OUR DIVIDEND GROWTH NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

June 1, 2018
Volume 7 Issue 6

Valuentum Securities Inc.
www.valuentum.com info@valuentum.com

NEW* Valuentum released a study on its **Best Ideas Newsletter portfolio! Please download the paper at the following link:*

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Microsoft Now $100+ Per Share

Almost every dividend-related presentation we made around the country, we talked about how much we liked Microsoft as a dividend growth idea. The stock was originally added to the simulated Dividend Growth Newsletter portfolio at inception at ~$26 per share, and we started the company out as an 8% position! It means the world to us to let you know that Microsoft's stock has now surpassed $100 per share! Seriously - could we possibly have done any better with our top dividend growth idea out of the gates?

By Brian Nelson,CFA

Image shown: Microsoft's performance relative to an ETF tracking the S&P 500 (SPY) since the beginning of 2012, the inception of the simulated Dividend Growth Newsletter portfolio.

Brian M. Nelson, CFA
President, Equity Research
brian@valuentum.com

Kris Rosemann
Associate Investment Analyst
kris@valuentum.com

Alexander J. Poulos
Healthcare & Biotech Contributor

Dividend Growth Ideas: MO, AAPL, BKLN, CBRL, CSCO, DLR, XLE, GM, GILD, HAS, IDV, INTC, JNJ, MSFT, NVS, O, ORCL, SDY

***NOTE:** The goal of the Dividend Growth Newsletter is to highlight ideas with strong dividend growth potential and update readers about new developments in the market. A simulated portfolio of dividend growth ideas is presented on page 5 of each edition.

"A stock [Microsoft] whose price has increased nearly four-fold as the company more-than-doubled its dividends-paid-per-share over the same time period!"

– Brian Nelson, CFA

I really don't know what to say. My goodness. Microsoft (MSFT).

The company has simply been a fantastic performer in the simulated Dividend Growth Newsletter portfolio these past many years. If you may recall, we used Microsoft as an example with every presentation walking through the tremendous benefits of the Dividend Cushion ratio. Many wrote the software giant off as "dead-money" years ago, but we did nothing but pound the table--and pound the table some more--about how we were huge fans of the company's tremendous free cash flow generation and balance-sheet health. It probably goes without saying, but we still like shares! For us to turn sour on them, both value and momentum indicators would have to "roll over."

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It was only prudent to reduce exposure to the company when it acquired LinkedIn. But it's now a $100 stock! Can you believe it? It's absolutely trounced the market's returns since inception of the simulated Dividend Growth Newsletter portfolio, too (see image above). When it was added to the newsletter portfolio at the beginning of 2012, Microsoft paid an annualized dividend of $0.80 per share, and now in just a few short years, it pays an annualized dividend of more than double that ($1.68 per share). What an incredible story. A stock whose price has increased nearly four-fold as the company more-than-doubled its dividends-paid-per-share over the same time period! I'm not sure that we could have positioned dividend-growth members better with our favorite idea out of the gates.

I understand that this is the Dividend Growth Newsletter, but if you haven't read through the analysis of the Best Ideas Newsletter portfolio, I implore you to do so. We're extremely proud of the simulated Best Ideas Newsletter portfolio's track record, but if it doesn't impress you (especially in the context of tremendous underperformance by active management, in general), then you might understand why we have moved to portfolio weighting ranges instead of specific weighting percentages in the newsletter products. The bottom line is that, while we're proud of our track record, newsletter portfolio success doesn't necessarily translate to member success, and we care more about member success than anything else. We're working on conducting similar analysis of the Dividend Growth Newsletter portfolio, but please have a read of the analysis of the Best Ideas Newsletter portfolio:

https://www.valuentum.com/articles/Study_Valuentums_Best_Ideas_Newsletter_Portfolio

More recently, the markets have been dealing with some indigestion from a combination of worries about Italy's (EWI) political environment and sovereign health and modest risk of contagion given Deutsche Bank's (DB) troubles, but the US equity markets are taking global setbacks in stride. Economic growth and employment levels in the US remain strong, all things considered, and while the Federal Reserve's ongoing contractionary monetary policy may put a damper on the pace of price appreciation of higher-yielding equities, many of the companies we include in the simulated Dividend Growth Newsletter portfolio have strong fundamentals and generally attractive valuations, if not reassuring technical/momentum indicators. I hope that you enjoy this June edition of the Dividend Growth Newsletter!

Cracker Barrel Raises Dividend; All-in Yield Impressive

By Kris Rosemann

We've been quite pleased with the income generation of Cracker Barrel (CBRL) since highlighting it as an idea in the simulated Dividend Growth Newsletter portfolio, and the unique restaurant operator appears to have made a habit of announcing dividend increases and special payouts, as it did with its fiscal third-quarter 2018 report, released May 22. Fiscal 2018 marked the fourth consecutive such year. The stock reacted favorably to the report, and shares yield ~3.1% after the recent increase in the regular dividend. Cracker Barrel's yield is much higher considering the special dividends investors have grown accustomed to.

Total revenue advanced 3% on a year-over-year basis at Cracker Barrel during the third quarter of its fiscal 2018 as comparable store restaurant sales increased 1.5%--thanks to a 2.8% increase in average check offsetting a 1.3% decline in traffic--and comparable store retail sales increased 0.9%. Commodity inflation and expenses related to strategic initiatives weighed on the operating line in the quarter as the company's operating margin fell to 8.8% from 10.2% in the comparable period of fiscal 2017, but diluted earnings per share advanced to $2.03 from $1.95 due to a materially lower tax bill.

Cracker Barrel continues to generate solid levels of free cash flow, which came in at $119 million through three quarters of fiscal 2018, a decline of only 2.4% from the comparable period of fiscal 2017 despite capital spending growing nearly 26%. The company's financial leverage remains reasonable as it ended the fiscal third quarter with $400 million in long-term debt and $174 million in cash and cash

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equivalents. At last check, the old country store and restaurant operator has a Dividend Cushion ratio of 1.6. Cash dividends paid through three quarters of fiscal 2018 were $88 million, and this free cash flow coverage gave management the confidence to hike its quarterly payout by 4% to $1.25 per share, as well as declare a special dividend of $3.75.

That said, food commodity inflation is expected to continue weighing on Cracker Barrel's bottom line, and the company lowered the top end of its earnings guidance range. Food commodity inflation is now expected to be 3.25% for the full year fiscal 2018 (was 2.5%-3.0%), operating income margin is now targeted at 9.5% for the year (was 9.5%-10%), and adjusted earnings per diluted share guidance now comes in a range of $9.30-$9.40 (was $9.30-$9.50). Total revenue is still expected to be roughly $3.1 billion, comparable store restaurant sales growth guidance remains 1%-2%, and roughly flat comparable store retail sales growth is still expected.

All things considered, we're not changing our position on this robust generator of income. Cracker Barrel may face a challenging operating environment that includes traffic pressures and food commodity cost inflation, but its execution has remained sound. There may be additional upside potential within its Holler & Dash Biscuit House fast-casual concept over the long haul, but we're not counting on it. We'll be watching closely for the potential of capital spending related to new restaurant openings to impact free cash flow generation moving forward as ample coverage of its dividends with free cash flow is what makes these income-investor pleasing reports possible.

Campbell Soup Representative of Weakening Consumer Staples Equities

When our team presented at the CFA Society of Houston in March 2017, we warned about the possible coming pressures on consumer staples stocks, and so far, our concerns have come to fruition. Not only have a number of high-profile players in the tobacco and beverage arena soured, but household consumer products and packaged foods players have felt the pain, too. Campbell Soup's recent fallout has been among the worst. Shares have been halved since mid-2017.

By Brian Nelson, CFA

The consumer staples sector, as measured by the Consumer Staples Select SPDR ETF (XLP), has faced considerable pressure of late, as big disappointments at Philip Morris (PM), which has impacted Altria (MO) in sympathy, weak quarterly performance from Procter & Gamble (PG) and generally lackluster results from Coca-Cola (KO) have weighed on the sector. The price of the Consumer Staples Select SPDR ETF has fallen more than 14% from late January 2018, trailing the market by more than 10 percentage points over that time. Since the beginning of 2017, the market has advanced more than 20%, while consumer staples shares, as measured by State Street's XLP ETF, have fallen ~4%, revealing ~24 points of underperformance.

