OUR BEST IDEAS NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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The Best Ideas Portfolio (see page 8): AAPL, MO, BRK-B, BKNG, CSCO, DG, FB, GM, GILD, GOOG, XLV, INTC, JNJ, PYPL, SDY, UNP, XLE,VRNT, V

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Goal of the Best Ideas Newsletter

The goal of the Best Ideas Newsletter is to highlight ideas with strong capital appreciation potential and to update readers about new developments in the market. A simulated portfolio of capital appreciation ideas is presented on page 8 of each edition.

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"Regardless, we expect the typical MLP structure to come under increasing levels of scrutiny, particularly as ongoing income disappointments for retail investors continue to pile up."

- Brian Nelson, CFA

Nearly 60 Distribution Cuts Later, We Maintain Our View on the Hazards of the MLP Business Model

By Kris Rosemann and Brian Nelson, CFA

Valuentum has been highlighting the inherent risks associated with the master limited partnership (MLP) structure for some time now, but we are not alone in acknowledging the limited sustainability of such structures. Internal simplification transactions may only become more common moving forward as management teams seek to optimize the structure of their entities. Readers should continue to cast a skeptical eye on this business model.

Quite possibly, Valuentum made the "call of the century" when it outlined its warning on MLPs in June 2015, embedded in its Kinder Morgan (KMI) "call," and more explicitly in September 2015, "Why the MLP Business Model May Be a Goner." There was a rebuttal to our take "MLPs for the Long Run" -- both in Barron's -- that tried to poke holes in our independent, authentic thesis. At the time, we were very surprised, but we appreciate varying opinions on the matter, as that's what makes a market. When debate and discussion happen, investors win!

Let's fast-forward to today. The firm that had issued a rebuttal to our opinion in 2015 noted that, "in fact, more MLPs cut distributions (21) in 2015 than in any other year in the sector's history (March 2016)." Further that same firm noted in a subsequent October 2017 piece that "companies in the Alerian MLP Index have reduced distributions 56 times, including 45 explicit cuts and 11 stealth cuts over the last 3 years." The very crux of our thesis in mid-2015 had been that MLPs were being "incorrectly" valued on the basis of a distribution yield. Here's what the firm that had rebutted our thesis in 2015 is now saying, from that same 2017 piece:

> Investors in the U.S. midstream energy sector should be aware of the number and level of dividend cuts announced by MLPs and understand that distribution yield may not be as effective a valuation metric as it once was (sources of quotes: CBRE Clarion Securities).

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Certainly, it has been a wild ride for investors in MLPs during the past few years, and we think our "warning" on the space in mid-2015 saved throngs of investors from multiple income disappointments. There have been dozens of instances of companies "cutting" their distributions in the Alerian MLP index since our call in mid-2015, and I don't think we could have done a better job getting out there, helping investors get ahead of what we thought was to come. Our assessment that MLPs were being "valued" incorrectly on a structural basis, a collapsing crude oil price environment at the time, and tightening credit market conditions with deteriorating credit quality in the customer base were but three of many colliding criteria that led to our major concerns.

Today, we maintain our view that the sustainability of the MLP structure (AMLP) may be in jeopardy over the long haul, as in our view, the primary reason why we think the MLP model had existed in the first place--to capture a "yield valuation" mispricing in the market to raise funds--has effectively gone away. It had been our contention that prior to the collapse of the MLP space in mid-2015, MLPs acted as a vehicle to take advantage of favorable capital-funding conditions, where MLPs would sport prices and issue equity on the basis of market "yield valuation" approaches. The issuer could float (create) an MLP and the market would end up pricing MLP units on the basis of their "yield," instead of on organically generated free cash flows, which include growth capital spending. Since most MLP distributions approximate an MLP's measure of distributable cash flow, the energy complex effectively had been using the MLP business model to raise external capital within the corporate umbrella at a lofty price on the basis of the market's "yield valuation," instead of on the basis of internally-generated free cash flow.

A systematic mispricing had occurred in an environment of ultra-low interest rates during 2015, and when the energy complex faced a massive threat given the collapse in crude oil prices, many owners of midstream MLPs realized that midstream equities were not immune to the troubles of their customers, as even fixed and seemingly iron-clad contracts could be broken during the chapter 11 process. Even some of the stronger oil and gas producers, for example, were facing tough times, and even while many midstream MLPs had a small percentage of direct exposure to energy prices, through their customers, the exposure was quite large. Unless the market goes back to valuing MLPs on the basis of "yield," we doubt the MLP business model will catch much favor again, and we continue to expect it will not last over the long haul.

For starters, many MLPs do not generate sufficiently positive free cash flow, as measured by cash flow from operations less all capital expenditures (both maintenance and growth) in any given year, but most continue to pay lofty and growing distributions to unitholders, with "safety" represented by the industry-specific coverage measures using distributable cash flow, which ignores the growth capital spending that helps to drive net income, the core component of distributable cash flow. When it comes to the concept of distributable cash flow, there remains an imbalance, see on our website: "MLP Speak: A Critique of Distributable Cash Flow." We think the market may have wised up on how to "value" MLPs, and we continue to see instances where MLPs are being consolidated or folded up.

In July 2016, for example, Plains All American (PAA) represented one of many instances, as the limited partner issued new common units in exchange for the incentive distribution rights of its general partner, "Plains All American to Undergo Simplification Transaction." The simplification also resulted in a reset of the distribution, which was necessary for the limited partner to arrive at more optimal levels for its cost of capital and distribution coverage moving forward.

The Energy Transfer family (ETE/ETP) announced a simplification transaction in late 2016, too, that resulted in an implicit distribution cut and consolidation of its ownership structure, but its IDRs were maintained. At the time we said, "We view this simplification transaction as a short term alleviation of what will eventually turn out to be long-term pressures." Energy Transfer management appears to

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agree with our opinion that additional measures will need to be taken to secure the long-term health of its businesses as it has noted multiple times in recent presentations to investors that it "Will evaluate optimal structure for the family, but do not expect any internal restructuring transaction to occur before late 2019."

In early 2017, Williams Cos (WMB) underwent a simplification that resulted in the general partner (Williams Cos) waiving its IDRs in limited partner Williams Partners (WPZ) and exchanging its general partner economic interest for new issued common units of the limited partner as it sought to lower it cost of equity capital, "MLPs: Williams' Double Equity Raise." However, the issuance of new equity from Williams Partners resulted in the need for a reduction in its quarterly distribution. Even with the elimination of IDRs, many MLPs find it necessary to reset their distributions to achieve the stated goals of the simplifications.

More recently, shareholders in beleaguered master limited partnership StoneMor (STON) have begun to push for the entity to reconsider its structure as an MLP and convert into a C Corp. The movement officially began with Axar Capital Management, which owns a 17.5% stake in StoneMor. According to a recent SEC filing dated March 9, (The Reporting Persons refers to Axar) "The Reporting Persons believe that the recent reductions of corporate tax rates effective for 2018 make the conversion of the Issuer into a C corporation more attractive than under prior tax rates. The Reporting Persons also believe that a conversion of the Issuer into a Subchapter C corporation, together with addressing the Issuer's incentive distribution rights, would result in a more liquid market for the Issuer's equity securities, improving the Issuer's opportunities for capital raising, senior management recruitment and other strategic transactions."

While this may only be the latest example of the MLP business model fading away, it is yet another data point on the continuance of the "investor-led" push against the hazards of the MLP business model, further explained in July 2016, "Distributing Truth on MLPs." Regardless, we expect the typical MLP structure to come under increasing levels of scrutiny, particularly as ongoing income disappointments for retail investors continue to pile up. We maintain our view that the long-term sustainability of many distribution growth trajectories within the space should be met with increasing levels of skepticism, and we are reiterating our opinion that the MLP business model may not survive over the long haul as "yield-valuation" pricing effectively goes away.

Our Ideas Are Performing Awesome So Far in 2018!!! 6 of the Top 7 of the Dow!

By Brian Nelson, CFA

Every day we think about how we can make things easier for our members.

Instead of having to visit multiple links on our website with screens, you now have access to one downloadable Excel file where you can sort and rank how you wish. Of course, you can always find those screens in the newsletters, each and every month, too, but we think a weekly data download is a huge value add to our offering. Can you imagine getting updated data every week for 52 weeks of the year for what we charge, let alone two newsletters, hundreds of reports, commentary, and education material? Wow, right? People keep saying we do too much, but when our members' money is on the line, we don't think that is possible.

We think we also made a huge step forward when it comes to showcasing just how proficient our stock selection can be. Every person has different goals and different risk tolerances, so where before in the simulated newsletter portfolios, we would outline the specific percentage weighting, we think providing ranges make much more sense. For example, depending on someone's risk tolerances, a larger cash position in an overheated market may be prudent. On the other hand, the longer one's time horizon,

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perhaps a smaller cash position may make more sense. This isn't for us to decide, and frankly, we want to be relevant for as many as we can in the investment community because we think we have something for everyone! The simulated newsletter portfolios are found in each newsletter.

But how have some of the ideas in the simulated newsletter portfolios performed? After all, who cares how much work we do or how much we write, if our process isn't bearing fruit, right? We've done multiple tests on our methodologies in the past, and we've been mighty pleased with their findings, but let's keep things very simple to provide perspective of just how much value we are adding. Year-to-date, in the simulated Best Ideas Newsletter portfolio and simulated Dividend Growth Newsletter portfolio, we've "picked" 6 out of the top 7 performers in the Dow Jones Industrial Average so far in 2018! We've had some missteps with a couple, but we also removed the worst performer in the Dow Jones Industrial so far in 2018 last year! To an experienced investment professional, the sorting should be viewed as amazing, particularly when you look at our track record.

We just keep delivering.

Of course I don't want to toot our own horn, but were you aware of how good our ideas have been so far this year? Admittedly, it's not always easy to see just how solid our stock-selection process is, so we have to publish pieces like this. Sure, we're not going to get everything right, but my goodness, I really don't think others can do better. If you're using a stock-selection analytical service at all, and Valuentum is not on your list, add us, even if we're your third or fourth opinion. Simply put, we have something special going on here, and we want you to notice it!

I hope you understand we can't always be quiet because others are out there screaming for your attention. Seriously, if these "picks" were all we did in 2018...that would be amazing. But you know we do much, much more.

Company (symbol)	Included in Portfolio?	Price (12/29/17 close)	Price (3/12/18 close)	YTD Return
Cisco Systems (CSCO)	**Yes, BIN and DGN**	**$38.02**	**$45.55**	**19.81%**
Boeing (BA)	**Yes, DGN**	**$293.46**	**$344.19**	**17.29%**
Microsoft Corp (MSFT)	**Yes, DGN**	**$85.14**	**$96.77**	**13.66%**
Intel Corp (INTC)	**Yes, BIN and DGN**	**$45.85**	**$51.52**	**12.37%**
JPMorgan Chase (JPM)		$106.39	$117.66	10.60%
Visa (V)	**Yes, BIN**	**$113.82**	**$124.24**	**9.15%**
Apple (AAPL)	**Yes, BIN and DGN**	**$168.54**	**$181.72**	**7.82%**
Goldman Sachs (GS)		$254.05	$273.38	7.61%
Nike (NKE)		$62.36	$66.82	7.15%
International Business Machines (IBM)		$151.92	$160.26	5.49%
The Travelers Companies (TRV)		$134.94	$141.49	4.85%
United Technologies (UTX)		$126.87	$131.50	3.65%
3M Company (MMM)		$233.99	$239.80	2.48%
Pfizer (PFE)		$35.89	$36.61	2.01%
UnitedHealth Group (UNH)		$219.73	$222.77	1.38%
DowDuPont (DWDP)		$70.85	$71.34	0.69%
American Express Company (AXP)		$98.96	$97.67	-1.30%
Caterpillar (CAT)		$156.85	$154.50	-1.50%
Merck & Co (MRK)		$56.27	$55.36	-1.62%
Walt Disney (DIS)		$107.51	$105.17	-2.18%
Coca-Cola (KO)		$45.88	$44.53	-2.94%
Johnson & Johnson (JNJ)	**Yes, DGN**	**$138.83**	**$132.63**	**-4.47%**
Home Depot (HD)		$188.46	$179.71	-4.64%
Chevron (CVX)		$123.96	$116.79	-5.78%
Verizon Communications (VZ)		$52.33	$48.80	-6.75%
McDonald's (MCD)		$171.04	$157.74	-7.78%
Exxon Mobil (XOM)		$82.79	$75.24	-9.12%
Walmart (WMT)		$98.16	$88.07	-10.28%
Procter & Gamble (PG)	**Yes, DGN**	**$91.18**	**$79.86**	**-12.42%**
General Electric (GE)	**Removed last year!**	**$17.31**	**$15.10**	**-12.77%**

*Adjusted close used when applicable. Source: YahooFinance.

Dollar General: A Model of Consistency

By Kris Rosemann

Dollar General's (DG) fiscal 2017 fourth quarter report, released before the open March 15, was full of reasons for investors to get excited, and its share price reacted accordingly. The company has been a model of consistency for nearly three decades, and it continues to have a significant runway for growth while simultaneously generating an attractive and growing free cash flow stream.

Same-store sales grew 3.3% in the quarter on a year-over-year basis, capping off the company's 28th consecutive year of positive same-store sales growth, as a slight decline in traffic was more than offset by an advance in average transaction amount. Full-year same-store sales growth was 2.7%, and the discount retailer also opened a company record 1,315 new stores in fiscal year 2017 in accordance with its robust store count growth plans.

Dollar General's gross margin advanced nicely in the fourth quarter of fiscal 2017, climbing to 32.1% from 31.6% in the year-ago period as negative mix shift was more than offset by higher initial inventory markups, improved inventory management, and lower markdowns. SG&A expenses rose nearly 160 basis points in the quarter from the comparable period of fiscal 2016 as a result of higher occupancy and labor costs. Diluted earnings per share, excluding the re-measurement of deferred tax assets and liabilities, came in at $1.48 in the fiscal fourth quarter, down slightly from diluted earnings per share of $1.49 in the year-ago period, and the full year measure of $4.49 was slightly ahead of fiscal 2016's $4.43.

Despite the relative flat bottom-line performance, Dollar General's cash flow from operations advanced more than 12% in fiscal 2017 over fiscal 2016 levels, and free cash flow increased 10.6% to nearly $1.2 billion despite more than 15% growth in capital spending related to its store count growth. Such strong free cash flow generation has allowed the firm to reduce its net debt position to ~$2.7 billion at the end of fiscal 2017 from ~$3 billion a year earlier while continuing its robust growth plan and returning $863 million in capital to shareholders via dividends and buybacks. Annual cash dividend obligations ran at ~$283 million in fiscal 2017, and management announced a 12% increase in its quarterly dividend to $0.29 per share.

