OUR DIVIDEND GROWTH NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

May 1, 2019
Volume 8 Issue 5

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

Dividend Growth Ideas: AAPL, BKLN, CBRL, CSCO, DLR, XLE, XLF, GM, KMI, XLV, IDV, INTC, JNJ, MSFT, XLV, O, ORCL, SDY
Most-recently Added: KMI, XLV
Most-recently Removed: HAS, NVS

Inside This Issue

1 Apple Soars! Enterprise (Universal) Valuation Matters
3 Earnings Reports Flying In!
5 Portfolio: Dividend Growth Ideas
6 Norfolk Southern Impress But Sustained Dividend Growth is Doubtful
10 Stocks with High Valuentum Buying Index Ratings and Strong Dividend Growth Prospects
11 The Financially-Healthiest Dividend Payers Yielding Over 2%
12 Yields to Consider Avoiding
14 Mortgage REITs Still Dangerous Income Vehicles
15 PepsiCo Fights off Forex Headwinds as it Gets Ready to Take on Amazon
19 J&J Beats Low Expectations, Revises Guidance Upward
22 Latest Channel Check at Malls… Scary
23 Disney Pushes Deeper into the Streaming Market
25 About the Dividend Cushion™ Ratio

© 2019 Valuentum. All rights reserved. Reproduction by any means is prohibited.

"We're sticking with Apple in the Best Ideas Newsletter portfolio, and we're sticking with shares in the Dividend Growth Newsletter portfolio. Apple upped its dividend 5.5%, to a quarterly rate of $0.77 per share, suggesting a forward dividend yield of about 1.5%."

– Brian Nelson, CFA

Apple Soars! Enterprise (Universal) Valuation Matters

By Brian Nelson, CFA

On April 30, Apple reported better-than-expected fiscal second-quarter results. Headlining the press release was that "services revenue reach(ed) a new all-time high of $11.5 billion." As is the case of many services business, this revenue is higher-margin and recurring, and we see only upside as Apple's ecosystem continues to flourish. The company's installed base is now over 1.4 billion users.

We have maintained our fair value estimate for Apple's shares of $222 following the release of the report. In fact, our fair value estimate has remained above $200 per share since December 2017 (that's 14 months ago). Enterprise (universal) valuation matters, and acts as a magnet to share prices, while momentum acts as an accelerator. We did our best to reiterate what matters in the Apple story, and we think a laser focus on intrinsic value estimation will continue to be the key.

Although revenue dropped more than 5% on a year-over-year basis during the period, the $58+ billion mark beat expectations, and Apple's fiscal second-quarter GAAP number of $2.46 per share came in a dime better than consensus, but off 10% from the year-ago period. The iPhone maker's results will always be lumpy, as product cycles ebb and flow, and we reiterate that product cycles are already embedded in future expectations of financial performance, and therefore any intrinsic value estimate.

Don't worry about them -- they work themselves out over time…

Please see *Apple Soars…*on next page

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

Christopher Araos
Associate Stock and Dividend Analyst
info@valuentum.com

Callum Turcan
Independent Contributor
info@valuentum.com

Matthew Warren
Independent Bank and Financials Contributor
info@valuentum.com

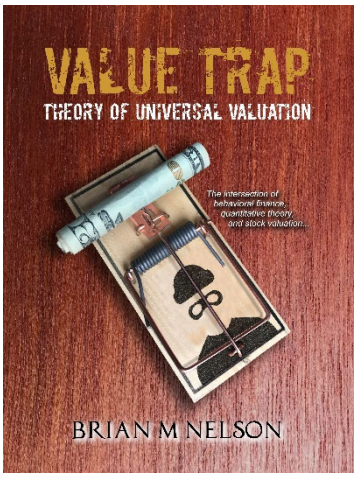
***NOTE:** The goal of the Dividend Growth Newsletter is to highlight ideas with strong dividend growth potential and update readers about new developments in the market. A simulated portfolio of dividend growth ideas is presented on page 5 of each edition.

Apple Soars...**from previous page**

Image*: Apple's (AAPL) shares have soared since the beginning of this year. We have maintained our fair value estimate of $222 per share following its fiscal second-quarter results, released April 30.*

Commentary in the press release was also quite reassuring. CEO Tim Cook noted that the March quarter delivered the strongest iPad growth in 6 years, and it's hard to simply dismiss his excitement about Apple's pipeline. He hasn't let shareholders down, and many are expecting some exciting developments at the company's annual conference in June. Not only was the press release upbeat, but Apple issued a fiscal third-quarter outlook that was better than what many had been anticipating.

We're sticking with Apple in the Best Ideas Newsletter portfolio, and we're sticking with shares in the Dividend Growth Newsletter portfolio. Apple upped its dividend 5.5%, to a quarterly rate of $0.77 per share, suggesting a forward dividend yield of about 1.5%. That yield may not entice a lot of investors, but it is backed by a huge net cash position on the balance sheet and free cash flow generation that may very well be second to none.



We continue to like Apple, and yes, *enterprise valuation matters*!

Order Value Trap: Theory of Universal Valuation today!

From Amazon:

https://www.amazon.com/Value-Trap-Theory-Universal-Valuation/dp/0998038490

Earnings Reports Flying In!

Please note these earnings updates were emailed to Valuentum's members in late April.

Visit Valuentum.com for ongoing earnings commentary. Thank you!

Earnings reports are flying in. We thought Air Products', Hasbro's, and Lockheed's quarterly updates were standouts.

By Brian Nelson, CFA

Let's get to some of the earnings reports out recently.

Air Products (APD): We're huge fans of the oligopolistic industrial gas business, and Air Products is now bumping up against 52-week highs. In its fiscal second-quarter report, released April 24, the company raised the lower end of its fiscal 2019 earnings guidance range to $8.15-$8.30 from $8.05-$8.30 previously. Adjusted earnings per share advanced 17% in the most recently-completed period, while it posted a record adjusted EBITDA margin of 37.7%. Expected earnings growth for fiscal 2019 is now 10% at the midpoint of the range.

Boeing (BA): There were no real surprises in Boeing's first-quarter 2019 numbers, released April 24. The company has been battling negative perception as a result of the widely-publicized 737 MAX crashes, and given the uncertainty regarding any potential fallout, management pulled its 2019 guidance. Total backlog of $487 billion includes 5,600 commercial airplanes, however, and we think Boeing will once again fly high. Its shares are still a bit pricey at current levels though.

Caterpillar (CAT): Caterpillar's results will ebb and flow with the economic cycle, and its first-quarter results, released April 24 suggest things are still going pretty well in key diversified industrial and mining end markets. The earth-moving equipment maker raised its 2019 earnings per share outlook, to the range of $12.06-$13.06 from $11.75-$12.75 previously, thanks to a tax adjustment. Underlying fundamentals are still solid, however. First-quarter revenue advanced 5% while it put up record first-quarter profit per share.

Coca-Cola (KO): Coca-Cola put up solid first-quarter numbers April 23. In fact, they were great. Organic sales jumped 6%, beating consensus by a couple percentage points, and its operating margin also came in better than expected. This led to a top- and bottom-line beat for the period. We still think the market is giving Coca-Cola's shares too much of a premium, however, given the company's large net debt position. As long as organic growth holds up, it doesn't seem investors will ask too many questions about valuation.

General Dynamics (GD): General Dynamics' shares have been under some pressure since they peaked in early 2018, but we didn't see anything in the quarterly report that would suggest its most recent breakout of the downtrend won't hold, at least for now. The company noted that order activity remained strong across both its aerospace and defense platforms, something we've been hearing from other companies, too. Orders of $10.7+ billion in the quarter resulted in a solid book-to-bill of 1.2 to 1.

Please see *Earnings Reports...*on next page

*Earnings Reports...*from previous page

General Motors (GM): General Motors' shares are cheap, in our view, and we like having some exposure to the automotive sector in the Best Ideas Newsletter portfolio and Dividend Growth Newsletter portfolio, even if the business does have cyclical tendencies. GM's first-quarter results, released April 30, weren't the greatest as net revenue, auto operating cash flow, and EBIT-adjusted margin all faced pressure on a year-over-year basis. Our thesis on GM is one that is value-based, however. Annualizing first-quarter EPS-diluted-adjusted for the year, one arrives at $5.64 per share. At ~$40 per share, GM is trading at about 7 times this year's earnings, and that's based on what we consider to be a conservative annual number. GM expects adjusted-diluted earnings per share in the range of $6.50-$7.00 for this year, and adjusted automotive free cash flow in the range of $4.5-$6 billion. GM's shares look cheap even for a cyclical industrial with operating leverage. The company sports a dividend yield north of 4%, too.

Hasbro (HAS): Former Dividend Growth Newsletter portfolio winner Hasbro posted excellent first-quarter 2019 numbers April 23 that remained consistent with our underlying thesis of the equity. The company's higher-margin Entertainment, Licensing and Digital segment is simply on fire, with sales advancing 24% in the quarter. We still like Hasbro, and we might even add shares back to the Dividend Growth Newsletter portfolio in the future.

