OUR DIVIDEND GROWTH NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

January 1, 2015
Volume 4 Issue 1

Valuentum Securities Inc.
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Last Alert, Nov 14: Added 100 shares of CSCO at $26.15/shr.

Annualized Return	Annualized Goal	Outperformance
17.1%	Mid-High Single Digits	9.6pts

*Please see note below regarding performance measurement.

Inside This Issue

"Knowing a company can cover its future dividend growth with future cash flows and cash on the balance sheet, a strong Dividend Cushion ratio, helps investors sleep at night." – Brian Nelson, CFA

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

A Hopeful 2015

By Brian Nelson, CFA

Brian Nelson, CFA
President, Equity Research
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Best Dividend Growth Ideas: MO, AAPL, COH, CSCO, CVX, ETP, GE, HAS, HCP, INTC, JNJ, KMI, MDT, MSFT, O, PG, PPL

2014 brought the sixth consecutive year that the Dow Jones Industrial Average (DJIA) posted an annual gain. One has to go back to 1999 to find such a winning streak. The doldrums of the March 2009 panic bottom are gone, and we've not only witnessed impressive gross domestic product expansion in the US (+5% in the third quarter) but unemployment is now approaching what most economists would consider full. Times are good, and in that light, we see no reason why 2015 couldn't make seven consecutive years of gains in the broader stock market indices! I'm hopeful.

Still, any reasonable and seasoned stock market prognosticator will cast a cautious eye on some of the market signals as of late. For one, falling crude oil prices could be considered a positive catalyst for discretionary spending and many of the industries that are heavily exposed to fluctuating prices of oil derivatives, but by itself, lower crude oil (and gas) prices aren't always a good thing. To more bearish-oriented investors, it signals that energy demand is not keeping up with new supply, suggesting that global economic growth may be waning. Most industries in some way shape or form have to use energy to generate revenue and/or invest capital. A depressed price for crude oil is perhaps the biggest red flag heading into 2015, and the one that keeps me up at night the most.

But for now, the Federal Reserve remains the common investors' best friend. The Fed's statement that it would remain "patient" about raising rates continues to offset the reason why crude oil prices are declining (global recession fears), wreckage in the REIT space due to American Realty Capital's (ARCP) accounting shenanigans, and ongoing geopolitical concerns--perhaps best punctuated by the freedom-of-speech issue surrounding the release of *The Interview*. Though not held in the Dividend Growth portfolio (see page 5), the largest defense contractors including Lockheed (LMT) and Boeing (BA) could offer unique opportunities in a very young 2015 (see page 11). Most also pay very healthy and growing dividends. Realty Income (O) remains our favorite REIT idea, though we point to HCP (HCP) as a recent portfolio addition.

This edition of the Dividend Growth Newsletter has a number of interesting articles. We couldn't omit the new developments in the hep-C market (see page 3), nor do we think it would be prudent to leave out potential merger talk in the luxury goods space (see page 16). Importantly, we address a number of outlooks provided by various industry bellwethers for the new year (see page 13). As for our duties in 2015, they'll be more of the same: constant attention to valuations and Dividend Cushion ratios (dividend growth potential) to maximize returns and annual income. Here's to another great year in 2015!

Kinder Morgan: A Dividend Growth Investor's Dream

By Brian Nelson, CFA

Favorite Ideas in Energy for 2015:
CVX, KMI, and ETP

The riskiness of the master limited partnership (MLP) structure is not something to scoff at, especially in the face of declining crude oil prices. Kinder Morgan (KMI)— 4.5% annual yield— will finalize the roll-up of its MLP subsidiaries, and we think holders of Kinder Morgan will literally reap dividends on the move.

Early December brought news that the firm expects to declare dividends of $2 per share in 2015 and post $500 million of excess dividend coverage. The concept of excess dividend coverage is nothing new at Valuentum, as the Dividend Cushion ratio (see page 20) focuses intensively on this very idea. The increase would represent a 16% move over the 2014 budget of $1.72 per share and a nice 4.8% annualized dividend yield. The increase is slightly better than our expectations for a 10% jump in 2015, and we're reiterating our 1+ Dividend Cushion ratio for the newly consolidated entity. Kinder Morgan announced in August that it would purchase KMP, KMR and EPB.

One of the reasons why we're huge fans of the midstream operators is that they own a diversified portfolio of stable and primarily fee-based assets that act more like toll roads, generating gobs of free cash flow, regardless of market conditions and commodity prices. This is unlike risky exploration and production entities that not only take on exploratory risk but also take on risk related to spot prices, if not today's then eventually. Kinder Morgan is more tied to the demand for transportation and storage of natural gas, NGLs, crude oil and refined products than the price of energy.

Here's the rest of Kinder Morgan's 2015 outlook (per its recent press release):

• Generate approximately $8.2 billion in business segment earnings before DD&A (adding back KMI's share of joint venture DD&A).

• Declare over $4.4 billion in dividends to its shareholders.

• Generate additional cash of over $500 million in excess of its dividend.

• Invest approximately $4.4 billion in expansions (including contributions to joint ventures) and small acquisitions.

• Finish the year with a Debt to EBITDA ratio of 5.6 times.

We like Kinder Morgan a lot, and the firm remains a key component in the Dividend Growth portfolio. Very few other companies in the energy sector are more resilient in the face of declining crude oil prices than Kinder Morgan. It is one of our top picks in energy for 2015.

For risk-seeking investors, two stocks that are most exposed to a potential rebound in crude oil prices are Continental Resources (CLR) and EOG Resources (EOG). However, even as we highlight these two firms for consideration, we don't intend to add them to the newsletter portfolios at the moment and are content with our existing exposure. Neither pays a meaningful dividend.

HCV Competition Not New "News" for Gilead

By Brian Nelson, CFA

This article originally appeared on the website Dec 26, 2014.

Let's set one thing straight. On a fundamental basis, biotech firm Gilead Sciences (GILD) is performing quite well, contrary to what its recent stock price move might suggest. Prescriptions for the firm's Harvoni and Sovaldi hepatitis-C drugs continue to track slightly ahead of projections, and we would expect a slightly stronger-than-forecast fourth-quarter report as a result. In coming periods, we look forward to positive management commentary that speaks to the strength and sustainability of the firm's hepatitis-C franchise (about half of Gilead's sales).

Any commentary, in light of the recent uncertainty and growing competition in the hepatitis C market, will be reassuring for investors that have been anxiously pursuing tax-loss selling and profit-taking in Gilead's shares the past few weeks. From our perspective, all is well at Gilead, and good news is forthcoming when the firm reports fourth-quarter results in early February (or late January), if the upcoming J.P. Morgan Healthcare Conference January 13 does not improve sentiment before then. We think patience is in order for new information, and the few weeks after the New Year could bring a wave of buying as fourth-quarter tax-loss sellers reinstate positions in this fundamentally-solid firm.

According to the World Health Organization, 130-150 million people globally have chronic hepatitis C infection, and a significant number of those who are chronically infected will develop liver cirrhosis or liver cancer, with as many as 350,000-500,000 people dying each year from hepatitis C-related liver diseases. According to Gilead, "the worldwide potential for all oral antiviral pan-genotypic HCV cure is sizable with over 12 million infected individuals in commercial markets alone." Chronic hepatitis C affects roughly 3-4 million people in the US, and the majority of these are baby boomers (individuals born between 1945 and 1965). The market for HCV-related treatments is large and growing due to demographic trends, and we think many industry biotech participants will be able to garner various levels of success in the space; it is not an all-or-nothing game. The HCV therapeutic market, by our estimates, continues to be vastly underserved, despite advances in treatments, and only a small fraction of those infected with HCV are actually diagnosed, let alone treated.

