THE NELSON EXCLUSIVE

Confidential*

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About Your Editor

Brian Nelson is the president of equity research and ETF analysis at Valuentum Securities.

He is the architect behind the company's research methodology and processes, developing the Valuentum Buying Index rating system, the Economic Castle rating, and the Dividend Cushion ratio. Mr. Nelson has acted as editor-in-chief of the firm's Best Ideas Newsletter and Dividend Growth Newsletter since their inception.

Before founding Valuentum Securities in early 2011, Brian worked as a director at Morningstar, where he was primarily responsible for training and methodology development within the firm's equity and credit research department. Prior to that position, he served as a senior industrials securities analyst covering aerospace, airlines, construction, and environmental services companies.

Before joining Morningstar, Mr. Nelson worked for a small capitalization fund covering a variety of sectors for an aggressive growth investment management firm in Chicago. He holds a Bachelor's degree in finance and a minor in mathematics, magna cum laude, from Benedictine University. Brian has an MBA from the University of Chicago Booth School of Business and also holds the Chartered Financial Analyst (CFA) designation.

Highlights:

Brian is frequently quoted in the media and has been a frequent guest on Nightly Business Report, Bloomberg TV, CNBC, and the MoneyShow.

Mr. Nelson is very experienced valuing equities, developing discounted cash-flow models used to derive the fair value estimates for companies in the equity coverage universes of two independent investment research firms, including Valuentum.

Brian worked on a small cap fund and a micro-cap fund that were ranked within the top 10th percentile and top 1st percentile within the Small Cap Lipper Growth Universe, respectively, in 2005.

Mr. Nelson led the charge in developing Morningstar's issuer credit ratings, creating and rolling-out one of the firm's proprietary credit metrics, the Cash Flow Cushion.

Updating Our Thoughts on Previous Ideas

Dear member,

The Nelson Exclusive publication sets out to deliver each month underfollowed ideas, one for income, one for capital-appreciation potential, and a short consideration. One of the key value-adds of the publication is that every idea is sourced outside of Valuentum's vast coverage universe -- so not only are you getting some of our favorite ideas, but the ideas are all incremental to your existing subscription. I wanted to make this publication better than anything else out there, and not only do I think it does that by hitting on three different strategic areas, but the thesis format of ideas makes the content we produce even more valuable. For example, you can go back into our archives and read our theses on previous ideas. With each passing month, the value of the Nelson Exclusive publication only increases.

Many of you are following our previous ideas very closely, and we update our thoughts on key developments periodically, so please stay engaged. We put together a 'Top 10' list of things to be aware of recently with respect to new developments on previous ideas, and we comment quite frequently about quarterly fundamental developments as well as track the performance of ideas from their highlight price. We don't highlight an idea and forget it, but we come back to ideas and talk about what has changed and why. As we add more and more ideas, this part of the Nelson Exclusive will become a larger part of the publication, and I'm glad that we can continue to add content for our best members.

Our favorite restaurant pick within the Nelson Exclusive publication, Wingstop (WING), has been doing fantastic of late, setting a brand new all-time high despite a weak market backdrop. The company surged 8%+ during the trading session May 4, to $53+ per share, significantly higher than the highlight price. Another capital-appreciation idea, Yum China (YUMC), has faced some pressure more recently, but we're still very excited about the KFC brand in China as the runway of growth is a long one. The company is encountering competitive challenges with Pizza Hut in the country, but we're not reading too much into them. We think the executive team knows how to fix the business, and we expect a rigorous pursuit of digital initiatives to mitigate some of the pressures. We continue to like both restaurant ideas, but Wingstop is our favorite of the two.

B&G Foods (BGS) caught a bid during the trading session May 4, advancing 10%+, and we couldn't be more pleased. The company is one of our beaten down income ideas, with it now yielding north of 8%. We've grown concerned about the sustainability of its dividend in light of "not-quite-good-enough" performance at Green Giant and a rather large net debt position. Investors should be aware that a dividend cut may be growing more likely, but any disappointment in that area may be delayed if the company can deliver on its fiscal 2018 guidance of $1.72-$1.755 billion in revenue and $2.05-$2.25 in earnings per share. The reaffirmation of its guidance recently suggests things may be getting back on track at B&G Foods, and the company recently announced a share buyback program to support the stock. But please be careful: Its debt load should not be taken lightly.

When I look across the board with respect to the performance of the previous ideas highlighted in the Nelson Exclusive, I like what I see. Maxim (MXIM) is now at $56, Douglas Dynamics (PLOW) is now at ~$42, Ennis (EBF) is at ~$18, Watsco (WSO) is north of $170, and Moelis (MC) is in the mid-$50s. Park National (PRK), NW Natural (NWN), and Vectren (VVC) have done well, despite pressures on income stocks, and the latter's shares are now trading north of $70 each, significantly above highlight price. Many of you may still be holding these ideas, and we plan to continue to provide updates, even though the performance calculations for some have been closed. The more recent income ideas haven't been doing that great in part due to a rising interest rate environment, but not one of them has cut its dividend thus far—and that's something we're proud of. Many have even hiked their payouts in a big way.

I'm happy with the performance of previous capital-appreciation ideas, too. I mentioned the strength at Wingstop already, but Qualys (QLYS), Guidewire Software (GWRE), Ferrari (RACE), Square (SQ), Planet Fitness (PLNT), and Insulet (PODD) have done really well, even better than what I could have expected in some cases. These recently-highlighted ideas with respect to capital-appreciation potential have truly bucked the trend of hefty declines across the broader market, and in my opinion, their resilience in the face of market adversity speaks to the value of the Nelson Exclusive publication. The short idea considerations have been phenomenal, too, even though some haven't worked out right away, and we continue to focus on delivering elevated success rates* across the board.

I sincerely hope that you enjoy the May edition of the Nelson Exclusive publication. Thank you.

Kind regards,

Brian Nelson, CFA
President, Investment Research
brian@valuentum.com

**Success rate: The percentage of ideas highlighted in the Nelson Exclusive that have moved in the direction of our thesis (i.e. up for capital appreciation ideas and down for short idea considerations) through the current price or closed price, with consideration of cash and stock dividends. Success rates do not consider trading costs or tax implications.*

