OUR DIVIDEND GROWTH NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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Most-recently Added: DKS, HD, HON, QCOM, UNH (Nov 27)
Most-recently Removed: INTC (Oct 28)

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"Even in the face of exogenous headwinds, many ideas within the Dividend Growth Newsletter portfolio were still able to grow their dividend payouts in 2020. The Dividend Growth Newsletter portfolio is well-positioned to capitalize on the continued economic recovery in 2021."

– Callum Turcan

Omni-Channel Strategy at Dick's Sporting Goods Makes It a Long-Term Dividend Growth Idea

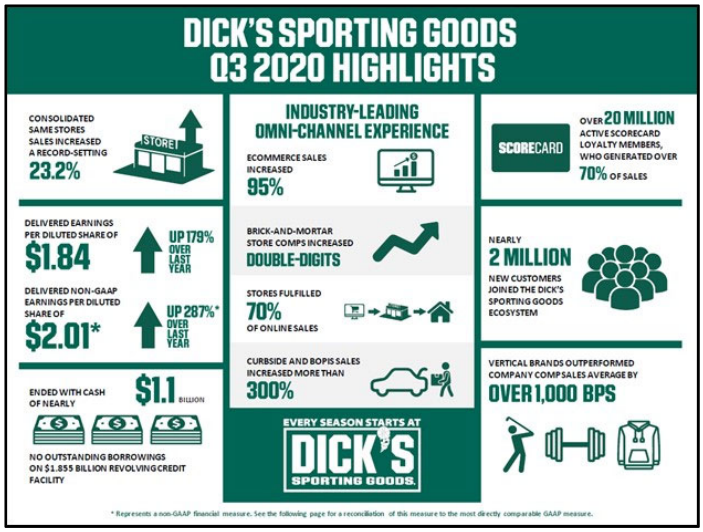

***Image Source**: Dick's Sporting Goods Inc - Third Quarter of 2020 Earnings Infographic*

By Callum Turcan

The ongoing coronavirus ('COVID-19') pandemic, due to the desire of households to socially distance, has driven a meaningful amount of consumer spending to e-commerce platforms. **Retailers that invested heavily in their online operations, while also bulking up their omni-channel sales capabilities, were in a much better position when the pandemic hit than those that had to rely largely on their physical footprint.** Over the past year, "contactless" delivery options have become much more popular. That includes fulfillment options such as curbside pickup and in-store pickup (usually in specially designated areas), where consumers purchase goods online and then travel to the relevant physical store location to acquire those products. Demand for home delivery services has surged as well.

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

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E-commerce Growth Is Key

On November 27, we added Dick's Sporting Goods Inc (DKS) to the Dividend Growth Newsletter portfolio **to gain exposure to a high-quality retailer with strong omni-channel sales operations, and the rise of e-commerce more broadly (shares are also priced attractively).** As we covered the company's financial performance and near-term outlook, we are going to focus more so on Dick's Sporting Goods' operational improvements and e-commerce strategy in this note.

First, some background information. During the firm's third quarter of fiscal 2020 (period ended October 31, 2020), **Dick's Sporting Goods reported that its e-commerce sales jumped higher 95% year-over-year and that its online sales represented ~21% of its total net sales during this period.** Strong e-commerce growth played an outsize role in growing its same-store sales by a little over 23% year-over-year last fiscal quarter, which helped the firm to grow its GAAP revenues by 23% year-over-year during this period. The company's store count grew marginally from the third quarter of fiscal 2019 (period ended November 2, 2019) to the third quarter of fiscal 2020.

Curbside and buy online, pickup in-store fulfillment options posted year-over-year sales growth north of 300% last fiscal quarter according to management commentary during the company's latest earnings call. Dick's Sporting Goods offers curbside pickup at all its physical stores, and most of those locations have dedicated parking spots for curbside fulfillment purposes. Management seeks to keep the momentum going in the right direction by adding curbside return options as part of the firm's broader strategy to create a "seamless omni-channel experience."

Furthermore, management noted that over half of Dick's Sporting Goods e-commerce sales came from mobile devices last fiscal quarter during the firm's latest earnings call. Dick's Sporting Goods' digital strategy is paying off because its mobile app is easy to use and comes with plenty of functionally as consumers can browse a wide selection of products, easily identify products that are on sale, view the status of their loyalty program (we will go into this program later), collect loyalty program points, and find nearby stores all within the mobile app.

This is important because retailers that did not have a serious online presence when the COVID-19 pandemic hit were at a major disadvantage and had to rush to catch-up. Rushing the rollout of online platforms often results in operations with limited functionality, poor user interfaces, and technical flaws and bugs. Additionally, rolling out new fulfillment options in the middle of a pandemic is no easy task, which is why Dick's Sporting Goods made the right call by having the necessary digital, physical, and operational infrastructure in place long before the pandemic hit. We appreciate the forward-thinking nature of Dick's Sporting Goods' management team and the firm's strategic goals.

Loyalty Program a Big Success

Pivoting now to Dick's Sporting Goods' customer loyalty program. The firm had over 20 million active 'ScoreCard' loyalty members last fiscal quarter, which **was responsible for over 70% of the company's sales during this period.** The firm has a base loyalty program, a 'Gold' membership, and offers a branded credit card. For reference, the ScoreCard allows customers to earn 'ScoreRewards', which can be redeemed for cash considerations, while also offering members exclusive discounts and various conveniences (such as faster checkout times).

Dick's Sporting Goods has done a tremendous job building up a returning/recurring customer base and combining its loyalty program with its online operations, which has helped solidify its relationship with its core customers. These customers generally spend significantly more per transaction than the retailer's customers who are not part of the loyalty program.

Please see *Omni-Channel Strategy …*on next page

*Omni-Channel Strategy ...*from previous page

Here is a key quote from management on this issue from the retailer's latest earnings call (emphasis added):

> *"**Another key to our omni-channel offering is our ScoreCard loyalty program, which provides robust data that we can leverage to increase engagement and drive traffic.** With over 20 million active members, our ScoreCard loyalty program drives over 70% of total sales through more meaningful and effective personalized offers and communications. We value our ScoreCard loyalty members deeply. **And with members spending approximately 30% more per transaction than nonmembers, retaining existing members and bringing new customers into the program is extremely important to us.**" --- Lauren Hobart, currently President and Director of Dick's Sporting Goods, who will become CEO effective February 1, 2021*

The data Dick's Sporting Goods gains from its customer loyalty program is quite valuable and offers multiple avenues for upside (such as better inventory management systems, insight into what types of products and which brands are experiencing high demand, and greater insight into seasonal spending patterns). Management mentioned that Dick's Sporting Goods' "new customers skew female and younger, representing a great opportunity for future growth" and that "sales from new customers [increased] over 70% compared to last year" during the firm's latest earnings call.

