OUR DIVIDEND GROWTH NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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Valuentum Securities Inc.
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Alert: We trimmed the weighting in Medtronic (MDT) and added General Motors (GM)! See portfolio on page 5.

Annualized Return	Annualized Goal	Outperformance
11.7%	Mid-High Single Digits	4.2pts

*Please see note below regarding performance measurement.

Inside This Issue

1 Tough Month -- My Goodness
2 Cracker Barrel Continues Positive Comparable Store Restaurant Sales Streak
3 **Transcript:** EVERYTHING DIVIDENDS + 3 TOP IDEAS
5 The Dividend Growth Portfolio
7 Earnings Insight – Medtronic's Free Cash Flow Story
9 Energy Transfer Partners' Implicit Distribution Cut
10 Stocks with High Valuentum Buying Index Ratings and Strong Dividend Growth Prospects
11 The Dividend Growth Watch List
12 Yields to Avoid
15 Earnings Insight - Cisco
17 **Transcript:** Dividends, Dividends, Dividends
18 Capella Education's Dividend Potential
23 About the Dividend Cushion™

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"After the 'Trump rally,' a sobering correction could be coming to the markets, but we didn't generate a near-12% compound annual return since inception in a dividend growth setting by chasing fads or ups and downs."
– Brian Nelson, CFA

Latest Changes

GM Earnings: http://www.valuentum.com/articles/20161028

MDT Earnings: http://www.valuentum.com/articles/Earnings_Insight_Medtronics_Free_Cash_Flow_Story

Tough Month – My Goodness

By Brian Nelson, CFA

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

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

The market rallied hard this month and seemed to leave a lot of the Dividend Growth Newsletter portfolio ideas behind. I'm not going to sugarcoat the results: The Dividend Growth Newsletter portfolio disappointed this month, and for that I'm sorry.

A lot of it may be "explainable" in light of what happened on Election Day 2016, however. I think a lot of investors have shifted capital from the stronger dividend payers to the more-speculative ones in hopes that a new, pro-business Trump administration will be their saving grace. We hope so, but Trump cannot be President forever, and dividend growth investors should consider a long-term perspective, in my opinion, especially when it comes to compounding payouts over time.

While it's possible Trump can overturn Dodd-Frank (to the benefit of banks), implement tariffs to protect domestic industry (positive for materials), overturn Obamacare (adding uncertainty to healthcare stocks), encourage domestic tech manufacturing (disrupting technology supply chains) and pursue pro-fossil fuel initiatives (helping Big Oil)--all of which may be detrimental to our dividend growth exposures in the near term--we're sticking to our long-term game plan.

Altria (MO) is rock-solid. Apple (AAPL), Cisco (CSCO), and Microsoft (MSFT) are overflowing with cash. Cracker Barrel (CBRL) had a fantastic month (see page 2). General Electric (GE) and the Energy Select Sector SPDR ETF (XLE)—ancillary benefits of the aforementioned developments—did well. Hasbro's (HAS) and Coach's (COH) equities advanced, and while we've reduced our position in Medtronic (MDT) by half (alert today), it and J&J (JNJ) remain strong healthcare holdings. P&G (PG) faced some expected weakness, while PP&L (PPL) held its ground as most other utilities faced pressure from a rising 10-year Treasury yield.

Realty Income (O) and the Vanguard REIT ETF (VNQ) were also hurt by rising Treasury rates, and while a widening yield curve speaks to good times to come, we're not sure the market has yet factored in higher borrowing costs (and discount rates). After the "Trump rally," a sobering correction could be coming to the markets, but we didn't generate a near-12% compound annual return since inception *in a dividend growth setting* by chasing fads or ups and downs. We're not going to chase the banks, nor are we going to lever up on energy in the Dividend Growth Newsletter portfolio. We are, however, going to stick with underpriced, strong yielders. General Motors (GM) is now the latest addition to the Dividend Growth Newsletter portfolio (alert today), already a big winner in the Best Ideas Newsletter portfolio. Be sure to check out its latest earnings, link to the left.

I hope you enjoy this edition of the Dividend Growth Newsletter!

Cracker Barrel Continues Positive Comparble Store Restaurant Sales Streak

By Kris Rosemann

Even prior to adding Cracker Barrel (CBRL) to the Dividend Growth Newsletter portfolio, we had been keen observers of the stock's potential as an income idea. We continue to believe the restaurant has been proficient in setting itself apart from the remainder of the dine-in restaurant space, and not just in the sense of its differentiated concept, but the proof is in the numbers, too.

For example, the company's operating margin expanded to 9.6% in fiscal 2016 from 6.9% in fiscal 2011, while sales growth at Cracker Barrel has expanded at a rate much faster than the broader casual dining industry, with significant outperformance originating in its fiscal 2013 and continuing through the present day. The first quarter of fiscal 2017, results released November 22, marked the company's 10th consecutive quarter of positive comparable store restaurant sales and its 20th consecutive quarter of outperforming the casual dining industry. We continue to believe Cracker Barrel is a long-term winner as restaurant performance remains stellar, despite weakness in its retail store. We love the dual nature of its business model in this regard.

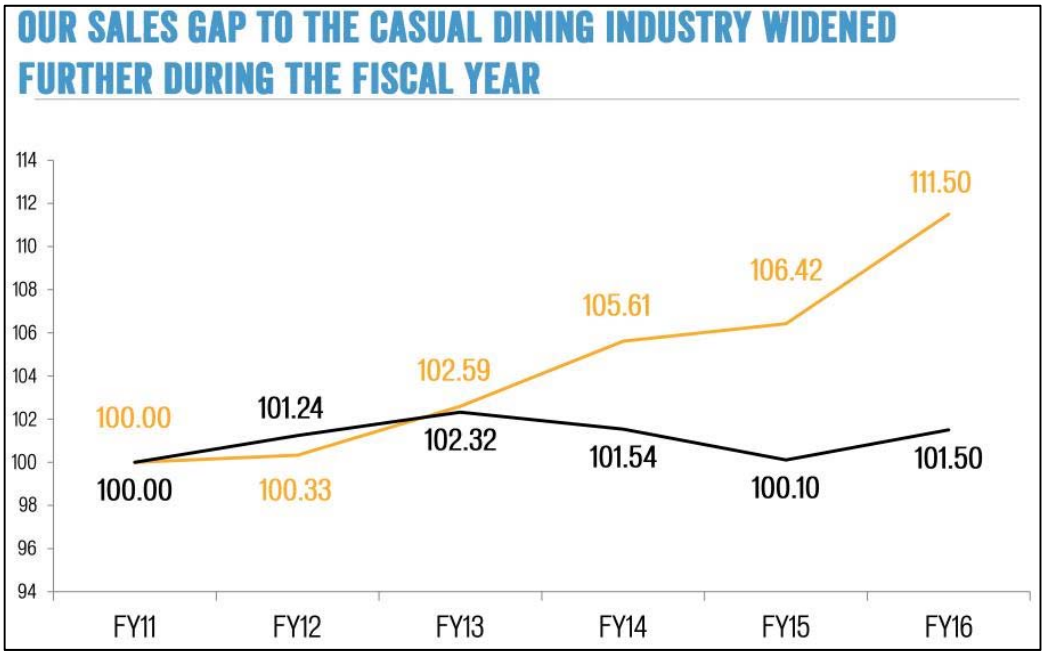


Image source: Cracker Barrel

Despite a genuinely difficult operating environment, Cracker Barrel exceeded expectations in comparable store restaurant sales and bottom-line performance during its fiscal first quarter. Retail weakness, however, was evident in the firm's comparable store retail sales performance, which fell 4% in the quarter and marked the first time since the second quarter of fiscal 2014 it reported negative quarterly retail sales as fewer guests made fewer retail purchases. Comparable store restaurant traffic experienced weakness as well, falling 1.7% from the year-ago period. This traffic pressure was more than offset by a 3% increase in average check in the quarter, which was driven by 2.2% growth in average check and a favorable mix impact of 0.8%. Cracker Barrel is doing a good job of raising prices to mitigate the impact from weaker traffic, which is also tied to weaker retail sales.

Recently, we highlighted the strength of breakfast-focused menu initiatives in the restaurant space. Cracker Barrel has used its all day breakfast, which it calls "Breakfast Y'all Day," as a differentiator for its brand since 1969, and it continues to do so as it targets the desires of the millennial consumer. While our expectation for traffic at Cracker Barrel to be energized by lower prices at the pump has not

Please see *Cracker Barrel...*on next page

*Cracker Barrel...*from previous page

materialized, the firm has used its brand differentiation and strong operational execution to offset the recent weakness in traffic. This could offer even more potential upside should recent traffic trends be rectified, though the weakness is largely an industry-wide issue.

