Valuentum Securities

Stock Analysis: From Value through Momentum Investing

OUR BEST IDEAS NEWSLETTER

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Goal of the Best Ideas Newsletter

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

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Inside This Issue

This Chart Changes Everything Quant

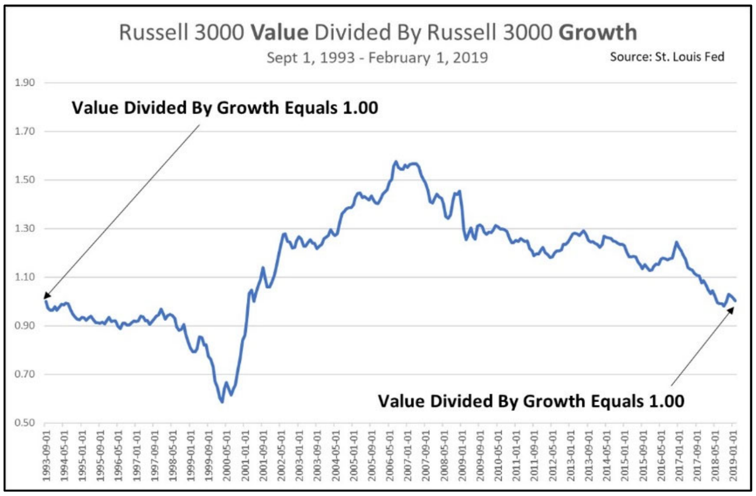

Image Shown: Russell 3000 Value Divided by Russell 3000 Growth since September 1993, roughly one year after the publishing of the influential three-factor model.

By Brian Nelson, CFA

Recently, I wrote up my views on whether quant value is giving value investing a bad name. The chart above changes everything quant. The chart is not so much about value and growth as it is about highlighting the hazards of extrapolating anything quantitative finance into the future.

For those that don't know why this chart is important, let me provide some background. The entire field of factor investing has been built on the idea that ambiguous and sometimes impractical metrics and data can be used to carve out risk-adjusted premia to exploit so-called market "anomalies."

Let's talk value. Though I believe the ongoing arbitrage of price-to-fair value assessments can be continuously arbitraged with a momentum overlay, I don't believe at all that the quant value metric makes much sense, it being based on price-observed multiples, as in the book-to-market (B/M) ratio in most academic literature.

> "Has the conversation already been lost as soon as we mention "value" or "growth?" Isn't the right conversation price versus estimated intrinsic value?"
>
> – Brian Nelson, CFA

A version of this article was emailed out on April 11.

*This Chart Changes Everything...*continued on next page

*This Chart Changes Everything…*from previous page

The chart on the previous page shows that since roughly the inception of the three-factor model (early 1990s)--a model that considers a market factor, a value factor in the book-to-market ratio, and a size factor--that how many are measuring value just isn't stacking up. The Capital Asset Pricing Model (CAPM) has already been shown to be ineffective, and the size factor has been shown to be sporadic with many suggesting there really isn't a size factor, and now the traditional quant value factor, as measured by book-to-market looks to largely be failing.

The problem at hand with today's quantitative finance is rather easy to get energized about. Here goes my "What Are We to Believe" Speech?

What Are We to Believe?

Are we to believe that not only can finance divide stocks between "growth" and "value," but that it can do so using ambiguous and impractical metrics and multiples such as book-to-market (B/M)?

Are we to believe that what we have witnessed since the "discovery" of the traditional quant value factor in the early 1990s hasn't been random? The image above may very well be the authentic walk-forward statistical assessment of significance, which excludes its pre-selected backtest.

What is randomness if it does not include significant stretches of underperformance and significant stretches of outperformance only to come back to original value as in the chart above? What are we to believe?

Are we to believe after the failures of the CAPM, of the traditional quant value factor, of the size factor that yet adding more and more ambiguous and impractical factors will somehow "fix" the issue?

Or, is there something else that's going on? Perhaps there are not "growth" and "value" stocks. **Perhaps Warren Buffett was on to something when he said: "Growth is always a component of value [and] the very term "value investing" is redundant."**

Are we to believe that somehow the same stocks are both "growth" and "value," as they are in the Russell 3000 indices? See images below.

Top 10 performers	1 month return %	Ticker
Sorrento Therapeutics	134.0	SRNE
Catalyst Pharmaceuticals	75.3	CPRX
Tricida Inc	67.0	TCDA
Dermira Inc	62.3	DERM
Key Energy Services Inc	58.6	KEG
Avid Technology Inc	56.8	AVID
Nextdecade	54.2	NEXT
Zion Oil & Gas Inc	53.1	ZN
Aveo Pharmaceuticals Inc	52.0	AVEO
Arqule Inc	46.5	ARQL

Top 10 performers	1 month return %	Ticker
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Zion Oil & Gas Inc	53.1	ZN
Aveo Pharmaceuticals Inc	52.0	AVEO
Arqule Inc	46.5	ARQL

Images Shown: Top performers of Russell 3000 Growth and Russell 3000 Value last month, respectively.

*This Chart Changes Everything…*continued on next page

*This Chart Changes Everything…*from previous page

Are we to believe that some of the most undervalued stocks on the market today are better classified as "growth" stocks than "value" stocks, as the Russell 3000 index implies? What are we to believe? See image below.

Top 10 holdings
Apple Inc
Microsoft Corp
Amazon Com Inc
Facebook Inc
Alphabet Inc Cl C
Alphabet Inc Cl A
Visa Inc
Unitedhealth Group Inc
Home Depot Inc
Mastercard Inc

Image Shown: Top 10 holdings in the Russell 3000 Growth.

Has the conversation already been lost as soon as we mention "value" or "growth?" Isn't the right conversation price versus estimated intrinsic value? **What are WE to believe?**

Even if the traditional quant value factor recovers, there is no reason to believe that it is still not randomness. Book equity does not pass muster as an adequate value-oriented metric among operating entities.

Isn't a bet on impractical and ambiguous data and multiples backed by historical backtests that have not stood the rigors of walk-forward performance more like gambling than investing? What do YOU believe?

I know what I believe. I've built an entire company on what I believe to be the right way to perform stock analysis. There may be nothing more to say.

Facebook's Huge New Opportunity in Instagram Checkout, Reiterating Fair Value Estimate ~$230

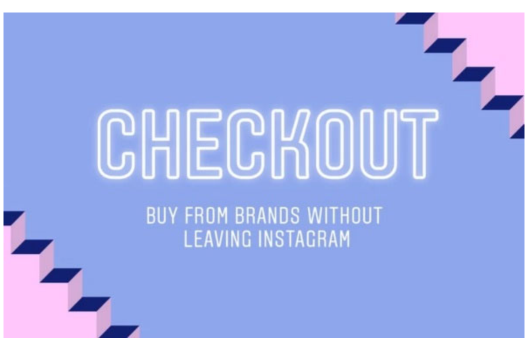

Image Source: Facebook's Instagram

A version of this article was emailed to members April 3

Facebook has bounced all the way back to ~$180 per share. We continue to expect new highs!

We continue to like Facebook, and we're huge fans of Instagram Checkout. Many may not know it yet, but Instagram Checkout may mark the beginning of retailers' websites becoming obsolete. The sell-off last summer in Facebook was a big gift for those that stuck with our thesis.

By Brian Nelson, CFA

*Facebook's Huge…*continued on next page

***Facebook's Huge…*from previous page**

I think one of the things that financial advisors and financial planners do extremely well is explain the concept of patience to their clients. Can you imagine if a client cashed out upon every 15%-20% decline? That'd be a recipe for continuous disaster.

On the path to the market setting broader market highs in 2018, there have been many disappointments along the way. There have been flat-out crises, too, not the least of which was the one 10 years ago that shook the markets to their core. Did you know that the S&P 500 (SPY) hit a closing low of 676.53 on March 9, 2009?

The S&P 500, today, is trading at 2,800+. Markets are going to be volatile, but enterprise valuation acts as the magnet to share prices over time. Price-to-fair value convergence doesn't happen overnight either. From our experience, it sometimes takes as long as a few years, if not longer.

I wrote this piece in order to express my continued excitement over Facebook (FB). I know – it's a name that gets terrible press. But regardless of one's opinion, stock values are based on a company's net cash position on the balance sheet and their future expected free cash flows discounted back to today. For Facebook, these two items offer considerable support to our estimate of its intrinsic value.

Recent news regarding Instagram's Checkout feature further buttresses our fair value estimate for shares. I think Facebook's Instagram may have changed the face of online retail forever, and lots of companies have already signed up for Checkout. This is exactly the path that we thought Facebook would pursue, on the trajectory of becoming what could be the "new Internet." **Most are myopically focusing on Facebook's PR troubles of today, but the long-term looks incredibly bright at Facebook.** Here's how Checkout works:

> *…(Facebook is) introducing checkout on Instagram. When you find a product you love, you can now buy it without leaving the app.*
>
> *When you tap to view a product from a brand's shopping post, you'll see a "Checkout on Instagram" button on the product page. Tap it to select from various options such as size or color, then you'll proceed to payment without leaving Instagram. You'll only need to enter your name, email, billing information and shipping address the first time you check out.*
>
> *Once your first order is complete, your information will be securely saved for convenience the next time you shop. You'll also receive notifications about shipment and delivery right inside Instagram, so you can keep track of your purchase.*

Some are saying the Instagram Checkout feature alone can bring in $10 billion in incremental expected revenue by 2021. That might even be conservative when it comes to what Facebook could do to make online retail even easier by that time. If shoppers don't have to leave social media websites to buy, are retailer's website's now on the path to obsolescence? Instagram's Checkout may mark the beginning of a huge migration to online shoppers buying on social media sites, and frankly, Facebook/Instagram is best positioned to capitalize.

Love or hate Facebook (the company), it may not matter. Even with all the negative PR and regulatory overhang, during the fourth quarter, the company still grew faster on the top line (+32%) than Amazon (AMZN), Netflix (NFLX), and Twitter (TWTR), some of the fastest-growing tech names out there. Facebook is a free-cash-flow cow, too, and its balance sheet is pristine, overflowing with net cash. Facebook had some missteps last summer relative to expectations as it tweaked its cost structure, but **I think investors may be in store for new highs yet again.**

Three Upstream Companies Contend with the Shale Treadmill

Image Source: Marathon Oil Corporation – Fourth quarter 2018 IR presentation

Global oil prices are climbing back up again and that got us thinking about three of the biggest independent upstream players in America's shale patch.

By Callum Turcan

Global oil prices are rising and that has gotten us thinking about upstream players EOG Resources Inc (EOG), Noble Energy Inc (NBL), and Marathon Oil Corporation (MRO). All three of these companies possess domestic and international producing operations, with unconventional upstream opportunities in America providing a key growth generator as market conditions allow. Stronger realizations will lead to improving financial performance on a sequential basis, but ultimately, valuations are based on price expectations over decades not quarters. This generally makes valuing upstream firms on P/E ratio basis an erroneous decision as the historical performance isn't indicative of future potential, as that is largely a function of capricious oil markets. For that reason, we prefer our discounted cash flow analysis instead.

