Valuentum Securities, Inc.

"Exclusive Analysis for the Discerning Investor"

Value-Focused, *Momentum*-Based Dividend Growth Investing

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January 2, 2016
American Association of Individual Investors, Phoenix Chapter

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Agenda

- About Valuentum
- Discuss: What Makes An Ideal Dividend Growth Stock?
- Illustrations of the Valuentum Strategy
- The Three Pillars of the Valuentum Buying Index
- The Benefits of Dividend Growth Investing
- Introducing the Valuentum Dividend Cushion Ratio™
- Hands On: Conducting a Cash-flow Based Dividend Analysis
- Microsoft (MSFT): One of Our Favorite Dividend Growth Ideas
- Stay in Touch! The Dividend Growth Newsletter

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About the Speaker

Brian Nelson is the President of Equity Research and ETF Analysis at Valuentum Securities. Before founding Valuentum in early 2011, Mr. Nelson worked as a director at Morningstar, where he was 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 in February 2006, 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. Mr. Nelson has an MBA from the University of Chicago Booth School of Business and also holds the Chartered Financial Analyst (CFA) designation.

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About Valuentum Securities

Valuentum (val·u·n·tum) [val-yoo-en-tuh-m] Securities Inc. is an independent investment research provider, offering premium equity reports and dividend reports, as well as commentary across all sectors/companies, a Best Ideas Newsletter (spanning market caps, asset classes), a Dividend Growth Newsletter, modeling tools/products, and more. Independence and integrity remain our core, and we strive to be a champion of the investor. Valuentum is based in the Chicagoland area.

Valuentum serves money-management institutions, financial advisors, and individual investors.

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How Valuentum Fits Into the Financial Industry

Financial Information Publishers

Serve

Financial Advisors – Provide Financial Advice

Advise

Educate

Publishers Are Not Financial Advisors. They Do Not Provide Personal Financial Advice. Subscription-based Information Services.

Individual Investors

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Question: What Makes an Ideal Dividend Growth Stock?

A) The company has a sufficient dividend yield, not one that implies risk to the payout (i.e. financially-engineered), but one that is supported organically.
B) A strong company with solid fundamentals (an attractive Economic Castle rating – it generates outsize economic profits).
C) The share price is going up (i.e. the market has conviction in the idea).
D) The company covers its dividend payment with copious amounts of free cash flow, as measured by cash flow from operations (CFO) less *all* capital spending.
E) It has a large amount of *net* cash on the balance sheet that can be used as reserves in case it encounters trouble.

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Wait… There's more!

F) The company is undervalued on the basis of a discounted cash flow process (and a relative valuation process, too!).

G) The firm's management has a strong willingness to keep paying an increasing dividend, as measured by its dividend track record.

H) The idea has a solid Dividend Cushion ratio (a measure of the safety and growth potential of the dividend).

I) Only some of the above… which ones?

J) All of the above (A though H).

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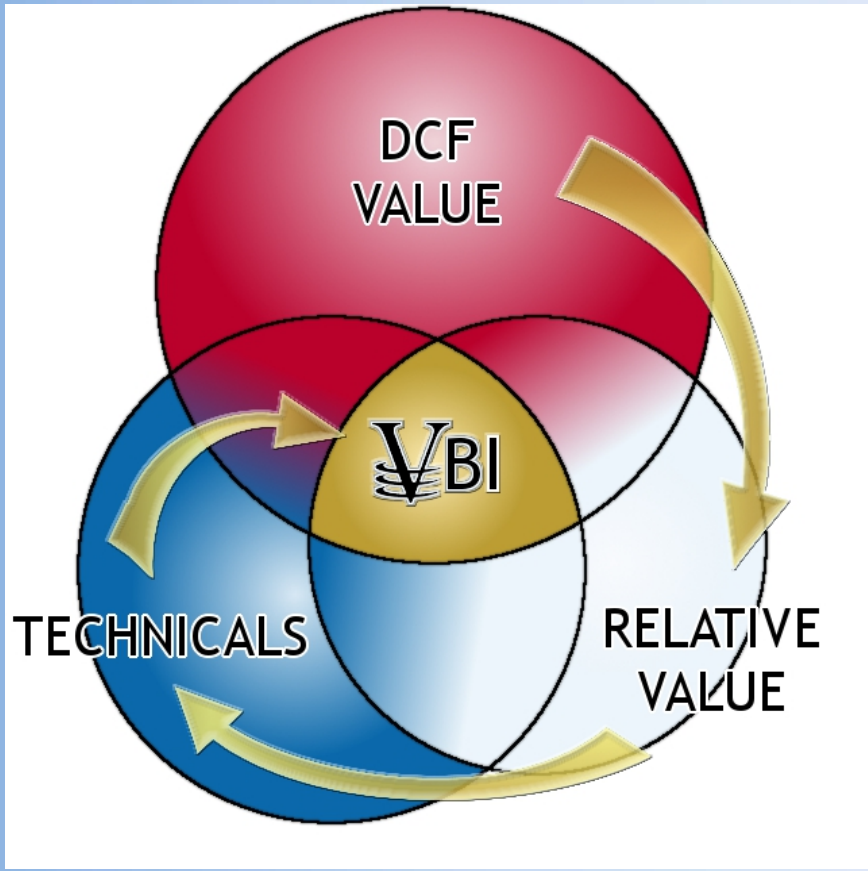
Valuentum's Extensive Due Diligence…



