OUR BEST IDEAS NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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Valuentum Securities Inc.
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Portfolio Return	Benchmark Return	Outperformance
96.9%	69.5%	27.4pts

Our Best Ideas (see page 8): AAPL, BABA, MO, CSCO, EBAY, XLF, GE, GILD, GOOG, XLV, INTC, KBE, RSG, RIO, PCLN, TEVA, UNP, XLU, V

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Goals of our Best Ideas Newsletter: We want to deliver positive returns to you, our subscriber, year after year, in addition to outperforming the market benchmark. Our Best Ideas portfolio is generally found on page 8 of each edition.

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"Greece is not Lehman Brothers, whose demise in 2009 simply sent shockwaves throughout the global financial markets."
-- Brian Nelson, CFA

Greece Is Not Lehman; Stick to the Fundamental Valuations

By Brian Nelson, CFA

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KEY CONCEPT: Firms in the Best Ideas portfolio (see page 8), which have generally registered a 9 or 10 on the VBI when added, should be considered our best ideas at any point in time. After adding firms to the Best Ideas portfolio, we may tactically trade around these positions when they have VBI ratings between 3 and 8 and depending on the size of their weighting in the portfolio or the attractiveness of them relative to other opportunities (a score of 3 through 8 is equivalent to a 'we'd hold'). We tend to remove firms from the Best Ideas portfolio when they register a 1 or 2 (we'd sell). View page 27 for more details about how the team utilizes the Valuentum Buying Index to run the portfolio.

Note: Intel Up After-Hours; eBay to Split

The S&P 500 has been stuck in neutral for most of 2015, and we're not surprised. The forces against a further advance have been mounting for some time. Not only are valuations stretched on some of the strongest business models, but global economic growth remains sluggish, perhaps punctuated by falling gross domestic product in the US during the first quarter of the year. But that is not all that is ailing the global equity markets as of late.

Nothing short of a 1929 US-equivalent stock-market crash in China is currently ensuing, and the government is doing all that it can to prop up the markets to ensure stability. The Shanghai Shenzhen 300 Index has fallen an incredible 30% in three weeks, and Chinese brokerages recently funded the state-owned China Securities Finance Corp with ~$20 billion (~130 billion yuan) to help stem the declines. From our perspective, this explicit "plunge-protection" action by the Chinese government is unprecedented and may do more harm than good over the long haul.

Greece continues to steal headlines as it struggles to navigate through its own depression. The country's economic growth has fallen considerably in recent quarters, and controversy over whether the age-old nation should still belong in the Eurozone remains heavily debated. Unlike China, however, the reality for global investors is that Greece simply is not that important to the global financial system or global economy. You wouldn't know that by the amount of news media coverage dedicated to it, but Greece is not Lehman Brothers, whose demise in 2009 simply sent shockwaves throughout the global financial markets.

Global macro concerns may eventually be the catalyst for a sustained pullback in equities around the globe, but this shouldn't be surprising. We've been outlining the valuation risks for some time. But even if market weakness is nothing more than profit-taking, there aren't a lot of reasons for investors to blindly rush back into the markets. We have ~30% cash positions in both the Best Ideas Newsletter portfolio and Dividend Growth Newsletter portfolio, and it's for a reason. We'll be looking to put that dry powder to work on firms in our watch list as the market weakens further, but we're remaining patient for now.

Warning! 5 Heavily-Followed Stocks to Avoid

By Brian Nelson, CFA

Zoetis (ZTS)

The share price of Zoetis, the leader in the production and commercialization of animal health medicines and vaccines, is trading at a substantial premium to its standalone intrinsic value as a result of speculative optimism that a takeout of its shares might happen. Activist Bill Ackman's near-10% stake in the 2013 spin-off of Pfizer (PFE) has investors believing a deal may be in the works, but there's no real evidence of one. In fact, it appears investors are desperate to see something (anything?) happen: on June 25, for example, Zoetis leapt more than 10% immediately on unfounded rumors that Valeant Pharma (VRX) was putting together a bid. We don't think a buyout of Zoetis is going to happen by Valeant or another company, at least anytime soon. On such a conservative down-to-earth view, shares of Zoetis are thus trading at nearly a 40% premium to a standalone intrinsic value estimate. We're pretty comfortable with a fair value estimate in the low-to-mid $30s per share because Zoetis' management has provided granular operating guidance for the next three years. In doing so, management is saying: "Look at our guidance! Don't blame us if the stock tanks." Investors may be sorely disappointed if a suitor doesn't emerge; from our perspective, the risk/reward implies considerable downside.

McDonald's (MCD)

McDonald's is far past its prime. The executive suite is doing all that it can to salvage a positive fundamental trajectory, but the rapidity of the decline in sales is something that is hard to overlook. In the first quarter of 2015, consolidated revenue at McDonald's fell a whopping 11%. Though revenue dropped just 1% on a constant-currency basis, the unadjusted figure is flat-out frightening for a business that is no longer resonating with its core customer. McDonald's is in a world of hurt: Not only is its premium coffee competing with Starbucks (SBUX) on the high end and Dunkin Donuts (DNKN) everywhere else, but its lucrative breakfast operations are under attack. From Yum! Brands' Taco Bell to Subway, almost every key player seems to be offering a breakfast option these days, with perhaps Chipotle the notable exception. But fast-casual is literally eating McDonald's lunch! Franchisees at McDonald's are extremely frustrated, and 17+ times current-year earnings is still too much for a company that may…dare we say…be in permanent secular decline. The best days are behind McDonald's, and the dividend and buybacks are there to keep investor attention away from the real operating issues.

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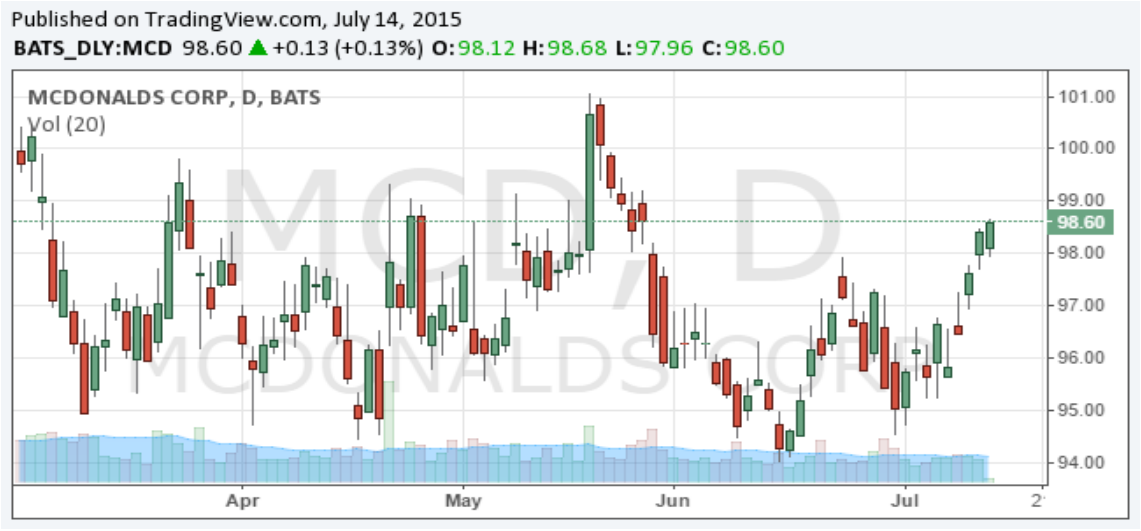

Kinder Morgan (KMI)

Kinder Morgan may go down in history as one of the biggest dividend flops ever--even bigger than SeaDrill (SDRL). For those that may not remember our call on Seadrill, it took nearly 3 years for our thesis to work out from the first public warning to its dividend cut. Of course we're not pin-pointing a time for trouble to occur at Kinder Morgan, but rather we're pointing out that its current situation is unsustainable—just as we did with SeaDrill a number of years ago. The potential for a share-price collapse following a dividend cut is significantly greater than the markets are factoring in. Our expectations of the company to achieve annual distributable cash flow (DCF) of ~$5 billion in 2015 may be greater than the $4.3 billion we expect it to shell out to shareholders in dividends for the year, but such a comparison completely ignores debt coming due and growth capital spending. "Total growth capital" spending, which includes acquisitions, is expected to be $7.3 billion for 2015 alone, and Kinder Morgan has long-term debt maturities of $715 million, $1.67 billion, $3 billion, $2.3 billion and 2.8 billion in 2015, 2016, 2017, 2018, 2019, respectively.

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A company with this debt and capital investment profile shouldn't be paying a dividend at all. We think it's just a matter of time before creditors clamp down; the debt cannot be repaid when almost every dollar generated from operations is going to shareholders in the form of dividend payments. Kinder Morgan's debt capacity has to have a limit, and we believe the credit rating agencies have yet to fully digest the re-consolidation and the magnitude of future dividend obligations Kinder Morgan continues to promise investors. They're astronomical.

Yum! Brands (YUM)

The owner of KFC, Pizza Hut and Taco Bell has a solid franchise, but its share price has rocketed too far too fast, perhaps on renewed speculation that it will spin off its Yum! China division into a separate entity, which may never happen. But while speculation fuels the share price advance, there are a few things we do know for certain. The fast-food environment in the US is cutthroat, and the trend toward fast-casual is a long-term secular dynamic, meaning recent progress by KFC and Taco Bell in the US market, albeit noteworthy, may not hold permanently. The firm's KFC brand is perhaps the best restaurant growth story in China and India, and its growth ambitions may pan out as planned, but such a dynamic is certainly not unknown, and from our perspective, it has been more-than-factored into the stock price. At more than 25 times present-year earnings, Yum! Brands is certainly not connected to its fundamental dynamics. With Chinese equity markets collapsing, the implications on consumer spending in the country, the most valuable one for Yum! Brands, cannot be ignored. We don't like the risk-reward.

Linn Energy (LINE) & Legacy Reserves (LGCY)

We've lumped these two together as one because the theme is similar. Linn Energy yields close to 15% at the moment, while Legacy Reserves yields close to 14%. If you think these dividend yields are sustainable at current levels, you are kidding yourself. These two may not cut their dividends tomorrow, but the odds are stacked against the resiliency of the payout. The market is simply not that inefficient, where such a dislocation in the form of these outsize yields would go unchecked. Results for both will improve (can they get worse?), but we're not counting on the dividends to be sustained at present levels. Linn Energy lost $339 million in the first quarter of 2015, while Legacy Reserves lost $228 million in the same period, and we don't think the recent fall in crude oil prices has yet to be factored into the models at both of these upstream MLPs. The announcement that Iran may flood the world with oil is not going to help them either.

Creditor Risk Aversion Rises Considerably in Energy, Metals & Mining Sectors

By Brian Nelson, CFA

Not all is well with commodity producers.

Moody's has been very quick to point out that "the latest plunge by base metals prices and the renewed slide (in) crude oil prices are more ominous for corporate credit than was the earlier plummet by crude oil prices amid relatively steady industrial metals prices." The credit rating agency's industrial metals price index has dropped more than 10% in the past 20 days ending July 9, reaching levels not seen since the depths of the Financial Crisis in 2009. Moody's industrial metals price index has fallen an incredible 25% since the same time stamp last year, something we've been witnessing anecdotally.

The International Energy Agency recently warned that the bottom in crude oil prices "may still be ahead." Crude oil prices have fallen to three-month lows, with Brent crude ~$59 per barrel and US WTI ~$53 per barrel (USO). Global oil demand growth is slowing, with the agency stating that "world oil demand appears to have peaked" in the first quarter of 2015. Meanwhile, global oil supply is surging as both OPEC and non-OPEC countries increase output, with OPEC supply hitting three-year highs in June. Iraq, Saudi Arabia, and the UAE keep producing at a breakneck pace. Supply growth from Non-OPEC producing entities is expected to "grind to a halt" in 2016, with potential negative implications on US-based pipeline entities, where volume growth is key to distribution/dividend expansion.

What may not be completely factored into such credit models, however, has been the frantic dislocation in the Chinese equity markets (FXI), which have been falling like a rock as of late. Conditions in China are best described as nothing short of a panic, and implications across the country that imports the most oil have yet to be hammered out, but they can't possibly be positive for the energy complex (XLE). Our latest equity report update across the energy space has forced us to implicitly assume billions and billions of incremental debt and equity capital issuances in 2016 to balance their models. Such a dynamic has not been lost on the credit rating agencies, nor have the high-yield markets ignored their risky-capital market dependency.

According to a post from zerohedge, "the renewed plunge in oil prices is kicking off a fresh round of debt concerns" with Bloomberg reporting that, according to Bank of America Merrill Lynch data, "yields on (speculative-grade energy securities) debt have climbed to an average 9.34%...levels that indicate investors view the typical security at high risk of default. Zerohedge has reported that bonds for Energy XXI (EXXI) and SandRidge (SD) are trading at 80-90 cents on the dollar, which doesn't bode well for implied equity values at all. Bloomberg has reported that Swift Energy (SFY) is having a difficult time finding buyers for a $640 million loan, and some are calling the high-yield energy market a "silo of misery."