Looking ahead to fiscal 2018, Dollar General expects net sales growth of ~9% and same-store sales growth to be in the mid-2% range. Its operating margin is projected to be roughly unchanged from fiscal 2017 at 8.55%, but diluted earnings per share are expected to leap to a range of $5.95-$6.15. Management expects to grow its capital spending in fiscal 2018 to a range of $725-$800 million from $646 in fiscal 2017 as it plans to open ~900 new stores, remodel 1,000 stores, and relocate 100 stores.

All things considered, we continue to love Dollar General's recession resistant business. Its consistency is simply incredible, and its ability to continue throwing off excess cash while executing its robust growth plan is similarly impressive. Such cash flow generation puts our minds at ease when it comes to its debt load (net debt-to-EBITDA remains reasonable at ~1.1x), and management clearly has confidence in its future trajectory of free cash flows as it hike the quarterly dividend and authorized an additional $1 billion for its share repurchase program. **Shares have had a tremendous trip since we first highlighted the idea in the simulated Best Ideas Newsletter in April 2017 at $68.83 to current levels in the mid-90s, and we hope our members have enjoyed watching the run of this well-timed idea as we have.**

Facebook – Still One of Our Favorites

Let's not beat around the bush with this article. Let's talk about why we like Facebook in layman's terms. The company is a veritable free-cash-flow generating powerhouse, and its balance sheet is pristine. We value shares at $238 each, and its rating of 7 on the Valuentum Buying Index isn't bad considering the frothiness of the market.

By Brian Nelson, CFA

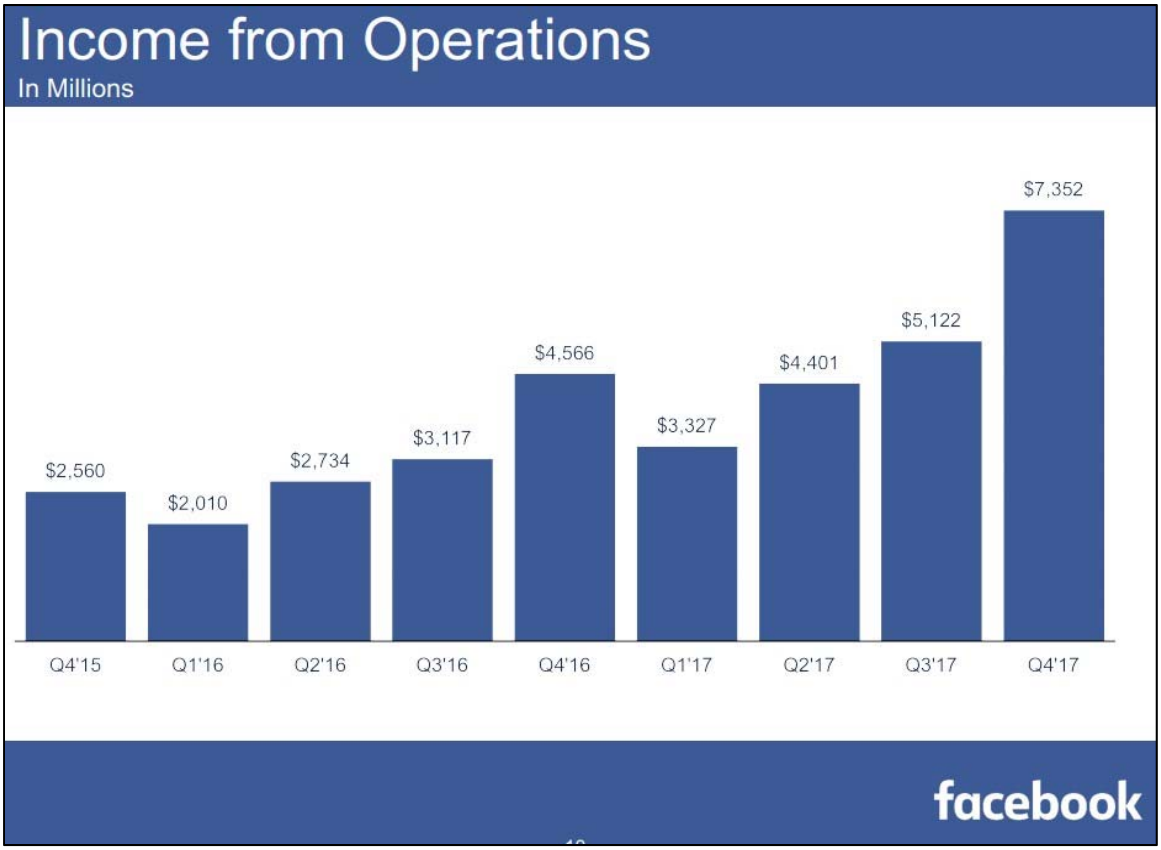

Image Source: Facebook

Shake off the idea that technology is riskier than any other sector because it might not be. Don't worry about the concept of "fake news" tarnishing the Facebook (FB) brand, as that's just noise.

Facebook operates at the heart of society, and while there will inevitably be changes to its platform along the way, literally everyone and their mother is on Facebook! If advertisers want to continue to engage what we believe to be a better avenue to target potential buyers than Twitter (TWTR) or Snapchat (SNAP), they are going to have to pay Facebook. It's that simple.

Many point to the idea that Facebook may be losing favor with the younger generation, but we're not worried about that. Monthly active users continue to march higher (up to 2.13 billion in the fourth quarter of 2017 from 1.59 billion in the fourth quarter of 2015), and those that may not like the platform may eventually find a need to come back in the years ahead, whether they're changing jobs, getting married, or a loved one moves far away.

Just like a book, don't judge a business by image. The core of what determines intrinsic value comes from the generation of free cash flow and balance sheet health—think of free cash flow as your salary less expenses—and balance sheet health as your cash in the bank less all your obligations, or your net worth (including other illiquid assets). Facebook's free cash flow expanded to $5.4 billion during the fourth quarter of 2017, roughly double that achieved during the fourth quarter of 2015. It holds $41.7 billion in net cash on the books and has no debt.

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The future will always be unpredictable, but now that Facebook has huge reach, it has an open-ended opportunity to continue to pursue monetization efforts, and we believe it is in the early innings with this. Perhaps Facebook is still getting warmed up and hasn't yet taken the field? Its opportunities range from a continuation of its ongoing fantastic fundamental trajectory to literally becoming the new 'Internet' where family and friends not only meet up to socialize but also to buy anything and everything there.

We value shares at $238 each, and the company has a rating of 7 on the Valuentum Buying Index, our methodology that combines intrinsic valuation with behavioral considerations and self-fulfilling technical dynamics.

Protectionists Gaining Control, Implications on Europe and China

By Kris Rosemann

Mr. Market reacted unfavorably to President Trump's top economic advisor Gary Cohn's resignation announcement March 7, as Cohn was seen as a voice for Wall Street in the White House. Though the reaction may be short-lived, fears of the implications of increasing control from protectionists probably shouldn't be ignored, and the probability of a trade war, particularly with China (FXI, MCHI) and with Europe, presumably moves higher with Cohn's exit. Canada (EWC) and Mexico (EWW) may be exempt from the tariffs, however.

The European Union is already reportedly preparing tariffs on certain US brands. A range of consumer goods and agricultural and steel products will be the key targets of a 25% retaliatory tariff on $3.5 billion in US-produced goods should Trump follow through with his stated tariff plans for steel imports. An extension of the retaliation from the EU could take place should Trump's aluminum tariffs be enacted as well, and the specific measures proposed by the EU have caused a growing level of disagreement among Republican lawmakers.

Many domestic industries are expecting to feel material pressure from the threat of the US-imposed tariffs as well, as a result of the prospect for significantly-rising raw materials costs. One key example is the auto making industry, where some are estimating the proposed tariffs could have a ~$1 billion impact on the annual adjusted operating income of industry bellwethers General Motors (GM) and Ford (F), assuming the proposed 25% tariff results in a similar increase in steel prices. According to some estimates, such a step change would be equivalent to ~12% and ~7% of GM's and Ford's 2017 adjusted operating income, respectively.

Though the auto sector has been a key area of focus due to the steel-intensive nature of its production, virtually every company with US-based production using steel or aluminum as a raw material can expect some form of potential margin pressure, in our view. The ability of such companies to use brand strength and other forms of pricing power may be able to mitigate such pressure, effectively pushing the tax further down the line to end-market customers and ultimately consumers. Those with the lowest ability to pull on the pricing lever and the tightest profit margins will experience the greatest impact of the tariffs, in our view. US-based companies with international operations fear retaliation from their international partners, fears that appear to have already been legitimized by the reports surrounding the EU.

In other world news, China continues to search for the appropriate level of foreign investment in its domestic markets as it plans to lower investment barriers for its service sector and pull back ownership limits in certain sectors. The country's multi-trillion-dollar financial sector has long been viewed as a material opportunity for international investors, but slow market reform and overbearing regulations have stymied such efforts thus far. Global investment uncertainty outside of the country, due in part to aforementioned trade policy uncertainty, has pushed demand higher for foreign direct investments in China, and an increase in such investments will be key for the country in hitting its lofty economic growth expectations.

*Protectionists...*continued on page 9

Valuentum's Best Ideas Portfolio

By Valuentum Analysts

Study: Valuentum released a study on its fair value estimates! Please download the paper at the following link: https://www.valuentum.com/downloads/20171031/download

Note: Alphabet's "weighting" now reflects a consolidation of Class A and Class C shares held previously in the simulated newsletter portfolio.

Valuentum's BEST IDEAS -- as of March 15, 2018

Portfolio Holdings	Symbol	Div Yield %	Fair Value	Economic Castle	VBI Rating	P/FV	Last Close	% of Portfolio
Berkshire Hathaway	BRK-B	0.00%	$185.00	NA	6	1.12	207.82	5.5%-10%
Facebook	FB	0.00%	$238.00	Very Attractive	7	0.77	183.86	5.5%-10%
Alphabet - Class C	GOOG	0.00%	$1181.00	Very Attractive	6	0.97	1149.58	5.5%-10%
Visa	V	0.69%	$111.00	Attractive	6	1.11	123.41	5.5%-10%
Apple Corp.	AAPL	1.41%	$201.00	Highest Rated	6	0.89	178.65	4%-5.5%
SPDR S&P Dividend ETF	SDY	2.23%	NA	NA	UR	NMF	93.16	4%-5.5%
Energy Select SPDR	XLE	3.28%	NA	NA	UR	NMF	67.19	4%-5.5%
Health Care ETF	XLV	1.45%	NA	NA	UR	NMF	85.69	4%-5.5%
Cisco	CSCO	2.92%	$43.00	Very Attractive	5	1.05	45.33	2.5%-4%
Intel	INTC	2.31%	$48.00	Attractive	7	1.06	50.88	2.5%-4%
Johnson & Johnson	JNJ	2.54%	$130.00	Attractive	7	1.02	133.06	2.5%-4%
Altria Group	MO	4.39%	$58.00	Very Attractive	6	1.10	63.81	2.5%-4%
Dollar General	DG	1.16%	$89.00	Attractive	7	1.05	93.44	1.5%-2.5%
Gilead Sciences	GILD	2.79%	$107.00	Very Attractive	7	0.74	79.51	1.5%-2.5%
General Motors	GM	4.03%	$45.00	Attractive	7	0.84	37.85	1.5%-2.5%
Bookings Holdings	BKNG	0.00%	$1989.00	Highest Rated	6	1.10	2187.77	1.5%-2.5%
PayPal	PYPL	0.00%	$72.00	Attractive	6	1.15	82.57	1.5%-2.5%
Verint Systems	VRNT	0.00%	$50.00	Very Attractive	6	0.79	39.50	1.5%-2.5%
Cash consideration	-	-	-	-	-	-	-	15%-30%

UR = Under Review
This portfolio is not a real money portfolio. Data as of March 15, 2018.
We have consolidated our simulated position in Alphabet to the highest weighting to reflect our confidence in the idea.

Goal: The simulated Best Ideas Newsletter portfolio seeks to find stocks that have both good value and good momentum characteristics and typically includes in the simulated portfolio each idea from a Valuentum Buying Index rating of a 9 or 10 (consider buying) to a rating of a 1 or 2 (consider selling). Just like a value manager may not include every single undervalued company in the market in his/her portfolio, not all highly-rated companies on the Valuentum Buying Index are included in the portfolio.

We may tactically add to or trim existing positions in the portfolio on the basis of sector or broader market considerations, but we seek to capture a stock's entire pricing cycle (from being underpriced with strong momentum to being overpriced with poor momentum). The Best Ideas Newsletter portfolio puts the Valuentum Buying Index into practice.

Every person has different goals and different risk tolerances, so where before in the simulated newsletter portfolios, we would outline the specific percentage weighting, we think providing ranges make much more sense. For example, depending on someone's risk tolerances, a larger cash position in an overheated market may be prudent. On the other hand, the longer one's time horizon, perhaps a smaller cash position may make more sense. This isn't for us to decide, and frankly, we want to be relevant for as many as we can in the investment community because we think we have something for everyone!

Ideas may not add up to 100% on either the low % or high % due to rounding and/or other combinations / permutations.

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

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Meanwhile, progress in the unstable relations on the Korean Peninsula could be coming after North Korea is reportedly willing to talk with the US on denuclearization following the nation's time spent with its neighbors to the south. Though we had outlined North Korea as a big threat to geopolitical stability in the past, it looks like things are moving in the right direction, but it all could just be posturing on the global stage, too. Regardless of what North Korea says it is going to do--versus what it actually does--it's likely geopolitical uncertainty will not be going away anytime soon.

BP (BP) CEO Bob Dudley believes crude oil prices (OIL, USO) have settled onto a "fairway" of a range of $50-$65 per barrel for the next couple of years. He credits the recent downturn in energy resource pricing as a learning opportunity for the industry, which is now far more adept at managing costs and gaining efficiencies from new technology and an increased use of data. Dudley also said that he expects peak oil demand to be reached in the late 2030s, though oil demand is still likely to be over 100 million barrels per day in 2040, a level OPEC leaders have suggested the world is rapidly approaching. OPEC has also expressed a concern over levels of investment in global oil production following years of underinvestment during the recent global supply glut that wreaked havoc on oil prices.

