OUR DIVIDEND GROWTH NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

February 1, 2019
Volume 8 Issue 2

Valuentum Securities Inc.
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Dividend Growth Ideas: AAPL, BKLN, CBRL, CSCO, DLR, XLE, GM, GILD, HAS, IDV, INTC, JNJ, MSFT, NVS, O, ORCL, SDY, XLNX

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"While the abuses by the investment banks have been lassoed in, I feel investors still need something better, and not just more ambiguous data or more stock screeners."

– Brian Nelson, CFA

What Drives Valuentum

By Valuentum Editorial Staff

The following is an excerpt from the Preface of Brian Nelson's new book *Value Trap: Theory of Universal Valuation*.

Brian M. Nelson, CFA, founded Valuentum in 2011 to help investors, to put investors first. It was all he knew. It was more than an extension of his principles as a CFA charterholder or his experiences at independent research giant Morningstar, however. There was something else to it. The research industry seemed to be flailing. The Global Analyst Research Settlement of 2003 helped to highlight the issues of conflict of interest in relation to securities analyst recommendations, but it only went so far. These ideals have not made it to the mainstream public, social media or blogosphere. In some ways, now 15 years after the research settlement, some investors may seem to be favoring the exact opposite of independent, objective analysis of stocks, confusing credibility and expertise with having "skin in the game."

Hardly anyone talks about the lessons of analyst research from the dot-com bubble anymore, where analysts were pumping "hot IPOs." While the abuses by the investment banks have been lassoed in, Mr. Nelson feels investors still need something better, and not more ambiguous data or more stock screeners. The conversation about investing for most investors seems to be limited to these types of topics or on financial advising, in general, such as saving for retirement, maxing out one's 401k, staying disciplined, and avoiding behavioral biases. There are blogs and websites that talk about stocks, of course, but access to high-quality financial analysis backed by iron-clad methods such as enterprise valuation just aren't as prevalent as they should be. Without enterprise valuation, an understanding of universal valuation cannot be attained. They are one and the same.

Valuentum, in some ways, is a reflection of Mr. Nelson's career experiences as an analyst and entrepreneur, a lens into how he views the stock market, but his book, Value Trap, is also a response to many worrisome trends and processes in the investment management business today. The text strives to answer the question: what is the appropriate empirical evidence in evidence-based finance? Surely, not just any empirical evidence will do. The book is not meant to be

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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.

IT'S HERE! ORDER YOURS TODAY!

Brian M Nelson

Value Trap: Theory of Universal Valuation

ISBN-13: 978-0998038490, ISBN-10: 0998038490

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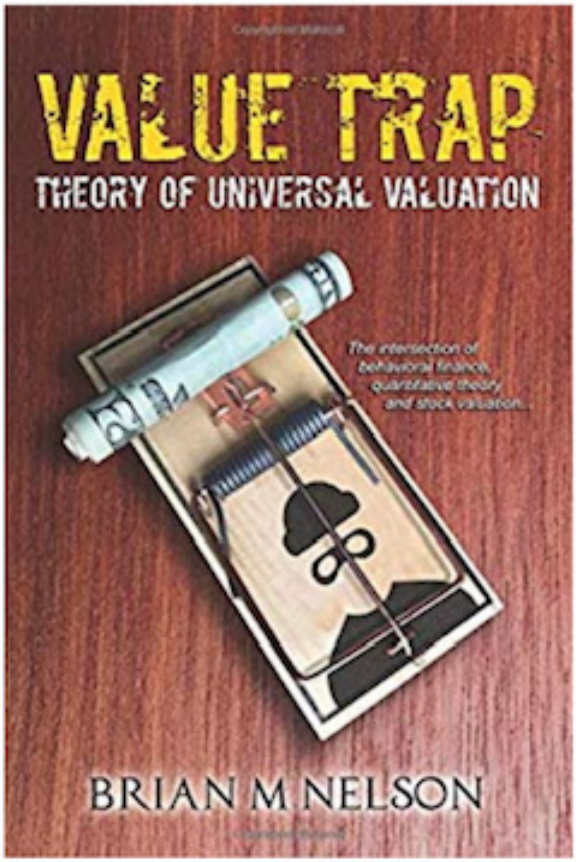

Format: Paperback

$13.99

FREE Shipping

The wait is no longer! President of Investment Research Brian Nelson's new book spent an extended period of time as the #1 best seller on Amazon for valuation. Order a paperback copy on Amazon or purchase a digital download at the Valuentum Store.

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controversial, but a discussion of the great contradiction of "explaining" stock return behavior between factor-based investing (which is based mostly on ambiguous, realized data within in-sample sets) and the efficient markets hypothesis (which is based on expectations of future data, realized or not) may make it so. The text is heavy in behavioral thinking and puts forth enterprise valuation as a behavioral framework in which to view stock prices and their movements. This book also shows how enterprise valuation is much more than a simple stock valuation tool, but rather that enterprise valuation is truly universal valuation, resting at the intersection of behavioral economics, quantitative theory, equity valuation, and therefore finance, itself. **Make sure *YOU* read this book.**

Apple's Services Growth on Track; Weakness to Persist in China

By Kris Rosemann

Apple delivered fiscal first quarter results after the close January 29 that were largely in-line with recently adjusted expectations. China has been and will likely continue to be a soft spot, but the company's Services revenue continues to impress. Strong free cash flow generation and balance sheet health are synonymous with the company.

Apple (AAPL) reported fiscal 2019 first quarter reports after the close January 29, but the market already had a good idea of what to expect due to a January 2 update from CEO Tim Cook that included a stark warning on the current demand environment in China (FXI, MCHI). Here's some of what Valuentum's President of Investment Research Brian Nelson had to say in his write up of that update, "Here It Comes… Apple's Shot Across the Bow:"

> Apple mentioned four anticipated factors that impacted performance during its fiscal first quarter of 2019 (and one new one). The only one of the four that didn't play out "broadly in line with (its) expectations" was "economic weakness in some emerging markets." In CEO Tim Cook's words, "this turned out to have a significantly greater impact than (it) had projected." In no uncertain terms, this was China (FXI, MCHI). According to Apple, "most of its revenue shortfall to (its) guidance, and over 100% of (its) year-over-year worldwide revenue decline, occurred in Greater China across iPhone, Mac, and iPad." The company also noted there were fewer upgrades within its iPhone product line than expected (the new factor), but the news with China is a big one.
>
> Without a doubt, it looks like US-China trade tensions are having a big impact, and while the market was already getting jittery in December, it appears these jitters haven't fully played out yet. Apple noted that Chinese economic growth is beginning to slow and that the country's GDP growth for the calendar third quarter was the second-lowest in a quarter century. Apple also noted that traffic to its retail stores and channel partners in China also declined as the quarter progressed. What this means is that fiscal second-quarter performance may be even worse. This may be the biggest negative. Again, we're taking all of this in stride.

We continue to highlight shares of Apple in both simulated newsletter portfolios, and we're sticking with our current fair value estimate of $217 per share for the time being. The company's Dividend Cushion ratio is among the strongest across our coverage universe at 5.8, but we cast a cautious eye over management's plan to take its fortress-like balance sheet to a net cash neutral position over time. Shares yield ~1.9% as of this writing, and with that, let's dig in to fiscal 2019 first quarter results.

Shares of Apple rallied after hours January 29 as results came in largely in-line with Cook's preliminary announcement earlier in the month, despite second quarter guidance coming up a bit short of consensus expectations. Revenue in the quarter fell 5% on a year-over-year basis as a 15% decline in iPhone revenue (accounted for ~62% of total revenue in the quarter, down from ~69% in the comparable period of fiscal

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2018) was too much for 19% growth in all other revenue to offset. The Greater China region (accounted for ~16% of total revenue in the quarter, down from ~20% in the comparable period of fiscal 2018) was the key source of weakness, and net sales fell nearly 27% in the region from the year-ago period.

Services revenue, which remained on track of its goal to be doubled over the period from fiscal 2016-2020 and accounted for ~13% of total revenue in the period, was a bright spot in Apple's fiscal first quarter as it grew 19% on a year-over-year basis to a quarterly record of $10.9 billion. Growth in this area was helped along by the company's active installed base of devices hitting an all-time high of 1.4 billion in the quarter. We continue to highlight Apple's incredible ecosystem and ability to make its products and applications an integrated part of the everyday lives of consumers. This may ultimately be the greatest strength it has, and it becomes even more bonding with consumers when taken with the status symbol that is its brand.

Mac revenue (~9% of total revenue in the period) advanced 9% from the year-ago period in the quarter, Wearables, Home, and Accessories revenue (~9% of total revenue in the period) leapt 33%, and iPad revenue (~8% of total revenue in the period) climbed 17%. The attractiveness of the Apple brand is not restricted to the iPhone, which is a notion supported by the impressive installed base of active devices.

Apple's GAAP gross margin came in at 38% in its fiscal first quarter, in-line with Cook's updated projections and down roughly 40 basis points from the year-ago period. GAAP operating margin was also in-line with recently set expectations but faced more material pressure in the period, as it contracted more than 2 percentage points to ~27.7%. Nevertheless, a significantly lower tax bill and lower share count helped grow diluted earnings per share by ~7.5% on a year-over-year basis to $4.18.

Operating cash flow followed Apple's operating income lower in the quarter, falling by nearly 6% from the year-ago period to $26.7 billion, and capital spending growth only further pressured free cash flow generation, which dropped more than 8% on a year-over-year basis to ~$23.3 billion. This is still a tremendous level of free cash flow generation, and it had no trouble in covering cash dividends paid in the period of ~$3.6 billion; share repurchases came in at ~$8.8 billion in the quarter. Management continues to reiterate its commitment to taking its balance sheet to a net cash neutral position over time, but its net cash position rose to $130.3 billion at the end of the quarter from $122.6 billion at the start of the period as it continues to throw off gobs of excess cash.

