



New Stocks on Safest Dividend Yields Model Portfolio: January 2017

10 new stocks make our [Safest Dividend Yield Model Portfolio](#) this month. [January's Safest Dividend Yield Model Portfolio](#) was made available to members on 1/20/17.

Recap from December's Picks

Our Safest Dividend Yield Model Portfolio (+2.0%) outperformed the S&P 500 (+0.6%) last month. The best performing stocks in the portfolio were large cap stock China Mobile Limited (CHL) which was up 7%, and small cap stock, Costamare Inc. (CMRE), which was up 7%. Overall, 13 out of the 20 Safest Dividend Yield stocks outperformed the S&P in December.

The success of the Safest Dividend Yield Model Portfolio highlights the value of our forensic accounting ([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 for 3000+ companies [under coverage](#).

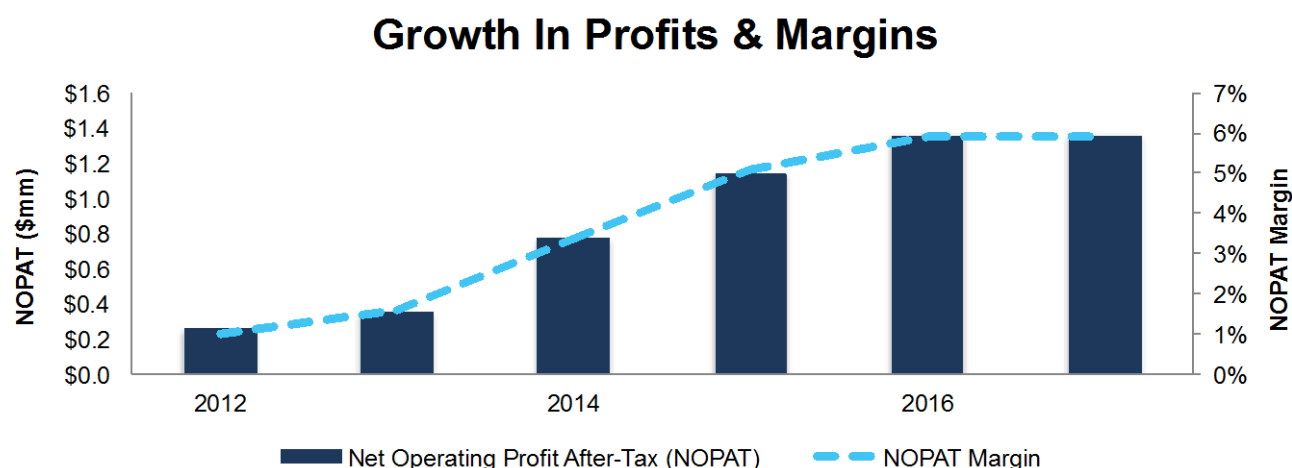
This Model Portfolio only includes stocks that earn an [Attractive or Very Attractive](#) rating, have positive free cash flow and [economic earnings](#), and offer a dividend yield greater than 3%. We think this combination provides a uniquely well-screened group of stocks that can deliver returns greater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

New Stock Feature for January: Highway Holdings (HIHO: \$3.50/share)

Highway Holdings (HIHO), metal and plastic OEM parts manufacturer, is one of the additions to our Safest Dividend Yield Model Portfolio in January.

Since 2012, Highway Holdings has grown after-tax profit ([NOPAT](#)) by over 50% compounded annually while NOPAT margins have improved from 1% in 2012 to 6% in 2016, per Figure 1. Highway Holdings' return on invested capital ([ROIC](#)) has improved from 2% in 2012 to a top-quintile 17% in 2016. Such strong fundamentals and an 11% dividend yield earn HIHO a spot on this month's Safest Dividend Yields Model Portfolio.