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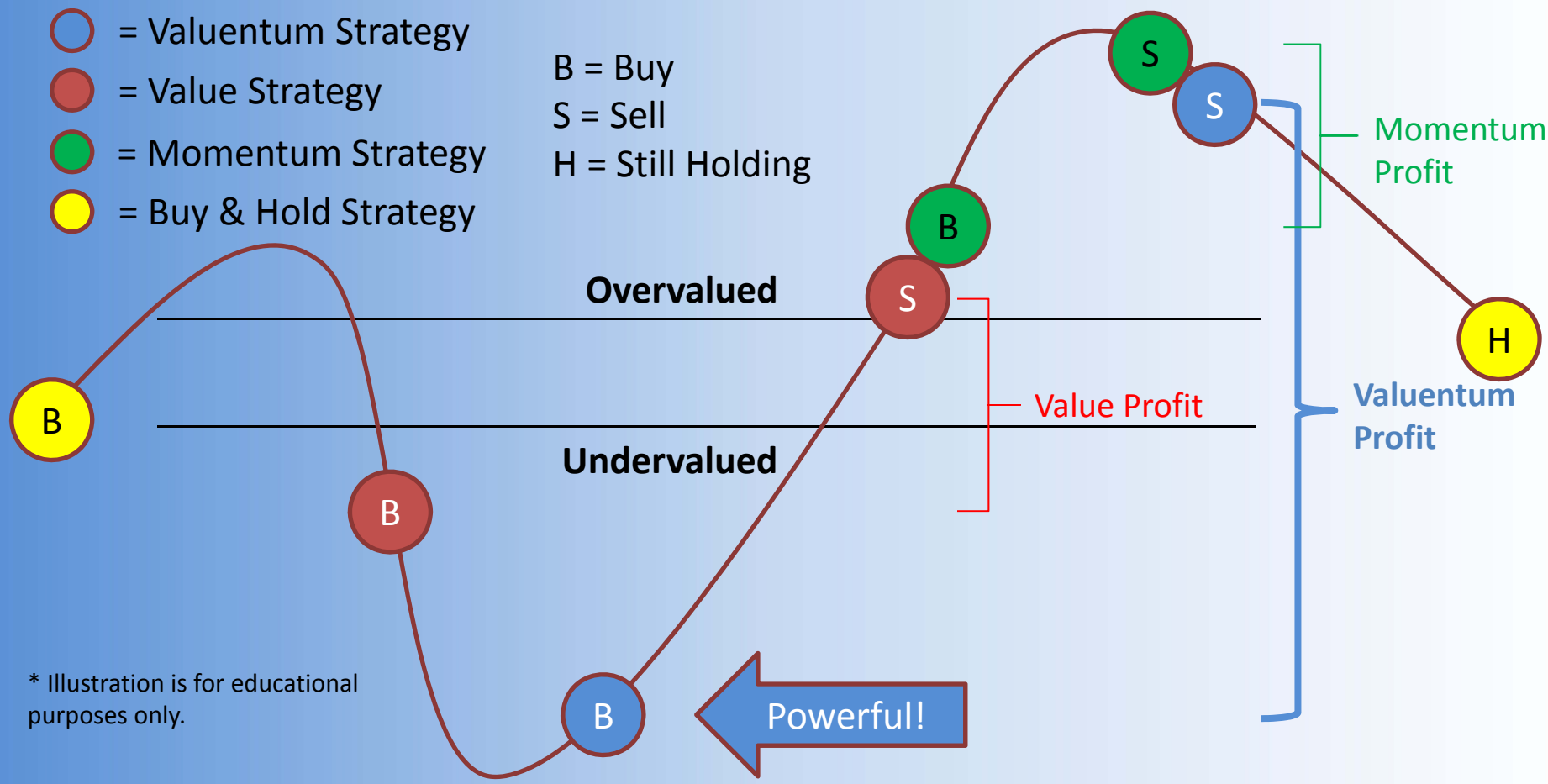
The Valuentum Strategy Has the Greatest Profit Potential*



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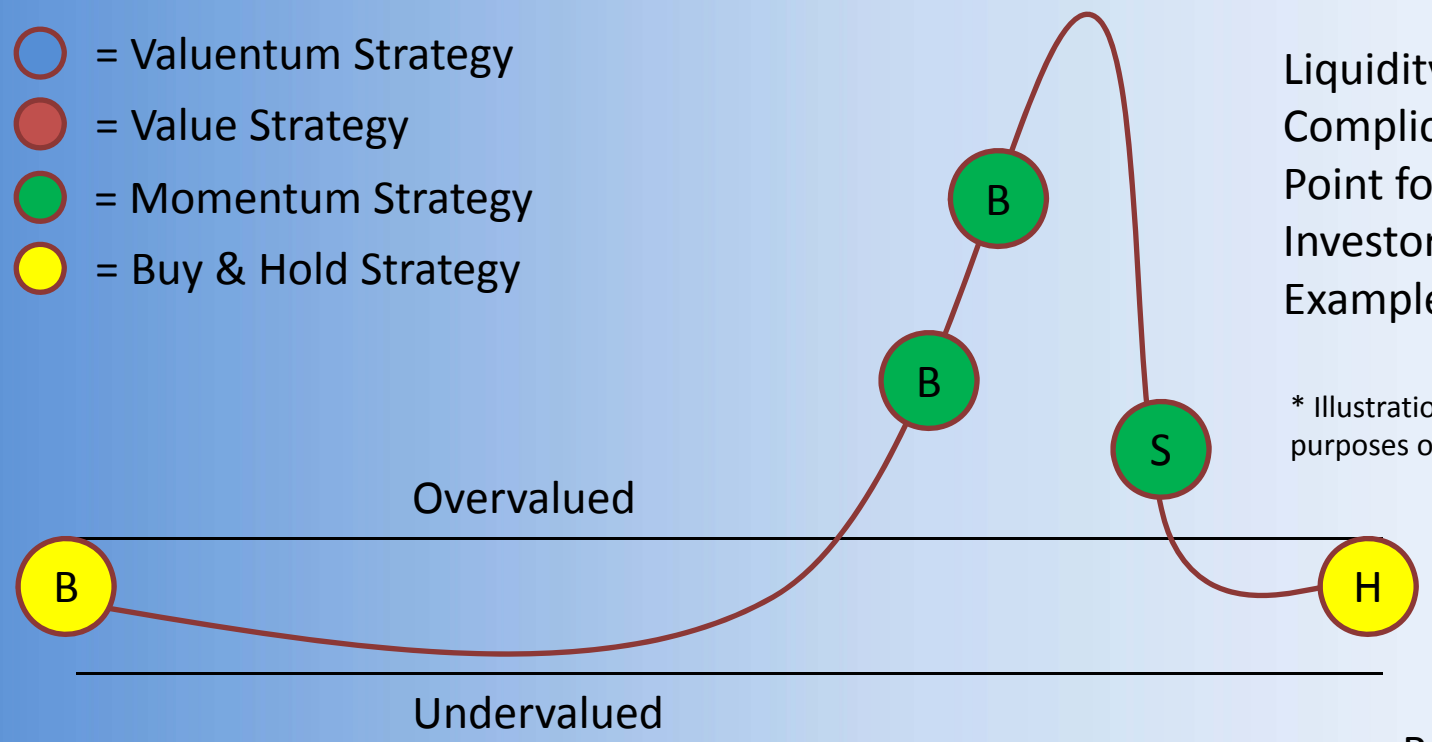
The Valuentum Strategy Helps Avoid Overpriced Extremes – We Don't Get Involved!*



Liquidity Squeeze Complicates Exit Point for Momentum Investors in This Example

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B = Buy
S = Sell
H = Still Holding

We're *not* momentum investors. We're Valuentum investors.

