OUR DIVIDEND GROWTH NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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Valuentum Securities Inc.
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*Study: Valuentum released a new study on its **fair value estimates**! Please download the paper at the following link:* https://www.valuentum.com/articles/How_Well_Do_Enterprise_Cash_Flow_Derived_Fair_Value_Estimates_Predict_Future_Stock_Prices_And_Thoughts_on_Behavioral_Valuation

New for 2018 – See page 6.

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"Certainly, the prospects of the changing structural dynamics of the PBM market have us concerned, but that is not all."

– Brian Nelson, CFA

The Dividend Growth Newsletter portfolio is not a real money portfolio. Results are hypothetical and do not represent actual trading. Actual results may differ from performance information being presented.

CVS Health Under Review – Hit by a Storm of Negativity

By Brian Nelson, CFA

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Dividend Growth Ideas: MO, AAPL, BA, CBRL, CSCO, CVS, XLE, GM, GILD, HAS, HBI, INTC, JNJ, MSFT, NVS, O, PG, PPL, SDY, VNQ

***NOTE:** The Dividend Growth portfolio's goal is to generate a mid-to-high single digit annual return (about 7.5%) over rolling 3-5 year periods. As of today, November 1, 2017, the portfolio is significantly exceeding this goal.

We are putting the fair value estimate of CVS Health under review while we re-evaluate the competitive environment and reassess the company's appetite for leverage, which could impact dividend health.

Boy has CVS Health (CVS) been hit by a storm of negativity in recent months.

After we added it to the newsletter portfolios, the company has gotten caught up in a whirlwind of investor concern regarding Amazon's (AMZN) probable entrance in the pharmacy market. We noted as much in our September 30 note. "Amazon Casts a Large Shadow Over the Pharmacy Market," and we said that even we were "growing more and more cautious on shares," as we pointed to Amazon's potential acquisition of Rite Aid's (RAD) PBM business that could accelerate its entrance into the pharmacy business:

> An opportunity for Amazon to purchase an existing PBM may become available once the long-running acquisition of a portion of Rite Aid's existing store base is completed. Rite Aid will offload a tad less than half of its 4,741 store network to Walgreens to raise cash to help mitigate some of the debt burden that continues to plague the company. The 2,186 stores combined with three distribution centers will help shrink Rite Aid's overall store footprint as the company will exit some key markets in its entirety, thus ending the company's aspiration to build out a credible national competitor to Walgreens and CVS Health.
>
> Curiously, Rite Aid owns a growing PBM business that it acquired in 2015 called Envision RX Options that is not included in the deal with Walgreens. We find it interesting that Walgreens continues to focus on building out its network, while purposely shying away from the lower-margin PBM business as opposed to the hybrid model employed by CVS Health. Walgreens' pure-play model allows for maximum optionality that can be operated through numerous partnerships, including a theoretical tie-up with Amazon should it choose to move forth with a foray into the pharmacy business. An acquisition of an existing PBM will accelerate the learning curve Amazon faces with entry into the field, though an outright purchase of an existing player may not be completely necessary for scale (it would make it easier though).

Please see *CVS Health…*on next page

*CVS Health…*from previous page

Frankly, we underestimated the ease of the path by which Amazon could enter the pharmacy space, especially as the online giant scoops up wholesale pharmacy licenses, and from a competitive standpoint, it's hard to argue that Amazon's robust free-cash-flow generation emanating from its AWS operations won't be used to fuel a more-directed attempt to tackle the pharmacy market, squeezing existing players. Certainly, the prospects of the changing structural dynamics of the PBM market have us concerned, but that is not all.

We probably were least-of-all pleased with having learned about the acquisitive nature of CVS Health in its bid for Aetna (AET) for no small sum, reportedly over $200 per share ($66 billion). Having also talked to Anthem (ANTM) and United Health (UNH), CVS Health is clearly on the defensive following Amazon's foray into the pharmacy space. However, launching a huge acquisition such as one with Aetna, one that might bury the company in debt while its operations could be squeezed on the margin, makes for a rather ominous scenario, at the very least with respect to the long-term health of the dividend.

We're taking a close look at our valuation model of CVS Health, and we expect to continue to update readers on our thoughts as we wait for more details about the reported CVS-Aetna tie-up, of which we are not fans.

Bellwethers Drive Dow Jones to Record Highs

By Brian Nelson, CFA

We couldn't be more excited for holders of newsletter portfolio idea General Motors. The auto giant released a solid third-quarter report October 24 that has sent shares rallying to the mid-$40s each. If you remember, GM's stock was languishing in the mid-$30s when we penned our September piece, "Why Won't GM Break Out Already:"

> Unfortunately, in GM's case, it doesn't appear that valuation and the dividend will combine to act as the catalyst, so we think the executive team may need to find a way to improve the "story" around the stock. As a fundamental, cash-flow based research entity, we care very little about "stories," but in a market where entities like Tesla are building "castles in the air" on the backs of the hopes of investors, we can't help but think that some "rhetoric" around the future innovative direction of GM would serve investors well. We continue to believe GM is a fascinating investment consideration, but investors seem like they need something to talk about these days. Hopefully, the executive team at GM will deliver on this sooner than later.
>
> GM: Get investors talking about your future! Your valuation is attractive, the dividend is sound, but investors are missing the "storyline." You need to change the public's perception from one of a tax-funded bailout to one where GM should not only garner a market multiple of 17+ times but arguably one that should be higher than that. There is absolutely no possible way you can sit idly by while the market assigns a castle-in-the-air valuation to Tesla. Do what you do best GM: make cars that consumers want but get them talking about "the next big thing" out of your pipeline. Shareholders might be rewarded handsomely if you do. Fantastic sales performance and improved inventory, as we witnessed in August, may not be enough. Start dazzling investors with your talk about the future. Give the public something to wonder about!

It didn't take long for GM's shares to break out in early October on talk of its autonomous vehicle program, "General Motors is Off to the Races," and the company has delivered yet again. General Motors noted that in the third quarter of 2017 that it was profitable in all business segments for the first time since late 2014, and with revenue coming in better than expectations, the market was given a lot to talk about. We love to hear GM talking about the future of automaking, and that's precisely what the stock needed:

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> In September, Chairman and CEO Mary Barra shared GM's vision for a world with zero crashes, zero emissions and zero congestion. To support this vision, GM outlined its all-electric path to zero emissions, announcing it will launch at least 20 electric vehicles by 2023, including two in the next 18 months…
>
> …GM and Cruise remain focused on developing self-driving all-electric cars to deploy at scale — to save lives, lower emissions and reduce congestion. In September, they unveiled the world's first mass-producible self-driving car. GM believes this autonomous vehicle, the third-generation test vehicle produced in just 14 months, will meet the redundancy and safety requirements necessary to operate without a driver. A critical proof point of this effort is the testing of self-driving electric vehicles in the challenging driving environment of San Francisco, and deploying them to transport employees who use a ride-hailing app called Cruise Anywhere.

General Motors has its sights set on the future, and Tesla (TSLA) may not be able to stave off the momentum in Detroit, which is fighting back in a huge way. The market may be large enough for a number of players, but our bets are on the established giants, many of which have survived the Great Depression a couple World Wars and more. GM may have needed some assistance during the Financial Crisis, but a rich history (dating back to the year it was founded by William C. Durant in 1908) is simply hard to ignore. We continue to like its dividend and valuation. GM remains in the newsletter portfolios.

More Room for McDonald's to Grow?

It's simply hard to believe that McDonald's can still have any more room ahead of it to grow (people have been eating burgers and fries from Mickey D's since the mid-1950s), but its third-quarter results, released October 24, revealed an increase in global same-store sales of 6%! Make no bones about it: we completely underestimated McDonald's new initiatives, not the least of which was all-day breakfast, and we simply can't believe the restaurant's current pace of same-store sales expansion, which is nearing the high-single-digit level. Kudos to management.

As the company's refranchising initiatives take hold, McDonald's revenue is expected to fall (as lower-margin operating revenue migrates to higher-margin franchise fees), so we're paying the most attention to the operating earnings line, which advanced 5% (3% in constant currencies) in the quarter on a year-over-year basis. Surely, we would have liked to see better operating earnings expansion, but efforts to grow the top line are certainly paying off. Its national beverage and McPick 2 value promotions and its Signature Crafted premium sandwich platform have been big hits.

That we weren't uber-bullish on McDonald's is a particularly tough pill to swallow because, well, who doesn't love McDonald's?!?! That McDonald's has "reached (its) target to refranchise 4,000 more restaurants more than a year ahead of schedule" only aids in its position to mitigate any impact from higher labor costs (rising minimum wage legislation) and volatile commodity prices. Remember – McDonald's is becoming largely a franchisor, where its customers are more the franchisees (entrepreneurs) than the end consumer (customer). Where the franchisees take on all of the operating risks of potentially higher labor costs and volatile commodity costs, McDonald's, the corporate, just keeps reaping in that higher-margin franchise fee.

We value McDonald's in the mid-$140s at the high end of our fair value range at the time of this writing, but the restaurant has somehow become a growth darling. We've been too cautious on shares in the past, even as we say that today, shares still look overpriced.

Caterpillar Puts Up Fantastic Third Quarter, Raises Outlook

It wasn't but a few months ago in late September that we were commenting on Caterpillar's improving fundamentals and that it reached a new all-time high of $120+ back then, "How Strong Is Caterpillar's 2.5% Dividend Yield?":

Please see *Bellwethers…*on next page

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> Caterpillar is one of our favorite companies from a fundamental perspective, if we look past the cyclicality of its operations and exposure to potential weak credits at its captive finance arm. No matter how you slice it or dice it though, the company's dealer network is a significant competitive advantage, and the executive team's ability to manage costs through the course of the economic cycle continues to be impressive. That its shares have now surged past $120+ to all-time highs, levels that it had only come close to reaching during 2011-2012, speak to the resilience of Cat's equity, especially given the myriad global economic growth concerns during the past decade. But should investors be celebrating the recent rise, or be more cautious because of it?
>
> We think they should be doing both, of course! What a wild ride Caterpillar's share price has experienced during the past 10 years, and those that held on through the ups and downs have been handsomely rewarded. They should be happy – and popping the champagne! That said, however, our ~$100 per-share fair value estimate suggests that the company's stock price is starting to get a little bit ahead of itself, especially considering the cyclical dynamics of its operations, which always seem to rear their ugly head at the worst possible time. We had picked up on Caterpillar's optimistic commentary in April of this year, "S&P 500 Poised to Make New Highs…Again?: "for the first time in more than two years, same quarter sales and revenues increased," and we continue to like its recent performance.