EOG Resources

Sometimes referred to as the Amazon Inc (AMZN) of the shale world, EOG Resources is active in several of the top plays in America. With operations in the Permian Basin, the Eagle Ford, and elsewhere, EOG Resources is well positioned to capitalized on any domestic liquids upside to be had through hydraulic fracturing and horizontal drilling (colloquially known as fracking). EOG Resources also has a sizable presence in Trinidad & Tobago and a minor footprint in China, where the firm is targeting resources that are heavily-weighted towards natural gas.

As of this writing, EOG Resources is trading right at the middle of its range of expected values and yields just 0.9%, as most of the company's net operating cash flow is directed towards capital expenditures. Shale is often described as a treadmill, where rising production can only be maintained through ever increasing capital expenditure budgets (to fund increased drilling and most importantly completion activity). The second you stop drilling and fracking those wells, company-wide production levels move precipitously lower due to sharp annual decline rates (50 – 80% depending on what play the well is developing, the geology of the formation being targeted, the water cut of that particular well's production, and other things like oil well choke management).

Three Upstream...continued on next page

*Three Upstream…*from previous page

Here is an example of this treadmill in action. When oil prices were subdued in 2016, EOG Resources spent $2.6 billion on capital expenditures (combining 'Additions to Oil and Gas Properties' and 'Additions to Other Property, Plant and Equipment') while generating just $2.4 billion in net operating cash flow. A year later when prices were significantly higher, EOG Resources generated $4.3 billion in net operating cash flow but spent $4.1 billion on capital expenditures, leaving little room for free cash flow. The company had to invest more in the business otherwise its production base would have dropped off a cliff.

Come 2018, when oil prices were (relatively speaking) quite dear, EOG Resources generated $7.8 billion in net operating cash flow versus $6.1 billion in capital expenditures. That's when management could finally point towards the shale business model as being economically viable. From 2016 to 2018, EOG Resources' total dividend payments were roughly $0.4 billion each year, meaning those payouts were fully covered for the first time in a while last year. EOG Resources plans to continue increasing its capital expenditures this year, bringing targeted spending up to $6.1 – 6.5 billion. Most of EOG Resources' 2019E investments are slated to go towards its Eagle Ford, Delaware Basin (within the Permian Basin), and 'Rocky Mountain area' (Powder River Basin and DJ Basin) divisions, which at the midpoint of guidance would generate 14% annual oil production growth from its domestic operations.

EOG Resources' management team is very shareholder friendly and has tried to reward shareholders the best they could, namely through dividend increases and by attempting to live within internal cash flow generation. In 2017 and 2018 combined, the company spent almost $1.0 billion retiring debt, which we are very supportive of but note EOG Resources still sported a $4.5 billion net debt position at the end of last year. While EOG Resources is considered one of the best in the business, the firm is always at the mercy of the shale treadmill. The company's Dividend Cushion Ratio of 2.3x indicates its modest yield is likely safe going forward, but any prolonged downturn in oil prices will put tremendous pressure on EOG Resources' financials.

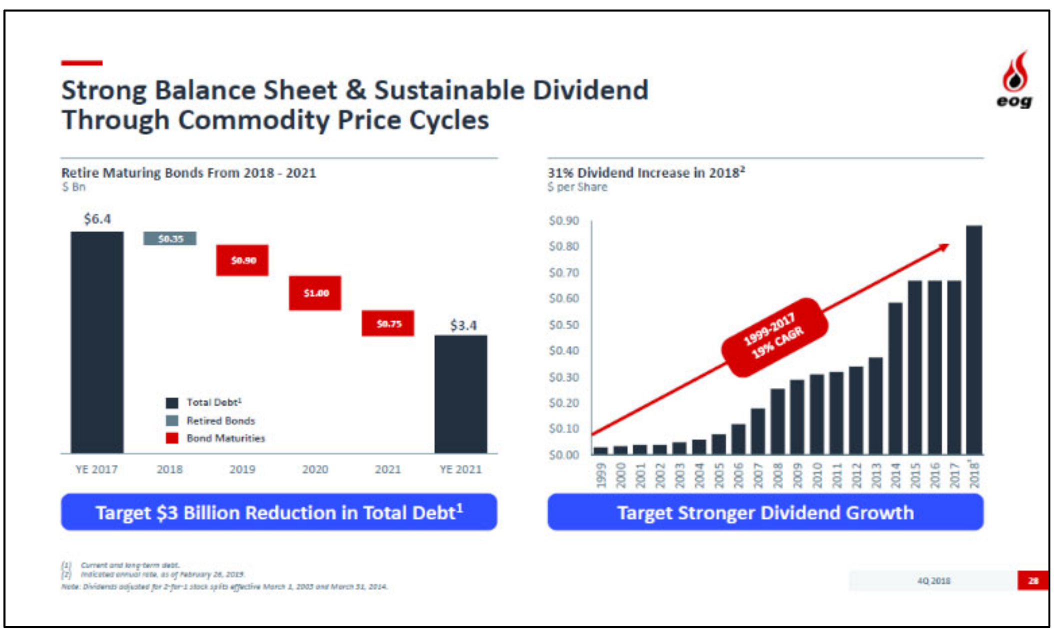

Image Shown: EOG Resources has posted strong dividend growth over the years, albeit off of a very low base, and plans to continue retiring debt going forward. Image Source: EOG Resources – Fourth quarter 2018 IR presentation

*Three Upstream…*continued on next page

*Three Upstream…*from previous page

Noble Energy

One key thing that makes Noble Energy stand out from its peers is its huge presence in Israel's offshore upstream industry, with an eye on the massive Tamar and Leviathan natural gas fields in the Mediterranean Sea. Gross natural gas production from the producing Tamar field is close to 1 billion cubic feet per day, and when the Leviathan field comes online at the end of this year or beginning of next year, that should continue marching higher. Beyond its offshore Israeli position, Noble Energy operates in the DJ Basin, the Permian Basin, the Eagle Ford, and has a material presence in Equatorial Guinea's hydrocarbon industry.

As of this writing, the company is trading modestly below the midpoint of our range of potential values and yields 1.8%. Keep in mind that yield isn't well protected and that Noble Energy sports a -2.9x Dividend Cushion Ratio. In the event of a prolonged downturn in global raw energy resource prices, namely oil, Noble Energy's quarterly dividend may prove not to be resilient. In the past, management was forced to cut Noble Energy's payout (which occurred in early-2016) in order to pare down spending levels.

Like EOG Resources, Noble Energy has had to contend with the shale treadmill, a situation made harder due to its big international investments (particularly, those in Israel). In 2016, the company generated $1.4 billion in net operating cash flow versus $1.5 billion in capital expenditures. By 2017, Noble Energy's net operating cash flow had perked up to $2.0 billion, but $2.6 billion in capital expenditures made positive free cash flow unobtainable. Last year, Noble Energy posted $2.3 billion in net operating cash flow, which fell way short of $3.3 billion in capital expenditures. The company spent roughly $0.2 billion on its annual dividend payments over this period, which clearly wasn't covered by free cash flow.

Noble Energy plans on spending $2.4 -2.6 billion on capital expenditures this year, which is projected to fall down to $2.0 -2.2 billion in 2020E. While that will free up capital for other uses at a time when, in theory, Noble Energy's net production should be climbing (management expects 5% company-wide production growth this year), keep in mind that any prolonged downturn in raw energy resource prices would have a severely negative impact on its financials. At the end of 2018, Noble Energy had a consolidated net debt position of $5.9 billion, keeping in mind the firm has a large economic stake in its midstream MLP spin-off Noble Midstream Partners LP (NBLX).

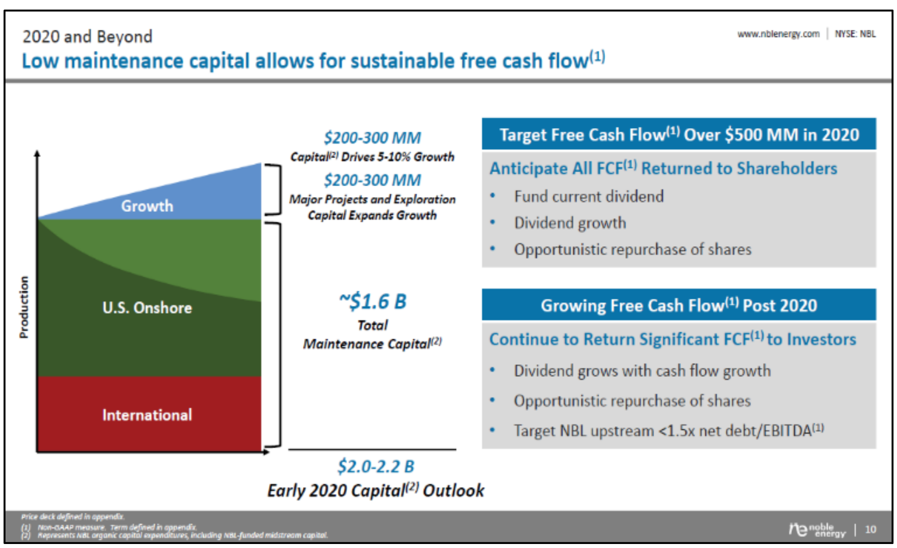

Image Shown: Noble Energy is targeting positive free cash flow generation in 2020. Image Source: Noble Energy – Fourth quarter 2018 IR presentation

*Three Upstream…*continued on page 9

Valuentum's Best Ideas Portfolio

By Valuentum Analysts

Valuentum's BEST IDEAS -- as of April 15, 2019

Portfolio Holdings	Symbol	Div Yield %	Fair Value	Economic Castle	VBI Rating	P/FV	Last Close	% of Portfolio
Berkshire Hathaway	BRK-B	0.00%	$229.00	NA	5	0.92	209.74	7%-12%
Facebook	FB	0.00%	$228.00	Very Attractive	10	0.79	179.65	7%-12%
Alphabet - Class C	GOOG	0.00%	$1524.00	Very Attractive	7	0.80	1221.10	7%-12%
Visa	V	0.66%	$153.00	Attractive	7	1.05	160.44	7%-12%
Apple Corp.	AAPL	1.50%	$218.00	Highest Rated	6	0.91	199.23	5.5%-7%
SPDR S&P Dividend ETF	SDY	2.44%	NA	NA	UR	NMF	101.10	5.5%-7%
Energy Select SPDR	XLE	3.13%	NA	NA	UR	NMF	67.16	5.5%-7%
Health Care ETF	XLV	1.53%	NA	NA	UR	NMF	90.17	5.5%-7%
Cisco	CSCO	2.53%	$56.00	Very Attractive	5	1.01	56.56	4%-5.5%
Intel	INTC	2.32%	$56.00	Attractive	6	1.01	56.28	4%-5.5%
Johnson & Johnson	JNJ	2.61%	$147.00	Attractive	7	0.93	136.52	4%-5.5%
Booking Holdings	BKNG	0.00%	$2133.00	Highest Rated	4	0.87	1846.23	2.5%-4%
Chipotle	CMG	0.00%	$469.00	Very Attractive	6	1.52	712.27	2.5%-4%
Dollar General	DG	1.01%	$106.00	Attractive	3	1.17	123.85	2.5%-4%
Financial Select SPDR ETF	XLF	2.05%	NA	NA	UR	NMF	26.97	2.5%-4%
General Motors	GM	4.02%	$51.00	Attractive	7	0.78	39.57	2.5%-4%
PayPal	PYPL	0.00%	$116.00	Attractive	6	0.93	108.14	2.5%-4%
Verint Systems	VRNT	0.00%	$60.00	Very Attractive	6	1.03	61.83	2.5%-4%
Cash consideration	-	-	-	-	-	-	-	0.0%

UR = Under Review
This portfolio is not a real money portfolio. Data as of April 15, 2019.