The latest blow to the traditionally-resilient consumer staples group came from Campbell Soup (CPB), which reported highly-disappointing fiscal third-quarter results May 18, news that coincided with the retirement of Denise M. Morrison from the CEO position at the soup maker. Shares of Campbell Soup have been halved since they peaked at nearly $70 in mid-2017, a nightmare for the executive team and holders of shares. Net sales at Campbell Soup increased 15% in its fiscal third quarter (ends April) thanks to the purchase of Snyder's-Lance, but adjusted operating income advanced just 1%. Echoing the concerns we said about pricing pressures in early 2017, Campbell Soup noted that gross-margin performance came in below expectations.

Shockingly, Campbell Soup's gross margin fell to 29.1% in the fiscal third quarter of 2018 from 35.9% in the year-ago period. Even after excluding items to improve comparability, its gross margin still contracted 3.9 percentage points as pricing/promotional pressures, cost inflation, and higher supply chain costs weighed

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on profitability. Campbell Soup lowered its fiscal 2018 earnings guidance during its third-quarter report, too, a rather surprising development so late into the company's fiscal year, and we think the troubles won't subside anytime soon. Adjusted EBIT is now expected to be down 9%-11% (negative 9%-11%) from expectations of a 5%-7% decline (negative 5%-7%) during the fiscal year.

It's not all dire at Campbell Soup, however. The company's operating cash flows advanced to $1.02 billion during the first nine months of its fiscal year from $1 billion during the same period last year. Capital spending remains controlled, though the measure did advance in the same year-over-year nine-month period, too, but free cash flow continues to cover cash dividends paid by a multiple. What is most concerning to investors of Campbell Soup, however, is the company's debt load, which exploded higher as a result of acquisitive activity, with total debt now standing at $9.8 billion at the end of April 2018 against a cash and cash equivalents balance of less than $200 million. Campbell Soup is now a story of gross-margin pressures and too-much leverage, and its 4% dividend yield isn't high enough to tempt us.

Procter & Gamble's quarterly results revealed evidence of pricing pressures and sent shockwaves through the household consumer products group, hurting shares of Clorox (CL), Kimberly-Clark (KMB), Church & Dwight (CHD), Colgate Palmolive (CL) and others, and now Campbell Soup's outlook did the same to the packaged foods space, drawing selling pressure at General Mills (GIS), J.M. Smucker (SJM), Kellogg (K) and others. Though some entities have pointed to concerns about increased costs from potential tariffs, increased pricing pressures and higher promotional expenses are likely the primary reasons. We're not looking to add exposure to the consumer staples sector in any simulated newsletter portfolio at the moment.

Cisco's Long Term Remains Bright; Not Worried

Cisco's fiscal third quarter results came in mostly as expected, but shares faced selling pressure following the release as the company's operating margin was squeezed in the quarter. We still like Cisco a lot and are not concerned about the market's tunnel vision. The company's free cash flow performance and a huge net cash position are hard not to like. We're not worried.

By Kris Rosemann

Networking giant and simulated newsletter portfolio holding Cisco (CSCO) showed solid progress in its ongoing transformation towards a software and subscriptions focused business model in its fiscal third quarter report, results released May 16, but shares faced selling pressure following the release as its operating contracted due in part to heavy investments related to recent acquisitions.

Revenue at Cisco grew 4% from the year-ago period, driven by strength in Product revenue, specifically in Applications and Security. Recurring revenue accounted for 32% of total revenue, up 2 percentage points from the comparable period of fiscal 2017, and deferred revenue advanced 9% on a year-over-year basis thanks to strong performance in subscription-based and software offers, which increased 29%.

Cisco's gross margin continues to be impacted by higher memory pricing, a dynamic expected to persist in the near term, as non-GAAP gross margin contracted 50 basis points. GAAP operating income fell 1% from the year-ago period as operating expenses were elevated due to the aforementioned investments related to recent acquisitions that are in early development phases. GAAP operating margin fell to 25.1% from 26.5% in the third quarter of fiscal 2017. Non-GAAP earnings per share advanced 10% on a year-over-year basis to $0.66.

Cash flow from operations in Cisco's fiscal third quarter fell 28% from the year-ago period due to a $1.3 billion payment of one-time foreign taxes, but excluding this impact, the measure advanced 11%. However, even after including this materially negative impact, free cash flow generation fell only 2% ($173 million in absolute terms) through nine months of fiscal 2018 on a year-over-year basis, and the more than $8.9 billion in free cash flow generated through three quarters is more than double cash

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Dividend Growth Ideas

By Valuentum Analysts

NEW* Valuentum released a study on its **Best Ideas Newsletter portfolio! Please download the paper at the following link:*

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DIVIDEND GROWTH IDEAS -- as of June 1, 2018

Company Name	Yrly Div's Paid ($) / Shr	Div Yield %	Fair Value	VBI Rating	Price/FV	Last Close	% of Portfolio
Intel (INTC)	1.20	2.10%	$ 54.00	7	1.06	57.08	5.5%-10%
Johnson & Johnson (JNJ)	3.36	2.77%	$ 133.00	3	0.91	121.26	5.5%-10%
S&P Dividend ETF SPDR (SDY)	2.21	2.39%	-	UR	-	92.35	5.5%-10%
Apple (AAPL)	2.92	1.53%	$ 220.00	6	0.86	190.24	4%-5.5%
Cisco (CSCO)	1.32	3.02%	$ 48.00	3	0.91	43.66	4%-5.5%
Digital Realty Trust (DLR)	4.04	3.72%	$ 96.00	3	1.13	108.51	4%-5.5%
iShares Int'l Select Dividend (IDV)	1.51	4.55%	-	UR	-	33.15	4%-5.5%
Energy Sector SPDR (XLE)	2.25	2.94%	-	UR	-	76.38	4%-5.5%
PowerShares Senior Loan (BKLN)	0.83	3.63%	-	UR	-	22.99	2.5%-4%
General Motors (GM)	1.52	3.52%	$ 43.00	6	1.00	43.20	2.5%-4%
Microsoft (MSFT)	1.68	1.67%	$ 87.00	6	1.16	100.79	2.5%-4%
Novartis (NVS)	2.98	3.94%	$ 80.00	3	0.95	75.60	2.5%-4%
Oracle (ORCL)	0.76	1.61%	$ 53.00	4	0.89	47.35	2.5%-4%
Cracker Barrel (CBRL)	4.80	3.08%	$ 165.00	3	0.95	156.04	1.5%-2.5%
Gilead Sciences (GILD)	2.28	3.34%	$ 98.00	3	0.70	68.30	1.5%-2.5%
Hasbro (HAS)	2.52	2.89%	$ 87.00	3	1.00	87.09	1.5%-2.5%
Altria (MO)	2.80	5.03%	$ 67.00	3	0.83	55.72	1.5%-2.5%
Realty Income (O)	2.63	4.96%	$ 56.00	6	0.95	53.04	1.5%-2.5%
Cash Consideration	-	-	-	-	-	-	10%-30%

UR = Under Review

This portfolio is not a real money portfolio. Data as of June 1, 2018.

Goal: The goal of the Dividend Growth Newsletter is to highlight ideas with strong dividend growth potential and update readers about new developments in the market. The simulated Dividend Growth Newsletter portfolio seeks to find underpriced dividend growth gems that generate strong levels of free cash flow and have solid balance sheets, translating into excellent Valuentum Dividend Cushion ratios. Stocks in the Dividend Growth Newsletter portfolio may have lengthy dividend growth track records spanning decades, but we focus most of our efforts on assessing the future safety and dividend growth potential of ideas.

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!

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

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

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

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dividends paid in the period of $4.4 billion. The company's balance sheet remains strong with a net cash position of nearly $26.4 billion as of the end of its fiscal third quarter, and Cisco's robust Dividend Cushion ratio of 2.4 is even more impressive when considering its dividend yield of ~3%.

We don't expect to make any changes to our highlighting of Cisco in either simulated newsletter portfolio as its financial health and long-term outlook remain appealing, in our view. We like the steady progress the company is making in its transformation to a business model focused on software and subscriptions, which is far from over. For an enterprise of Cisco's size, a rapid transformation is unrealistic, and there may be more bumps in the road related to the transformation and ongoing investments related to reshaping its portfolio.