Intel (INTC): As is often the case around key developments, Intel's shares have been mighty volatile recently, leaping on its decision to halt initiatives in building out 5G modems in the wake of the Qualcomm-Apple truce and then of course its quarterly report April 25. The first-quarter numbers were largely in line, but the company's second-quarter and full-year outlook was much worse than what the market was expecting. This could be little more than conservatism by new CEO Bob Swan, in our view, but it has us on high alert. We're not overacting and still view shares of Intel about fair valued.

Kimberly-Clark (KMB): Kimberly-Clark put up good first-quarter numbers April 22 thanks in part to strong product pricing gains. We had grown concerned about pricing power of branded consumables given developments late last year, and we don't think the threats of cost inflation and private-label competition are neutralized. Innovation will be key for consumer staples equities, and net debt positions will only offer headwinds to future dividend growth. We like Kimberly-Clark, but there are other stronger dividend payers out there, in our view.

Lockheed Martin (LMT): Lockheed issued a fantastic first-quarter report April 23, and the defense contractor raised its fiscal 2019 earnings per share guidance to the range of $20.05-$20.35 per share, up from $19.15-$19.45. It also upped its fiscal 2019 revenue growth guidance, too, on the heels of a near-23% increase in revenue during the first quarter. The company may be getting some interest from investors as a result of Boeing's woes, but it's hard not to like Lockheed in any case. Shares aren't a bargain, however.

McDonald's (MCD): McDonald's continues to do well. The company's strategic refranchising initiative is paying off in spades, and it better positions the company against rising labor costs, which will hurt restaurant operators. In its first-quarter report, released April 30, McDonald's noted that global comparable store sales advanced 5.4%, easily trouncing consensus estimates (US comps also beat expectations). That said, we would have liked to see better performance with respect to consolidated operating income, which increased a modest 3% in constant currencies and diluted earnings per share, which was up only 5% in constant currencies. We expect only a modest increase in our fair value estimate as a result of the report.

Microsoft Puts up 14% Revenue Growth in Fiscal Third Quarter

We traveled the country talking about Microsoft (MSFT), and how much we liked shares and its dividend growth prospects. The company has become the poster child for what can be considered a strong Dividend Cushion ratio, and with shares up to $130 per share as of April 26, it's hard for us not to be extremely happy about keeping this one in front of members for years! We value shares at $114 each, but we're not removing them. We'd wait for signs of deteriorating dividend health, which doesn't look like it will happen anytime soon. Had this been a Best Ideas Newsletter portfolio idea, we'd wait for technical and momentum indicators to roll over before removing it. Demand for Microsoft's cloud offerings drove commercial cloud revenue to $9.6 billion in the quarter -- that's up 40% on a year-over-year basis.

The Dividend Growth Newsletter Portfolio

By Valuentum Analysts

DIVIDEND GROWTH IDEAS -- as of May 1, 2019

Company Name	Yrly Div's Paid ($) / Shr	Div Yield %	Fair Value	VBI Rating	Price/FV	Last Close	% of Portfolio
Intel (INTC)	1.26	2.47%	$ 56.00	6	0.91	51.04	7.5%-12.5%
Johnson & Johnson (JNJ)	3.60	2.55%	$ 147.00	7	0.96	141.20	7.5%-12.5%
S&P Dividend ETF SPDR (SDY)	2.48	2.44%	-	UR	-	101.52	7.5%-12.5%
Apple (AAPL)	3.08	1.53%	$ 222.00	6	0.90	200.67	5.5%-7.5%
Cisco (CSCO)	1.40	2.50%	$ 56.00	5	1.00	55.95	5.5%-7.5%
Digital Realty Trust (DLR)	4.32	3.67%	$ 96.00	3	1.23	117.71	5.5%-7.5%
Energy Sector SPDR (XLE)	2.07	3.13%	-	UR	-	66.17	5.5%-7.5%
Health Care Select Sector SPDR ETF (XLV	1.37	1.53%	-	UR	-	89.26	5.5%-7.5%
iShares Int'l Select Dividend (IDV)	1.80	5.67%	-	UR	-	31.69	5.5%-7.5%
General Motors (GM)	1.52	3.90%	$ 51.00	7	0.76	38.95	3.5%-5.5%
Invesco Senior Loan (BKLN)	1.06	4.60%	-	UR	-	22.97	3.5%-5.5%
Microsoft (MSFT)	1.84	1.41%	$ 114.00	7	1.15	130.60	3.5%-5.5%
Oracle (ORCL)	0.96	1.74%	$ 59.00	7	0.94	55.33	3.5%-5.5%
Cracker Barrel (CBRL)	5.00	2.96%	$ 159.00	3	1.06	168.74	2.5%-3.5
Financial Select Sector SPDR ETF (XLF)	0.57	2.05%	-	UR	-	28.02	2.5%-3.5
Kinder Morgan (KMI)	0.80	4.03%	$ 23.00	6	0.86	19.87	2.5%-3.5
Realty Income (O)	2.71	3.87%	$ 56.00	5	1.25	70.01	2.5%-3.5
Cash Consideration	-	-	-	-	-	-	0.0%

UR = Under Review

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

Goal: The goal of the Dividend Growth Newsletter portfolio is to highlight ideas with strong dividend growth potential and update readers about new developments in the market. The Dividend Growth Newsletter portfolio seeks to find underpriced dividend growth gems that generate strong levels of free cash flow and have solid balance sheets, translating into excellent Valuentum Dividend Cushion ratios. *Given market conditions and the importance of diversification, not all stocks can be undervalued*. Stocks in the Dividend Growth Newsletter portfolio may have lengthy dividend growth track records spanning decades, but we focus most of our efforts on assessing the future safety and dividend growth potential of ideas.

Every subscriber 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. The Dividend Cushion ratios are so important, so please stay up to date with them.

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

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

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

Norfolk Southern Impresses But Sustained Dividend Growth is Doubtful

Image Source: Norfolk Southern Corporation – First quarter 2019 IR presentation

While Norfolk Southern posted a solid first quarter earnings report and continued to showcase real operational improvement, an onerous net debt load combined with the long-term decline of coal in America puts its dividend growth trajectory in doubt.

By Callum Turcan

Norfolk Southern Corporation (NSC) is a major rail transportation provider with operations primarily located in the Midwest, the East Coast, and the Southeastern regions of the United States. As things stand today, the company yields 1.7% but its dividend coverage isn't great with a Dividend Cushion ratio of just 0.6x. While we recognize that Norfolk Southern is a robust free cash flow generator, note that its dividend obligations are hefty, and its net debt load onerous. The company posted a solid first quarter earnings report and continued to showcase improvement where it's needed, but, long-term problems in the coal industry (particularly in America) combined with its large net debt load have created clouds over its dividend growth potential.

Where Norfolk Southern is Doing Well

One thing we will give Norfolk Southern credit for is management's focus on operational efficiency, which is already having an effect on the firm's profitability. In our view (from our 16-page report);

> *"Norfolk Southern has some solid targets for the years ahead, including 100+ basis points of operating margin improvement in 2019, an operating ratio of 60% by 2021 (was ~65.4% in 2018), a revenue CAGR of ~5% through 2021 a double digit annual EPS growth, capital spending of ~16%-18 of revenue through 2021, and a dividend payout ratio of ~33%."*

Please see *Norfolk Southern…*on next page

***Norfolk Southern…*from previous page**

Last quarter, the rail operator posted 5% annual revenue growth due to 5% growth at its 'Merchandise' segment and 6% growth at its 'Intermodal' segment. Note that its 'Coal' revenue was flat year-over-year. Norfolk Southern's operating expenses were flat in the first quarter versus the same period a year-ago, enabling its GAAP operating margin to firm up by almost 330 basis points as its income from railways (operating income) jumped 16% annually to $0.9 billion. This can also be seen through Norfolk Southern's operating ratio (or GAAP operating expenses as a percent of GAAP revenue) falling from 69.3% during the first quarter last year to 66.0% in the first quarter of this year. Lower fuel, materials, and labor costs were the primary factor, with efficiency being the key (we will get into that later on). Ultimately, this enabled Norfolk's net income to climb up 23% year-over-year to $0.7 billion in the first quarter, resulting in 30% GAAP EPS growth as the firm's share count fell by 6% from the first quarter of 2018 to the first quarter of 2019.

Norfolk Southern is guiding for its operating ratio to continue falling over the next couple of years, guidance that is largely predicated on meeting certain operational efficiency goals by then. That includes investments in faster rail logistics (such as enabling additional railroads to support 60 mph speeds), which markedly improved its average rail speed last quarter on a year-over-year basis. Reduced train downtime (referred to as 'Terminal Dwell'), increased train weight (more tonnage per railcar), and other factors are all driving Norfolk Southern's operating ratio lower and thus its operating margins higher.