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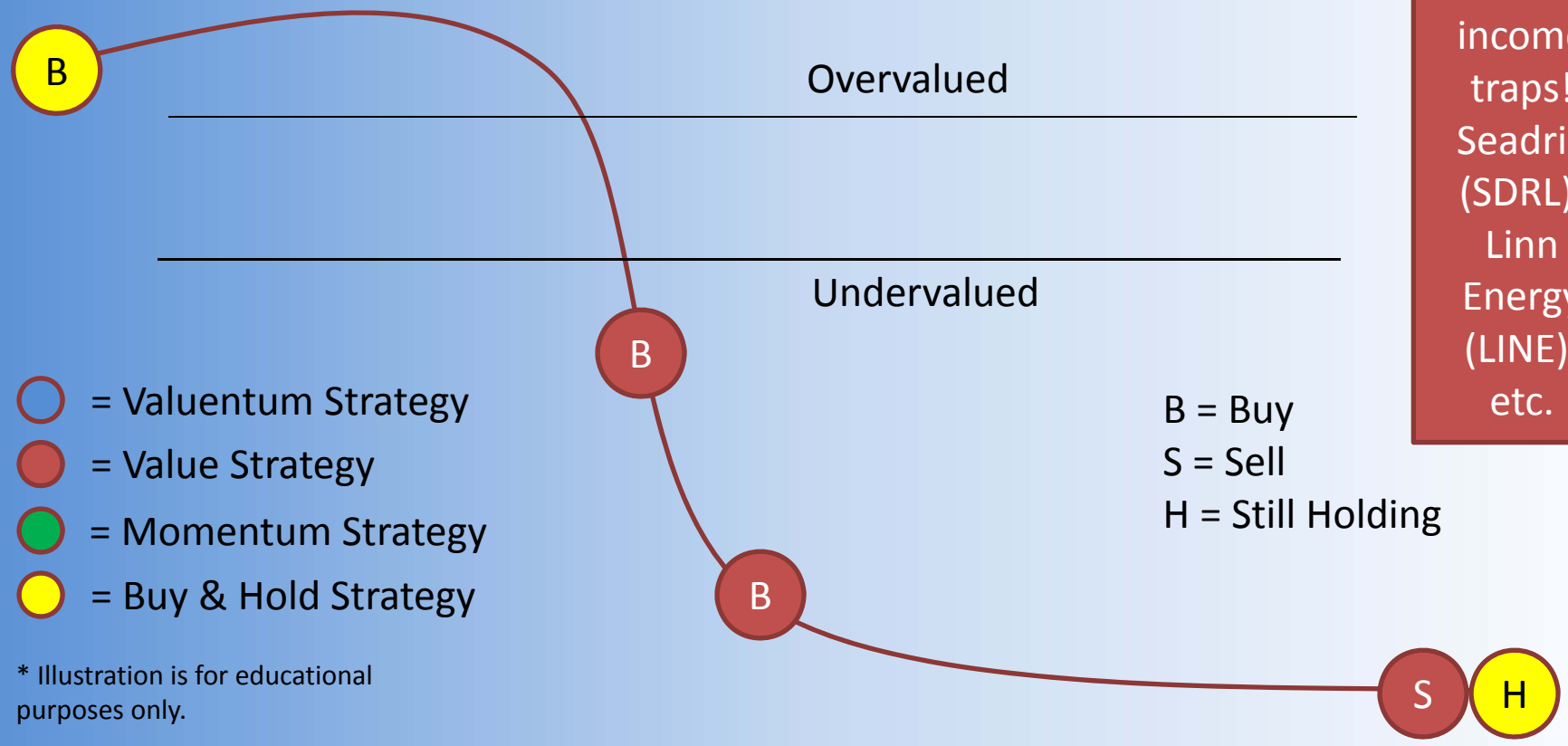
The Valuentum Strategy Helps Avoid Value Traps – We Don't Get Involved!*



We avoid income traps! Seadrill (SDRL), Linn Energy (LINE), etc.

B = Buy
S = Sell
H = Still Holding

= Valuentum Strategy
= Value Strategy
= Momentum Strategy
= Buy & Hold Strategy

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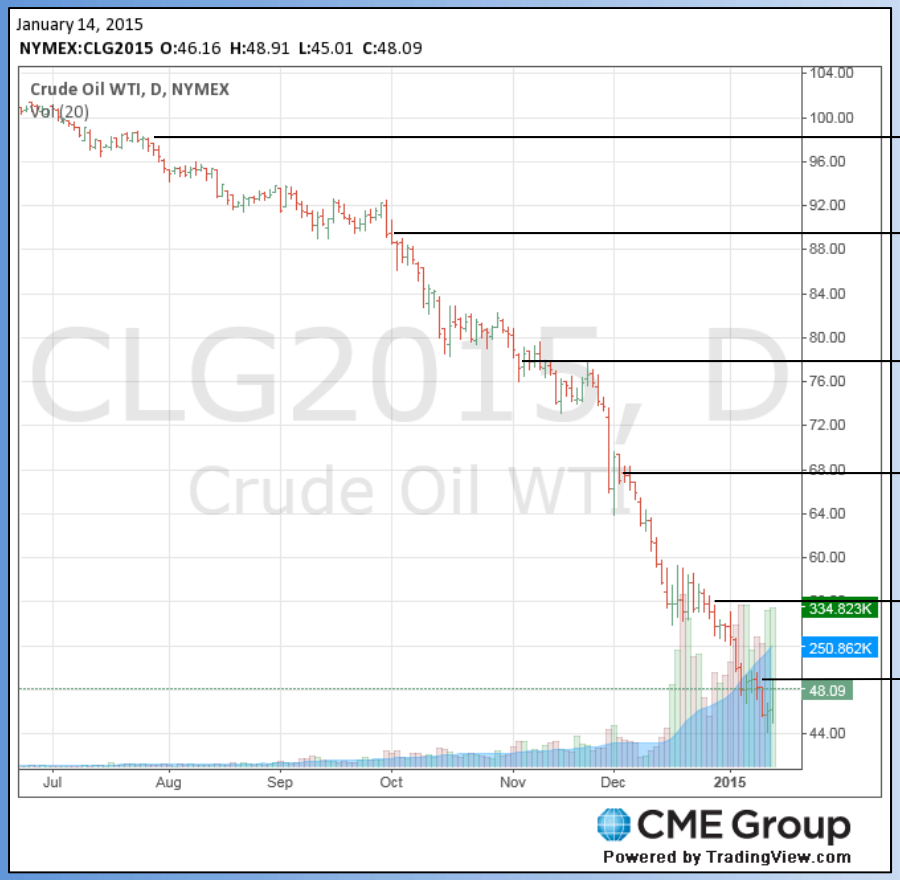
Recent Illustration in Oil Equities

We avoid falling knives!