We've been expecting Cisco to continue performing in-line with its projections of lower growth in the near term, and our current fair value estimate of $45 per share does not include meaningful operating margin expansion from levels seen in its most recent quarter. We're sticking by this idea thanks to its robust free cash flow generation and strong balance sheet, the combination of which gives us confidence in its ability to navigate its transformation. Nevertheless, we'll be watching its performance on the top line and operating line for potentially material and sustained weakness, neither of which we are seeing from its fiscal third quarter report.

Boeing's Long-Term Strength Intact; Embraer Deal Nearing?

Boeing's first-quarter report was highlighted by stable top-line growth, impressive bottom-line expansion, and increased full-year guidance. The long-term health of its business is supported by its massive backlog of unfulfilled deliveries.

By Kris Rosemann

Former simulated Dividend Growth Newsletter idea Boeing (BA) turned in a solid first quarter report April 25, and the drivers of its long-term strength remain fully intact as it continues to generate impressive levels of free cash flow and pursue a deal with Embraer's (ERJ) commercial aviation operations.

Revenue in the first quarter grew 6% on a year-over-year basis thanks to higher commercial deliveries, defense contract volume and services growth. The company's GAAP operating margin in the period expanded more than 2 percentage points from the year-ago quarter, largely due to strong operating performance on production programs in its 'Commercial Airplanes' segment, and operating income leapt 30% in the quarter.

Boeing's GAAP earnings per share advanced an impressive 63% during the first quarter of 2018 from the comparable period of 2017 thanks to the increased margins and lower tax bill, and this helped free cash flow jump 68% to $2.7 billion. The aerospace giant continues to showcase impressive coverage of its dividends paid (~$1 billion in the first quarter) with free cash flow, and its balance sheet remains reasonably healthy with a good amount of liquidity. Its total debt position, including Boeing Capital, of nearly $12.5 billion still rests above its cash balance of ~$9.9 billion, but we're not reading too much into its net debt position. Given the availability of financing around the globe, Boeing Capital is a much smaller and much less significant part of its business than it was years ago.

Driving Boeing's long-term potential is its tremendous backlog that stood at $486 billion as of the end of the first quarter of 2018, up from $475 billion at the end of 2017. Management expects 30% of this backlog to be converted to revenue through 2019 with ~71% to be converted through 2022, so it has tremendous visibility. The Dreamliner-maker estimates that the world will need 41,000+ new planes over the next couple decades, from 2017-2036, as the middle-class population grows around the world and air travel for business and leisure continues to proliferate.

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Boeing continues to pursue an acquisition of a portion of Embraer, with the most recent reports suggesting that complications in separating Embraer's business segments are causing a delay in the proceedings. An outright acquisition is largely out of the picture as the Brazilian government has sovereign control over Embraer's military programs and holds a strategic veto, but the two companies have made it known that they are in talks to create a new company focused on commercial aviation, of which Boeing is likely to have a significant majority stake. A closer relationship between Boeing-Embraer will help both better navigate the skies against Airbus' (EADSY) recent decision to take a majority stake in Bombardier's (BDRBF, BDRAF) C-series regional aircraft.

While larger deal talks with Embraer are ongoing, Boeing recently agreed to scoop up aerospace parts maker KLX (KLXI) for an enterprise value of $4.25 billion as it works to build a $50 billion services division within the next decade, but the deal's success depends on the separation of KLX's Energy Services Group business. Boeing's CEO Dennis Muilenburg calls the highly-profitable global services operations the company's "biggest market-growth opportunity." The provision of maintenance, parts, and other services over the decades-long lives of jetliners and military aircraft has the potential to mitigate the inherent sales cyclicality of its jet-sales business, providing an even more secular bent to growth on top of the visibility its robust backlog already provides. Boeing was reportedly in talks with partsmaker Woodward (WWD), too, but a response from the company has dismissed this.

As Boeing continues to optimize its product portfolio and increase purchasing power via consolidation, the company is also working its way through messy geopolitical uncertainty and potential trade policy issues as new US sanctions on Iran were considered to be detrimental to its business. Management is not fazed by the developments, however, and has stated that steps have been taken to mitigate the loss of $20 billion in jet sales to Iran. It is noteworthy that key rival Airbus is facing the same sanctions, and though $20 billion sounds like a lot, the global market for new jets is estimated north of $6 trillion.

We recently raised our fair value estimate for Boeing by nearly 10% as a result of its ongoing backlog growth (which provides tremendous top-line visibility for a company of its size) and expectations for margin expansion, an enhanced services business, and robust free cash flow growth. Shares still look a bit pricey, but the midpoint of our fair value range currently values them at ~$300 each. The company's strong Dividend Cushion ratio of 2.2 goes along with a dividend yield of ~2% as of this writing.

CVS Health Story Unchanged; Still Okay with Its Removal

CVS Health continues to face long-term threats to its business, and relatively weak near-term performance expectations have done little to inspire confidence. The company's long-term debt load has exploded as it prepares to acquire Aetna, and we don't expect the company to bounce back onto our radar given the materially increased financial leverage amidst other challenges.

By Kris Rosemann

Shares of former simulated newsletter portfolios idea CVS Health (CVS) continue to face pressure, and its first quarter 2018 report, released May 2, offered little support. Our opinion of the risks facing the company are unchanged, as threats such as Amazon (AMZN) teaming up with Berkshire Hathaway (BRK.A, BRK.B) and JP Morgan (JPM) to form a new healthcare company muddy the long-term picture for CVS. Its agreement to purchase Aetna (AET) at a time when its core business is facing material disruption becomes substantially more concerning when considering the amount of debt necessary to make the acquisition was enough for us to part ways with the idea.

Revenue at CVS in the first quarter of 2018 grew 2.6% on a year-over-year basis thanks in part to same store prescription volume growth of 8.5%. This volume growth was driven by ongoing adoption of its Patient Care Programs, partnerships with PBMs and health plans, branded drug inflation, and inclusion in additional Medicare Part D networks in 2018 but was partially offset by continued reimbursement pressure and recent

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generic introductions, both of which are expected to persist at least through the near term as the healthcare industry continues to work to reduce costs of care. Front store same store sales advanced 1.6% in the quarter, but seasonal factors such as the shift of the Easter holiday and the cough and cold season supplied a meaningful boost. Soft customer traffic continues to provide a drag.

Gross profit increases in pharmacy helped push consolidated operating profit 8.5% higher in the quarter from the year-ago period, but net income advanced only 4.7% on a year-over-year basis as a significant increase in net interest expense more than offset a materially lower tax bill. CVS is already feeling the impact of a growing total debt load related to the pending Aetna deal, and it expects full-year 2018 interest expense to be $2-$2.3 billion compared to just over $1 billion in 2017. Free cash flow generation took a large step back in the quarter, falling 39% from the first quarter of 2017 to less than $1.9 billion, which was still sufficient in covering cash dividends paid in the quarter of $508 million.

CVS continues to expect 2018 adjusted consolidated operating profit growth to be between down 1.5% to up 1.5%, which was reduced in its fourth quarter 2017 report from initial guidance of growth of 1%-4%. Adjusted earnings per share guidance for the year has been issued in a range of $6.87-$7.08, up from $5.90 in 2017, and consolidated revenue growth guidance has been increased to 1.25%-3% from previous guidance of 0.7%-2.5% growth.

We don't expect to return to highlighting CVS Health as an idea in either simulated newsletter portfolio in the foreseeable future. Meaningful long-term threats to its business remain in place, and its balance sheet will be materially deteriorated upon the closing of the Aetna deal, a feature we typically look to avoid, particularly as it relates to a healthy dividend growth profile. Lackluster near-term performance expectations only add to the negativity surrounding the company.

We currently value shares at $80 each, and the stock yields ~3.1% as of this writing to go along with a tight Dividend Cushion ratio of 1.1. We expect its Dividend Cushion ratio to be severely impacted by the meaningful increase in its net debt load once the Aetna deal closes, highlighting the long-term risks to the payout associated with a massive debt load.

Hanesbrands Continues to Battle Tough Operating Environment

Apparel maker Hanesbrands is working to change its fortunes with its "Sell More, Spend Less and Generate Cash" strategies, but its business is facing challenges that include a difficult US brick-and-mortar environment.

