OUR DIVIDEND GROWTH NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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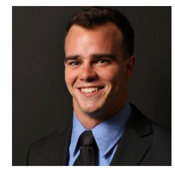

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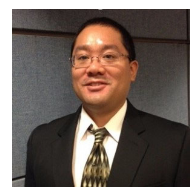

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***NOTE**: The goal of the Dividend Growth Newsletter is to highlight ideas with strong dividend growth potential and update readers about new developments in the market. A simulated portfolio of dividend growth ideas is presented on page 5 of each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

Inside This Issue

"Look – times are good right now, and a lot of people have made a lot of money during this upswing, but now is the time to be smart."

– Brian Nelson, CFA

ICYMI -- Wild Ride in the Markets -- Nelson

By Brian Nelson, CFA

Market volatility has picked up quite a bit of late, and frankly you shouldn't be the bit surprised. I've been quite active explaining the impact that the proliferation of index investing and quantitative investing has had **and will have** on the marketplace. The more people index or invest on backward-looking empirical criteria, as in most quant models, regardless of future expectations, the more people that buy everything at any price and hold no matter what, the more people that aren't making decisions on the basis of underlying valuations, *then* the more people that can contribute to severe price-to-fair value dislocations.

In many ways, when nobody is paying attention to what is going on, it sets the table for a painful stock pricing bubble…when everyone is buying regardless of price, and when people aren't paying attention, bad things tend to happen. The attraction of low-cost index investing is a great one, and past returns artificially bolstered by ultra-low interest rates and accommodative policies following the Great Recession have only emboldened those looking for an easy way to riches. Let me assure you: **there is no easy way to riches**, and those promising you this are more interested in receiving fees from you than anything else.

Since the launch of the simulated Best Ideas Newsletter portfolio, the ideas have generated significant capital appreciation, without a doubt. The same is true with the simulated Dividend Growth Newsletter portfolio. The ideas in the Exclusive publication have been solid and backed by strong theses, and despite a very challenging environment, ideas in the High Yield Dividend Newsletter have held up, even in the face of a rising 10-year Treasury yield. Let us know what you think. Believe it or not, some of the best value investors are down over 26% this year!

All in, however, I know how well we're doing as a research provider, and we can't be anything but pleased with our publication suite, and given how effective our fair value estimates, how solid the Dividend Cushion ratio has performed, and the innovative metrics we've created with respect to **new dividend-adjusted leverage** and the Economic Castle rating, we know that we're providing our members with tremendous value. The lure of index investing and backward-looking quantitative investing will be great though, but you know better.

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I've been spending these past few months writing intensively on a new book (which I hope to share soon!), where I will explain the major pitfalls of backward-looking quantitative analysis, what the word "empirical" truly means in finance, as well as the concerns that may arise with respect to an increased level of indexing across the marketplace. From what I understand, those that have been members of Valuentum have benefited greatly from this economic boom and cyclical upswing in equities, but it is when things really start to hit the fan where the value of a membership comes in.

Importantly, however, think of index investing as that adjustable-rate mortgage that sucks you into thinking that everything is just going to be fine, that stock prices (like housing prices) always go up in the long run, that one doesn't have to pay attention to stock selection. Indexing sounds so easy, right? And now indexing is free! C'mon -- You know better than to fall for such things. Pay attention to what you buy and what you own. Seriously. You know if everybody is doing something, it's not going to end well.

Now is the time to be careful, not greedy. I know things are great more than 9 years into a bull market, but investing is not so much about making money, **it is about keeping it!** There is nothing worse than a fortune lost, and I fear that many of the thousands of newly-minted 401k millionaires will find it rather frustrating when what has worked during the previous decade falls incredibly short in the coming decade. With the vast majority of trading on the markets today comprised of index funds and quants, nobody truly knows how volatile the markets will become.

That is why intrinsic value analysis is so important. Enterprise valuation is not about being precise. It's about making sure that the ideas that you are interested in also have a solid foundation. It's about evaluating the size of the fair value estimate range to get a feel for the riskiness of a company's fundamentals, and how wide a range of probable fair value outcomes might be, as that range in many ways may imply just how volatile the stock price may be.

Frankly, you shouldn't care if your neighbor made money on cryptocurrency, or if your best friend is chasing cannabis stocks, or if your uncle is crazy about Tesla (TSLA) and Netflix (NFLX). Look – times are good right now, and a lot of people have made a lot of money during this upswing, but now is the time to be smart. Now is not the time to think that all you have to do is buy an index fund and things will just work out! Don't confuse a bull market with brains!

I have to admit I am so worried about the coming generation. Okay – I'm scared. I think some believe that stocks are merely pieces of paper or some potion that can be distilled into separate qualities to extract some possible excess return. You know that investing involves real companies, and if others want to take the chance on not knowing anything about their investments, let them. Frankly, you've worked too hard for your money not to pay attention!

I get the sense that we're building into something climactic soon. The 800-point drop in the Dow Jones Industrial Average October 10 was just eerie. Frankly, it came out of nowhere, and nobody really could give a good fundamental explanation, other than the 10-year Treasury yield was on the march higher. It's hard to believe that consultants are actually allowing index investing and quantitative investing for their clients, in such large scale. I just wonder who will be to blame when things really start heading south. Will the client say, "You mean -- you really didn't know anything about the underlying stocks that you've invested in?" For some reason, I think that conversation is not going to go well for consultants.

I know Valuentum is doing a great job. I know of perhaps one other research firm that publishes fair value estimates on over 1,000 stocks. I mean – we're talking fully populated intrinsic-value models! **We update the fair value estimates roughly four times a year**, too! That's in addition to all that we do with respect to the newsletter publications. The marketplace, to me, is just crazy right now, and while prudence hasn't been rewarded as much as moral hazard since the Financial Crisis, the tide will eventually turn. It always does.

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Valuentum is going to be here for a long time. We know what we're doing, and we know what others are doing. We know the core component of investing is free cash flow, and we know it better than just about anybody else. It's easy to get sucked into the blogosphere on a hot tip, but don't. It's easy to buy index funds and forget it, but you know it's not that easy. Remember when buying a home was a no-brainer, too? Look – you've already experienced cycles like this.

I know it's hard work to study your companies inside and out, but now is the time to do it. **Now is the time to prepare for the worst because now the times are good.** The very worst thing you can do is to sit back and think that ultra-low interest rates and accommodative policy, two drivers of this prolonged bull market, will last forever. Stick with fundamental, free-cash-flow based analysis, and embrace the idea that the market contains valuable information in its prices.

We're here for you. You know how much you pay us. We're not charging you 2% and 20% like hedge funds, and we're not charging you 1% of your assets. We work really, really hard for you as a publisher, and we understand that it is vitally important that you keep more of your money. I don't know how investors can give away 20% of their upside or give away 1% of their assets every year in index funds held by advisors. Maybe I'm old school. I don't know, but I am glad that we have an advisor client base that is so focused on their clients' needs that they have a membership to Valuentum.

It makes me proud to be a part of this company.

That's it for now. We're in the middle of earnings season, so we're publishing quite frequently on the website, so please do visit. **If you ever have a question, please be sure to ask it, too.** We'll do our best to get that information available to all. Finally, I am so excited about the book that I am writing, and I sincerely hope that you will read it. I talk about so much in it, including my experiences at Morningstar and Driehaus. **I'm counting on your book review, too!**

Adding Xilinx to the Dividend Growth Newsletter Portfolio

By Brian Nelson, CFA

Xilinx (XLNX) rewrites the book when it comes to free cash flow efficiency!

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*Adding Xilinx…*from previous page

The company makes programmable logic devices (PLDs), including programable System on Chips (SoCs) and three-dimensional integrated circuits (3D ICs), and its intellectual property is a key component of its value proposition. During the three fiscal years ending 2018, for example, Xilinx's operating cash flow averaged over $830 million, while its entire cash bill for capital spending, including growth and maintenance, averaged just over $50 million, meaning all capital spending represented, on average, approximately 6% of operating cash flow. This is simply incredible.

During the three fiscal years ending 2018, Xilinx generated substantial free cash flow, averaging roughly $780 million per year. Xilinx is about as capital light of an entity as one can imagine, and we love these types of companies in the simulated Dividend Growth Newsletter portfolio because it means more of their free cash flow can go to future dividend growth. Though shares are not necessarily cheap, we expect an upward revision to our fair value estimate upon the next update.

The company's share-price breakout has us excited, too, and its recent deal with Microsoft (MSFT), ousting Intel's (INTC) Altera unit is very encouraging on the competitive front. Shares yield ~1.8% at the time of this writing, but we're expecting some big growth in coming years. Its impressive dividend growth potential is further bolstered by a net cash position on the balance sheet.

