OUR DIVIDEND GROWTH NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

April 1, 2016
Volume 5 Issue 4

Valuentum Securities Inc.
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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
13.3%	Mid-High Single Digits	5.8pts

*Please see note below regarding performance measurement.

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The 'Multiplier' can be used with the dividend yield, Dividend Cushion, dividend payout track record and other metrics to assess the various qualities of dividend payers. – see page 6

***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, April 1, 2016, the portfolio is significantly exceeding this goal.

Confession: "Valuation Awareness" Is Everything

By Brian Nelson, CFA

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

Latest Dividend Growth Portfolio Alerts

February 17: Added 99 shares of CSCO

February 9: Removed HCP

February 1: Added 18 shares of CBRL
Added 32 shares of VNQ

All email transaction alerts are emailed from the account info@valuentum.com.

Image Source: John Morgan

"Much like anyone that has never played baseball won't be able to recognize a curveball by the tight dot that forms on the ball as it rotates out the pitcher's hand, readers that aren't familiar with what matters in investing won't be able to separate good research from bad research. They can't recognize good valuation sense and concepts that can help them from a bunch of numbers or backward-looking price-to-earnings graphs. To the non-ball player, the pitch is just a baseball, not a curveball. To the uninformed reader, financials are just numbers with little differentiation - they can't recognize which ones are helpful and which ones are not and why. These readers need to work on their valuation awareness." - Brian Nelson, CFA

I never really thought about my first job interview after college as much as I have in the past few years. I still remember the first question I was asked from a senior analyst: What is a gross margin? At the time, I thought nothing of it when the interviewer was surprised by the thoroughness of my answer. But now I know why.

Launching Valuentum has been an extraordinary experience for me – you can even say an enlightening one, even a humbling one. I admit it – 5 years ago, I was a fool. I had no idea what the average investor was truly like.

Please see *Confession*...on next page

***Confession…*from previous page**

Many years ago I thought everybody knew about the importance of the financial statements and discounted cash-flow modeling. How could they not? It's the sand in the sandbox, it's the core of the apple -- it is what investing is all about. Readers really weren't focused on the journalistic prose in the blogosphere, were they?

Having built the extensive discounted cash-flow modeling infrastructures for the largest investment research firms, one pretty much has to know everything about how the financial statements work together. A gross margin is just one of thousands and thousands of things one has to know. I forgot that, through my professional life, I had been through intensive, rigorous training. I had developed the equivalent of Navy-SEAL situational awareness whenever I was near anything finance or valuation-related, something we can call "valuation awareness."

At Valuentum, I used this "valuation awareness" to develop the best valuation infrastructure on the market today. But what I didn't know was that for a long time, I'd be just "blinking in the dark." Am I still? Most readers wouldn't be able to tell the difference. Yikes!

I started writing at Seeking Alpha about 5 years ago, and it was "culture shock" for me. You see – I've only worked with analysts or portfolio managers my whole life, so I wasn't ready for the comments from the anonymous reader that wanted to bully my work, or worse. You see -- I've never worked with individuals that didn't have some background in finance or accounting, but yet were so insistent that I was wrong. It was a horrendous experience to take such bullying. I may never recover.

Sadly, it was even worse seeing highly-followed authors on other websites write "I like stock XYZ because of reason 1, reason 2 and reason 3…" but they really had no idea what the stock was worth, nor did they really care. They'd try to put a valuation together, and it might look and sound nice to the untrained eye, but I couldn't get past the first few steps without finding errors in logic or approach. Readers were actually believing this stuff, applauding it, championing it. I was sick to my stomach for some time.

In many ways, the blogosphere has made a mockery of the investment analyst profession, and the onlooker is none the wiser.

Having been baptized by fire, it's now not surprising to me why so many investors lose so much money in the stock market. They really don't know who to believe or what to believe. They never heard of the Chartered Financial Analyst designation, or they don't care to know. They love free research because it's free! Except it costs them dearly time and time again. Or not. They might not know or not care.

Oh and how readers love to have their egos stoked, and boy do they love writings that agree with them. After all, they think they are right, and therefore anybody that agrees with their view, must be right also, and therefore those that produce research that agrees with them are good researchers. It's a behavioral fallacy wrapped around some circular thinking, and it's often why readers tend to see mostly positive research reports out there.

Authors want to stoke their egos and be agreeable – and hope that maybe it turns them into a client. Why do they want to disagree? What's the benefit in disagreeing? It's sometimes frustrating being independent and objective and telling people what we really think. To me, a service like that is priceless. It's the variant perspective that matters.

Having invested considerable resources in building one of the best, if not the best, valuation infrastructures, it was disappointing to me when I finally came to grips that most readers don't know much about the financial statements at all, let alone discounted cash-flow valuation; therefore, they'd have a difficult time seeing how we truly stand head-and-shoulders above anyone else out there.

Please see *Confession…*on next page

***Confession*...from previous page**

Surely they would know that the 16-page valuation reports IS the analysis. Researchers can write what they want, but they have to put numbers to it to value the equity. They'd have to know this – and they'd have to know that arriving at an informed fair value estimate takes time, so they'd understand our update schedule. They'd want us to take our time, do the best work.

I've learned a lot over the past few years: Awareness is everything. Much like anyone that has never played baseball won't be able to recognize a curveball by the tight dot that forms on the ball as it rotates out the pitcher's hand, readers that aren't familiar with what matters in investing won't be able to separate good research from bad research. They can't recognize good valuation sense and concepts that can help them from a bunch of numbers or backward-looking price-to-earnings graphs. To the non-ball player, the pitch is just a baseball, not a curveball. To the uninformed reader, financials are just numbers with little differentiation – they can't recognize which ones are helpful and which ones are not and why. These readers need to work on their valuation awareness.

I'm dedicated to increasing your valuation awareness, whichever type of investor you are or level of experience. You'll not only become a better investor in doing so, but I truly believe that you'll avoid some of the biggest investing mistakes once you become more aware of the financials and valuation via the discounted cash-flow process, among other things. You'll be able to separate the good research from the bad.

That most may not be paying close attention to the financials is actually quite interesting, if you think about it – I wonder if it has something to do with why our performance has exceeded the average benchmark return for some time. What do you think?

The Strongest *Corporate* Dividend Payers Yielding Over 2%

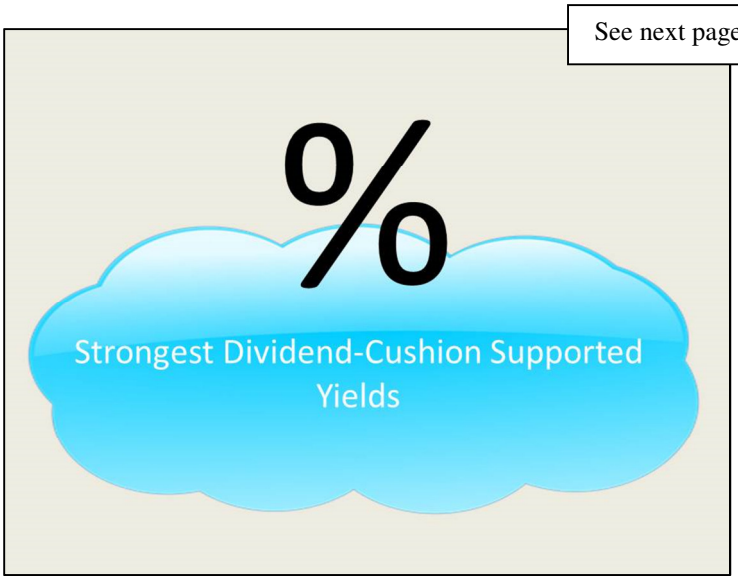
By Valuentum Analysts

There are a number of ways to evaluate the health of a company's dividend.

We think a minimum threshold for a company's yield is par for the course in any income-oriented screen, and we peg the dividend yield hurdle rate for the screen on the next page at 2%. For firms that make this cut, we want to find those that generate free cash flow at a pace that is far larger than the cash paid out as dividends and have a strong balance sheet to boot, or companies that have high Dividend Cushion ratios.

Enter stocks that have the highest multiplicative combination of their dividend yield and Dividend Cushion ratio. We exclude the business models of master limited partnerships and real estate investment trusts in this screen and focus exclusively on corporates. Income investors have a lot to choose from, and this screen is one of our favorites. Please take a look at the strongest corporate dividend payers on the next page.

See next page.



Corporates, master limited partnerships, and real estate investment trusts are unique business models. Though there are strong corporates that may never need to access the capital markets and weak ones that do, almost all MLPs and REITs are capital-market dependent, posing additional risks to holders and the strength of the distribution/dividend.

Please see *The Strongest Corporate Dividend Payers*...on next page

***The Strongest Corporate Dividend Payers*...from previous page**

Company Name	Symbol	Sector	Est Div Yield	Div Cushion	Multiplier
QUALCOMM	QCOM	Information Technology	4.4%	3.5	15.47
GameStop	GME	Consumer Discretionary	5.6%	2.6	14.84
Lexmark	LXK	Information Technology	4.6%	3.0	14.08
Automatic Data Processing	ADP	Information Technology	2.4%	5.5	13.10
AVX Corp	AVX	Information Technology	3.5%	3.6	12.38
Best Buy	BBY	Consumer Discretionary	3.4%	3.6	12.31
Hewlett-Packard	HPQ	Information Technology	4.3%	2.7	11.89
Teekay	TGP	Industrials	5.8%	2.0	11.47
CA Tech	CA	Information Technology	3.5%	3.2	11.08
Nu Skin	NUS	Consumer Discretionary	4.2%	2.6	10.99
H&R Block	HRB	Consumer Discretionary	2.5%	4.4	10.94
National Oilwell Varco	NOV	Energy	5.5%	2.0	10.84
Garmin	GRMN	Industrials	5.8%	1.9	10.82
Apple	AAPL	Information Technology	2.0%	5.3	10.44
Finish Line	FINL	Consumer Discretionary	2.2%	4.7	10.13
Intersil	ISIL	Information Technology	3.9%	2.6	10.09
Guess	GES	Consumer Discretionary	4.1%	2.5	9.97
American Eagle	AEO	Consumer Discretionary	3.3%	3.0	9.78
Cisco	CSCO	Information Technology	3.7%	2.6	9.62
Quality Systems	QSII	Health Care	4.9%	2.0	9.56
Taiwan Semiconductor	TSM	Information Technology	3.3%	2.9	9.42
Superior	SUP	Consumer Discretionary	3.9%	2.2	8.74
Pfizer	PFE	Health Care	3.7%	2.3	8.50
Applied Materials	AMAT	Information Technology	2.2%	3.9	8.49
Coach	COH	Consumer Discretionary	4.3%	2.0	8.47
Western Union	WU	Information Technology	3.3%	2.5	8.43
AbbVie	ABBV	Health Care	4.2%	2.0	8.39
Intel	INTC	Information Technology	3.6%	2.3	8.23
Olin Corp	OLN	Materials	4.6%	1.8	8.22
Paychex	PAYX	Information Technology	3.1%	2.6	8.18
Computer Prog and Syst	CPSI	Health Care	6.5%	1.3	8.17
American Railcar	ARII	Industrials	3.9%	2.1	8.15
KLA-Tencor	KLAC	Information Technology	3.1%	2.6	8.05
STMicroelectronics	STM	Information Technology	6.9%	1.2	8.00
Corning	GLW	Information Technology	2.6%	3.0	7.98
Parker-Hannifin	PH	Industrials	2.6%	3.0	7.98
Chico's FAS	CHS	Consumer Discretionary	2.5%	3.2	7.96
Cummins	CMI	Industrials	4.0%	2.0	7.93
Thor	THO	Industrials	2.2%	3.5	7.86
Weyerhaeuser	WY	Materials	4.8%	1.6	7.85
Chicago Rivet	CVR	Consumer Discretionary	3.0%	2.6	7.81
Emerson Electric	EMR	Industrials	4.2%	1.8	7.65
Xilinx	XLNX	Information Technology	2.5%	3.1	7.61
Gentex	GNTX	Consumer Discretionary	2.5%	3.0	7.56
Lincoln Electric	LECO	Industrials	2.5%	3.0	7.49
Ralph Lauren	RL	Consumer Discretionary	2.0%	3.7	7.44
Williams-Sonoma	WSM	Consumer Discretionary	2.7%	2.8	7.41
Gap	GPS	Consumer Discretionary	3.1%	2.4	7.39
Manpower	MAN	Information Technology	2.0%	3.7	7.38
Microsoft	MSFT	Information Technology	2.9%	2.6	7.35

Valuentum has developed a proprietary Multiplier metric that not only considers the size of a dividend payer's yield but also the size of the cushion the company has in covering the yield with balance sheet health and future free cash flow generation.