Apple is expecting its revenue decline to accelerate in its fiscal second quarter, as measured by the midpoint of its $55-$59 billion revenue guidance range for the period. Ongoing gross margin pressure is expected in the period (down to 37%-38% from ~38.4%), and operating expenses are expected to grow materially over the comparable period of fiscal 2018. This should not come as a surprise to Valuentum members, as Brian Nelson had already put the potential for similar expectations on members' radars.

Despite the less-than-rosy near-term outlook, we continue to like shares of Apple, which are trading below the lower bound of our fair value estimate as of this writing. The company has unparalleled balance sheet strength, though it may eventually wane as a result of its own strategy, and tremendous free cash flow generation; its dividend is among the healthiest we've seen. We're not panicking over short-term weakness in the Chinese market, and the firm's seemingly ever-growing ecosystem of devices and applications appears poised to find itself more and more integrated into the lives of consumers.

We're not letting one bad apple ruin a great bushel, and we expect to continue highlighting shares of Apple in both newsletter portfolios for the foreseeable future in the face of what may very well be transient weakness in an important market.

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 February 1, 2019

Company Name	Yrly Div's Paid ($) / Shr	Div Yield %	Fair Value	VBI Rating	Price/FV	Last Close	% of Portfolio
Intel (INTC)	1.26	2.59%	$ 56.00	4	0.87	48.73	7.5%-12.5%
Johnson & Johnson (JNJ)	3.60	2.68%	$ 137.00	6	0.98	134.20	7.5%-12.5%
S&P Dividend ETF SPDR (SDY)	2.44	2.56%	-	UR	-	95.23	7.5%-12.5%
Apple (AAPL)	2.92	1.75%	$ 217.00	6	0.77	166.52	5.5%-7.5%
Cisco (CSCO)	1.32	2.79%	$ 54.00	3	0.88	47.34	5.5%-7.5%
Digital Realty Trust (DLR)	4.04	3.72%	$ 96.00	3	1.13	108.56	5.5%-7.5%
iShares Int'l Select Dividend (IDV)	1.70	5.52%	-	UR	-	30.85	5.5%-7.5%
Energy Sector SPDR (XLE)	2.03	3.13%	-	UR	-	64.89	5.5%-7.5%
Invesco Senior Loan (BKLN)	1.01	4.49%	-	UR	-	22.46	3.5%-5.5%
General Motors (GM)	1.52	3.92%	$ 54.00	7	0.72	38.78	3.5%-5.5%
Microsoft (MSFT)	1.84	1.79%	$ 114.00	7	0.90	102.78	3.5%-5.5%
Novartis (NVS)	2.94	3.35%	$ 82.00	7	1.07	87.66	3.5%-5.5%
Oracle (ORCL)	0.76	1.50%	$ 59.00	7	0.86	50.81	3.5%-5.5%
Cracker Barrel (CBRL)	5.00	2.99%	$ 159.00	6	1.05	167.05	2.5%-3.5
Gilead Sciences (GILD)	2.28	3.25%	$ 92.00	3	0.76	70.05	2.5%-3.5
Hasbro (HAS)	2.52	2.78%	$ 95.00	6	0.96	90.78	2.5%-3.5
Realty Income (O)	2.71	4.00%	$ 56.00	5	1.21	67.83	2.5%-3.5
Xilinx (XLNX)	1.44	1.29%	$ 95.00	6	1.18	112.02	2.5%-3.5
Cash Consideration	-	-	-	-	-	-	0.0%

UR = Under Review

This portfolio is not a real money portfolio. Data as of February 1, 2019.

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.

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

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

We've taken the cash weighting in our portfolio to 0%. The midpoints of our respective weighting ranges sum to 100% to reflect the range of possible combinations that may result in this allocation.

Microsoft's Free Cash Flow Strong Despite Robust Strategic Growth Investments

By Kris Rosemann

Microsoft continues to take advantage of strong demand for its hybrid cloud portfolio, and it is winning business from leading enterprise customers. Free cash flow generation remains strong despite significantly higher levels of strategic growth investments.

Shares of simulated Dividend Growth Newsletter portfolio idea Microsoft (MSFT) faced a bit of selling pressure following its fiscal second quarter report, results released January 30, as investors digested mixed quarterly results, a relative slowdown in Azure revenue growth, and roughly in-line guidance for the full fiscal year. We still like shares, and operating margin expansion and robust free cash flow generation drive optimism while management continues to focus on strategic growth investments.

Overall revenue growth in the quarter came in at 12% on a year over-year basis thanks to ongoing customer demand for its hybrid cloud portfolio as the company continues to ride favorable secular trends amid a rising IT spending environment. Commercial bookings rose 18% from the year-ago period in the quarter, and commercial cloud revenue leapt 48%. Microsoft continues to win business from leading enterprises across a wide range of industries.

Microsoft's 'Intelligent Cloud' segment (~29% of total revenue in the quarter) led the company in revenue growth with a 20% year-over-year increase as server products and cloud services revenue growth of 24% was driven by Azure revenue jumping 76% from the year-ago period. This still robust rate of Azure revenue growth came in well below the 98% measure of the comparable quarter of fiscal 2018, but management was encouraged by an increase in larger, longer-term Azure contracts and a significant improvement in Azure gross margin. The acquisition of GitHub, which closed in the calendar fourth quarter, also boosted segment revenue.

The 'Productivity and Business Processes' segment (~31% of total revenue in the quarter) turned in 13% revenue growth from the year-ago period as Office 365 Commercial revenue advanced 34%, LinkedIn revenue climbed 29%, and Dynamics revenue grew 17%, the latest of which was driven by Dynamics 365 revenue growth of 51%. The segment's gross margin faced a bit of pressure on a year-over-year basis as the benefits of improved LinkedIn and Office 365 margins were offset by increased cloud mix.

Microsoft's largest segment, 'More Personal Computing,' (~40% of total revenue in the quarter) drove revenue growth of 7% on a year-over-year basis as strong Surface revenue growth (39%) helped offset a 5% decline in Windows OEM revenue. Management pointed to a delay in chip supply to its OEM partners as a constraint on an otherwise healthy PC ecosystem. Windows OEM Pro revenue declined by 2% from the year-ago period, a rate that roughly reflects the contraction of the commercial PC market, while Windows OEM non-Pro revenue fell by 11%. Segment gross margin contracted in the period as a result of a higher mix of lower-margin Surface and gaming revenue, the latter of which advanced at an 8% rate in the quarter on a year-over-year basis.

Company-wide gross margin was roughly flat at 62% in Microsoft's fiscal second quarter, but its GAAP operating margin expanded by approximately two percentage points to ~32% in the period. Management cited focused investment, solid execution, and improving gross margins across key product areas as drivers of margin expansion, but a shift of some of its fiscal second quarter marketing budget into the subsequent quarter also helped keep operating expenses below previously anticipated levels. Non-GAAP diluted earnings per share advanced to $1.10 from $0.96 in the comparable period of 2017.

Microsoft continues to generate robust free cash flow, but it also investing in a material way for the future. Operating cash flow advanced 13% on a year-over-year basis in its fiscal second quarter, but a

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~43% increase in capital spending resulted in a 2% decline in free cash flow to $5.2 billion. Through the first two quarters of fiscal 2019, free cash flow faced a similar decline from the comparable period, but the $15.2 billion in free cash flow generation was more than enough in covering cash dividends paid in the period of ~$6.8 billion.

As of the end of calendar 2018, Microsoft held ~$127.7 billion in cash, cash equivalents, and short-term investments (down from ~$133.8 at the end of fiscal 2018) and $73.2 billion in total debt (down from $76.2 billion at the end of fiscal 2018). The company is one of two firms that boasts a 'AAA' credit rating, and its Dividend Cushion ratio is an impressive 3.3 at last check. Shares yield ~1.75% as of this writing, and management has been aggressive in buying back shares of late, as it repurchased nearly $10.2 billion of its shares in the first half of the year. Our fair value estimate for shares currently sits at $114 each, so we think they offer a decent value proposition at this point.

Moving forward, management expects a strong US dollar to continue weighing on reported results, but strong customer demand, healthy bookings growth, and ongoing improvements in its commercial revenue annuity mix, which grew to 89% in the fiscal second quarter from 86% in the year-ago period, should continue to provide positive momentum in its commercial business in the near term. Its highly-watched Azure revenue is expected to reflect a balance between strong growth in consumption-based business and moderating growth in its per-user business, suggesting relative slowdowns may become more commonplace, but it is important to keep in mind the still-robust growth rates at increasing scale. Operating margin expansion is expected to be slight in the full fiscal year, including the impact of the GitHub acquisition.

We continue to highlight shares of Microsoft in the simulated Dividend Growth Newsletter portfolio, and it remains one of our favorite dividend growth ideas on the market. The company's balance sheet health is simply tremendous as it boasts a net cash position of $54.5 billion, and free cash flow coverage of dividends paid remains strong. Shares are currently changing hands in the lower half of our fair value range, which is anchored by a midpoint of $114 per share.

Intel Disappoints with 2019 Guidance; Sell-off Overdone

By Kris Rosemann

Simulated newsletter portfolio idea Intel disappointed with its fourth quarter 2018 results and guidance for 2019 as multiple headwinds are expected to persist in the near term. Nevertheless, we don't think the sell-off was entirely justified as the company continues to position itself to take advantage of the high-growth potential of its data-centric businesses.

Shares of simulated newsletter portfolio idea Intel (INTC) faced material selling pressure following the release of its 2018 fourth quarter results and 2019 guidance, released January 25, but we're not convinced the sell-off was justified. Our fair value estimate for shares remains $56 each, and the company's Dividend Cushion ratio currently sits at 2.6, though that may be subject to change as the model is rolled forward with full year 2018 results via the upcoming release of Intel's 10-K.

Intel's PC-centric business helped drive company-wide revenue growth of 9% on a year-over-year basis as its top line advanced 10% amid ongoing demand strength for Intel's high-performance products in commercial and gaming applications. The company's data-centric businesses, which include its Data Center Group, Internet of Things Group, Memory, and Programmable Solutions Group, collectively grew revenue 9% from the year-ago period thanks in part to 24% revenue growth in its cloud segment of the Data Center Group.

