OUR BEST IDEAS NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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Valuentum Securities Inc.
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Portfolio Return	Benchmark Return	Outperformance
117.3%	87.0%	30.3pts

The Best Ideas Portfolio (see page 8): AAPL, MO, BWLD, BRK-B, CSCO, CVS, FB, XLF, GE, GM, GOOG, GOOGL, XLV, INTC, JNJ, KBE, KMI, KORS, PYPL, PCLN, RSG, SDY, TEVA, UNP, XLE, XLU, V

See page 8.

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Goals of the Best Ideas Newsletter: We want to deliver positive returns, year after year, in addition to outperforming the market benchmark. We may not always be successful, however. Our Best Ideas portfolio is generally found on page 8 of each edition.

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"Our 2016 additions to the Best Ideas Newsletter portfolio have been performing quite nicely…We added six new ideas to the Best Ideas Newsletter portfolio during 2016…and all have advanced nicely…"
- Brian Nelson, CFA

The Coming "Goldman Sachs Era"

By Brian Nelson, CFA

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= ALL TIME HIGH

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

It's been more than 8 years now.

The month of September 2008 shaped my view of the financials and banking sector more than any other month possibly could--The Wall Street Journal pages etched in my mind, the crisis 'specials' on CNBC, the late-night coverage on Bloomberg, the ongoing heated debates at the office. "Crisis on Wall Street as Lehman Totters, Merrill Is Sold, AIG Seeks to Raise Cash" graced the cover of the Wall Street Journal September 15, 2008. "WaMu Seized, Sold Off to J.P. Morgan in Largest Failure in U.S. Banking History," would be the headline a little more than a week later.

These weren't headlines during the largely unregulated banking environment of the early 1930s following the Crash of 1929. No – these were headlines in the 21st century on companies we all know very well by name. Perhaps we even worked for them, too. There were many causes for the Financial Crisis of the last decade (the repeal of Glass-Steagall, loose lending standards, liar loans, too-much leverage, too-optimistic credit ratings, derivatives, to name a few), and there has been a lot of finger-pointing since, but that the Financial Crisis happened is enough for me to always cast a cautious eye on the financials and the banks in general.

Every bank is different, some with fantastic missions and unique competitive advantage, but they all are the same in one very important way: they generally operate highly-leveraged business models that don't hold enough capital on hand to repay depositers in full. It is simply the nature of their business, and as a result, they will always be exposed to "run-on-the-bank" risks. No, perhaps not a run-on-the-bank like that of the Bailey Building and Loan in It's A Wonderful Life. But one like that of WaMu in 2008, or one of the digital variety, can never truly be ruled out.

During the Obama administration, the Federal Reserve has annually assessed whether the largest bank holding companies have sufficient capital levels to handle adversity (and challenges to confidence) that may cause an all-out failure of their institutions. Dodd-Frank legislation, in our view, has largely been responsible for the banking sector's inability during the past several years to generate a collective return on equity (ROE) above its cost of equity (COE).

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Holding too much equity to protect against adverse conditions depresses the percentage returns generated on the outsize capital in place. Since 2009, the largest 33 bank holding companies have added $700 billion in new common equity capital, according to the Federal Reserve.

That said, the lower returns due in part to higher capital bases generally means that banks are operating on much firmer foundations, but the higher costs of regulatory compliance have also weighed on profits, driving General Electric (GE), for example, to take actions to even shed its SIFI (systematically important financial institution) designation. The latest reading of the Federal Reserve stress tests, the ones released June 2016, however, showed that "the nation's largest bank holding companies continue to build their capital levels and improve their credit quality, strengthening their ability to lend to households and businesses during a severe recession…[Capital is important to banking organizations, the financial system, and the economy because it acts as a cushion to absorb losses and helps to ensure that losses are borne by shareholders.]" From our perspective, during the past several years, bank returns have been sacrificed to ensure ongoing global financial safety.

The election of Donald Trump as the 45th President of the United States has put into question at least some of the Dodd-Frank regulations that were implemented following the Financial Crisis, including even the nature of the supervisory stress tests. The soon-to-be-President has argued that Dodd-Frank rules have only made the big banks bigger (e.g. the too-big-to-fail mantra) while causing local community banks to close their doors, leaving the tax payer on the hook and costing jobs. The extent of any dismantling of the Dodd-Frank Act under the Trump administration (including the 'Volker rule,' which bars financial institutions from making certain speculative investments) will certainly be politically-charged, but if capital requirements are loosened (and well-capitalized banks are allowed to pursue more speculative endeavors), the group may once again be in a position to consistently generate economic value for shareholders. Bank stocks, including and especially the largest investment banks and money centers, have been rallying hard as a result.

Bank of America's (BAC) stock price has advanced more than 35% since Election Day, Goldman Sachs' (GS) 34%, Morgan Stanley's (MS) 28%, J.P. Morgan's (JPM) 24%, Wells Fargo's (WFC) 21%, and Citigroup's (C) 19%. Though the yield curve plays a very important role in the profitability of lending institutions, the market price leadership by the investment-banking money centers implies that optimism is running rampant on the roll back of the most prohibitive Dodd-Frank regulations. Adding more fuel to the fire, Trump has been hiring Goldman Sachs' executives to his cabinet around every turn. The President-elect's choice for Treasury Secretary, former Goldman banker Steven Mnuchin, has vowed to "strip back" Dodd-Frank rules, and candidly, he would know which rules to relax to drive the sector to new heights. Other Goldman veterans added to the Trump team include Steve Bannon, new chief White House strategist, Gary Cohn, new director of the National Economic Council, Jay Clayton, new head of the Securities & Exchange Commission, and most recently Dina Powell, new senior counselor for economic initiatives.

We're optimistic of what changes the Trump administration may bring in the coming years, even as we note the severe risks of the regulatory pendulum swinging too far back in the other direction (as arguably what happened with Glass-Steagall in 1999 prior to the dot-com crash), but I'll never forget September 2008, and I doubt Trump's new advisors will either. After all, they, like me, lived it, breathed it, and studied it. They know the weaknesses of the banking business model and the global financial system, as well as the importance of confidence as the duct tape that holds everything together. They simply know that Goldman Sachs, itself, in that same month of September 2008, received its very own private "bailout" from Warren Buffett's Berkshire Hathaway (BRK.A, BRK.B). That's right—on September 24, 2008, Warren Buffett said he would invest up to $10 billion in Goldman to steady the waters at the time, a 10%-20% stake in the global investment bank. We believe any roll back in banking regulations will be pursued with caution, and we think Trump's Goldman cabinet will get things right. The stakes are too high.

We highlighted a very fascinating small cap bank in the January edition of the Nelson Exclusive, released January 7, and the Best Ideas Newsletter portfolio has been reaping the rewards of a conservative and diversified stance on banking equities. The newsletter portfolio includes both the Financial Select Sector

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SPDR (XLF) and the SPDR S&P Bank ETF (KBE). Please note how we can be cautious about a company or group in our writing, but still have exposure to it. Every security holds some degree of risk, and only through assessing such risks in full can we effectively determine our preferred exposures. Largely under the radar, these two investment vehicles, the XLF and KBE, have roughly doubled since they were added to the Best Ideas Newsletter portfolio, and the Financial Select Sector SPDR, in particular, includes arguably the prime beneficiaries of potential regulatory relaxes in 5 out of its top 6 holdings—J.P. Morgan, Wells Fargo, Bank of America, Citigroup, and Goldman Sachs. Berkshire Hathaway, a holding in the Best Ideas Newsletter itself, is also a top holding in the Financial Select Sector SPDR, and we can't complain. The stock price of Warren Buffett's Berkshire has advanced nearly 10% since Trump was elected.

We outlined our "5 Shocking Stock Market Predictions for 2017" in late December, including expectations for the ongoing stock market bubble to continue to inflate, with both crude oil prices and the 10-year Treasury continuing their respective advances during the year. When it comes to the banks, rising Treasury yields offer significantly more opportunities for net interest income generation and net interest margin expansion, but we'll be watching movements at both the short end and long end of the yield curve to assess ongoing bank health as well as their technicals to evaluate market confidence in the global financial system as a whole. Though we expect consumer staples stocks to underperform during the year in light of their respective relative overvaluations, we continue to expect Donald Trump to be the "wizard behind the curtain" to drive the market to new heights in 2017, even as we note the very real risks of a fall-out in the market during the latter stages of his Presidency (if on the basis of valuations alone). The market is at frothy valuations (the S&P 500 is trading at more than 17 times forward earnings at the time of this writing), but that doesn't mean it can't keep going higher during 2017 before reversion-to-the-mean dynamics begin to take hold, if they take hold.

Some of you may have decided to retain the special stock dividend of the Financial Select Sector SDPR (XLF) in the form of The Real Estate Select Sector SPDR Fund (XLRE), which was paid in September, as State Street modified the index constituents of the Financial Select Sector Index, shedding it of real estate exposure (as real estate became a new sector in the S&P 500). The distribution for the special dividend from the XLF in September was 0.139146 shares of XLRE or $4.44356 per share of XLF (or ~18.7%). In the case of the Best Ideas Newsletter portfolio, the special stock dividend was converted to approximately 28 additional shares of the XLF, an equivalent increase of ~18.7%, at the time. While rising rates may pose opportunities for banking entities, since many real estate considerations are influenced by cap-rate assessments, rising rates offer material headwinds to real estate valuations, even if many REITs may offset such hurdles through net operating income expansion.

Overall, we really can't complain about all-time highs in the Best Ideas Newsletter portfolio again! Our 2016 additions to the Best Ideas Newsletter portfolio have been performing quite nicely, too. We added six new ideas to the Best Ideas Newsletter portfolio during 2016. Facebook (FB) and Johnson & Johnson (JNJ) were added in January 2016. Kinder Morgan (KMI) was added in February 2016. Berkshire Hathaway (BRK.B) and the SPDR S&P Dividend ETF (SDY) were added in April 2016. General Motors (GM) was added August 2016, and all have advanced nicely since making the cut. We recently added CVS Health (CVS), and please have a read of our write up in this edition if you haven't read the piece on the website yet. Though other newsletters and research firms may trade a position dozens of times over the course of several weeks, you know that stock selection takes patience, and swinging at a fat pitch is much better than swinging at every pitch.

With each new year, I always like to remind members that you can always reach out to me if you have any questions, comments, or concerns. We always put our customers first, and we sent a reminder on how you can cancel your membership if you'd like. I hope you won't, but we're here for you and we put your interests first. Also, it's always a good time to remind you that Valuentum is a financial publisher, not a financial advisor, and that you should always be sure to check with your personal financial advisor that knows your individual needs and risk tolerances to ascertain whether any idea is ever right for you. With that said, I'm energized and excited as ever by what 2017 may bring. Let's make it the best year yet!

Cardinal Health: An Undervalued Free Cash Flow Generating Powerhouse

By Alex Poulos and Brian Nelson, CFA

Cardinal Health reset investor expectations lower when it cut its fiscal 2017 guidance late October. The company operates in an attractive oligopolistic industry and is trading at less than 14 times current fiscal-year earnings with a free cash flow yield north of 10%. Is it worth a look?

Overview

The bulk of Cardinal Health's (CAH) massive $120 billion revenue stream is generated from the distribution of healthcare needs. The company operates a network of warehouses whose primary purpose is to distribute healthcare products to a broad swath of customers ranging from your local drug store to hospitals. Due to the expense and unpredictability of inventory needs, customers prefer the next day delivery option where they rely on wholesalers to deliver immediate solutions to their pressing healthcare requirements. For example, a rare med such as Albenza, an expensive treatment for intestinal parasites, is often not carried by the local pharmacies due to the enormous cost of the product. The wholesalers fill a critical need in the supply chain by making such products available, often the next day to take care of the healthcare needs of the community.

The wholesale business operates on razor-thin margins. Cardinal is no exception to this rule, as its $2.45 billion in operating earnings during 2015 earned it a meager 2.02% operating margin for the year – but that's just the way of the distributor business (razor thin margins translate into material profits thanks to robust volume). Cardinal generates a far-higher margin on generic or multi-source medications than branded meds which carry a higher price tag, however. The most opportune time for the wholesale industry, in our view, is when a branded product loses patent exclusivity. Typically, the generic manufacturer that is first to file will be granted a six-month exclusivity period where they often charge in line with the branded product. Once the product is open to multi-source producers, a period exists where reimbursements are lowered to reflect the increase in competition. The margin often exceeds what is usually generated, setting up a virtuous profit cycle for the wholesale industry.

The wholesale industry carries an enormous amount of inventory (net inventories are about one third of total assets in Cardinal's case, for example). Valued at the lower of cost or market (LIFO), as in the case of Cardinal, merchadise inventory held on the books generally tends to appreciate as prices usually advance with each passing year. For example, inventory purchased several reporting periods ago generally costs less than what is available on the market, netting the wholesale industry a larger reported profit margin (assuming there is a decrease in inventory levels that have experienced appreciation). Conversely, however, the opposite would be true as price deflation would have a negative impact on reported profit margins (or when there is a decrease in inventory levels that have experienced price declines). The latter is the current dilemma as generic price deflation works its way through the industry. The effect was most recently witnessed in Cardinal Health's first-quarter 2017 results, where pharmaceutical segment profit margin dipped 76 basis points due to "generic pharmaceutical pricing and changes in product and customer mix," even while revenue in its pharmaceutical division increased 14% on a year-over-year basis during the period. Pharmaceutical segment profit (about 80% of total) fell 19%.

The end demand for medications certainly remains robust, and while we suspect the deflationary environment is temporary, the timing of any recovery is difficult to predict, especially as politicians continue to badger pharma pricing in general. To help mitigate the impact of margin pressure in its pharmaceutical segment, however, the Cardinal management team has skillfully acquired complimentary lines of business outside of their core distribution arm. In addition to distributing branded, generic, specialty, and OTC pharmaceuticals, the company's medical segment (about 20% of total company profit), while much smaller than its pharmaceutical one, distributes a broad range of medical, surgical, and laboratory products. It accounts for a far lower percent of overall revenue and profits, but the profitability of the medical segment business continues to move in the right direction. During the first quarter of fiscal 2017, revenue in the division advanced 12%, while segment profit increased 26% (segment margins leapt 42 basis points).

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Oligopoly

The medical distribution industry operates as a virtual oligopoly, with the three largest players controlling over 85% of overall market share—McKesson (MCK) and AmerisourceBergen (ABC) are the other two players. As an oligopoly, pricing decisions tend to remain rational, and the characteristically low margins of the distribution industry often preclude a price war. Also, the recession-resistant nature of the business augurs well for the generation of excess free cash flow by participants.

New entrants are largely shut out, too. Once a distribution network is built, capital spending needs are minimal, allowing companies to earmark profits to either grow their businesses through bolt-on acquisitions or to reward shareholders via a combination of dividend increases and share repurchases. We like Cardinal's industry dynamics, and the field remains rational with little incentive for a margin-crushing price war, in our view. Due to the stable pricing and high barriers to entry, it's easy to understand why we assign Cardinal Health a very attractive Economic Castle rating.

Red Oak Sourcing

In July 2014, Cardinal entered into a generic drug sourcing agreement with CVS Health (CVS). The agreement allows the two entities to combine their respective buying power to negotiate a top rate price for generic drugs. We have been excited about the deal for two reasons. The primary reason is the tighter integration between the two companies. Due to the sourcing agreement, Cardinal has become a much more formidable rival against its two peers.

The second reason is the deal allows Cardinal to source products at the absolute lowest price, thus ensuring as robust a margin as possible. The cost savings from the Red Oak venture should help Cardinal mitigate margin pressure in its pharmaceutical division, partially serving to offset the deflationary forces that are plaguing the industry. The benefits from Red Oak Sourcing may be less significant in fiscal 2017 than in prior years, however, and we'd be remiss not to note that Cardinal's sales and credit concentration with CVS is significant at more than 20%, respectively.

Financials

Cardinal Health is forecasting revenue to advance at a high-single-digit clip during fiscal 2017, and non-GAAP earnings per share to be in the range of $5.40-$5.60 for the year (was $5.48-$5.73 previously), up from $5.24 in fiscal 2016. The first quarter of fiscal 2017 witnessed non-GAAP earnings per share drop 10% on a year-over-year basis, so we expect fiscal 2017 to be back-end loaded when it comes to the company achieving its own forecasts. In addition to generic pharmaceutical pricing, reduced levels of branded inflation, stimulated by political pressures, could also act as a headwind to the company achieving its targeted bottom-line range. Customer attrition and increased expenses related to ongoing investments in its information systems are other areas that could pose challenges during the year, but even if the team comes up short, shares seem to offer a nice margin of safety.