We've taken the cash weighting in the Best Ideas Newsletter 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.

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

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

Every person has different goals and different risk tolerances, so where before in the 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.

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

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

*Three Upstream...*from page 7

Marathon Oil

The last upstream firm we are going to look at is Marathon Oil, which used to be a part of a larger integrated oil company before the upstream and downstream businesses were split back in 2011. Marathon Petroleum Corporation (MPC), the downstream player, has vastly outperformed Marathon Oil since then. As of this writing, Marathon Oil trades near our midpoint of its range of expected values and yields 1.2%.

Marathon Oil operates in many of the same unconventional plays as EOG Resources and Noble Energy including; the Bakken, the STACK/SCOOP in the Anadarko Basin, the Eagle Ford, the Permian Basin, and even the emerging Louisiana Austin Chalk play (where EOG is also active). Internationally, Marathon Oil has a significant presence in Equatorial Guinea, just like Noble Energy. Another similarity between Marathon Oil and Noble Energy is that Marathon Oil cut its dividend in late-2015 to reduce its cash flow outlays during the nadir of the prolonged crude oil pricing downturn since late-2014.

In 2016, Marathon Oil generated $0.9 billion in net operating cash flow versus $1.2 billion in capital expenditures. As you can see, there is a common theme here and that is 2016 was a terrible time to be an upstream producer with a liquids-rich production base. However, Marathon Oil was fortunate to close the gap in 2017, with $2.0 billion in net operating cash flow covering $2.0 billion in capital expenditures. The company's $0.2 billion in annual dividend payments were covered with cash on hand, a product of divestment proceeds. Marathon Oil's total dividend payouts stood at that level from 2016 to 2018.

By 2018, Marathon Oil was generating $3.2 billion in net operating cash flow, which outpaced $2.8 billion in capital expenditures. That left enough room to generate free cash flow to cover its dividend payments. Marathon Oil has an ongoing share repurchase program which consumed $0.7 billion of its cash pile last year. As Marathon Oil exited 2018 with a net debt position of $4.0 billion, the company arguably should have allocated those proceeds towards further debt reduction activities after allocating a lot of capital to debt reduction in 2017 ($1.8 billion on a net basis when including borrowings and repayments). Management plans on allocating $2.4 billion towards Marathon Oil's capital expenditures this year, down from 2018 levels, which is expected to generate 10% company-wide oil production growth on an annual basis.

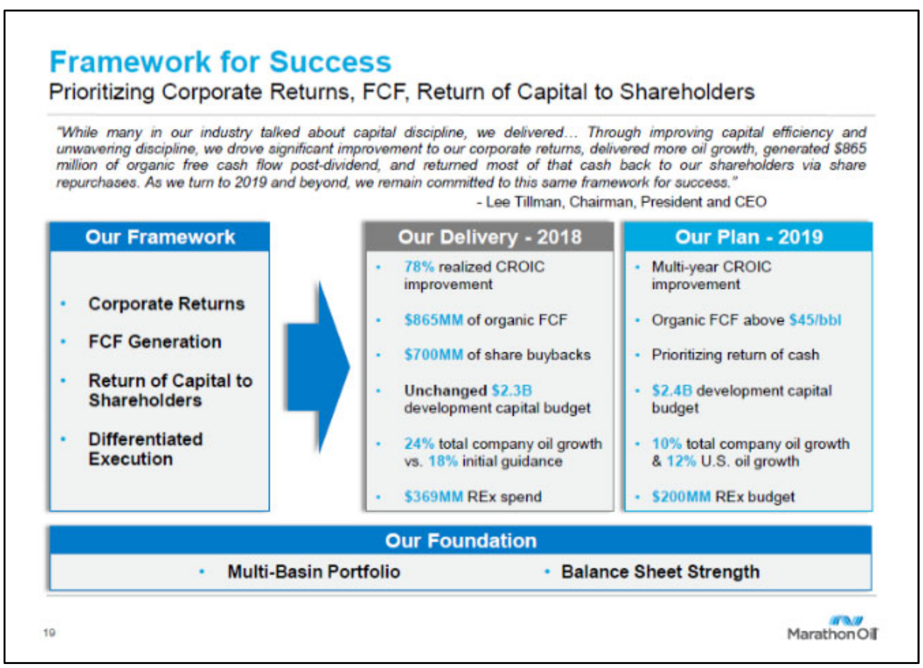

Image Shown: Marathon Oil's battleplan for 2019. Image Source: Marathon Oil – Fourth quarter 2018 IR presentation

*Three Upstream...*continued on next page

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Concluding thoughts

While all three of the firms we covered today have promising growth prospects, those opportunities are only economical in a world where oil prices cooperate. All three of these firms sport sizable net debt loads, have been quite free cash flow negative in recent past, and have inconsistent net operating cash flow streams due to fluctuations in global oil prices. Generally speaking, all three firms are quality upstream operators and trade near the midpoint of their range of potential values, but there is still a lot that needs to be done before we would ever become interested in EOG Resources, Noble Energy, and Marathon Oil.

Disclosure: The author of this piece, Callum Turcan, does not own any of the companies mentioned in the article above.

Lyft Takes a Fall, S-1 Reads Like Business School Homework

Consolidated Statement of Operations Data

	Year Ended December 31, 2016	2017	2018
	(in thousands, except for per share amounts)		
Revenue	$ 343,298	$1,059,881	$2,156,616
Costs and expenses(1)			
Cost of revenue	279,011	659,533	1,243,400
Operations and support	97,880	183,513	338,402
Research and development	64,704	136,646	300,836
Sales and marketing	434,344	567,015	803,751
General and administrative	159,962	221,446	447,938
Total costs and expenses	1,035,901	1,768,153	3,134,327
Loss from operations	(692,603)	(708,272)	(977,711)
Interest income, net	6,964	20,243	66,462
Other income, net	3,246	284	652
Loss before income taxes	(682,393)	(687,745)	(910,597)
Provision for income taxes	401	556	738
Net loss	$ (682,794)	$ (688,301)	$ (911,335)
Net loss per share attributable to common stockholders, basic and diluted(2)	$ (37.08)	$ (35.53)	$ (43.04)
Weighted-average number of shares outstanding used to compute net loss per share attributable to common stockholders, basic and diluted(2)	18,413	19,371	21,176

Image Source: Lyft's S-1

Reminiscences of the dot-com boom came back to the markets with the over-hyped initial public offering of Lyft, a stock that continues to get shellacked as its first days as a publicly-traded enterprise. Those that know Valuentum know that we wouldn't touch such investments with a 10-foot pole. The company lost $43 per share in 2018.

By Brian Nelson, CFA

Call me old school, but I'm surprised as to the widely-accepted nature of the business models of Lyft (LYFT) and Uber, and other ridesharing services. For those that don't know Lyft, the company maintains "peer-to-peer marketplace for on-demand ridesharing," and thus far has "facilitated over one billion rides," according to its S-1 filing. It generates almost all its revenue from service fees and commissions from drivers for their use of its ridesharing marketplace.

*Lyft Takes a Fall…*continued on next page

*Lyft Takes a Fall…*from previous page

If you turn on the evening news, you'll understand why I remain skeptical. Do you really know the person that is in the driver's seat? Are people "hitchhiking with strangers?" There may be benefits to ridesharing, including lower vehicular fatalities and arrest rates for certain offenses (e.g. DUIs), but don't we learn as children not to get into cars with strangers? What gives, right?

Well, the reality is that ridesharing is booming, and I must admit that I am neither a user of Lyft or Uber, nor do I think I ever will be. Nonetheless, Lyft raked in $8.1 billion in bookings in 2018 and generated $2.2 billion in revenue for the year, as it has operations in 300+ markets in the US and Canada, all while striving to achieve its mission: Improve people's lives with the world's best transportation.

Lyft believes that "the world is at the beginning of a shift away from car ownership to Transportation-as-a-Service." Though it's hard to argue with the traction ridesharing platforms have achieved thus far, car ownership is simply not going away. Nobody wants to wait in the rain to catch a cab, let alone a Lyft or Uber. Have you ever gone on a road trip, and just wished you had your car with you? Ironically, Lyft needs others to own cars for its business to work, too.

Regardless, the company's business is firing on all cylinders:

> (Lyft's) U.S. ridesharing market share was 39% in December 2018, up from 22% in December 2016… Our revenue was $343.3 million, $1.1 billion and $2.2 billion in 2016, 2017 and 2018, respectively, representing year-over-year growth of 209% from 2016 to 2017 and 103% from 2017 to 2018. We generated Bookings of $1.9 billion, $4.6 billion and $8.1 billion in 2016, 2017 and 2018, respectively, representing year-over-year growth of 141% from 2016 to 2017 and 76% from 2017 to 2018.