Here's what we say about the company in its Dividend Report:

> **Key Strengths**
>
> Xilinx is expecting expansion in the markets it serves thanks to 'multi-market high growth megatrends' including cloud computing, embedded vision, industrial Internet of Things, and 5G wireless. These dynamics add to the dividend growth potential embedded in the firm's capital-light business model, which drives solid free cash flow and helps maintain a healthy balance sheet. As of the end of fiscal 2018, the company had a net cash position of ~$1.7 billion, inclusive of current debt. Free cash flow generation averaged ~$781 million over the past three fiscal years (2016-2018), more than enough to cover annual run rate cash dividend obligations of just over $353 million.
>
> **Potential Weaknesses**
>
> Xilinx appears to have very little dragging on its dividend growth potential. Management has been very shareholder friendly as of late, having returned more than 100% of operating cash flow to shareholders via dividends and share repurchases in the past ten years. Competing capital allocation options in the form of share repurchases (averaged nearly $480 million from fiscal 2016-2018) have the potential to impact the pace of dividend expansion moving forward. Nevertheless, we expect the supporting macro trends to continue to fuel demand for Xilinx, and its solid free cash flow generation and impressive balance sheet health should drive ongoing dividend growth.

Readers should expect a material increase in our fair value estimate of Xilinx, in part because of its new deal with Microsoft, but mostly due to a lower cost of capital assumption to better reflect its fundamental financial risk.

General Motors Overcomes Challenges in Strong Third Quarter; Ford Backs Off 2020 Targets

Despite challenges in its cost structure and the Chinese market, simulated newsletter portfolio idea General Motors turned in a strong third quarter report, and shares reacted favorably after several months of selling pressure. Rival Ford also reported a solid third quarter report, but it no longer expects to hit its 2020 EBIT margin and ROIC targets.

By Kris Rosemann

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Dividend Growth Ideas

By Valuentum Analysts

Valuentum Highlighted as One of
The Best Websites for Dividend-Stock Ideas
-- BARRON'S
https://www.barrons.com/articles/the-best-websites-for-dividend-stock-ideas-1468037242

DIVIDEND GROWTH IDEAS -- as of November 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	2.49%	$ 56.00	4	0.86	48.22	5.5%-10%
Johnson & Johnson (JNJ)	3.60	2.56%	$ 133.00	6	1.06	140.82	5.5%-10%
S&P Dividend ETF SPDR (SDY)	2.40	2.54%	-	UR	-	94.46	5.5%-10%
Apple (AAPL)	2.92	1.31%	$ 236.00	6	0.94	222.22	4%-5.5%
Cisco (CSCO)	1.32	2.89%	$ 54.00	6	0.85	45.65	4%-5.5%
Digital Realty Trust (DLR)	4.04	3.82%	$ 102.00	6	1.04	105.72	4%-5.5%
iShares Int'l Select Dividend (IDV)	1.61	5.17%	-	UR	-	31.18	4%-5.5%
Energy Sector SPDR (XLE)	1.96	2.89%	-	UR	-	67.73	4%-5.5%
Invesco Senior Loan (BKLN)	0.88	3.81%	-	UR	-	23.03	2.5%-4%
General Motors (GM)	1.52	4.17%	$ 56.00	3	0.65	36.47	2.5%-4%
Microsoft (MSFT)	1.84	1.74%	$ 116.00	7	0.91	105.92	2.5%-4%
Novartis (NVS)	2.98	3.38%	$ 77.00	4	1.15	88.20	2.5%-4%
Oracle (ORCL)	0.76	1.56%	$ 58.00	7	0.84	48.59	2.5%-4%
Cracker Barrel (CBRL)	5.00	3.12%	$ 155.00	3	1.04	160.47	1.5%-2.5%
Gilead Sciences (GILD)	2.28	3.24%	$ 96.00	6	0.73	70.31	1.5%-2.5%
Hasbro (HAS)	2.52	2.58%	$ 102.00	6	0.96	97.55	1.5%-2.5%
Altria (MO)	3.20	5.03%	$ 67.00	6	0.95	63.67	1.5%-2.5%
Realty Income (O)	2.65	4.33%	$ 58.00	6	1.06	61.19	1.5%-2.5%
Xilinx (XLNX)	1.44	1.66%	$ 64.00	6	1.36	86.99	1.5%-2.5%
Cash Consideration	-	-	-	-	-	-	10%-20%

UR = Under Review

This portfolio is not a real money portfolio. Data as of November 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. *Given market conditions and the importance of diversification, not all stocks can be undervalued*. 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! The Dividend Cushion ratios are so important, so please stay up to date with them.

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

*General Motors…*from page 4

Shares of simulated newsletter portfolio idea General Motors (GM) leapt during the October 31 trading session after the company released a strong earnings report before the open that included record third-quarter adjusted diluted earnings per share and record third-quarter equity performance from GM China. Net revenue in the period advanced 6.4% on a year-over-year basis to $35.8 billion, and adjusted diluted earnings per share of $1.87 was nearly 42% higher than that of the year-ago period.

GM North America delivered an EBIT-adjusted margin of 10.2%, which was notably higher than the 9.4% mark in the second quarter of 2018 and 8.3% in the year-ago period, thanks to all-new full-size trucks, ongoing crossover performance, and all-around favorable pricing, but management continues to take a cautious tone as it must work to mitigate rising commodity costs. It expects fourth quarter EBIT-adjusted margin to be near the high end of its 9%-10% guidance for the full-year 2018.

GM China delivered record third-quarter equity income of $0.5 billion thanks to improved mix and ongoing focus on cost and productivity improvements, and the business is in the process of introducing ten new or refreshed models in the second half of this year. Such performance was especially notable given the industry-wide weakness seen of late in China, but management points to the company's growing strength in luxury and premium segments, which are growing in popularity among Chinese consumers, as keys to its success in the quarter. More positive news out of the country recently came via a report that the nation is considering reducing its sales tax on new cars by 50% to stimulate demand. Currency headwinds in South America continue to provide a drag on GM International's overall results, but the company is quick to note that it has lowered its breakeven point by 40% in the past few years via structural cost initiatives.

We continue to be fans of GM's income generating potential for shareholders, and management reiterated its full-year 2018 guidance for automotive free cash flow to be roughly $4 billion before the impact of pre-funding non-US pension contributions. Through the first three quarters of 2018, traditional free cash flow came in at nearly $2.7 billion, easily covering cash dividends paid in the period of just under $1.7 billion. The company's adjusted Dividend Cushion ratio, which mitigates the impact of debt related to GM Financial, currently sits at 3.1 (its unadjusted Dividend Cushion ratio is 1.15), and shares yield ~4.1% as of this writing.

In addition to reiterating its automotive free cash flow guidance, management reiterated its expectations for $2 billion in equity income from GM China and now expects its full-year earnings per share to be at the top of its previously-issued guidance, which was reduced to ~$6.00 from the mid-$6.00 range after the second quarter. We continue to like what we see from GM Cruise, including a partnership with Honda (HMC) to develop a new autonomous vehicle, and management values the business at $14.6 billion as it has now attracted $5 billion in external capital. The company also has plans to increase Bolt EV production by 20% in the fourth quarter of 2018 to meet rising electronic vehicle demand in the evolving auto market, and it has partnered with Delta Electronics to deliver a vehicle capable of a 180-mile driving range with less than 10 minutes of charging.

We believe GM will be at the forefront of the auto revolution as we march towards increasing penetration of electric vehicles and ultimately autonomous vehicles, and major partnerships with the likes of Honda and SoftBank (SFTBY) support such a notion. GM Cruise is targeting commercialization in 2019 in a dense urban environment, and the $2.75 billion contribution from Honda over the span of the next 12 years ($750 million up front) will only boost its prospects. We currently value shares of General Motors at $56 each.

Ford Pulls 2020 EBIT Margin and ROIC Targets

Shares of rival Detroit automaker Ford (F) have also performed nicely since its third quarter report October 24, which revealed strength in its North American business. Revenue advanced 3% on a year-over-year basis in the quarter, but net income and adjusted EBIT both fell from the year-ago period due

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in large part to ongoing challenges in China. A favorable mix of higher margin products and high-end trim levels in North America were key in driving top-line growth and its 8.8% EBIT margin in North America in the quarter, which was flat compared to the year-ago period as commodity costs provided a headwind.

Management reiterated its 2018 guidance for adjusted earnings per share in a range of $1.30-$1.50 and positive cash flow below that of 2017, but higher costs, uncertainty surrounding the auto industry as a whole, and deterioration in its Europe and China businesses in 2018 will combine to keep it from achieving its previously announced targets of an 8% EBIT margin and high-teens ROIC by 2020. We continue to prefer GM over Ford for a number of reasons, not the least of which is its decisions to mitigate its exposure to less favorable international markets and drive margins higher, especially in the important North American market. Ford's adjusted Dividend Cushion ratio currently sits at 1.3, and shares yield ~6.3%.

We also prefer GM over Ford due to the former's budding prospects in next-generation vehicle technology. High-level partnerships may prove to be increasingly important as we move forward in the transition to new auto technology, and GM appears to have a notable leg up in this regard, though we are monitoring recent developments tying Ford to potential partnerships with Chinese Internet giant Baidu (BIDU) and Volkswagen (VWAGY). We currently value shares of Ford at $13 each.