Exxon Mobil (XOM) is sure to play a role in satisfying growing levels of global energy demand, and the oil and gas giant recently outlined a set of aggressive growth plans aimed at more-than-doubling earnings and cash flow from operations by 2025, assuming 2017 crude oil price levels hold. The company expects double digit rates of return in all three of its business segments--upstream, downstream, and chemical. Its upstream segment expects to benefit from low-cost growth initiatives in US tight oil, deepwater, and liquefied natural gas. A significant ramp in production in the Permian Basin, a result of multiple acquisitions in 2017, and 25 startup projects worldwide are expected to be key drivers of the upstream growth.

Exxon's downstream operations expect increased production of higher-value products, including ultra-low sulfur diesel, chemicals feedstocks, and basestocks for lubricants to help expand margins by 20% by 2025. Demand growth in emerging markets will also help in its quest to double earnings and cash flow from operations, and the ongoing integration of its chemical manufacturing segment and upstream production will help its efficiency. The company plans to grow chemical manufacturing capacity in North America and Asia Pacific by 40% to help meet the growing global demand. All in, management anticipates its growth initiatives to result in a company-wide return on capital employed (ROCE) of 15% by 2025, up from 9% in 2017 (including the impact of US tax reform).

Interestingly, the Commodity Futures Trading Commission can now legally classify and regulate cryptocurrencies as commodities after a ruling from a Federal judge March 6 upheld the CFTC's 2015 decision that digital currencies fit the plain meaning of the word "commodity." The implications of such a decision are far from clear, and legislation on cryptocurrencies (XBT, GBTC) is still in its infancy as the US federal government has avoided making any significant rulings.

Shares of US-retail giant Target (TGT) faced pressure following its fiscal fourth quarter earnings report, released before the open March 6, despite comparable sales growing 3.6% on a year-over-year basis. Solid increases in both physical and digital channels helped traffic grow 3.2% from the year-ago period, and digital channel sales leapt 29%, good for 1.8% of the total comparable sales growth. However, digital fulfillment costs proved to be a meaningful headwind on margin performance as its fourth quarter EBIT fell to 5.1% from 6.5% in the same period of fiscal 2016. Pricing and promotion initiatives were largely offset by cost savings programs, but SG&A expense came in a full percentage point higher than the year-ago period as a result of higher compensation costs. The company expects both fiscal 2018 adjusted earnings per share and GAAP earnings per share from continuing operations be in a range of $5.15-$5.45 and comparable sales growth to be in the low single digits.

Retail Weakness Not Gone Yet; Is J.C. Penney a $0?

By Kris Rosemann

Department store operator JC Penney (JCP) bucked the positive trend of department stores rallying following their respective earnings releases with its fiscal fourth quarter report before the open March 2. Shares sold off aggressively following the announcement of results, despite comparable sales climbing 2.6% from the year ago period. Gross margin improved 50 basis points thanks largely to lower promotional activity, a positive development across department stores this quarter as consumer spending remains robust (US consumer sentiment jumped to 99.7 in the month of February from 95.7 in January, led by the current conditions component, which indicates positive consumer spending). Gross margin improvement and cost discipline helped the firm raise its adjusted earnings per share to $0.57 in the quarter from $0.22 in the prior year period.

JC Penney's fiscal 2018 guidance for comparable sales to be flat to up 2%, despite likely being an improvement over 0.1% growth in fiscal 2017, may be the core driver behind its material share price decline following the release of its earnings report. The company previously issued guidance of a 3% CAGR for comparable sales from fiscal 2017-2019, and with fiscal 2017 coming in significantly below that target and another year of underperformance relative to that target expected in fiscal 2018, investors may be losing confidence in management's turnaround plan. *This may be an appropriate time to remind readers that the lower end of our fair value range for JC Penney's shares is $0.*

Shoe retailer Foot Locker (FL) continued its recent struggles in its fourth quarter of fiscal 2017, results released before the open March 2, as comparable-store sales fell 3.7% from the year-ago period. Unlike the department stores, Foot Locker was unable to distance itself from the overly promotional environment, which helped contract its gross margin to 31.4% in the quarter compared to 33.7% a year earlier. Non-GAAP earnings per share fell to $1.26 from $1.37 in the fourth quarter of fiscal 2016.

Foot Locker expects early fiscal 2018 to bring many of the same challenges as fiscal 2017, but a return to positive comparable–store sales growth is expected by mid-2018 as it targets full year comparable store sales to be flat to up at a low-single-digit rate. Gross margins are projected to begin recovering in the year, and management expects a double-digit growth rate in annual earnings per share. However, the expectations for weakness to persist at least in the near term continues to weigh on shares, which fell precipitously following the release of the report. Foot Locker's turnaround may be more difficult than management lets on.

Though we prefer to refrain from making political statements or commentary on the politically-charged topic of gun control, its impact on related retailers should be noted. In our opinion, the confluence of a challenging demand environment--American Outdoor Brands (AOBC) expects lower firearm demand to continue for "some time" and its firearm revenue to be flattish over the next 12-18 months--and tremendous political scrutiny make the space largely "uninvestable" for the time being. Potential regulatory action could push this point further, and Vista Outdoor (VSTO), which generates more than half of its revenue from 'Shooting Sports,' has noted in its most recent 10-K that it "could find it difficult, expensive or even practically impossible to comply with" legislation regulating firearms and ammunition.

Markets continue to be highly volatile of late.

Cigna, Express, and the Unwinding of the PBM Market

Given its track record of creative destruction, when Amazon plans to enter a particular line of business, it presents an ominous threat to incumbents. What is often overlooked, too, is that Amazon is more than willing to try new verticals—if they prove promising, additional assets will be devoted to the new line of business, often with fawning media coverage. If Amazon is unsuccessful in its endeavor, however, then it seems as though it will "fail fast" and shut down the project and move on. We found the recent announcement of a joint venture to tackle the healthcare industry as particularly noteworthy.

By Alexander J. Poulos

Amazon as the Great Disrupter

We have marveled at Amazon's (AMZN) rumored ambition into pharmaceutical services especially in light of the recent purchase of Whole Foods giving the internet behemoth a network of brick-and-mortar storefronts.

Our recent piece discussing the finer aspects of entering into the pharmacy markets can be seen as "small potatoes" when measured against the ambition of the trio headlined by Amazon (along with JP Morgan (JPM) and Berkshire Hathaway (BRK.B). A new company will be formed with its own independent management team that will look to tackle the way in which healthcare is delivered in the US, with an eye towards leveraging technology to reduce overall cost and produce superior outcomes.

It sounds marvelous, but it is important to note that we have seen other outside corporations form their own buying groups with minimal impact on the overall cost of healthcare. We feel a different trend is far more noteworthy at this juncture that ironically can be traced back to Amazon's rumored entry into pharmacy.

The End of the Standalone Pharmacy Benefit Manager (PBM)?

The standalone PBM business along with its business model may now officially in terminal decline, underscoring the need to merge with a managed-care organization to salvage any value for beleaguers shareholders. This is a bold statement, so lets break it down into its individual components to determine if it's a justifiable statement or mere hyperbole.

- The PBM is a network that administers the healthcare benefits of a managed care organization (MCO) such as Anthem (ANTM).
- Let's keep in mind, by virtue of the definition of bullet 1, the PBM is an intermediary-- the infamous "middle man" that adds to the overall cost of care as it extracts its fee.
- There is nothing proprietary in the PBM model. The customer data is provided by the MCO; as such, there is little in the way of brand or customer loyalty, unlike in the MCO's. Typically, if a patient is receiving excellent care with their healthcare insurance and is comfortable with the network of providers, he or she is loath to change especially in the Medicare market.
- The business model is rife with conflict predominately based on the role of rebates. The PBM will attempt to reduce costs by offering preferred formulary placement in exchange for a rebate based on volume. It seems innocent enough, but the conflict arises based on the percentage of rebate retained by the PBM. In essence, the PBM can "negotiate" a higher cost for the drug (for example, $100 per month) and based on the number of patients prescribed the product, a volume rebate of 20% (lowering the overall cost of the monthly treatment to $80 thus saving the insurer "$20" per month). If the PBM has an agreement in place to retain 15% of the overall rebate, it becomes clear it is in the PBM's interest, not the payers', to raise overall gross cost of treatment, only to insure a larger percentage rebate. The best example of this is the pending Anthem litigation against Express Scripts (ESRX), seeking $15 billion in damages and the abrupt end of its contract with Express.

*Cigna, Express...*continued on next page

*Cigna, Express…*from previous page

The potential demise of the standalone PBM may now be complete, with Express Scripts willing to sell itself to Cigna (CI) in a deal worth $67 billion, which includes the assumption of Express debt. We find it remarkable the speed of the unwinding of the PBM market. In less than a year after the rumored Amazon foray, CVS Health (CVS) purchased Aetna (AET) in a deal we unambiguously derided in a recent piece titled "CVS Health at the Crossroads, Too Much Debt" as we believe the combination is taking on an enormous debt load coupled with the distinct lack of meaningful synergies (as the management team indicated the deal will become accretive to earnings in year 2 of the deal). We have included a direct quote from our piece that neatly illustrates our disdain for the deal.

> *Unfortunately, we also weren't very happy with the seeming lack of meaningful potential synergies as the proposed $750 million in "synergies," if achieved, would kick in year two after the approval of the deal. We are looking at a mid-2020 event assuming the deal closes in mid-2018 as projected. Denton further clarified the synergy expectations in the following quote:*
>
> > *On the $750 million synergies, there's virtually no revenue synergies tied to this. This is mostly cost and a little bit of, I'll say, care management synergies as we think about getting -- or helping consumers get the lowest-cost site of care for the most part. So, I wouldn't think about this as revenue synergies at this moment. I do think longer term, there are opportunities to grow revenues as we think about the enterprise and all the capabilities that we'll have here. As it relates to the permanent financing and the cost of that debt, it will depend a bit about the tenor in which we place our portfolio. But you would think about it probably in the 4% ZIP code is our current thinking. That could wiggle a bit based on the amount of short- versus long-term debt that we ultimately place at the end of the day.*
> >
> > *Quote Source: CVS Health*

Keep in mind CVS Health is predominately a PBM (Caremark division) with a network of providers of pharmaceutical services that encompass the entire spectrum of practice settings.

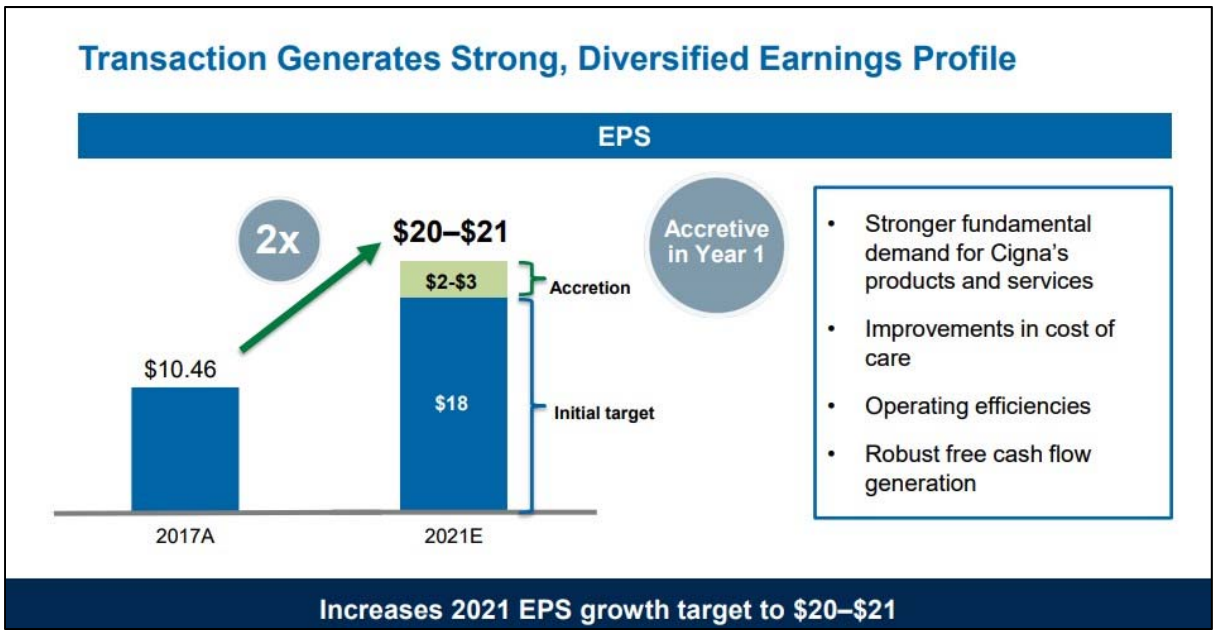


Image Source: Cigna Express acquisition presentation deck

*Cigna, Express…*continued on next page

*Cigna, Express…*from previous page

Analyzing the Cigna Deal

We are far more constructive on the Cigna/Express deal than the Aetna/CVS Health deal as the Cigna deal is immediately accretive to earnings. Cigna believes the deal will aid in nearly doubling 2017 realized earnings to $20-21 per share in 2021 as the new entity has identified nearly $600 million in duplicate cost reductions, which will enhance free cash flow thus allowing the company to rapidly de-lever.

Sources & Uses of Capital

Sources ($B)	Available Cash	7.2
	New Debt and Commercial Paper	22.5
	Express Scripts Debt Assumed	13.2
	New Equity Issued in Transaction	26.6
	Total Sources	69.6
Uses ($B)	Purchase Equity	54.0
	Express Scripts Debt Assumed	15.0
	Other	0.6
	Total Uses	69.6

- Upon closing, proforma debt to capitalization ratio will be ~49%
- Prioritization of debt repayment over other forms of capital deployment until leverage returns to the 30s in 18 to 24 months
- Post-close, ability for some continued capital deployment

Image Source: Cigna Express acquisition presentation deck

Two Different Models

There are now two unique business models at work, the augmentation of the PBM business through external acquisition coupled with the organic "build it by yourself" model. The main proponent of the organic model is United Healthcare which again has proven its leadership in healthcare by cultivating its superbly-managed OptumRx division. Optum has grown into the third-largest PBM in the country; it has also served as a rapidly-growing source of profitability for United, much to the dismay of its competitors.

We do not believe it is an accident that the new CEO of Anthem, Gail Boudreaux, a former executive of United is building out its own PBM from scratch via the aid of CVS Health. Anthem may have a golden opportunity thanks to Cigna to wiggle out of its disastrous Express deal earlier than expected.

By essentially removing the independent PBM for the marketplace, one of the potential areas for Amazon to disrupt has been eliminated, thus reducing the overall cost of healthcare. We would not be quick to count out Amazon out though, as its impressive track record of disrupting well-entrenched players is lengthy.

