OUR DIVIDEND GROWTH NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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Volume 5 Issue 1

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

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

*Please see note below regarding performance measurement.

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"To borrow from one of my favorite entrepreneurs, Henry Ford, 'whether you think you can, or you think you can't—you're right.'"
– 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, 2016, the portfolio is significantly exceeding this goal.

A Little Inspiration

By Brian Nelson, CFA

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

Latest transaction alert
We removed half of the position in Altria (MO) on November 5, 2015.

For more information, please access the following link: http://www.valuentum.com/articles/20151105_2

"Whether you think you can, or you think you can't--you're right." — Henry Ford

Everyday someone is told they can't. Everyday someone is told it is just luck. But year after year, investors beat the market. It happens all the time.

Warren Buffett has put up outperformance of such magnitude that the skeptics just ignore his work. Bill Miller's Legg Mason Capital Management Value Trust beat the S&P 500 for 15 consecutive years from 1991 through 2005, after fees. The manager of the Magellan Fund at Fidelity Investments from 1977 through 1990, Peter Lynch averaged nearly a 30% annual return – more than doubling that of the S&P 500 during that time.

The skeptics won't have any of it.

Leonard Mlodinow's "The Drunkard's Walk" noted that, in Miller's case, the odds of someone beating the market for 15 years in a row is ~75%, far better than even – as if it were no achievement at all, just luck. Some may even argue the streak was bound to happen – they may go so far as to say it would be unlikely if such an occurrence had never happened. They'll do their best to explain away Buffett and Lynch, and some may do their best to make sure you don't even try.

"You can't beat the market. Just buy an index fund. Those guys are just lucky." – says the skeptic.

I don't see it that way.

From my vantage point, it is often the case that the ones that observers call the luckiest are the ones that work the hardest. They leave no stone unturned, they're not bound by "normal" working hours, they can piece things together in ways others simply can't. Those that make it big say it takes 10 years or more to become an "overnight" success. It's funny how that works.

To borrow from one of my favorite entrepreneurs, Henry Ford, "whether you think you can, or you think you can't—you're right."

Let's assume someone has never swung a baseball bat or has ever seen a game of baseball. He might say, "Are you joking? Nobody can hit a round, laced ball of cowhide thrown at 90 miles per hour with a cylindrical wooden object more than 400 feet over land in the air…"

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A Little Inspiration…**from previous page**

Seems like a reasonable reaction, wouldn't you say? After all, the skeptic has never hit a homerun, nor has he ever seen anyone hit a homerun before. Maybe all of his friends have never played baseball either… and they think a homerun is just luck, too, if such a thing was even possible.

The skeptic and his friends then go around telling everybody that they can't beat the market (sorry: hit a homerun), and therefore they shouldn't try either. The propaganda works – those skeptics often are quite believable. They wear suits and work for name-brand companies.

The skeptic hasn't put in the decade-plus of work just to make it to the "Show." The skeptic doesn't have blisters on his hands that a good ol' ballplayer would wear as evidence of his dedication. The skeptic may not even like baseball. He's in for the quick sale…

But wait… it gets worse.

Let's say the skeptic tries, but half-heartedly, and after failing, then confirms in his view that hitting a homerun isn't possible. Or worse, let's say the skeptic gave it his all, but failed all the same, absolutely confirming in his eyes what he thinks he already knows: a homerun is just luck if not impossible.

In truth, maybe all the skeptic can do is hit a "Texas Leaguer."

We all know hitting a homerun is possible, and we all know that beating the market is possible. Let's keep working hard, uncovering new ideas. But in 2016, just like in 2015 and the years prior, let's keep a good eye and not swing at everything!

We're going to hit solid line-drives and base hits, but if we do hit homeruns, it will be on a good pitch, a "fat" pitch. With valuations as they are, Mr. Market will be throwing us a lot of curveballs this year, but we don't have to swing, and neither do you.

As an investor, make sure you get your right pitch! And if you swing, drive it clear over the left-field wall. Leave the "nay-saying" to the skeptics! Here's to a prosperous New Year!

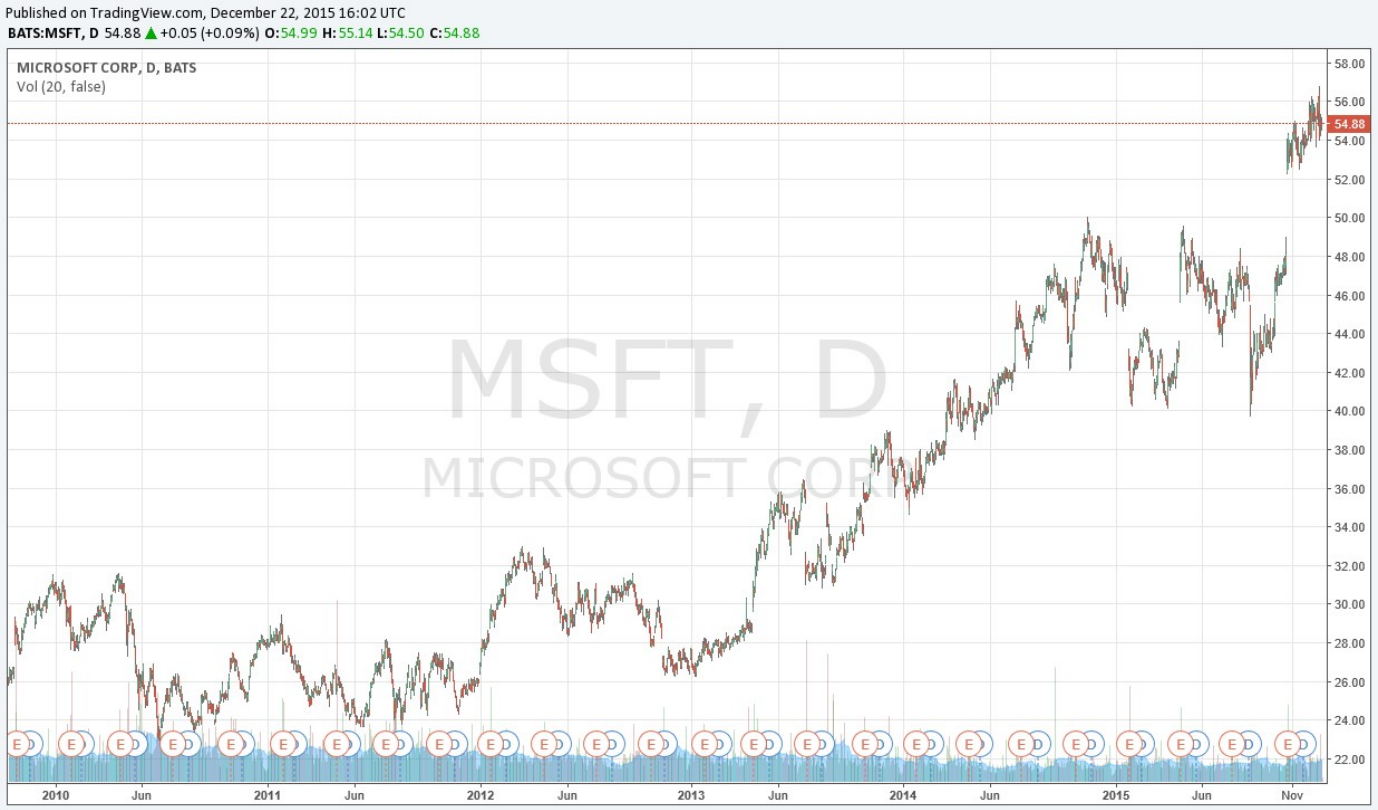
Image Source: slgckgc

Cash Is King: Microsoft Leading the Charge!

By Brian Nelson, CFA

It's sometimes difficult for companies to overcome a tarnished reputation, particularly when it comes to a spotty dividend track record, but also as it relates to equity performance. The stock market is often unforgiving at times. Microsoft (MSFT) had long been viewed as "dead money," or a term that describes an equity that languishes in a small trading range for years. For example, from 2010 to the beginning of 2013 (at the time it was added to the Dividend Growth Newsletter portfolio), Microsoft had bounced around in the mid-$20s per share.

But as the chart below shows, overcoming a tarnished reputation is not impossible; in fact, Microsoft has put its "dead money" reputation behind it, powering past levels even witnessed during the height of the dot-com bubble in the late 1990s/early 2000s. Though shares have reached our fair value estimate, part of the Valuentum methodology focuses on letting our winners run until both value and technical/momentum indicators wane. In Microsoft's case, the company still has meaningful upside toward the high end of the fair value range, and while shares could certainly close the recent "gap up" in the near term, the company's technical/momentum indicators are about as healthy as it gets, in our view.



For most of the past few years, we traveled around the country to local American Association of Individual Investors (AAII) societies, explaining to investors the benefits of the Dividend Cushion ratio in assessing risks related to both the sustainability and growth of the dividend, using Microsoft as one of our favorite examples of a company that could increase its payout in a big way (it has). On the basis of several of the financial metrics below, we continue to believe the software giant is a "Dividend Aristocrat-to-be," a company that we expect will put together an impressive streak of dividend increases for 20 years or more in the future.