Value Investor: Energy stocks are cheap!

Your Broker: Energy stocks are really cheap!

Deep Value Guys: Oil stocks are dirt cheap!

Your Broker Again: An unbelievable deal!

Value Investors: Now I'm insolvent!!!

Valuentum: We're going to let the market tell us when the bottom is in. Valuentum investors don't fall into value traps, falling knives.

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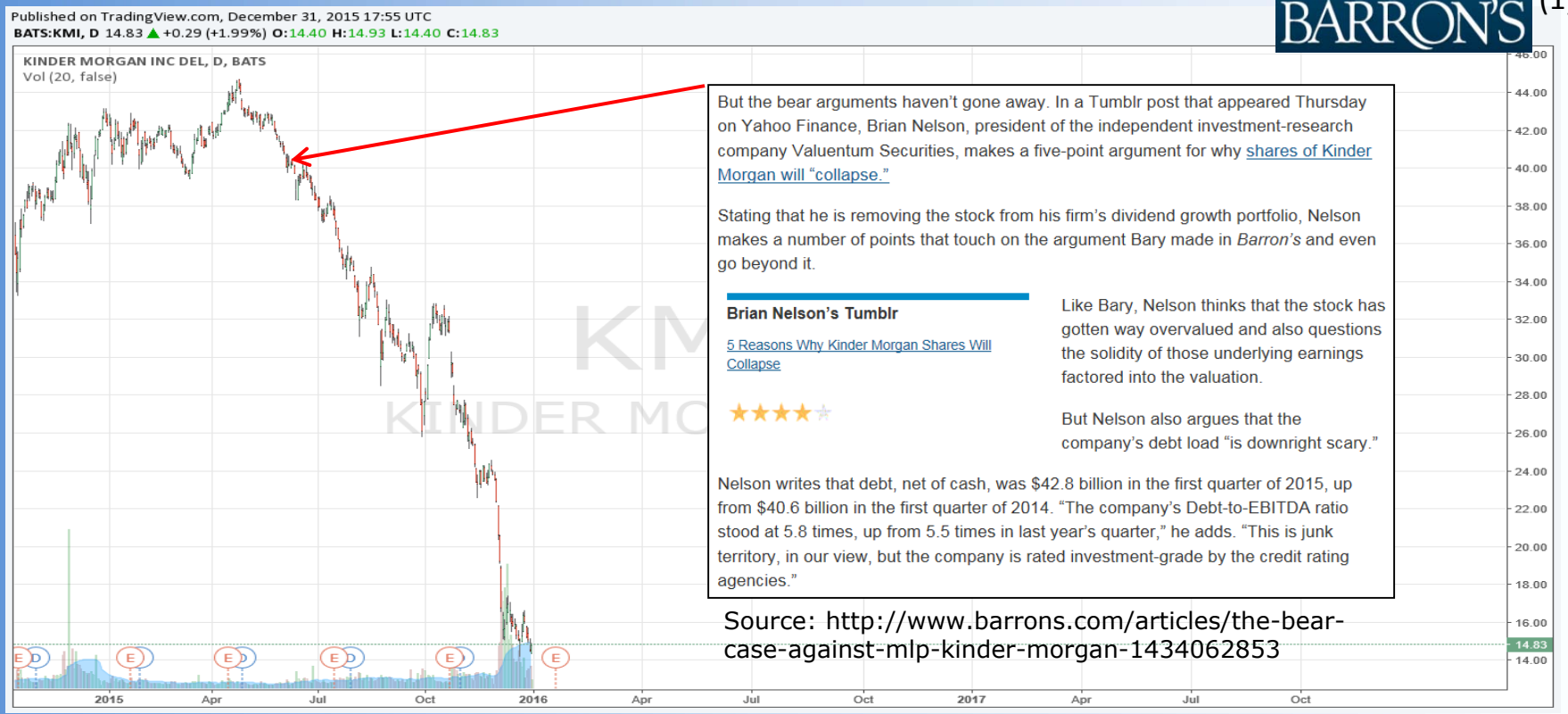
"The Bear Case Against Kinder Morgan" – Barron's, Jun 11 2015

"5 Reasons Why We Think Kinder Morgan's Shares Will Collapse," by Valuentum

BARRON'S (1)



But the bear arguments haven't gone away. In a Tumblr post that appeared Thursday on Yahoo Finance, Brian Nelson, president of the independent investment-research company Valuentum Securities, makes a five-point argument for why shares of Kinder Morgan will "collapse."

Stating that he is removing the stock from his firm's dividend growth portfolio, Nelson makes a number of points that touch on the argument Bary made in *Barron's* and even go beyond it.

Brian Nelson's Tumblr

5 Reasons Why Kinder Morgan Shares Will Collapse

★★★★☆

Like Bary, Nelson thinks that the stock has gotten way overvalued and also questions the solidity of those underlying earnings factored into the valuation.

But Nelson also argues that the company's debt load "is downright scary."

Nelson writes that debt, net of cash, was $42.8 billion in the first quarter of 2015, up from $40.6 billion in the first quarter of 2014. "The company's Debt-to-EBITDA ratio stood at 5.8 times, up from 5.5 times in last year's quarter," he adds. "This is junk territory, in our view, but the company is rated investment-grade by the credit rating agencies."

Source: http://www.barrons.com/articles/the-bear-case-against-mlp-kinder-morgan-1434062853

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The Three Pillars of the Valuentum Strategy

1) Discounted Cash Flow Process
   - Let's open up a DCF model!
2) Relative Valuation Process
3) Technical/Momentum Assessment
   - Let's open up a 16-page valuation report!

Add email to sign-in sheet to receive FREE DCF modeling tool!

- The more favorable the interdependence of these pillars…the higher the Valuentum Buying Index rating.

Note: All of the DCF models and reports are available with a membership to www.valuentum.com.

