OUR BEST IDEAS NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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"In November 2021, the CPI-U (Consumer Price Index for All Urban Consumers) hit 6.8% on a year-over-year basis as inflationary headwinds continue to grow. The ideas included in the simulated Best Ideas Newsletter portfolio have ample pricing power, which should enable these firms to maintain and potentially expand their operating margins going forward, even in the face of inflationary headwinds."

-- Callum Turcan

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The Best Ideas Newsletter Portfolio (page 8): AAPL, BRK-B, CMG, CSCO, CVX, DG, DIS, DPZ, FB, GOOG, JNJ, KFY, MSFT, PYPL, XLE, XLF, XLV, XOM, V, VRTX

Latest Changes:

Added SPY Put Options --- Oct 4

Best Idea Korn Ferry Continues to Fire on All Cylinders

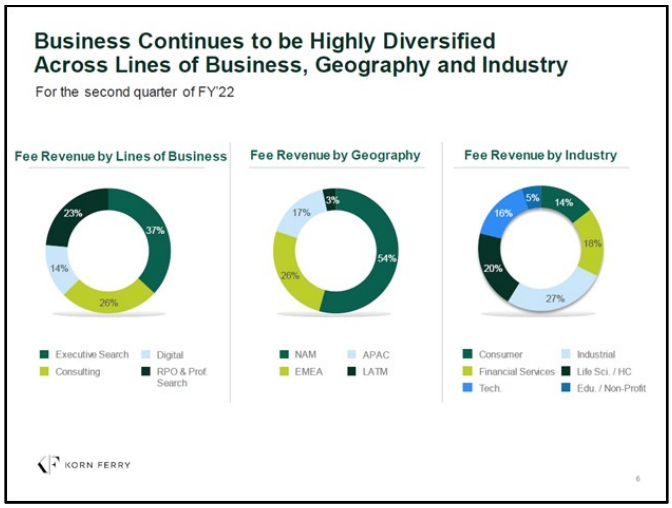

Image Shown: *Korn Ferry, an idea in our Best Ideas Newsletter portfolio, reported a strong earnings report on December 8.* ***Image Source:*** *Korn Ferry - Second Quarter of Fiscal 2022 IR Earnings Presentation*

By Callum Turcan

On December 8, the consulting firm and one of our favorite ideas, Korn Ferry (KFY) reported second-quarter earnings for fiscal 2022 (period ended October 31, 2021) that beat both consensus top- and bottom-line estimates. Strength was seen across the board at its 'Consulting,' 'Digital,' 'Executive Search,' and 'RPO and Professional Search' business operating segments which all reported nice fee revenue growth and non-GAAP adjusted EBITDA margin expansion. Please note that RPO stands for recruitment process outsourcing.

*Best Idea Korn Ferry...*continued on next page

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Goal of the Best Ideas Newsletter

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

*Best Idea Korn Ferry…*from previous page

The company issued guidance for the fiscal third quarter within its latest earnings update that indicated the underlying strength in its business seen of late is expected to continue. **We include shares of KFY as an idea in the Best Ideas Newsletter portfolio and recently updated our cash flow model covering the company. Our recently revised fair value estimate sits at $87 per share of Korn Ferry.**

Earnings Update

The company's GAAP revenues grew 47% year-over-year in the fiscal second quarter, hitting $643 million. Its Consulting sales were up 30%, its Digital sales were up 18%, its Executive Search sales were up 59%, and its RPO and Professional Search sales were up 76% year-over-year during this period (additionally, revenues related to 'reimbursed out-of-pocket engagement expenses' were up 68%).

On a non-GAAP basis, Korn Ferry reported that its adjusted EBITDA margin rose to 21.1% in the fiscal second quarter, up ~590 basis points versus levels seen last fiscal year. All of Korn Ferry's core business operating segments reported meaningful adjusted EBITDA margin expansion on a year-over-year basis last fiscal quarter.

Economies of scale and pricing strength enabled Korn Ferry to more than double its GAAP operating income in the fiscal second quarter year-over-year, which hit $104 million. The ability to digitally deliver many of its offerings further supported improvements in its profitability levels. **Korn Ferry's GAAP operating margin rose by over 510 basis points year-over-year last fiscal quarter.** Its GAAP diluted EPS came in at $1.38 in the second quarter of fiscal 2022 versus $0.51 in the second quarter of fiscal 2021. The company's latest earnings report not only reflected strong growth on a year-over-year basis, but solid sequential growth as well.

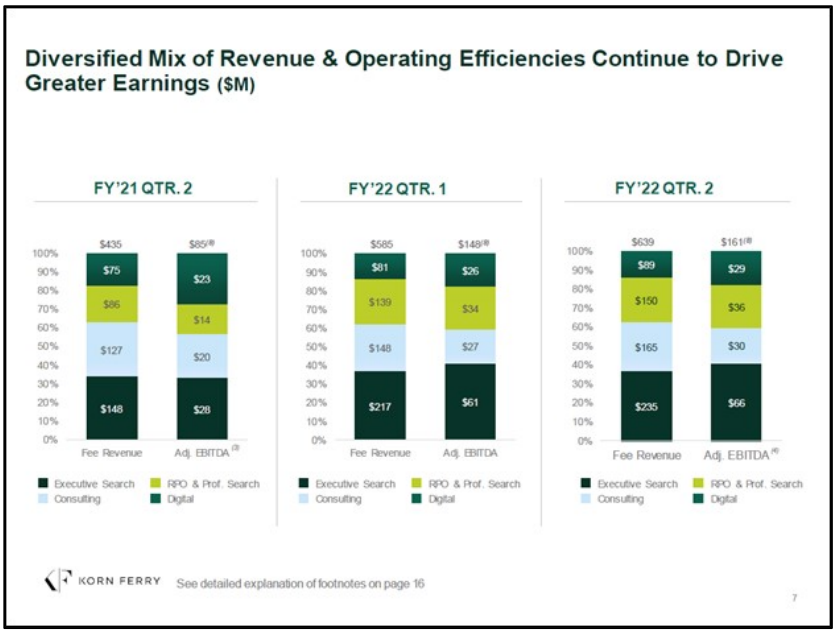

Image Shown: *Korn Ferry reported nice year-over-year and sequential growth in its key financial metrics last fiscal quarter.* ***Image Source:*** *Korn Ferry – Second Quarter of Fiscal 2022 IR Earnings Presentation*

*Best Idea Korn Ferry…*continued on next page

Best Idea Korn Ferry...from previous page

Both Korn Ferry's fee revenue (core revenue excluding items such as reimbursed out-of-pocket engagement expenses) and adjusted EBITDA hit all-time highs in the second quarter of fiscal 2022. While the coronavirus ('COVID-19') pandemic created headwinds for its business, the company's growth trajectory remained intact over the past several fiscal quarters. For the current fiscal quarter, Korn Ferry expects its fee revenue will come in at $640-$660 million, representing modest sequential growth over the $639 million in fee revenue the firm generated last fiscal quarter. The firm's non-GAAP adjusted diluted EPS is expected to come in at $1.42-$1.58 this fiscal quarter (down modestly at the midpoint of guidance on a sequential basis and up sharply on a year-over-year basis at the midpoint).