That said, here's where the rubber hits the road. Not only would I not consider taking a Lyft or Uber (for my own safety), but the company is far from profitable. Lyft lost approximately $680-$690 million in each of 2016 and 2017, and losses were over $910 million in 2018. The company's S-1 reads like business school homework. Tell us less about what you think people may prefer and show us the path to substantial and sustainable profitability. We just don't see it happening on sufficient scale. *People still want cars.* I know I do. **The company lost $43 per share in 2018.**

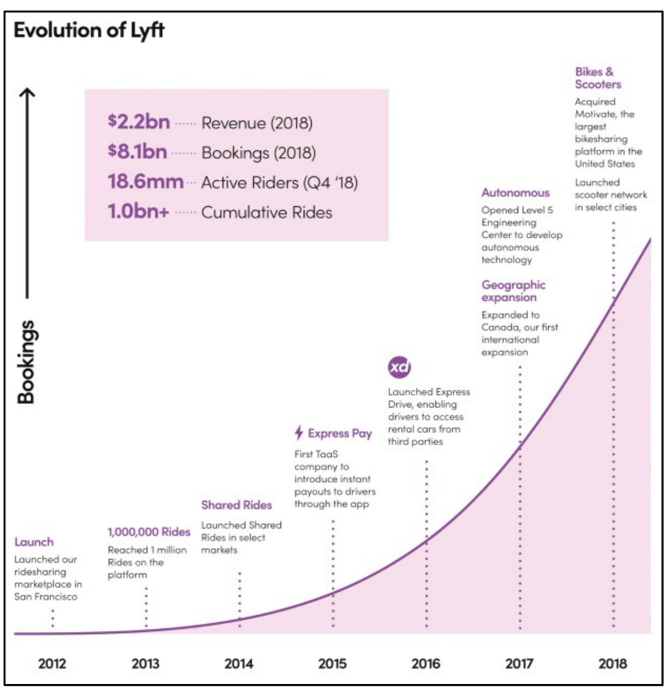

Image Source: Lyft's S-1

*Lyft Takes a Fall…*continued on next page

*Lyft Takes a Fall…*from previous page

The bottom line is profits, and more specifically free cash flow. We have no qualms with the underlying metrics of Lyft, including active riders, revenue per active rider, and rides, all of which have expanded nicely in recent years, but the company's business model is not scaling as we would like. As revenue expands, losses should be getting smaller, not larger as they have. Even if you take out all its Sales & Marketing expenses, it still would have lost money in each of the past three years. Net cash flow from operations has also been negative in each of the past three years, albeit improving. There are some serious risks inherent to business model execution, particularly as other rivals inevitably try to enter the ridesharing space in the coming years.

I'm also very skeptical of Lyft's proposed market opportunity. The company notes that transportation is the second-largest household expense after housing and roughly double that of healthcare, and consumer spending on transportation reached $1.2 trillion in 2017 in the US alone. Here's the deal, however: I doubt that many will ever consider getting into a Lyft or an Uber. Lyft may operate in more of a niche segment than represent a disruption in transportation, and the company is already fending for share against Uber, Gett (Juno) and Via.

What would get us interested in Lyft? Well, first of all, we need some tangible numbers to better estimate its intrinsic value. At this point in its corporate lifecycle, the range of potential fair value estimate outcomes is just too large. That means that Lyft is merely a speculative play on ridesharing, and its financials aren't living up to the hype. Lyft's business model does not appear to be as highly-profitable as one that should be very asset light. Something is not lining up, even after backing out Sales & Marketing expenses. It's too cost-heavy.

We fully expect Lyft to continue to grow its top line at a rapid pace in the coming years, but that doesn't mean it will be a successful stock over the long haul. Because the company doesn't have any real profits or free cash flow, the market's only way to analyze the company will be on the growth of underlying metrics (e.g. active riders, revenue per active rider, rides, etc.), the pace of which will fluctuate wildly against expectations, in our view. Perhaps obvious after its initial public offering, the only thing investors can count on right now with Lyft, in our view, is substantial share-price volatility. Not one for the Best Ideas Newsletter portfolio.

Tesla and GameStop Face Selling Pressure After Notable Disappointments

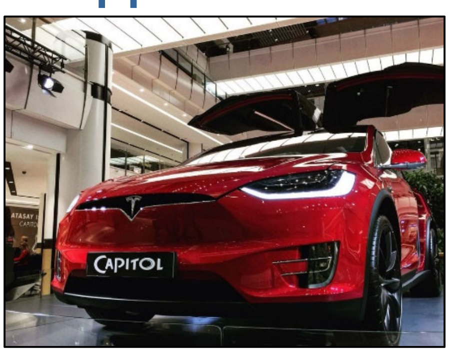

Image Source: Kamil Murat Yılmaz

Tesla reported a significant shortfall in its first quarter 2019 deliveries amid global distribution growing pains, which called in to question its ability to deliver on its reiterated guidance for 2019. Meanwhile, video game retailer GameStop continues to face challenges presented by headwinds beyond its control and expects its revenue contraction to accelerate in fiscal 2019. We're not interested in shares of either company.

*Tesla and GameStop…*continued on next page

*Tesla and GameStop…*from previous page

By Kris Rosemann

Tesla's First Quarter Deliveries Disappoint, But Full Year Guidance Reiterated

Electric car maker Tesla (TSLA) stumbled out of the open April 4 after its April 3 release of its first quarter 2019 deliveries figure, which came in markedly short of expectations. 63,000 deliveries in the quarter was more than double the figure of the first quarter of 2018 but marked a 31% sequential drop. Management pointed to significantly higher deliveries in Europe and China causing growing pains with respect to its distribution capabilities, which should shift a notable number of deliveries to the second quarter. This is not the first time the company has experienced execution issues in the production or distribution phases of its business, but it reiterated its expectations for 360,000-400,000 vehicle deliveries in 2019. Management also disclosed that it "ended the quarter with sufficient cash on hand," but did not provide an explicit figure. Total cash was nearly $3.9 billion at the end of 2018 compared to nearly $12 billion in total debt.

Tesla's bottom-line will be negatively impacted by the significant shortfall in deliveries (consensus deliveries expectations were in the mid-70,000s range), as well as several pricing adjustments. The disappointment calls in to question the sustainability of Tesla's recent positive free cash flow generation, though the company did previously note that the measure would likely be in negative territory in the first quarter of 2019 even before its weak deliveries report. It is worth noting that the company's exit rate of deliveries in the quarter was solid, as it delivered roughly half of the quarter's vehicles in the final ten days of the period.

We've stated in the past that we love Tesla's future expected free cash flow, but we also remain skeptical of the company's long-term success in such a fiercely competitive environment, especially after considering its lack of a reliable track record when it comes to profitability, production, and distribution. We're not dismissing Tesla by any means, it may very well come out of the electric vehicle revolution on top, but it has a long way to go in proving itself as a reliable generator of free cash flow, which is the only sound basis for the value of any equity. For the time being, we continue to view Tesla as a speculative entity, and its share price is likely to remain volatile for some time as it continues to sort out its production and distribution growing pains on its quest for consistent free cash flow generation. Our fair value estimate for Tesla remains relatively unchanged at $290 per share.

GameStop's Top-Line Rate of Decline to Accelerate, We've Cut Our Fair Value Estimate

GameStop's (GME) struggles of late have been no secret, and the ongoing shift away from hardware in the videogame space has been well publicized. Unfortunately for the video game retailer, the keys to its success are largely beyond its control. The company's video game accessories, digital, and collectibles sales are growing nicely, but these products account for just over 22% of total revenue as of the full fiscal year 2018, results released April 2. Its new video game hardware and pre-owned and value video game products, which account for ~21% and ~23% of total revenue, respectively, remain mired in secular decline, while its new video game software sales (~30% of total) are tied in part to poor hardware trends and are largely hit driven, or dependent upon the release of popular video game titles.

Management issued fiscal 2019 guidance for both total sales and comparable store sales to fall by 5%-10% over fiscal 2018 levels, which marks an acceleration in the decline from fiscal 2018's ~3% drop in total sales and 0.3% decline in comparable store sales. We've slashed our fair value estimate for shares to $14 each following the guidance update, and free cash flow trends are becoming increasingly worrisome (the measure fell to $231 million in fiscal 2018 from $484 million in fiscal 2015).

*Tesla and GameStop…*continued on next page

*Tesla and GameStop…*from previous page

GameStop is still able to cover annual run rate cash dividend obligations of $157 million with free cash flow, and it holds a net cash position of ~$804 million as of the end of fiscal 2018. This net cash position provides a considerable portion of its equity value, but it should be noted that off-balance sheet obligations exist in the form of purchase agreements and operating leases. In this vein, the company retains some financial optionality, but it continues to pull back on capital spending to buoy free cash flow generation, which may only further impair future growth prospects. The best-case scenario for shareholders may very well end up being a go-private offer, but management ended its sale exploration process in January 2019. We’re not being roped in to this downward spiraling retailer by its artificially lofty dividend yield.

US Steel Helped by Steel Import Tariffs

Image Source: US Steel

US Steel has allocated billions of dollars towards upgrading its flat-rolled steel business in order to remain competitive in a very tough industry, as the more recent American tariffs on steel imports won’t necessarily be around forever.

By Callum Turcan

United States Steel Corporation (X) is a major integrated steel producer with production facilities in America and Slovakia, which joined the European Union in 2004. The company primarily produces flat-rolled and tubular steel products, along with an ‘Other Businesses’ segment that is made up its railroad and real estate assets. Aided by the imposition of additional tariffs on American steel imports (particularly the 25% tariff placed on imports from the EU, Canada and Mexico) and ongoing economic growth (both globally and in the US), US Steel posted significantly stronger financial performance in 2018 than it has in recent past. The company’s yield as of this writing is not as enticing at 1.1% as US Steel is investing heavily in its asset revitalization program to bolster its existing production facilities and reduce ongoing operating costs.

Upgrading Existing Assets to Enhance Profitability

In 2017, US Steel embarked on a $2.0 billion revitalization program seeking incremental efficiencies at its flat-rolled steel division. $1.5 billion of that program consists of capital expenditures (the rest being operating expenses incurred specifically to support this strategy), which is largely why US Steel’s total capital expenditures have sharply increased since then.

*US Steel Helped…*continued on next page

*US Steel Helped…*from previous page

UNITED STATES STEEL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in millions)	Year Ended December 31, 2018	2017	2016
Increase (decrease) in cash and cash equivalents			
Operating activities:			
Net earnings (loss)	$ 1,115	$ 387	$ (440)
Adjustments to reconcile net cash provided by operating activities:			
Depreciation, depletion and amortization (Notes 13 and 14)	521	501	507
Impairment of intangible assets (Note 14)	—	—	14
Gain associated with retained interest in U. S. Steel Canada Inc. (Note 5)	—	(72)	—
Gain on equity investee transactions	(38)	(2)	—
Restructuring and other charges (Note 25)	—	31	122
Loss on debt extinguishment (Note 17)	98	54	22
Provision for doubtful accounts	4	1	—
Pensions and other post-employment benefits	77	(16)	(62)
Deferred income taxes (Note 11)	(329)	(72)	9
Net (gain) loss on disposal of assets	(6)	(5)	5
Equity investees earnings, net of distributions received	(47)	(32)	(89)
Changes in:			
Current receivables	(312)	(36)	(182)
Inventories	(374)	(117)	491
Current accounts payable and accrued expenses	282	225	287
Income taxes receivable/payable	(8)	(52)	10
Bank checks outstanding	1	(2)	—
All other, net	(46)	33	60
Net cash provided by operating activities	938	826	754
Investing activities:			
Capital expenditures	(1,001)	(505)	(306)
Disposal of assets	10	5	12
Proceeds from sale of ownership interests in equity investees	30	116	—
Investments, net	(2)	(2)	(21)
Net cash used in investing activities	(963)	(386)	(315)
Financing activities:			
Revolving credit facilities - borrowings, net	228	—	—
Issuance of long-term debt, net of financing costs (Note 17)	640	737	958
Repayment of long-term debt (Note 17)	(1,299)	(1,127)	(1,093)
Settlement of contingent consideration	—	—	(15)
Net proceeds from public offering of common stock (Note 27)	—	—	482
Common stock repurchased (Note 27)	(75)	—	—
Receipts from exercise of stock options (Note 15)	35	20	35
Taxes paid for equity compensation plans (Note 15)	(8)	(10)	(4)
Dividends paid	(36)	(35)	(31)
Net cash (used in) provided by financing activities	(515)	(415)	332
Effect of exchange rate changes on cash	(17)	17	(8)
Net (decrease) increase in cash, cash equivalents and restricted cash	(557)	42	763
Cash, cash equivalents and restricted cash at beginning of year	1,597	1,555	792
Cash, cash equivalents and restricted cash at end of year	$ 1,040	$ 1,597	$ 1,555

Image Shown: US Steel has posted significant net operating cash flow growth since 2016, which has been outpaced by rising capital expenditures as management embarks on a major corporate revamp. Image Source: US Steel – 2018 Annual Report

From 2016 to 2017, US Steel's capital expenditures shot up from $0.3 billion to $0.5 billion and climbed further still in 2018 to over $1.0 billion. While US Steel's net operating cash flow jumped by 24% over this period north of $0.9 billion, it's clear major capital expenditure increases are outpacing cash flow gains. Management expects US Steel will spend $1.2 billion on capital expenditures this year, $0.3 billion of which is expected to go towards its revitalization program (similar to 2018 levels). Longer-term, US Steel will likely need to scale back its capital expenditures in order to better live within its net operating cash flow generation.