Concluding Thoughts

The healthcare sector is undergoing some significant changes, in an attempt to drive down the overall cost of healthcare, a very worthy undertaking. While a path has opened to reduce some of the intermediaries such as the PBM's a whole host of unanswered questions remain. We will continue to closely monitor events in the healthcare sector with timely evaluations forthcoming when warranted. At the moment, we continue to prefer ideas in the Best Ideas Newsletter portfolio and Dividend Growth Newsletter portfolio.

Toys 'R' Us Liquidation News Transient to Toy Makers

Another icon from past decades announced that it may have to liquidate. Though we expect the toy makers to experience a transient impact, we don't expect it to be lasting. Digital entertainment licensing remains a faster-growing, higher-margin business for them than physical toy sales, and we expect the focus for many toy makers going forward will be on the former, particularly given Disney's Frozen success.

By Brian Nelson, CFA

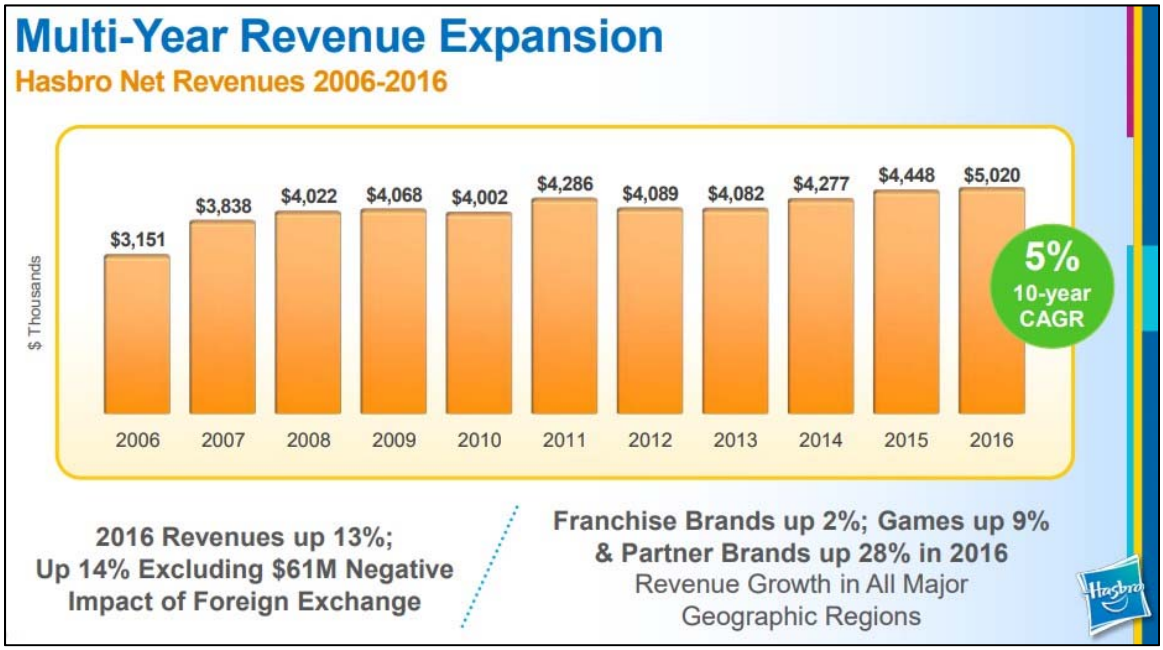


Image Source: Hasbro

There's nothing like the announcement of a customer's possible liquidation to send shares of suppliers tumbling. That's what happened when Toys 'R' Us announced that it may have to cease operations as nobody appears to be coming to the rescue. Hasbro (HAS), Mattel (MAT), and JAKKS Pacific (JAKK) may feel some near-term operational discomfort, but we're not overreacting.

If a rescue deal doesn't happen for Toys 'R' Us, online verticals and big box retailers such as Walmart (WMT) and Target (TGT) may easily fill the void. Target's CEO Brian Cornell noted, in particular, that his company is "playing to win in toys." Though we're viewing the Toys 'R' Us announcement as more 'headline noise' than anything that may impact the toy makers over the long haul, readers may expect forward near-term guidance to now have a more cautious bent, and that may disappoint some investors.

Rumors of a deal between Hasbro and Mattel haven't let up from what we can tell, and we think the Toys 'R' Us possible liquidation could grease the wheels for further talks, as anti-trust interference may not be that fierce given end market troubles and concentrated online distributor power through the likes of Amazon (AMZN) and eBay (EBAY). We continue to like Hasbro the most out of the toy makers, but we caution management against the temptation to overpay for Mattel's assets, as the Barbie franchise could very well be in terminal decline, given Disney's (DIS) Frozen success. We also like that Hasbro continues to pull a variety of levers, the latest an agreement with Netflix (NFLX) to create toys and games from the Super Monsters animated kids series. This follows the Hasbro-Netflix's joint effort to bring a collection of games to Stranger Things' fans.

*Toys 'R' Us…*continued on next page

*Toys 'R' Us...*from previous page

We wrote about Hasbro's fourth-quarter report, released February 7, and we did highlight that management had pointed "to slower consumer demand for both the company and its industry in November and December," but we also said that we think "management is confident that its innovative lines that are supported by storytelling and digital initiatives have the company well-positioned for 2018 and beyond." What we're watching closely at Hasbro is the long-term trajectory of its 'Entertainment and Licensing' business line, where on a full-year basis, operating profit in the segment nearly doubled, to $96.4 million on just ~8% revenue expansion (the division posted a near-34% operating margin). This segment may hold the keys to Hasbro's future, but even so, Hasbro was able to still drive revenues nearly $1 billion higher during the past 5 years. Physical toy sales are under pressure, but by no means, dead.

Hasbro's equity has advanced considerably since it graced the inaugural simulated Dividend Growth Newsletter portfolio. Its 10%+ dividend increase, to a quarterly payout of $0.63, on February 7, means shares now have a forward yield of 2.8%. We're not overreacting to the Toys 'R' Us announcement by any stretch, with our fair value estimate of Hasbro hovering in the high-$80s at the time of this writing.

Updating Our Thoughts on Celgene

Although the combination of disruptive new discoveries coupled with burgeoning demand thanks to the aging demographics of the world's population sets the biotech space for a potential virtuous long-term cycle, we're not too happy with the recent developments at Celgene. Let's dig in.

By Alexander J. Poulos

2018 Guidance

	2018 Guidance[1]	Δ vs. 2017
Total Revenue	$14.4B-$14.8B	↑ 12%[2]
REVLIMID® Net Product Sales	~$9.4B	↑ 15%
POMALYST®/IMNOVID® Net Product Sales	~$1.9B	↑ 18%
OTEZLA® Net Product Sales	~$1.5B	↑ 17%
ABRAXANE® Net Product Sales	~$1.0B	↑ 1%
Adjusted Operating Margin	~60.0%	~↑ 200 bps
Adjusted Tax Rate	~18%	~↑ 210 bps
Adjusted Diluted EPS	$8.70-$8.90	↑ 18%[2]
Weighted Average Diluted Shares	~775M	↓ 34M

1. 2018 guidance does not include the impact of our recently announced pending acquisition of Juno Therapeutics Inc., which is expected to be dilutive to adjusted EPS in 2018 by approximately $0.50
2. Using mid-point of the range

15

Pipeline Woes Continue

The share price of Celgene (CELG) was accelerating heading into the Fall of 2017 as the strength of its existing oncology pipeline coupled with a few late-stage molecules augured well for a continued advance in the share price.

As detailed in a recent piece aptly named "Celgene Implodes," the costly discontinuation of Mongersen cast doubt on Celgene's ability to hit its long-term sales and earnings targets. Celgene, unlike its competitors in the biotech space, namely Gilead Sciences (GILD), remained a darling on the Street as the management team at Celgene would promote an earnings "roadmap" that assumed the approval of key pipeline assets, in direct contrast to the more reserved team at Gilead that would avoid such proclamations, in our view.

*Updating Our Thoughts...*continued on next page

*Updating Our Thoughts…*from previous page

The drug-discovery business is inherently risky with little in the way of guaranteed success. Celgene's descent began with the stunning failure of Mongersen in phase 3 trials even though the phase 2 data was less than robust. We continue to feel the weight of the roadmap may have clouded longer-term judgment, and the team at Celgene decided to "wing it" and press forth with a very costly phase 3 flop. The failure of Mongersen began the downward cascade that culminated with a simply abysmal earnings report on October 26, 2017, which saw revenues come in less than expected, which placed further pressure on the vaunted "roadmap." Management saw fit to pour additional gasoline on the fire by reducing longer-term expectations—never a positive with the share price dropping nearly $20 per share to the $100 range, as many exited positions.

Our focus immediately shifted to Ozanimod, an asset Celgene acquired via the acquisition of Receptos in July of 2015 for the staggering sum of $7.2 billion in cash. Celgene initially believed it could break into the lucrative Multiple Sclerosis (MS) market and take on some of the industry heavyweights such as Biogen (BIIB) and Novartis (NVS). The Novartis treatment dubbed Gilenya is the most comparable product yet, in what we can only describe as another failure by Celgene's management. Gilenya is losing patent coverage in 2019 after a recent courtroom failure. Bringing to market a similar product in a very expensive field when the mainstay therapy has lost patent protection is not the recipe for success. We fully expect payers will push back on the cost of Ozanimod, which will hamper its overall sales potential.

To neatly sum up the chain of events: Instead of sticking to its lucrative field of oncology, Celgene decided to venture into a new vertical (MS) by wildly overpaying for an asset with a challenging path to market that would have had a very difficult time distinguishing itself from the established product (Gilenya). Overpaying for an asset is hardly a recipe for longer-term success. Instead, we should view the disaster as a cautionary tale of the importance of disciplined deal-making.

Our preferred biotech idea, Gilead wisely declined to invest large sums in crowded fields. Gilead very methodically waited for the Car-T space to take shape and pounced on the asset (Kite) that has a commanding lead, in stark contrast to Celgene, which in our view, overpaid for an asset (Juno) that is much further away from entering the market. Celgene paid the equivalent of $9.9 billion versus $11 billion paid by Gilead for Kite, but Gilead gained critical first-mover advantage. Celgene is optimistically targeting a 2019 approval while Gilead's product is already approved with the provider network ramping up as we speak.

Breakdown in Management

The skill of the management team in the biotech industry is heightened above what is typically seen in other sectors, as the best performers typically combine a stellar sense of the underlying science coupled with a sharp business acumen.

The team that comes from a strict sciences background is well versed in some of the underlying challenges in research versus the positive spin that often emanates from those with a marketing background. We can not stress enough we feel the long-term roadmap out to 2020 remains a critical misstep in a once-vaunted team—dare we say slavishly following the plan that has set forth a cascade of negative events that has simply destroyed the share price?

We feel the final straw is the recent refusal to file letter issued by the FDA for its key near-term asset Ozanimod. We harken back to what we originally posted—

> *Celgene wisely hedged its bets with the acquisition of Mongersen by acquiring the rights to Ozanimod, too, an innovative oral treatment that is being studied for a host of specialty diseases ranging from multiple sclerosis to Ulcerative colitis. We have recently reviewed the data posted by Ozanimod versus beta-interferon (Avonex) and came away impressed with the efficacy coupled with a side-effect profile on par with Avonex. We feel the oral dosage form is a crucial differentiator on par with Roche's (RHHBY) recently-approved MS treatment Ocrevus. Ozanimod is*

*Updating Our Thoughts…*continued on next page

*Updating Our Thoughts...*from previous page

> *currently in phase 3 trials for Multiple Sclerosis and Ulcerative Colitis along with phase 2 for Crohn's Disease. Assuming the molecule is a success, it will in our opinion more than offset the expected loss of revenue from Mongersen.*
>
> Quote attributed to Alexander J. Poulos

The reason stated for the rejection by the FDA in our view highlights the utter disarray at Celgene—the application was rejected due to insufficiencies in the application.

> *Upon its preliminary review, the FDA determined that the nonclinical and clinical pharmacology sections in the NDA were insufficient to permit a complete review. Celgene intends to seek immediate guidance, including requesting a Type A meeting with the FDA, to ascertain what additional information will be required to resubmit the NDA.*
>
> The quote is taken from Celgene's press release.

We cannot stress enough the huge anomaly of the FDA issuing a refusal to file especially for such a well-capitalized company such as Celgene. In layman's terms, the application was filled out incorrectly—this is 100% unacceptable as an experienced team in conjunction with legal should have had the application in an acceptable form for the FDA to begin the review process. The denial will now set back the clock, which in our view, will delay the potential approval, thus wasting critical time in establishing the product before Gilenya loses patent protection and further complicating the product's ability to become the blockbuster Celgene envisioned when it acquired the asset.

Celgene has a "Humira Problem."

We currently view the mess at Celgene in similar terms to AbbVie (ABBV), namely a company with an outsize dependence on a single product for the vast majority of its revenue. We have been generally bearish on AbbVie's prospects as multiple companies launched extensive patent challenges, which we felt would result in a binary event that could wreck an investment overnight if the patent protecting Humira was overturned. In essence, AbbVie holders could wake up the next day down over 30%, maybe more--never a good feeling.

AbbVie's share price, however, has nearly doubled since the summer as euphoria has set in with clinical data on two late-stage assets, along with a more-favorable patent outlook. We do not believe Celgene will follow a similar path for a variety of reasons. The primary reason may perhaps revolve around the lack of a dividend. AbbVie wisely, in our view, rewarded shareholders with a generous payment, which provides underlying support for the share price.

Celgene, on the other hand, has decided to repurchase stock. It recently authorized a $5 billion share-repurchase plan, which in our view, parallels the failed plan undertaken by Gilead in 2016, which did little to arrest the share price slide. We cannot emphasize enough: Biotech and to a lesser extent big pharma may trade on the viability of the near-term pipeline—one shouldn't let a low price-earnings multiple fool you, as it is a misleading metric as the assets valued are a wasting asset versus what is typically ongoing in other industries. Once the patent lapses, the product will often lose 90% of sales, maybe more, within five years due to generic competition.

Celgene's best hope of diversifying its revenue stream took a big hit with the delay of Ozanimod. We think the failure coupled with the severe drop in the share price may more than likely lead to another takeout, as Celgene is now placed in a rather uncomfortable position of having to purchase an asset at elevated prices to more than likely meet its 2020 guidance. A further reduction in long-term guidance may further destroy any credibility the management team may still possess. This is far from the ideal set-up to negotiate a transaction, as the target now has the upper hand of waiting out Celgene, thus forcing them to overpay.

Conclusion

To say the least, the past two quarters have been less-than-kind for shareholders of Celgene as a series of missteps—some clinical and others avoidable—has simply decimated the share price. At this juncture, we are very uncomfortable in considering the company to the simulated newsletter portfolios, as we feel a few issues would need to be resolved before we are again comfortable with the company.