On the other hand, to explain situations of poor dividend health (e.g. commodity-dependent, capital-intensive, and overleveraged entities paying out more than free cash flow and earnings as dividends), we used Kinder Morgan (KMI) and the master limited partnership model (AMLP), in general, as examples. The

Please see *Cash is King* ...on next page

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MLP business model has lost so much money for retirees over the past few years that we're hoping (praying) the recent bounce in units will facilitate some sustained recovery. Many retirees may not be aware of the eroding characteristics of dividend/distribution payments to intrinsic value and the impact of a rising interest rate on the intrinsic valuation of the equities/partnerships. The long-term works against MLP units, in our view.

As those that are familiar can attest, the Valuentum process is completely forward-looking, meaning we're far more interested in companies that we think will increase their dividends in the future, than ones that have increased them in the past and may be pushing the limit, putting income investors at risk. A Dividend Cushion ratio below 1 indicates heightened risk with respect to the dividend payout, but we're most concerned about companies that have a negative Dividend Cushion ratio. Please be sure to take a look at our list of "Dividend Yields to Avoid!" We update this list monthly and publish it at www.valuentum.com and in each monthly edition of the Valuentum Dividend Growth Newsletter. Many of the firms that have slashed their payouts were on this list before they cut the payout (and many suffered significant declines in their share prices).

What we like about Microsoft and most of big tech, including Cisco (CSCO) and Apple (AAPL) is their extremely healthy balance sheets. Where a company such as Energy Transfer Partners (ETP) has a massive long-term debt position of $27.5 billion, as of the third quarter of 2015, and a meager cash position of less than $1 billion, Microsoft, by comparison, at the end of September 30, had a total cash balance of nearly $100 billion relative to short- and long-term debt of ~$37 billion, good for well over $60 billion in net cash on the books to use to pay out the dividend, should traditional measures of free cash flow come under pressure.

That's not all, however. In the third quarter of 2015 alone, Microsoft hauled in $8.6 billion in net cash from operations, while additions to property plant and equipment were $1.36 billion, good for more than $7 billion in positive free cash flow generation. The software giant paid out $2.5 billion in dividends during the period, revealing substantial excess coverage on the basis of free cash flow generation alone, even if we ignored its tremendous cash reserves. By comparison, cash flow from operations at Energy Transfer Partners was $2 billion through the first nine months of the year, while capital spending totaled $6.5 billion, good for a $4.5 billion shortfall (negative $4.5 billion). Yet, Energy Transfer Partners paid out $2.25 billion in distributions to partners! The MLP business model is about as risky as it gets, in our view, and we don't think it is going to make it to the other end of this energy cycle.

Those that are in the pipeline business will say that such analysis is not how one should evaluate pipeline equities – they use industry measures of distributable cash flow, not to be confused with widely-accepted measures of discounted cash flow used in the valuation process – both going by DCF. But we also remember during the dot-com bubble when investors were valuing Internet equities burning through free cash on the basis of "eyeballs," hits to the site. Investors know that cash is king -- net cash on the balance sheet and traditional measures of free cash flow, as defined by cash flow from operations less all capital spending. Investors know that MLP accounting is far from transparent, and disclosures regarding non-GAAP free cash flow and GAAP measures of leverage will only help investors make better decisions. Why not include these measures on every press release? We think management teams should take lead in making sure investors are aware of these measures.

It should be no surprise that entities such as Microsoft, Apple and Cisco, which are overflowing with net cash on the balance sheet and generate traditional measures of free cash flow far in excess of dividends paid, are among the strongest dividend payers on the market. Their financial conditions fly in the face of more risky companies that have piles of debt on the balance sheet and run at a deficit in traditional free cash flow generation, but still pay out massive distributions. The latter is an unsustainable proposition, in our view. We're sticking with tried-and-true investing principles and a focus on traditional measures of free cash flow.

The Dividend Growth Portfolio

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

DIVIDEND GROWTH PORTFOLIO -- as of January 1, 2016 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	101	3,001.65	58.21	5,879.21	3.6%	228.26
Apple (AAPL)	7/24/2013	63.17	51	3,228.45	105.26	5,368.26	3.3%	106.08
Cisco (CSCO)	11/14/2014	26.15	100	2,622.00	27.16	2,716.00	1.6%	84.00
Coach (COH)	9/19/2014	37.55	80	3,011.00	32.73	2,618.40	1.6%	108.00
Energy Sector SPDR (XLE)	4/1/2015	72.63	121	8,795.76	60.32	7,298.72	4.4%	249.23
General Electric (GE)	10/21/2013	26.18	240	6,290.20	31.15	7,476.00	4.5%	220.80
Hasbro (HAS)	12/30/2011	31.89	110	3,514.90	67.36	7,409.60	4.5%	202.40
HCP (HCP)	9/19/2014	40.11	75	3,015.25	38.24	2,868.00	1.7%	169.50
Intel (INTC)	12/30/2011	24.25	289	7,015.25	34.45	9,956.05	6.0%	277.44
Johnson & Johnson (JNJ)	12/30/2011	65.58	107	7,024.06	102.72	10,991.04	6.7%	321.00
Medtronic (MDT)	12/30/2011	38.25	157	6,012.25	76.92	12,076.44	7.3%	238.64
Microsoft (MSFT)	12/30/2011	25.96	154	4,004.84	55.48	8,543.92	5.2%	221.76
Proctor & Gamble (PG)	12/30/2011	66.71	105	7,011.55	79.41	8,338.05	5.1%	278.25
PP&L (PPL)	12/30/2011	29.42	238	7,008.96	34.13	8,122.94	4.9%	359.38
Realty Income (O)	7/24/2013	44.35	60	2,668.00	51.63	3,097.80	1.9%	137.40
Talen Energy (TLN)	6/1/2015	Spin off	29	Spin off	6.23	180.67	0.1%	NA
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 tradi				2,363.42		61,741.72	37.5%	3,202.14
Dividend Growth Portfolio				100,000.00		**164,682.82**	100.0%	**TBD**
DG Portfolio Annualized Return (from inception through current date)								**13.3%**
DG Portfolio Annualized Return Goal (Mid-to-High Single Digit Returns)								7.5%
DG Portfolio Annualized Return Outperformance								**5.8%**
SPDR S&P Dividend ETF (SDY)								**11.3%**

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, 2016. Cost basis includes commissions. Results include divdends, but no interest received on cash balance.

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

5 Concerns About Impending Rate Hikes

By Brian Nelson, CFA

The first Fed rate hike in nearly a decade came and went December 16, putting an environment of ZIRP (zero interest rate policy) to an end, a policy that grew out of the Financial Crisis and the depths of the Great Recession late last decade.

The Fed had paused plans to hike the federal funds rate for much of 2015 as a result, in our view, of getting a more informed read on the potential implications of emerging market developments--namely dislocations in the local Chinese equity markets (FXI) and recessionary conditions in Brazil (EWZ)--and the stock market crash (SPY) in the US in August that sent equities of some of the most well-known stocks including Apple (AAPL) and General Electric (GE) tumbling. With several months now past since those events, the latest read on US economic data indicates to Fed officials that the impact from the aforementioned events may not be too severe, giving the committee the confidence to inch toward a higher interest-rate environment, if for the sole reason to generate some monetary-policy flexibility in the event US economic growth sours, or in the event of a broader global financial calamity not yet known.

After months (if not years) of telegraphing and "talking about talking about" raising rates, the Fed finally did it, increasing the target federal funds rate to the range of ¼ to ½ percent, noting to perhaps soften the blow to the equity markets, that "the stance of monetary policy remains accommodative after this increase." Though many market observers are hoping for a scenario of "one (raise) and done," we think Janet Yellen and team wouldn't have taken the first step at all if they didn't have a higher target interest rate in mind.

In the release, the Fed noted that "economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run." Valuentum believes the hike will be the first of many in the coming years, though as the release explained "the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data." Junk spreads, which are north of 700 basis points, according to Moody's, could limit the pace of increases, as the absolute cost of borrowing would be prohibitively expensive.

Though one of the most anticipated pieces of news in some time, it's important to note that the modest rate hike by the Fed, by itself, should be nothing to panic about -- alone, a quarter point really shouldn't mean much at all to the broader equity markets. That said, however, a prolonged contractionary monetary policy is a much different consideration and surfaces several concerns -- 5 of our biggest are listed below.

1. Continued Rout in Commodity Prices

We need to cover some economics first.

In the event of ongoing interest rate hikes by the Fed, yields on US government-backed debt and corporate bonds (in absolute terms), which are tied to the risk-free rate in the US, will generally increase, all else equal. This scenario would then serve to attract non-US capital to the US dollar, which would be needed to buy the incrementally higher-yielding US assets, in turn driving the value of the US dollar higher relative to other currencies.