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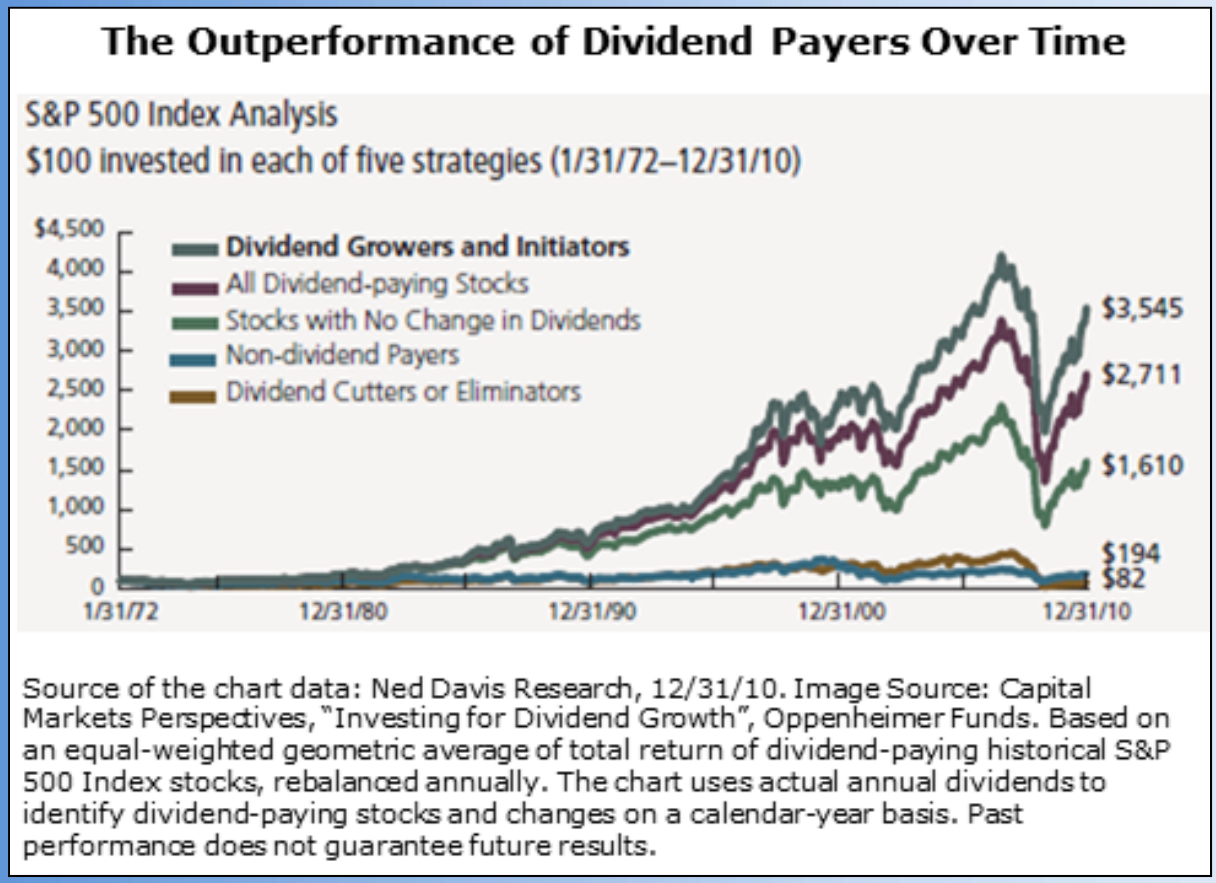
Benefits of Dividend Growth Investing



Valuentum is working diligently on an independent study to provide further granularity of the long-term benefits of dividend growth investing.

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Overlaying the Valuentum Strategy to Pursue Dividend Growth – Key Tenets

- Capital preservation is always paramount.
- The focus on valuation should *not* be sacrificed to "chase" yield. **Not all dividends are created equal!**
- A company's dividend growth track record is important, but its future dividend growth and safety is more important.
- A comprehensive analysis of its business model, future free cash flows and balance sheet health will uncover the strongest dividend growers.
- The Dividend Cushion ratio offers a more comprehensive measure of the safety of a dividend than the payout ratio.
- Substantial dividend growth over time should provide for an adequate yield on cost in time.
- It's not about finding the best dividend growers of the past 25 years, but it's finding the best dividend growers for the next 25 years…

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Introducing: The Valuentum Dividend Cushion Ratio™

- An objective, cash-flow based fundamental ratio that gauges a company's ability to *continue raising* its dividend long **into the future**.
- Adds five-year forecast of free cash flow (CFO less capital expenditures) to net balance sheet (cash less long-term debt) and divides that sum by five-year forecast of expected cash dividends paid.
- It is pure cash-flow dividend coverage ratio that considers the health of a firm's balance sheet, which is a key funding source for dividend expansion.
- **The bigger the positive number above 1 the better**. Anything less than 0 (a negative number) signals trouble.
- A more comprehensive measure of growth and safety than the payout ratio (dividends per share divided by earnings per share).

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The Valuentum Dividend Cushion™ Helps Dividend Growth Investors Avoid Dividend Cuts

- The Valuentum Dividend Cushion measure has predicted, in *real-time*, the dividend cuts, of SuperValu (SVU), Roundy's (RNDY), Dover Downs (DDE), Strayer (STRA), Exelon (EXC), Cliffs Natural (CLF), Pitney Bowes (PBI), CenturyLink (CTL) and JC Penney (JCP)…and more.

The Valuentum Dividend Cushion Caught These Dividend Cuts in Advance

A Valuentum Dividend Cushion Score Below 1 Indicates a Firm's Dividend is At Risk in the Years Ahead

Dividend Cutter	Cut Date	Dividend Cushion (Before Cut)	Reason for Dividend Cut
Avery Dennison (AVY)	31-Jul-09	0.66	Reduced dividend to support debt-reduction efforts.
ConAgra Foods (CAG)	16-Mar-06	-0.59 (1)	Restructuring, divestitures.
Constellation (CEG)	18-Feb-09	-4.36	Refocus on core business of generating and selling power.
DR Horton (DHI)	6-May-08	-0.03	Housing turmoil.
Gannett Co. (GCI)	25-Feb-09	-0.06	Excessive debt; preserve cash amid downturn of newspaper industry.
La-Z-Boy (LZB)	17-Feb-09	0.89	Suspended dividend to preserve cash amid downturn in home furnishings.
Marriott Intl (MAR)	1-May-09	2.18 (2)	Suspended dividend in the wake of weak business travel, but dividend achieved record highs again, May 6, 2011.
Masco Corp (MAS)	11-Feb-09	-0.74	Cut dividend to ensure ability to fund operations and service debt coming due.
New York Times (NYT)	20-Nov-08	0.04	Effort to preserve cash. Downturn in newspaper industry. Loss of investment-grade credit rating.
Pfizer (PFE)	26-Jan-09	0.54	Bought Wyeth to diversify revenue base. Raised $22 billion+ in debt.
Sara Lee Corp (SLE)	8-Aug-06	0.70	Streamlining operations, business unit divestitures to raise cash.
Sunoco Inc. (SUN)	6-Oct-09	-0.85 (3)	Poor margins, overseas competition.
SuperValu (SVU)	20-Oct-09	-5.78	Rising unemployment, competition from Wal-Mart, etc.
Valero Energy (VLO)	27-Jan-10	0.15	Lower demand for gas and diesel.
Vulcan Materials (VMC)	14-Oct-11	-1.42	Free up much-needed cash amid downturn in aggregate demand.