Data Center Leads Intel's Impressive Top-Line Growth; Guidance Raised

Intel continues to throw off gobs of free cash flow and boasts a solid combination of a competitive dividend yield and a strong Dividend Cushion ratio.

By Kris Rosemann

Simulated newsletter portfolio idea Intel (INTC) has found itself out of the market's favor of late as a result of a delayed chip launch that some expect will allow rivals to take notable market share from the company, but shares gained nicely following its third quarter report, released after hours October 25. Intel's top-line advanced 19% on a year-over-year basis to an all-time company record of $19.2 billion as its data-centric businesses turned in 22% growth and PC-centric business growth checked in at 16%. The company's 'Data Center Group' led its data-centric businesses with 26% revenue growth from the year-ago period, and ongoing strength in commercial and gaming helped drive PC-centric revenue growth.

In addition to its impressive top-line growth, Intel reported tremendous operating leverage in the third quarter as its operating margin expanded by five percentage points and came in at the lowest spending as a percentage of revenue in over a decade. Operational efficiencies, volume, and average selling price all played a role in the company's margin expanding to 39.7% in the third quarter, which drove non-GAAP earnings per share to $1.40 from $1.01 in the comparable period of 2017.

Free cash flow in the quarter leapt nearly 52% from the year-ago period to just under $5 billion, which was more than sufficient in covering cash dividends paid of ~$1.4 billion. Intel holds nearly $13.2 billion in cash and cash investments, in addition to $11.1 billion in long-term equity investments and other long-term investments, and nearly $27.9 billion in total debt on its balance sheet. The company's Dividend Cushion ratio checks in at a strong 2.5, which pairs nicely with a ~2.6% dividend yield as of this writing.

Management raised its full-year 2018 guidance for a number of metrics after the strong third quarter, and it now expects non-GAAP revenue to be approximately $71.2 billion, up from previous guidance of ~$69.5 billion. Its non-GAAP operating margin guidance now sits at 34.5% compared to 32% previously, and non-GAAP earnings per share guidance was raised to $4.53 from $4.15. Free cash flow is now expected to be $15.5 billion, $500 million higher than its previous target.

Intel's impressive third quarter report, particularly its return to satisfying market expectations with respect to robust data center growth, was a nice reminder of the chip giant's momentum in its transformation to large and rapidly growing markets. Management noted that it remains on track and is making "good progress" with its 10-nm chip launch for the 2019 holiday season. Our fair value estimate currently sits at $56 per share, and we expect to continue highlighting the company in both simulated newsletter portfolios moving forward.

Microsoft Reports Strong Start to Fiscal Year

Simulated Dividend Growth Newsletter portfolio idea Microsoft reported impressive results in its fiscal first quarter, and its robust free cash flow generation continues to pave the way for future dividend increases.

By Kris Rosemann

Shares of simulated Dividend Growth Newsletter portfolio idea Microsoft (MSFT) received a nice boost after its fiscal 2019 first quarter report, released October 24. Revenue in the quarter advanced 19% on a year-over-year basis to $29.1 billion, led by 24% revenue growth in its 'Intelligent Cloud' from the year ago period as strength in Azure continues to drive server products and cloud services revenue higher. The company's 'Business Processes' segment turned in 19% year-over-year revenue growth in the quarter thanks to continued momentum in Office commercial and consumer products, 33% revenue growth at LinkedIn, and a 20% increase in Dynamics products and cloud services revenue. The 'More Personal Computing' segment drove revenue 15% higher from the comparable period of fiscal 2018 as gaming revenue leapt 44% on a year-over-year basis.

Despite Microsoft's impressive top-line growth, its gross margin contracted slightly on a year-over-year basis due to a sales mix shift towards gaming and commercial cloud. Nevertheless, operating margin expanded by nearly 3 percentage points from the year-ago period as investments in the company's engineering and sales capacity in large and growing markets are generating notable operating leverage, and operating income jumped 29% from the comparable period of fiscal 2018 to ~$10 billion, led by 37% year-over-year operating income growth in 'Intelligent Cloud.' Diluted earnings per share came in at $1.14 in the quarter, good for 36% growth from the year-ago period.

Microsoft's bottom-line performance translated nicely into strong cash flow generation as cash from operations advanced nearly 10% on a year-over-year basis to ~$13.7 billion, but a nearly 70% increase in capital spending drove free cash flow lower by roughly 2.5% from the year-ago period to ~$10.1 billion. This was still more than sufficient in covering cash dividends paid in the quarter of $3.2 billion, and the company's net cash position continued to grow. As of the end of the first quarter of fiscal 2019, it held $135.9 billion in cash, cash equivalents, and short-term investments compared to total debt of $76.2 billion, which is good for a net cash position of $59.7 billion compared to $57.5 billion one quarter earlier.

Microsoft's Dividend Cushion ratio was an impressive 3.6 at last check, and shares yield ~1.7% as of this writing. We expect the company to continue delivering reliable income to investors, even as it is investing for growth in a material way. Our current fair value estimate for Microsoft sits at $116 per share.

Pricing Drives Altria's Top Line Slightly Higher

Tobacco giant and simulated Dividend Growth Newsletter portfolio idea Altria pushed its top line slightly higher in the third quarter thanks to ongoing pricing power, and its flagship brand Marlboro continues to dominate in terms of retail share.

By Kris Rosemann

Simulated Dividend Growth Newsletter portfolio idea and tobacco giant Altria (MO) reported third quarter results October 25, revealing slight year-over-year top-line growth of 1.6% as higher pricing offset volume declines in its 'Smokeable Products' segment en route to 1% net revenue growth and pricing strength in its 'Smokeless Products' segment drove 6.5% net revenue growth. The company's total cigarettes retail share declined 50 basis points from the third quarter of 2017 to 50.1%, and Marlboro continues to dominate the market at 43.1% retail share, which is roughly consistent with its market share through the first half of 2018 as well as the year-ago period. Adjusted operating companies income (OCI) in its 'Smokeable Products' segment was roughly flat from the year-ago period thanks to higher pricing offsetting lower volumes, higher resolution expenses, and higher costs that included strategic initiative investments, but higher pricing in the 'Smokeless Products' segment drove reported OCI up 6.3% from the comparable period of 2017.

Please see *Pricing…*on next page

*Pricing…*from previous page

Altria's adjusted diluted earnings per share advanced 22.6% on a year-over-year basis to $3.04 thanks to a lower tax bill, higher equity earnings from its stake in AB-InBev (BUD), and higher OCI in the 'Smokeless Products' segment, as well as a lower share count, but these factors were partially offset by investments in strategic initiatives and the lower OCI in the 'Smokeable Products' segment. Cash flow from operations jumped more than 58% in the first nine months of 2018 on a year-over-year basis, helping drive free cash flow ~61% higher than the comparable period of 2018 to $6.4 billion, which easily covered cash dividends paid of $3.9 billion. The company's balance sheet remains relatively healthy as it holds $13.9 billion in total debt and $2.4 billion in cash and cash equivalents, which does not consider its ~10% stake in beer giant AB-InBev, and its debt-to-consolidated EBITDA ratio is a reasonable 1.3x as of the end of the third quarter.

Altria's income generating capacity has been a sight to behold in recent years, and its Dividend Cushion ratio is currently 1.2. Shares are currently trading in the lower half of our fair value range, of which the midpoint is $67, and are yielding ~5.2% as of this writing. We expect to continue highlighting the company as an idea in the simulated Dividend Growth Newsletter portfolio, but we continue to monitor the news stream closely as it relates to potential regulatory changes and other competitive developments across the big tobacco space.

In response to the FDA's plan to address underage use of e-vapor products, Altria will remove MarkTen Elite and Apex by MarkTen pod based products until the products receive a market order from the FDA or the issue is otherwise addressed. It will also sell only tobacco, methol, and mint varieties of its remaining MarkTen and Green Smoke cig-a-like products in response to the FDA's flavored e-vapor mandate. Management notes that approximately 80% of Nu Mark's e-vapor volume as of the third quarter will remain on the market after taking these actions.

Johnson & Johnson Driven By Pharma Growth

Simulated newsletter portfolio idea Johnson & Johnson turned in a strong third quarter report that was driven once again by growth in its 'Pharmaceutical' segment, namely its 'Oncology' division.

By Kris Rosemann

Johnson & Johnson (JNJ) reported 3.6% year-over-year revenue growth in the third quarter of 2018 thanks to ongoing strength in its 'Pharmaceutical' segment, which turned in reported revenue growth of 6.7% as reported revenue in its 'Oncology' division within the segment leapt 36%+ from the year-ago period. Key sales growth leaders in 'Oncology' were DARZALEX, IMBRUVICA, and ZYTIGA, while REMICADE revenue erosion from biosimilar competition was more than offset by strength in other key 'Immunology' drugs including STELARA and SIMPONI/SIMPONI ARIA. Overall, nine key pharma products turned in double-digit sales growth in the quarter.