Management helped drive a more favorable mix via the targeted marketing of seasonal, and a favorable food commodity environment helped improve gross margin materially. This, along with a shift in the timing of expenses, including marketing and investment in employee-related expenses, pushed the firm's quarterly operating income up to 10.7%, compared to 9.3% in the comparable quarter of fiscal 2016. Net income per diluted share came in at $2.01, an 18% increase on a year-over-year basis, while free cash flow was impacted by an increase in capital expenditures, largely due to ongoing store expansion efforts.

As a result of its solid fiscal first quarter bottom-line performance, Cracker Barrel raised its guidance range for fiscal 2017 earnings per diluted share to a range of $8.10-$8.25, a welcome improvement over previous expectations of $7.95-$8.10 and a favorable comparison to consensus estimates of $8.13, "Cracker Barrel Rocks Back on Weak Guidance." Although management continues to expect wage pressures to impact its performance, it has identified potential synergies within its current service structure that will reduce store hourly labor by 25-30 hours per week. Specifically it will now cross-train its retail sales associate and cashier positions for low-volume hours, expecting such an initiative to be a significant contributor to cost savings in the fiscal year. Comparable store restaurant sales growth projections for the full fiscal year remained unchanged in a range of 1%-2%.

Though free cash flow generation may face some pressure over the full fiscal year as a result of increased capital expenditures, we continue to view its dividend growth potential in a positive light. Cracker Barrel's Dividend Cushion ratio currently sits at 1.7, a solid measure when considering its 2.8% yield, and a recent run-up in shares has turned our position from an income-based, capital appreciation-neutral one to an overall best-case scenario. In addition to a 2.8% dividend yield (and a special dividend), shares are up more than 20% since being added to the Dividend Growth Newsletter portfolio early February 2016, as of this writing. We're hanging on to shares.

EVERYTHING DIVIDENDS + 3 TOP IDEAS

By Valuentum Analysts

Kris Rosemann:

Hello and welcome to the Valuentum Securities podcast. My name is Kris Rosemann and with me today is Chris Araos and Brian Nelson, the president of equity research and ETF analysis here at Valuentum, and today we're going to be discussing the Dividend Cushion ratio, the Dividend Growth Newsletter portfolio, and some of our favorite dividend ideas on the market today.

So Brian, if you could, let's start by discussing the different Dividend Cushion ratio measurements we have on the Valuentum website. We have the raw, unadjusted Dividend Cushion ratio, and we have the adjusted Dividend Cushion ratio, and I think it can be confusing sometimes for investors to really understand the difference where we choose to distinguish between the two and why we choose to distinguish between the two for certain companies.

Brian Nelson, CFA:

That's a great question, and I think it speaks to the dynamic nature of our research depending on various credit market and financial market decisions (conditions). The Dividend Cushion ratio has been a fantastic ratio for predicting dividend cuts, and its track record over the past 12 months alone, it is predicted a dividend cut at Kinder Morgan (KMI), Potash (POT), ConocoPhillips (COP), BHP (BHP), and the list goes on and on. Those are just a few bellwethers.

Please see *Everything Dividends...*on next page

*Everything Dividends...*from previous page

The Dividend Cushion ratio's success emanates from its forward-looking nature and basis of free cash flow, and mapping that to a company's cash dividends paid. We tend to be relatively debt-averse when it comes to identifying ideas, and companies that are financially-leveraged with a lot of debt tend to be weaker dividend payers than those that tend to have a lot of (net) cash -- and that just makes sense. The more cash you have the more flexibility you have in paying (dividends), so this is a simple concept of the Dividend Cushion ratio embraces.

In terms of the difference between an (raw) unadjusted and an adjusted Dividend Cushion ratio -- really what we're after is the essence of capital-market access. Business models such as MLPs and real estate investment trusts tend to be revolving doors of capital-market access, meaning they're issuing equity, raising debt pretty frequently for necessary reasons, and because of that, the adjusted Dividend Cushion ratio factors in our team's assessment of whether that capital market access will continue into the future.

That's a unique perspective that overlays the raw, unadjusted Dividend Cushion ratio for all other sectors and business models in our coverage, so the REITs and MLPs tend to have two different Dividend Cushion ratios -- one being our assessment of the marketplace of credit markets tend to be open and the other based on whether capital-market access is tight, and you'll see that there are two, often two, different answers to that question (for each REIT and MLP).

What we saw during the energy market collapse during 2015 was that when credit markets tightened, we saw a lot of dividend cuts in the energy space so that's (in part) helps explain why we have two different Dividend Cushion ratios -- to help identify risks under two different and unique market conditions for the same company.

Kris:

Wow, great. Very, very interesting stuff there Brian. Next, could you talk for a minute about our Dividend Growth Newsletter portfolio, how our returns have stacked up against our expectations, and maybe some of the considerations that go into how we manage the portfolio.

Brian:

Absolutely, that's a great question. So the Dividend Growth Newsletter portfolio is a portfolio that is housed within the monthly Dividend Growth Newsletter that we deliver to members each month on the first of the month. The Dividend Growth Newsletter portfolio's goal is to generate a high-single-digit annual return over rolling three to five-year periods. So far, the annualized returns have been well in excess of our target.

Part of that has been due to the strength of dividend-paying entities and them coming into favor, but also we think that a very in-depth cash-flow based valuation focus has allowed us to identify significantly undervalued companies -- companies that have performed incredibly well from a capital appreciation standpoint. But most relevantly, the Dividend Cushion ratio has allowed us to avoid dividend cuts, holding companies that have cut their dividends while they've been in our portfolio.

So, for example, we held at ConocoPhillips in 2012, and when the Dividend Cushion ratio for ConocoPhillips fell significantly, flashing a warning of it having to cut its dividend…three years later when ConocoPhillips cut its dividend, its shares were substantially lower than when we removed it a number of years ago. The same story rings true with Rio Tinto (RIO) where the Dividend Cushion ratio flashed a very serious risk flag of the company, and we removed it well in advance its dividend cut.

We have had zero dividend cuts in the Dividend Growth Newsletter portfolio. Part of that is attributed to the talent of our team at Valuentum, but also how the methodology really focuses on what matters for dividends -- and that's the (net) cash of a company's business and the leverage that it has on the books.

Please see *Everything Dividends...*on page 6

The Dividend Growth Portfolio

Annualized Return	Annualized Goal	Outperformance
11.7%	Mid-High Single Digits	4.2pts

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

Company Name	First Purchase	Avg Cost ($)	# of Shares	Total Cost ($)	Last	Current Value ($)	% of Portfolio	Exp. Yrly Div's ($)
Altria (MO)	12/30/2011	29.65	101	3,001.65	62.89	6,351.89	3.7%	246.44
Apple (AAPL)	7/24/2013	63.17	51	3,228.45	109.49	5,583.99	3.2%	116.28
Cisco (CSCO)	11/14/2014	26.31	199	5,242.53	29.45	5,860.55	3.4%	206.96
Coach (COH)	9/19/2014	37.55	80	3,011.00	36.28	2,902.40	1.7%	108.00
Cracker Barrel (CBRL)	2/1/2016	133.50	18	2,410.00	167.41	3,013.38	1.7%	82.80
Energy Sector SPDR (XLE)	4/1/2015	72.63	121	8,795.76	74.61	9,027.81	5.2%	240.14
General Electric (GE)	10/21/2013	26.18	240	6,290.20	31.39	7,533.60	4.4%	220.80
General Motors (GM) New	12/1/2016	36.43	119	4,342.17	36.43	4,335.17	2.5%	180.88
Hasbro (HAS)	12/30/2011	31.89	110	3,514.90	84.13	9,254.30	5.4%	224.40
Intel (INTC)	12/30/2011	24.25	289	7,015.25	33.76	9,756.64	5.7%	300.56
Johnson & Johnson (JNJ)	12/30/2011	65.58	107	7,024.06	111.38	11,917.66	6.9%	342.40
Medtronic (MDT) Reduced	12/30/2011	38.25	78	2,990.50	71.88	5,606.64	3.3%	134.16
Microsoft (MSFT)	12/30/2011	25.96	77	2,005.92	59.19	4,557.63	2.6%	120.12
Proctor & Gamble (PG)	12/30/2011	66.71	105	7,011.55	81.86	8,595.30	5.0%	281.40
PP&L (PPL)	12/30/2011	29.42	238	7,008.96	33.10	7,877.80	4.6%	361.76
Realty Income (O)	7/24/2013	44.35	60	2,668.00	53.49	3,209.40	1.9%	145.20
S&P Dividend ETF SPDR (SDY)	4/20/2016	81.33	105	8,546.65	85.18	8,943.90	5.2%	222.70
Vanguard REIT ETF (VNQ)	2/1/2016	77.07	32	2,473.24	79.21	2,534.72	1.5%	92.26
Latest Changes: Removed half of the position in MDT (12/1/16); Added GM (12/1/2016).								
Cash -- changes in monthly cash balance reflects dividends received and trading				2,363.42		55,576.04	32.2%	3,627.27
Dividend Growth Portfolio				100,000.00		**172,438.82**	100.0%	**TBD**
DG Portfolio Annualized Return (from inception through current date)								**11.7%**
DG Portfolio Annualized Return Goal (Mid-to-High Single Digit Returns)								7.5%
DG Portfolio Annualized Return Outperformance								**4.2%**

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 September 1, 2016. Cost basis includes commissions. Results include divdends, but no interest received on cash balance.