From our perspective, we've yet to see the long-term implications of $40-$60 crude, as many implied equity prices across the energy space assume a return to $90-$120 prices. This has not been lost on us. We are forecasting a return to normalized conditions by Year 5 of our valuation models, but in many cases, normalized conditions are an ever-moving target, and a return to any sort of "normalcy" cannot be guaranteed, particularly in light of OPEC's market-share retention tactics and talks of lifting sanctions on Iran. We would expect Iran to claw for market share should sanctions be repealed.

We view the list of companies on the following page most exposed to ongoing creditor risk aversion. Of companies on the list, we only hold Energy Transfer Partners (ETP) in the Dividend Growth Newsletter portfolio, and we may look to eliminate the MLP on any upward advance in its share price. The pile of bad energy loans continues to increase.

Creditor Risk...continued on next page

Creditor Risk...from previous page

Company Name	Symbol	Sector	Industry	Adj Net Debt / Adj EBITDA
Arch Coal	ACI	Energy	Industrial Minerals	16.0
Alpha Natural	ANR	Energy	Industrial Minerals	10.6
Williams Co	WMB	Energy	Oil & Gas Pipelines	8.7
Enbridge	ENB	Energy	Oil & Gas Pipelines	7.1
AK Steel Hldg	AKS	Materials	Metals & Mining - steel	6.6
Peabody Energy	BTU	Energy	Industrial Minerals	6.3
Noranda Aluminum	NOR	Materials	Aluminum	6.1
EV Energy	EVEP	Energy	Oil & Gas Pipelines	5.9
Natural Resource Partners	NRP	Energy	Industrial Minerals	5.6
DCP Midstream	DPM	Energy	Oil & Gas Pipelines	5.5
Kinder Morgan	KMI	Energy	Oil & Gas Pipelines	5.4
Energy Transfer Partners	ETP	Energy	Oil & Gas Pipelines	5.3
Boardwalk Pipeline	BWP	Energy	Oil & Gas Pipelines	5.3
Buckeye Partners	BPL	Energy	Oil & Gas Pipelines	5.2
Linn Energy	LINE	Energy	Independent Oil & Gas	5.1
NuStar	NS	Energy	Oil & Gas Pipelines	5.0
SeaDrill	SDRL	Energy	Energy - Offshore Drilling	5.0
Allegheny Technologies	ATI	Materials	Aluminum	4.4
Plains All American	PAA	Energy	Oil & Gas Pipelines	4.4
Enterprise Product Partners	EPD	Energy	Oil & Gas Pipelines	4.4
Eastman Chemical	EMN	Materials	Chemicals - broad	4.3
POSCO	PKX	Materials	Metals & Mining - steel	4.3
Ashland	ASH	Materials	Chemicals - broad	4.2
Spectra Energy Partners	SEP	Energy	Oil & Gas Pipelines	4.2
Sealed Air	SEE	Materials	Containers & Packaging	4.1
Western Gas	WES	Energy	Oil & Gas Pipelines	4.1
Weatherford Intl	WFT	Energy	Energy Equipment - Large	4.0
Ultra Petroleum	UPL	Energy	Independent Oil & Gas	4.0
Holly Energy	HEP	Energy	Oil & Gas Pipelines	3.9
Crown	CCK	Materials	Containers & Packaging	3.8
Cliffs Natural Resources	CLF	Materials	Mining - diversified	3.8
Freeport McMoRan	FCX	Materials	Mining - diversified	3.6
Legacy	LGCY	Energy	Independent Oil & Gas	3.5
Tidewater	TDW	Energy	Energy Equipment	3.5
Rowan Companies	RDC	Energy	Energy - Offshore Drilling	3.5
Steel Dynamics Inc	STLD	Materials	Metals & Mining - steel	3.2
Huntsman	HUN	Materials	Chemicals - broad	3.1
Olympic Steel	ZEUS	Materials	Metals & Mining - steel	3.1
Gerdau	GGB	Materials	Metals & Mining - steel	3.0
Atwood Oceanics	ATW	Energy	Energy - Offshore Drilling	3.0
Southwestern Energy	SWN	Energy	Independent Oil & Gas	3.0

Teva Pharmaceuticals Committed to Acquiring Mylan

By Kris Rosemann

We have been adamant on our stance on Best Ideas Newsletter portfolio holding Teva Pharmaceuticals (TEVA) since the initiation of our thesis on the generics industry in June 2013, shortly before we initiated our position in the firm. Since then shares have advanced nearly 50%, and we've continued to let this winner run.

Teva...continued on next page

Teva...from previous page

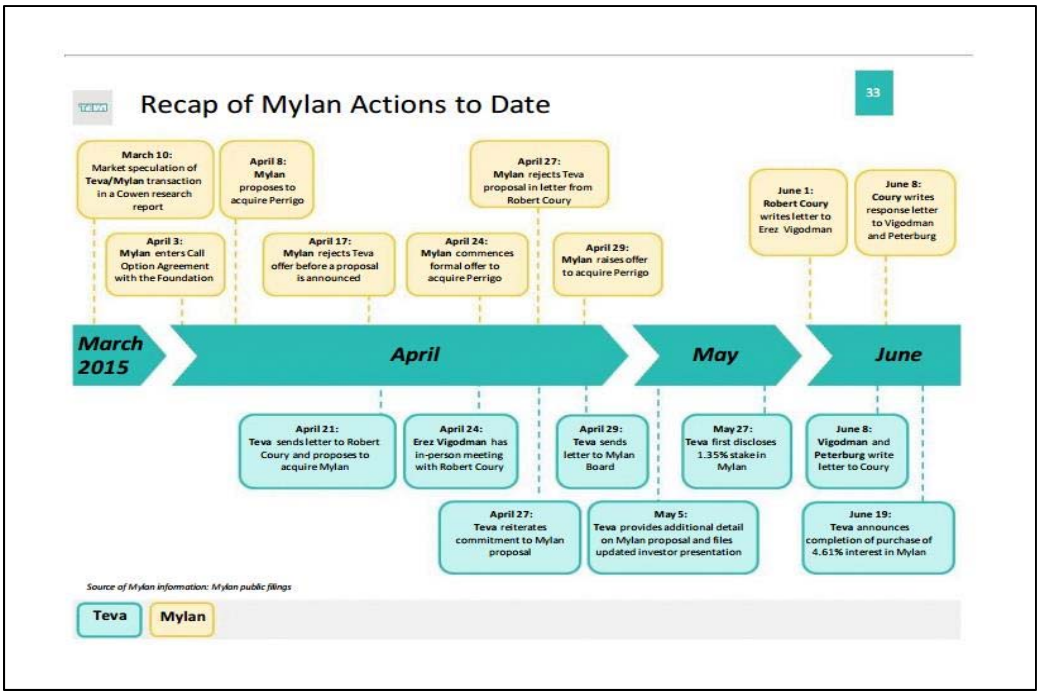

Image Source: Teva

A large portion of Teva's success has been tied to the incredible performance of Copaxone, the leading multiple sclerosis therapy worldwide. In the first quarter of 2015, the drug alone comprised 18.5% of revenue, while contributing an astounding ~55% of net income. These figures are down from the year-ago period--and the majority of its production life--due in part to strong sales in 2014. Teva's patent on Copaxone recently expired, and considering these impressive statistics, it is understandable why the firm is willing to do whatever it takes to maintain significant market share. Though Teva has been taking steps to prepare for the loss of exclusivity on Copaxone, such as the acquisition of Auspex and a focus on increasing profitability of its generic medicines and other special medicines segments, the acquisition of Mylan (MYL) may be exactly what the doctor ordered for Teva.

But even if the deal does not go through, not all is lost at Teva. The recent patent expiration pertains only to a daily dosage of Copaxone. Teva still holds a patent until 2030 on a higher dosage version of the drug that is taken three times a week and may be its best answer to combating coming generic competitors, though payer pushback could be a significant issue. As of July 5, 69% of Copaxone patients had converted to the tri-weekly version. In addition to the collaboration of Momenta Pharmaceuticals (MNTA) and the Sandoz pharma business of Novartis (NVS) recently releasing its version of Copaxone, Mylan has stated it has a competing product, though its near-term approvability may not be favorable. Teva's merger with Mylan may provide it with the multiple sclerosis market share stability it desires.

Aside from enhancing both its portfolio and geographical diversification, a Teva-Mylan tie-up is projected to provide an impressive $2 billion in annual cost and tax savings/synergies ($20+ billion in perpetuity value), and the combined entity is expected to receive an investment-grade rating by the rating agencies, allowing for rapid deleveraging and ease of funding of future growth. Management also believes the combined entity could save ~$350 million in capital spending that the separate entities otherwise would have to spend individually. The combined entity's cash flow profile would be significantly augmented.

But that's not all. The potential promise of mitigating further pricing pressure across its drug portfolio, particularly with respect to Copaxone, could be material in the event of such a combination, and the consolidation of Teva's top customers from wholesalers (Walgreen's-Alliance Boots; Express Scripts-Medco; CVS-Cardinal Health joint venture) means that scale and bargaining power as in the case that would be

Teva ...continued on page 9

The Best Ideas Portfolio

Portfolio Return	Benchmark Return	Outperformance
96.9%	69.5%	27.4pts

By Valuentum Analysts

Below we outline the constituents of the portfolio and their respective weightings and returns thus far. Each subsequent issue discusses Valuentum's latest changes to the portfolio and analysis and trends impacting companies in our Best Ideas portfolio. We currently have ~29% of the portfolio in cash, a level we're looking to bring down in coming months. Tactically, we like to have the most cash when the market is making new highs and fully invested when the market is putting in short-term lows.

Our investment process is completely transparent and easy to implement in your own portfolio. The goal of our Best Ideas portfolio is to outperform the S&P 500 Index and to generate positive returns each year regardless of the market environment. Firms added to our Best Ideas portfolio are the cream of the crop based on our stock-selection methodology, the Valuentum Buying Index.

OUR BEST IDEAS PORTFOLIO -- as of July 15, 2015 — **Best Ideas Portfolio Inception Date: May 17, 2011**

Portfolio Holdings	Symbol	Initial VBI*	Current VBI**	First Purchase	Cost Basis ($)	Total Shares	Total Cost ($)	Price/Share ($)	Current Value ($)	% of Portfolio	% Return (dividends included)
Bullish											
Apple Corp.	AAPL	10	6	17-Jun-11	51.92	161	8,372.96	126.82	20,418.02	10.4%	152.1%
Alibaba	BABA	IPO	3	19-Sep-14	92.95	78	7,264.10	80.73	6,296.94	3.2%	-13.3%
Altria Group	MO	8	3	28-Jun-11	28.39	315	8,958.11	51.23	16,137.45	8.2%	101.0%
Cisco	CSCO	9	7	14-Nov-14	26.15	100	2,622.00	28.11	2,811.00	1.4%	7.9%
eBay	EBAY	10	7	3-Oct-11	31.04	100	3,103.50	63.44	6,344.00	3.2%	104.4%
Financial Select SPDR	XLF	NA	6	9-Jan-11	13.46	150	2,026.00	25.21	3,781.50	1.9%	94.1%
General Electric	GE	7	3	21-Oct-13	25.99	375	9,761.75	26.77	10,038.75	5.1%	7.6%
Gilead Sciences	GILD	10	9	19-Sep-14	106.76	68	7,273.34	117.39	7,982.52	4.1%	9.8%
Google	GOOG	10	4	23-Oct-12	450.92	14	6,326.84	560.22	7,843.08	4.0%	24.0%
Health Care ETF	XLV	9	6	22-May-12	36.60	125	4,582.00	76.78	9,597.50	4.9%	116.0%
Intel	INTC	6	4	12-Sep-11	20.48	150	3,086.50	29.69	4,453.50	2.3%	56.3%
SPDR S&P Bank ETF	KBE	NR	NR	9-Jan-12	21.07	100	2,114.00	36.80	3,680.00	1.9%	81.1%
Priceline	PCLN	10	10	26-Feb-15	1248.97	3	3,753.91	1167.54	3,502.62	1.8%	-6.7%
Republic Services	RSG	8	4	19-May-11	31.42	201	6,329.42	40.41	8,122.41	4.1%	41.0%
Rio Tinto	RIO	9	3	22-May-12	46.40	75	3,487.00	40.47	3,035.25	1.5%	-0.6%
Teva Pharma	TEVA	6	3	24-Jul-13	41.22	77	3,180.94	63.42	4,883.34	2.5%	59.2%
Union Pacific	UNP	6	3	24-Jul-13	79.67	40	3,193.80	96.98	3,879.20	2.0%	25.5%
Utilities Select SPDR	XLU	NR	NR	18-Mar-14	41.12	83	3,419.96	43.14	3,580.62	1.8%	7.5%
Visa	V	7	6	30-Nov-11	26.86	188	5,064.39	70.02	13,163.76	6.7%	163.5%
Latest change: A new position in PCLN was opened 2/26/2015. Please contact us at info@valuentum.com if you are not receiving the email transaction alerts.											
Cash -- changes in monthly cash balance reflects dividends received and trading gains/losses, where applicable.									57,323.41	29.1%	0.0%
Bearish											
For investors seeking 'short' or 'put option' exposure, please consider firms with VBI ratings with 1 and 2 as ideas.											
Best Ideas Portfolio Value							100,000.00		**196,874.87**		**96.9%**
S&P 500 Index (SPY)				17-May-11	132.69	754	100,000.00	210.61	158,723.34	93.7%	
Cash									10,757.40	6.3%	
Benchmark Portfolio Value									**169,480.74**		**69.5%**
Relative Outperformance											**27.4 pts**

Data as of July 15, 2015. Cost basis includes commissions. Results include dividends, but not interest received on cash balance.