Tracking Nelson Exclusive Idea Simulated Performance

Highlight Date	Company (symbol)	Highlight Price	Annual Divs per Share at Highlight	Current Fwrd Dividends per Share	Current Fwrd Exp Dividend Yield	Time Horizon	Notes - Data as of May 4, 2018
Income Ideas							
Jul, 16	Universal Corp (UVV)	57.74	2.12	2.20	4.6%	Closed - 2/12/2017	Universal has years of dividend growth ahead of it, but we closed this big winner for the time being. We still like it!
Aug, 16	B&G Foods (BGS)	51.54	1.68	1.86	7.5%	Closed - 7/17/2017	B&G Foods has taken its share of lumps, the latest coming from Amazon's entrance into the grocery business with the proposed purchase of Whole Foods. We closed the idea.
Sep, 16	Maxim Integrated (MXIM)	41.12	1.32	1.68	3.0%	Closed - 2/12/2017	We closed position due to fickle nature of tech. Solid net cash position, strong free cash flow -- ~3% yield. May re-establish idea in future.
Oct, 16	Douglas Dynamics (PLOW)	31.94	0.94	1.06	2.5%	Closed - 2/12/2017	We closed as stock had been suspiciously volatile on little news. Insider buying though. We still like it and may re-establish in future.
Nov, 16	Ennis Inc. (EBF)	14.60	0.70	0.80	4.5%	Closed -- 11/12/2016	We captured more than 2 years' worth of income via capital appreciation in a very short period of time. Unfortunately, this ended in a quick "trade."
Dec, 16	Watsco, Inc. (WSO)	150.57	4.20	5.80	3.4%	Closed - 2/12/2017	We closed this idea. Investors have been assessing impact on demand from HVAC price hikes at key customer Carrier (UTX). We still like it, but it is a cyclical industrial.
Jan, 17	Star Gas Partners (SGU)	11.21	0.41	0.47	4.8%	0-2 yrs	Star Gas raised its dividend ~7% in April 2018. Fiscal second quarter performance showed a 28.6% increase in total revenue thanks to solid volume growth and per-gallon price increases.
Feb, 17	Moelis & Co (MC)	35.00	1.28	1.88	3.4%	Closed - 7/22/2017	We continue to like shares of Moelis & Co, but we have closed the idea for now. Special dividends are the cherry on top of this income generator and are not included in our measure of its yield.
Mar, 17	Park National (PRK)	108.59	3.76	3.84	3.4%	0-20 yrs	The bank's loan book advanced slowly in 2017, and management is optimistic about customer service initiatives implemented in the year. It recently declared a $0.96/share quarterly dividend.
Apr, 17	American Software (AMSWA)	10.44	0.44	0.44	3.3%	Closed - 7/22,23/2017	An email delay by us caused a notication to be delayed until after material information impacted AMSWA's stock. As a result, price adjusted from price in email to the low price of the next trading day to reflect conservative, punitive accounting ($12.04 --> $10.57).
May, 17	NW Natural (NWN)	59.20	1.88	1.89	3.0%	0-20 yrs	Nice dividend yield. Customer growth ensues, and returns have been solid. It issued 2018 EPS guidance ($2.10 - $2.30 per share), and 2017 marked its 62nd consecutive year of annual dividend growth.
Jun, 17	Japan Tobacco (JAPAY)	19.03	0.60	0.66	4.7%	0-20 yrs	Tobacco stocks have done well during this multi-year bull market. Japan Tobacco is an interesting idea, but regulatory changes could be on the horizon in Japan that may pose challenges.
Jul, 17	Vectren Corp (VVC)	58.21	1.68	1.80	2.6%	Closed 8/30/2017	Takeout speculation drove Vectren's price significantly higher, and we closed the position as a result. Recent results show its utility performance is on track, and its non-utility group is performing well.
Aug, 17	National Retail Properties (NNN)	40.50	1.90	1.90	4.8%	0-20 yrs	2017 results were solid. Core FFO per common share increased more than 7% during the period, and occupancy remains impressive at 99.1% as of the end of 2017.
Sep, 17	STORE Capital (STOR)	25.72	1.16	1.24	4.8%	0-20 yrs	On September 12, STORE Capital increased its quarterly dividend ~7%, to $0.31 per quarter. 2018 AFFO per share is expected to be $1.78-$1.84, up from $1.71 in 2017.
Oct, 17	Fortis (FTS)	36.14	1.60	1.70	5.0%	0-20 yrs	Management recently announced an increase to its 5-year capital spending plan. Its rate base is expected to increase at an annual rate of 5% over the next five years, while annual dividend growth guidance has been set at 6% for the same period.
Nov, 17	Black Hills (BKH)	61.23	0.45	1.90	3.2%	0-20 yrs	Black Hills raised its dividend nearly 7% November 15. The company initiated non-GAAP 2018 earnings per share guidance of $3.35-$3.55 when it reported third-quarter results November 2, but it has since adjusted this to a range of $3.30-$3.50.
Dec, 17	Four Corners Propety Trust (FCPT)	26.03	0.97	1.10	4.8%	0-20 yrs	We continue to have high hopes for this young REIT as a dividend payer as it currently offers a ~4.8% yield. We're encouraged by management's ~13% dividend hike in November 2017.
Jan, 18	TransCanada Corp (TRP)	49.47	1.98	2.14	5.0%	0-20 yrs	TransCanada offers investors a ~5% yield, and annual dividend hikes have become common. A raise in the first quarter of 2018 marked the 18th consecutive annual dividend increase. News related to the Keystone pipeline can have an impact on share price performance.
Feb, 18	Siemens (SIEGY)	71.13	3.86	2.30	3.5%	0-20 yrs	The 'German GE' could benefit from GE's recent missteps, and we expect its industrial technology portfolio to play a meaningful role in the proliferation of the Industrial Internet of Things. Dividends can be impacted by currency exchange rates.
Mar, 18	Philips 66 Partners (PSXP)	49.63	2.71	2.86	5.8%	0-20 yrs	Philips 66 Partners finished 2017 on a high note and will increase capital spending in 2018 as it grows capacity. This MLP's distribution yield is top notch, and we like the backing of Philips 66 and its major shareholder, Berkshire Hathaway.
Apr, 18	PS Business Parks (PSB)	113.68	3.40	3.40	2.9%	0-20 yrs	PS Business Parks turned in a solid first quarter report as funds from operations per share advanced ~5% from the year-ago period to $1.59, and weighted average square foot occupancy remained unchanged at 94.6%.

Many members have said that they prefer to focus on the long-term income-oriented dynamics of our income ideas, and we think this makes sense.

We have subsequently changed the formatting of the table to include a focus more on the trajectory of the dividend as well as the current forward expected annualized dividend yield.

We hope that you find this layout more helpful as you sort through the prior income ideas.

The information provided in the tables is offered for the convenience of the reader, for illustrative purposes only, and no actual trading is taking place. Actual results may differ from the simulated information being presented. Valuentum is a publisher of financial information, not a money manager, broker, or financial advisor.

Highlight Date	Company (symbol)	Highlight Price	Current or "Close" Price	Div's Received	'Hypothetical' 'Closed'Gain %	Time Horizon	Notes - Data as of May 4, 2018
Capital Appreciation Ideas							
Jul, 16	Bloomin Brands (BLMN)	17.87	19.28	0.07	8.3%	Closed -- 11/12/2016	We took what the market gave us. We may re-open idea again. We still believe in long term. Stock very cheap.
Aug, 16	Healthcare Srvs Group (HCSG)	38.91	41.02	0.369	6.4%	Closed - 2/12/2017	We closed this one. Nice streak of consecutive quarterly dividend increases. Very strong end market, and we may re-open in the future.
Sep, 16	Grupo Aeroportuario (ASR)	157.87	181.61	-	15.0%	Closed - 4/5/2017	We closed this idea. The strength in the US dollar had hurt. We still love the long-term picture though. Travel to Cancún not going away.
Oct, 16	Swedish Match (SWMA.ST)	314.80SEK	385.20SEK	17.7	-	0-20 yrs	Tobacco (snus) demand is about as resilient as it gets through the economic cycle. Currency had been hurting shares, but stock has rallied back in a meaningful way more recently.
Nov, 16	Symrise AG (SYIEY)	16.25	16.34	-	0.6%	Closed - 4/5/2017	We closed this idea, but we still like it. EBITDA margins don't get much steadier than Symrise's (18-22% from 2006-2015) though.
Dec, 16	Tootsie Roll (TR)	37.80	28.55	0.54	-	0-20 yrs	A fantastic company with solid financials. Potential big dividend growth story with takeout catalyst as a growing possibility. Two stock dividend adjustments (3/3/17, 3/5/18) reflected in price.
Jan, 17	Texas Capital Bancshares (TCBI)	78.05	85.10	-	9.0%	Closed - 2/12/2017	Stock grew too extended, so we closed with expectations to re-establish. It's important to gain your trust -- and simulated profits go a long way in doing so.
Feb, 17	Arconic (ARNC)	25.90	29.62	-	14.4%	Closed - 2/12/2017	We closed this idea. We may re-establish again, but this type of gain in one week is hard not to be prudent with.
Mar, 17	Tesaro (TSRO)	180.84	122.62	-	-32.2%	Closed - 7/7/2017	Very risky biotech. Not for everybody. We highlighted this one to fill an industry void among considerations. We have closed it.
Apr, 17	Yum China (YUMC)	31.15	37.67	-	20.9%	Closed - 5/23/2017	The long-term potential of Yum China is amazing. If you haven't read our thesis on shares, please do so. We closed this idea on strong share-price performance, but we may look at it again.
May, 17	Galapagos (GLPG)	87.67	76.13	-	-13.2%	Closed - 7/7/2017	Another very risky biotech. Shares are not for everybody, and principle could be completely wiped out if things go wrong with this consideration. We closed the idea.
Jun, 17	Huntington Ingalls (HII)	193.79	206.39	-	6.5%	Closed 8/18/2017	The Navy needs more ships with more advanced capabilities, and Huntington Ingalls is at the center of this need. We closed it, but the company is a compelling idea.
Jul, 17	Orbital ATK (OA)	102.33	104.65	-	2.3%	Closed 8/18/2017	The geopolitical environment is becoming more heated, and it seems that tensions with North Korea have only heightened. We closed it, but we like Orbital's position to benefit.
Aug, 17	Wingstop (WING)	32.28	53.38	3.38	-	0-20 yrs	Buffalo Wild Wings' younger cousin may be taking a bite out of its share. We like Wingstop's long-term opportunity, and the company paid a special dividend of $3.17 per share in early 2018.
Sep, 17	Qualys (QLYS)	51.10	74.30	-	-	0-20 yrs	One of the most interesting cybersecurity ideas on the market today. We continue to like shares, which received a nice boost from a strong fourth-quarter 2017 report.
Oct, 17	Guidewire Software (GWRE)	78.24	88.19	-	-	0-20 yrs	We like this indirect "play" on the insurance business. Its fundamentals are top notch. Guidance for fiscal 2018, released November 29, was mixed though, but we're focused long term.
Nov, 17	Ferrari N.V. (RACE)	117.43	137.33	0.872	-	0-20 yrs	Ferrari's shares may not be as cheap as we would like, but it's hard to argue with the company's brand strength. Shares will continue to be extremely volatile.
Dec, 17	Square (SQ)	38.22	49.10	-	-	0-20 yrs	This financial technology company has a long runway of growth ahead of its, but execution risk and competition should not be taken lightly. Its Bitcoin product could take the market by storm.
Jan, 18	Planet Fitness (PLNT)	33.70	40.45	-	-	0-20 yrs	Planet Fitness recently hit milestones of 1,500 locations in all 50 states, and it has more than 10.5 million members in all. It is now moving into the Mexican market.
Feb, 18	Insulet Corp (PODD)	75.84	83.88	-	-	0-20 yrs	Insulet expects top-line growth to remain robust in 2018 with revenue growth guidance coming in at 21%-25% for the year. Recent strategic milestones include gaining Medicare coverage for its Omnipod System.
Mar, 18	Preferred Bank (PFBC)	64.01	63.25	0.22	-	0-20 yrs	We like the seasoned management team at Preferred Bank, as well as its recent earnings growth trajectory. The business/credit cycle is worth watching. We like the added bonus of a nice little dividend.
Apr, 18	Esperion Therapeutics (ESPR)	66.43	41.54	-	-	0-20 yrs	Shares of Esperion were pummeled after mortality rates in a late-stage study of its bempedoic acid treatment spooked investors. This idea may be too risky for some investors.