Keeping the Ball Rolling in the Right Direction

We appreciate that Dick's Sporting Goods places a big emphasis on innovation. The firm has continued to roll out new valuable services for its members while also optimizing its internal operations. Here is another key quote from management during the firm's latest earnings call (emphasis added):

> *"Importantly, **while our eCommerce business continues to be highly successful and penetration continues to increase, we also continue to improve the profitability of the channel**, especially as stores play a larger role in fulfillment. In the third quarter, **we saw significant improvement in eCommerce gross margins driven by higher penetration of curbside and BOPIS [buy online, pickup in-store] sales as well as fewer promotions and leverage of fixed costs**.*
>
> *Furthermore, we continue to make technology enhancements to provide an increasingly seamless omni-channel experience. In fact, as part of this year's holiday campaign, we're highlighting the technology and logistics systems in our supply chain in a unique and an engaging way. From a store perspective, **we recently rolled out a contactless, self-checkout app called Scan, Pay, & Play to over 300 stores**, which enables an efficient checkout solution for our athletes while also giving them the ability to quickly look up pricing information and product descriptions as they shop in our stores. We will continue to refine this technology and roll it out to additional stores in the near future.*
>
> ***We also recently launched HOME PLATE, a mobile communications app that provides our store teammates with real-time metrics** and important communications all while on the sales floor, giving them more time to focus on providing great service to athletes." --- The incoming CEO of Dick's Sporting Goods*

As the company continues to scale up its e-commerce business, the firm's profitability should improve considerably. We are keeping a close eye on the retailer's margins. In the third quarter of fiscal 2020, the company's GAAP gross margins rose by over 530 basis points year-over-year, aided by rising economies of scale, rising private label sales (management refers to these offerings as its "vertical brands"), and meaningful profitability improvements across its omni-channel sales operations (namely its e-commerce business).

Please see *Omni-Channel Strategy ...*on next page

Omni-Channel Strategy ...from previous page

Concluding Thoughts

We continue to be big fans of Dick's Sporting Goods. Shares of DKS yield ~2.2% as of this writing. The company's Dividend Cushion ratio sits at 3.2, underpinned by its high-quality cash flow profile and impressive growth outlook, earning the firm an "EXCELLENT" Dividend Safety rating. Please note that these two metrics consider our expectations that Dick's Sporting Goods will push through meaningful per share dividend growth over the coming fiscal years. We give the firm an "EXCELLENT" Dividend Growth rating.

Looking ahead, **Dick's Sporting Goods appears well-positioned to navigate the storm caused by the COVID-19 pandemic as global health authorities continue to work towards putting an end to the public health crisis.** The upcoming graphic down below provides a visual overview of the numerator and denominator used in Dick's Sporting Goods' Dividend Cushion ratio calculation.

Dividend Cushion Ratio Evaluation

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

Dividend Cushion Ratio Deconstruction

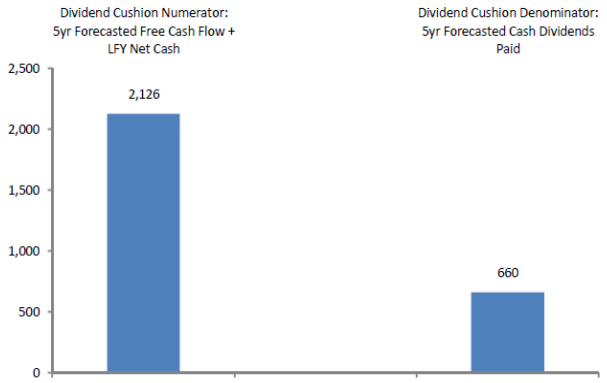

Image Shown: *An overview of Dick's Sporting Goods' stellar Dividend Cushion ratio, keeping in mind this metric factors in our expectations that the company will push through meaningful per share dividend growth over the coming fiscal years.*

Disclosure: *Callum Turcan does not own shares in any of the securities mentioned above.*

The Dividend Growth Newsletter Portfolio

By Valuentum Analysts

Most-recently Added: DKS, HD, HON, QCOM, UNH (Nov 27)
Most-recently Removed: INTC (Oct 28)

DIVIDEND GROWTH IDEAS -- as of January 1, 2021

Company Name	Yrly Div's Paid ($) / Shr	Dividend Yield %	Fair Value Estimate	*NEW* Dividend Cushion Ratio	VBI Rating	Price/FV	Last Close	% of Portfolio
Johnson & Johnson (JNJ)	4.04	2.57%	$143.00	2.14	3	1.10	157.38	8.25%-13.5%
S&P Dividend ETF SPDR (SDY)	3.02	2.85%	-	-	-	-	105.93	8.25%-13.5%
Cisco (CSCO)	1.44	3.22%	$51.00	2.85	7	0.88	44.75	6.25%-8.5%
Digital Realty Trust (DLR)	4.48	3.21%	$148.00	1.12	6	0.94	139.51	6.25%-8.5%
Health Care Sector SPDR ETF (XLV)	1.69	1.49%	-	-	-	-	113.44	6.25%-8.5%
iShares Int'l Select Dividend (IDV)	1.61	5.46%	-	-	-	-	29.47	6.25%-8.5%
Lockheed Martin (LMT)	10.40	2.93%	$385.00	1.75	3	0.92	354.98	6.25%-8.5%
Microsoft (MSFT)	2.24	1.01%	$236.00	4.39	6	0.94	222.42	6.25%-8.5%
Oracle (ORCL)	0.96	1.48%	$67.00	2.99	6	0.97	64.69	6.25%-8.5%
Apple (AAPL)	0.82	0.62%	$140.00	7.10	6	0.95	132.69	3.25%-4.5%
Newmont Mining (NEM)	1.60	2.67%	$67.00	2.71	3	0.89	59.89	3.25%-4.5%
Realty Income (O)	2.81	4.52%	$56.00	0.74	6	1.11	62.17	3.25%-4.5%
Republic Services (RSG)	1.70	1.77%	$99.00	1.71	6	0.97	96.30	3.25%-4.5%
Qualcomm (QCOM)	2.60	1.71%	$164.00	3.39	7	0.93	152.34	1.5%-2.5%
Home Depot (HD)	6.00	2.26%	$265.00	1.53	7	1.00	265.62	1.5%-2.5%
Honeywell Intl (HON)	3.72	1.75%	$202.00	2.27	5	1.05	212.70	1.5%-2.5%
UnitedHealth Group (UNH)	5.00	1.43%	$321.00	3.08	7	1.09	350.68	1.5%-2.5%
Dick's Sporting Goods (DKS)	1.25	2.22%	$67.00	3.22	6	0.84	56.21	1.5%-2.5%
Cash Consideration	-	-	-		-	-	-	~0%

UR = Under Review
Last close and dividend per share information for equities retrieved from Seeking Alpha. Dividend yield information for ETFs retrieved from Seeking Alpha.
This portfolio is not a real money portfolio. Data as of January 1, 2021

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 in the newsletter portfolio can be undervalued, however*. 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 weighting ranges makes 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. By our estimates, the efficacy of the Dividend Cushion ratio in warning about dividend cuts is roughly 90%. We're available for any questions.

The cash weighting in the Dividend Growth Newsletter portfolio is now ~0%. The midpoints of our respective weighting ranges approximately sum to 100% to reflect the range of possible combinations that may result in various allocations.