* VBI score at the time we added the firm to the portfolio.

** See our methodology regarding the Valuentum Buying Index (VBI). Best Ideas portfolio is not a real money portfolio.

Standard Disclaimer: Our Best Ideas 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 Best Ideas portfolio and accepts no liability for how readers may choose to utilize the content.

*Teva...*from page 7

achieved in such a transaction has become significantly more important. The share of Teva's top three customers in the US has advanced to more than 80% since 2009. Teva is working hard to offset potential pricing pressures, and a combination with Mylan is one way to do so.

However, it seems as though Mylan is doing everything in its power to avoid the takeover. In a 2014 tax inversion, Mylan moved its corporate address to the Netherlands and adopted a poison pill provision to avoid hostile takeovers. Further complicating Teva's efforts is resistance from Abbott Laboratories (ABT), which sold its generic drugs business to Mylan in exchange for what is now a 14.5% stake in the company, the largest position of any shareholder. At the moment, Abbott says it will back Mylan's efforts to avoid the takeover by Teva, perhaps to keep its intellectual property from abruptly landing in Teva's lap so soon after its own deal with Mylan.

In April 2015, Mylan amplified its takeover defense by making two informal offers to buy Dublin-based generics firm Perrigo (PRGO) for a substantial premium. Teva made it known that if the Mylan-Perrigo deal goes through, it will rescind its offer for Mylan. Perrigo declined both offers, as it felt the offers undervalued the company. Mylan has also looked to the Federal Trade Commission for help with its resistance, contending that, while it is headquartered in the Netherlands, it should be treated as a US issuer by the FTC, which would require Teva's purchase of Mylan shares to be reviewed by US antitrust officials. Though such defenses may not matter in the end, the situation is fast-developing, and reportedly, Teva is preparing to increase its offer for Mylan from its informal April price of $82 per share to a formal offer in the range of $86-$88 per share in the coming weeks. The higher offer will provide an alternative for Mylan shareholders, who are set to vote this summer on its Perrigo proposal.

Though we think the merger would be a material positive for Teva, it is not a make-or-break deal for the company's future health. The most recent update of our analysis of the firm assumes significant loss of share within the multiple sclerosis market, and while that may still happen, other drugs in Teva's pipeline offer significant potential upside. Management anticipates more than $5 billion in incremental annual "risk-adjusted" revenue from new specialty product launches initiating in 2014. The chart below is a snapshot of the firm's pipeline as of April 15, following the acquisition of Auspex, a move that solidified Teva's position as a global leader in the central nervous system treatment market. Regardless of the outcome of the acquisition proceedings with Mylan, a budding late-stage pipeline provides significant growth opportunities, and it's hard to dislike a company that expects to haul in more than $3.5 billion in free cash flow during 2015, despite all the challenges outlined in this piece.

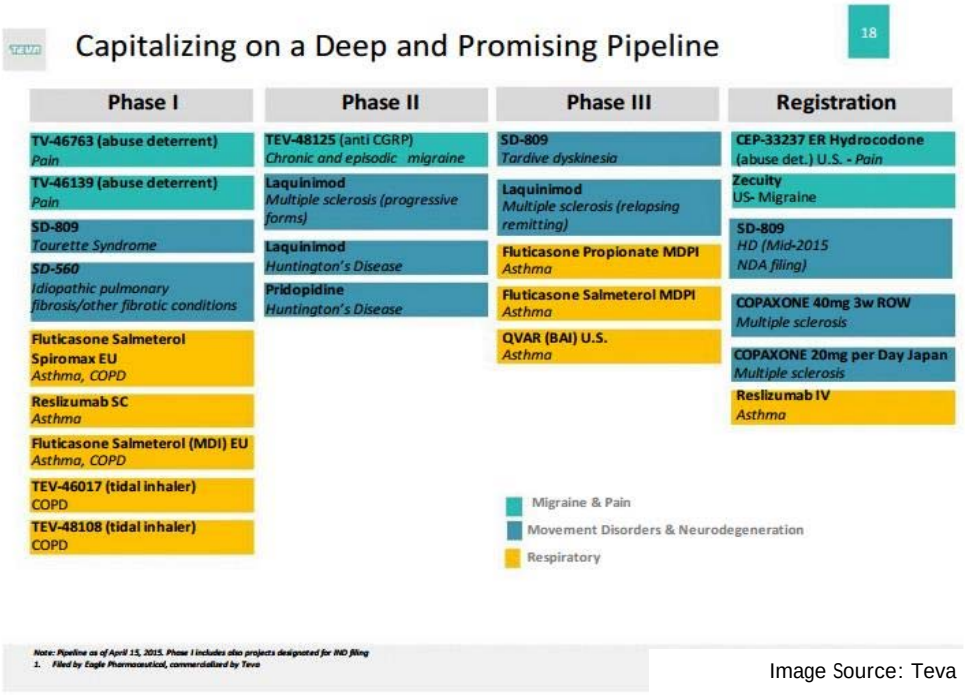

Image Source: Teva

June Sales Keep Auto Industry on Track for Best Year in A Decade

Images Sources: Respective Company Filings

By Kris Rosemann

Key Takeaways

- The auto industry continues its strong comeback in 2015. Volume and profits are growing, and the industry is poised for a banner year.
- SUV and light truck demand are the primary drivers behind the sales growth, as the drop in gasoline prices slows purchases of smaller, more fuel-efficient cars.
- America's best-selling line, the Ford F-Series, remains in limited supply, even as demand for the truck line remains high, but other producers, including GM, are looking to take advantage of the mismatch.
- Toyota remains the top-selling retail brand in the US, despite weak industry-wide car sales.

June US auto sales, according to Autodata Corp, increased 3.9% over the year-ago period to a total of 1.48 million units, the most June sales since 2006, helping the industry to its strongest first half since before the Great Recession and bringing the seasonally adjusted annual rate (SAAR) to ~17.16 million. Pricing and profits also increased in the month, while the average vehicle price came in at ~$33,340, a 2.5% increase from June 2014

Strong demand for light trucks and SUVs drove sales thanks to lower gasoline prices. This dynamic, along with years of pent-up demand from delayed purchases during the Financial Crisis, should push annual auto sales past the 17 million mark in 2015. The National Automobile Dealers Association, for example, recently increased its forecast to 17.17 million for the year, and we think the industry will hit or beat that mark. During the first half of 2015, light truck and SUV sales have increased ~10% while car sales have dropped 1.7% from the same period in 2014. Mid-size trucks have claimed their highest ever share of the light truck market with 15.1% of overall truck sales at the half-way point of the year, and sales have grown nearly 52% from last year.

Despite the solid reported numbers, the 1.48 million unit sales in June came in slightly below consensus expectations that were only slightly higher (1.49 million). Though GM (GM) was the sole major automaker to report a decline in unit sales, only Toyota (TM) beat consensus expectations in the month. Ford (F), Honda (HMC), and Fiat Chrysler (FCAU) all reported growth below that of expectations, but still strong performance nonetheless. There was one additional selling day in June 2015 than June 2014. Let's break down the monthly performance of individual automakers.

Ford's New Models Flying Off Assembly Lines

Ford experienced a slight 1.6% improvement in unit sales to a total of 225,647 in June, and a similar 1.9% increase during the first half of 2015. Highlights for the month include SUV sales growing 11.7%, with unit sales of the all-new Edge rising 29.8% and unit sales of the newly-redesigned Explorer increasing 30.2%, and the F-Series, achieving record average transaction pricing. Though a small portion of sales, the firm's Lincoln brand continues to show strong momentum, increasing units sold by 14.5% in the month.

Ford's performance was similar to the mixed overall market trends in the month of June, with impressive SUV growth and declines in unit car sales--though the latest Mustang model continued momentum with unit expansion of 53.6%. The limited availability of Ford's top-seller, the F-Series, continues to weigh on the company's 'Trucks' division, where unit sales fell 0.7%, and its overall sales. Unit sales for the F-Series dropped 8.9% in the month as the firm continues to build inventory for the innovative aluminum-bodied F-150. Ford is operating at full production for the model, but only had half of its normal inventory on dealer lots in June. The company is expecting to have full supply by the end of September 2015.

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	June 2015	June 2014	% Change
SALES BY BRAND			
Ford	217,321	214,793	1.2
Lincoln	8,326	7,271	14.5
Total Vehicles	225,647	222,064	1.6
SALES BY TYPE			
Cars	77,948	81,198	-4.0
Utilities	70,143	62,785	11.7
Trucks	77,556	78,081	-0.7
Total Vehicles	225,647	222,064	1.6

Demand remains "sky-high" for the new F-150. The model turned twice as fast on dealer lots than the industry average half-ton pickup, and its average transaction price was $3,600 higher than that in June 2014. In addition, the Ford brand as a whole increased average transaction prices by $2,700, good for three times the average industry increase. We like where Ford is headed, and despite the aggressive competition from GM's truck lines, once Ford is able to reach full capacity on the F-Series, we expect unit sales to accelerate significantly. Our fair value estimate for the company is $16 per share, slightly lower than the previous fair value estimate on account of reduced global growth expectations.

GM's Lackluster June Sales Not Reflective of Strong First Half

GM was the only major automaker to report a decline in unit sales in the month of June, down 3%, to 259,353, versus consensus expectations of 3% growth. Though retail sales advanced 6.8%, the biggest highlight for the company in the month was the head-to-head performance of its Chevrolet division with the Ford brand. Chevrolet retail sales were up 9%, surpassing that of the Ford brand in the month. The division's leading truck, the Silverado, outsold the F-Series on a retail basis, though the latter continues to be impacted by supply issues.

June	Total Sales	YOY Change
Chevrolet	181,256	-3.9%
GMC	47,051	8.0%
Buick	17,531	-18.1%
Cadillac	13,515	-3.1%
Total	259,353	-3.0%

GM's share gains in the truck market have been a result of the ongoing success of the full-size Silverado and GMC Sierra pickups, which were redesigned in the 2014 model year, as well as the strong momentum of the Chevy Colorado, where "days to turn" are just 15 days (among the best in its group). The Colorado continues to gain share relative to the Toyota Tacoma, while the GMC Canyon also hopes to gain share in the increasingly crowded mid-size market. The Silverado and Sierra unit sales grew 18.4% and 20.8%, respectively, as GM continues to take advantage of the limited supply of the F-Series.

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The GMC division has grown its retail sales for 17 consecutive months and increased retail sales 12% in June. GMC was the only division to improve unit sales from the year-ago period as the firm seeks to capitalize on strong retail demand for the line. Poor unit sales have continued for the Buick and Cadillac divisions, even though retail sales advanced for Cadillac in the month. Unit sales of the Buick Encore and the Cadillac SRX, however, are growing 33.4% and 23.5%, respectively. The GMC Acadia, a crossover SUV, also reported solid growth of 17.4% in unit sales. In line with market trends, the company experienced lackluster performance from all of its car models, excluding the Chevy Camaro, where unit sales advanced 11.5%.

Despite mixed June results, GM has performed well during the first half of 2015, having increased total unit sales 3.4% in the period. The firm is well positioned to continue to take advantage of market trends, as it has truck, van, and SUV share of 38.9%, up 2.1 percentage points from the year-ago period. We expect performance at GM to remain resilient in the face of incremental supply from the F-Series, but we're monitoring customer behavior and overall retail trends from the lots closely. Our fair value estimate is $43.