Gilead Sciences (GILD) – Page 1 of 16

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

By Valuentum Analysts

Valuentum Retail Equity Research — Visit us at www.valuentum.com — Ratings as of 9-Mar-2018 — Data as of 2-Mar-2018

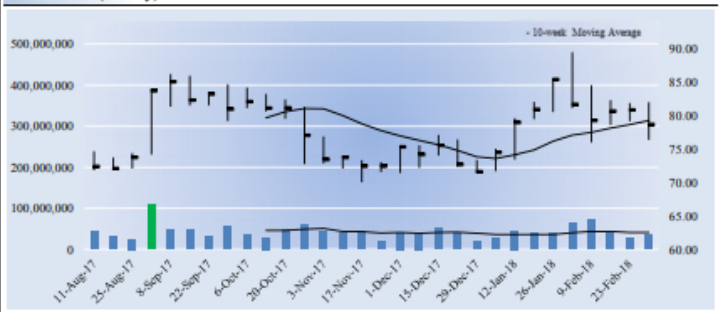
Gilead Sciences GILD UNDERVALUED 1.7%

Buying Index™ 7 **Value Rating** ✓

Economic Castle	Estimated Fair Value	Fair Value Range	Investment Style	Sector	Industry
Very Attractive	$107.00	$80.00 - $134.00	LARGE-CAP VALUE	Health Care	Pharma - Generic/Other

Gilead Sciences had been operating in a rational oligopoly in the HCV market, but revenue erosion is now a reality. We like the pipeline diversification that comes with its acquisition of Kite Pharma.

Stock Chart (weekly)



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

Investment Considerations

DCF Valuation	UNDERVALUED
Relative Valuation	NEUTRAL
ValueCreation™	EXCELLENT
ValueRisk™	MEDIUM
ValueTrend™	POSITIVE
Cash Flow Generation	STRONG
Financial Leverage	LOW
Growth	DECLINING
Technical Evaluation	BULLISH
Relative Strength	NEUTRAL
Money Flow Index (MFI)	NEUTRAL
Upside/Downside Volume (U/D)	BULLISH
Near-term Technical Resistance, 10-wk MA	79.00

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

Business Quality — ValueCreation™

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

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

Company Vitals

Market Cap (USD)	$106,861
Avg Weekly Vol (30 wks)	42,781
30-week Range (USD)	70.05 - 89.54
Valuentum Sector	Health Care
5-week Return	-7.6%
13-week Return	4.3%
30-week Return	8.1%
Dividend Yield %	2.9%
Dividends per Share	2.28
Forward Dividend Payout Ratio	64.9%
Est. Normal Diluted EPS	6.35
P/E on Est. Normal Diluted EPS	12.4
Est. Normal EBITDA	12,336
Forward EV/EBITDA	12.8
EV/Est. Normal EBITDA	8.2
Forward Revenue Growth (5-yr)	-6.0%
Forward EPS Growth (5-yr)	-4.8%

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

Investment Highlights

• Gilead's primary areas of focus include HIV/AIDS, hepatitis B and C, serious cardiovascular/metabolic and respiratory conditions. The firm's drug Sovaldi and its successor Harvoni, a once-daily oral treatment of HCV infection, are its primary product drivers and comprise a large portion of antiviral product sales. Complera/Eviplera and Stribild--single tablet regimens for HIV--are also experiencing nice sales expansion. Gilead is marketing a next generation version of its HIV combination franchise by substituting TAF which should expand patent coverage well into the end of the next decade. Gilead's pipeline also offers other opportunities.

• According to the World Health Organization, 130-150 million people globally have chronic hepatitis C infection, and a significant number of those who are chronically infected will develop liver cirrhosis or liver cancer, with as many as 350,000-500,000 people dying each year from hepatitis C-related liver diseases. The HCV market is vastly underserved, providing long-term opportunities for Gilead.

• Gilead had been operating in a rational oligopoly in the HCV market, but revenue erosion is now a reality. Janssen's Olysio and AbbVie's Viekira Pak are two key rivals, and Merck's Zepatier recently entered the marketplace at a materially lower price. This can't be ignored, but Merck has discontinued its HCV developments outside of Zepatier.

• Gilead acquired Kite Pharma, a leading player in Car-T therapy, in 2017 for ~$11.9 billion in a deal that addresses its pipeline shortfalls outside of the HCV market. We like the move, as it instantly gives the firm a meaningful presence in oncology and cell therapy.

Relative Valuation

	Forward P/E	PEG	Price / FV
Allergan	NMF	NMF	76.6%
Teva Pharma	NMF	NMF	112.7%
Valeant Pharma	NMF	NMF	64.7%
Zoetis	46.5	2.4	147.8%
Peer Median	46.5	2.4	94.7%
Gilead Sciences	**22.4**	**NMF**	**73.5%**

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

Returns Summary — 3-year Historical Average

Return on Equity	89.6%
Return on Assets	36.3%
ROIC, with goodwill	107.4%
ROIC, without goodwill	116.4%

ROIC = Return on Invested Capital; NMF = Not Meaningful

Leverage, Coverage, and Liquidity

In Millions of USD

Total Debt	26,346
Net Debt	-6,034
Total Debt/EBITDA	1.4
Net Debt/EBITDA	NMF
EBITDA/Interest	19.5
Current Ratio	2.2
Quick Ratio	4.0

NMF = Not Meaningful

Financial Summary

	----- Actual -----		Projected
Fiscal Year End:	Dec-15	Dec-16	Dec-17
Revenue	32,639	30,390	26,107
Revenue, YoY%	31.1%	-6.9%	-14.1%
Operating Income	22,193	17,633	6,766
Operating Margin %	68.0%	58.0%	25.9%
Net Income	18,108	13,501	4,725
Net Income Margin %	55.5%	44.4%	18.1%
Diluted EPS	11.91	9.94	3.51
Diluted EPS, YoY %	62.0%	-16.5%	-64.6%
Free Cash Flow (CFO-capex)	19,582	15,921	11,308
Free Cash Flow Margin %	60.0%	52.4%	43.3%

In Millions of USD (except for per share items)

Structure of the Pharma - Generic/Other - Industry — **GOOD**

The pharma (generic/other) industry is composed of makers of both brand and generic drugs. Intellectual property protection remains vital to the successful commercialization of safe/effective medicines and offers brand firms competitive advantages over the life of such patents. However, when brand drugs lose market exclusivity, makers of generic pharmaceuticals generate intense price competition. Long-term success for brand pharma companies depends on a strong drug pipeline, while cost-efficiency and being first-to-market are drivers of generic firms' success. We generally like the group.

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VALUENTUM

Bookings Holdings (BKNG) – Page 1 of 16

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

By Valuentum Analysts

Valuentum Retail Equity Research — Visit us at www.valuentum.com — Ratings as of 1-Mar-2018 — Data as of 28-Feb-2018

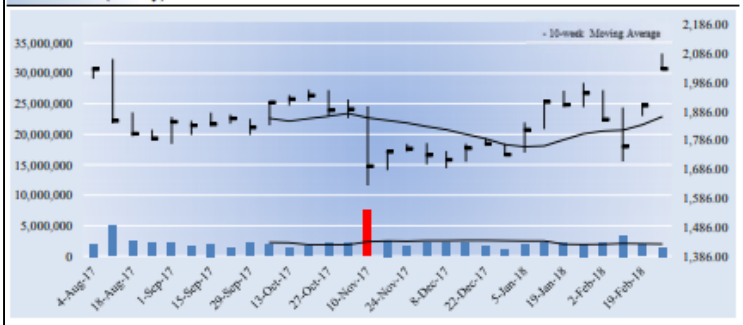
Booking Holdings BKNG FAIRLY VALUED

Buying Index™ 6 **Value Rating**

Economic Castle	Estimated Fair Value	Fair Value Range	Investment Style	Sector	Industry
Highest Rated	$1989.00	$1591.00 - $2387.00	LARGE-CAP GROWTH	Consumer Discretionary	Internet & Catalog Retail

Priceline changed its name to Bookings Holdings to align itself with its largest subsidiary, Booking.com.

Stock Chart (weekly)



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

Investment Considerations

DCF Valuation	FAIRLY VALUED
Relative Valuation	NEUTRAL
ValueCreation™	EXCELLENT
ValueRisk™	LOW
ValueTrend™	POSITIVE
Cash Flow Generation	STRONG
Financial Leverage	MEDIUM
Growth	HIGH
Technical Evaluation	BULLISH
Relative Strength	STRONG
Money Flow Index (MFI)	NEUTRAL
Upside/Downside Volume (U/D)	BULLISH
Near-term Technical Support, 10-week MA	1868.00

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

Business Quality

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

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

Company Vitals

Market Cap (USD)	$100,303
Avg Weekly Vol (30 wks)	2,267
30-week Range (USD)	1630.56 - 2087.34
Valuentum Sector	Consumer Discretionary
5-week Return	6.5%
13-week Return	15.6%
30-week Return	0.2%
Dividend Yield %	0.0%
Dividends per Share	0.00
Forward Dividend Payout Ratio	0.0%
Est. Normal Diluted EPS	94.63
P/E on Est. Normal Diluted EPS	21.5
Est. Normal EBITDA	6,171
Forward EV/EBITDA	30.4
EV/Est. Normal EBITDA	16.7
Forward Revenue Growth (5-yr)	13.7%
Forward EPS Growth (5-yr)	24.8%

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

Returns Summary

	3-year Historical Average
Return on Equity	27.9%
Return on Assets	15.4%
ROIC, with goodwill	66.0%
ROIC, without goodwill	153.6%

ROIC = Return on Invested Capital; NMF = Not Meaningful

Leverage, Coverage, and Liquidity

In Millions of USD

Total Debt	7,167
Net Debt	2,867
Total Debt/EBITDA	2.2
Net Debt/EBITDA	0.9
EBITDA/Interest	15.8
Current Ratio	1.9
Quick Ratio	1.8

NMF = Not Meaningful

Investment Highlights

- Bookings Holdings is a leader in global online hotel reservations. The firm is composed of four primary brands--Booking.com, Bookings Holdings.com, Agoda.com, Kayak and Rentalcars.com--and several ancillary brands. Bookings growth continues to be excellent across its platforms. The company was founded in 1997 and is headquartered in Connecticut.
- Demand in Bookings Holdings's business model is boosted by a virtuous cycle. Its partnerships allow it to offer an enhanced customer experience, driving increased conversion and traffic. Growing traffic levels give it the opportunity to test and improve customer and partner satisfaction.
- Bookings Holdings has made a habit of issuing conservative quarterly guidance, which the market tends not to like. Investors should be prepared for material swings on quarterly reports due to such guidance, and the firm's equity may be better served by management not issuing such punitive quarterly guidance. Nevertheless, we continue to have confidence in the firm's fundamentals.
- Priceline changed its name to Bookings Holdings to align itself with its largest subsidiary, Booking.com. Booking.com accounts for the majority of its gross bookings and operating income with more than 1.5 million listed properites and an average of 1 million bookings per day. Management has hinted that it may be open to acquisitions to further expand its portfolio.
- As it rides the wave of secular growth in Internet penetration in travel, Bookings Holdings will also benefit from expansion into new markets in North America, the Asia Pacific, and South America. The company's strong brand helps prop up share in the mature US market.

Relative Valuation

	Forward P/E	PEG	Price / FV
Amazon.com	NMF	6.7	149.5%
eBay	-43.9	NMF	119.0%
Expedia	42.9	1.8	87.4%
Liberty Interactive	21.9	2.2	95.0%
Peer Median	21.9	2.2	107.0%
Booking Holdings	**43.4**	**1.9**	**102.3%**

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

Financial Summary

	---- Actual ----		Projected
Fiscal Year End:	Dec-15	Dec-16	Dec-17
Revenue	9,224	10,743	12,681
Revenue, YoY%	9.3%	16.5%	18.0%
Operating Income	3,259	2,906	2,987
Operating Margin %	35.3%	27.1%	23.6%
Net Income	2,551	2,135	2,311
Net Income Margin %	27.7%	19.9%	18.2%
Diluted EPS	49.45	42.65	46.86
Diluted EPS, YoY %	8.3%	-13.8%	9.9%
Free Cash Flow (CFO-capex)	2,928	3,705	4,373
Free Cash Flow Margin %	31.7%	34.5%	34.5%

In Millions of USD (except for per share items)

Structure of the Internet & Catalog Retail Industry — GOOD

The Internet and catalog retail industry benefits as a whole from the secular trend toward consumer digital (online) consumption. The industry consists of a number of exclusive online retailers led by Amazon, which continues to disrupt the broader retail space, and businesses that offer Internet travel services such as Bookings Holdings, while online auctions are dominated by eBay. The industry generates high returns on investment due to minimal capital costs, but the landscape will be vastly different in the decades ahead. Still, we like the group.

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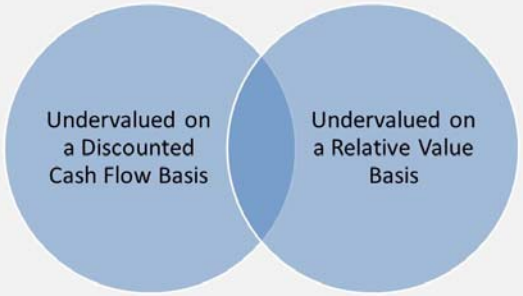
VALUENTUM

The Watch List

By Valuentum Analysts

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



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

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

[Screen expanded to include stocks with NEUTRAL relative value ratings.]

You'll notice there are not many ideas in this market that pass this stringent "value" test. We continue to emphasize that some of our best ideas are included in our simulated newsletter portfolios.