Dividend Cushion: The Dividend Cushion ratio is a forward-looking, analyst-driven ratio that considers a company's future free cash flow generation, as measured by cash flow from operations less all capital spending, while considering its balance sheet to determine how many times a company can cover annual dividends over the immediate *future* 5-year period. The higher the Dividend Cushion ratio, the better.

Multiplier: The Multiplier helps quantify the potential dividend growth opportunity while considering the current size of the company's dividend yield. Said differently, a Dividend Cushion ratio of 2 is a much more powerful measure on a company with a dividend yield of 2% than on one with 0.5%, for example. Multiplying the dividend yield and Dividend Cushion ratio helps identify companies that have the greatest dividend payout capacity. The higher the Multiplier, the better.

The Multiplier can be used with the dividend yield, Dividend Cushion, dividend payout track record and other metrics to assess the various qualities of dividend payers.

The Dividend Growth Portfolio

Annualized Return	Annualized Goal	Outperformance
13.3%	Mid-High Single Digits	5.8pts

DIVIDEND GROWTH PORTFOLIO -- as of March 31, 2016 — Dividend Growth Portfolio Inception Date: January 1, 2012

Company Name	First Purchase	Avg Cost ($)	# of Shares	Total Cost ($)	Last	Current Value ($)	% of Portfolio	Exp. Yrly Div's ($)
Altria (MO)	12/30/2011	29.65	101	3,001.65	62.66	6,328.66	3.7%	228.26
Apple (AAPL)	7/24/2013	63.17	51	3,228.45	108.99	5,558.49	3.3%	106.08
Cisco (CSCO)	11/14/2014	26.31	199	5,242.53	28.47	5,665.53	3.3%	206.96
Coach (COH)	9/19/2014	37.55	80	3,011.00	40.09	3,207.20	1.9%	108.00
Cracker Barrel (CBRL)	2/1/2016	133.50	18	2,410.00	152.67	2,748.06	1.6%	79.20
Energy Sector SPDR (XLE)	4/1/2015	72.63	121	8,795.76	61.89	7,488.69	4.4%	262.33
General Electric (GE)	10/21/2013	26.18	240	6,290.20	31.79	7,629.60	4.5%	220.80
Hasbro (HAS)	12/30/2011	31.89	110	3,514.90	80.10	8,811.00	5.2%	224.40
Intel (INTC)	12/30/2011	24.25	289	7,015.25	32.35	9,349.15	5.5%	300.56
Johnson & Johnson (JNJ)	12/30/2011	65.58	107	7,024.06	108.20	11,577.40	6.8%	321.00
Medtronic (MDT)	12/30/2011	38.25	157	6,012.25	75.00	11,775.00	6.9%	238.64
Microsoft (MSFT)	12/30/2011	25.96	154	4,004.84	55.23	8,505.42	5.0%	221.76
Proctor & Gamble (PG)	12/30/2011	66.71	105	7,011.55	82.31	8,642.55	5.1%	278.25
PP&L (PPL)	12/30/2011	29.42	238	7,008.96	38.07	9,060.66	5.3%	361.76
Realty Income (O)	7/24/2013	44.35	60	2,668.00	62.51	3,750.60	2.2%	143.40
Talen Energy (TLN)	6/1/2015	Spin off	29	Spin off	9.00	261.00	0.2%	NA
Vanguard REIT ETF (VNQ)	2/1/2016	77.07	32	2,473.24	83.80	2,681.60	1.6%	140.54
Latest changes: CSCO position increased Feb 17; HCP removed Feb 9; CBRL and Vanguard REIT ETF added February 1.								
Cash -- changes in monthly cash balance reflects dividends received and trad				2,363.42		57,139.79	33.6%	3,441.94
Dividend Growth Portfolio				100,000.00		**170,180.40**	100.0%	**TBD**

DG Portfolio Annualized Return (from inception through current date)	**13.3%**
DG Portfolio Annualized Return Goal (Mid-to-High Single Digit Returns)	7.5%
DG Portfolio Annualized Return Outperformance	**5.8%**
SPDR S&P Dividend ETF (SDY)	**12.5%**

UR = Under Review

** Upper bound of fair value range noted.

**** The yield an investor would have received if they had held the fund over the last 12 months assuming the most recent NAV.

This portfolio is not a real money portfolio. Data as of April 1, 2016. Cost basis includes commissions. Results include divdends, but no interest received on cash balance.

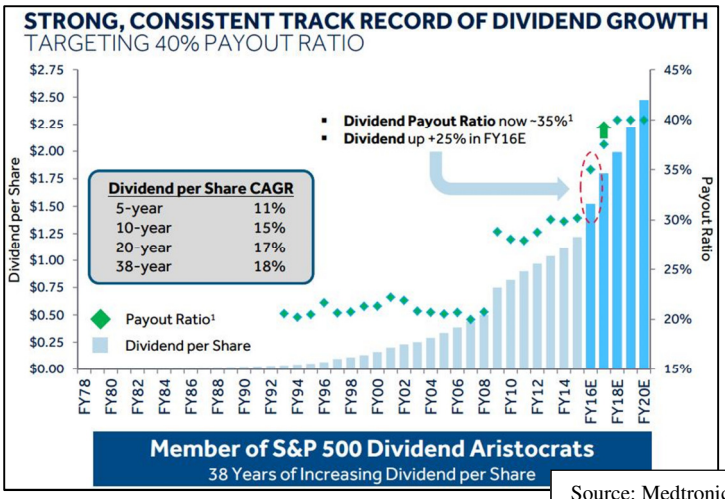
DIVIDEND GROWTH PORTFOLIO -- as of March 31, 2016 — Fundamental data as of March 31, 2016

Company Name	Yrly Div's Paid ($) /Shr	Div Yield %	Ex Div Date	Next Pay Date (cycl)	Div Cushion™	Div Safety	Div Growth	Fair Value	VBI Score	Price/Fair Value
Altria (MO)	2.26	3.61%	mid-Jun 2016	mid Jun 2016 (quart)	1.1	GOOD	GOOD	$55.00	6	1.14
Apple (AAPL)	2.08	1.91%	early May 2016	May 2016 (quart)	5.3	EXCELLENT	EXCELLENT	$142.00	3	0.77
Cisco (CSCO)	1.04	3.65%	early Apr 2016	early Apr 2016 (quart)	2.6	GOOD	EXCELLENT	$37.00	7	0.77
Coach (COH)	1.35	3.37%	early Jun 2016	early Jun 2016 (quart)	2.0	GOOD	EXCELLENT	$38.00	6	1.06
Cracker Barrel (CBRL)	4.40	2.88%	mid Apr 2016	late Apr 2016 (quart)	1.3	GOOD	GOOD	$132.00	4	1.16
Energy Sector SPDR (XLE)	2.17	3.50%	late Jun 2016	early Jun 2016 (quart)	-	GOOD	NEUTRAL	-	UR	-
General Electric (GE)	0.92	2.89%	late May 2016	Jun 2016 (quart)	2.1	GOOD	GOOD	$31.00	6	1.03
Hasbro (HAS)	2.04	2.55%	late Apr 2016	mid May 2016 (quart)	1.6	GOOD	GOOD	$67.00	6	1.20
Intel (INTC)	1.04	3.21%	early May 2016	early Jun 2016 (quart)	2.3	GOOD	EXCELLENT	$38.00	3	0.85
Johnson & Johnson (JNJ)	3.00	2.77%	late May 2016	early Jun 2016 (quart)	2.4	GOOD	EXCELLENT	$111.00	6	0.97
Medtronic (MDT)	1.52	2.03%	late Jun 2016	Jun 2016 (quart)	1.5	GOOD	EXCELLENT	$67.00	7	1.12
Microsoft (MSFT)	1.44	2.61%	mid May 2016	mid Jun 2016 (quart)	2.6	GOOD	EXCELLENT	$55.00	3	1.00
Proctor & Gamble (PG)	2.65	3.22%	late Apr 2016	early May 2016 (quart)	1.5	GOOD	EXCELLENT	$67.00	7	1.23
PP&L (PPL)	1.52	3.99%	early Jun 2016	early Jun 2016 (quart)	Held for diversification reasons.			$28.00	6	1.36
Realty Income (O)	2.39	3.82%	monthly	monthly	2.0	GOOD	GOOD	$59.00	5	1.06
Talen Energy (TLN)	NA	NA	NA	NA	-	-	-	-	-	-
Vanguard REIT ETF (VNQ)	4.39	5.24%	early Apr 2016	Apr 2016 (quart)	-	GOOD	NEUTRAL	-	UR	-

Standard Disclaimer: Our Dividend Growth portfolio is for information purposes only and should not be considered a solicitation to buy or sell any security. Valuentum is not responsible for any errors or omissions or for results obtained from the use of our Dividend Growth Newsletter and accepts no liability for how readers may choose to utilize the content.

Medtronic to Generate $40 Billion in Free Cash Next 5 Years

By Brian Nelson, CFA



Source: Medtronic

On March 1, top holding in the Dividend Growth Newsletter portfolio Medtronic (MDT) reported solid fiscal third-quarter results, now a full year after it completed the deal with Covidien.

We've been huge fans of the Medtronic-Covidien tie up, and part of the reason has to do with the tremendous free cash flow generation capacity the combined entity retains. In the nine months ended January 29, 2016, for example, net cash provided by operating activities totaled ~$3.9 billion while additions to property, plant and equipment came in at ~$690 million, good for roughly $3.2 billion in free cash flow. Adjusting for restructuring items and certain litigation and tax items, adjusted free cash flow for the period came in at ~$4.1 billion, good for more than 19% of revenue. Said differently, for every dollar that Medtronic generates, nearly 20 cents is raw free cash flow that can be used for share buybacks or dividend growth. Dividends to shareholders during the nine-month period totaled $1.6 billion, meaning Medtronic currently covers dividend payments more than 2.5 times with adjusted free cash flow.