Toyota Retains Retail Sales Leader Crown

The only major automaker to beat consensus expectations in the month, Toyota reported unit sales of 209,912, an increase of 4.1% from June 2014. Toyota was once again the top selling retail brand in the US, led by strong sales of Tacoma, RAV4, and Highlander. Unit sales of the firm's Toyota and Lexus divisions grew 3.1% and 11.1%, respectively, and the performance of both divisions was in line with overall market trends. Toyota division car sales fell 6.9%, while its truck and SUV division increased 11.8%. Lexus division car sales were relatively flat at 0.2%, while its truck division was up 19.6%.

	-- CURRENT MONTH --			
			DSR %	VOL %
	2015	2014	CHG	CHG
TOTAL TOYOTA	**209,912**	**201,714**	**-0.1**	**4.1**
TOTAL TOYOTA DIV.	183,791	178,196	-1.0	3.1
TOTAL LEXUS	26,121	23,518	6.6	11.1

Toyota's top-selling SUVs, the RAV4 and Highlander, drove segment growth, along with 36.8% growth from the 4Runner. Driving growth in its truck segment was the Tacoma, the top-selling mid-size pickup, increasing sales an impressive 31.1%. Toyota has been the leader in the difficult-to-perfect mid-size truck market, though times may be changing with the growing popularity of GM's new offerings and the expected release of more models from the likes of Honda and Nissan in coming years. Toyota is confident its 2016 model will continue the momentum, however.

The Lexus division experienced a solid month in its luxury SUV segment, where unit sales grew 24.6%, driven by the all-new NX compact crossover and 17.3% growth from the GX. Lexus has long been synonymous with luxury vehicles, and we think its brand continues to resonate with consumers. Consumer Reports, for example, continues to rate Lexus at the top of its best brands list, calling Lexus a company "known for making quiet, plush, and very reliable cars."

All-in, Toyota continues to sell high volumes of cars, and first-half numbers were better than June results throughout all segments, and we don't think recent PR nightmares in the executive suite will impact fundamental performance. Our fair value estimate of shares is $154.

Honda's SUVs and Acura Brand Drives Solid June

Despite missing consensus expectations calling for 7.1% growth, Honda reported an increase in unit sales of 4.2% from the year-ago period, resulting in total sales of 134,397. The firm continues to capitalize on consumer demand trends. Both its Honda and Acura divisions' truck and SUV segments posted record June unit sales, and company-wide total truck and SUV sales increased 18%.

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Acura cars continue to buck market trends, with sales more than doubling during the month. Such strength, however, was not significant enough to salvage the company's total car sales performance, which declined 6.6% (with the much larger Honda car division losing 11.3% of sales from last June). The Honda brand as a whole grew just 0.9% in the month, while the Acura brand grew 38.6%.

American Honda Vehicle Sales for June 2015	Month-to-Date			
	June 2015	June 2014	DSR** % Change	MoM % Change
American Honda Total	**134,397**	**129,023**	**0.0%**	**4.2%**
Total Car Sales	67,081	71,791	-10.3%	-6.6%
Total Truck Sales	67,316	57,232	12.9%	17.6%
Honda Total Car Sales	**61,203**	**68,963**	**-14.8%**	**-11.3%**
Honda Total Truck Sales	**57,667**	**48,854**	**13.3%**	**18.0%**
Acura Total Car Sales	**5,878**	**2,828**	**99.5%**	**107.9%**
Acura Total Truck Sales	**9,649**	**8,378**	**10.6%**	**15.2%**

Consistent with Honda's recent efforts to strengthen its SUV lineup, Honda's CR-V and HR-V crossovers saw significant growth. Though the introduction of the redesigned 2016 Pilot in June strengthened the company's SUV lineup, the new model did not grow at the same pace as the smaller crossovers. Management remains confident that its light truck lineup will continue to perform as it focuses on renewing and expanding the car lineup. Efforts in this area are vital, as company-wide car sales still make up just under half of total unit sales. Both the Accord and Civic have suffered thus far in 2015, but we think the company will be successful in re-igniting these two popular brands. Our fair value estimate is $35.

Fiat Chrysler Remains a Mixed Bag in June

Fiat Chrysler reported June unit sales of 185,035, an 8% increase from June 2014, and its 63rd consecutive month of year-over-year sales gains. The firm owns the Fiat, Chrysler, Jeep, Dodge, and Ram brands. Chrysler, Jeep, and Ram grew by 28%, 25%, and 2% respectively, while Fiat and Dodge declined 30% and 14%. Jeep is its largest brand by volume and benefited from consumer demand for SUVs, Jeep's specialty. Ram pickup sales were relatively flat, as it struggled to take advantage of the limited availability of the F-Series.

Defying overall industry-wide weak demand in car unit sales was growth in the Chrysler division, driven by strong unit performance of the 200 sedan. The mid-size sedan has had an impressive run of 10 consecutive months in which it has posted a sales record. Furthering growth was the 300, one of the most popular large sedans on the market; its unit sales grew by 11% in June. Dodge division car sales did not fare as well, with the Challenger being the only material model increasing sales. The Dodge Journey minivan also grew sales, but not enough to combat the significant backslide of fellow family vehicle Caravan. The Fiat brand's compact cars also took it on the chin in the month; neither of its two pre-existing models grew sales.

Fiat Chrysler plans to spin-off its Ferrari unit later this year via an IPO. The split of the luxury brand Ferrari should enable Fiat Chrysler to further focus on its core brands, helping both its US operations and performance in Europe, where it has ~7% market share. In the US, Fiat Chrysler will need to regain the health of its Dodge brand to keep growing, as the terrific momentum of Chrysler sedans is not likely sustainable. Jeep may lose some momentum as demand for SUVs normalizes in the future. Chrysler's situation is much more dynamic than its peers' at the moment.

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Tesla

Though many may rule out Tesla (TSLA) as a key US automaker, we think it belongs. Tesla Motors reported deliveries of 11,507 Model S vehicles in the second quarter of 2015. This is a company record and a 50%+ increase from the year-ago period, but only 3% growth sequentially. We continue to be of the opinion that Tesla is the future of advanced electric automobile technology, though the path won't be without challenges. From our perspective, the firm has capabilities and a thirst for innovation that no other automaker does at this point in time. Tesla is expected to begin deliveries of the newly-developed Model X, its second premium sedan engineered from the ground up as an electric vehicle, in the third quarter of this year. Our fair value estimate for the company is $257.

eBay – PayPal Split

By Kris Rosemann

Under previous but subsiding pressure from Carl Icahn and other shareholders, eBay (EBAY) announced last September that it would separate its payments business PayPal in July of this year. Now that July is here, we wanted to remind members of the split and explain what it means for the holdings in the Best Ideas Newsletter portfolio. On July 17, eBay shareholders will receive one share of PayPal under the ticker PYPL for each share of eBay owned. We will be launching coverage of PayPal shortly after it becomes an independent, publicly-traded company.

The separation of eBay and PayPal will make eBay leaner and more efficient while greatly increasing the potential for expansion of PayPal within the booming mobile payments market. As a distinct entity, PayPal now has the freedom to explore and engage in other business opportunities with other marketplaces and is prepared to hit the ground running after the spin-off. Already, PayPal has announced it will acquire digital money transfer provider Xoom (XOOM) for $890 million in cash. The addition of Xoom will extend PayPal's existing US offering and accelerate its global expansion. Xoom's reach spans 37 countries, including Mexico, India, China, Brazil, and the Philippines.

Life on its own won't be a walk in the park for PayPal, and competition will be stiff. We think the strongest competitor over the long haul will be Apple (AAPL) via its Apple Pay segment. Apple's reach and brand recognition is unparalleled, and the firm's partnership with Stripe has further augmented its platform. Apple Pay also has the ability to support credit and debit cards on the payment networks of Visa (V), MasterCard (MA), and American Express (AXP). In its latest quarterly results, CEO Tim Cook says that he has seen "great momentum with Apple Pay." Discover (DFS) will make contactless payments in relevant stores through Apple Pay beginning later this year, and during the month of March, the number of locations accepting Apple Pay tripled. Best Buy (BBY) and major hospitals across the country are signing up.

Amazon (AMZN) Mobile Payment Services is another competitor with significant reach and brand recognition and has similar ease-of-use features as Apple Pay, though we do not think its influence is as significant as the iPhone giant's. The tokenization of major credit card processors will be an obstacle for PayPal, as MasterCard and Visa continue to innovate their data security services in order to capture the demands of online shoppers. Alibaba's (BABA) AliPay arm, China's leading third-party online payment solution, recently reached a deal with Wal-Mart (WMT) that will enable customers to use the Alipay Wallet to make purchases at participating stores in China. Alibaba has been rapidly expanding into India, and we wouldn't be surprised to see it gain ground across the globe.

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PayPal has not been asleep at the wheel though. The company's One Touch technology, released April 2015, is a competing product to Apple Pay's Stripe and the similar Amazon feature, and allows users to make payments on mobile platforms with the touch of a button. One Touch may have a material advantage over Stripe in that it can be used on iPhones and Android devices. The firm has been competing with Amazon as an eBay business for years, so we don't expect any material share shifts in the payments landscape between the two.

Following the separation, PayPal will continue to handle 80% of eBay's gross merchandise volume over the next five years through contractual stipulations. The stability of retaining eBay as a partner coupled with a distinct focus on its own standalone returns should provide ammunition to combat myriad threats. We were fans of PayPal as a segment of eBay, and our opinion will not change July 17, the date of the split. Our biggest fear is selling pressure on the legacy eBay position, as some investors may migrate to a full position in PayPal, but at the moment we plan to hold onto both stakes. We maintain our view that eBay, on a consolidated basis, is significantly underpriced, and the separation will unlock shareholder value.

Alibaba Shares Disappoint

By Kris Rosemann

No need for boo-hooing BABA just yet. We're aware of the poor performance of Alibaba's shares, and we're as disappointed as any. But we haven't gone sour on the firm.

Chinese stocks (FXI) recently entered a bear market as the Shanghai Composite Index has dropped over 20% from its June 12 peak. The market is now in the midst of what most call a "self-correction," as Chinese equity valuations have become out of touch with underlying fundamentals, though we maintain our view that both Alibaba and Baidu (BIDU) remain significantly undervalued.

The People's Bank of China, in an attempt to halt the recent slide in share prices, cut both its one-year lending and deposit rates by 0.25%. In addition, the bank lowered the amount of cash that large banks must keep on reserve by 0.50%, intended to increase the ease of lending for banks. After that didn't work, the Chinese government then published draft rules that would allow its pension fund to invest up to 30% of its net asset value--the equivalent of up to $97 billion--in the market. The latter seems to have eased the pain a bit.

But artificial moves to prop up its equity markets may do more harm than good over the long haul.

Economic growth is slowing in China, as the country experienced the slowest GDP growth in a quarter since 2009, and continued easing of the pace of expansion is to be expected, even if it remains robust by most any standard. The country continues to navigate through what many have described to be a real estate bubble. Some statistics are staggering: "the ratio of unsold property to annual sales reached 51.5% in 2014 from 24.7% in 2011." That's certainly an inventory glut, which doesn't bode well for housing prices, which could have implications on the country's banking system, a dynamic we know well as a result of the Global Financial Crisis of late last decade. The makings of a financial calamity have been building for some time in the country.

Unfortunately, Best Ideas Newsletter portfolio holding Alibaba has experienced a fate similar to the overall Chinese market, reaching a peak near $94 on May 21 falling nearly 14% to ~$81 just a little over a month later. We're not happy about it, especially in light of the excitement of shares reaching $120 last November. Stock selection, however is never performed in isolation, and while the weighting of the position has declined due to poor overall performance, the position is just ~3.4% of the Best Ideas Newsletter portfolio. Other than Alibaba, we have no other international exposure in the Best Ideas Newsletter portfolio (absent multi-nationals), and we think the company remains one of the best ideas to fill that void.

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On a firm-specific level, things continue to progress well. Alibaba is looking to invest ~$600 million in Indian online/mobile payments platform Paytm, further boosting Alibaba's Ant Financial/Alipay affiliate. The news follows reports that Alibaba may invest in Indian online marketplace Snapdeal, and allocate nearly $1 billion in joint-venture Koubei, which will offer local services via mobile devices such as food delivery and booking appointments. Alibaba is taking a giant leap into establishing a foundation in the budding Indian e-commerce market. Alibaba is managing its business for the long haul, and we like the moves.

We're not running for the exits. Alibaba reports second-quarter results August 12. All eyes will be on its reported monetization rate, and we expect an upside surprise.

Target-CVS Agreement: What It Really Means

By Kris Rosemann and Brian Nelson, CFA

Image source: Mike Mozart

Target (TGT) and CVS Health (CVS) announced an agreement June 15 in which CVS would acquire, rebrand, and operate Target's pharmacies and clinics for the price of approximately $1.9 billion. After the deal closes, CVS will operate 1,660 of Target's pharmacies in its stores under the CVS/pharmacy brand name. The nearly 80 Target clinics involved in the deal will be rebranded as MinuteClinic, and CVS plans to open up to 20 new clinics in Target stores, part of the CVS/MinuteClinic goal to operate 1,500 clinics by 2017. Target and CVS also plan to open five to ten small, flexible store formats that will be branded TargetExpress and include a CVS/pharmacy.

