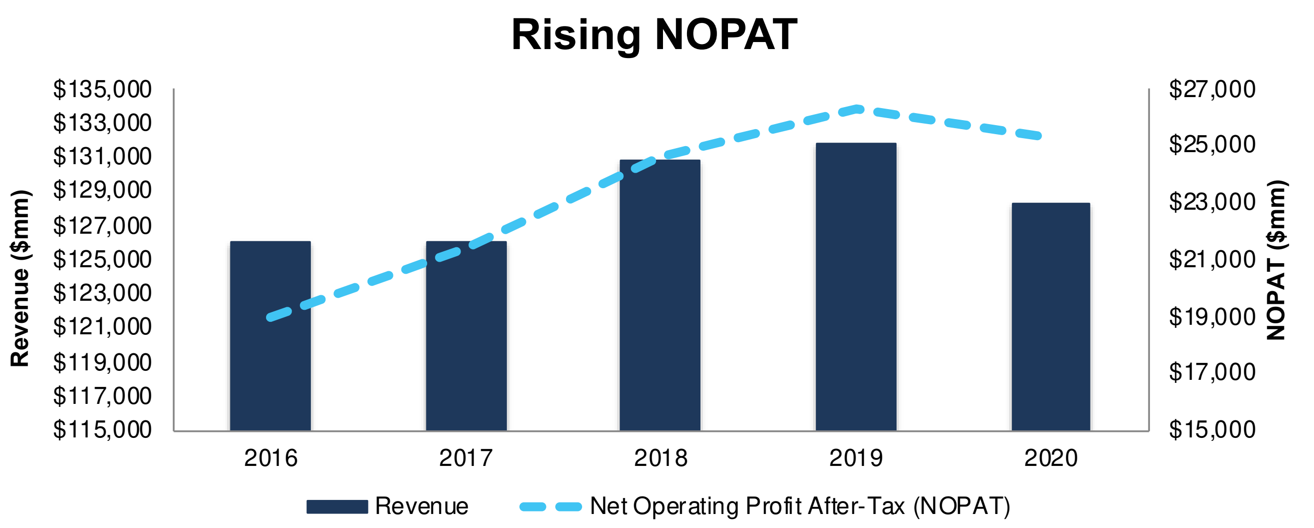
We most recently made Verizon a Long Idea in October 2020, which reiterated our September 2019 report. While the stock has underperformed as a Long Idea since both reports were published, VZ remains attractive.

Verizon has grown revenue by 4% compounded annually and net operating profit after tax (NOPAT) by 5% compounded annually over the past two decades. Verizon's NOPAT margin increased from 15% in 2016 to 20% in 2020 while its return on invested capital (ROIC) improved from 6% to 8% over the past decade.

The firm's economic earnings, or the true cash flows of the business, rose from $10 billion in 2016 to nearly $17 billion in 2020.

[1] Harvard Business School features our research automation technology in the case Disrupting Fundamental Analysis with Robo-Analysts.
[2] See how our models overcome flaws in Bloomberg and Capital IQ's (SPGI) analytics in the detailed appendix of this paper.

Figure 1: Verizon's Revenue & NOPAT Since 2016



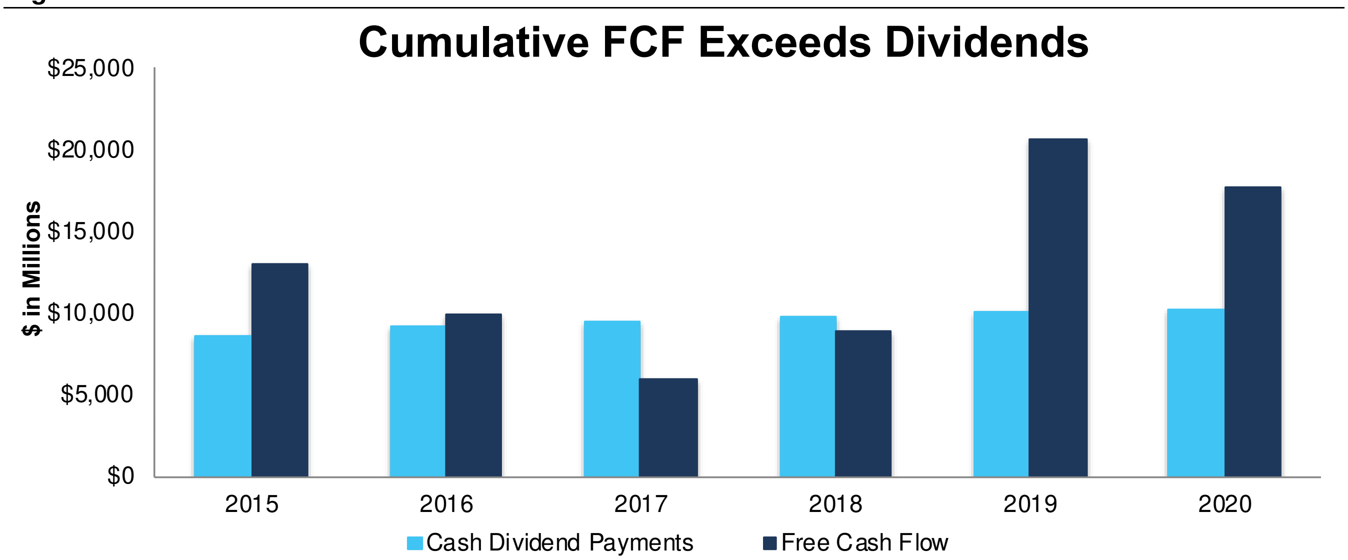
Sources: New Constructs, LLC and company filings