CEO Omar Ishrak is quick to note that his team plans to return at least 50% of its adjusted free cash flow to shareholders through dividends and share repurchases. If the company makes good on its target to generate $40 billion in adjusted free cash flow over the next 5 years, the sheer magnitude of free cash flow generation offers significant promise for the payout. For one, on an annual run-rate basis, following the massive ~25% dividend hike in June, the company's dividend obligations are barely north of $2 billion. The Covidien integration continues to progress nicely, and management noted that it "is delivering robust operating leverage" as synergies are captured. The executive team also said on the conference call that its "confidence around the sustainability and consistency of revenue growth within mid-single-digit range continues to build with each passing quarter." Through fiscal 2018, it expects to be "at the high-end of or exceed (its) EPS leverage goal of 200 to 400 basis points." It's hard not to like the fundamental news.

We like Medtronic's willingness to increase the payout on the basis of its future targets of free cash flow. How can we not like the executive suite's following words: "As an S&P Dividend Aristocrat, we expect to deliver dependable long-term dividend growth." Look for more dividend increases, as Medtronic accelerates its dividend payments to reflect a 40% payout ratio (it is ~34% currently). We continue to like the company as a holding in the Dividend Growth Newsletter portfolio, but it's also fair to say that we may trim our weighting should shares continue to run far ahead. Medtronic is currently a weighting north of 7% in the portfolio, which surpasses a "full" position defined as ~5% of total portfolio assets.

"We're deploying our capital with a balanced focus in M&A investments, meeting our debt reduction commitments and returns to shareholders. We are committed to returning a minimum of 50% of our adjusted free cash flow to our shareholders through dividends and share repurchases. As an S&P Dividend Aristocrat, we expect to deliver dependable long-term dividend growth.." – Medtronic CEO Omar Ishrak

Don't Be Tempted By Homebuilders' Dividends

By Kris Rosemann

The underproduction of homes since 2008 has created pent-up demand, providing a material tailwind for homebuilders as of late. According to estimates from Toll Brothers (TOL), the total estimated shortfall of housing starts from the period 2008-2014 was 5.7 million. That equates to an annual shortfall in production of ~818,000 new homes, providing significant opportunities for the homebuilding group as a whole moving forward.

Pent-up housing demand has been accruing for years, and stronger general economic conditions, including lower unemployment, modest wage growth, and general consumer confidence continue to drive demand. A favorable jobs/wage market has the potential to provide a material boost for homebuilders, and additional demand could be found in the fact that an increasing percentage of adults ages 18-34 years old live with their parents, even more than during the Great Recession. If these young adults are able to accumulate wealth and potentially pay off student debt in a favorable job market, the housing market will benefit.

While pent-up demand and strong general economic conditions drive demand higher, land and labor shortages and the mortgage market constraining potential home buyers' access to mortgages will continue to pressure supply. Financing will be particularly tough for young adults and first time home buyers due to ballooning national levels of student debt and credit issues. New home inventory is limited, which makes for an environment conducive to driving housing price improvements (as a result of simple supply/demand dynamics). Though we acknowledge the concept of 'shadow inventory'—sellers currently without a 'for sale' sign in their front yard—overall inventory trends continue to move in a positive direction for homebuilders.

Recent price movements have provided empirical evidence for the favorable trends appearing in the housing market. The S&P/Case-Shiller Home Pricing Index showed a 5.4% year-over-year increase in January 2016, far more than recent inflation rates. Continued growth in existing home prices will encourage further activity in housing starts as well. According to the Index Committee at S&P Dow Jones Indices, there is a five-month supply deficiency in homes for sales in the US, meaning that potential sellers are encountering difficulty in trading up for larger homes.

However, this shortage may be beginning to change. Starts of single family homes in February 2016 were the highest since November 2007, and single family home share of total housing starts was 70% in February, compared to a low of 57% in June 2015 and 75%-80% share before the housing crisis. Total housing starts have remained above an annual run rate of 1 million starts per year since March 2015, yet another piece of evidence for the material tailwind homebuilders have been experiencing.

Recent performance at many of the major homebuilders also provides support for the dynamics outlined above, and backlog trends across the industry are pointing to continued growth for the group. DR Horton (DHI) reported homes in backlog growth of 15% in the first quarter of fiscal 2016, ended December 31, on a year-over-year basis, and value of net homes in backlog growing slightly faster at 16%.

In the first quarter of its fiscal 2016, ended February 29, KB Home (KBH) reported backlog units increased 22% while backlog value jumped 29% from the year-ago period. The firm's number of orders in the quarter increased 4%, but net order value advanced 9%; average selling price in the quarter grew 5%. Lennar's (LEN) average selling price increase in its first quarter of fiscal 2016, ended February 29, was an impressive 12% compared to the first quarter of fiscal 2015. Meanwhile, year-over-year backlog value growth of 19% outpaced units in backlog growth of 13%.

Despite the recent strength in volume and pricing, the capital intensive nature of the homebuilding business continues to suppress dividend potential in the industry. Inventory-management strategy is key to generating consistent free cash flow generation, and many companies have struggled doing so

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Don't Be Tempted **...from previous page**

effectively and consistently to be steady dividend payers. Net debt positions are also common across the industry, and while industry veterans will say that leverage and the timing of cash flows is just part of the business, it may not matter. Companies with strong net cash positions and tremendous free cash flow capacity are much better choices for long-term dividend growth investors.

Homebuilders are not often dedicated to their dividends than traditional dividend payers either, with the exception of MDC (MDC), which has a yield of more than 4% and was one of a few builders that managed to preserve its investment-grade credit rating through the housing crisis of the late 2000s. However, despite having a "less bad" Dividend Cushion ratio, the firm's dividend is far from safe, from our perspective.

The chart below shows the hurdles to dividend health at the homebuilders, not the least of which are free cash flow pressures and ballooning net debt positions on the books.

Company	Price/FV	Free Cash Flow - LFY ($ in millions)	Net Cash - MRQ ($ in millions)	Dividend Cushion	Dividend Yield
CalAtlantic (CAA)	68.3%	-$283.3	-$3,275.4	NA	0.50%
DR Horton (DHI)	115.8%	$644.3	-$2,068.5	-10.1	1.09%
St. Joe (JOE)	111.3%	$19.1	$171.4	NA	NA
KB Home (KBH)	80.0%	$176.5	-$2,066.5	-50.1	0.72%
Lennar (LEN)	101.4%	-$511.0	-$4,131.7	-27.6	0.34%
MDC (MDC)	90.9%	-$1.3	-$555.8	-3.9	4.15%
Meritage (MTH)	79.3%	-$19.4	-$841.7	NA	NA
NVR (NVR)	109.1%	$185.1	-$174.9	NA	NA
PulteGroup (PHM)	87.5%	-$393.6	-$1,598.5	NA	1.99%
Toll Brothers (TOL)	90.6%	$50.7	-$2,969.9	NA	NA

Price as of 3/31 open

Though there may be further runway in the housing recovery in light of the factors mentioned in this article, we have very little interest in any homebuilder for the Dividend Growth Newsletter portfolio at this time. Logically stated, our best dividend growth ideas are those characterized by relatively strong balance sheets and material free cash flow generation--two dynamics the builders tend to lack. We wanted to get our thoughts out to you as soon as possible in case you get talked into buying a homebuilder's equity for income purposes a full seven years after the March 2009 panic bottom in the S&P 500.

Oracle: The Other Tech Dividend Growth Idea

By Kris Rosemann

If only Oracle's (ORCL) 1.5% dividend yield was higher…

The company is working to transform its operations to a cloud-based business model, but it is already selling more new software as a service (SaaS) and platform as a service (PaaS) annually recurring cloud revenue than any other company in the world, including key competitors Salesforce.com (CRM) and Workday (WDAY).

Oracle competes in large SaaS markets that Salesforce.com does not, such as Enterprise Resource Planning (ERP) and Human Capital Management (HCM). After many years of developing the most complete ERP suite in the cloud, Oracle Fusion ERP is the overall market leader in the enterprise cloud ERP market. The firm has more than 10 times the number of ERP customers than Workday, and Oracle believes that the breadth of its cloud product portfolio will enable it to maintain a high level of cloud growth for an extended period of time. The transition is still in its early phases.

Please see *Oracle*...on next page

***Oracle*...from previous page**

Despite cloud SaaS and PaaS revenues jumping 57% in the third quarter of Oracle's fiscal 2016, total revenue fell 3% as reported--or 1% on a constant-currency basis--from the year-ago period; revenue fell in every non-cloud related category. Total cloud revenue rose to 8% of total revenue from 6% in the same quarter of fiscal 2015, a positive sign for the transformation but still a long way from a complete transformation. Total on-premise software revenue and total hardware revenue fell 4% and 13% on a year-over-year basis, respectively. New software licenses fell 15% and made up 18% of total revenue compared to 21% in the year-ago period, largely due to the high growth in cloud-based revenue.

However, short-term deferred revenue increased 7% on a year-over-year basis to $6.9 billion thanks to strong bookings and deferred revenue growth from its cloud offerings. SaaS and PaaS deferred revenue nearly doubled in the third quarter of fiscal 2016, and SaaS and PaaS bookings grew 77% in constant currency in the quarter from the year-ago period. These growth ates are much higher than those of Oracle's competitors, and the company is encouraged with the market share continues to take.

Operating income and operating margins have also been affected by Oracle's transitional period. GAAP operating income in the quarter fell more than 10% to $3 billion, and GAAP operating margin fell to 34% from 36% from the third quarter of fiscal 2015. Earnings per share have been pressured as well, declining nearly 11% on a GAAP basis from the year-ago period. The company did beat its expectations for earnings per share in the quarter, a positive sign for its roadmap to a successful transition.

Despite the earnings headwinds, management continues to trumpet its rising gross margin in its SaaS and PaaS offering, which jumped to 51% in the quarter from 43% in the second quarter of fiscal 2016. The company is targeting an 80% gross margin in this category in the long run, an attractive figure that may not be attainable for multiple years as its cloud business continues to scale. It is also quick to note that only 15% of total capital expenditures in the quarter were cloud related and expects this to continue to fall compared to last fiscal year as past investments are utilized. This aspect of the cloud-business will improve with scale as well.

Through the first nine months of fiscal 2016, free cash flow too has been suppressed as a result of Oracle's change of strategy. Lower cash from operations and increased capital expenditures led to a nearly 5% decline in free cash flow generation in the first three quarters of 2015, and though management expects its cloud-based capital expenditures to decline in coming quarters, it may not be enough to boost free cash flow in the near term. Over the last 12 months, the company has returned nearly 120% of free cash flow to shareholders via dividends and share repurchases, and it recently approved an additional $10 billion in buybacks.