The efficacy of Gilead's Solvaldi has been well-established in patients with HCV genotypes 1, 2, 3, or 4 infections, and cure rates are as high as 90%; therapy has been reduced to 8-12 weeks from 24-48 weeks. Solvadi and its successor Harvoni are excellent examples of what we would describe as interferon-free, all-oral regimens that achieve *extremely* high cure rates with fewer side effects. Previous HCV treatments, for example, caused side effects that ranged from bone marrow suppression and fatigue to debilitating rash and anemia. Harvoni's efficacy, by combining the NS5A inhibitor ledipasvir with the nucleotide analog polymerase inhibitor sofosbuvir (Solvadi), is so impressive that it can achieve cure rates in the range of 94%-99%. This efficacy will be difficult for any competing therapy to better.

But competition is a-coming, though it certainly shouldn't be unexpected.

AbbVie (ABBV), 2.9% dividend yield, has made in-roads into the lucrative hep-C market, and we think it, along with Johnson & Johnson (JNJ) and Gilead Sciences (GILD), will act as a rational oligopoly.

Please see *HCV Competition…*on next page

*HCV Competition…*from previous page

Litigation regarding Sovaldi covers a large portion of Gilead's regulatory filings ranging from contract arbitration with Jeremy Clark—a former employee and inventor of a patent that claims metabolites of sofosbuvir and RG7128—and arbitration with Roche regarding the exclusive license to sofosbuvir to interference proceedings and litigation with Merck's (MRK)—3.0% annual dividend yield—Idenix and litigation with Merck itself that requests Gilead pay royalties on the sales of sofosbuvir. It is only that the news has been so prominent related to litigation with AbbVie (ABBV)—2.9% annual dividend yield, which recently obtained patents that claim the use of a combination of LDV (ledipasvir)/SOF (sofosbuvir) for the treatment of HCV, that the most attention has been given to the recent Abbott (ABT)—2.0% annual dividend yield—spin-off. The stakes are high, and participants want a piece of the lucrative HCV market. We won't know the final decisions of these cases for some time, but the likelihood of an adverse ruling materially hurting Gilead is low, in our view. Instead, we think it is more likely that AbbVie or Merck will acquire Gilead in the future rather than destroy value in the HCV market through the court system.

There are a number of therapies that compete with Sovaldi and Harvoni. Johnson & Johnson (JNJ)—2.6% annual dividend yield—Janssen's Olysio (simeprevir), Merck's Victrelis, and Vertex's (VRTX) Incivek (telaprevir) are a few antivirals that come immediately to mind, though the latter two aren't specifically indicated as such. AbbVie's Viekira Pak was recently approved by the FDA. "Viekira Pak contains three new drugs—ombitasvir, Enanta's (ENTA) paritaprevir and dasabuvir—that work together to inhibit the growth of HCV…Viekira Pak is the fourth drug product approved by the FDA in the past year to treat chronic HCV infection. The FDA approved Olysio (simeprevir) in November 2013, Sovaldi (sofosbuvir) in December 2013 and Harvoni (ledipasvir and sofosbuvir) in October 2014 (source: FDA)." Further, Achillion Pharmaceuticals (ACHN) believes its HCV regimen has "best in-disease" performance, though results so far have extended only to a Phase 2 "Proxy Study" and use sofosbuvir for treatment.

The HCV-landscape continues to evolve, and there is plenty of room for a number of players in this space, including the big 3: Johnson & Johnson, Gilead, and now AbbVie. At the moment, we believe that Gilead's Harvoni is the most efficacious, as Viekira Pak trials showed a bigger and lower bottom-rung of cure rates (91%-100%), compared to Gilead's Harvoni registering a much tighter range of 94%-99%. Those using the Viekira Pak reported side effects of feeling tired, itching, feeling weak or lack of energy, nausea and trouble sleeping; the most common side effects of Harvoni include tiredness and headache. The Viekira Pak is four-to-six pills per day, while Harvoni is only a single pill taken daily, so convenience also appears to edge in Gilead's favor.

Cause for concern over a pricing war in the HCV market also appears overblown. A standard course of treatment for Sovaldi costs $84,000, while Harvoni is priced in the neighborhood of $94,500. AbbVie is expected to price the Viekira Pak regimen at ~$83,319 per patient per 12-week course – hardly signaling a price war. In fact, the Viekira Pak pricing scheme is rational and perhaps, dare we say, a best-case scenario for Gilead. We would have grown more concerned if, on the other hand, the list price for the Viekira Pak had been set drastically below than that of Solvaldi/Harvoni – say at $10,000 per regimen. It appears that AbbVie will be a rational participant in the HCV market.

Please see *HCV Competition…*on page 6

The Dividend Growth Portfolio

Annualized Return	Annualized Goal	Outperformance
17.1%	Mid-High Single Digits	9.6pts

DIVIDEND GROWTH PORTFOLIO -- as of January 1, 2015 — Dividend Growth Portfolio Inception Date: January 1, 2012

Company Name	First Purchase	Avg Cost ($)	# of Shares	Total Cost ($)	Last Close	Current Value ($)	% of Portfolio	Exp. Yrly Div's ($)
Altria (MO)	12/30/2011	29.65	202	5,996.30	49.27	9,952.54	6.2%	420.16
Apple (AAPL)	7/24/2013	63.17	77	4,870.76	110.38	8,499.26	5.3%	144.76
Chevron (CVX)	12/30/2011	106.40	56	5,965.40	112.18	6,282.08	3.9%	239.68
Cisco (CSCO)	11/14/2014	26.15	100	2,622.00	27.82	2,782.00	1.7%	76.00
Coach (COH)	9/19/2014	37.55	80	3,011.00	37.56	3,004.80	1.9%	108.00
Energy Transfer (ETP)	12/30/2011	45.85	142	6,517.70	65.00	9,230.00	5.7%	553.80
General Electric (GE)	10/21/2013	26.18	240	6,290.20	25.27	6,064.80	3.8%	211.20
Hasbro (HAS)	12/30/2011	31.89	220	7,022.80	54.99	12,097.80	7.5%	378.40
HCP (HCP)	9/19/2014	40.11	75	3,015.25	44.03	3,302.25	2.1%	163.50
Intel (INTC)	12/30/2011	24.25	289	7,015.25	36.29	10,487.81	6.5%	277.44
Johnson & Johnson (JNJ)	12/30/2011	65.58	107	7,024.06	104.57	11,188.99	7.0%	299.60
Kinder Morgan (KMI)	10/22/2014	38.72	157	6,086.04	42.31	6,642.67	4.1%	276.32
Medtronic (MDT)	12/30/2011	38.25	157	6,012.25	72.20	11,335.40	7.1%	191.54
Microsoft (MSFT)	12/30/2011	25.96	308	8,002.68	46.45	14,306.60	8.9%	381.92
Proctor & Gamble (PG)	12/30/2011	66.71	105	7,011.55	91.09	9,564.45	6.0%	269.85
PP&L (PPL)	12/30/2011	29.42	238	7,008.96	36.33	8,646.54	5.4%	354.62
Realty Income (O)	7/24/2013	44.35	60	2,668.00	47.71	2,862.60	1.8%	132.00

Last Trade: CSCO was added to the portfolio November 14.