Company Name	Symbol	DCF Valuation	Relative Valuation	Price / Fair Value	Fair Value Estimate
Cardinal Health	CAH	UNDERVALUED	NEUTRAL	0.71	$83.00
AMC Networks Inc	AMCX	UNDERVALUED	ATTRACTIVE	0.72	$71.00
Sally Beauty	SBH	UNDERVALUED	NEUTRAL	0.71	$22.00
Gilead Sciences	GILD	UNDERVALUED	NEUTRAL	0.74	$107.00
Nautilus Inc	NLS	UNDERVALUED	ATTRACTIVE	0.75	$17.00

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

*Ideas...*continued on next page

*Ideas...*from previous page

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

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

Due to the frothy stock market environment, which is making driving up prices, there are no stocks that register a 9 or 10 on the Valuentum Buying Index rating system at this time. **Please consult the Best Ideas Newsletter portfolio on page 8 for our best ideas.**

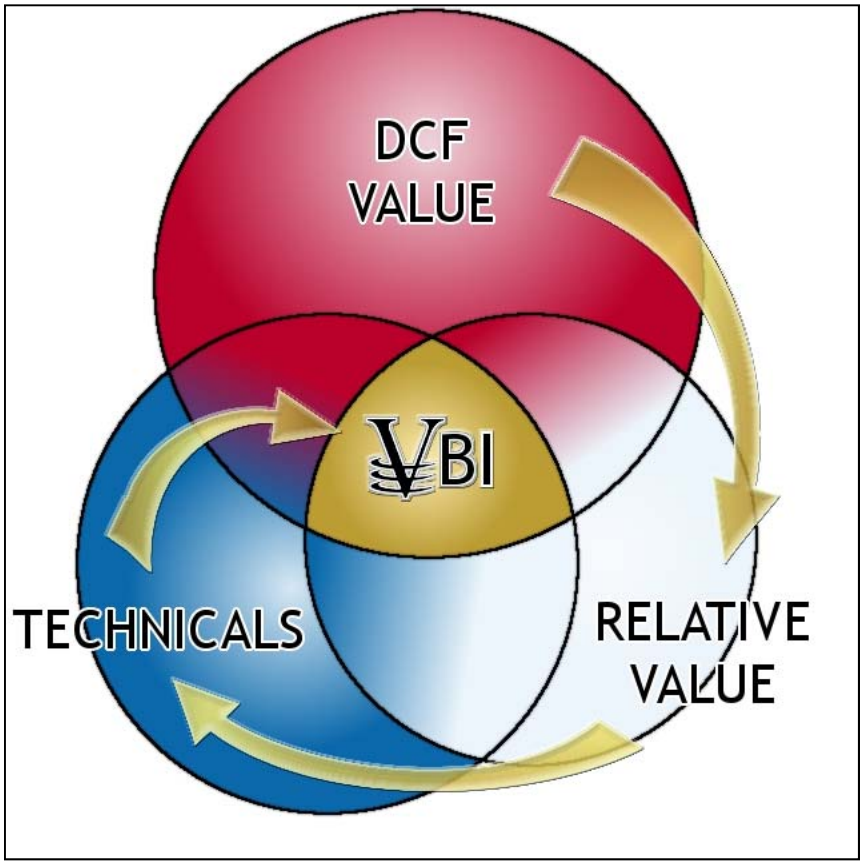
Company Name	Symbol	Sector	VBI
Amphenol Corp	APH	Information Technology	1
Analog Devices	ADI	Information Technology	1
Bio-Rad	BIO	Health Care	1
Clorox	CLX	Consumer Staples	1
Cogent Comm	CCOI	Telecom Services	1
Ecolab	ECL	Materials	1
Graco	GGG	Industrials	1
Illinois Tool Works	ITW	Industrials	1
Intercontinental	IHG	Consumer Discretionary	1
Intl Flavors	IFF	Materials	1
Lancaster Colony	LANC	Consumer Staples	1
Martin Marietta	MLM	Industrials	1
Mettler-Toledo	MTD	Health Care	1
National Beverage	FIZZ	Consumer Staples	1
National Instruments Corp	NATI	Information Technology	1
Nordson	NDSN	Industrials	1
OmegaFlex	OFLX	Industrials	1
Overstock.com	OSTK	Consumer Discretionary	1
Owens Corning	OC	Industrials	1
Quidel Corp	QDEL	Health Care	1
RBC Bearings	ROLL	Industrials	1
South Jersey	SJI	Energy	1
STMicroelectronics	STM	Information Technology	1
Sun Hydraulics	SNHY	Industrials	1
Synopsys	SNPS	Information Technology	1
Teledyne	TDY	Industrials	1
Teradyne	TER	Information Technology	1
Universal Health Realty	UHT	Financials	1

Our Methodology – The Valuentum Buying Index (VBI)

By Valuentum Analysts

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

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



Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

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

We think research firms that just focus on valuation may expose readers to a stock on its way down (a falling knife), while those that just use technical and momentum indicators may expose portfolios to significantly overpriced stocks at their peaks. It is our view that only when both sides of the investment spectrum are combined can investors find undervalued stocks at potentially timely prices for consideration.

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

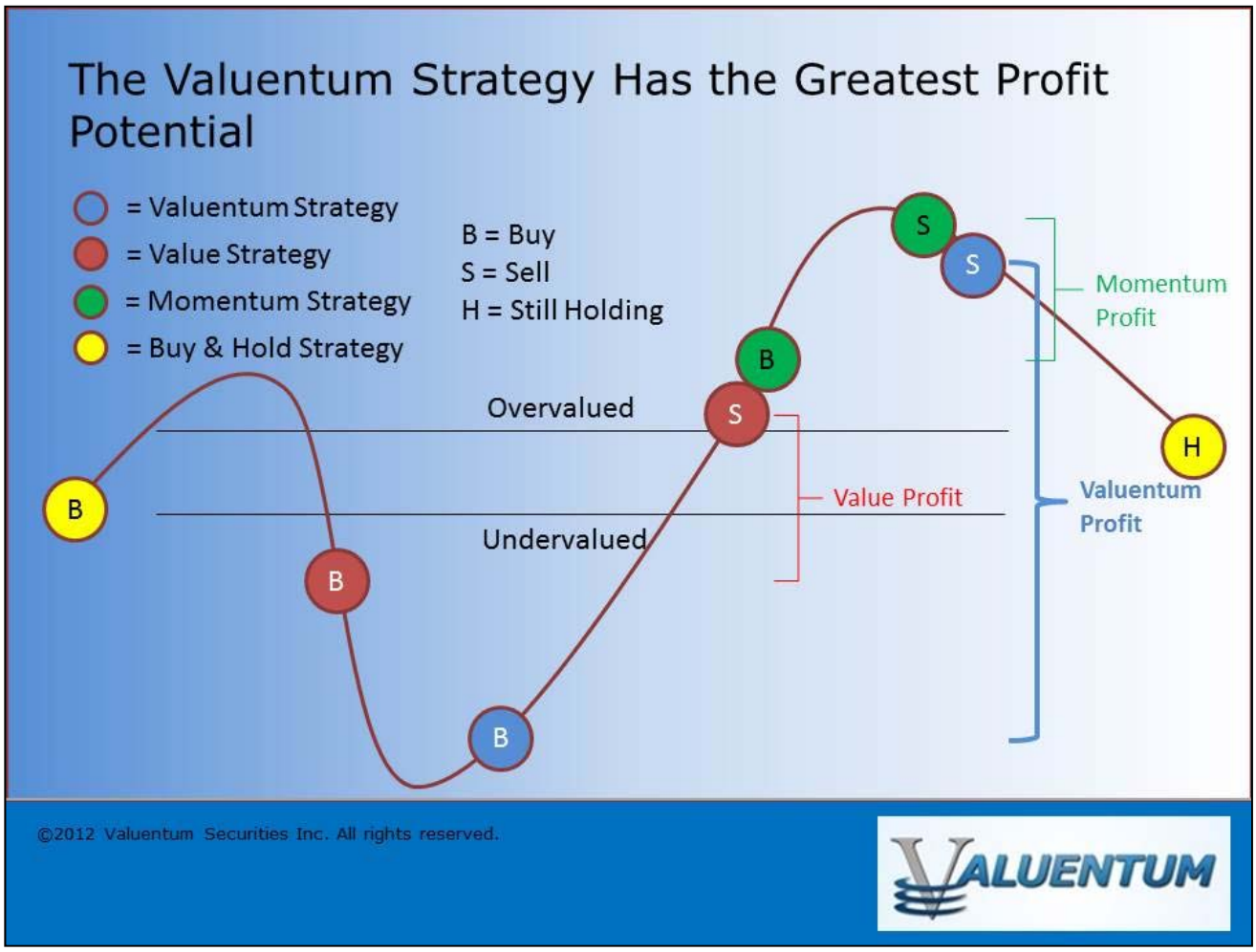


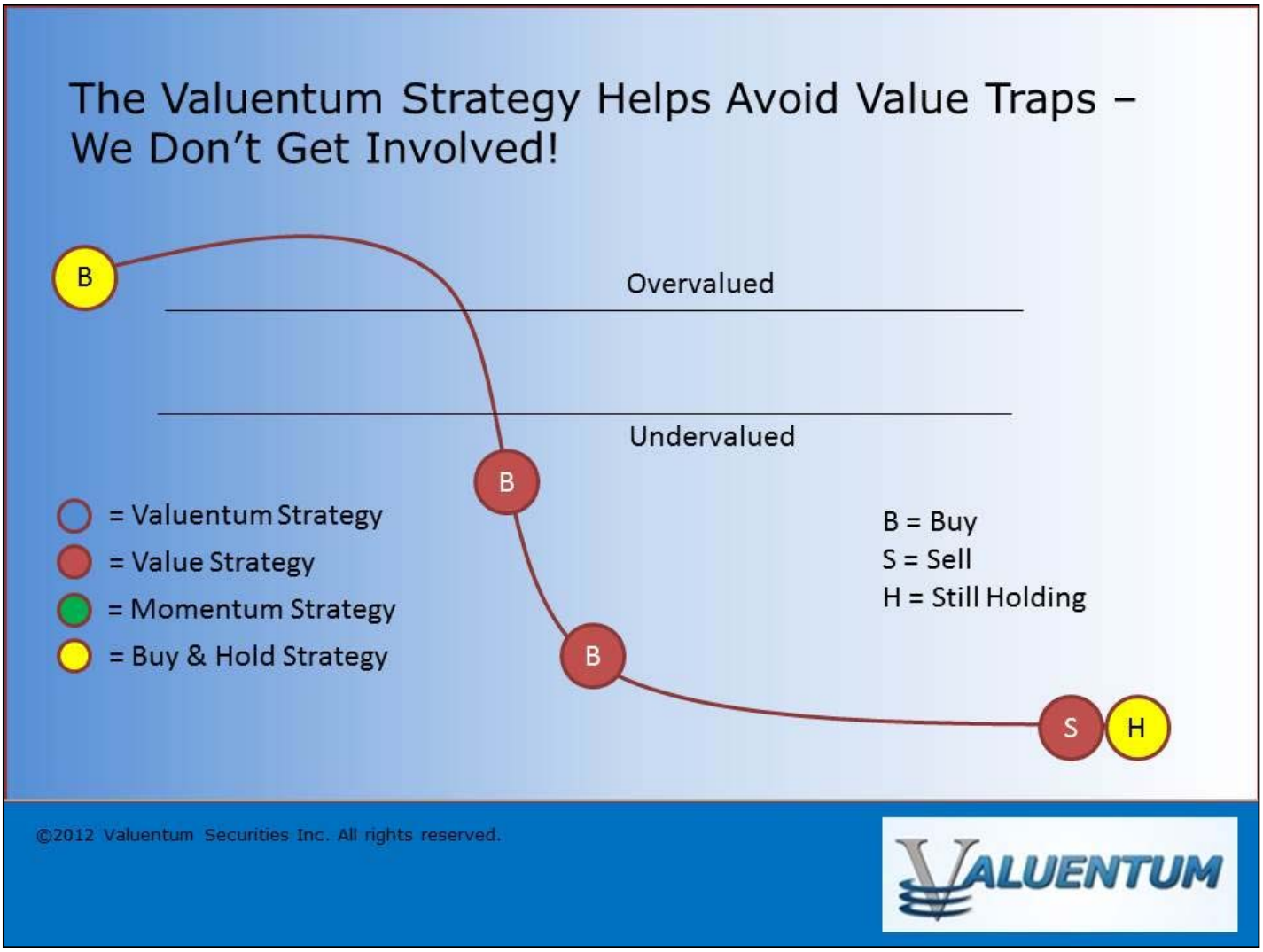
Illustration for educational purposes only.

Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

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

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



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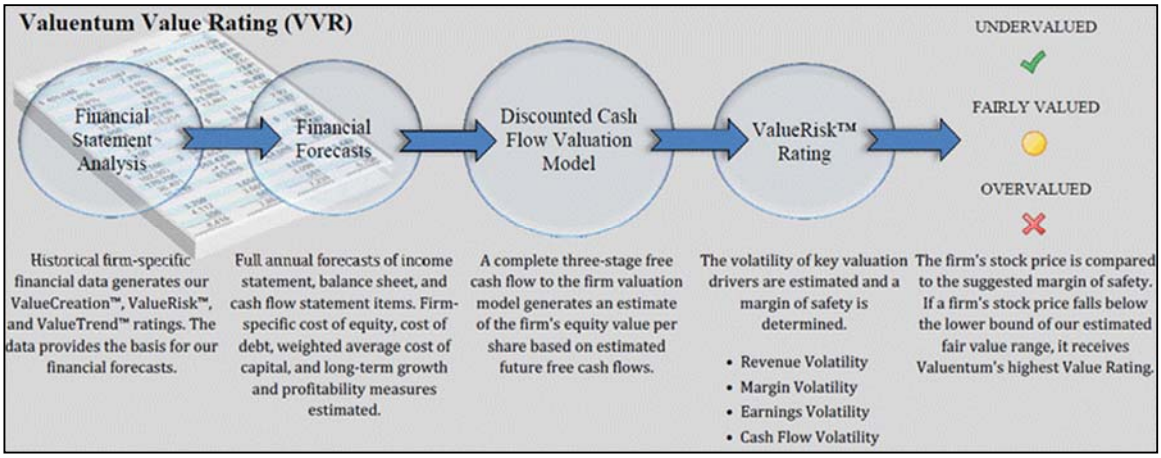
Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

Let's walk through the three investment pillars of our stock-selection methodology.