In the past, we have pointed to the company's large cash balance as a source of cushion as it continues its transition to a cloud-based business model. At the end of the third quarter of fiscal 2016, Oracle had $50.8 billion in cash, equivalents, and marketable securities, down from $54.4 billion at the end of fiscal 2015, while non-current notes payable increased to $40.1 billion from $40 billion in the same period--Oracle issued $20 billion in senior notes in fiscal 2015.

Though this still amounts to a sizeable net cash balance, the nearly $4 billion decline in cash, equivalents, and marketable securities in three quarters is not as good as it could be. The substantial increase in debt points to the fact that Oracle, like many other multinational corporations, is hesitant to bring home the cash it is holding in foreign countries to avoid paying US taxes. As of the end of fiscal 2015, the company held $42.7 billion of its cash, cash equivalents, and marketable securities overseas.

Despite the large hit to its cash balance, Oracle remains upbeat about the long-term potential of its transition. Cloud computing requires lower costs and less complexity and offers more reliability, better security, and rapid innovation than on-premise software systems. Lower capital expenditures and a growing gross margin are key positives that are expected to come from the transition, but a large portion of the benefit is anticipated on the transitioning of revenue from on-premise software to cloud-based services and the growth in customer wallet share.

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Stocks with High Valuentum Buying Index Ratings and Strong Dividend Growth Prospects

By Valuentum Analysts

The table below showcases firms in our coverage universe that have high Valuentum Buying Index™ ratings and strong dividend growth prospects. The table represents a list of interesting dividend-paying stocks that are *among* the most timely dividend growth ideas based on our stock-selection methodology. You'll see that many of them are already holdings in our Dividend Growth portfolio (see page 5).

Though our dividend-growth portfolio may be fully-invested at times, we may swap in firms on this list or firms on our dividend-growth watch list (see the next page) at the right price or if our analyst team determines that a new add has more potential total return opportunity than a current holding. At any time, however, our favorite dividend growth ideas are included in the Dividend Growth portfolio.

Company Name	Symbol	Sector	Div Yield	VBI	Div Growth	Div Cushion
Holly Energy	HEP	Energy	6.5%	6	EXCELLENT	1.7
Iron Mountain	IRM	Industrials	5.9%	6	GOOD	1.5
Quality Systems	QSII	Health Care	4.9%	7	GOOD	2.0
QUALCOMM	QCOM	Information Technology	4.4%	6	EXCELLENT	3.5
Hewlett-Packard	HPQ	Information Technology	4.3%	6	GOOD	2.7
Coach	COH	Consumer Discretionary	4.3%	6	EXCELLENT	2.0
Retail Properties	RPAI	Financials	4.2%	7	EXCELLENT	1.3
Diebold	DBD	Industrials	4.1%	6	GOOD	1.8
ABB	ABB	Industrials	4.1%	6	GOOD	1.3
Guess	GES	Consumer Discretionary	4.1%	6	EXCELLENT	2.5
Cummins	CMI	Industrials	4.0%	6	EXCELLENT	2.0
Digital Realty Trust	DLR	Financials	4.0%	7	EXCELLENT	1.4
Altria Group	MO	Consumer Staples	3.8%	6	GOOD	1.1
Cisco	CSCO	Information Technology	3.7%	7	EXCELLENT	2.6
CA Tech	CA	Information Technology	3.5%	7	EXCELLENT	3.2
NTT Docomo	DCM	Telecom Services	3.5%	6	GOOD	1.9
Procter & Gamble	PG	Consumer Staples	3.4%	7	EXCELLENT	1.5
Western Union	WU	Information Technology	3.3%	7	EXCELLENT	2.5
Enbridge	ENB	Energy	3.3%	6	EXCELLENT	2.3
American Eagle	AEO	Consumer Discretionary	3.3%	7	EXCELLENT	3.0
Darden Restaurants	DRI	Consumer Discretionary	3.2%	6	GOOD	1.7
United Parcel Service	UPS	Industrials	3.2%	7	EXCELLENT	1.6
Unilever PLC	UL	Consumer Staples	3.1%	6	GOOD	1.5
Gap	GPS	Consumer Discretionary	3.1%	7	EXCELLENT	2.4
General Electric	GE	Industrials	3.1%	6	GOOD	2.1
Unilever N.V.	UN	Consumer Staples	3.1%	6	GOOD	1.5
Coca-Cola	KO	Consumer Staples	3.1%	6	EXCELLENT	1.8
Reynolds American	RAI	Consumer Staples	3.0%	6	GOOD	1.3
Xerox	XRX	Industrials	2.9%	9	EXCELLENT	2.1
Johnson & Johnson	JNJ	Consumer Staples	2.9%	6	EXCELLENT	2.4
PepsiCo	PEP	Consumer Staples	2.9%	6	GOOD	1.2
Deere	DE	Industrials	2.8%	6	EXCELLENT	1.4
Genuine Parts	GPC	Consumer Discretionary	2.8%	6	EXCELLENT	1.6
Kimberly-Clark	KMB	Consumer Staples	2.8%	6	GOOD	1.2
Waste Management	WM	Industrials	2.8%	7	GOOD	1.6
Fastenal	FAST	Industrials	2.7%	6	GOOD	1.4
Scotts Miracle-Gro	SMG	Materials	2.7%	6	EXCELLENT	1.3
Leggett & Platt	LEG	Consumer Discretionary	2.7%	6	GOOD	1.5
United Technologies	UTX	Industrials	2.7%	7	EXCELLENT	1.4
Corning	GLW	Information Technology	2.6%	6	GOOD	3.0
Ritchie Bros	RBA	Industrials	2.6%	6	EXCELLENT	2.3
Rockwell Automation	ROK	Industrials	2.6%	6	EXCELLENT	2.2
Omnicom	OMC	Consumer Discretionary	2.5%	6	EXCELLENT	1.8
Chico's FAS	CHS	Consumer Discretionary	2.5%	6	EXCELLENT	3.2
Yum! Brands	YUM	Consumer Discretionary	2.5%	7	EXCELLENT	1.7
Abercrombie & Fitch	ANF	Consumer Discretionary	2.5%	6	GOOD	2.9
Hasbro	HAS	Consumer Discretionary	2.5%	6	GOOD	1.6
Xilinx	XLNX	Information Technology	2.5%	6	EXCELLENT	3.1

At any time, our favorite dividend growth ideas are included in the Dividend Growth portfolio, page 5.

The Dividend Growth Watch List

By Valuentum Analysts

The dividend growth watch list, which is proprietary to the Dividend Growth Newsletter, showcases firms commonly held in many dividend growth portfolios.

As with the list on the previous page, we may replace firms held in the Dividend Growth portfolio (see page 5) with companies found in the table below should their dividend growth potential (and/or total return potential) become relatively more attractive than portfolio constituents'.

We find tremendous value in keeping track of dividend growth firms in order to better monitor ideal entry points. We continue to scour our coverage universe for firms to add to our dividend growth watch list, which we update in every edition of our Dividend Growth Newsletter.

DIVIDEND GROWTH WATCH LIST - as of March 31, 2016 Fundamental data as of March 31, 2016

Company Name	Yrly Div's Paid ($) /Shr	Div Yield %	Div Cushion™	Div Safety	Div Growth	Fair Value	VBI Score	Price/Fair Value	Price ($)
3M (MMM)	4.44	2.66%	1.5	GOOD	EXCELLENT	$122.00	4	1.37	166.74
Abbott (ABT)	1.04	2.48%	2.6	GOOD	EXCELLENT	$43.00	6	0.97	41.90
AbbVie (ABBV)	2.28	3.98%	2.0	GOOD	EXCELLENT	$69.00	4	0.83	57.26
ADP (ADP)	2.12	2.36%	5.5	EXCELLENT	EXCELLENT	$94.00	6	0.95	89.72
Analog Devices (ADI)	1.68	2.84%	2.2	GOOD	EXCELLENT	$51.00	3	1.16	59.14
Becton, Dickinson (BDX)	2.64	1.74%	2.6	GOOD	EXCELLENT	$161.00	6	0.94	151.82
Boeing (BA)	4.36	3.43%	2.0	GOOD	EXCELLENT	$119.00	4	1.07	127.12
Coca-Cola (KO)	1.40	3.01%	1.8	GOOD	EXCELLENT	$39.00	6	1.19	46.48
Colgate-Palmolive (CL)	1.56	2.21%	1.6	GOOD	EXCELLENT	$53.00	3	1.33	70.66
Deere (DE)	2.40	3.09%	1.4	GOOD	EXCELLENT	$93.00	6	0.83	77.61
Dover (DOV)	1.68	2.62%	1.5	GOOD	EXCELLENT	$61.00	3	1.05	64.15
DuPont (DD)	1.52	2.38%	2.2	GOOD	GOOD	$64.00	5	1.00	63.78
Eli Lilly (LLY)	2.04	2.84%	2.0	GOOD	GOOD	$73.00	3	0.98	71.85
General Dynamics (GD)	3.04	2.32%	3.3	EXCELLENT	EXCELLENT	$127.00	7	1.03	131.07
Genuine Parts (GPC)	2.63	2.65%	1.6	GOOD	EXCELLENT	$84.00	6	1.18	99.26
H&R Block (HRB)	0.80	3.04%	4.4	EXCELLENT	GOOD	$38.00	3	0.69	26.33
Harris (HRS)	2.00	2.58%	1.9	GOOD	EXCELLENT	$90.00	3	0.86	77.60
Honeywell (HON)	2.38	2.12%	2.4	GOOD	EXCELLENT	$95.00	6	1.18	112.18
Hormel Foods (HRL)	0.58	1.34%	3.0	EXCELLENT	EXCELLENT	$45.00	6	0.96	43.20
IBM (IBM)	5.20	3.43%	1.8	GOOD	EXCELLENT	$165.00	3	0.92	151.81
Illinois Tool Works (ITW)	2.20	2.15%	2.1	GOOD	EXCELLENT	$80.00	6	1.28	102.42
Kimberly-Clark (KMB)	3.68	2.73%	1.2	GOOD	GOOD	$106.00	6	1.27	134.67
Lockheed Martin (LMT)	6.60	2.98%	1.4	GOOD	EXCELLENT	$175.00	4	1.27	221.80
Merck (MRK)	1.84	3.46%	2.0	GOOD	GOOD	$55.00	3	0.97	53.15
Northrop Grumman (NOC)	3.20	1.61%	2.4	GOOD	EXCELLENT	$154.00	4	1.29	198.50
Paychex (PAYX)	1.68	3.12%	2.6	GOOD	EXCELLENT	$44.00	4	1.22	53.87
Phillip Morris (PM)	4.08	4.14%	0.5	GOOD	GOOD	$76.00	7	1.30	98.63
Raytheon (RTN)	2.93	2.39%	2.5	GOOD	EXCELLENT	$100.00	4	1.23	122.65
St. Jude (STJ)	1.24	2.26%	3.2	EXCELLENT	EXCELLENT	$65.00	4	0.84	54.91
Texas Instr (TXN)	1.52	2.63%	1.9	GOOD	EXCELLENT	$50.00	3	1.15	57.72
United Technologies (UTX)	2.56	2.56%	1.4	GOOD	EXCELLENT	$105.00	7	0.95	100.10
UPS (UPS)	3.12	2.96%	1.6	GOOD	EXCELLENT	$96.00	7	1.10	105.55
VF Corp (VFC)	1.48	2.29%	2.0	GOOD	EXCELLENT	$55.00	4	1.18	64.75
Walgreens (WBA)	1.44	1.71%	3.0	EXCELLENT	EXCELLENT	$75.00	3	1.12	84.25

UR = Under Review

Yields to Avoid

By Valuentum Analysts

As many investors know, firms can often become cheap for good reasons. That is, they are not trading cheaply because of Mr. Market's irrational behavior, but instead are trading at depressed levels due to deteriorating underlying fundamental characteristics that actually justify its current share price, even if traditional valuation techniques suggest the firm's shares are inexpensive. On a similar note, firms that boast high dividend yields may do so because the market has little confidence in the sustainability of its dividend and believes a cut may be just around the corner.