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The recent acquisition of Mobileye continues to provide a source of optimism, as the business turned in 43% year-over-year revenue growth in the fourth quarter, and it is building excitement regarding Intel's participation in autonomous vehicles. The company's Internet of Things Group revenue took a hit as a result of the divestment of Wind River, and its Memory business turned in record quarterly revenue despite less-than-ideal pricing in the memory space.

While we say that we do not feel the sell-off following Intel's fourth quarter report was warranted, we understand the market's reaction to some near-term headwinds that may persist for multiple quarters. Weak demand in China, which is the posterchild for current uncertainty surrounding global trade tensions and growing macroeconomic concerns, is weighing on sentiment and Intel's outlook, including in its Data Center Group as all three verticals within the group were impacted by China-related softness in demand. Uncertainty over pricing in the memory space, particularly in NAND, is also weighing on expectations.

Management is pointing to a "digestion" period for its cloud service provider customers as another potential near-term headwind as these service providers have moved from building to absorbing capacity, which is weighing on expectations for pricing moving forward. The well-publicized strengthening of rivals such as AMD (AMD) relative to Intel's delayed 10-nanometer chip launch has become old news at this point, but the competitive threat is still in place, even if the vast majority of the risk related to the situation has been priced into Intel's share price. These combinations of potential headwinds are impacting near-term guidance on both the top line and operating margin.

In the fourth quarter, Intel's non-GAAP operating margin was roughly flat from the year-ago period at just over 35% as strong mix and ongoing spending leverage was offset by 10-nanometer chip costs and growth related to adjacent businesses. Non-GAAP earnings per share advanced 18% in the fourth quarter on a year-over-year basis to $1.28 thanks in part to a materially lower tax rate.

Cash flow from operations took a bit of a hit in the fourth quarter at Intel as the measure fell ~4.7% to $6.9 billion, and slightly lower capital spending was not enough to keep free cash flow from falling ~5% from the year-ago period to ~$3 billion, which was still more than enough to cover cash dividends paid of ~$1.4 billion in the quarter. While we think shares offer an attractive valuation proposition based on our fair value estimate of $56 per share, Intel continues to aggressively buy back stock, as it repurchased ~$2.3 billion in the fourth quarter alone. As of the end of 2018, it held a net debt position of $14.7 billion (~$26.4 billion total debt compared to ~$11.7 billion in cash investments) compared to net debt of $12.8 billion a year earlier. Management estimates that it generated ~$14.3 billion in free cash flow in 2018 and returned nearly $16.3 billion to shareholders, only ~$5.5 billion of which was via dividends.

Intel's modest revenue growth guidance for 2019 highlights the aforementioned near-term headwinds that may very well persist for multiple quarters, but we continue to have confidence in the company's ability to continue taking advantage of a large and growing market. The company appears to remain on track with respect to its 10-nanometer launch prior to the holiday season, and its data-centric businesses are expected to remain growth drivers.

Management expects 2019 revenue to grow by ~1% to roughly $71.5 billion as its PC-centric business revenue is expected to fall at a low-single-digit rate while its data-centric businesses are expected to grow at a mid-single-digit rate. It expects gross margin weakness in the year as a result of the 10-nanometer production ramp and ongoing growth in adjacent businesses, and non-GAAP operating margin is expected to contract by roughly one percentage point to ~34% as the gross margin weakness will be partially offset by operating leverage and optimized R&D spending. Non-GAAP earnings per share in 2019 are targeted at ~$4.60 (a target that implies shares are trading at just over 10x 2019 non-GAAP earnings) compared to $4.58 in 2018, but perhaps most importantly, Intel expects free cash flow to grow ~12% in 2019 to $16 billion after projected capital spending of ~$15.5 billion. Management also announced a 5% dividend increase along with its fourth quarter results.

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Shares of Intel are currently changing hands near the lower bound of our fair value, and we continue to highlight the company in both newsletter portfolios. The company is expecting only modest growth in 2019, but the combination of continued strength in its data-centric businesses, which generally target massive and rapidly-growing markets, coupled with the eventual launch of its 10-nanometer chip prior to the 2019 holiday season should help it return to more noteworthy top-line growth in 2020 and beyond. We think the sell-off following the company's fourth quarter report was overdone, and the stock currently offers a ~2.7% dividend yield to go along with its solid 2.6 Dividend Cushion ratio. Our fair value estimate currently sits at $56 each, and shares are trading at just over 10x 2019 non-GAAP earnings guidance.

Johnson & Johnson Overcoming Pharma Pricing Pressure

By Kris Rosemann

Johnson & Johnson's 'Pharmaceutical' segment continues to deliver top-line growth despite ongoing headwinds related to net price decreases in the US pharma space. The company remains one of our favorite dividend growth ideas as its higher-growth 'Pharmaceutical' segment is augmented by a solid 'Consumer' business and improving 'Medical Devices' business.

Simulated newsletter portfolio idea Johnson & Johnson (JNJ) is simply a powerhouse, but that does not mean its shares are immune to broader market volatility, global economic expectations, and headline risk. While the final of those factors via ongoing legal issues has provided an overhang on shares of the consumer and pharmaceutical giant, its track record of consistency cannot be disputed.

2018 marked Johnson & Johnson's 35th consecutive year of adjusted operational earnings growth (excludes intangible amortization expense, special items and the impact of translational currency) and its 56th consecutive year of annual dividend increases, and it generates ~70% of sales from products with #1 or #2 global market share positions while having 26 brands or platforms with $1 billion or more in annual sales. The company is one of only two companies to currently hold an AAA credit rating, the other being fellow simulated Dividend Growth Newsletter portfolio idea Microsoft (MSFT).

While we await the release of Johnson & Johnson's 10-K to roll its valuation model forward and have a look at its balance sheet and cash flow statement for the full-year 2018, we are sticking with our fair value estimate of $137 per share following its fourth quarter earnings report, released January 22. The company's strong Dividend Cushion ratio of 2.3 pairs nicely with its dividend yield of 2.8% as of this writing, and we expect to continue highlighting it as an idea in the simulated newsletter portfolios. Our stance on its pending legal matters remains the same, and members can find that opinion here.

Ongoing strength in Johnson & Johnson's 'Pharmaceutical' segment continues to drive its top line, and the segment reported 7.2% operational sales (excludes impact of currency translation) growth in the fourth quarter on a year-over-year basis thanks in large part to impressive performance from its 'Oncology' and 'Immunology' divisions. The company's 'Consumer' segment turned in 3.3% operational sales growth from the year-ago period as its 'OTC' division performed will in the quarter thanks in part to the acquisition of Zarbee's natural-based product portfolio, but its 'Medical Devices' segment saw sales decline 2.2% on an operational basis from the fourth quarter of 2017 as it continued to divest businesses such as LifeScan to position itself to achieve its target of above market sales growth in 2020. Overall, worldwide sales at Johnson & Johnson grew 3.3% on an operational basis in the fourth quarter on a year-over-year basis, but the negative impact of currency translation brought its reported growth rate down to 1%.

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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	Dividend Yield	VBI	Div Growth	Div Safety	Div Cushion
General Motors	GM	4.0%	7	GOOD	EXCELLENT	3.4
NewMarket	NEU	1.7%	7	EXCELLENT	GOOD	1.5
IBM	IBM	4.2%	7	GOOD	GOOD	1.2
Applied Industrial	AIT	1.5%	7	VERY POOR	POOR	1.1
Fidelity National	FIS	1.2%	7	EXCELLENT	GOOD	1.8
Bunge	BG	3.0%	7	VERY POOR	VERY POOR	0.3
Kroger	KR	1.9%	7	VERY POOR	VERY POOR	-0.8
Walgreens Boots Alliance	WBA	2.2%	7	EXCELLENT	EXCELLENT	2.8
Cardinal Health	CAH	3.5%	7	EXCELLENT	GOOD	1.4
Microchip Technology	MCHP	1.8%	7	POOR	POOR	0.7
Royal Caribbean	RCL	2.6%	7	VERY POOR	VERY POOR	0.0
Dover	DOV	2.2%	7	EXCELLENT	GOOD	2.0
CBS Corp	CBS	1.2%	7	POOR	GOOD	1.8
Becton, Dickinson	BDX	1.2%	7	POOR	POOR	0.2
Amgen	AMGN	2.9%	7	EXCELLENT	GOOD	2.4
Novartis	NVS	3.4%	7	GOOD	GOOD	1.7
Omega Healthcare	OHI	6.9%	7	VERY POOR	POOR	0.9
Kimco Realty	KIM	6.8%	7	VERY POOR	POOR	0.7
WP Carey	WPC	5.9%	7	VERY POOR	POOR	0.7
Brinker	EAT	3.1%	7	VERY POOR	VERY POOR	-1.0
Dick's Sporting	DKS	2.4%	7	EXCELLENT	GOOD	2.6
Microsoft	MSFT	1.7%	7	EXCELLENT	EXCELLENT	3.3
Oracle	ORCL	1.5%	7	EXCELLENT	EXCELLENT	4.5
GameStop	GME	9.6%	7	POOR	POOR	1.7
BCE	BCE	5.6%	7	VERY POOR	VERY POOR	0.0
DTE Energy	DTE	3.1%	7	VERY POOR	VERY POOR	-1.5
Entergy	ETR	4.2%	7	VERY POOR	VERY POOR	-2.9
Exelon	EXC	3.1%	7	VERY POOR	VERY POOR	-1.1
First Energy	FE	3.8%	7	VERY POOR	VERY POOR	0.1
Crown Castle	CCI	3.9%	7	VERY POOR	POOR	1.2