For corporations operating in non-US dollar terms, dollar-denominated commodities are then more expensive to them due to the exchange-rate shift. All else equal, this would then result in a price-driven reduction in demand for such commodities until inevitably the US dollar denominated commodity price reaches a sufficiently low level until a new equilibrium is set, where demand then equals supply again.

Though widespread economic generalizations are neither absolute nor precise, the likelihood of a continuation of the rout in commodity prices from crude oil (USO) and natural gas (NGAS) to iron ore

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and beyond, in the event of ongoing rate hikes, is enhanced, if not accelerated. The weekly petroleum status report from the EIA, for example, released December 16, continues to note that "at 490.7 million barrels, US crude oil inventories remain near levels not seen for this time of year in at least the last 80 years." OPEC's new strategy of producing to put weaker US domestics out of business is also pressuring the price of the black liquid, like no other time in economic history (price stability is no longer its objective).

Further, just this week, the Journal noted that natural gas prices "plunged to a 16-year low," and our contention is that global conventional and unconventional resources of natural gas are sufficient for more than 200 years' worth of demand at current rates, which in our view, is enough to pressure prices for some time (well beyond this unseasonably warm winter season). Weakening construction activity and steel-making in China coupled with ongoing over-production at the largest iron ore companies, including BHP (BHP) and Rio Tinto (RIO) could keep iron ore prices at 10-year lows or lower. The implications on mining equipment spending may challenge Caterpillar's (CAT) dividend, just as it has done with Joy Global (JOY).

On a very high level, a multiple rate-hike scenario in the US could cause more pain at US commodity producers and reverberate through the energy services and mining equipment supply chain, a concern that would only be exacerbated by the direct result of tightening credit, itself. According to Bloomberg, for example, the oil industry "needs half a trillion dollars to endure (the) price slump." Such debt capacity may simply be unavailable or prohibitively expensive in coming years; the credit rating agencies, for one, are already expecting a significant ramp in high-yield defaults, and it might get a lot worse if the Fed hits the brake too hard.

Though we may comment from time to time, we've dropped some of the lowest quality oil and gas names, Legacy Reserves (LGCY), Linn Energy (LINE) and Ultra Petroleum (UPL), from our valuation coverage universe.

2. Ongoing Pressures on Emerging Market Currencies

From a global perspective, for those whose wealth and income is generated in US dollars, one can arguably buy more with one US dollar today than at any other time in more than a decade, according to a popular index that measures the value of the dollar versus a basket of other currencies. Ongoing rate hikes by the Fed means, in our view, that assets may continue to fly into US greenbacks from all over the world, for better risk-adjusted yields but also for capital preservation. The dollar has been strengthening for some time against the euro, the pound, the loonie, the aussie, the rand, and the list goes on and on. There's very little doubt in our minds that the US dollar will remain the world's reserve currency for the foreseeable future (sorry conspiracy theorists).

To long-time market observers, the summer of 2015 has acted as a bout of nostalgia, as emerging market currencies dipped to levels not seen since the currency crises of the late 1990s--the 1997 Asian financial crisis and 1998 Russian financial crisis--that led to the collapse of hedge fund Long Term Capital Management. From our perspective, in the event that emerging market economies, including those of Brazil, most of Latin America, and Asia continue to weaken, rate hikes in the US may inflict significant damage to their respective currencies as asset flight from those countries take hold. Simultaneous weakness in commodity-based economies such as Canada (EWC) and Australia (EWA), as a result of several of the secular drivers noted above, could drive the US dollar to nosebleed levels against a basket of emerging-market currencies.

We've witnessed the US dollar gain a tremendous amount of strength during the past few years, and we would not be surprised to bear witness to a "US dollar value spike" in coming years, as assets in higher-risk geographies flow back into America. From where we stand, the Fed is walking a very tight rope, and the summer of 2015 hinted at what an international currency crisis would mean for US equities: on Monday, August 24, the Dow Jones Industrial Average (DIA) opened 1,000 points down and followed that up Tuesday with another 200+ point drop. It could be much worse in the event large hedge funds are caught by surprise and forced-selling ensues should a more severe currency dislocation ensue.

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3. Deflationary Possibilities Are Difficult To Dismiss

This isn't a popular observation, but the cost of living in the US isn't that bad, all things considered. Let's walk through a few anecdotes.

Though rent and transportation costs can vary by region in the US and around the world, rent conditions in the US aren't that tight, at least from our perspective. For one, housing prices have yet to recover from the go-go years of late last decade, and many housing developments and subdivisions remain unfinished, abandoned in many cases. The foreclosure market (unfortunately) still looks robust, and bargains can still be had, even in some of the "nicest" areas of the country. The price of gasoline has plummeted, and one can lease a brand new daily driver, a new Nissan Sentra, for as little as ~$60 month (~$2/day) with very little down, for example.

Though commodity cost inflation continues to challenge some restaurants (e.g. Buffalo Wild Wings--BWLD--and chicken wings, for example) and food products companies alike (egg prices, for example, have surged), the reality is that one can order 10 chicken nuggets from Burger King (QSR) for just $1.49. If chicken nuggets aren't your "thing," two pizzas from Little Caesars can feed a family of 4-6 and only set the buyer back $10 plus tax. A senior coffee at McDonald's (MCD) costs less than a $1, and Mickey D's has been known to give coffee away for free as a loss-leader to stimulate demand.

This is what we're trying to say: If significant and prolonged accommodative monetary policy has done little to send living, transportation and food costs "through the roof," what will happen under an environment of ongoing contractionary monetary policy, one with rate hike after rate hike? In this context, we have a difficult time dismissing deflationary concerns, even if such on-the-ground references are regionally-oriented and anecdotal. What about inflation? In our view, there have been two primary areas: wage levels (think: the Fight for $15) and the US stock market (the S&P 500 has literally tripled since the March 2009 panic bottom). Could this contractionary monetary cycle be the one that sparks a feared spiral of ever-lower price levels?

4. Continued Pressure on Multinational Reported Operating Earnings

One of the biggest themes of 2015 has been the analytical focus on "currency-neutral" performance. From Coca-Cola (KO) to Pepsi (PEP) to Procter & Gamble (PG) to Kimberly Clark (KMB) to Philip Morris (PM) to Johnson & Johnson (JNJ) and beyond, multinational equities have witnessed reported top-line and operating-income growth shrink due to pressures from currency translation.

Though many have excused negative foreign-exchange headwinds as a transient, impermanent event and perhaps rightfully so, ongoing rate hikes in the US could drive the US dollar to new heights, which would then act to pressure reported operating results at some of the largest multinationals. It's very possible that currency headwinds may turn into a way of life for global firms housed in the US next year, and for as long as the US dollar strengthens. Typically adjusted to reflect currency-neutral performance, earnings estimates in coming years may not be factoring in this reset.

Will investors continue to accept with open arms currency-neutral performance, or will this contractionary monetary cycle result in a structural shift that pushes the US dollar permanently higher, where reported results become the "new norm?"

5. The Tipping Point in Yields

From our September 3 observations:

> We give Ben Bernanke and team a lot of credit for successfully delaying a prolonged global economic recession following the worst financial crisis of our generation late last decade, one that swallowed up such household names as GM (GM) and AIG (AIG), but such policies always come with unintended consequences. New Fed Chair Janet Yellen may have to deal with the true aftermath, and it's been thrust upon her, perhaps unfairly.

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> …retirees and near-retirees, after suffering significant capital losses during the Financial Crisis, have been lured into higher-yielding dividend-paying equities, the prices of some almost completely supported by debt-infused dividend policies. What's worse, many retirees and near-retirees have seemingly been schooled by their financial advisors to completely ignore market volatility and focus on long-term goals, with the assumption that the income streams associated with these lofty high-yielders are supported by organic means.
>
> The problem is that with respect to most MLPs, the preferred vehicle of choice for some retirees and near-retirees seeking income, it is our contention that their equity prices are being propped up by a distribution that can only be sustained via external capital market issuance in the equity or debt arenas. Not only that, but most capital-market-dependent dividend payers are being priced as fixed-income vehicles on "growing coupons" that are, in our view, financially-engineered, inorganic dividends. Said differently, such equity instruments are fetching valuations that have become materially disconnected, in our view, from traditional organic free cash flow measures of their underlying operations. With their distributions used as "growing coupon payments" for retirees and near-retirees, their equity prices have inevitably become more debt-like than could have ever been imagined.
>
> A contractionary monetary tightening cycle, in our view and by extension, will be devastating to those same retirees and near-retirees that flocked into high-yielding dividend payers, after losing significant capital during the Great Recession. Not only will these "debt-like" dividend-paying equities be repriced substantially lower in the event of contractionary monetary policy as interest rates rise, but the lending environment will also tighten under such conditions, in our view, further exacerbating tangible project NPVs and organic free cash flows of these entities as well. Such conditions, in our view, would spell massive declines in some of the highest dividend-paying stocks as 1) the debt-infused bubble is popped (and shares/units are repriced lower and re-valued as "true" equities), and 2) their economic profit streams are squeezed due to higher borrowing costs and costs of capital…
>
> …(as) the Fed starts to raise interest rates, we'd expect (the possibility of) significant asset-flight out of equities (to increase), led by selling in unsustainably high-yielders spreading to speculative "lofty-multiple" entities and beyond, something we've been talking about for some time…. one of the largest pension funds in the US, CalSTRS, was reported to be considering large asset allocation shifts away from equities, likely the first public announcement of many more to come.