By Kris Rosemann

Former simulated Dividend Growth Newsletter portfolio idea Hanesbrands (HBI) is battling a challenging US brick-and-mortar retail environment and higher commodity costs as it works to transform its performance, and increased marketing spending is expected to weigh on bottom-line results in the near term. Recent acquisitions have helped boost top-line growth as the company turned in reported net sales growth of 7% from the year-ago period in its first quarter of 2018, results released May 1. Organic sales growth in constant currency was up 1% on a year-over-year basis, and the first quarter marked its third consecutive quarter of organic sales growth.

Strong growth in Hanesbrands' Champion brand and direct-to-consumer (including online) sales were largely offset by declines related to its US brick-and-mortar channel, and operating profit growth in its International segment was offset by a weak showing from its domestic business. Adjusted operating profit was roughly flat compared to the first quarter of 2017, and adjusted operating profit margin contracted to 11.3% from 11.9%. GAAP earnings per share advanced 16% from the year-ago period to $0.22 thanks in part to lower one-time expenses related to acquisitions and other action-related charges.

Please see *Hanesbrands...*on next page

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Cash flow from operations in the typically weak first quarter came in substantially lower (and substantially negative) in the first quarter of 2018 from the comparable period of 2017, and the meaningfully negative free cash flow generation led to an increase in the company's net debt position from the end of 2017. As of the end of the first quarter, its net debt position was nearly $4 billion, compared to just over $3.4 billion one quarter earlier.

Hanesbrands' Dividend Cushion ratio was cut to 0.3 upon its latest update due to its growing long-term debt load and lower optimism surrounding its improving free cash flow generation despite recent improvements in its direct-to-customer business. When we highlighted the idea in the simulated Dividend Growth Newsletter portfolio, its debt load was a key concern, and the ongoing growth in financial leverage played a key role in our decision to part ways with the idea, not to mention the prolonged weakness in the traditional US retail space.

Hanesbrands continues to expect to deliver a growing free cash flow stream, with cash flow from operations guidance for 2018 coming in at $675-$750 million (the measure was ~$656 million in 2017), and net sales are expected to be $6.72-$6.82 billion in the year (was ~$6.5 billion in 2017). Adjusted earnings per share are expected to take a step back in the year to a range of $1.72-$1.80 from $1.93 in 2017 as increased marketing spending related to new product launches and commodity costs pressure the bottom line.

All things considered, we are sticking by our decision to part ways with Hanesbrands as an idea in the simulated Dividend Growth Newsletter portfolio. The company should continue to cover annual dividend obligations with free cash flow generation, but the rising debt load sours our opinion of its long-term dividend health. Its improving online and direct-to-consumer operations are nice improvements, but its far more significant exposure to traditional retail channels in the US will keep organic top-line growth in check for the time being. We currently value shares at $23 each, and the stock yields nearly 3.3% as of this writing.

Strong Backdrop Driving Homebuilders' Top Lines But Rising Costs Making Presence Known

Homebuilding stocks have experienced volatility following recent earnings reports from major companies in the industry. The economic backdrop for the group has translated into robust top-line growth, but cost increases have called into question the group's ability to turn that growth into bottom-line gains, at least for some operators.

By Kris Rosemann

A strong job market with low levels of unemployment and rising wages are providing tailwinds to homebuilders as the US housing market recovery marches on, and rising home prices are offering additional equity for buyers to spend on new move-up homes, too. Supply remains relatively constrained while home ownership and new household formation continue to rise. For example, PulteGroup (PHM) notes that it is seeing home supply at about half of the six-month mark that it considers to be a healthy level in the markets it serves.

Toll Brothers Hit By Rising Costs

Mortgage rates have risen of late, and are expected to continue doing so, but homebuilders have yet to notice a negative impact from the higher borrowing costs, which remain very low when taking a longer-term perspective. Despite the healthy backdrop and robust top-line growth, Toll Brothers' (TOL) weak bottom line results in its fiscal second quarter, released May 22, highlighted a key concern for homebuilders as the group battles rising 'stick-and-brick' and labor costs, neither of which are expected to recede in the near term.

Please see *Strong Backdrop*...on page 13

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

By Valuentum Analysts

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

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

Don't forget to visit the website at www.valuentum.com.

Company Name	Symbol	Est Div Yield	VBI	Div Growth	Div Safety	Div Cushion
Magellan Midstream	MMP	5.5%	7	EXCELLENT	GOOD	1.2
Ford	F	5.4%	7	GOOD	GOOD	1.4
ABB	ABB	3.4%	7	GOOD	GOOD	1.9
Archer-Daniels-Midland	ADM	3.2%	7	EXCELLENT	GOOD	1.9
Omnicom	OMC	3.2%	7	EXCELLENT	GOOD	2.3
Sonoco	SON	3.2%	7	EXCELLENT	GOOD	0.9
Gap	GPS	3.1%	7	GOOD	GOOD	2.7
Cheesecake Factory	CAKE	2.4%	7	EXCELLENT	GOOD	2.7
Intel	INTC	2.3%	7	EXCELLENT	GOOD	2.4
Analog Devices	ADI	2.1%	7	EXCELLENT	GOOD	1.5
Robert Half	RHI	1.7%	7	EXCELLENT	EXCELLENT	3.4
Celenese	CE	1.7%	7	EXCELLENT	GOOD	2.5
NewMarket	NEU	1.7%	7	EXCELLENT	GOOD	1.6
PPG Industries	PPG	1.5%	7	EXCELLENT	EXCELLENT	3.0
Papa John's	PZZA	1.5%	7	EXCELLENT	GOOD	2.0
Equifax	EFX	1.3%	7	EXCELLENT	GOOD	2.3
Factset Research	FDS	1.1%	7	EXCELLENT	EXCELLENT	3.2
Franklin Electric	FELE	1.0%	7	EXCELLENT	EXCELLENT	3.9
Morningstar	MORN	1.0%	7	EXCELLENT	EXCELLENT	4.2

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

The Financially-Healthiest Dividend Payers Yielding Over 2%

By Valuentum Analysts

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

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

Company Name	Symbol	Est Div Yield	Div Cushion	Economic Castle	Multiple
GameStop	GME	12.0%	1.6	Attractive	19.82
Automatic Data Processing	ADP	2.1%	7.0	Very Attractive	14.89
General Motors	GM	4.0%	3.5	Attractive	14.01
Chico's FAS	CHS	3.4%	4.0	Attractive	13.66
Cooper Tire & Rubber	CTB	1.4%	9.5	Neutral	13.31
Gilead Sciences	GILD	3.5%	3.4	Very Attractive	11.78
Chicago Rivet	CVR	2.7%	3.9	Neutral	10.62
Abercrombie & Fitch	ANF	3.0%	3.4	Attractive	10.11
Finish Line	FINL	3.4%	2.9	Attractive	9.88
QUALCOMM	QCOM	4.0%	2.4	Very Attractive	9.56
Foot Locker	FL	3.1%	3.0	Attractive	9.40
Honda	HMC	2.8%	3.3	Neutral	9.30
AVX Corp	AVX	2.7%	3.4	Attractive	9.05
Apple	AAPL	1.4%	6.2	Highest Rated	8.53
Fluor	FLR	1.8%	4.6	Attractive	8.52
Gap	GPS	3.1%	2.7	Attractive	8.25
Cisco	CSCO	3.1%	2.6	Very Attractive	8.08
Gentex	GNTX	1.8%	4.4	Attractive	8.05
Graham Holdings Co	GHC	0.9%	9.0	Attractive	8.03
Rio Tinto	RIO	5.2%	1.5	Neutral	7.97
American Eagle	AEO	2.4%	3.3	Attractive	7.88
CA Tech	CA	3.0%	2.6	Very Attractive	7.83
Resources Connection	RECN	3.0%	2.6	Attractive	7.81
Hewlett-Packard	HPQ	2.6%	3.0	Very Attractive	7.68
Ford	F	5.4%	1.4	Neutral	7.67
Western Union	WU	3.9%	1.9	Neutral	7.55
Interpublic	IPG	3.5%	2.2	Very Attractive	7.53
Newmont Mining	NEM	1.4%	5.2	Neutral	7.52
Oracle	ORCL	1.6%	4.5	Very Attractive	7.42
Big 5	BGFV	10.9%	0.7	Neutral	7.36
Omnicom	OMC	3.2%	2.3	Attractive	7.35
Amgen	AMGN	3.1%	2.4	Very Attractive	7.34
Cardinal Health	CAH	2.6%	2.8	Very Attractive	7.29
Pfizer	PFE	3.8%	1.9	Attractive	7.25
Lear Corp	LEA	1.4%	5.0	Attractive	7.22
Guess	GES	3.6%	2.0	Attractive	7.14
Total	TOT	4.8%	1.5	Neutral	7.11
Williams-Sonoma	WSM	3.3%	2.2	Attractive	7.04
Paychex	PAYX	3.0%	2.3	Highest Rated	7.00
Best Buy	BBY	2.5%	2.8	Very Attractive	6.98
NTT Docomo	DCM	3.5%	2.0	Attractive	6.92
Methode Electronics	MEI	1.1%	6.2	Attractive	6.81
Garmin	GRMN	3.5%	1.9	Attractive	6.78
CoreCivic	CXW	7.7%	0.9	Attractive	6.77
Ralph Lauren	RL	1.5%	4.5	Attractive	6.76
H&R Block	HRB	3.5%	1.9	Very Attractive	6.65
Xilinx	XLNX	2.0%	3.2	Highest Rated	6.57
Ethan Allen	ETH	3.0%	2.2	Unattractive	6.57
ABB	ABB	3.4%	1.9	Attractive	6.51
Acuity Brands	AYI	0.4%	18.3	Attractive	6.47