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.

Honeywell is a Tremendously Resilient Enterprise and a Rock-Solid Dividend Player

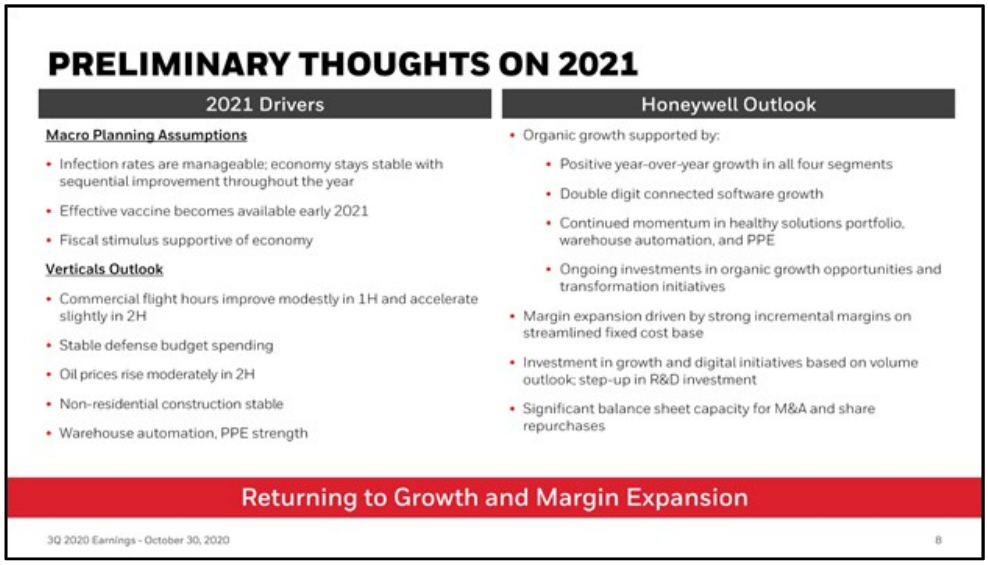

***Image Shown**: Honeywell International Inc expects its financial performance will post a significant rebound in 2021. Please note this guidance assumed a safe and viable COVID-19 vaccine would get distributed by early-2021, though distribution activities started before then in December 2020, which supports Honeywell's near-term outlook. **Image Source**: Honeywell International Inc – Third Quarter of 2020 IR Earnings Presentation*

By Callum Turcan

We added one of our favorite industrial stocks, Honeywell International Inc (HON), to the Dividend Growth Newsletter portfolio on November 27, as the firm's operational and financial performance has proven to be incredibly resilient in the face of the ongoing coronavirus ('COVID-19') pandemic. As global health authorities begin to put an end to the pandemic, aided by recent COVID-19 vaccine developments, Honeywell is well-positioned to capitalize on a global economic recovery. Shares of HON yield ~1.8% as of this writing and its Dividend Cushion ratio sits at 2.3, earning the firm a "GOOD" Dividend Safety rating. Please note that the forward-looking Dividend Cushion ratio and Dividend Safety rating incorporates our forecast that Honeywell will push through meaningful dividend increases in the coming years. Honeywell's foundation of dividend health is quite strong, even considering future growth in the payout.

Operational Update

Honeywell's 'Safety and Productivity Solutions' business operation segment has been a bright spot of late. In the third quarter of 2020, this segment's sales were up 8%, its segment-level profit was up 12%, and its segment-level profit margin expanded by 50 basis points year-over-year. Productivity gains and greater economies of scale were cited by management as being key to improving this segment's financial performance during the firm's latest earnings call.

This segment offers various products and software including personal protection equipment ('PPE'), workplace apparel, gear, and footwear for outdoor activities, gas detection technology, cloud-based notification and emergency messaging systems, equipment that helps enable supply chain and warehouse automation, customized sensors, software solutions for data and asset management productivity needs, and much more. **Management noted that many of this segment's offerings posted growth in the third quarter of 2020** during the firm's latest earnings call including its PPE, mobility, and scanning products.

Please see *Honeywell...*on next page

*Honeywell…*from previous page

Another key offering (which is included across several of Honeywell's business operating segments) is Honeywell Forge, which offers solutions that "digitally automate processes to improve efficiency while reducing downtime and safety costs." During Honeywell's third quarter of 2020 earnings call, management noted that the firm had established a partnership with Microsoft Corp (MSFT) that aims to integrate Honeywell Forge with the latter's cloud-oriented "Dynamics' field service to provide cloud-based predictive solutions to building owners and operators through closed loop maintenance workflows, strengthening business continuity and improving operational efficiency." Going forward, **Honeywell and Microsoft are exploring ways to further integrate Honeywell Forge with Microsoft's cloud-computing Azure operations.** As an aside, Dynamics is Microsoft's suite of cloud-based enterprise resource planning (ERP) and customer relationship management ('CRM') offerings.

Preventative Maintenance a Key Trend

The company's 'Honeywell Building Technologies' business operating segment sells products, services, and software, including systems for monitoring and managing energy systems in buildings, video surveillance offerings, remote patient monitoring systems, and access control systems, and services related to installing, maintaining, and upgrading building systems. **Honeywell's deal with Microsoft will allow the company to bulk up its preventive maintenance offerings, which represents a secular growth market.** These offerings can detect problems and potential problems ahead of time. In the case of buildings, the preventative maintenance system could detect systems that may need to be repaired—or are at risk of failing—significantly faster than traditional detection methods (given the advantages of digitized monitoring systems). Such building technologies can save the customer significant sums of money by detecting major problems ahead of time.

During the third quarter of 2020, the 'Honeywell Building Technologies' segment experienced an 8% year-over-year decline in sales. However, its segment-level operating profit fell by just 5% year-over-year as its segment-level profit margin expanded by 60 basis points year-over-year, due primarily to effective cost control measures implemented during the pandemic. Some of the sales decline was attributed to various quarantine efforts worldwide according to recent management commentary. Management cited strong backlog growth at some of the 'Honeywell Building Technologies' core offerings during the firm's latest earnings call (emphasis added, lightly edited):

> *"**Orders for the business solutions projects and energy businesses both grew double digits organically in the third quarter. Additionally, the building solutions service backlog was up double digits year over year**, driven by larger orders in the Middle East and Asia. We are experiencing significant customer momentum with our portfolio of healthy building solutions. Our sales pipeline is over $600 million, and we have secured orders around the world from Charlotte to Singapore. [The Honeywell Building Technologies segment's] **margins expanded versus last year by 60 basis points in the quarter, driven by commercial excellence and cost actions to improve productivity**, which offset the impact of lower sales volumes." --- Greg Lewis, CFO of Honeywell*

Aerospace and Energy End Markets Still Weak but Recovering

Honeywell's 'Aerospace' and 'Performance Materials and Technologies' business operating segments have both faced significant headwinds due to the COVID-19 pandemic. Delayed commercial airplane deliveries (particularly for commercial airliners), and a sharp slowdown in global commercial airplane production combined with subdued demand from customers in the oil & gas industry (due to lackluster demand for refined petroleum products and various petrochemical products worldwide) weighed negatively on these operations, though headwinds are starting to abate. A recovery on these two fronts combined with strength at its other two business operating segments underpins Honeywell's bright outlook.