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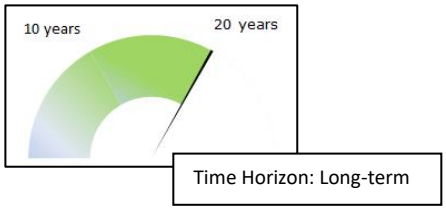
Short Idea Considerations							
Jul, 16	Lands' End (LE)	16.76	16.10	NA	3.9%	Closed -- 12/2/2016	We were worried Eddie Lampert may start buying more heavily. Very volatile equity. Not being greedy, so we closed position.
Aug, 16	Vivint Solar (VSLR)	2.94	2.85	NA	3.1%	Closed -- 12/2/2016	Stock wasn't acting right despite an ongoing negative solar backdrop. We locked gain in as a result.
Sep, 16	Lloyds Banking (LYG)	3.31	2.78	NA	16.0%	Closed -- 11/4/2016	We didn't like Lyolds' leverage and were worried about Brexit. We picked our spot to take profits.
Oct, 16	GoPro (GPRO)	16.68	11.12	NA	33.3%	Closed -- 11/4/2016	This was a big winner. We continue to have concerns, and the stock keeps falling. We're not looking back, however.
Nov, 16	Seritage Growth Properties (SRG)	44.31	42.13	-0.25	4.4%	Closed -- 1/6/2017	The REIT continues to trade on euphoric expectations, but we closed this for a gain. Dividends work against us as it relates to short performance. Buffett is watching.
Dec, 16	Royal Bank of Scotland (RBS)	4.91	7.47	-	-	0-2 yrs	The stock rallied alongside financials peers. We're watching it closely as Brexit looms. The UK government has announced that it will begin selling its 71% ownership stake in the bank.
Jan, 17	Sequential Brands Group (SQBG)	4.62	4.18	-	9.5%	Closed 2/12/2017	We locked this short idea in. Retail continues to get pummeled, and we picked the right spot at the right time.
Feb, 17	Sportman's Warehouse (SPWH)	6.85	6.11	-	10.8%	Closed 2/12/2017	As with Sequential Brands, we picked the right spot at the right time. We locked in this big gain, too.
Mar, 17	Fitbit (FIT)	6.07	5.71	-	5.9%	Closed 4/5/2017	Very timely short idea again. We locked this in. The success rate on short idea considerations remains fantastic.
Apr, 17	Santander Consumer (SC)	12.51	11.65	-	6.9%	Closed 5/23/2017	Subprime auto may be in for a rough landing. We're expecting continued tough times, but we're going to lock this idea in.
May, 17	Snap, Inc (SNAP)	23.19	17.19	-	25.9%	Closed 5/10/2017	Fantastic timing! Another short idea consideration homerun! See May 10 email: 'Another Exclusive Homerun: Oh SNAP'
Jun, 17	Mallinckrodt (MNK)	42.65	36.41	-	14.6%	Closed - 8/18/2017	There's a lot of hair on this one. Famed short seller Jim Chanos doesn't like it. We locked in this winner.
Jul, 17	Deutsche Lufthansa AG (DLAKY)	23.05	29.88	-	-	0-20 yrs	We think Ryanair will be a thorn in Deutsche Lufthansa's side in the coming years, and the cyclical nature of the airline industry won't ever go away.
Aug, 17	Del Frisco's (DFRG)	14.35	11.93	-	16.9%	Closed - 10/16/17	We locked in a solid gain after its third-quarter results left a good deal to be desired. Restaurant traffic continues to face pressure.
Sep, 17	Fiesta Restaurant Group (FRGI)	15.90	21.55	-	-	0-2 yrs	Fiesta continues to close units in the overheated restaurant space. Geographic concentration adds to risk. Buyout rumors have been helping smaller restaurant shares of late, however.
Oct, 17	Ingles Markets (IMKTA)	26.50	24.20	-	8.7%	Closed - 10/16/17	We closed this idea quickly as shares faced pressure due to industry-wide concerns over margin performance. The idea worked out well.
Nov, 17	Fogo de Chao (FOGO)	10.85	15.62	-	-44.0%	Closed - 3/3/2018	Fogo de Chao has accepted a buyout offer from Rhone Capital for $15.75 per share. Takeout risk is a key consideration for short sellers, and should not be taken lightly.
Dec, 17	TrueCar (TRUE)	12.07	10.84	-	10.2%	Closed - 12/27/17	We closed this idea quickly for a solid 'gain' as shares continue to face pressure due in part to poor recent performance and concerns surrounding its relationship with the USAA persist.
Jan, 18	Shake Shack (SHAK)	44.17	55.95	-	-	0-2 yrs	Weak traffic trends across the restaurant space, a saturated burgers and fries market, and meaningful execution risk are key considerations working against Shake Shack.
Feb, 18	iShares Core US Aggregate Bond ETF (AGG)	107.20	105.86	0.718	-	0-2 yrs	Rising interest rates continue to work against long-duration fixed income vehicles. We expect such a development to persist in the near term, but the monthly yield of this idea should be noted.
Mar, 18	iShares iBoxx $ High Yield Corporate Bond ETF (HYG)	85.75	85.42	0.712	-	0-2 yrs	Demand for high-yield debt remains solid, but investors have begun to reduce risk exposure as volatility rises. The first quarter of 2018 was the underlying index's works quarter since 2008.
Apr, 18	Houghton Mifflin Harcourt (HMHC)	7.25	7.00	-	-	0-2 yrs	Houghton missed consensus bottom-line estimates in the first quarter of 2018, and both net sales and billings fell by 1%. Negative free cash flow underscores the weakness in its business.
	Average Capital Efficiency* for 'Closed' Positions					Varies	Performance information is hypothetical and "trading" is simulated. Information provided in table for illustrative purposes only.

The tables above are provided for the sole purpose of transparency, to allow readers to measure Nelson Exclusive ideas in a way they feel is most appropriate. Ideas within the Nelson Exclusive are not constructed as a portfolio, nor should they be viewed as a portfolio, and performance information is hypothetical and "trading" is simulated. "Hypothetical annualized returns," now labeled "Capital Efficiency," cannot be achieved and are provided for the sole purpose of rightsizing each idea to a common measurement period (one year), to compare ideas 'closed' within one year to ones 'open' longer than one year, taking into account capital efficiency. A reader, for example, may view a 20% hypothetical return over a period of five weeks as much better than a 20% hypothetical return over a period of five years. Whereas both represent 20% hypothetical returns, hypothetical annualized performance is much different under each case. Readers may have different views and time horizons. To retain independence, neither Valuentum nor Brian Nelson own any shares, nor do they plan to own any shares, of any companies highlighted in the Nelson Exclusive. Importantly, shorting stocks involves a number of abnormal risks, including theoretically the infinite loss of capital, and is not for everyone. Valuentum is a financial publisher not a financial advisor. Please contact your personal financial advisor to determine if any idea in the Nelson Exclusive may be appropriate for you.



Hubbell (HUBB)

"Our strategy remains the same: to be a trusted provider of reliable, electrical and related infrastructure solutions primarily in North America with desired brands, high quality service, and a competitive cost structure. We aim to grow at twice the market rate via organic sales and acquisitions and to deliver high single digit earnings growth plus dividends to shareholders… As our actions demonstrate, we remain focused on returns to shareholders. In 2017, our Board approved a 10% increase in our quarterly dividend to $0.77 per share, as well as a new authorization for a three-year share repurchase program of up to $400 million." – Hubbell 2017 Annual Report

Thesis

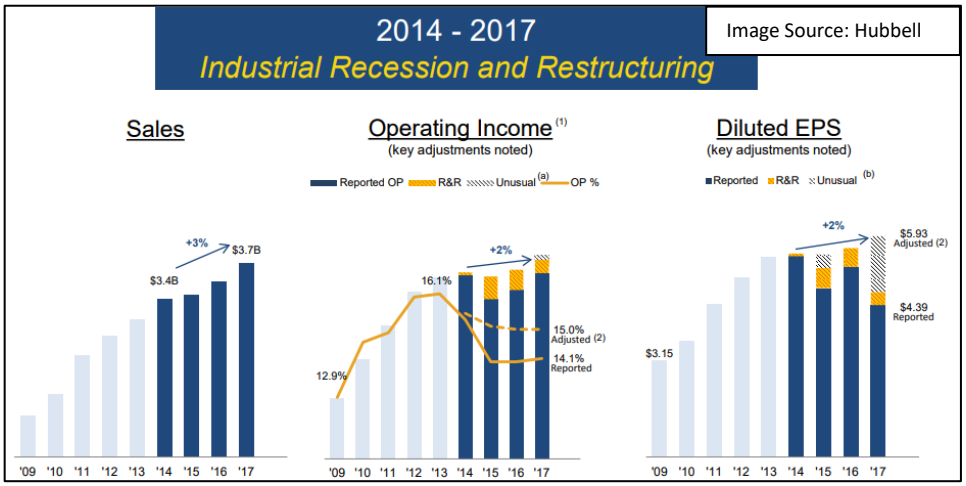
As we continue to move out of the recent downturn in industrial end markets, outlooks are brightening for certain manufacturers, and we think this month's income idea captures the attractive trends within those end markets. In addition to a rosy end market outlook, Hubbell brings a track record of navigating tough operating environments, most notably the recent stretch from 2014-2017, as well as a decent dividend track record and impressive free cash flow generation. Its annual targets include free cash flow in excess of net income, and 2017 marked its tenth consecutive year of dividend growth.