DIVIDEND GROWTH PORTFOLIO -- as of December 1, 2016 — Fundamental data as of December 1, 2016

Company Name	Yrly Div's Paid ($) / Shr	Div Yield %	Ex Div Date	Next Pay Date (cycl)	Div Cushion™	Div Safety	Div Growth	Fair Value	VBI Score	Price/Fair Value
Altria (MO)	2.44	3.88%	mid-Dec 2016	mid Dec 2016 (quart)	1.1	GOOD	GOOD	$58.00	3	1.08
Apple (AAPL)	2.28	2.08%	early Feb 2017	Feb 2016 (quart)	4.7	EXCELLENT	EXCELLENT	$147.00	7	0.74
Cisco (CSCO)	1.04	3.53%	early Jan 2017	early Jan 2017 (quart)	2.8	EXCELLENT	EXCELLENT	$39.00	7	0.76
Coach (COH)	1.35	3.72%	early Dec 2016	early Dec 2016 (quart)	1.9	GOOD	GOOD	$41.00	6	0.88
Cracker Barrel (CBRL)	4.60	2.75%	mid Jan 2017	late Jan 2017 (quart)	1.7	GOOD	GOOD	$171.00	6	0.98
Energy Sector SPDR (XLE)	1.98	2.66%	late Dec 2016	early Dec 2016 (quart)	-	GOOD	NEUTRAL	-	UR	-
General Electric (GE)	0.92	2.93%	mid Dec 2016	Dec 2016 (quart)	3.1	EXCELLENT	GOOD	$32.00	6	0.98
General Motors (GM)	1.52	4.17%	early Dec 2016	Dec 2016 (quart)	2.0	GOOD	GOOD	$43.00	6	0.85
Hasbro (HAS)	2.04	2.42%	late Jan 2017	late Jan 2017 (quart)	1.7	GOOD	EXCELLENT	$73.00	3	1.15
Intel (INTC)	1.04	3.08%	early Feb 2017	Feb 2017 (quart)	2.6	GOOD	GOOD	$42.00	6	0.80
Johnson & Johnson (JNJ)	3.20	2.87%	mid Feb 2017	Feb 2017 (quart)	2.7	GOOD	EXCELLENT	$121.00	7	0.92
Medtronic (MDT)	1.72	2.39%	late Dec 2016	Dec 2016 (quart)	1.4	GOOD	EXCELLENT	$76.00	6	0.95
Microsoft (MSFT)	1.56	2.64%	mid Feb 2017	Feb 2017 (quart)	2.7	GOOD	EXCELLENT	$52.00	3	1.14
Proctor & Gamble (PG)	2.68	3.27%	late Jan 2017	early Feb 2017 (quart)	1.5	GOOD	EXCELLENT	$70.00	3	1.17
PP&L (PPL)	1.52	4.59%	early Dec 2016	early Dec 2016 (quart)	Held for diversification reasons.			$33.00	3	1.00
Realty Income (O)	2.42	4.52%	monthly	monthly	2.1	GOOD	GOOD	$59.00	3	0.91
S&P Dividend ETF SPDR (SDY)	2.12	2.49%	mid Dec 2016	late Dec 2016	-	-	-	-	UR	-
Vanguard REIT ETF (VNQ)	2.88	3.64%	late Dec 2016	Dec 2016 (quart)	-	GOOD	NEUTRAL	-	UR	-

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

*Everything Dividends...*from page 4

Chris Araos:

Post-recession, fixed-income investors have invested a significant amount of money into consistent dividend payers. This has resulted in a distinct difference in valuation between what an analyst would price the company and what the company's stock is actually selling at -- what is to prevent the bottom from falling out of this market?

Brian:

Mr. Araos, that's a great question, and you're speaking to the asset-flight dynamic of assets flowing out of fixed income due to the ultra-low interest rate environment into relatively higher-yielding, dividend-paying stocks. When I say higher-yielding, I'm talking about dividend-paying stocks that are paying 2%-3% relative to a 10-year Treasury that's under 2% (at the time of this podcast), and so what has happened is a lot of asset flight from fixed income to capture that dividend (growth) yield.

A lot of great research centers on the benefits of dividend growth investing, and I think that has been the cause surrounding the asset flow into that strategy. I think there are a lot of concerns regarding the tipping point of when dividend-paying stocks, which are risky assets, when they start yielding below that of a risk-less asset like a Treasury bond. When that tipping point happens, I believe that we are going to see some significant selling pressure within dividend-paying equities. But remember these are good, strong companies, too, companies like Coca Cola (KO) and Clorox (CLX) and Procter & Gamble (PG).

So we're not going to see, you know, a dot-com bust (equivalent); we're not going to see a Financial Crisis, but we will see, in my view, a reversion to what I think are intrinsic values. Right now, the consumer staples sector is trading at nearly 20 times its forward earnings. It wouldn't be surprising to me to see that revert back to 15 times, which doesn't sound like a lot, but in the context of that kind of an adjustment, that could be a 25% adjustment. I think a lot of income investors may be really surprised if they saw their portfolios impaired by 25% on a normalized basis, and we know that the markets overshoot all the time.

Kris:

Great thanks. Can you speak to some of the holdings in our Dividend Growth Newsletter portfolio that you think present investors with the best opportunity to generate safe income that might not be as exposed to the dividend growth, the dividend cliff that you hinted at?

Brian:

Sure, well one thing I want to emphasize is that safe is a relative word. Nothing is safe when it comes to equity investing. There are just degrees of risk, so what we like to focus on is on the lower level degree of risk, and really...I think in assessing that (risk) comes from a good assessment of the balance sheet. One stock, in particular, that I wanted to emphasize as having one of the strongest balance sheets out there, and yes Apple (AAPL) does have a strong balance sheet, but one company that I think is equally strong is Microsoft (MSFT) -- and while it has purchased LinkedIn (LNKD) and utilized a large portion of that cash position on its balance sheet, we think that its dividend growth years have a long runway of growth, and we continue to be optimistic about Microsoft's dividend-paying years.

Another company that I think flies under the radar due to its questionable industry, and I think it catches a lot of flak because tobacco has been under attack more recently than decades past, but Altria (MO) is still one of our favorite income-oriented ideas and not only does the company cover its dividend with earnings--its payout ratio is 80% consistently on a non-GAAP basis--but it has significant pricing strength with respect to its product, and it has the ace-in-the-hole with its ownership stake AB-Inbev-SABMiller, which just recently tied the knot. That (stake) gives Altria significant financial flexibility; if it ever were to liquidate that position, the catalyst its dividend growth would be substantial.

Please see *Everything Dividends...*on next page

*Everything Dividends...*from previous page

Those are a couple ideas that have been staples of our Dividend Growth Newsletter portfolio, and I think have attributed to its significant strong performance, but you know I'd like to maybe ask the same question to you Kris -- what might be you one of your favorite ideas in our Dividend Growth Newsletter portfolio?

Kris:

Sure, I think that Hasbro (HAS), the toy giant, is really an interesting consideration, and it has continued to transition to a licensing business model, as opposed to a physical toy maker, and in doing so, it has an asset-light business model that allows it to generate a high return on invested capital, and therefore its free cash flow conversion rate is very high, allowing it to cover its dividend payments relatively easily.

Its business continues to experience strong momentum its relationship with Disney (DIS), specifically with the *Frozen* franchise, and coming into the holiday season, it's already showing some great momentum in its business this year, and we love its free-cash-flow coverage of its dividends, as I mentioned, its asset-light, high-ROIC licensing business model that it continues to transition to really sets it apart from some of the other more traditional operators in our coverage universe.

Hasbro is also a good example of something that we've encountered in this (currently) overheated market to a degree as its share price continues to run near the upper bound of our fair value range of the company. Many may question whether or not we're going to remove our position, or a portion of the position in the company, as it grows closer and closer to that upper bound of our fair value range. Our reasoning at this point is that we want to retain equity exposure to as many high-quality names as we possibly can in this current market environment -- as our cash position in the Dividend Growth Newsletter portfolio is already at 30% (at the time of this podcast) -- and we view Hasbro as a high-quality equity name that we will continue to retain exposure to.

Brian:

That's just a really, really great point. Hasbro is starting to get a little bit pricey, but when you look across the dividend-paying universe, there are a lot more companies that are far more expensive. If we had removed companies when they reached fair value (in this market), we would have lost significant potential outperformance from what we describe to be "letting our winners run," and that has proven to be a core component of the Valuentum strategy, and that has worked out wonderfully both in the Dividend Growth Newsletter portfolio, as well as in the Best Ideas Newsletter portfolio.

