New Stocks on Safest Dividend Yield Model Portfolio: March 2017

15 new stocks make our Safest Dividend Yield Model Portfolio this month, which was made available to members on 3/22/17.

Recap from February's Picks

Our Safest Dividend Yields Model Portfolio (-1.6%) underperformed the S&P 500 (+0.4%) last month. The best performing stocks in the portfolio were large cap stock China Mobile Limited (CHL), which was up 5%, and small cap stock, NVE Corporation (NVEC), which was up 3%. Overall, seven out of the 20 Safest Dividend Yields stocks outperformed the S&P in February and nine had positive returns.

The success of the Safest Dividend Yields Model Portfolio highlights the value of our forensic accounting research (featured in Barron's). Companies with strong free cash flow provide higher quality and safer dividend yields because we know they have the cash to support the dividend. By analyzing footnotes in SEC filings, we are able to calculate cash flow more accurately and diligently.

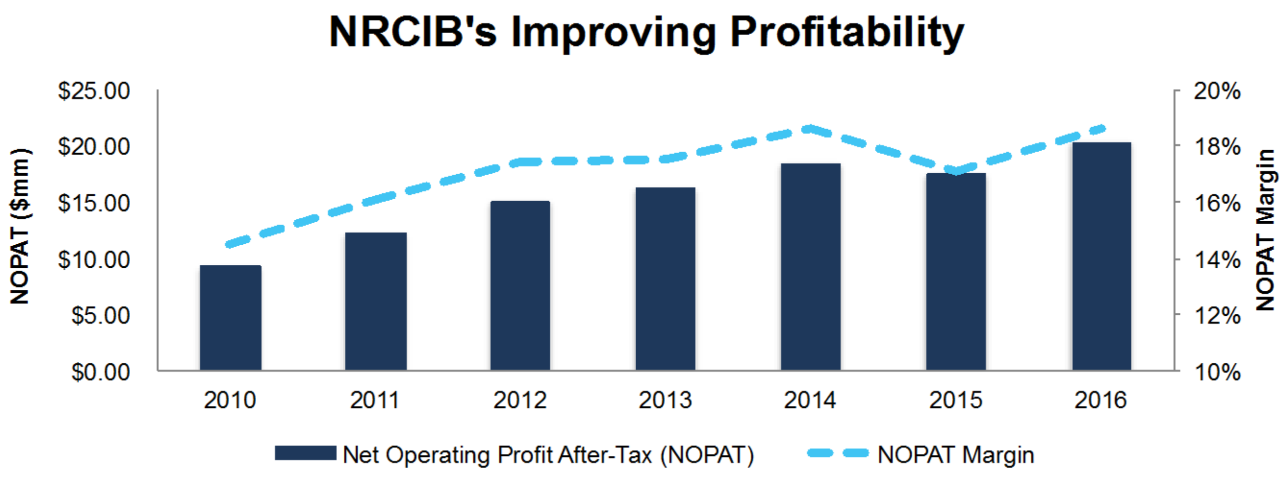
This Model Portfolio only includes stocks that earn an Attractive or Very Attractive rating, have positive free cash flow and economic earnings, and offer a dividend yield greater than 3%. We think this combination provides a uniquely well-screened group of stocks that can deliver returns greater than the market.

New Stock Feature for March: National Research Corp (NRCIB: $40/share)

National Research Corp (NRCIB) is one of the additions to our Safest Dividend Yields Model Portfolio in March. We featured National Research Corp in October 2016 when we highlighted its impressive decade of profit growth and undervalued stock price compared to industry peers. Since then, NRCIB is up 4% while the S&P is up 9%. This underperformance relative to the market makes NRCIB even more undervalued.

Since 2010, National Research Corp has grown after tax profit (NOPAT) by 14% compounded annually. NOPAT margins have improved from 15% in 2010 to 18% in 2016, per Figure 1. National Research Corp's return on invested capital (ROIC) has improved from 14% in 2010 to a top-quintile 33% in 2016. Such strong fundamentals and a 6% dividend yield earn NRCIB a spot on this month's Safest Dividend Yields Model Portfolio.

Figure 1: National Research Corp's Profit Growth



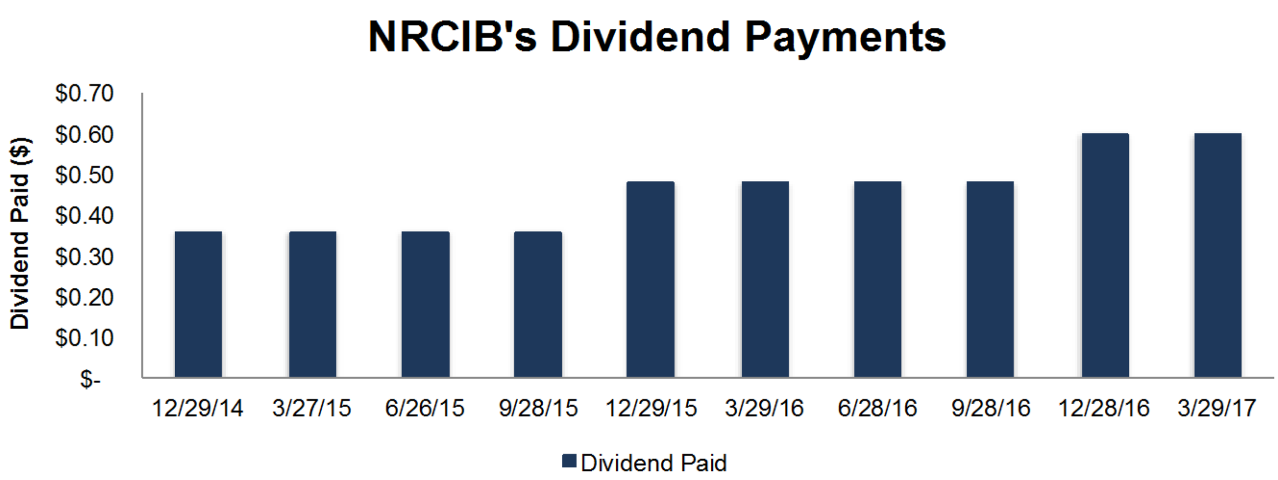
Sources: New Constructs, LLC and company filings