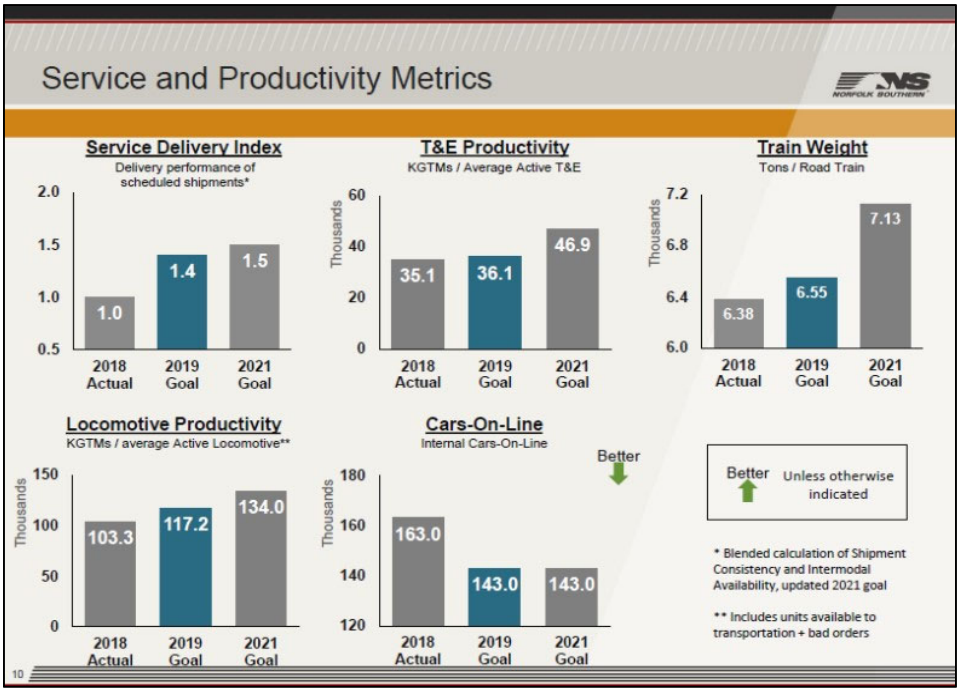


Image Shown: Norfolk Southern is seeking margin expansion through operational improvements on and off the railroad. Image Source: Norfolk Southern – First quarter 2019 IR presentation

This is an area where we give Norfolk Southern a lot of credit because for the most part, these are organic improvements with long-lasting implications for its intrinsic value. However, we still view Norfolk Southern shares are very generously valued as of this writing, with NSC trading well above the upper end of our range of potential values for the company. We aren't optimistic on the long-term trajectory of the coal industry either domestically or abroad, particularly as it relates to power generation.

Please see *Norfolk Southern…*on next page

*Norfolk Southern…*from previous page

Where Norfolk Southern is Struggling

As mentioned previously, Norfolk Southern's net debt position is a problem. The company's $0.4 billion cash balance at the end of March 2019 less total debt of $11.4 billion gives Norfolk Southern a net debt load of $11.0 billion, hefty for a company that generated $1.8 billion in free cash flow (defined as net operating cash flow less property additions) last year while spending $0.8 billion on dividend payments and $2.8 billion on share buybacks. As Norfolk Southern's current shares are very richly valued, in our view, we would be far more supportive of management allocating funds to debt reduction. Instead, buybacks have been pursued at inopportune times leading to net debt accumulation (as was the case in 2018). Buybacks have been aggressively ramped up in recent years.

Norfolk Southern's 'Coal' segment accounted for over 15% of its first quarter revenues and 16% of its full-year 2018 sales. A key excerpt from its 2018 annual report:

> *"Revenues from coal accounted for 16% of our total railway operating revenues in 2018. We handled 115 million tons, or 1.0 million carloads, in 2018, most of which originated on our lines from major eastern coal basins, with the balance from major western coal basins received via the Memphis and Chicago gateways. Our coal franchise supports the electric generation market, serving approximately 70 coal generation plants, as well as the export, domestic metallurgical and industrial markets, primarily through direct rail and river, lake, and coastal facilities, including various terminals on the Ohio River, Lamberts Point in Norfolk, Virginia, the Port of Baltimore, and Lake Erie."*

We aren't optimistic on the long-term trajectory of coal as a source of fuel for electricity generation, especially in America which is currently awash in natural gas. Norfolk Southern caters to states that are major coal consumers, but as you can see in the chart below from the U.S. Energy Information Administration, natural gas is aggressively stealing away coal's market share. The Marcellus and Utica shale plays in Appalachia (namely Ohio, Pennsylvania and West Virginia) have witnessed enormous natural gas production growth since 2010 due to the fracking boom. Surging gas production has heavily depressed natural gas prices both regionally and nationwide. In particular, note the rising volumes to the Eastern Midwest which is home to several major coal consuming states. Take a look at the pictures from the U.S. EIA below that highlight this threat to Norfolk Southern's business model.

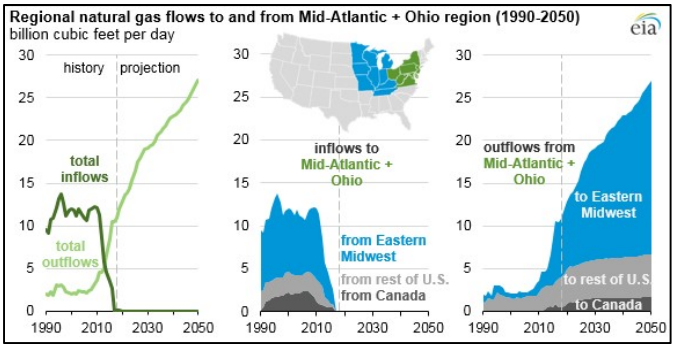


Image Shown: The United States Energy Information Administration notes that a flood of Appalachian-sourced natural gas is coming to key coal consuming regions in the Eastern Midwest. Image Source: U.S. EIA

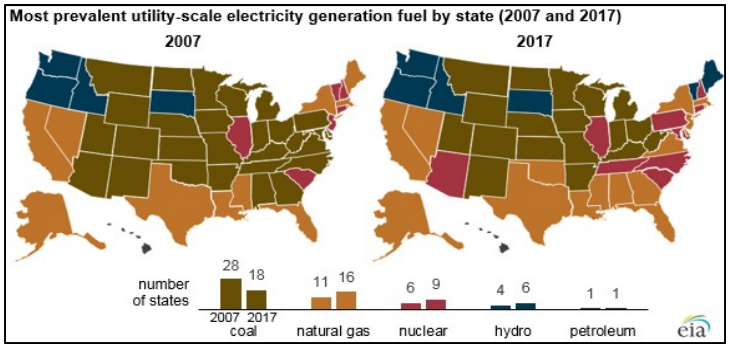


Image Shown: Natural gas is stealing market share away from coal as a fuel for electricity generation with an eye on the East Coast, Gulf Coast, and Midwestern markets. Image Source: U.S. EIA

Please see *Norfolk Southern…*on next page

***Norfolk Southern…*from previous page**

Note that natural gas overtook coal in Virginia and nuclear in New Jersey to become those state's top type of fuel for electricity by 2017. The concern is that coal consumption will face tremendous downward pressure in states that Norfolk Southern caters to, especially in the Midwest, with coal exports not able to make up the difference. As natural gas as a fuel for electricity became more prevalent in America, total coal shipments began tanking. That includes coal shipped by rail. We view this as a long-term trend and one that's very unlikely to change regardless of legislative or executive action, which would only have a short-term impact on this trajectory. Below is a look at the precipitous drop in American coal shipments.

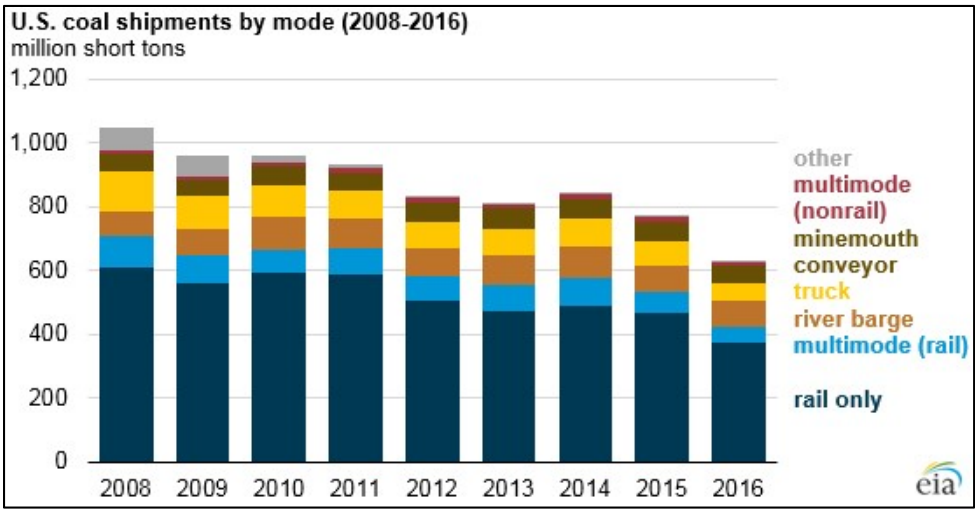


Image Shown: Coal shipments in America have been on the decline for some time. Image Source: U.S. EIA

Keep in mind that this has an outsized influence on Norfolk Southern due to the company having a heavy presence in the aforementioned regions as you can see below:

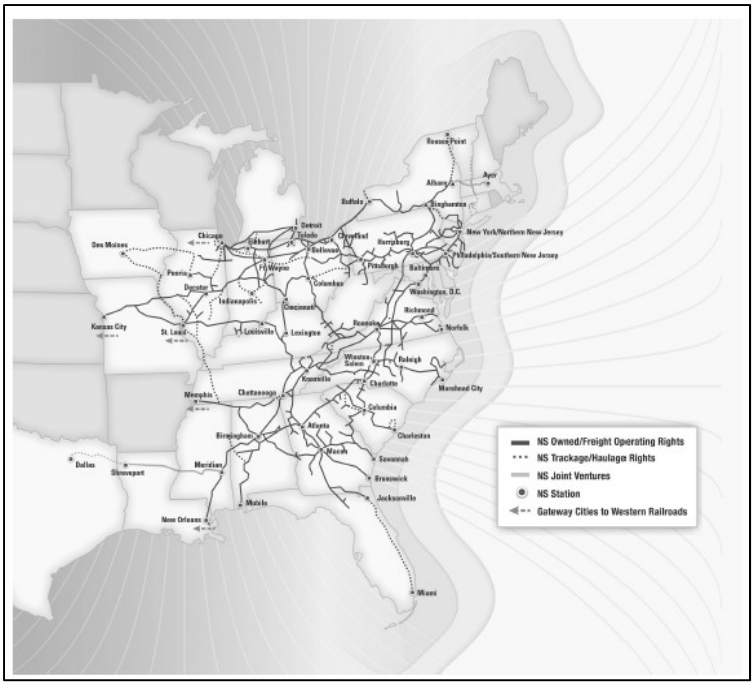


Image Shown: Norfolk Southern's operational footprint is heavily exposed to changes in the American Midwest's coal consumption. Image Source: Norfolk Southern – 2018 Annual Report

Please see *Norfolk Southern…*on page 13

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

By Valuentum Analysts

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

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

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

Company Name	Symbol	Est Div Yield	VBI	Div Growth	Div Safety	Div Cushion
General Motors	GM	3.8%	7	GOOD	EXCELLENT	3.6
Broadcom	AVGO	3.6%	7	GOOD	GOOD	1.0
Celenese	CE	2.1%	7	EXCELLENT	GOOD	2.7
DowDuPont	DWDP	3.9%	7	EXCELLENT	GOOD	1.3
Huntsman	HUN	2.7%	7	EXCELLENT	EXCELLENT	3.0
LyondellBasell	LYB	4.5%	7	GOOD	GOOD	1.0
Eaton	ETN	3.6%	7	GOOD	GOOD	1.2
Core Labs	CLB	3.2%	7	GOOD	GOOD	1.3
Visa	V	0.7%	7	EXCELLENT	EXCELLENT	5.3
Cardinal Health	CAH	3.5%	7	EXCELLENT	GOOD	1.4
Johnson & Johnson	JNJ	2.6%	7	GOOD	GOOD	2.4
Kimberly-Clark	KMB	3.3%	7	GOOD	GOOD	1.0
Caterpillar	CAT	2.5%	7	GOOD	GOOD	2.5
Dover	DOV	2.0%	7	GOOD	GOOD	1.8
Stanley Black & Decker	SWK	1.9%	7	EXCELLENT	GOOD	1.9
Interpublic	IPG	4.2%	7	EXCELLENT	GOOD	1.4
Baxter Intl	BAX	1.0%	7	GOOD	EXCELLENT	3.4
Stryker	SYK	1.1%	7	EXCELLENT	EXCELLENT	2.9
Pfizer	PFE	3.4%	7	GOOD	GOOD	1.8
Donaldson Co	DCI	1.6%	7	GOOD	GOOD	2.6
Cheesecake Factory	CAKE	2.8%	7	EXCELLENT	GOOD	2.5
American Eagle	AEO	2.6%	7	EXCELLENT	EXCELLENT	3.5
Microsoft	MSFT	1.7%	7	EXCELLENT	EXCELLENT	3.3
Oracle	ORCL	1.5%	7	EXCELLENT	EXCELLENT	4.5
Foot Locker	FL	2.3%	7	EXCELLENT	EXCELLENT	3.3
Williams-Sonoma	WSM	3.4%	7	EXCELLENT	GOOD	2.0
Equifax	EFX	1.4%	7	EXCELLENT	GOOD	1.8
Manpower	MAN	2.4%	7	EXCELLENT	EXCELLENT	3.1
Robert Half	RHI	1.9%	7	EXCELLENT	EXCELLENT	3.5

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

The Financially-Healthiest Dividend Payers Yielding Over 2%

By Valuentum Analysts

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

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

Company Name	Symbol	Est Div Yield	Div Cushion	Economic Castl	Multiplie
GameStop	GME	17.3%	1.8	Attractive	31.29
General Motors	GM	3.8%	3.6	Attractive	13.82
Chico's FAS	CHS	5.9%	2.3	Attractive	13.74
Honda	HMC	3.6%	3.7	Neutral	12.98
Gilead Sciences	GILD	3.9%	3.1	Very Attractive	12.17
Chicago Rivet	CVR	3.0%	3.9	Neutral	11.78
Guess	GES	2.7%	3.9	Attractive	10.48
Automatic Data Processing	ADP	2.1%	5.0	Very Attractive	10.36
Abercrombie & Fitch	ANF	3.1%	3.3	Attractive	10.17
Cooper Tire & Rubber	CTB	1.2%	8.1	Neutral	9.96
Methode Electronics	MEI	1.6%	6.0	Attractive	9.75
Hewlett-Packard	HPQ	3.1%	3.1	Attractive	9.74
Bristol-Myers Squibb	BMY	3.4%	2.7	Very Attractive	9.29
Western Union	WU	4.5%	2.1	Neutral	9.22
American Eagle	AEO	2.6%	3.5	Attractive	9.19
Gap	GPS	3.6%	2.3	Attractive	8.46
Gentex	GNTX	1.9%	4.4	Attractive	8.37
Total	TOT	5.1%	1.6	Neutral	8.27
Huntsman	HUN	2.7%	3.0	Attractive	8.25
Ralph Lauren	RL	1.9%	4.3	Attractive	8.19
Omnicom	OMC	3.5%	2.3	Unattractive	8.01
Dick's Sporting	DKS	3.0%	2.6	Attractive	7.96
Cummins	CMI	3.1%	2.6	Attractive	7.94
Tapestry	TPR	4.1%	1.9	Attractive	7.93
Fluor	FLR	1.8%	4.4	Attractive	7.87
H&R Block	HRB	3.7%	2.1	Very Attractive	7.84
Walgreens Boots Alliance	WBA	3.2%	2.4	Attractive	7.80
Foot Locker	FL	2.3%	3.3	Attractive	7.74
Apple	AAPL	1.4%	5.5	Very Attractive	7.69
Archer-Daniels-Midland	ADM	3.3%	2.3	Attractive	7.66
Graham Holdings Co	GHC	0.8%	9.1	Attractive	7.50
AVX Corp	AVX	2.5%	2.9	Attractive	7.50
Manpower	MAN	2.4%	3.1	Attractive	7.47
Lear Corp	LEA	1.8%	4.1	Attractive	7.45
McKesson	MCK	1.2%	6.0	Very Attractive	7.45
Newmont Mining	NEM	1.8%	4.1	Neutral	7.40
Granite Construction	GVA	1.1%	6.8	Attractive	7.37
Amgen	AMGN	3.1%	2.4	Very Attractive	7.37
Ethan Allen	ETH	4.0%	1.8	Unattractive	7.31
Cisco	CSCO	2.5%	2.9	Very Attractive	7.29