Kris:

Great. Thanks for your time Brian, and please stay tuned for more updates on our Dividend Growth Newsletter portfolio and future podcasts.

Earnings Insight – Medtronic's Free Cash Flow Story

By Brian Nelson, CFA

Let's cover some ground on Medtronic's (MDT) calendar third-quarter report, its second-quarter fiscal 2017 results.

What management said:

"Q2 revenue was disappointing and did not meet our expectations. We faced issues that affected our growth, including slower than expected revenue as we await new product introductions, particularly in CVG and Diabetes," said Omar Ishrak, Medtronic chairman and chief executive officer. "Despite this revenue shortfall, we produced a strong improvement in operating margins and double digit constant currency earnings per share growth."

Please see *Earnings Insight...*on next page

*Earnings Insight...*from previous page

The scoop:

Medtronic probably did more to frighten investors with its use of the word "disappointing" in its fiscal second-quarter press release, issued November 22, than anything fundamental. Fiscal second-quarter revenue increased 4%, or 3% on a constant-currency basis, while non-GAAP earnings per share leapt 15% on a constant-currency basis. GAAP and non-GAAP operating margins increased 50 and 150 basis points, respectively, on a year-over-year basis in the period.

Revenue generated in the US (up 1%), non-US (up 5% on a constant currency basis), and emerging markets (up 10% on a constant currency basis) advanced during the quarter. Segment sales in Medtronic's 'Cardiac and Vascular,' 'Minimally Invasive Therapies,' Restorative Therapies,' and 'Diabetes' groups increased 3%, 4%, 3%, and 3%, respectively, on a constant-currency basis. Medtronic's drug-eluting stents business in the US and Japan faced some pressure due to timing of approval for Resolute Onyx and its implantables revenue came in lower-than-expected in the UK, but there was more good news than bad in the quarter, in our view, particularly with respect to its 'Diagnostics' business (mid-teens growth) and its Spine business, the latter experiencing the best performance in seven quarters.

Medtronic updated its fiscal 2017 guidance for revenue, free cash flow, and earnings per share guidance. The top line is expected to advance at a mid-single-digit pace (down modestly from its prior expectations), while non-GAAP diluted earnings per share is targeted in the range of $4.55-$4.60. Free cash flow during the fiscal year is expected in the range of $5-$6 billion; its annualized cash dividend run-rate is ~$2.4 billion, so free cash flow coverage is fantastic. Medtronic ended the quarter with ~$3 billion of cash and cash equivalents and ~$29 billion in long-term debt.

(in billions)	Full Fiscal Year 2017 Estimate Low	High
Net cash provided by operating activities (1)	$ 6.2	$ 7.1
Additions to property, plant, and equipment	(1.2)	(1.1)
Free Cash Flow (2)	$ 5.0	$ 6.0

See description of non-GAAP financial measures at the end of the earnings press release.

(1) Estimated full fiscal year net cash provided by operating activities includes assumptions related to the timing and amount of cash flows resulting from charges or gains that result from transactions or events that management believes may or may not recur with similar materiality or impact to operations in future periods (Non-GAAP Adjustments). The estimated full year range is broad to capture the unpredictability inherent in the timing and amount of cash flows related to Non-GAAP Adjustments. The estimate includes projected cash flows related to Non-GAAP Adjustments which have been recognized in the Company's statements of income. If the Company were to incur charges or gains related to Non-GAAP Adjustments which have not yet been recognized in the statements of income, the estimated full fiscal year net cash provided by operating activities may be significantly effected.

(2) Free cash flow represents operating cash flows less property, plant, and equipment additions.

Image Source: Medtronic

Insight from the quarterly conference call:

"Across all of our groups, our product pipeline remains robust. We have important new growth catalysts that we expect to lead to improved second half growth. Some of these products have already been launched and others are coming to the market in the coming months. We are confident we can drive sustainable growth of our new therapies growth vector and expect to be well within our 200 to 350 basis point goal in the back half of the year and over the longer term." – CEO Omar Ishrak

"...we are modifying our free cash flow outlook methodology. Recall that last quarter, we were forecasting an adjusted free cash flow of $6.5 billion to $7 billion for fiscal year '17, a range that would exclude cash payments related to non-GAAP items that might occur during the year. Going

Please see *Earnings Insight...*on next page

*Earnings Insight...*from previous page

forward, we will include these items to more closely align our free cash flow projection with the results we report each quarter. However, in light of the unpredictability of the precise amount and timing of cash payments, we are expanding the range. Given this, along with the revenue and net income expectations already discussed, we expect our free cash flow for the fiscal year to be in the range of $5 billion to $6 billion." – CFO Karen Parkhill

Are we changing our mind with our position?:

No, but as we outlined in previous write-ups, we may look to take some profits off the top. Medtronic has been a huge winner in the Dividend Growth Newsletter portfolio, and its weighting had run away from us a bit, but it still resides below our mandatory 10% cap for any position.

We think CEO Omar Ishrak was a little hard on the team's performance, as everything fundamental looks "fixable," in our view, since most of it was timing-related. We also think that his thoughts may have been more near-term oriented than we would have liked as investors are looking at Medtronic as a long-term opportunity, not a short-term trade.

That said, we don't think many investors liked the change in Medtronic's free cash flow methodology, though we've always defined free cash flow as cash flow from operations less all capital spending, which for Medtronic continues to be substantially greater than cash dividend obligations.

Shares of the medical-device giant are trading at ~16.5 current-year earnings at the time of this writing and about ~14.5 times next fiscal year earnings. We don't like its debt load, but we think it's manageable given its robust free cash flow generating capacity, and we expect dividend growth to remain robust. Shares yield 2.3%.

Energy Transfer Partners' Implicit Distribution Cut

By Kris Rosemann

Another simplification transaction in the MLP space -- who would have thought an MLP needed material changes in their corporate structures? If you've been reading our analysis of the industry recently, you would be on that list. To us, the merger agreement between Energy Transfer Partners (ETP) and Sunoco Logistics Partners (SXL) November 21 is yet another acknowledgement of the flaws in the MLP business model and recognition of the lack of clarity regarding the long-term viability of the MLP model.

In the merger agreement, Energy Transfer Partners unitholders will receive 1.5 units of Sonoco Logistics Partners for each Energy Transfer Partners unit held. Also, all Sunoco common and Class B units held by Energy Transfer Partners will be retired, and all Class H units of Energy Transfer Partners held by Energy Transfer Equity (ETE) will be retired, which will result in Energy Transfer Equity owning 100% of the combined company's General Partner and incentive distribution rights. The deal is expected to close in the first quarter of 2017.

We cannot dispute the simplification benefits of the transaction, but a greater issue lies in the leverage of the to-be-formed entity. Sunoco will assume Energy Transfer Partners' outstanding debt, resulting in the addition of ~$30.4 billion of Energy Transfer Partners' total debt to Sunoco's current total debt load of more than $6 billion. The cash balances of each firm are negligible compared to the debt loads, and the resulting net debt load of ~$36 billion leads us to a net debt-to-adjusted EBITDA ratio of more than 6.4x when using annualized adjusted EBITDA results provided by management.

The merger is also expected to be accretive to Sunoco's distributable cash flow and distribution per unit, which management has said will put the company in a position to achieve near-term distribution increases in the low double digit range with a more than 1x distribution coverage ratio (in questionable industry-specific metrics, of course). We're not fond of any entity with the leverage of the proposed combination of these two MLPs targeting double digit distribution increases.

Please see *Energy Transfer Partners...*on page 13

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

By Valuentum Analysts

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

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

Company Name	Symbol	Sector	Est. Div Yield	VBI	Div Growth	Div Cushion
QUALCOMM	QCOM	Information Technology	4.0%	7	EXCELLENT	3.0
Caterpillar	CAT	Industrials	3.9%	7	GOOD	0.6
Gap	GPS	Consumer Discretionary	3.6%	7	EXCELLENT	2.1
Darden Restaurants	DRI	Consumer Discretionary	3.6%	7	GOOD	1.3
Cisco	CSCO	Information Technology	3.4%	7	EXCELLENT	2.8
CA Tech	CA	Information Technology	3.1%	7	GOOD	3.0
Xerox	XRX	Industrials	3.0%	9	EXCELLENT	1.6
Nucor	NUE	Materials	2.8%	7	GOOD	1.6
Johnson & Johnson	JNJ	Consumer Staples	2.7%	7	EXCELLENT	2.7
United Technologies	UTX	Industrials	2.4%	7	EXCELLENT	1.4
CVS Caremark	CVS	Consumer Staples	2.3%	8	GOOD	0.9
Raytheon	RTN	Industrials	2.1%	7	EXCELLENT	2.2
Apple	AAPL	Information Technology	2.0%	7	EXCELLENT	4.7
Foot Locker	FL	Consumer Discretionary	1.9%	7	EXCELLENT	4.4
Finish Line	FINL	Consumer Discretionary	1.9%	7	GOOD	4.7
Ralph Lauren	RL	Consumer Discretionary	1.8%	7	EXCELLENT	3.5
NASDAQ	NDAQ	Financials	1.8%	7	EXCELLENT	2.1
Deluxe	DLX	Information Technology	1.8%	7	GOOD	4.5
Jabil Circuit	JBL	Information Technology	1.5%	9	GOOD	3.3
Oracle	ORCL	Information Technology	1.5%	7	EXCELLENT	4.7
Ashland	ASH	Materials	1.3%	7	GOOD	2.9
Broadcom	AVGO	Information Technology	1.3%	7	EXCELLENT	1.6
Tetra Tech	TTEK	Information Technology	1.2%	7	EXCELLENT	4.7
H.B. Fuller	FUL	Materials	1.2%	7	EXCELLENT	2.3
Computer Sciences	CSC	Information Technology	1.1%	7	EXCELLENT	4.4
Forward Air	FWRD	Industrials	1.1%	7	EXCELLENT	4.5
Dillard's	DDS	Consumer Discretionary	0.4%	7	GOOD	12.3
Thermo Fisher Scientific	TMO	Health Care	0.4%	7	GOOD	7.0
PVH Corp	PVH	Consumer Discretionary	0.1%	7	GOOD	14.7