Caterpillar's shares have now eclipsed the $137 per share mark as of the time of this writing on the heels of what was a fantastic third-quarter report and improved outlook. What a comeback. Third-quarter 2017 revenue advanced to $11.4 billion compared with $9.2 billion in the third quarter of 2016, while third-quarter 2017 adjusted profit per share was $1.95 compared with adjusted profit per share of $0.85. Caterpillar's cost-cutting and efficiency initiatives are playing a key role in generating the positive operating leverage it is reaping on the improved sales performance. The enhanced outlook for 2017 has the Street buzzing, and shares continue to gain ground:

> Caterpillar continues to see strength in a number of industries and regions, including construction in China, onshore oil and gas in North America, and increased capital investments by mining customers. We are working with our supply chain to increase production levels to satisfy customer demand for those markets that have improved. In July 2017, Caterpillar provided an outlook range for full-year 2017 sales and revenues of $42 billion to $44 billion, with a midpoint of $43 billion. The company now expects full-year 2017 sales and revenues of about $44 billion. For the full year of 2017, Caterpillar now expects profit per share of about $4.60, or adjusted profit per share of about $6.25. The previous outlook for 2017 profit was about $3.50 per share at the midpoint of the sales and revenues outlook, or adjusted profit per share of about $5.00.

Caterpillar's equity is trading at 20+ times full-year adjusted profit per share of $6.25, so the company's shares aren't necessarily cheap, but if the trajectory of sales improvement and operating leverage continues, earnings growth may continue to be fantastic in the quarters ahead. Don't forget, however, that Caterpillar's operations are highly cyclical, and one only has to look at the past few years to see how painful performance can get when end markets don't cooperate.

Dividend Growth Ideas Doing Well

*Study: Valuentum released a new study on its **fair value estimates**! Please download the paper at the following link:* https://www.valuentum.com/articles/How_Well_Do_Enterprise_Cash_Flow_Derived_Fair_Value_Estimates_Predict_Future_Stock_Prices_And_Thoughts_on_Behavioral_Valuation

SIMULATED DIVIDEND GROWTH PORTFOLIO -- as of November 1, 2017 Dividend Growth Portfolio Inception Date: January 1, 2012

Company Name	First Purchase	Avg Cost ($)	# of Shares	Total Cost ($)	Last	Current Value ($)	% of Portfolio	Exp. Yrly Div's ($)
Altria (MO)	12/30/2011	29.65	50	1,489.50	64.70	3,235.00	1.7%	132.00
Apple (AAPL)	7/24/2013	63.17	51	3,228.45	166.89	8,511.39	4.4%	128.52
Boeing (BA)	1/26/2017	168.44	16	2,702.04	258.50	4,136.00	2.2%	90.88
Cisco (CSCO)	11/14/2014	26.31	199	5,242.53	34.62	6,889.38	3.6%	230.84
Cracker Barrel (CBRL)	2/1/2016	133.50	18	2,410.00	156.44	2,815.92	1.5%	86.40
CVS Health (CVS)	1/6/2017	81.84	107	8,763.88	69.00	7,383.00	3.8%	214.00
Energy Sector SPDR (XLE)	4/1/2015	72.63	121	8,795.76	68.68	8,310.28	4.3%	258.34
General Motors (GM)	12/1/2016	36.43	119	4,342.17	43.13	5,132.47	2.7%	180.88
Gilead Sciences (GILD)	7/31/2017	76.32	49	3,746.68	74.83	3,666.67	1.9%	101.92
Hasbro (HAS)	12/30/2011	31.89	28	899.92	90.47	2,533.16	1.3%	63.84
Hanesbrands (HBI)	1/26/2017	23.77	221	5,260.17	22.01	4,864.21	2.5%	132.60
Intel (INTC)	12/30/2011	24.25	289	7,015.25	46.71	13,499.19	7.0%	315.01
Johnson & Johnson (JNJ)	12/30/2011	65.58	107	7,024.06	139.98	14,977.86	7.8%	359.52
Microsoft (MSFT)	12/30/2011	25.96	77	2,005.92	83.18	6,404.86	3.3%	129.36
Novartis (NVS)	7/19/2017	85.16	65	5,542.40	82.77	5,380.05	2.8%	176.80
Proctor & Gamble (PG)	12/30/2011	66.71	105	7,011.55	86.89	9,123.45	4.7%	289.80
PP&L (PPL)	12/30/2011	29.42	238	7,008.96	36.94	8,791.72	4.6%	376.04
Realty Income (O)	7/24/2013	44.35	60	2,668.00	53.93	3,235.80	1.7%	152.40
S&P Dividend ETF SPDR (SDY)	4/20/2016	81.33	105	8,546.65	92.45	9,707.25	5.1%	298.10
Vanguard REIT ETF (VNQ)	2/1/2016	77.07	32	2,473.24	82.60	2,643.20	1.4%	126.24
Latest Changes: Removed 82 shares of HAS (8/18).								
Cash -- changes in cash balance reflects dividends received and trading gains/losses, where applicable						60,869.10	31.7%	3,843.48
Dividend Growth Portfolio				100,000.00		**192,109.96**	100.0%	**TBD**
DG Portfolio Annualized Return (from inception through current date)								**11.8%**
DG Portfolio Annualized Return Goal (Mid-to-High Single Digit Returns)								7.5%
DG Portfolio Annualized Return Outperformance								**4.3%**

UR = Under Review

This portfolio is not a real money portfolio. Data as of November 1, 2017. Cost basis includes commissions. Results include dividends, but no interest received on cash balance.

SIMULATED DIVIDEND GROWTH PORTFOLIO -- as of November 1, 2017 Fundamental data as of November 1, 2017

Company Name	Yrly Div's Paid ($) / Shr	Div Yield %	Ex Div Date	Next Pay Date (cycl)	Div Cushion™	Div Safety	Div Growth	Fair Value	VBI Score	Price/Fair Value
Altria (MO)	2.64	4.08%	mid Dec 2017	mid Dec 2017 (quart)	1.2	GOOD	GOOD	$58.00	3	1.12
Apple (AAPL)	2.52	1.51%	Nov 2017	Nov 2017 (quart)	5.2	EXCELLENT	EXCELLENT	$199.00	7	0.84
Boeing (BA)	5.68	2.20%	early Nov 2017	Nov 2017 (quart)	2.4	GOOD	EXCELLENT	$223.00	6	1.16
Cisco (CSCO)	1.16	3.35%	early Jan 2017	Jan 2017 (quart)	2.7	GOOD	EXCELLENT	$42.00	7	0.82
Cracker Barrel (CBRL)	4.80	3.07%	mid Jan 2017	Jan 2017 (quart)	1.6	GOOD	GOOD	$171.00	4	0.91
CVS Health (CVS)	2.00	2.90%	mid Jan 2017	Jan 2017 (quart)	1.1	GOOD	GOOD	$103.00	6	0.67
Energy Sector SPDR (XLE)	2.14	3.11%	mid Dec 2017	mid Dec 2017 (quart)	-	GOOD	NEUTRAL	-	UR	-
General Motors (GM)	1.52	3.52%	early Dec 2017	Dec 2017 (quart)	3.4	EXCELLENT	GOOD	$43.00	7	1.00
Gilead Sciences (GILD)	2.08	2.78%	early Dec 2017	Dec 2017 (quart)	5.0	EXCELLENT	EXCELLENT	$109.00	7	0.69
Hasbro (HAS)	2.28	2.52%	mid Jan 2017	late Jan 2017 (quart)	2.1	GOOD	EXCELLENT	$87.00	3	1.04
Hanesbrands (HBI)	0.60	2.73%	mid Nov 2017	Nov 2017 (quart)	1.1	GOOD	GOOD	$27.00	7	0.82
Intel (INTC)	1.09	2.33%	mid Nov 2017	Nov 2017 (quart)	2.9	EXCELLENT	EXCELLENT	$48.00	5	0.97
Johnson & Johnson (JNJ)	3.36	2.40%	mid Nov 2017	Nov 2017 (quart)	1.9	GOOD	EXCELLENT	$121.00	7	1.16
Microsoft (MSFT)	1.68	2.02%	mid Nov 2017	Nov 2017 (quart)	2.7	GOOD	EXCELLENT	$76.00	6	1.09
Novartis (NVS)	2.72	3.29%	mid March 2018	March 2018 (annual)	1.7	GOOD	GOOD	$80.00	5	1.03
Proctor & Gamble (PG)	2.76	3.18%	early Jan 2017	Jan 2017 (quart)	1.7	GOOD	EXCELLENT	$74.00	4	1.17
PP&L (PPL)	1.58	4.28%	late Dec 2017	late Dec 2017 (quart)	Held for diversification reasons.			$34.00	4	1.09
Realty Income (O)	2.54	4.71%	monthly	monthly	1.2	GOOD	GOOD	$58.00	6	0.93
S&P Dividend ETF SPDR (SDY)	2.84	3.07%	mid Dec 2017	mid Dec 2017 (quart)	-	-	-	-	UR	-
Vanguard REIT ETF (VNQ)	3.95	4.78%	mid Dec 2017	mid Dec 2017 (quart)	-	GOOD	NEUTRAL	-	UR	-

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

Taking Care of Our Members

We're excited about what's in store for 2018 and beyond, and here are a few things to look forward to!

By Brian Nelson, CFA

NEW for 2018

We are expanding and optimizing our stock coverage. In addition to the 16-page stock reports, dividend reports, and ETF reports, we will now be publishing more thematic coverage in pdf fashion on the stock and ETF symbol pages. This will allow us to provide even more breadth of coverage as we continue to focus on enhancing the depth of analysis. We believe this optimization will be a valuable improvement for members, regardless of which membership plan you are on.

We are launching a brand-new High-Yield Dividend Newsletter and accompanying simulated portfolio, the first edition is planned for release January 1, 2018. We're going to be looking for some of the biggest (and strongest) yields on the market and putting them in a simulated income portfolio. Reserve your membership to this add-on monthly newsletter today. Contact us for more details.