Cash Flow and Capital Allocation Commentary

In 2016 and 2017, US Steel generated $448 million and $321 million in free cash flow, respectively, when defining free cash flow as net operating cash flow less capital expenditures. That was more than enough to cover $31 million in dividend payments in 2016 and $35 million in dividend payments in 2017. However, as US Steel was free cash flow negative in 2018 and will potentially be free cash flow negative this year in light of continued capital expenditure increases, $36 million in dividend payments in 2018 were covered by cash on hand.

*US Steel Helped…*continued on next page

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US Steel approved a $300 million share buyback program that was announced at the beginning of November 2018. That month, the company spent $75 million repurchasing almost 2.8 million shared at an average price of $27.17 per share. As of this writing, US Steel is trading below $19 per share, highlighting the many risks involved in share repurchasing strategies. Like US Steel's 2018 dividend payments, share buybacks were funded with cash on hand.

At the end of 2018, US Steel was sitting on $1.0 billion in cash versus $2.4 billion in short & long-term debt, good for a net debt position of $1.4 billion. Note US Steel's total debt load slipped by a tad over $0.3 billion from the end of 2017 to the end of 2018 as management has been steadily chipping away at US Steel's liabilities over the past few years. That being said, the reduction in its cash balance from the end of 2017 to the end of 2018 saw US Steel's net debt load increase during this period by roughly $0.2 billion. Here is a key excerpt from US Steel's fourth quarter 2018 conference call:

> *"**The strong financial performances for our business in 2018 allowed us to make significant progress on our balance sheet and capital structure**. Let me go through some of the highlights. **In the year, we retired $322 million of debt and extended our maturity profile. Our next senior note maturity is not until 2025**. This further de-risks our execution on the asset revitalization program, and gives us a good runway to continue to execute strategy.*
>
> *In the quarter, we began executing on our previously announced stock repurchase program. In Q4, we repurchased $75 million worth of stock. In January, we repurchased an additional $25 million. Since the announcement of the program on November 1st, we've repurchased just over 2% of shares outstanding. **We continue to believe stock repurchases are an attractive value opportunity and remain committed to our balanced capital allocation framework**."*

The company set benchmarks and performance goals in order to gauge the effectiveness of its corporate revamp. One of its most important goals is achieving a $275 – 325 million improvement in its annual EBITDA from 2016 levels by the end of 2020. In 2018, US Steel had been able to realize $111 million in incremental EBITDA generation through this program (as determined by the company), well above guidance. US Steel is targeting $125 – 150 million in incremental EBITDA generation this year versus 2016 levels.

US Steel appears ready to continue repurchasing stock as market conditions allow, however, we would be more supportive of management allocating the company's cash to retiring debt and further reducing its annual interest expenses. The company's interest expense has fallen from $230 million in 2016 to $168 million in 2018, while its interest income has jumped from $5 million to $23 million during this period.

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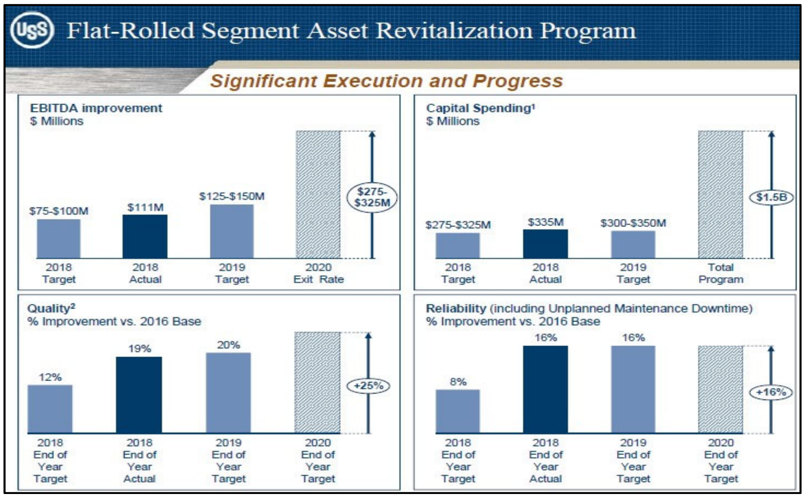


Image Shown: These metrics are how management is gauging the effectiveness of US Steel's ongoing asset revitalization program. Image Source: US Steel – Fourth quarter 2018 IR presentation

US Steel has grown its adjusted EBITDA generation from $0.5 billion in 2016 to $1.8 billion in 2018, highlighting the effectiveness of this program and the favorable impact of domestic tariffs on steel imports. The company has also realized major improvements in its operational uptime and the quality of its products through its asset revitalization program. Fundamentally, this is a holistic strategy with incremental improvements targeted across the board. Here is a key excerpt from US Steel's 2018 10-K highlighting the nature of the revamp;

> *"In 2017, we launched our asset revitalization program, a multi-year, comprehensive $2 billion investment in our most critical assets within our Flat-rolled segment. The program is composed of many projects designed to continuously improve safety, quality, delivery and cost performance…*
>
> ***Importantly, while this is a large program, most projects are not complex, making projects easier to execute. Due to the smaller nature of many of the projects, we do not have to complete the entire program in order to start seeing benefits, as evident in our 2018 performance**. Also, by breaking the program down into a series of smaller projects, we have greater flexibility to adjust the scope and pace of project implementation based on changes in business conditions."*

This flexibility is essential as it allows US Steel to scale back in the event of an economic slowdown or a recession, while still enabling the company to make much needed upgraded to its asset base. Steel prices, especially when tariffs are involved, can be quite volatile and that volatility has an outsized impact on US Steel's financial performance. Should economic conditions deteriorate, capital expenditure reductions are one of the few levers US Steel can pull in the short-term to adjust to market conditions.

Concluding Thoughts

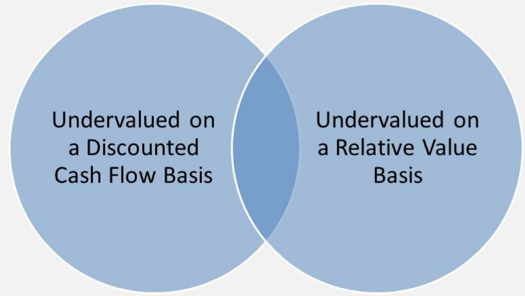
The imposition of additional tariffs on US steel imports under President Trump's administration, namely the 25% tariff slapped on steel imports from the EU, Mexico and Canada, has greatly behooved US Steel's financial performance. Going forward, those tariffs may not always be in place which is why management is making prudent capital allocation decisions as it relates to revamping US Steel's flat-rolled business. Longer term, US Steel will eventually have to scale back capital expenditures in order to live within net operating cash flow generation and ultimately enable more cash to flow back to investors via dividend increases. For now, we aren't buyers, but appreciate all the work management has done to turn things around at US Steel.

Disclosure: The author of this piece, Callum Turcan, does not own any of the companies mentioned in the article above.

The Watch List

By Valuentum Analysts

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



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

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

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

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

Company Name	Symbol	Industry	Price/Fair Value	DCF Valuation	Relative Valuation
Tenneco	TEN	Auto Parts Suppliers	0.68	UNDERVALUED	NEUTRAL
Discover Financial	DFS	Banks & Money Centers	0.71	UNDERVALUED	UNATTRACTIVE
Goldman Sachs	GS	Banks & Money Centers	0.79	UNDERVALUED	ATTRACTIVE
LG Display	LPL	Electronic Suppliers	0.79	UNDERVALUED	UNATTRACTIVE
Tivity Health	TVTY	Health Providers & Svcs	0.60	UNDERVALUED	ATTRACTIVE
Alphabet	GOOG	Internet Software & Svcs	0.73	UNDERVALUED	UNATTRACTIVE
Facebook	FB	Internet Software & Svcs	0.71	UNDERVALUED	ATTRACTIVE
AK Steel Hldg	AKS	Metals & Mining - steel	0.48	UNDERVALUED	NEUTRAL
Celgene	CELG	Pharma - Generic/Other	0.60	UNDERVALUED	ATTRACTIVE
Gilead Sciences	GILD	Pharma - Generic/Other	0.72	UNDERVALUED	UNATTRACTIVE
Valero Energy	VLO	Refiners	0.76	UNDERVALUED	NEUTRAL
AutoNation	AN	Specialty Retail - auto	0.73	UNDERVALUED	ATTRACTIVE

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

Ideas...continued on next page

*Ideas…*from previous page

Sourcing Ideas from the Valuentum Buying Index

The first table below showcases stocks that may fit the bill of the Valuentum investor, with each posting a 9 or a 10 on the Valuentum Buying Index. These are names that we may swap into the simulated Best Ideas Newsletter portfolio on the long side (if not already held) should their upside potential become greater than our current holdings, in our view.

We also show firms that register a 1 or 2 on the VBI. These names represent put-option candidates, or stocks that we might generally avoid. We provide the respective lists below, and each company's stock report can be found on our website at www.valuentum.com.

Facebook (FB) is the only company in our coverage that registers either a 9 or 10 on the Valuentum Buying Index at this time (the best rating). It remains one of our favorite ideas.