We think Cardinal Health's balance sheet is solid, even though it does hold a net debt position of ~$3.5 billion, as of the end of the first quarter of fiscal 2017 and up from ~2.6 billion at the end of the first quarter of the prior fiscal year. Though it is not a hard-and-fast rule and taking advantage of the low interest rate environment can be opportunistic at times, we tend to prefer equities that have strong net cash positions. That said, Cardinal's net-debt-to-capital ratio of 35% at the end of the first quarter of fiscal 2017 isn't too frightening, even though it is up 7 percentage points on a year-over-year basis. Cardinal Health also stands to benefit from proposed domestic tax law changes as the company is based in the US and pays a corporate tax rate of ~37%.

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Conclusion

At Valuentum, we love free cash flow. A company's ability to consistently grow cash flow from operations above the needs of the capital required to maintain the business leaves ample room to reward shareholders in the form of an increasing dividend and share repurchases. Cardinal Health exemplifies the type of company we tend to like.

The company generated ~$2.5 billion in free cash flow during fiscal 2016, ~$2.2 billion in fiscal 2015, and ~$2.3 billion in fiscal 2014 thanks to robust cash flow from operations generation and manageable capital spending. Capital spending is expected in the range of $400-$500 million during fiscal 2017, the midpoint slightly lower than the $465 million mark during fiscal 2016. On the basis of last year's free cash flow, Cardinal's equity is trading at a free-cash-flow yield of over 10%. We reiterate that it is very rare to find such a well-run company trading at a free cash flow above 10%, especially in today's frothy market.

The company's strong free cash flow generation should allow Cardinal Health to repurchase shares and continue to raise the dividend (at the time of this writing, its Dividend Cushion ratio was a solid 2.9). Cardinal Health is slated to repurchase between 8-10 million of its undervalued shares before the close fiscal year 2017, which concludes in June 2017. Also, the yearly dividend of $1.80 per share equates to a yield of 2.4%, which isn't too shabby. Though there are myriad risks, including generic price deflation and concentration to CVS Health, Cardinal Health's attractive free cash flow yield and earnings multiple of less than 14 times 2017 expected earnings may make it one worth considering. Though we're not quite ready to include the company in the newsletter portfolio just yet, we wanted to get this one in front of you. We think it is worth a look.

CVS Health In The Bargain Bin? We Think So

By Alex Poulos

The stock market can be a fickle creature, bestowing its affections seemingly upon random industries. As 2016 comes to a close, the financial and energy-related names are all the rage with many pundits gushing about their prospects in 2017. I have often found when the Street is waxing eloquently about a certain sector, most of the easy gains have been made. Often, a contrarian view is necessary to generate acceptable returns. An unusual opportunity is before us in a company that operates in one of the most unloved fields of all, healthcare.

CVS Health

CVS Health (CVS) is generally categorized in the consumer staples (XLP) sector of the S&P 500, yet over 85% of their revenue is healthcare related! The consumer staples and healthcare sectors were notable laggards in 2016 with healthcare posting a loss for 2016. The lack of momentum in these companies is exciting from a contrarian's point of view; the industry lacks froth, unlike the 2015 period where healthcare was all the rage. The lack of momentum is a positive as multiples have shrunk allowing value-conscious investors to consider building positions at favorable prices.

CVS, unlike its nearest rival Walgreens-Boots Alliance (WBA) operates a hybrid model with a thriving healthcare distribution model backed by the ubiquitous stand-alone pharmacies in addition to the newly acquired long-term healthcare provider Omnicare. In addition to the delivery of pharmaceutical needs through various forms of pharmacy services (retail, mail order and long-term care), the Caremark division is one of the largest Pharmaceutical Benefits Managers (known by the acronym PBM) in the world. PBM's handle the payment of pharmaceutical benefits at the point of sale of various pharmacy providers, in addition to aiding in lowering the cost of medications. The PBM's manage cost through the mechanism known as a formulary, an exclusive list of products covered by the plan administered by the PBM. The PBM will extract favorable contract terms from the pharma/biotech to gain favorable placement on the

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formulary. Often, the savings manifest themselves in a direct rebate from the manufacturer based on volume sold. In CVS' case, to differentiate itself from its nearest competitor, the pure play PBM Express Scripts (ESRX), CVS returns 90% of the rebates earned back to the providers (healthcare plans or individual companies such as General Electric).

The PBM industry remains one of the most effective in lowering the overall cost of healthcare. A notable recent example of the heft of the PBM's is their ability to extract massive price concessions from the three large HCV (hepatitis C) players, most notably Gilead Sciences (GILD). Express Scripts was at the forefront of the move by inking an exclusive deal in December 2014 for the inferior Viekira Pak produced by Abbvie (ABBV), thus excluding Gilead Sciences' Harvoni from their national formulary. The move set off a wave of dominos where Gilead management, in its own exclusive deal with CVS in January 2015, decided to sacrifice price for access thus lowering the overall cost per patient cured dramatically. In part due to recent FDA warnings regarding Viekira Pak, Express Scripts, however, welcomed Gilead's Harvoni back into its formulary late 2016. In any case, drug-industry price rivalries will remain intense, and the PBMs are fighting to pit drug providers against each other to reduce prices.

Political Overview

The election of Donald Trump has done little to vanquish the fears of new regulations that will hamper overall profitability of the healthcare sector. The fear is that a repeal of the Affordable Care Act (ACA), otherwise known as Obamacare, would lead to disruption across the sector and a permanent reduction in profitability for many. The widespread consensus is there remains a notable lack of control mechanisms in place to combat runaway drug price inflation, and how might the back and forth of the implementation of Obamacare coupled with its potential partial repeal during a Trump administration impact business confidence in the sector – and if Trump is only a one-term President, will Democrats reimplement any repeals implemented during the previous four years? Such uncertainty has offered up compelling opportunities to consider adding a number of ideas in all ranges of the healthcare complex at favorable prices. The PBM model has proven to be an effective way to corral the price of medications, and since this is consistent with the political trajectory, we doubt meaningful changes will come down leaving CVS in an enviable position to thrive for years to come.

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= ALL TIME HIGH

The Best Ideas Portfolio

By Valuentum Analysts

Portfolio Return	Benchmark Return	Outperformance
117.3%	87.0%	30.3pts

Below we outline the constituents of the portfolio and their respective weightings and returns thus far (please note that many stocks have been removed since inception). Each subsequent issue discusses Valuentum's latest changes to the portfolio and analysis and trends impacting companies in our Best Ideas portfolio.

We currently have ~12% of the portfolio in cash, a level we're looking to bring down in coming months. Tactically, we like to have the most cash when the market is making new highs and fully invested when the market is putting in short-term lows.

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

THE BEST IDEAS PORTFOLIO -- as of January 15, 2017 — **Best Ideas Portfolio Inception Date: May 17, 2011**

Portfolio Holdings	Symbol	Initial VBI*	Current VBI**	Fair Value	P/FV	First Purchase	Cost/Shr ($)	# Shares	Total Cost ($)	Price/Shr ($)	Current Value ($)	Cumulative Div's Rec'd	% of Portfolio	% Return (dividends included)
Bullish														
Apple Corp.	AAPL	10	7	$147.00	0.81	17-Jun-11	51.92	107	5,569.33	119.02	12,735.14	1,150.82	5.9%	149.3%
Altria Group	MO	8	6	$58.00	1.17	28-Jun-11	28.39	157	4,471.86	67.58	10,610.06	2,475.56	4.9%	192.6%
Berkshire Hathaway	BRK-B	6	5	$160.00	1.01	20-Apr-16	146.13	69	10,089.97	161.90	11,171.10		5.1%	10.7%
Buffalo Wild Wings	BWLD	6	6	$190.00	0.79	27-Aug-15	179.81	16	2,876.90	150.05	2,400.80		1.1%	-16.5%
Cisco	CSCO	9	3	$42.00	0.72	14-Nov-14	26.33	221	5,831.87	30.07	6,645.47	332.84	3.1%	19.7%
CVS Health	CVS	9	9	$103.00	0.80	6-Jan-17	81.84	79	6,472.36	81.98	6,476.42		3.0%	0.1%
Energy Select SPDR	XLE	NR	NR	NA	NMF	6-Oct-15	67.14	143	9,608.02	74.38	10,636.34	320.79	4.9%	14.0%
Facebook	FB	6	6	$142.00	0.90	29-Jan-16	112.10	50	5,612.00	128.34	6,417.00		3.0%	14.3%
Financial Select SPDR	XLF	NA	6	NA	NMF	9-Jan-11	13.46	178	2,405.83	23.51	4,189.93	290.05	1.9%	86.2%
General Electric	GE	7	6	$32.00	0.98	21-Oct-13	25.99	375	9,761.75	31.36	11,760.00	1,077.00	5.4%	31.5%
General Motors	GM	6	6	$43.00	0.87	26-Aug-16	31.65	132	4,184.80	37.34	4,928.88	100.32	2.3%	20.2%
Google - Class C	GOOG	10	7	$855.00	0.94	23-Oct-12	450.92	7	3,170.42	807.88	5,655.16	10.35	2.6%	78.7%
Google - Class A	GOOGL	10	7	$855.00	0.94	4-Apr-14	Split	7	Split	830.94	5,816.58		2.7%	+++
Health Care ETF	XLV	9	6	NA	NMF	22-May-12	36.60	125	4,582.00	70.92	8,865.00	529.61	4.1%	105.0%
Intel	INTC	6	7	$42.00	0.88	12-Sep-11	20.48	150	3,086.50	36.79	5,518.50	634.50	2.5%	99.4%
Johnson & Johnson	JNJ	6	7	$121.00	0.95	29-Jan-16	104.18	54	5,632.72	114.60	6,188.40	170.10	2.8%	12.9%
SPDR S&P Bank ETF	KBE	NR	NR	NA	NMF	9-Jan-12	21.07	100	2,114.00	43.86	4,386.00	266.14	2.0%	120.1%
Kinder Morgan	KMI	5	6	$20.00	1.12	17-Feb-16	17.29	157	2,721.53	22.42	3,519.94	58.88	1.6%	31.5%
Michael Kors	KORS	8	3	$66.00	0.64	27-Aug-15	43.44	68	2,953.80	42.39	2,882.52		1.3%	-2.4%
PayPal	PYPL	UR	6	UR	UR	17-Jul-15	Spin-off	100	Splt	41.60	4,160.00		1.9%	+++
Priceline	PCLN	10	6	$1551.00	1.00	26-Feb-15	1239.49	6	7,450.91	1545.82	9,274.92		4.3%	24.5%
Republic Services	RSG	8	6	$48.00	1.19	19-May-11	31.42	201	6,329.42	57.24	11,505.24	1,287.42	5.3%	102.1%
SPDR S&P Dividend ETF	SDY	NR	NR	NA	NMF	20-Apr-16	81.33	124	10,091.92	85.99	10,662.76	197.09	4.9%	7.6%
Teva Pharma	TEVA	6	6	$58.00	0.59	24-Jul-13	41.22	77	3,180.94	33.97	2,615.69	364.09	1.2%	-6.3%
Union Pacific	UNP	6	6	$87.00	1.21	24-Jul-13	79.67	40	3,193.80	105.25	4,210.00	264.20	1.9%	40.1%
Utilities Select SPDR	XLU	NR	NR	NA	NMF	18-Mar-14	41.12	83	3,419.96	48.51	4,026.33	366.85	1.9%	28.5%
Visa	V	7	7	$84.00	0.97	30-Nov-11	26.86	188	5,064.39	81.17	15,259.96	362.69	7.0%	208.5%
Latest changes: 79 shares of CVS purchased (1/6).														
Cash -- changes in monthly cash balance reflects dividends received and trading gains/losses, where applicable.											24,808.05		11.4%	0.0%
Bearish														
For investors seeking 'short' or 'put option' exposure, please consider firms with VBI ratings with 1 and 2 as ideas.														
Best Ideas Portfolio Value								Original -->	100,000.00	Current -->	**217,326.19**			**117.3%**
S&P 500 Index (SPY)						17-May-11	132.69	754	100,000.00	227.05	171,113.12	15,870.40	91.5%	
Cash											15,870.40		8.5%	
Benchmark Portfolio Value											**186,983.53**			**87.0%**
Relative Outperformance														**30.3 pts**

Data as of January 15, 2017. The cost basis of positions includes commissions. The Best Ideas Newsletter portfolio's performance includes dividends received, but not interest received on cash balances. The Best Ideas Newsletter portfolio is not a real money portfolio. The 'Benchmark Portfolio Value' reflects dividends received and held as cash.

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

** See our methodology regarding the Valuentum Buying Index (VBI).

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

CVS Health...from page 7

Metrics

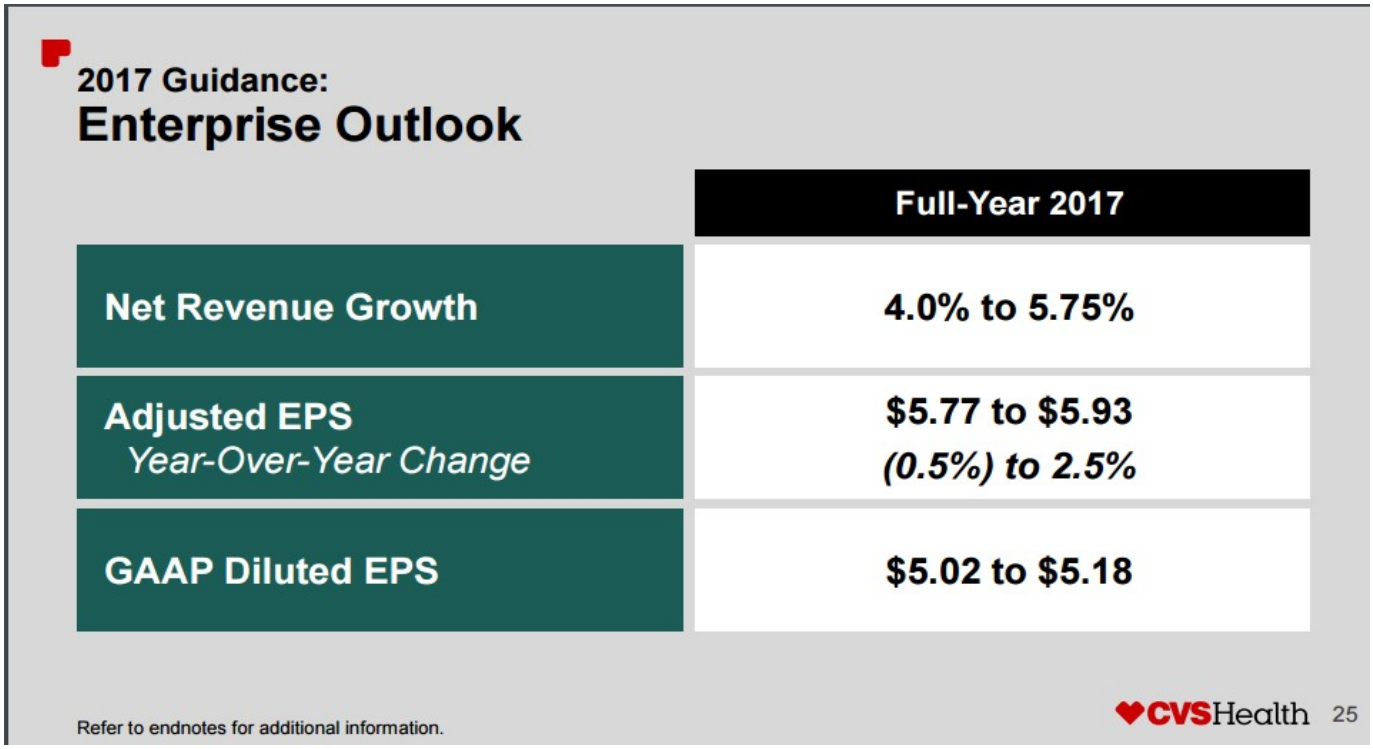

Image Source: CVS Health

CVS Health sports a below-market multiple of less than 14 times 2017 earnings at the time of this writing, a level we find quite attractive, particularly in light of the frothy levels of the market. The issue plaguing CVS is its expense base, which is geared towards higher prescription volume. The loss of the Tricare contract leaves the company with a sub-optimal cost base that we expect will be rectified by management as 2017 progresses. A modern pharmacy has a certain amount of fixed costs namely labor, in addition to rent, equipment, benefits, etc. To drive profitability, each additional prescription filled above the number needed to breakeven is pure profit. Hence, the loss of volume adds an outsized impact on overall profitability. We call this negative operating leverage, or negative earnings leverage.

In essence, pharmacy remains a volume game -- the higher the volume driven per location, the more profitable for the company. The greatest challenge facing management is the ability to grow revenue; yet in what is termed a poor year, CVS revenue growth will continue in 2017. Though the loss of prescription volume will negatively affect overall 2017 growth, as the year progresses, we expect the company's expense base to be brought in line with the lower prescription volume, thus gearing CVS for a notable bounce in 2018. We're excited about this.