The company's 'Consumer' segment grew reported revenue 1.8% on a year-over-year basis as strength in 'Beauty' and 'OTC' product lines were offset by weakness in 'Wound Care/Other,' 'Baby Care,' and 'Women's Health,' while its 'Medical Devices' segment revenue was down slightly from the comparable period of 2017 as high growth in 'Interventional Solutions' was offset by weakness in 'Diabetes Care' and 'Orthopaedics,' the latter of which was impacted by pricing pressure. Management remains confident in the 'Meidcal Devices' segment as it gears up in targeting a goal of above-market performance in 2020.

J&J's operating line faced some pressure in the quarter as a result of a partial write-down of an 'in-process research and development' asset associated with the acquisition of Alios BioPharma, but its bottom line benefit from a lower tax rate than in the year-ago period as adjusted earnings per share grew 7.9% to $2.05. Management reported a net debt position of roughly $12 billion at the end of the quarter, comprised of $19 billion in cash and marketable securities and ~$31 billion in debt.

Please see *Johnson & Johnson…*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
General Dynamics	GD	1.9%	7	EXCELLENT	GOOD	1.6
PepsiCo	PEP	3.3%	7	GOOD	GOOD	1.1
NewMarket	NEU	1.7%	7	EXCELLENT	GOOD	1.4
QUALCOMM	QCOM	3.8%	7	EXCELLENT	GOOD	2.4
IBM	IBM	4.2%	7	GOOD	GOOD	1.2
United Technologies	UTX	2.1%	7	GOOD	GOOD	1.7
Barnes Group	B	1.1%	7	GOOD	EXCELLENT	3.6
Standex Intl	SXI	0.7%	7	GOOD	EXCELLENT	4.9
Republic Services	RSG	2.0%	7	GOOD	GOOD	1.6
Waste Management	WM	2.0%	7	EXCELLENT	GOOD	1.9
Fidelity National	FIS	1.2%	7	EXCELLENT	GOOD	1.8
VF Corp	VFC	2.2%	7	EXCELLENT	GOOD	1.8
Caterpillar	CAT	2.4%	7	GOOD	GOOD	2.3
Cummins	CMI	3.2%	7	EXCELLENT	GOOD	2.5
Ingersoll-Rand	IR	2.4%	7	GOOD	GOOD	2.1
Snap-on	SNA	2.0%	7	EXCELLENT	GOOD	2.6
Disney	DIS	1.6%	7	GOOD	EXCELLENT	3.0
Medtronic	MDT	2.1%	7	EXCELLENT	GOOD	2.2
AbbVie	ABBV	3.9%	7	GOOD	GOOD	1.3
Amgen	AMGN	2.9%	7	EXCELLENT	GOOD	2.5
Merck	MRK	3.1%	7	GOOD	GOOD	2.0
Dick's Sporting	DKS	2.4%	7	EXCELLENT	GOOD	2.4
Dun & Bradstreet	DNB	1.5%	7	GOOD	GOOD	2.4
Moody's	MCO	1.0%	7	EXCELLENT	GOOD	2.6
Microsoft	MSFT	1.5%	7	EXCELLENT	EXCELLENT	3.6
Oracle	ORCL	1.6%	7	EXCELLENT	EXCELLENT	4.4
Crown Castle	CCI	3.7%	7	EXCELLENT	GOOD	1.4

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 Castl	Multiplie
GameStop	GME	10.2%	1.7	Attractive	17.71
Chico's FAS	CHS	4.4%	3.4	Attractive	14.84
Abercrombie & Fitch	ANF	4.6%	3.1	Attractive	14.20
General Motors	GM	4.3%	3.1	Unattractive	13.23
Automatic Data Processing	ADP	1.9%	6.0	Very Attractive	11.57
Manpower	MAN	2.7%	4.2	Attractive	11.15
Honda	HMC	3.1%	3.5	Neutral	10.83
Cooper Tire & Rubber	CTB	1.4%	7.5	Neutral	10.60
Chicago Rivet	CVR	2.6%	3.9	Neutral	10.31
Thor	THO	2.3%	4.3	Attractive	9.95
Gilead Sciences	GILD	2.9%	3.3	Very Attractive	9.80
Cardinal Health	CAH	3.9%	2.4	Very Attractive	9.57
American Eagle	AEO	2.6%	3.6	Attractive	9.37
QUALCOMM	QCOM	3.8%	2.4	Very Attractive	9.26
Applied Materials	AMAT	1.7%	5.3	Very Attractive	9.06
Foot Locker	FL	2.8%	3.2	Attractive	9.02
Guess	GES	4.4%	2.0	Attractive	8.87
Cisco	CSCO	2.9%	3.0	Very Attractive	8.65
Gap	GPS	3.6%	2.4	Attractive	8.53
H&R Block	HRB	4.0%	2.1	Very Attractive	8.50
Paychex	PAYX	3.5%	2.4	Very Attractive	8.23
CA Tech	CA	2.4%	3.5	Very Attractive	8.22
Cummins	CMI	3.2%	2.5	Attractive	8.16
Gentex	GNTX	1.8%	4.5	Attractive	8.12
Pfizer	PFE	3.7%	2.2	Attractive	8.12
Interpublic	IPG	3.9%	2.1	Very Attractive	8.11
Ford	F	6.3%	1.3	Neutral	8.04
Total	TOT	4.6%	1.7	Neutral	7.94
Fluor	FLR	1.7%	4.7	Attractive	7.89
Ralph Lauren	RL	1.8%	4.3	Attractive	7.86
Omnicom	OMC	3.5%	2.2	Attractive	7.66
Rio Tinto	RIO	5.4%	1.4	Neutral	7.54
McKesson	MCK	1.0%	7.3	Very Attractive	7.48
Lear Corp	LEA	1.6%	4.6	Attractive	7.48
Hewlett-Packard	HPQ	2.3%	3.3	Very Attractive	7.48
Graham Holdings Co	GHC	0.9%	8.2	Attractive	7.47
Ethan Allen	ETH	3.1%	2.3	Unattractive	7.27
Amgen	AMGN	2.9%	2.5	Very Attractive	7.17
Apple	AAPL	1.3%	5.5	Highest Rated	7.13
Tupperware	TUP	9.0%	0.8	Attractive	7.10
MKS Instruments	MKSI	0.8%	8.7	Attractive	7.10
ABB	ABB	3.9%	1.8	Attractive	7.07
Oracle	ORCL	1.6%	4.4	Very Attractive	6.96
Robert Half	RHI	2.0%	3.6	Very Attractive	6.94
Nucor	NUE	2.5%	2.8	Attractive	6.93
Garmin	GRMN	3.5%	2.0	Attractive	6.93
ConocoPhillips	COP	1.5%	4.6	Attractive	6.90
Deluxe	DLX	2.3%	2.9	Very Attractive	6.76
Newmont Mining	NEM	1.5%	4.4	Neutral	6.74
British American	BTI	5.0%	1.3	Unattractive	6.72

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	0.5%	VERY POOR	-50.9
Range Resources	RRC	Independent Oil & Gas	0.5%	VERY POOR	-33.8
CIRCOR Intl	CIR	Electrical Equipment	0.4%	VERY POOR	-33.2
Superior	SUP	Auto Parts Suppliers	1.6%	VERY POOR	-11.0
Yamana Gold	AUY	Metals & Mining - gold	0.6%	VERY POOR	-8.6
R.R. Donnelley	RRD	Commercial Services	12.9%	VERY POOR	-7.1
General Electric	GE	Conglomerates	0.4%	VERY POOR	-6.9
NiSource	NI	Utilities	2.8%	VERY POOR	-6.9
Ryder System	R	Rental and Leasing	2.8%	VERY POOR	-6.2
Casey's General	CASY	Food Retailers	0.9%	VERY POOR	-6.2
HCA Healthcare	HCA	Health Care Services	1.0%	VERY POOR	-5.2
Keurig Dr Pepper	KDP	Beverages - nonalcoholic	2.4%	POOR	-4.9
H.B. Fuller	FUL	Chemicals - broad	1.1%	VERY POOR	-4.5
Intl Game Technology	IGT	Leisure	3.8%	VERY POOR	-3.9
Silgan	SLGN	Containers & Packaging	1.5%	VERY POOR	-3.8
Centurylink	CTL	Telecom Services - diversified	12.0%	VERY POOR	-3.6
Teekay	TGP	Shipping	3.2%	VERY POOR	-2.7
Dine Brands Global	DIN	Restaurants - Fast Cas & Full Svc	3.5%	VERY POOR	-2.6
Noble Energy	NBL	Independent Oil & Gas	1.4%	VERY POOR	-2.6
Wendy's Co	WEN	Restaurants - Fast Food & Coffee	1.9%	VERY POOR	-2.3
Pitney Bowes	PBI	Commercial Services	11.2%	VERY POOR	-2.1
American Railcar	ARII	Railroads	3.4%	VERY POOR	-1.8
Olin Corp	OLN	Chemicals - mid/small	2.8%	VERY POOR	-1.8
Meredith	MDP	Media - advertising	4.2%	VERY POOR	-1.6
Molson Coors	TAP	Beverages - alcoholic	2.4%	VERY POOR	-1.3
DDR	DDR	REIT - Retail	11.2%	VERY POOR	-1.2
Newell Brands	NWL	Household Durables	3.7%	VERY POOR	-1.2
Kroger	KR	Food Retailers	1.8%	VERY POOR	-1.1
Macerich	MAC	REIT - Retail	5.0%	VERY POOR	-1.1
Anheuser-Busch InBev	BUD	Beverages - alcoholic	4.4%	VERY POOR	-1.1

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

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

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

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The company took the opportunity following its strong third quarter to raise a number of guidance metrics for the full year 2018. It now expects reported revenue to grow 6%-6.5% to $81.0-$81.4 billion compared to prior guidance of 5.3%-6.3% growth and a guidance range of $80.5-$81.3 billion. Adjusted pre-tax operating margin is now projected to improve by at least 150 basis points as compared to prior guidance for roughly 150 basis points of expansion, which is expected to help drive reported adjusted earnings per share to a range of $8.13-$8.18 compared to prior guidance of $8.07-$8.17.

