Valuentum Securities, Inc. 7/1/2018 Edition 7, Volume 1

HIGH YIELD DIVIDEND NEWSLETTER

UNDERSTANDING THE INVERSE NATURE OF INTEREST RATES AND HIGH-YIELDING EQUITIES

We wanted to share the following transcript excerpts with High Yield Dividend Newsletter members given the wealth of information it contains.

Nelson's Prepared Remarks – June 30, 2018

These are the best of times.

We have now surpassed the 9-year mark since the March 2009 panic bottom that sent shudders through the global financial system, and the US economy is as strong as it has ever been. US gross domestic product is now approaching $20 trillion on a seasonally adjusted annual rate, eclipsing the prior peak of $15 trillion before the Financial Crisis of late last decade -- by roughly a third. The US has been in an economic expansion since 2010, and all signs appear that the expansion will continue for the foreseeable future.

The unemployment rate in the US of 3.8% hasn't been this low since 1969, in almost a half a century. Meanwhile upward pressures on wages are only intensifying, and the health of the consumer looks about as strong as it has ever been. The promises in the areas of autonomous vehicles, mobile devices that make our lives easier, and in medicine with CAR-T therapy are groundbreaking, and **there likely has been no better time to be alive in America than in 2018.**

President Donald Trump's landmark legislation, the Tax Cuts and Jobs Act of 2017, has resulted in a pace of earnings growth that nobody could have ever predicted just a few years ago. FactSet (FDS) estimates that earnings growth for S&P 500 companies (SPY) is estimated at a whopping 20% during the second quarter of 2018, this being the second-highest earnings growth rate since the third quarter of 2010, when the country was bouncing back from the Great Recession. Growth

> "AS KEY BENCHMARK RATES SUCH AS THE 10-YEAR TREASURY INCREASE, THE VALUE OF EQUITIES, IN GENERAL, FALLS, ALL ELSE EQUAL. INCOME-ORIENTED IDEAS FACE THIS BROADER HEADWIND, BUT ALSO ANOTHER UNIQUE RISK. IN THE EVENT FIXED-INCOME INSTRUMENTS BEGIN TO APPROACH YIELDS THAT MAKE THEM MORE ATTRACTIVE ON A RISK-ADJUSTED BASIS THAN INCOME-ORIENTED EQUITY CONSIDERATIONS, ASSETS COULD SHIFT AWAY FROM EQUITY INCOME INTO FIXED INCOME, PRESSURING EQUITY PRICES ON HIGHER-YIELDING INCOME ENTITIES EVEN MORE. WE MAINTAIN OUR VIEW THAT A HOLISTIC VIEW OF A COMPANY'S FUNDAMENTALS IN THE DERIVATION OF AN INTRINSIC VALUE ESTIMATE REMAINS CORE TO ANY INVESTMENT PROCESS."
> – BRIAN NELSON, CFA

of this magnitude following a 9-year expansion is highly unusual, almost ultra-cyclical in nature.

Borrowing costs, while rising, are still near all-time lows. The 10-year Treasury (TLT, TBT), a benchmark rate used in stock valuation and in setting bond rates, is hovering under 3%, despite moving sharply higher since its near-term bottom in 2016. Though we are watching the 10-year Treasury rate very closely, given its implications on stock and bond prices, we must point out that the 10-year Treasury rate was once north of 15% in the early 1980s. Many of you may have had double-digit interest rates on your first mortgage, and everything from the housing markets (ITB) to ancillary businesses (XHB) continues to benefit from today's ultra-low rates.

The world perhaps has never been safer. There appears to be steady progress with respect to peace on the Korean Peninsula, and President Donald Trump's "madman theory," a strategy popularized by Richard Nixon--one of being irrational and volatile--seems to have brought North Korea to the negotiations table regarding denuclearization. We won't know if the progress is the equivalent of Neville Chamberlain in 1938, who had thought he secured "peace for our time" through appeasement of Germany before the worst of the Second World War, but President Donald Trump is a student of history and has shown to not give his opponents an inch, for they may take a mile.

We believe President Donald Trump is aware of the negative impact that tariffs can have with respect to global trade, and we're viewing his stance against China (FXI, MCHI) as merely posturing, as a means to extract a better trade agreement with the country that has roughly 1.4 billion people, more than 4 times that of the US. China needs the US today for its technology and business intellectual property, and we wouldn't expect either country to erect trade barriers to the point where global GDP is devastated. **Over the long haul, however, the US may need China more than China needs the US.** A market of people 4 times that of the US represents considerable opportunity for US businesses.

US corporations perhaps have never been better positioned for growth. The reduction in the corporate tax rate to 21% from 35% has been a boon to companies' free cash flow generation, giving US firms additional capital by which to invest and hire new workers, helping to aid in the natural multiplier effect of economic activity. The tax cuts, enacted January 1, 2018, are evident. Take investment bank Moelis & Co (MC), for example. During its first quarter of 2018, provisions for income taxes fell to $2.6 million from $7 million, a 60%+ reduction, translating into considerable improvements in cash flow generation.

The current wonderful situation in America is probably best summed up by the burgeoning performance of Boeing (BA), a tried-and-true Dow Jones Industrial Average (DIA) component. The world's appetite for new planes appears to be almost insatiable. Global air travel is a good coincident indicator of consumer and business health, and the order books at the airframe makers are overflowing, despite trade tariff tremors. Boeing's backlog of unfulfilled deliveries stood at $486 billion, almost a half of trillion dollars, with over 5,800 plane orders on the books. Expected to deliver 810-815 planes in 2018, that means Boeing's backlog amounts to roughly 7 years' worth of visibility. This is incredible for what has historically been a cyclical industrial, and the executive team may very well be right: airplane making is a long-term growth story.

"FANG" stocks, an acronym standing for Facebook (FB), Amazon (AMZN), Netflix (NFLX) and Google (GOOG, GOOGL), continue to take the market by storm. We include Facebook and Alphabet, the parent company of Google, in the simulated Best Ideas Newsletter portfolio, and the performance of all four continue to be phenomenal during this multi-year bull market. **We value Facebook's equity at $250 per share on an advertising business-model-only basis, far above where shares are currently trading.** Amazon is disrupting industries at will, the latest with respect to the grocery complex with Whole Foods and the pharmaceutical supply chain with PillPack. Netflix seems to have found an investor base that is undeterred in the face of significantly negative free cash flow and rising net debt, and at Alphabet, it's business as usual with its dominance in search, as the company remains a daily part of consumer lives.

Prices at the pump aren't giving travelers too much of a headache. Though crude oil prices (USO, OIL) have

advanced at a double-digit clip thus far in 2018, they remain well off their previous highs set years ago. August West Texas Intermediate crude oil stands at ~$74, in-line with what we had been expecting at the start of 2017, offering breathing room for many independents (XLE) as well as the pipeline infrastructure (AMLP). There are myriad factors driving the price of crude oil, but geopolitical uncertainty seems to be fueling most of the recent gains. The White House continues to put pressure on Iran, for example, with oil buyers now encouraged to cut Iranian crude imports by November. Such uncertainty is adding to the geopolitical premium embedded in crude pricing, despite OPEC's recent deal to raise production, albeit modestly.

The legal environment is fast-changing on the state level in the US, and two particular measures look to impact a few pockets of the economy. The legalization of sports betting will open the door for additional state tax revenue as vacationers now won't have to travel to Las Vegas to bet legally on their favorite sports team or event. We think Churchill Downs (CHDN), which shares its name with the legendary race track in Louisville, will be a big winner of this development, as it seeks to offset a generally weakened backdrop of thoroughbred horse racing, despite another Triple Crown winner in 2018 in trainer Bob Baffert's Justify. It was just in 2015, too, that American Pharaoh took the racing industry by storm with its own Triple Crown sweep, two now in the last four years.

Another Supreme Court ruling overturned a 26-year old precedent that said businesses that didn't have a physical presence in a state need not collect sales taxes there. The development should help level the playing field for brick-and-mortar retailers (XRT), but we note some of the larger online powerhouses, including Amazon, have already been collecting sales taxes, meaning the impact itself may serve to merely enhance state tax coffers but truly do little to help some of the most troubled retailers. We believe department-store retail is in for a lot of pain during the next recession, and we doubt J.C. Penney (JCP) and Sears (SHLD) will make it to the other side of the next downturn with shareholder equity intact. Online purchasing is wreaking havoc on their business models, much to the benefit of the credit card networks such as Visa (V) and MasterCard (MA) and payment processors such as PayPal (PYPL) and Square (SQ).