We have incorporated the mid-point of revenue projections in addition to the higher end of capital spending and a ~39% tax rate to generate a fair value north of $100 per share. We are figuring a steep drop in EBITDA margin with a full recovery in 2019. Both the discount rate and exit multiple applied are reasonable. Though most are focusing on what we consider as the overblown fears of loss of healthcare sector profitability, the favorable change in domestic tax rates should provide a positive tailwind for CVS. We view the drop in corporate tax rates a much more likely event than healthcare reform that would permanantly destroy provider profitability. A drop in the US corporate tax rate to 25%, for example, would generate a nice boost in future earnings and push CVS' fair value estimate higher than what we are currently modeling. CVS, in line with other US-based corporations, pays a tax rate north of 35%, one of the highest in the industrialized

CVS Health...continued on next page

CVS Health...from previous page

world. The projections do not take into account CVS' expected share repurchase scheme, which we believe would be value-added in light of the price-to-fair value consideration.

Valuation Breakdown

In the chart below, we show the build up to our estimate of total enterprise value for CVS Caremark and the break down to the firm's total equity value, which we estimate to be about 116.54USD billion. The present value of the enterprise free cash flows generated during each phase of our model and the net balance sheet impact is displayed. We divide total equity value by diluted shares outstanding to arrive at our $103 per share fair value estimate.

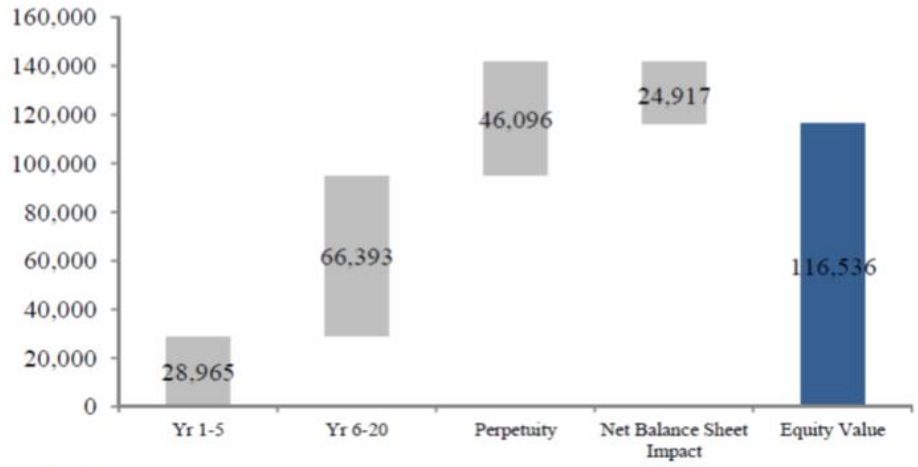

Image source: Valuentum

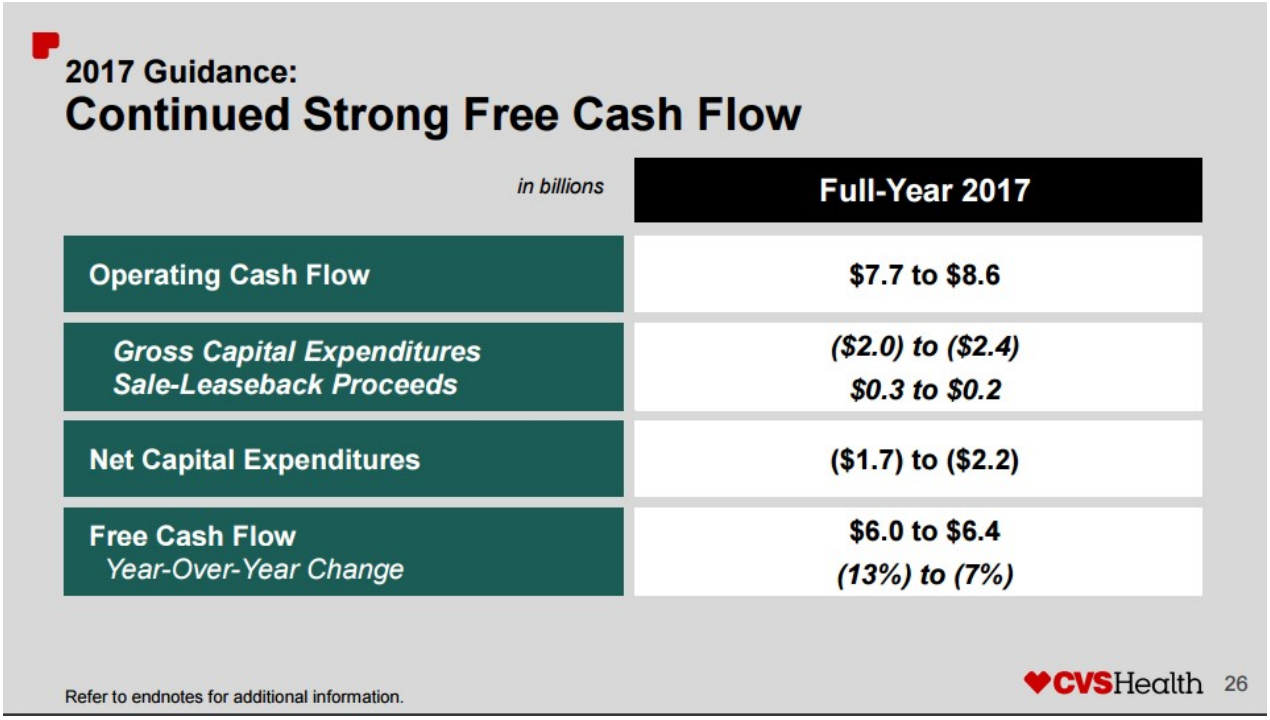

Image Source: CVS Health

CVS Health...continued on next page

*CVS Health...*from previous page

One of our favorite metrics is free cash flow yield. CVS' free cash flow yield is over 7% on the basis of its market capitalization at the time of this writing. We continue to like companies that generate an abundance of cash above the needs required to fund their business, and we think CVS is setting up to make above-average shareholder gains through a combination of dividends and share repurchases in coming years. True to form, CVS is following a time-tested playbook returning cash to shareholders, as shown below. The share repurchase scheme at CVS current market cap would retire nearly 6% of the overall market capitalization in addition to a yield of ~2.5%.

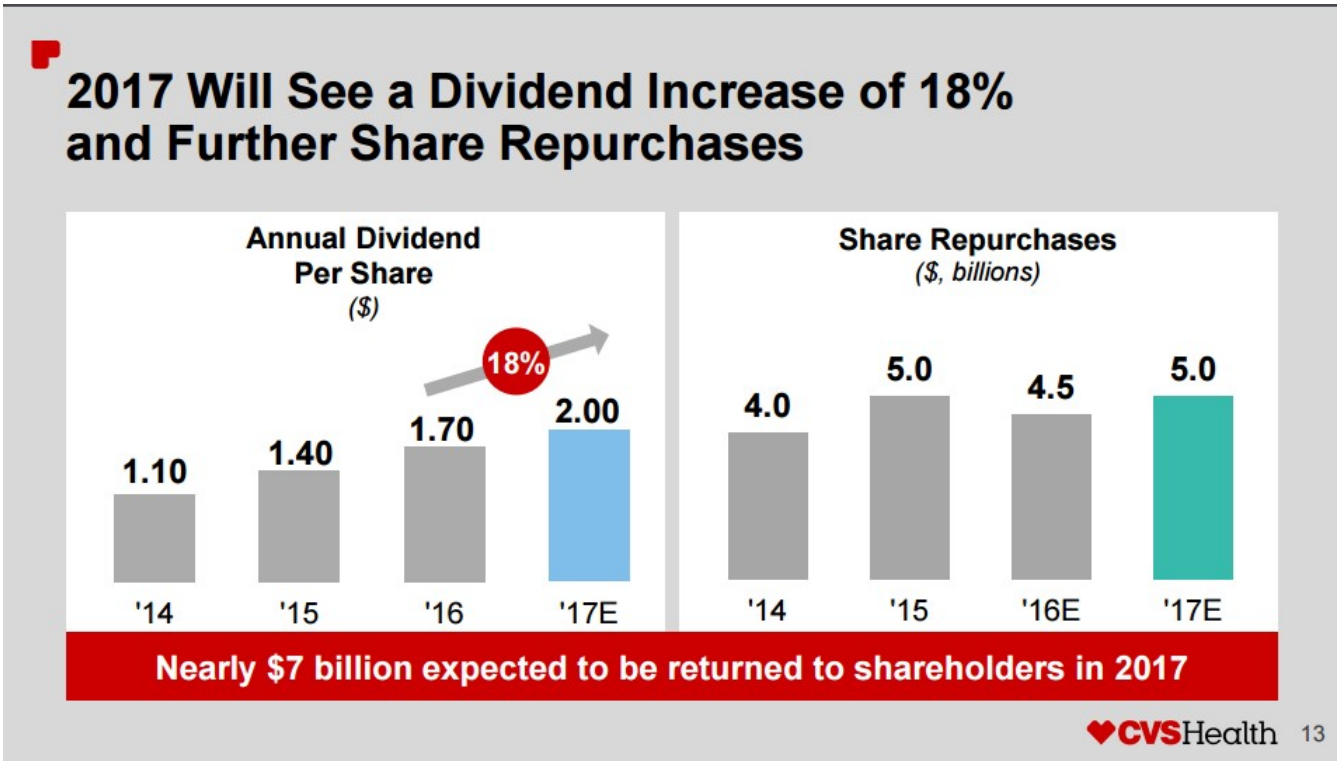

Image Source: CVS Health

Dividend Growth

In addition to an unjustified below-market multiple, CVS' ample cash flow should allow for an ever-rising dividend, which is sweet music for the dividend growth investor. CVS' dividend accounts for less than one third of free cash flow generated, thus offering ample room for significant hikes as the years progress. The company's ability to retire a notable amount of shares over the next year at bargain-basement prices should aid in the overall payout of the dividend as the reduction in share count leaves additional funds for those leftover. A virtuous cycle is forming where CVS generates an abundance of cash well above the needs of the existing business. A well-timed share repurchase plan can add significant value for long-term shareholders. Even though we're not big fans of its net debt position, which weighs on its Dividend Cushion ratio, we very much like its valuation and dividend growth prospects.

Disclosure: Alex Poulos is long CVS.

Pedal to the Metal for GM Heading Into 2017

By Kris Rosemann

Newsletter portfolio holding General Motors (GM) expects to report company records for revenue, EBIT-adjusted, and EBIT-adjusted margin for the full-year 2016 later this quarter, but its 2017 expectations are cause for even more optimism after management presented updated guidance for the year at the Deutsche Bank 2017 Global Auto Industry Conference in Detroit January 10. We continue to like GM's valuation and dividend growth opportunity, and the company remains a position in both newsletter portfolios.

The automaker expects 2017 earnings per share on an adjusted and diluted basis to come in a range of $6.00-$6.50, compared to expectations of $5.50-$6.00 for 2016. It also expects to at least maintain 2016 levels of EBIT-adjusted and EBIT-adjusted margin on higher revenue in the current year en route to $6 billion in automotive-adjusted free cash flow. GM has increased its cost efficiency target by $1 billion to $6.5 billion in savings through the year 2018, $4 billion of which has already been realized as of the end of 2016. The efficiency estimate increase is largely due to anticipated savings in material, logistics, manufacturing, and general administrative costs.

GM's strong overall outlook for 2017 is based on its expectations for another year of solid performance from its North America and China (FXI) operations, improving conditions in South America, growth in its financial arm, the aforementioned cost efficiencies, and ongoing vehicle launches. The automaker projects that 38% of its global volume in the period from 2017-2020 will come from new or refreshed vehicles (those in production less than 18 months), up from 26% in the 2011-2016 period. Crossovers, SUVs and light trucks are the main drivers of such a shift, as those vehicle classes are anticipated to make up 52% of GM's global volume of new or refreshed vehicles in the 2017-2020 period, up from 38% from 2011-2016. Though we like the strength of GM's new and refreshed vehicle lineup, we will be watching the performance and popularity of these unproven vehicle models closely.

With 2016 hardly in the rearview mirror, GM's 2017 outlook has us excited. We are aware of the potential for the US auto market to have reached a peak for this cycle in terms of demand, but GM's building presence in the Chinese market, where it recently set a company annual sales volume record, reduces its dependence on the US market if only slightly. We also note the hazards of investing in such a cyclical operator this late in the economic cycle, especially one with growing financial division, but the company's shares are just too cheap and its dividend is on solid ground, in our view. Credit profiles across the auto loan market have been worsening, but we don't think they are cause for concern just yet. In any case, if GM expects to continue outperforming its peers, it will have to deliver on the majority of its new and refreshed vehicle models in coming years. We think it will.

Importantly, however, for opportunistic investors, shares of GM are still changing hands at abnormally low earnings multiples--less than 6x the midpoint of 2017 guidance--and a ~4.2% dividend yield makes shares even harder to pass up. We're holding onto shares for the time being in both newsletter portfolios as we see the potential for upside to our current fair value estimate of $43 given today's (1/10) news.

Looking Closely at Zimmer Biomet

By Alex Poulos and Brian Nelson, CFA

The medtech field offers an intriguing combination of high-margin growth coupled with defensive characteristics as the end product is considered recession resistant. To add context, an individual who requires a knee transplant may wait a bit before having the surgery, but as the joint disintegrates the need will hasten irrespective of economic conditions. The ebbs and flows of the economic cycle have little to do with such a decision, in most cases.

That said, the field remains fiercely competitive with many upstarts that have innovative technologies, presenting challenges for the larger players but also ample acquisition targets to drive top-line sales and growth and ultimately profitability. We like the space quite a bit, and we are strongly considering Zimmer Biomet (ZBH) for addition to the Best Ideas Newsletter portfolio. We currently include Johnson & Johnson (JNJ) and Medtronic (MDT) in the Dividend Growth Newsletter portfolio, at the time of this writing (J&J is also included in the Best Ideas Newsletter portfolio).

Zimmer Biomet Product Lineup

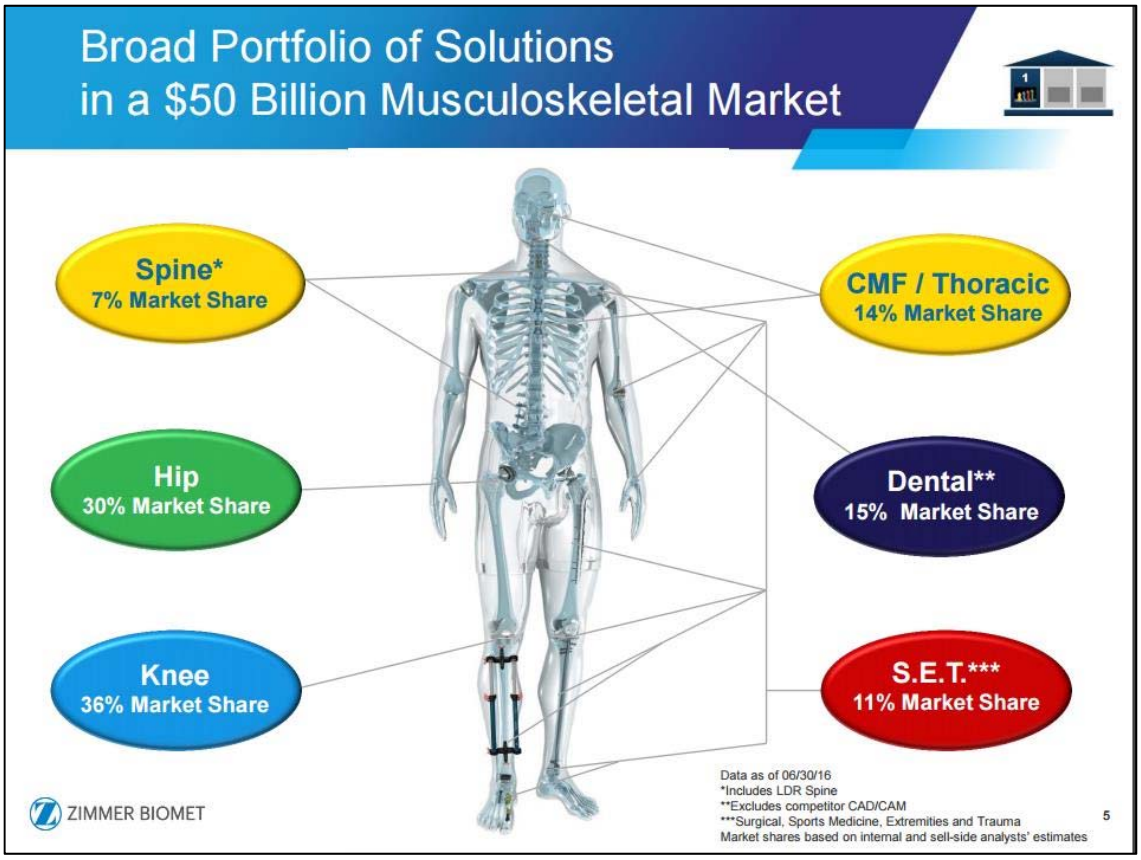

Image Source: Zimmer Biomet

Zimmer Biomet is the recently-formed entity that resulted after Zimmer acquired Biomet in early 2015 to significantly augment its product lineup to better compete with powerhouse Johnson & Johnson and rival Stryker Corp (SYK) in musculoskeletal healthcare. The Indiana-based company has been around for a long time, since before the Crash of 1929, but the acquisition of Biomet will take it to new heights, in our view. The deal is expected to generate $350 million in net annual operating synergies by year three of closing as the new company optimizes production and reduces unnecessary overhead.