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

The Financially-Healthiest Dividend Payers Yielding Over 2%

By Valuentum Analysts

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

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

Company Name	Symbol	Est. Div Yield	Div Cushion	Economic Castl	Multiplier
General Motors	GM	4.0%	3.4	Attractive	13.88
Gilead Sciences	GILD	3.4%	3.5	Very Attractive	12.13
Automatic Data Processing	ADP	2.4%	4.9	Very Attractive	11.86
Chicago Rivet	CVR	3.0%	3.9	Neutral	11.78
Apple	AAPL	1.9%	5.8	Very Attractive	11.15
Manpower	MAN	2.9%	3.7	Attractive	10.85
Honda	HMC	3.1%	3.5	Neutral	10.83
Western Union	WU	4.4%	2.3	Neutral	10.35
Hewlett-Packard	HPQ	2.8%	3.6	Attractive	10.01
Applied Materials	AMAT	2.3%	4.4	Very Attractive	9.97
Cooper Tire & Rubber	CTB	1.2%	8.1	Neutral	9.96
Thor	THO	2.3%	4.3	Attractive	9.95
Ralph Lauren	RL	2.4%	4.1	Attractive	9.70
American Eagle	AEO	2.6%	3.6	Attractive	9.37
Gap	GPS	3.8%	2.4	Attractive	9.21
Cisco	CSCO	3.1%	3.0	Very Attractive	9.16
Total	TOT	5.6%	1.6	Neutral	9.08
Foot Locker	FL	2.8%	3.2	Attractive	9.02
Best Buy	BBY	3.2%	2.8	Very Attractive	8.94
Guess	GES	4.4%	2.0	Attractive	8.87
Cummins	CMI	3.5%	2.5	Attractive	8.86
KLA-Tencor	KLAC	3.1%	2.7	Very Attractive	8.46
Gentex	GNTX	1.9%	4.4	Attractive	8.37
MKS Instruments	MKSI	1.1%	7.7	Attractive	8.30
Iron Mountain	IRM	7.4%	1.1	Attractive	8.13
Interpublic	IPG	3.9%	2.1	Very Attractive	8.11
Bristol-Myers Squibb	BMY	3.4%	2.4	Very Attractive	8.09
Ford	F	6.3%	1.3	Neutral	8.04
Paychex	PAYX	3.4%	2.4	Very Attractive	7.99
Tapestry	TPR	3.8%	2.1	Attractive	7.98
Fluor	FLR	1.8%	4.4	Attractive	7.87
H&R Block	HRB	3.7%	2.1	Very Attractive	7.84
Omnicom	OMC	3.5%	2.2	Attractive	7.66
Archer-Daniels-Midland	ADM	3.2%	2.4	Attractive	7.64
Ethan Allen	ETH	4.0%	1.9	Unattractive	7.57
Rio Tinto	RIO	5.4%	1.4	Neutral	7.54
Graham Holdings Co	GHC	0.8%	9.1	Attractive	7.50
ABB	ABB	4.3%	1.7	Attractive	7.47
Lear Corp	LEA	1.8%	4.1	Attractive	7.45
McKesson	MCK	1.2%	6.0	Very Attractive	7.45
Welltower	WELL	4.8%	1.6	Neutral	7.42
Newmont Mining	NEM	1.8%	4.1	Neutral	7.40
Granite Construction	GVA	1.1%	6.8	Attractive	7.37
Ventas	VTR	5.2%	1.4	Neutral	7.20
Tupperware	TUP	9.0%	0.8	Attractive	7.10
Digital Realty Trust	DLR	3.8%	1.8	Neutral	7.08
Williams-Sonoma	WSM	3.3%	2.2	Attractive	7.03
Caterpillar	CAT	2.8%	2.5	Attractive	7.02
Robert Half	RHI	2.0%	3.6	Very Attractive	6.94
Pfizer	PFE	3.4%	2.1	Attractive	6.94

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	0.7%	VERY POOR	-31.9
CIRCOR Intl	CIR	Electrical Equipment	0.4%	VERY POOR	-27.1
Superior	SUP	Auto Parts Suppliers	7.1%	VERY POOR	-12.5
Yamana Gold	AUY	Metals & Mining - gold	0.8%	VERY POOR	-9.2
Ryder System	R	Rental and Leasing	3.9%	VERY POOR	-7.3
R.R. Donnelley	RRD	Commercial Services	12.9%	VERY POOR	-7.1
General Electric	GE	Conglomerates	0.5%	VERY POOR	-7.1
Owens & Minor	OMI	Healthcare Products	4.3%	VERY POOR	-5.3
HCA Healthcare	HCA	Health Care Services	1.0%	VERY POOR	-4.9
H.B. Fuller	FUL	Chemicals - broad	1.3%	VERY POOR	-4.7
Casey's General	CASY	Food Retailers	0.9%	VERY POOR	-4.3
Intl Game Technology	IGT	Leisure	5.2%	VERY POOR	-4.1
Silgan	SLGN	Containers & Packaging	1.5%	VERY POOR	-3.8
Teekay	TGP	Shipping	3.6%	VERY POOR	-3.8
Centurylink	CTL	Telecom Services - diversified	10.1%	VERY POOR	-3.3
Devon Energy	DVN	Independent Oil & Gas	1.3%	VERY POOR	-3.0
Noble Energy	NBL	Independent Oil & Gas	2.1%	VERY POOR	-2.9
Dine Brands Global	DIN	Restaurants - Fast Cas & Full Svc	2.8%	VERY POOR	-2.3
Olin Corp	OLN	Chemicals - mid/small	3.8%	VERY POOR	-2.3
Wendy's Co	WEN	Restaurants - Fast Food & Coffee	1.9%	VERY POOR	-2.2
CVS Health	CVS	Food Retailers	2.7%	POOR	-2.1
Pitney Bowes	PBI	Commercial Services	11.2%	VERY POOR	-2.1
SITE Centers	SITC	REIT - Retail	6.4%	VERY POOR	-2.0
Meredith	MDP	Media - advertising	4.2%	VERY POOR	-1.6
Newell Brands	NWL	Household Durables	4.6%	VERY POOR	-1.6
Molson Coors	TAP	Beverages - alcoholic	2.6%	VERY POOR	-1.5
Hess	HES	Refiners	1.9%	VERY POOR	-1.2
Anheuser-Busch InBev	BUD	Beverages - alcoholic	4.4%	VERY POOR	-1.0
Brinker	EAT	Restaurants - Fast Cas & Full Svc	3.1%	VERY POOR	-1.0
Compass Minerals	CMP	Chemicals - agriculture	6.5%	POOR	-0.9
Kroger	KR	Food Retailers	1.9%	VERY POOR	-0.8
Plains All American	PAA	Oil & Gas Pipelines	5.0%	VERY POOR	-0.8
Apache	APA	Independent Oil & Gas	3.3%	VERY POOR	-0.8
Macerich	MAC	REIT - Retail	6.6%	VERY POOR	-0.8
Campbell Soup	CPB	Food Products - Large	3.8%	VERY POOR	-0.7
CyrusOne	CONE	REIT - Retail	3.6%	POOR	-0.7
Ball Corp	BLL	Containers & Packaging	0.9%	VERY POOR	-0.7
SL Green	SLG	REIT - Retail	3.8%	VERY POOR	-0.7
Big 5	BGFV	Retail - Sporting Goods	5.6%	VERY POOR	-0.6
Scotts Miracle-Gro	SMG	Chemicals - agriculture	3.2%	VERY POOR	-0.3
AT&T	T	Telecom Services - diversified	6.4%	VERY POOR	-0.2
Taubman	TCO	REIT - Retail	5.3%	VERY POOR	-0.2
Vector Group	VGR	Tobacco	16.9%	VERY POOR	-0.2
Viacom	VIA	Media - CATV	2.3%	VERY POOR	-0.2
Murphy Oil	MUR	Refiners	3.7%	VERY POOR	-0.2
Service Corp Intl	SCI	Personal Services	1.6%	VERY POOR	-0.1
Kraft Heinz	KHC	Food Products - Large	4.6%	VERY POOR	-0.1
Cogent Comm	CCOI	Wireless Telecom Services	4.8%	VERY POOR	-0.1
Verizon	VZ	Telecom Services - diversified	4.2%	VERY POOR	-0.1

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

Johnson & Johnson...from page 9

Johnson & Johnson's gross margin expanded 190 basis points to 65.9% in the fourth quarter from the year-ago period thanks in part to favorable mix and an inventory step-up related to Actelion, which was acquired in 2017. EBIT margin also fared well in the quarter, expanding to 15.3% from 12.7% in the fourth quarter of 2017, as both selling, marketing, and administrative and R&D expenses declined as a percentage of revenue due in part to lower milestone payments to collaborators. Adjusted net earnings per diluted share advanced to $1.97 from $1.74 in the comparable period of 2017.

Management estimates that it ended 2018 with a net debt position of ~$10.8 billion, consisting of $30.5 billion in debt and $19.7 billion in cash, which is down from $16.3 billion in net debt at the end of 2017. Free cash flow for the full year is estimated at $18.6 billion, an ~$800 million improvement over 2017 levels, and it completed roughly 20% of its $5 billion share repurchase program in 2018.

Looking ahead to 2019, Johnson & Johnson expects operational sales growth to be flat to up 1%, and adjusted earnings per share guidance for the year comes in a range of $8.50-$8.65, which includes a projected $0.15 per share negative impact of currency translation due to expectations for a stronger US dollar, compared to $8.58 in 2018. Adjusted sales growth, which excludes the impact of currency translation and the impact of acquisitions and divestitures, is expected to be 2%-3% in 2019.

Anticipated headwinds for 2019 include generic and biosimilar competition in its 'Pharmaceutical' segment--US pharma pricing pressure will likely persist at elevated levels after coming in at "greater than 6%," according to management--but the company still expects overall segment revenue growth in the year. Excluding the impact of generic and biosimilar competition, which is expected to be a $3-$3.5 billion headwind over the course of the year, company-wide organic growth of 5.7%-7.3% is being targeted. Management expects its 'Medical Devices' segment to experience accelerating revenue growth in 2019, and new product innovation and improving omni-channel performance to help its 'Consumer' segment grow slightly above market growth rates in the year.

Management commented briefly on its talc-related legal issues on the quarterly conference call, stating that it does not have an impact on the long-term strategic outlook of its 'Consumer' segment, a notion we agree with. As we have reiterated in the past regarding the developments:

> The magnitude of damages against J&J with respect to its talcum-powder products could be large, but we think the market has slowly factored in the risk of legal liabilities. Once J&J puts these troubles behind it, we think the market may once again warm up to the equity.