Figure 1: Highway Holdings' Improving Profitability



Sources: New Constructs, LLC and company filings

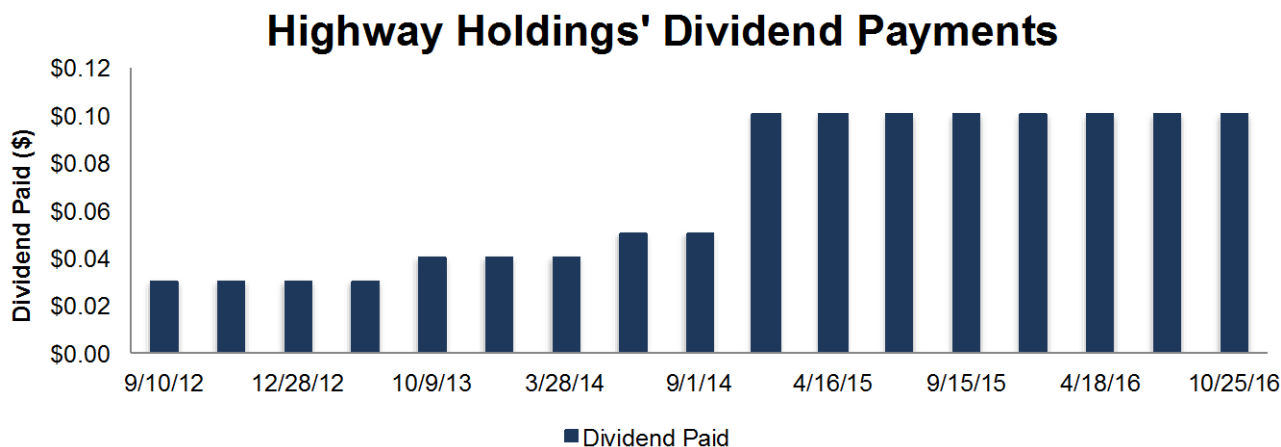
Free Cash Flow Supports Dividend Payments

Highway Holdings has increased its dividend payment from \$0.03/quarter in 2012 to \$0.10/quarter in 2016, per Figure 2. The increase in dividend payment has been facilitated by HIHO's positive free cash flow ([FCF](#)). Over the past five years, Highway Holdings has generated a cumulative \$8 million in FCF (62% 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, dividend yields from companies with low or negative free cash flow cannot be trusted as much because the company may not be able to sustain such a high dividend for much longer.

Figure 2: Increasing Dividend Payment Since 2012



Sources: New Constructs, LLC and company filings

Despite Strong Fundamentals, HIHO Remains Undervalued

Despite Highway Holdings' share price increasing nearly 30% over the past five years, shares remain undervalued. At its current price of \$4/share, HIHO has a price-to-economic book value ([PEBV](#)) ratio of 0.3. This ratio means the market expects HIHO's NOPAT to permanently decline by 70% from current levels. Such expectations seem overly pessimistic for a firm that has grown NOPAT by 17% compounded annually since 2003.

However, if Highway Holdings can [grow NOPAT by just 1% compounded annually for the next five years](#), the stock is worth \$12/share today – a 300% upside. Such upside potential coupled with HIHO's 11% dividend yield provide investors a great low risk/high reward opportunity.

Impacts of Footnotes Adjustments and Forensic Accounting

In order to derive the true recurring cash flows, an accurate invested capital, and a real shareholder value, we made the following adjustments to Highway Holdings' 2016 10-K:

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

Balance Sheet: we made \$12 million of adjustments to calculate invested capital with a net increase of \$4 million. The most notable adjustment was \$3 million (27% of reported net assets) related to [asset write-downs](#). See all adjustments to HIHO's balance sheet [here](#).

Valuation: we made \$9 million of adjustments with a net effect of increasing shareholder value by \$7 million. The largest adjustment to shareholder value was \$8 million [in excess cash](#). This adjustment represents 62% of HIHO'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

Incorporated in July 2002, [New Constructs](#) is an independent publisher of investment research that provides clients with consulting and research services. We specialize in quality-of-earnings, forensic accounting and discounted cash flow valuation analyses for all U.S. public companies. We translate accounting data from 10Ks into economic financial statements, i.e. [NOPAT](#), [Invested Capital](#), and [WACC](#), to create [economic earnings models](#), which are necessary to understand the true profitability and valuation of companies. Visit the [Free Archive](#) to download samples of our research. New Constructs is a [BBB accredited](#) business and a member of the [Investorside Research Association](#).



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