The list of 5 concerns are not predictions, but mere possibilities, even as a couple of them are more probable than the others. As we've outlined many a time before, there's never a good reason to panic about anything, and economic prognostications are fraught with risks and uncertainties. As we can only expect, the Fed will continue to monitor the data and adjust policy accordingly, and barring exogenous economic shocks from China or currency crises from weakening emerging economies, a rate hike here or there shouldn't do too much damage to equities. That said, we're still wearing our seatbelts with near-30% cash positions in each newsletter portfolio, just in case the Fed hits the brake too hard.

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.

Company Name	Symbol	Sector	Est Div Yield	VBI	Div Growth	Div Cushion
Holly Energy	HEP	Energy	6.5%	6	EXCELLENT	1.7
Omega Healthcare	OHI	Financials	6.5%	6	EXCELLENT	2.0
Iron Mountain	IRM	Industrials	6.1%	6	GOOD	1.6
Universal Health Realty	UHT	Financials	5.3%	6	GOOD	1.5
Quality Systems	QSII	Health Care	4.9%	7	GOOD	2.0
Realty Income Corp	O	Financials	4.8%	6	EXCELLENT	1.5
Altria Group	MO	Consumer Staples	4.3%	6	GOOD	1.2
Brookfield Infrastructure	BIP	Energy	4.3%	6	GOOD	1.2
Meridian	VIVO	Health Care	4.3%	7	GOOD	1.7
Guess	GES	Consumer Discretionary	4.1%	6	EXCELLENT	2.4
ABB	ABB	Industrials	4.1%	6	GOOD	1.6
QUALCOMM	QCOM	Information Technology	3.8%	6	EXCELLENT	3.7
Superior	SUP	Consumer Discretionary	3.7%	6	GOOD	2.0
Abercrombie & Fitch	ANF	Consumer Discretionary	3.6%	6	GOOD	2.7
Reynolds American	RAI	Consumer Staples	3.4%	6	GOOD	1.4
Paychex	PAYX	Information Technology	3.3%	6	EXCELLENT	2.6
Procter & Gamble	PG	Consumer Staples	3.3%	7	EXCELLENT	1.5
Enbridge	ENB	Energy	3.3%	6	EXCELLENT	2.3
Intel	INTC	Information Technology	3.3%	9	GOOD	2.5
Western Union	WU	Information Technology	3.2%	7	EXCELLENT	2.8
GameStop	GME	Consumer Discretionary	3.2%	6	EXCELLENT	2.9
Kimberly-Clark	KMB	Consumer Staples	3.1%	7	GOOD	1.1
Unilever PLC	UL	Consumer Staples	3.1%	6	GOOD	1.5
Diebold	DBD	Industrials	3.1%	6	GOOD	1.9
Compass Minerals	CMP	Materials	3.1%	6	GOOD	0.8
Waste Management	WM	Industrials	3.1%	6	GOOD	1.6
General Electric	GE	Industrials	3.1%	6	GOOD	2.1
Unilever N.V.	UN	Consumer Staples	3.1%	6	GOOD	1.5
Darden Restaurants	DRI	Consumer Discretionary	3.0%	6	GOOD	1.3
IBM	IBM	Information Technology	3.0%	6	EXCELLENT	1.9
Cisco	CSCO	Information Technology	3.0%	9	EXCELLENT	3.2
United Parcel Service	UPS	Industrials	3.0%	7	EXCELLENT	1.8

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

The Strongest Dividend Payers Yielding Over 2%

By Valuentum Analysts

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

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

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

Company Name	Symbol	Sector	Est Div Yield	Div Cushion	Multiplier
QUALCOMM	QCOM	Information Technology	3.8%	3.7	13.93
Automatic Data Processing	ADP	Information Technology	2.3%	5.9	13.43
Lexmark	LXK	Information Technology	4.2%	3.2	13.40
Garmin	GRMN	Industrials	5.6%	2.0	11.50
CA Tech	CA	Information Technology	3.7%	3.1	11.39
AVX Corp	AVX	Information Technology	3.1%	3.6	11.37
Best Buy	BBY	Consumer Discretionary	2.8%	4.0	11.37
Nvidia	NVDA	Information Technology	2.0%	5.6	11.15
Intersil	ISIL	Information Technology	4.6%	2.4	11.13
Hewlett-Packard	HPQ	Information Technology	2.3%	4.7	10.74
Taiwan Semiconductor	TSM	Information Technology	3.6%	2.9	10.72
H&R Block	HRB	Consumer Discretionary	2.4%	4.1	10.09
Iron Mountain	IRM	Industrials	6.1%	1.6	9.78
Guess	GES	Consumer Discretionary	4.1%	2.4	9.77
Abercrombie & Fitch	ANF	Consumer Discretionary	3.6%	2.7	9.73
Nu Skin	NUS	Consumer Discretionary	3.5%	2.8	9.65
Cisco	CSCO	Information Technology	3.0%	3.2	9.62
Quality Systems	QSII	Health Care	4.9%	2.0	9.56
Xilinx	XLNX	Information Technology	3.1%	3.0	9.35
Olin Corp	OLN	Materials	3.1%	3.0	9.31
GameStop	GME	Consumer Discretionary	3.2%	2.9	9.24
American Eagle	AEO	Consumer Discretionary	3.1%	2.9	8.96
Western Union	WU	Information Technology	3.2%	2.8	8.93
Coach	COH	Consumer Discretionary	4.4%	2.0	8.74
Paychex	PAYX	Information Technology	3.3%	2.6	8.74
Applied Materials	AMAT	Information Technology	2.2%	3.9	8.49
Chico's FAS	CHS	Consumer Discretionary	2.1%	4.0	8.43
Computer Prog and Syst	CPSI	Health Care	6.5%	1.3	8.17
Microchip Technology	MCHP	Information Technology	3.4%	2.4	8.14
Gap	GPS	Consumer Discretionary	3.0%	2.7	8.11
Corning	GLW	Information Technology	2.4%	3.3	8.08
KLA-Tencor	KLAC	Information Technology	3.1%	2.6	8.05
Intel	INTC	Information Technology	3.3%	2.5	8.00
Emerson Electric	EMR	Industrials	4.2%	1.9	7.91
STMicroelectronics	STM	Information Technology	5.7%	1.4	7.87
Parker-Hannifin	PH	Industrials	2.5%	3.2	7.87
Thor	THO	Industrials	2.2%	3.5	7.86
Pfizer	PFE	Health Care	3.3%	2.4	7.79
Superior	SUP	Consumer Discretionary	3.7%	2.0	7.49
Cummins	CMI	Industrials	3.2%	2.3	7.47
Chicago Rivet	CVR	Consumer Discretionary	2.9%	2.6	7.34
Meridian	VIVO	Health Care	4.3%	1.7	7.30
Schweitzer-Mauduit	SWM	Materials	4.6%	1.6	7.27
National Oilwell Varco	NOV	Energy	3.7%	1.9	7.17
Johnson & Johnson	JNJ	Consumer Staples	3.0%	2.4	7.14
Interpublic	IPG	Consumer Discretionary	2.4%	3.0	7.04
Linear Technology	LLTC	Information Technology	3.0%	2.4	7.03
Cypress Semi	CY	Information Technology	4.4%	1.6	6.98
Microsoft	MSFT	Information Technology	2.7%	2.6	6.91
Accenture	ACN	Information Technology	2.1%	3.2	6.76