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

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

Yields to Consider Avoiding

By Valuentum Analysts

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

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

Company Name	Symbol	Industry	Est Div Yield	Div Safety	Div Cushion
Ensco	ESV	Energy Svcs - Offshore Drilling	0.6%	VERY POOR	-50.4
Range Resources	RRC	Independent Oil & Gas	0.6%	VERY POOR	-35.2
Superior	SUP	Auto Parts Suppliers	2.5%	VERY POOR	-11.9
R.R. Donnelley	RRD	Commercial Services	8.3%	VERY POOR	-6.6
Ryder System	R	Rental and Leasing	2.8%	VERY POOR	-5.2
H.B. Fuller	FUL	Chemicals - broad	1.1%	VERY POOR	-4.8
Silgan	SLGN	Containers & Packaging	1.5%	VERY POOR	-4.0
Diebold Nixdorf	DBD	Commercial Services	3.2%	VERY POOR	-3.8
Intl Game Technology	IGT	Leisure	3.1%	VERY POOR	-3.6
Casey's General	CASY	Food Retailers	0.9%	VERY POOR	-3.5
Devon Energy	DVN	Independent Oil & Gas	1.0%	VERY POOR	-3.5
Newell Brands	NWL	Household Durables	3.3%	VERY POOR	-2.9
Rent-A-Center	RCII	Rental and Leasing	3.5%	VERY POOR	-2.9
Centurylink	CTL	Telecom Services - diversified	11.4%	VERY POOR	-2.7
Dine Brands Global	DIN	Restaurants - Fast Cas & Full Svc	3.9%	VERY POOR	-2.6
Yamana Gold	AUY	Metals & Mining - gold	0.7%	VERY POOR	-2.6
Noble Energy	NBL	Independent Oil & Gas	1.4%	VERY POOR	-2.3
Viacom	VIA	Media - CATV	2.1%	VERY POOR	-2.1
Pitney Bowes	PBI	Commercial Services	8.2%	VERY POOR	-2.0
Teekay	TGP	Shipping	2.9%	VERY POOR	-1.9
Olin Corp	OLN	Chemicals - mid/small	2.4%	VERY POOR	-1.7
Wendy's Co	WEN	Restaurants - Fast Food & Coffee	1.9%	VERY POOR	-1.7
Ashland	ASH	Chemicals - broad	1.2%	VERY POOR	-1.3
Campbell Soup	CPB	Food Products - Large	4.2%	VERY POOR	-1.2
Kroger	KR	Food Retailers	2.1%	VERY POOR	-1.1
Molson Coors	TAP	Beverages - alcoholic	2.2%	VERY POOR	-1.1
Regal	RGC	Media - entertainment	3.8%	VERY POOR	-1.1
Macerich	MAC	REIT - Retail	5.2%	VERY POOR	-1.0
CyrusOne	CONE	REIT - Retail	3.7%	POOR	-1.0

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

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

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

*The Strong Backdrop...*from page 9

Toll Brothers drove revenue growth of 17% on a year-over-year basis in its fiscal second quarter (ended April 30) to a record $1.6 billion for the quarter, and net signed contract value set a quarterly record as it rose 18% from the year-ago period to $2.38 billion. However, delayed higher-margin closings in certain markets and growing labor and material costs weighed on its margin performance as its adjusted gross margin contracted nearly two percentage points from the comparable period of fiscal 2017 to 22.5%, and its operating income margin fell to 8.4% from 10.1%. Net income per diluted share fell to $0.72 in the quarter from $0.73 in the year-ago period. Though concerns regarding its bottom-line performance persist, Toll Brothers tightened and raised the midpoint of its deliveries guidance range for fiscal 2018, which now sits at 8,000-8,500 compared to previous guidance of 7,800-8,600.

DR Horton and PulteGroup Fare Better

DR Horton (DHI) reported similarly-strong top-line performance in its fiscal second quarter (ended March 31, results released April 26) as its net sales orders advanced 13% and revenue grew 16% on a year-over-year basis. However, the company was able to expand net income 53% from the year-ago period to $351 million as its gross margin and pre-tax profit margin expanded 1 percentage point and 80 basis points, respectively. Management attributes the margin growth to lower interest, litigation, and warranty costs in addition to controlled construction cost increases, reduced incentives, and higher prices. The strong quarter gave DR Horton the confidence to raise its fiscal 2018 pre-tax profit margin guidance to 12.1%-12.3% from 11.8%-12.0%.

Continuing with the trend of strong top-line performance, PulteGroup reported 21% year-over-year growth in home sale revenue in its first-quarter 2018 report, results released April 24, and its value of new orders advanced 18% from the year-ago period. The company more-than-doubled its bottom line in the quarter as earnings per share came in at $0.59 compared to $0.28 in the first quarter of 2017. PulteGroup's operating margin expanded an impressive 270 basis points on a year-over-year basis in the first quarter, which management attributes to its strategic pricing methodology driving enhanced profitability. The aforementioned supply constraint is certainly exacerbating the effect of the pricing lever, and the company expects to continue to be able to offset sustained high levels of lumber costs.

The strong backdrop should continue to provide homebuilders with plenty of top-line expansion opportunities for the foreseeable future, but labor and construction costs are rising. Strong execution from the likes of DR Horton and PulteGroup provided optimism surrounding these dynamic factors, but Toll Brothers' shortfall in its fiscal second quarter is a prime example of what may be a more realistic outlook from some homebuilders.

Conclusion

Investors looking for diversified exposure to equities in the US housing market may consider the iShares US Home Construction ETF (ITB), which has ~65% exposure to home building via high weightings in DR Horton, Lennar (LEN), NVR (NVR), PulteGroup, and Toll Brothers, or the SPDR S&P Homebuilders ETF (XHB), which has ~33% exposure to homebuilders and ~32% exposure to building products. The XHB provides a higher level of diversification, despite having fewer holdings, as it pursues the tracking of a modified equal weighted index and includes Lowe's (LOW) and Home Depot (HD) as its top tow holdings as well as Williams-Sonoma (WSM), Whirlpool (WHR), and Johnson Controls (JCI) in its top ten holdings.

We expect the healthy fundamentals driving top-line performance for homebuilders to be felt in adjacent markets as well, with the home improvement market being particularly noteworthy. Retailers such as Home Depot and Lowe's have been experiencing a strong fundamental backdrop for some time now, and the ongoing price appreciation and increasing home equity levels, not to mention other indicators of a healthy economy, bode well for spending levels on home improvement projects. Temporary weakness in Home Depot's first quarter report is of little concern, in our opinion, as weather-related issues do little to impact the long-term outlook for the company.