Please see *Honeywell…*on next page

***Honeywell…*from previous page**

We want to stress that Honeywell is much more than just an "old-guard" industrial firm. **Honeywell's digitally focused businesses, such as Honeywell Forge, represent its way of adapting to the changing needs of the 21st Century and allows the firm to offer a more comprehensive slate of products and solutions for its customers.** Additionally, Honeywell's automation-oriented offerings are likely to be in high-demand over the coming years as its enterprise customers seek to improve efficiency while reducing costs. Certain tasks can be quite risky and/or time consuming, and by automating those endeavors, Honeywell offers its customers a way to boost their productivity, improve their cost structure, and better ensure the safety of their workforce.

Financial Update

Unlike some of its industrial peers, Honeywell's balance sheet is quite strong, relatively speaking. At the end of September 2020, Honeywell had $15.0 billion in cash, cash equivalents, and short-term investments combined on the books. Stacked up against $4.5 billion in short-term debt and $17.7 billion in long-term debt, Honeywell's net debt load of ~$7.2 billion is, in our view, manageable. During the first nine months of 2020, Honeywell generated $2.5 billion in free cash flow. Though down year-over-year, **we are impressed with the firm's ability to generate sizable free cash flows in the face of serious exogenous headwinds.**

During the first nine months of 2020, Honeywell spent $1.9 billion covering its dividend obligations and $2.1 billion buying back its stock. Honeywell effectively completed its 2020 share repurchasing program in the first quarter of 2020 according to management commentary given during the firm's earnings call covering that period, though during Honeywell's third quarter of 2020 earnings call, management noted the firm planned to resume share buybacks in the fourth quarter of 2020. We would prefer Honeywell to improve its balance sheet, though given its ample liquidity on hand and ability to generate sizable free cash flows in (almost) any environment, Honeywell should still be able to improve its financial position going forward as the global economy recovers.

Concluding Thoughts

We are big fans of Honeywell and are impressed with the resilience of its business model. Honeywell continues to improve its digital operations, and we are intrigued by its recent strategic partnership with Microsoft. Expanding this partnership and further integrating Honeywell's industrial, productivity, and building management solutions with Microsoft's cloud-computing operations would go a long way in improving Honeywell's digital-oriented offerings, which in turn would support Honeywell's long-term cash flow growth outlook.

As the distribution of various COVID-19 vaccines has now begun in the US and elsewhere, Honeywell's outlook has improved significantly of late. As demand from its aerospace and oil & gas customers recovers, Honeywell's cash flows should experience a nice uplift. That dynamic, along with Honeywell's stellar cash flow profile, supports our view that the company will push through meaningful dividend increases over the coming years.

Disclosure: *Callum Turcan does not own shares in any of the securities mentioned above.*

UnitedHealth Group's Dividend Growth Potential is Impressive

***Image Shown**: UnitedHealth Group Inc has a tremendous dividend growth runway, one that is supported by its high-quality cash flow profile, pristine balance sheet, and improving near-term outlook. Shares of UNH have staged an impressive recovery over the past several months since crashing in March 2020 due to headwinds arising from the ongoing COVID-19 pandemic. We added UnitedHealth Group to our Dividend Growth Newsletter portfolio on November 27, 2020.*

By Callum Turcan

On November 27, we added UnitedHealth Group Inc (UNH) to the Dividend Growth Newsletter portfolio. The company has an "EXCELLENT" Dividend Growth rating as the firm is well-positioned to push through meaningful dividend increases in the coming years. Additionally, UnitedHealth Group earns an "EXCELLENT" Dividend Safety rating as its Dividend Cushion ratio sits at 3.1, and please keep in mind these metrics factor in our expectations that the company will meaningfully grow its payout going forward. As of this writing, shares of UNH yield ~1.5%. **We like UnitedHealth Group's stellar cash flow profile, pristine balance sheet, improving near-term outlook, and resilient business model.** During the ongoing coronavirus ('COVID-19') pandemic, the company's financial performance has remained rock-solid, too.

Before covering UnitedHealth Group's historical financials and future expected financial performance, let us first provide a brief overview of its business profile. UnitedHealth Group has two main business platforms: UnitedHealthcare (focuses on providing health insurance plans to individuals, enterprises, and governments) and Optum (a health services business that seeks to use technology to improve care delivery, generate insights that can improve various health care operations, and provide a comprehensive array of pharmacy care services).

Its four main business reporting segments are as follows: UnitedHealthcare (provides health insurance plans), OptumHealth (includes its local ambulatory care services business and a health care provider business), OptumInsight (provides a slate of services to drive efficiencies and improve quality of care including health information and electronic data exchange, revenue cycle management, administrative and clinical technology for claims editing, and risk analytics services), and OptumRx (provides diversified pharmacy care services through a vast network of retail and community health pharmacies while also helping provide home delivery services, specialized pharmacy services, and more).

Please see *UnitedHealth Group…*on next page

*UnitedHealth Group…*from previous page

Stable Historical Financial Performance

From 2017 to 2019, UnitedHealth Group saw its GAAP revenues climb higher 20% with growth experienced across the board (here we will note that UnitedHealth Group includes 'investment and other income' in its GAAP revenues figure). Rising premium payments from its health insurance business led the way and was responsible for the lion's share of its revenue growth during this period. UnitedHealth Group's GAAP operating income rose 29% from 2017 to 2019, aided by economies of scale and well-managed operating expense growth.

We appreciate the steady improvement in UnitedHealth Group's financial performance during the past few years as that speaks favorably towards its expected future financial performance. From 2017 to 2019, UnitedHealth Group generated ~$13.9 billion in annual free cash flow on average, which significantly exceeded its annual dividend obligations of ~$3.9 billion in 2019. Though UnitedHealth Group's share repurchases have become much more significant in recent years (growing from $1.5 billion in 2017 to $5.5 billion in 2019), **its shareholder return strategy remains well-funded by its organic free cash flow generating abilities.**

UnitedHealth Group
Consolidated Statements of Operations

(in millions, except per share data)	For the Years Ended December 31, 2019	2018	2017
Revenues:			
Premiums	$189,699	$178,087	$158,453
Products	31,597	29,601	26,366
Services	18,973	17,183	15,317
Investment and other income	1,886	1,376	1,023
Total revenues	242,155	226,247	201,159
Operating costs:			
Medical costs	156,440	145,403	130,036
Operating costs	35,193	34,074	29,557
Cost of products sold	28,117	26,998	24,112
Depreciation and amortization	2,720	2,428	2,245
Total operating costs	222,470	208,903	185,950
Earnings from operations	19,685	17,344	15,209
Interest expense	(1,704)	(1,400)	(1,186)
Earnings before income taxes	17,981	15,944	14,023
Provision for income taxes	(3,742)	(3,562)	(3,200)
Net earnings	14,239	12,382	10,823
Earnings attributable to noncontrolling interests	(400)	(396)	(265)
Net earnings attributable to UnitedHealth Group common shareholders	$ 13,839	$ 11,986	$ 10,558
Earnings per share attributable to UnitedHealth Group common shareholders:			
Basic	$ 14.55	$ 12.45	$ 10.95
Diluted	$ 14.33	$ 12.19	$ 10.72
Basic weighted-average number of common shares outstanding	951	963	964
Dilutive effect of common share equivalents	15	20	21
Diluted weighted-average number of common shares outstanding	966	983	985
Anti-dilutive shares excluded from the calculation of dilutive effect of common share equivalents	10	6	5