In the period from 2014-2017, which Hubbell calls an era of industrial recession and restructuring, the company was able to grow sales at a 3% rate annually, while adjusted operating income and adjusted diluted earnings per share advanced at a 2% rate annually. While we are not anticipating a return to a similar operating environment in the near term, its ability to maintain solid results, and continue growing the payout, through trying times is a testament to management and the resiliency of its business. The cyclical nature of its end markets will never go away and present a key risk that it will continually have to overcome, and it is worth noting that strategic acquisitions are a portion of its growth strategy.

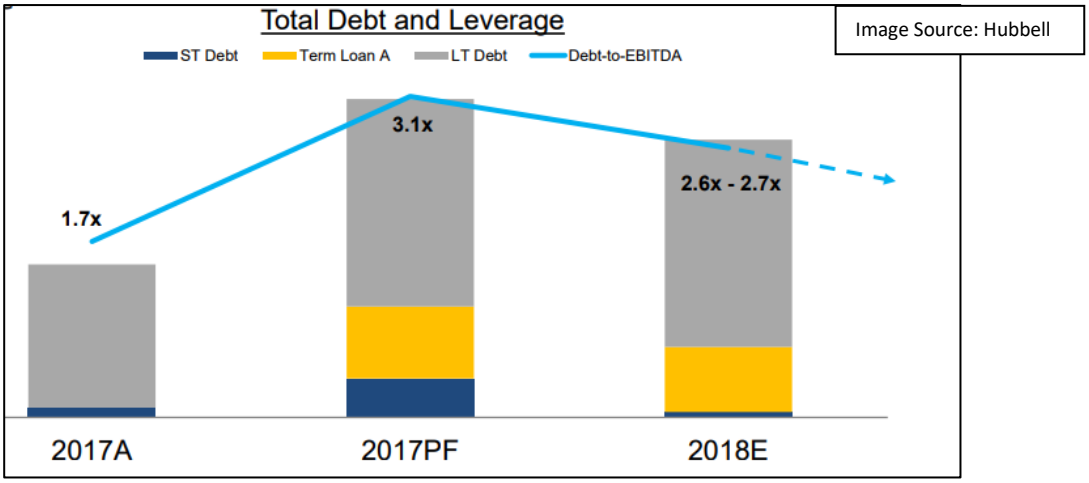
Corporate Profile

Hubbell is a manufacturer of electrical and electronic products for non-residential and residential construction, industrial, and utility applications. It operates in two segments, Electrical and Power, which accounted for 69% and 31% of 2017 revenues. The company holds roughly 1,800 active US and foreign patents, and its operations are primarily based in the US (89% of 2017 revenues), though it has international operating assets in Canada, Mexico, the UK, and China, among others. It was founded in 1888 and is headquartered in Connecticut.

Key Statistics	
Last Close	$103.97
52-week range	$100.55-$149.03
Market Cap	$5.7 B
Avg Daily Vol (30 wks)	401,832
Annual Dividend Yield	2.96%
Trailing Dividend Payout Ratio	70%
Trailing P/E	23.7
Net Debt (LFY)	$666 M
Net Debt/Adj. EBITDA (LFY)	1.1x



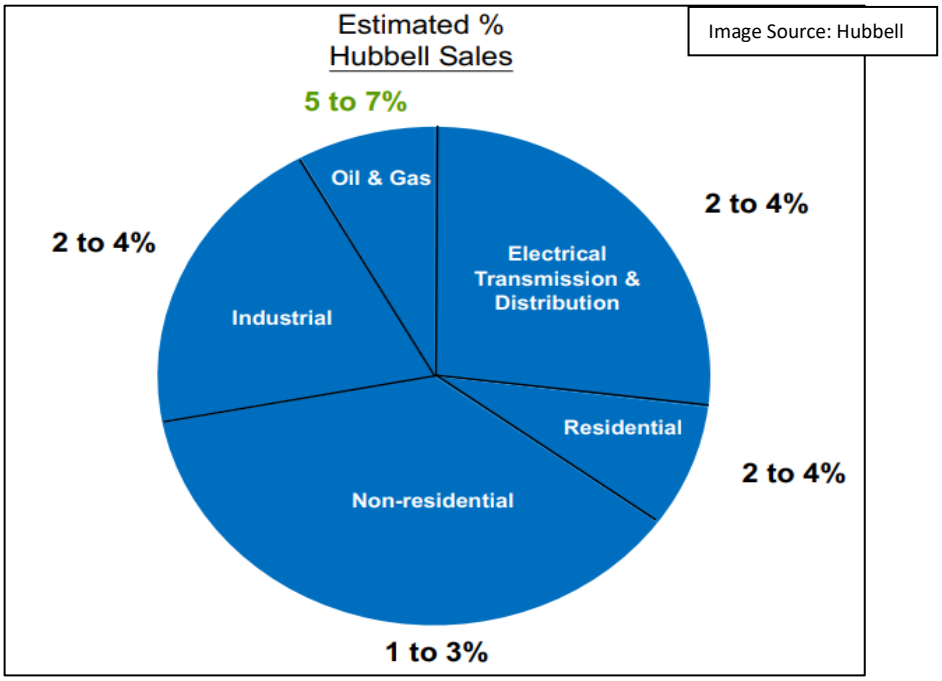
Despite its recent robust M&A activity (27 acquisitions made from 2012-2017 with total value of $890 million), including its recent purchase of Alcara, a leading smart infrastructure solutions provider primarily in public power markets, in early 2018 for $1.1 billion, the largest acquisition in its history, its pro forma total debt-to-EBITDA was a reasonable 3.1x following the Alcara deal. Management expects to reduce this leverage ratio to 2.6x-2.7x by the end of 2018. Total debt was $2.1 billion at the end of the first quarter of 2018, and it held a cash balance of $216 million, and it holds solid investment grade credit ratings of Baa1/BBB+ with a stable outlook.



Free cash flow at Hubbell averaged $302 million during the past three years (2015-2017), in the heart of what it called an industrial recession, a level that easily surpassed annual cash dividend obligations of $158 million in 2017. Free cash flow conversion did not fall below 95% of net income in any year of this three-year period and came in at a robust 117% and 123% in 2016 and 2017, respectively. Its capital-light operations are a key driver of its free cash flow generating capacity as it typically targets capital spending to be ~2.5% of net sales in a given year (capital spending was ~2.1% of net sales in 2015-2017).

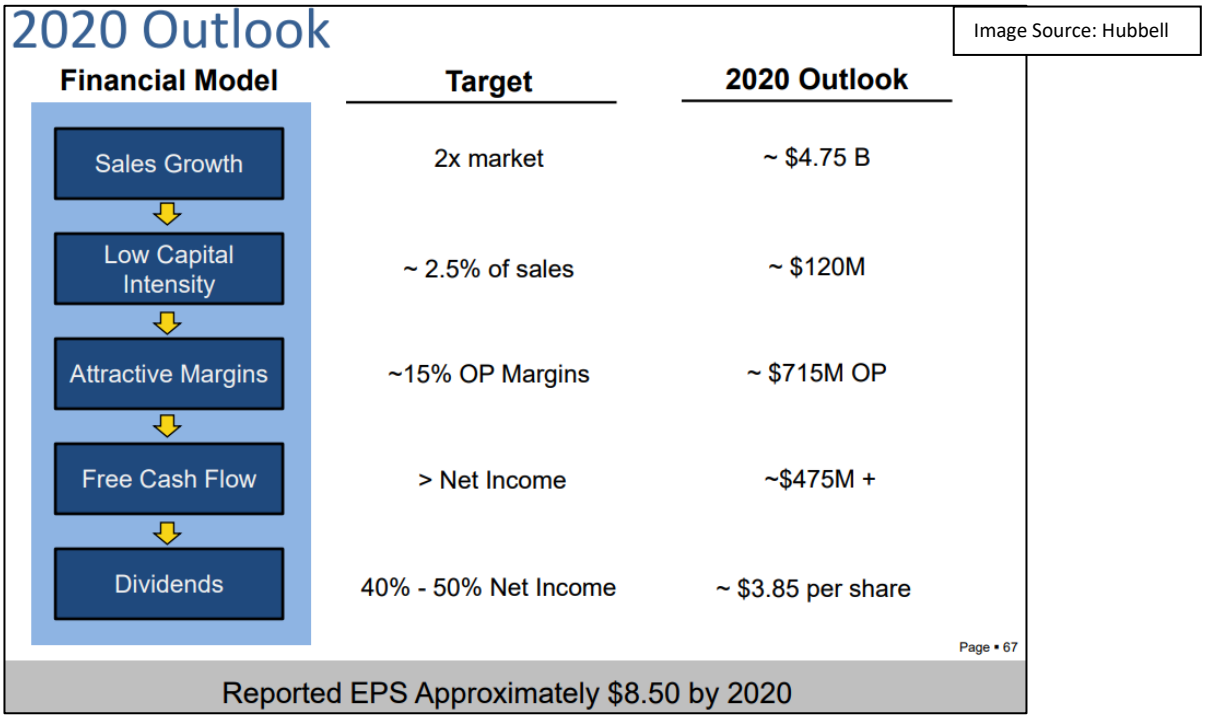
Hubbell's core strategy is based on its strong presence in key channels and markets, particularly distribution and original equipment manufacturers (OEMs), and its products are of self-proclaimed high quality and largely specialized, making its products integral for customers' operations. It boasts a competitive cost structure, and we believe management understands the necessity of continual innovation on the digital front as the industrial Internet of things takes hold. The company will remain focused on creating products that sense data, communicate, and are controllable, and its recent purchase of Aclara brings it a suite of products that are underpinned by software and analytical solutions as well as a more notable and expanded presence in automation.