Though we fall short of saying the following list of firms will slash their respective dividends anytime soon, our dividend-cut predictive indicator—the Valuentum Dividend Cushion™--indicates that the firms below are at significant risk for a dividend cut in coming years. We think the dividend-growth investor should steer clear of the following firms' shares:

Company Name	Symbol	Industry	Est Div Yield	Div Safety	Div Cushion
Peabody Energy	BTU	Industrial Minerals	0.2%	VERY POOR	-355.4
CONSOL Energy	CNX	Industrial Minerals	0.5%	VERY POOR	-113.5
KB Home	KBH	Homebuilders	0.7%	VERY POOR	-50.1
Lennar	LEN	Homebuilders	0.3%	VERY POOR	-27.6
Windstream	WIN	Telecom Services - diversified	9.5%	VERY POOR	-23.1
Range Resources	RRC	Independent Oil & Gas	0.7%	VERY POOR	-22.3
Pioneer Natural Resources	PXD	Independent Oil & Gas	0.1%	VERY POOR	-18.3
Barrick Gold	ABX	Metals & Mining - gold	0.9%	VERY POOR	-15.8
Apache	APA	Independent Oil & Gas	2.3%	VERY POOR	-13.8
Newmont Mining	NEM	Metals & Mining - gold	0.6%	VERY POOR	-11.2
D. R. Horton	DHI	Homebuilders	1.1%	VERY POOR	-10.1
Ryder System	R	Rental and Leasing	3.3%	VERY POOR	-9.4
Textainer	TGH	Rental and Leasing	9.7%	VERY POOR	-9.0
Hess	HES	Refiners	2.3%	VERY POOR	-8.1
Allegheny Technologies	ATI	Aluminum	3.4%	VERY POOR	-7.8
Tidewater	TDW	Energy Equipment	11.2%	VERY POOR	-6.8
Tailored Brands	TLRD	Retail - Men's, Women's	4.2%	VERY POOR	-6.6
Yamana Gold	AUY	Metals & Mining - gold	4.0%	VERY POOR	-6.4
Devon Energy	DVN	Independent Oil & Gas	2.9%	VERY POOR	-6.3
Anadarko	APC	Independent Oil & Gas	2.2%	VERY POOR	-6.1
ConocoPhillips	COP	Major Oil & Gas	2.9%	VERY POOR	-5.8
TAL Intl	TAL	Rental and Leasing	17.6%	VERY POOR	-5.8
Noble Energy	NBL	Independent Oil & Gas	2.2%	VERY POOR	-5.3
Cimarex	XEC	Independent Oil & Gas	0.6%	VERY POOR	-5.0
Alcoa	AA	Aluminum	1.6%	VERY POOR	-4.6
Cablevision	CVC	Media - CATV	2.0%	VERY POOR	-4.4
MDC	MDC	Homebuilders	4.2%	VERY POOR	-3.9
Deltic Timber	DEL	Building Materials	0.7%	VERY POOR	-3.8
Murphy Oil	MUR	Refiners	7.3%	VERY POOR	-3.5
NiSource	NI	Utilities	3.0%	VERY POOR	-3.3
Canadian Natural	CNQ	Independent Oil & Gas	4.0%	VERY POOR	-3.0
Frontier Comm	FTR	Telecom Services - diversified	8.2%	VERY POOR	-3.0
EOG Resources	EOG	Independent Oil & Gas	0.9%	VERY POOR	-2.2
Huntsman	HUN	Chemicals - broad	4.5%	VERY POOR	-2.0
Time Warner Cable	TWC	Media - CATV	1.7%	VERY POOR	-2.0
Quad/Graphics Inc	QUAD	Book Publishing	9.4%	VERY POOR	-1.9
PetroChina	PTR	Major Oil & Gas	2.8%	VERY POOR	-1.9
Centurylink	CTL	Telecom Services - diversified	8.1%	VERY POOR	-1.8
PG&E	PCG	Utilities - Large	3.4%	VERY POOR	-1.7
Royal Caribbean	RCL	Leisure	1.8%	VERY POOR	-1.7
Natural Resource Partners	NRP	Industrial Minerals	15.5%	VERY POOR	-1.7
Silgan	SLGN	Containers & Packaging	1.2%	VERY POOR	-1.6

The Dividend Cushion Beats the Dividend Aristocrats:
http://www.valuentum.com/articles/20150506

The Valuentum Dividend Cushion™ has an excellent track record of predicting dividend cuts. For more information, please select the following link (login required):

http://www.valuentum.com/articles/20130528

Oracle...from page 9

While the firm realizes that it will not be able to complete a one-to-one transition of all of its customers from on-premise to cloud offerings, it is confident that its enormous installed base will provide a reasonable amount of its new cloud bookings. The company has more applications in the cloud that will attract new customers and additional revenue from existing customers, and as on-premise customers switch to the cloud, Oracle will deepen its wallet share of the process via additional services required on its end to run the cloud. As the firm's on-premise software exists, customers manage their own hardware and do all the labor themselves. In the cloud-based business model, customers will end up paying and additional support fee, which will actually cost the customer less than it would to run its own on-premise database.

The full transition will not be completed for some time, as evidenced by cloud revenue only accounting for 8% of total revenue. The near-term pressures will continue, but management surely paints nothing but a rosy picture for its long-term opportunity. The firm has a ways to go before fully turning the corner with respect to completing the transition, and it could take years to complete. However, we like the fact that the company is able to lean on its strong free cash flow generating software business as it wanes. We cannot disagree that the transition would create value over the long-term if successfully executed, but that "if" remains. Investors in Oracle are betting on the notion that that "if" will turn into a "when."

Oracle remains one of the better ideas in big cap technology, but readers have others to choose from as well, including Apple (AAPL), Microsoft (MSFT), Cisco (CSCO), and other constituents of the newsletter portfolios. Oracle's dividend yield of 1.5% is just a little light to make the cut to the Dividend Growth Newsletter portfolio.

Valuentum Applauds SEC's Move To Evaluate Non-GAAP Reporting

By Brian Nelson, CFA

Too many investors have been hurt.

Management teams want to present their results the best way they can within the boundaries of the law, to bolster their holdings. Some analysts want to "pitch" their stocks in the most optimistic light possible, to preserve their jobs. The consumers of such research want the future to always be bright, so they want to believe the "good news." The result: there are now very few places to find objective, unbiased research and analysis. It therefore has become more important for companies to provide the most accurate and helpful information possible, and non-GAAP earnings presentation isn't it -- in fact, it has gotten way out of whack. The SEC noted March 16 that it is looking at "rein(ing)" in some of the liberties management teams enjoy by presenting adjusted earnings. We like the news and have been calling for a reevaluation of what types of metrics management should be able to pass off to investors for some time.

In particular, we had warned investors in master limited partnerships that the non-GAAP metric "distributable cash flow" was nothing but nonsense within the valuation context, and the informative value of such a metric that ignores tangible expenses and all of the growth capital spending used to drive net income, which itself is a component of distributable cash flow, was a severe imbalance that was sure to get investors in deep trouble. The dividend cut at Kinder Morgan (KMI), now a corporate, was one such example, but the fallout in equities in the midstream energy MLP space has been nothing short of disastrous. Even today, investors are beholden to the non-GAAP metric distributable cash flow, as if it somehow is more informative than the actual GAAP financials. It's not. It's "made up."

Management teams are also having a field day enjoying the standard adjustments by the rating agencies when assessing leverage, sharing them. Things have gotten so out of whack that in some

Please see *Valuentum Applauds*...on next page

***Valuentum Applauds…*from previous page**

cases, in Energy Transfer Equity (ETE) more specifically, investors believe what management and the credit rating agencies tell them, instead of actually looking at the financial statements. For example, in this case, a close look at the actual reported financials revealed an MLP that is more than 7x leveraged on a net debt to EBITDA basis, far more than the 4.5x presented in any communications. We're not picking on Energy Transfer Equity, which recently lost its CFO and had to issue convertible shares to help pay for the Williams (WMB) deal, as such mismatches are rather widespread. Energy Transfer Equity's recent convertible offering was effectively a dividend cut, and participants have had to sacrifice a portion of their income streams.

For sophisticated investors that can cut through the "fluff" in investor presentations, non-GAAP distributable cash flow and leverage metrics that make little sense when compared to GAAP results may not be a big deal, but there are thousands of individuals and advisors that depend on getting the best information, the correct information. We're doing our best to give that to them, but while we warned readers far in advance of the goings-on in the energy master limited partnership space, the reality is that with better disclosures by management, investors that "fell" for the non-GAAP information or are still holding on wouldn't have gotten involved in the first place.

We hope the SEC really cracks down on such adjusted earnings metrics and the sooner the better.

Part II: Nelson's Evaluation of Berkshire's 2015 Annual Report

By Brian Nelson, CFA

"If you want to guarantee yourself a lifetime of misery, be sure to marry someone with the intent of changing their behavior." – a "Mungerism" explaining the importance of identifying good managers when pursuing a hands-off ownership style.

We covered quite a bit of ground in the first part of the evaluation of Berkshire Hathaway's 2015 annual report, and we'll cover even more ground in this second installment. We left off with a good conversation about the insurance business, and how part of Berkshire Hathaway's business strength emanates from its fortress balance sheet and credit rating, rather than any commoditized insurance policy it may be able to write. Let's keep going through the Oracle of Omaha's writings in similar format as the first installment, picking select excerpts to highlight and then comment on: Mr. Buffett's words in italics, mine in standard type. Let's proceed.

While Charlie and I search for new businesses to buy, our many subsidiaries are regularly making bolt-on acquisitions. Last year we contracted for 29 bolt-ons, scheduled to cost $634 million in aggregate. The cost of these purchases ranged from $300,000 to $143 million.

Charlie and I encourage bolt-ons, if they are sensibly-priced. (Most deals offered us most definitely aren't.) These purchases deploy capital in operations that fit with our existing businesses and that will be managed by our corps of expert managers. That means no additional work for us, yet more earnings for Berkshire, a combination we find highly appealing. We will make many dozens of bolt-on deals in future years.