Image Shown: *UnitedHealth Group's revenues and operating income have steadily climbed higher in recent years, which we appreciate as that speaks favorably towards its outlook.* ***Image Source:*** *UnitedHealth Group – 2019 Annual Report*

During the first nine months of 2020, UnitedHealth Group's financials have held up incredibly well in the face of the COVID-19 pandemic. Its GAAP revenues advanced 6% year-over-year, once again led by strength at its health insurance business, while its GAAP operating income surged higher 29% year-over-year as management continues to keep a lid on the firm's operating expense growth. **UnitedHealth Group generated $14.6 billion in free cash flow during the first nine months of 2020** while spending $2.5 billion on share buybacks and $3.4 billion covering its dividend obligations.

Please see *UnitedHealth Group…*on next page

UnitedHealth Group...from previous page

At the end of September 2020, UnitedHealth Group's balance sheet remained pristine. The firm had $20.8 billion in cash and short-term investments on hand as well as $39.2 billion in long-term investments on the books. Stacked up against $3.9 billion in short-term debt and $39.9 billion in long-term debt, **UnitedHealth Group's net cash position of ~$16.2 billion at the end of September 2020 is an immense source of strength** during these turbulent times. The combination of its high-quality cash flow profile, pristine balance sheet, and strong outlook supports UnitedHealth Group's Dividend Cushion ratio.

UNITEDHEALTH GROUP
CONDENSED CONSOLIDATED BALANCE SHEETS
(in millions)
(unaudited)

	September 30, 2020	December 31, 2019
Assets		
Cash and short-term investments	$20,809	$14,245
Accounts receivable, net	12,171	11,822
Other current assets	21,841	16,567
Total current assets	54,821	42,634
Long-term investments	39,184	37,209
Other long-term assets	96,964	94,046
Total assets	$190,969	$173,889
Liabilities, redeemable noncontrolling interests and equity		
Medical costs payable	$21,167	$21,690
Short-term borrowings and current maturities of long-term debt	3,899	3,870
Other current liabilities	41,531	36,222
Total current liabilities	66,597	61,782
Long-term debt, less current maturities	39,895	36,808
Other long-term liabilities	14,526	13,137
Redeemable noncontrolling interests	1,847	1,726
Equity	68,104	60,436
Total liabilities, redeemable noncontrolling interests and equity	$190,969	$173,889

***Image Shown**: We are big fans of UnitedHealth Group's pristine balance sheet.* ***Image Source**: UnitedHealth Group – Third Quarter of 2020 Earnings Press Release*

Promising Outlook

During UnitedHealth Group's third quarter of 2020 earnings report, management increased the firm's full-year adjusted non-GAAP EPS guidance to $16.50-$16.75 for 2020 (versus $16.25-$16.50 previously), which is significantly above the $15.11 in non-GAAP adjusted EPS the company posted in 2019. We appreciate the company's growing optimism as it has seen "strong underlying performance across [its] business segments" of late. Though increased costs (some of which are voluntary) due to the COVID-19 pandemic are a concern. Considering that the distribution of a COVID-19 vaccine has recently begun in the US and elsewhere, it appears UnitedHealth Group's outlook continues to get brighter and brighter.

Over the long haul, management is targeting significant earnings growth at UnitedHealth Group, which in turn should drive its cash flows higher over time. Here is what the firm had to say during its third quarter of 2020 earnings call in response to an analyst's question (emphasis added, moderately edited):

> *"**We approach the future with continued conviction on our long-term 13% to 16% earnings growth objective.** Some of the factors giving us confidence include our rapidly expanding care delivery services now benefiting from over a decade of building and investing in local value-based care systems and extension into market leading post-acute home and modern behavioral health intervention services. [Continued on next page]*

Please see *UnitedHealth Group*...on next page

*UnitedHealth Group…*from previous page

[Continued from previous page] Our ability to support seniors across multiple channels and markets [involves] increasingly innovative high-value offerings. The way we meet the growing needs of people with highly complex conditions [is] with comprehensive personalized care, including people across commercial, federal and state-based programs. [This] innovative and consumer [suite] of products is now being offered through the employer and individual market channels.

Our unmatched ability to support a more interoperable and intelligent health system [is] a result of significant investments over many years to improve performance, [from] integrating data analytics and clinical information to provide essential insights to evidence-based next best care actions and our restless drive to allocate capital in line with other innovative companies *as we lead in the development of the next generation health system in a socially conscious way." --- David Wichmann, CEO of UnitedHealth Group*

In early December, UnitedHealth Group released guidance for 2021. Though significant headwinds remain due to the ongoing COVID-19 pandemic, **management appears confident that UnitedHealth Group would still be able to post solid revenue income, and cash flow growth in 2021 versus forecasted 2020 levels,** as one can see in the upcoming graphic down below. Please note this solid expected performance comes on top of the company's expectations that its revenues, income, and cash flows will grow materially in 2020 over 2019 levels.

UNITEDHEALTH GROUP®

($ in billions, except per share data; shares in millions)	2019	CONSOLIDATED FINANCIAL METRICS 2020E	2021P
Revenue	$242.2	$256.5	$277.0 – $280.0
Operating Earnings	$19.7	$22.2	$22.6 – $23.4
EBITDA[1]	$22.4	$25.1	$25.7 – $26.5
Net Earnings to UNH Shareholders	$13.8	$15.3	$16.1 – $16.6
Operating Cash Flows	$18.5	$19.5	$20.0 – $21.0
Operating Margin	8.1%	8.7%	8.1% – 8.5%
Net Income Margin	5.7%	6.0%	5.7% – 6.0%
Medical Care Ratio — Consolidated	82.5%	~79.2%	83% ± 50 bps
Operating Cost Ratio	14.5%	~16.2%	14% ± 30 bps
Dividends Paid *(at current rate)*	$3.9	$4.6	~$4.7
Share Repurchase	$5.5	$4.5	$4.5 – $5.5
Capital Spending	$2.1	$2.1	~$2.3
Weighted-Average Fully Diluted Common Shares Outstanding	966	960	950 – 955
Tax Rate	20.8%	24.0%	20.8% – 21.3%
Earnings per Share to UNH Shareholders	$14.33	~$15.90	$16.90 – $17.40
Adjusted Earnings per Share[1]	$15.11	~$16.75	$17.75 – $18.25

Image Shown: *UnitedHealth Group expects its financials will continue moving in the right direction in 2021.* ***Image Source:*** *UnitedHealth Group – 2020 Investor Conference*

Please see *UnitedHealth Group…*on next page

*UnitedHealth Group…*from previous page

Some of the key strategic initiatives UnitedHealth Group is currently working on includes investing in its telehealth capabilities, which involves connecting patients with physicians via online platforms. In theory, this makes it significantly easier for patients to complete their routine check-ups and frees up time for physicians, resulting in greater efficiencies across the board. Management noted during UnitedHealth Group's third quarter of 2020 earnings call that "OptumCare physicians have facilitated 1 million digital clinical visits directly with their patients" as mid-October. Going forward, the company plans to continue bulking up its digital capabilities.