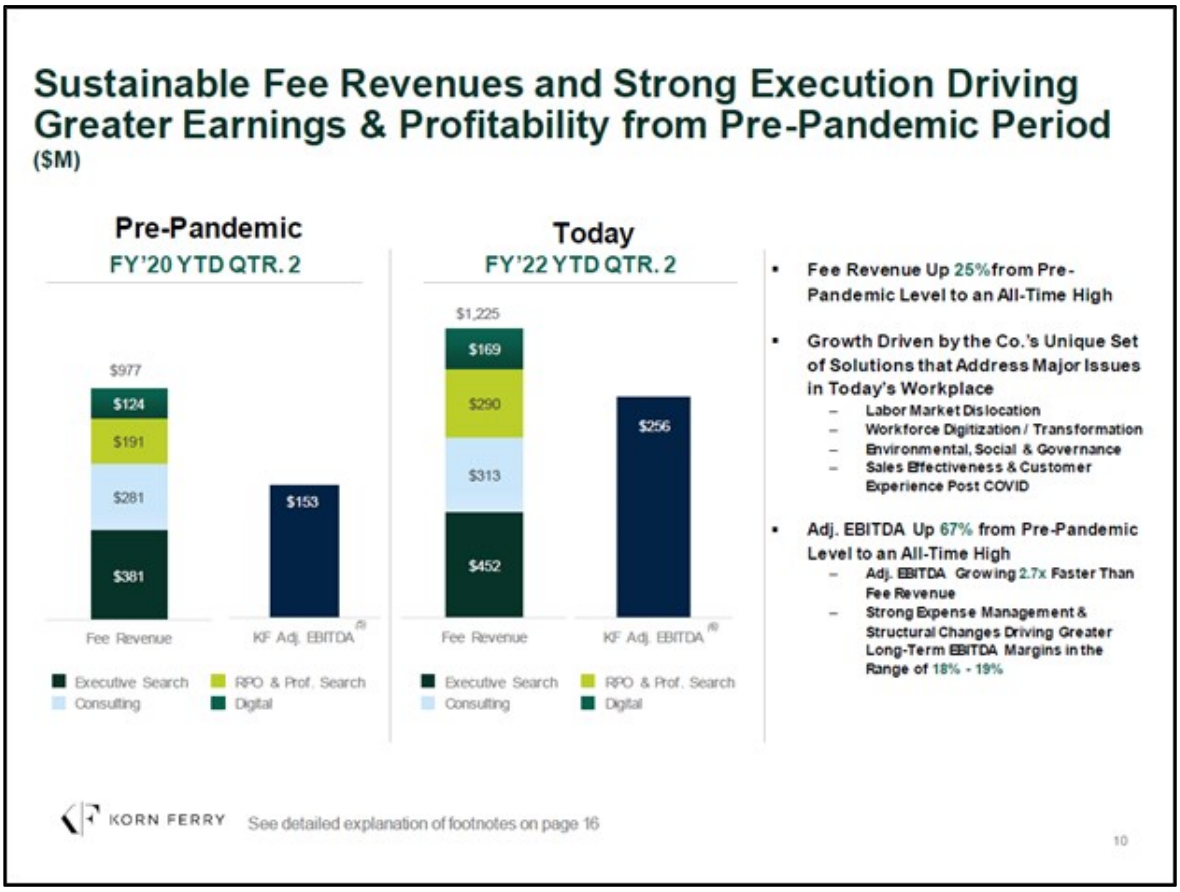

Image Shown: *Korn Ferry's underlying business is firing on all-cylinders as it reported record fee revenue and adjusted EBITDA generation last fiscal quarter.* ***Image Source:*** *Korn Ferry – Second Quarter of Fiscal 2022 IR Earnings Presentation*

Pristine Balance Sheet

At the end of October 2021, Korn Ferry had $997 million in cash, cash equivalents, current marketable securities, and non-current marketable securities on hand stacked up against no short-term debt and $395 million in long-term debt on the books. **We are big fans of Korn Ferry's $602 million net cash position at the end of this period,** though please note that a sizable chunk of its cash equivalents position is effectively reserved for bonuses and deferred compensation purposes.

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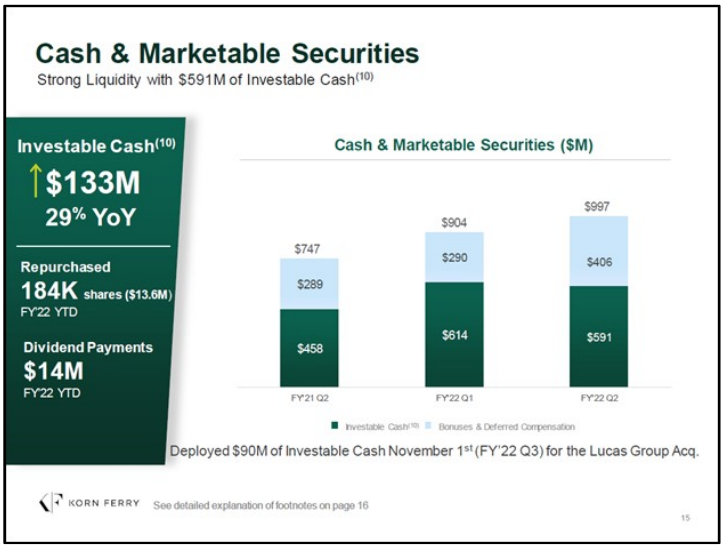

Image Shown*: Korn Ferry exited October 2021 with a pristine balance sheet.* ***Image Source****: Korn Ferry – Second Quarter of Fiscal 2022 IR Earnings Presentation*

Acquisition Closes

On November 1, Korn Ferry completed its acquisition of Lucas Group which was announced on October 23. In the October 2021 press release, Korn Ferry noted that (emphasis added):

> The broader professional search and contract staffing market is a fragmented, multi-billion-dollar global opportunity. The addition of Lucas Group to Korn Ferry's broader talent acquisition portfolio—spanning Executive Search, Recruitment Process Outsourcing, and Professional Search—is expected to accelerate Korn Ferry's ability to capture additional share of this significant market. **Terms of the deal were not disclosed. Upon closing, the acquisition is expected to be immediately accretive to Korn Ferry's adjusted earnings.**

Within Korn Ferry's latest earnings representation, the company noted that it had "deployed $90 million of investment cash" for the Lucas Group acquisition at the start of the current fiscal quarter. Please note that there may be other financial considerations. We appreciate that Korn Ferry continues to scale up its business and improve its competitive edge in the consulting space.

Concluding Thoughts

We added Korn Ferry to the Best Ideas Newsletter portfolio on January 12, 2021. Since then, shares of KFY have surged higher by ~59% as of mid-December 2021 before taking dividend considerations into account. The top end of our recently-revised fair value estimate sits at $104 per share. Shares of Korn Ferry yield ~0.6% as of this writing, offering modest income generation upside to its sizable capital appreciation upside We liked what we saw in Korn Ferry's latest earnings update.