Yields to Avoid

By Valuentum Analysts

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

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

Company Name	Symbol	Industry	Est Div Yield	Div Safety	Div Cushion
Windstream	WIN	Telecom Services - diversified	5.7%	VERY POOR	-30.4
Pioneer Natural Resources	PXD	Independent Oil & Gas	0.1%	VERY POOR	-16.3
Range Resources	RRC	Independent Oil & Gas	0.3%	VERY POOR	-12.6
Newmont Mining	NEM	Metals & Mining - gold	0.6%	VERY POOR	-11.5
Apache	APA	Independent Oil & Gas	1.7%	VERY POOR	-10.8
Ryder System	R	Rental and Leasing	1.8%	VERY POOR	-8.7
Tidewater	TDW	Energy Equipment	11.2%	VERY POOR	-6.8
Koppers	KOP	Building Materials	4.2%	VERY POOR	-6.5
Barrick Gold	ABX	Metals & Mining - gold	2.8%	VERY POOR	-6.2
MDC	MDC	Homebuilders	3.9%	VERY POOR	-5.2
Cablevision	CVC	Media - CATV	2.4%	VERY POOR	-5.1
Yamana Gold	AUY	Metals & Mining - gold	2.9%	VERY POOR	-4.8
Noble Energy	NBL	Independent Oil & Gas	1.6%	VERY POOR	-4.7
NiSource	NI	Utilities	3.6%	VERY POOR	-4.7
Hess	HES	Refiners	1.9%	VERY POOR	-4.4
Anadarko	APC	Independent Oil & Gas	1.3%	VERY POOR	-4.1
Devon Energy	DVN	Independent Oil & Gas	1.6%	VERY POOR	-4.1
Murphy Oil	MUR	Refiners	4.4%	VERY POOR	-3.8
Men's Wearhouse	MW	Retail - Men's, Women's, Kids' Apparel	1.7%	VERY POOR	-3.7
TAL Intl	TAL	Rental and Leasing	9.4%	VERY POOR	-3.4
Textainer	TGH	Rental and Leasing	7.3%	VERY POOR	-3.3
Frontier Comm	FTR	Telecom Services - diversified	8.3%	VERY POOR	-2.6
Allegheny Technologies	ATI	Aluminum	4.1%	VERY POOR	-2.2
Cimarex	XEC	Independent Oil & Gas	0.6%	VERY POOR	-2.2
Deltic Timber	DEL	Building Materials	0.6%	VERY POOR	-2.1
Canadian Natural	CNQ	Independent Oil & Gas	3.0%	VERY POOR	-2.1
Time Warner Cable	TWC	Media - CATV	1.7%	VERY POOR	-2.0

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

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

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

Valuentum Applauds ONEOK; More Clarity on "FCF" Still Needed

By Brian Nelson CFA

We're very happy to announce that ONEOK (OKE/OKS) has released a form of a non-GAAP measure of free cash flow in its 2016 outlook press release. Even though we still would like more clarity around the measure (stand-alone capital spending, etc.), we applaud management's step forward in disclosing additional information to investors.

Valuentum has been calling for the disclosure of non-GAAP free cash flow, as measured by cash flow from operations less all capital spending, in press releases for some time (in addition to other measures management would like to release: distributable cash flow, etc.), and we're happy that ONEOK Partners appears to be the first, from what we can tell, to take the step forward to help MLP investors better understand free cash flow.

In ONEOK's case, why not – traditional free cash flow less expected distributions is fantastic (relative to peers, of course)! – see table below.

We believe the news this week represents a victory for MLP investors when it comes to additional disclosures. Here's what we're talking about. These are the measures disclosed in ONEOK's most recent press release, the 2016 outlook, released December 21, 2015 (note the measure of free cash flow):

> *ONEOK and ONEOK Partners have disclosed in this news release expected 2016 cash flow available for dividends, free cash flow, dividend coverage ratio, adjusted EBITDA, distributable cash flow and cash distribution coverage ratio, which are non-GAAP financial metrics, used to measure ONEOK's and ONEOK Partners' financial performance.*

Please compare this to ONEOK's disclosures in the third-quarter results, released November 3:

> *ONEOK Partners has disclosed in this news release adjusted EBITDA, DCF, distributable cash flow to limited partners per limited partner unit and cash distribution coverage ratio, which are non-GAAP financial metrics used to measure the partnership's financial performance.*

ONEOK's "free cash flow" guidance doesn't go so far as to say whether they are deducting all capital expenditures, as it defers to "standalone capital spending," nor does it actually use cash flow from operations, but we like the step forward in any case. The closer the industry moves to offering investors non-GAAP free cash flow, as measured by cash flow from operations less all capital spending, the better decisions investors can make, in our view, as it relates to assessing the risks of the business, not the least of which is capital-market dependency. Though ONEOK's measure appears to fall short from standard measures of non-GAAP free cash flow, we're still pleased – as long as investors understand that the disclosure is still not traditional non-GAAP free cash flow (and it doesn't lead to more confusion). delever the balance sheet when times are good?

We think it is worth mentioning that ONEOK Partners' expected performance in 2016 appears to be the exception, not the norm when it comes to MLPs. For one, management noted that it expects adjusted EBITDA at ONEOK Partners (OKS) to be ~$1.88 billion for 2016 and both growth and maintenance capital spending of ~$460 million and ~$140 million at the entity, totaling about ~$600 million in total capital spending for the year. If we assume that EBITDA can be considered a proxy in part for cash flow from operations, assuming neutral working capital movements, after deducting such capex, we're looking at non-GAAP "free cash flow" of close to ~$1.28 billion for the year. Cash distributions were $1.05 billion, $909.7 million, and $760.9 million in 2014, 2013, and 2012 at Oneok Partners, respectively – meaning traditional free cash flow, by our translation of cash flow from operations less all capital spending, will likely cover distribution payments alone in 2016.

This is fantastic compared to its peers. From our perspective, we don't understand why analysts were saying that ONEOK Partners would be in trouble?

Please see *More Clarity Still Needed…*on next page

More Clarity Still Needed…**from previous page**

Based on its guidance for 2016, the distribution at ONEOK Partners is one of the strongest out of all the MLPs – the entity literally looks like it will cover distributions with traditional free cash flow generation for the year – not to mention that the equity markets appear open to the company as it sits on substantial liquidity. It is not surprising why shares have spiked considerably! Unfortunately, however, ONEOK Partners is the exception. For most MLPs, and almost all in our coverage universe, traditional free cash flow generation, as measured by cash flow from operations less all capital spending is substantially lower than distributions paid. In some cases, traditional free cash flow is materially negative.

Here is a table that shows traditional free cash flow less distributions, dividends through the first half of 2015 for our MLP coverage universe, for example (note: energy resource pricing has deteriorated since the end of the second quarter) – the column called free cash flow after distributions, dividends is the one to pay attention to (this is through the first half of 2015 – we expect to update this table following 2015 results):

Updated August 11, 2015 - Through the First Half of Calendar 2015 - $ mil

	Adjusted Reported EBITDA	Cash from Operating Activities (CFO)	Total Capital Expenditures	Dividends, Distributions	Free Cash Flow after Dividends, Distributions	Net Debt	Net Debt/ Annualized Adj EBITDA
Linn Energy (LINE)	517.0	673.5	-416.3	-212.6	44.6	10,320.6	10.0
Legacy Partners (LGCY)	46.4	0.21	-23.7	-76.1	-99.6	962.4	10.4
Energy Transfer Equity (ETE)	2,520.0	1,113.0	-4,181.0	-1,642.0	-4,710.0	33,187.0	6.6
Kinder Morgan (KMI)	3,182.0	2,538.0	-1,909.0	-2,006.0	-1,377.0	44,390.0	**7.0**
Spectra Energy (SE)	1,333.0	1,456.0	-989.0	-499.0	-32.0	13,413.0	5.0
Williams Co (WMB)	1,474.0	1,483.0	-1,654.0	-1,338.0	-1,509.0	21,459.0	**7.3**
Boardwalk Pipeline (BWP)	371.3	285.5	-136.3	-50.4	98.8	3,474.3	4.7
Buckeye Partners (BPL)	392.2	291.6	-298.4	-293.9	-300.7	3,775.3	4.8
CONE Midstream (CNNX) (1)	52.9	60.5	-138.2	-25.4	-103.1	22.8	0.2
DCP Midstream (DPM)	148.0	350.0	-194.0	-241.0	-85.0	2,388.0	**8.1**
Energy Transfer (ETP)	2,476.0	1,133.0	-4,143.0	-1,751.0	-4,761.0	27,458.0	5.5
EnLink Midstream (ENLK)	313.0	292.3	-349.2	-278.1	-335.0	2,819.1	4.5
Enterprise Products (EPD)	2,471.2	1,901.6	-1,638.0	-1,462.1	-1,198.5	21,695.8	4.4
EQT Midstream Partners (EQM)	238.3	239.1	-208.9	-117.3	-87.1	804.0	1.7
Genesis Energy (GEL)	109.5	71.1	-240.6	-117.3	-286.9	1,676.3	**7.7**
Magellan Midstream (MMP)	509.7	414.8	-275.8	-321.2	-182.3	3,297.9	3.2
Plains All American (PAA)	795.0	660.0	-1,031.0	-810.0	-1,181.0	10,024.0	**6.3**
Spectra Energy Partners (SEP)	779.0	731.0	-604.0	-459.0	-332.0	5,997.0	3.8
Tallgrass Energy Partners (TEP)	123.0	112.2	-49.5	-67.1	-4.4	704.2	2.9
Western Gas Partners (WES)	381.0	301.5	-338.2	-259.2	-296.0	2,589.3	3.4

(1) Unaudited; pending 10-Q.