*Looking Closely...*continued on next page

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Other areas of focus to drive consistent operating margin and earnings expansion from the transaction include strategic sourcing, shared services, a tax-efficient supply chain, and pursuing lean processes across the combined entity. We think management will be successful in achieving desired goals, even if it may have fits and starts along the way. By virtue of the deal, Zimmer Biomet has solidified its leadership position in orthopedic surgery. As the world population over 65 years of age increases (expected to be higher than 16% of total by 2050) and the availability of healthcare in emerging markets improves, Zimmer Biomet is going to be a large part of that growth story, no matter what happens during the uncertain Trump administration.

Mergers & Acquisitions

M&A remains a key feature of the medtech industry as top-line growth tends to trend in the mid-single-digit range due to the fragmented and highly competitive nature of the field. This isn't a poor rate of growth, but to augment and consolidate the field, frequent M&A is often pursued, and Zimmer Biomet has acquired several smaller upstarts that have helped fill in the gaps of its product lineup.

Most of the established players in the industry, except for high-growth idea Edwards LifeSciences (EW) with its innovative Transcatheter Heart Valve Therapy, are expected to register single-digit annual revenue expansion, yet all outside of Zimmer Biomet support an above-average earnings multiple. We find this very compelling, and we believe the anomaly requires further investigation to determine if the market is offering investors an opportunity to consider a low-risk entry, or there are deeper problems with Zimmer Biomet that justifies the unfair treatment.

Most Recent Quarterly Performance

In late October, Zimmer Biomet updated its full-year 2016 constant-currency revenue and adjusted earnings per share guidance. Though we're anxiously awaiting full-year results, to be released in the new year, the company estimates full-year 2016 revenue to have come in a range of $7.63 billion to $7.65 billion, an increase of approximately 27% on a reported basis, or 2.4% to 2.7% on an adjusted pro forma year-over-year basis.

Zimmer Biomet expects foreign currency translation to have hurt full-year revenue by ~0.3%, compared to its previous estimate of 0.5%. At the time, it modified its adjusted revenue growth outlook for the full year 2016, to the range of 1.65% to 1.9%. Previously, the company was expecting full-year revenue growth to be in a range of 2.5%-3% on a similar basis. The downward revision wasn't very welcome.

Additionally, Zimmer Biomet expects its full-year 2016 diluted earnings per share to be in a range of $1.50 to $1.60, and $7.90 to $7.95 on an adjusted basis. Previously, the company had estimated diluted earnings per share to be in a range of $1.50 to $1.75 on a reported basis, and $7.90 to $8.00 on an adjusted basis. Though minor, the revision wasn't in the direction we were hoping (Source).

The lowered revenue and earnings expectations for the full-year underscore some of the trouble Zimmer Biomet, and by extension, most of the medtech industry ran into during the third quarter. One of our favorite ideas, a holding in the Dividend Growth Newsletter portfolio, Medtronic also faced some trouble in the period, using the word "disappointing" to describe its performance, and moderating expectations:

> 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.

Peer Edwards LifeSciences also disappointed investors during its third-quarter report, results released late October. Performance from the structural heart disease and critical care monitoring company weren't poor by any stretch, with revenue and earnings growing at a nice clip during the period, but the top line

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did come up a bit short. The company may have issued guidance that came in a little light for the fourth quarter versus whisper numbers, too, and it did mention at its annual investor conference December 8 that fourth-quarter sales were trending at the low end of its guidance range of $750 million to $790 million for the period, but the market may be overreacting.

In any case, the broadbased top-line weakness in all three medtech bellwethers indicates the quarterly troubles may be an industry-wide phenomena, perhaps mostly attributable to a delay in elective surgery, more than likely as the political process continued to its eventual conclusion in early November. We reiterate that a patient may be able to delay surgery for a bit, but the need remains as the underlying issue continues to erode/decline. Also, the long-term outlook as the aging population continues to increase and emerging-market penetration advances remains a compelling one.

Zimmer Biomet Fundamentals

The transformational move to acquire Biomet formed a leader in the field of orthopedic surgery with a notable market share in knee and hip replacements. As is custom with larger mergers of this nature, integration of legacy systems tends to be a challenge as this theme came into full view in the recent quarterly report.

Some of the weaker top-line growth was a direct result of too-little inventory in place to service the needs of Zimmer Biomet surgeon base. We suspect the lack of supply is a direct result of the integration of the two companies, with CEO David Dvorak pledging the issue has been corrected on a go-forward basis. Judging by the magnitude of the fallout from the announcement, the Street has a different view with Zimmer Biomet, and the company is clearly in the penalty box for now.

At its current quote slightly higher than $100 per share, the stock price is trading on par with levels not seen since 2014 as shown in the chart below.

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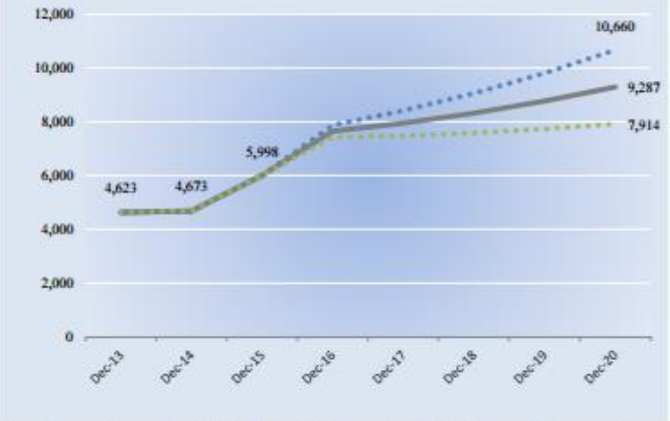
We've provided a number of metrics to help gauge the attractiveness of the equity, including our revenue growth and EBITDA expectations. Companies that generate high and resilient EBITDA margins tend to have "moaty" characteristics built into their businesses that prevent competitors from stealing share and depleting margins, and Zimmer Biomet's numbers are quite attractive. As is often witnessed in the more-commoditized players, a new entrant can crush margins and often the stock price. That's why we like companies with sustainable, competitive advantages, and Zimmer Biomet is one of them. The company's Economic Castle rating is attractive.

Revenue Growth — **HIGH**

		Last Fiscal Year Revenue	3-year Historical CAGR	5-year Projected CAGR
Zimmer Biomet	USD	**5,998**	**10.3%**	**9.1%**
Intuitive Surgical	USD	2,384	3.1%	10.4%
Medtronic	USD	28,833	20.2%	3.3%
Varian Medical Systems	USD	3,218	3.0%	2.7%
Waters	USD	2,042	3.5%	5.2%
Peer Median			3.3%	4.2%
Industry Median			3.1%	5.2%

Zimmer Biomet's revenue expansion has been greater than the median of both its peer group and industry group during the past three years. We expect the firm's revenue expansion to outpace the median of its peer group and industry group during the next five years. Our growth assessment of each firm is based on the firm's 5-year forward revenue CAGR. Zimmer Biomet's future pace of revenue growth is HIGH, in our opinion.

Projected Revenue (in millions of USD)



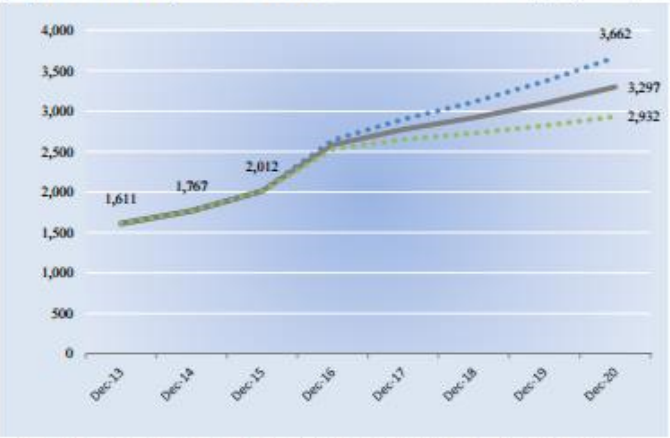
In the chart above, we show our baseline forecast for revenue as well as potential upside and downside cases.

EBITDA Growth

		Last Fiscal Year EBITDA	3-year Historical CAGR	5-year Projected CAGR
Zimmer Biomet	USD	**2,012**	**6.6%**	**10.4%**
Intuitive Surgical	USD	856	-4.1%	16.4%
Medtronic	USD	8,916	15.4%	7.5%
Varian Medical Systems	USD	619	-2.7%	8.7%
Waters	USD	665	3.4%	7.6%
Peer Median			0.4%	8.2%
Industry Median			-2.7%	13.5%

Zimmer Biomet's EBITDA expansion has been greater than that of both its peer group and industry group during the past three years. We expect the firm's EBITDA to outpace its peer group but trail that of its industry group during the next five years. Intuitive Surgical sports the highest expected EBITDA growth rate among peers.

Projected EBITDA (in millions of USD)



In the chart above, we show our baseline forecast for EBITDA as well as potential upside and downside cases.

Image source: Valuentum

Zimmer Biomet's current debt load of $11 billion, as of the end of September 2016, results in a rather high debt-to-EBITDA ratio, but debt repayment remains a top priority of management with bolt-on acquisitions as the second use of cash. The debt is structured as long-term debt, and we think management should be applauded for taking advantage of low-interest rates to significantly bulk up the size of the overall company. Interest payments are roughly $300 million per year, a number the company can comfortably accommodate, in our view.

Further, the management team at Zimmer Biomet continues to lower the duration and net yearly interest paid on the debt with strategic exchanges and issuances of notes denominated in currencies other than the

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US dollar. In our view, the absurdly low-interest rates in the European Union offers an appealing opportunity for companies to issue lower-cost debt and monetize some of the assets held overseas for tax purposes while lowering the overall debt paid by the corporation. Zimmer Biomet is an excellent example of this trend, as it generates approximately 35% of its sales outside the US. That said, however, we tend to generally be debt-averse, all else equal.

Zimmer Biomet is also committed to its dividend program and returning cash to shareholders via buybacks. The company currently has a dividend yield of ~1%, which is roughly 15% of net profits leaving ample room for increases as the years progress. As for debt, it will continue to target an investment-grade credit rating, and we don't have many worries on that front, especially as Zimmer Biomet pursues deleveraging initiatives.

Fair Value Estimate

Our fair value estimate for Zimmer Biomet is $123 per share at the time of this writing, substantially higher than the current share price. The medtech field along with healthcare sector as a whole remains deeply out of favor as the sector posted a loss during the year. The election of Donald Trump has done little to alleviate fears as analysts await the expected changes to the Affordable Care Act (ACA).

A notable change that is likely to happen that will benefit the medtech field, however, is a permanent repeal of the medical device tax (it is currently suspended), which should benefit existing newsletter portfolio holdings, Johnson & Johnson and Medtronic, as well. With Zimmer Biomet trading at attractive EBITDA and earnings multiples, the latter about 13 times on an adjusted basis, the company is offering investors a substantial discount to the overall market multiple (about 17 times forward earnings at present). We're strongly considering adding Zimmer Biomet to the Best Ideas Newsletter portfolio, even as we note our existing exposure to the healthcare sector.

Disclosure: Alexander J. Poulos is long options on ZBH.

MLPs: Williams' Double Equity Raise

By Kris Rosemann and Brian Nelson, CFA

Valuentum's opinion of the significant capital-market dependence of the master limited partner (MLP) business model has not changed, and it appears the Williams' family, Williams Companies (WMB) Williams Partners (WPZ), has become the latest illustration of this ongoing need. We maintain our view that there will be continued challenges to the MLP structure in the coming years, particularly in the event energy resource prices start to give back some of their recent gains and/or if high-yield spreads begin to expand (making borrowing more costly, irrespective of what the 10-year Treasury does). However, with energy resource pricing improving since the doldrums of January/February and the high-yield market warming up to issuers, equity prices of MLPs have started to "re-inflate," but whether such a recovery is sustainable is something largely beyond their control, in our view.

Our initial take on the Williams news, announced January 9, is that both Williams Companies and Williams Partners (WPZ) will be issuing new equity, and from what we understand, Williams Companies will be buying the equity issuance from Williams Partners in a private-placement, effectively resulting in what we'd describe as a double-capital raise, with the parent using its own newly-raised proceeds to support the partner by buying its partner's new issues. Essentially, from our perspective, Williams Companies has largely acted as the "market" for Williams Partners' units in this transaction, and we wonder if capital-market access continues to be very difficult for highly-leveraged MLPs as the reason why. We'll be monitoring unit prices of MLPs very closely to see if the market starts to get nervous again in light of this deal. Shares of Williams Companies sold off aggressively on the news.

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Under this transaction, Williams Companies will be waiving its incentive distribution rights and exchanging its general partner economic interest for 289 million newly-issued common units of Williams Partners, which will increase its ownership stake in Williams Partners to ~72%. Williams Partners will issue the new units in a private placement, and Williams Companies will also raise capital for the purchase of the new units via its own equity issuance (a 65 million share public offering). Though the cost of capital is largely a subjective measurement, particularly in valuation, management expects such a move to improve Williams Partners' cost of capital (generally an equity infusion reduces leverage metrics and shores up liquidity), and management hopes that it will now not require access to the public equity markets for the next several years. From where we stand, this huge, double equity-issuance is a tell-tale sign that the entities are raising capital now while the going is good (in case in the next few years, the capital markets are closed to them).

Though Williams Partners has eliminated the additional payments formerly required to its general partner, it will issue 289 million new units on which it will have to pay a distribution. In order to maintain coverage of its distribution, Williams Partners cut its quarterly payout by 29% to $0.60 per unit. Management indicated that such a move will translate into a distribution coverage ratio of ~1.2 times in 2017, but we emphasize that management's coverage ratio is based on distributable cash flow projections for the year, which currently sit at $2.8 billion and do not take into account expectations for growth capex to be in a range of $2.1-$2.8 billion. Subtracting growth capex from distributable cash flow may not be an accurate comparison to traditional free cash flow, but the exercise remains useful in illustrating the massive amounts of capital that are ignored in the calculation of distribution coverage ratios from MLPs. Capital is not free – and especially in the context of valuation, both cash flow generated and cash flow used to generate cash flow must be considered. We continue to emphasize free cash flow (cash flow from operations less all capital spending) in our analysis, and such a measure is consistently applied across our coverage universe.

Williams Companies will up its dividend for the March quarter by 50%, to $0.30 per share, adding to its massive obligations that may inevitably come back to bite hard if times continue to be tough for the energy space. Long-term debt stood at $23.9 billion at Williams Companies at the end of September 2016 (see page 8 here), while free cash flow stood at $505 million through the first nine months of the year (see page 10 here). During the same nine months, Williams paid more than $1.1 billion in dividends, implying that traditional free cash flow measures were coming up short with respect to dividend coverage, even before the latest announcement of a dividend hike.

Though we are considering adding a diversified MLP ETF, in the form of the ALPS Alerian MLP ETF (AMLP) to the Dividend Growth Newsletter portfolio, solely in light of a potential capital-allocation decision to the recovering energy arena, we're not ready to pull the trigger on this diversified ETF. If we ever do, our finger will be on the 'remove' button the whole way, as we'd only view such an addition as a short-term "trade." We continue to include Kinder Morgan (KMI) in the Best Ideas Newsletter portfolio as our only exposure to the midstream space for now. We expect to update our reports shortly. Please be careful with these highly-leveraged, capital-market dependent, income-vehicles that are tied to the commodity-price cycle…

Now, what if we told you there was a master limited partnership whose distribution was covered several times over by traditional free cash flow and supported by a net cash position…

Want to find out what MLP this might be, along with other ideas each month, from Valuentum's President of Investment Research Brian Nelson? Each monthly edition of The Nelson Exclusive includes three stock ideas from outside the Valuentum coverage universe (one for income, one for capital appreciation, and a "short" idea), fully-laid out in thesis form.