In 2018 Hubbell expects consistent growth across its end markets: non-residential construction growth expected at 1%-3%, residential construction 2%-4%, electrical transmission & distribution 2%-4%, industrial 2%-4%, and oil & gas 5%-7%. In addition to the ongoing broader industrial recovery, Hubbell expects near-term commodity inflation, household formation, an increased emphasis on efficiency, efficacy, and automation, and an aging US infrastructure to be among key near-term drivers of end market growth. Near-term input cost headwinds, namely steel, should be noted, but management remains confident in its expected margin performance thanks to its favorable outlook, cost reductions, and recent pricing gains taking hold.



Hubbell's 2018 financial outlook includes net sales growth of 15%-20% with acquisitions accounting for the bulk of the growth and end market growth of 2%-4% in aggregate. Diluted earnings per share guidance comes in a range of $6.10-$6.50, but adjusted earnings per share guidance, which excludes Aclara acquisition-related and transaction costs and includes ~$0.50 of legacy intangible asset amortization, is materially higher at a range of $6.95-$7.35 and may represent a more accurate picture of underlying performance at the company. As usual, free cash flow is expected to be greater than net income.

Even more impressive than Hubbell's near-term outlook is its 2020 outlook. The company is targeting sales growth at twice the rate of its aggregate end markets with an explicit goal of ~$4.75 billion in 2020 (2017 revenue was less than $3.7 billion). Low capital intensity at ~2.5% of sales is projected to continue, and it expects to deliver ~15% operating margins in coming years with a ~$715 million operating income target in 2020 (2017 reported operating income was $504 million).



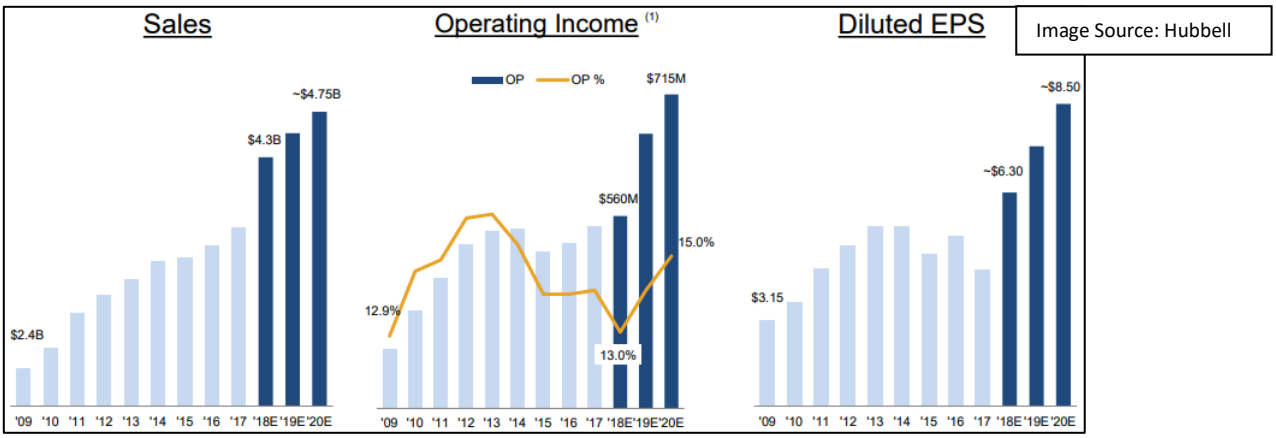
Though we believe there are concerns within Hubbell's business that hold merit, such as rising input costs, US trade policy uncertainty, persistently cyclical end markets, competition, innovating end markets, and a notable (though not worrisome) debt load with a penchant for M&A activity, management appears to have a strong hold on its business, as evidenced by its performance through the most recent industrial recession and its ability to maintain the dividend through the Great Recession. We do note, however, that operating margins faced pressure over the course of the 2014-2017, falling to 15% as adjusted in 2017 from 16.1% in 2013. Investors should be watching these key risk areas closely moving forward.

Nevertheless, we have confidence in management's expectations for it to return to a period of growth in 2018. It lists performance drivers in key areas of innovation, specifically digital evolution, including power on the go, iDevices (connected home technology), NX intelligence (lighting control solutions), power over Ethernet (POE) energy management, and the recently purchased Aclara product portfolio of cutting edge smart infrastructure solutions for utilities. Not only are Hubbell's end markets growing more attractive, but the company appears well-positioned to take on the next era of industrial innovation.

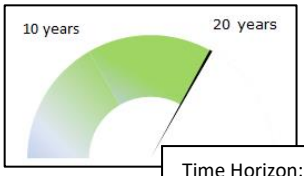
In addition to its strategic positioning, we are big fans of Hubbell's free cash flow conversion rates and overall free cash flow generating capacity. Ten consecutive years of annual dividend increases is nothing to shake a stick at, and we love its 2020 annual dividend target of $3.85 per share while maintaining a 40%-50% payout ratio, which becomes even more attractive when considering free cash flow routinely comes in above net income. Shares are currently trading at ~16.5x the midpoint of management's 2018 diluted earnings per share guidance, or ~14.6x the midpoint of adjusted earnings per share guidance, and its dividend yield is roughly 3%.

Image Source: Hubbell

OPERATIONS, years ended December 31,	2017	2016	2015	2014	2013
Net sales	$ 3,668.8	$ 3,505.2	$ 3,390.4	$ 3,359.4	$ 3,183.9
Gross profit	$ 1,151.9	$ 1,100.7	$ 1,091.8	$ 1,109.0	$ 1,070.5
Operating income	$ 503.7	$ 477.8	$ 474.6	$ 517.4	$ 507.6
Adjusted operating income [1]	$ 534.1	$ 512.8	$ 513.5	$ 522.5	$ 507.6
Operating income as a % of sales	13.7%	13.6%	14.0%	15.4%	15.9%
Adjusted operating income as a % of sales [1]	14.6%	14.6%	15.1%	15.6%	15.9%
Net income attributable to Hubbell [2]	$ 243.1	$ 293.0	$ 277.3	$ 325.3	$ 326.5
Adjusted net income attributable to Hubbell [1]	$ 328.0	$ 316.8	$ 321.0	$ 328.8	$ 326.5
Net income attributable to Hubbell as a % of net sales	6.6%	8.4%	8.2%	9.7%	10.3%
Adjusted net income attributable to Hubbell as a % of net sales [1]	8.9%	9.0%	9.5%	9.8%	10.3%
Net income attributable to Hubbell as a % of Hubbell shareholders' average equity	15.1%	17.6%	15.1%	17.0%	18.3%
Earnings per share — diluted	$ 4.39	$ 5.24	$ 4.77	$ 5.48	$ 5.47
Adjusted earnings per share — diluted [1]	$ 5.93	$ 5.66	$ 5.52	$ 5.54	$ 5.47
Cash dividends declared per common share	$ 2.87	$ 2.59	$ 2.31	$ 2.06	$ 1.85
Average number of common shares outstanding — diluted	55.1	55.7	58.0	59.2	59.6
Cost of acquisitions, net of cash acquired	$ 184.1	$ 173.4	$ 163.4	$ 183.8	$ 96.5
FINANCIAL POSITION, AT YEAR-END					
Working capital [3]	$ 898.0	$ 961.7	$ 784.7	$ 1,130.3	$ 1,165.4
Total assets	$ 3,720.6	$ 3,525.0	$ 3,208.7	$ 3,320.1	$ 3,184.0
Total debt	$ 1,055.2	$ 993.7	$ 644.1	$ 596.3	$ 594.3
Total Hubbell shareholders' equity	$ 1,634.2	$ 1,592.8	$ 1,740.6	$ 1,927.1	$ 1,906.4
NUMBER OF EMPLOYEES, AT YEAR-END	**17,700**	**17,400**	**16,200**	**15,400**	**14,300**



Kris Rosemann contributed to this article.



Time Horizon: Long-term

Heidrick & Struggles (HSII)

"Our outlook for the market demand for executive search and leadership advisory services remains positive. The strategic actions that we took at the end of 2017 are enabling us to execute our plan to drive profitable growth and operating excellence. Our digital transformation – driving and leveraging our propriety IP-based solutions and data—will continue to distinguish Heidrick & Struggles in the market." – Heidrick & Struggles' CEO Krishnan Rajagopalan, first-quarter 2018 earnings release

Thesis

The capital-appreciation idea in the May 2018 edition of the Nelson Exclusive is one that had a very strong technical breakout recently, and the market seems to be fervently supporting its shares. Heidrick & Struggles (HSII) is the one.