Image Source: Valuentum Securities

We hope the news this week is a step forward by executive teams to help investors better understand traditional free cash flow, as measured by cash flow from operations less all capital spending, and not the beginning of just throwing around the word "free cash flow" to add further confusion to the mix. In Valuentum's view, the best measure of free cash flow is one that deducts all capital spending (both growth and maintenance) from cash flow from operations. Thank you for reading!

For beginners, Investopedia has a video about free cash flow (see here → http://www.investopedia.com/video/play/understanding-free-cash-flow/) : cash flow from operations less all capital expenditures. Why can't we get this measure on all MLP press releases?

Stock Returns and Financially-Engineered Dividends

By Brian Nelson, CFA

This article seeks to introduce investors to a critical concept often lost on those focused intensely on a company's dividend payout: dividends are not an additive source to total stock returns above and beyond what a company would generate in capital appreciation. Dividends, instead, deduct from the capital appreciation a stock would otherwise have generated in the event that it did not pay a dividend.

From what we can tell, this concept is not well understood. For one, widely-circulated research implies that dividends "generate" a large portion of stock returns, and easily-communicated methodologies oversimplify the stock return composition (e.g. dividend yield + earnings + speculative component), arguably misleading investors to believe that a higher dividend payout and yield will augment the total stock return equation.

This is simply not true.

Stock returns aren't enhanced by a company's dividend yield, no more than an entrepreneur's company is worth more because he or she pays himself or herself a large dividend this holiday season or next. In fact, because the company has less cash on the books as a result of the payment of the dividend, one can say the franchise is worth less (the sources of intrinsic value are discussed later in this article). What is not explained well (and something that we believe should be emphasized) is that the higher the dividend yield of a company, the lower the capital appreciation potential; and the lower the dividend yield, the higher the capital appreciation potential, all else equal.

If, for example, a company's total return for a given year is 8% and a company paid a dividend yield of 2% during the year, the company's capital appreciation for the year would be 6% (2%+6%=8%). If the company paid a 4% dividend yield, the company's capital appreciation for the year would be 4% (4%+4%=8%). If it didn't pay a dividend, shares of the company would have advanced 8%. The total return of the company is 8%, regardless of its dividend policy, all else equal.

When a company pays a dividend, its intrinsic value is reduced by an amount equal to cash dividends paid (even the stock exchanges reduce the price of the stock by the dividend payment per share when it goes "ex dividend"). Although the proliferation of dividend growth strategies in recent years has arguably enhanced the capital appreciation component of dividend-paying stocks, in aggregate, due to the introduction of a wider audience (more buying) to these particular equities, the core relationship between capital appreciation and dividends has not changed.

Let's really hit this concept home by talking about the three primary sources of intrinsic value: the net cash position on the balance sheet, the future enterprise free cash flows a company generates, and any "hidden" assets not captured in those future expected enterprise free cash flows.

First, the company's balance sheet can be a source of value. For example, let's assume a company has $1 billion in total cash and $500 million in total debt. If the board of directors decides to shut down the company, shareholders would be entitled to the net cash position of the firm, or $500 million, adjusted for closing (run-off) expenses. In another example, a company with $1 billion in net cash on the books is worth more than a company with $10 million of net cash on the books, all else equal.

The balance sheet matters! The payment of dividends reduces the cash that otherwise could have accumulated on the balance sheet (if it had not been paid), which would have enhanced the value of the company (and by extension, its capital appreciation potential). Perhaps counter-intuitively, paying a distribution or dividend reduces the intrinsic value of the company because it reduces the net cash position on the balance sheet relative to what it otherwise would have been if it didn't pay the distribution/dividend, all else equal. Assuming prices are "tied" to value, prices (and capital appreciation) are reduced as well.

Second, the company's operations generate value, as measured by the present value of all future enterprise free cash flows (FCFF) that are generated to all stakeholders. A company's low-cost position, its network effect, its brand strength, or any intangible asset can effectively be valued by summing up the

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firm's ability to translate those strengths into future enterprise free cash flows. We call this exercise: "quantifying the qualitative assessment." After all, if a company can't translate these "moaty" characteristics into what matters (enterprise free cash flow), then what good are they?

Third, a company's "hidden" assets such as an overfunded pension or an equity stake in another company that is not accurately reflected in GAAP accounting statements have value. There are a large number of companies that have "hidden" assets and perhaps an equally large number of activist investors seeking to encourage executive teams to unlock value from such "hidden" assets. When a company is able to monetize these "hidden" assets, management is said to have "unlocked shareholder value."

Most everything else, however, is already captured within the intrinsic value calculation itself (i.e. the three primary sources of intrinsic value: balance sheet net cash, future enterprise free cash flows, "hidden" assets), whether it be the company's decision to increase its dividend, buy back stock, or pursue any other strategic endeavor. Over time, for example, a company's intrinsic value will increase at the discount rate less the dividend yield, the amount of value a company's buyback program generates or destroys is contingent upon the relationship between a company's share price and its intrinsic value estimate, and future strategic endeavors are captured within estimates of future enterprise free cash flow growth. When one thinks about the concept of intrinsic value in a financial valuation context, as in the case of future enterprise free cash flows, it helps to cut through a lot of the qualitative noise.

The only way a company's dividend policy can theoretically "generate" value, in our view, is if management would have otherwise invested that capital elsewhere in value-destroying businesses (acquisitions) or bought back stock at irrational, overpriced levels. A company's dividend policy is neither value-creating, nor value-destroying in the case of business (economic) returns, though if management's dividend policy strains the balance sheet, a higher cost of capital can eventually hurt intrinsic value. This is what we're seeing now in many overleveraged, capital-market-dependent entities whose fundamentals are waning.

If the dividend is not a driver behind intrinsic value, but rather a symptom of it (or an output of it), how does one measure what something is worth then? Well, the answer to this question rests in evaluating the three sources of intrinsic value above. Ask these questions, for example: What is the company's net cash position on the balance sheet? What are the enterprise free cash flows the firm is expected to generate in the future? Does the entity have any "hidden" assets, whose value is not captured in those future enterprise free cash flows? The answers to these questions will lead to objectively estimating intrinsic worth.

It's really that rudimentary, and you'll notice these three drivers of intrinsic worth have nothing to do with a company's distribution or dividend.

An asset, adjusted for balance sheet considerations, whether it is a house or a car or a stock or an MLP or anything else, cannot be worth more than the discounted future enterprise free cash flows that it generates. A house is worth the discounted rental stream to the owner plus resale price (though many real estate agents may use "comps" as a way to help "price" the property). A car is worth the present value of lease payments to the dealer plus a terminal/scrap value. A stock is worth the net cash on the company's books plus the present value of future enterprise free cash flows, discounted back to today (+/- "hidden" assets). An MLP is valued the same way as that of a corporate -- no matter how investors may want to "price" these business models.

Though assets are sold every day at prices that exceed their intrinsic worth (did you sell someone your overpriced stock recently?), and many may still want to believe in what we would describe to be an "invalid" pricing paradigm focused on financially-engineered dividends, it should go without saying that no matter what price you pay for an asset (including stocks), their value is what you end up getting. Price and value, however, are almost never the same, and both are moving targets over time. [Note: we define a financially-engineered dividend as one in which management uses the financing section of the cash flow statement via equity and debt issuance to offset net free cash flow shortfalls, as measured by cash flow from operations less all capital spending, to keep paying a dividend to sustain an artificial equity pricing

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paradigm surrounding the dividend payment. Not all distributions/dividends are authentic, or organic, in our view.]

One of the business models that we spend a lot of time talking about is the MLP structure, but this is an area that we really don't care much about, unfortunately. We did our very best to save investors a ton of money in the space, warning in advance of the recent unit-price collapse, but for those just joining us, you might not know that the MLP space has never really resonated with our team. We've known for a long time that investors today already own whatever their investment will ever pay them in distributions/dividends in the future, and we'll never be lured into the promise of a higher distribution/dividend payment, when underlying fundamentals of the entity are heading south, especially when the payout is already a multiple of free cash flow or earnings.

This is sometimes a difficult concept for new investors to understand.

Often is the case that the company's higher dividend yield reflects greater risk with respect to the sustainability of the stock's distribution/dividend and the company's business model than anything else. Investors already own via the stock price whatever future distributions/dividends (and the growth in them) a company will ever pay to them (it's already in there, and paying the distribution/dividend reduces the unit/stock price). Though far from a perfect indicator, raising the dividend is but a symptom of management's expectations for improving future enterprise free cash flow generation, assuming the distribution/dividend is organically-derived -- meaning it is a portion (a subset) of enterprise free cash flow.

Because the dividend itself is not a driver behind future enterprise free cash flow generation (it is paid from it), it therefore cannot be a driver behind intrinsic value. In the event equity prices are not "wrongly" set on artificial pricing paradigms based on financially engineered payouts that are a multiple of organically derived free cash flow and earnings, stock prices should (and do) inevitably follow the enterprise free cash flow valuation estimate of the equity, though various estimates exist. On the other hand, entities that are "priced" on financially-engineered payouts have a significantly higher chance of witnessing their unit prices collapse.