After Target's recent Canada debacle, we were left scratching our heads as to where the company would look next for geographic growth opportunities, and we think this question remains unanswered. For those that may have missed the event, Target closed the last of its 133 retail stores in Canada April 12, laying off 17,000 employees and taking a $5.1 billion quarterly charge. The justification for leaving Canada boiled down to the following rather unusual short-term oriented statement: "Unfortunately, we were unable to find a realistic scenario that would get Target Canada to profitability until at least 2021." We didn't think the problems in Canada were unfixable. Inventory, pricing, and branding should be core competencies for any successful retailer.

But that brings us to today, and the deal with CVS makes sense.

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In the minds of consumers, Target is more of a retailer, as opposed to a pharmacy, and management has finally admitted that reality with the CVS accord announced. If abandoning Canada was the first indication, the executive suite at Target seems to be one focused on simplicity, and changing healthcare regulations have certainly become a headache in an operation that's losing money, as Target's pharmacy business had been. Not only will Target offload this profit headwind, but the company will retain pharmacy-related traffic by keeping the stores within, well, its very own stores. It will also capture CVS customers that visit Target to fill subscriptions, helping it compete more effectively with Walmart (WMT) and Costco (COST), for example.

The acquisition of Target's pharmacy and clinic business is a natural extension of what CVS does best, and taking out a "smaller" competitor in this area only makes sense. The deal will also improve CVS' swagger at the negotiations table. As a pharmacy benefit manager (PBM), CVS participates in bidding wars against other PBMs for large contracts with drug producers. Following the purchase, big pharma should find the growth potential of being associated with CVS' larger post-deal network incrementally more attractive, likely helping CVS win more contracts, which have been trending toward all-or-none exclusivity arrangements. The firm will also be able to use its larger scale to demand higher reimbursement rates from insurance networks.

PBM peers, Express Scripts (ESRX)--which together with CVS, controls more than half of the market--Rite Aid (RAD) and United Health (UNH) are likely watching in worried fascination as the deal with Target is not the only major move CVS has made recently. In late May, CVS acquired Omnicare (OCR), the largest institutional pharmacy operator in the US, for ~$12.7 billion. The acquisition will enable CVS to significantly expand its prescription dispensing abilities in assisted living and long-term care facilities, a market expected to continue to grow at a strong rate due to the aging of baby boomers (seniors' use of pharmaceuticals is more than three times that of the general population). CVS will capture the cost advantages associated with the size and scope of Omnicare, and institutional exposure is a new segment for CVS, pushing its operations outside the traditional retail drugstore arena.

But another winner of the agreement between Target and CVS may not be completely obvious.

Last winter, Express Scripts thought it had changed the game after coming to an agreement with AbbVie (ABBV) in which the PBM would exclusively offer AbbVie's HCV treatments in the pharmacies it represents. In exchange for such exclusivity, the agreement was priced attractively and sparked concerns that high-priced drugs across the pharma chain would face tremendous pricing pressure, to the detriment of Big Pharma profits. In perhaps an equally savvy move, CVS countered the agreement by announcing it would offer exclusive coverage of Best Idea Newsletter portfolio holding Gilead Sciences' (GILD) HCV treatments, which studies suggest are more convenient for patients and have better cure rates.

This deal may be a win-win for Target and CVS, but as the latter gains share in the PBM arena, Gilead becomes a key derivative beneficiary as well; in fact, we attribute some of the recent strength in 9-rated Gilead's equity to CVS' deal-making. We're reiterating our view that price-to-fair value convergence continues at Gilead, and we value shares at $162 each, offering huge upside at the moment. Though their respective business models are certainly attractive, Target and CVS aren't nearly as cheap, and while we like the agreement, we're not rushing to add either of them to the respective newsletter portfolios.

The Watch List

By Valuentum Analysts

Our Valuentum Buying Index (VBI), which places a considerable emphasis on a firm's valuation, is the primary driver behind names included in our Best Ideas portfolio (see page 8). However, the size of our coverage universe lends itself to a plethora of new ideas beyond the ones we seek to capitalize on. Below, we provide a unique screen that sorts companies we feel are undervalued on both a DCF and relative value basis (the first two pillars of our VBI; the third is a technical assessment).

We update this screen monthly and deliver it to you in our newsletter (for your added convenience, we also post it on our site). You'll see we often hold a number of these firms in our portfolio, and we continue to monitor the remainder for the most opportune time to add them. The names on this list are the cream of the crop for the value investor and can supplement your "shopping list" of new ideas.

The second screen is a list of the '25 Cheapest Stocks on the Market' on the basis of the of the price-to-fair value ratio.

Company Name	Symbol	Industry	DCF Valuation	Relative Valuation	P/FV
Century Aluminum	CENX	Aluminum	UNDERVALUED	ATTRACTIVE	0.65
USG Corp	USG	Building Materials	UNDERVALUED	ATTRACTIVE	0.73
Perficient	PRFT	Business Services	UNDERVALUED	ATTRACTIVE	0.73
QUALCOMM	QCOM	Communications Equipment	UNDERVALUED	ATTRACTIVE	0.70
Owens-Illinois	OI	Containers & Packaging	UNDERVALUED	ATTRACTIVE	0.73
Avnet	AVT	Electronic Suppliers	UNDERVALUED	ATTRACTIVE	0.73
NASDAQ	NDAQ	Exchanges	UNDERVALUED	ATTRACTIVE	0.76
AIG	AIG	Insurance - Property & Casualty	UNDERVALUED	ATTRACTIVE	0.79
Priceline.com	PCLN	Internet & Catalog Retail	UNDERVALUED	ATTRACTIVE	0.75
Baidu	BIDU	Internet Software & Svcs	UNDERVALUED	ATTRACTIVE	0.78
Michael Kors Hldg	KORS	Luxury - Ultra & Aspirational	UNDERVALUED	ATTRACTIVE	0.63
Commercial Vehicle Group	CVGI	Machinery - trucks	UNDERVALUED	ATTRACTIVE	0.60
Gilead Sciences	GILD	Pharma - Generic/Other	UNDERVALUED	ATTRACTIVE	0.71
Nathan's Famous	NATH	Restaurants - Fast Food & Coffee	UNDERVALUED	ATTRACTIVE	0.78
Microsoft	MSFT	Software	UNDERVALUED	ATTRACTIVE	0.77

Company Name	Symbol	Sector	Industry	Price/Fair Value
Canadian Solar	CSIQ	Industrials	Solar	0.49
Sony	SNE	Consumer Discretionary	Luxury - Established Brands	0.56
Michael Kors Hldg	KORS	Consumer Discretionary	Luxury - Ultra & Aspirational	0.63
Alibaba	BABA	Consumer Discretionary	Internet & Catalog Retail	0.65
Century Aluminum	CENX	Materials	Aluminum	0.65
NeuStar	NSR	Telecom Services	Wireless Telecom Services	0.68
Helix Energy	HLX	Energy	Energy Equipment	0.68
QUALCOMM	QCOM	Information Technology	Communications Equipment	0.70
Herbalife	HLF	Consumer Discretionary	Luxury - Established Brands	0.71
Gilead Sciences	GILD	Health Care	Pharma - Generic/Other	0.71
CECO Environmental	CECE	Industrials	Pollution Controls	0.72
Owens-Illinois	OI	Materials	Containers & Packaging	0.73
Jabil Circuit	JBL	Information Technology	Electronic Suppliers	0.73
American Railcar	ARII	Industrials	Railroads	0.73
Avnet	AVT	Information Technology	Electronic Suppliers	0.73
Perficient	PRFT	Information Technology	Business Services	0.73
USG Corp	USG	Industrials	Building Materials	0.73
Pandora	P	Information Technology	Broadcasting - Radio	0.74
LG Display	LPL	Information Technology	Electronic Suppliers	0.74
Strayer Education	STRA	Consumer Discretionary	Education Services	0.75
Rio Tinto	RIO	Materials	Mining - diversified	0.75
Priceline.com	PCLN	Consumer Discretionary	Internet & Catalog Retail	0.75
NASDAQ	NDAQ	Financials	Exchanges	0.76
Supervalu	SVU	Consumer Staples	Food Retailers	0.76
Facebook	FB	Information Technology	Internet Software & Svcs	0.76

*Ideas...*continued on next page

***Ideas...*from previous page**

The initial table below showcases firms that fit the bill of the Valuentum investor, with each posting a 9 or a 10 on our index. These are names that we may swap into our portfolio on the long side (if not already held) should their upside potential become greater than our current holdings.

We also show firms that register a 1 or 2 on our VBI. These names represent put-option candidates. We provide the respective lists below, and each firm's report can be found on our website.

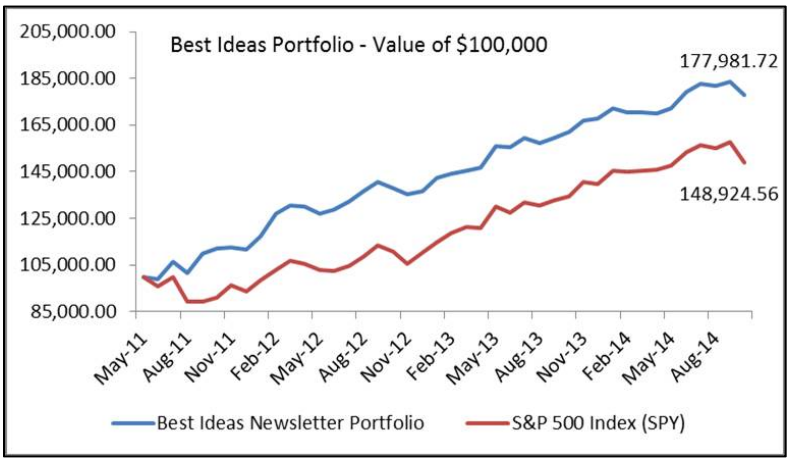
Company Name	Symbol	Sector	Industry	VBI
Priceline.com	PCLN	Consumer Discretionary	Internet & Catalog Retail	10
AIG	AIG	Financials	Insurance - Property & Casualty	9
Gilead Sciences	GILD	Health Care	Pharma - Generic/Other	9
NASDAQ	NDAQ	Financials	Exchanges	9
USG Corp	USG	Industrials	Building Materials	9
Michael Kors Hldg	KORS	Consumer Discretionary	Luxury - Ultra & Aspirational	8
Nathan's Famous	NATH	Consumer Discretionary	Restaurants - Fast Food & Coffee	8

Company Name	Symbol	Sector	Industry	VBI
BJ's Restaurants	BJRI	Consumer Discretionary	Restaurants - Fast Cas & Full Svc	1
Brown-Forman	BF.B	Consumer Staples	Beverages - alcoholic	1
Choice Hotels	CHH	Consumer Discretionary	Hotels	1
Columbia Sportswear	COLM	Consumer Discretionary	Retail - Under 30, Off-Price, Sport Appar	1
Hess	HES	Energy	Refiners	1
Hyatt	H	Consumer Discretionary	Hotels	1
Jack in the Box	JACK	Consumer Discretionary	Restaurants - Fast Food & Coffee	1
Kinder Morgan	KMI	Energy	Oil & Gas Pipelines	1
Madison Square Garden	MSG	Consumer Discretionary	Media - entertainment	1
Magellan Midstream	MMP	Energy	Oil & Gas Pipelines	1
McDonald's	MCD	Consumer Discretionary	Restaurants - Fast Food & Coffee	1
NewMarket	NEU	Materials	Chemicals - mid/small	1
Novartis	NVS	Health Care	Pharmaceuticals - Big	1
Novo Nordisk	NVO	Health Care	Pharmaceuticals - Big	1
Quidel Corp	QDEL	Health Care	Diagnostic Substances	1
Rayonier	RYN	Industrials	Conglomerates	1
Air Products & Chemicals	APD	Materials	Chemicals - broad	2
Alere	ALR	Health Care	Health Providers & Svcs	2
DineEquity	DIN	Consumer Discretionary	Restaurants - Fast Cas & Full Svc	2
Eli Lilly	LLY	Health Care	Pharmaceuticals - Big	2
Mercury General	MCY	Financials	Insurance - Property & Casualty	2
Red Robin	RRGB	Consumer Discretionary	Restaurants - Fast Cas & Full Svc	2
Rollins	ROL	Materials	Chemicals - mid/small	2
Vulcan Materials	VMC	Industrials	Building Materials	2

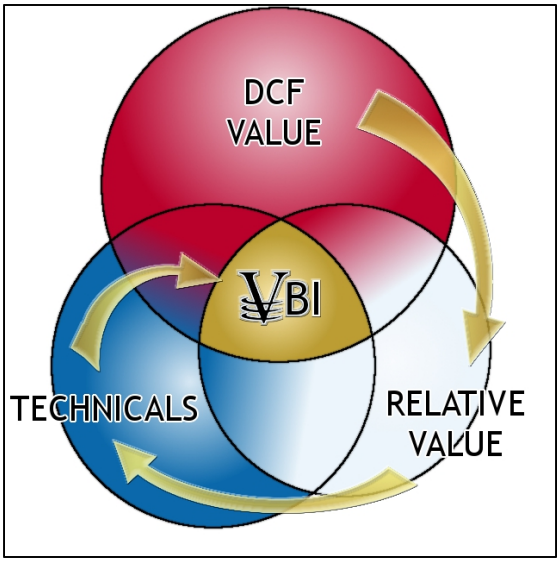
Our Methodology – The Valuentum Buying Index (VBI)

By Valuentum Analysts

At Valuentum, we think the best opportunities arise from a complete understanding of all investing disciplines in order to identify the most attractive stocks at any given time. Valuentum therefore analyzes each stock across a wide spectrum of philosophies, from deep value through momentum investing. We think companies that are attractive from a number of investment perspectives--whether it be growth, value, income, momentum, etc.--have the greatest probability of capital appreciation and relative outperformance. The more deep-pocketed institutional investors that are interested in the stock for reasons based on their respective investment mandates, the more likely it will be bought and the more likely the price will move higher to converge to its true intrinsic value (buying a stock pushes its price higher). On the other hand, we think the worst stocks will be shunned by most investment disciplines and display expensive valuations, poor technicals and deteriorating momentum indicators.