These are the best of times, but there are risks, some we know, and some we simply cannot possibly know. Donald Rumsfeld may have said it best: "There are known knowns. These are things we know that we know. There are known unknowns. That is to say, there are things that we know we don't know. But there are also unknown unknowns. There are things we don't know we don't know." The prices of equities will always be a function of future expectations, and those expectations can take a turn for the worse rather quickly, especially as market participants remain guarded about the possibility of an impending bear market. The average bull market, according to research from First Trust, lasts 9 years with an average cumulative return of 474%. The current bull market is over 9 years in duration with gains north of 330%.

Nothing is ever average though--and using history as a means of precisely predicting the future is rather foolish, but such a view helps to provide some perspective. As companies anniversary the earnings growth expected in 2018 that has been driven in part by tax reform, a breakneck pace of earnings expansion in 2019 and 2020 may only grow more difficult to achieve, as the idea of companies investing for growth also indirectly implies increased competition and the threat of profit pressure. Deflationary trends in generic drug pricing, for example, have wreaked havoc across the healthcare complex (XLV), while gross margin pressures at tried-and-true consumer staples (XLP) entities such as Campbell Soup (CPB) have revealed heightened tension. Consumers have been absorbing price increases for years, and the weakness at Starbucks (SBUX), which is facing challenging same-store sales trends, may be telling of this theme. Consumer spending may be healthy, but has the incremental consumer reached a point where he or she is balking at paying up, trusting more in private-label and shunning the $5 venti white mocha from the corner Starbucks?

From where we stand, it appears to be growing more likely that consumers are becoming more discerning and cost-conscious about the prices they pay for things, particularly as a new generation of millennials (MILN) is ushered in, a generation that suffered financially through the Great Recession and its aftermath. Many that

graduated shortly after the worst of the credit crunch may finally be getting their financial lives back on track. Over the years, they've been trained to be "money wise," and consumer preferences are changing, too, perhaps best illustrated at Harley-Davidson (HOG). Hitting the open road on a Harley, for example, may no longer be considered cool by the coming generation, and many bikes are priced beyond what many of them can afford. President Donald Trump's protectionist policies have only given the bike maker more headaches, too, as it seeks to move some production oversees to avoid retaliatory tariffs from the EU. **Where business is booming at one American icon, Boeing, business is significantly challenged at another, Harley.**

What a difference a few years can make for a company, too. General Electric (GE), once a staple of the Dow Jones Industrial Average, is no longer a part of the prestigious index, recently replaced by Walgreens Boots, which itself is now facing myriad challenges from Amazon's entrance into the grocery and pharmacy arenas. Coming on the heels of the announcement that Walgreens would be added to the index, the timing of the news release of Amazon's acquisition of PillPack proved to be quite interesting. Perhaps Amazon's CEO Jeff Bezos thought his company should be the new Dow component instead. Regardless, it was clear by the share-price reactions of Walgreens, CVS Health (CVS) and Rite Aid (RAD) on the news of Amazon's purchase of PillPack that the online retailer is one powerful influence on the economy--often good for consumers, often bad for the profits of other companies.

As the economic recovery and bull market ages, valuations remain at generally lofty levels, in our view, especially in the context of a rising interest-rate environment. The forward 12-month P/E ratio on S&P 500 companies stands at 16.1 times, which is about in-line with its five-year average, but still above its 10-year average of 14.4. We don't view the market as significantly overpriced, per se, but we think there are risks to the downside as, to put it quite simply, the economy and market have both been "juiced" by ultra-low interest rates and rising government and corporate debt, which stand at $21.1 trillion and $6.3 trillion, respectively. **The change in the tax code has made the cyclically-adjusted price-to-earnings ratio, or the CAPE ratio, a less meaningful statistic, but the idea of a potential reversion in the tax code during the next recession to prop up federal tax stuffs cannot be ruled out.**

Corporate tax reform has helped employees with one-time bonuses at a number of companies, but it seems most of the incremental benefits to free cash flow from tax reform may go to buybacks, some at relatively elevated price levels and 9+ years into an economic recovery and bull market. Estimates are calling for $650-$800 billion in stock buybacks this year, money that if not executed at a value-creating price could do nothing more but destroy value for shareholders and wealth of Americans. **Said plainly, money that could have gone to government tax receipts to potentially aid in balancing budgets and curtailing the growing US national debt load is now being pumped into the market at what could very well turn out to be peak or near-peak levels of this bull-market run.** If the US economy should weaken and earnings and valuations are reset lower, we could see significant wealth destruction from buybacks that have only increased the burden of debt owed by the United States. Today, each of the roughly 326 million people in the US individually owes about ~$65,000 in national debt. The situation has gotten out of control, it appears the current administration may have made matters worse.

My long-held view is that the global economy, including that of the US is cyclical, and it is not a matter of if we have another recession, but rather when and how severe it will be. The reduced corporate tax rate coupled with the new capital-expensing provision may result in substantial budget deficits during the next downturn, prompting a potential reversal of this administration's corporate tax policy, which may then only exacerbate the conditions of what would have been a "normal" recession. **The ultra-cyclical nature of positive earnings growth at this point in the economic cycle may also result in ultra-cyclical weakness during the depths of any coming recession, the timing of which is the only uncertainty.** Could the next recession faced in America be the culmination of what government efforts have only delayed with the expansionary policies to bounce back from bubble after bubble in prior years, the last two the dot-com and housing crash? Possibly.

We have reason to be optimistic, however. The stress tests of the US banks (XLF) continue to show resiliency, and while buybacks in general pose a risk in potential wealth destruction, that banks are returning capital to shareholders is a positive foundational element to a sound global financial system, which runs primarily on confidence. The threat of a combination of Deutsche Bank's (DB) troubles and Italy's (EWI) sovereign credit risk may be largely contained, too, and the worries over Brexit (EWU) seem to have faded with time. It has become more and more difficult to outline a scenario that may cause the next recession, but that doesn't mean that one is not on the horizon. It is our contention that even posturing by the US and China with respect to trade--should it cause a pause in spending and hiring by US companies--may do damage to economic growth.

The pace of news regarding cryptocurrencies has slowed in recent months, particularly as the price of the most widely-watched cryptocurrency Bitcoin (BTC, GBTC) has fallen from over $19,000 around the holiday season late in 2017 to roughly $6,000 today, a decline that is nothing short of precipitous, yet the price remains well above the sub-$1,000 levels at the start of 2017, just 18 months ago. We view Bitcoin as a good example of the "greater fool" theory at its finest, and as with any currency, the value is only relative to that of another currency and based on widespread confidence that it will hold its value, not necessarily a function of future free cash flows or dividends to shareholders. **We think the dramatic fall in Bitcoin illustrates not only the speculative temperament of the marketplace to absorb cryptocurrency assets, but also the tremendous value in basing investment decisions on fundamental-based principles that lead to the derivation of cash-flow-based intrinsic values in order to avoid price bubbles.**

More recently, I have been more outspoken on the risks of widespread index investing and the shortcomings of quantitative research processes that may not be soundly measuring the business values of companies. I believe the proliferation of indexing and quantitative algorithmic trading systems may pose structural risks to the market, which itself is a leading indicator to economic activity and a source of wealth for many Americans. Earlier in the year, the breakdown of a volatility ETF (XIV) caused a substantial dislocation in the market, and we think this newfound volatility may be illustrative of changing market conditions, where buyers and sellers are relying less and less on fundamental-based intrinsic value analysis and more and more on portfolio management theory, which could have shortcomings, if based solely on quantitative backward-looking analysis. Where a rising 10-year Treasury rate or a reversion in the corporate tax code may be fundamental issues that may cause declining stock values, a structural dislocation of the marketplace is something different in its entirety, likely reducing investor confidence in the markets themselves.

Many of you are following our income ideas very closely, and I think it makes sense to address a broader theme regarding the inverse nature of interest rates and high-yielding equities. Though future operating performance is critical to the valuation of any equity, so is the rate at which future free cash flows are discounted. As key benchmark rates such as the 10-year Treasury increase, the value of equities, in general, falls, all else equal. Income-oriented ideas face this broader headwind, but also another unique risk. In the event fixed-income instruments begin to approach yields that make them more attractive on a risk-adjusted basis than income-oriented equity considerations, assets could shift away from equity income into fixed income, pressuring equity prices on higher-yielding income entities even more. We maintain our view that a holistic view of a company's fundamentals in the derivation of an intrinsic value estimate remains core to any investment process.