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

Vertex Pharma Boosts Guidance (Again), Buying Back Stock While Awaiting Key Clinical Trials

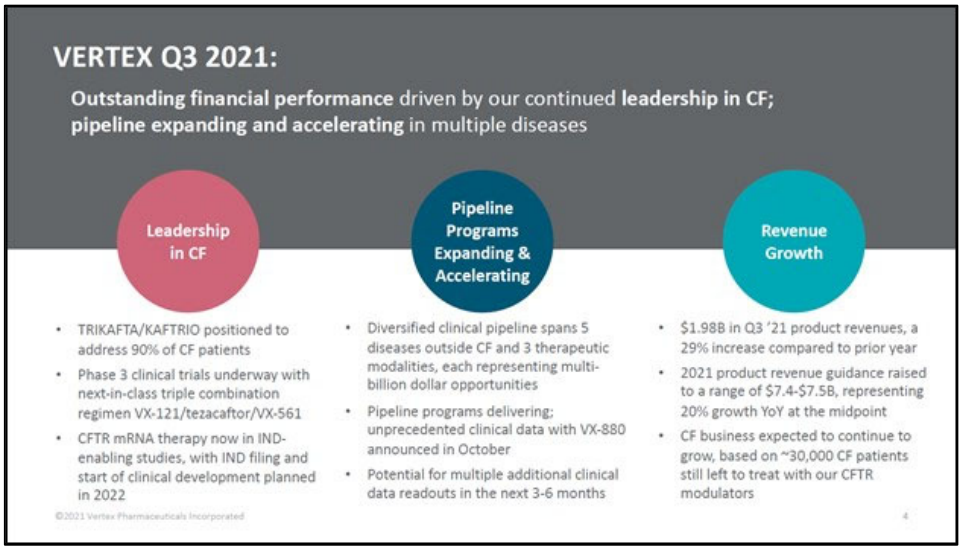

***Image Shown**: Vertex Pharmaceuticals Inc is one of our favorite biotech ideas. **Image Source**: Vertex Pharmaceuticals Inc - Third Quarter of 2021 IR Earnings Presentation*

By Callum Turcan

One of our favorite biotech plays out there is Vertex Pharmaceuticals Inc (VRTX). The company's commercial portfolio, meaning therapeutics that have already been approved by key health regulators, is centered on drugs that treat cystic fibrosis ('CF'), including patients as young as four months old as well as older patients. Its branded commercialized CF treatments include TRIKAFTA/KAFTRIO, SYMDEKO/SYMKEVI, ORKAMBI, and KALYDECO. **Vertex Pharma is currently generating substantial revenue and cash flows from these offerings.** We include shares of VRTX as an idea in our Best Ideas Newsletter portfolio.

Guidance Update

Sales of its CF treatments are performing quite well, with Vertex Pharma beating both consensus top- and bottom-line estimates when it reported third-quarter 2021 earnings in early November. In its latest third-quarter 2021 earnings release, the company guided to generate $7.4-$7.5 billion in product revenues (a proxy for total sales, as the firm will occasionally generate some sales via activities such as collaboration and royalty revenues). For reference, it generated $6.2 billion in GAAP revenue in 2020 (the lion's share of which was generated by product revenues).

Vertex Pharma has now raised its full-year guidance during both its second and third quarter earnings reports in 2021. **At the midpoint of guidance, Vertex Pharma is forecasting that it will post 20% annual sales growth in 2021.** During the first three quarters of 2021, Vertex Pharma generated $5.5 billion in GAAP revenues, representing 20% year-over-year growth. The firm is clearly on track to match its current guidance.

*Vertex Pharma ...*continued on next page

Vertex Pharma ...from previous page

The company's GAAP operating income came in at $1.9 billion during this period, down 10% year-over-year, though it's important to note that this decline was entirely due to the firm recording a $0.9 billion increase in its R&D expenses relating to a deal with CRISPR Therapeutics AG (CRSP). When removing that item, Vertex Pharma's adjusted non-GAAP operating income would have grown to $2.8 billion (up ~33% year-over-year).

Major Potential Growth Catalyst

In April 2021, Vertex Pharma agreed to pay CRISPR Therapeutics $0.9 billion with the potential for up to $0.2 billion in additional milestone payments to increase its economic interest in the potential CTX001 therapeutic. Please note that CTX001, which is "an investigational CRISPR/Cas9-based gene editing therapy that is being developed as a potentially curative therapy for sickle cell disease ('SCD') and transfusion-dependent beta-thalassemia ('TDT')," has not been approved by health regulators yet, as key clinical trials are ongoing.

There is a large commercial opportunity here as CTX001, if it receives regulatory approval, would represent a major leap forward in the realm of therapeutics. According to Vertex Pharma, there are over 30,000 potential patients in the US and EU alone that would immediately benefit from CTX001 getting approved (those with severe cases of SCD and TDT). Under "gentler conditioning regimens," the potential treatment's addressable market grows to over 165,000 prospective patients in the US and EU, with room for upside via international market expansion.

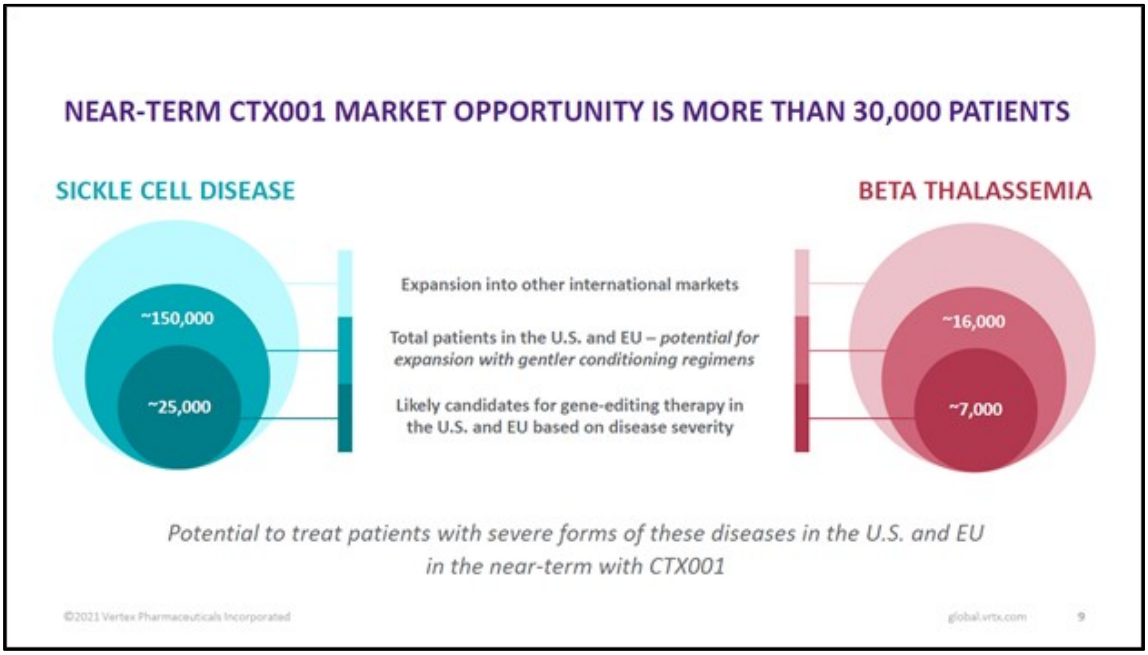

Image Shown: *CTX001 is targeting a large opportunity with ample room for upside as its prospective patient pool could grow in the event Vertex Pharma and CRSIPR Therapeutics offer "gentler conditioning regimens" and by expanding CTX001 into international markets, assuming the potential treatment receives regulatory approval.* ***Image Source:*** *Vertex Pharma – First Quarter of 2021 IR Earnings Presentation*

Vertex Pharma ...continued on next page

Vertex Pharma ...from previous page

Within its third quarter 2021 earnings press release, Vertex Pharma noted that "target enrollment has been achieved in the ongoing clinical trials in TDT and SCD to support the planned regulatory submissions in late 2022" as it concerns its CTX001 drug candidate. During Vertex Pharma's third quarter of 2021 earnings call, management had this to say on the status of the potential CTX001 therapeutic (emphasis added):