We continue to highlight shares of Johnson & Johnson in both simulated newsletter portfolios.

Novartis Closes Out Busy Year; Proposes Dividend Hike

By Kris Rosemann

European pharmaceutical giant Novartis had a busy year in 2018 on its quest to renew its focus on medicines, and management is excited about its future growth trajectory. We continue to like its free cash flow generation and dividend growth potential.

2018 was a busy year for simulated Dividend Growth Newsletter idea Novartis (NVS), which reported fourth quarter results January 30. The company completed a strategic review resulting in the planned first half 2019 spin-off of its Alcon division, it agreed to sell its Sandoz US oral solids and dermatology portfolio, it sold its stake in the GlaxoSmithKline (GSK) consumer healthcare joint venture for $13 billion, and it invested in long-term growth drivers such as the acquisition of AveXis gene therapy. Four of Novartis' drugs surpassed the $1 billion annual sales mark for the first time in 2018, giving it fifteen in total in its 'Innovative Medicines' division, and three more potential blockbusters were launched in the year in Lutathera (oncology), Aimovig (migraines), and Kymriah (oncology).

Please see *Novartis*...on next page

***Novartis…*from previous page**

Net sales as reported at Novartis in the fourth quarter rose 3% on a year-over-year basis, or 6% in constant currency, as impressive volume growth of 9% was partially offset by a two percentage point drag from pricing and one percentage point of negative impact from generic competition. Key drivers of volume growth in the quarter were Cosentyx (psoriasis), Entresto (heart failure), its 'Oncology' division, and Alcon.

Operating income as reported was decimated in the fourth quarter by restructuring and impairment charges and the impact of M&A activity, but core operating income advanced 5% as higher sales in 'Innovative Medicines' and gross margin expansion across all divisions were partially offset by growth investments such as those in AveXis. Core operating margin expanded 50 basis points in the period on a year-over-year basis to 25.5%. Core earnings per share advanced 3% in the fourth quarter from the year-ago period to $1.25 as growth in core operating income was weighed down by the divestment of core income from the GlaxoSmithKline consumer healthcare joint venture.

In the fourth quarter and full year 2018, Novartis showcased its traditional free cash flow generating prowess as the measure rose ~17% and ~11%, respectively, both on a year-over-year basis. The full year measure came in at just over $10.9 billion, which was more than sufficient in covering cash dividends paid of ~$7 billion in the year, as cash flow from operations advanced to $14.3 billion from $12.6 billion in 2017. The company ended the year with a net debt position of $16.2 billion (consisting of ~$32.1 billion in total debt and nearly $16 billion in cash), and it maintains an 'A' credit rating (A1/AA-). At last check Novartis' Dividend Cushion ratio was a solid 1.7, and shares yield ~3.4% as of this writing, though management proposed a 2% annual dividend hike in its home currency, the Swiss franc. The increase would mark the 22nd consecutive annual dividend increase in its home currency.

Novartis is calling itself a new focused medicines company, a transformation that will be complete following the Alcon spinoff and Sandoz US oral solids and dermatology business divestiture, and it expects this new group of businesses to deliver mid-single digit net sales growth in 2019 on a constant currency basis. Its 'Innovative Medicines' business is anticipated to grow net sales at a mid-single-digit rate in constant currency, while the remaining Sandoz business is expected to realize sales roughly in line with that of 2018. Group core operating income in 2019 is projected to rise at a mid- to high-single-digit rate, which should continue to benefit from expectations for ongoing operating margin expansion in 'Innovative Medicines,' but these targets may be subject to change if a generic competitor for Gilenya enters the market.

Not only do we continue to like Novartis' income generating potential for shareholders, but its pipeline continues to progress nicely. Management expects the solid momentum of 2018 to accelerate in the next two years a it has 10+ potential blockbuster launches planned for 2019-2020.

We continue to highlight shares of Novartis in the simulated Dividend Growth Newsletter portfolio. Shares are trading just above our fair value estimate of $82 per share, but if management is able to deliver on its high expectations for blockbuster drug launches, the upper bound of our fair value range may very well be within reach. There are certainly headwinds in place, including intensifying generic competition, general pricing pressure in the pharmaceutical space, and execution risk related to its ongoing portfolio transformation, but if Novartis continues to deliver from its 'Innovative Medicines' pipeline, we expect it to realize its solid long-term dividend growth potential for shareholders.

Xilinx Rides Momentum to Impressive Free Cash Flow Generation

By Kris Rosemann

Recent addition to the simulated Dividend Growth Newsletter portfolio Xilinx continues to impress with its robust free cash flow generating capacity, and the company is taking advantage of momentum in key end markets as its top-line growth has been nothing short of impressive.

Shares of recent addition to the simulated Dividend Growth Newsletter portfolio Xilinx (XLNX) soared after it surpassed market expectations in its fiscal third quarter and provided compelling upside guidance for its final quarter of fiscal 2019. The company continues to be a tremendous example of free cash flow efficiency, and we think it makes up for its relatively small dividend yield with its robust dividend growth potential. Shares are currently changing hands near the upper bound of our fair value range, but we expect a nice bump in our fair value estimate in a coming update to its valuation. We highlighted shares in the November edition of the Dividend Growth Newsletter, released November 1, when shares closed at a price of $86.99. Just a few short months later, the stock price has reached the mid-$100s as of the January 24 trading session.

Xilinx's fiscal third quarter report, results released January 23, revealed impressive top-line strength as revenue advanced 34% on a year-over-year basis to $800 million. Its 'Communications' end market (35% of total revenue in the quarter) turned in 41% year-over-year revenue growth thanks to early production in 5G and pre-5G deployments, particularly in South Korea and China. The 'Industrial, Aerospace, & Defense' end market (27% of total revenue in the quarter) reported 17% revenue growth from the year-ago period as a result of strength across multiple defense and stage programs. Core data center revenue, which excludes the contracting cryptocurrency category, nearly doubled from the comparable period of fiscal 2018, and management points to strong momentum with hyperscale data center operators, which will be an increasingly important portion of the data center market moving forward, as reason for confidence moving forward.

Better-than-expected top-line performance helped drive a greater than 60% increase in non-GAAP operating income at Xilinx in its fiscal third quarter. Gross margin of 69% was in line with guidance but fell by roughly one percentage point from the year-ago period, and operating expenses were also in line with management's expectations, which helped expand non-GAAP operating margin to 32.9% from 27% in the comparable period of fiscal 2018. Non-GAAP diluted earnings per share leapt more than 40% on a year-over-year basis.

Where Xilinx truly shines is on the cash flow statement thanks in part to its minimal capital spending requirements. Through three quarters in fiscal 2019, the company generated $742 million in free cash flow, a ~35% increase over the comparable period of fiscal 2018 despite capital spending more than doubling, and the measure easily eclipsed non-GAAP net income of $650 million for a free cash flow conversion rate of 114%.

Cash dividends paid in the nine-month period came in at $273 million, revealing significant coverage with internally-generated cash flow, even after considering $162 million in share repurchases in the period. As of the end of its fiscal third quarter, Xilinx held nearly $3.5 billion in cash, cash equivalents, and short-term investments compared to a total debt load of $1.7 billion, and this sizable net cash position helps boost its Dividend Cushion ratio to an impressive 3.5 at last check.

Not only did Xilinx surpass expectations in its fiscal third quarter report, but it also issued better-than-expected guidance for the fourth quarter of the fiscal year. We like what we're seeing from the company in terms of momentum in key end markets, and its free cash flow margin is top-notch. Shares yield just ~1.4% as of this writing, but we continue to believe the payout has a long runway for growth ahead of it, as evidenced by its robust Dividend Cushion ratio. We continue to highlight the company as an idea in the simulated Dividend Growth Newsletter portfolio.

Digital Realty 2019 Guidance Indicative of Datacenter Pricing Trends

By Kris Rosemann

Digital Realty expects weakness in rental rates on renewal leases on a cash basis in 2019, which is indicative of negotiating power held by large cloud operators, but the REIT expects top-line growth to continue thanks in part to ongoing growth in leasing volume.

Shares of simulated Dividend Growth Newsletter portfolio idea Digital Realty Trust (DLR) faced selling pressure following the release of its 2019 guidance January 9. The update revealed expectations for a high-single-digit decline in rental rates on renewal leases on a cash basis and core funds from operations (FFO) guidance of $6.60-$6.70, the latter of which came in below the market's expectations. However, cash-releasing spreads being expected to decline in 2019 is indicative of the pricing environment for wholesale datacenter capacity across the industry as releasing rates become increasingly dependent upon moves made by large cloud operators such as Amazon (AMZN), Apple (AAPL), and Alibaba (BABA).

According to the Cisco Global Cloud Index report, hyperscale datacenters will account for ~53% of all installed datacenter servers by 2021, which is a material increase compared to an estimated ~38% at the end of 2018, and such a concentration makes the current 24 global hyperscale operators of high importance to datacenter landlords such as Digital Realty. Fortunately for such landlords, however, is the generally impressive credit quality of these operators and the long-duration leases that help to mitigate the negative impact of poorer pricing power.

As of the end of the third quarter of 2018, Digital Realty's top 20 customers accounted ~53.2% if its total annualized rent, and 64 of its 205 data centers were occupied by single customers as of the end of 2017. Its largest customers are subsidiaries of IBM (IBM), an undisclosed Fortune 50 software company, and Facebook (FB) with 6.4%, 6.3%, and 6.3%, respectively, of annualized base rent at the end of the third quarter of 2018. The image at the top of this article provides a breakdown of the REIT's top 20 customers.

As a result of the expected increase in concentration among hyperscale operators, tenant concentration is not anticipated to decrease materially for datacenter landlords, and Digital Realty is no exception. In addition to the industry-wide trend of concentration, the REIT increased its tenant concentration with the 2017 acquisition of DuPont Fabros, but the move also increased its presence in the important Northern Virginia datacenter market. Key risks for Digital Realty include concentration and the resulting weakness in pricing power and near-term lease expirations as leases expiring in 2019 accounted for 22.5% of the REIT's annual rental revenue as of the third quarter of 2018.