With these risks plainly said, I believe the stock markets can be a fantastic way to generate wealth over the long haul, and as with all of our publications, I believe the High Yield Dividend Newsletter only helps to provide insight and opinion on ideas of interest to members.

Why the Global X SuperIncome Preferred ETF and Why the Weighting?

Member Question:

I subscribe to your High Yield Dividend Newsletter. SPFF is the top weighted idea. When looking at Yahoo Finance, I see that both share price and Div/Share ($)

have gone down over the last four years. Do you anticipate a reversal of this trend? If not, why the high weighting, and why include it at all?

Answer:

Thank you for your membership to this publication. As you note, the Global X SuperIncome Preferred ETF is included in the simulated High Yield Dividend Newsletter portfolio. The ETF generally seeks investment returns that correspond to the price and yield performance of the S&P Enhanced Yield North American Preferred Stock Index, or 50 of the highest-yielding preferreds in the US and Canada.

There are a couple features that make this one an interesting idea for consideration, though each investor, of course, will have varying goals and risk tolerances. For starters, preferred equities or those within this particular ETF oftentimes offer investors a higher yield than even corporate bonds of similar credit quality. Second, the preferred nature of the holdings in this ETF offer some additional diversification of the simulated portfolio relative to corporate common dividends and even REIT and MLP distributions.

The yield on the Global X SuperIncome Preferred ETF is among the highest among simulated portfolio ideas, and its outsize weighting helps to bolster the portfolio's overall yield while adding another layer of diversification. Some of the ETF's top holdings include preferred shares from Crown Castle, Barclays Vereit, Kinder Morgan, and even J.P. Morgan, for example. Financials, which tend to have implicit, if not explicit, backing by the federal government in most cases represent more than 70% of the ETF's exposure.

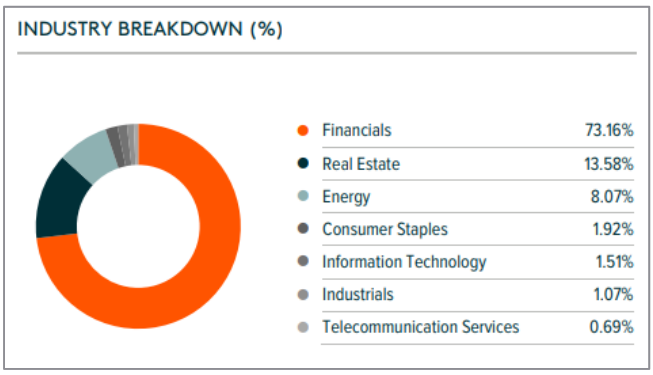


Image Source: Global X's SPFF.

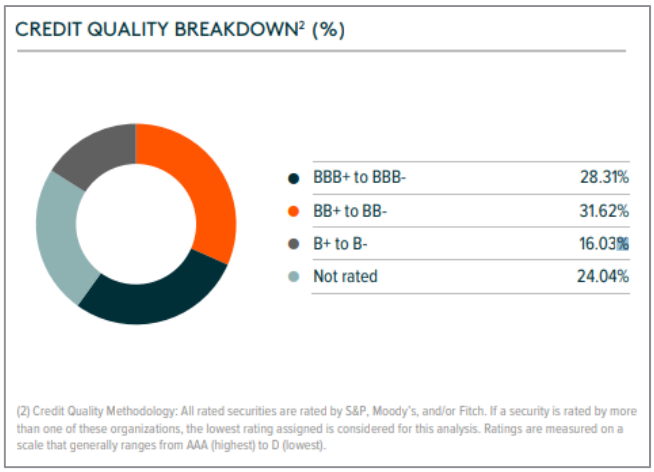


Image Source: Global X's SPFF.

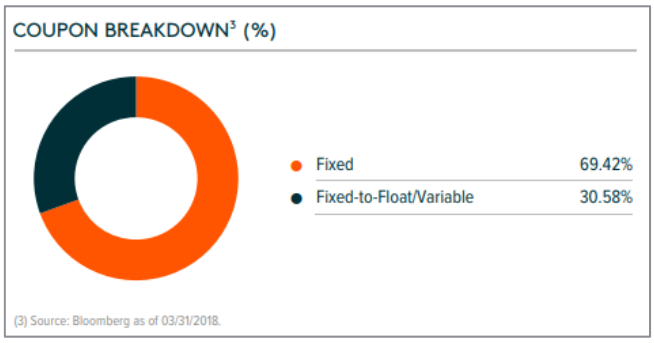


Image Source: Global X's SPFF.

The pricing performance of the ETF has hovered near $12 per share for most of the year, and we're not expecting significant price appreciation potential given the nature of preferred equity value in general, which is priced more bond-like on the basis of interest rates and credit quality (assuming a constant coupon). For example, benchmark interest rates and credit quality may have a greater impact on the ETF's performance than the performance of underlying companies, per se.

Roughly 30% of the ETF's coupon is fixed-to-float/variable, so some variation in the payout should be expected. For example, in the case of fixed-to-floating rate issues, many may have a fixed rate over a certain time period, and then they go to a floating rate. The nature of the floating coupon payments coupled with movements in the aforementioned interest rates and credit-quality profile add to the pricing volatility of the ETF.

Though interest rates will pose headwinds to the price of this preferred-focused ETF as we have outlined, in

terms of meeting the requirements of high yield and adding a much-needed additional layer of diversification relative to common dividends or distribution, we like the idea. The simulated High Yield Dividend Newsletter portfolio targets high yield, not necessarily capital appreciation or dividend growth, which are more appropriately targeted in the simulated Best Ideas Newsletter portfolio and simulated Dividend Growth Newsletter portfolio, respectively.

TOP 10 HOLDINGS As of 6/29/18

NET ASSETS %	NAME
5.51	GMAC CAP(ALLY) PFD 8.125%
5.49	BARCLAYS BANK PFD 8.125%
5.45	WELLS FARGO CO 8.00% SER
5.23	CCI 6.875% 08/20 PFD
3.60	ING GROEP 1.59375 (PS)
3.58	KINDER MORGAN INC/DELAWA
3.56	VEREIT PFD
3.41	AEGON NV PREFERRED STCK
3.39	DB CAP TRUST V PFD 8.05%
3.16	JP MORGAN 6.7 12/31/19-49

Holdings are subject to change.

Image Source: Global X's SPFF.

A High Yielder to Consider Avoiding and Why

Owens & Minor (OMI): Dividend At Risk, But Shares Not Expensive

Image shown: Owens & Minor's share-price performance since August 2017.

We're fans of consistent dividend payers with strong free-cash-flow coverage and solid balance sheets, but we remain very skeptical of companies with a dividend that seems "too good to be true" as the eye-popping dividend is often a byproduct of an egregious drop in the price of the stock. We believe Owens & Minor is an example of an overleveraged, slow-growth entity that may have trouble maintaining its dividend in coming years. We value shares at $20 each, however, so the market may be overreacting a bit on the downside.

By Alexander J. Poulos

Key Takeaways

Business disruption has taken its toll on Owens & Minor's margins and underlying profitability.

From where we stand, there is little in the way of proprietary offerings by Owens, which opens the company up for potential disruption by more well-established players such as Cardinal Health or Amazon that can steal crucial market share.

We feel the acquisitions made to offset the decline in margins are "more of the same;" hence, cash is declining while return on invested capital continues to decline.

We're skeptical about the resilience of the dividend, but shares are not expensive.

Overview

Owens & Minor (OMI) remains a pioneer in the medical distribution business as the company traces its origins back to 1882. The medical distribution business has evolved dramatically since the founding of Owens with the company managing to stay one step ahead of the changes in the industry. Owens' main customers originate in the acute care and hospital settings versus the retail drug setting, which compromises far-better capitalized entities such as Cardinal Health (CAH). While Owens has dutifully expanded its niche, the recent competitive entry of Cardinal Health has caused a great deal of heartburn for the executive team at Owens.

Medical Distribution Facing Competitive Headwinds

The deflationary forces that continue to wreak havoc in the retail drug distribution segment, as recently highlighted in a recent piece titled "Generic Drug Deflation Continue to Hamper Cardinal Health and Amerisource," are evident to a certain degree in the hospital sector, too, as an extremely competitive environment has led to severe margin compression at Owens--as Cardinal seeks additional verticals to offset the decline in its core drug distribution sector. Cardinal views Owens' niche as a fertile whitespace for additional expansion, in our view, with more attractive margins than in its core business, hence its willingness to compete on price.