(1) Forecast period for ConAgra, 2007 through 2011.

(2) Marriott is an instance where management prematurely cut its dividend, in our opinion. The Cushion reflected little risk at the time of cut, and sure enough Marriott restored its payout to record high

(3) Forecasts adjusted to reflect Sunoco's poor free cash flow trends beyond last reported year.

Backtesting Methodology: Net balance sheet (year prior to dividend cut). Free cash flow for years beginning in year of dividend cut through reported years. If reported years do not total five, last reported year is extrapolated for remainder of forecast period. Dividends paid reflects what the dividends would be ex dividend cut.

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The Valuentum Dividend Cushion™ Helps Identify Stocks with Long-term Dividend Growth Potential

- The Dividend Cushion ratio highlights stocks with:
  - Substantial *future* free cash flow generation in excess of cash dividends paid
  - Fantastic balance sheets with solid net cash positions (i.e. total cash less total debt is significantly positive)
  - Little financial leverage or debt refinancing risk (emphasis is placed on *true* balance sheet cash-rich entities)

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The Dividend Cushion: Some Finance Definitions

- Cash flow from operations (CFO)
  - Found on the cash flow statement
  - A good measure of cash earnings
  - Takes into consideration changes in working capital (inventory, accounts receivable, accounts payable)
- Capital expenditures (capex)
  - Found on the cash flow statement
  - Growth and maintenance spending necessary to continue growing cash from operations
- Traditional free cash flow (FCF)
  - Derived by analyst
  - Cash from operations less capital expenditures
- Long-term debt
  - Found on the balance sheet
  - Debt due after one-year
- Total cash and cash equivalents
  - Found on the balance sheet
  - Cash that can generally be used for dividends, share repurchases, and/or acquisitions
- Cash dividends paid
  - Found on the cash flow statement
  - The actual cash going out the door in the form of cash dividend payments

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Microsoft: By the Numbers (FYE June 2014)

Cumulative 5-year Forecasted Cash from Operations	190,536
Culumative 5-year Forecasted Capital Expenditures	-34,344
Cumulative 5-year Forecasted Free Cash Flow (CFO - capex)	156,192
Total Cash - Last Fiscal Year	85,709
Total Long-term Debt - Last Fiscal Year	20,645
Net Cash (total cash less total long-term debt)	65,064
Cumulative 5-year Forecasted Dividends Paid (from CF statement)	67,015
Valuentum Dividend Cushion Score (greater than 1.25 = good)	3.30

In USD millions

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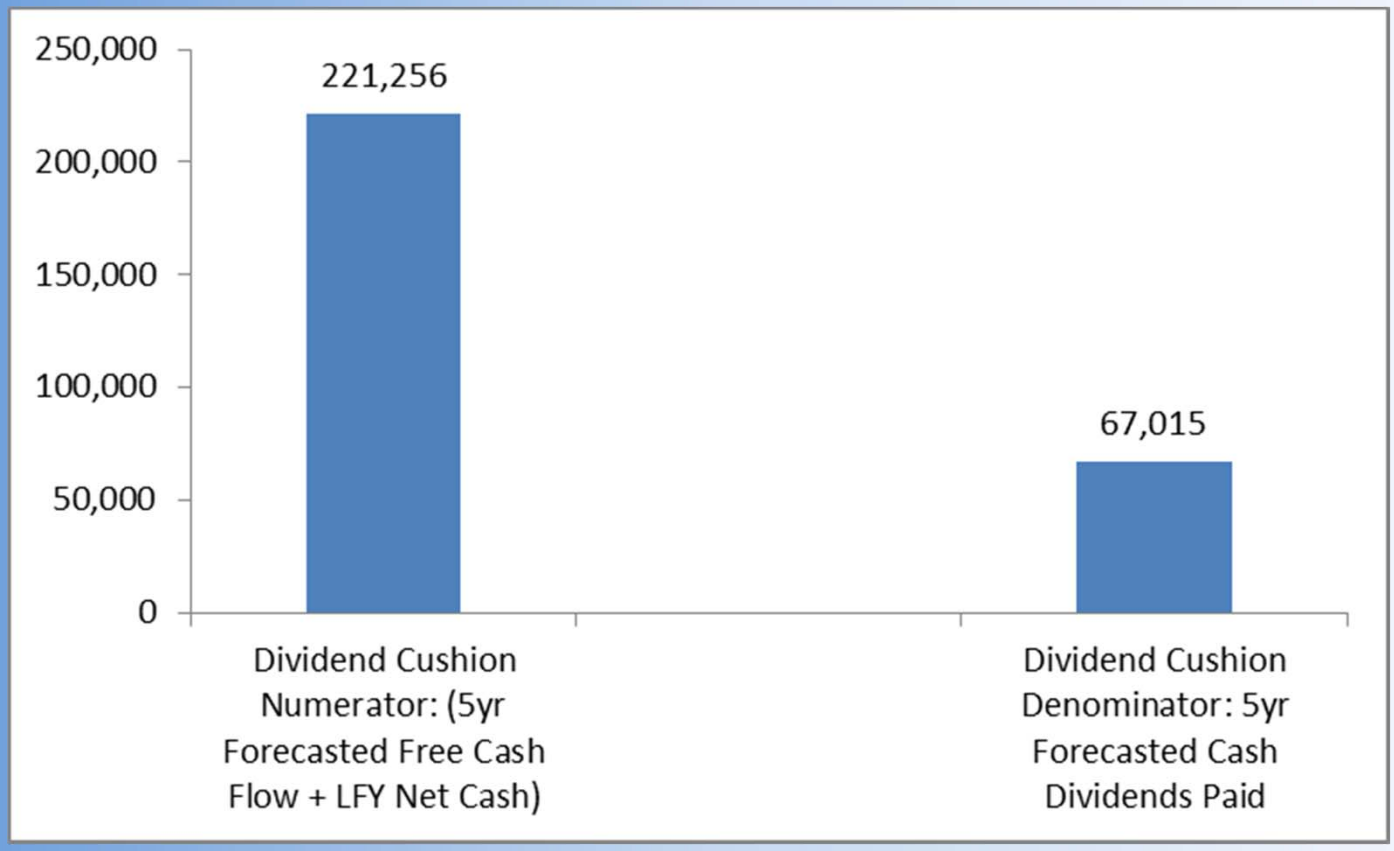
Microsoft: Dividend Cushion Derived