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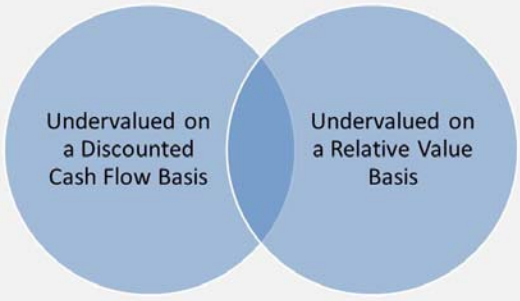
The Watch List

By Valuentum Analysts

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



"By overlaying a relative valuation process on a robust forward-looking discounted cash flow valuation methodology, "pure" value investors add an extra degree of conviction to their undervalued ideas. For the ideas in this screen to register the highest rating on the Valuentum Buying Index, however, the market would also have to agree that shares are undervalued, as evidenced by an advancing stock price, one that has good momentum." – Valuentum's Brian Nelson, CFA

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

Company Name	Symbol	DCF Valuation	Relative Valuation	P/FV	Fair Value Estimate
Supervalu	SVU	UNDERVALUED	ATTRACTIVE	0.48	$10.00
Xerox	XRX	UNDERVALUED	ATTRACTIVE	0.59	$12.00
Omega Healthcare	OHI	UNDERVALUED	ATTRACTIVE	0.60	$48.00
Prudential Financial	PRU	UNDERVALUED	ATTRACTIVE	0.67	$116.00
Viacom	VIA	UNDERVALUED	ATTRACTIVE	0.67	$66.00
CNO Financial	CNO	UNDERVALUED	ATTRACTIVE	0.69	$23.00
Synaptics	SYNA	UNDERVALUED	ATTRACTIVE	0.69	$76.00
Celgene	CELG	UNDERVALUED	ATTRACTIVE	0.70	$141.00
Korn/Ferry	KFY	UNDERVALUED	ATTRACTIVE	0.71	$33.00
Mylan	MYL	UNDERVALUED	ATTRACTIVE	0.72	$53.00
Jabil Circuit	JBL	UNDERVALUED	ATTRACTIVE	0.73	$30.00
Juniper Networks	JNPR	UNDERVALUED	ATTRACTIVE	0.73	$31.00
Buffalo Wild Wings	BWLD	UNDERVALUED	ATTRACTIVE	0.74	$190.00
Super Micro	SMCI	UNDERVALUED	ATTRACTIVE	0.74	$29.00
Express Scripts	ESRX	UNDERVALUED	ATTRACTIVE	0.75	$91.00
MetLife	MET	UNDERVALUED	ATTRACTIVE	0.75	$56.00
Regal Beloit	RBC	UNDERVALUED	ATTRACTIVE	0.75	$76.00
CA Tech	CA	UNDERVALUED	ATTRACTIVE	0.75	$42.00
AIG	AIG	UNDERVALUED	ATTRACTIVE	0.76	$78.00
Red Robin	RRGB	UNDERVALUED	ATTRACTIVE	0.76	$60.00
Hanesbrands Inc	HBI	UNDERVALUED	ATTRACTIVE	0.76	$30.00
Mellanox Tech	MLNX	UNDERVALUED	ATTRACTIVE	0.77	$53.00
Interface	TILE	UNDERVALUED	ATTRACTIVE	0.79	$21.00
CVS Caremark	CVS	UNDERVALUED	ATTRACTIVE	0.79	$103.00
Vitamin Shoppe	VSI	UNDERVALUED	ATTRACTIVE	0.79	$32.00
Cracker Barrel	CBRL	UNDERVALUED	ATTRACTIVE	0.79	$171.00

The price-to-fair value measures reflect the metric at the time of report publishing and may differ from today's metric.

*Ideas...*continued on next page

***Ideas…*from previous page**

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

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

Company Name	Symbol	Sector	Industry	VBI
CVS Caremark	CVS	Consumer Staples	Food Retailers	9
Jabil Circuit	JBL	Information Technology	Electronic Suppliers	9
AIG	AIG	Financials	Insurance - Property & Casualty	8
Prudential Financial	PRU	Financials	Insurance - Life	8

Amphenol Corp	APH	Information Technology	Electronic Suppliers	2
AO Smith Corp	AOS	Industrials	Electrical Equipment - industrial	2
Arch Capital	ACGL	Financials	Insurance - Property & Casualty	2
Bio-Rad	BIO	Health Care	Medical Devices	2
Drew Indust	DW	Industrials	Recreational Vehicles	2
Infinity	IPCC	Financials	Insurance - Property & Casualty	2
Johnson Outdoors Inc	JOUT	Consumer Discretionary	Sporting Goods	2
Lancaster Colony	LANC	Consumer Staples	Food Products	2
Manhattan Associates Inc	MANH	Information Technology	Software	2
MGM Resorts	MGM	Consumer Discretionary	Gaming	2
Natural Resource Partners	NRP	Energy	Industrial Minerals	2
New Oriental Education	EDU	Consumer Discretionary	Education Services	2
Nordson	NDSN	Industrials	Machinery & Tools	2
Northern Trust	NTRS	Financials	Banks & Money Centers	2
Nu Skin	NUS	Consumer Discretionary	Luxury - Established Brands	2
NuVasive	NUVA	Health Care	Medical Instruments	2
South Jersey	SJI	Energy	Utilities	2
State Auto	STFC	Financials	Insurance - Property & Casualty	2
Amazon.com	AMZN	Consumer Discretionary	Internet & Catalog Retail	1
American Electric	AEP	Energy	Utilities - Large	1
Badger Meter	BMI	Industrials	Electrical Equipment	1
Brown-Forman	BF.B	Consumer Staples	Beverages - alcoholic	1
Church & Dwight	CHD	Consumer Staples	Household Products	1
General Mills	GIS	Consumer Staples	Food Products - Large	1
Heartland	HTLD	Industrials	Air Freight & Logistics	1
Hyatt	H	Consumer Discretionary	Hotels	1
IDEX	IEX	Industrials	Machinery & Tools	1
IDEXX	IDXX	Health Care	Diagnostic Substances	1
Illinois Tool Works	ITW	Industrials	Machinery & Tools	1
Jack in the Box	JACK	Consumer Discretionary	Restaurants - Fast Food & Coffee	1
Kraft Heinz	KHC	Consumer Staples	Food Products - Large	1
Lockheed Martin	LMT	Industrials	A&D Prime	1
McDonald's	MCD	Consumer Discretionary	Restaurants - Fast Food & Coffee	1
MSCI	MSCI	Information Technology	Software	1
Neogen	NEOG	Health Care	Diagnostic Substances	1
Northrop Grumman	NOC	Industrials	A&D Prime	1
Quad/Graphics Inc	QUAD	Consumer Discretionary	Book Publishing	1
Rayonier	RYN	Industrials	Building Materials	1
Toro Co	TTC	Industrials	Machinery & Tools	1
Ulta Salon	ULTA	Consumer Discretionary	Personal Services	1

CVS Health (CVS) – Page 1 of 16

By Valuentum Analysts

Download CVS Health's 16-page report, 2-page supplemental dividend report and read Valuentum's latest commentary on its website at www.valuentum.com.

Valuentum Retail Equity Research | Visit us at www.valuentum.com | Ratings as of 6-Jan-2017 | Data as of 2-Jan-2017

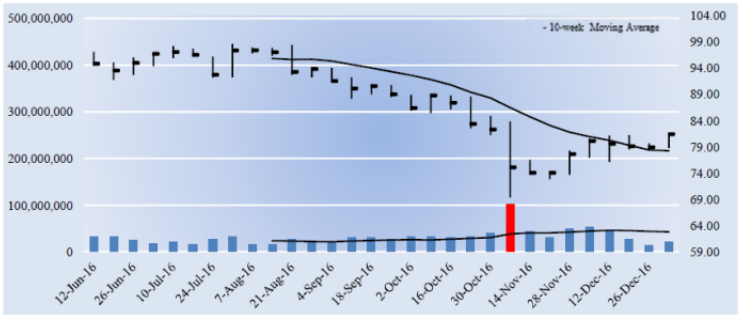
CVS Caremark CVS UNDERVALUED 0.7%

Buying Index™ 9 Value Rating ✓

Economic Castle	Estimated Fair Value	Fair Value Range	Investment Style	Sector	Industry
Attractive	$103.00	$82.00 - $124.00	LARGE-CAP VALUE	Consumer Staples	Food Retailers

CVS Caremark's integrated model includes both pharmacies and medical clinics, enabling the firm to gain a greater share of health care spending.

Stock Chart (weekly)



The week with the highest trading volume out of the last 13 weeks was a week of heavy selling, or distribution (red bar).

Company Vitals

Market Cap (USD)	$91,679
Avg Weekly Vol (30 wks)	31,570
30-week Range (USD)	69.3 - 98.66
Valuentum Sector	Consumer Staples
5-week Return	5.0%
13-week Return	-6.3%
30-week Return	-15.6%
Dividend Yield %	2.1%
Dividends per Share	1.70
Forward Dividend Payout Ratio	29.0%
Est. Normal Diluted EPS	7.38
P/E on Est. Normal Diluted EPS	11.0
Est. Normal EBITDA	16,835
Forward EV/EBITDA	8.3
EV/Est. Normal EBITDA	6.9
Forward Revenue Growth (5-yr)	7.9%
Forward EPS Growth (5-yr)	15.8%

NMF = Not Meaningful; Est. = Estimated; FY = Fiscal Year

Returns Summary

	3-year Historical Average
Return on Equity	12.8%
Return on Assets	6.4%
ROIC, with goodwill	10.2%
ROIC, without goodwill	21.9%

ROIC = Return on Invested Capital; NMF = Not Meaningful

Leverage, Coverage, and Liquidity

In Millions of USD

Total Debt	27,464
Net Debt	24,917
Total Debt/EBITDA	2.4
Net Debt/EBITDA	2.2
EBITDA/Interest	13.4
Current Ratio	1.3
Quick Ratio	0.6

NMF = Not Meaningful

Investment Highlights

• The 2007 merger of CVS Corp and Caremark created the largest pharmacy health care provider in the US. The company has more than 7,800 retail locations and operates in 98 of the top 100 US drugstore markets. Its PBM business serves more than 60 million plan members. The company was founded in 1892 and is headquartered in Rhode Island.

• CVS recently acquired Target's pharmacies and clinics and it will operate the acquired pharmacies in a store-within-a-store format. The deal expands its footprint of pharmacies by ~20% (adding more than 1,660) and clinics by ~8% (adding ~80 clinics).

• CVS Caremark's integrated model includes both pharmacies and medical clinics, enabling the firm to gain a greater share of health care spending. The power of this integrated model has created a sustainable competitive advantage highlighted by the growth of CVS/pharmacy's share of its own PBM's retail network claims.

• CVS recently announced a multi-year enterprise streamlining initiative, which it expects to deliver $700-$750 million in annual savings by 2021 or $3 billion cumulatively over the next five years. In 2017, the firm is anticipating adjusted EPS to be in a range of $5.77-$5.93, with free cash flow generation between $6.0-$6.4 billion.

• Though we like the company's business model, efforts to reduce prescription drug costs and pharmacy reimbursement rates could impact long-term profitability. Investors should watch new developments closely.

Investment Considerations

DCF Valuation	UNDERVALUED
Relative Valuation	ATTRACTIVE
ValueCreation™	EXCELLENT
ValueRisk™	LOW
ValueTrend™	POSITIVE
Cash Flow Generation	MEDIUM
Financial Leverage	MEDIUM
Growth	MODEST
Technical Evaluation	VERY BULLISH
Relative Strength	WEAK
Money Flow Index (MFI)	NEUTRAL
Upside/Downside Volume (U/D)	BEARISH
Near-term Technical Support, 10-week MA	78.00

DCF = Discounted Cash Flow; MFI, U/D = Please see glossary. MA = Moving Average

Business Quality

ValueRisk™ \ ValueCreation™	Very Poor	Poor	Good	Excellent
Low				■
Medium				
High				
Very High				

Firms that generate economic profits with little operating variability score near the top right of the matrix.

Relative Valuation

	Forward P/E	PEG	Price / FV
Costco	26.7	1.4	103.8%
Kroger	15.6	1.6	93.1%
Target	14.3	2.6	99.1%
Wal-Mart	16.2	2.3	110.8%
Peer Median	15.9	2.0	101.5%
CVS Caremark	**13.9**	**1.1**	**79.0%**

Price / FV = Current Stock Price divided by Estimated Fair Value

Financial Summary

	----- Actual -----		Projected
Fiscal Year End:	Dec-14	Dec-15	Dec-16
Revenue	139,367	153,290	179,656
Revenue, YoY%	9.9%	10.0%	17.2%
Operating Income	8,799	9,454	11,606
Operating Margin %	6.3%	6.2%	6.5%
Net Income	4,645	5,228	6,541
Net Income Margin %	3.3%	3.4%	3.6%
Diluted EPS	3.97	4.64	5.87
Diluted EPS, YoY %	5.9%	16.8%	26.4%
Free Cash Flow (CFO-capex)	5,481	6,036	5,186
Free Cash Flow Margin %	3.9%	3.9%	2.9%

In Millions of USD (except for per share items)

Structure of the Food Retailers Industry — NEUTRAL

Firms in the mature food retailers industry generally have slim profit margins and face significant competition from brick-and-mortar locations (discount, department, drug, dollar, warehouse clubs and supermarkets) as well as Internet-based retailers (including Amazon). Though the industry is not terribly cyclical, economic conditions, disposable income, credit availability, fuel prices, and unemployment levels drive ticket size and traffic trends. Offering consumers a compelling value proposition is a must, even as higher-priced organic food offerings proliferate. We're generally neutral on the group.

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Cisco (CSCO) – Page 1 of 16

By Valuentum Analysts

Download Cisco's 16-page report, 2-page supplemental dividend report and read Valuentum's latest commentary on its website at www.valuentum.com.

Valuentum Retail Equity Research | Visit us at www.valuentum.com | Ratings as of 13-Jan-2017 | Data as of 6-Jan-2017

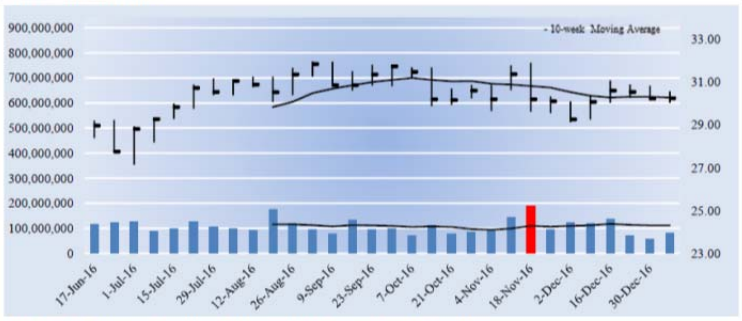
Cisco CSCO UNDERVALUED 12.5%

Buying Index™ 3 | Value Rating ✓

Economic Castle	Estimated Fair Value	Fair Value Range	Investment Style	Sector	Industry
Very Attractive	$42.00	$34.00 - $50.00	LARGE-CAP VALUE	Information Technology	Networking Equipment

We like the progress Cisco is making in its transition to a software and subscription based business model.

Stock Chart (weekly)



The week with the highest trading volume out of the last 13 weeks was a week of heavy selling, or distribution (red bar).

Company Vitals

Market Cap (USD)	$153,810
Avg Weekly Vol (30 wks)	107,744
30-week Range (USD)	27.13 - 31.95
Valuentum Sector	Information Technology
5-week Return	3.1%
13-week Return	-4.2%
30-week Return	4.3%
Dividend Yield %	3.4%
Dividends per Share	1.04
Forward Dividend Payout Ratio	43.4%
Est. Normal Diluted EPS	2.61
P/E on Est. Normal Diluted EPS	11.6
Est. Normal EBITDA	17,585
Forward EV/EBITDA	7.0
EV/Est. Normal EBITDA	6.6
Forward Revenue Growth (5-yr)	1.8%
Forward EPS Growth (5-yr)	6.0%

NMF = Not Meaningful; Est. = Estimated; FY = Fiscal Year

Returns Summary

	3-year Historical Average
Return on Equity	15.5%
Return on Assets	8.3%
ROIC, with goodwill	26.6%
ROIC, without goodwill	61.0%

ROIC = Return on Invested Capital; NMF = Not Meaningful

Leverage, Coverage, and Liquidity

In Millions of USD

Total Debt	28,643
Net Debt	-37,113
Total Debt/EBITDA	1.9
Net Debt/EBITDA	NMF
EBITDA/Interest	22.3
Current Ratio	3.2
Quick Ratio	3.0

NMF = Not Meaningful

Investment Highlights

• Cisco sells Internet Protocol based networking and other products related to the communications and IT industry. The firm provides a broad line of products for transporting data, voice, and video. It is #1 or #2 across a wide variety of architectures, and we like the progress it is making in its transition to a software and subscription based business model. It was founded in 1984 and is headquartered in California.