Pivoting to UnitedHealth Group's health insurance business, management noted that "the number of people (it) serves with individual health coverage has grown by 15%" in 2020 during the firm's third quarter of 2020 earnings call. The company also noted it has significantly grown the reach of its Medicare Advantage plans and expects 2021 to be a good year for this part of its business. Combined, these two dynamics are expected to help improve UnitedHealth Group's financial performance going forward.

New Partnership

On December 4, UnitedHealth Group announced it had partnered up with Eli Lilly & Co (LLY) to help deal with the COVID-19 pandemic. The venture aims to study Eli Lilly's "new monoclonal antibody treatment, bamlanivimab, for non-hospitalized people recently diagnosed with COVID-19," which will involve leveraging UnitedHealth Group's digital capabilities to provide the study's volunteers with a "seamless observational study experience" and to improve care delivery. For reference, the US Food and Drug Administration ('FDA') has approved bamlanivimab for emergency authorization use to treat mild-to-moderate cases of COVID-19 in adult and pediatric patients.

The study's volunteers that begin experiencing COVID-19 symptoms can use an app, ProtectWell, which UnitedHealth Group developed in collaboration with Microsoft Corporation (MSFT) to indicate that they need to take a COVID-19 test. At that point, UnitedHealth Group will help arrange for the patient to take a COVID-19 test, and should that test turn up positive, the company would then help put the patient in contact with "an Optum infusion nurse to schedule a home infusion treatment of the therapy." We are intrigued by this study and wish UnitedHealth Group and Eli Lilly the best in their endeavors.

Concluding Thoughts

UnitedHealth Group is a tremendous company with a promising growth outlook, stellar cash flow profile, and pristine balance sheet. We view the company's dividend growth trajectory quite favorably, and the strength of its dividend coverage on a forward-looking basis is impressive. Additionally, the high end of our fair value estimate range sits at $401 per share of UNH, indicating UnitedHealth Group has decent capital appreciation upside, too, as of this writing. We emphasize, however, that its dividend growth potential is the paramount reason why we include shares of UNH in the Dividend Growth Newsletter portfolio.

***Disclosure**: Callum Turcan does not own shares in any of the securities mentioned above.*

Lockheed Makes an Intriguing Acquisition

Image Source: *Lockheed Martin Corporation – December 2020 IR Presentation covering Lockheed Martin Corporation's pending acquisition of Aerojet Rocketdyne Holdings Inc*

By Callum Turcan

On December 20, Lockheed Martin Corporation (LMT) announced it was acquiring Aerojet Rocketdyne Holdings Inc (AJRD) for $56.00 per share in cash, or $51.00 per share after taking into account a special $5.00 per share pre-closing cash dividend payment that Aerojet Rocketdyne plans to pay out. The deal has a total equity value of ~$5 billion when including the special dividend component and is expected to close in the second half of 2021. **In our view, this deal is highly complementary to Lockheed Martin's existing operations.** Combining Aerojet Rocketdyne's propulsion and power systems business segments with Lockheed Martin's expansive aircraft, helicopter, missile, space, maritime, and weapon systems business segments should lead to sizable operational and developmental synergies.

Image Shown: *Aerojet Rocketdyne's operations are highly complementary with Lockheed Martin's. We are intrigued by the potential synergies that could be generated as it concerns the combined entity's space operations.* ***Image Source:*** *Aerojet Rocketdyne – September 2020 IR Presentation*

Please see *Lockheed Makes…*on next page

*Lockheed Makes…*from previous page

In the graphic located near the bottom of the previous page, Aerojet Rocketdyne provides an overview of its operational focus. Lockheed Martin has an extensive presence in all of these categories. **We are intrigued by the potential synergies the combined firm could generate in the realm of space** given expectations that space-related investment will grow materially over the coming decades.

Federal governments are expected to play a leading role in boosting space-related investment with an eye towards national security activities. In late 2019, the US Space Force was officially created when the 2020 National Defense Authorization Act was signed into law by President Trump. On the private-sector side of things, Virgin Galactic Holdings Inc (SPCE) plans to offer space tourism travel packages. Those trips could begin in 2021, but more likely a bit later as there are serious operational concerns with space flight. For instance, one of Virgin Galactic's test flights in December 2020 did not go as planned, though the pilots were able to safely land the vessel.

Beyond space, missile systems and aerospace are two key areas where Lockheed Martin and Aerojet Rocketdyne's operations overlap. Lockheed Martin is the prime contractor on the Joint Strike Fighter ('JSF') program which is developing and manufacturing the F-35 jet fighter for the US and various Western-allied nations worldwide. During the first nine months of its fiscal 2020 (period ended September 27, 2020), Lockheed Martin delivered 78 F-35 jet fighters. There is ample room for upside as Lockheed Martin's total project backlog is enormous as of September 27 and is pictured in the upcoming graphic down below. Furthermore, US defense spending remains resilient and will continue to support demand for the F-35 jet fighter and Lockheed Martin's other offerings (such as its expansive missile defense portfolio).

2020 Financial Outlook

The following table and other sections of this news release contain forward-looking statements, which are based on the corporation's current expectations. Actual results may differ materially from those projected. It is the corporation's typical practice not to incorporate adjustments into its financial outlook for proposed acquisitions, divestitures, joint ventures, changes in law, or new accounting standards until such items have been consummated, enacted or adopted. For additional factors that may impact the corporation's actual results, refer to the "Forward-Looking Statements" section in this news release.

(in millions, except per share data)	2020 Current Outlook[3]
Net sales	$62,750 - $64,250
Business segment operating profit	$6,800 - $6,950
Net FAS/CAS pension adjustment[1]	~$2,090
Diluted earnings per share[2]	$23.65 - $23.95
Cash from operations	≥$7,600

1 The net FAS/CAS pension adjustment above is presented as a single amount and includes total expected 2020 U.S. Government cost accounting standards (CAS) pension cost of approximately $1,975 million and total expected financial accounting standards (FAS) pension income of approximately $115 million. CAS pension cost and the service cost component of FAS pension expense is included in operating profit. The non-service cost components of FAS pension expense are included in non-operating income (expense). For additional detail on the corporation's FAS/CAS pension adjustment see the supplemental table included at the end of this news release.