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*Strong Backdrop...*from previous page

That said, the homebuilding group is not one of particular interest for income investors, in our view, given the relatively low yields found within the space, and for good reason. The capital-intensive nature of the industry makes free cash flow generation difficult and often leads to a bloated balance sheet. The cyclical nature of the industry only gives investors another reason for pause when considering depending on a homebuilder for income generation. We're not crazy about the industry, but we do note the relatively healthy backdrop.

Home Depot's First-Quarter A Little Light; Long-term Still Bright

Home Depot's fiscal 2018 first quarter results came in short of expectations largely due to adverse weather conditions in many parts of the country, but the company reiterated its full-year guidance in a vote of confidence from management.

By Kris Rosemann

Home improvement retailer Home Depot's (HD) fiscal first quarter results, released May 15, were impacted by Mother Nature as many consumers delayed purchases of seasonal products. The slow start to the spring selling season resulted in a 1.3% drop in customer transactions in the quarter on a year-over-year basis, but the company was still able to realize comparable sales growth of 4.2% (US-only comps growth was 3.9%). The company expects to see a strong second quarter as consumers begin to make up for their delayed home projects, and management indicated that comparable store sales are up at a double-digit rate thus far in the month of May.

Net sales at Home Depot grew 4.4% from the year-ago period in the quarter, and diluted earnings per share leapt nearly 25% to $2.08 thanks in large part to a materially reduced tax bill. Free cash flow in the quarter fell by almost 17% on a year-over-year basis to just over $3.4 billion but was still easily sufficient in covering cash dividends paid of less than $1.2 billion. The company was also able to reduce its net debt load to just under $22.2 billion at the end of the fiscal first quarter from more than $23.4 billion one quarter earlier. This debt load, along with its sizable dividend obligations, weighs on its Dividend Cushion ratio, which sat at 1.4 at last check. Shares yield ~2.2% as of this writing, and management targets a payout ratio of roughly 55%.

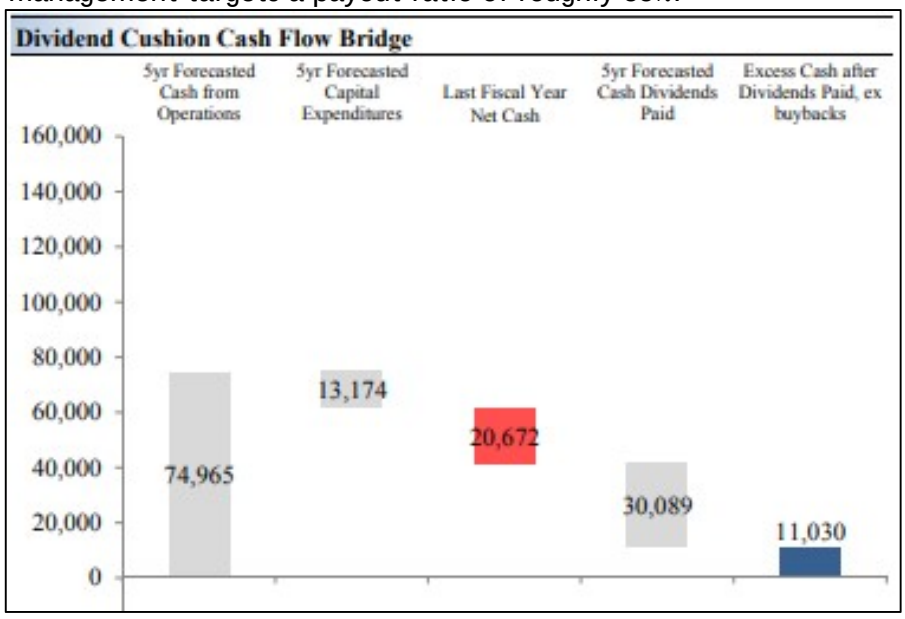

Image source: Valuentum. Note: Dividend Cushion calculation ignores the impact of short-term debt.

Please see *Home Depot's...*on next page

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Home Depot's update on its progress thus far in the month of May and its reiteration of its full-year guidance are indicative of the fundamental strength currently driving its business. Clearly it is not insulated from risks beyond its control as was the case in the first quarter of fiscal 2018 as it battled unusually challenging weather conditions, especially in the month of April, but the company's progress thus far in the second quarter of its fiscal year coupled with its observations of a favorable housing and macroeconomic backdrop suggest the issues faced in the first quarter are transient. Management continues to expect fiscal 2018 net sales growth of ~6.7%, comparable sales growth of ~5%, and diluted earnings per share growth of ~28%. We value shares at $158 each.

Has Macy's Found Its Winning Formula? J.C. Penney Might Be a $0

Shares of Macy's surged following its fiscal first quarter report May 16 as the department store beat estimates and raised its full-year guidance. That said, we continue to be cautious on the long-term prospects of big box retailers and the department stores, in particular. You won't see us adding any department store to the simulated newsletter portfolios. J.C. Penney might be a $0 during the next downturn, whenever that comes.

By Kris Rosemann

Management at Macy's (M) is full of confidence following a strong fiscal 2018 first quarter report, results released May 16, and Chairman and CEO Jeff Gennette believes his team has found the winning formula for the company in "a healthy brick & mortar business, robust e-commerce and a great mobile experience." Though we are not making a trend of one quarter--and the omni-channel approach from a general perspective is hardly a conceptual breakthrough for retailers--he may not be too far off as Macy's turned in comparable sales growth of 4.2% on an owned plus licensed basis from the year-ago period and raised its full-year earnings per share guidance to a range of $3.75-$3.95, a 20 cent hike over its previous guidance.

Management pointed to execution of its North Star Strategy, which is focused on merchandising and marketing initiatives, healthy levels of consumer spending, and increased international tourism as key drivers of its success in the quarter, and it was able to grow its digital business by double-digits yet again. Though Macy's comparable sales growth impressed in its first quarter, the measure was boosted by the shifting of its 'Friends and Family' event from its second quarter to the first. When accounting for this change, comparable sales rose 1.7% on an owned plus licensed basis.

Macy's gross margin expanded 70 basis points in its first quarter from the year-ago period, and SG&A spend as a percentage of revenue fell 90 basis points, which, along with a lower tax bill, helped the company grow adjusted earnings per share to $0.42 from $0.12 a year earlier. Free cash flow generation in the quarter more than doubled from the first quarter of fiscal 2017 to $132 million and was sufficient in covering cash dividends paid in the quarter of $116 million. Macy's net debt load remains somewhat menacing at nearly $4.4 billion at the end of the fiscal first quarter, but a cash balance of more than $1.5 billion offers some liquidity.

We're still not looking to the company as an income idea despite shares yielding ~4.7% at the time of this writing as its Dividend Cushion currently sits at 0, but free cash flow coverage of dividends paid by a retailer in the first quarter is certainly a welcome development. Macy's hasn't been able to do so since the first quarter of fiscal 2013.

Please see *Has Macy's...*on next page

*Has Macy's...*from previous page

Strong consumer spending may be one of a few factors that can resurrect the traditional retail space, and Macy's appears to be effectively tapping into the strength found in discretionary income from American consumers. Management called the improvement in international tourism "significant" in its first quarter, and the confluence of these factors enabled it to raise its full-year guidance. In addition to the aforementioned bottom-line guidance hike, total sales are now expected to be between down 1% and up 0.5% from fiscal 2017 levels (previous guidance was for a decline of 2%-0.5%), and comparable sales on an owned plus licensed basis are now expected to grow 1%-2% compared to previous guidance of flat to up 1%.

All things considered, we like what we saw in Macy's fiscal first quarter report, but given the prolonged struggles traditional retail has faced and the ongoing proliferation of e-commerce, we're not overreacting to any one quarter, as strong as it may have been. Healthy consumer spending is providing a solid backdrop across the retail space, which was supported by a strong April retail sales report that saw 4.1% year-over-year growth in the clothing/clothing accessories category.

Macy's progress in its digital business is encouraging as well, and we currently value shares at $27 each, though the upper half of our fair value range may be an appropriate intrinsic value estimation given its recent guidance increases. We're not looking to add exposure to department-store retail at this point in time, and J.C. Penney's (JCP) recent weak showing and lowered full-year 2018 guidance only raises more red flags about the group's longevity. Given the secular trends that continue to work against the space, but strong consumer spending is a rising tide that has the potential to lift all retail boats in the near term. However, we think J.C. Penney may be a $0 during the next downturn, whenever that comes.