We view this development as a significant impediment for the prospects of Owens. We feel the pricing environment will remain challenging, bordering on irrational, as Cardinal seeks to wrest greater share from the now poorly-capitalized Owens. Speaking of the retail drug distribution sector, the three main competitors are similarly capitalized, hence a rational oligopoly exists which has tended to lead to stable pricing. We fear, however, that Cardinal aspires to become an aggressive competitor, as it may be able to easily fund a price war. A price war with its peers in the drug distribution space could lead to significant profit pressure.

A large degree of the headwinds plaguing the industry is the lack of differentiation in the core products sold by the companies as they continue to compete in an increasingly commoditized sector. For example, from where we stand, there is little to distinguish between the hospital gowns or surgical gloves sold by either entity. Hence the easiest way to garner business in a largely-commoditized space is to compete on price. We think it is a largely commoditized industry with very little in the way of pricing power, making cost-containment paramount.

Owens Minor on the Acquisition Trail?

We're generally fine with companies making complementary bolt-on businesses, as the move tends to help top-line sales, and sometimes profitability, if the purchase is made on favorable terms in a business line that is growing. Owens' purchase of Halyard Health's Surgical and Infection Prevention (S&IP) business fails in this regard, however, as the business remains challenged, even though the S&IP business further augments Owens' position in surgical gowns and exam gloves, an area which is becoming increasingly commoditized.

We do not share the view the patent estate portfolio is a key differentiator, as Halyard's S&IP unit struggles mightily in 2017, even though volumes rose as net selling prices contracted, a clear sign to us that end users are demanding severe price concessions to purchase the products. We applaud Halyard's decision to jettison the unit to focus on its core medical device units as the margins in this business line are more robust (mid 20% range) versus the single digit levels in the S&IP division. The decision on the part of Owens to purchase Halyard's S&IP division will further augment current offerings, but it does very little to address the challenges posed to the underlying business.

Owens remained on the hunt for new lines of business in 2017 with the move to acquire Medical Action Industries for Byram Healthcare for $380 million in cash. The acquisition will broaden Owens reach in the direct-to-consumer healthcare market as Bayram distributes a wide range of products such as ostomy supplies. We view the move as incremental at best as the pivot into this vertical does little in the way of differentiating Owen's product suite. We believe the pivot opens Owens to further disruption this time in the form of Amazon (AMZN), the internet powerhouse with a commanding lead in the online shopping. We see little to prevent Amazon from offering similar products to its vaunted Prime members as the products travel well and

do not need special handling, hence they can easily be included with other household essential items.

Balance Sheet

The acquisition spree of 2017 has taken its toll on the balance sheet of Owens as the management team has steadily drained the vast majority of cash accrued by the underlying business. Cash stood at ~$87.6 million at the end of the first quarter of 2018. We are very concerned by the current debt carried on the books (~$900 million) coupled with the steady decline in operating performance, as the trend hasn't been great. Net revenue has fallen to $9.3 billion in 2017 from $9.7 billion in 2015, while adjusted EBITDA of $257 million in 2017 was the lowest since at least 2013. Free cash flow has also fallen to $206 million in 2017 from $269 million in 2015 trends. The acquisition spree, in our view, does little to arrest the steady decline.

Adding additional fuel to the fire that Owens may have become become, the CFO recently decided to abruptly resign, and while we can never be sure, we hardly view the occurrence as pre-planned. Our read of this event is that conditions for the core underlying business have continued to deteriorate, but we're hesitant to make such a proclamation so early into 2018.

Valuentum Ratings

We view Owens' dividend in poor shape with little in the way to give us confidence that the next CFO may not cut the overly generous dividend rate. We think Owens will have a tough time preserving the payout, and if it does cut the dividend, it may lead to a new leg down in the price of the equity, as business conditions continue to deteriorate. Our Dividend Cushion ratio captures the challenges at Owens with a poor -0.8 ratio (anything less than 0 suggests elevated payout risk), which coupled with our Dividend Safety rating of very poor, gives readers a quick guide to the inherent troubles we forecast with the dividend.

Concluding Thoughts

We don't think Owens & Minor's troubles are over, and the risk of a cut in the dividend might serve to drive income investors away from the investment. We value shares at $20 each, so downside from a valuation standpoint may be largely limited, assuming performance doesn't deviate too much from our current expectations.

Disclosure: Alexander J. Poulos is long Amazon.

This article appeared on Valuentum's website June 24, 2018.

Educational: Walking Through the Calculation of the Dividend Cushion Ratio

This article is for educational purposes only to explain the nuts-and-bolts behind the calculation of the Dividend Cushion ratio. To access our updated opinion on Kimberly-Clark, please view its 16-page report and dividend report on its stock landing page.

We've received a significant amount of interest in the Dividend Cushion ratio, and we wanted to walk through the Dividend Cushion ratio calculation for an example company, Kimberly Clark (KMB), in this article. Kimberly-Clark is generally what is described as a Dividend Aristocrat, meaning it has raised its dividend in each of the past 25+ years (40+ years in Kimberly Clark's case). The firm's dividend yield is above the ~2% average for S&P 500 companies, offering a ~3% annual payout at recent price levels.

The Dividend Cushion ratio is derived from the forecasts within our discounted cash-flow models, and the ratio measures the financial capacity of a company to pay and grow its dividend, not the willingness of the company to pay and grow its dividend. Both capacity and willingness are necessary to achieve sustainable growth in a company's payout, in our view. We measure the safety of a company's dividend in a unique but very straightforward fashion.

As many know, accounting earnings (EPS) can fluctuate significantly through the course of the economic cycle, so using the dividend payout ratio (dividends per share divided by earnings per share) in any given year has limitations. Plus, companies can often encounter unforeseen charges, which makes accounting (reported) earnings a less-than-predictable measure of the safety of the dividend. For example, we know companies won't always cut the dividend just because earnings have declined or in cases, for example, where a firm had a restructuring charge that put it in the red for a quarter (or year or two).

We therefore believe that assessing the forward-looking free-cash-flow and balance-sheet dynamics of a business, in conjunction with the firm's dividend payout ratio and other items, is a more reasonable approach in determining whether a firm has the capacity to continue paying and growing dividends than the dividend payout ratio alone. This line of thinking has led us to develop the forward-looking Valuentum Dividend Cushion ratio. The Dividend Cushion measure is a ratio that sums the existing net cash (total cash less total debt) a company has on hand (on its balance sheet) plus its expected future free cash flows (cash from operations less all capital expenditures) over the next five years and divides that sum by future expected cash dividends (including expected growth in them, where applicable) over the same time period.

Basically, if the ratio is significantly above 1, the company has financial capacity to pay out its expected future dividends, by our estimates. The higher the ratio, the better, all else equal. An elevated ratio doesn't ensure the company will keep paying dividends, however, as management's willingness to do so is another key consideration, but the ratio acts as a logical, cash-flow based ranking of dividend health, much like a corporate credit rating, for example, ranks a company's ability to pay back debt (default risk).

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

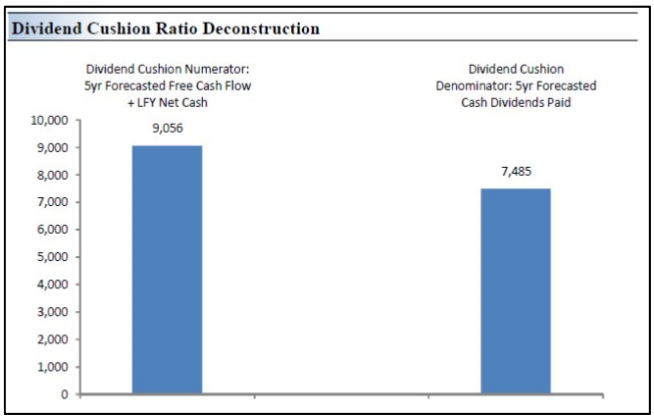
Income investors generally would like to see a Dividend Cushion ratio much larger than 1 for a couple of reasons: 1) the higher the ratio, the more "cushion" the company has against unexpected earnings and cash shortfalls, and 2) the higher the ratio, the greater capacity a dividend-payer has in boosting the dividend in the future. At the time of the publishing of this article, for Kimberly-Clark, the ratio is 1.2, revealing that on its current path the firm should be able to cover its future dividends (and the expected growth in them) with net cash on hand and future free cash flow over the measurement period.