I. The Valuentum Buying Index Applies A Rigorous Discounted Cash Flow Valuation Process

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



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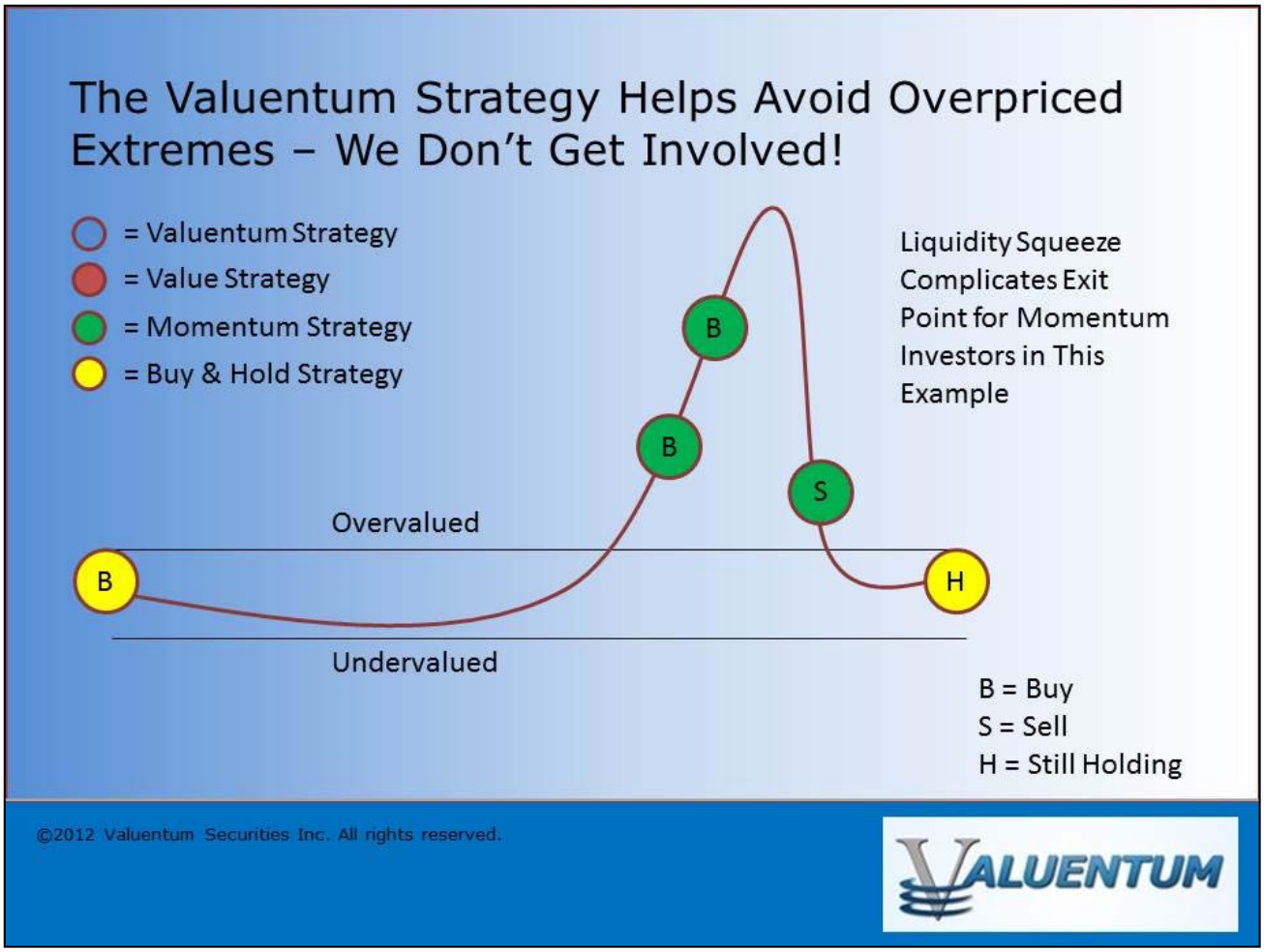
After evaluating historical trends, we then make full annual forecasts for each item on a company's income statement and balance sheet to arrive at a firm's future free cash flows. We derive a company-specific cost of equity (using a fundamental beta based on the expected uncertainty of key valuation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

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

We think a focus on discounted cash-flow (DCF) valuation helps to prevent investors from exposing their portfolios to significantly overpriced stocks at their peaks. The image below reveals how pure momentum investors may expose their portfolios to pricing extremes and dramatic falls (green circles: Buy --> Sell). The Valuentum Buying Index attempts to steer clear from these situations.

Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page



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II. The Valuentum Buying Index Incorporates A Forward-Looking Relative Value Assessment

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

III. The Valuentum Buying Index Seeks to Avoid Value Traps, Falling Knives and Opportunity Cost

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

Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

valuation criteria).

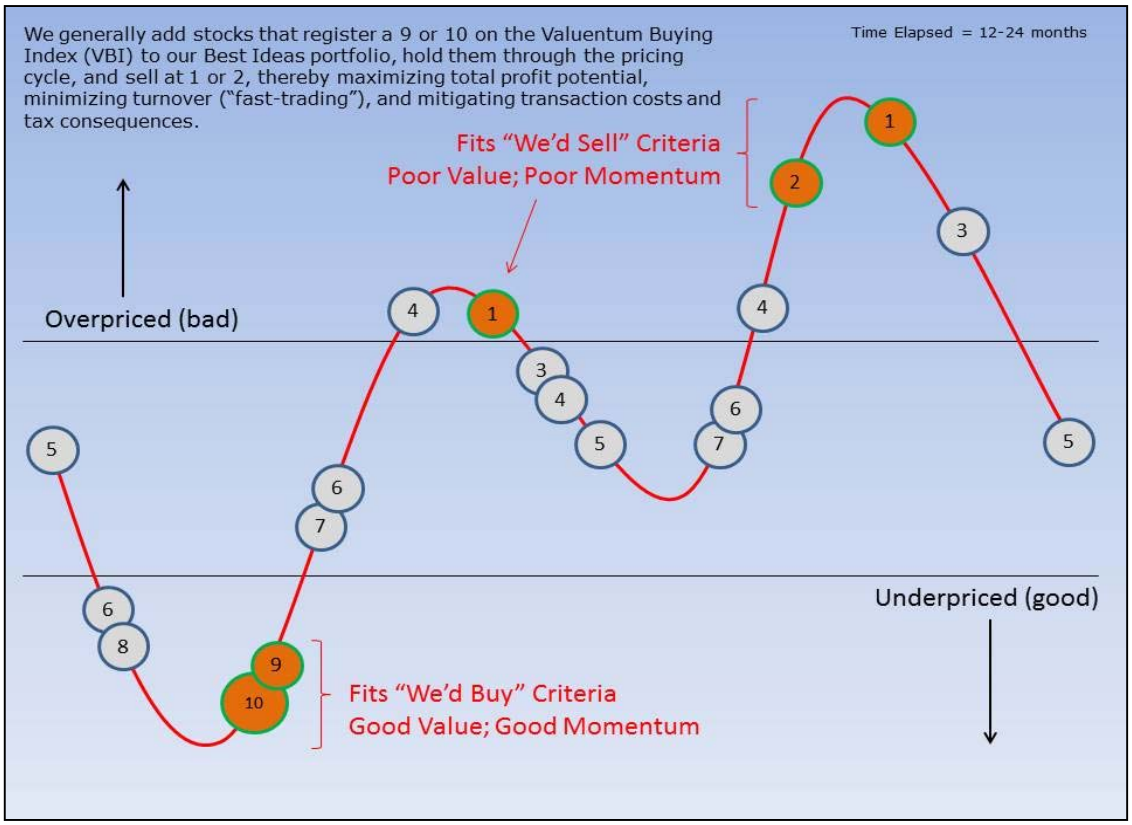
Rigorous valuation analysis and technical analysis are not mutually exclusive, and we believe both can be used together to bolster idea generation. An evaluation of a stock's moving averages, relative strength, upside-downside volume, and money flow index are but a few considerations we look at with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

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

Putting It All Together - the Valuentum Buying Index

Though the time frame varies depending on each idea, on a theoretically basis, we would expect our best ideas to "work out" over a 12-24 month time horizon (on average) -- the duration of any individual idea can vary considerably, however. We tend to include firms in the Best Ideas Newsletter portfolio when they register a 9 or 10 on our Valuentum Buying Index (VBI) and tend to remove firms from the Best Ideas Newsletter portfolio when they register a 1 or 2 on the Valuentum Buying Index.

In theory, the Valuentum Buying Index attempts to maximize profits on every idea within the Best Ideas Newsletter portfolio, with the understanding that momentum does exist and that prices over and under shoot intrinsic value all of the time. A value strategy (10 --> 5), for example, may truncate potential profits, while a momentum strategy (4 --> 1), for example, may ignore profits generated via value assessments. The Valuentum Buying Index seeks to capture the entire profit potential, as shown below.



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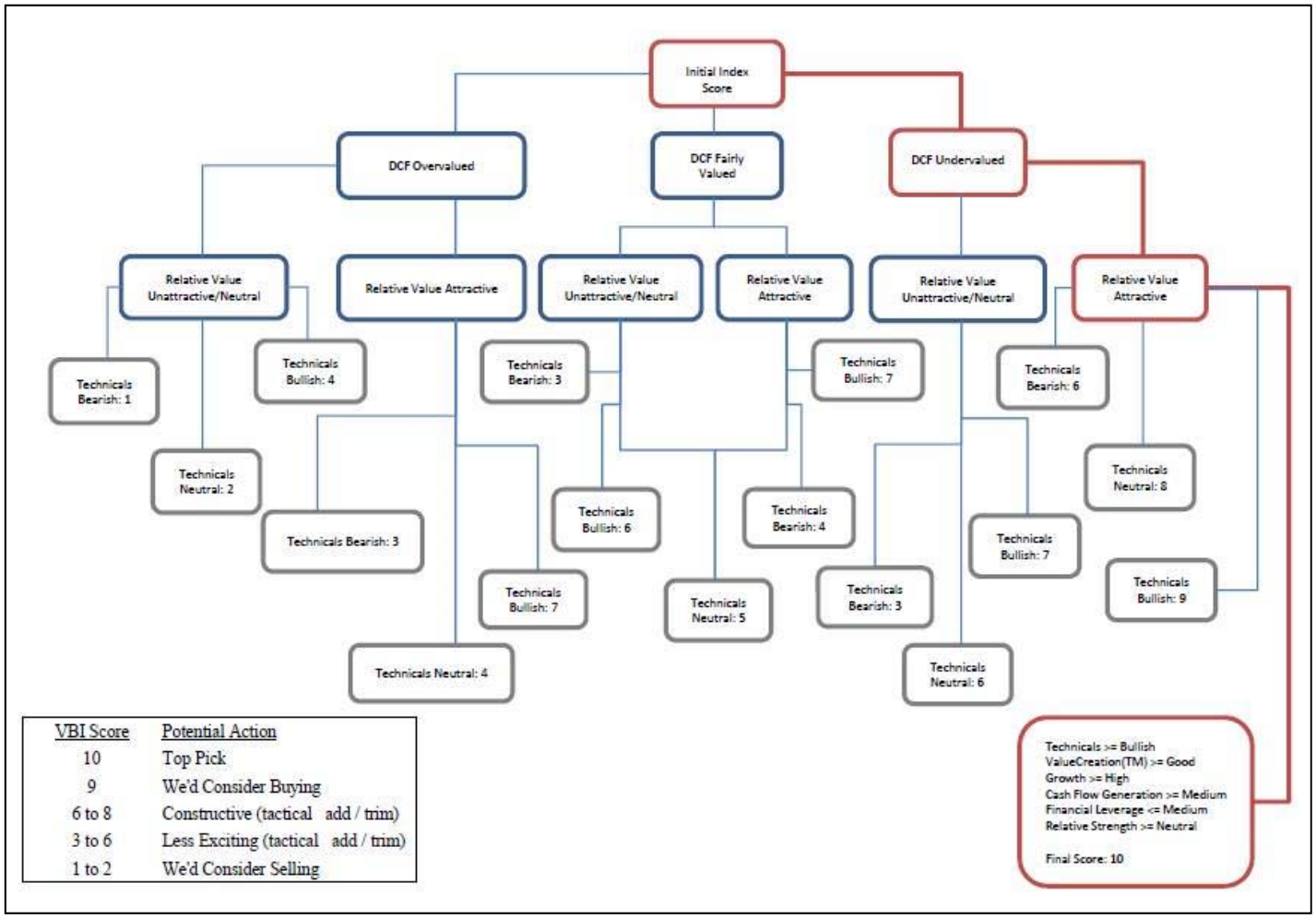
Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

Let's follow the red line on the flow chart below to see how a firm can score a 10, the best mark on the Valuentum Buying Index (a "Top Pick"). Please click here to view an enlarged pdf version.

First, the company would need to be 'UNDERVALUED' on a DCF basis and 'ATTRACTIVE' on a relative value basis. The stock would also have to be exhibiting 'BULLISH' technicals. The firm would need a ValueCreation rating of 'GOOD' or 'EXCELLENT', exhibit 'HIGH' or 'AGGRESSIVE' growth prospects, and generate at least a 'MEDIUM' or 'NEUTRAL' assessment for cash flow generation, financial leverage, and relative price strength.

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



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

Illustration for educational purposes only.

Our Methodology – The Valuentum Buying Index continued on next page

About the Fair Value Range

By Valuentum Analysts

Understanding the Fair Value Range and Why It's Important

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

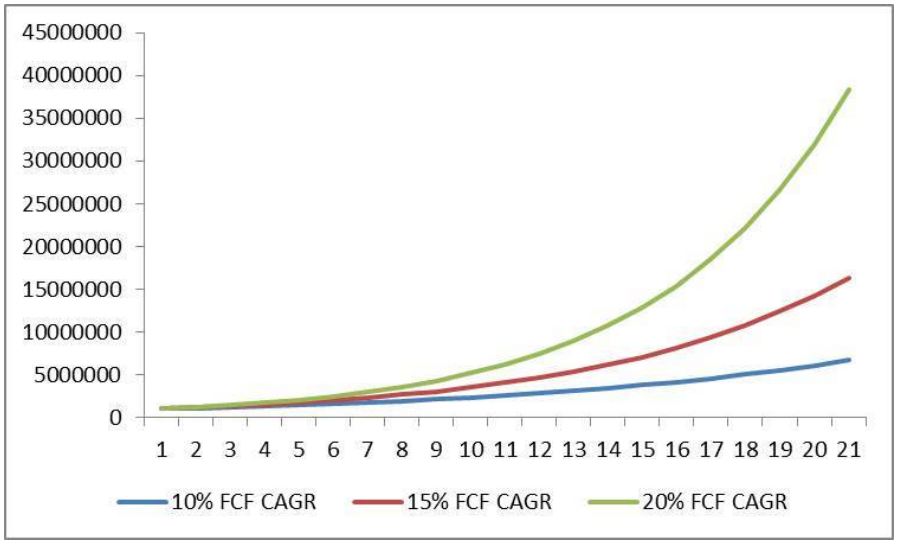
One of the most important concepts of the Valuentum methodology (and valuation in general) is the understanding that the value of a company is a range of probable valuation outcomes, not a single point estimate. Even well-seasoned stock analysts are guilty of saying that a company's shares are worth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

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

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

But why the large range in many cases?