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

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

Yields to Consider Avoiding

By Valuentum Analysts

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

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

Company Name	Symbol	Industry	Est. Div Yield	Div Safety	Div Cushion
Ensco	ESV	Energy Svcs - Offshore Drilling	1.0%	VERY POOR	-49.4
Range Resources	RRC	Independent Oil & Gas	0.7%	VERY POOR	-31.9
R.R. Donnelley	RRD	Commercial Services	2.2%	VERY POOR	-27.5
CIRCOR Intl	CIR	Electrical Equipment	0.4%	VERY POOR	-27.1
Superior	SUP	Auto Parts Suppliers	7.1%	VERY POOR	-12.5
Yamana Gold	AUY	Metals & Mining - gold	0.8%	VERY POOR	-9.2
Ryder System	R	Rental and Leasing	3.9%	VERY POOR	-7.3
General Electric	GE	Conglomerates	0.4%	VERY POOR	-6.6
NiSource	NI	Utilities	3.0%	VERY POOR	-6.3
Pitney Bowes	PBI	Commercial Services	2.8%	VERY POOR	-5.7
Intl Game Technology	IGT	Leisure	5.7%	VERY POOR	-5.7
Teekay	TGP	Shipping	3.7%	VERY POOR	-5.7
Owens & Minor	OMI	Healthcare Products	4.3%	VERY POOR	-5.3
HCA Healthcare	HCA	Health Care Services	1.0%	VERY POOR	-4.9
H.B. Fuller	FUL	Chemicals - broad	1.3%	VERY POOR	-4.1
Centurylink	CTL	Telecom Services - diversified	8.2%	VERY POOR	-3.9
Spire	SR	Utilities	3.0%	VERY POOR	-3.6
ConAgra Brands	CAG	Food Products - Large	3.7%	VERY POOR	-3.0
Devon Energy	DVN	Independent Oil & Gas	1.3%	VERY POOR	-3.0
Noble Energy	NBL	Independent Oil & Gas	2.1%	VERY POOR	-2.9
Entergy	ETR	Utilities	4.1%	VERY POOR	-2.9
Alliant Energy Corp	LNT	Utilities	3.2%	VERY POOR	-2.5
CMS Energy	CMS	Utilities	2.9%	VERY POOR	-2.4
Silgan	SLGN	Containers & Packaging	1.5%	VERY POOR	-2.4
American Electric	AEP	Utilities	3.4%	VERY POOR	-2.1
SITE Centers	SITC	REIT - Retail	6.4%	VERY POOR	-2.0
Kraft Heinz	KHC	Food Products - Large	4.8%	VERY POOR	-2.0
Casey's General	CASY	Food Retailers	0.9%	VERY POOR	-1.9
Duke Energy	DUK	Utilities	4.2%	VERY POOR	-1.8
PPL	PPL	Utilities	5.4%	VERY POOR	-1.8
Eversource Energy	ES	Utilities	2.9%	VERY POOR	-1.7
Dine Brands Global	DIN	Restaurants - Fast Cas & Full Svc	3.0%	VERY POOR	-1.7
Anadarko	APC	Independent Oil & Gas	1.9%	VERY POOR	-1.6
Pinnacle West	PNW	Utilities	3.4%	VERY POOR	-1.5
Southern Co	SO	Utilities	4.9%	VERY POOR	-1.5
DTE Energy	DTE	Utilities	3.2%	VERY POOR	-1.5
Molson Coors	TAP	Beverages - alcoholic	2.6%	VERY POOR	-1.5
CVS Health	CVS	Food Retailers	3.7%	POOR	-1.5
Olin Corp	OLN	Chemicals - mid/small	3.5%	VERY POOR	-1.5
Public Service	PEG	Utilities	3.3%	VERY POOR	-1.5

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

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

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

*Norfolk Southern…*from page 9

What We Think

Here is a concise summary of what we see as Norfolk Southern's key strengths from our two-page Dividend Report:

> *"Metrics at Norfolk Southern have been moving in the right direction the past few years, and its 2021 targets suggest it will keep the momentum rolling.* ***It expects to move its operating ratio to 60% by 2021 (was ~65.4% in 2018) and is targeting capital spending as ~16%-18% of revenue (from ~19% in 2016)****. The company's dividend policy may be attracting income investors more than its underlying fundamentals, however, and it is targeting a dividend payout ratio of ~33% in 2020.* ***Norfolk Southern has a 135+ consecutive quarters of paying dividends, even as it buys back stock and allocates investment capital to growth projects****.Its Dividend Cushion ratio isn't the strongest, but management is committed to returning capital to shareholders."*

As we always say, no investment analysis is complete without looking at the downside risks involved as well. Here is a concise summary of how we view Norfolk Southern's key weaknesses from our two-page Dividend Report:

> *"Norfolk Southern's ~190-year history doesn't mean it is immune to all challenges.* ***A hefty tilt in its carloads to coal (15%+ of total railway operating revenues) will make for a challenging time as the commodity loses favor relative to cleaner and relatively abundant natural gas in the electric generation market****, even as Trump works to reinvigorate the industry in the near term. The long-term viability of coal as an energy resource does not look favorable.* ***Not unlike its peers, the company's net debt load leaves a good deal to be desired, and while free cash flow generation has been robust, dividend obligations are not small****. We're expecting very modest growth in the payout, but investors should note the risks highlighted by its poor Dividend Cushion ratio."*

Furthermore, it's important to take a look at the quality of the market the company is operating in. We like the railroad space:

> *"The railroad industry operates at a significant competitive advantage relative to motor transportation in that it can charge lower rates for long-haul bulk shipments (coal, grain, rock). Still, participants face competition from other railroads that operate parallel routes, from motor carriers that provide similar services, and from barges in routes close to inland and Gulf Coast waterways. Operating a railroad is a capital-intensive proposition, and participants face cost pressures from both union labor and fuel. Pricing and volume trends in commodity categories can be quite volatile from year to year. We like the group."*

Concluding Thoughts

Norfolk Southern is doing an excellent job improving its profitability, but we are very concerned with its high net debt load and exposure to the long-term decline in America's coal market. While there could be upside through increased coal shipments for export, that strategy has its limits as its largely dependent on factors outside of Norfolk Southern's control. Going forward, Norfolk Southern's high debt load will inhibit its ability to keep increasing its quarterly dividend, but its strong free cash flow generation could enable management to chip away at that burden. We are not interested in the company at these levels.

Callum Turcan does not own shares in any of the securities mentioned above. Some of the companies written about in this article may be included in Valuentum's simulated newsletter portfolios. Contact Valuentum for more information about its editorial policies.

Mortgage REITs Still Dangerous Income Vehicles

Please note that a version of this article was published on Valuentum.com April 29.

***Image**: Since late May 2013, mortgage REITs, as measured by the iShares Trust Mortgage Real Estate ETF (REM), middle, have fallen more than 20%, while the master limited partnership space, as measured by the Alerian MLP ETF (AMLP), has fallen by nearly 45%, bottom. Meanwhile, the S&P 500 (SPY) has rallied more than 75%, all on a price-basis, top.*

By Brian Nelson, CFA

There's nothing "safe" about mortgage REITs (REM). The industry caught a lot of attention with the high-profile performance of some of the larger players, including AGNC Investment (AGNC) and Annaly Capital (NLY), in years past, but the hype has fizzled out. Not only has the mortgage REIT industry vastly underperformed a broad market benchmark such as the S&P 500 during the past few years, but the industry is not easy for many to understand. Even a greater understanding of the space may not lead to investment success either. We think investors should continue to steer clear of the space, as we said in late May 2013. Excerpted from our May 2013 write-up:

> The good times are over for mortgage REITs.
>
> Mortgage market dynamics are inherently difficult to predict.
>
> A flatter yield curve has negatively impacted net interest rate spread income across the entire mortgage REIT universe. We're already seeing deteriorating gross ROE's from some of the largest industry constituents.
>
> The Fed has only caused a marginal tightening in mortgage spreads, and in our view, a marginal widening due to reduced Fed activity (if/when it happens) is perhaps the best-case scenario as it relates to spread income for the group. A continuation of spread tightening is likely the base-case scenario, which is negative for the group.
>
> Net interest rate spread income and gross ROE's will only be materially enhanced in the future through more risky dealings and increased leverage. Adding leverage is like "pulling the wool over investors' eyes." It's a very, very low-quality way of bolstering returns relative to core net interest margin expansion.
>
> The book value of some mortgage REITs will be punished regardless of what happens to interest rates. However, a rising interest rate environment can be devastating by causing other comprehensive losses (unrealized losses on investments marked to market) that will completely wipe out period spread income, causing rapid and uncomfortable declines in book value.
>
> Dividend payments may not be sustainable under these conditions.

To continue reading, please visit the following link (login required):
https://www.valuentum.com/articles/Mortgage_REITs_Still_Dangerous_Income_Vehicles

PepsiCo Fights off Forex Headwinds as it Gets Ready to Take on Amazon

Image Source: PepsiCo Inc – IR Presentation

While foreign currency headwinds are proving quite troublesome, PepsiCo continues to post strong organic growth that helped drive its outperformance during the first quarter of 2019. That strong performance will be needed as Amazon gets ready to enter the energy beverage arena.

By Callum Turcan

PepsiCo Inc's (PEP) shares shot up to record highs on April 17 after posting first quarter results that clearly impressed the market. With shares now trading around $127 as of this writing, the beverage and snack giant yields 2.9% with decent dividend coverage going forward. The company beat consensus top and bottom-line estimates while reaffirming 2019E guidance, which signals to the market that management is confident in PepsiCo's brand power.

Earnings and Guidance Overview

Underlying organic revenue growth came in at 5.2%, with net revenue growing by 2.6% year-over-year during the first quarter of 2019. Negative foreign currency movements were the primarily factor holding down sales growth as net revenue touched $12.9 billion, above market expectations for $12.7 billion in net revenue. GAAP EPS came in at $1.00, up from $0.94 in the same quarter a year ago. PepsiCo's non-GAAP core EPS climbed by 3.0% annually to $0.97 last quarter, beating expectations calling for $0.92 in core EPS. The company reduced its share count by 1.2% year-over-year during this period, better enabling GAAP and non-GAAP EPS growth, as its GAAP net income rose by 5.2% to just over $1.4 billion during the first quarter of 2019.