Derivation of Kimberly-Clark's Dividend Cushion - $ mil

-- Note: The following analysis is for educational purposes only. Readers should visit www.valuentum.com for Kimberly-Clark's most recent dividend information. --

To arrive at the Dividend Cushion ratio for Kimberly-Clark, we divide the numerator ($9,056 million) by the denominator ($7,485 million) in the image below. The numerator represents the sum of a firm's net cash position and its cumulative analyst-driven 5-year expected free cash flows, as measured by cash flow from operations less all capital spending. The denominator represents the sum of a firm's cumulative 5-year expected cash dividends paid.

A ratio of 1.2, as it is for Kimberly-Clark, can be considered GOOD, absent any extraordinary considerations. In most cases, the higher the Dividend Cushion ratio above 1, the better. As shown in the image below, we estimate the sum of Kimberly-Clark's net balance sheet position at the end of last fiscal year and its future expected free cash flow to be generated over the next five years is ~$9.1 billion. We also estimate that the company will pay out ~$7.5 billion in cash as dividends over the same time period (this forecast includes dividend-per-share growth). In a simple construct, we divide the numerator by the denominator to arrive at a Dividend Cushion ratio of 1.2 for Kimberly-Clark.



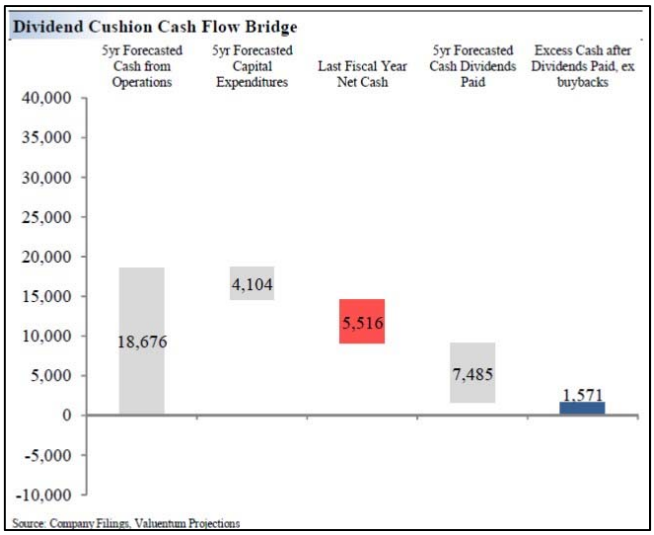
The difference between the numerator and denominator of the Dividend Cushion ratio is the firm's 'total cumulative 5-year forecasted distributable excess cash after dividends paid, ex buybacks.' The difference represents the excess cash that can be applied to more dividend increases (above that which are forecast in the analysis) during the 5-year measurement period. The following build in the image below is a mapping of Kimberly-Clark's residual free cash flow after deducting both capital spending and cash dividends (and after considering net debt obligations).

The build-up below (on the top left of the next page) illustrates why Kimberly-Clark has a Dividend Cushion above 1. The residual blue bar at the right of the chart, or the difference between the numerator and the denominator in the above graph, is positive, even if it may be modest in the context of the firm's robust cash-flow-from-operating dynamics. All else equal, when it comes to dividend growth, we tend to like equities that have large Dividend Cushion ratios, though management's willingness to sustain and raise the dividend, business model risk and valuation can and should never be ignored.

It's worth noting that companies that have high Dividend Cushion ratios may have a significantly larger 'blue bar' than Kimberly-Clark's, relatively speaking and in the context of their respective financial statements. We posit that such companies have significantly more excess cash that can be applied to future dividend increases, all else equal.

Derivation of Kimberly-Clark's Total Cumulative 5-year Forecasted Distributable Excess Cash after Dividends Paid, ex buybacks - $ mil

-- Note: The following analysis is for educational purposes only. Readers should visit www.valuentum.com for Kimberly-Clark's most recent dividend information. --



The chart immediately above shows that Kimberly-Clark has a significant amount of dividend obligations to pay out in the coming years relative to its future expected free-cash-flow generation over this time frame (the dividends paid is the fourth bar from the left and absorbs cash generated from operations, the first bar on the left). The above analysis at the time of publishing considers ~4% annual future growth rate dividends per share, as shown on the front page of the firm's dividend report (see image at bottom of article) -- meaning the analysis is forward-looking and considers growth expectations in the dividend, too. This is an important consideration--the Dividend Cushion ratio measures the Safety and Dividend Growth Potential of the dividend payout above and beyond our expected dividend growth rates.

Though such ideas are very difficult to find in the land of high yield, we generally prefer firms that have a very large estimated residual cash position over the next five years, or a very large measure of 'total cumulative 5-year forecasted distributable excess cash after dividends paid, ex buybacks' -- the blue bar in the graph immediately above. ***This is very rare in high yield.*** The companies with the largest 'blue bars' are the ones with the strongest future dividend-growth prospects as measured by financial capacity, in our view. Investors may consider equities that have a good balance of a strong dividend yield that meets certain personal criteria, a strong Dividend Cushion ratio to capture both required income and dividend growth dynamics--and is headed by a management team dedicated to sustaining and growing the payout. Such firms have nice income

streams, but they also may be ones poised for material expansion.

Now on to a discussion of the potential growth of Kimberly-Clark's dividend. As mentioned above, the greater the "cushion," the greater financial capacity a firm has to raise the dividend, in our view--but such dividend growth analysis is lacking if management's willingness to increase the dividend is ignored. As such, we evaluate the company's historical dividend track record. If a) there have been no dividend cuts during the past 10 years, b) the company has had a nice growth rate in recent years, and c) the firm boasts a strong Dividend Cushion ratio, we'd rate its future Potential Dividend Growth as EXCELLENT, which is the case for Kimberly-Clark. After all, in this case, Kimberly-Clark is a Dividend Aristocrat--meaning it has raised its dividend in at least each of the past 25 years.

The dividend is important, but it is not everything. Capital preservation is also an important consideration for income investors, or for all investors, for that matter. We therefore assess the risk associated with the potential for capital loss. The in-depth valuation analysis is primarily included in each firm's 16-page report (a separate report than the Dividend Report), but we also provide the valuation conclusions in a firm's Dividend Report for convenience. In Kimberly-Clark's case, at the time of the publishing of this article, we think the shares are FAIRLY VALUED (the firm's share price falls within our estimated fair value estimate range), so the risk of capital loss is rated as MEDIUM. If we thought shares were undervalued, the risk of capital loss would be rated as LOW.

Wrapping Things Up

The Dividend Cushion ratio is a forward-looking ratio (with a numerator and a denominator). It tells readers, on the basis of our estimates, how many times future free cash flow (cash from operations less capital spending) will cover future cash dividend payments after considering the net cash on the balance sheet, also a key source of dividend strength. It is purely fundamentally-based and driven from items taken directly from the financial statements. We think the Dividend Cushion ratio should be assessed at least quarterly, as it reflects an ongoing assessment of the health and safety of a company's dividend payout. Firms with high dividend yields, strong Dividend Cushion ratios, and a committed management team are ones with relatively large income streams that are poised for continued expansion, in our view.

A version of this article appeared on our website July 3, 2013. Updated July 10, 2017 and adapted July 1 for the High Yield Dividend Newsletter.

Holding on to a Simplified Tallgrass Energy Partners…for Now

In the April edition of the High Yield Dividend Newsletter, we detailed the pending simplification transaction between Tallgrass Energy Partners (TEP) and its general partner, Tallgrass Energy GP (TEGP), a deal that closed Friday June 29.

To recap, investors received 2 shares of Tallgrass Energy GP for each unit of Tallgrass Energy Partners owned, and Tallgrass Energy GP's first quarter 2018 dividend was raised to be exactly half that of Tallgrass Energy Partners. This means that Tallgrass Energy Partners unitholders did not experience an implicit distribution cut that has become all-too-synonymous with master limited partnership simplification transactions. Tallgrass Energy GP will change its name to Tallgrass Energy LP and will trade under the ticker "TGE" on the NYSE moving forward.