Cash				2,363.42		24,359.87	15.2%	4,478.79
Dividend Growth Portfolio				100,000.00		**160,610.46**	100.0%	TBD
DG Portfolio Annualized Return (from inception through current date)								**17.1%**
DG Portfolio Annualized Return Goal (Mid-to-High Single Digit Returns)								7.5%
DG Portfolio Annualized Return Outperformance								**9.6%**

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 January 1, 2015. Cost basis includes commissions. Results include divdends, but no interest received on cash balance.

DIVIDEND GROWTH PORTFOLIO -- as of January 1, 2015

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)	2.08	4.22%	mid-Mar 2015	mid Mar 2015 (quart)	1.1	GOOD	GOOD	$47.00	6	1.05
Apple (AAPL)	1.88	1.70%	early-Feb 2015	Feb 2015 (quart)	4.7	EXCELLENT	EXCELLENT	$135.00	6	0.82
Chevron (CVX)	4.28	3.82%	mid-Feb 2015	early Mar 2015 (quart)	1.3	GOOD	EXCELLENT	$116.00	3	0.97
Cisco (CSCO)	0.76	2.73%	early Jan 2015	early Jan 2015 (quart)	3.4	EXCELLENT	EXCELLENT	$33.00	9	0.84
Coach (COH)	1.35	3.59%	early Mar 2014	early Mar 2015 (quart)	1.9	GOOD	EXCELLENT	$49.00	9	0.77
Energy Transfer (ETP)	3.90	6.00%	late Jan 2015	Feb 2015 (quart)	2.5	GOOD	GOOD	$67.00	7	0.97
General Electric (GE)	0.88	3.48%	early Mar 2015	Mar 2015 (quart)	2.3	GOOD	GOOD	$32.00	6	0.79
Hasbro (HAS)	1.72	3.13%	late Jan 2015	mid Feb 2015 (quart)	1.9	GOOD	EXCELLENT	$62.00	6	0.89
HCP (HCP)	2.18	4.95%	early Feb 2015	early Feb 2015 (quart)	1.8	GOOD	GOOD	$47.00	6	0.94
Intel (INTC)	0.96	2.65%	early Feb 2015	early Mar 2015 (quart)	2.1	GOOD	GOOD	$33.00	6	1.10
Johnson & Johnson (JNJ)	2.80	2.68%	late Feb 2015	early Mar 2015 (quart)	2.3	GOOD	EXCELLENT	$110.00	6	0.95
Kinder Morgan (KMI)	1.76	4.16%	late Jan 2015	mid Feb 2015 (quart)	1.2	GOOD	GOOD	$41.00	6	1.03
Medtronic (MDT)	1.22	1.69%	early Apr 2015	Apr 2015 (quart)	4.1	EXCELLENT	EXCELLENT	$72.00	7	1.00
Microsoft (MSFT)	1.24	2.67%	mid Feb 2015	mid Mar 2015 (quart)	3.3	EXCELLENT	EXCELLENT	$58.00	7	0.80
Proctor & Gamble (PG)	2.57	2.82%	mid Jan 2015	early Feb 2015 (quart)	1.7	GOOD	EXCELLENT	$84.00	7	1.08
PP&L (PPL)	1.49	4.10%	early Mar 2015	early Mar 2015 (quart)	Held for diversification reasons.			$35.00	6	1.04
Realty Income (O)	2.20	4.61%	monthly	monthly	1.9	GOOD	GOOD	$60.00	7	0.80

***HCV Competition…*from page 4**

By extension, we believe AbbVie had to offer a 30%-35% discount to land the deal with Express Scripts (ESRX) because its product could potentially be viewed as an inferior, four-to-six pills-a-day, less-efficacious regimen by physicians. Additionally, Express Scripts seems to be mounting pressure on all drug makers, revealing that the discount will hardly be an HCV-specific issue. From our perspective, however, price will be only one deciding factor when it comes to human health, and ultimately we believe a patient's doctor will determine overall HCV market share, even if physicians encounter obstacles across the PBM chain. Some doctors, for example, may refuse to switch regimens. In fact, the AbbVie/Express Scripts deal seems to fly in the face of increasing patient treatment options (one of the goals of modern medicine), and we would not be surprised if Express Scripts eventually backs off a bit with its exclusivity clause.

In any case, given that a large portion of the HCV market is the baby-boomer generation (which may already take a number of pills daily), even with Express Scripts, the Viekira Pak may not move the market-share needle too much, or not as much as market observers believe. The Viekira Pak may generate $2-$3 billion in sales during 2015, or about what Solvaldi did during the most recent third quarter alone, which was depressed due to impending Harvoni sales. From our point of view, Johnson & Johnson, AbbVie, and Gilead are "still playing nicely in the sandbox," and it appears a rational oligopoly is present. Neither firm has any incentive to destroy the HCV-market value pie, especially as litigation ensues.

Wrapping Things Up

Gilead Sciences continues to trade like a stock that is experiencing tax-loss selling and profit taking, not one that is fundamentally (or technically) in much trouble. We think the HCV market is a rational oligopoly, and eventually, we would expect Express Scripts to lighten up exclusivity on account of improving patient treatment options. From our perspective, physicians will ultimately decide which HCV treatment is most appropriate for patients, and on the basis of efficacy and convenience, Gilead's Harvoni still appears to be a very, very good option, if not the best.

We think news flow over the next several weeks will improve at Gilead as a result of positive management commentary at an upcoming conference and as we near the firm's fourth-quarter results, which we expect to be strong. Our fair value estimate for Gilead remains unchanged at ~$150 per share, and our technical evaluation of the firm indicates that support is healthy. Consensus estimates reveal a stock that is trading at just 10 times 2015 earnings, and even under a bear-case scenario where expected earnings are slashed by 35% next year, Gilead's shares are still trading at a very digestible 14 times 2015 earnings.

Market participants are being way too punitive with Gilead's shares, and the weighting of the firm in the Best Ideas portfolio remains unchanged in light of recent events. Shares could fall to as low as $70 each before we would become concerned technically. The company closed above $90 per share before the Christmas holiday.