The company flies under the radar as it doesn't have the same curb appeal as a fancy tech company or an up-and-coming new energy-saving gadget, for example, but in some ways, we like that Heidrick & Struggles business is rather boring. It has been around for more than 60 years, today as a leading advisory company providing executive search and leadership consulting services around the globe. Heidrick & Struggles' niche is in sourcing and placing top-level senior executives, and this focus in turn gives Heidrick & Struggles improved brand visibility and higher fees per search. The primary revenue-generating function at the company are fees on the annual compensation for a placed executive. In 2017, Heidrick & Struggles recruited senior executives whose first-year base salary and bonus totaled more than $360,000, on average.

Corporate Profile

The company's origins date back to 1953 when Gardner Heidrick and John Struggles created one of the first executive search firms in the US. Heidrick & Struggles has been expanding ever since, and the company remains a trusted advisor for many businesses requiring solutions for executive search and leadership consulting. It has a team of over 380 consultants around the world, and its niche remains in Executive Search, accounting for the vast majority of revenue generated.

Key Statistics	
Last Close	$37.65
52-week range	$17.90-$39.32
Market Cap	$712 M
Avg Daily Vol (30 wks)	128,611
Trailing P/E	NMF
Net Cash (LFY)	$208 M

We like Heidrick & Struggles' ongoing growth opportunities, especially as it relates to the fast-changing business environment and its focus on placing decision-makers that have great influence across organizations. The executive search industry is also quite fragmented, as there may be as many as several thousand smaller boutique executive search companies around the globe, giving Heidrick & Struggles a unique opportunity to roll up parts of the industry, if needed, or gain market share through its growing breadth and influence. The company's long history and established relationships with key clients gives it a leg up on winning new and recurring business, in our view. Its executive search business remains the bread-and-butter of its operations at ~90% of revenue, though it does have leadership consulting (succession planning) and culture-shaping services (new strategies and structures) as well, the latter two divisions combining to form "Heidrick Consulting" in 2018.

The relative percentages of net revenue attributable to each segment were as follows:

	Year Ended December 31,		
	2017	2016	2015
Executive Search			
Americas	55%	53%	55%
Europe	20%	19%	17%
Asia Pacific	14%	15%	17%
Leadership Consulting	7%	7%	4%
Culture Shaping	4%	6%	7%

Image Source: Heidrick & Struggles

Global Industry Practices. Our executive search and leadership consulting businesses operate in six broad industry groups listed below. These industry categories and their relative sizes, as measured by billings for 2017, 2016 and 2015, are as follows:

	Percentage of Billings		
Global Industry Practices	2017	2016	2015
Financial Services	27%	28%	27%
Global Technology & Services	22	21	22
Industrial	18	21	21
Consumer Markets	17	17	16
Healthcare & Life Sciences	12	11	10
Education, Non-Profit & Social Enterprise	4	2	4
	100%	100%	100%

Heidrick & Struggles finds itself in elite company with the likes of other executive search firms such as Egon Zehnder, Korn Ferry, Russel Reynolds, and Spencer Stuart, and these big 5 are highly established. Barriers to entry may be relatively low for upstarts, but barriers to success are very high, especially as some of the bigger players can provide ancillary add-on services, including leadership consulting. Reputation and global access are also very difficult for new players to achieve out of the gates, and many top companies may not look beyond the big 5 when thinking about sourcing a key executive. Heidrick & Struggles also finds itself in a very lucrative portion of the staffing industry, as companies may pay up significantly for top talent, meaning more fees for Heidrick & Struggles as clients seem to be more quality-sensitive than price-sensitive at the top.

2017 was one of the best years in the 64-year history of Heidrick & Struggles, with the company posting the highest net revenue, which leapt 6.7% from the year ago. Executive Search revenue led the charge, increasing nearly 9%, while adjusted operating income advanced 17% from last year. In its 2017 annual report, Heidrick & Struggles outlined four areas of focus: growth, cross-enterprise collaboration, premium service experience, and cost containment. Management has been aggressively hiring and seeking strategic acquisitions to help power Executive Search revenue higher in coming years. Cross-training consultants may provide other opportunities, a continued high service level only makes sense, and attention to cost to continue to drive operating leverage is par for the course. We like this, and it is showing up in the numbers, too.

During the first quarter of 2018, for example, net revenue in its Executive Search division jumped more than 17% (consolidated sales increased 14%+), while operating income nearly doubled thanks to significant improvement on the operating line. We think Heidrick Consulting may help with revenue performance in coming years, even though it is currently a drag, but Heidrick & Struggles is reaping sales from previous investments in Executive Search, and we expect expansion to continue. Perhaps the biggest catalyst for shares and something that we think is sustainable is the company's focus on managing costs. During the first quarter of 2018, for example, Heidrick & Struggles' operating margin improved to 8.2% from 4.7% in the first quarter of 2017. Productivity per consultant, the number of confirmed searches, and the average revenue per executive search all improved in the period.

	Year Ended December 31,				
	2017	2016	2015	2014	2013
	(in thousands, except per share and other operating data)				
Statements of Operations Data:					
Revenue:					
Revenue before reimbursements (net revenue)	$621,400	$582,390	$531,139	$494,292	$461,995
Reimbursements	18,656	18,516	17,172	18,947	18,998
Total revenue	640,056	600,906	548,311	513,239	480,993
Operating expenses:					
Salaries and employee benefits	434,219	400,070	369,385	337,448	319,499
General and administrative expenses	147,316	147,087	127,692	130,191	126,931
Impairment charges (1)	50,722	—	—	—	—
Restructuring charges (2)	15,666	—	—	—	—
Reimbursed expenses	18,656	18,516	17,172	18,947	18,998
Total operating expenses	666,579	565,673	514,249	486,586	465,428
Operating income	(26,523)	35,233	34,062	26,653	15,565
Non-operating (expense) income:					
Interest, net	385	244	(122)	(358)	(175)
Other, net	(3,280)	2,289	(2,386)	(2,108)	(2,002)
Net non-operating (expense) income	(2,895)	2,533	(2,508)	(2,466)	(2,177)
Income (loss) before income taxes	(29,418)	37,766	31,554	24,187	13,388
Provision for income taxes	19,217	22,353	14,422	17,390	7,041
Net income (loss)	$ (48,635)	$ 15,413	$ 17,132	$ 6,797	$ 6,347
Basic weighted average common shares outstanding	18,735	18,540	18,334	18,210	18,077
Diluted weighted average common shares outstanding	18,735	18,939	18,715	18,432	18,232
Basic earnings (loss) per common share	$ (2.60)	$ 0.83	$ 0.93	$ 0.37	$ 0.35
Diluted earnings (loss) per common share	$ (2.60)	$ 0.81	$ 0.92	$ 0.37	$ 0.35
Cash dividends paid per share	$ 0.52	$ 0.52	$ 0.52	$ 0.52	$ 0.39
Balance Sheet Data (at end of period):					
Working capital (3)	$ 77,998	$ 77,838	$ 79,533	$112,387	$107,177
Total assets (3)	587,204	581,502	572,718	568,621	552,937
Long-term debt, less current maturities	—	—	—	23,500	29,500
Stockholders' equity	212,705	258,590	254,802	244,664	247,873
Other Operating Data:					
Average number of consultants during the period	389	347	326	313	341

(1) Includes impairment charges of $39.2 million related to Culture Shaping and $11.6 million related to Leadership Consulting in 2017.
(2) Includes restructuring charges of $15.7 million in 2017. These charges consist of $13.1 million of employee-related costs associated with severance arrangements, $2.3 million in professional fees and other expenses and $0.3 million in real estate related expenses.
(3) As adjusted for the adoption of ASU 2015-17, *Income Taxes: Balance Sheet Classification of Deferred Taxes*.

Image Source: Heidrick & Struggles

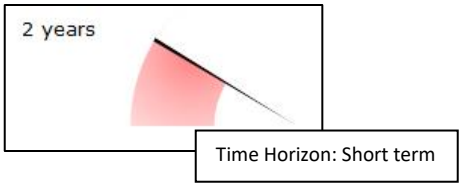
Heidrick & Struggles' outlook for the second quarter of 2018 came in better than what many had been expecting, and the executive team at the company noted that the outlook for executive search and leadership advisory offerings is solid. Though investors in the company will always have the risk of brand reputational damage or execution missteps or growing digital competition (Microsoft's LinkedIn), Heidrick & Struggles is standing on quite the foundation to achieve continued growth. The company's 1.6% dividend yield is icing on the cake, too, and is covered considerably by free cash flow generation, which came in at nearly $53 million during 2017.

By comparison, cash dividends paid during 2017 were ~$10 million, and the company has only modest debt on the books with a meaningful net cash position. We like Heidrick & Struggles for capital appreciation potential, even as we note there remains risk with respect to economic/employment cycles, but the company could also be considered a great dividend growth story, too, given its current healthy cash-based financials. A big catalyst for the stock could be a huge dividend increase in coming years, but we like Heidrick & Struggles in any case. We think the company fills a unique space in the Nelson Exclusive publication.