> *"CTX001 is our non-viral ex vivo gene editing therapy that is designed as a one-time curative approach for sickle-cell disease and beta thalassemia. It also stands out as a clear example of how we have accelerated our pipeline in 2021.* ***CTX001 is our most advanced programs outside of CF and continues to have strong momentum.*** *We've now fully enrolled the target number of patients in both the sickle-cell disease and beta thalassemia clinical studies.*
>
> *Based on the clinical data we've presented to-date, physician and patient interest in these trials has been high. And we have additional patients beyond the target 45 in each trial who are now completing eligibility assessments and will be enrolled this month.* ***We anticipate closing out our regulatory discussions in the near term and submitting regulatory filings for approval of CTX001 by year-end 2022****, based on these clinical results.* ***We have high confidence that CTX001 will be our next launched medicine."*** *--- Reshma Kewalramani, President and CEO of Vertex Pharma*

Additionally, Vertex Pharma's management team noted (emphasis added):

> ***"We are focused on three key areas of launched preparation for CTX001.*** *First, people.* ***We've hired many of the key people who will support the launch.*** *Second, manufacturing. This is an area we have focused on from the earliest days of our work on CTX001.*
>
> *To ensure we can supply our consistent and high-quality product to the large number of patients we believe will benefit from the medicine on day 1 of the launch.* ***Importantly, we are using the same manufacturing sites and processes for commercialization that we are using for our clinical trials.***
>
> *And third, patients, making sure we really listen, understand them and their experience.* ***So, we can provide them at launch with the information, resources and support they need as they consider treatment with CTX001."*** *--- Stuart Arbuckle, EVP and COO of Vertex Pharma*

Vertex Pharma is confident that it will be able to leverage its expertise commercializing its CF drug portfolio as it concerns bringing to market CTX001, according to recent management commentary. The company has already identified its prospective patient pool, is bulking up its sales and support staff, and is getting its manufacturing operations ready should CTX001 get the green light. We appreciate that Vertex Pharma is laying the groundwork for its, potentially, next big treatment.

Vertex Pharma ...continued on page 9

Valuentum's Best Ideas Portfolio

By Valuentum Analysts

Recent Changes:

Added SPY Put Options --- Oct 4

Valuentum's BEST IDEAS -- as of December 15, 2021

Portfolio Holdings	Symbol	Div Yield %	Fair Value	Economic Castle	VBI Rating	P/FV	Last Close ($)	% of Portfolio
Alphabet - Class C	GOOG	-	$3504.00	Very Attractive	4	0.84	2,947.37	8%-10%
Facebook (Meta Platforms)	FB	-	$507.00	Very Attractive	6	0.67	341.66	8%-10%
Visa	V	0.71%	$255.00	Very Attractive	6	0.83	212.31	8%-10%
Apple	AAPL	0.50%	$160.00	Highest Rated	6	1.12	179.30	6%-8%
Health Care ETF	XLV	1.34%	-	-	-	-	138.07	6%-8%
Microsoft	MSFT	0.76%	$342.00	Very Attractive	6	0.98	334.65	6%-8%
PayPal	PYPL	-	$208.00	Very Attractive	5	0.92	190.66	6%-8%
Cisco	CSCO	2.56%	$62.00	Very Attractive	7	0.97	59.93	4%-6%
Johnson & Johnson	JNJ	2.49%	$161.00	Attractive	3	1.06	171.14	4%-6%
ExxonMobil	XOM	5.72%	$92.00	Attractive	3	0.67	61.27	4%-6%
Berkshire Hathaway	BRK-B	-	$229.00	Very Attractive	5	1.29	294.58	3%-5%
Disney	DIS	-	$176.00	Attractive	5	0.85	150.40	3%-5%
Dollar General	DG	0.75%	$226.00	Attractive	7	1.00	226.12	3%-5%
Chevron	CVX	4.61%	$140.00	Neutral	6	0.83	115.56	3%-5%
Korn/Ferry	KFY	0.63%	$87.00	Very Attractive	4	0.88	76.55	1%-2%
Chipotle	CMG	-	$1635.00	Very Attractive	3	1.04	1,701.17	1%-2%
Domino's	DPZ	0.72%	$532.00	Highest Rated	6	0.98	523.92	1%-2%
Vertex Pharma	VRTX	-	$250.00	Very Attractive	6	0.84	211.13	1%-2%
Energy Select SPDR	XLE	3.90%	-	-	-	-	55.15	1%-2%
Financial Select SPDR	XLF	1.56%	-	-	-	-	38.97	1%-2%
Put options (SPY) -- $412 strike (Dec 31 expiration)				-	-	-	-	~3%

UR = Under Review

This portfolio is not a real money portfolio. Data as of December 15, 2021, retrieved from YF, Valuentum, Seeking Alpha.

The cash weighting in the Best Ideas Newsletter portfolio is ~0%. The midpoints of our respective weighting ranges sum to ~100% to reflect the range of possible combinations that may result in this allocation.

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

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

Every person has different goals and different risk tolerances, so where before in the newsletter portfolios, we would outline the specific percentage weighting, we think providing ranges make much more sense. For example, depending on someone's risk tolerances, a larger cash position in an overheated market may be prudent. On the other hand, the longer one's time horizon, perhaps a smaller cash position may make more sense.

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

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

Vertex Pharma ...from page 7

Other Drug Candidates

Beyond CTX001, Vertex Pharma has other drug candidates in the works. For instance, its VX-147 (treats certain kinds of kidney diseases) and VX-548 (pain management) drug candidates are undergoing Phase 2 clinical trials. In early-December 2021, Vertex Pharma reported favorable Phase 2 clinical trial data from its VX-147 drug candidate which is treating APOL1-mediated kidney disease. The company noted in a recent press release that "VX-147 was well tolerated" and that, should VX-147 prove successful, there are "more than 100,000 patients in the U.S. and Europe living with APOL1-mediated kidney disease" who could potentially benefit from this drug candidate. Additionally, the press release noted:

> …[I]n a Phase 2 proof-of-concept ('POC') study in patients with APOL1-mediated focal segmental glomerulosclerosis ('FSGS'), VX-147 on top of standard of care achieved a statistically significant, substantial and clinically meaningful mean reduction of 47.6% in the urine protein to creatinine ratio ('UPCR') at Week 13 compared to baseline. VX-147 was well tolerated. These results provide the first clinical evidence and POC that an oral small molecule APOL1 inhibitor can decrease proteinuria in patients with APOL1-mediated kidney disease. Based on these results, Vertex plans to advance VX-147 into pivotal development in APOL1-mediated kidney disease, including FSGS, in Q1 2022…
>
> **About the VX-147 Phase 2 Study**
>
> The Phase 2 open-label, single-arm study evaluated the efficacy, safety and pharmacokinetics of VX-147 in patients with APOL1-mediated FSGS. Patients with biopsy-confirmed FSGS, two *APOL1* genetic variants, proteinuria defined by at least 0.7 g/g in the UPCR and an estimated glomerular filtration rate (eGFR) of at least 27 mL/min/1.73 m^2 were eligible for enrollment in the study.
>
> Patients were on a stable standard-of-care regimen, which could include an angiotensin-converting enzyme (ACE) inhibitor, an angiotensin II receptor blocker (ARB), immunosuppressants and/or low doses of corticosteroids. Patients were treated with VX-147 for a total of 13 weeks. The primary endpoint was percent change from baseline in UPCR at Week 13. The secondary endpoints were safety and pharmacokinetics. In addition, there is a 28-day safety follow-up period after the last dose of treatment and an optional off-treatment follow-up period of up to 12 weeks after the last dose of treatment. The study is ongoing for these follow-up periods.