Valuentum Buying Index Rating Case Study

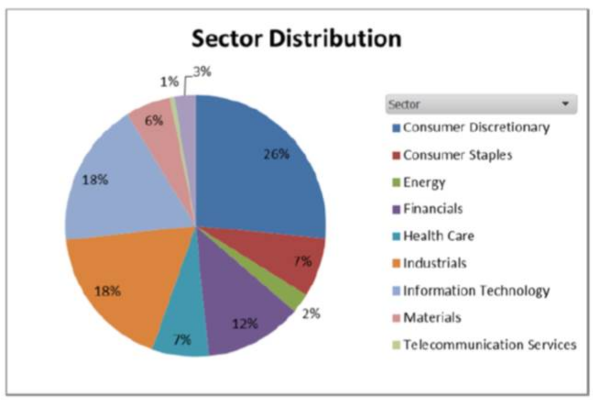
By Valuentum Analysts

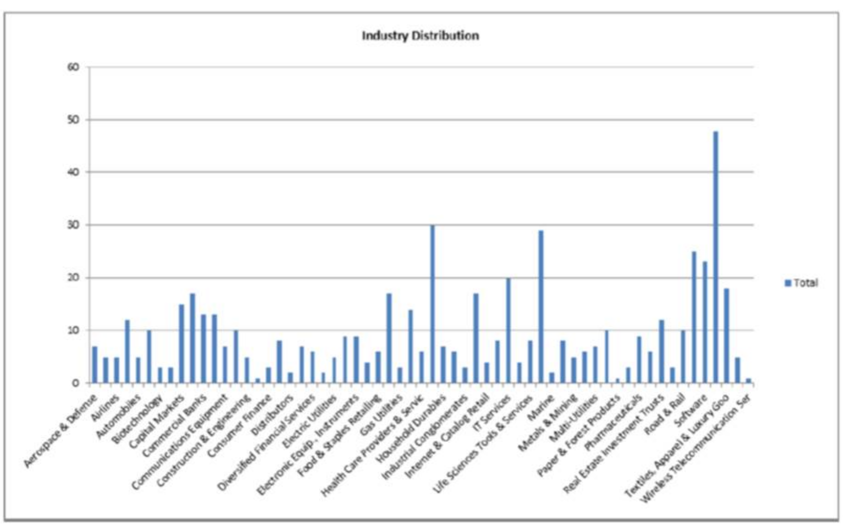
On September 30, 2013, Valuentum was tasked by an institutional money manager to assign Valuentum Buying Index (VBI) ratings individually to companies in a portfolio of 570 stocks. The companies were assigned to Valuentum directly from the institutional money manager. Valuentum did not have any prior knowledge of the companies or any of their qualities with respect to such items as market capitalization, sector, industry, etc. In no way did Valuentum have any influence over the selection of the companies. The Valuentum Buying Index was targeted for portfolio optimization and weighting considerations with no time horizon defined.

Universe

The stocks assigned to Valuentum totaled 570. The sector and industry distributions are displayed below. Where complete data is available, the average of the last fiscal year revenue for the stocks selected was approximately $13 billion, with a range of $438.2 billion (b) to $39.8 million (m). The average market capitalization for companies included in the study was $26.1 billion, with a range of $662.9 billion (b) to $214 million (m). Roughly two thirds of the companies included in the study paid a dividend, with the average yield of ~1.9% for those paying a dividend. The descriptive statistics are approximate of the group at the end of the study. The universe spanned all sectors, industries, market capitalizations, and dividend characteristics.

Row Labels	Count of Sector
Consumer Discretionary	151
Consumer Staples	42
Energy	14
Financials	69
Health Care	40
Industrials	102
Information Technology	102
Materials	32
Telecommunication Services	3
Utilities	15
Grand Total	**570**





Please see *Valuentum Buying Index…*on next page

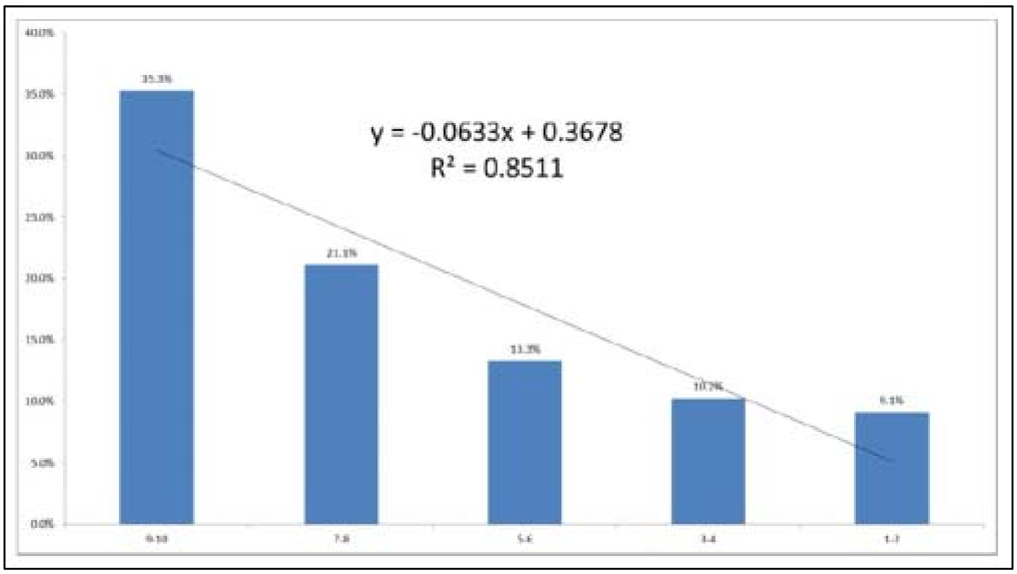
***Valuentum Buying Index…*from previous page**

…to access the full case study: http://www.valuentum.com/articles/20141003_1

Applications

In the study, the Valuentum Buying Index acted as a portfolio optimization tool, highlighting outperforming stocks from underperforming stocks within a very diverse portfolio provided by an institutional money manager. The study showed the efficacy and implications of using the Valuentum Buying Index as a portfolio management optimization tool (i.e. the incremental alpha that could be attained by overweighting high-VBI rated stocks and underweighting low-VBI rated stocks without altering selection).

Though not used as such in the study, the Valuentum Buying Index can also be used as an idea-generator to further enhance portfolio returns. For example, the one idea that registered a Valuentum Buying Index rating of a 10 at the beginning of the study was Baidu (BIDU)—not included in study. Shares of Baidu (BIDU) gained 40.6% over the time period measured ($155.18 → $218.23). Adding Baidu to the individual VBI return distribution significantly enhances its R-squared value, all else equal.



General Electric Is Still in Good Shape

By Brian Nelson, CFA

General Electric (GE)—3.5% annual dividend yield—continues to represent a rare opportunity for dividend growth investors.

Most (not all) dividend growth investors *seem to* dedicate their analysis to what has happened to the dividend in the past, instead of thinking about what will happen to the dividend in the future – not next quarter or next year, but over the next 5, 10, 20 years. Holdings in the Dividend Growth portfolio aren't chosen because they are heroes of yesteryear, but instead, they are chosen because we think they will be the best dividend growth performers in the future. In this light, we think GE continues to be shunned by new dividend growth investors that are looking to its dividend cut in 2009 as a means to not own the stock. We simply don't think that's fair, as the past…well…it's the past.

Please see *General Electric…*on next page

*General Electric …*from previous page

Today, GE is fundamentally a different company. No longer is it beholden to the outsize credit risks related to far-reaching financial operations that forced it to cut its dividend. In the third quarter of 2014 alone, the company completed the successful IPO of Synchrony Financial and moved forward its plans to shed the GE Money Bank AB (Nordics) consumer finance unit. Though its Alstom energy acquisition could have been better-timed and better-structured, GE remains on track with its strategy to achieve 75% of its earnings from its Industrial businesses in 2016, and *the firm is well on its way to permanently reducing the risk that caused it to slash its dividend in the past*.

On December 16, the industrial conglomerate released an investor presentation titled "The Pivot." Though the firm noted ongoing challenges with respect to lower oil prices, Russia (RSX), and foreign-exchange volatility, it pointed to the strong recovery in the US, strength in air (aviation in China), rail (global locomotives) and US healthcare, as well as global infrastructure demand as key positives. GE thinks China (FXI) is "still ok," and mentioned cheaper oil as a potential catalyst from struggling Japanese (EWJ) and European economies.