Principal Stockholders

Set forth in the table below is information about the number of shares held by persons we know to be the beneficial owners or more than 5% of the issued and outstanding Common Stock.

Name and Address	Shares of Common Stock Beneficially Owned	Percent (7)
BlackRock, Inc. (1) 55 East 52nd Street New York, New York 10055	2,414,523	12.9
Royce & Associates, LP (2) 745 Fifth Avenue New York, New York 10151	1,543,906	8.22
Dimensional Fund Advisors LP (3) Building One 6300 Bee Cave Road Austin, Texas 78746	1,489,567	7.93
Renaissance Technologies LLC (4) 800 Third Avenue New York, New York 10022	1,150,302	6.12
The Vanguard Group (5) 100 Vanguard Blvd. Malvern, Pennsylvania 19355	1,049,746	5.58
Paradice Investment Management LLC (6) 257 East Fillmore Street, Suite 200 Denver, Colorado 80206 Paradice Investment Management Pty Ltd (6) Level 27 The Chifley Tower 2 Chifley Square Sydney NSW 2000 Australia	960,176	5.1



Noodles & Company (NDLS)

Thesis

Though trends have improved more recently, the broader restaurant industry continues to face traffic declines; comparable traffic fell 2.1% in the month of March, according to TDn2K. Growing levels of personal income have helped buoy comparable sales trends as price increases have begun to offset traffic declines, but we are not convinced that this will continue to be an effective strategy over the long haul. Improving weather has the potential to give comparable sales a boost in the near-term on a sequential basis, but without a meaningful return to traffic growth, material execution risk will remain for restaurant operators as they work to optimize menus and pricing.

This month's short idea, Noodles & Company, is among those that have faced pressure as a result of weak industry traffic trends in recent years. Comparable restaurant sales declined each year from 2015-2017, falling 0.2%, 0.9%, and 2.7% in 2015, 2016, and 2017, respectively. This has helped cause stagnation in its total revenue, which came in at $456 million in 2017 compared to $455 million in 2015. Closings of underperforming was prevalent in 2017 (55 in the first quarter alone) as well as the company works to execute on its turnaround strategy.

Corporate Profile

Noodles & Company is a fast casual restaurant chain offering a variety of menu options that range from healthy to indulgent that are focused on noodle and pasta dishes with a tilt toward value. At the end of 2017 it had 412 company-owned restaurants and 66 franchise restaurants in 29 states and the District of Columbia. The company was founded in 1995 and is headquartered in Colorado.

Key Statistics	
Last Close	$7.25
52-week range	$3.35-$8.20
Market Cap	$298 M
Avg Daily Volume (30 weeks)	142,053
Shares Outstanding	39.6 M
Float	16.4 M
Shares Short	2.8 M
Short Ratio	19.2
Short % of Float	22.1%
Shares short (prior month)	3.5 M

One of the core concerns we have with Noodles' restaurant closing is the rationale management offered behind many of the closings. In its 10-K for the 2017 year, it stated, "Many of these restaurants were open for only the last three or four years in newer markets where brand awareness of our restaurants was not as strong and where it has been more difficult to adequately staff our restaurants." This leads us to believe that brand strength may not be nearly what management believes it to be, and while strengthening its brand is part of its transformation plan, a significant amount of work is needed to go from a brand that is unable to adequately staff its restaurants in new markets to one that is readily recognized by consumers in new markets.

Noodles' bottom-line performance has left a great deal to be desired in recent years as well. It reported a loss from operations, as well as a net loss, in each of the past three years as its restaurant contribution margin faced meaningful pressure, falling to 14.2% in 2017 (but an improvement over 12.8% in 2016) from 19.1% in 2014. One of our largest concerns with the company's cost structures is its relatively high occupancy costs, which came in at 11.5% and 11.6% of revenue in 2017 and 2016, respectively. According to third party sources, optimal occupancy cost levels are below 10% of revenue, and occupancy costs above that level have the potential to materially impair profitability, a notion supported by recent bottom-line performance at Noodles & Company.

In addition to net losses in the past three years, Noodles has turned in negative free cash flow each year since 2011. The company was forced to tap into the common and preferred equity markets in 2017 to help it reduce

debt and finance its transformation plan, which we view as a necessity given its deteriorated restaurant contribution margin. As of the end of 2017, its debt load is not a concern in itself as net debt sat just above $54 million, which is a healthy level when considering management provided adjusted EBITDA of $30.6 million in 2017.

Image Source: Noodles & Company

Net cash provided by operating activities	4,102	24,737	44,506
Investing activities			
Purchases of property and equipment	(20,828)	(43,335)	(50,093)

Image shown: Noodles & Company's free cash flow generation in 2015 (far right) through 2017 (far left).

There are a number of positive developments that should be noted in Noodles & Company's transformation plan. The company appears to be progressing nicely in its digital initiatives, with online ordering accounting for 11% of sales in the fourth quarter of 2017, and it continues to develop in store infrastructure, such as rapid pick up shelves, which are aimed at expediting this growth. Noodles also continues to test delivery with such capabilities currently available in 15% of its restaurants, but we have yet to be convinced that digital and delivery will be able to effectively differentiate its offerings from competitors, especially as we see similar capabilities being implemented across the fast-casual space. Another material risk to our short thesis on Noodles is its potential as a takeout candidate as an increasing number of restaurant chains have been taken private more recently, including the likes of Panera and Buffalo Wild Wings.

Nevertheless, there are areas of the plan that may not be as effective. The company notes taking advantage of potential leverage as a margin expansion driver, but its sizable restaurant closure in 2017 and its plans to slow unit growth in the near-term (one to four openings expected in 2018) will limit the positive effect of operating leverage. Labor efficiency and supply chain initiatives are solid aspirations, but ongoing food commodity and wage inflation have the potential to put notable pressure on margin performance. Price increases may help offset some weakness as well, but given its recent performance, historical tilt towards value, and relatively weak brand notoriety, we are less positive on the potential of price hikes to be a meaningful difference maker.

In 2018, Noodles & Company expects total revenue to be in a range of $440-$450 million, down from $456 million in 2017, but it projects modest comparable restaurant sales growth in the year. Restaurant contribution margin is expected to expand to 14.5%-15% in the full year, up from 14.2% in 2017 but still considerably weaker than 19.1% and 20.7% in 2014 and 2013, respectively, and lower than the 15.1% margin reported in the fourth quarter of 2017. Adjusted earnings per share guidance has been issued in a range of -$0.01-$0.03 (negative $0.01 to positive $0.03), and we do not expect the company to be profitable on a GAAP basis yet again in the year. Adjusted EBITDA is expected to be $31-$33 million, up only slightly from $30.6 million in 2017.

Noodles & Company's first quarter expectations are somewhat less optimistic than those for its full year. Management expects negative comparable restaurant sales in the quarter due to a variety of factors including weather and a shift in the Easter holiday, and the aforementioned negative forces should be reflected across its performance for the quarter. We're looking ahead to its first quarter report, scheduled for May 10, in anticipation of a potentially weak showing.

All things considered, though modest improvements may be in store for Noodles & Company in 2018, we're not expecting its transformation plan to yield materially improved results in the near-term. Its less than ideal cost structure is likely to be exacerbated by commodity and wage inflation, making its cost savings initiatives an even steeper uphill climb, and negative free cash flow generation is never a sign of a healthy business. We wouldn't be surprised to see the firm have to tap into the capital markets once again for additional funding as its cash balance was a mere $3.4 million as of the end of 2017.

Positive developments related to digital capabilities and the potential for a takeover offer to boost shares are key concerns as they relate to our short thesis. However, ongoing industry-wide traffic weakness, bloated operating costs, and commodity and wage inflation will continue to make Noodles & Company's turnaround efforts an uphill climb, and we expects shares to feel pressure as the market sifts through the impact these dynamics will have on its results. Noodles & Company does not pay a dividend.

	Fiscal Year Ended				
	January 2, 2018	January 3, 2017	December 29, 2015	December 30, 2014	December 31, 2013
	(in thousands)				
Revenue:					
Restaurant revenue	$ 451,599	$ 482,544	$ 450,482	$ 398,993	$ 347,140
Franchising royalties and fees	4,893	4,930	4,969	4,748	3,784
Total revenue	456,492	487,474	455,451	403,741	350,924
Costs and Expenses:					
Restaurant operating costs (exclusive of depreciation and amortization, shown separately below):					
Cost of sales	121,473	130,630	120,455	107,217	91,892
Labor	150,161	161,219	143,145	120,492	104,040
Occupancy	51,877	55,912	50,300	42,540	35,173
Other restaurant operating costs	64,091	73,011	63,549	52,580	44,078
General and administrative [1][2]	39,746	55,654	37,244	31,394	35,893
Depreciation and amortization	24,613	28,134	27,802	24,787	20,623
Pre-opening	935	3,131	4,407	4,425	3,809
Restaurant impairments, closure costs and asset disposals [3]	37,446	47,311	29,616	1,391	1,164
Total costs and expenses	490,342	555,002	476,518	384,826	336,672
(Loss) income from operations	(33,850)	(67,528)	(21,067)	18,915	14,252
Debt extinguishment expense	—	—	—	—	624
Interest expense, net	3,839	2,916	1,432	365	2,196
(Loss) income before income taxes	(37,689)	(70,444)	(22,499)	18,550	11,432
(Benefit) provision for income taxes	(207)	1,233	(8,734)	7,122	4,767
Net (loss) income	(37,482)	(71,677)	(13,765)	11,428	6,665
Accretion of preferred stock to redemption value [4]	(7,967)	—	—	—	—
Net (loss) income attributable to common stockholders	$ (45,449)	$ (71,677)	$ (13,765)	$ 11,428	$ 6,665