Please see *PepsiCo Fights…*on next page

*PepsiCo Fights…*from previous page

Management reiterated guidance for 2019 that calls for 4% organic sales growth (meaning revenue growth adjusted for foreign currency movements, which have been very negative of late) and a 1% decline in core constant currency EPS (an adjusted EPS measure that removes the effects of foreign currency movements and one-off events like certain restructuring charges) on an annual basis. In its press release PepsiCo noted that:

> *"Current market consensus rates implies a 2-percentage-point foreign exchange translation headwind to both reported net revenue and EPS performance. This assumption and the guidance above implies 2019 core earnings per share of $5.50, a 3 percent decrease compared to 2018 core earnings per share of $5.66."*

Foreign currency headwinds have been a key theme for US-based companies that have reported first quarter earnings so far, and that is unlikely to go away in the near-term. While the US FED is now holding off on raising rates, relatively speaking, the US dollar is still quite strong and will remain so for year-over-year comparisons throughout 2019 unless things change. PepsiCo still intends on being very free cash flow positive this year and reiterated guidance that calls for:

> *"Approximately $9 billion in cash from operating activities and free cash flow of approximately $5 billion, which assumes net capital spending of approximately $4.5 billion [this forecast is for 2019, and there appears to be generous rounding here]… Total cash returns to shareholders of approximately $8 billion, comprised of dividends of approximately $5 billion and share repurchases of approximately $3 billion."*

Turbulent foreign currency movements aside, PepsiCo remains committed to rewarding its shareholders. That commitment is part of the reason why PepsiCo's share price has been on a strong upward trend since the nadir of the Great Recession. As things stand today, PepsiCo is trading at the upper end of our range of potential fair value outcomes, indicating the market is likely pricing in expectations for continued outperformance going forward.

Competition Creeping In

As has been the case for several other industries, the beverage space (specifically energy drinks) is possibly on the verge of getting disrupted by Amazon Inc (AMZN). Amazon's private-label Solimo Red Energy Drink and Solimo Silver Energy Drink spooked shareholders of Monster Beverage Corporation (MNST) as the launch of those energy drinks marked the first time Amazon directly entered the energy drink market. Monster Beverage shares were down sharply last week the day the news broke (before later rebounding), highlighting investor apprehension as it relates to both margins and sales when it comes to competing with Amazon.

PepsiCo is active in the energy drink market through its AMP Energy brand, which underwent a major rework in 2017 – 2018 in order to revamp that offering as sales were lackluster due to intense competitive pressures. The company launched AMP Energy Organic in a bid to remain relevant in a world where consumers are increasingly favoring healthy options (or at least the perception of being healthy). Keep in mind PepsiCo is also playing the energy drink market through Mountain Dew Kickstart, an energy drink that leverages the popularity of the Mountain Dew soda brand with consumer's love of caffeine. Beyond selling energy drinks, PepsiCo distributes Rockstar Energy drinks through a deal struck in 2009 that saw PepsiCo steal away business from The Coca-Cola Company (KO).

For reference, a 12-pack of Solimo Red Energy Drinks sells for $14.99 on Amazon without any discounts, while a 12-pack of AMP Energy Original sells for $19.99 on Amazon without any discounts. A lot of energy drinks are purchased in stores as consumers need that caffeine fix right away, where prices may be a tad different, but it's clear that Amazon wants to fight on price and that is a major concern for a company like PepsiCo (and competitors like Monster Beverage).

Please see *PepsiCo Fights…*on next page

*PepsiCo Fights…*from previous page

PepsiCo's Energy Drink Strategy

Here is an excerpt from our 16-page stock report that highlights how we view the non-alcoholic beverage market;

> *"The nonalcoholic beverage segment of the commercial beverage industry is highly competitive, consisting of numerous companies that make various sparkling beverages, water products, juices, fruit drinks, energy and other performance enhancing drinks. Pricing, advertising, product innovation, the availability of in-store private-label beverages, and health concerns about sugar-sweetened beverages are key drivers that impact demand. Leading brands with high levels of consumer acceptance and an expansive distribution network are sources of competitive strengths. We like the structure of the group."*

Overall, we like the space because there is room for differentiation and the ability to make moats. Having a large distribution system on top of a massive advertising budget offers two solid ways to keep the competition at bay, or in some cases, encourage the competition to team up with a giant in the industry like PepsiCo as was the case with Rockstar Energy.

Changing up the size, shape, and aesthetic appeal of its AMP Energy brand so the cans appear slim and sleek is a perfect example of PepsiCo attempting to differentiate its products. Another example can be found at PepsiCo's new Mountain Dew AMP Game Fuel offering, which is attempting to appeal to younger gamers who often enjoy drinking caffeinated beverages while sitting down playing videogames or watching professional gamers play (including competitions that are streamed on Amazon's Twitch service). In 2018, PepsiCo launched Gatorade Zero in order to cater to athletes that are seeking a hydrating beverage without sugar or carbohydrates. Having a commanding presence in the athletic beverage market is a core part of PepsiCo's business strategy. PepsiCo's management had this to say during the company's latest conference call with investors;

> *"So in energy, we're challengers, and our opportunity in energy is clearly innovate to go into spaces that the current players are not now playing. So we're addressing energy from the coffee market. We're addressing energy from energy, like Game Fuel, with specific positionings within that, narrower but probably more functional. And so we are challengers, and we want to have that mentality of going after existing leaders in this category and trying to get market share from that segment.*
>
> *In the other 2 categories that you mentioned [coffee, sports, and energy were the three topics brought up by the analyst], our critical role is to keep building the -- make sure that those categories remain very healthy. They keep growing above NRB, and that's what's happening with coffees and with sports drinks. They're both growing fast. Our biggest innovation in beverages is Gatorade Zero. I think it's going to be a, I think, very good innovation, very incremental to the category and good for our share of market.*
>
> *So we're investing big into Gatorade Zero, and we're investing big into Gatorade. Of course, Propel is doing very well. So we have a broad-based approach to the sports category, and we see our velocities improving. When it comes to coffee, the same approach.* ***And we think our role is to continue to innovate in this category, make sure that we "premiumize". At the same time, we give value. We cover all the different spaces where the category can go****. And we see our Starbucks coffee partnership very strong and clearly growing above what is the average of our company, so very accretive."*

International markets are a key growth driver for all consumer staples and consumer discretionary companies, and PepsiCo is no exception. Last quarter, PepsiCo posted 1% annual net sales growth from its Latin American division on a GAAP basis. However, when factoring out massive foreign currency headwinds, PepsiCo's organic sales growth in Latin America clocked in at 10% during the first quarter of 2019. The firm's Latin American beverage sales volumes grew by 7% annually on an organic basis last quarter.

Please see *PepsiCo Fights…*on next page

***PepsiCo Fights…*from previous page**

PepsiCo entered into an agreement with Starbucks Corporation (SBUX) back in 2015 that covered the marketing, sale, and distribution of Starbuck's ready-to-drink beverages in Latin American markets, specifically coffee and energy drinks. So far that partnership seems to be panning out favorably on an organic basis, the main problem is outside the control of the partnership, with that problem being the strong US dollar.

Image Source: PepsiCo Inc – IR Presentation

Concluding Thoughts

As PepsiCo is trading at the upper end of our fair value estimate range and sports a good (but not stellar) dividend growth trajectory, we still prefer ideas in the simulated newsletter portfolios instead. The company is doing a solid job maintaining its position in several key markets, but it will be imperative for PepsiCo to find a way to combat Amazon now that the tech giant is moving into the energy drinks space. We will be closely monitoring the energy drink market going forward. Bigger picture, PepsiCo has a lot of potential, but one of the major risks of pushing forever deeper into international markets relates to the threat of a strong US dollar becoming very real.

Callum Turcan does not own shares in any of the securities mentioned above. Some of the companies written about in this article may be included in Valuentum's simulated newsletter portfolios. Contact Valuentum for more information about its editorial policies.

Please see *PepsiCo Fights…*on next page

J&J Beats Low Expectations, Revises Guidance Upward

Image Source: Johnson & Johnson

Johnson & Johnson issued updated guidance for 2019 that called for stronger adjusted sales and EPS growth than previously expected, which along with earnings that beat low expectations was enough to send shares up over 1% on the day, April 16.

By Callum Turcan

Embattled medical giant Johnson & Johnson (JNJ) posted first quarter earnings for 2019, which the market clearly liked as shares of JNJ were bid up by 1.1% on April 16. We include the company in both the simulated Dividend Growth Newsletter portfolio and the simulated Best Ideas Newsletter portfolio. The medical giant is active in the pharmaceuticals, medical device, and packaged consumer goods segments of the healthcare world. As of this writing, J&J yields 2.6% with a promising dividend growth trajectory ahead of it even in the face of legal and foreign currency-related tailwinds. J&J has increased its dividend for the past 56 consecutive years (as of 2018), placing it firmly in the Dividend Aristocrat category.

Report Better Than Expected

J&J generated $20 billion in revenue during the first quarter of 2019, which was broadly flat with the same period last year. Stronger performance at its pharmaceuticals business offset weaker performance at its consumer and medical devices segments. The firm's GAAP gross profit margin also remained flat at just under 67% during that period. A favorable one-time price adjustment at its US pharmaceuticals business helped prop up J&J's gross margins, as its baby care sales dropped by 14% globally which likely depressed gross margins at the unit. The company is still dealing with lawsuits over J&J allegedly selling talc products (including baby powder) that the company knew may have contained asbestos, a situation that is currently playing out in the courts. We think liabilities will be contained.