We are monitoring events closely and appreciate Vertex Pharma's success on this front. Pivoting here, Vertex Pharma expects to receive Phase 2 clinical trial data for its VX-548 drug candidate by the first quarter of 2022. Vertex Pharma also has additional CF treatments in the works as well, with its potential VX-121/tezacaftor/VX-561 drug combination undergoing Phase 3 clinical trials.

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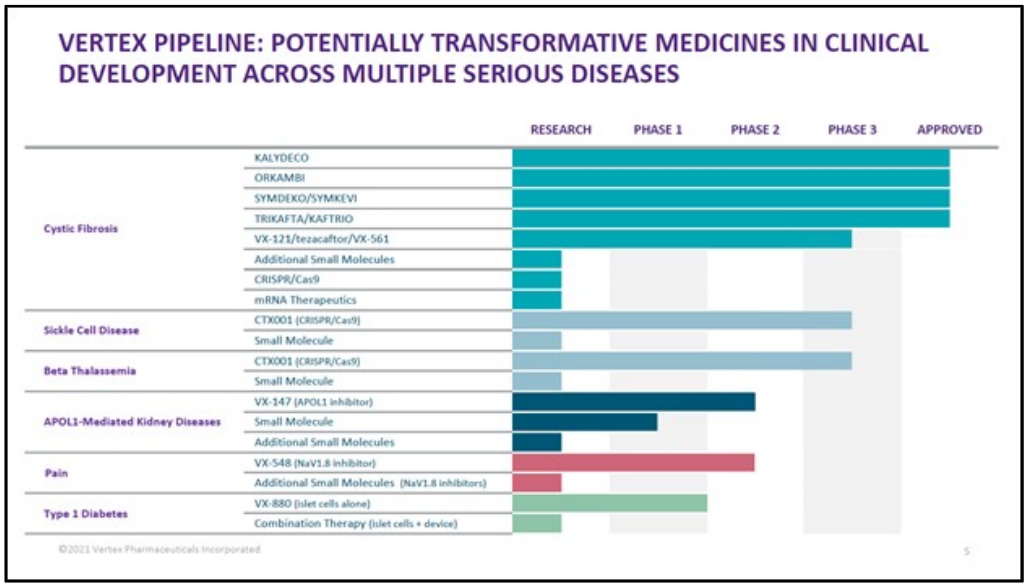

***Image Shown**: In our view, Vertex Pharma has a robust drug pipeline complemented by its existing commercialized CF drug portfolio. **Image Source**: Vertex Pharma – Third Quarter of 2021 IR Earnings Presentation*

CRISPR Upside

Utilizing CRISPR gene editing technologies to develop innovative new therapeutics represents Vertex Pharma's long-term goal. CTX001 and its strategic partnership with CRSIPR Therapeutics represents one such example of Vertex Pharma's efforts on this front. Here is what this technology aims to do, from our August 2021 article *Best Idea Vertex Pharma Marching Forward with Innovative CRISPR Technology*:

> **What Is CRISPR?**
>
> In short, CRISPR gene editing technology can identify a specified portion of DNA in a cell and when done properly (this is no easy task), CRISPR technology can alter that DNA, potentially replace faulty genes, and turn certain genes on and off without altering their sequence. However, this nascent technology comes with its risks.
>
> CRISPR stands for 'Clustered Regularly Interspaced Short Palindromic Repeats' and is built around the Cas9 protein, with the "Cas" proteins (meaning CRISPR-associated proteins) found in bacteria. Researchers have found that by adding a guide RNA and the Cas9 protein to a cell, the guided Cas9 protein is able to identify the desired DNA sequence that the researcher aims to edit.
>
> The gene editing process involves the Cas9 protein cutting the DNA, which introduces mutations that usually disable the gene after the cut is repaired, though this process is not necessarily as precise as researchers, patients, and the pharmaceutical industry would like. CRISPR technology can also be used to replace faulty genes, though this is much more complicated. [Continued on the next page]

Vertex Pharma ...continued on next page

*Vertex Pharma …*from previous page

> [Continued from the previous page] Other forms of the technology include CRISPRa and CRISPRi, which aim to turn certain genes on or off depending on the desired outcome. There are also currently academic efforts out there that aim to edit just one DNA letter in the DNA sequence (which a team at Harvard University are testing out). We are intrigued by this technology, though a lot of work still needs to be down before commercial opportunities arise. Vertex Pharma, though various strategic partnerships, is a leader on this front.

In October 2021, Vertex Pharma announced a new partnership with Mammoth Biosciences "to develop in vivo gene-editing therapies for two genetic diseases using Mammoth's next-generation CRISPR systems" according to the press release. Additionally, the press release noted that:

> Driven by its unique protein discovery engine, Mammoth's CRISPR platform consists of a proprietary toolbox of novel, ultracompact Cas enzymes, including Cas14 and Casϕ. The small size of these Mammoth systems, together with further optimized parameters, have the potential to facilitate advanced delivery, which may increase the scope of in vivo gene-editing for genetic diseases…
>
> Under the terms of the agreement, Mammoth Biosciences will receive upfront payments of $41 million, including an investment in the form of a convertible note, and is eligible to receive up to $650 million in potential future payments based upon the successful achievement of prespecified research, development and commercial milestones across two potential programs. In addition, Vertex will pay tiered royalties on future net sales on any products that may result from this collaboration.

While light on details, these are the types of deals that we like to see. This is just one of many similar types of partnerships involving CRISPR gene editing technology that Vertex Pharma is pursuing. Back in August 2021, Vertex Pharma announced a "new collaboration" with Arbor Biotechnologies that builds on their existing partnership first established back in 2018. According to the August 2021 press release:

> Under this new partnership, Vertex will receive rights to use Arbor's technology to research and develop *ex vivo* engineered cell therapies towards Vertex's goal of generating fully differentiated, insulin-producing hypoimmune islet cells for the treatment of type 1 diabetes, for next-generation approaches in sickle cell disease and beta thalassemia, and for the treatment of other diseases…
>
> Under the terms of the agreement, Arbor will receive an upfront cash payment and is eligible to receive up to $1.2 billion in potential payments based upon the successful achievement of specified research, development, regulatory and commercial milestones across up to seven potential programs. In addition, Vertex will pay tiered royalties on future net sales on any products that may result from this collaboration. Vertex will also make an investment in Arbor in the form of a convertible note.

*Vertex Pharma …*continued on next page

Vertex Pharma ...from previous page

Please note that most of these deals do not involve relatively large upfront cash payments. The largest financial component is usually the milestone payments and potential royalty payments should early-stage drug candidates eventually get commercialized, which would represent a major win for both Vertex Pharma and its strategic partners. We are keeping a close eye on Vertex Pharma's efforts in the CRISPR gene editing realm.

Financial Update

At the end of September 2021, Vertex Pharma had $7.0 billion in cash, cash equivalents, and current marketable securities on hand versus $0.6 billion in finance lease obligations on the books. **The company's $6.4 billion net cash position provides Vertex Pharma with ample financial firepower** and represents a sizable chunk of the intrinsic value of the company's equity.

During the first nine months of 2021, Vertex Pharma generated $1.5 billion in free cash flow and spent $1.1 billion buying back its common stock. Please note Vertex Pharma does not pay out a common dividend at this time.

In response to disappointing clinical trial data from VX-864 (which aimed to treat Alpha-1 Antitrypsin Deficiency, abbreviated as AATD) announced back in June 2021, a drug candidate which "will not advance into late-stage development" according to the press release, Vertex Pharma announced it had approved a $1.5 billion share buyback program later that same month (via an 8-K SEC filing) which is set to run through December 2022. Vertex Pharma has ample room to continue buying back its stock going forward given its pristine balance sheet and stellar free cash flow generating abilities.