Stocks that meet our demanding criteria fall in the center of the Venn diagram below, displaying attractive characteristics from a discounted cash-flow basis, a relative value basis, and with respect to a technical and momentum assessment. The size of the circles reveals the relative emphasis we place on each investment consideration, while the arrows display the order of our process -- value first then technicals and momentum last. We may like firms that are undervalued both on a DCF basis and relative value basis, but we won't like firms just because they're currently exhibiting attractive technical or momentum indicators. We're not traders or speculators. We're long-term investors and want to have complete confirmation and conviction in the best ideas we deliver to our subscribers.



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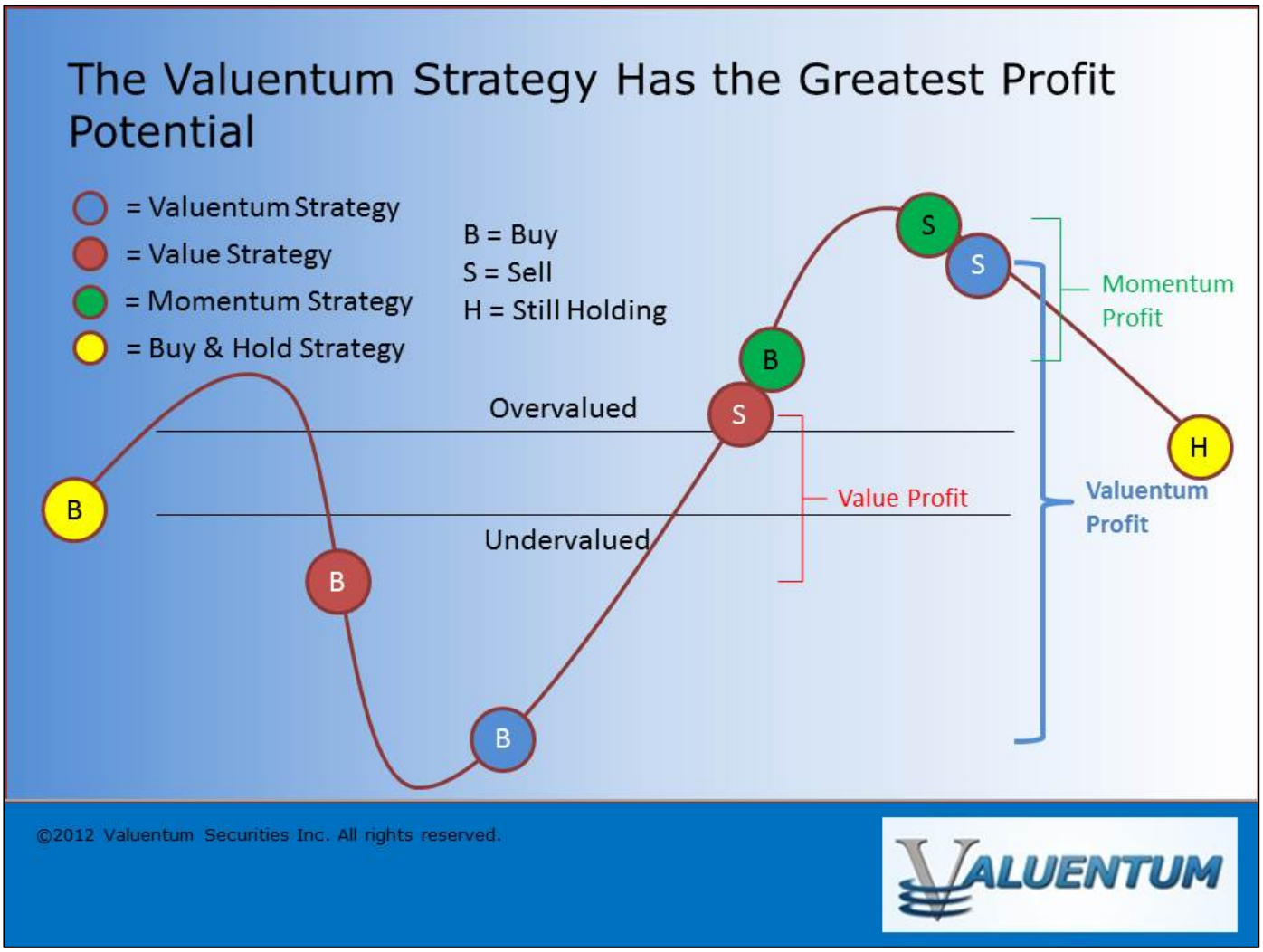
The center of the Venn diagram above, the Valuentum Buying Index (VBI) combines rigorous financial and valuation analysis with an evaluation of a firm's technicals and momentum indicators to derive a score between 1 and 10 for each company (10=best). Because our process factors in a technical and momentum assessment after we evaluate a firm's investment merits via our rigorous DCF and relative-value process, we're better able to pinpoint the best entry and exit points on the most undervalued stocks.

Research firms that just focus on valuation may encourage investors to buy a stock all the way down (a falling knife), while those that just use technical and momentum indicators may expose portfolios to significantly overpriced stocks at their peaks. Only when both sides of the investment spectrum are combined can investors get the best stocks on the market today at the best prices, in our view.

Let's examine the chart below, which showcases how the Valuentum process has the greatest profit potential of any investing strategy. The Valuentum process targets adding stocks to actively-managed portfolios when both value and momentum characteristics are "good" and removing them when both value and momentum characteristics are "bad" (blue circles: Buy --> Sell). The Valuentum strategy captures the entire equity pricing cycle, while the value and momentum strategies individually truncate profits.



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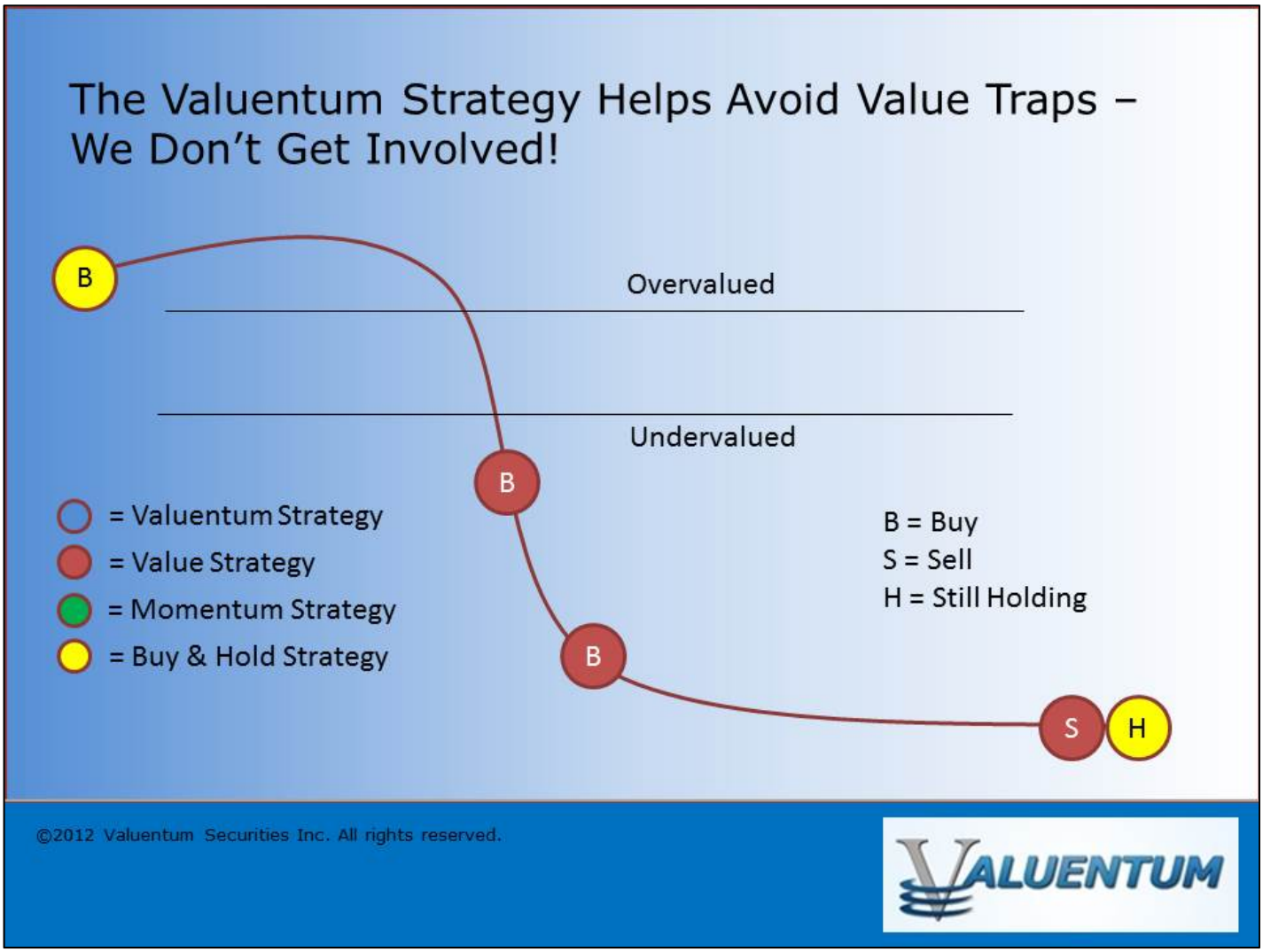
Furthermore, Valuentum subscribers are less likely to be involved in value traps because we demand material revenue and earnings growth for firms to earn a 10 on our Valuentum Buying Index. Value traps often occur as a result of secular declines in a firm's products or services, resulting in deteriorating revenue and earnings trends (and a falling stock price). Valuentum subscribers are less likely to be exposed to these "falling knives" since our process requires firms to not only be undervalued but also be exhibiting bullish technical and momentum indicators before we would consider adding them to our actively-managed portfolios.

Since the stock market is a forward-looking mechanism, price usually leads fundamentals. Without a turnaround in price, the risk that the fundamentals of an undervalued stock have not turned for the positive is higher. Where value strategies may encourage the buying of a stock all the way down regardless of whether fundamentals ever turn (red circles: Buy --> Sell), the Valuentum strategy simply steers clear of these situations. We wait for technical improvement in the equity, which often precedes fundamental changes at the company.