We are optimizing how we communicate our best ideas in the Best Ideas Newsletter portfolio and how we communicate our best dividend growth ideas in the Dividend Growth Newsletter portfolio.

> We think we can better rank our best ideas and best dividend growth ideas in a list for these newsletters. Visa (V) is a prime example as to why we will be migrating to list format with these two newsletters. Its stock reached a new high today, November 1, but even though it is the top-weighted stock in the Best Ideas Newsletter portfolio, many may not take that to mean it is one of our very favorites.
>
> The lists, which will include ideas currently in the respective simulated newsletter portfolios, will begin with the editions of the Best Ideas Newsletter and Dividend Growth Newsletter in January 2018. We will close the calculations of the simulated Best Ideas Newsletter portfolio and simulated Dividend Growth Newsletter portfolio effective December 31, 2017.
>
> We will publish analysis of the Best Ideas Newsletter and Dividend Growth Newsletter simulated portfolios in the coming months, and we'll continue to direct our attention to the existing ideas currently in the simulated portfolios, but the portfolios will now be in list format. Stocks will still be added and removed from the lists as needed, so you won't miss any changes in our thoughts or theses on ideas.
>
> The goal of the Best Ideas Newsletter list will be to source interesting ideas with capital appreciation potential from within our coverage universe. The goal of the Dividend Growth Newsletter list will be to source interesting ideas with strong dividend-growth potential from within our coverage universe. [Please evaluate our new High Yield Dividend Newsletter for higher-yielding ideas.]

We are launching a new data product that combines our archived data into one document. Please contact us if you are interested in receiving this. Many of our members love data, and we have it!

We are very excited about these initiatives, and we hope that you are, too! If you have any questions or concerns, please be sure to let us how we can be of any assistance. Thank you as always for your feedback.

Key Oncology Assets Powering Johnson & Johnson Higher

By Alexander J. Poulos and Kris Rosemann

J&J is a top-weighted idea in the Dividend Growth Newsletter portfolio – see page 5.

Pharmaceutical Highlights – 3rd Quarter 2017

Sales: $9.7B WW 15.4%, U.S. 15.4%, Int'l 15.5%

Ops Change[1]: WW 14.6%, U.S. 15.4%, Int'l 13.5%

PHARMACEUTICAL SEGMENT	TOTAL WW SALES $MM	REPORTED % GROWTH	OPERATIONAL % GROWTH[1]
Immunology	$3,269	6.0%	5.3%
Infectious Diseases	813	(3.4)	(5.3)
Neuroscience	1,498	2.3	2.0
Oncology	1,898	25.1	23.8
Cardiovascular/ Metabolism/ Other	1,547	3.6	3.3
Pulmonary Hypertension	670	—	—
Total Pharma	**$9,695**	**15.4%**	**14.6%**

KEY DRIVERS OF OPERATIONAL PERFORMANCE[1]

Immunology	– Growth driven by strong uptake of STELARA® in Crohn's Disease, U.S. immunology market growth and launch of TREMFYA®, partially offset by increased discounts/rebates and modest share loss for REMICADE® and SIMPONI® – OUS strength across major regions for STELARA® and SIMPONI® / SIMPONI ARIA®. Lower sales of REMICADE® due to biosimilar competition
Infectious Diseases	– Lower sales of OLYSIO®, vaccines and PREZISTA®; partially off set by strong sales of PREZCOBIX® /REZOLSTA® and continued success of ODEFSEY®
Neuroscience	– WW paliperidone long-acting injectables grew on strength of INVEGA TRINZA®/TREVICTA® and INVEGA SUSTENNA®/XEPLION® , partially offset by cannibalization of RISPERDAL® CONSTA®
Oncology	– DARZALEX® continued strong uptake in U.S. and EU, especially 1 prior line setting; now launched in 25 countries in Europe – Strong sales of IMBRUVICA® due to increased patient uptake globally; U.S. new and total patient share leader for 1st and 2nd line CLL and 2nd line MCL
Oncology (cont.)	– Strong U.S. sales of ZYTIGA® driven by market growth and LATITUDE data. Strong growth in Japan
Cardiovascular/ Metabolism / Other	– XARELTO® increase in market share driven by access wins, partially offset by higher discounts to Managed Care/government channels – INVOKANA®/INVOKAMET® lower sales due to increased contracting discounts, higher utilization in Medicaid and share loss
Pulmonary Hypertension	– Acquisition of Actelion June 2017; leading products OPSUMIT® , TRACLEER® and UPTRAVI®
Total Pharmaceutical	– Excluding impact of acq/div[2], WW +6.7%, U.S. +7.7%, OUS +5.1%

Image Source: JNJ third quarter earnings presentation

Immunology

Johnson & Johnson's (JNJ) largest pharmaceutical division remains Immunology--an area where the company continues to be a pioneer--but the division has begun to feel the strain of the coming biosimilar onslaught as its legacy molecule Remicade continues to cede ground to biosimilar competition. The drug posted a 7.6% year-over-year revenue decline in the third quarter of 2017 to ~$1.65 billion as biosimilars continue to take share and essentially place a cap on potential price hikes.

Fortunately for J&J, the continued growth in Stelara more than offset the weakness in Remicade, but the growth trajectory of Stelara may not be secure going forward. The recent crop of biologic agents such as Talz, Kevzara, and Cosentyx, in addition to the expected growth of the Jak-1 class, will likely pressure growth of Stelara. To J&J's credit, however, it was able to expand the prescribing label for Stelara to include Crohn's Disease, where strong uptake was a driver of growth in the third quarter of 2017.

We expect the Immunology division to remain a nice profit driver, but the group's best days may be behind it. J&J is in the process of bringing to market two new molecules in an attempt to maintain market share in Immunology. The first of the two, Sirukamab, a product for Rheumatoid Arthritis, received a complete response letter (CRL) requesting additional clinical data to determine the side effect profile of the product. Such a development will inevitably push back a potential launch of the product.

However, the company did receive a dose of good news with the approval of Tremfya for the treatment of plaque psoriasis. Tremfya will enter a crowded field of next-generation products, but Tremfya performed splendidly in head-to-head against market leader Humira. Tremfya's outstanding results compared to Humira should be exploited by J&J in gaining favorable formulary placement.

Oncology

We remain impressed with the growth trajectory of Johnson & Johnson's Oncology division as it posted 25% year-over-year revenue growth in the third quarter of 2017--the kind of growth typically seen from a junior biotech. Its top-selling product remains Zytiga, a treatment for prostate cancer, but Zytiga's

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future growth trajectory is in doubt as the molecule faces significant patent uncertainty.

Zytiga posted sales north of $2 billion in 2016, a worthy target for the generic drug industry. Zytiga's 213 patent (which expired in December 2016) is the original composition of matter patent, while its 438 patent (the patent currently in question) was granted much later in the life cycle of the product, which could make the product's patent protection more vulnerable. Patent challenges are notoriously challenging to handicap, and even if J&J loses the case, the loss of sales will likely be masked by the company's overall revenue of more than $70 billion. However, such a setback would impact the growth trajectory of the Oncology division, which could have bigger than expected ramifications on the firm's share price as Oncology continues to be an area of emphasis across pharma.

Perhaps the greatest strength of Johnson & Johnson is its broad product diversity that can offset the potential loss of even a $2 billion revenue product, and continued growth of drugs such as Darzalex and Imbruvica are sources of confidence for investors. Darzalex is an innovative new treatment for multiple myeloma and remains firmly entrenched in the early stages of its growth trajectory, and we expect J&J to broaden the prescribing label for the treatment, thus enhancing its sales trajectory in coming years. Imbruvia, on the other hand continues its torrid run of growth as it remains relatively unchallenged in lymphoma. Gilead Sciences' (GILD) Zydelig remains a very distant second in overall prescriptions written and new perscriptions written.

Cardiovascular/Metabolism

Results from Johnson & Johnson's Cardiovascular division have begun to demonstrate the strain of recent negative clinical developments, though it was able to continue delivering year-over-year revenue growth of 3%+ in the third quarter of 2017. Revenue erosion of Invokana, the company's formerly dominant subtype 2 sodium-glucose transport inhibitors (SGLT-2), has begun in what may be an irreversible decline. Unfortunately for J&J, Invokana posted a slightly increased risk of amputations, an area of notable concern for diabetics. The results may very well be the death knell for the product with recent prescription data confirming bearish sentiment surrounding the drug. Eli Lilly's Jardiance is now in the cat-bird seat with a noticeable ramp in new prescriptions written, and we expect Jardiance to become the king of the class, depriving J&J of a once promising asset and market position.

The news on the Xarelto front for Johnson & Johnson is also a bit of a mixed bag with clinical data coming in less robust than expected, and the firm needs additional positive clinical data to prevent the ceding of further ground to Eliquis. Xarelto posted an impressive 20% jump in quarterly sales to $635 million in the third quarter of 2017, but it is no longer the top-seller in the field. Eliquis also has a more robust prescribing label, which could allow it to negotiate more favorable formulary placement and deprive Xarelto of sales moving forward. However, management has recognized its vulnerability and is working to shore up this area of potential weakness. The recent acquisition of Actelion was likely consummated with an eye towards melding the Pulmonary Arterial Hypertension products with J&J's Cardio unit to mask the weakness of Xarelto and Invokana.

Clinical Pipeline

Johnson & Johnson has suffered two late stage setbacks with molecules it initially expected to help serve as catalysts for its next leg higher. The first molecule is the previously-mentioned Sirukumab, an anti-interleukin-6 antibody for the treatment of rheumatoid arthritis. These developments could represent a missed opportunity for J&J as the company has withdrawn its applications for Sirukumab in RA in light of the less than stellar safety data. Aiding in the decision is the competitive landscape with Roche's (RHHBY) Actemra and Regeneron (REGN) and Sanofi's (SNY) Kevzara collaboration--both of which have delivered safety data far superior to that of Sirukumab. As a point of reference, Actemra generated sales of ~1.4 billion Swiss Francs in the first nine months of 2017 as the product is well into its life cycle after gaining initial approval in 2010.

Please see *Key Oncology…*on next page

*Key Oncology…*from previous page

The recent string of pipeline disappointments extend into Johnson & Johnson's Oncology division after the company terminated the development of Talacotuzumab for the treatment of acute myeloid leukemia (AML). J&J moved the product into phase 3 testing in early 2017 but quickly reversed field as the safety data remained unappealing. Such a change of course underscores the inherently risky nature of new drug discovery, and even large cap behemoths such as J&J can fall victim to the spell of clinical data.