Without a doubt, a company's dividend policy can create excitement around its stock price, particularly with interest rates so low, but the financial engineering of lofty dividend payments is an impermanent phenomenon that, in our view, will eventually come back to bite companies engaged in such activities. Many of these "types of companies" have already succumbed to the ballast of their overleveraged balance sheets and their artificial dividend payments, and we think it's only the beginning as the credit cycle matures. Two things to remember: the dividend yield is not additive to stock returns and not all dividends are created equal!

Focus on ETE, Not ETP; Strive for Balance and Stick to the SEC Filings

By Brian Nelson, CFA

We continue to be grateful for the favorable reception of our research and analysis. Our mission to help investors of all types remains our core focus and a cause buttressed by our independence and analytical integrity. You can read more here about Valuentum and its President of Equity Research Brian Nelson, CFA.

It appears there continues to be a significant amount of confusion about the securities associated with the Energy Transfer companies, a collection of assets that includes the corporate parent Energy Transfer Equity (ETE) as well its consolidated subsidiaries: "Energy Transfer Partners (ETP), ETP GP, ETP LLC, Regency, Regency GP, Regency LLC, Panhandle, Sunoco, Inc., Sunoco Logistics (SXL), Sunoco LP (SUN), Susser and ETP Holdco (per Energy Transfer Equity, L.P, Form 10-K)." The distinction that requires more clarification, at least it seems, is that Energy Transfer Equity—trading under the symbol ETE—is a different security than Energy Transfer Partners—trading under the symbol ETP—despite sharing a very similar name.

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The leverage analyses of the two are separate and unique, albeit intertwined, and the SEC filings of both are different, though their economics are inextricably linked. In this light, we maintain our view that evaluating the latest information regarding the fully-consolidated entity, Energy Transfer Equity (ETE), is of critical importance to the analytics of the subsidiaries, including perhaps its most widely-followed, Energy Transfer Partners (ETP). Critically, evaluating Energy Transfer Equity (ETE) through its reported SEC filings, in our opinion, puts the whole picture of all its subsidiaries together, as through ETE they are tied together, even as we note that consolidated debt plus off-balance sheet debt (from unconsolidated joint ventures/JVs) at Energy Transfer Equity (ETE) is even higher than its reported total debt numbers (ETE Form 10-K, page 39 "excluding the debt of our joint ventures"). The reported SEC filings are still the best place for unbiased information, in our view, and viewing the whole consolidated picture from ETE down is most informative of related-party risk.

Energy Transfer Equity's massive ownership stake in Energy Transfer Partners' (ETP) common units ties the economics of the two (ETE and ETP), and we maintain our view that the financial health of Energy Transfer Equity (ETE), while a separate and distinct security from Energy Transfer Partners, is still of considerable analytical importance and "information value" to Energy Transfer Partners (ETP). Here's why, from Energy Transfer Partners' (ETP) Form 10-K:

> The credit and business risk profiles of our General Partner, and of ETE as the indirect owner of our General Partner, may be factors in credit evaluations of us as a publicly traded limited partnership due to the significant influence of our General Partner and ETE over our business activities, including our cash distributions, acquisition strategy and business risk profile. Another factor that may be considered is the financial condition of our General Partner and its owners, including the degree of their financial leverage and their dependence on cash flow from the Partnership to service their indebtedness (page 31).

Absent direct commodity price risk (~5% at ETP, per the latest available information) and customer credit risk, two factors to be addressed later in this piece, the following is what concerns us most from a financial analysis standpoint about the collection of Energy Transfer companies, particularly in light of collapsing energy resource pricing and a tightening credit environment. Again, we point to consolidated, all-in analysis of Energy Transfer Equity (ETE) as the best, "most complete" and available information to get a read on the entire picture of all subsidiaries together.

Through the first nine months of 2015, Energy Transfer Equity's reported operating income fell more than 6% (it fell more than 20% in the third quarter alone--a lot for a supposedly "commodity-price immune" entity), while cash flow from operations dropped to $2.15 billion from $2.5 billion in the nine-month period. Meanwhile, capital spending outflows soared to $6.69 billion through the first nine months of the year, resulting in traditional free cash flow, as measured by cash flow from operations less all capital expenditures, of -$4.52 billion (negative $4.52 billion). This compares to traditional free cash flow of -$1.21 billion (negative $1.21 billion) through the first nine months of last year, a substantial decline mostly due to capital spending build.

Through the first nine months of 2015, Energy Transfer Equity's (ETE) 'distributions to partners' and 'distributions to noncontrolling interests' totaled $2.5 billion ($790 million and $1.7 billion, respectively). By extension, we estimate that free cash flow after all distributions was more than -$7 billion (negative $7 billion) through the first nine months of the year. Of note, Energy Transfer Equity's current market capitalization is $11.6 billion. We continue to believe the industry's definition of distributable cash flow, which excludes growth capital that drives future net income, which itself is included in distributable cash flow, is an imbalanced metric, and one not to be used in the intrinsic valuation context.

From our perspective, economic performance at the consolidated entity, Energy Transfer Equity (ETE), is deteriorating meaningfully, as measured by reported operating income and reported traditional free

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cash flow declines, and the entity's leverage picture isn't improving either, from our point of view. We published a consolidated, all-in analysis of Energy Transfer Equity's (ETE) reported net debt to EBITDA, which as mentioned before includes all of its subsidiaries, including Energy Transfer Partners, but not off-balance sheet (JV) debt, and we concluded that, in light of Energy Transfer Equity's deteriorating operating performance, the entity was on track for reported net debt to EBITDA metric of 7x+ on an annualized, consolidated basis from the SEC filings.

Energy Transfer Equity's most recent income statement and balance sheet can be found here (pdf). The balance sheet can be found on page 1-2 of the pdf, and the income statement can be found on page 3. Net debt can be calculated by adding 'long-term debt, less current maturities' to 'current maturities of long-term debt' (page 2) and then subtracting cash and cash equivalents (page 1) on the balance sheet and reported EBITDA can be calculated by adding operating income (EBIT) to depreciation, depletion, amortization (page 3) on the income statement.

Here's what we wrote December 10:

> In the nine months ended September 30, Energy Transfer Equity's operating income was $2.16 billion, while depreciation and amortization was $1.53 billion, good for $3.69 billion in EBITDA, or $4.92 billion in EBITDA on an annualized basis.
>
> The company noted short and long-term debt of $36.3 billion and cash and cash equivalents of $1 billion, resulting in a net debt position of $35.3 billion… By our calculations, Energy Transfer Equity is nearly 7.2x leveraged ($35.3/$4.92).

[Please note that this is our estimate Energy Transfer Equity's (ETE) degree of leverage, which includes Energy Transfer Partners (ETP) and other subsidiaries, but not JV-related debt. Also, please note that additional confusion has arisen about whether previously-closed acquisitions prior to the beginning of the third quarter have been considered in third quarter operating results. They are or they should be. It is therefore important to emphasize that Energy Transfer Equity's operating income was $650 million in the three months ended September 30, down from $822 million in the prior-year period. Annualizing that EBIT and corresponding period DD&A gets to ~$4.7 billion in annualized reported EBITDA (on the income statement), not that far from the $4.92 billion annualized measure we used in the analysis above. In other words, the most recent quarterly performance, which we assume includes all consolidated activities prior to the beginning of the third quarter, means Energy Transfer Equity may be in worse shape than originally believed.]

We maintain our view that balance is very important in the context of any calculation of leverage. Let us explain. If a line item is added to the denominator in the leverage calculation (i.e. EBITDA), it is our view that the corresponding debt associated with that line item must also be added to the numerator (i.e. net debt). Due to the near-infinite ways imbalances can occur, we continue to believe annualized GAAP reported leverage at Energy Transfer Equity (ETE) is the best available representation of leverage, per its most recent Form 10-Q (annualized). Importantly, however, if credit analysts are adding 'adjusted EBITDA related to unconsolidated affiliates' to reported EBITDA, which they might be doing, the proportionate unconsolidated debt of joint-ventures (or all of it in its entirety depending on economic substance and recourse) should also be included in the leverage calculation. If not, an imbalance would reside in the leverage metric.

Let's explain further.

As mentioned above, through the first nine months of 2015, reported EBITDA from the income statement (page 3) at Energy Transfer Equity was $3.69 billion and adjusted EBITDA to unconsolidated affiliates was $487 million, per management, amounting to reported EBITDA, including that from unconsolidated affiliates, of ~$4.2 billion (~$5.6 billion annualized). If unconsolidated EBITDA is added in the leverage calculation, Energy Transfer Equity's proportionate share of the ~$3 billion in outstanding off-balance sheet debt at the joint-venture level is ~$1.5 billion must also be added, too (or all of the off-balance sheet debt depending on the analyst's assessment of economic consequence and/or recourse).