The transaction is expected to bring a host of benefits to the simplified family structure, not the least of which is a lower cost of capital, and the elimination of the general partner's incentive distribution rights more closely aligns management's interests with those of the common shareholder. Income investors have no need to fret about the magnitude or pace of dividend growth in the near term either. As of the close June 29, shares of Tallgrass Energy GP yield 8.8%, and former Tallgrass Energy Partners unitholders can expect to realize distribution growth of 5%-8% in 2018, according to management. The company expects to have a comfortable distribution coverage ratio of 1.2x for the year, though we are not too fond of coverage metrics based on industry-specific definitions of cash flow.

We plan to continue to include shares of the new Tallgrass Energy LP (TGE) in the simulated High Yield Dividend Newsletter portfolio at the same 5%

weighting that is currently filled by Tallgrass Energy Partners. This change will be reflected in the August edition of the High Yield Dividend Newsletter, after the new entity begins trading.

Simulated High Yield Dividend Newsletter Idea BP (BP) Approaches Multi-Year Highs

Image shown: BP's performance since the beginning of 2016.

Simulated High Yield Dividend Newsletter portfolio idea BP (BP) continues to be a bright spot. The company's first-quarter 2018 results, released in early May, showcased a 70%+ increase in underlying replacement cost profit ($2.6 billion versus $1.5 billion during the first quarter of 2017). Management also noted that its Upstream segment reported its strongest quarter since the third period of 2014, as reported oil and gas production marched higher by 6% on a year-over-year basis.

BP's operating cash flow, excluding Gulf of Mexico oil spill payments, came in at $5.4 billion (up $1 billion from last year's quarterly tally), even with the first-quarter 2018 mark including a negative $1.8 billion impact from a higher working-capital drag. Capital expenditures were flat at $3.5 billion on a year-over-year basis, so the operating cash flow expansion translated almost to an identical increase in free cash flow--good news for dividend coverage, in our view.

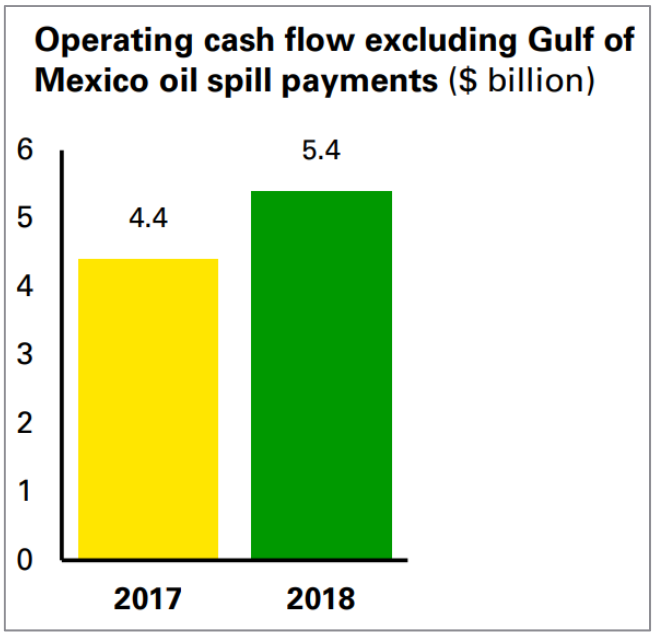


Image Source: BP's first-quarter earnings report

We like that BP's equity price has been quite resilient during the past many months, despite volatile equity markets and the overhang that the Gulf of Mexico spill continues to provide. BP's net debt stood at a lofty $40 billion at the end of the first quarter of 2018, though the company's leverage marks are within the executive team's target range (gearing of 28.1% at the end of the first quarter of 2018 versus a range of 20%-30%).

Though BP is not with material risks, as a turnaround "story," expectations are not as high as they otherwise would be. We like that management is focused on the right things, too, as CEO Bob Dudley noted in the first-quarter 2018 report: "Moving through 2018 we're determined to keep delivering our operational targets and maintaining capital discipline while growing cash flow and returns." For an upstream high-yield play, BP is an interesting one, and we intend to keep it in the simulated High Yield Dividend Newsletter portfolio.

- Brian Nelson, CFA
President, Investment Research

- Kris Rosemann
Head of Data, Associate Investment Analyst

Disclosure: Brian Nelson and Kris Rosemann do not own any shares of any securities mentioned in this newsletter. Please contact info@valuentum.com for more information regarding Valuentum's editorial policies.

THE SIMULATED HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO

We continue to be excited about the launch of the simulated High Yield Dividend Newsletter portfolio, the inaugural edition released January, 1, 2018. This is now the seventh edition of the newsletter! We've learned a lot in recent months about what works and what doesn't work for our members. Thank you for the feedback.

Many of our members continue to prefer the list-versus-weighting perspective across our simulated newsletter portfolios. It may also be true that a lot of new members won't feel like they have missed out on anything under a list-versus-weighting format, too, which has been a concern when brand new members see a simulated portfolio that has been around for half decade or longer.

Though we may calculate simulated performance of the High Yield Dividend Newsletter periodically, we don't think it is necessary to do so on a monthly basis. The list-and-weighting format facilitates a level of consistency across our newsletter products, and we may consider migrating the simulated High Yield Dividend Newsletter portfolio to a range-of-percentage-weightings, too, as we have with respect to both the simulated Best Ideas Newsletter portfolio and simulated Dividend Growth Newsletter portfolio.

The simulated High Yield Dividend Newsletter portfolio is presented each month in similar fashion (list and weightings) as that of the first edition. If you have any questions, comments, or concerns, please be sure to let us know at info@valuentum.com.

Idea	Symbol	Weighting	Est Annual Div's/Share ($)	Est Div Yield
CORE				
Global X SuperDividend ETF	SDIV	5.0%	1.48	7.04%
Global X SuperIncome Preferred ETF	SPFF	10.0%	0.87	7.32%
iShares International Select Dividend ETF	IDV	5.0%	1.55	4.83%
iShares MSCI Australia ETF	EWA	5.0%	0.99	4.38%
iShares U.S. Preferred Stock ETF	PFF	5.0%	2.09	5.55%
PowerShares Senior Loan Portfolio	BKLN	5.0%	0.85	3.72%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	3.86	5.78%
EQUITY				
AmeriGas Partners	APU	5.0%	3.80	9.00%
BP PLC	BP	5.0%	2.40	5.26%
Digital Realty Trust	DLR	5.0%	4.04	3.62%
Enterprise Products Partners	EPD	5.0%	1.71	6.18%
Magellan Midstream Partners	MMP	5.0%	3.75	5.43%
Omega Healthcare Investors	OHI	5.0%	2.64	8.52%
Public Storage	PSA	5.0%	8.00	3.53%
Realty Income Corporation	O	5.0%	2.64	4.91%
Tallgrass Energy Partners	TEP	5.0%	3.90	9.00%
		85.0%		**5.07%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 6/29/2018.

We expect to increase our allocation to 100% soon, as we look to add to the Core component of the portfolio.

HIGH YIELD DIVIDEND WATCH LIST

Company Name	Symbol	Industry	Div Yield	Div Growth	Div Safety	Div Cushion	Div Track Record	Leverage
Golar LNG Partners	GMLP	Oil & Gas Pipelines	15.3%	VERY POOR	POOR	0.9	HEALTHY	HIGH
Buckeye Partners	BPL	Oil & Gas Pipelines	14.1%	VERY POOR	POOR	0.9	HEALTHY	HIGH
Energy Transfer Partners	ETP	Oil & Gas Pipelines	12.2%	VERY POOR	VERY POOR	1.2	HEALTHY	HIGH
GameStop	GME	Specialty Retailers	12.0%	POOR	POOR	1.6	HEALTHY	LOW
Centurylink	CTL	Telecom Services - diversified	12.0%	VERY POOR	VERY POOR	-3.6	RISKY	HIGH
Alliance Resource Partners	ARLP	Industrial Minerals	11.6%	POOR	GOOD	1.6	RISKY	LOW
Frontline	FRO	Shipping	10.7%	NMF	NMF	NMF	RISKY	HIGH
NuStar	NS	Oil & Gas Pipelines	10.6%	VERY POOR	POOR	1.1	RISKY	HIGH
Pier 1	PIR	Specialty Retailers	10.6%	NMF	NMF	NMF	RISKY	LOW
DDR	DDR	REIT - Retail	10.2%	VERY POOR	VERY POOR	0.3	RISKY	HIGH
Omega Healthcare	OHI	REIT - Healthcare	9.8%	VERY POOR	POOR	1.0	HEALTHY	HIGH
Spectra Energy Partners	SEP	Oil & Gas Pipelines	9.5%	GOOD	GOOD	1.3	HEALTHY	HIGH
AmeriGas Partners	APU	Utilities	9.3%	NMF	NMF	NMF	HEALTHY	HIGH
Holly Energy	HEP	Oil & Gas Pipelines	9.1%	VERY POOR	POOR	1.2	HEALTHY	HIGH
ADA-ES Inc	ADES	Pollution Controls	9.0%	NMF	NMF	NMF	HEALTHY	LOW
Spirit Realty	SRC	REIT - Retail	8.9%	NMF	NMF	NMF	HEALTHY	HIGH
Fred's Inc	FRED	Multiline Retail - discount	8.5%	NMF	NMF	NMF	RISKY	HIGH
R.R. Donnelley	RRD	Commercial Services	8.3%	VERY POOR	VERY POOR	-6.6	HEALTHY	MEDIUM
Pitney Bowes	PBI	Commercial Services	8.2%	VERY POOR	VERY POOR	-2.0	RISKY	HIGH