From our point of view, the Actelion acquisition is management's attempt at masking the weakness of the Cardiovascular division and restoring its pipeline with assets from Actelion's. J&J is faced with the unenviable task of having to replace the revenue stream of its top-selling product (Remicade), while suffering a setback to the growth rate of a key asset (Invokana), which will place additional strain on the high-growth Oncology division to make up the loss of expected revenue.

Conclusion

We expect to continue to include Johnson & Johnson in both newsletter portfolios for the foreseeable future. The firm's balance sheet health is not what it once was after the Actelion acquisitions--it holds net debt of ~$19 billion as of the third quarter of 2017--but we continue to expect robust free cash flow generation to be sufficient in delivering a competitive dividend. The company has yet to submit its 10-Q for the third quarter of the year, but through the first six months of 2017, free cash flow came in at more than $7.4 billion, up from just under $5.4 billion in the same period of 2016 and far higher than cash dividends paid of ~$4.4 billion. Its Dividend Cushion ratio is currently a strong 1.9 to go along with a yield of ~2.4% at recent price levels.

Following a solid third quarter, Johnson & Johnson raised its reported sales guidance for 2017, as well as its adjusted EPS guidance. Operational sales growth guidance remains unchanged at 5.5%-6%, but reported sales growth guidance has been increased to 6%-6.5% due to movement in the EUR/USD exchange rate. Adjusted EPS guidance on an operational and constant currency basis has been increased to a range of $7.22-$7.27, up from previous guidance of $7.17-$7.27 and initial guidance of $7.05-$7.20. In its quarterly conference call, management also reiterated its expectations for above market growth in its Pharmaceutical segment through 2021 despite recent setbacks in some key pipeline assets. If the company is able to deliver on such an initiative, it would achieve its goal of delivering a decade of revenue CAGR above the branded pharma market.

Image source: JNJ Pharma Overview Presentation

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

By Valuentum Analysts

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

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

Company Name	Symbol	Est Div Yield	VBI	Div Growth
FLIR Systems	FLIR	1.5%	7	EXCELLENT
Northrop Grumman	NOC	1.5%	7	EXCELLENT
Kaiser Aluminum	KALU	2.1%	7	EXCELLENT
Ford	F	5.1%	7	GOOD
General Motors	GM	3.9%	7	GOOD
Coca-Cola	KO	3.3%	7	EXCELLENT
PepsiCo	PEP	2.8%	7	GOOD
Celenese	CE	2.0%	7	EXCELLENT
PPG Industries	PPG	1.4%	7	EXCELLENT
Intl Flavors	IFF	1.9%	7	EXCELLENT
NewMarket	NEU	1.6%	7	EXCELLENT
Apple	AAPL	1.6%	7	EXCELLENT
W.W. Grainger	GWW	2.8%	7	EXCELLENT
Watts Water	WTS	1.1%	7	EXCELLENT
ABB	ABB	3.1%	7	GOOD
Eaton	ETN	3.1%	7	GOOD
Franklin Electric	FELE	1.0%	7	EXCELLENT
Archer-Daniels-Midland	ADM	3.0%	7	EXCELLENT
Choice Hotels	CHH	1.3%	7	GOOD
Johnson & Johnson	JNJ	2.5%	7	EXCELLENT
Dover	DOV	2.1%	7	GOOD
Exxon Mobil	XOM	3.8%	7	EXCELLENT
Cisco	CSCO	3.6%	7	EXCELLENT
Avery Dennison	AVY	1.9%	7	GOOD
Gilead Sciences	GILD	2.6%	7	EXCELLENT
Merck	MRK	2.9%	7	GOOD
CECO Environmental	CECE	3.5%	7	EXCELLENT
Canadian National	CNI	1.7%	7	EXCELLENT
Hanesbrands Inc	HBI	2.4%	7	GOOD
Gap	GPS	3.2%	7	GOOD
Dun & Bradstreet	DNB	1.7%	7	GOOD
Applied Materials	AMAT	0.7%	7	GOOD
Oracle	ORCL	1.6%	7	EXCELLENT
Insperity	NSP	1.4%	7	GOOD
Manpower	MAN	1.6%	7	EXCELLENT
Robert Half	RHI	2.0%	7	EXCELLENT

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

The Financially-Healthiest Dividend Payers Yielding Over 2%

By Valuentum Analysts

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

Enter stocks that have the highest multiplicative combination of their dividend yield and Dividend Cushion ratio. We exclude the business models of master limited partnerships and real estate investment trusts in this screen and focus exclusively on corporates. We also make a few other tweaks with respect to business model risk considerations. Income investors have a lot to choose from, and this screen is one of our favorites -- it focuses on identifying the financially-healthiest dividend-payers with yields over 2%. We've overlayed the screen with an Economic Castle assessment to consider business-model risk, too!

Company Name	Symbol	Est Div Yiel	Div Cushion	Economic Castl	Multiplie
Automatic Data Processing	ADP	2.1%	7.6	Very Attractive	15.98
Ford	F	5.1%	3.1	Neutral	15.71
Finish Line	FINL	4.9%	3.2	Unattractive	15.61
GameStop	GME	7.0%	2.2	Very Attractive	15.24
Chico's FAS	CHS	4.0%	3.7	Attractive	14.65
Cooper Tire & Rubber	CTB	1.3%	11.3	Neutral	14.24
General Motors	GM	3.9%	3.4	Attractive	13.18
Gilead Sciences	GILD	2.6%	5.0	Very Attractive	13.02
Abercrombie & Fitch	ANF	5.6%	2.2	Unattractive	12.43
QUALCOMM	QCOM	4.3%	2.7	Very Attractive	11.66
Foot Locker	FL	3.4%	3.4	Attractive	11.44
American Eagle	AEO	3.6%	2.8	Attractive	10.08
Honda	HMC	2.9%	3.4	Neutral	9.77
Cisco	CSCO	3.6%	2.7	Very Attractive	9.61
Guess	GES	5.6%	1.7	Attractive	9.61
Chicago Rivet	CVR	2.5%	3.8	Neutral	9.37
Big 5	BGFV	8.4%	1.1	Neutral	9.30
Scholastic Corp	SCHL	1.5%	5.9	Attractive	8.97
CA Tech	CA	3.2%	2.8	Highest Rated	8.97
Gentex	GNTX	2.3%	3.8	Attractive	8.77
Hewlett-Packard	HPQ	2.7%	3.2	Very Attractive	8.71
Capella Education	CPLA	1.9%	4.5	Highest Rated	8.68
Gap	GPS	3.2%	2.7	Attractive	8.68
Western Union	WU	3.7%	2.3	Neutral	8.43
Williams-Sonoma	WSM	3.4%	2.5	Attractive	8.43
Graham Holdings Co	GHC	0.9%	9.5	Attractive	8.38
AVX Corp	AVX	2.4%	3.5	Attractive	8.26
Apple	AAPL	1.6%	5.2	Highest Rated	8.21
Resources Connection	RECN	3.1%	2.6	Attractive	8.19
Ralph Lauren	RL	2.6%	3.2	Attractive	8.16
Fluor	FLR	2.0%	4.2	Attractive	8.13
Interpublic	IPG	3.6%	2.2	Very Attractive	8.01
Lear Corp	LEA	1.4%	5.5	Attractive	7.76
Paychex	PAYX	3.3%	2.3	Very Attractive	7.60
Best Buy	BBY	2.3%	3.3	Attractive	7.58
Garmin	GRMN	3.7%	2.0	Attractive	7.45
Insperity	NSP	1.4%	5.0	Neutral	7.25
Pfizer	PFE	3.5%	2.1	Attractive	7.24
Meridian	VIVO	3.6%	2.0	Attractive	7.23
CECO Environmental	CECE	3.5%	2.1	Attractive	7.21
Intel	INTC	2.5%	2.9	Attractive	7.08
NTT Docomo	DCM	3.1%	2.3	Attractive	7.01
Amgen	AMGN	2.5%	2.7	Very Attractive	6.82
Xilinx	XLNX	2.2%	3.1	Highest Rated	6.78
Baker Hughes	BHGE	2.0%	3.4	Neutral	6.78
Helmerich & Payne	HP	5.5%	1.2	Neutral	6.71
Cardinal Health	CAH	2.7%	2.5	Very Attractive	6.69
Seagate	STX	7.6%	0.9	Attractive	6.68
Xerox	XRX	3.1%	2.2	Very Attractive	6.67
McKesson	MCK	0.9%	7.6	Very Attractive	6.66

Note: The 'Multiple' in this list considers a company's dividend yield and Dividend Cushion ratio as a multiplicative combination. Though it is a robust and largely objective measure, there could be exogenous or secular dynamics that could impact the business, where a dividend may not be as strong as the financials indicate.

For example, GameStop (GME) is dealing with a secular shift toward digital gaming, while Abercrombie & Fitch (ANF) is navigating changing consumer preferences as millennials seek 'experiences' not 'things' (e.g. fashion). The Dividend Cushion is only one factor that we use in assessing the overall health of a company's dividend.