We currently value shares of Johnson & Johnson at $133 each, and its Dividend Cushion ratio sits at a healthy 2.2 to go along with a dividend yield of ~2.65% as of this writing. We expect to continue highlighting the company in the simulated newsletter portfolios for the time being.

Gilead Sciences Beats Expectations; Raises Product Sales Guidance

Gilead Sciences continues to battle challenges in the HCV market, but its HIV product sales grew nicely in the third quarter. Management remains optimistic regarding the potential of its cell therapy treatment, headlined by Yescarta.

By Kris Rosemann

Simulated newsletter portfolio idea Gilead Sciences (GILD) turned in a better than expected third-quarter report after the close October 25, though its top line continues to face pressure as its HCV products sales fight rising levels of competition. Total revenues fell to ~$5.6 billion from $6.5 billion in the year-ago period as HCV product sales declined to $902 million in the period from $2.2 billion in the third quarter of 2017. HIV product sales climbed 10.6% on a year-over-year basis to more than $3.7 billion thanks to solid growth in the US (where it holds notable market share), the ongoing uptake of Genvoya and Odefsey, and the adoption of Biktarvy, but increased generic competition in Europe negatively impacted HIV product sales in the region.

Gilead's HCV product sales decline remains in line with its expectations, and the company plans to launch generic versions of Epclusa and Harvoni in the US in January 2019 via a new subsidiary, Asegua Therapeutics, which is expected to increase price transparency, reduce out-of-pocket patient expenses, and open up its HCV medicines for access for Medicaid patients. The company is encouraged by the progress it is seeing with cell therapy drug Yescarta, which turned in $75 million in sales in the third quarter, and the drug was approved in Europe in the quarter after being approved in the US roughly one year ago.

Gilead's bottom-line continues to face pressure as well, and R&D and SG&A expenses both grew in the third quarter on a year-over-year basis due in part to higher spending to support growth following the purchase of Kite Pharma in October 2017, which brought the aforementioned Yescarta into its portfolio. As a result, non-GAAP operating margin fell to 55.9% from 63.6%, and non-GAAP diluted earnings per share fell to $1.84 in the quarter from $2.27 in the comparable period of 2017.

We're patiently awaiting the release of the company's 10-Q to get a better look at its cash flow statement and balance sheet, but management reported a decline in its cash, cash equivalents, and marketable securities to $30.8 billion at the end of the quarter from $31.7 billion one quarter earlier. It lists total adjusted debt at $27.5 billion, and its adjusted debt-to-adjusted EBITDA ratio is ~2.55x as of the end of the third quarter. Operating cash flow came in at $2.2 billion for the quarter, while cash dividends paid in the period were $742 million, which means that Gilead's capital spending would have to rise significantly from the first half of the year ($509 million in the first and second quarters combined) to come close to not covering dividend obligations.

Management raised its full-year 2018 top-line guidance following the third quarter, and it now expects net product sales to be $20.8-$21.3 billion, compared to $20-$21 billion previously. All other guidance, aside

Please see *Gilead Sciences…*on next page

*Gilead Sciences…*from previous page

from expected effective tax rate, was unchanged. We expect to continue highlighting Gilead Sciences in the simulated newsletter portfolios as its solid 3.3 Dividend Cushion ratio pairs nicely with its ~3.2% dividend yield, and shares are trading near the lower bound of our fair value range as of this writing.

Earnings Roundup: Past, Present, and Potential Dividend Growth Ideas

Let's take a look at the earnings reports of some past, present, and potential simulated Dividend Growth Newsletter portfolio ideas, including that of Novartis, Procter & Gamble, Honeywell, and Kinder Morgan.

By Kris Rosemann

Novartis Reports Solid Volume Growth But Pricing Pressure

Simulated Dividend Growth Newsletter portfolio idea Novartis (NVS) reported third quarter 2018 earnings October 18, and its top line was driven 3% higher as reported thanks to nine percentage points of volume growth, which was partially offset by negative pricing action, generic competition, and currency headwinds. Drivers of the volume growth include Cosentyx, Entresto, its oncology portfolio, and Alcon, but reported operating income faced material pressure as a result of the voluntary withdrawal of CyPass microstent, higher restructuring, and growth investments. Core operating income, which adjusts for a number of the aforementioned one-time items, advanced 9% on a constant currency basis, however. Management expects full-year 2018 core operating income to grow at a mid- to high-single-digit rate, while net sales growth is expected at a mid-single-digit rate.

Free cash flow generation remained robust at Novartis as the measure advanced 10% through three quarters of 2018 on a year-over-year basis to nearly $8.8 billion. Dividends paid in the same period checked in at roughly $7 billion, revealing ongoing coverage of the payout with internally-generated funds, and net debt has fallen by $1.9 billion through the first nine months of 2018 to $17.1 billion at the end of the third quarter. Novartis' Dividend Cushion ratio sits at 1.7, and shares yield ~3.35% as of this writing. We view the company's equity as fairly valued at recent prices as shares are changing hands in the upper half of our fair value range.

Procter & Gamble Volumes Advance, Pricing Flat, Guidance Reaffirmed

Former simulated Dividend Growth Newsletter portfolio idea Procter & Gamble (PG) reported its fiscal 2019 first quarter earnings October 19, and net sales in the quarter came in roughly flat with the same period of fiscal 2018 as organic volume (up 3%) and positive mix impact (1% boost) were offset by currency headwinds, acquisitions and divestitures, and neutral pricing. Core operating margin faced pressure as a result of currency headwinds and commodity cost increases but expanded 50 basis points on a currency neutral basis thanks to robust productivity cost savings.

Core earnings per share advanced 3% on a year-over-year basis, and the company maintained its fiscal 2019 core earnings per share guidance for 3%-8% growth to go along with its all-in sales growth guidance of down 2% to flat compared to fiscal 2018. A lack of top-line growth following its massive portfolio reshaping was a core part of our reason to part ways with the consumer product giant in the simulated newsletter portfolio, and its lack of pricing growth seems to support this notion.

Procter & Gamble turned in just under $2.5 billion in free cash flow in the first quarter of its fiscal 2019, which was well in excess of cash dividends paid of $1.85 billion in the period. The company's $28.7 billion net debt load as of the end of its fiscal first quarter weighs on our opinion of its dividend growth potential, but its Dividend Cushion ratio remains relatively healthy at 1.7 at last check thanks to its free cash flow generating prowess, which is supported by management's expectations for adjusted free cash flow productivity at 90%+ in fiscal 2019. Shares look a bit pricey following the market's favorable reaction to its earnings report and reaffirmation of guidance October 19 and are now trading just below the upper bound of our fair value range. Procter & Gamble's dividend yield is ~3.35% as of this writing.

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Industrial Giant Honeywell Plows Ahead With Impressive Dividend Coverage

We've had industrial giant Honeywell (HON) on your radars as a top industrial idea for some time now, "Honeywell Remains a Top Industrial Idea," and the company continues to impress after it adjusted 2018 guidance once again in its third quarter earnings report, released October 19. Organic sales grew 7% on a year-over-year basis thanks to strength in its 'Aerospace' and 'Safety and Productivity Solutions' businesses, and higher volumes, along with operational excellence initiatives, helped drive 70 basis points of segment margin expansion.

As a result, adjusted earnings per share advanced 17% from the year-ago period to $2.03, and the company altered its full year adjusted earnings per share guidance to a range of $7.95-$8.00 from $8.10-$8.20 as the impact of business separations more than offset increased expectations for the fourth quarter. Organic sales guidance was raised to ~6% from 5%-6% previously, segment margin expansion is now expected to be 19.5%-19.6% compared to 19.4%-19.6% previously, and adjusted free cash flow, which adjusts for one-time costs related to business separations, guidance now comes in a range of $5.8-$6.2 billion compared to $5.6-$6.2 billion previously.