Nevertheless, Digital Realty expects 2019 revenue to be in a range of $3.2-$3.3 billion compared to expectations for 2018 revenue to be $3.0-$3.2 billion. Its adjusted EBITDA margin guidance for 2019 (57%-59%) suggests it will be roughly in line with 2018 expected results, and year-end portfolio occupancy rates are also expected to be approximately flat compared to 2018 results (guidance of +/- 50 basis points). Increases in leasing volume thanks in part to new growth projects, should help offset pricing weakness among the REIT's largest tenants.

Digital Realty holds investment grade credit ratings (BBB/Baa2/BBB), so it should continue to have adequate access to capital markets to fund expansion initiatives and dividend growth moving forward. We'll be watching developments related to its largest tenants closely moving forward, but its outlook benefits from its global footprint, which should benefit from its recent move in the growing Brazilian market, and diversified product suite that includes shorter term leases in co-location and interconnection.

We're sticking with our current fair value estimate for shares of $96 a piece for the time being, and the REIT's adjusted Dividend Cushion ratio, which gives it credit for access to capital markets, currently sits at 1.8. We expect to continue highlighting shares, which yield ~3.8% as of this writing, in the simulated Dividend Growth Newsletter portfolio for the foreseeable future.

Altria's Sprawling Business to Underperform Long-Term Bottom-Line Target in 2019

By Kris Rosemann

Altria's business has grown increasingly complex recently as it has levered up to add exposure to new growth opportunities. We don't find the convoluted company attractive, even after considering its lofty yield, and its core cigarette business continues to face material industry-wide volume declines.

We extinguished Altria (MO) from the simulated Dividend Growth Newsletter portfolio December 21 after assessing the announcement of its deal to acquire a 35% stake in US e-cigarette leader JUUL Labs. Here's our conclusion from the announcement of our decision, "Parting with Altria on News of Stake in JUUL:"

> We think Altria may have thrown in the towel on harvesting its core smoking demographic and may now be entering into a long rebuilding period, as it repositions for the future. This means that we could see even more value-destroying deals, which could further threaten dividend growth. Unfortunately, it looks like the time has come to part with one of the best performing stocks in history.

Following Altria's recent share price decline, shares now offer a lofty dividend yield of ~6.6%, but we're not looking to add back exposure to the company in the simulated Dividend Growth Newsletter portfolio any time soon.

The company has its hands in a number of businesses via economic interests in global beer giant AB InBev (BUD), Canadian marijuana company Cronos Group (CRON), and privately-held JUUL Labs, and its increasingly convoluted structure has only increased the haze surrounding the stock. The amount of regulatory uncertainty facing the group of businesses alone is reason for pause. Throw in a core cigarette business that is in secular decline -- volumetrically speaking at least as US cigarette volumes are estimated to decline by 4%-5% per year from 2019-2023 -- and we find ourselves comfortably sitting on the sidelines.

	2017	2018	2019 E
Secular Decline Rate*	-2.5%	-2.5%	
Additional Cross Category Movement (e-vapor & other)	-0.2%	-0.4%	
Total Secular Decline Rate	**-2.7%**	**-2.9%**	
Macroeconomic & Other Factors (including Gas Prices)	0.0%	-0.5%	
Cigarette Price Elasticity	-1.3%	-1.1%	
Estimated Industry Decline	**-4.0%**	**-4.5%**	**-3.5% to -5%**
For 2019 through 2023, our estimate for average annual U.S. cigarette industry volume declines is -4% to -5%.			

Image source: Altria fourth quarter presentation

Net revenues at Altria in the fourth quarter of 2018, results released January 31, were roughly flat on a year-over-year basis as higher pricing roughly offset volume declines in both smokeable and smokeless products. Total cigarette market share declined by 60 basis points over the full year 2018 to 50.1%, while smokeless product market share held steady at 54%. Adjusted operating companies income (OCI) margin in its 'Smokeable Products' segment (~87% of total fourth quarter revenue) contracted 10 basis points in the fourth quarter from the year-ago period as lower volumes, higher investments in strategic initiatives, and higher resolution costs were only partially offset by higher pricing and lower promotional investments. Adjusted diluted earnings per share in the period rose 4.4% on a year-over-year basis to $0.95 thanks in large part to a lower tax bill and lower share count.

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Management has yet to release its cash flow statement for the full year 2018, but it disclosed the significant increase in financial leverage as of the end of the year due to its active deal making in the year. The company ended 2018 with more than $25.7 billion in total debt and $1.3 billion in cash and cash equivalents, but it lists its investments in AB InBev and JUUL at $17.7 billion and $12.8 billion, respectively. Debt-to-consolidated EBITDA at the end of the year sat at 2.5x. Altria paid ~$5.4 billion in cash dividends in 2018, a figure it could have covered with free cash flow generation through only three quarters of the year, and it bought back nearly $1.7 billion of its shares at an average price of $60 each.

In 2019, Altria expects to deliver adjusted diluted earnings per share in a range of $4.15-$4.27, which represents growth of 4%-7% over 2018. This guidance takes into account higher interest expense related to its significantly higher debt load, savings from its cost reduction program (which is expected to hit annualized savings of $575 million in 2019), investments related to Philip Morris USA's plans for launching IQOS (assuming it is authorized by the FDA), and it assumes no earnings contributions from the Cronos or JUUL investments. Management maintains its long-term target dividend payout of 80% of adjusted diluted earnings per share, but its expectations for its bottom-line in 2019 come up short of its long-term target of 7%-9% annual growth in adjusted diluted earnings per share.

Our fair value estimate for Altria currently sits at $54 per share.

Consumer Staples Giants Fight Input Cost Inflation

By Kris Rosemann

Procter & Gamble and Kimberly-Clark reported calendar fourth quarter earnings January 23, and both were able to deliver organic sales growth in the period. Commodity cost inflation and currency weakness are key headwinds to keep an eye on moving forward as they have weighed on margin performance, particularly at Kimberly-Clark as Procter & Gamble reported impressive productivity cost savings.

Consumer staples giants Procter & Gamble (PG) and Kimberly-Clark (KMB) are working to offset the impact of input cost inflation with pricing power and cost saving and productivity initiatives. Currency headwinds have proved to be a material drag on reported sales growth of late, but both companies were able to deliver positive organic top-line growth in the calendar fourth quarter. Kimberly-Clark is expecting 2019 to remain a challenging, but potentially improving, operating environment, and Procter & Gamble will be impacted by many of the same factors. Relatively speaking, we like how Procter & Gamble has been able to navigate its fiscal 2019 (ends June 30) thus far, particularly in terms of operating margin thanks to notable productivity cost savings. We're not looking to add exposure to either company in either simulated newsletter portfolio.

Procter & Gamble Raises Fiscal 2019 Organic Sales Guidance

Procter & Gamble turned in another quarter of solid organic sales growth in its fiscal 2019 second quarter, results released January 23. Organic volume growth of 2%, positive mix impact of 1%, and pricing growth of 1% all combined to drive organic sales growth 4% higher on a year-over-year basis, but reported net sales came in roughly flat as a result of a 4% drag from unfavorable foreign exchange rates. Management noted that it has not seen a slowdown in China and is "fairly confident" on its prospects in the country in the back half of its fiscal year, and e-commerce sales growth in the 30% range helped drive organic sales growth in its fiscal second quarter.

Procter & Gamble's gross margin performance continues to be impacted by rising commodity costs, among other factors, as core gross margin on a currency-neutral basis contracted 20 basis points from the year-ago period. Productivity savings and pricing benefits were more than offset by commodity cost increases, innovation reinvestments, and unfavorable product mix on the gross margin line. Core operating margin

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on a currency-neutral basis expanded 80 basis points from the comparable period of fiscal 2018 thanks to material productivity cost savings, but the reported figure was impacted by negative foreign exchange rate impact (90 basis points) and non-core restructuring charges (10 basis points). Core earnings per share came in at $1.25 in the quarter, up 5% on a year-over-year basis, thanks in part to a lower tax rate.

Solid bottom-line performance at Procter & Gamble translated to the cash flow statement in the first half of fiscal 2019, as cash flow from operations advanced 3.5% on a year-over-year basis. Disciplined capital spending in the first six months of the fiscal year helped drive free cash flow generation to ~$5.8 billion, up nearly 7% from the year-ago period, and cash dividends paid in the period came in at $3.7 billion. At the end of its fiscal second quarter, the company held a net debt position of ~$21.5 billion ($33.6 billion in total debt versus $12.1 billion in cash), and this lofty debt load, which has grown in the first six months of fiscal 2019 as a result of acquisitions, has an impact on its Dividend Cushion ratio, though the ratio was relatively solid as of the end of fiscal 2018 at 1.8. Shares yield roughly 3% as of this writing.

Management raised the upper bound of its fiscal 2019 organic sales guidance by 1% following the second quarter to a range of 2%-4%, but foreign exchange rates are expected to provide a 3%-4% headwind with a modest impact to the reported sales figure coming from the net impact of acquisitions and divestitures. Procter & Gamble also reiterated its guidance of 3%-8% growth in core earnings per share in the year over $4.22 in fiscal 2018, and that growth target includes an estimated $1.4 billion headwind from currency and higher commodity and transportation costs. The company expects to exceed its target of 90% adjusted free cash flow productivity (ratio of free cash flow to net earnings).

While we credit Procter & Gamble for turning in solid organic sales growth as it returned to slight pricing growth, which was a key piece of is strategic rationale in its recent massive portfolio transformation, in its fiscal second quarter, we're not interested in highlighting shares in either simulated newsletter portfolio at this time. Potential headwinds not included in its explicit guidance ranges include significant deceleration of market growth rates, significant currency weakness, further commodity cost increases, and further political and economic volatility. Shares are trading near the upper bound of our fair value range.