Yields to Consider Avoiding

By Valuentum Analysts

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

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

Company Name	Symbol	Industry	Est. Div Yield	Div Safety	Div Cushion
Textainer	TGH	Rental and Leasing	0.8%	VERY POOR	-73.2
Ensco	ESV	Energy Svcs - Offshore Drilling	0.8%	VERY POOR	-55.0
Range Resources	RRC	Independent Oil & Gas	0.5%	VERY POOR	-42.9
KB Home	KBH	Homebuilders	0.4%	VERY POOR	-27.1
Lennar	LEN	Homebuilders	0.3%	VERY POOR	-22.5
Frontier Comm	FTR	Telecom Services - diversified	20.2%	VERY POOR	-16.5
Superior	SUP	Auto Parts Suppliers	2.5%	VERY POOR	-12.1
Devon Energy	DVN	Independent Oil & Gas	0.8%	VERY POOR	-9.8
Teva Pharma	TEVA	Pharma - Generic/Other	2.3%	VERY POOR	-8.4
R.R. Donnelley	RRD	Commercial Services	5.7%	VERY POOR	-6.9
Anadarko	APC	Independent Oil & Gas	0.5%	VERY POOR	-6.5
Tailored Brands	TLRD	Retail - Men's, Women's, Kids' Apparel	4.9%	VERY POOR	-5.9
Ryder System	R	Rental and Leasing	2.5%	VERY POOR	-5.8
Deltic Timber	DEL	Building Materials	0.5%	VERY POOR	-5.7
Intl Game Technology	IGT	Leisure	4.0%	VERY POOR	-5.5
Silgan	SLGN	Containers & Packaging	1.2%	VERY POOR	-4.1
Yamana Gold	AUY	Metals & Mining - gold	0.7%	VERY POOR	-3.4
NiSource	NI	Utilities	2.7%	VERY POOR	-3.3
Diebold Nixdorf	DBD	Commercial Services	1.9%	VERY POOR	-2.9
Orchids Paper	TIS	Paper Products	11.6%	VERY POOR	-2.5
Rent-A-Center	RCII	Rental and Leasing	2.3%	VERY POOR	-2.5
Noble Energy	NBL	Independent Oil & Gas	1.6%	VERY POOR	-2.5
Wendy's Co	WEN	Restaurants - Fast Food & Coffee	1.9%	VERY POOR	-2.4
Viacom	VIA	Media - CATV	2.3%	VERY POOR	-2.3
CF Industries	CF	Chemicals - agriculture	3.9%	VERY POOR	-2.2
MDC	MDC	Homebuilders	3.0%	VERY POOR	-2.0
Newell Brands	NWL	Household Durables	2.1%	VERY POOR	-1.9
Centurylink	CTL	Telecom Services - diversified	10.7%	VERY POOR	-1.9
Olin Corp	OLN	Chemicals - mid/small	2.3%	VERY POOR	-1.7
Hess	HES	Refiners	2.5%	VERY POOR	-1.7
DineEquity	DIN	Restaurants - Fast Cas & Full Svc	9.5%	VERY POOR	-1.6
First Energy	FE	Utilities - Large	4.5%	VERY POOR	-1.5
Teekay	TGP	Shipping	3.3%	VERY POOR	-1.5
Service Corp Intl	SCI	Personal Services	1.7%	VERY POOR	-1.4
Molson Coors	TAP	Beverages - alcoholic	1.8%	VERY POOR	-1.3
Regal	RGC	Media - entertainment	5.2%	VERY POOR	-1.3
Plains All American	PAA	Oil & Gas Pipelines	5.6%	POOR	-1.2
Huntsman	HUN	Chemicals - broad	1.9%	VERY POOR	-1.2
Ball Corp	BLL	Containers & Packaging	1.0%	VERY POOR	-1.1
PG&E	PCG	Utilities - Large	4.0%	VERY POOR	-1.1
PPL	PPL	Utilities - Large	4.1%	VERY POOR	-1.0
SCANA	SCG	Utilities	3.8%	VERY POOR	-1.0

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

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

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

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Johnson & Johnson has been a tremendous performer in the Best Ideas Newsletter portfolio since it was added at ~$104 per share in January 2016, and the company is the largest weighting in our Dividend Growth Newsletter portfolio, where it has been a holding since the portfolio's inception. Shares have experienced quite the run of late and are bumping up against the upper bound of our fair value range, but the Valuentum strategy often includes "letting winners run" as long as technical momentum remains supportive of strong fundamentals. Such appears to be the case with Johnson & Johnson, and we continue to like the unique diversity of its business model, which combines its strong pharma portfolio with the steady characteristics of its Consumer segment and the growth potential of its Medical Devices segment.

Disclosures: Independent Healthcare and Biotech Contributor Alexander J. Poulos is long Regeneron Pharmaceuticals and Gilead Sciences.

GE Cuts Guidance, All Eyes Turn to November 13

On October 20, General Electric slashed its guidance for earnings and cash flow from operating activities after reporting another weak quarter. Could the dividend be next on the chopping block? Management will update investors on company strategy and its 2018 framework Monday, November 13, an event to which we'll be paying close attention.

By Kris Rosemann

Our decision to rid the newsletter portfolios of shares of General Electric (GE) in mid-May was driven by expectations for material pressure to build on the industrial giant's free cash flow generation, "Newsletter Alert: Title Withheld – Members Only." Such concerns have all but materialized as management has slashed its adjusted EPS and Industrial CFOA targets for full year 2017 following a disappointing third quarter, results released October 20. It now expects Industrial CFOA (excluding deal taxes and GE Pension Plan funding) to be ~$7 billion in the year, down from previous guidance of $12-$14 billion, and adjusted EPS is now expected to be in a range of $1.05-$1.10 for the year, compared to initial guidance of $1.60-$1.70.

INDUSTRIAL CASH FLOWS FROM OPERATING ACTIVITIES (INDUSTRIAL CFOA) AND INDUSTRIAL CFOA EXCLUDING DEAL TAXES AND GE PENSION PLAN FUNDING

	Three months ended September 30			Nine months ended September 30		
(Dollars in millions)	2017	2016	V%	2017	2016	V%
Cash from GE's operating activities (continuing operations), as reported (GAAP)	$ 465	$ 7,575	(94)%	$ 4,050	$ 18,342	(78)%
Less: dividends from GE Capital	—	5,050		4,016	16,050	
Industrial CFOA (Non-GAAP)	$ 465	$ 2,525	(82)%	$ 34	$ 2,292	(99)%
Less adjustments:						
Deal taxes	61	$ 376		112	1,076	
GE Pension Plan funding	1,214	$ —		1,431	—	
Industrial CFOA excluding deal taxes and GE Pension Plan funding (Non-GAAP)	$ 1,740	$ 2,901	(40)%	$ 1,577	$ 3,368	(53)%

Image Source: GE third quarter report

The table above breaks down GE's cash flow from operations, or lack thereof--Industrial CFOA has been virtually non-existent through the first nine months of the year when excluding contributions from GE Capital and other adjustments from management--but once 2017 expectations for this measure (~$7 billion) are compared to ~$6 billion in planned capital expenditures for the year and $8+ billion in annual run-rate cash dividend obligations, the cash flow shortfall plaguing GE's business becomes clear. This does not even begin to consider the industrial giant's pledge to return an additional $11-$13 billion to its shareholders via share repurchases in 2017. In this context, a dividend cut may be all too likely for the industrial giant, especially after considering the mountain of debt that resides on its balance sheet (net debt was nearly $58 billion at the end of the third quarter of 2017).

Please see *GE Cuts...*on next page

*GE Cuts…*from previous page

The culmination of these developments has caused new CEO John Flannery to embark on additional asset sales, and he plans $20+ billion in business exits over the next one to two years. Such proceeds will likely be necessary in shoring up the balance sheet and providing a potential bridge to more normalized levels of cash flow generation for the company. Flannery has told investors to think of 2018 as a "reset year," but is confident that his team will be able to cut cost significantly moving forward. Investor frustration with the previous management team has only built since former CEO Jeff Immelt stepped down, and the combination of a poor third quarter report with allegations of massive amounts of corporate greed (see allegations of extravagant executive retreats and the unnecessary use of multiple corporate planes) seem to have brought such frustration to a head. The most prudent course of action for Flannery, beyond reigning in unnecessary corporate spending, may be cutting the dividend and putting an end to the firm's massive share buyback program. If such an announcement does not come sooner, we would be less than surprised if management uses its November 13 update to announce a materially altered capital allocation program.

In August, We "Cut" Position in Hasbro in Dividend Growth Newsletter Portfolio

By Brian Nelson, CFA

On August 18, 2017, we released the following email notification alert on Hasbro (HAS) to members, "ALERT: Newsletter Notification and Website Changes:"

> We are removing 75% of our position in Hasbro from the Dividend Growth Newsletter portfolio, or 82 shares at $96.54. Hasbro's cost basis in the newsletter portfolio is ~$32. The company's performance has been absolutely phenomenal.
>
> Stock page: https://www.valuentum.com/search2?q=has&searchtype=symbol&btn=Search

In August, we thought it made sense to take a large portion of one of the largest positions in the Dividend Growth Newsletter portfolio off the table, and it turns out we were right. Shares of Hasbro sold off aggressively during the trading session October 23, despite a solid earnings beat. We continue to like Hasbro, but as always, we pay close attention to valuation--and frankly, shares weren't cheap before the release of the quarterly results, and that's why we took some off the table a few months ago. Readers should not be surprised by the sell-off as valuation matters…eventually. Hasbro's shares are up tremendously during the past several years.

Hasbro is not a "toy company," per se, as much as it is an emerging licensing/brand powerhouse. We think this is partly why shares have done so much better than rival Mattel (MAT) lately, though Disney's (DIS) *Frozen* princesses having taken significant share from Mattel's Barbie has helped, too (share that may not return to Mattel). Hasbro's third-quarter revenue advanced 7% as the company returned $164 million to shareholders during the quarter ($71.4 million in dividends and $92.9 million in share repurchases).

During the period, Hasbro's operating profit was essentially flat at 20.1% of net revenue, but management did allude to the Toys "R" Us bankruptcy filing as impacting quarterly performance. Toys "R" Us has already received debtor-in-possession financing, but we think the view that Hasbro may still be meaningfully tied to its physical-toy-company roots may be what has investors spooked. From Hasbro's third-quarter report:

> **As a result of the Toys"R"Us bankruptcy filing in the U.S. and Canada, there was a negative impact on our quarterly revenues and operating profit.** However, our multi-platform content strategy, combined with an industry leading investment in innovation and an omni-channel commercial approach, is driving strong consumer takeaway heading into the holiday season as consumers engage with Hasbro brands across a multitude of experiences…

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> …The quarter presented several obstacles, but the team delivered with higher revenue and earnings, as well as executing nearly $93 million of share repurchases…We are well positioned for the holiday, including good quality inventory at Hasbro and at retail, backed by strong consumer momentum. **We continue to work closely with Toys"R"Us as we head into the holiday period. Given our new view to the holiday based on Toys"R"Us and the economic outlook in certain markets, our updated expectation is fourth quarter revenues will increase in a range of 4% to 7% versus the fourth quarter 2016.**

The forward guidance for revenue was a little lighter than what the market had been anticipating, but 4%-7% growth isn't bad by any stretch. As we noted, the market may be getting a little nervous about its dependence on Toys "R" Us, even as it transitions its operating earnings away from physical-toy dependence in growing its 'Entertainment and Licensing' business. During the period, for example, the company's higher-margin 'Entertainment and Licensing' segment grew revenue 4% as it leveraged such a gain to a 20% operating-profit increase. The division's operating margin came in at nearly 29% of net revenue in the quarter, up 3.8 percentage points. We still like the Hasbro story, but stocks can't go up forever. We think the "profit-taking" in August was well-timed.