	Fiscal Year Ended				
	January 2, 2018	January 3, 2017	December 29, 2015	December 30, 2014	December 31, 2013
	(in thousands, except share and per share data and restaurants)				
(Loss) earnings per Class A and Class B common share, combined:					
Basic	$ (1.20)	$ (2.58)	$ (0.48)	$ 0.38	$ 0.25
Diluted	$ (1.20)	$ (2.58)	$ (0.48)	$ 0.37	$ 0.24
Weighted average Class A and Class B common shares outstanding, combined:					
Basic	37,759,497	27,808,708	28,938,901	29,717,304	26,406,904
Diluted	37,759,497	27,808,708	28,938,901	31,001,099	27,688,629
Selected Operating Data:					
Company-owned restaurants at end of period	412	457	422	386	318
Franchise-owned restaurants at end of period	66	75	70	53	62
Company-owned:					
Average unit volumes [1]	$ 1,072	$ 1,075	$ 1,103	$ 1,147	$ 1,179
Comparable restaurant sales [2]	(2.7)%	(0.9)%	(0.2)%	0.3%	3.4%
Restaurant contribution [3]	$ 63,997	$ 61,772	$ 73,033	$ 76,164	$ 71,957
as a percentage of restaurant revenue	14.2 %	12.8 %	16.2 %	19.1%	20.7%

	As of				
	January 2, 2018	January 3, 2017	December 29, 2015	December 30, 2014	December 31, 2013
	(in thousands)				
Balance Sheet Data:					
Total current assets	$ 22,058	$ 25,788	$ 25,401	$ 22,776	$ 18,333
Total assets	185,233	209,461	239,961	238,539	187,350
Total current liabilities	43,869	49,033	32,914	25,831	24,165
Total long-term debt	57,624	84,676	67,732	27,136	5,860
Total liabilities	149,372	183,643	146,189	98,424	62,877
Total stockholders' equity	35,861	25,818	93,772	140,115	124,473

Kris Rosemann contributed to this article.

July 1, 2016

Inaugural Letter to Members

Dear Valued Member,

Welcome! You are one of a very limited number of members that will ever bear witness to the pages that follow.

The launch week of the Nelson Exclusive coincided with news that Britain has voted to leave the European Union. The decision, while sending the European banks tumbling violently, does little to muddy the context setting the background of the inaugural edition of this publication.

Broader stock market valuations are at frothy levels, and interest rates continue to hover near all-time lows. The investment-decision landscape is more complicated today than ever before for all types of investors, from those seeking long-term capital appreciation to those that are targeting certain income goals. Cyclicals today are trading at peak multiples on peak earnings, and even consumer staples equities have reached valuation levels that may be more appropriate for aggressive growth equities, not mature operators. *Said differently, the market has laid down the gauntlet.*

The next few years in the markets may be among the most difficult witnessed since the Great Recession. Even a broader market pullback 20% from current all-time highs wouldn't be abnormal given that the collective market valuation of S&P 500 companies has effectively tripled from the March 2009 panic bottom. The launch of the Nelson Exclusive in such conditions can be considered perilous as broader market performance inevitably will act as ballast to the returns of ideas surfaced. In this spirit, I want to remind you that not all ideas in this publication will be successful, and some that are eventually may encounter tough sledding over extended periods of time. As a swimmer cannot achieve his best time swimming against the current, a stock selector cannot achieve his best performance in a down market. Regardless, the value placed on a steady hand during challenging times is priceless.

Let's first cover what the Exclusive is and then we'll talk about what it is not. As you know, the Valuentum investment coverage universe is vast, and what we're seeking to deliver in this publication is ideas that fall outside its reach. We're breaking down the traditional barriers of equity coverage to identify underfollowed gems across the investing spectrum, delivering in each monthly edition one idea for income investors, one idea for readers seeking long-term capital appreciation, and a bonus idea for those looking for a "short" consideration (1). Underfollowed doesn't mean obscure, however, and the ideas that we're targeting will be investable ones, avoiding thinly-traded instruments and penny stock "traps." We'll clearly define our expected time horizon for each consideration, and where applicable, we'll update our theses in subsequent editions. We'll keep score, tracking performance over time.

Let's talk about what the Exclusive isn't. The Exclusive does not constitute individual investment advice, and the ideas within it are not personal recommendations. Each of you reading should always work with your

personal financial advisor who knows your individual goals and risk tolerances. I do not. Only you and your personal financial advisor know what's best for your life circumstances. The personal financial advising markets and what we do at Valuentum via financial publishing are two different verticals in the same industry, but they are different nonetheless. I just want to be very clear about this because I can never tell you to buy or sell anything at any time, even if this may be what you want. It's not that I don't have conviction in my work – it's the rules of the business.

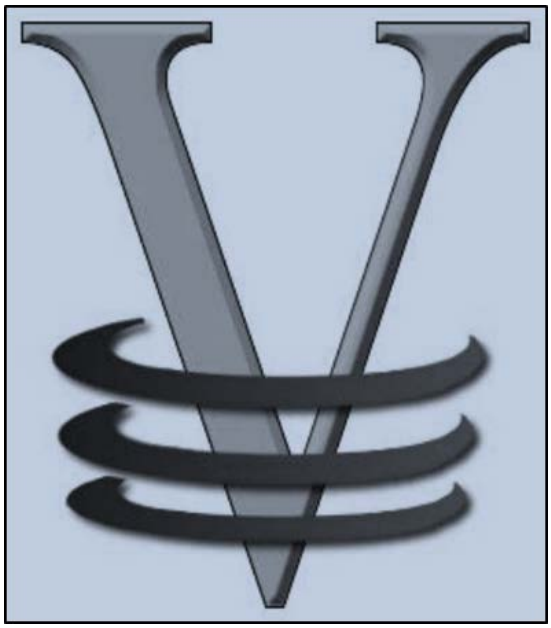
Within the twelve editions of the Nelson Exclusive each year, we'll be highlighting in total 36 ideas for consideration with varying investment parameters. That's a lot. Depending on the time horizon set forth with each idea, fantastic performance might mean a success rate of 60%, great performance might be 55%, average performance might be 50%, while anything below that mark may constituent a poor showing. Obviously, I'm aiming for a 100% success rate, but I also have to be realistic. The great Joe DiMaggio may have hit safely for 56 consecutive games in the last baseball season before the United States was thrust into World War II, but he "only" hit .357 that year. That season of '41, the great Ted Williams would be the last player to hit .400, meaning that one of the best hitters in baseball…ever…was still called out ~60% of the time.

The greatest investors face a similar paradigm. Stock selection is a process where there will be homeruns and strikeouts. You know me. The Exclusive is not a "get-rich-quick" product, and you should keep a close eye on your wallet if you encounter anyone promising anything of the sort. In the inaugural edition of the Nelson Exclusive, I'm going to take 36 swings – they are going to be hard and through the zone, and I'm not going to pull my shoulder out or take my eye off the ball. Market conditions are expected to be stormy in coming years as "reversion-to-the-mean" dynamics rain down, and a crafty lefthander with great "stuff" may be on the mound, but we're stepping up to the plate and digging in.

Batter up!

Sincerely,

Brian Nelson, CFA
President, Investment Research & Analysis
Valuentum Securities, Inc.
brian@valuentum.com



P.S. On a very personal note, I wanted to thank you for your continued support. Without you, neither the Nelson Exclusive publication nor Valuentum would exist. This fact is not lost on me. I thank you deeply.

The Nelson Exclusive: Volume 3, Issue 5

The Nelson Exclusive is published monthly. Contact us at info@valuentum.com for more information.

(1) From the SEC's website: A short sale is the sale of a stock that an investor does not own or a sale which is consummated by the delivery of a stock borrowed by, or for the account of, the investor. Short sales are normally settled by the delivery of a security borrowed by or on behalf of the investor. The investor later closes out the position by returning the borrowed security to the stock lender, typically by purchasing securities on the open market.

Investors who sell stock short typically believe the price of the stock will fall and hope to buy the stock at the lower price and make a profit. Short selling is also used by market makers and others to provide liquidity in response to unanticipated demand, or to hedge the risk of an economic long position in the same security or in a related security. If the price of the stock rises, short sellers who buy it at the higher price will incur a loss.

Brokerage firms typically lend stock to customers who engage in short sales, using the firm's own inventory, the margin account of another of the firm's customers, or another lender. As with buying stock on margin, short sellers are subject to the margin rules and other fees and charges may apply (including interest on the stock loan). If the borrowed stock pays a dividend, the short seller is responsible for paying the dividend to the person or firm making the loan (Source: SEC https://www.sec.gov/answers/shortsale.htm)

Short selling is not for all types of investors, and readers should consult their personal financial advisor that understands their individual goals and risk tolerances before considering any investment or any strategy. Potential losses for an investor engaging in a short selling strategy are theoretically infinite.

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