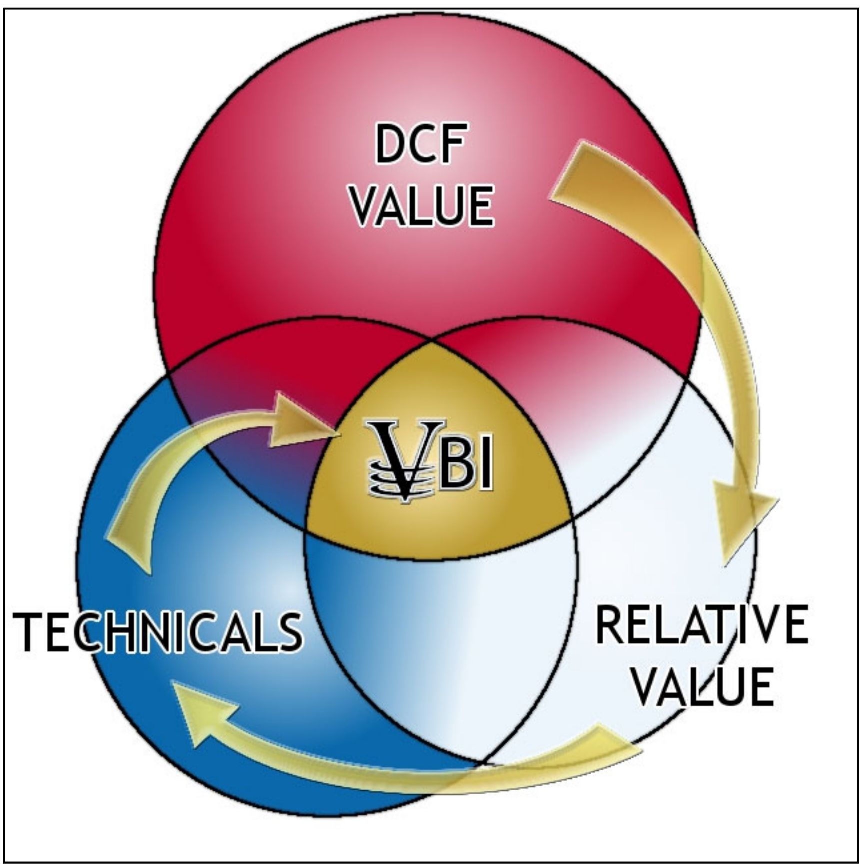
Company Name	Symbol	Industry	VBI
HEICO	HEI	A&D Suppliers	1
Brown-Forman	BF.B	Beverages - alcoholic	1
Badger Meter	BMI	Electrical Equipment	1
Casella Waste	CWST	Environmental Services	1
Lancaster Colony	LANC	Food Products	1
McCormick	MKC	Food Products	1
Clorox	CLX	Household Products	1
RBC Bearings	ROLL	Machinery & Tools	1
Bright Horizons Family	BFAM	Personal Services	1
Ecolab	ECL	Chemicals - broad	2
Amphenol Corp	APH	Electronic Suppliers	2
Corning	GLW	Electronic Suppliers	2
Dolby	DLB	Electronic Suppliers	2
Waste Management	WM	Environmental Services	2
MBIA Inc	MBI	Insurance - Property & Casualty	2
Selective Insurance	SIGI	Insurance - Property & Casualty	2
Jack Henry	JKHY	IT Services	2
Graco	GGG	Machinery & Tools	2
Cree	CREE	Semi Equipment	2
Synopsys	SNPS	Semi Equipment	2
VeriSign	VRSN	Software - security	2
Allete	ALE	Utilities	2
MGE Energy	MGEE	Utilities	2
Sempra Energy	SRE	Utilities	2

Our Methodology – The Valuentum Buying Index (VBI)

By Valuentum Analysts

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

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



Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

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

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

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

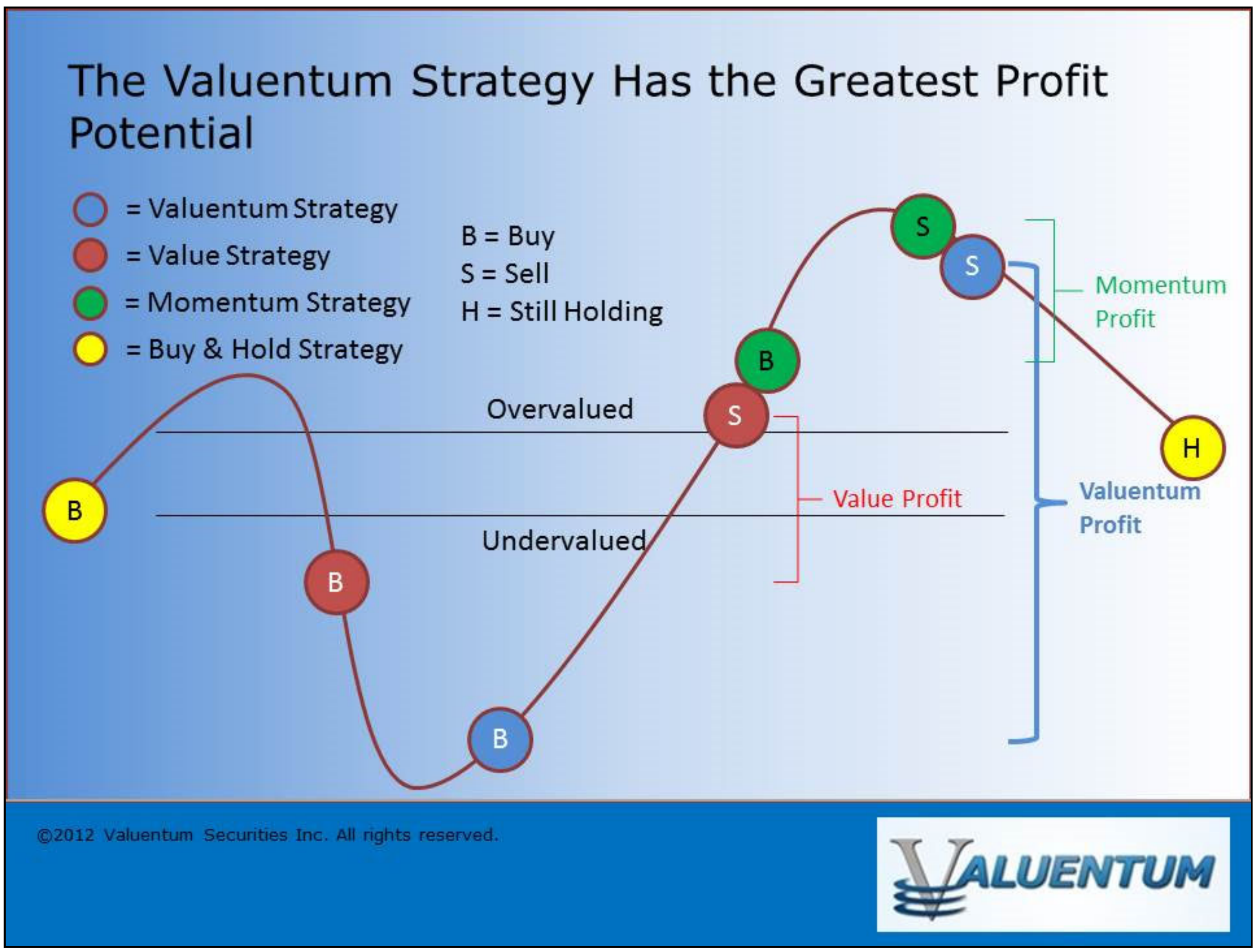


Illustration for educational purposes only.

Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

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

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

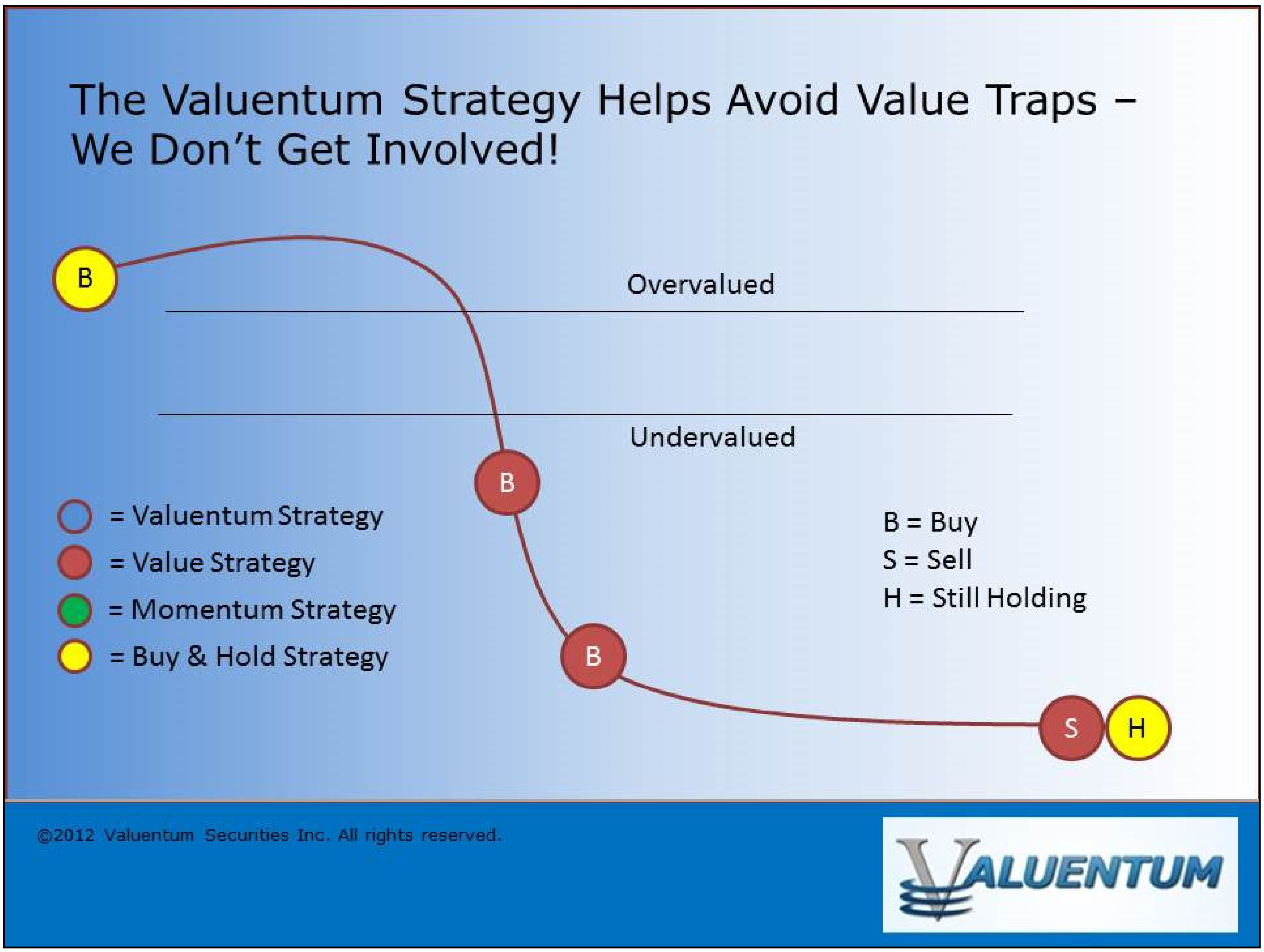


Illustration for educational purposes only.