• Cisco has been acquisitive as of late. Instead of targeting suppliers to improve its gross margin, the firm's M&A strategy will be focused on disruptive technology and software and cloud acquisitions that will positively impact gross margins.

• We like that Cisco is aggressively buying back stock. In fact, the firm intends to return a minimum of 50% of annual free cash flow to shareholders via dividends and buybacks. Since its share repurchase program began through the end of July 2016, the firm has repurchased more than $112 billion in shares, and has more than $15 billion remaining authorized for share repurchases.

• Future revenue growth at Cisco is now expected to be in the range of 3%-6% during the next 3-5 years. This is down from 5%-7% annual growth expectations it set during its conference in 2011. The firm must continue to adapt to evolving markets and meet the changing demands of customers.

• Cisco had an incredible $65.8 billion in cash and cash equivalents at the end of fiscal 2016. Such a cash hoard gives it tremendous financial flexibility to pursue value-creating acquisitions and/or significantly increase the dividend.

Investment Considerations

DCF Valuation	UNDERVALUED
Relative Valuation	NEUTRAL
ValueCreation™	EXCELLENT
ValueRisk™	LOW
ValueTrend™	POSITIVE
Cash Flow Generation	STRONG
Financial Leverage	MEDIUM
Growth	MODEST
Technical Evaluation	VERY BEARISH
Relative Strength	WEAK
Money Flow Index (MFI)	NEUTRAL
Upside/Downside Volume (U/D)	BEARISH
Near-term Technical Resistance, 10-wk MA	30.00

DCF = Discounted Cash Flow; MFI, U/D = Please see glossary. MA = Moving Average

Business Quality

ValueCreation™

ValueRisk™	Very Poor	Poor	Good	Excellent
Low				■
Medium				
High				
Very High				

Firms that generate economic profits with little operating variability score near the top right of the matrix.

Relative Valuation

	Forward P/E	PEG	Price / FV
Finisar	14.5	1.7	93.8%
Juniper Networks	11.4	1.6	73.2%
Knowles Corp	15.7	NMF	96.0%
Nokia	23.8	0.7	64.1%
Peer Median	15.1	1.6	83.5%
Cisco	**12.6**	**2.4**	**72.0%**

Price / FV = Current Stock Price divided by Estimated Fair Value

Financial Summary

	----- Actual -----		Projected
Fiscal Year End:	Jul-15	Jul-16	Jul-17
Revenue	49,161	49,247	48,311
Revenue, YoY%	4.3%	0.2%	-1.9%
Operating Income	11,254	12,928	14,453
Operating Margin %	22.9%	26.3%	29.9%
Net Income	8,981	10,739	12,030
Net Income Margin %	18.3%	21.8%	24.9%
Diluted EPS	1.75	2.11	2.39
Diluted EPS, YoY %	17.4%	20.9%	13.4%
Free Cash Flow (CFO-capex)	11,325	12,424	13,350
Free Cash Flow Margin %	23.0%	25.2%	27.6%

In Millions of USD (except for per share items)

Structure of the Networking Equipment Industry — POOR

Firms in the networking equipment industry provide products for transporting data, voice, and video within businesses and around the world. Participants must adapt to address virtualization/cloud-driven needs in the enterprise data center market; the convergence of video, collaboration, and networked mobility technologies; and the move toward programmable, virtual networks. The industry is characterized by low barriers to entry, rapid technological change and significant pricing competition. Gross margins can be volatile and should be watched closely. We don't like the structure of the group.

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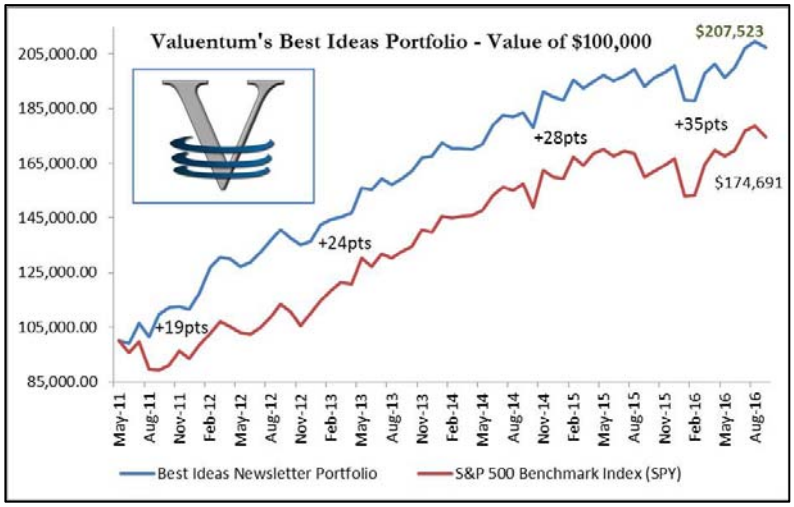
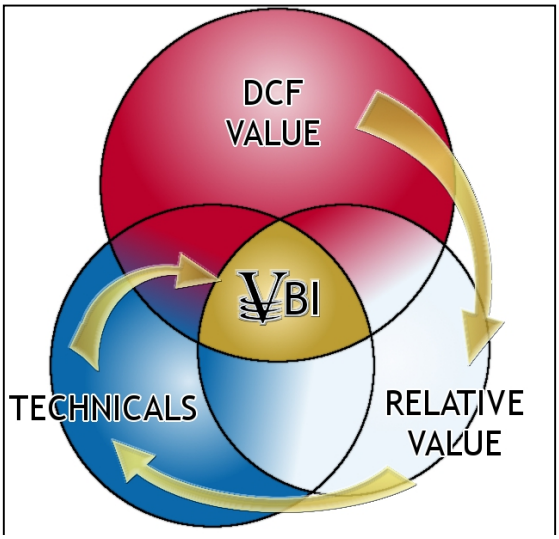
Our Methodology – The Valuentum Buying Index (VBI)

By Valuentum Analysts

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



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



Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

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

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

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

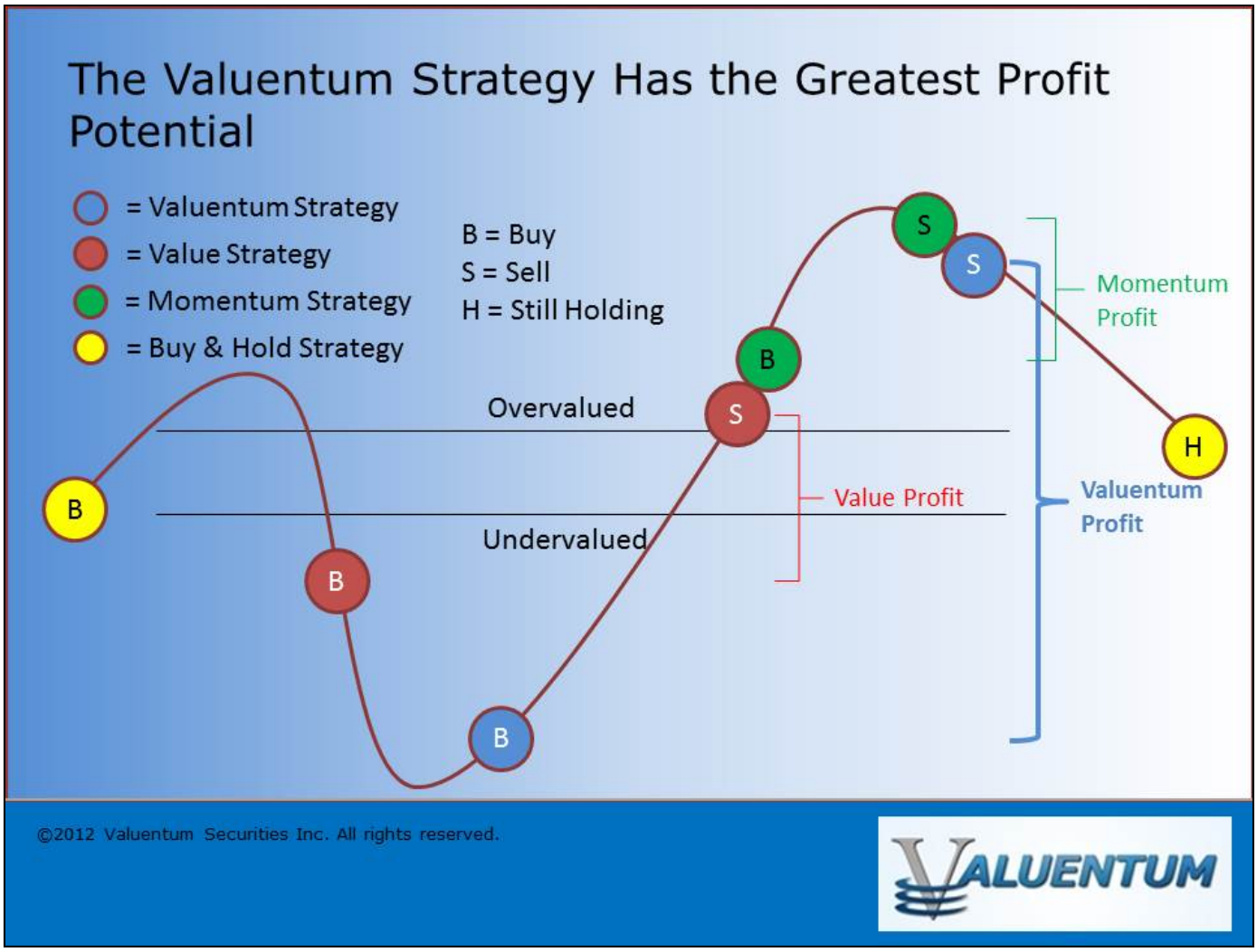


Illustration for educational purposes only.

Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

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

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

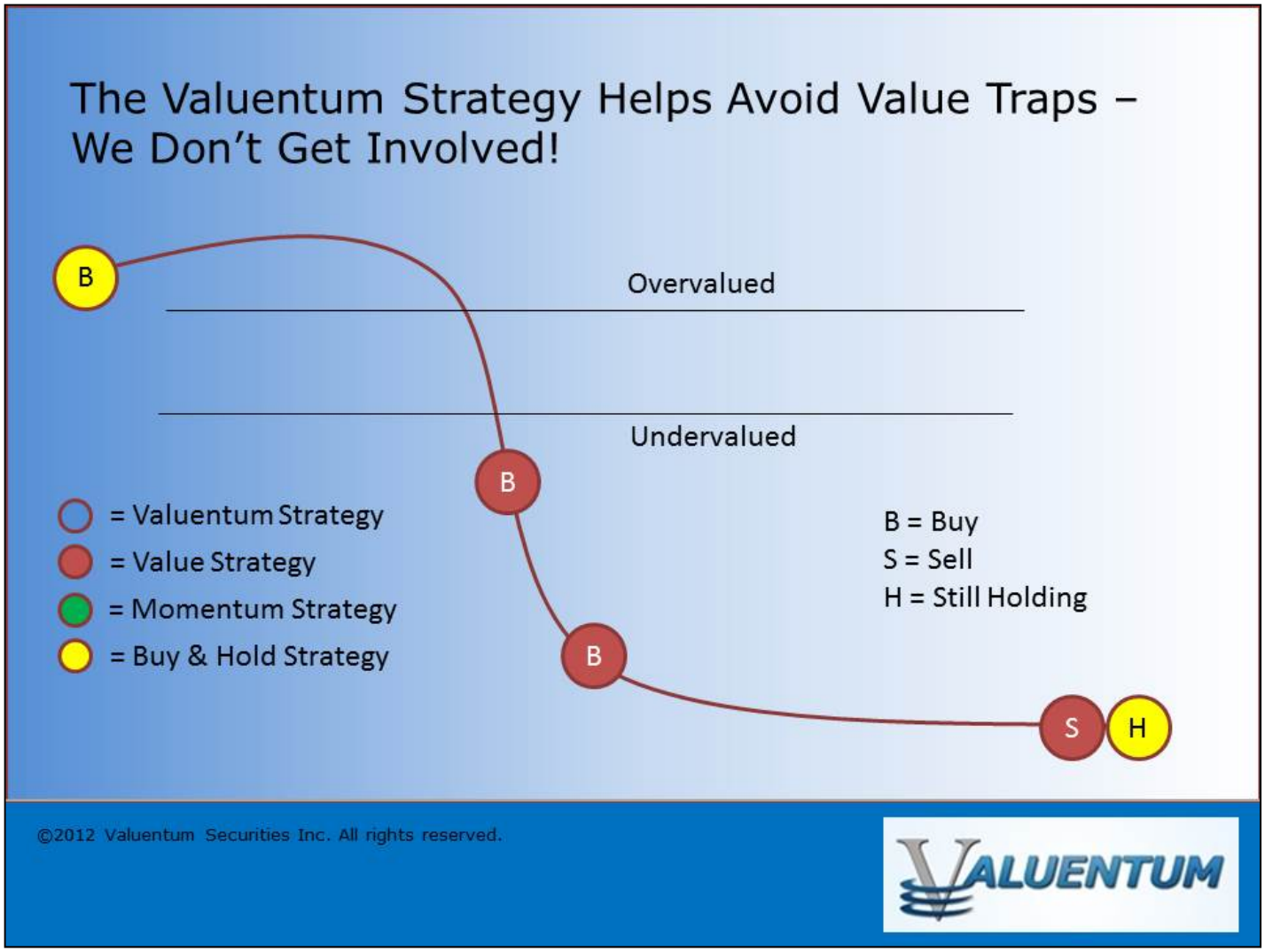


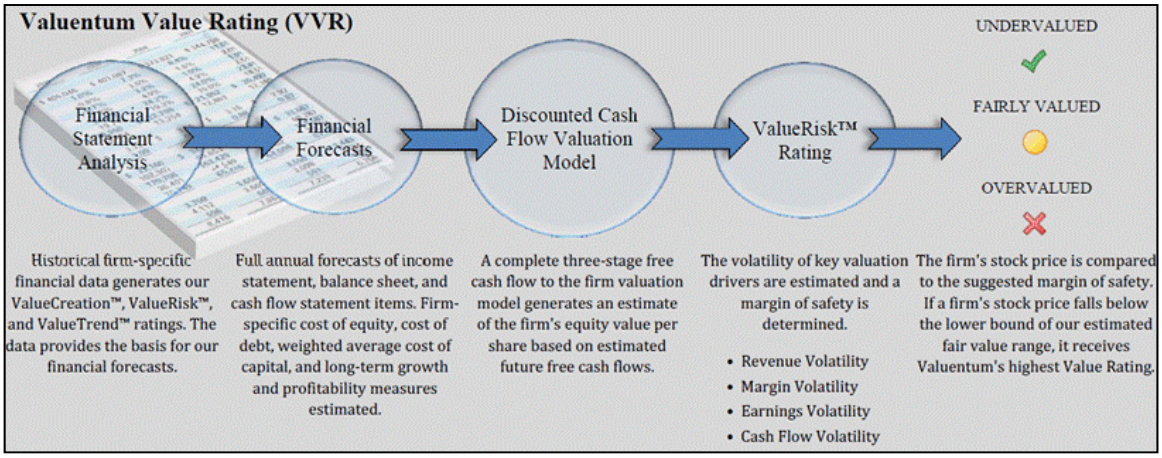
Illustration for educational purposes only.

Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

I. We Use a Rigorous Discounted Cash Flow Valuation Process

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



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

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

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

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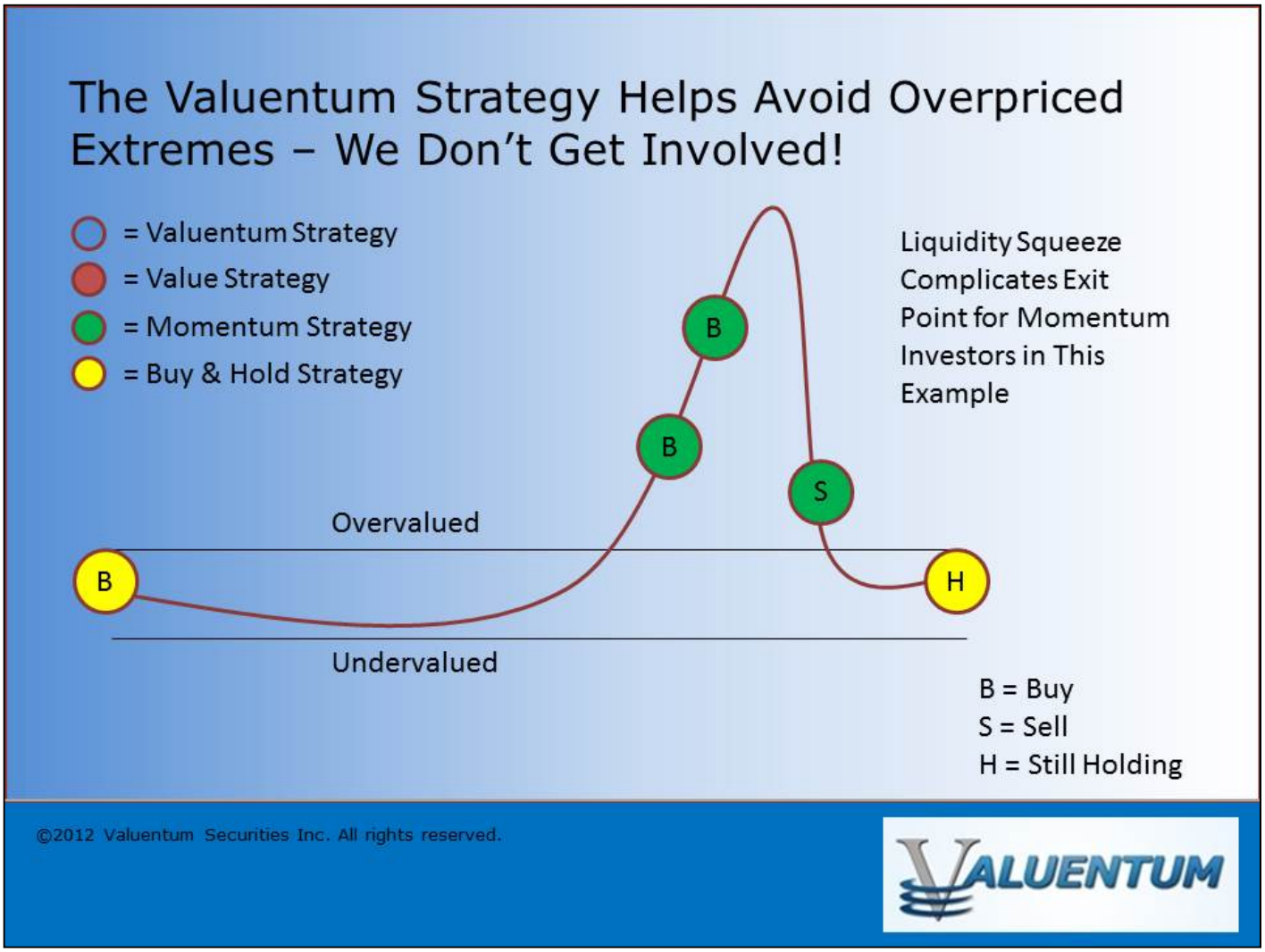

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II. We Perform a Forward-Looking Relative Value Assessment

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

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

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

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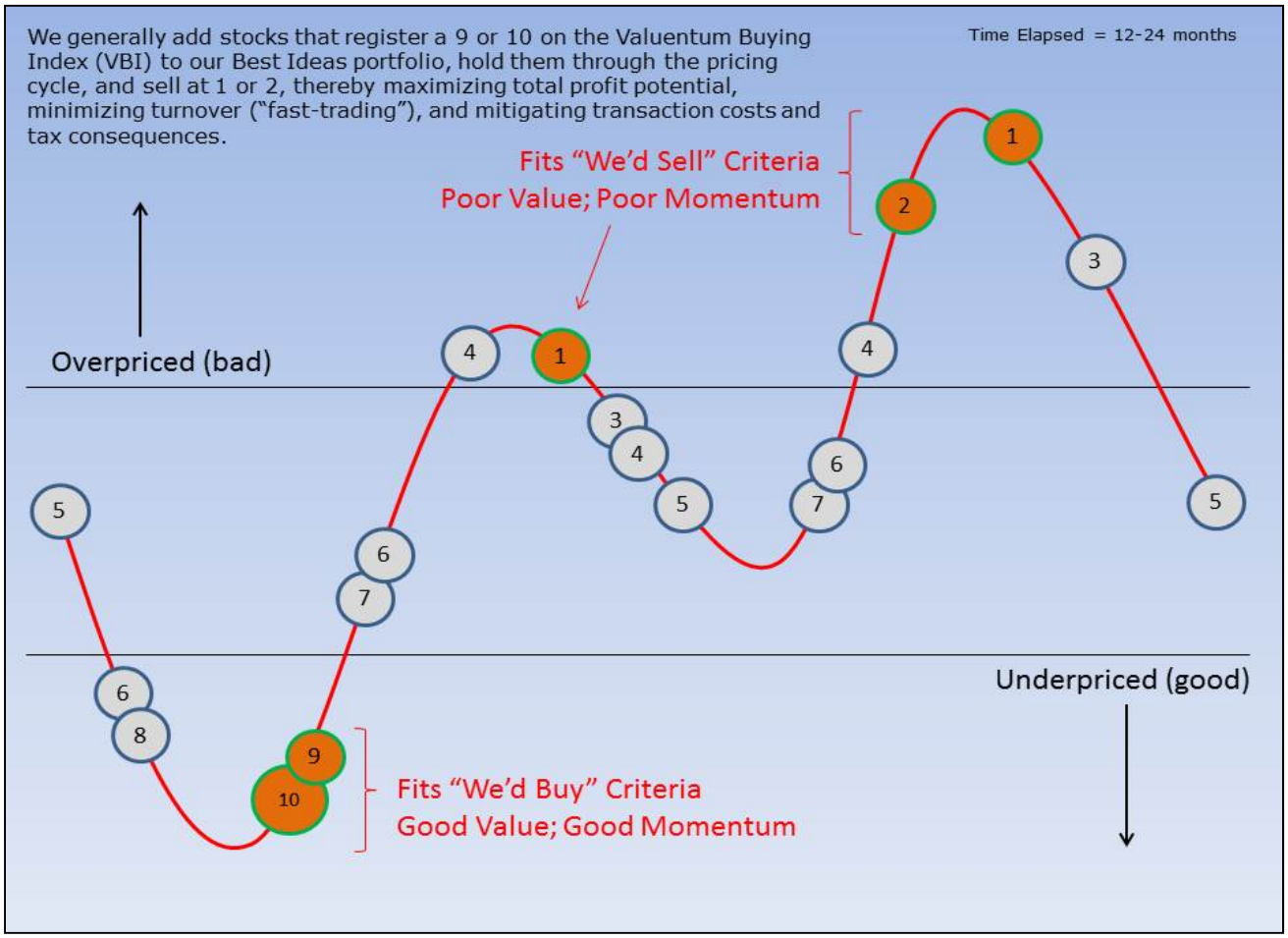
valuation criteria). Rigorous valuation analysis and technical analysis are not mutually exclusive, and we believe both can be used together to bolster returns. An evaluation of a stock's moving averages, relative strength, upside-downside volume, and money flow index are but a few considerations we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

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

Putting It All Together - the Valuentum Buying Index

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

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



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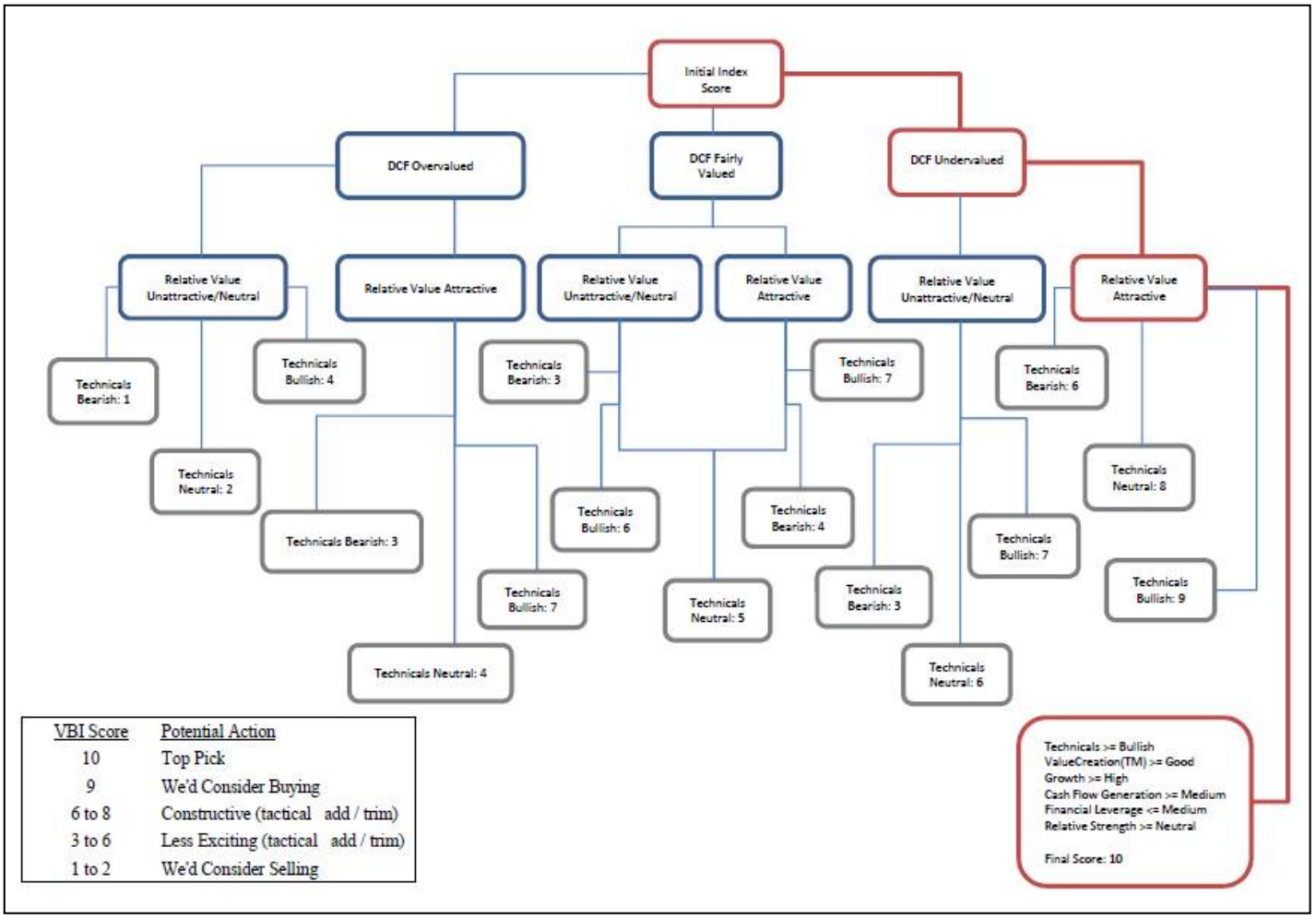
Let's follow the red line on the flow chart below to see how a firm can score a 10, the best mark on our index (a "Top Pick"). Please click here to view an enlarged pdf version. First, the company would need to be 'UNDERVALUED' on a DCF basis and 'ATTRACTIVE' on a relative value basis. The stock would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

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



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About the Fair Value Range

By Valuentum Analysts

Understanding the Fair Value Range and Why It's Important

FAQ: Why do you use such a wide fair value range for certain companies?

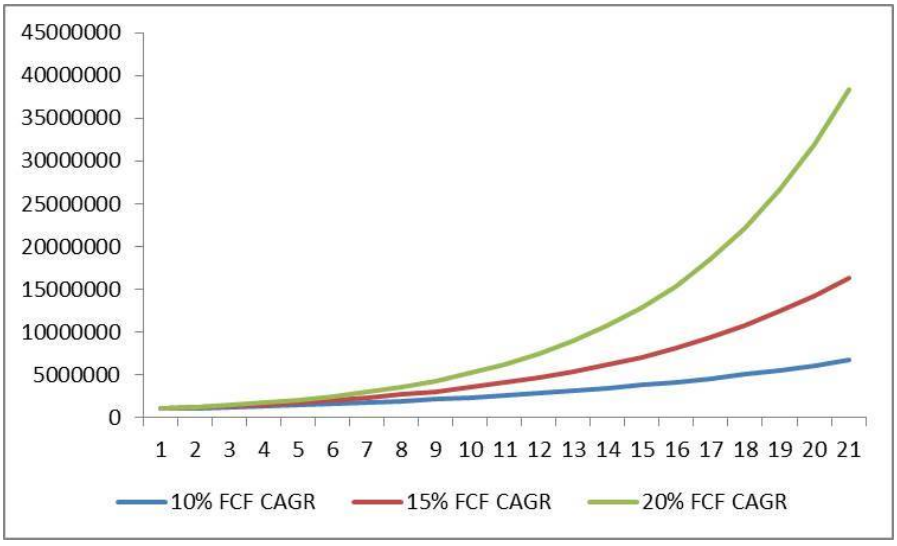
One of the most important concepts of the Valuentum methodology (and valuation in general) is the understanding that the value of a company is a range of probable valuation outcomes, not a single point estimate. Even well-seasoned stock analysts are guilty of saying that a company's shares are worth exactly $25 or a firm's stock is worth exactly $100. The reality is that, in the first case, the company's shares are probably worth somewhere between $20 and $30, and in the latter case, the stock is worth somewhere between $75 and $125.

Why? Because all of the value of a company is generated in the future (future earnings and free cash flow), and the future is inherently unpredictable (unknowable). If the future could be predicted with absolute certainly (knowable), then a stock analyst could say a company's shares are worth precisely this, or that a firm's stock is worth precisely that. Not *because he or she would know where the stock would be trading at*, but because he or she would know precisely what future free cash flows would be (and all other modeling facts-not assumptions in this case) and arrive at the exact and **non-debatable** value of the firm.

But the truth of the matter is that nobody knows the future, and analysts can only estimate what a company's future free cash flow stream will look like. Certain unexpected factors will hurt that free cash flow stream relative to forecasts, while other unexpected factors will boost performance. That's how a downside fair value estimate and an upside fair value estimate is generated, or in the words of Warren Buffett and Benjamin Graham how a "margin of safety" is generated. Only the most likely scenario represents the point fair value estimate. Any stock analyst that says a company is worth a precise figure--whether it's $1 or $100--falls short of understanding one of the most important factors behind valuation.

But why the large range in many cases?

Well, there are many firms in our coverage universe that have a very large range of outcomes in their future free cash flow growth. And because discounting free cash flows is an integral part of calculating the fair value estimate of a company, the range of fair values will also be large. To illustrate this point, let's take a look at the difference between the levels of free cash flows in Year 20 under three different future growth rates: 10%, 15%, and 20%. Though the growth rate between each scenario is but 5 percentage points, the magnitude of the free cash flow difference is astounding many years into the future, and our discounted cash-flow process considers the long-term intrinsic value of firms.



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Under these future free-cash-flow scenarios, if we assume an 8% discount rate and 100,000 shares outstanding (and no debt), the difference in the fair value estimate between the upside case (green line) and downside case (blue line) would be an incredible $68 per share ($82 per share less $14 per share). That's a huge fair value range (80%+), and all because of just a 10 percentage point difference in a future free cash flow growth assumption. For firms that are growing cash flows at 200% or 300% per annum, a large range of fair value outcomes is not only inevitable but also very reasonable. In other words, the Valuentum framework provides an avenue to quantify the upside and downside risks investors are taking in high uncertainty and fast-growing enterprises.

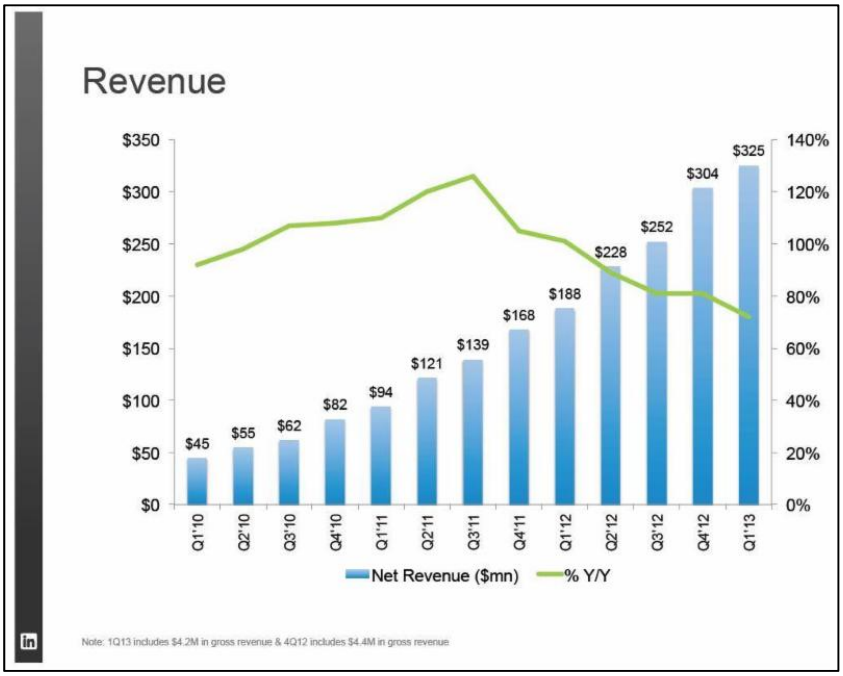

Image Source: LinkedIn

To really hit this point home, shown above is a slide of LinkedIn's (LNKD) revenue from the first quarter of 2010 through the first quarter of 2013. The green line (mapped to the right axis) shows LinkedIn's revenue growth rate. Let's assume revenue expansion translates into similar free cash flow growth expectations (not exactly a precise assumption, given the leverage in LinkedIn's business model), but bear with us for simplistic illustrative purposes. Will LinkedIn's revenue/cash flows expand at a 20% rate, a 40% rate, or a 60% rate (or an even greater pace) through year 20?