Note: The Dividend Cushion ratio and qualitative assessments in the table above may change following the date of this publication. Please be sure to access the website at www.valuentum.com for more information. Please also note that Valuentum publishes both an adjusted Dividend Cushion ratio and an unadjusted Dividend Cushion ratio. Many of the equities included in this table have substantial equity-price and dividend-payment risk.

SCREEN OF THE MONTH – TOP HOLDINGS OF THE ISHARES INTERNATIONAL SELECT DIVIDEND ETF (IDV)

Name	Ticker	Weight (%)	Sector	Country	Market Currency	Dividend Yield[1]
ASTRAZENECA PLC	AZN	5.1	Health Care	United Kingdom	GBP	3.87%
MACQUARIE GROUP LTD DEF	MQG	4.6	Financials	Australia	AUD	5.13%
ROYAL DUTCH SHELL PLC CLASS A	RDSA	3.4	Energy	United Kingdom	GBP	5.36%
COMMONWEALTH BANK OF AUSTRALIA	CBA	3.2	Financials	Australia	AUD	8.51%
GALLIFORD TRY PLC	GFRD	2.3	Industrials	United Kingdom	GBP	9.02%
VTECH HOLDINGS LTD	303	2.2	Information Technology	Hong Kong	HKD	6.58%
SSE PLC	SSE	2.1	Utilities	United Kingdom	GBP	6.80%
WESFARMERS LTD	WES	2.1	Consumer Staples	Australia	AUD	6.02%
ENI	ENI	2	Energy	Italy	EUR	5.12%
TOTAL SA	FP	2	Energy	France	EUR	4.93%
SALMAR ASA	SALM	1.9	Consumer Staples	Norway	NOK	5.39%
GLAXOSMITHKLINE PLC	GSK	1.9	Health Care	United Kingdom	GBP	5.17%
CANADIAN IMPERIAL BANK OF COMMERCE	CM	1.9	Financials	Canada	CAD	4.62%
SWEDBANK	SWED A	1.6	Financials	Sweden	SEK	6.91%
AZIMUT HOLDING S.P.A.	AZM	1.6	Financials	Italy	EUR	7.33%
GAS NATURAL SA	GAS	1.6	Utilities	Spain	EUR	5.86%
CASINO GUICHARD PERRACHON SA	CO	1.5	Consumer Staples	France	EUR	9.26%
ENERGIAS DE PORT SA	EDP	1.5	Utilities	Portugal	EUR	5.59%
NATIONAL AUSTRALIA BANK LTD	NAB	1.4	Financials	Australia	AUD	10.35%
WESTPAC BANKING CORPORATION CORP	WBC	1.4	Financials	Australia	AUD	9.54%

1) Dividend yield in terms of home currency

Source: iShares https://www.ishares.com/us/products/239499/ishares-international-select-dividend-etf.

DIVIDEND REPORT PAGE 2 – GAMESTOP (GME)

Valuentum's Stock Dividend Research | Visit us at www.valuentum.com | Ratings as of 10-Apr-2018 | Data as of 29-Mar-2018

GameStop GME FAIRLY VALUED

Buying Index™ 4 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Attractive	$12.00 - $36.00	HEALTHY	POOR /1.7	POOR	12.04%

Assessment of Company Dividend Strategy

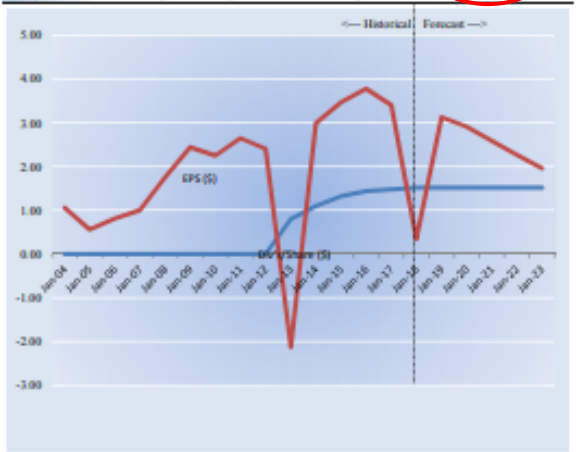
Key Strengths

GameStop's multichannel video game retail business has put up solid performance in recent years. It expects a 3%-5% earnings CAGR through 2019, when it expects half of its operating earnings to be generated from non-physical gaming earnings (up from 25% of total operating earnings in fiscal 2015, ended January 2016). The firm's net cash position flipped to a net debt position in fiscal 2016, but its free cash flow generation (averaging ~$400 million from fiscal 2015-2017) has been more than enough to cover annual run rate cash dividend obligations of ~$155 million. We see no reason for management to raise the dividend, and a cut is growing likely.

Potential Weaknesses

GameStop's dividend coverage metrics and financial position appear to be healthy, but we have concerns about the sustainability of its dividend at present levels. For starters, performance of its used-game business may face pressure over the long haul, and the company's former net cash position was somewhat misleading due to its off-balance sheet debt that comes in the form of operating leases. Share repurchases can be expected to continue to eat up capital that could be otherwise used to augment dividend growth and ongoing investments to diversify GameStop's business model, which will be necessary for the long-term health of the company.

Graphical Relationship, Earnings and Dividends (per share)

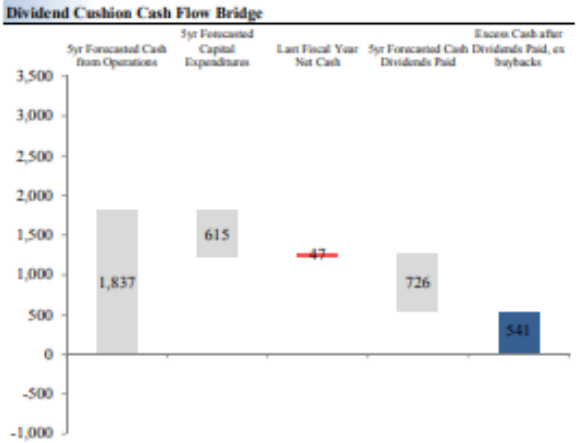


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

Dividend Cushion Cash Flow Bridge Evaluation

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

Dividend Cushion Cash Flow Bridge

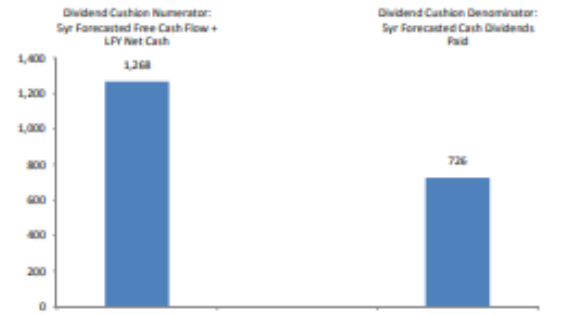


Source: Company Filings, Valuentum Projections

Dividend Cushion Ratio Evaluation

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

Dividend Cushion Ratio Deconstruction



The information and data contained in this report is not represented or warranted to be timely, complete, accurate, or correct. This report is for informational purposes only and should not be considered a solicitation to buy or sell a security. Before acting on any information in this report, you should consider whether the information is suitable for your particular circumstances and, if necessary, seek professional advice. Assumptions, opinions, and estimates are based on our judgment as of the date of the report and are subject to change without notice. Valuentum is not responsible for any errors or omissions or for results obtained from the use of this report. Redistribution is prohibited without written permission. To license Valuentum research, contact us at valuentum@valuentum.com.