Our fair value estimate for Vertex Pharma sits at $230 per share, and we view its share repurchases as a solid use of capital given the discount to their intrinsic value that shares of VRTX are currently trading at as of this writing (and have been for some time). Please note our fair value estimate has a rather wide range ($130-$322 per share) given the inherently volatile outlook of biotech firms as they seek to secure regulatory approval for key drug candidates.

Concluding Thoughts

Vertex Pharma has a robust drug pipeline, though all eyes are on its potential CTX001 treatment. Should the treatment receive the green light from key healthcare regulators, Vertex Pharma's financial performance would benefit from a major growth catalyst. In the meantime, we think it is prudent for Vertex Pharma to continue leveraging its financial strength to repurchase sizable chunks of its stock.

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

We Remain Bullish on Disney's Capital Appreciation Upside Potential

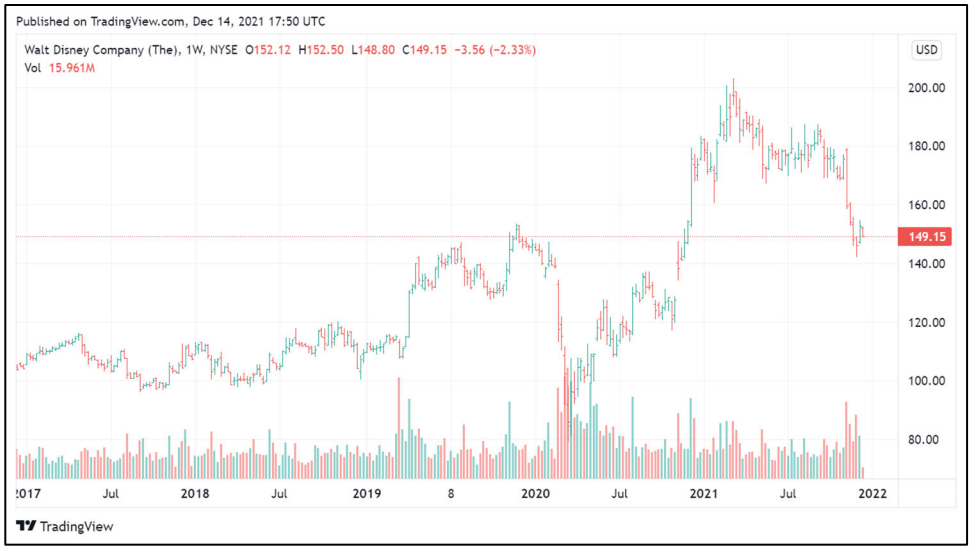

Image Shown: *Shares of The Walt Disney Company have shifted lower over the past month, though are still bullish on its capital appreciation upside. Our fair value estimate sits at $192 per share of Disney.*

By Callum Turcan

The Walt Disney Company (DIS) reported fourth-quarter earnings for fiscal 2021 (period ended October 2, 2021) on November 10 that missed consensus top- and bottom-line estimates. While the company's 'Disney Parks, Experiences and Products' segment (includes its theme parks and resorts operations) staged an impressive turnaround last fiscal quarter, its 'Disney Media and Entertainment Distribution' segment (includes its video streaming businesses) grew at a slower pace than expected.

Shares of Disney sold off after its latest earnings report, though we remain confident that the company's free cash flow growth outlook remains stellar and continue to view Disney's capital appreciation upside potential quite favorably. We include shares of DIS as an idea in our Best Ideas Newsletter portfolio.

Financial Update

Last fiscal quarter, its Disney Parks, Experiences and Products segment reported 99% year-over-year sales growth and its segment-level operating income flipped from a loss of ~$0.95 billion in the same period the prior fiscal year to a profit of ~$0.65 billion in the fourth quarter of fiscal 2021. That turnaround highlights the favorable impact widespread coronavirus ('COVID-19') vaccine distribution efforts and the ending of many lockdown measures are having on Disney's financial performance. Its Disney Media and Entertainment Distribution segment reported 9% year-over-year sales growth last fiscal quarter, though its segment-level operating income dropped by 39% year-over-year, hitting ~$0.95 billion, as Disney stepped up its investments in original content for its video streaming services.

We Remain Bullish on Disney's ...**continued on next page**

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Disney's GAAP revenues grew 26% year-over-year last fiscal quarter, hitting $18.5 billion. Its GAAP diluted EPS came in at a positive $0.09 last fiscal quarter versus a loss in the same quarter the prior fiscal year. Disney exited fiscal 2021 with $16.0 billion in cash and cash equivalents on hand versus $5.9 billion in short-term debt and $48.5 billion in long-term debt, **equal to a net debt load of $38.4 billion.** Please note this does not include Disney's $3.9 billion in long-term 'investments' line item at the end of fiscal 2021, which includes strategic assets such as its 50% equity stake in the A&E network.

The company's net debt load swelled higher during the COVID-19 pandemic, and management has noted in the past that Disney has aimed to reduce its leverage ratio "to levels more consistent with a single A credit rating" before resuming share buybacks or dividend payouts, which we appreciate. **In fiscal 2021, Disney generated $2.0 billion in free cash flow and did not repurchase a meaningful amount of its stock or payout any dividends.** Back in May 2020, Disney announced it was suspending its semi-annual dividend and those payouts remain suspended.

As Disney's free cash flow generating abilities steadily return, driven by the resumption of its theme parks and resorts operations, which historically have been its cash cows, we expect the firm's balance sheet strength to recover over the coming fiscal years. **We view Disney's net debt load as manageable given its improving outlook, impressive cash flow generating abilities, and ample liquidity levels on hand.**

Disney noted during its latest earnings call that the firm expects its capital expenditures to grow by $2.5 billion in fiscal 2022 (the current fiscal year) versus fiscal 2021 levels. As the company's cash flows swell higher, Disney should have the capacity to make these investments. Beyond the likely recovery at its theme parks and resorts operations, its movie making business should rebound as households return in the theaters in earnest.

For instance, the company's new animated film *Encanto* put up solid performance at the box office this past Thanksgiving holiday weekend, though there remains ample room for upside here as box office ticket sales remained subdued in the US (and elsewhere) versus pre-pandemic levels. As the pandemic eventually fades, keeping potential headwinds from variants of COVID-19 in mind, households should feel more comfortable returning to movie theaters.

Video Streaming Update

On a sequential basis, Disney+ added 2.1 million net paying subscribers to its service in the fiscal fourth quarter (ending the fiscal quarter at 118.1 million subscribers) while EPSN+ added 2.2 million net paying subscribers (ending the fiscal quarter at 17.1 million subscribers) and Hulu added 1.0 million net paying subscribers (ending the fiscal quarter at 43.8 million) during this period. While decent, the market was expecting more. During the worst of the COVID-19 pandemic, demand boomed for video streaming services at a time when production activities for major TV shows and movies were negatively impacted. For a time, companies were able to continue refreshing their original content lineup and utilize third-party content to fill in the gaps, but eventually those strategies wore out. Disney was no exception to these dynamics.