On the one hand, J&J's top line growth stalled out but on the other hand, **the company handily beat expectations that called for just $19.6 billion in sales.** Low expectations are likely a key reason why the market bid J&J's shares up on April 16. When investors are expecting sales to tank, that usually implies the market is factoring in the high probability that the company's margins will also come under pressure. As J&J's GAAP gross margins held up during what was expected to be a tough quarter, that signals to investors that J&J may be more resilient than previously thought.

When removing the impact of foreign currency adjustments, which were quite negative during the first three months of 2019, J&J posted 2.2% revenue growth at its consumer segment, 7.9% revenue growth at its pharmaceuticals segment, and saw its medical device sales decline by 1% on a year-over-year basis. Combined, J&J would have generated 3.9% in annual sales growth during the first quarter of this year if it weren't for negative foreign currency movements.

Please see *J&J Beats...*on next page

***J&J Beats…*from previous page**

That said, J&J's GAAP operating margin weakened materially due in part to legal costs. During the first quarter of 2019, J&J's GAAP operating margin dropped by over 500 basis points, ending up just north of 22%. Note that was largely due to a $423 million litigation expense, which primarily had to do with J&J and its partner Bayer AG (BAYRY) settling more than 25,000 lawsuits over the blood thinner Xarelto for $775 million in total (split two ways). In the same quarter last year, J&J's litigation expense came out to zero.

The other major factor was a sharp rise in J&J's R&D expenses, which climbed 19% annually to $2.9 billion in the first quarter of 2019. Most of that was represented by a $0.3 billion milestone payment related to its pharmaceuticals business. Also, J&J recorded a $0.9 billion in-process R&D charge last quarter, up from nothing in the same quarter in 2018. Management noted that within this expense there was *"an IPR&D charge of $0.7 billion, which is related to the write-down of the IPR&D asset from the acquisition of Alios BioPharma"* during the firm's quarterly conference call. J&J bought Alios BioPharma for $1.75 billion in cash back in 2014. The company was seeking to gain exposure to Alios BioPharma's promising treatments for infectious diseases at the time the deal was announced.

On a GAAP basis, J&J's bottom line tanked by 14% annually to $3.7 billion during the first quarter, dragging down its GAAP diluted EPS by 13%, to $1.39. That was entirely due to J&J's operating income diving by 19% year-over-year to $4.4 billion, offsetting the favorable impact of a 510 basis point reduction in its effective corporate income tax rate. When making a sea of adjustments, J&J highlights how its non-GAAP net income would have come in at $5.7 billion last quarter, up marginally from the same period in 2018. The company's adjusted diluted earnings per share would have grown by 2% year-over-year to $2.10.

What We Think

Here are some of J&J's key strengths that are worth keeping in mind when evaluating the company (from our two-page dividend report);

> *"Dividend Aristocrat Johnson & Johnson is in a class by itself. Founded in 1886, everybody seemingly has come into contact with its brands in one way or another; 70% of sales are generated from #1 or #2 global leadership positions across its markets. J&J has driven 30+ years of adjusted earnings increases and more than 55 years of annual consecutive dividend increases! We like its diversified presence, and generally view its consumer portfolio as the core foundation and its pharmaceutical pipeline the icing on the cake; its Oncology division is growing at a robust rate. Free cash flow has averaged ~$17.3 billion during the past three years (2016-2018), well in excess of its yearly run-rate cash dividend obligations (~$9.5 billion)."*

Furthermore (from our 16-page stock report);

> *"J&J's pharma portfolio is impressive. REMICADE has ~90% share of the US market for IV immunology products by volume, but the therapy's US exclusivity expired in 2018. STELARA (exclusivity through 2023 in US) and SIMPONI (exclusivity through 2024 in US) are also key profit drivers. Biosimilars competition is accelerating, but J&J's Oncology division is growing at a tremendous pace…*
>
> *Top-line growth at Johnson & Johnson will be driven by its impressive pharma portfolio pipeline, which will be supported by its steady consumer product business. The firm has at least 10 new molecular entities it believes have $1+ billion in individual annual sales potential that it expects to launch or file for approval from 2017-2021."*

Please see *J&J Beats…*on next page

***J&J Beats…*from previous page**

Pharmaceutical performance is a key valuation driver at J&J. Last quarter, J&J posted 4.1% annual GAAP sales growth at its pharmaceutical segment, pushing those sales up over $10.2 billion. Over half of J&J's revenue came from its pharmaceutical segment last quarter, with strong growth seen at its DARZALEX and IMBRUVICA oncology medications and its STELARA immunology offering. This helped offset declining REMICADE sales as that immunology drug's US exclusivity expired last year, keeping in mind *"REMICADE has ~90% share of the US market for IV immunology products by volume"* and represented 10.8% of J&J's total pharmaceutical sales last quarter.

In order to take a balanced approached to investing, the good needs to be contemplated alongside the bad so here are some potential downside risks to be aware of;

> *"There's a lot embedded in J&J's expectations. Management expects to file or launch at least 10 new drugs from 2017-2021 that have potentially as much as $1 billion in annual sales, individually. Its top-notch positions across the consumer spectrum are a solid foundation for payout sustainability, but any large disappointments in its pharma pipeline could impact the pace of long-term dividend growth. R&D will eat up some profits as J&J continues to invest in its business, and it remains acquisitive. But we have no qualms with either. Share repurchases will be ongoing. Management has done a nice job deleveraging after the recent Actelion acquisition as its net debt load was $10.8 billion at the end of 2018 compared to $16.3 billion a year earlier."*

Of course, there are also legal risks to be aware of as well. As of the latest update we could find, J&J faces over 13,000 lawsuits concerning its talcum powder product sales with the plaintiffs alleging that those products gave them ovarian cancer or mesothelioma. The size of this liability is hard to pin down, but note that some juries have imposed very harsh penalties on J&J in the past. We will be closely monitoring how that situation plays out going forward. For its part, J&J has come out and strongly denied these reports and is currently aggressively defending itself in the courtroom.

Guidance Update

J&J issued updated guidance for 2019 that likely helped instill a level of certainty in market expectations of its near-term performance. When factoring in the projected impact of planned acquisition and divestment activity, J&J is now guiding it will post adjusted (for currency movements) revenue growth this year. Previously, management was expecting flat revenue growth when adjusting for currency movements. While negative currency movements are still expected to generate negative GAAP revenue growth this year, J&J is at least moving in the right direction. J&J also revised its annual EPS and adjusted EPS growth projections upwards for 2019, with projections calling for decent mid-single-digit growth.

2019 Guidance

	April	January	Comments
Adjusted Operational Sales[1]	2.5% - 3.5%	2.0% - 3.0%	Net Impact Acq./Div.: ~2.0%
Operational Sales[2]	$82.0B - $82.8B 0.5% - 1.5%	$81.6B - $82.4B 0.0% - 1.0%	
Estimated Reported Sales[3]	$80.4B - $81.2B (1.5%) - (0.5%)	$80.4B - $81.2B (1.5%) - (0.5%)	FX ($1.6B) or (2.0%) impact
Adjusted Pre-Tax Operating Margin[4,5]	Slight improvement	Slight improvement	
Net Interest Expense	$100 - $200 million	$100 - $200 million	
Net Other Income[4]	$2.4 - $2.7 billion	$2.0 - $2.3 billion	Completed the divestiture of ASP in Q2
Effective Tax Rate[4]	17.0% - 18.0%	17.0% - 18.0%	
Adjusted EPS (Operational)[2,4]	$8.73 - $8.83 6.7% - 7.9%	$8.65 - $8.80 5.7% - 7.6%	Increased midpoint to $8.78 or 7.3%
Adjusted EPS (Reported)[3,4]	$8.53 - $8.63 4.3% - 5.5%	$8.50 - $8.65 3.9% - 5.8%	Consistent midpoint of $8.58 FX ($0.20) or (2.4%) impact

Johnson & Johnson

[1] Non-GAAP measure; excludes acquisitions and divestitures
[2] Non-GAAP measure; excludes the impact of translational currency
[3] Rate: Average Rate: April = $1.12 January = $1.14
[4] Non-GAAP measure; excludes intangible amortization expense and special items
[5] Sales less: COGS, SM&A and R&D expenses

17

Image Shown: J&J's management team issued out a favorable guidance update, with the company now expected to post organic sales growth this year. Image Source: J&J - IR presentation

Please see *J&J Beats…*on next page

***J&J Beats…*from previous page**

Management had this to say during the firm's latest quarterly conference call:

> *"Now let me provide a few comments on the updates to our guidance for 2019, which we noted in this morning's press release.* ***Our first quarter results have elevated our confidence in our performance****, strengthening the outlook for our operational sales growth.* ***As a result, we are increasing our guidance by 50 basis points, reflecting full year adjusted operational sales growth of 2.5% to 3.5% and operational sales growth of 0.5% to 1.5%. The negative impact of translational currency, however, has increased, but we plan to absorb that impact with the strength of our operational sales outlook I just referenced****. Therefore, our expectation for total reported sales in 2019 remains the same."*

Concluding Thoughts

There are still numerous uncertainties clouding over J&J's medium-term outlook, namely ongoing foreign currency headwinds, potential legal liabilities, and the inherent risks involved with the pharmaceutical business. However, a**s a stalwart dividend payer with strong free cash flow potential and with signs of a turnaround beginning to emerge, we aren't worried about J&J's payout at all.** We appreciate J&J's strong dividend coverage, its promising dividend growth trajectory that is built on the back of its pharmaceuticals growth story, and note the company trades near the midpoint of our range of potential values.