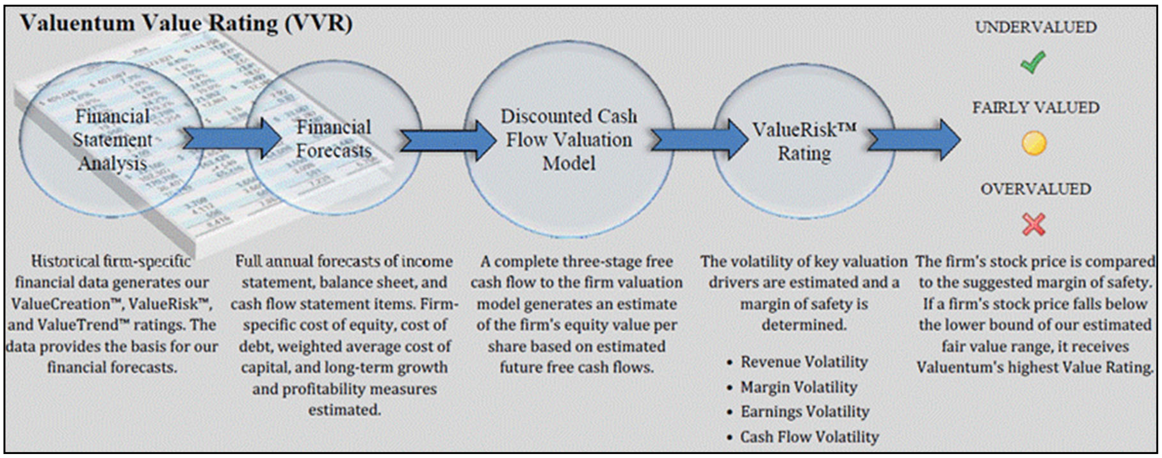
Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

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

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

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



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

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

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

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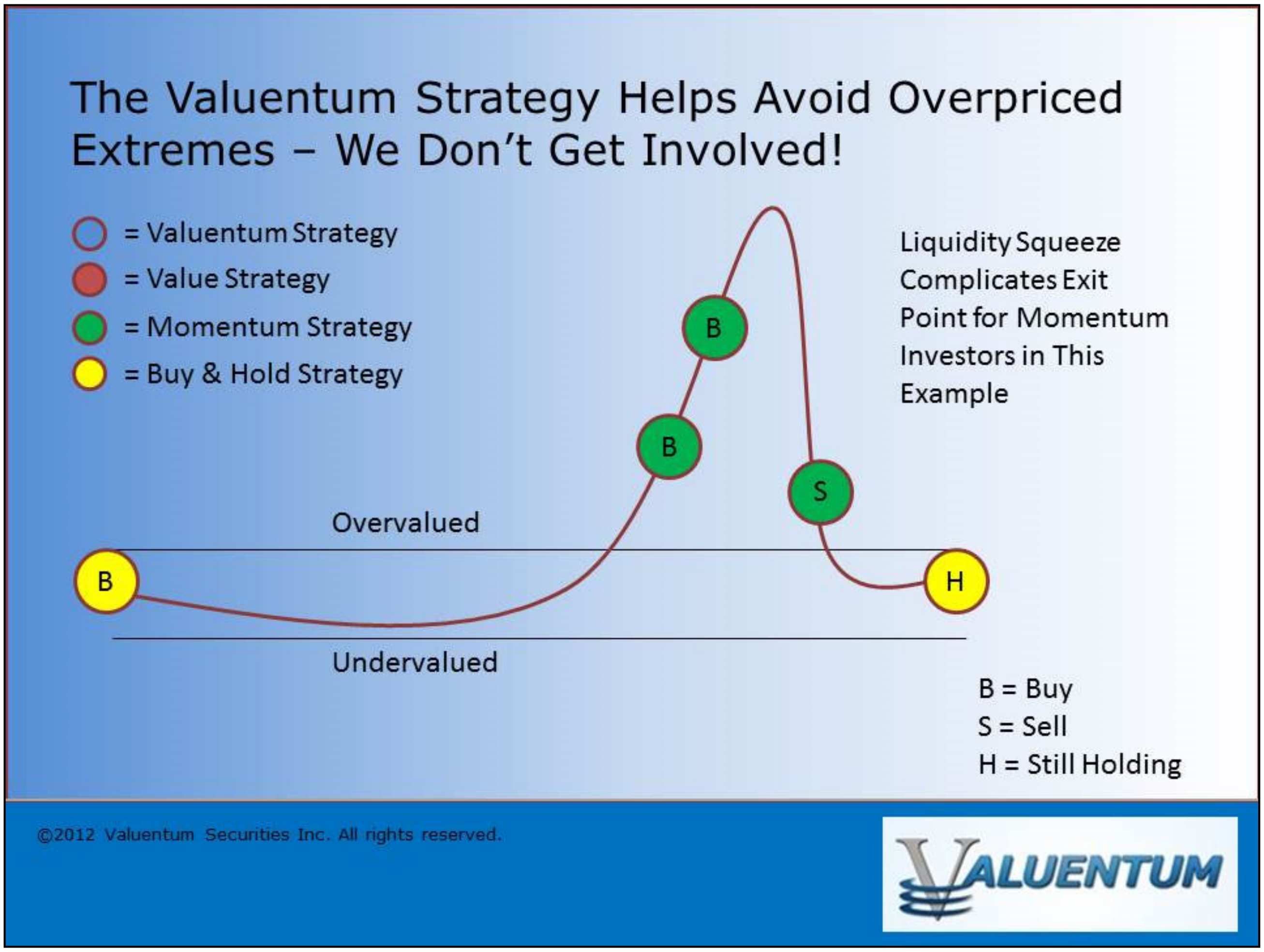

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II. The Valuentum Buying Index Incorporates A Forward-Looking Relative Value Assessment

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

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

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

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valuation criteria).

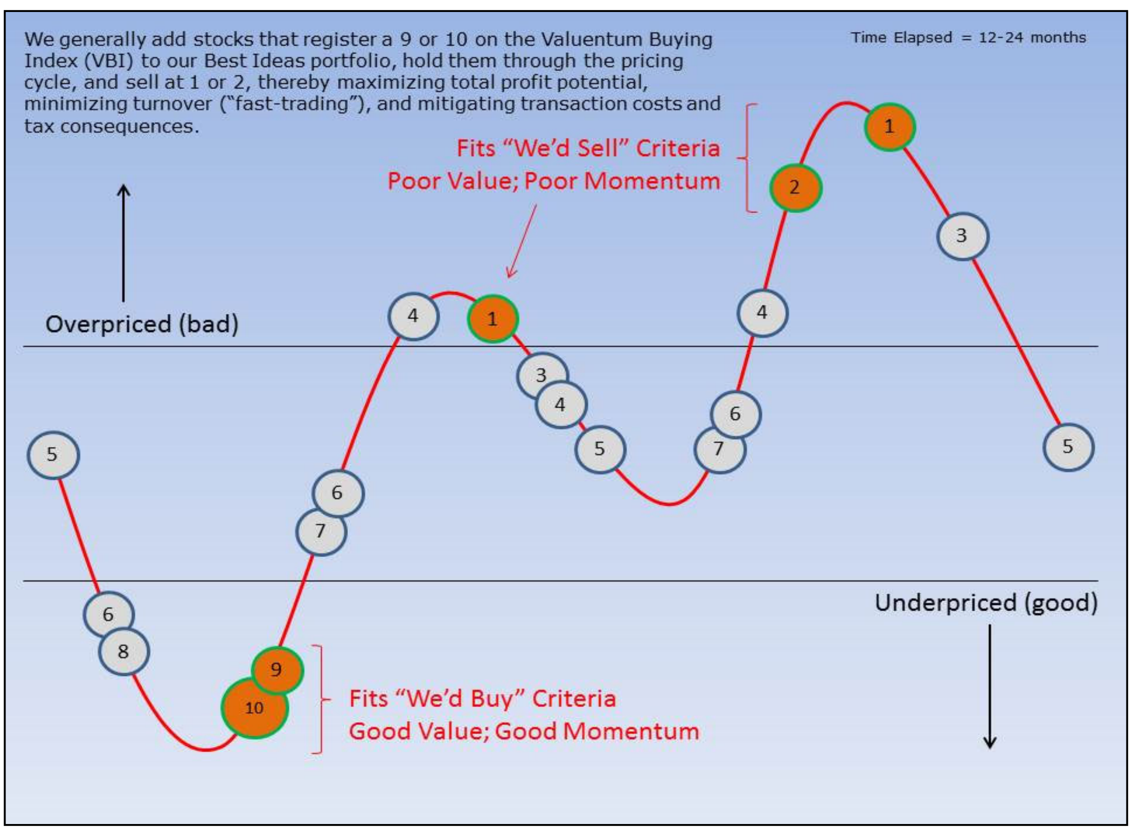
Rigorous valuation analysis and technical analysis are not mutually exclusive, and we believe both can be used together to bolster idea generation. An evaluation of a stock's moving averages, relative strength, upside-downside volume, and money flow index are but a few considerations we look at with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