Honeywell's free cash flow through nine months in 2018 came in at roughly $4.35 billion, which is ~37% higher than the comparable period of 2017 and more than 2.5 times greater than cash dividends paid of less than $1.7 billion in the period. The company's total debt load of less than $18.3 billion is not a concern given its robust free cash flow generation and cash and short-term investments balance of nearly $11.7 billion. This reasonable financial leverage and strong free cash flow generation helps drive Honeywell's Dividend Cushion ratio to an impressive 2.7, and shares yield just over 2.10% as of this writing after management raised its quarterly dividend by 10% in September. Shares are changing hands just above our fair value estimate of $151 per share.

Kinder Morgan Makes Notable Progress in Deleveraging

Pipeline operator Kinder Morgan (KMI) falls into both the former and potential simulated Dividend Growth Newsletter idea categories, and we recently touched on the company's deleveraging progress and dividend growth plans, "Update on 5 Top Energy Stocks: KMI, ETP, EPD, MMP, XOM." The company reported third quarter earnings October 17, and net income more than doubled in the period to $693 million on a year-over-year basis. Distributable cash flow, an industry-specific measure of cash flow that ignores growth capital spending among other adjustments, advanced 4% from the year-ago period, and it reached a notable milestone in its multi-year balance sheet strengthening plan that began after it slashed its dividend in December 2015 as its adjusted net debt-to-adjusted EBITDA ratio checked in at 4.6x at the end of the quarter. Management adjusted its long-term leverage target to 4.5x from 5.0x, and it received notice from S&P (SPGI) that the rating agency expects to raise Kinder Morgan's credit rating in January.

Kinder Morgan expects to exceed its $4.57 distributable cash flow and $7.5 billion adjusted EBITDA targets in 2018, and it raised its growth capital spending budget by $300 million to $2.5 billion, which it still expects to fund with internally-generated cash flows with no need for capital market assistance. It expects to maintain its 4.6x net debt-to-adjusted EBITDA ratio through the end of the year, and management is confident that it will be able to deliver on the three major credit rating agencies placing it on positive outlook for an upgrade. Kinder Morgan's distributable cash flow came in at more than $650 million above its declared dividend in the third quarter, but the company's unadjusted Dividend Cushion ratio being in negative territory highlights the discrepancy between traditional free cash flow, which accounts for all capital spending, and distributable cash flow, as well as the impact of its still sizable debt load.

Nevertheless, its adjusted Dividend Cushion ratio, which gives credit for ongoing access to the capital markets, currently sits just above parity, and shares yield just over 4.40% as of this writing. If management is able to continue executing on its more appropriate capital allocation plan as it has in recent quarters, we think shares have upside potential, and our fair value estimate currently sits at $24 per share.

Hasbro's Top Line Drops Amid Ongoing Challenges

Hasbro continues to face the fallout of the Toys 'R' Us bankruptcy earlier this year, as well as challenges from the rapidly changing retail environment and retail inventory clearing. Management remains optimistic regarding a return to profitable growth in 2019, however.

By Kris Rosemann

Simulated Dividend Growth Newsletter portfolio idea Hasbro (HAS) saw its shares face selling pressure following a disappointing third quarter report October 22 as its top line declined 12% as reported on a year-over-year basis due to the temporary loss of Toys 'R' Us revenue, a rapidly-changing retail environment, clearing through retail inventory, and currency headwinds. Management noted retail inventory was down significantly in the US and Europe, and it is working to clear excess inventory by year-end as retailers begin to ramp up to battle for market share in the holiday season. The company's 'International' business revenue dropped 24% from the year-ago period, and the segment's operating profit was halved as a result of the aforementioned issues related to Toys 'R' Us and the clearing of excess retail inventory in Europe.

'US and Canada' segment revenue faced pressure as well, declining 7% on a year-over-year basis, but operating profit in the region advanced 4% thanks to favorable product mix and lower administrative and royalty expense. Hasbro's 'Entertainment and Licensing' segment continues to make up a greater portion of its overall business as revenue leapt 45% thanks to a multi-year streaming deal for Hasbro television programming and strength from the 2017 release of My Little Pony: The Movie and operating profit roughly doubled from the comparable period of 2017 thanks to favorable mix and cost reductions boosted. Operating profit margin in the segment came in at 39.7% in the quarter, compared to 24.5% and 11.8% in its 'US and Canada' and 'International' segments, respectively, but the 'Entertainment and Licensing' segment accounted for only ~5% of total revenue in the quarter. Overall, Hasbro's operating margin contracted 10 basis points in the third quarter, and management expects full-year operating margin to be lower than in 2017.

Net earnings in the third quarter came in at $263.9 million for Hasbro, down from $265.6 million in the year-ago period, and cash flow from operations fell more than 13% through the first nine months of the year to ~$175 million, which pressured free cash flow generation. It is worth noting that Hasbro typically generates a sizable majority of its cash flow in the final quarter of the year given the nature of its products, and failing to cover cash dividends paid through three quarters of the year is not uncommon. The company held a net debt position of ~$808 million at the end of the third quarter compared to ~$637 million a year earlier. Its Dividend Cushion ratio sits at 2.1 at last check, and shares yield ~2.6% as of this writing.

We're sticking with Hasbro as one of the lowest-weighted ideas in the simulated Dividend Growth Newsletter portfolio for the time being, and we continue to expect management to right the ship as it gears up for the holiday season and other retailers battle for the vacuum of market share left by Toys 'R' Us. Management noted in its prepared remarks for the third quarter earnings call that it had recaptured roughly one third of Toys 'R' Us revenue in the US and Canada heading into the holiday season, which doesn't include orders that had yet to be shipped, but the disruption may persist in certain markets, namely international markets Europe and Asia Pacific as they are behind Canada and the US in retailer share recapture and Toys 'R' Us ownership transition, for "the next few quarters."

Hasbro continues to be confident in the end market demand for its products, and a third-party source lists the company as the market share leader on Amazon (AMZN) in the toy and game category. It continues to invest in the future of entertainment as well as optimize its organization for the changing retail landscape, which was reflected in its cost savings plan that was announced along with its third-quarter results. Management expects to take a $50-$60 million restructuring charge in the fourth quarter of 2018 related to employee severance costs, but the plan is projected to result in $30-$40 million in annual savings by 2020.

Earnings Roundup: Bellwethers and Big Name Dividend Payers

Let's take a look at some high-profile earnings reports of this week, including those from Boeing, Caterpillar, 3M, AT&T, and Verizon.

By Kris Rosemann

Boeing Raises Full-Year Guidance

Former simulated Dividend Growth Newsletter portfolio idea Boeing (BA) reported third-quarter results October 24, and a strong showing enabled management to increase its guidance for the full year. Revenue in the third quarter advanced 4% on a year-over-year basis thanks to higher defense volume and services growth as the company works to build the latter into a $50 billion business in the next five to ten years from its current $12+ billion run rate. The company's operating margin faced pressure (GAAP operating margin contracted by two percentage points) as a result of planned investments in certain programs in its 'Defense, Space & Security' business and ongoing cost growth in the KC-46 Tanker program. Nevertheless, core earnings per share still advanced to $3.58 in the quarter from $2.62 in the year-ago period thanks to strong performance in its 'Commercial Airplanes' business and a one-time tax benefit.

Boeing's massive backlog continued to grow during the period, advancing to $491 billion from $488 billion at the start of the quarter. It raised its revenue guidance by $1 billion, to the range of $98-$100 billion and increased core earnings per share guidance to a range of $14.90-$15.10 from $14.30-$14.50 previously. Operating cash flow guidance was maintained at $15-$15.5 billion, and capital spending guidance was reduced to $2 billion from $2.2 billion as the company continues to throw off robust free cash flow. Through the first nine months of 2018, Boeing has generated more than $11.1 billion in free cash flow, up 22% over the comparable period of 2017, which is more than 3.5 times cash dividends paid of less than $3 billion in the same period. The company's Dividend Cushion ratio is a robust 2.6, and shares yield just over 1.9% as of this writing. We currently value shares at $333 each.

Strong Demand Continues At Caterpillar Excluding Industrial; Guidance Maintained

Caterpillar (CAT), which reported third quarter results October 23, continues to ride a wave of strong demand in key areas such as mining and heavy construction equipment, construction equipment, and most energy and transportation end markets except industrial. Third quarter sales and revenue grew 18% on a year-over-year basis thanks to volume growth across its three segments and positive pricing, particularly in its 'Resource Industries' business. Higher volumes and favorable pricing also led to 41% growing in consolidated operating profit from the year-ago period, and adjusted profit per share leapt to $2.86 compared to $1.95 in the comparable period of 2017. Nevertheless, the company maintained its adjusted profit per share guidance in a range of $11.00-$12.00 for the full-year 2018.

