Featured Stocks in March's Safest Dividend Yields Model Portfolio

15 new stocks make our Safest Dividend Yield Model Portfolio this month, which was made available to members on March 21, 2018.

Recap from February's Picks

The Model Portfolio rose 0.1% on a price return basis and rose 0.4% on a total return basis. The S&P 500 rose 0.1% on a price return basis and 0.5% on a total return basis. The best performing stocks in the portfolio were large cap stock Seagate Technology (STX), which was up 18%, and small cap stock, DSW Inc. (DSW), which was up 10%. Overall, six out of the 20 Safest Dividend Yield stocks outperformed the S&P in February.

This Model Portfolio leverages our Robo-Analyst technology[1], which scales our forensic accounting expertise (featured in Barron's) across thousands of stocks.[2]

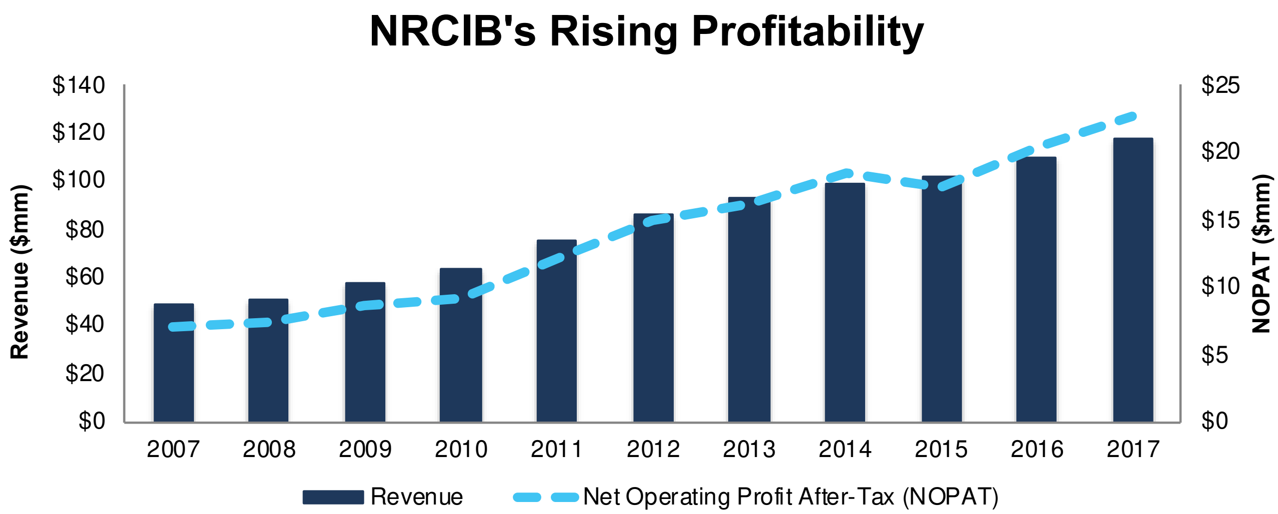
This Model Portfolio only includes stocks that earn an Attractive or Very Attractive rating, have positive free cash flow and economic earnings, and offer a dividend yield greater than 3%. Companies with strong free cash flow provide higher quality and safer dividend yields because we know they have 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 March: National Research Corp (NRCIB: $50/share)

National Research Corp (NRCIB), a healthcare data analytics/insights provider, is the featured stock in March's Safest Dividend Yields Model Portfolio. We previously featured NRCIB as a Long Idea in October 2016. Since then, the stock is up 29% while the S&P 500 is up 22%. Despite its outperformance, NRCIB remains undervalued.

Since 2007, NRCIB has grown revenue 9% compounded annually while after-tax profit (NOPAT) has grown 12% compounded annually, per Figure 1. NOPAT margins have increased from 14% in 2007 to 19% in 2017 while the company's return on invested capital (ROIC) improved from 14% to 33% over the same time.

Figure 1: NRCIB Revenue & NOPAT Since 2007



Sources: New Constructs, LLC and company filings

[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] Ernst & Young's recent white paper "Getting ROIC Right" proves the superiority of our holdings research and analytics.

Free Cash Flow Supports Dividend Payments

Since 2014, NRCIB's quarterly dividend has increased from $0.36/share to $0.60/share, or 19% compounded annually. The consistent dividend payment, and growth, has been supported by NRCIB's strong free cash flow. Since 2013, NRCIB has generated a cumulative $62 million (18% of market cap) in FCF while paying $55 million in dividends.

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.

NRCIB Remains Undervalued

At its current price of $50/share, NRCIB has a price-to-economic book value (PEBV) ratio of 0.7. this ratio means the market expects NRCIB's NOPAT to permanently decline by 30%. This expectation seems rather pessimistic for a firm that has grown NOPAT 12% compounded annually over the past decade and 15% compounded annually since 1998.

If NRCIB can maintain 2017 NOPAT margins (19%) and grow NOPAT by just 3% compounded annually for the next five years, the stock is worth $86/share today – a 72% upside.

Auditable Impact of Footnotes & Forensic Accounting Adjustments

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 2017 10-K:

Income Statement: we made $4 million of adjustments with a net effect of removing less than $1 million in non-operating expense (<1% of revenue). We removed $2 million related to non-operating expenses and $2 million related to non-operating income. See all adjustments made to NRCIB's income statement here.

Balance Sheet: we made $43 million of adjustments to calculate invested capital with a net decrease of $26 million. The most notable adjustment was $34 million (36% of reported net assets) related to excess cash. See all adjustments to NRCIB's balance sheet here.

Valuation: we made $44 million of adjustments with a net effect of increasing shareholder value by $23 million. Apart from the excess cash noted above, the largest adjustment to shareholder value was $4 million in deferred tax liabilities. This adjustment represents 1%> of NRCIB's market value.

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

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New Constructs leverages the latest in machine learning to analyze structured and unstructured financial data with unrivaled speed and accuracy. The firm's forensic accounting experts work alongside engineers to develop proprietary NLP libraries and financial models. Our investment ratings are based on the best fundamental data in the business for stocks, ETFs and mutual funds. Clients include many of the top hedge funds, mutual funds and wealth management firms. David Trainer, the firm's CEO, is regularly featured in the media as a thought leader on the fiduciary duty of care, earnings quality, valuation and investment strategy.

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2. **Un-conflicted** - Clients deserve unbiased research.
3. **Transparent** - Advisors should be able to show how the analysis was performed and the data behind it.
4. **Relevant** - Empirical evidence must provide tangible, quantifiable correlation to stock, ETF or mutual fund performance.

Value Investing 2.0: Diligence Matters: Technology is Key to Value Investing With Scale

Accounting data is only the beginning of fundamental research. It must be translated into economic earnings to truly understand profitability and valuation. This translation requires deep analysis of footnotes and the MD&A, a process that our robo-analyst technology empowers us to perform for thousands of stocks, ETFs and mutual funds.

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