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Therefore, through the first nine months of the year, assuming a non-GAAP, all-in calculation that factors into a) the proportionate share or b) all of JV-related debt, Energy Transfer Equity's leverage would stand at a) 6.5x ($36.8/$5.6) or b) 6.8x ($38.3/$5.6), the latter assuming that from an economic (and/or recourse) standpoint, Energy Transfer Equity (ETE), or its subsidiaries would be on the hook should any partnership get into trouble (note: Energy Transfer management noted that, based on the process we outlined and with a variety of additions to the denominator, some we don't think are warranted (e.g. compensation), and including just the proportionate share of JV debt, net debt to EBITDA would be ~6.25x.) This is still substantially greater than the 4.5x that many may continue to believe Energy Transfer Equity (ETE) is leveraged, however; please also remember that Energy Transfer Equity (ETE) is a consolidated representation of all subsidiaries, including Energy Transfer Partners (ETP), and the two are economically, if not inextricably, linked.

In light of Energy Transfer Equity's degree of financial leverage (6.25x-7x+ depending on how you measure it), deteriorating operating income through the first nine months of the year (down 20% in the third quarter alone), increasing credit risk among its customer base due to collapsing energy resource pricing, and the general tightening credit environment among energy-related entities, we were shocked that Moody's put the outlook for Energy Transfer Equity's currently junk-rated debt (Ba2) to positive in September, despite Energy Transfer Equity's decision to take on $6 billion of more debt and become the "co-obligor of Williams' (WMB) existing long-term debt, which approximates $4.25 billion." We noted, through the first half of 2015, Williams Co had a net debt to annualized adjusted EBITDA mark of 7.3x and that free cash flow after dividends/distributions paid was -$1.5 billion (negative $1.5 billion). Energy Transfer Equity and Williams Co had the two biggest traditional free cash flow shortfalls compared to distribution obligations in our entire midstream coverage universe. You can see the first-half 2015 calculations here.

We know that the credit rating agencies are doing the best they can to keep up with the fast-changing energy resource market environment in evaluating new exposures/combinations and stress-testing sensitivities, but from where we stand, we don't believe that the credit outlook for Energy Transfer Equity (ETE) is improving, and we can only trust that the credit rating agencies are pursuing balance in all respective leverage calculations. The standard adjustments the agencies make don't, in our view, add a significant amount of transparency for bondholders, who have to evaluate whether they want to continue to allow the Energy Transfer companies pay out billions to unitholders as dividends/distributions.

We maintain our view that in light of a collapsing energy resource pricing environment and deteriorating credit conditions, bondholders in the MLP (AMLP) universe may have to eventually decide whether it makes more sense for dividends and distributions to be paid out of traditional free cash flow, as measured by cash flow from operations less all capital spending, or earnings – just like most every other dividend-payer out there. For Energy Transfer Equity (ETE), whose operating income and traditional free cash flow metrics are deteriorating as it runs -$7 billion shortfall through the first nine months of the year, by our estimates (free cash flow less distributions paid) on $11.6 billion market capitalization, we're growing increasingly more nervous for all stakeholders involved. Consolidating all subsidiaries into a corporate like Kinder Morgan (KMI) and cutting the payout seems like the most responsible course of action for the Energy Transfer collection of companies, in our view.

Notably, we continue to point investors to the idea that Energy Transfer Equity's (ETE) fully-consolidated operating income is declining at a mid-to-high-single digit pace (and worse if we consider the third quarter alone, where operating income fell 20%+) and that its subsidiary, Energy Transfer Partners (ETP), has ~10% of its business directly tied to commodity prices or other non-fee margin, not too unlike that of Kinder Morgan. Unlike Kinder Morgan, however, we don't have a good feel for Energy Transfer Partners' (ETP) hedging portfolio, and whether there will be implications in 2016 when or if any hedges roll off. If the company is completely unhedged, we would expect some meaningful EBIT deterioration in coming years, given the drop in energy resource pricing. Please

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note, reported operating income fell 20%+ in the third quarter ($650 million versus $822 million), and this is a large decline for a company supposedly not levered to commodity prices.

It's also worth noting that a considerable portion of Energy Transfer Equity's net debt remains tied to floating/rising interest rates, and rate hikes in coming years may pressure junk-rated issuers, perhaps to the point where the Fed may be hand-cuffed to raise rates any further, without completely locking out the high-yield market of new capital. Given its junk-rated credit status, it is growing more and more likely, in our view, that Energy Transfer Equity (ETE) and its subsidiaries, including Energy Transfer Partners (ETP) may fall victim to a credit crunch in coming periods, though there's never a good reason ever to panic. We also remain very cautious of Energy Transfer Equity's customer credit profile; by what we can gather, roughly one third of Energy Transfer Equity's customer profile is BBB- rated, one notch above junk, and Moody's just announced that it has put 29 E&P companies from the US and 7 from Canada under review for a potential downgrade.

On this note, we think Moody's has it right:

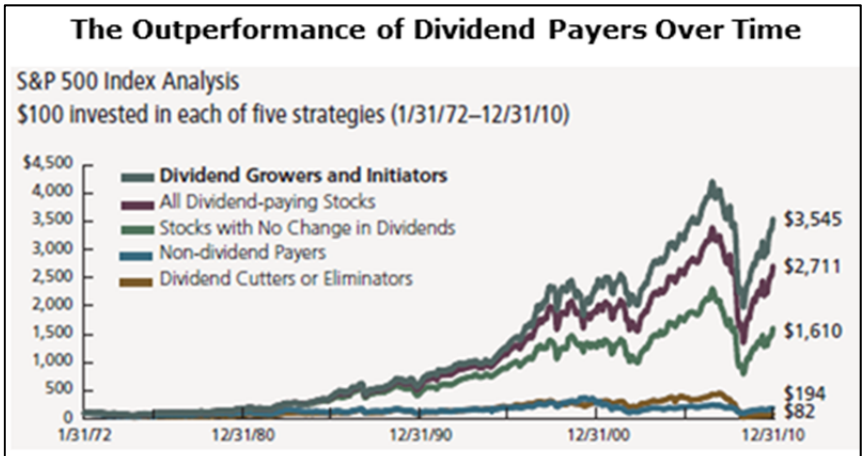
> Industry conditions have weakened further with oil and natural gas prices at multi-year lows…E&P companies will be stressed for a longer period with much lower cash flows, difficulty selling assets and limited capital markets access… Moody's expects weaker industry conditions through at least 2017, as lower prices lead to weaker cash flows, a challenging asset sales environment and restricted access to capital markets…Low oil and natural gas prices will reduce companies' cash flows and further weaken their credit metrics. Asset sales are much more difficult to transact in this environment and the values of these assets are much lower. Capital markets access, both debt and equity, is limited for energy companies, heightening refinancing risk, particularly for speculative-grade rated companies. Based on the severity and potential duration of the industry challenges, Moody's expects that many companies will be downgraded a notch and some companies could be downgraded more than one notch. However, some companies' ratings could be confirmed as well. Moody's expects to conclude most reviews over the next several months.

All in, we remain very concerned about the sustainability of the Energy Transfer companies, as they currently are structured and their respective payouts to investors, particularly in light of weakening operating income, deteriorating energy resource pricing, tightening credit conditions, massive capital spending plans, and huge distribution/dividend obligations. It's always possible that energy resource pricing increases may come to the rescue (long odds given OPEC's market share grab strategy and current near-century high inventory levels in the US, however), but in any case, we believe creditors should take a hard look at the combined entity's unadjusted measures of financial leverage on an annualized reported GAAP basis, and if not, at least ensure that any representation of leverage provided to them is balanced, meaning that proportionate or full-recourse (or economic recourse) off-balance sheet JV debt is considered in any scenario that unconsolidated EBITDA is included.

About the Valuentum Dividend Cushion™

By Valuentum Analysts

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



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

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

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

The Importance of Forward-Looking Dividend Analysis

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

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

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

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

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

The Valuentum Dividend Cushion Caught These Dividend Cuts in Advance

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

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

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

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

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

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

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

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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 5, 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.

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).

Source of baseball image: https://www.flickr.com/photos/slgc/16173880801/in/photolist-qDengP-4MijY8-67wGYy-57apDN-2ZPHH-bZWY9S-67NxuK-2ZPHG-cqDXu-9K3M1k-7EpjjQ-542Ed2-3CL5Zb-68G3ST-9RQVsK-rNJ2em-gHnh4G-cnnSS-k7KBHH-cNjqvU-8D5vVt-qinzRC-ut2j1f-7Q7QsB-4upyw1-bZWVjU-fBRKRR-fP3Ceb-9WpiVf-9Wmtf6-qwdqv9-niGc1S-iZe1Y-4zPnGz-e8PEJu-mLLbFR-9xdCCi-bZX1gq-bZWZz9-bZWTgf-6UJ6D2-6UJ6tH-aA9ikL-9Wms8i-2ZPwm-9WpiHs-9Wmszt-6G8zRF-9nd6ea-9Kh5LK

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

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

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

-- The **Valu-entum** Team

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