Though shares of Caterpillar faced material selling pressure as a result of the flat guidance and concerns over the future growth rate of its industrial end markets, we continue to like what we're seeing in terms of its overall demand environment. The company was able to grow operating cash flow by $237 million on a year-over-year basis despite a discretionary $1 billion pension contribution, but operating cash flow is down more than 13% through three quarters in 2018. Nevertheless, free cash flow of $2.3 billion was still more than sufficient in covering cash dividends paid of $1.4 billion in the first nine months of the year. Caterpillar's unadjusted Dividend Cushion ratio currently sits at roughly 1.3, while its adjusted Dividend Cushion ratio, which is less punitive on debt related to its financial services arm, sits at 2.3. Our fair value estimate for shares is $142.

Currency Headwinds Ding 3M's Results and Guidance

Industrial giant 3M (MMM) reported somewhat disappointing third quarter results October 23 as reported sales were down 0.2% on a year-over-year basis due to 1.7% on currency headwinds more than offsetting organic currency-neutral sales growth of 1.3% and 0.2% of acquisition-driven growth. The company's

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'Industrial' segment sales came in flat from the year-ago period, and 7% sales growth in 'Safety and Graphics' was not enough to offset 2.8%, 3.4%, and 4.8% declines in 'Health Care,' 'Consumer,' and 'Electronics and Energy,' respectively. Geographically speaking, notable top-line weakness was reported in the EMEA and Latin America/Canada regions. Operating income in the quarter was roughly flat compared to the year-ago period at $2 billion, but diluted earnings per share advanced to $2.58 from $2.33 thanks to a materially lower tax bill.

Nevertheless, management lowered its full-year adjusted earnings per share guidance to a range of $9.90-$10.00 compared to $10.20-$10.45 previously due in part to expectations for a $0.05 negative impact from foreign currency exchange rates as opposed to previous expectations for a $0.10 tailwind. Organic local-currency sales growth was also lowered to ~3% from 3%-4%, and free cash flow conversion is now expected to be 90%-95% compared to 90%-100% previously. Through the first three quarters of the year, free cash flow fell nearly 10% to $3.1 billion and is expected to be in a range of $4.8-$5.2 billion for the full year (was nearly $4.9 billion in 2017). Cash dividends in the first nine months of 2018 checked in at $2.4 billion, suggesting free cash flow coverage of the payout is still solid, and the company's Dividend Cushion ratio is currently 1.6 to go along with a ~2.9% yield. Shares are now trading roughly in line with our fair value estimate of $185 following the selling pressure that has resulted from its quarterly results.

AT&T Drops On Wireless and Entertainment Weakness

Shares of wireless and entertainment giant AT&T (T) faced notable selling pressure following the release of its third quarter results October 24. The drop was due in part to top-line weakness in its 'Entertainment Group' and 'Business Wireline' businesses as linear video subscribers and legacy wireline service revenues continued to decline, which may be casting doubt over the new-age media 'conglomerate' and its debt-fueled growth strategy. Consolidated revenues advanced 15.3% to $45.7 billion thanks in large part to the Time Warner acquisition, but declines in domestic video and legacy wireline services were enough to catch investors' attention. Its 'Entertainment Group' EBITDA margin was hit by one-time items as the company hopes to stabilize profitability levels in the segment for 2019, and the company expects margin stability in the 'Business Wireline' segment to help it achieve its previously announced guidance for earnings per share of ~$3.50 and free cash flow generation guidance of ~$21 billion.

AT&T reported 16.6% year-over-year growth in free cash flow generation in the third quarter thanks in part to 14.3% growth in cash flow from operations, and free cash flow of $14.4 billion through the first three quarters of the year has been more than sufficient in covering cash dividends paid of less than $10 billion. AT&T's Dividend Cushion ratio currently sits below parity (0.6 at last check) due to its massive net debt load, which sat at ~$175 billion as of the end of the third quarter, and management continues to make deleveraging a priority as it targets a debt-to-EBITDA ratio of 2.5x by the end of 2019. We value shares, which yield an eyebrow-raising 6.5% as of this writing, at $40 each.

Verizon Turns in Solid Third Quarter Results, Phone Subscribers Growing

While AT&T's third quarter report was somewhat eventful, rival Verizon's (VZ) less than exciting quarterly report, released October 23, was solid. Total consolidated operating revenue advanced 2.8% on a year-over-year basis to $32.6 billion, as growth in its 'Wireless' segment as able to offset weakness in its 'Wireline' segment. Solid phone subscriber growth helped offset concerns related to weakness in its 'Oath' business, its media business consisting of digital content division such as AOL and Yahoo!, and segment EBITDA in its 'Wireless' business continues to march higher, advancing 10% on a year-over-year basis in the third quarter. Overall adjusted EBITDA advanced ~$0.4 billion from the second quarter of 2017 to $11.8 billion, and adjusted earnings per share advanced to $1.22 from $0.98 in the year-ago period. Management expects full-year GAAP revenue growth to be in the low-to-mid single-digit range, and adjusted earnings per share growth is projected to be in the low single-digit range.

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Verizon continues to be a robust cash flow generator, and through the first three quarters of 2018, its cash flow from operations exploded to $26.2 billion (was $16.5 billion in the comparable period of 2017). Such robust growth makes slightly higher capital expenditures in the period immaterial as free cash flow leapt to $14.2 billion from $5.2 billion in the year-ago period. Cash dividends paid in the period checked in at $7.3 billion, and the company was able to reduce its total debt load by $4.6 billion en route to a 2.4x net debt-to-adjusted EBITDA ratio. Nevertheless, Verizon's massive net debt load of $110 billion as of the end of the third quarter continues to weigh on its Dividend Cushion ratio, which is currently in negative territory. Shares yield ~4.2% as of this writing, and our fair value estimate sits at $54 each.

Upstream Oil Major On the Upswing

By Callum Turcan

ConocoPhillips (COP) may present a strong dividend growth opportunity as it appears set to build upon its current 1.8% dividend yield. First, let's cover exactly what forced the company to cut its dividend a few years back, and then dig into the potential drivers for dividend growth in the coming years.

ConocoPhillips spun-off its downstream division and a large part of its midstream operations from its upstream business in 2012. The rationale behind such a move was that the sum of the parts were worth more than the whole, as this type of business maneuver assumes there are hidden assets within a company's portfolio that would be valued at a much higher price if those operations weren't buried deep within a 10-K filing. Another key consideration was due to the tax advantages of structuring the ownership of midstream assets under a master limited partnership.

However justified this decision may have been at the time, it left ConocoPhillips exposed to volatile market forces beyond its control. Prior to the separation, Conoco's upstream division had a natural hedge through its downstream division. If oil (or to a lesser extent natural gas) prices (USO) tanked, Conoco could recoup some of those losses via stronger performance at its refining business thanks to higher cracking spreads, but that dynamic disappeared as the company headed into the oil price rout of 2014-2017.

When Brent and West Texas Intermediate tanked from over $100/barrel to around $30-$40 per barrel by early-2016, ConocoPhillips' cash flow generation followed suit. In 2014, Conoco generated $16.7 billion in net operating cash flow. By 2016, that had dropped to just $4.4 billion. The image below offers a good snapshot of how the change in Conoco's realized prices for its hydrocarbon output (measured in barrels of oil equivalent) is largely responsible for the changes in its net operating cash flow generation. The company's estimated 2018 results are an extrapolation based off Conoco's performance during the first three quarters of this year and are for illustrative purposes only.

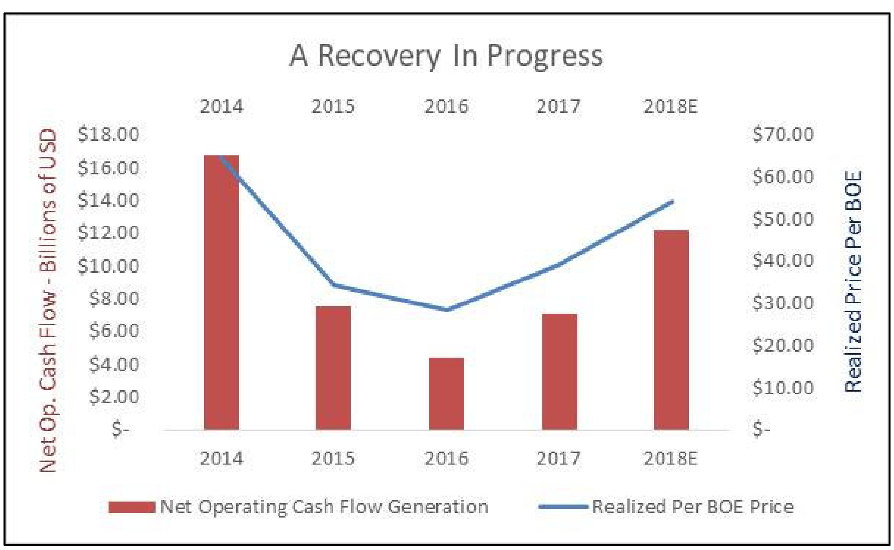

Image Source: Author's Calculations and SEC Filings

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As ConocoPhillips' cash flow moved precipitously lower, so did its dividend. In early-2016, Conoco cut its dividend for the first time in over two decades, pushing its annual payout down to $1 per share from $2.96 per share. This was a necessity as the firm was hemorrhaging cash and had to choose between paying out cash to shareholders or investing in the business to maintain its production profile. Upstream firms have a base level of capital expenditure that needs to be spent in order to maintain output levels, so Conoco decided to preserve its business profile at the expense of income-minded investors. Valuentum members should be all too familiar with this story as the Dividend Cushion ratio was ahead of the curve in highlighting the risks of Conoco's payout at the time; the company's Dividend Cushion ratio sat at negative 1 at the time of the cut, "The Dividend Cushion, ConocoPhillips Cuts!"