In USD millions

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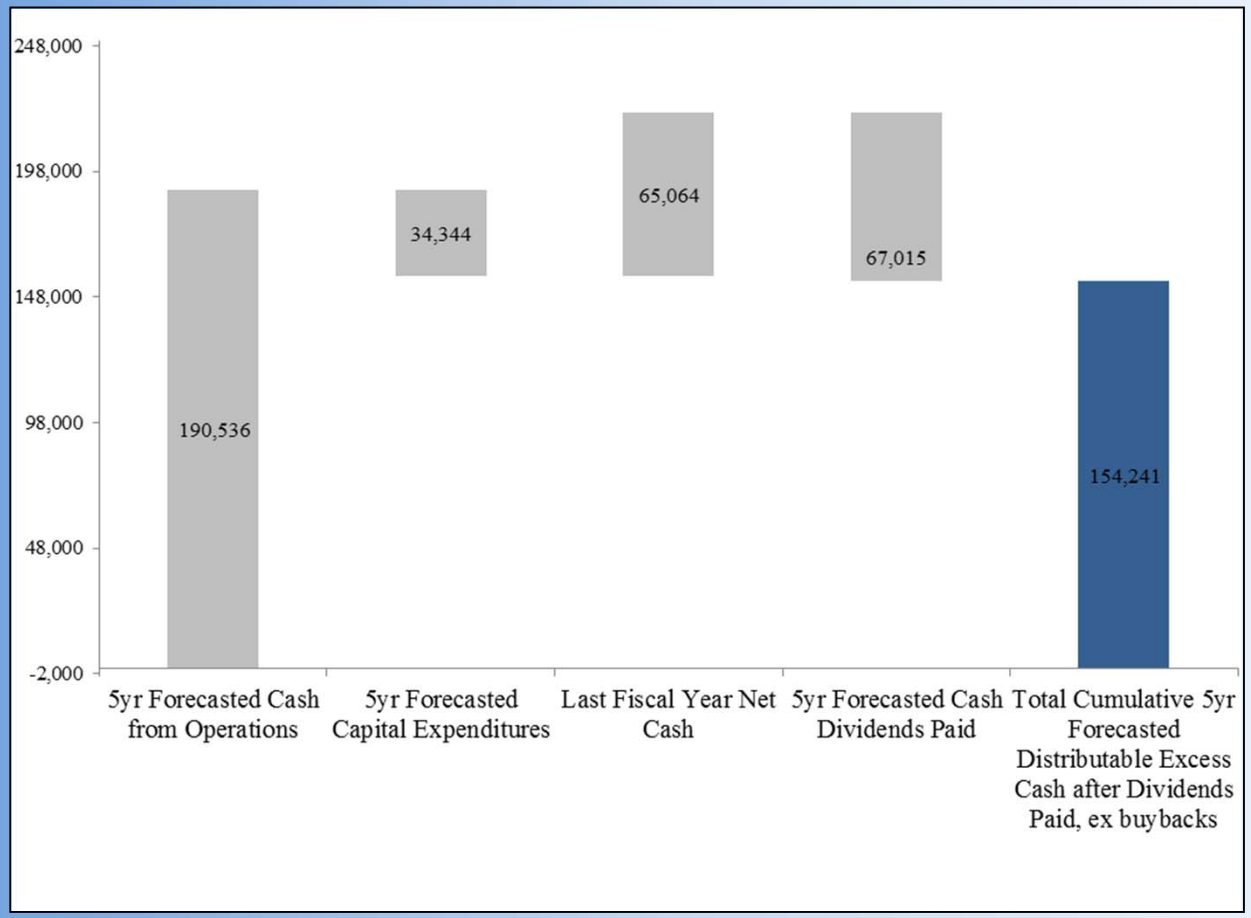
Microsoft Dividend Cushion Cash-Flow Bridge



In USD millions

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What Does This Mean for Microsoft?

- Valuentum Dividend Cushion™ Ratio: **3+** (FYE June 2014)
- Translation: Microsoft could cover its *growing* dividend with expected free cash flow and its net cash position **more than 3 times** over the measurement period!
- Conclusion: The company has fantastic dividend growth prospects on the basis of its free-cash-flow profile and net balance sheet.

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Follow Up: What Do You Think Microsoft Did?

- Microsoft raised its dividend September 2015 by 16%+ (updated Dividend Cushion ratio: **~2.6**).
- Question #1: Why did the ratio fall?
- Question #2: Could Microsoft still *double its dividend* and still have room to grow the payout? *Yes.*
- These are the types of solid, secure dividend growth ideas we seek to deliver to members in the Dividend Growth Newsletter portfolio.
- Not one position in the Dividend Growth Newsletter portfolio has ever experienced a dividend cut!

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Important Risks for Dividend Growth Investors

- Beware of financially-engineered dividends as in the case of MLPs and some REITs.
- Too many definitions of cash flow – focus on traditional free cash flow (cash flow from operations less *all* capital spending)
- If the dividend yield is too good to be true, it probably is… (8%+ = danger!). Use common sense.
- Rising interest rates could complicate the strategy. Higher rates could cause permanent capital impairment in income-oriented equity holdings, especially ones with financially-engineered payouts.
- Don't fall in love with the past – the future is all that matters. A dividend track record is history.
- The current state of the global economy.

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What We Learned

- Dividend growth investing has both advantages and unique risks.
- Adding criteria related to value and momentum can augment the core dividend growth process.
  - A focus on valuation helps limit exposure to overpriced ideas.
  - A focus on momentum helps build conviction in underpriced ideas.
- A value-focused, momentum-based dividend growth process is a tool for your kit.
- The Dividend Cushion ratio may be your best friend.