VALUENTUM

NOTE: GameStop (GME) has a high dividend yield, but the company is facing structural pressures on its business. Even though its financial profile is strong, management may cut the dividend as there may be no need to continue paying a 12% yield in a market where the average yield on an S&P 500 company is ~2%. This is partly why we assign the company poor dividend metrics, despite its solid financial profile.

Emerson Electric EMR FAIRLY VALUED

Buying Index™ 3 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Attractive	$49.00 - $73.00	HEALTHY	GOOD / 2.1	GOOD	2.78%

Assessment of Company Dividend Strategy

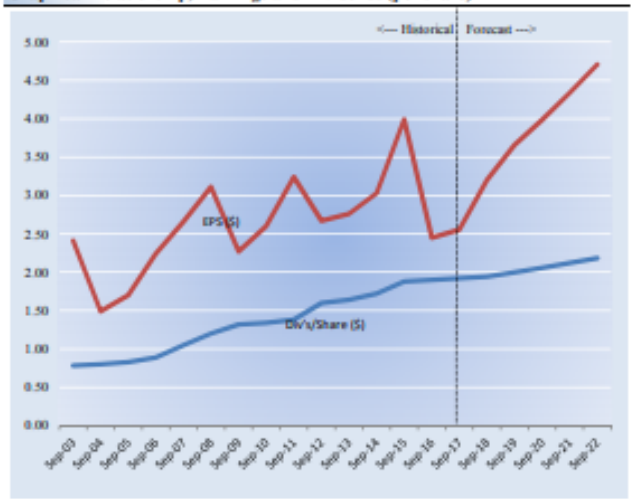
Key Strengths

Emerson serves a variety of industrial, commercial and consumer markets, some of which are cyclical, but many of which have long-term secular trends supporting them. The company has increased its dividend for each of the past 60+ years, earning it a place on the Dividend Aristocrat list. Strong free cash flow generation has been the base on which Emerson has built this impressive dividend track record, and though free cash flow suffered in fiscal 2015-2017, it has averaged roughly $1.9 billion in annual free cash flow generation over the past three fiscal years. We think this free cash flow generation and a reasonable balance sheet will support continued dividend increases moving forward. Management will not let its track record go easily.

Potential Weaknesses

Even though Emerson has strong free cash flow, fiscal 2015-2017 levels were suppressed due to ongoing struggles in a complex and volatile marketplace and operational adjustments. Capital allocation plans could provide a headwind to future dividend growth potential. The company can be expected to continue pursuing acquisitions, which could allocate billions of dollars in capital away from dividends. However, free cash flow generation will benefit from a focus on improved working capital performance and the reduction of capital spending. All things considered, we are not anticipating any material weakness in Emerson's payout anytime soon, and the firm is dedicated to returning 50%-60% of operating cash flow to shareholders.

Graphical Relationship, Earnings and Dividends (per share)

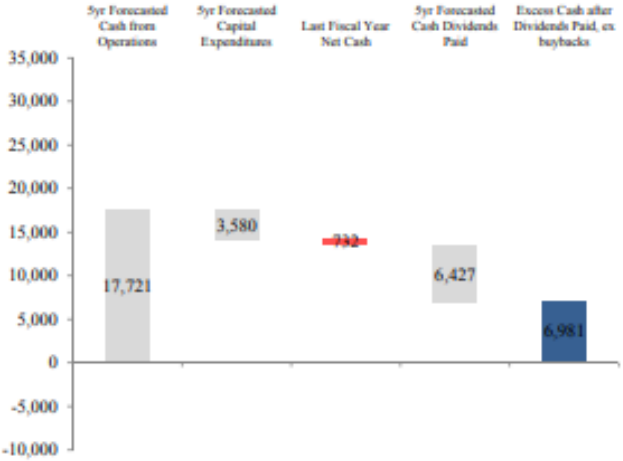


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

Dividend Cushion Cash Flow Bridge Evaluation

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

Dividend Cushion Cash Flow Bridge

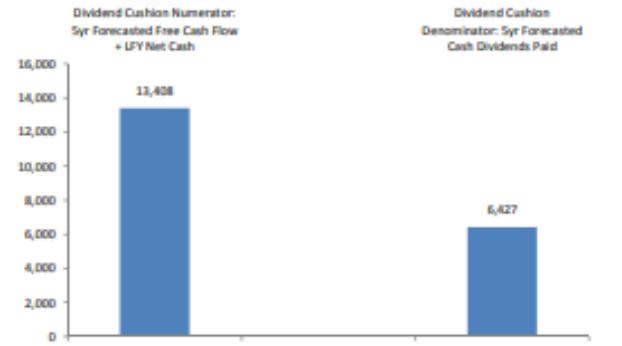


Source: Company Filings, Valuentum Projections

Dividend Cushion Ratio Evaluation

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

Dividend Cushion Ratio Deconstruction



The information and data contained in this report is not represented or warranted to be timely, complete, accurate, or correct. This report is for informational purposes only and should not be considered a solicitation to buy or sell a security. Before acting on any information in this report, you should consider whether the information is suitable for your particular circumstances and, if necessary, seek professional advice. Assumptions, opinions, and estimates are based on our judgment as of the date of the report and are subject to change without notice. Valuentum is not responsible for any errors or omissions or for results obtained from the use of this report. Redistribution is prohibited without written permission. To license Valuentum research, contact us at valuentum@valuentum.com.

DEFINITIONS

ValueCreation. This is a proprietary Valuentum measure. ValueCreation indicates the firm's historical track record in creating economic value for shareholders, taking the average difference between ROIC (without goodwill) and the firm's estimated WACC during the past three years. The firm's performance is measured along the scale of EXCELLENT, GOOD, POOR, and VERY POOR. Those firms with EXCELLENT ratings have a demonstrated track record of creating economic value, while those that register a VERY POOR mark have been destroying economic value.

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).

ValueTrend. This is a proprietary Valuentum measure. ValueTrend indicates the trajectory of the firm's return on invested capital (ROIC). Firms that earned an ROIC last year that was greater than the 3-year average of the measure earn a POSITIVE rating. Firms that earned an ROIC last year that was less than the 3-year average of the measure earn a NEGATIVE rating.

Copyright © 2018 by Valuentum, Inc. All rights reserved. No part of this publication may be reproduced in any form or by any means.

The information contained in the High Yield Dividend Newsletter or any report from Valuentum is not represented or warranted to be accurate, correct, complete, or timely. This newsletter is for informational purposes only and should not be considered a solicitation to buy or sell any security. No warranty or guarantee may be created or extended by sales or promotional materials, whether by email or in any other format. The securities or strategies mentioned herein may not be suitable for all types of investors. The information contained in this report does not constitute any advice, especially on the tax consequences of making any particular investment decision. This material is not intended for any specific type of investor and does not take into account an investor's particular investment objectives, financial situation or needs. This report is not intended as a recommendation of the security highlighted or any particular investment strategy. Before acting on any information found in this report, readers should consider whether such an investment is suitable for their particular circumstances, perform their own due diligence, and if necessary, seek professional advice. The sources of the data used in this report are believed by Valuentum to be reliable, but the data's accuracy, completeness or interpretation cannot be guaranteed. Assumptions, opinions, and estimates are based on our judgment as of the date of the report and are subject to change without notice. Valuentum is not responsible for any errors or omissions or for results obtained from the use of this report and accepts no liability for how readers may choose to utilize the content. In no event shall Valuentum be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the information contained in this document. Investors should consider this report as only a single factor in making their investment decision. Valuentum is not a money manager, is not a registered investment advisor, and does not offer brokerage or investment banking services. Valuentum has not received any compensation from the company or companies highlighted in this report. Valuentum, its employees, independent contractors and affiliates may have long, short or derivative positions in the securities mentioned herein. Information and data in Valuentum's valuation models and analysis may not capture all subjective, qualitative influences such as changes in management, business and political trends, or legal and regulatory developments. Redistribution is prohibited without written permission. Readers should be aware that information in this work may have changed between when this work was written or created and when it is read. There is risk of substantial loss associated with investing in financial instruments. 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. The portfolio in the High Yield Dividend Newsletter is hypothetical and does not represent real money. Past simulated performance, whether backtested or walk-forward or other, is not a guarantee of future results. Actual results may differ from simulated portfolio information being presented in this newsletter. For general information about Valuentum's products and services, please contact us at valuentum@valuentum.com or visit our website at www.valuentum.com.