Callum Turcan does not own shares in any of the securities mentioned above. Some of the companies written about in this article may be included in Valuentum's simulated newsletter portfolios. Contact Valuentum for more information about its editorial policies.

Latest Channel Checks at Malls… Scary

We know malls come and go, and location is everything, but our latest visit to a few malls in the Chicagoland area leave us scratching our heads in a big way. One was eerily empty.

By Brian Nelson, CFA

A small sample set is never one to extrapolate, but our latest checks of malls in the northwest Chicagoland area came up a little surprising. We're not sounding the alarm bells just yet, but we think some caution is in order for the largest mall REITs, including Tanger Factory (SKT), Macerich (MAC), Simon Property (SPG) and Taubman (TCO).

Please see *Latest Channel Checks…*on next page

***Latest Channel Checks…*from previous page**

Something just wasn't quite right on our latest visit, and we attribute it primarily to failing anchor department stores, namely Carson Pirie Scott (BONTQ), and dominating e-commerce proliferation from the likes of Amazon (AMZN) and eBay (EBAY), but also from companies like Wayfair (W). Frankly, one of the malls that we visited was so empty that strolling through it was rather eerie. There hardly was anybody there.

We removed Realty Income (O) from the High Yield Dividend Newsletter portfolio some time ago but this retail REIT still resides as a dividend growth play in the Dividend Growth Newsletter portfolio, albeit a very small weighting at that. Realty Income is more of a retail REIT than a mall REIT, so we're not as concerned with the business from our recent channel checks, but the REITs, in general, are now also feeling a bit of pressure from a bounce in interest rates, too, with the 10-year Treasury inching back to 2.6%.

For some, diversified REIT exposure as in the Vanguard VNQ (VNQ) may make the most sense, but Digital Realty Trust (DLR) is also a fascinating play on data center proliferation. We include a couple other REITs in the High Yield Dividend Newsletter portfolio, too, but their exposure falls outside the retail-oriented theme of this piece. Up to this point, we thought the malls wouldn't approach extinction for decades, but our latest channel checks suggest that Gen Z (those born in the mid-1990s through the 2000s) may be significantly less likely to visit malls than millennials (MILN).

With Facebook's (FB) Instagram Checkout and competing forms of entertainment for the youngest generation than aspiring to be "mall rats," as was common for Gen X-ers (born 1960-1979), from Netflix (NFLX) to dating apps to the social trend toward "experiences" rather than gathering material items, malls may have an even more difficult road ahead than previously expected. The mall REITs will fight the good fight, of course, but our latest checks only indicate that secular trends appear to be intensifying against them. Mall vacancy rates are worth watching closely.

Disney Pushes Deeper into the Streaming Market

By Callum Turcan

The Walt Disney Company (DIS) is getting ready to enter the streaming market in a move that has largely won praise from Wall Street, with DIS shares trading up sharply since the entertainment giant released its first quarter earnings report. As of this writing, Disney shares are trading right at the top of our range of potential outcomes and the firm yields 1.3%. We like Disney's dividend growth prospects and its tremendous dividend coverage but note that investors are placing a premium on Disney's growth story.

Please see *Disney Pushes…*on next page

*Disney Pushes…*from previous page

Streaming Ambitions

Starting this November, Disney will be launching a $6.99 per month (or $69.99 per year) streaming service, undercutting the likes of Netflix Inc (NFLX) ($12.99 per month) and Amazon Inc (AMZN) ($12.99 per month for Prime), as Disney+ is priced to gain a real foothold in the streaming market. Disney plans on investing billions of dollars on original content that will be created specifically for Disney+ in order to differentiate this offering from the offerings of Disney's very competitive peers.

That price point also makes Disney+ competitive against Hulu, a streaming service that Disney owns roughly two thirds of (on a pro forma basis) along with Comcast Corporation (CMCSA) now that AT&T Inc (T) sold its 9.5% stake in the joint-venture back to Hulu on April 15 in a transaction that valued the streaming service at $15.0 billion.

Regardless of how the cards fall in the global streaming wars, Disney intends on being the victor with several ways to play this growth market. Note that according to Disney's 2018 10-K:

> *"At the end of fiscal 2015, the Company had a 33% interest in Hulu, a joint venture owned one-third each by the Company, 21CF and Comcast Corporation. Warner Media LLC (WM) acquired a 10% interest from Hulu for $0.6 billion in August 2016, which diluted the Company's ownership interest to 30%. In addition, WM has made $0.2 billion in subsequent capital contributions. For not more than 36 months from August 2016, WM has the right to sell its shares to Hulu and Hulu has the right to purchase the shares from WM under certain limited circumstances arising from regulatory review.*
>
> ***The Company and 21CF have agreed to make a capital contribution for up to approximately $0.4 billion each if Hulu is required to repurchase WM's shares**. The August 2016 transaction resulted in a deemed sale by the Company of a portion of its interest in Hulu at a gain of approximately $175 million. The Company expects to recognize the gain if and when the put and call options expire. **Following completion of the 21CF acquisition the Company will consolidate Hulu's financial results and assume 21CF's capital contribution obligations**."*

It appears that Disney will likely contribute $0.8 billion to the joint-venture in order to enable Hulu to repurchase AT&T's stake (held by Warner Media) in the consortium. As of this writing, Disney hadn't issued a press release covering the Hulu news, so it isn't clear if this will be the case or if it has already occurred. In early-May, Disney will report second quarter results for its 2019 fiscal year which should give the market greater clarity on this subject.

Concluding Thoughts

Disney is a tremendous company and we will be keeping an eye on its foray into the streaming space. We expect substantial dividend increases over the coming years which would be supported by its strong free cash flow generation. Its 3.0x Dividend Cushion Ratio earns Disney an excellent dividend safety rating. That being said, keep in mind that investors are already placing a nice premium on Disney's growth trajectory as DIS shares are currently trading at the top end of our Fair Value Range.

Callum Turcan does not own shares in any of the securities mentioned above. Some of the companies written about in this article may be included in Valuentum's simulated newsletter portfolios. Contact Valuentum for more information about its editorial policies.

About the Valuentum Dividend Cushion™ Ratio

By Valuentum Analysts

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

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

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

The Importance of Forward-Looking Dividend Analysis

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

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

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

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

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

*About the Valuentum Dividend Cushion…*from previous page

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

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

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

The Valuentum Dividend Cushion Caught These Dividend Cuts in Advance

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

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

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

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

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

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

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

*About the Valuentum Dividend Cushion…*from previous page

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

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

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

Understanding Dividend Growth

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

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

*About the Valuentum Dividend Cushion…*from previous page

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

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

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

The Dividend Cushion Ratio Helps Income Investors

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

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

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

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

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

Valuentum Dividend Growth Newsletter: Volume 8, Issue 5

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

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

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

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

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

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

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

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

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

Copyright @2019 by Valuentum, Inc. All rights reserved.

No part of this publication may be reproduced in any form or by any means.

The information contained in this report is not represented or warranted to be accurate, correct, complete, or timely. This report is for informational purposes only and should not be considered a solicitation to buy or sell any security. No warranty or guarantee may be created or extended by sales or promotional materials, whether by email or in any other format. The securities or strategies mentioned herein may not be suitable for all types of investors. The information contained in this report does not constitute any advice, especially on the tax consequences of making any particular investment decision. This material is not intended for any specific type of investor and does not take into account an investor's particular investment objectives, financial situation or needs. This report is not intended as a recommendation of the security highlighted or any particular investment strategy. Before acting on any information found in this report, readers should consider whether such an investment is suitable for their particular circumstances, perform their own due diligence, and if necessary, seek professional advice.

The sources of the data used in this report are believed by Valuentum to be reliable, but the data's accuracy, completeness or interpretation cannot be guaranteed. Assumptions, opinions, and estimates are based on our judgment as of the date of the report and are subject to change without notice. Valuentum is not responsible for any errors or omissions or for results obtained from the use of this report and accepts no liability for how readers may choose to utilize the content. In no event shall Valuentum be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the information contained in this document. Investors should consider this report as only a single factor in making their investment decision.

Valuentum is not a money manager, is not a registered investment advisor, and does not offer brokerage or investment banking services. Valuentum has not received any compensation from the company or companies highlighted in this report. Valuentum, its employees, independent contractors and affiliates may have long, short or derivative positions in the securities mentioned herein. Information and data in Valuentum's valuation models and analysis may not capture all subjective, qualitative influences such as changes in management, business and political trends, or legal and regulatory developments. Redistribution is prohibited without written permission. Readers should be aware that information in this work may have changed between when this work was written or created and when it is read. There is risk of substantial loss associated with investing in financial instruments.

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

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

The portfolio in the Valuentum Dividend Growth 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.