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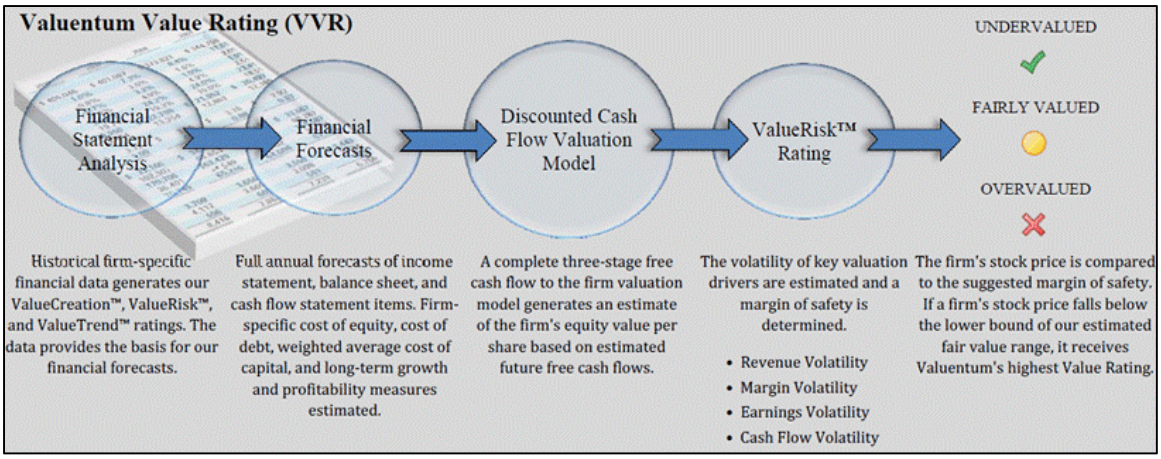
I. We Use a Rigorous Discounted Cash Flow Valuation Process

Our methodology starts with in-depth financial statement analysis, where we derive our ValueCreation, ValueRisk, and ValueTrend ratings, which together provide a quantitative assessment of the strength of a firm's competitive advantages. We compare a company's return on invested capital (ROIC) to our estimate of its weighted average cost of capital (WACC) to assess whether it is creating economic profit for shareholders (ROIC less WACC equals economic profit). Firms that have improving economic profit spreads over their respective cost of capital score high on our ValueCreation and ValueTrend measures, while firms that have relatively stable returns score well with respect to our ValueRisk evaluation, which impacts our margin-of-safety assessment.



After evaluating historical trends, we then make full annual forecasts for each item on a company's income statement and balance sheet to arrive at a firm's future free cash flows. We derive a company-specific cost of equity (using a fundamental beta based on the expected uncertainty of key valuation drivers) and a cost of debt (considering the firm's capital structure and synthetic credit spread over the risk-free rate), culminating in our estimate of a company's weighted average cost of capital (WACC). We don't use a market price-derived beta, as we embrace market volatility, which provides investors with opportunities to buy attractive stocks at bargain-basement levels.

We then assess each company within our complete three-stage free cash flow to the firm (enterprise cash flow) valuation model, which generates an estimate of a company's equity value per share based on its discounted future free cash flows and the company's net balance sheet impact, including other adjustments to equity value (namely pension and OPEB adjustments). Our ValueRisk rating, which considers the underlying uncertainty of the capacity of the firm to continue to generate value for shareholders, sets the margin of safety bands around this fair value estimate. For firms that are trading below the lower bound of our margin of safety band, we consider these companies undervalued based on our DCF process. For firms that are trading above the higher bound of our margin of safety band, we consider these companies overvalued based on our DCF process.

We think a focus on discounted cash-flow valuation prevents investors from exposing their portfolios to significantly overpriced stocks at their peaks. The chart below reveals how pure momentum investors may expose their portfolios to pricing extremes and dramatic falls (green circles: Buy --> Sell). We stay away from these situations.

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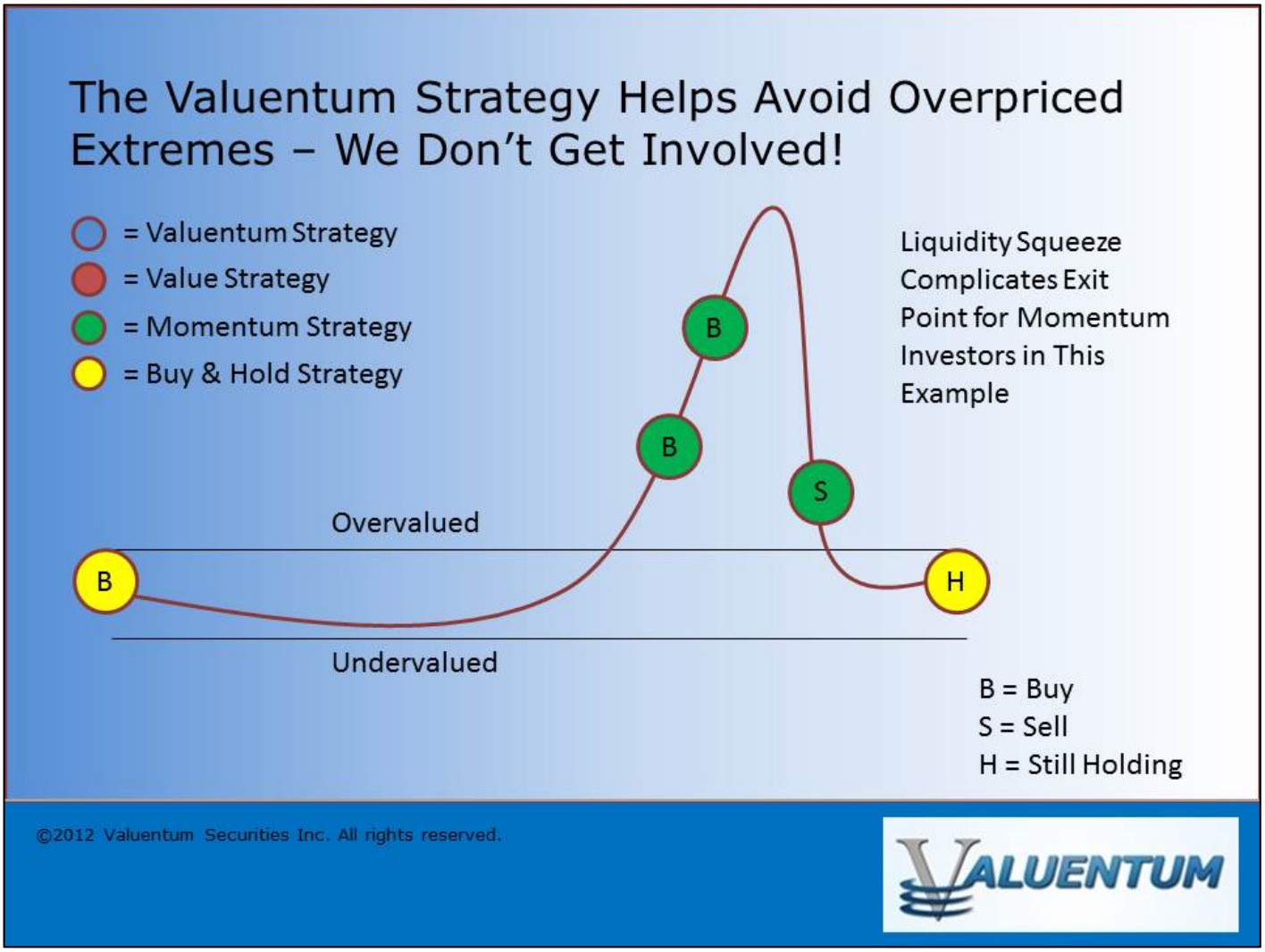

II. We Perform a Forward-Looking Relative Value Assessment

Our discounted cash-flow process allows us to arrive at an absolute view of the firm's intrinsic value. However, we also understand the critical importance of assessing firms on a relative value basis, versus both their industry and peers. Many institutional money-managers--those that drive stock prices--pay attention to a company's price-to-earnings (PE) ratio and price-earning-to-growth (PEG) ratio in making buy/sell decisions. With this in mind, we have included a forward-looking relative value assessment in our process to further augment our rigorous discounted cash-flow process. If a company is undervalued on both a price-to-earnings ratio and a price-earnings-to-growth (PEG) ratio versus industry peers, we would consider the firm to be attractive from a relative value standpoint.

III. We Seek to Avoid Value Traps, Falling Knives and Opportunity Cost

Once we have estimated a firm's intrinsic value on the basis of our discounted cash-flow process, determined if it is undervalued according to its firm-specific margin of safety bands, and assessed whether it has relative value versus industry peers, we then evaluate the company's technical and momentum indicators to pin-point the best entry and exit points on the stock (but only after it meets our stringent

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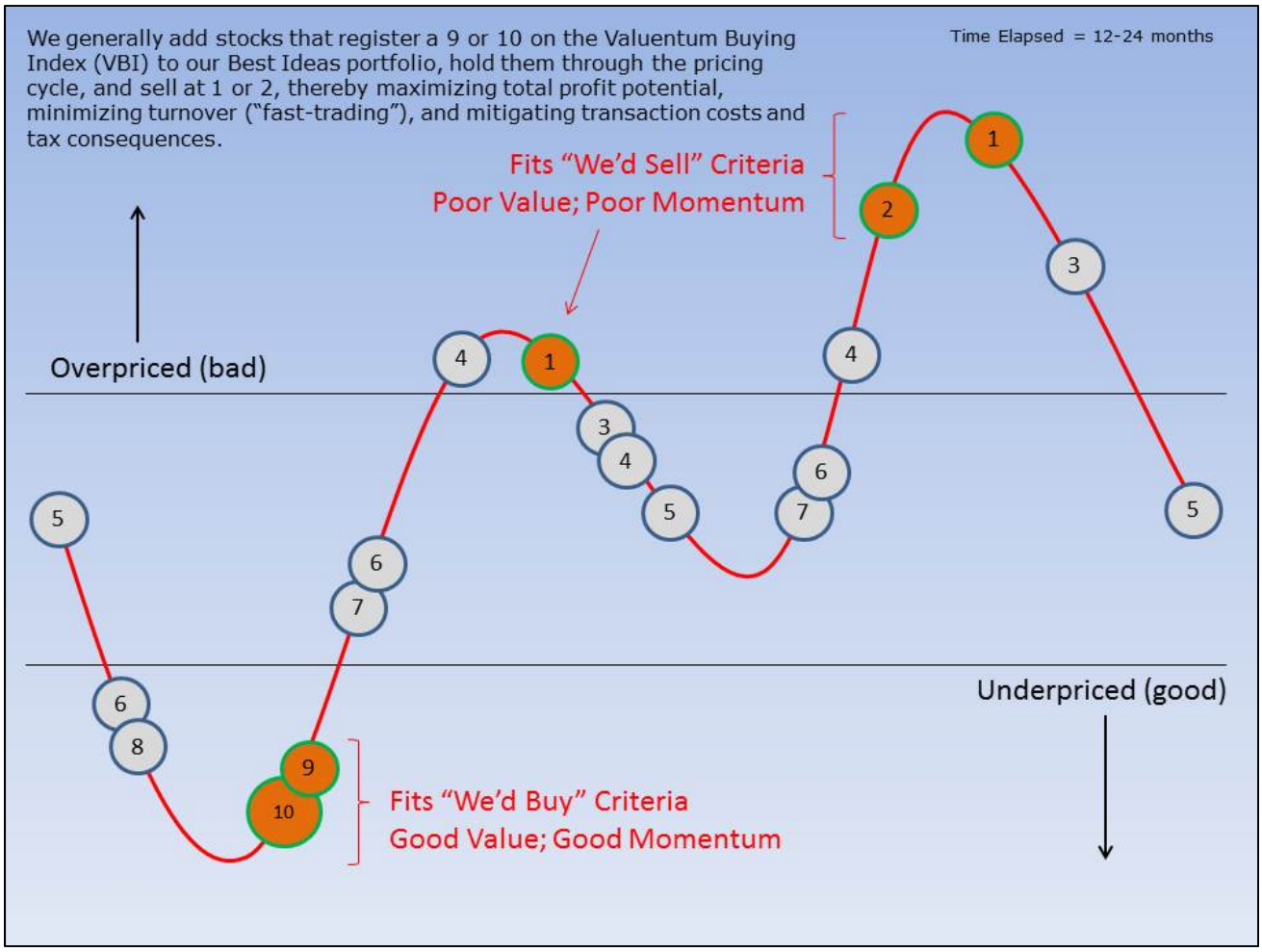
valuation criteria). Rigorous valuation analysis and technical analysis are not mutually exclusive, and we believe both can be used together to bolster returns. An evaluation of a stock's moving averages, relative strength, upside-downside volume, and money flow index are but a few considerations we look at with respect to our technical and momentum assessment of a company's stock.

We embrace the idea that the future is inherently unpredictable and that not all fundamental factors can be included in a valuation model. By extension, we use technical and momentum analysis to help safeguard us against value traps, falling knives, and the opportunity cost of holding an undervalued equity for years before it converges to fair value. Other research firms do not consider opportunity cost as a legitimate expense for investors.

Putting It All Together - the Valuentum Buying Index

Though the time frame varies depending on each idea, we expect our best ideas to work out over a 12-24 month time horizon (on average) -- any shorter than that is mostly luck, in our view. We tend to add firms to our Best Ideas portfolio when they register a 9 or 10 on our Valuentum Buying Index (VBI) and tend to remove firms from our Best Ideas portfolio when they register a 1 or 2 on our VBI.