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

Putting It All Together - the Valuentum Buying Index

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

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



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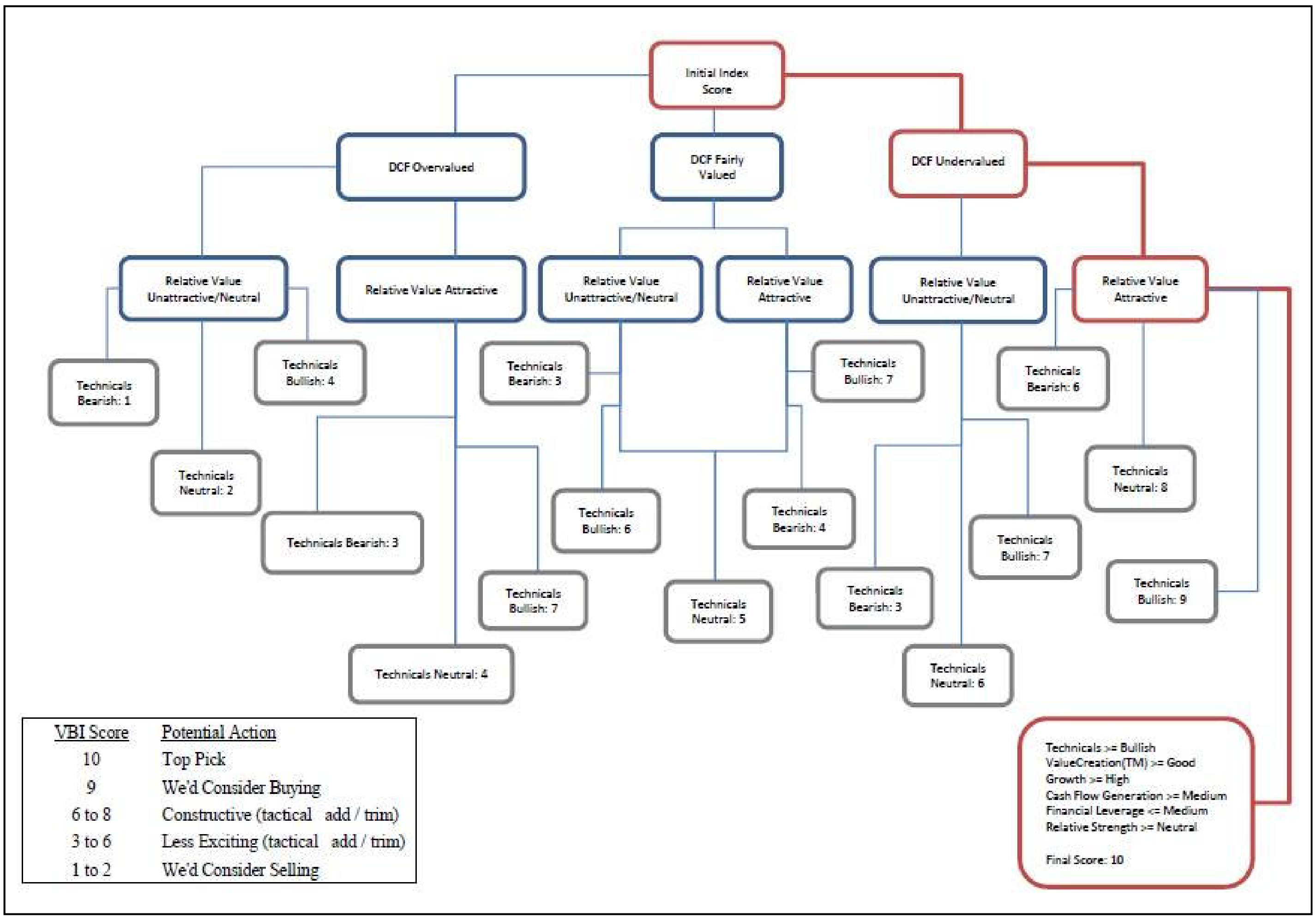
Our Methodology – The Valuentum Buying Index **continued from previous page**

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

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

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



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About the Fair Value Range

By Valuentum Analysts

Understanding the Fair Value Range and Why It's Important

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

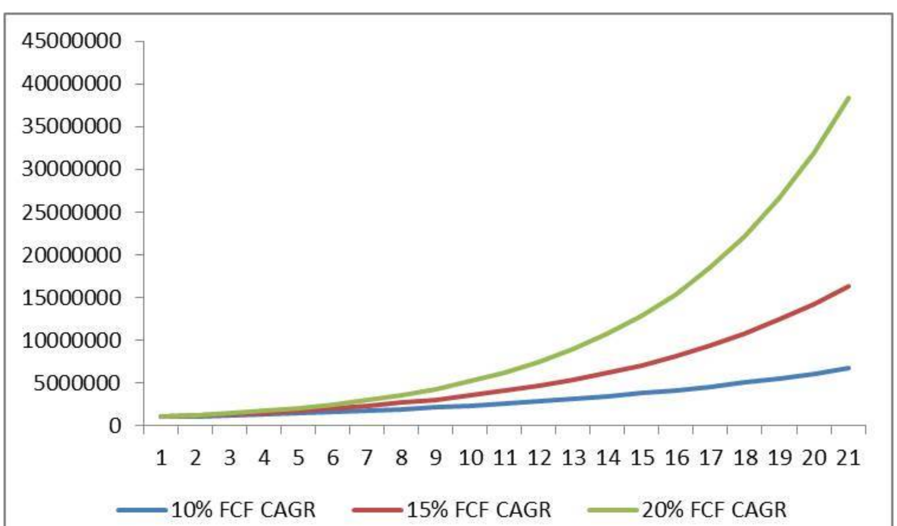
One of the most important concepts of the Valuentum methodology (and valuation in general) is the understanding that the value of a company is a range of probable valuation outcomes, not a single point estimate. Even well-seasoned stock analysts are guilty of saying that a company's shares are worth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

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

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

But why the large range in many cases?

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



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About the Fair Value Range continued from previous page

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

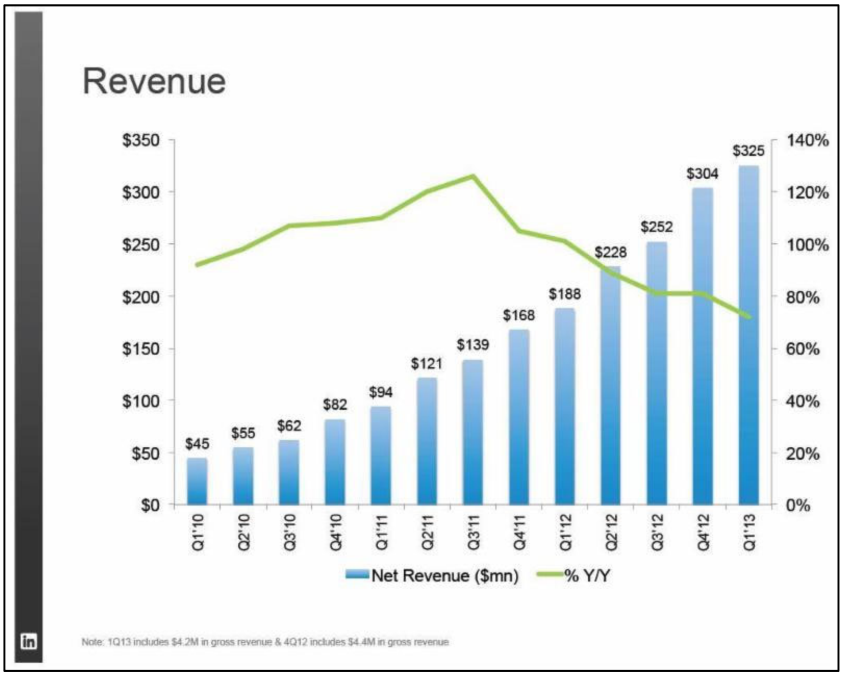

Image Source: LinkedIn

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

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

Shares collapsed in a huge way.

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

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

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

By Valuentum Analysts

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

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

The Valuentum Buying Index Has Checks and Balances

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

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

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

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

*How We Use...*continued on next page

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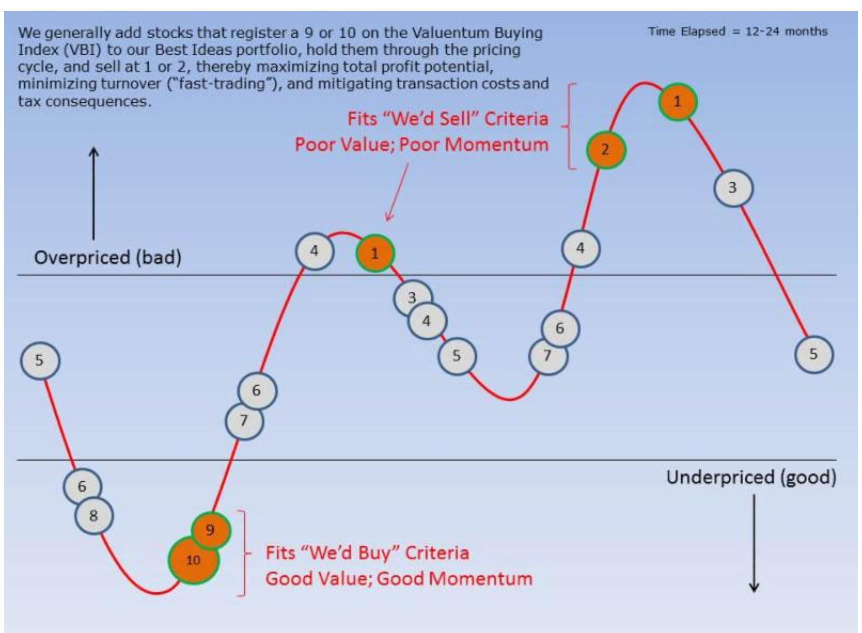
may be the secret to success in investing, a lot could have gone wrong with the temptation to do something each day. Obviously, we're very disciplined, but we also credit the portfolio outperformance to the VBI methodology itself. It is a very helpful tool.

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

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

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

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



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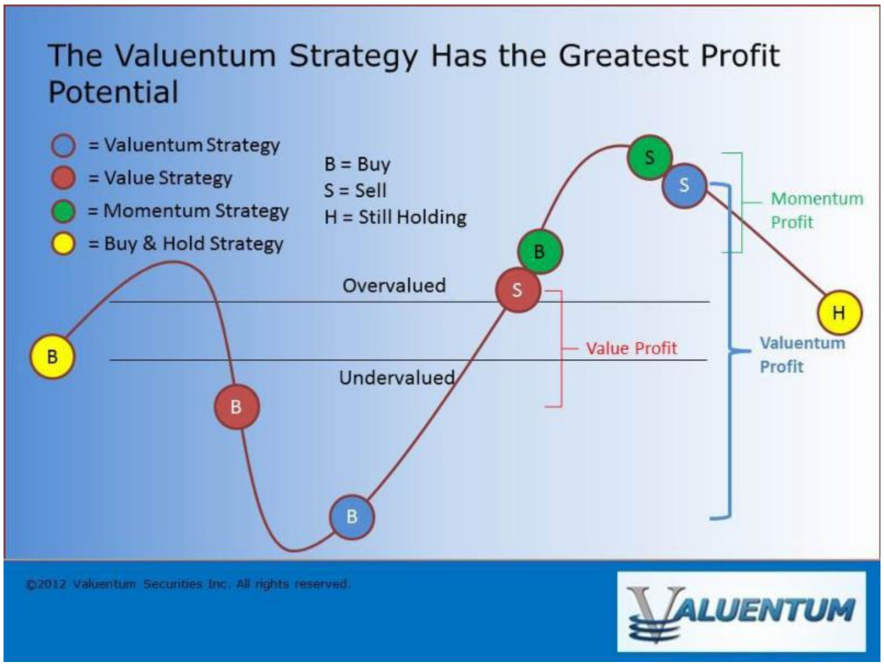
But why don't we churn our ideas by updating daily and trading a lot? Obviously, we don't think that's the secret to investment success. In quite the opposite approach, we strive to maximize profits on every idea that we pursue, with the understanding that momentum does exist and that prices over and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



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

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

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

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

Some Examples of the Valuentum Buying Index In Action

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

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

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

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About Our Name

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

-- Warren Buffett, Berkshire Hathaway annual report, 1992

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

Valuentum Best Ideas Newsletter: Volume 9, Issue 4

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

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

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

The portfolio in the Valuentum Best Ideas Newsletter is hypothetical and does not represent real money. Past simulated performance, whether backtested or walk-forward or other, is not a guarantee of future results. Actual results may differ from simulated portfolio information being presented in this newsletter. For general information about Valuentum's products and services, please contact us at valuentum@valuentum.com or visit our website at www.valuentum.com.