Earnings Roundup: Unilever, Procter & Gamble, Kimberly-Clark

We love the business models of consumer staples, but recent fundamental performance hasn't been great, and valuations are a bit stretched. Unilever is blaming natural disasters in the US for its underlying sales growth shortfalls, Procter & Gamble has to deliver now that it defeated Nelson Peltz, and Kimberly-Clark's meager top-line expansion may not support its valuation. A good business does not always make a good stock.

By Brian Nelson, CFA

Consumer staples stocks (VDC, FSTA, XLP) are fundamentally-sound entities that sell everyday items that consumers need regardless of the ups and downs of the economic cycle. That makes their business models quite resilient through thick and thin, but it also means that many are household companies that everybody knows about, making investment opportunities (stock mis-pricings) in them quite rare. Many, however, boast dividend yields in excess of the 10-year Treasury rate (the foundation to price many debt instruments), meaning that certain members in the group can often provide satisfactory income, especially considering that bank instruments--as in savings, checking, or certificates of deposit--are yielding practically nothing this day and age.

Our biggest concern with consumer staples stocks hasn't been their business models or the name-brand products they sell that boast tremendous pricing power, but rather the valuations of the group. When it comes to stock picking, what you pay for something is often different than what it is worth. Said differently, the price of a stock on the stock exchange is what you pay for it, but the value of the stock is based on the present value of all future free cash flows (including balance-sheet considerations) that it will eventually pay to shareholders. Price and value are seldom the same. At the time of this writing, according to Factset, **the average consumer staples stock is trading at over 19 times its forward 12-month earnings, above its 10-year average of 16.3 times**, meaning the consumer staples sector as a whole is likely as much as 20% overvalued, if not more – and that's if stocks don't overshoot to the downside (in the event of a bear market).

There are three consumer staples equities that reported earnings recently that may help set the fundamental backdrop of the group. You've probably heard of them and use a lot of their products, too: Unilever (UN, UL), Procter & Gamble (PG), and Kimberly-Clark (KMB). Unliver's brands include Dove,

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Hellman's, Knorr, Lipton and many others like Ben & Jerry's and Country Crock. Procter & Gamble's include Charmin, Tide, Crest, Old Spice, and Febreze, among others like Head & Shoulders and Mr. Clean. Kimberly-Clark is probably best known for its Huggies, Kleenex, Cottonelle, Scott, and Kotex brands. These companies are three of the biggest players in the consumer staples sector. Walking through their respective calendar third-quarter results will offer perspective on the operating environment of late.

Unilever Says Turnover (Sales) Impacted by US Storms

M&A talk involving Unilever has been quite abuzz of late. Kraft Heinz (KHC) recently shot down the idea of making a second bid to acquire Unilever in September, according to the New York Post. If Unilever doesn't want to be taken over, Warren Buffett, who owns more than a quarter of Kraft Heinz, will have none of it. He is not one to make hostile overtures. Something tells us that Unilever may be more open to talks once this bull market ends, the timing of which is the only uncertainty from where we stand. Unilever has also been talked about as an acquirer, with Estee Lauder (EL) potentially identified as a good fit and even Colgate-Palmolive being talked about as of interest. Something on the M&A front is going to happen with respect to Unilever in the coming years, in our view, so stay tuned.

The company's 'Trading Statement Third Quarter 2017,' released October 19, showed some trends to keep an eye on. Turnover decreased by 1.6% in the third quarter, as currency headwinds of 5.1 percentage points tore into the top line performance. Management noted that "conditions in…developed markets remain challenging," and while it pointed to "poorer weather in Europe compared with last year and natural disasters in the Americas" as temporary reasons for the weak growth in the period, we'll have to wait and see whether something more concerning is brewing.

In any case, for the full-year, Unilever continues to expect underlying sales growth within the 3-5% range on improving underlying operating margins of 100 basis points (underlying sales growth was 2.6% in the third quarter, below the yearly target). Many have been taken aback by Unilver's recent three-second diversity video ad (#BoycottDove), and while we think the Dove brand will eventually recover, the brand may feel some impact in the last quarter of 2017. Unilever's next quarterly dividend is payable in December 2017 (€0.3585 per Unilver N.V. share and £ 0.3199 per Unilver PLC share; US$ 0.4217). We maintain our view that shares of Unilever are overpriced on the basis of our fair value estimate.

Procter & Gamble Holds the Line

We continue to like the fundamental business model of Dividend Growth Newsletter portfolio idea Procter & Gamble, but as with many of its consumer staples brethren, shares are a bit pricey. Here's what we said about P&G last August, "Procter & Gamble Is No Gamble:"

> In the past, we were worried about Procter and Gamble's business transformation where it shed many well-known brands rather quickly, but we think our worries were overblown--if the company's share-price performance is any indication. The company wrapped up fiscal 2017 results July 27, and frankly, the results were solid. Both the top line and operating income advanced over fiscal 2016 results, and net earnings from continuing operations approached levels that were once were a function of higher revenue performance.
>
> P&G's net income margin, for example, hit 15.7% in fiscal 2017, steadily increasing from 11.7% in fiscal 2015, and up from the 14.3%, 14%, and 12.1% marks set in fiscal 2014, fiscal 2013, and fiscal 2012, respectively. Clearly, we were underestimating P&G's ability to execute its transformation plan, but we sure are happy to have still included the idea in the Dividend Growth Newsletter portfolio. Letting winners run has proven to be a fantastic component of the Valuentum approach during this prolonged, multi-year market upswing.

P&G recently beat activist investor Nelson Peltz bid for a board seat, by what appears to be less than a percentage point, and we now think the P&G executive team has its work cut out for it. Having won over the loyalty of its shareholder base, it now has to deliver in a big way. If it were us, why not give Nelson

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Peltz a board seat? What does P&G have to lose by receiving varying perspective and new ideas to keep the company going in the right direction? Perhaps there is more to hide than there is to gain? We, outsiders, can only wonder. P&G's calendar third-quarter results (its fiscal first quarter) were about in line with what we were anticipating, despite operating in what management described as "a decelerating global market and against a strong base period." The company's outlook for fiscal 2018 was maintained:

> P&G said it is maintaining its guidance for organic sales growth in the range of two to three percent for fiscal 2018. The Company estimates all-in sales growth of about three percent for fiscal 2018, which includes a neutral to half-a-percentage-point benefit to sales growth from the combined impacts of foreign exchange, acquisitions and divestitures.
>
> The Company also maintains its expectation for core earnings per share growth of five to seven percent versus fiscal 2017 Core EPS of $3.92. P&G noted that it is maintaining estimates despite over $100 million of incremental commodity cost headwinds resulting from the hurricanes that impacted the Gulf Coast in September. All-in GAAP earnings per share are expected to decrease 26% to 28% versus fiscal year 2017 GAAP EPS of $5.59, which included a significant benefit from the Beauty Brands transaction that was completed in October 2016. The fiscal 2018 GAAP EPS estimate includes approximately $0.10 per share of non-core restructuring costs.

We continue to include Procter & Gamble as an idea in the Dividend Growth Newsletter portfolio on the basis of its strong brand, healthy free cash flow generation, and solid dividend. However, as with most of its consumer staples peers and many in this frothy US stock market, P&G's shares aren't really a bargain--and there's not much of a catalyst for shares on the horizon (given the Peltz defeat). P&G remains a potential source of cash in the Dividend Growth Newsletter portfolio.

Kimberly-Clark's Valuation Is Stretched

We talked a lot about our concerns about consumer staples stock valuations in our August piece titled "Coca-Cola, Pepsi, Kimberly-Clark: Great Businesses But Lofty Earnings Multiples and Net Debt Positions," and not much has changed given the recent move in the stock market higher since then. The crux of the piece is that the top line of many consumer staples equities just isn't growing fast enough to justify the earnings multiples they are being given, particularly as much of their bottom-line enhancement is being driven by lower-quality and largely unsustainable cost cuts (a company can't cut costs forever). We saw the paltry top line performance in Kimberly-Clark's third quarter report, released October 23, with sales basically rising "slightly," which we estimate at less than 1%.

As with Unilever and Procter & Gamble, Kimberly-Clark also said that it is operating in a "challenging environment." Given the many years of the current economic expansion and where consumer wealth levels are as a result of the stock market rise, the times today may be the best these consumer staples entities may see for some time. We're just having a hard time believing that the current market environment is "challenging" or "difficult." Nelson Peltz and his bid for a board seat at Procter & Gamble likely reveals the disgust many investors are feeling, if they aren't talking about it. Kimberly-Clark's outlook is essentially in-line with what we're modeling:

> The company continues to expect that full-year 2017 net sales and organic sales will be similar, or up slightly, year-on-year. The company also continues to anticipate that full-year 2017 earnings per share will be at the low end of its target range of $6.20 to $6.35.

With Kimberly-Clark's shares trading at 18 times current year earnings at the low end of the guided range, it's hard to say the company's equity is a bargain. We have no qualms with the health of the dividends of Unilever, Procter & Gamble, and Kimberly-Clark, but the valuations of all three remain stretched, in our view. Investor caution is always warranted, stocks don't always go up forever, and valuation matters. The bull market is hiding a lot of weak fundamentals, in our view, and it may not be long before investors start paying more attention to the price-to-fair value equation, especially if interest rates hit the all-important inflection point, which we estimate near 4% on the 10-year. It may be some time yet, however.

Novartis Gearing Up for Growth

Dividend Growth Newsletter portfolio idea Novartis continues to grow its free cash flow stream while producing a string of products still in the infancy of their respective growth curves. The pharma/biotech realm remains bedeviled with patent issues that can disrupt cash flow generation once protection is lost, causing us to look for companies positioned for a fresh leg of growth. To that end, let's take a look at Novartis' pipeline, near-term potential, and how it relates to its dividend health.