Though perhaps an observation more than anything else, I find it interesting that Berkshire Hathaway completed a bolt-on acquisition to the tune of $300,000 in 2015. That company must have been a great fit, and it's more than likely that Berkshire underpaid for those assets, if only because any assets that would be worth acquiring by Berkshire are likely worth more than that nominal value. That's neither here nor there, however, and the real focus of the two paragraphs above should be on the importance of recognizing that "price" matters.

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Mr. Buffett notes that, while he and Charlie encourage bolt-ons, he does so only if they are sensibly-priced. The Oracle of Omaha is well-known for helping investors understand that the price of something is what you pay for it, and the value of something is based on the net cash position on the books, the present value of future enterprise free cash flows, and the value of non-operating assets (or "what you get"). Folding into the portfolio cheap assets that fit well with existing operations is simply a no-brainer and explains why nearly 30 bolt-on deals were completed at Berkshire during the year.

Savvy investors approach the art of investing in a similar capacity. Remember: price and value are two different concepts, and estimating intrinsic worth for any asset is par for the course before purchasing it. Only when a price can be had at a level on par (for a fantastic enterprise) or preferably materially lower than the fair value of those assets does an investment become intriguing. Bargain-basement opportunities don't come up that often, as Mr. Buffett outlines when he says most deals presented to him come with price tags that are too high.

Our Heinz partnership with Jorge Paulo Lemann, Alex Behring and Bernardo Hees more than doubled its size last year by merging with Kraft…

Jorge Paulo and his associates could not be better partners. We share with them a passion to buy, build and hold large businesses that satisfy basic needs and desires. We follow different paths, however, in pursuing this goal.

Their method, at which they have been extraordinarily successful, is to buy companies that offer an opportunity for eliminating many unnecessary costs and then – very promptly – to make the moves that will get the job done. Their actions significantly boost productivity, the all-important factor in America's economic growth over the past 240 years. Without more output of desired goods and services per working hour – that's the measure of productivity gains – an economy inevitably stagnates. At much of corporate America, truly major gains in productivity are possible, a fact offering opportunities to Jorge Paulo and his associates.

The passages above reiterate the importance of productivity to the pace of economic growth. From the development of the assembly line to the invention of the personal computer, America has sourced the ingenuity to make things better and more efficient, seemingly without fail. What Mr. Buffett is talking about in the above amounts to the cost-cutting variety of enhancing efficiency rather than of the "invention" or "discovery" method, but productivity in any form remains the lifeblood of economic growth.

By logical extension, the biggest question on any investor's mind is what will be the next 'assembly line' or 'personal computer' over the next 30 years to drive even more productivity. We say as much not in the sprit of uncovering the coming decades' Ford (F) or Microsoft (MSFT), per se, but to help build the case (and better understand) why investors should be optimistic about future economic growth in America, as Mr. Buffett outlines at the bottom of this piece. Eternal optimists and/or perma bulls may like the future "just because," but we think it's important to think about what may be the "next big thing" because without it, as Mr. Buffett states, "an economy inevitably stagnates."

Unfortunately, neither the Oracle nor I know with absolutely certainty what will be the source of the next giant leap in productivity, but the future not only holds this promise, it may also come with significant challenges. After all, how can we forget that the federal funds rate in 1980 was a staggering 20% and now its near-0%? Markets benefitted from the ongoing loosening of monetary policy over the past 30+ years, and the coming contractionary monetary policy will have the opposite impact, increasing discount rates across equity valuations and making the lending environment all the more stringent to achieve consistent expansion. One must be cognizant of the obstacles to future economic growth, and how the tailwinds of the past may very well soon turn into the stiff headwinds of the future.

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At Berkshire, we, too, crave efficiency and detest bureaucracy. To achieve our goals, however, we follow an approach emphasizing avoidance of bloat, buying businesses such as PCC that have long been run by cost-conscious and efficient managers. After the purchase, our role is simply to create an environment in which these CEOs – and their eventual successors, who typically are like-minded – can maximize both their managerial effectiveness and the pleasure they derive from their jobs. (With this hands-off style, I am heeding a well-known Mungerism: "If you want to guarantee yourself a lifetime of misery, be sure to marry someone with the intent of changing their behavior.")

Investors love Warren Buffett's letters to shareholders not only because they are full of wisdom, but also because they are full of quips, the treasure in the above from his partner Charlie Munger, which we also reproduced at the top of this article. Mr. Buffett and the Berkshire team are owners, not managers, so they rely on their proficiency in selecting the best managers, in part because they don't have the skill set to change them.

In the passage above, Mr. Buffett makes another reference to the managerial prowess of the team at Precision Castparts (PCC), a company that we have been quite fond of for many years and in part is a large reason why we are considering adding Berkshire Hathaway to the portfolio of the Best Ideas Newsletter. Precision's CEO Mark Donegan may be one of the best executives to head up any organization across any industry.

Berkshire increased its ownership interest last year in each of its "Big Four" investments – American Express (AXP), Coca-Cola (KO), IBM (IBM) and Wells Fargo (WFC). We purchased additional shares of IBM (increasing our ownership to 8.4% versus 7.8% at yearend 2014) and Wells Fargo (going to 9.8% from 9.4%). At the other two companies, Coca-Cola and American Express, stock repurchases raised our percentage ownership. Our equity in Coca-Cola grew from 9.2% to 9.3%, and our interest in American Express increased from 14.8% to 15.6%. In case you think these seemingly small changes aren't important, consider this math: For the four companies in aggregate, each increase of one percentage point in our ownership raises Berkshire's portion of their annual earnings by about $500 million.

These four investees possess excellent businesses and are run by managers who are both talented and shareholder-oriented. Their returns on tangible equity range from excellent to staggering. At Berkshire, we much prefer owning a non-controlling but substantial portion of a wonderful company to owning 100% of a so-so business. It's better to have a partial interest in the Hope Diamond than to own all of a rhinestone.

If Berkshire's yearend holdings are used as the marker, our portion of the "Big Four's" 2015 earnings amounted to $4.7 billion. In the earnings we report to you, however, we include only the dividends they pay us – about $1.8 billion last year. But make no mistake: The nearly $3 billion of these companies' earnings we don't report are every bit as valuable to us as the portion Berkshire records.

The earnings our investees retain are often used for repurchases of their own stock – a move that increases Berkshire's share of future earnings without requiring us to lay out a dime. The retained earnings of these companies also fund business opportunities that usually turn out to be advantageous. All that leads us to expect that the per-share earnings of these four investees, in aggregate, will grow substantially over time. If gains do indeed materialize, dividends to Berkshire will increase and so, too, will our unrealized capital gains.

There is a lot to digest in the passages above, but we'd like to make just a couple observations, and let Mr. Buffett's words speak for themselves, for the most part.

First, we're surprised that, for as much as Uncle Warren talks about the pitfalls of accounting within Berkshire's own reporting that he is relying on return on tangible equity (ROTE) as an evaluation of the "Big Four." Though ROTE may be appropriate for financial entities such as American Express and Wells Fargo, we don't think it makes much sense for operating entities such as Coca-Cola and IBM, and we think its use is in part why the Oracle made one of his few mistakes in loading up on the latter. Return on invested capital will always trump accounting measures of return on tangible equity, and he knows this.

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The other reason Berkshire may have made a compounding error with IBM rests on the tech giant's aggressive repurchase program, and Mr. Buffett's perception of it. It sounds like the Berkshire team had been focusing on increasing its share of the IBM earnings over time as shares were retired, instead of a focus on whether the buybacks are actually creating value for shareholders – i.e. whether the company is repurchasing stock below an estimate of intrinsic value. We're shocked to say this but Warren Buffett fell into the "earnings-per-share" trap at IBM, and it could be a long time before Berkshire makes good on the trade, if at all. Remember: focus on return on invested capital and economic value creation, not on return on equity, which can be augmented by more-risky leverage (debt), or buybacks, which can be value-destructive if executed at the wrong price (above fair value).

For the conclusion of this second installment, let's reproduce the Oracle's optimistic views on America. It's a great read, if only because the nationalistic, optimistic bent may offer some calm in an otherwise hectic world. Be sure to tune in for Part III as we wrap up this year's review. Enjoy! The following is Warren Buffett at his finest.

It's an election year, and candidates can't stop speaking about our country's problems (which, of course, only they can solve). As a result of this negative drumbeat, many Americans now believe that their children will not live as well as they themselves do.

That view is dead wrong: The babies being born in America today are the luckiest crop in history.

American GDP per capita is now about $56,000. As I mentioned last year that – in real terms – is a staggering six times the amount in 1930, the year I was born, a leap far beyond the wildest dreams of my parents or their contemporaries. U.S. citizens are not intrinsically more intelligent today, nor do they work harder than did Americans in 1930. Rather, they work far more efficiently and thereby produce far more. This all-powerful trend is certain to continue: America's economic magic remains alive and well.

Some commentators bemoan our current 2% per year growth in real GDP – and, yes, we would all like to see a higher rate. But let's do some simple math using the much-lamented 2% figure. That rate, we will see, delivers astounding gains.

America's population is growing about .8% per year (.5% from births minus deaths and .3% from net migration). Thus 2% of overall growth produces about 1.2% of per capita growth. That may not sound impressive. But in a single generation of, say, 25 years, that rate of growth leads to a gain of 34.4% in real GDP per capita. (Compounding's effects produce the excess over the percentage that would result by simply multiplying 25 x 1.2%.) In turn, that 34.4% gain will produce a staggering $19,000 increase in real GDP per capita for the next generation. Were that to be distributed equally, the gain would be $76,000 annually for a family of four. Today's politicians need not shed tears for tomorrow's children.

Indeed, most of today's children are doing well. All families in my upper middle-class neighborhood regularly enjoy a living standard better than that achieved by John D. Rockefeller Sr. at the time of my birth. His unparalleled fortune couldn't buy what we now take for granted, whether the field is – to name just a few – transportation, entertainment, communication or medical services. Rockefeller certainly had power and fame; he could not, however, live as well as my neighbors now do.

Though the pie to be shared by the next generation will be far larger than today's, how it will be divided will remain fiercely contentious. Just as is now the case, there will be struggles for the increased output of goods and services between those people in their productive years and retirees, between the healthy and the infirm, between the inheritors and the Horatio Algers, between investors and workers and, in particular, between those with talents that are valued highly by the marketplace and the equally decent hard-working Americans who lack the skills the market prizes. Clashes of that sort have forever been with us – and will forever continue. Congress will be the battlefield; money and votes will be the weapons. Lobbying will remain a growth industry.

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The good news, however, is that even members of the "losing" sides will almost certainly enjoy – as they should – far more goods and services in the future than they have in the past. The quality of their increased bounty will also dramatically improve. Nothing rivals the market system in producing what people want – nor, even more so, in delivering what people don't yet know they want. My parents, when young, could not envision a television set, nor did I, in my 50s, think I needed a personal computer. Both products, once people saw what they could do, quickly revolutionized their lives. I now spend ten hours a week playing bridge online. And, as I write this letter, "search" is invaluable to me. (I'm not ready for Tinder, however.)

For 240 years it's been a terrible mistake to bet against America, and now is no time to start. America's golden goose of commerce and innovation will continue to lay more and larger eggs. America's social security promises will be honored and perhaps made more generous. And, yes, America's kids will live far better than their parents did.