Free Cash Flow Supports Standard and Special Dividends

National Research Corp has increased its dividend payment from $0.36/quarter in 4Q14 to $0.60/quarter in 1Q17, per Figure 2. Over this time, National Research Corp has also paid out a special dividend of $2.16 in 4Q15. The special dividend and quarterly dividend increases are made possible by NRCIB's positive free cash flow (FCF). Over the past five years, National Research Corp has generated a cumulative $96 million in FCF (33% of market cap).

Companies with strong free cash flow provide higher quality dividend yields because we know the firm has the cash to support its dividend. On the flip side, dividends from companies with low or negative free cash flow cannot be trusted as much because the company may not be able to sustain paying dividends.

Figure 2: Increasing Dividend Payment Since 2014



Sources: New Constructs, LLC and company filings

Despite Strong Fundamentals, NRCIB Remains Undervalued

Despite National Research Corp's strong fundamentals, shares remain undervalued. At its current price of $40/share, NRCIB has a price-to-economic book value (PEBV) ratio of 0.5. This ratio means the market expects NRCIB's NOPAT to permanently decline by 50% from current levels. Such expectations seem overly pessimistic for a firm that has grown NOPAT by 15% compounded annually since 1998.

Even if NRCIB were to never again grow profits from current levels, the economic book value, or no growth value of the firm is $78/share – a 95% upside from the current valuation.

If National Research Corp can maintain 2016 NOPAT margins of 18% and grow NOPAT by just 8% compounded annually over the next five years, the stock is worth $112/share today – a 180% upside. Large upside potential coupled with NRCIB's 6% dividend yield provide investors a great low risk/high reward opportunity.

Impacts of Footnotes Adjustments and Forensic Accounting

Our robo-analyst technology enables us to perform forensic accounting with scale and provide the research needed to fulfill fiduciary duties. In order to derive the true recurring cash flows, an accurate invested capital, and a real shareholder value, we made the following adjustments to National Research Corp's 2016 10-K:

Income Statement: we made less than $1 million of adjustments with a net effect of removing less than $1 million in non-operating income (<1% of revenue). We removed less than $1 million related to non-operating expenses and less than $1 million related to non-operating income. See all adjustments made to NRCIB's income statement here.

Balance Sheet: we made $48 million of adjustments to calculate invested capital with a net decrease of $28 million. One of the most notable adjustments was $3 million (3% of reported net assets) related to other comprehensive income. See all adjustments to NRCIB's balance sheet here.

Valuation: we made $43 million of adjustments with a net effect of increasing shareholder value by $19 million. The largest adjustment to shareholder value was $31 million in excess cash. This adjustment represents 11% of NRCIB's market value.

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

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How New Constructs Creates Value for Clients

We find it. You benefit. Cutting-edge technology enables us to scale our forensic accounting expertise across 3000+ stocks. We shine a light in the dark corners of SEC filings so our clients can make safer, more informed decisions.

Our stock rating methodology instantly informs you of the quality of the business and the fairness of the stock's valuation. We do the diligence on earnings quality and valuation so you don't have to.

In-depth risk/reward analysis underpins our ratings. Our rating methodology grades every stock, ETF, and mutual fund according to what we believe are the 5 most important criteria for assessing the quality of an equity. Each grade reflects the balance of potential risk and reward of buying that equity. Our analysis results in the 5 ratings described below. Very Attractive and Attractive correspond to a "Buy" rating, Very Dangerous and Dangerous correspond to a "Sell" rating, while Neutral corresponds to a "Hold" rating.

QUESTION: Why shouldn't fund research be as good as stock research? Why should fund investors rely on backward-looking price trends?

ANSWER: They should not.

Don't judge a fund by its cover. Take a look inside at its holdings and understand the quality of earnings and valuation of the stocks it holds. We enable you to choose the best fund based on its stock-picking merits so you do not have to rely solely on backward-looking technical metrics.

The drivers of our forward-looking fund ratings are Portfolio Management (i.e. the aggregated ratings of its holdings) and Total Annual Costs. The Total Annual Costs Rating (details here) captures the all-in cost of being in a fund over a 3-year holding period, the average period for all fund investors.

Our Philosophy About Research

Accounting data is not designed for equity investors, but for debt investors. Accounting data must be translated into economic earnings to understand the profitability and valuation relevant to equity investors. Respected investors (e.g. Adam Smith, Warren Buffett and Ben Graham) have repeatedly emphasized that accounting results should not be used to value stocks. Economic earnings are what matter because they are:

1. Based on the complete set of financial information available.
2. Standard for all companies.
3. A more accurate representation of the true underlying cash flows of the business.

Additional Information

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