By Alexander J. Poulos

Alcon Division

In Novartis' (NVS) third quarter of 2017, results released October 24, its Alcon division posted an impressive constant-currency revenue jump of 7% from the year-ago period and a 23% year-over-year increase in core operating income, reversing the lackluster trend in which the division has been stuck over the past few quarters. The Alcon division has significantly underperformed expectations since becoming part of Novartis, and the underperformance has led to calls for a cleaving off of the group as expected synergies have failed to materialize.

Alcon's underachievement thus far should serve as a cautionary tale of the risks associated with the growth-by-acquisition model. Investors should be cognizant of the achievability of synergy targets management teams sometimes use to rationalize debt-fueled acquisitions, which can be a major source of shareholder capital erosion. Not only can these deals represent poor investments on an individual basis on the part of the company, but they can also bloat a firm's balance sheet, reducing management's ability to navigate potentially changing market conditions.

Update on Alcon strategic review

Alcon is a strong business with the potential to grow sales at or above market, while delivering profitability at least in line with the industry

Near term will benefit by focusing on turnaround, leveraging infrastructure and financial strength of Novartis

Creating a standalone company via capital markets exit could create additional shareholder value; however, no decision made today. Significant progress made **preparing for a potential capital markets transaction**

Key criteria for final decision and timing dependent on continued Alcon sales growth and margin improvement; **potential action not likely before H1 2019**

Image Source: Novartis Earnings Presentation

Novartis has floated the idea of spinning off the Alcon division to shareholders as a way of unlocking what it believes to be hidden value in the assets, a view we share as the eye-care marketplace does not mesh well with the heavy emphasis on immunology and oncology that Novartis' business contains. From a sales force perspective, there is minimal potential overlap thus requiring Novartis to maintain a separate sales force, reducing the productivity of the reps, and increasing operating costs.

Though Novartis emphasized that a final decision has not been reached regarding the ultimate fate of Alcon, it has laid out a credible path towards a split-off of the Alcon division with the first half of 2019 being the earliest time frame such a transaction may take place. We support the potential move as the Alcon division does not hold the strategic purpose it once did. The continued growth of Regeneron's

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(REGN) retina disease treatment Eylea coupled with a generic launch of Roche Holding's (RHHBY) Avastin has taken the wind out of Lucentis' sails, thus leaving Novartis with fewer reasons for holding on to the ophthalmology division.

New Product Growth

The continued growth of Cosentyx has been nothing short of impressive--the molecule has now morphed into one of Novartis' top-selling products with sales of $1.5 billion through the first three quarters in 2017. Cosentyx is firmly entrenched in its growth trajectory, and we fully expect the treatment to remain one of the top-selling products in Novartis' product line-up for many years to come.

On the conference call, management indicated Cosentyx's share of the rheumatology market has now surpassed the long-established behemoths in Humira and Enbrel while gaining share in the psoriasis market as well. Such an outcome should not come as a surprise as Cosentyx has a cleaner side effect profile coupled with superior clinical and real-world data. The IL-17 class, which is headlined by Cosentyx, is able to clear the skin of psoriasis sufferers more effectively than Humira, suggesting additional share will be ceded by Humira to the more efficacious treatments. The growth of Cosentyx has been directly related to the stunning sell-off in the shares of Celgene (CELG), where sales of Otezla have failed to live up to expectations.

However, the excellent results posted by Cosentyx have not been matched by Entresto, which has gotten off to a sluggish start. The product came with high initial expectations, but a Cosentyx-like sales ramp continues to evade Entresto as prescribers continue to prefer a litany of generic remedies. Sales of Entresto have increased to $322 million through the first three quarters of 2017, up from $102 million through three quarters of 2016, and we are cautiously optimistic the product will evolve into a blockbuster product (sales north of $1 billion per year). However, patient resistance to paying a premium co-payment may continue to limit sales growth.

Novartis recently launched two new innovative oncology treatments that complement already existing product lines to help form the backbone of Novartis' key franchise. The first product is Kisqali, a novel therapy for a specific form of metastatic breast cancer. The drug is still in the very early stages of its potential growth trajectory, but it enters into a crowded field that includes Pfizer's (PFE) Ibrance as the established entity along with Eli Lilly's (LLY) recently approved Verzenio.

Not to be outdone, Novartis remains on the forefront of the CAR-T field with its recently approved Kymriah for the treatment of patients up to 25 years of age with B-cell precursor acute lymphoblastic leukemia (ALL) that is refractory or that have failed previous therapy. The CAR-T field remains in its infancy, but the results posted are nothing short of stunning, as evidenced by Kite Pharma's stellar clinical data in the area, which led to its acquisition at a material premium by Gilead Sciences (GILD). Kymriah is first to market, but the approval for ALL is a small overall market. Gilead Sciences has a significant first-mover advantage here with a much broader label, an advantage that justifies the price tag for Kite Pharma.

Novartis' strength in oncology is due in part to its "multiple shots on goal" approach via strategic partnerships with innovative biotechs such as Incyte (INCY) for the marketing rights to Jakafi outside the US and the oncology assets acquired in an asset swap with Glaxo SmithKline (GSK). The oncology franchise as a whole is weathering the patent loss of its key product Gleevec very well, and the patent cliff is nearing completion with growth expected to resume in 2018 thanks to the performance of Novartis' innovative pipeline of newly released products in conjuncture with the maturation of assets such as Cosentyx.

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Outlook

We remain impressed with the pace of innovation that continues to spring forth from Novartis as the promise of its clinical pipeline becomes reality. The returns on capital generated from the latest batch of innovation should allow for a series of annual dividend hikes as Novartis' free cash flow continues to expand. We will continue to monitor the progress made towards a potential spin off of the Alcon division, and the concept of a pure-play ophthalmology firm is an intriguing one as the renewed focus the business would receive after being set free from the parent could prove to be exactly what it needs.

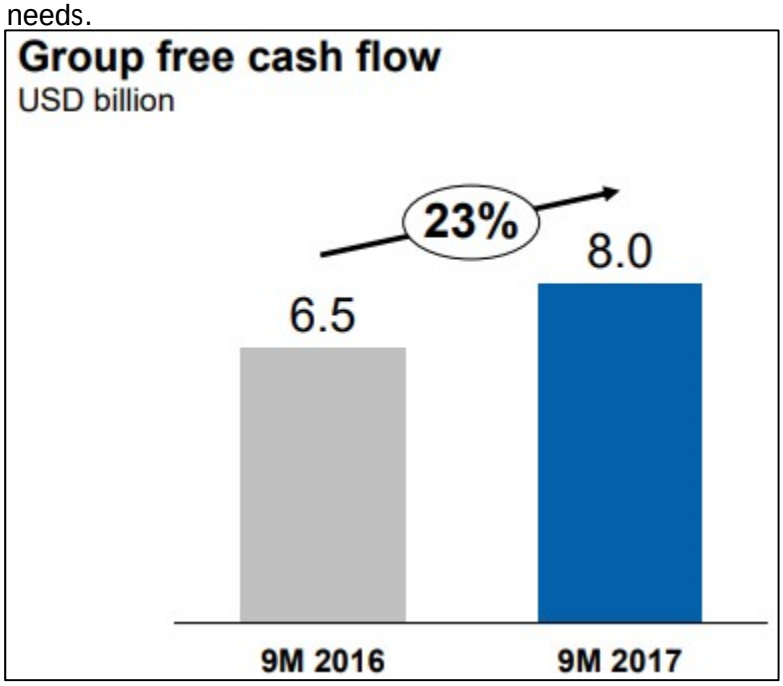

Image Source: Novartis Earnings Presentation

All things considered, Novartis will remain an idea in the Dividend Growth Newsletter portfolio as we feel the dividend is solid. Through the first three quarters of 2017, free cash flow came in at nearly $8 billion, up from ~$6.5 billion in the comparable period of 2016, while cash dividend obligations came in just under $6.5 billion for the nine-month period. It registers a Dividend Cushion of 1.7 at last check to go along with a yield of nearly 3.4% as of this writing.

Disclosure: Independent Healthcare and Biotech contributor Alexander J. Poulos is long Gilead Sciences and Celgene.

How Well Do Enterprise-Cash-Flow-Derived Fair Value Estimates Predict Future Stock Prices?

Valuentum released a study on its Enterprise-Cash-Flow-Derived Fair Value Estimates! To download the paper in PDF form:

https://www.valuentum.com/downloads/20171031/download

How Well Do Enterprise-Cash-Flow-Derived Fair Value Estimates Predict Future Stock Prices?

And Thoughts on Behavioral Valuation

Brian Nelson, CFA
Kris Rosemann
Tatiana Dmietrieva

First Version: October 2017

Abstract

This paper attempts to solidify the efficacy of the predictive power of fair value estimates for stocks, as derived by the discounted enterprise cash flow (free cash flow to the firm) process. The piece emphasizes the difference between share prices and estimated fair (intrinsic) values and offers an overview of the discounted enterprise cash flow model, what causes fair value estimates to change, and what drivers may be most important within the context of the discounted enterprise cash flow model. The work examines the importance of both art and science in discounted enterprise cash flow valuation, and introduces the topic of behavioral valuation. An explanation of the methods used in the study include the creation of price-to-fair value comparisons and subsequent share-price performance of companies relative to their respective price-to-fair value ratios. The study in this work measures the predictive power of fair value estimates through eight subsequent time periods, or approximately 3 years. The subsets of data are broken into "undervalued" and "overvalued" stock groupings, and the predictive power of fair value estimates is then evaluated for each category.

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Brian Nelson, MBA Booth School of Business, University of Chicago, formerly Director of Training and Methodology Development at Morningstar, is President of Equity Research and ETF Analysis at Valuentum, an independent investment research publisher serving individual investors, financial advisors, and institutional money-managers. Special thanks to Tatiana Dmitrieva, Data Scientist at Valuentum, and Kris Rosemann, Head of Data and Associate Investment Analyst at Valuentum for their work and diligence on this project. The views expressed herein are those of the authors and may not reflect the views of any company or organization mentioned.