We like to maximize profits on every idea, with the understanding that momentum does exist and that prices over and under shoot intrinsic value all of the time. A value strategy (10 --> 5) truncates potential profits, while a momentum strategy (4 --> 1) ignores profits generated via value assessments. We're after the entire profit potential, as shown below.



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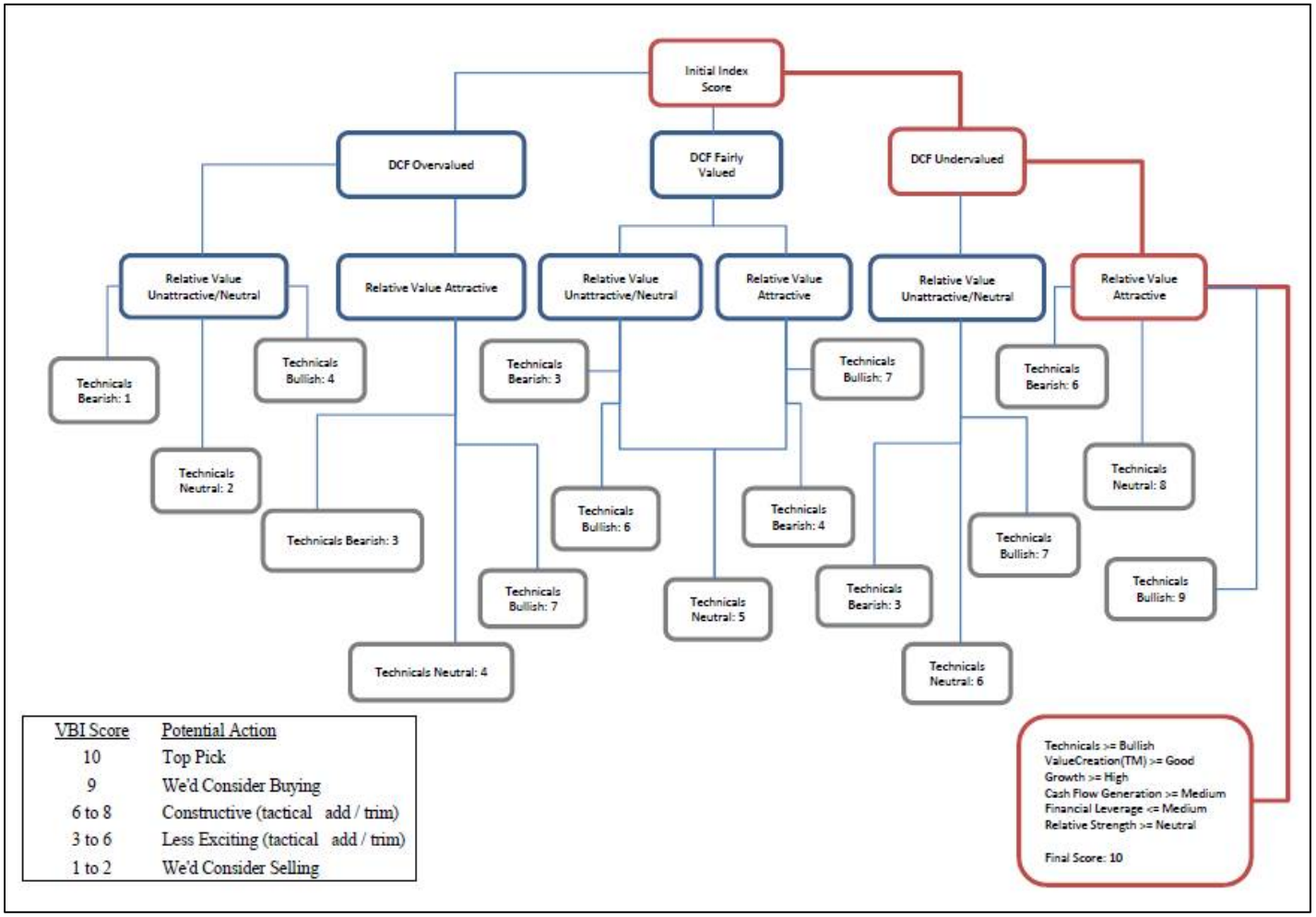
Let's follow the red line on the flow chart below to see how a firm can score a 10, the best mark on our index (a "Top Pick"). Please click here to view an enlarged pdf version. First, the company would need to be 'UNDERVALUED' on a DCF basis and 'ATTRACTIVE' on a relative value basis. The stock would also have to be exhibiting 'BULLISH' technicals. The firm would need a ValueCreation rating of 'GOOD' or 'EXCELLENT', exhibit 'HIGH' or 'AGGRESSIVE' growth prospects, and generate at least a 'MEDIUM' or 'NEUTRAL' assessment for cash flow generation, financial leverage, and relative price strength.

This is a tall order for any company, but we're looking to deliver the very best of ideas to our clients and subscribers. Firms that don't make the cut for a 10 are ranked accordingly, with the least attractive stocks garnering a score of 1 ("We'd sell"). Most of our coverage universe falls between 3 and 7, but at any given time there could be large number of companies garnering either high or low scores, especially at market lows or tops, respectively.



VBI Score	Potential Action
10	Top Pick
9	We'd Consider Buying
6 to 8	Constructive (tactical add / trim)
3 to 6	Less Exciting (tactical add / trim)
1 to 2	We'd Consider Selling

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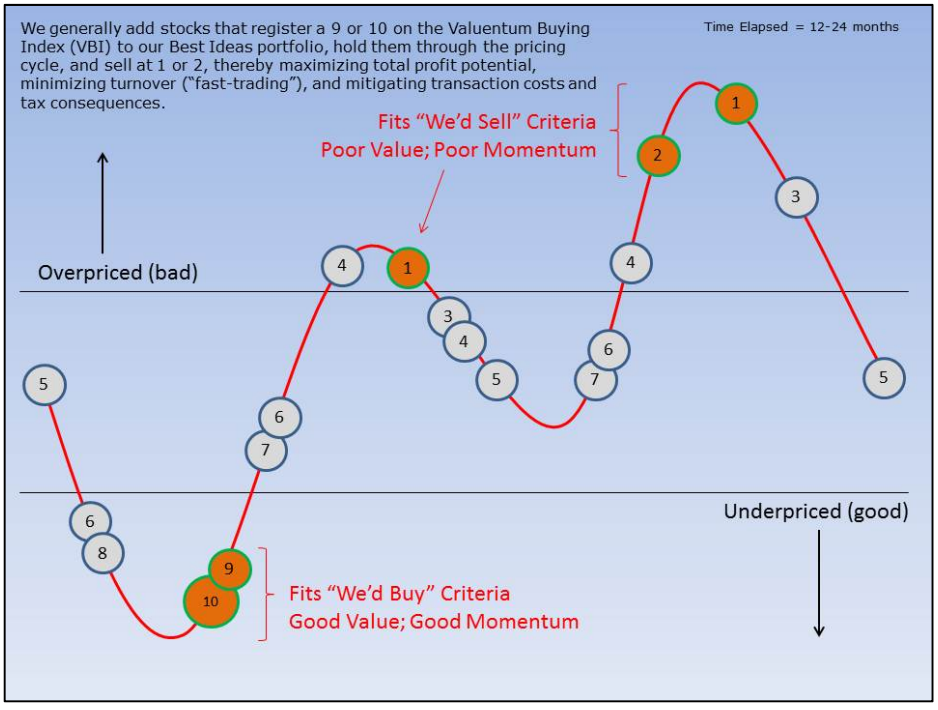
How We Use the Valuentum Buying Index in the Best Ideas Newsletter Portfolio

First and foremost, firms in our Best Ideas portfolio should be considered our best ideas at any point in time. The Best Ideas portfolio can always be found on page 8 of our monthly Best Ideas Newsletter. Firms in our Dividend Growth portfolio should be considered our best dividend growth ideas at any point in time. The Dividend Growth portfolio can always be found on page 5 of our monthly Dividend Growth Newsletter.

Let's talk about how the Valuentum Buying Index (VBI) informs which ideas we include in our actively-managed portfolios. We've noticed via our statistical backtesting that the momentum factor behind our process tends to be much more pronounced (powerful) over longer periods of time. This was one of the interesting findings of our academic white paper study. We try to replicate this dynamic with the update cycle of our reports (and the time horizon for our ideas to work out). That's why our reports are updated regularly (at least quarterly) or after material events and not daily or weekly. We don't want to whipsaw our membership, nor do we think churn is the way to generate outperformance.

Though the time frame varies depending on each idea, we expect our best ideas to work out over a 12-24 month time horizon (on average) -- any shorter than that is mostly luck, in our view. We tend to add firms to our Best Ideas portfolio when they register a 9 or 10 on our Valuentum Buying Index (VBI) and tend to remove firms from our Best Ideas portfolio when they register a 1 or 2 on our VBI. You'll notice that we have a qualitative overlay in the portfolio, which is necessary and similar in thinking as if you were to imagine a value investor not adding every undervalued stock to his/her portfolio. There are always tactical and sector weighting considerations in any portfolio construction.

As for the time horizon for ideas, we like to maximize profits on every idea, with the understanding that momentum does exist and that prices over and under shoot intrinsic value all of the time. A value strategy (10 --> 5) truncates potential profits, while a momentum strategy (4 --> 1) ignores profits generated via value assessments. We're after the entire profit potential. So, for example, if a firm is added to the Best Ideas portfolio as a 10 and is removed as a 5, we would have truncated profit potential. Most of our highly-rated Valuentum Buying Index rated stocks have generated the vast outperformance of the Best Ideas portfolio. Please view the pricing cycle below.



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Importantly, regarding our process, we don't blindly and immediately add firms to our portfolio once they score a 9 or 10 (and we do not add all firms that score a 9 or 10 to our portfolio). For example, Google (GOOG), a current Best Ideas portfolio holding, registered a 10 on our scale, but we remained patient and didn't add the company to our portfolio until after it reported earnings in late 2012, which provided us with an even better entry point (as new information came to light). We engage in a qualitative portfolio management overlay to maximize returns and minimize risk. The number informs our process, but the team makes the allocation decisions of the portfolio.

After adding firms to our Best Ideas portfolio, we may tactically trade around these positions when they have VBI ratings between 3 and 8 depending on the size of their weighting in our portfolio or their attractiveness relative to other opportunities (a score of 3 through 8 is typically equivalent to a 'we'd hold'). We tend to remove firms from our Best Ideas portfolio when they register a 1 or 2 on our process. Importantly, however, firms in our Best Ideas portfolio, which have generally registered a 9 or 10 on our scale when we added them, should be considered our best ideas at any point in time.

Take eBay (EBAY) as another example of our process in action. The firm initially flashed a rating of 10 in late September 2011 (at $32 per share), and we added it to our Best Ideas portfolio. The VBI rating changed to a 6 in December 2011 and then back to a 10 in May 2012. Because the rating never breached a 1 or 2, we did not remove the position from our portfolio. In fact, we tactically added to it. eBay is probably one of the better examples to use for illustrating the prolonged outperformance driven by undervalued stocks that are beginning to generate good momentum. We like to capture the entire pricing cycle and not truncate it as most value investors do.

Though eBay may register a lower VBI rating in a subsequent update, we would still view it as one of our best ideas, as it is a holding in our Best Ideas portfolio (it has never flashed a 'We'd Sell' signal, 1 or 2). Obviously, there have been more straight-forward opportunities in our Best Ideas portfolio, especially in the case of EDAC Tech (EDAC), which had tripled since we added it to the portfolio (never registering below a 9 along the way). The VBI ratings on our most recent 16-page reports, downloadable directly from our website, reflect our current opinion on the company.

The Valuentum Buying Index, like all methodologies, informs the investment decision process, but in constructing a portfolio, a qualitative overlay is not only necessary but has been shown to optimize performance in the white paper study.

About Our Name

But how, you will ask, does one decide what [stocks are] "attractive"? Most analysts feel they must choose between two approaches customarily thought to be in opposition: "value" and "growth,"...We view that as fuzzy thinking...Growth is always a component of value [and] the very term "value investing" is redundant.

-- Warren Buffett, Berkshire Hathaway annual report, 1993

At Valuentum, we take Buffett's thoughts one step further. We think the best opportunities arise from a complete understanding of all investing disciplines in order to identify the most attractive stocks at any given time. Valuentum therefore analyzes each stock across a wide spectrum of philosophies, from deep value to momentum investing. And a combination of the two approaches found on each side of the spectrum (value/momentum) in a name couldn't be more representative of what our analysts do here; hence, we're called Valuentum.

Valuentum Best Ideas Newsletter: Volume 5, Issue 7

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

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No warranty is made regarding the accuracy of any data or any opinions. The portfolio in the Valuentum Best Ideas Newsletter is hypothetical and does not represent real money. Performance assessment of the Valuentum Buying Index™ is currently ongoing, and we intend to update investors as soon as such results are available. Past performance is not a guarantee of future results.

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

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