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

The Dividend Growth Watch List

By Valuentum Analysts

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

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

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

DIVIDEND GROWTH WATCH LIST - as of December 1, 2016 Fundamental data as of December 1, 2016

Company Name	Yrly Div's Paid ($) / Shr	Div Yield %	Div Cushion™	Div Safety	Div Growth	Fair Value	VBI Score	Price/Fair Value	Price ($)
3M (MMM)	4.44	2.57%	1.4	GOOD	EXCELLENT	$133.00	4	1.30	172.63
Abbott (ABT)	1.04	2.77%	2.7	GOOD	EXCELLENT	$43.00	3	0.87	37.60
AbbVie (ABBV)	2.56	4.33%	1.4	GOOD	EXCELLENT	$74.00	4	0.80	59.16
ADP (ADP)	2.28	2.38%	6.2	EXCELLENT	EXCELLENT	$98.00	6	0.98	95.77
Analog Devices (ADI)	1.68	2.43%	2.3	GOOD	EXCELLENT	$53.00	6	1.30	69.01
Becton, Dickinson (BDX)	2.92	1.77%	0.7	POOR	VERY POOR	$161.00	7	1.02	164.62
Boeing (BA)	4.36	2.86%	2.0	GOOD	EXCELLENT	$124.00	4	1.23	152.39
Coca-Cola (KO)	1.40	3.49%	1.4	GOOD	EXCELLENT	$39.00	3	1.03	40.17
Colgate-Palmolive (CL)	1.56	2.40%	1.7	GOOD	EXCELLENT	$60.00	3	1.08	65.08
Deere (DE)	2.40	2.34%	1.1	POOR	VERY POOR	$93.00	3	1.10	102.70
Dover (DOV)	1.76	2.33%	1.1	POOR	VERY POOR	$64.00	4	1.18	75.53
DuPont (DD)	1.52	2.06%	2.4	GOOD	GOOD	$62.00	6	1.19	73.62
Eli Lilly (LLY)	2.04	3.09%	1.9	GOOD	GOOD	$73.00	6	0.90	65.97
General Dynamics (GD)	3.04	1.72%	3.0	EXCELLENT	EXCELLENT	$129.00	6	1.37	176.40
Genuine Parts (GPC)	2.63	2.73%	1.9	GOOD	EXCELLENT	$88.00	6	1.09	96.22
H&R Block (HRB)	0.88	4.04%	1.6	GOOD	GOOD	$28.00	3	0.78	21.78
Harris (HRS)	2.12	2.03%	0.1	VERY POOR	VERY POOR	$92.00	7	1.13	104.34
Honeywell (HON)	2.66	2.34%	2.9	EXCELLENT	EXCELLENT	$106.00	6	1.07	113.67
Hormel Foods (HRL)	0.68	2.04%	2.7	GOOD	EXCELLENT	$42.00	6	0.79	33.29
IBM (IBM)	5.60	3.50%	1.5	GOOD	EXCELLENT	$164.00	6	0.97	159.82
Illinois Tool Works (ITW)	2.60	2.08%	1.8	GOOD	EXCELLENT	$88.00	1	1.42	125.30
Kimberly-Clark (KMB)	3.68	3.23%	1.2	GOOD	GOOD	$112.00	4	1.02	114.01
Lockheed Martin (LMT)	7.28	2.73%	1.2	POOR	VERY POOR	$193.00	1	1.38	266.40
Merck (MRK)	1.88	3.09%	1.9	GOOD	GOOD	$55.00	6	1.10	60.76
Northrop Grumman (NOC)	3.60	1.45%	1.8	GOOD	EXCELLENT	$160.00	1	1.56	249.07
Paychex (PAYX)	1.84	3.14%	2.6	GOOD	EXCELLENT	$48.00	4	1.22	58.68
Phillip Morris (PM)	4.16	4.74%	0.6	GOOD	GOOD	$84.00	4	1.04	87.77
Raytheon (RTN)	2.93	1.96%	2.2	GOOD	EXCELLENT	$104.00	7	1.44	149.24
St. Jude (STJ)	1.24	1.57%	2.1	GOOD	EXCELLENT	$85.00	5	0.93	78.78
Texas Instr (TXN)	2.00	2.84%	2.1	GOOD	EXCELLENT	$54.00	6	1.30	70.41
United Technologies (UTX)	2.64	2.46%	1.4	GOOD	EXCELLENT	$107.00	7	1.00	107.48
UPS (UPS)	3.12	2.68%	1.7	GOOD	EXCELLENT	$100.00	6	1.16	116.43
VF Corp (VFC)	1.68	3.01%	2.0	GOOD	EXCELLENT	$55.00	5	1.01	55.77
Walgreens (WBA)	1.50	1.78%	2.2	GOOD	EXCELLENT	$75.00	6	1.12	84.22

UR = Under Review

Yields to Avoid

By Valuentum Analysts

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

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

Company Name	Symbol	Industry	Est. Div Yield	Div Safety	Div Cushion
Textainer	TGH	Rental and Leasing	1.2%	VERY POOR	-80.8
CONSOL Energy	CNX	Industrial Minerals	0.2%	VERY POOR	-65.1
KB Home	KBH	Homebuilders	0.7%	VERY POOR	-38.9
Windstream	WIN	Telecom Services - diversified	6.7%	VERY POOR	-36.1
Alcoa	AA	Aluminum	0.4%	VERY POOR	-33.6
Lennar	LEN	Homebuilders	0.3%	VERY POOR	-25.6
Devon Energy	DVN	Independent Oil & Gas	0.6%	VERY POOR	-21.3
Anadarko	APC	Independent Oil & Gas	0.3%	VERY POOR	-12.7
Ryder System	R	Rental and Leasing	2.3%	VERY POOR	-8.0
Tailored Brands	TLRD	Retail - Men's, Women's, Kids' Apparel	5.0%	VERY POOR	-7.1
Allegheny Technologies	ATI	Aluminum	1.8%	VERY POOR	-5.4
D. R. Horton	DHI	Homebuilders	1.0%	VERY POOR	-5.3
ConocoPhillips	COP	Major Oil & Gas	2.4%	VERY POOR	-4.9
Barrick Gold	ABX	Metals & Mining - gold	0.5%	VERY POOR	-4.8
Koppers	KOP	Building Materials	3.1%	VERY POOR	-4.5
MDC	MDC	Homebuilders	4.0%	VERY POOR	-4.4
Teekay	TGP	Shipping	4.9%	VERY POOR	-4.4
Yamana Gold	AUY	Metals & Mining - gold	0.7%	VERY POOR	-4.3
Hill-Rom	HRC	Medical Instruments	1.3%	VERY POOR	-4.2
Hess	HES	Refiners	1.8%	VERY POOR	-3.8
Murphy Oil	MUR	Refiners	4.4%	VERY POOR	-3.7
Ball Corp	BLL	Containers & Packaging	0.7%	VERY POOR	-3.7
Rent-A-Center	RCII	Rental and Leasing	2.7%	VERY POOR	-3.4
Olin Corp	OLN	Chemicals - mid/small	3.9%	VERY POOR	-2.7
Noble Energy	NBL	Independent Oil & Gas	1.2%	VERY POOR	-2.7
Apache	APA	Independent Oil & Gas	1.7%	VERY POOR	-2.5
Wendy's Co	WEN	Restaurants - Fast Food & Coffee	2.2%	VERY POOR	-2.4
Deltic Timber	DEL	Building Materials	0.6%	VERY POOR	-2.3
Quad/Graphics Inc	QUAD	Book Publishing	4.8%	VERY POOR	-2.1
Huntsman	HUN	Chemicals - broad	2.8%	VERY POOR	-2.0
Service Corp Intl	SCI	Personal Services	2.0%	VERY POOR	-1.9
Centurylink	CTL	Telecom Services - diversified	7.8%	VERY POOR	-1.7