Within its industrial operations, management expects Alstom synergies, a broader focus on gross profit, and more scale with a simpler foundation to propel industrial earnings. Industrial segment organic growth of 2%-5% in 2015 is achievable, and the firm expects industrial segment margins to reach 17% by 2016, which is quite notable given headwinds in its energy segment, where operating profit is expected to fall just ~0%-5% despite plunging crude oil prices. Aggregate industrial segment return on total capital measures are expected to be very solid during the next couple years.

GE is targeting earnings per share in 2015 in the range of $1.70-$1.80 (with the industrial segment accounting for about $1.10-$1.20 of the total). Cash flow from operations in 2015 will be a very, very healthy $14-$16 billion. The executive suite is anticipating earnings per share growth in 2016, even after the Synchrony split. The company is on solid ground.

Wrapping Up the Pitch

We simply think investors don't believe the transformational story behind GE. The company is trading at ~13.5 times 2015 earnings, and in a market that is offering 20+ multiples to any firm with a 3% dividend yield (whether earnings are growing or not), GE is simply mispriced and being left out in the cold. To us, the transformation story is obvious, and the valuation opportunity is tremendous, especially as investors are paid with a nice healthy dividend to wait. We'd grow mighty interested in adding to the positions in the newsletter portfolios under any further weakness. Our fair value estimate of GE is $32 per share.

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 is near fully-invested, 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.

Name	Symbol	Industry	Div Yield	VBI	Div Growth	Div Cushion
Kinder Morgan Partners	KMP	Oil & Gas Pipelines	5.9%	6	EXCELLENT	2.1
Energy Transfer Partners	ETP	Oil & Gas Pipelines	5.8%	7	GOOD	2.5
Universal Health Realty	UHT	REIT - Healthcare	5.6%	6	GOOD	2.1
Holly Energy	HEP	Oil & Gas Pipelines	5.5%	6	EXCELLENT	1.8
Corrections Corp	CXW	Management Services	5.5%	7	EXCELLENT	1.3
Omega Healthcare	OHI	REIT - Healthcare	5.4%	7	EXCELLENT	1.9
HCP	HCP	REIT - Healthcare	5.0%	6	GOOD	1.8
Realty Income Corp	O	REIT - Retail	4.8%	7	EXCELLENT	1.9
Healthcare Realty Trust	HR	REIT - Healthcare	4.8%	6	GOOD	1.9
Health Care REIT	HCN	REIT - Healthcare	4.7%	6	GOOD	2.1
Brookfield Infrastructure	BIP	Utilities	4.6%	6	GOOD	1.1
Reynolds American	RAI	Tobacco	4.6%	7	GOOD	1.1
Verizon	VZ	Telecom Services - diversified	4.4%	7	GOOD	2.0
Ventas	VTR	REIT - Healthcare	4.4%	7	EXCELLENT	1.6
Altria Group	MO	Tobacco	4.2%	6	GOOD	1.1
Rio Tinto	RIO	Mining - diversified	4.2%	6	EXCELLENT	2.4
Retail Properties of America	RPAI	REIT - Retail	4.1%	6	EXCELLENT	2.8
Ameren	AEE	Utilities	4.0%	6	GOOD	1.5
Cracker Barrel	CBRL	Restaurants - Fast Cas & Full Svc	4.0%	6	GOOD	1.2
Entergy	ETR	Utilities - Large	4.0%	6	GOOD	1.5
Unilever N.V.	UN	Food Products - Large	3.8%	7	EXCELLENT	1.3
Unilever PLC	UL	Food Products - Large	3.7%	7	EXCELLENT	1.3
Coach	COH	Luxury - Ultra & Aspirational	3.7%	9	EXCELLENT	1.9
Computer Prog and Syst	CPSI	Medical Srvc Providers	3.6%	6	EXCELLENT	1.6
Thomson Reuters Corp	TRI	Securities Research	3.5%	7	GOOD	1.2
American Eagle	AEO	Retail - Under 30	3.5%	6	EXCELLENT	2.4

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 January 1, 2015

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)	3.42	2.08%	1.9	GOOD	EXCELLENT	$ 123.00	6	1.34	164.32
Abbott (ABT)	0.88	1.95%	3.5	EXCELLENT	GOOD	$ 41.00	5	1.10	45.02
AbbVie (ABBV)	1.96	3.00%	1.9	GOOD	EXCELLENT	$ 58.00	6	1.13	65.44
ADP (ADP)	1.96	2.35%	6.0	EXCELLENT	EXCELLENT	$ 94.00	3	0.89	83.37
Analog Devices (ADI)	1.48	2.67%	2.8	EXCELLENT	EXCELLENT	$ 52.00	3	1.07	55.52
Becton, Dickinson (BDX)	2.40	1.72%	2.5	GOOD	EXCELLENT	$ 108.00	3	1.29	139.16
Bob Evans (BOBE)	1.24	2.42%	1.6	GOOD	EXCELLENT	$ 45.00	3	1.14	51.18
Boeing (BA)	2.92	2.25%	3.0	EXCELLENT	EXCELLENT	$ 133.00	3	0.98	129.98
Chicago Rivet (CVR)	0.72	2.34%	2.9	EXCELLENT	GOOD	$ 33.00	3	0.93	30.76
Coca-Cola (KO)	1.22	2.89%	1.7	GOOD	EXCELLENT	$ 37.00	6	1.14	42.22
Colgate-Palmolive (CL)	1.44	2.08%	1.9	GOOD	EXCELLENT	$ 56.00	3	1.24	69.19
Cracker Barrel (CBRL)	4.00	2.84%	1.2	GOOD	GOOD	$ 116.00	6	1.21	140.76
Deere (DE)	2.40	2.71%	1.9	GOOD	EXCELLENT	$ 88.00	6	1.01	88.47
Dover (DOV)	1.60	2.23%	2.5	GOOD	EXCELLENT	$ 86.00	4	0.83	71.72
DuPont (DD)	1.88	2.54%	2.1	GOOD	GOOD	$ 69.00	4	1.07	73.94
Eli Lilly (LLY)	1.96	2.84%	2.0	GOOD	GOOD	$ 57.00	6	1.21	68.99
Exxon Mobil (XOM)	2.76	2.99%	1.9	GOOD	EXCELLENT	$ 91.00	3	1.02	92.45
General Dynamics (GD)	2.48	1.80%	3.2	EXCELLENT	EXCELLENT	$ 106.00	6	1.30	137.62
Genuine Parts (GPC)	2.30	2.16%	1.8	GOOD	EXCELLENT	$ 81.00	6	1.32	106.57
H&R Block (HRB)	0.80	2.38%	4.4	EXCELLENT	GOOD	$ 35.00	3	0.96	33.68
Harris (HRS)	1.88	2.62%	1.9	GOOD	EXCELLENT	$ 72.00	3	1.00	71.82
Honeywell (HON)	2.07	2.07%	3.1	EXCELLENT	EXCELLENT	$ 92.00	3	1.09	99.92
Hormel Foods (HRL)	0.80	1.54%	3.1	EXCELLENT	EXCELLENT	$ 45.00	4	1.16	52.10
IBM (IBM)	4.40	2.74%	2.6	GOOD	EXCELLENT	$ 173.00	3	0.93	160.44
Illinois Tool Works (ITW)	1.94	2.05%	3.0	EXCELLENT	EXCELLENT	$ 85.00	4	1.11	94.70
Kimberly-Clark (KMB)	3.36	2.91%	1.3	GOOD	EXCELLENT	$ 103.00	4	1.12	115.54
Lockheed Martin (LMT)	6.00	3.12%	1.9	GOOD	EXCELLENT	$ 149.00	6	1.29	192.57
Mattel (MAT)	1.52	4.91%	1.3	GOOD	EXCELLENT	$ 36.00	4	0.86	30.95
Merck (MRK)	1.80	3.17%	2.3	GOOD	GOOD	$ 54.00	7	1.05	56.79
Northrop Grumman (NOC)	2.80	1.90%	3.0	EXCELLENT	EXCELLENT	$ 138.00	6	1.07	147.39
Occidental Petrol (OXY)	2.88	3.57%	1.7	GOOD	EXCELLENT	$ 101.00	6	0.80	80.61
Owens & Minor (OMI)	1.00	2.85%	1.7	GOOD	EXCELLENT	$ 33.00	4	1.06	35.11
Paychex (PAYX)	1.52	3.29%	2.9	EXCELLENT	EXCELLENT	$ 42.00	6	1.10	46.17
Phillip Morris (PM)	4.00	4.91%	1.0	GOOD	GOOD	$ 86.00	4	0.95	81.45
Raytheon (RTN)	2.42	2.24%	2.9	EXCELLENT	EXCELLENT	$ 92.00	7	1.18	108.17
St. Jude (STJ)	1.08	1.66%	2.9	EXCELLENT	EXCELLENT	$ 70.00	4	0.93	65.03
Texas Instr (TXN)	1.36	2.54%	1.6	GOOD	EXCELLENT	$ 41.00	3	1.30	53.47
United Technologies (UTX)	2.36	2.05%	1.8	GOOD	EXCELLENT	$ 113.00	4	1.02	115.00
UPS (UPS)	2.68	2.41%	2.0	GOOD	EXCELLENT	$ 102.00	6	1.09	111.17
VF Corp (VFC)	1.28	1.71%	2.3	GOOD	EXCELLENT	$ 54.00	7	1.39	74.90
Verizon (VZ)	2.20	4.70%	2.0	GOOD	GOOD	$ 56.00	7	0.84	46.78
Walgreen (WAG)	1.35	1.78%	1.9	GOOD	EXCELLENT	$ 58.00	3	1.31	76.05
Wal-Mart (WMT)	1.92	2.24%	1.5	GOOD	EXCELLENT	$ 75.00	6	1.15	85.88