Microsoft (MSFT) – Page 1 of 2

By Valuentum Analysts

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

Valuentum's Stock Dividend Research | Visit us at www.valuentum.com | Ratings as of 28-Oct-2017 | Data as of 27-Oct-2017

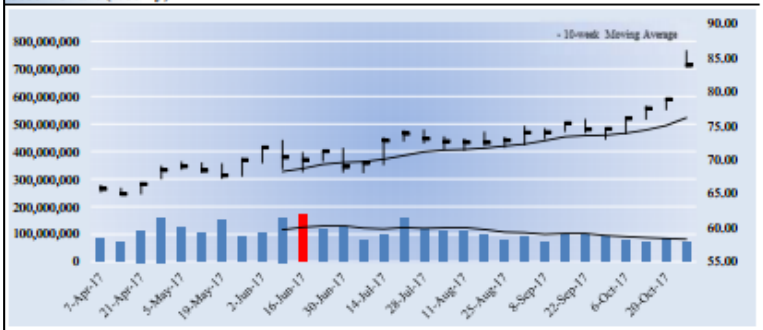
Microsoft MSFT FAIRLY VALUED

Buying Index™ 6 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Very Attractive	$61.00 - $91.00	HEALTHY	GOOD / 2.7	EXCELLENT	2.00%

Microsoft remains a strong dividend growth idea, and its balance sheet remains an area of strength even after the pricey LinkedIn acquisition.

Stock Chart (weekly)



Key Dividend Considerations

Current Annual Dividend Yield	2.00%
Annual Dividends per Share	$1.68
Initial Annual Div's Paid, $10k Investment	$200.45
Dividend Track Record	HEALTHY
Dividend Safety	GOOD
Valuentum Dividend Cushion™	2.7
Dividend Growth Potential	EXCELLENT
Risk of Capital Loss	MEDIUM
ValueRisk™ (Equity Margin of Safety)	LOW

The Valuentum Dividend Cushion is a ratio that compares the firm's excess cash and cash flow to its future dividend stream. A score above 1 indicates cash flow is sufficient to cover future dividends (higher is better).

Company Vitals

Market Cap (USD)	$671,570
Avg Weekly Vol (30 wks)	105,594
30-week Range (USD)	64.85 - 86.19
Valuentum Sector	Information Technology
Last Fiscal Year Revenue	85,320
Last Fiscal Year EPS	2.10
Last Fiscal Year EBITDA	27,914
Forward Revenue Growth (5-yr)	6.6%
Forward EPS Growth (5-yr)	16.3%

Dividend Vitals

Current Annual Dividend Yield %	2.0%
Annual Dividends Per Share	1.68
Forward Dividend Payout Ratio	62.1%
3-yr Historical Dividend CAGR	16.2%
15-yr Historical Dividend CAGR	NA
3-yr Hist Median Div Payout Ratio	66.2%
15-yr Hist Median Div Payout Ratio	30.9%

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

Initial Annual Income Per Investment ($)

# of Shares	Investment ($)	Annual Div's ($)
25	2,095.25	42.00
50	4,190.50	84.00
100	8,381.00	168.00
200	16,762.00	336.00
300	25,143.00	504.00
400	33,524.00	672.00
500	41,905.00	840.00
1,000	83,810.00	1,680.00
2,000	167,620.00	3,360.00
5,000	419,050.00	8,400.00
10,000	838,100.00	16,800.00
50,000	4,190,500.00	84,000.00
100,000	8,381,000.00	168,000.00

Initial annual income is based on the firm's current forward annual dividend yield and could be subject to change.

Dividend Safety / Cushion — GOOD / 2.7

We assess the safety of a firm's dividend by adding the company's net cash to our forecast of its free cash flows over the next five years. We then divide that sum by the total expected dividends over the next five years. This process results in our Dividend Cushion™ ratio. A Dividend Cushion™ above 1 indicates a firm can cover its future dividends with net cash on hand and future free cash flow, while a score below 1 signals trouble may be on the horizon. And by extension, the greater the score, the safer the dividend, as excess cash can be used to offset any unexpected earnings shortfall. Microsoft scores a 2.7 on our Dividend Cushion™, which is GOOD.

Dividend Growth Potential — EXCELLENT

We judge the future potential growth of the dividend by evaluating the capacity for future increases, as measured by the Dividend Cushion™, and management's willingness to consistently raise the dividend, as measured by the firm's dividend track record. Microsoft registers an EXCELLENT rating on our scale, and we think the firm's annual dividend will be $2.64 per share within the next several years.

Risk of Capital Loss — MEDIUM

We assess the risk of capital loss based on our analysis of a firm's intrinsic value at this point in time. If the stock is undervalued (based on our DCF process), we think the risk of failing to recoup one's original capital investment (ex dividends) is relatively LOW. If the stock is fairly valued (it falls within our fair value estimate range), we think the likelihood of losing capital (ex dividends) is MEDIUM. If the stock is trading above our estimate of its intrinsic value, we think the likelihood of losing at least a portion of one's original investment (ex dividends) is HIGH. Microsoft registers a score of MEDIUM on our scale.

Dividend Strength

Dividend Safety \ Dividend Growth	Very Poor	Poor	Good	Excellent
Excellent				
Good				
Poor				
Very Poor				

Firms that have safe and growing dividends score at the top right of our scale.

Dividend Track Record — HEALTHY

Fiscal Year	Div's/Share ($)	Div Growth %	EPS ($)	Payout Ratio
Jun-02	0.00	0.0	0.71	0.0%
Jun-03	0.08	0.0	0.92	8.7%
Jun-04	0.16	100.0	0.75	21.3%
Jun-05	3.40	2025.0	1.12	303.6%
Jun-06	3.32	-2.4	1.20	276.7%
Jun-07	0.39	-88.3	1.42	27.5%
Jun-08	0.43	10.3	1.87	23.0%
Jun-09	0.50	16.3	1.62	30.9%
Jun-10	0.52	4.0	2.10	24.8%
Jun-11	0.61	17.3	2.69	22.7%
Jun-12	0.76	24.6	2.00	38.0%
Jun-13	0.89	17.1	2.58	34.5%
Jun-14	1.07	20.2	2.63	40.7%
Jun-15	1.21	13.1	1.48	81.8%
Jun-16	1.39	14.9	2.10	66.2%
Jun-17	*1.68*	*20.9*	*2.71*	*62.1%*
Jun-18	*1.88*	*12.0*	*3.22*	*58.4%*
Jun-19	*2.11*	*12.0*	*3.64*	*57.8%*
Jun-20	*2.36*	*12.0*	*4.06*	*58.1%*
Jun-21	*2.64*	*12.0*	*4.47*	*59.2%*

Light green shading denotes a dividend increase, while light red shading denotes a dividend decrease. Heavy green shading denotes a significant dividend increase, while heavy red shading denotes a significant dividend decrease or an excessive payout ratio. NA = Not Applicable.

To view our full 16-page equity report on Microsoft, please visit our website at www.valuentum.com

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VALUENTUM

About the Valuentum Dividend Cushion™

By Valuentum Analysts

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

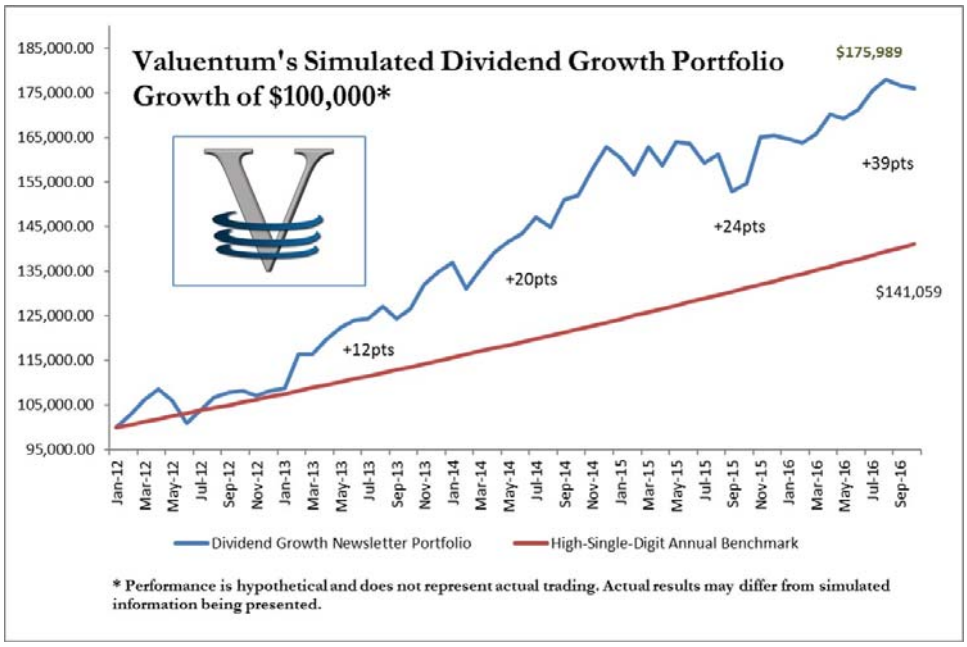
Such analysis is difficult to ignore, and we believe investors may be well-rewarded in future periods by finding the best dividend-growth stocks out there. As such, we've developed a rigorous dividend investment methodology that uncovers firms that not only have the strongest dividends but also ones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

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

The Importance of Forward-Looking Dividend Analysis

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

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



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

*About Our Valuentum Dividend Cushion…*from previous page

The Dividend Cushion Ratio Helps Income Investors

$$\frac{\sum_{t=1}^{5}[A(t) - B(t)] + C(0) - D(0)}{\sum_{t=1}^{5} E(t)}$$

A = cash flow from operations (from the operating section of the cash flow statement),
B = capital expenditures or additions to property plant and equipment (from the investing section of the cash flow statement),
C = cash and cash equivalents (from the balance sheet),
D = long-term debt (from the balance sheet), and
E = cash dividends paid (from the financing section of the cash flow statement).

"All else equal, a firm with billions of net cash on the balance sheet is better positioned to keep paying a dividend than a firm with billions of net debt on the balance sheet. More cash on the books relative to debt reveals significantly more financial flexibility. The dividend payout ratio ignores this important concept, while the Dividend Cushion ratio embraces it." – Valuentum's Brian Nelson, CFA

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

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

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

See more at the following link: http://www.valuentum.com/articles/20130528

The Valuentum Dividend Cushion Caught These Dividend Cuts in Advance

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

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

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

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

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

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

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

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

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

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

Understanding Dividend Growth

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

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

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

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

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

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

Valuentum Dividend Growth Newsletter: Volume 6, Issue 11

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

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

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

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

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

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

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

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

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

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