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

Energy Transfer Partners...from page 9

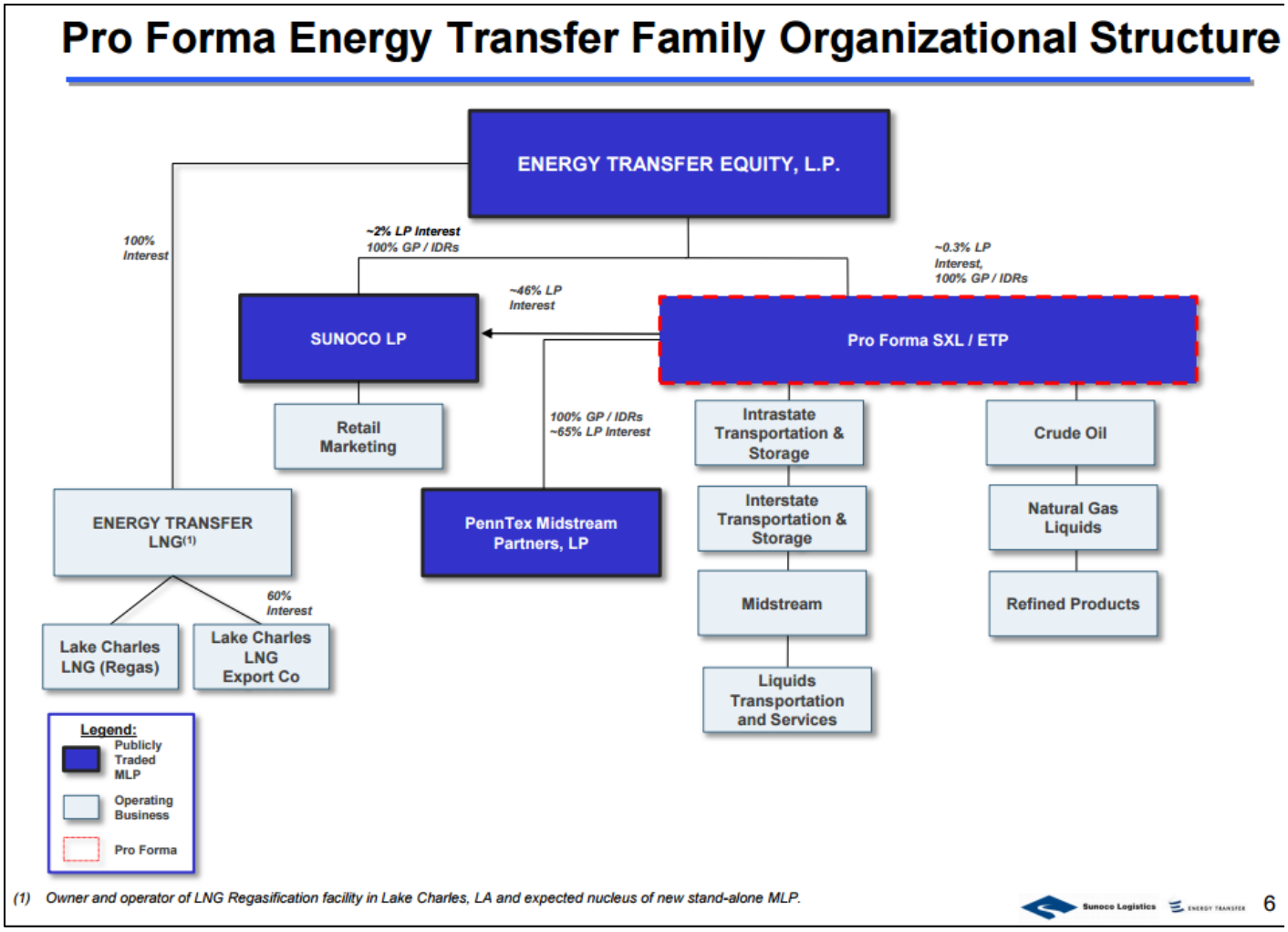


Image source: Energy Transfer presentation

Additionally, the deal will result in an implied distribution reduction, which likely would have been necessary anyway. Management has noted that without the deal, Energy Transfer Partners "would need to consider a distribution reduction in the range of 15-25%, subject to a number of assumptions, in order to reduce leverage and increase distribution coverage to strengthen ETP's financial health and future cash distribution growth profile." The terms of the deal will result in an implied distribution reduction for unitholders from current quarterly levels at Energy Transfer Partners of $1.055 to $0.765 (1.5 times Sonoco's current quarterly distribution of $0.51). Energy Transfer Partners' unadjusted Dividend Cushion ratio is currently -1.2 (negative 1.2).

While we continue to be wary of the structure of the MLP business model, the underlying fundamentals of those businesses are strong, and should benefit from more relaxed regulatory environment in the US with the coming administration change. In this light, the deal makes a reasonable amount of sense. The simplification transaction will ensure strong access to capital markets in the near term and help maintain investment grade credit metrics and attractive funding costs, all of which enhance the firms' ability to manage the inherent risk in large-scale growth investments (read: Donald Trump's promise to promote infrastructure investments).

If Energy Transfer Partners was going to be forced to reevaluate its distribution, which would have undoubtedly sent shockwaves through the MLP space, a reduction of the distribution in the form of a simplification transaction may be a savvy move, even if it only alleviates some of our concerns

Please see *Energy Transfer Partners*...on next page

*Energy Transfer Partners...*from previous page

temporarily. There's also the potential that management may be using the transaction to avoid a downgrade of Energy Transfer Partners' credit rating to junk territory, of which it is currently on the precipice of. Each major credit rating agency currently rates its debt as the lowest rung of investment grade, Moody's (MCO) recently reduced its outlook to 'Negative,' and traditional free cash flow generation remains substantially negative as of the end of the third quarter of 2016. Sunoco's free cash flow generation is also in negative territory, but it currently has higher credit ratings, and the moving parts of the simplification transaction could convolute the rating agencies' processes for the time being.

Management will continue to tout the operational synergies and growth potential of the newly combined entity, and we're not here to discredit those remarks. What we're concerned about is the long-term viability of the MLP structure that have, at times, used lofty distribution yields to lure investors into what could turn out to be severely destructive to their invested capital. We view this simplification transaction as a short term alleviation of what will eventually turn out to be long-term pressures. As the market digested the news of the hidden distribution cut, shares were punished, but aside from the equity impact of the implied distribution reduction, the transaction should benefit the Energy Transfer family in the near to medium term.

The recent developments at the Energy Transfer family does very little to change our opinion of the midstream MLP space. In fact, it seems to add more validity to our thesis. From a July 2016 article:

> We expect the MLP business/financial model to eventually be reevaluated at the highest regulatory levels and deemed an "unfair" structure. That MLPs can recirculate capital raised from the financial markets (financing section of the cash flow statement) to pay distributions, which are widely followed by "trusting" investors and often used to value their equities is incredible. How can you be sure that our perspective is worth considering? **Ask one question: what would happen to MLPs if the capital markets shut down?** The answer: They would have to cut their distributions as cutting off growth and investment would be a bonehead move in light of potential positive NPV projects. In any business seeking to generate value for shareholders, which all are, investment growth capital therefore will always be funded first and foremost through a company's operating cash flow, and since most capital investment and dividends, collectively, overwhelm operating cash flow generation, most all MLP payouts are in part financially-engineered (i.e. supported by the financing section of the cash flow statement). External capital is not the primary source of growth funding.
>
> Though it may not happen anytime soon, we believe there will eventually be an "investor-led" crusade against this dangerous business model. Such opposition doesn't necessarily have to come from investors either. It could come from a corporate coalition. There are many corporates, for example, that have decent balance sheets and cover their dividends with traditional free cash flow, but have much less sanguine credit marks by the agencies relative to those of such
>
> overleveraged, "cash-burning" (after dividend payments) pipeline MLP plays. Moreover, we believe the SEC should take a hard look at the industry's definition of "cash flow," which we believe is very misleading to even the most sophisticated investors. In particular, an MLP's definition of distributable cash flow excludes the very growth capital spending that drives net income, which itself is included in the calculation of distributable cash flow. When analysts use distributable cash flow in valuation, they, by its very own definition, exclude a portion of the cash capital outflows (shareholder money) that are used to drive net income higher, a severe imbalance in the valuation equation.