2 Although the corporation typically does not update its outlook for proposed changes in law, the above includes the effect of proposed tax regulations confirming that foreign military sales (FMS) qualify for tax deductions for foreign derived intangible income. The corporation believes incorporating the effect of the proposed regulations more accurately reflects its expectations because the proposed regulations describe the tax treatment of FMS sales in accordance with the corporation's analysis of the Internal Revenue Code.

3 The corporation's financial outlook for 2020 does not include potential impacts to the corporation's programs, including the F-35 program, resulting from U.S. Government actions related to Turkey. Currently, the corporation does not expect this event will have a material impact on its 2020 financial results.

Image Shown: *Lockheed Martin's total backlog continued to grow in fiscal 2020 versus levels seen at the end of fiscal 2019.* ***Image Source:*** *Lockheed Martin – Third Quarter of Fiscal 2020 Earnings Press Release*

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*Lockheed Makes…*from previous page

Financial Considerations

Lockheed Martin has the strength to acquire Aerojet Rocketdyne without harming its financial position. After taking the special dividend and expected debt repayments into account, Lockheed Martin forecasts that Aerojet Rocketdyne will have a ~$0.2 billion net cash position when the deal closes (for a total transaction value of ~$4.4 billion), though Lockheed Martin will likely tap debt markets for funds to cover the acquisition.

From the end of fiscal 2018 (period ended December 31, 2018) **to the end of Lockheed Martin's third quarter of fiscal 2020** (period ended September 27, 2020), **Lockheed Martin's net debt load dropped from $13.3 billion to $9.1 billion (inclusive of short-term debt), putting the firm in a better position to cover this deal.** We appreciate management's past fiscal prudence and expect that the company will work towards improving its balance sheet once the deal closes.

During the first three quarters of fiscal 2020, Lockheed Martin generated $5.3 billion in free cash flow while spending $2.0 billion covering its dividend obligations and another $1.1 billion buying back its stock. **Given that Aerojet Rocketdyne has historically been comfortably free cash flow positive** (the firm generated $0.1 billion during the first nine months of 2020) **as has Lockheed Martin, the latter should be able to quickly improve its balance sheet once the deal closes**, especially if share repurchases are kept in kept.

Though we prefer net cash positions, Lockheed Martin's impressive cash flow profile and stellar 'A-rated' investment grade credit rating indicates the company has the financial capacity to continue growing its dividend, fund its acquisition of Aerojet Rocketdyne, and maintain its financial strength going forward.

In the recent past, Lockheed Martin has been able to raise funds via debt issuances at attractive rates. In May 2020, the company issued $0.4 billion in 1.85% senior unsecured notes due 2030 and $0.75 billion in 2.80% senior unsecured notes due 2050. Those proceeds were used to retire debt and improve Lockheed Martins' debt maturity schedule through various actions taken in June 2020. We expect Lockheed Martin will be able to continue tapping capital markets at attractive rates going forward.

Concluding Thoughts

We like Lockheed Martin's dividend growth outlook and view its pending acquisition of Aerojet Rocketdyne as favorably augmenting its cash flow growth trajectory. Lockheed Martin is included in the Dividend Growth Newsletter portfolio at a moderate weighting, and shares of LMT yield a nice ~2.9% as of this writing.

On a final note, Lockheed Martin has reportedly been selected to assist a consortium that seeks to develop a new jet fighter with Japan, with Mitsubishi Heavy Industries Ltd (MHVYF) taking the lead on that endeavor. When Lockheed Martin reports its next earnings report, we will be keeping a close eye on its integration plans for Aerojet Rocketdyne and any update on the news concerning Japan's potential new jet fighter.

***Disclosure**: Callum Turcan does not own shares in any of the securities mentioned above.*

Oracle Posts Solid Earnings and Provides Favorable Near-Term Guidance

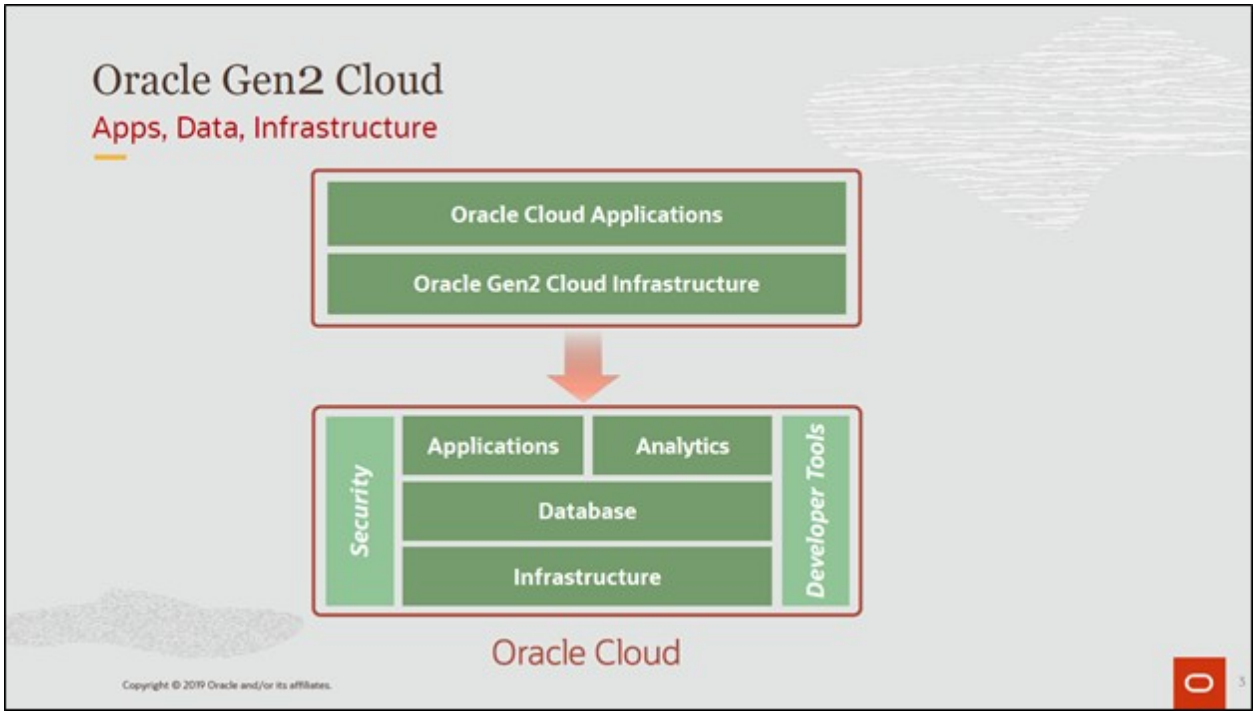

Image Source: *Oracle Corporation – September 2019 IR Presentation*

By Callum Turcan

On December 10, Oracle Corp (ORCL) reported second-quarter earnings for fiscal 2021 (period ended November 30, 2020) that beat both consensus top- and bottom-line estimates. In the fiscal second quarter, Oracle's GAAP revenues advanced 2% year-over-year on the back of its 'Cloud services and license support' segment posting 4% sales growth. The company's GAAP operating income rose 13% year-over-year last fiscal quarter, as operating expenses shifted lower 3% thanks to the efforts of **Oracle's management team to make cost containment efforts a priority.**

The firm's diluted GAAP EPS came in at $0.80 during the second quarter of fiscal 2021, up 16% year-over-year thanks in part to its weighted-average outstanding diluted share count falling almost 9% during this period. We are maintaining our $67 per share fair value estimate for Oracle and continue to include shares of ORCL in the Dividend Growth Newsletter portfolio. Shares of ORCL yield ~1.6% as of this writing with room for ample payout growth going forward, in our view.