Recently Asked Questions

By Valuentum Editorial Staff

The following questions cover the following topics:

1) Can you explain what the Dividend Cushion ratio measures and what it doesn't?

2) Can you explain the difference between the raw, unadjusted Dividend Cushion ratio and the adjusted Dividend Cushion ratio?

3) Can you talk more about the Valuentum Buying Index (VBI) ratings? Why do some of your favorite ideas in the newsletter portfolios have lower VBI ratings than ones that are not in the newsletter portfolios?

4) Can you explain why you don't always include companies in the newsletter portfolios that have strong Economic Castles, solid Dividend Cushion ratios and that are undervalued? top of the Dividend Cushion ratio or our extensive discounted cash flow processes, or more. Trust me -- it will help you over the long haul.

1Q: Question regarding your ratings for dividend growth. I was checking out your recent list of stocks listed by Dividend Cushion ratio and reading dividend report for the top one (CIR); you give it a dividend growth rating of "GOOD". Though the company's Dividend Cushion ratio is good, how do you justify this rating since management has not seen fit to raise the dividend in the past 15 years, and your own projection table at the right of the page projects 0% dividend growth in future years? By your own records and this history, wouldn't this stock warrant a Dividend Growth rating of 'VERY POOR"? Interested in your response. Thanks.

1A: This is a great question because it allows us to explain the layers embedded within our analysis, and what exactly the Dividend Cushion ratio measures, and what it doesn't.

First, your question is probably more appropriately phrased as: why is CIR's Dividend Growth Potential GOOD (emphasis on "potential"), as it is the title that corresponds to the GOOD rating and what the rating applies to. In many ways, this answers your question: the Dividend Cushion ratio is strong, and therefore the company has tremendous potential to raise the dividend if it so chooses.

In particular, the Dividend Cushion ratio measures the capacity of the company to keep raising the dividend in the future. It does not measure the board's willingness to keep raising the dividend, which is another important consideration, something best expressed with an assessment of the company's historical dividend track record. Both capacity and willingness must be present to uncover the best dividend growth ideas for the coming years, in our view. That's why CIR doesn't make the cut for the Dividend Growth Newsletter portfolio. CIR has a relatively small dividend yield as well;

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in this light, it should be no surprise that the company has the capacity to cover such a minor payout given that it is a rather small financial obligation.

Perhaps most importantly, management and the board can do whatever they want with the dividend; we see cases all the time where a company puts up terrible performance and raises the dividend on hopes that investors will be satisfied with an increased payout that theoretically they already own. The Dividend Cushion ratio is a pure reflection of the financials used to assess the dividend growth potential of the company in the context of a firm's balance sheet and future financial forecasts. It is not a measure of willingness. Sometimes the board stretches too much with the payout; sometimes the board falls short. The Dividend Cushion ratio is the yardstick that measures the dividend growth potential of each entity.

It perhaps goes without saying, however, that the Dividend Cushion ratio is not all that we provide with respect to dividend analysis. We publish our assessment of the company's dividend track record, too, and we're doing tons more beyond the dividend analysis itself. Hope this helps clarify.

2Q: I'm a subscriber. I'm looking at your Dividend report for EPD Enterprise Product Partners. It says your Valuentum Dividend Cushion ratio for EPD is a 2, but several lines below it says the unadjusted Div Cushion is 0.25. Please explain the difference between the two ratios, and what is considered a good score for the unadjusted div cushion, what is an excellent score, what is neutral and what is poor? Also, how much relative importance should I give to each score?

Also, further down in the section on Unadjusted Dividend Cushion, the chart of EPD has a large negative number in the blue bar, and your text says: "Generally speaking, the greater the 'blue bar' to the right is in the positive, the more durable a company's dividend, and the greater the 'blue bar' to the right is in the negative, the less durable a company's dividend." So that means that EPD's dividend isn't durable, yet your report earlier says that EPDs div Safety is GOOD. Can you elaborate?

2A: Thank you for your question. It is a great one because it hits at the heart of the capital-market-dependency risk inherent to MLPs.

First, the raw, unadjusted Dividend Cushion ratio adds a firm's net cash position to the sum of its future free cash flows (cash flow from operations less all capital spending) over the next five years and takes that sum and divides it by the sum of the company's expected cash dividends paid and growth in them over the next five years. The Dividend Cushion ratio is essentially a coverage ratio -- the higher the ratio above 1, the better able the company will be able to cover dividend payments in the future, in our view. For most of our coverage and for most corporates, the qualitative ratings for safety and growth are a function of the raw, unadjusted Dividend Cushion ratio.

For MLPs, REITs, and some utilities, however, we make modifications to the raw, unadjusted Dividend Cushion ratio in deriving the adjusted Dividend Cushion ratio. For example, with MLPs, we add back future equity issuance to the numerator and mitigate the company's debt load to a degree on account of assuming ongoing refinancing capacity for such entities. These adjustments result in a sharp upward revision to the raw, unadjusted Dividend Cushion ratio. For MLPs, REITs, and some utilities, we base the qualitative rating on this enhanced adjusted Dividend Cushion ratio, but we also disclose the raw, unadjusted Dividend Cushion ratio in each case.

In short, we believe both the raw, unadjusted Dividend Cushion ratio and the adjusted Dividend Cushion ratio offer insights. The former reveals the capital-market-dependency risks inherent to MLPs, for example, while the latter acknowledges that under benign market conditions, continued funding of the distribution/dividend would ensue. We place greater emphasis on the raw, unadjusted Dividend Cushion ratio because it is more of a pure risk measure than the adjusted one, which considers a variety of incremental funding sources, which cannot be guaranteed during difficult credit conditions. We don't include any MLPs in the Dividend Growth Newsletter portfolio.

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The breakpoints are as follows for both measures (they can be found on the definitions page in the Dividend report in the back):

> Dividend Safety. We measure the safety of a firm's dividend by adding its net cash to our forecast of its future cash flows and divide that sum by our forecast of its future dividend payments. This process results in a ratio called the Dividend Cushion™. Scale: Above 2.75 = EXCELLENT; Between 1.25 and 2.75 = GOOD; Between 0.5 and 1.25 = POOR; Below 0.5 = VERY POOR.

Please let us know if we can elaborate further.

3Q: First of all, I want to say thank you for all the work that you and the Valuentum team does. I really appreciate the amount of time and effort that must go into all of the information that you provide.

I have had a question for a while which I was always curious about, and finally decided to send it in to get your take. How should an individual use the VBI rating when they just start using this indicator as input on new positions? In other words, how does someone build their own portfolio? The VBI rating on the majority of the best ideas would not indicate a time to buy. For example, is "AIG" currently a better idea than "AAPL" for a new investor based on their VBI indicators?

There is clearly more going into the transactions then just VBI rating. The website indicates that the Best Ideas Newsletter portfolio contains the best ideas at any point in time, but the VBI rating on many of them would not indicate that someone should start a new position in them. I understand that portfolio management is a different topic then valuation, but I was interested to know how the Valuentum team would go about building a new portfolio if they were to start today.

3A: Thank you very much for your email and membership.

As you mentioned, we primarily use the Valuentum Buying Index as a screening mechanism to surface new ideas for consideration. The rating is not absolute within the investment-decision making process, meaning that there are other factors beyond the rating that we consider before a company is added to the newsletter portfolios, the most important of which is approval from the Valuentum team (a precursor to adding the company to the newsletter portfolios). Our research indicates that the VBI rating is highly effective across large sample sets, but we take greater care when running the concentrated newsletter portfolios which target 15-20 holdings, not 500+ as in the published case study.

To your question in particular: "How should an individual use the VBI rating when they just start using this indicator as input on new positions?"

We're not aware of your personal goals or risk tolerances, so we don't have a basis for suggesting how you should build a portfolio, or phase into holdings over time. We can never give any personal financial advice in that regard. That said, we use the VBI as a screening mechanism to surface ideas we want to add to the existing newsletter portfolios, to augment the existing positions in the newsletter portfolios in order to achieve the goals of both newsletter portfolios. We tend to add most 9s and 10s to the newsletter portfolios but not all of them and hold the ones that we add until they surpass fair value and begin to "roll over" from a technical standpoint, usually registering a 1 or 2 at that time.

We take a disciplined approach to new idea generation, so 9s and 10s don't come up too frequently. Apple is a holding in both newsletter portfolios, while AIG is not included, so we prefer the former despite its relatively lower VBI rating. The latter, however, is still highlighted as an idea, but it's just not for the Valuentum newsletter portfolios. Here's why:
http://www.valuentum.com/articles/20120805.

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There's a lot that goes into adding a company to the newsletter portfolios. Portfolio additions undergo a rigorous analyst-driven qualitative process, while the VBI rating is largely a quantitative output, though it, too, is driven by analyst expectations. The following goes into why we consider the holdings in the newsletter portfolios the best ideas at any given time, and why at times non-portfolio holdings can have higher weightings than portfolio holdings: http://www.valuentum.com/articles/20151026_1.

Also pasted below is another link as to how many members use our services, and the goals that we strive to achieve with respect to the newsletter portfolios:

http://www.valuentum.com/articles/How_to_Use_Valuentums_Investment_Services

Please let us know if we can elaborate further.

4Q: I don't understand why Oracle - with a very attractive Economic Castle and a Dividend Cushion of 5.3 doesn't deserve a prominent place in the Valuentum portfolios.

Why was the Economic Castle adapted from "highest rated" to "very attractive"?

Despite your article "Oracle's Cloud Performance Leaves a Hazy Overall Outlook" dated June 22, the fair value was not adapted in the September report. A lot of fuss about nothing?

4A: This is a great question because it hits at the heart of the difficult portfolio allocation decisions in managing the newsletter portfolios. We imagine that many members have similar questions about companies that they like, too: why aren't they part of the newsletter portfolios?

In short, you are correct. Oracle is a fantastic business, has a strong Economic Castle, and fantastic dividend coverage. Shares are also undervalued, though the company's Valuentum Buying Index rating, which considers a 'market conviction' assessment through an evaluation of pricing strength, is not that great; part of the reason why we're not pushing to add it to the newsletter portfolios right now.

That said, Oracle is a top consideration. The primary reason why Oracle, and many other top-rated companies, are not included in the newsletter portfolios may have nothing to do with them at all, and everything to do with the opportunity cost of investing. In the case of Oracle, for one, we're already quite tech-heavy in the newsletter portfolios, and it's difficult to argue with the fantastic performance of Apple and Microsoft the past few years. We like Oracle; we've just liked a few tech names better, but Oracle has done well, too.