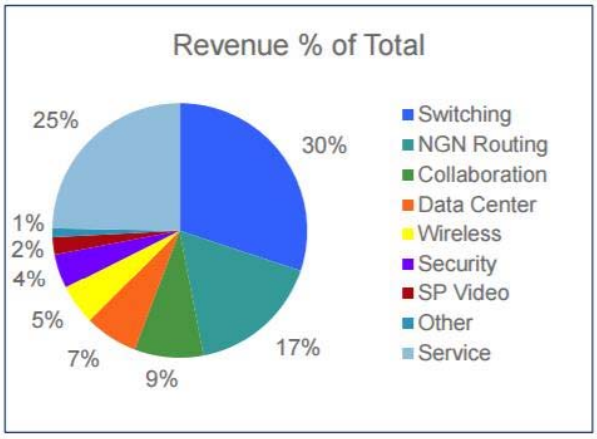
We can only hope our members are not among those who allow the wool to be pulled over their eyes, but we can only promise one thing: we are going to give it, and have been giving it, to you straight.

Earnings Insight - Cisco

By Brian Nelson, CFA

Q1 FY 2017 – Revenue Highlights

	$M	Y/Y % Change*
Switching	$3,716	(7%)
NGN Routing	2,089	6%
Collaboration	1,081	(3%)
Data Center	834	(3%)
Wireless	632	(2%)
Security	540	11%
Service Provider Video	271	(2%)
Other Products	139	88%
Service	3,050	7%
Total Cisco	$12,352	1%



Percentages may not sum to 100% due to rounding

** Year-over-year change normalized to exclude the SP Video CPE Business for Q1 FY 2016, which was divested during Q2 FY 2016 on November 20, 2015. SP Video CPE Business revenue was $411M for Q1 FY 2016.*

Image source: Cisco

Let's cover some ground on Cisco's (CSCO) calendar third-quarter report, its first quarter of fiscal 2017.

What management said:

"We had a good quarter despite a challenging global business environment and we performed well in our priority areas," said Chuck Robbins, CEO, Cisco. "We are leading our customers in their digital transition by providing them with highly secure, automated, and intelligent solutions in the ways they want to consume them. Our innovation pipeline is robust and we are well positioned for the future."

"We executed well in Q1 delivering profitable growth, and saw strong adoption of our subscription-based and software offerings as we transition our business to a more recurring revenue model," said Kelly Kramer, CFO, Cisco. "We will invest in key growth areas and continue to focus on delivering shareholder value."

The scoop:

Cisco's first-quarter 2017 results, released November 16, were mixed. The pace of revenue growth came in in-line with management's guidance for the period, but it wasn't robust by any stretch at ~1% expansion year-over-year. 'Security' and NGN Routing' were areas of strength, but weakness across the rest of its portfolio, including 'Switching' and 'Data Center' proved to be stiff headwinds to top-line growth. A pause in enterprise spending due to macroeconomic uncertainty and a market shift from "Blade to Rack" were the culprits, respectively.

Cisco's gross profit trends were encouraging as productivity improvements and its divestiture of its SP Video CPE Business drove product gross margin 250 basis points higher in the period (non-GAAP gross margins also increased). The better levels of gross profitability, however, didn't translate into significant bottom-line growth, however, as net income dropped 4%, a rate that matched the decline in GAAP diluted earnings per share. On a non-GAAP basis, excluding its SP Video CPE Business, net income

Please see *Earnings Insight...*on next page

***Earnings Insight…*from previous page**

did advance 3% as GAAP operating measures were weighed down by lofty restructuring charges, including headcount reductions.

The networking giant's cash flow from operations remained robust at $2.7 billion during the quarter, and it ended the period with $71 billion in cash and cash equivalents on hand, speaking to its incredible financial strength and dividend-paying power. Cisco's shares faced selling pressure following the quarterly release, however, as a result of a rather muted outlook for the current quarter. Revenue for the second period of its fiscal 2017 is expected to fall at a 2%-4% annual pace, with non-GAAP earnings per share coming in at $0.55-$0.57, both modestly below consensus forecasts at the time.

Insight from the quarterly conference call:

"Let me review a few areas of our business where our innovation is driving momentum. First security; our security revenue grew 11% marking the 4th consecutive quarter of double-digit growth. We're driving more subscription based recurring business resulting in deferred revenue growth of 39%. Our competitive position in security is growing stronger as our integrated architecture approach and best-of-breed portfolio resonates with our customers. In fact, we're the only company with security product revenue exceeding $2 billion annualized run rate with double-digit growth." – CEO Chuck Robbins

"Second, our next generation data center. Our goal is to build the best private and hybrid cloud solutions for our customers. We're investing heavily in our data center portfolio to extend our market leadership. To do this, we're delivering software, hardware and systems at all levels of the data center stack and across delivery models. Our customers widespread adoption of Cisco ASI family of data center networking products continued in Q1 with revenue growth of 33% to an annualized revenue run rate now of $3 billion." – CEO Chuck Robbins

Are we changing our mind with our position?:

Capital Allocation

$M	Q1 FY 2016	Q2 FY 2016	Q3 FY 2016	Q4 FY 2016	Q1 FY 2017
Share Repurchases	$1,207	$1,262	$649	$800	$1,001
Dividends Paid	1,068	1,065	1,308	1,309	1,308
Total	$2,275	$2,327	$1,957	$2,109	$2,309

	Q1 FY 2016	Q2 FY 2016	Q3 FY 2016	Q4 FY 2016	Q1 FY 2017
Dividends per Share	$0.21	$0.21	$0.26	$0.26	$0.26

Image Source: Cisco

No. Cisco's balance sheet remains incredibly robust, and policy changes with respect to the tax code on repatriated cash would only play into a better market price for Cisco as participants give it greater credit for its net cash position on the books. The company remains committed to growing the dividend, regardless of the interest rate environment, and while we weren't happy with the modest outlook for the current quarter, management may be taking a more conservative approach in light of the election results, which have caught many by surprise. We're comfortable collecting dividend checks on Cisco – it's massive net cash position is extremely reassuring. Shares are currently yielding ~3.5%.

Dividends, Dividends, Dividends

By Valuentum Analysts

Originally published September 10, 2014.

Brian Nelson, CFA:

This is Brian Nelson from Valuentum Securities. I wanted to share with you three insights on dividends that I don't think are talked about enough in today's dividend growth investing handbook.

The first is the idea that the dividend is a symptom of a company's strength so the key driver behind a firm's valuation is its free cash flows, and the dividend is a symptom of the company being able to continue to generate those free cash flows and to pay a portion of those cash flows to shareholders. So it's important to remember as investors that the driver behind a business' valuation is its free cash flows, and the dividend is a symptom those cash flows.
The second point I wanted to highlight is the idea that a higher yield isn't always better. In many cases, a higher yield is a greater reflection of a company's risk regarding the sustainability of the payout than anything else. For stocks that pay out a large portion of their earnings and free cash flows as dividends, these are essentially income vehicles, fixed-income vehicles in some cases, and many times their equity prices, their stock prices, reflect that particular fixed-income nature.

If we think about it in terms these higher-yielding dividend (paying) companies, those that (yield) 9-10% or above, they're in many cases, they're priced similar to higher-yielding debt, where for a debt instrument the spread over the Treasury would have to be wider -- debt investors would demand a higher yield on a debt instrument in order to hold that debt security due to the risk of default.

It is similar with respect to dividend growth investing in high-yielding companies where for a stock investor to hold a particular stock that is somewhat risky with respect the payout, they demand a higher yield, and that's why you see companies with higher yields have a greater likelihood of cutting those dividends because the market is assessing the risk regarding the payout and demanding a higher yield (lower stock price) in order to take on that particular risk.

The third point that I think is worth highlighting is the origination of the dividend, and that could come from three particular sources. The first is free cash flows -- this is cash flow from operations, which is driven in part by net income (earnings), and then of course the working capital changes that lead into cash flow from operations, less capital expenditures, both growth and maintenance "capex" to propel future cash flow from operations and earnings. Cash flow from operations less capital expenditures is going to be free cash flows, that which a business has left over after investing into its business to continue that earnings trajectory. So that's one source where cash can come from the company in terms of the paying a dividend.

The other source is net cash on the balance sheet. For example, a company that may have a cash or earnings shortfall in any given period could go to its balance sheet to pull cash from the balance sheet to pay shareholders the dividend. This is why we pay very close attention to the balance sheet because it is a very important source of dividend strength and growth potential. Then finally, more or less as it relates to companies that pay out a large portion up their particular earnings and cash flow as dividends.

A company's ability to access the capital markets -- debt and equity markets -- is vital to the continuation of paying out a particular dividend (distribution). If, for example, a high-yielding company that is dependent on the capital markets, if that access to capital is shut off, they are at a greater likelihood of cutting their particular dividends -- and you'll see this within our (dividend) methodology framework for business structures such as REITs and master limited partnerships (MLPs).

So, these particular dynamics in terms of the origination of the dividend -- free cash flow, the net balance sheet, access to the debt and capital markets -- roll into the Dividend Cushion ratio. This ratio helps us assess the safety of a particular dividend, and the higher the ratio above 1, the "safer" the company's dividend assuming that it does have access to capital markets.

Capella Education's Dividend Potential

By Valuentum Analysts

Page 2 of Valuentum's dividend report!