PPL's UK Business Provides Drag to Otherwise Strong Earnings

By Kris Rosemann

It has been tough sledding for shares of former simulated Dividend Growth Newsletter portfolio idea PPL Corp (PPL) as the high-yielding utility stock has not fared well amid a rising interest-rate environment. We parted ways with the idea in December 2017 in anticipation of rising rates, and a potentially material regulatory overhang exists in pending UK legislation to enact energy price caps on electricity and gas utilities. Some observers believe the cap could be in place by Christmas 2018, and regulatory bodies could ultimately extend the price cap through 2023.

Even without the potential price cap, PPL's UK operations, which accounted for ~57% of 2017 earnings from ongoing operations, weighed on its results in the first quarter of 2018, results released May 3. Earnings from ongoing operations in the first quarter grew to $0.74 per share from $0.62 in the first quarter of 2017 thanks to strength in its domestic business driven in part by higher volumes and rates in its Kentucky segment and lower expenses in its Pennsylvania segment, but UK regulated earnings from ongoing operations per share fell to $0.37 from $0.45 due to one-time tax items, an April 2017 price decrease, lower volumes, and share dilution.

The overall strength in PPL's earnings from ongoing operations allowed management to reaffirm its 2018 guidance for earnings from ongoing operations per share in a range of $2.20-$2.40, and the company continues to expects an earnings per share CAGR of 5%-6% from 2018-2020 off the midpoint of this guidance. The company expects its equity financing needs through 2020 to be near the lower end of its previous guidance of $2-$3 billion due to the impact of US tax reform. It also received some favorable news as the UK regulator Ofgem decided to forgo a mid-period review during the current RIIO-ED1 price-control period.

Please see *PPL's UK...*on next page

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Though our core rationale for removing PPL as an idea in the simulated Dividend Growth Newsletter portfolio was the rising interest-rate environment (we also removed the Vanguard REIT ETF (VNQ) from the Dividend Growth Newsletter portfolio and the Utilities Select Sector SPDR ETF (XLU) from the Best Ideas Newsletter portfolio at that time), the pending legislative risk in its largest segment provides additional risk. The UK is undergoing massive political reform as it prepares to exit the European Union, giving us additional reason for pause when considering its otherwise solid forward-looking expectations. We don't expect to highlight PPL as an idea (again) in the simulated Dividend Growth Newsletter portfolio for the foreseeable future despite the stock currently yielding ~6%. We currently value shares of PPL at $31 each.

Uncertainty of Italy's Political Future Weighing on Global Investors' Minds

Italy holds ~$2.7 trillion in public debt, and global investors are worried that a new government could implement policies that would weaken the country's credit status. Though a sovereign debt crisis does not seem probable at this point, bond markets are suggesting that risks are rising.

By Brian Nelson, CFA

We do not want investors to be worried by events unfolding in Italy (EWI) of late, as they may not be any more significant than the impact of Brexit (EWU) on equity market returns during the past few years. We can't cast a blind eye to developments either, however, as Italy's sovereign debt is not-at-all small by any country's standards (it's the third-largest in the world), and the political uncertainty is contributing to modest unrest in the sovereign credit markets.

We think investors have started to guard themselves against a very, very small probability of an adverse event that may cause contagion within the global banking system but given the long duration of Italy's credit profile (its average debt maturity is ~7 years), we're not sure the probability of a liquidity crisis is meaningful at the moment, even if expectations for continued deterioration of credit health cannot be ruled out.

Here are the rating agencies' latest stances on Italy's sovereign debt, courtesy of Reuters:

> Moody's has placed Italy's "Baa2" rating on review for a possible downgrade, citing pledges in a government pact signed by the anti-establishment 5-Star Movement and the far-right League to increase spending, cut taxes and scrap a key 2011 pension reform.
>
> S&P's affirmed Italy at "BBB" on April 27, warning that the rating would come under pressure if a new government strayed from the path of budgetary improvement or unwound past reforms.

Given rising sovereign bond yields on Italy's debt, it is clear the credit markets are already reacting negatively to political developments in the country, and while a downgrade by the rating agencies may do nothing more than confirm the market's moves, any further downgrades won't be positive by any stretch given the corresponding increase in borrowing costs on a rather large sovereign debt position. Italy's two-year bond yield had been unusually low at -0.172% (negative 0.172%) at the start of May, and it now yields ~0.981%.

According to Moody's, Italy has a "very high public debt ratio of over 130% of GDP," and by any measure of risk, the country's cost of borrowing should probably be much higher than it currently is, even after the recent rise (negative interest rates made little sense, in our view). We don't think investors should overreact to the developments in any way, however, and we continue to monitor news flow regarding the implications of a new government in Italy, implications on its sovereign credit quality, the health of the euro as a currency, and the composition of the European Union.

Please see *Uncertainty*...on next page

*Uncertainty…*from previous page

Italy is the third-largest economy in the Eurozone and eighth-largest in the world, with nominal GDP of $2.05 trillion in 2018. The country is the eighth-largest exporter in the world, with Germany (EWG), France (EWQ), and the US (SPY) as its top three trading partners. The country's economy was among the most negatively impacted by the combination of the credit crunch of the last decade and the European debt crisis that subsequently followed.

Omega's First-Quarter Results Not Terrible; Dividend Still Intact

Omega Healthcare is a healthcare real estate investment trust (REIT) that has been battling concerns within its customer base regarding rent payments. Just how healthy its customer line-up truly is will likely play out in coming years, but for now, management is leaving the dividend intact. Shares yield 9%+ at the time of this writing.

By Brian Nelson, CFA

We've been concerned about the healthcare REIT arena ever since healthcare REIT HCP (HCP) slashed its payout in late 2016, "Dividend Aristocrat No More: HCP Cuts Its Payout," leaving behind its long-term track record of consecutive annual dividend increases and the coveted Dividend Aristocrat nameplate. Omega Healthcare (OHI) has been one that we continue to keep a close eye on, too, in part because management seems committed to a dividend that implies a 9%+ yield, but also because its weakening customer base may have implications on other healthcare REITs we cover.

Where HCP struggled with a key customer HCRManor Care before it cut its payout a couple years ago, Omega is struggling with a number of customers, too, not the least of which are two of its top 5, Orianna Health Systems and Signature. What Omega and its skilled nursing facility customers are working through is a ho-hum backdrop given the aging of the "baby bust" generation. However, as the "baby boom" generation starts to reach the 85+ age group, a cohort that is expected to increase to 18 million people in the coming decades and make up as much as 5% of the total US population by 2050 (up from 6 million and 2% recently), things are expected to improve considerably. Though the long term looks good, industry participants are still feeling near-term pain, and this is having spillover implications on the healthcare real estate industry as customers fall behind on rent payments.