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:

Name	Symbol	Industry	Est. Div Yield	Div Safety	Div Cushion
CONSOL Energy	CNX	Industrial Minerals	0.7%	VERY POOR	-10.7
Range Resources	RRC	Independent Oil & Gas	0.2%	VERY POOR	-10.1
Ryder System	R	Rental and Leasing	1.6%	VERY POOR	-8.8
Barrick Gold	ABX	Metals & Mining - gold	1.2%	VERY POOR	-8.6
Cablevision	CVC	Media - CATV	2.9%	VERY POOR	-7.7
Peabody Energy	BTU	Industrial Minerals	2.8%	VERY POOR	-7.6
Tidewater	TDW	Energy Equipment	3.0%	VERY POOR	-5.3
Roundy's Inc	RNDY	Food Retailers	14.5%	VERY POOR	-5.3
Chesapeake	CHK	Independent Oil & Gas	1.3%	VERY POOR	-5.3
Cliffs Natural Resources	CLF	Mining - diversified	8.9%	VERY POOR	-5.2
Newmont Mining	NEM	Metals & Mining - gold	0.4%	VERY POOR	-3.7
TAL Intl	TAL	Rental and Leasing	6.4%	VERY POOR	-3.2
MDC	MDC	Homebuilders	4.0%	VERY POOR	-3.2
Textainer	TGH	Rental and Leasing	5.3%	VERY POOR	-3.1
Service Corp Intl	SCI	Personal Services	1.5%	VERY POOR	-2.6
Yamana Gold	AUY	Metals & Mining - gold	2.1%	VERY POOR	-2.5
Quad/Graphics Inc	QUAD	Book Publishing	6.1%	VERY POOR	-2.1
DineEquity	DIN	Restaurants - Fast Cas & Full Svc	3.6%	VERY POOR	-2.0
Windstream	WIN	Telecom Services - diversified	10.0%	VERY POOR	-1.9
Murphy Oil	MUR	Refiners	2.5%	VERY POOR	-1.6
Frontier Comm	FTR	Telecom Services - diversified	5.8%	VERY POOR	-1.5
Time Warner Cable	TWC	Media - CATV	2.0%	VERY POOR	-1.5
Noble Energy	NBL	Independent Oil & Gas	1.0%	VERY POOR	-1.4
Centurylink	CTL	Telecom Services - diversified	5.3%	VERY POOR	-1.4
American Tower	AMT	Wireless Telecom Services	1.4%	VERY POOR	-1.1
ConAgra Foods	CAG	Food Products - Large	2.7%	VERY POOR	-1.0
Regal	RGC	Movie Production	4.6%	VERY POOR	-1.0
Apache	APA	Independent Oil & Gas	1.0%	VERY POOR	-1.0

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

Gearing Up for 2015 Outlooks

By Brian Nelson, CFA

Though the firms below aren't included in the newsletter portfolios, we keep a close eye on them should an opportunity ever present itself. Not only are they fantastic companies with strong business models, but they also provide insight into the broad industries in which they operate. With only a couple weeks left in 2014, management teams are actively preparing their budgets for 2015. Let's have a look at what a few bellwethers have been saying about their outlooks for next year.

Industrial Bellwether 3M (MMM)—2.2% annual dividend yield

The maker of Post-it notes has become the poster child of aggressive dividend growth policy as of late. Having traditionally raised its dividend a penny or two per year in the past, 3M upped the payout by more than $0.22 per share for 2014, to $0.855 per quarter, and then raised it December 16 by another $0.17 per share (a 20% increase), to $1.025 per quarter beginning in 2015. On the basis of 3M's Dividend Cushion ratio of 1.9, we were expecting another big hike in the payout, but this pace of expansion will have to let up soon. The firm said it expects organic growth, ex-currency, to increase 3%-6% in 2015 and that earnings for the year would come in between $8.00-$8.30, bounding consensus of ~$8.20 per share. You won't hear us say anything bad about 3M because it truly is a fantastic company, but at nearly $160 per share, investors are paying up for the company's dividend growth potential, and this may not be wise if interest rates begin to head north in a hurry. The high end of our fair value estimate range for 3M is $145 per share at the time of this writing, implying downside risk.