Capella Education CPLA FAIRLY VALUED

Buying Index™ 6 Value Rating

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Highest Rated	$40.00 - $84.00	HEALTHY	EXCELLENT / 3.8	EXCELLENT	2.61%

Assessment of Company Dividend Strategy

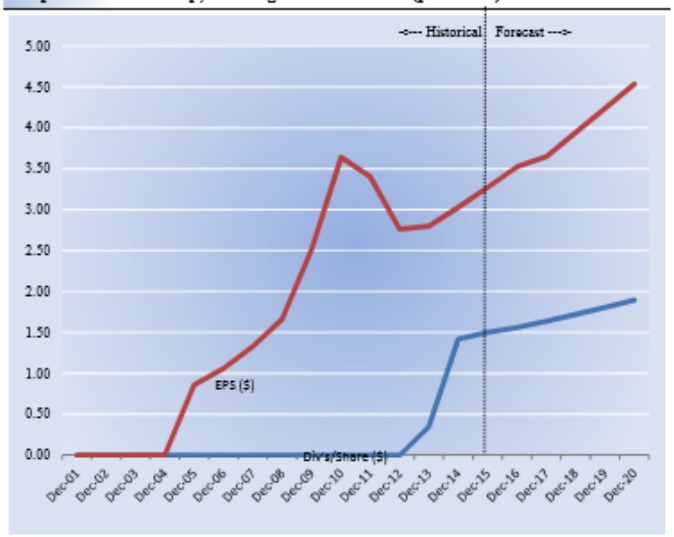
Key Strengths

Capella Education has the best business model in the for-profit education space, in our opinion. Cash from operations has been consistently higher than operating income in recent years, and its online platform keeps investments relatively low. Management targets capital expenditures of 5% of revenue each year, allowing the company solid free cash flow generation. This strong cash flow generation has the ability to fully fund operations and investments, which enables the company to maintain its pristine balance sheet. All of these aspects boost the firm's Dividend Cushion ratio and pave the way for safe dividend growth in the future. The firm is targeting a dividend yield of ~3% for the foreseeable future.

Potential Weaknesses

Though it has significant potential based on our Dividend Cushion ratio, Capella's dividend is still young. Management does not give much guidance towards its future plans for its dividend, which adds a degree of uncertainty to the future of the payout, but we expect quarterly payout growth similar to what investors have seen in recent years. The firm has an ongoing share repurchase program that will compete for capital allocation in the place of dividends, but we think the company's strong balance sheet and free cash flow generating ability will be more than enough to continue to make appropriate investments and return capital to shareholders.

Graphical Relationship, Earnings and Dividends (per share)

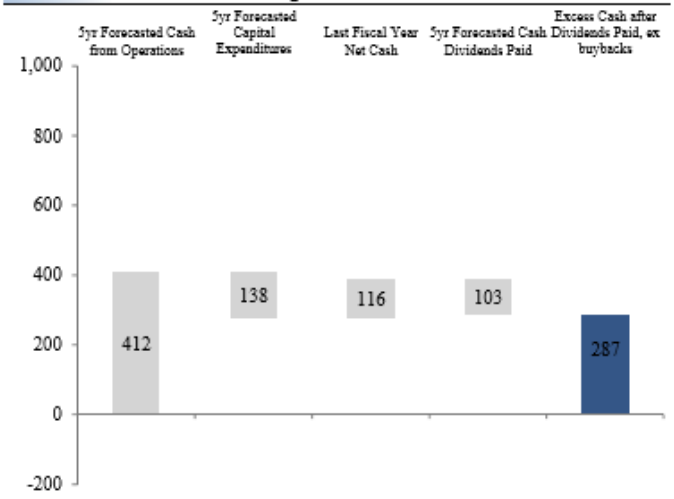


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

Dividend Cushion Cash Flow Bridge Evaluation

The Dividend Cushion Cash Flow Bridge, shown in the image to the right, illustrates the components of the Dividend Cushion ratio and highlights in detail the many drivers behind it. Capella Education's Dividend Cushion Cash Flow Bridge reveals that the sum of the company's 5-year cumulative free cash flow generation, as measured by cash flow from operations less all capital spending, plus its net cash/debt position on the balance sheet, as of the last fiscal year, is greater than the sum of the next 5 years of expected cash dividends paid. Because the Dividend Cushion ratio is forward-looking and captures the trajectory of the company's free cash flow generation and dividend growth, it reveals whether there will be a cash surplus or a cash shortfall at the end of the 5-year period, taking into consideration the leverage on the balance sheet, a key source of risk. On a fundamental basis, we believe companies that have a strong net cash position on the balance sheet and are generating a significant amount of free cash flow are better able to pay and grow their dividend over time. Firms that are buried under a mountain of debt and do not sufficiently cover their dividend with free cash flow are more at risk of a dividend cut or a suspension of growth, all else equal, in our opinion. Generally speaking, the greater the 'blue bar' to the right is in the positive, the more durable a company's dividend, and the greater the 'blue bar' to the right is in the negative, the less durable a company's dividend.

Dividend Cushion Cash Flow Bridge

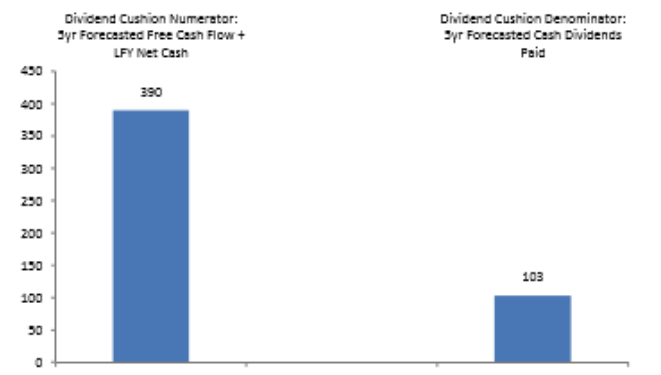


Source: Company Filings, Valuentum Projections

Dividend Cushion Ratio Evaluation

The Dividend Cushion Ratio Deconstruction, shown in the image to the right, reveals the numerator and denominator of the Dividend Cushion ratio. At the core, the larger the numerator, or the healthier a company's balance sheet and future free cash flow generation, relative to the denominator, or a company's cash dividend obligations, the more durable the dividend. In the context of the Dividend Cushion ratio, Capella Education's numerator is larger than its denominator suggesting strong dividend coverage in the future. The Dividend Cushion Ratio Deconstruction image puts sources of free cash in the context of financial obligations next to expected cash dividend payments over the next 5 years on a side-by-side comparison. Because the Dividend Cushion ratio and many of its components are forward-looking, our dividend evaluation may change upon subsequent updates as future forecasts are altered to reflect new information.

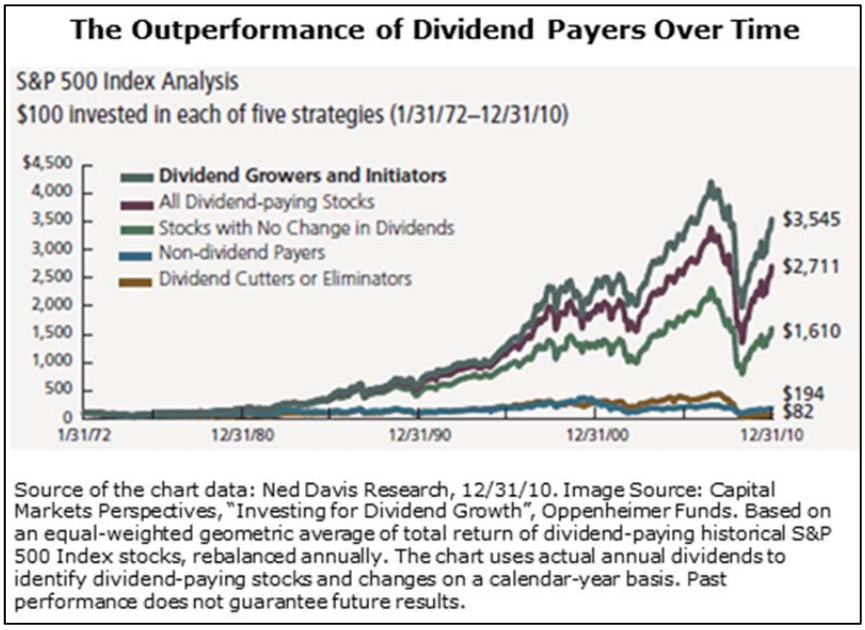
Dividend Cushion Ratio Deconstruction



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.

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

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

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

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

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

The Valuentum Dividend Cushion Caught These Dividend Cuts in Advance

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

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

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

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

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

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

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

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

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

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

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

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

Understanding Dividend Growth

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

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

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

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

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

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

Valuentum Dividend Growth Newsletter: Volume 5, Issue 12

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

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

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

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

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

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

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

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

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

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

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