Kimberly-Clark's Margins Contract; Expects Challenging but Improving Environment

Kimberly-Clark reported organic sales growth of 3% in the fourth quarter of 2018, results released January 23, as net selling prices advanced 3% from the year-ago period, and reported sales dropped 1% on a year-over-year basis as a result of the negative impact of foreign exchange rates. Adjusted operating profit, which excludes charges such as those related to the 2018 Global Restructuring program, dropped nearly 13% in the quarter from the year-ago period as higher net selling prices and cost savings were easily eclipsed by higher input costs. Foreign exchange rates and higher advertising spending also weighed on the operating line in the period, which ultimately resulted in a ~230 basis point contraction in adjusted operating margin, and GAAP earnings per share were shellacked by the aforementioned pressures and one-time charges.

Cash provided by operations in the full year 2018 at Kimberly-Clark advanced slightly to nearly $3 billion, which helped limit the decline in free cash flow in the year to ~2.4% as capital spending rose nearly 12% on a year-over-year basis. Free cash flow came in just under $2.1 billion in the year, which was more than sufficient in covering cash dividends paid of ~$1.4 billion. We like what we're seeing in terms of free cash flow coverage of dividends, but the company's net debt load of $6.9 billion (~$7.5 billion in total debt versus $539 million in cash) weighs on its Dividend Cushion ratio, which currently sits at parity, or 1. Shares yield ~3.6% as of this writing.

In 2019, Kimberly-Clark expects organic sales growth to continue to be driven by price increases with guidance coming in at 2% over 2018 thanks to 3%+ projected growth in net selling prices. Foreign exchange rates are anticipated to have a 3%-4% negative impact, and divestitures in conjunction with the 2018

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Global Restructuring Program will reduce reported sales slightly. Adjusted operating profit is expected to grow 1%-4% in 2019 as cost savings are expected to be at least partially offset by key input cost inflation, especially in international markets. Adjusted earnings per share guidance comes in a range of $6.50-$6.70 compared to $6.61 in 2018, and capital spending is expected to rise to $1.1-$1.3 billion from $877 million in 2018 due in part to significant spending related to the 2018 Global Restructuring Program, suggesting free cash flow may face pressure in the year.

In its fourth quarter report, Kimberly-Clark revealed its K-C Strategy 2022 plan. The plan's three growth pillars are to elevate core businesses, accelerate growth in developing and emerging markets, and drive digital marketing and e-commerce. The company will focus on improving margins and funding growth initiatives by improving supply chain productivity, executing its 2018 Global Restructuring Program, and closely controlling discretionary spending, and it expects annual capital spending to settle in a range of 4%-5% after the restructuring program is completed. Financial objectives associated with the K-C Strategy 2022 plan include 1%-3% sales and organic sales growth, mid-single-digit annual growth in adjusted earnings per share, which should be roughly followed by similar dividend growth, and the maintenance of adjusted return on capital at least at current levels.

We're not looking to add exposure to Kimberly-Clark as the company is likely to continue facing a challenging operating environment. Management projects improving margins, which isn't saying much after a poor showing in 2018, but headwinds from commodity costs and currency will persist. Shares are currently changing hands in the upper half of our fair value range, the midpoint of which sits at $102 per share.

Earnings Roundup: Big Name Dividend Payers

By Kris Rosemann

Let's take a quick look at the fourth quarter earnings reports of a few wide-ranging, big-name dividend payers, all of which are leaders in their respective industries.

Boeing Reports Record Fourth Quarter Results

Shares of aerospace giant and former simulated Dividend Growth Newsletter Portfolio idea Boeing (BA) rallied following its fourth quarter report, released January 30, as it turned in record fourth quarter marks for revenue, operating profit, and GAAP earnings per share. Revenue in the period advanced 14% on a year-over-year basis thanks to record commercial aerospace deliveries and higher defense and services volumes. Its 'Commercial Airplanes' segment led the way in terms of operating margin expansion, which grew 270 basis points from the year-ago period on a GAAP, consolidated basis, and earnings from operations leapt 40% from the fourth quarter of 2017. The company's total backlog sat at an incredible $490 billion at the end of 2018, up from ~$475 billion one year earlier and nearly five times its annual revenue in 2018.

Boeing continues to generate impressive levels of free cash flow, and cash flow from operations advanced roughly 15% in 2018 on a year-over-year basis, driving free cash flow higher by ~17% to $13.6 billion. Cash dividends paid in the year came in at just over $3.9 billion, and the company repurchased $9 billion of its own shares in 2018. Boeing's net debt position grew slightly in 2018 to nearly $5.3 billion (~$13.8 billion in total debt versus ~$8.6 billion in cash) due in part to the acquisition of aerospace parts and services provider KLX Aerospace Solutions, which is part of its strategy to enhance its position in the massive aerospace services market. At last check, the company had an impressive Dividend Cushion ratio of 2.2 thanks to its robust free cash flow generating capacity, and shares yield ~2.1% as of this writing.

Boeing's massive backlog of unfulfilled orders continues to help drive a solid outlook, and 2019 is no exception. It expects revenue in a range of $109.5-$111.5 billion (was $101 billion in 2018), core earnings per share in a range of $19.90-$20.10 (was $16.01 in 2018), and operating cash flow in a range of $17-$17.5 billion (was $15.3 billion in 2018). Our fair value estimate for Boeing currently sits at $330 per share, but the upper half of our fair value range, which tops out at $404 per share, may be more

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appropriate given this strong near-term guidance. Nevertheless, shares are pushing the $390 mark, and we're not particularly interested in adding exposure at these levels. The company appears to have put its recent margin concerns behind it, but we're still comfortable watching the aerospace giant from the sidelines.

McDonald's Comps Impress; Long-Term Targets Solid

McDonald's (MCD) turned in its fourteenth consecutive quarter of positive global comparable sales in its fourth quarter report January 30, and 2018 marked a second consecutive year of growth in its global guest count for the first time since 2012. In the fourth quarter, global comparable sales advanced 4.4% from the year-ago period with positive comps across all segments, but its franchising efforts led to consolidated revenues falling 3% from the year-ago period on an as-reported basis. Operating income declined 7% from the fourth quarter of 2017 due in large part to non-cash impairment charges, and diluted earnings per share came in at $1.82, more than double the measure in the year-ago period.

Cash flow from operations at McDonald's in the full year 2018 advanced an impressive ~25%, which helped free cash flow grow by 14%+ to $4.2 billion as capital spending rose materially in the year. Cash dividends paid in 2018 came in at nearly $3.3 billion, and the company repurchased ~$5.2 billion of its own shares. At the end of 2018, the company held $866 million in cash and equivalents and nearly $31.1 billion in long-term debt, and this debt load provides material pressure to its Dividend Cushion ratio, which sat at 0.4 at last check. Shares yield ~2.55% as of this writing.

Now that it has largely completed its franchising strategy, McDonald's is expecting annual systemwide sales of 3%-5% over the long haul, annual earnings per share growth rates in the high-single-digits, and return on invested capital in the mid-20% range. These are attractive targets but are roughly in-line with our mid-cycle assumptions that drive our fair value estimate of $145 per share for the company. We're not interested in shares of McDonald's due to its rich valuation -- shares are trading near the upper bound of our fair value range -- and we prefer companies with far less debt for long-term dividend growth considerations, even as we applaud management for some of its recent strategic moves in refreshing the image of the iconic American brand in the minds of investors.

AT&T's Top-Line Grows; Wireless Subscriber Additions Miss Estimates

Next-generation media giant AT&T (T) faced some selling pressure following its fourth quarter report, results released January 30, despite consolidated revenues advancing 15.2% on a year-over-year basis. The acquisition of Time Warner was partially offset by the impact of the new ASC 606 revenue recognition standard, and declines in its legacy wireline service, wireless equipment, domestic video, and Vrio (DirecTV in Latin America) were overcome by growth in domestic wireless services and Xandr (its new advertising platform) and the impact of WarnerMedia. Management noted solid growth in operating income thanks to the acquisition of Time Warner and the write-off of certain network assets in the comparable period of 2017, and its adjusted operating margin expanded to 19.6% from 15.1%. Adjusted earnings per share, which was altered for a number of asset sales and merger-related items, advanced to $0.86 in the fourth quarter of 2018 from $0.78 in the year-ago period.

AT&T's reputation as a tremendous free cash flow generator was solidified in 2018 as it turned in cash flow from operations of $43.6 billion, 15% higher than that of 2017, and free cash flow jumped nearly 36% to ~$22.4 billion. Cash dividends paid in the year came in at $13.4 billion, suggesting significant coverage of the dividend with internally generated cash flow, but its Dividend Cushion ratio is a paltry -0.2 at last check due to its massive debt load. Management remains focused on deleveraging, and it has lowered its net debt load to ~$171 billion as of the end of 2018 from $180 billion at the time of the closing of the Time Warner merger. Its net debt-to-adjusted EBITDA ratio sits at 2.8x, and shares yield ~6.9% as of this writing.

AT&T expects to continue its robust free cash flow generation in 2019, with guidance for the measure coming in at ~$26 billion for the year. Adjusted earnings per share growth is expected to be in the low-single-digits, which the company expects to result in a dividend payout ratio in the high-50% range. Capital spending is expected to continue growing in the year as well as it works to achieve its goals of winning in all facets of the next-generation media space, and management is targeting a net debt-to-adjusted EBITDA ratio of 2.5x at the end of 2019. Our fair value estimate for shares currently sits at $38 each.

Caterpillar Crushed by Expectations for No Growth in China

By Kris Rosemann

Concerns regarding macroeconomic uncertainty and the impact of the ongoing trade dispute between the US and China have dominated headlines of late, and these areas, as expressed through notable company outlooks, will remain in focus throughout this earnings season. Caterpillar's (CAT) fourth quarter report, released January 28, was no exception as its comment on the recent demand environment and forward-looking expectations were closely dissected. The market was significantly disappointed with what it found, particularly as it relates to the company's operating margin and what it expects to see in China (FXI), which accounts for 5%-10% of its annual sales and revenues in a given year.

Sales and revenues in Caterpillar's fourth quarter rose 11% on a year-over-year basis, with increases across all regions and all three major segments, and key drivers included higher demand for 'Resource Industries' machines, higher sales of construction equipment in North America, and higher demand for reciprocating engines, which support well servicing and gas compression applications, in North America. However, sales in the 'Construction Industries' segment in China declined from the year-ago period as a result of an unusual comparable segment in 2017.