Favorable Guidance

Most importantly, **Oracle provided decent guidance for the current fiscal quarter that indicated its revenue growth trajectory remains resilient.** During Oracle's latest earnings call, management noted that the firm's revenues would grow by 2%-4% in US dollar terms while its non-GAAP EPS is expected to grow by 13%-17% in US dollar terms during the third quarter of fiscal 2021 on a year-over-year basis. These expected growth rates are modestly lower on a constant-currency basis, but the trajectory remains the same.

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One of Oracle's biggest hurdles is growing its cloud-oriented business at a fast-enough pace to offset declines at its legacy IT business. Part of that process involves building out the data centers that enable its Infrastructure-as-a-Service ('IaaS') platform Oracle Cloud Infrastructure ('OCI') to meet rising demand. The company's 'Autonomous Database' offering "runs natively on Oracle Cloud Infrastructure while providing workload-optimized cloud services for transaction processing and data warehousing" and has played a key role in supporting Oracle's revenue growth of late. During Oracle's latest earnings call, management noted that the company's revenues would have grown at a faster rate if not for capacity constraints (emphasis added, lightly edited):

> *"We just completed a great quarter, **but the quarter would have been even better if we would have had more — and we would have had more revenue growth if we had not been capacity constrained in OCI during Q2**. There was more demand than we have supply.*
>
> ***To remedy this capacity shortfall, we are adding OCI capacity and building new OCI data centers as fast as we can.** We are now up to 29 regional data centers around the world… OCI added customers and grew revenue at a rate well in excess of 100% year-over-year in Q2. The Oracle Autonomous Database was up over 60%." --- Larry Ellison, co-founder, executive chairman, and chief technology officer of Oracle*

The launch of new services will help keep the momentum going in the right direction as it concerns Oracle's revenue growth trajectory, in our view. Management specifically mentioned that Heat Wave, a "massively parallel query accelerator" which is used on the open-source relational database management system MySQL, represented an exciting new opportunity for Oracle. During Oracle's latest earnings call, management noted that "MySQL plus Heat Wave processes queries hundreds of times faster than the current version of MySQL by itself and other MySQL-compatible databases." Heat Wave is optimized for OCI and allows for real-time analytics. Oracle sees the service being more cost-effective than its peers.

For reference, enterprise resource planning ('ERP') software is used by businesses for day-to-day operations (from accounting to supply chain operations). Oracle's Fusion Cloud ERP and NetSuite Cloud ERP offerings posted 33% and 21% revenue growth, respectively, on a year-over-year basis last fiscal quarter. A growing customer base supported sales growth at both segments. Looking ahead, Oracle appears confident that these offerings will be able to continue winning over new customers.

Looking ahead, Oracle aims to have "38 Cloud regions live by [what appears to be calendar year] mid-2021" after recently opening new commercial cloud regions in Chile, Dubai in the UAE, and the UK. These cloud regions refer to areas where Oracle has data centers and interconnection operations in place, enabling the firm to offer high-quality cloud-computing services including "zero-data-loss architectures for applications like Oracle Database." So far, Oracle has opened 13 new regional data centers to broaden its geographical reach in calendar year 2020. Expanding its geographical reach will go a long way to supporting and extending Oracle's growth runway on this front.

Financial Update

During the first half of fiscal 2021, Oracle generated $6.3 billion in free cash flow. **One of the things we appreciate about Oracle is its free cash flow conversion ratio (free cash flow as a percent of net income), which has consistently been above 110% on a trailing twelve-month basis during the past several fiscal quarters.** The upcoming graphic at the top of the next page highlights this strong performance, which signals high earnings quality.

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ORACLE CORPORATION
Q2 FISCAL 2021 FINANCIAL RESULTS
FREE CASH FLOW - TRAILING 4-QUARTERS (1)
($ in millions)

	Fiscal 2020				Fiscal 2021			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GAAP Operating Cash Flow	$ 13,829	$ 13,796	$ 13,947	$ 13,139	$ 13,092	$ 13,967		
Capital Expenditures	(1,663)	(1,591)	(1,544)	(1,564)	(1,614)	(1,833)		
Free Cash Flow	$ 12,166	$ 12,205	$ 12,403	$ 11,575	$ 11,478	$ 12,134		
% Growth over prior year	(12%)	(11%)	(6%)	(10%)	(6%)	(1%)		
GAAP Net Income	$ 10,955	$ 10,933	$ 10,759	$ 10,135	$ 10,249	$ 10,380		
Free Cash Flow as a % of Net Income	111%	112%	115%	114%	112%	117%		

(1) To supplement our statements of cash flows presented on a GAAP basis, we use non-GAAP measures of cash flows on a trailing 4-quarter basis to analyze cash flow generated from operations. We believe free cash flow is also useful as one of the bases for comparing our performance with our competitors. The presentation of non-GAAP free cash flow is not meant to be considered in isolation or as an alternative to net income as an indicator of our performance, or as an alternative to cash flows from operating activities as a measure of liquidity.

***Image Shown**: Oracle does a tremendous job converting net income into free cash flow. **Image Source**: Oracle – Second Quarter of Fiscal 2021 Earnings Press Release*

The company spent $1.4 billion covering its dividend obligations and $9.0 billion buying back its stock during the first half of fiscal 2021, activities that were partially funded by the balance sheet. As of November 30, Oracle had $38.6 billion in cash, cash equivalents, and marketable securities on hand versus $7.3 billion in short-term debt and $63.5 billion in long-term debt. Though we would prefer Oracle to pare down its debt load over time, we view its net debt load as manageable given the company's ability to consistently generate sizable free cash flows.

Concluding Thoughts

We continue to view Oracle's dividend growth trajectory favorably. Modest revenue growth and operating expense containment efforts will support Oracle's cash flow profile going forward. Shares of Oracle have been on an upward climb of late and investors appear to be warming up to the company's improving outlook. As of this writing, shares of ORCL yield ~1.5%.

On a final note, Oracle noted in its latest 10-Q SEC filing that the firm plans to move its headquarters from the heart of Silicon Valley in Redwood City, California, over to Austin, Texas. In our view, this move could help Oracle keep a lid on operating expenses without losing access to top tier talent. The company reportedly plans to allow for more flexible work arrangements over the long-term, particularly as it concerns where employees work (with an eye towards greater amounts of its employees working from home), and Oracle will maintain its workforce hubs in key IT regions across the US.

***Disclosure**: Callum Turcan does not own shares in any of the securities mentioned above.*

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 10, Issue 1

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

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

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

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

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

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

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

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

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Amended October 28, 2020