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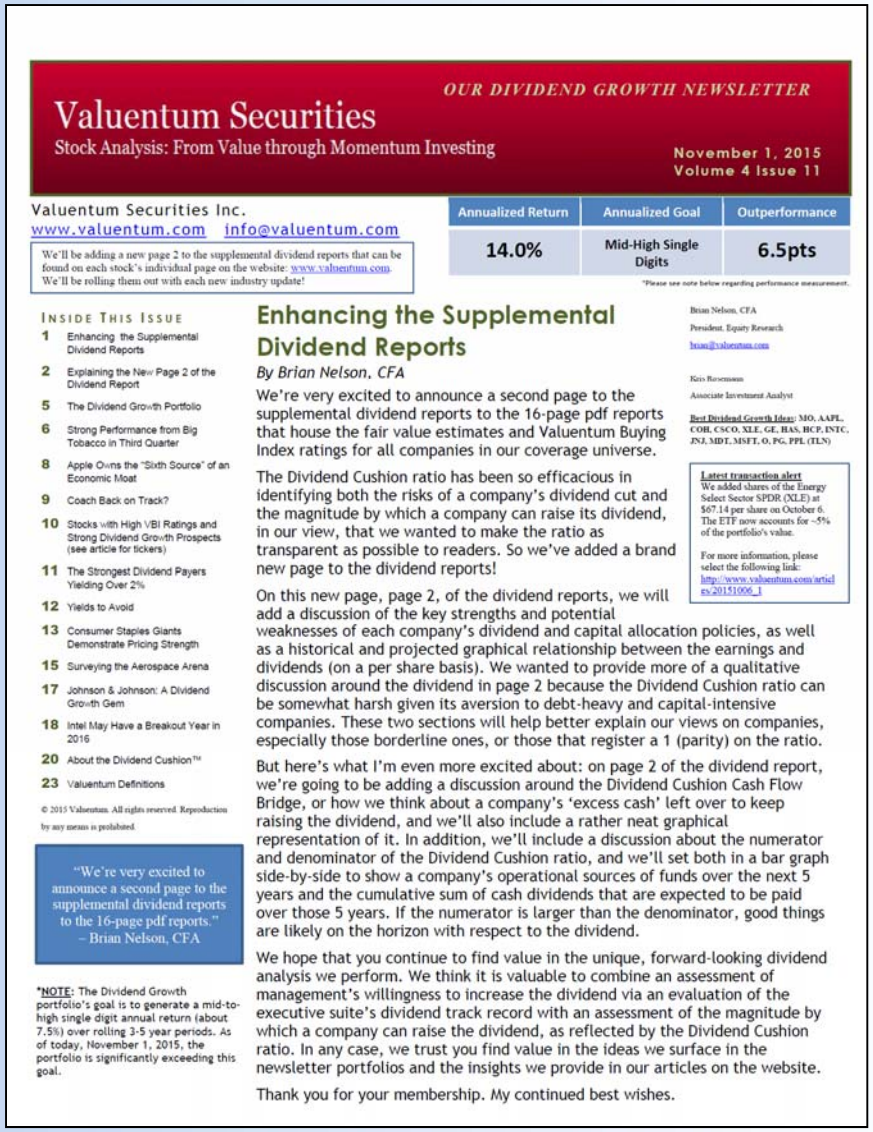
Stay In Touch With Valuentum…

Access all of the Dividend Cushion ratios, the monthly Dividend Growth Newsletter, the monthly Best Ideas Newsletter and more for just $149.99/year.

That's for a year!



OUR DIVIDEND GROWTH NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

November 1, 2015
Volume 4 Issue 11

Valuentum Securities Inc.
www.valuentum.com info@valuentum.com

We'll be adding a new page 2 to the supplemental dividend reports that can be found on each stock's individual page on the website: www.valuentum.com. We'll be rolling them out with each new industry update!

Annualized Return	Annualized Goal	Outperformance
14.0%	Mid-High Single Digits	6.5pts

*Please see note below regarding performance measurement.

INSIDE THIS ISSUE

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"We're very excited to announce a second page to the supplemental dividend reports to the 16-page pdf reports."
– Brian Nelson, CFA

*NOTE: The Dividend Growth portfolio's goal is to generate a mid-to-high single digit annual return (about 7.5%) over rolling 3-5 year periods. As of today, November 1, 2015, the portfolio is significantly exceeding this goal.

Enhancing the Supplemental Dividend Reports

By Brian Nelson, CFA

We're very excited to announce a second page to the supplemental dividend reports to the 16-page pdf reports that house the fair value estimates and Valuentum Buying Index ratings for all companies in our coverage universe.

The Dividend Cushion ratio has been so efficacious in identifying both the risks of a company's dividend cut and the magnitude by which a company can raise its dividend, in our view, that we wanted to make the ratio as transparent as possible to readers. So we've added a brand new page to the dividend reports!

On this new page, page 2, of the dividend reports, we will add a discussion of the key strengths and potential weaknesses of each company's dividend and capital allocation policies, as well as a historical and projected graphical relationship between the earnings and dividends (on a per share basis). We wanted to provide more of a qualitative discussion around the dividend in page 2 because the Dividend Cushion ratio can be somewhat harsh given its aversion to debt-heavy and capital-intensive companies. These two sections will help better explain our views on companies, especially those borderline ones, or those that register a 1 (parity) on the ratio.

But here's what I'm even more excited about: on page 2 of the dividend report, we're going to be adding a discussion around the Dividend Cushion Cash Flow Bridge, or how we think about a company's 'excess cash' left over to keep raising the dividend, and we'll also include a rather neat graphical representation of it. In addition, we'll include a discussion about the numerator and denominator of the Dividend Cushion ratio, and we'll set both in a bar graph side-by-side to show a company's operational sources of funds over the next 5 years and the cumulative sum of cash dividends that are expected to be paid over those 5 years. If the numerator is larger than the denominator, good things are likely on the horizon with respect to the dividend.

We hope that you continue to find value in the unique, forward-looking dividend analysis we perform. We think it is valuable to combine an assessment of management's willingness to increase the dividend via an evaluation of the executive suite's dividend track record with an assessment of the magnitude by which a company can raise the dividend, as reflected by the Dividend Cushion ratio. In any case, we trust you find value in the ideas we surface in the newsletter portfolios and the insights we provide in our articles on the website.

Thank you for your membership. My continued best wishes.

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

Kris Rosenmann
Associate Investment Analyst

Best Dividend Growth Ideas: MO, AAPL, COH, CSCO, XLE, GE, HAS, HCP, INTC, JNJ, MDT, MSFT, O, PG, PPL (TLN)

Latest transaction alert
We added shares of the Energy Select Sector SPDR (XLE) at $67.14 per share on October 6. The ETF now accounts for ~5% of the portfolio's value.

For more information, please select the following link:
http://www.valuentum.com/articles/20151006_1

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Competitive Advantages of Valuentum's Approach

- Completely independent - NO conflicts of interest
- Integrity and systematic application of analytical process
- Comprehensive equity research provider – from value through momentum investing
- Breadth and depth of coverage
- Commitment to expanding coverage
- Strong performance track record
- Valuation expertise

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