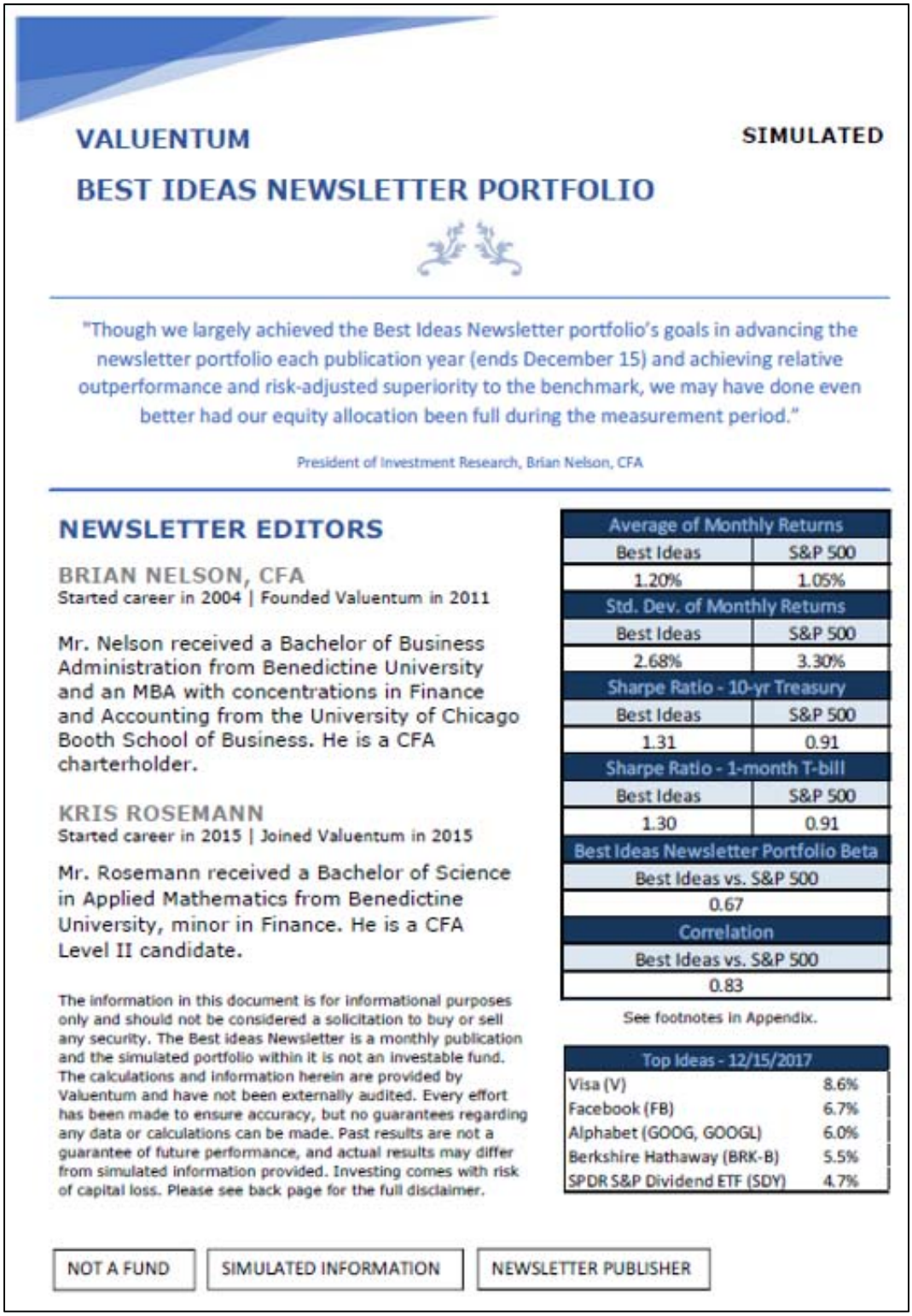
Omega Healthcare, which specializes in skilled nursing facilities, remains in the penalty box after revealing ongoing difficulties with collecting rent from a couple troubled customers. Things may not be as bad as they seem, however. Omega Healthcare's adjusted funds from operations came in at ~$683 million, or $3.30 per share in 2017, compared to ~$689 million in the prior-year period. Though many viewed its adjusted funds from operations per-share guidance of $2.96-$3.06 for 2018 as disappointing, when it issued it at the time it reported fourth-quarter 2017 results, Omega Healthcare is currently just paying $2.64 per share in dividends, revealing some nice coverage. Omega Healthcare even raised its dividend in February 2018, to the current $0.66 per-share quarterly rate, and while it doesn't expect to increase the payout in 2018, management is confident in the sustainability of the current quarterly dividend rate of $0.66 per share (see image above).

Omega Healthcare's first-quarter earnings results, released May 7, brought some good news, too. Management noted that troubled customer Orianna recommenced partial rent payments, Signature's consensual restructuring is nearing completion, and that adjusted funds from operations per-share guidance remains on track for the range of $2.96-$3.06 for the year. Though first-quarter results were buoyed by the timing of new investments and asset sales, things could have been a lot worse. Considerable risks to the payout remain, but for now, the dividend remains intact at Omega Healthcare. We value shares at $31 each.

Study: Best Ideas Newsletter Portfolio

NEW* Valuentum released a study on its **Best Ideas Newsletter portfolio! Please download the paper at the following link:*

https://www.valuentum.com/downloads/20180530/download



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"Though we largely achieved the Best Ideas Newsletter portfolio's goals in advancing the newsletter portfolio each publication year (ends December 15) and achieving relative outperformance and risk-adjusted superiority to the benchmark, we may have done even better had our equity allocation been full during the measurement period."

President of Investment Research, Brian Nelson, CFA

NEWSLETTER EDITORS

BRIAN NELSON, CFA
Started career in 2004 | Founded Valuentum in 2011

Mr. Nelson received a Bachelor of Business Administration from Benedictine University and an MBA with concentrations in Finance and Accounting from the University of Chicago Booth School of Business. He is a CFA charterholder.

KRIS ROSEMANN
Started career in 2015 | Joined Valuentum in 2015

Mr. Rosemann received a Bachelor of Science in Applied Mathematics from Benedictine University, minor in Finance. He is a CFA Level II candidate.

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Average of Monthly Returns	
Best Ideas	S&P 500
1.20%	1.05%
Std. Dev. of Monthly Returns	
Best Ideas	S&P 500
2.68%	3.30%
Sharpe Ratio - 10-yr Treasury	
Best Ideas	S&P 500
1.31	0.91
Sharpe Ratio - 1-month T-bill	
Best Ideas	S&P 500
1.30	0.91
Best Ideas Newsletter Portfolio Beta	
Best Ideas vs. S&P 500	
0.67	
Correlation	
Best Ideas vs. S&P 500	
0.83	

See footnotes in Appendix.

Top Ideas - 12/15/2017	
Visa (V)	8.6%
Facebook (FB)	6.7%
Alphabet (GOOG, GOOGL)	6.0%
Berkshire Hathaway (BRK-B)	5.5%
SPDR S&P Dividend ETF (SDY)	4.7%

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About the Valuentum Dividend Cushion™ Ratio

By Valuentum Analysts

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

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

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

The Importance of Forward-Looking Dividend Analysis

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

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

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

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

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

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

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

The following link, for example, provides more information of the Dividend Cushion ratio tested in a robust out-of-sample walk-forward study across our coverage universe from its inception in 2012 through 2017:

Our Dividend Growth Methodology Is Rocking! *http://www.valuentum.com/articles/20130528*

The Valuentum Dividend Cushion Caught These Dividend Cuts in Advance

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

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

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

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

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

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

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

*About the Valuentum Dividend Cushion…*from previous page

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

Here's a glimpse of the Valuentum Dividend Cushion™ ratio (as of November 2017) for a sample set of firms in our coverage universe. Please note that the current score on these and hundreds more are available with a membership to our website:

Company Name	Symbol	Sector	Div Cushion
Coca-Cola	KO	Consumer Staples	1.4
PepsiCo	PEP	Consumer Staples	1.2
Air Products & Chemicals	APD	Materials	1.3
Ecolab	ECL	Materials	1.2
PPG Industries	PPG	Materials	2.5
Cintas Corp	CTAS	Industrials	2.7
3M	MMM	Industrials	1.6
W.W. Grainger	GWW	Industrials	1.4
Emerson Electric	EMR	Industrials	2.1
Hormel Foods	HRL	Consumer Staples	2.2
McCormick	MKC	Consumer Staples	1.7
Archer-Daniels-Midland	ADM	Consumer Staples	2.1
Sysco	SYY	Consumer Staples	1.4
Target	TGT	Consumer Staples	1.4
Walgreens Boots Alliance	WBA	Consumer Staples	2.0
Wal-Mart	WMT	Consumer Staples	1.6
Leggett & Platt	LEG	Consumer Discretionary	1.3
Clorox	CLX	Consumer Staples	1.2
Colgate-Palmolive	CL	Consumer Staples	1.8
Johnson & Johnson	JNJ	Consumer Staples	2.2
Kimberly-Clark	KMB	Consumer Staples	1.2
Procter & Gamble	PG	Consumer Staples	1.8
VF Corp	VFC	Consumer Discretionary	1.6
Dover	DOV	Industrials	1.2
Illinois Tool Works	ITW	Industrials	1.6

Understanding Dividend Growth

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

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

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

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

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

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

The Dividend Cushion Ratio Helps Income Investors

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

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

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

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

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

Valuentum Dividend Growth Newsletter: Volume 7, Issue 6

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

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

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

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

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

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

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

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

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

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