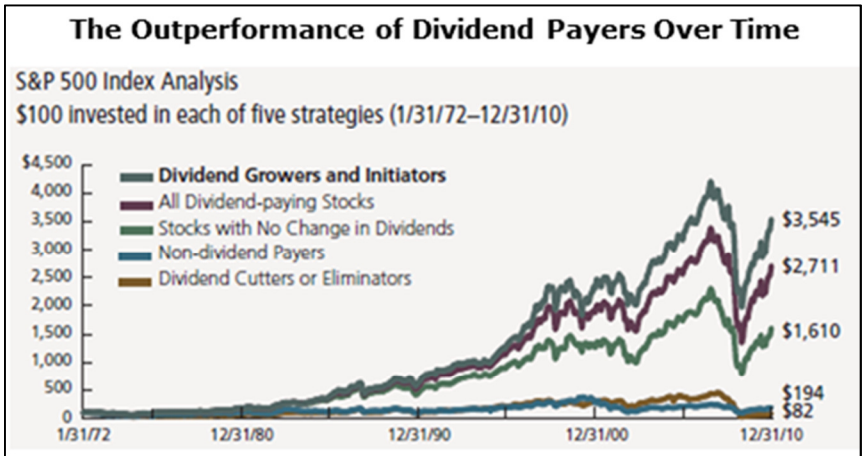
It comes down to the idea that we can't include every company we like in the newsletter portfolios, mostly due to sector weighting considerations. In all cases, however, we do our best to highlight those that may not be in there via their attractive price/fair values, Economic Castle ratings, and Dividend Cushion ratios, an oftentimes, their better-than-average Valuentum Buying Index ratings.

Please feel free to reach out to us at any time at info@valuentum.com. Thank you for your questions!

About the Valuentum Dividend Cushion™

By Valuentum Analysts

History has revealed that the best performing stocks during the previous decades have been those that shelled out ever-increasing cash to shareholders in the form of dividends. In a recent study, S&P 500 stocks that initiated dividends or grew them over time registered roughly a 9.6% annualized return since 1972 (through 2010), while stocks that did not pay out dividends or cut them performed poorly over the same time period.



Source of the chart data: Ned Davis Research, 12/31/10. Image Source: Capital Markets Perspectives, "Investing for Dividend Growth", Oppenheimer Funds. Based on an equal-weighted geometric average of total return of dividend-paying historical S&P 500 Index stocks, rebalanced annually. The chart uses actual annual dividends to identify dividend-paying stocks and changes on a calendar-year basis. Past performance does not guarantee future results.

Such analysis is difficult to ignore, and we believe investors may be well-rewarded in future periods by finding the best dividend-growth stocks out there. As such, we've developed a rigorous dividend investment methodology that uncovers firms that not only have the safest dividends but also ones that are poised to grow them long into the future.

How did we do this? Well, first of all, we scoured our stock universe for firms that have cut their dividends in the past to uncover the major drivers behind the dividend cut. This is what we found out: The major reasons why firms cut their dividend had to do with preserving cash in the midst of a secular or cyclical downturn in demand for their products/services or when faced with excessive leverage (how much debt they held on their respective balance sheets).

The Importance of Forward-Looking Dividend Analysis

Armed with this knowledge, we developed the forward-looking Valuentum Dividend Cushion™, which is a ratio that gauges the safety of a dividend over time.

Most dividend analysis that we've seen out there is backward-looking – meaning it rests on what the firm has done in the past. Although analyzing historical trends is important, we think assessing what may happen in the future is even more important. The S&P 500 Dividend Aristocrat List, or a grouping of firms that have raised their dividends for the past 25 years, is a great example of why backward-looking analysis can be painful. One only has to look over the past few years to see the removal of well-known names from the Dividend Aristocrat List (including General Electric and Pfizer) to understand that backward-looking analysis is hardly worth your time. After all, you're investing for the future, so the future is all you should care about.

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We want to find stocks that will increase their dividends for 25 years into the future, not use a rear-view mirror to build a portfolio of names that may already be past their prime dividend growth years. The Valuentum Dividend Cushion™ measures just how safe the dividend is in the future. It considers the firm's net cash on its balance sheet (cash and cash equivalents less debt) and adds that to its forecasted future free cash flows (cash from operations less capital expenditures) and divides that sum by the firm's future expected dividend payments. At its core, it tells investors whether the firm has enough cash to pay out its dividends in the future, while considering its debt load. If a firm has a Valuentum Dividend Cushion™ above 1, it can cover its dividend, but if it falls below 1, trouble may be on the horizon.

In our study, the Valuentum Dividend Cushion™ process caught every dividend cut made by a non-financial, operating firm that we have in our database, except for one (Marriott). But interestingly, the Valuentum Dividend Cushion™ indicated that Marriott should have never cut its dividend, and sure enough, two years after the firm did so, it raised it to levels that were higher than before the cut.

Here are the results of the study (a Valuentum Dividend Cushion™ below 1 indicates the dividend may be in trouble). The Valuentum Dividend Cushion™ score shown in the table below is the measure in the year before the firm cut its dividend, so it represents a predictive indicator. The measure continues to do well by members in real-time as well (beyond the constraints of any academic study).

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) Forecast 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.

At the very least, using the Valuentum Dividend Cushion™ can help you avoid firms that are at risk of cutting their dividends in the future. And we are the only firm out there that does this type of in-depth analysis for you. We provide the Valuentum Dividend Cushion™ score in the dividend reports and monthly Dividend Growth Newsletter, and we also scale the safety of a firm's dividend based on this measure in simple terms: Excellent, Good, Poor, Very Poor.

Please see *About Our Valuentum Dividend Cushion…*on next page

About Our Valuentum Dividend Cushion…**from previous page**

Here's a glimpse of the Valuentum Dividend Cushion™ score (as of November 2011) for a sample set of firms in our coverage universe. Please note that the current score on these and hundreds more are available with a membership to our website:

Company Name	Dividend Cushion
Abbott Labs (ABT)	2.3
Coca-Cola (KO)	1.9
Family Dollar (FDO)	4.4
International Business Machines (IBM)	3.7
Johnson & Johnson (JNJ)	2.5
Merck (MRK)	2.5
Molex (MOLX)	2.5
Pepsi (PEP)	1.3
Proctor & Gamble (PG)	1.4
Wal-Mart (WMT)	1.4

Subscribe to Valuentum to monitor the Dividend Cushion of firms you own.

Understanding Dividend Growth

It takes time to accumulate wealth through dividends, so dividend growth investing requires a long-term perspective. We assess the long-term future growth potential of a firm's dividend, and we don't take management's word for it. Instead, we dive into the financial statements and make our own forecasts of the future to see if what management is saying is actually achievable. We use the Valuentum Dividend Cushion™ as a way to judge the capacity for management to raise its dividend – how much cushion it has – and we couple that assessment with the firm's dividend track record, or management's willingness to raise the dividend.

In many cases, we may have a different view of a firm's dividend growth potential than what may be widely held in the investment community. That's fine by us, as our dividend-growth investment horizon is often longer than others'. We want to make sure that the firm has the capacity and willingness to increase the dividend years into the future and will not be weighed down by an excessive debt load or cyclical or secular problems in fundamental demand for their products/services. We scale our dividend-growth assessment in an easily-interpreted fashion: Excellent, Good, Poor, Very Poor.

What Are the Dividend Ideas We Seek to Deliver to You in Our Newsletter?

First of all, we're looking for stocks with dividend yields that are greater than the average of the S&P 500, or about 2% (but preferably north of 3%). This excludes many names, but we think such a cutoff eliminates firms whose dividend streams aren't yet large enough to generate sufficient income. Second, we're looking for firms that register an 'EXCELLENT' or 'GOOD' rating on our scale for both safety and future potential growth. And third, we're looking for firms that have a relatively lower risk of capital loss, as measured by our estimate of the company's fair value.

The Valuentum Dividend Cushion™ has an excellent track record of predicting dividend cuts. For more information, please select the following link (login required):

http://www.valuentum.com/articles/20130528

Valuentum Dividend Growth Newsletter: Volume 5, Issue 4

Valuentum's Dividend Growth Newsletter is published monthly. To receive this newsletter on a monthly basis, please subscribe to Valuentum by visiting our website at http://www.valuentum.com. Or contact us at info@valuentum.com.

Fair Value Range. The fair value range represents an upper bound and lower bound, between which we would consider the firm to be fairly valued. The range considers our estimate of the firm's fair value and the margin of safety suggested by the volatility of key valuation drivers, including revenue, gross margin, earnings before interest, and enterprise free cash flow (the determinants behind our ValueRisk™ rating).

ValueRisk™. This is a proprietary Valuentum measure. ValueRisk™ indicates the historical volatility of key valuation drivers, including revenue, gross margin, earnings before interest, and enterprise free cash flow. The standard deviation of each measure is calculated and scaled against last year's measure to arrive at a percentage deviation for each item. These percentage deviations are weighted equally to arrive at the corresponding fair value range for each stock, measured in percentage terms. The firm's performance is measured along the scale of LOW, MEDIUM, HIGH, and VERY HIGH. The ValueRisk™ rating for each firm also determines the fundamental beta of each firm along the following scale: LOW (0.85), MEDIUM (1), HIGH (1.15), VERY HIGH (1.3).

Dividend Track Record. We assess each firm's dividend track record based on whether the fundamentals of the firm have ever forced it to cut its dividend. If the firm has ever cut its dividend (within the last 10 years), we view its track record as RISKY. If the firm has maintained and/or raised its dividend each year (over the past 10 years), we view its track record as HEALTHY.

Dividend Safety. We measure the safety of a firm's dividend by adding its net cash to our forecast of its future cash flows and divide that sum by our forecast of its future dividend payments. This process results in a ratio called the Dividend Cushion™. Scale: Above 2.75 = EXCELLENT; Between 1.25 and 2.75 = GOOD; Between 0.5 and 1.25 = POOR; Below 0.5 = VERY POOR.

Valuentum Dividend Cushion™. This is a proprietary Valuentum measure that drives our assessment of the firm's Dividend Safety rating. The forward-looking measure assesses dividend coverage via the cash characteristics of the business.

Dividend Growth Potential. We blend our analysis of a firm's Dividend Safety with its historical Track Record, while also considering historical dividend growth trends. We believe such a combination captures a firm's capacity (cash flow) and willingness (track record) to raise its dividend in the future. Scale: EXCELLENT, GOOD, POOR, VERY POOR.

Risk of Capital Loss. We think capital preservation is key for the dividend investor. As such, we evalute the risk of capital loss by assessing the intrinsic value of each firm based on our discounted cash-flow process. If a firm is significantly OVERVALUED, we think the risk of capital loss is HIGH. If a firm is FAIRLY VALUED, we think the risk of capital loss is MEDIUM, and if a firm is UNDERVALUED, we think the risk of capital loss is LOW.

Dividend Strength. Our assessment of the firm's dividend strength is expressed in a matrix. If the safety of a firm's dividend is EXCELLENT and its growth prospects are also EXCELLENT, it scores high on our matrix (top right). If the firm's dividend safety and the potential future growth are VERY POOR, it scores lower on our scale (bottom left).

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Excerpt from *The 13 Steps to Understand the Stock Market*

Step #12: **Valu**e and Mom**entum** Outperform Everywhere

Momentum is the biggest embarrassment to efficient markets (according to the "father of modern finance" and Nobel laureate in Economics, Eugene Fama), academic research continues to conclude that 'Value and Momentum' combined outperform in every market across every asset class, and we continue to demonstrate empirical evidence of the superiority of a combined value-momentum process in the portfolio of our Best Ideas Newsletter. Key takeaway: Value and momentum combined outperform in every market across every asset class.

-- The **Valu**-**entum** Team

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