Housing-related Bellwether Whirlpool (WHR)—1.6% annual dividend yield

Whirlpool continues to register a 9 on the Valuentum Buying Index, and the company has surged from under $130 per share to nearly $160 per share at the time of this writing. The leading manufacturer and marketer of major home appliances has significant operating leverage in its business model, where a small increase in sales has a very large impact on the bottom line. By our estimates, there remains a significant gap between "normal" annual appliance demand (as measured by US T7 industry shipments), and the current pace of unit sales. We've included the firm as one of our favorite housing related ideas in the past, and Whirlpool continues to deliver. Looking ahead, the firm said it expects full-year ongoing business earnings per diluted share of $14-$15 in 2015 and $700-$800 million in free cash flow generation for the year, in-line with consensus. We regret not adding it to the Best

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Consumer-related Bellwether Coca-Cola (KO)—2.9% annual dividend yield

Coca-Cola is included in a lot of investor portfolios thanks in part to its brand awareness, but the company has had better times. The firm's results were one of the bigger disappointments during third-quarter earnings season, and it recently reiterated its meager outlook for 2015. The beverage giant does not expect currency-neutral 2015 earnings per share growth to be "significantly different" from 2014, and foreign exchange is anticipated to provide a stiff headwind to performance during 2015. At more than $40 per share, the company is trading at nearly 20 times 2015 expected earnings, which aren't expected to grow at any "significant" pace. We value shares in the mid-to-high $30s per share, and we note that we are being rather generous with the discount rate in the model given Coca-Cola's easy ability to access capital. Under a more punitive scenario, we could see Coca-Cola's shares drop 10% or more, and we wouldn't think much of it given both earnings and the pace of expansion. The company's dividend remains healthy, however.

Aerospace & Defense Bellwether Boeing (BA)—2.3% annual dividend yield

Orders continue to pile in for commercial airplanes, and we think the multi-year backlogs of unfulfilled deliveries at Boeing and Airbus (EADSY) are a key asset to any investment thesis in the commercial aerospace supply chain. For the airframe makers, however, the question is not whether there is burgeoning demand (there is), the question is whether they'll be able to translate such unit demand into increased profitability and cash-flow generation.

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Boeing-rival Airbus, for example, recently noted that it expects flat profits in 2016 as it deals with sluggish performance from the A380 superjumbo as well as production and pricing uncertainty related to the A330. The long-awaited A350 is expected to be delivered December 22 to Qatar Airways, and while we think Airbus will be able to return to significant profit growth post-2016, we don't think we've seen the last of production-related issues to the new A350 or even its A380 superjumbo.

Boeing's third-quarter report showed a peculiar and unwelcome decline in cash-flow generation, and management is working to assuage concerns by upping its dividend and buyback program, which it announced December 15. The commercial aerospace giant increased its quarterly dividend 25%, to $0.91 per share, up from $0.73 per share previously and said that it would increase its repurchase authorization to $12 billion from the $4.8 billion that had been left. We like Boeing a lot, but we like the commercial aerospace supply chain better, as most constituents are not dependent on whether Boeing or Airbus wins the global aerospace duopoly. Firms such as Precision Castparts (PCP)—0.1% annual dividend yield—and Rockwell Collins (COL)—1.4% annual dividend yield, for example, are much better positioned.

Industrial Bellwether Honeywell (HON)—2.1% annual dividend yield

As with many of the industrial conglomerates, Honeywell is a fantastic company with a deep executive bench of talent. The firm recently showcased its strength during the third quarter, and management guided 2015 organic sales growth to ~4% and earnings per share in the range of $5.95-$6.15 per share, with free cash flow expected to come in at $4.2-$4.3 billion, a very impressive outlook. The firm continues to raise its dividend, and we view its payout as very healthy. Honeywell's valuation opportunity isn't as compelling, however, as our fair value estimate of shares falls roughly in-line with where the company is trading at the moment. We think a better entry point can be had with Honeywell in the next few years.

Merger Talk: Coach May Be In Play

By Brian Nelson, CFA

With interest rates at lows, the equity markets at all-time highs, and executive teams looking for strategic and opportunistic growth opportunities, the table is set for some wheeling and dealing, in our view. We think Coach (COH)—4.0% annual dividend yield, the aspirational maker of handbag and accessories, is on the radar of a number of suitors, the most likely being LVMH Moet Hennessy (LVMHF), according to Prime Retailer:

> LVMH groups representatives have recently shown interest in Coach, sources say. Recent shows and fashion line has appealed to the design team of LVMH, one of the persons admits. It could be the turnaround that attracts LVMH – turning its attention from classical high end luxury accessories label to full RTW apparel lineup.

There are five reasons why we think Coach may be attractive to a potential acquirer:

1) The company's shares are dirt cheap. Shares of Coach have been punished recently as a result of poor performance from its North American women's handbag business. However, we value the company at nearly $50 per share, materially higher than its $35 per share price tag. During fiscal 2013, the company earned more than $3.60 per share on a diluted basis, putting its valuation at roughly 10 times *achievable* earnings should it turn around its North American business, and this valuation excludes its robust net cash position on the balance sheet. Coach's attractive price tag sets the table for an opportunistic play from a potential suitor, in our view.

2) Coach's balance sheet is extremely healthy. Unlike situations where a struggling firm may need a white knight to ensure survival, a suitor would not be bailing out Coach in any way. To the contrary, Coach is quite healthy. The firm had more than $860 million in net cash and just $140 million in current and long-term debt on the balance sheet as of mid-2014. In this light, we think its robust financial profile makes a deal much easier to consummate, as a suitor would not have a difficult time lining up debt financing. From a financial standpoint, Coach is an investment-grade credit, which was reiterated by Moody's in the company's recent unsecured shelf registration.

3) Coach's free cash flow generation is solid. The company's cash-flow generating profile is quite robust, and we think this is a key attribute to getting any deal done. Coach generated over $765 million in traditional free cash flow (cash from operations less capital expenditures) during fiscal 2014, and its free cash flow generation in fiscal 2013 and fiscal 2012 was even better. Under any combination, a potential suitor would not have to absorb its own pre-merger free cash flow to support Coach's operations. In fact, Coach's excess cash flow could be used to help support the strategy of the potential acquirer's portfolio. This would be a win for any suitor.

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4) It is common for luxury companies to hold a large portfolio of brands. Richemont (CFRUY), for example, has a luxury-goods portfolio that includes such prestigious names as Cartier, Van Cleef & Arpels, Piaget, Vacheron Constantin, and Montblanc, among others. LVMH Moet Hennessy has over 60 prestigious brands spanning segments such as wines & spirits, fashion & leather goods, perfumes & cosmetics, watches & jewelry, and selective retailing. Brand diversification is important to reduce the fashion risk that is typically inherent to a luxury-good maker's operations.

In 2011, LVMH bought Italian peer Bulgari and paid a 60% premium for the company, so it's not uncommon to see luxury goods maker's pay up for strong brands either, and Coach is certainly one of those. Though either a Richemont-Coach or LVMH-Coach combination may result in more of an extension of the combined entity's existing business lines, a deal may make particular sense for Coach, which remains heavily reliant on a struggling North American women's handbag and small leather goods operation. As increased diversification (lower volatility) would reduce the discount rate applied to a future expected free cash flow stream, Coach, under any acquisition scenario, would be worth considerably more to an acquirer than on a standalone basis.

5) The synergies and growth opportunities would be material. Either a Richemont-Coach or LVMH-Coach combination may spark greater interest in the combined entity's handbag and leather goods operations, helping Coach to stabilize and then potentially grow its North American women's business. In any combination, cost-sharing and margin enhancement potential would be material. For one, bringing Coach's operations in-house would reduce a well-armed competitor, inevitably improving the competitive profile of the luxury goods space. In particular, LVMH's global retail network would be a huge asset to Coach's line of products, as the latter seeks to diversify geographically. The recent designs at Coach have caught the eye of LVMH, and this has likely sparked deal talks, even if they may not have been reported as such. It is very likely Coach has had talks with many a suitor already, with Kering perhaps close to the top of the list as well.