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



About the Fair Value Range continued on next page

About the Fair Value Range continued from previous page

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

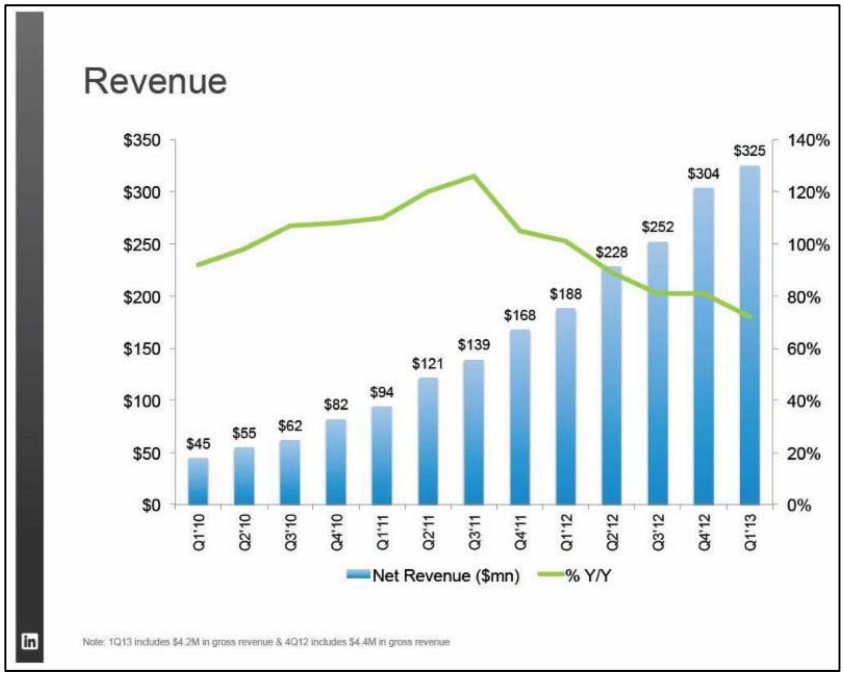


Image Source: LinkedIn

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

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

Shares collapsed in a huge way.

About the Fair Value Range continued on next page

About the Fair Value Range **continued from previous page**

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

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

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

By Valuentum Analysts

We often receive questions about how we use the Valuentum Buying Index (VBI) rating system, one of the key metrics we use to source ideas, but we think it is equally important to mention up front that it is only one of the many facets of our website and services. For example, if you haven't checked out the Dividend Cushion ratios on the stocks in your portfolio or the dividend growth product (from individual reports to the newsletter and beyond), surely you are not maximizing your membership! Don't forget about the Economic Castle rating and the Nelson Exclusive publication, too.

No matter your strategy or process though (it is not for us to say what is best for you), the Valuentum Buying Index rating system is still a helpful tool to have at your disposal, even if you are not using it. Admittedly, the VBI, as we call it, is not as easy to evaluate as 1, 2, 3, or even buying 9s and 10s and selling 1s and 2s until their VBI changes upon the next update. Generally speaking, we measure the process over longer-term time periods--from the time a company registers a rating to a defined time in the future--not an interim update basis. Please read more our case study, where Valuentum Buying Index ratings, as of September 2013, were recorded and the performance of stocks were measured from that time through September 2014.

The Valuentum Buying Index Has Checks and Balances

With prudence and care, the Valuentum Buying Index process and its components are carried out. Our analyst team spends most of its time thinking about the intrinsic value of companies within the context of a discounted cash-flow model and evaluating the risk profile of a company's revenue model. We have checks and balances, too. First, we use a fair value range in our valuation approach as we embrace the very important concept that value is a range and not a point estimate. A relative value overlay as the second pillar helps to add conviction in the discounted cash-flow process, while a technical and momentum overlay seeks to provide confirmation in all of the valuation work. There's a lot happening behind the scenes even before a VBI rating is published, but it will always be just one factor to consider.

Within any process, of course, we value the human, qualitative overlay, which captures a wealth of experience and common sense. We strive to surface our best ideas for members, and flying blind is never a good strategy, in our opinion. In probably one of the most obvious cases, for example, an experienced investor knows when a price-to-earnings (P/E) ratio isn't informative (as in the case of negative or negligible earnings), but a quantitative rating system that uses a P/E ratio may not know any better. That's why the VBI has checks and balances and focuses on the discounted cash-flow process first and foremost, but the human, qualitative overlay is still extremely important, especially when considering various business models and unique "un-modelable" risks. In our opinion, a golf club is only as good as the player that uses it, and in a similar light, a financial model or a rating system is only as good as the user that applies it.

That said, for the sake of transparency, we measure the performance* of the portfolios in the Best Ideas Newsletter and Dividend Growth Newsletter. The portfolios, in part, represent data points measuring the outcome of the work we do on the website, rolled into an assessment: our best ideas for each respective strategy. The ideas in the portfolios in the Best Ideas Newsletter and Dividend Growth Newsletter have been evaluated by our analyst team for consideration in the newsletter portfolios. The thoughts behind the weighting of each idea and the portfolio management process revealed in full transparency on a month to month basis may be worth the cost of a membership alone, even if you're not using the portfolios!

Here's why this is important. In a market environment where more than 90% of large-cap funds have trailed the S&P 500 in the 5-year period ending August 31, 2016, the Best Ideas Newsletter portfolio* has exceeded its benchmark return over a similar time period. What's more, we showcased this performance in full transparency, and we wrote every single day, and some days weren't all that great. When patience

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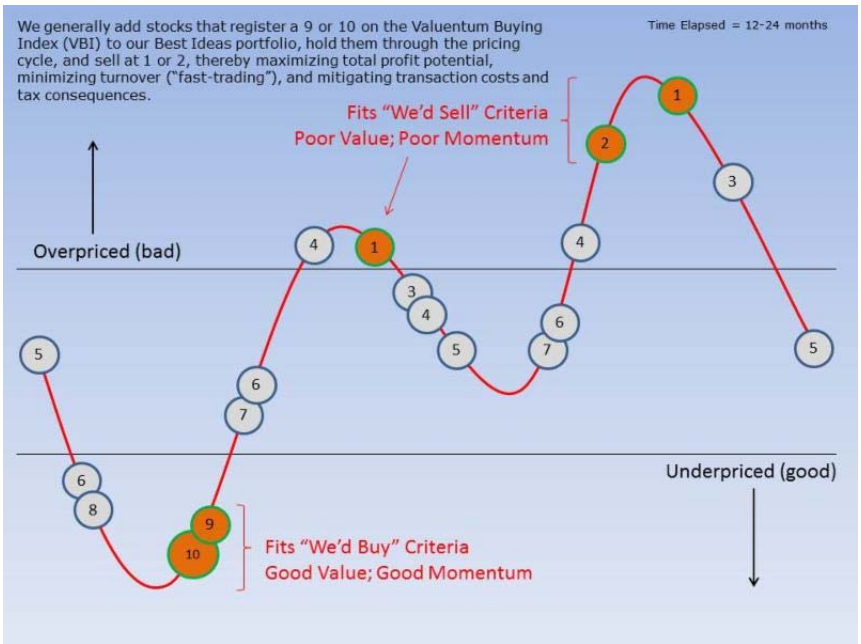
may be the secret to success in investing, a lot could have gone wrong with the temptation to do something each day. Obviously, we're very disciplined, but we also credit the portfolio outperformance to the VBI methodology itself. It is a very helpful tool.

** Actual results may differ from simulated information being presented. The Best Ideas Newsletter portfolio and Dividend Growth Newsletter portfolio are not real money portfolios. Results are hypothetical and do not represent actual trading.*

The Valuentum Buying Index Is One of Many Important Factors to Consider

That said, let's talk about how the VBI helps to inform which ideas we include in the Best Ideas Newsletter portfolio. This is where some clarification is probably important. For one, the word choice is critical, "inform," because the VBI is generally just one factor that goes into whether we add a company to the Best Ideas Newsletter portfolio, even if the VBI is one of the most important factors. Second, the timing element or duration concept is a key consideration. We've noticed via our statistical backtesting that a momentum factor can be much more pronounced (powerful) over longer periods of time. This was one of the interesting findings of our academic white paper study (2012). We try to consider this dynamic with the update cycle of our reports (and the time horizon for ideas to work out). That's why our reports are updated regularly (generally on a quarterly basis) or after material events and not daily or weekly. Perhaps most practically though, we don't think portfolio churn is the way to generate outperformance. Momentum may be high turnover, but Valuentum is low turnover.

Though the time frame varies depending on each idea that we consider for the Best Ideas Newsletter portfolio, we would expect our best ideas to generally work out over a 12-24 month time horizon (on average). Not all ideas will be successful, however. Our "holding period" is targeted to be much, much longer for some ideas in the Dividend Growth Newsletter portfolio, as income and dividend growth are other key factors (in addition to the Valuentum Buying Index and capital appreciation potential). The time horizon or duration concept is where the Valuentum Buying Index rating system becomes more complicated than a simple 1, 2, 3. For example, we tend to "add" stocks to the Best Ideas Newsletter portfolio when they register a 9 or 10 on the Valuentum Buying Index (VBI), "hold" them for some time depending on a number of variables (the VBI, market conditions, sector weightings within the portfolio itself), and then we tend to "remove" stocks from our Best Ideas Newsletter portfolio when they register a 1 or 2 on the VBI. You'll notice that we have a qualitative overlay for the Best Ideas Newsletter portfolio (and one for the Dividend Growth Newsletter portfolio, too, based on dividend-related considerations).



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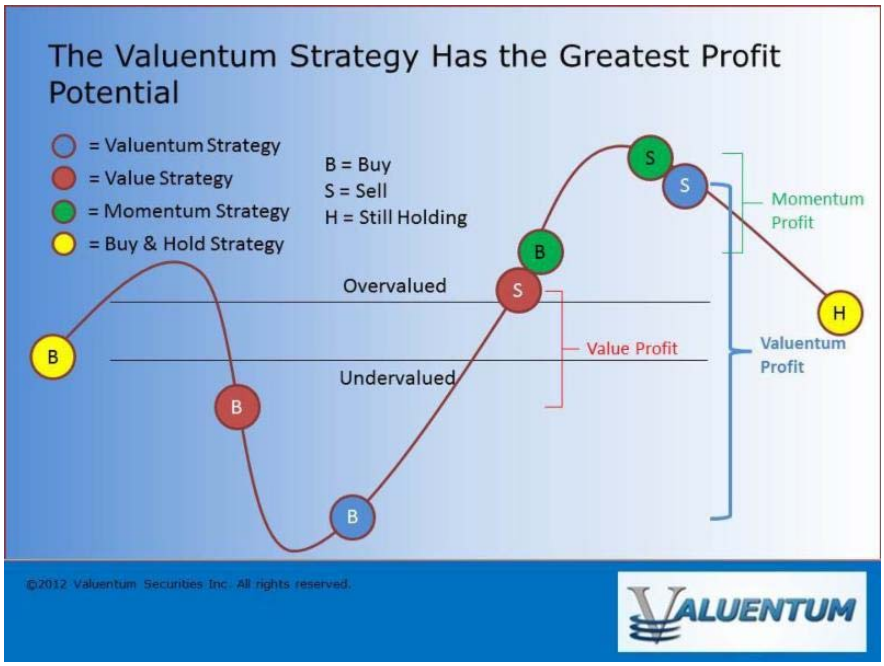
But why don't we churn our ideas by updating daily and trading a lot? Obviously, we don't think that's the secret to investment success. In quite the opposite approach, we strive to maximize profits on every idea that we pursue, with the understanding that momentum does exist and that prices over and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



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Not All Highly-Rated Stocks Are Added to the Newsletter Portfolios

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

But why not add every highly-rated stock on the Valuentum Buying Index to the Best Ideas Newsletter portfolio? Think of it as if you were to imagine a value investor not adding and holding every undervalued stock to his/her portfolio. He or she wants the very best ones, in his or her opinion -- obviously, that means having to leave some good ideas behind. And then, of course, there are always tactical and sector weighting considerations in any portfolio construction, yet another reason why the human touch remains a vital aspect of the Valuentum process. At the core of how we use the VBI in the Best Ideas Newsletter portfolio, however, is a qualitative portfolio management overlay. The VBI rating helps to inform the

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process, but the Valuentum team makes the allocation decisions of the newsletter portfolio on the basis of a number of other firm-specific and portfolio criteria. Sometimes, under certain market conditions, we may even have to relax the VBI criteria entirely in order to do what we think is required to achieve newsletter portfolio goals.

Some Examples of the Valuentum Buying Index In Action

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

There have been more straightforward opportunities in the Best Ideas Newsletter portfolio, too, especially in the case of EDAC Tech, which tripled since it was added to the newsletter portfolio (never registering below a 9 along the way), and then of course, Apple (APPL), Visa (V) and Altria (MO), but it is usually through the nuances of the process that one truly comes to understand it (as in the eBay example). Not to be overlooked either, the Valuentum Buying Index rating also informs us when we may consider "removing" a position from the newsletter portfolios. Kinder Morgan (KMI), for example, registered a 1 on the Valuentum Buying Index just prior to its notorious fall and dividend cut. The VBI ratings on each stock's most recent 16-page report, downloadable directly from the website at www.valuentum.com, reflect our current opinion on the company.

In all, the Valuentum Buying Index rating system, as with all methodologies, helps to inform the investment decision process, but in constructing the newsletter portfolio, a qualitative overlay is not only necessary, in my view, but helps to optimize performance. If the returns of the Best Ideas Newsletter portfolio during the past 5+ years are any measure of the VBI rating system, it is performing fantastically well. Of course, please always contact your financial advisor to determine if any idea or strategy may be right for you.

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About Our Name

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

-- Warren Buffett, Berkshire Hathaway annual report, 1992

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

Valuentum Best Ideas Newsletter: Volume 8, Issue 3

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

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Valuentum's company-specific forecasts used in its discounted cash flow model are rules-based. These rules reflect the experience and opinions of Valuentum's analyst team. Historical data used in our valuation model is provided by Xignite and from other publicly available sources including annual and quarterly regulatory filings. Stock price and volume data is provided by Xignite. No warranty is made regarding the accuracy of any data or any opinions. Valuentum's valuation model is based on sound academic principles, and other forecasts in the model such as inflation and the equity risk premium are based on long-term averages. The Valuentum proprietary automated text-generation system creates text that will vary by company and may often change for the same company upon subsequent updates.

Valuentum uses its own proprietary stock investment style and industry classification systems. Peer companies are selected based on the opinions of the Valuentum analyst team. Research reports and data are updated periodically, though Valuentum assumes no obligation to update its reports, opinions, or data following publication in any form or format. Performance assessment of Valuentum metrics, including the Valuentum Buying Index, is ongoing, and we intend to update investors periodically, though Valuentum assumes no obligation to do so. Not all information is available on all companies. There may be a lag before reports and data are updated for stock splits and stock dividends.

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