Higher than expected material and freight costs weighed on Caterpillar's fourth quarter adjusted operating margin of ~13.8%, as did write-offs at Cat financial, and the measure came in below expectations and company performance in the first three quarters of the year. Steel prices, tariffs, and supply chain inefficiencies are weighing on margin performance despite higher sales volume and higher price realization working in its favor. Adjusted profit per share came in at $2.55 in the fourth quarter, an 18% increase over the year-ago period, but a significant shortfall compared to consensus expectations.

Free cash flow on a consolidated basis in the year was pressured by rising capital spending levels, which leapt ~25% from 2017 when including expenditures for equipment leased to others, but still came in at $3.6 billion in 2018, 8% higher than 2017. However, the company's non-financial operations (Machinery, Energy, & Transportation) turned in nearly 13% year-over-year growth in free cash flow generation in 2018, and the measure came in $5.1 billion, easily covering cash dividends paid in the year of $1.95 billion.

We like the free cash flow generating potential of Cat's non-financial operations, but as a result of its captive finance arm, we calculate two Dividend Cushion ratios for the company. Its adjusted Dividend Cushion ratio currently sits at 2.5 and reduces the impact financial services-related debt has on the ratio, and its unadjusted Dividend Cushion ratio currently sits at 1.07 and does not mitigate the impact of financial services-related debt. As of the end of 2018, Caterpillar held roughly $8 billion in total debt related to its non-financial operations, but it also held more than $28.5 billion in debt related to financial products. Cash and short-term investments sat just under $7.9 billion at the end of the year.

We're sticking with our fair value estimate for Caterpillar of $134 per share for the time being, though the lower half of our fair value range, which is where shares are currently changing hands, may be more appropriate given some of the caution emanating from management during its quarterly earnings call. Looking ahead to the rest of 2019, the company does see some pockets of strength, and it expects the year to bring a company record in terms of adjusted profit per share, as guidance came in a range of $11.75-$12.75.

In its 'Construction Industries' segment, it expects a healthy economy, pipeline construction, and local infrastructure funding to help drive demand in the US, but demand will likely remain slow in Latin America. The Europe, Africa, and Middle East (EAME) region is marked by political and economic

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uncertainty, and the Asia-Pacific region is being impacted by a lack of growth in China, which is a significant change from prior years. In 2018, construction industry demand in China was up 40% on a year-over-year basis after doubling in 2017, but management expects sales in 'Construction Industries' in China to be roughly flat in 2019.

As it relates to its 'Resource Industries' segment, Cat expects commodity prices to remain at levels to support investment, and mining companies are expected to increase capital spending budgets in 2019. Heavy construction demand in quarry and aggregate equipment are projected to remain strong in the year as well, but in its 'Energy and Transportation' segment, oil price volatility and transportation bottlenecks in the Permian are expected to weigh on demand for well servicing equipment in the early part of 2019. Gas compression and power generation equipment should continue to experience positive demand, and the US economy remains a positive for industrial engine demand, but some headwinds are expected in the EAME region.

Though the developments related to China do little to change our opinion of Caterpillar and the cyclical end markets it serves, market observers continue to piece together data points coming from quarterly reports similar to Cat's. Apple (AAPL) may have been the first to fire a warning shot, "Here It Comes… Apple's Shot Across the Bow," but others have followed suit. Chip-maker Nvidia (NVDA) released a gloomy outlook January 28 as well that included a citation of deteriorating macroeconomic conditions, particularly in China.

Caterpillar's outlook impacted shares of a number of industrial entities with exposure to the potentially slowing of construction activity and overall economic growth in China, but it continues to expect modest sales growth in 2019 thanks to its exposure to a diverse range of end markets and geographies. Nevertheless, the outlook is an important reminder of increasing levels of concern over the health of the global economic environment as geopolitical uncertainty persists for a notable part of the world, as evidenced by Cat's apprehensions over political and economic uncertainty in the EAME region, and growth in the world's second largest economy continues to slow. China recently lowered its target for 2019 GDP growth to a range of 6%-6.5%, and preliminary readings suggest the country's economy grew at ~6.6% in 2018, the lowest mark since 1990.

We're not making any changes to the simulated newsletter portfolios as a result of the tepid outlook from Caterpillar, but the developments are important to note as they relate to the formulation of a broader picture of the state of the end markets it serves.

Disappointing Department Store Updates

By Kris Rosemann

Company Name	Symbol	VBI	Fair Value Estimate	Low Fair Value	High Fair Value	Dividend Yield	Div Growth	Div Safety	Div Cushion
Dillard's	DDS	3	$74.00	$56.00	$93.00	0.6%	GOOD	EXCELLENT	9.4
J.C. Penney	JCP	6	$2.00	$0.00	$4.00	0.0%	-	-	-
Kohl's	KSS	3	$58.00	$44.00	$73.00	3.7%	VERY POOR	POOR	0.9
Macy's	M	3	$31.00	$21.00	$41.00	6.3%	VERY POOR	VERY POOR	0.2
Nordstrom	JWN	3	$48.00	$38.00	$58.00	3.3%	VERY POOR	POOR	1.2

Disappointing holiday sales reports have not been uncommon thus far in early 2019 with household names such as Macy's (M), Kohl's (KSS), and Nordstrom (JWN) all facing pressure as a result of holiday season reports coming in below prior expectations. JC Penney (JCP) was the beneficiary of clearing low expectations in its 2018 holiday update as comparable store sales continue to slide and the company remains focused on optimizing inventory and liquidity.

The group may benefit in the near term from the liquidation of Sears, but the once-prominent retailer's bankruptcy filing is a stark reminder of the necessity for traditional brick-and-mortar operators to innovate and evolve alongside changing consumer shopping habits. Unfortunately, this may very well mean higher levels of investments in omni-channel capabilities, and margin contraction may be an unavoidable reality for many, especially after considering recent upward cost trends in areas such as transportation of goods and labor.

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The rising tide of strength in consumer spending, which may very well face pressure in the near term as concerns over the US-China trade dispute, stock market volatility, the lapping of US tax reform, and political gridlock, has lifted the boats of traditional brick-and-mortar retailers relative to the pain felt across the space in recent years, but the threat of e-commerce has never been higher. Online holiday sales advanced 16.5% in 2018 over 2017, according to Adobe Analytics, while overall sales for the 2018 US holiday shopping season up roughly 5.1% according to a report from Mastercard.

Nordstrom's 1.3% year-over-year comparable sales growth rate in the nine-week period ending January 5, results released January 15, was a disappointment relative to its expectation for ~2% growth over the full fiscal year 2018, and Full-Price comparable sales performance was the key area of disappointment. The measure came in at 0.3%, which pales in comparison to its 1.9% growth rate through three quarters in fiscal 2018 and was largely due to soft traffic. Off-Price comparable sales growth came in at 3.9% in the nine-week holiday season, a level consistent with year-to-date trends and company expectations, and digital sales in the holiday season leapt 18% from the year-ago period and accounted for 36% of total sales.

Management adjusted its full year fiscal 2018 guidance to account for higher markdowns taken during the holiday season and expectations to reposition inventory by the end of the fiscal year. Gross margin has faced pressure more recently due to the higher mix of off-price sales, and the company now expects earnings per diluted share to be around the low end of its prior guidance of $3.27-$3.37. Our fair value estimate for Nordstrom currently sits at $48 per share, and its Dividend Cushion ratio is 1.2, highlighting the long-term challenges its business is facing. Shares currently yield ~3.3% as of this writing.

Kohl's reported comparable sales growth of 1.2% for the nine-week 2018 holiday season that ends January 5, results released January 10, but the figure was a material disappointment relative to the 6.9% comparable sales growth reported in the comparable year-ago period despite consumer confidence remaining strong. Nevertheless, management points to positive transaction growth and double-digit digital sales growth as reasons for optimism moving forward.

Kohl's now expects fiscal 2018 diluted earnings per share to be in a range of $5.50-$5.55 compared to prior guidance of $5.35-$5.55, excluding charges related to debt extinguishment and other non-recurring chares related to voluntary debt redemption. Our fair value estimate for shares of Kohl's is $58 each, and its Dividend Cushion ratio is just below parity at 0.9. Shares yield ~3.7% as of this writing.

Macy's may have turned in the most disappointing holiday sales update of the major department stores January 10 as comparable sales on an owned plus licensed basis advanced 1.1%, which marked its second consecutive year of positive holiday season comparable sales growth. Double-digit growth in its digital business was a bright spot for the company, but it noted that early strength in the holiday season centered around Black Friday and Cyber Monday waned in mid-December and did not return to management's anticipated patterns until the week of Christmas. We're watching the promotional environment, which had appeared to wane to a degree alongside strength in consumer confidence more recently, surrounding Macy's and its peers closely.

Macy's adjusted a number of guidance measures for its fiscal year 2018, including net sales now projected to be roughly flat compared to fiscal 2017 levels (was up 0.3%-0.7%), and comparable sales growth on an owned plus licensed basis is now expected to be ~2% compared to prior expectations for 2.3%-2.5% growth. Diluted earnings per share excluding one-time events guidance now comes in a range of $3.95-$4.00, down from previous guidance of $4.10-$4.30. We've lowered our fair value estimate for shares to $31 each, and the company's Dividend Cushion ratio leaves a lot to be desired at 0.2. If the company continues to face material margin pressures in addition to muted top-line growth, the bottom end of our fair value range may be a more appropriate estimation of its intrinsic value. Shares yield ~6.3% as of this writing, and the outsize yield is indicative of mounting long-term risks facing the company.

All things considered, we're not interested in adding exposure to the department store space, even if consumer confidence does not face any form of pressure moving forward. The proliferation of e-commerce is only beginning, and we're not comfortable looking to any of the industry participants for income generation given the uncertainty facing spending levels amid muted top-line growth prospects.

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

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

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

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

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

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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

Valuentum Dividend Growth Newsletter: Volume 8, Issue 2

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

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

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

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

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

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

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

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

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

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