*We Remain Bullish on Disney's …*continued on next page

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While demand boomed across the board for its video streaming services, the company has not been able to produce enough original content for these services fast enough, specifically for its Disney+ offering. That includes titles that leverage its Star Wars, Pixar, National Geographic, Marvel, and Disney intellectual properties. However, **Disney has a solid plan to get its content lineup back in order.** During Disney's latest earnings call management noted that (emphasis added, lightly edited):

> *"**In total, we are nearly doubling the amount of original content from our marquee brands**, Disney, Marvel, Pixar, Star Wars, and National Geographic coming to Disney+ in FY '22, with the majority of our highly anticipated titles arriving July through September… **We recognize that the single most effective way to grow our streaming platforms worldwide is with great content**, and we are singularly focused on making new, high-quality entertainment, including local and regional content that we believe will resonate with audiences.*
>
> *Of note, we have 340 plus local original titles in various stages of development and production for our [direct-to-consumer] platforms over the next few years. As you know… **we expect our total content expense to be between $8 and $9 billion in fiscal 2024, and we will now be increasing that investment further with the primary driver being more local and regional content**. We are expanding our global reach by introducing Disney+ in additional markets around the world." ---Bob Chapek, CEO of Disney*

Additionally, management noted this during Disney's latest earnings call (lightly edited):

> *"[The fourth quarter of fiscal 2022] will be the first time in Disney+ history that we plan to release original content throughout the quarter from Disney, Marvel, Star Wars, Pixar, and Nat Geo all in one quarter." --- Christine McCarthy, Senior EVP and CFO of Disney*

Disney reiterated its commitment to achieve 230-260 million paying subscribers at its Disney+ service by fiscal 2024 during its latest earnings call, the same fiscal year that it aims to achieve profitability at the service. The company is spending handsomely on original content to support growth at its video streaming services, and more on rolling out these services around the world (its spending is greater than originally expected). Management noted that "in just 2 short years, we're now in over 60 countries and more than 20 languages, and next year, we plan to bring Disney+ to consumers in 50 plus additional countries, including in Central, Eastern Europe, The Middle East, and South Africa" during Disney's latest earnings call. The firm recently launched Disney+ in several East Asian markets including South Korea, Taiwan, and Hong Kong.

We continue to view Disney's video streaming ambitions quite favorably. Disney owns 67% of Hulu with Comcast Corp (CMCSA) owning the remaining 33%. Starting in January 2024, Disney could compel Comcast to sell it its stake in Hulu to Disney, or Comcast could compel Disney to acquire its stake in Hulu via an existing put/call agreement. This is one of the big reasons why Disney will likely not resume meaningful share buybacks or restart its dividend program anytime soon, **as the firm will need to build up capital to acquire the 33% stake in Hulu that it does not already own.**

*We Remain Bullish on Disney's …*continued on next page

We Remain Bullish on Disney's **from previous page**

Reportedly, there are arguments over the price such a stake should fetch according to the *WSJ*. The put/call agreement between Disney and Comcast established a floor equity value of $27.5 billion for all of Hulu, though reporting by the *WSJ* indicates that Comcast views the equity value of Hulu at multiples of that level.

Comcast has reportedly mulled pulling some of its NBCUniversal (a subsidiary of Comcast) content off Hulu and putting that content on its new Peacock video streaming service, though such a move could have significant implications for Comcast's bottom-line. We are monitoring these events closely, though in any event, Hulu has ample content to keep its subscriber base entertained. On a final note, Hulu has been steadily pushing through pricing increases, including for its live TV offering, while maintaining and growing its paying subscriber base.

Concluding Thoughts

The slowdown in Disney's video streaming subscriber growth trajectory weighed on the company's stock price in the wake of its latest earnings report, though please note that this busienss has still put up tremendous performance. For instance, from the end of Disney's first quarter of fiscal 2020 (period ended December 28, 2019) to the end of its fiscal 2021, the firm's core video streaming services (Disney+, ESPN+, Hulu) **have added 115.5 million net paying subscribers combined, including 91.6 million net paying subscribers at its Disney+ service.**

After that kind of performance, Disney was bound to see its paid subscriber growth slow down relative to the breakneck performance seen over the past two years, though we expect its video streaming growth trajectory will pick up going forward as it expands into new international markets and adds additional original content to these services. Disney also recently launched its Star video streaming service which is geared towards international markets, providing Disney with another source of upside on this front.

We remain incredibly optimistic that Disney's video streaming strategy will eventually create an immense cash flow cow that churns out sizable profits, though the firm needs to scale up this business first. Original content investments are how Disney is differentiating its service from the likes of Netflix Inc's (NFLX) namesake service and Amazon Inc's (AMZN) Prime service. **Our fair value estimate sits at $192 per share of DIS, well above where Disney is trading at as of this writing.** We see room for ample capital appreciation upside potential at shares of Disney going forward.

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

Best Idea Dollar General Announces Plans to Go International

Image Source: *Dollar General Corporation – Fiscal 2020 Annual Report*

By Callum Turcan

On December 2, Dollar General Corporation (DG) reported third quarter earnings for fiscal 2021 (period ended October 29, 2021) that matched consensus top-line estimates and beat consensus bottom-line estimates. **The discount retailer also once again raised its full-year guidance for fiscal 2021**, which we will cover in just a moment. For reference, please note that Dollar General's fiscal years end in late-January or early-February.

We will start off by stressing that Dollar General put up banner performance in fiscal 2020 (period ended January 29, 2021) when its same-store sales boomed higher by over 16% and its GAAP net revenues grew by almost 22% on an annual basis. Its performance in fiscal 2021 is facing tough year-over-year comparisons due to the "panic" shopping spree brought on the by early days of the coronavirus ('COVID-19') pandemic, **though Dollar General has continued to put up stellar results even as that tailwind faded.**

We continue to like Dollar General and the top end of our fair value estimate range sits at $266 per share of DG. Furthermore, its modest dividend policy offers incremental upside to its substantial capital appreciation potential. As of this writing, shares of DG yield ~0.8%. Due to the discount retailer's stellar free cash flow generating abilities and promising growth runway, there is ample room for its dividend to grow going forward. Shares of DG are included as an idea in our Best Ideas Newsletter portfolio.

*Best Idea Dollar General Announces …*continued on next page

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Earnings Update

Last fiscal quarter, Dollar General's GAAP revenues grew by 4% year-over-year to reach $8.5 billion. Sales growth at its consumables (up 5%), seasonal (up 1%), and home products (up 7%) offerings offset an 11% drop in its apparel sales. Factory closures and other disruptions in Southeast Asia due to lockdowns related to the COVID-19 pandemic weighed negatively on global apparel production this year, which hurt Dollar General along with various other apparel retailers. However, those headwinds have eased up somewhat in recent weeks.
Dollar General exited the fiscal third quarter with $5.3 billion in merchandise inventories (up 1% on a year-over-year basis). Though inventories were down marginally year-over-year on a *per-store* basis, Dollar General should still be able to meet robust consumer demand during the current holiday shopping season.

New store openings were key to supporting Dollar General's sales growth last fiscal quarter as its same-store sales fell by 0.6% year-over-year. The company's GAAP gross margin shrank by over 55 basis points year-over-year last fiscal quarter, hitting ~30.8%. Its GAAP gross margins were negatively impacted by an unfavorable product mix shift (higher lower-margin consumable sales), higher transportation expenses, a higher LIFO provision, and an increase in inventory damages (possibly due to ongoing logistical hurdles combined with the effects of the holiday rush). Higher inventory pricing markups and a reduction in inventory shrink (usually means lower theft) helped offset those headwinds to its gross margin performance, to a degree.

Rising SG&A expenses, primarily a product of higher labor and rent expenses, combined with headwinds facing its gross margin performance saw Dollar General's GAAP operating margin fall over 160 basis points year-over-year in the fiscal third quarter, hitting ~7.8%. The firm's GAAP operating income dropped 14% year-over-year, declining to just under $0.7 billion. Expenses related to COVID-19 shifted lower year-over-year last fiscal quarter. Dollar General's GAAP diluted EPS came in at $2.08 in the fiscal third quarter, down 10% year-over-year. The company's outstanding diluted share count shrank 6% year-over-year last fiscal quarter due to Dollar General's sizable share repurchases.