Cash Flow Supports Dividend Payments

Verizon has increased its dividend for 14 consecutive years. More recently, the firm increased its dividend payments from $2.29/share in 2016 to $2.49/share in 2020, or 2% compounded annually. The current quarterly dividend, when annualized provides a 4.5% dividend yield.

Since 2015, Verizon's cumulative FCF easily covers it annual dividend payments even after the $3.4 billion spent to acquire Fleetmatics and Telogis in 2016 as well as the $6.4 billion spent to acquire Yahoo, XO Communications' fiber business, and fiber optic network assets from WideOpenWest in 2017. Over the past five years, Verizon generated $63.2 billion (27% of current market cap) in FCF while paying $48.8 billion in dividends, per Figure 2.

Figure 2: Verizon'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.

VZ Is Undervalued

At its current price of $56/share, VZ has a price-to-economic book value (PEBV) ratio of 0.3. This ratio means the market expects Verizon's NOPAT to permanently decline by 70%. This expectation seems overly pessimistic given that Verizon has grown NOPAT by 4% compounded annually over the past five years and 5% compounded annually over the past two decades.

Even if Verizon's NOPAT margin falls to 10% (twenty-year low, vs. 20% in 2020) and the firm grows revenue by just 1% compounded annually over the next decade, the stock is worth $82/share today – a 46% upside. In this scenario, Verizon's NOPAT falls by 6% compounded annually over the next ten years. See the math behind this reverse DCF scenario.

Critical Details Found in Financial Filings by Our Robo-Analyst Technology

Fact: we provide superior fundamental data and earnings models – unrivaled in the world.
Proof: Core Earnings: New Data & Evidence, forthcoming in The Journal of Financial Economics.

Below are specifics on the adjustments we make based on Robo-Analyst findings in Verizon's 10-K:

Income Statement: we made $8.9 billion of adjustments with a net effect of removing $7.5 billion in non-operating expenses (6% of revenue). See all adjustments made to Verizon's income statement here.

Balance Sheet: we made $168 billion of adjustments to calculate invested capital with a net increase of $49 billion. The most notable adjustment was $71 billion (26% of reported net assets) in deferred tax assets. See all adjustments to Verizon's balance sheet here.

Valuation: we made $254 billion of adjustments with a net effect of decreasing shareholder value by $215 billion. Apart from total debt, one of the most notable adjustments to shareholder value was $20 billion in excess cash. This adjustment represents 9% of Verizon's market value. See all adjustments to Verizon's valuation here.

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Disclosure: David Trainer, Kyle Guske II, Alex Sword and Matt Shuler receive no compensation to write about any specific stock, style, or theme.

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It's Official: We Offer the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our "novel database" enables investors to overcome these flaws and apply reliable fundamental data in their research.
3. Our proprietary measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

Forthcoming in The Journal of Financial Economics, a top peer-reviewed journal, Core Earnings: New Data & Evidence proves our Robo-Analyst technology overcomes material shortcomings in legacy firms' data collection processes to provide superior fundamental data, earnings models, and research. More details.

Key quotes from the paper:

- "[New Constructs'] *Total Adjustments* differs significantly from the items identified and excluded from Compustat's adjusted earnings measures. For example… 50% to 70% of the variation in *Total Adjustments* is not explained by *S&P Global's (SPGI) Adjustments* individually." – pp. 14, 1st para.
- "A final source of differences [between New Constructs' and S&P Global's data] is due to data collection oversights…we identified cases where Compustat did not collect information relating to firms' income that is useful in assessing core earnings." – pp. 16, 2nd para.

Superior Models

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg's in Getting ROIC Right. See the Appendix for direct comparison details.

Key quotes from the paper:

- "…an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC." – pp. 8, 5th para.
- "The majority of the difference…comes from New Constructs' machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies." – pp. 4, 2nd para.

Superior Stock Ratings

Robo-Analysts' stock ratings outperform those from human analysts as shown in this paper from Indiana's Kelley School of Business. Bloomberg features the paper here.

Key quotes from the paper:

- "the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant." – pp. 6, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are here.

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