Wrapping Things Up

Coach is certainly a risky entity that is heavily exposed to fashion trends, which are difficult for any experienced expert to predict. However, the company does pay a safe and healthy 4% dividend yield that we think offers some support to the stock in the mid-$30s. We view the prospect of a suitor scooping up shares of Coach at a substantial premium as merely icing on the cake. Our fair value estimates of Coach, Richemont and LVMH Moet Hennessy are unchanged. We don't expect to alter our relatively small weighting in Coach in the Dividend Growth portfolio at the moment

Business Development Companies Reveal Risks

By Brian Nelson, CFA

As is often the case, the larger the dividend yield, the more risky the payout. We tend to prefer cash-flow-based operating companies such as Microsoft (MSFT)—2.6% annual dividend yield— rather than opaque, risky structures such as business development companies (BDCs), where traditional fundamental analysis is less informative.

It almost goes without saying that the biggest threat to BDC profitability is movement in interest rates -- and not just in one direction. With interest rates collapsing over the past several years, investors of all types have been forced to chase riskier assets for yield. This means that new competitors have emerged in the form of hedge funds and other investors seeking to finance lower-middle market and middle-market businesses. In its regulatory filings, Triangle Capital (TCAP)—10.6% annual yield, for example, lists such competition as a major risk factor, saying:

> "**We operate in a highly competitive market for investment opportunities.** A large number of entities compete with us to make the types of investments that we make in target companies. We compete for investments with other BDCs and investment funds (including private equity funds and mezzanine funds), as well as traditional financial services companies such as commercial and investment banks and other sources of funding. Moreover, alternative investment vehicles, such as hedge funds, also invest in lower middle market companies. As a result, competition for investment opportunities in lower middle market companies is intense. Many of our competitors are substantially larger and have considerably greater financial, technical and marketing resources than we do. For example, some **competitors may have a lower cost of capital and access to funding sources that are not available to us.** In addition, some of our competitors may have higher risk tolerances or different risk assessments than we have. These characteristics could allow our competitors to consider a wider variety of investments, establish more relationships and offer better pricing and more flexible structuring than we are able to do. We may lose investment opportunities if we do not match our competitors' pricing, terms and structure."

Conversely, an increase in interest rates would increase the cost of borrowing for BDCs, potentially reducing net investment income margins while hurting the value of existing securities held on their books. In its regulatory filings, Main Street (MAIN)—6.7% annual dividend yield— agrees, listing rising rates as a major risk factor, saying:

> "Changes in interest rates may affect our cost of capital and net investment income. Some of our debt investments will bear interest at variable rates and the interest income from these investments could be **negatively affected by decreases in market interest rates**. In addition, an increase in interest rates would make it more expensive for us to use debt to finance our investments. As a result, a **significant increase in market interest rates could increase our cost of capital, which would reduce our net investment income**. Also, an increase in interest rates available to investors could make an investment in our securities less attractive than alternative investments, a situation which could **reduce the value of our securities.** Conversely, a decrease in interest rates may have an adverse impact on our returns by requiring us to seek lower yields on our debt investments and by increasing the risk that our portfolio companies will prepay our debt investments, resulting in the need to redeploy capital at potentially lower rates. A decrease in market interest rates may also adversely impact our returns on idle funds, which would reduce our net investment income."

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Competition for deals and interest rate movements make for a difficult competitive environment, and sure enough, a dividend cut at Prospect Capital (PSEC) —12.8% annual dividend yield—came in a warm holiday package recently. The business development company announced that it would reduce cash dividends to shareholders to $0.08333 on a monthly basis with the following record and payment dates:

> "8.333 cents per share for February 2015 (record date of February 27, 2015 and payment date of March 19, 2015);
>
> 8.333 cents per share for March 2015 (record date of March 31, 2015 and payment date of April 23, 2015); and
>
> 8.333 cents per share for April 2015 (record date of April 30, 2015 and payment date of May 21, 2015)."

Prospect's expected dividends will mark about a 25% reduction from its prior dividend of $0.1106. You may ask: Why are we writing about a firm that just announced it has cut its dividend? Well, for one, the lure of a monthly cash dividend payout has attracted many a financial advisor to scoop up shares to satisfy clients' monthly income needs. Second, even after the dividend cut, Prospect will have a forward yield of 11.7%, luring new individual investors to the table. To us, we see it as our responsibility to inform financial advisors and individual investors of the significant risks related to BDCs -- not only related to the sustainability of the dividend, but also related to the material risk of capital erosion, which has been the case at Prospect for some time. The business models of BDCs are not as transparent as we would prefer.

Prospect said that the reason for the dividend cut centered on electing "in the past year to take on less risk and focus on higher earnings quality by increasing (the) percentage of first lien loans and accepting lower interest rates in this yield compressed environment." Though we give credit to management for not chasing higher yields on investments with abnormal risk profiles, that doesn't mean its income investors are happy. Instead, it speaks to the challenging competitive environment of a BDC, and the entity's inextricable ties to the interest rate markets. Management threw in a teaser in the press release for dividend growth investors, nonetheless:

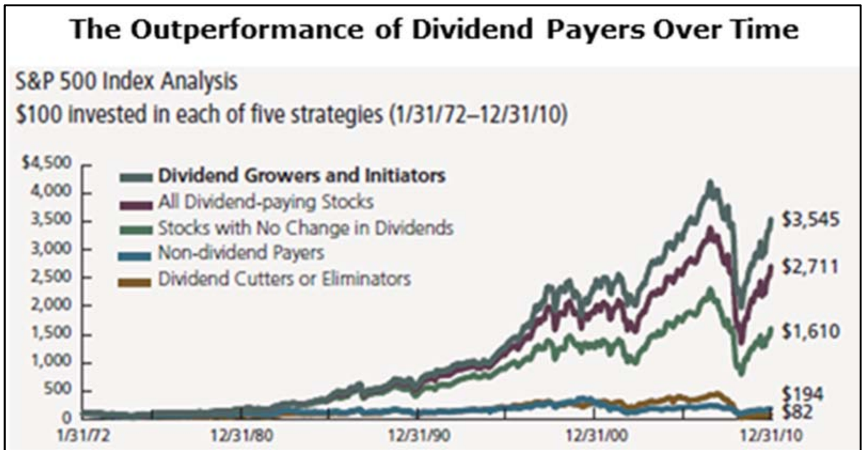
> "We believe *there may be upside to our new reduced dividend level*, a dividend level we believe we can sustain over the next year and longer even with no dividends or fees from portfolio companies. We also believe we should wait for upside events to occur before committing to any increase in our dividend. If we earn one penny per quarter or more in dividends or fees from portfolio companies, we expect to earn $1.00 per share or more in NII over the next twelve months (25 cents per share or more on average each quarter). As a result, we believe 8.333 cents per share per month is a sustainable payment from NII over the next 12 months. To the extent our taxable earnings continue to exceed NII as well as our regular dividends, we may need to declare additional special dividends to meet our requirement as a tax-efficient regulated investment company to distribute 90% of our taxable income to shareholders."

In any case, our opinion on BDCs should be clear: we're not interested in running out and adding a company that slashed its dividend to the Dividend Growth portfolio, nor do we think its BDC peers are worthy of consideration given that they are operating in the very same environment. Let's just say that we pay close attention to Warren Buffett's rule No. 1: Never lose money.

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

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

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

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

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

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.

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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 4, Issue 1

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

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

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).

For general information about Valuentum's products and services, please contact us at info@valuentum.com.