It's a very, very difficult question to answer. Remember how significant that 10 percentage point spread was in the hypothetical example above? Well, it's even more significant for LinkedIn. We know LinkedIn's free cash flows will expand, and expand fast, but just how fast is certainly debatable. To a very large extent, that's why LinkedIn's range of probable outcomes (fair value range) is so large. Understanding the cone of fair value outcomes of a company is helpful because the size of the range tends to be positively correlated to the equity's volatility. If you recall, look at what happened to LinkedIn's stock recently when investors ratcheted down their long-term growth assumptions (and by extension, the company's intrinsic value).

Shares collapsed in a huge way.

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But it was largely because of that same weakness in equity pricing that drove Microsoft (MSFT) to take the leap to buy LinkedIn's equity outright just a few months later. Over just a very short period of time, LinkedIn's shares effectively collapsed and then surged as the chart below shows (its intrinsic value range didn't change much, however). Having a fair value range that adequately captures both the upside and downside cases for a company's shares remains an integral part of stock investing. Not only does it help hone in on the potential risk-reward profile of an equity at any given time, it also helps reveal the attractiveness of various "entry" or "exit" points using a robust free-cash-flow based and fundamentally-sound intrinsic value estimate as the anchor.

We're scouring our coverage universe for firms that are trading outside of their respective fair value ranges. A firm trading below the low end of its fair value range, for example, is undervalued, while a firm trading above its fair value range is overvalued. The fair value range for each company captures the inherent uncertainty of the trajectory of that firm's unique future free cash flow stream. For the 1,000+ companies we include in our coverage universe, we provide a discounted cash flow derived fair value estimate and a corresponding fair value range -- *and a robust discounted cash-flow process is only one aspect of our service.*

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

By Valuentum Analysts

We often receive questions about how we use the Valuentum Buying Index (VBI) rating system, but we think it is equally important to mention that it is only one of the many facets of our website and services. For example, if you haven't checked out the Dividend Cushion ratios on the stocks in your portfolio or the dividend growth product (from individual reports to the newsletter and beyond), surely you are not maximizing your membership! We love dividends, but you can also trust us to make sure you're aware of the real risks of any dividend strategy in today's market.

No matter your strategy or process though, the Valuentum Buying Index rating system is still a helpful tool to have at your disposal, even if you are not using it. Admittedly, the VBI, as we call it, is not as easy to use as 1, 2, 3, or even buying 9s and 10s and selling 1s and 2s until their VBI changes upon the next update. Within any quantitative process, we value the human, qualitative overlay, which captures a wealth of experience and common sense. We want to make sure that we're surfacing the best ideas for members, and flying blind is never a good strategy, in our opinion. With prudence and care, the VBI process is carried out.

In probably one of the most obvious cases, for example, an experienced investor knows when a price-to-earnings (P/E) ratio isn't informative (as in the case of negative or negligible earnings), but a quantitative rating system that uses a P/E ratio, which the VBI does, may not know any better. Of course the VBI has checks and balances to adjust for such instances, but we believe the human, qualitative overlay is still extremely important, especially when considering various business models and unique "un-modelable" risks (particularly with respect to the banks). In our opinion, a golf club is only as good as the player that uses it, and in a similar light, a financial model or a rating system is only as good as the user that applies it.

That said, we stake so much on the performance of the portfolios in the Best Ideas Newsletter and Dividend Growth Newsletter. They represent the outcome of all of the work we do on the website, rolled into one final assessment: our best ideas for each respective strategy. Sure we have other screens on the website, but those are just screens -- listings of companies with similar data and information. The ideas in the portfolios in the Best Ideas Newsletter and Dividend Growth Newsletter have undergone a painstaking process with our analyst team to ensure that we're delivering the very best to members within a portfolio setting. The thoughts behind the weighting of each idea and the portfolio management process revealed in full transparency on a month to month basis may be worth the cost of a membership alone, even if you're not using the portfolios!

Here's why. In a market environment where more than 90% of large-cap funds have trailed the S&P 500 in the 5-year period ending August 31, 2016, the Best Ideas Newsletter portfolio has exceeded the market return by 33 percentage points over a similar time period. Absolutely phenomenal. What's more, we didn't hide behind standard quarterly reviews and updates either, sending out pre-packaged information to members. We showcased this performance in full transparency, and we had to write every single day to capture interest! When patience is the secret to success in investing, do you know how much could have gone wrong when having to produce daily? Obviously, we're very disciplined, but we also credit the portfolio outperformance to the VBI methodology itself.

Let's talk about how the VBI helps to inform which ideas we include in the Best Ideas Newsletter portfolio (not the Dividend Growth Newsletter portfolio as additional criteria must be met, namely as it relates to yield and Dividend Cushion ratio). That's such an important word, "informs." Notice how we didn't say "dictate" in this reference. For starters, we've noticed via our statistical backtesting that the momentum factor behind our process tends to be much more pronounced (powerful) over longer periods of time. This was one of the interesting findings of our academic white paper study. We try to replicate this dynamic with the update cycle of our reports (and the time horizon for our ideas to work out). That's why our

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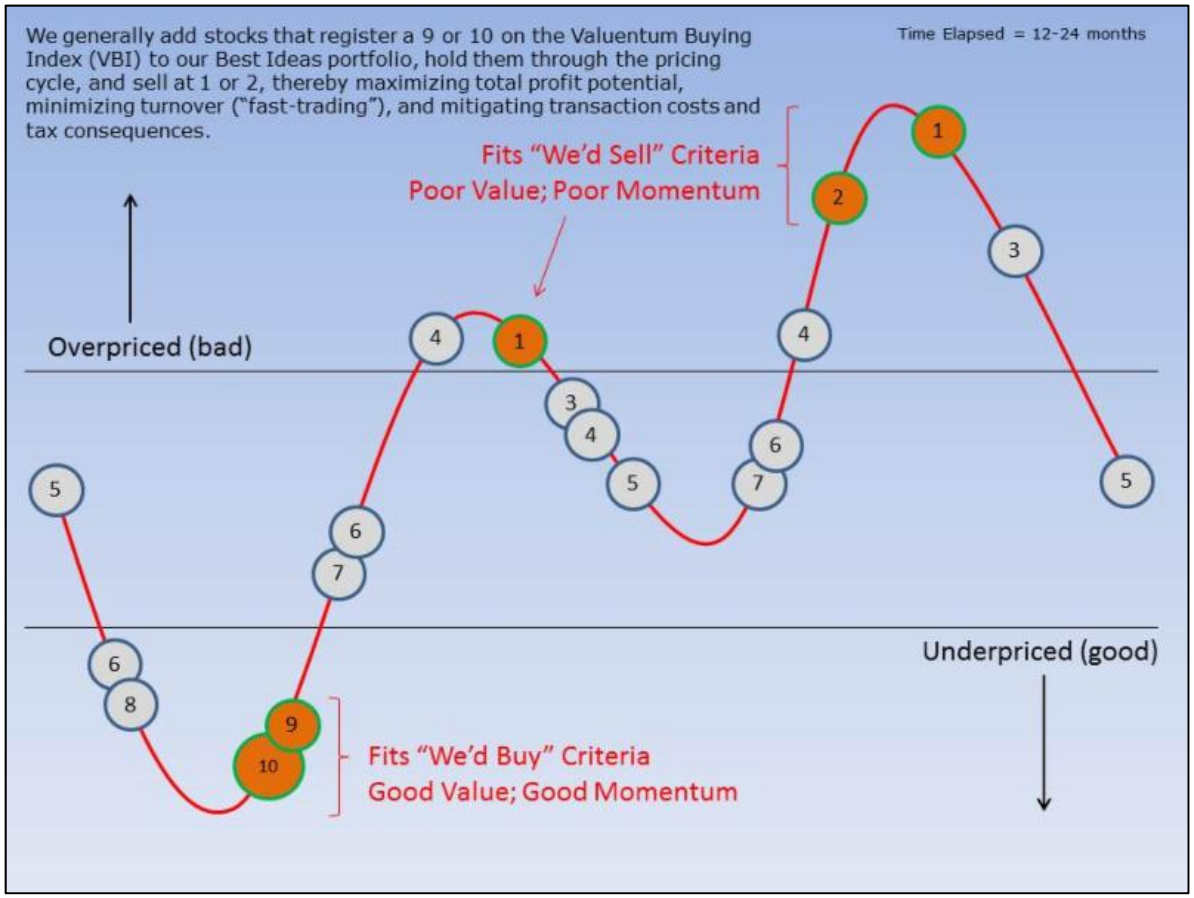
reports are updated regularly (generally on a quarterly basis) or after material events and not daily or weekly. Perhaps most practically though, we don't want to whipsaw our membership, nor do we think churn is the way to generate outperformance.

Though the time frame varies depending on each idea that we consider for the Best Ideas Newsletter portfolio, we expect our best ideas to generally work out over a 12-24 month time horizon (on average). Our holding period is targeted to be much, much longer for some ideas in the Dividend Growth Newsletter portfolio, however. Here is where the VBI rating system becomes somewhat more advanced than a simple 1, 2, 3. We tend to add stocks to the Best Ideas Newsletter portfolio when they register a 9 or 10 on the Valuentum Buying Index (VBI), hold them for some time depending on a number of variables (the VBI, market conditions, sector weightings within the portfolio itself), and then we tend to remove stocks from our Best Ideas Newsletter portfolio when they register a 1 or 2 on the VBI. You'll notice that we have a qualitative overlay for the Best Ideas Newsletter portfolio (and one for the Dividend Growth Newsletter portfolio, too, though it is based on dividend-related considerations).



But why don't we churn and burn by updating daily and trading a lot? Obviously, we don't think that's the secret to success. In quite the opposite approach, we like to maximize profits on every idea that we pursue, with the understanding that momentum does exist and that prices over and under shoot intrinsic value all of the time. For example, as shown in the image above, a value strategy (10 --> 5) truncates potential profits, while a momentum strategy (4 --> 1) ignores profits generated via value assessments. At Valuentum, we're after the entire profit potential of each idea. So, for example, if a firm is added to the Best Ideas Newsletter portfolio as a 10 and is removed as a 5, we would have truncated profit potential by not letting it run to lower ratings. Most of our highly-rated Valuentum Buying Index rated stocks have generated the vast outperformance of the Best Ideas portfolio, but these stocks' ratings declined over time as they were held (a good thing -- a declining VBI rating generally means the share price has advanced, assuming all else is well).

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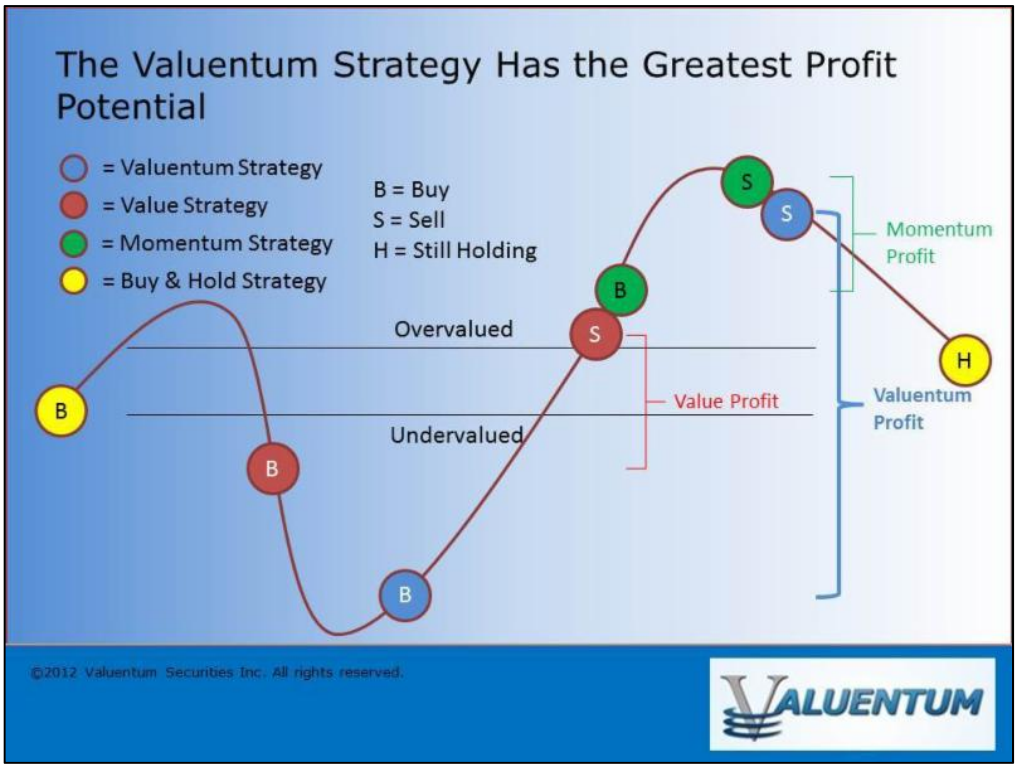

Critically, regarding the Valuentum process, as it is executed in the Best Ideas Newsletter portfolio, we do not add all firms that register a 9 or 10, nor do we add the ones we do immediately thereafter. For example, Google (GOOG, GOOGL), now Alphabet, a current Best Ideas Newsletter portfolio holding, registered a 10 on the Valuentum Buying Index, but we remained patient and didn't add the company to our portfolio until after it reported earnings at the time, providing us with an even better entry point (as new information came to light). There are more "structural/timing" instances like the one with Alphabet, for example, that are extremely difficult to capture in any model, and understandably aren't as obvious to those outside looking in.

But why not add every highly-rated stock to the Best Ideas Newsletter portfolio? Think of it as if you were to imagine a value investor not adding and holding every undervalued stock to his/her portfolio. He or she wants the very best ones -- obviously, that means having to leave some good ideas behind. And then, of course, there are always tactical and sector weighting considerations in any portfolio construction, yet another reason why the human touch remains a vital aspect of the Valuentum process. At the core of how we use the VBI in the Best Ideas Newsletter portfolio, however, is a qualitative portfolio management overlay. The VBI rating helps to inform the process, but the Valuentum team makes the allocation decisions of the newsletter portfolio on the basis of a number of other firm-specific and portfolio criteria. Sometimes, under certain market conditions, we may have to relax the VBI criteria entirely in order to achieve newsletter portfolio goals.

Okay, a couple examples. Take pre-split eBay (EBAY), which many years ago included PayPal (PYPL), as an example of our process in action. The stock initially flashed a rating of 10 in late September 2011, and we added it to the Best Ideas Newsletter portfolio. The VBI rating changed to a 6 in December 2011 and then back to a 10 in May 2012, but because the rating never breached a 1 or 2, we did not remove the position from the Best Ideas Newsletter portfolio. In the case of pre-split eBay, we sought to capture the entire pricing cycle and avoided truncating it as most pure value investors often do (and what we would had done, if we had removed the stock at that time). In many ways, pre-split eBay/PayPal has become one of the better examples to use for illustrating the prolonged outperformance driven by undervalued stocks that are beginning to generate good momentum. [We no longer include eBay in the newsletter portfolio, but its split-off PayPal is retained.]

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There have been more straightforward opportunities in the Best Ideas Newsletter portfolio, too, especially in the case of EDAC Tech, which had tripled since it was added to the newsletter portfolio (never registering below a 9 along the way), and then of course, Apple (APPL), Visa (V) and Altria (MO), but it is usually through the nuances of the process that one truly comes to understand it. The VBI ratings on each stock's most recent 16-page report, downloadable directly from the website at www.valuentum.com, reflect our current opinion on the company. The VBI rating system, as with all methodologies, helps to inform the investment decision process, but in constructing the newsletter portfolio, a qualitative overlay is not only necessary, in our view, but helps to optimize performance. If the returns of the Best Ideas Newsletter portfolio during the past 5+ years are any measure of the VBI rating system, it is performing fantastically well.

About Our Name

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

-- Warren Buffett, Berkshire Hathaway annual report, 1993

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

Valuentum Best Ideas Newsletter: Volume 7, Issue 1

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

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