Thanks in large part to the oil market recovery, Conoco has been able to start growing its dividend once again. The firm recently boosted its annual payout by 7% to $1.22 per share, and an argument can be made for there being additional payout increases on the horizon.

Financial Overview

During the first three quarters of 2018, Conoco generated $9.2 billion in net operating cash flow and spent $5.1 billion on capital expenditures, which amounts to free cash flow generation of just over $4 billion. This free cash flow was more than sufficient in covering cash dividends paid in the period of $1.0 billion, while share buybacks checked in at $2.1 billion. Debt reduction activities are largely being funded through divesture proceeds, which will be covered later in this piece.

Conoco has issued guidance for capital spending and share buybacks in 2018 at $6.1 billion and $3 billion, respectively, which indicates roughly $1 billion will be spent on each activity during the fourth quarter. Assuming oil prices hold relatively steady and free cash flow follows suit, the company should continue to have ample coverage of its payout with internally generated cash flow.

A combination of production growth, lower interest payments resulting from a decreased debt load, and a reduced share count may all be expected to help make dividend increases in the near term more viable, but the volatile nature of energy resource pricing cannot be ignored and will always pose a threat to the long-term health of Conoco's dividend. However, management is quick to note that it expects to be able cover sustaining capital spending and its current dividend with cash flow from operations at oil prices at or below $40 per barrel, and it expects to return 20%-30% of cash flow from operations to shareholders annually. We're expecting healthy free cash flow generation to drive dividend growth in the near term, and the company's Dividend Cushion ratio currently sits at a robust 4.6.

Production Growth

Conoco produced 1,224,000 barrels of oil equivalent per day during the third quarter of 2018, which excludes its Libyan operations due to the volatile nature of output in that region. Adjusting for asset sales and bolt-on acquisitions, this was up 6% versus last year's third quarter levels. Management expects growth to continue into the fourth quarter. Conoco stands to gain from an improving Libyan situation via its stake in the Waha Concession. During the third quarter of 2018, Conoco produced 37,000 BOE/d net out of Libya.

Investors need look no further than ConocoPhillips' Big Three unconventional assets--its positions in the Eagle Ford, Bakken, and Permian Basin plays--to find the drivers of production growth. Production from this division increased by 48% year-over-year to 313,000 BOE/d during the third quarter of 2018, offsetting losses from mature field declines elsewhere.

After the completion of the Bakken Pipeline project in 2017, which really is a two-part endeavor (the Dakota Access Pipeline and the Energy Transfer Crude Oil Pipeline), North Dakotan oil production is finally able to fetch prices close to WTI as upstream players in the region now have greater access to Gulf Coast, Midwestern, and East Coast markets. This reduced the differential Bakken oil fetches versus WTI,

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vastly improving incremental well economics in the crude-rich play. While forced to become a Tier 2 play back when regional oil differentials were fluctuating around $10-15/barrel, the Bakken has since become more of a Tier 1.5 play (behind the Eagle Ford, Permian, and STACK plays) now that this pipeline network is operational.

The operator of the Bakken Pipeline system, Energy Transfer LP (ET), is considering expanding the capacity of this takeaway option. Being able to reach out-basin markets is essential to supporting upstream players operating in North Dakota, which is crucial for ConocoPhillips as it considers the Bakken one of its main growth engines. Conoco had a 630,000 net acre position in the Bakken at the end of 2017 and is currently running four rigs in the play (assuming management kept Conoco's 2018 drilling activity flat versus 2017, as the company doesn't always update investors on its drilling activity levels).

The real giant of Conoco's unconventional division is its Eagle Ford position, as it represents nearly half of its Big Three output. While Conoco's acreage position was only 230,000 net acres in size at the end of 2017, these acres are located in the core of the play. ConocoPhillips has a major leasehold position in DeWitt County, Texas, which is core Tier 1 Eagle Ford acreage and home to some of the most prolific onshore wells in the world outside of the Middle East. The company also has a sizeable position in Karnes and Live Oak counties in Texas.

ConocoPhillips operated six rigs in the Eagle Ford last year and that figure most likely grew to seven rigs this year, as management shifted capital away from the Permian Basin and towards the Eagle Ford. This decision was based on the at times massive Midland-WTI differential (oil in the Permian Basin sells for significantly less than crude in Cushing, Oklahoma) and the nice premium Gulf Coast crude oil fetches over WTI (oil in Louisiana sells for a lot more than oil in Cushing). Eagle Ford oil output has access to Louisiana Light Sweet pricing, which trades at a premium to WTI due to Louisiana Light Sweet being heavily influenced by Brent.

During ConocoPhillips' second quarter 2018 conference call management noted:

"With wider differentials in Midland, we're taking advantage of our flexibility and stronger LLS pricing in the Gulf Coast to shift an unconventional rig in the Delaware Basin to the Eagle Ford. And we're also laying down our one conventional rig in the Permian Basin."

Expect ConocoPhillips to keep cranking its Eagle Ford production higher over the coming years, especially when these barrels can fetch a $6-9/barrel premium over WTI.

Over the long haul, Conoco has big plans for its Permian position as well. With 1 million net acres in the Permian Basin, Conoco has plenty of unconventional opportunities to capitalize on once more pipeline takeaway capacity is built out (which will bring down the Midland-WTI differential). Only 134,000 of those net acres are prospective for unconventional opportunities in the Delaware Basin, one of the major oil & gas producing sub-basins within the Permian. The company may only be running one rig on its acreage as things stand today, but that could easily be flexed upwards as market conditions dictate.

Conoco's Delaware Basin position is centered around Culberson and Reeves counties in Texas, and Eddy and Lea counties in New Mexico. This is core Tier 1 acreage that is extremely valuable, but Conoco doesn't want to bring wells online in a play where the average realized oil price is materially below WTI ($5-15/barrel depending on the month). While the firm could still earn a very generous return on its investment if it decided to develop this acreage, ConocoPhillips has opted to play the long game.

Going forward, continued production growth from ConocoPhillips' Big Three unconventional division will not just offset output losses elsewhere but should enable strong company-wide growth over the coming years. All three of those plays yield wells with a high oil mix.

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Less Debt, Fewer Shares

As the energy resource pricing downturn got underway, ConocoPhillips was forced to turn to debt to cover its cash flow outspend as operating cash flow was outstripped by hefty dividend payouts and a large capital expenditure budget. The need for funds pushed Conoco's long-term debt load to $26.2 billion by the end of 2016 from $22.4 billion at the end of 2014. Unsurprisingly, this led to meaningful increases in its interest expenses.

After high-grading its portfolio by shedding various assets, including a vast amount of its oil sands operations, its San Juan Basin unit, and assets in Southeast Asia, ConocoPhillips directed most of those cash proceeds to debt reduction. The company has pocketed almost $15 billion in divestment proceeds over the past two years.

At the end of the third quarter of 2018, Conoco had less than $15 billion in long-term debt outstanding, a target it achieved 18 months ahead of schedule, and it is on track to save around $0.5 billion per year in interest expenses compared to 2016 levels. ConocoPhillips' materially lower debt load has helped boost its Dividend Cushion ratio, and the reduction in its debt servicing costs only adds to the resiliency of its bottom line, regardless of the volatility of energy resource pricing.

Another driver of Conoco's per share dividend growth comes from its materially reduced share count. Conoco spent $3 billion buying back shares in 2017 and plans to spend a similar amount reducing its share count this year. Next year, management has indicated Conoco will spend around $2 billion buying back shares, and the repurchases won't end there as it recently increased its repurchasing authority to $15 billion, which represents roughly 20% of its total shares outstanding as of the end of the third quarter of 2016. While we view buybacks at current prices as roughly value neutral given that shares are trading near the midpoint of our fair value range, the materially reduced share count will lower the hurdle that ConocoPhillips must clear in future dividend increases.

Summary

ConocoPhillips has plenty of free cash flow generation, is growing its underlying production base, has an extensive growth runway in the shale patch, has a significantly smaller debt burden than the recent past, has materially lowered interest expenses, has a significantly smaller share count, and the oil market's recovery may very well still be ongoing. While ConocoPhillips yields only 1.8% as of this writing, we expect that to grow over the coming years as management directs larger amounts of its rising internally-generated cash flow to patient investors.

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.

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

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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.

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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

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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).