During the first three quarters of fiscal 2021, **Dollar General generated over $1.4 billion in free cash flow** and spent $0.3 billion covering its dividend obligations along with another $2.1 billion buying back its stock. The company exited the fiscal third quarter with $3.6 billion in net debt with no short-term debt on the books, though Dollar General has sizable current and non-current operating lease liabilities to be aware of.

On December 1, Dollar General's board increased the company's authorized share buyback capacity up to $2.0 billion (which stood at $0.6 billion at the end of the fiscal third quarter). In moderation, share buybacks can be a good use of capital, though we would prefer that Dollar General also pare down its net debt load over time as well. Given its stellar free cash flow generating abilities and ample liquidity on hand ($0.5 billion in cash and cash equivalents at the end of the fiscal third quarter), we view Dollar General's net debt load and future dividend obligations as manageable.

*Best Idea Dollar General Announces …*continued on next page

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During the discount retailer's latest earnings call management noted (emphasis added):

> *"Our capital allocation priorities continued to serve us well and remain unchanged.* ***Our first priority is investing in high return growth opportunities, including new store expansion in our strategic initiatives****. We also remain committed to returning significant cash to shareholders through anticipated share repurchases, and quarterly dividend payments, all* ***while maintaining our current investment grade credit rating*** *in managing to a leverage ratio of approximately 3x adjusted debt to EBITDA." --- John Garratt, EVP and CFO of Dollar General*

Guidance Boost

The discount retailer raised its full-year guidance (again) for fiscal 2021 in conjunction with its latest earnings report. **Dollar General boosted its sales growth forecast to 1.0%-1.5% (up from 0.5%-1.5%) and raised its diluted EPS guidance to $9.90-$10.20 (up from $9.60-$10.20 previously) for the current fiscal year.** The firm also reduced its expected same-store sales decline to 2.5%-3.0% (versus a decline of 2.5%-3.5% previously) for fiscal 2021.

Please note that Dollar General also boosted its full-year guidance for fiscal 2021 back when reporting its first and second fiscal quarter earnings reports. When publishing its fourth quarter of fiscal 2020 earnings report, Dollar General expected its net sales would decline 2% in fiscal 2021 or at best come in flat, while its same-store sales were expected to drop by 4%-6% and its diluted EPS was expected to come in at $8.80-$9.50. The company's outlook has improved considerably since then.

When reporting its fourth-quarter fiscal 2020 earnings update, Dollar General forecasted that it would spend $1.05-$1.15 billion on capital expenditures and another $1.8 billion on share repurchases in fiscal 2021. Now Dollar General intends (as of the third quarter of fiscal 2021) to spend $1.1-$1.2 billion on capital expenditures and another $2.4 billion on share purchases in fiscal 2021.

Strategic Announcements

We view Dollar General's growth runway quite favorably and appreciate the numerous strategic initiatives it currently has underway. In September 2021, Dollar General expanded into its 47th US state by beginning construction at a new store in Idaho, which is set to be operational by the spring of 2022. Back in April 2020, Dollar General opened its first store in Washington state, which represented its 46th US state to operate in.

One thing that caught our eye during Dollar General's latest earnings report was the announcement that it would enter Mexico. Within Dollar General's fiscal third-quarter earnings press release, its CEO Todd Vasos was quoted as saying that "we are also excited to announce our plans to expand our footprint internationally for the first time, with plans to open up to ten stores in Mexico by the end of fiscal 2022, as we continue to lay the foundation for future growth." This represents a major strategic change by Dollar General, though one that makes sense.

Best Idea Dollar General Announces ...continued on next page

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Dollar General's core business model is built around operating in small cities and towns with populations of 20,000 or less, regions that are arguably underserved by major retailers and difficult for e-commerce firms to operate in. While Dollar General intends to continue growing its physical store footprint in the US going forward, eventually it would run out of new store opening opportunities that still fit in with its core business model. **Expanding into Mexico further extends Dollar General's growth runway.** Here is what Dollar General's management team had on say on the issue during the company's latest earnings call (moderately edited, emphasis added):

> *"We are also now at the early stages of plans to extend our footprint into Mexico, **which will represent our first store locations outside the continental United States**. We believe Mexico represents a compelling expansion opportunity for Dollar General given [its] demographics and proximately -- proximity to the U.S and we are confident that our unique value and convenience proposition will resonate with the Mexican consumer. While our initial entry into Mexico is focused on piloting a small number of stores in 2022, [what] we plan today will ultimately turn into additional growth opportunities in the future." --- CEO of Dollar General*

Looking ahead, Dollar General "plans to execute 2,900 real estate projects in fiscal year 2021, including 1,050 new store openings, 1,750 store remodels, and 100 store relocations" and "for fiscal year 2022, the Company plans to execute 2,980 real estate projects, including 1,110 new store openings, 1,750 remodels, and 120 store relocations" according to its latest earnings press release. For reference, Dollar General had over 17,900 stores in operation at the end of the third quarter of fiscal 2021, up from just below 17,000 store locations at the end of the third quarter of fiscal 2020.

Part of its strategy in this area, beyond expanding into new US states and the Mexican market, is through the launch of its new store concept pOpshelf (announced in October 2020). In short, pOpshelf is Dollar General's way to catering moderately more affluent consumers (households in the $50,000 - $125,000 per year range) located in urban/suburban/exurban regions, as compared to the more working class households in rural areas that has traditionally represented its core customer focus.

According to Dollar General, its pOpshelf store concept has performed quite well of late. During the firm's latest earnings call its CFO noted that "we continue to be very pleased with the performance of our pOpshelf stores, which have far exceeded our expectations for both sales and gross margin."

By fiscal 2025, Dollar General aims to open ~1,000 pOpshelf stores. While there is a substantial degree of operational execution risk, we are intrigued by the new store concept and appreciate that Dollar General first proved the concept was viable by launching a few dozen stores before committing to a big expansion project. The company's CFO also noted during the firm's latest earnings call that "we anticipate year one annualized sales volumes for our current locations to be between $1.7 million and $2 million per store and expect the initial average gross margin rate for these stores to exceed 40%," **highlighting the potential uplift these store concepts could provide Dollar General's company-wide operations (keeping in mind its GAAP gross margin came in just below 31% last fiscal quarter).**

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Other Initiatives

Dollar General has various other strategic initiatives in the works that involve improving its distribution operations (reducing the need for more expensive third-parties logistics services), expanding its higher margin non-consumable sales, adding additional coolers to its stores, adding more fresh produce to its stores along with other products, upgrading its e-commerce presence and in-store digital capabilities (such as adding self-checkout kiosks), along with other endeavors. Dollar General has many other initiatives underway, too. Here are some of its recent updates from its latest earnings call (emphasis added):

> *"Turning now to DG Fresh, which is a strategic multi-phase shift to self-distribution of frozen and refrigerated goods. As a reminder, we completed the initial rollout of DG Fresh across the entire chain in Q2 and are now delivering to more than 18,000 stores from 12 facilities.* ***The primary objective of DG Fresh is to reduce product costs on our frozen and refrigerated items.*** *And we continue to be very pleased with the savings we are seeing as DG Fresh remains a meaningful contributor to our gross margin rate.*
>
> *Another goal of DG Fresh is to increase sales in these categories. And we are very happy with the performance on this front. As overall comp sales of our frozen and refrigerated goods outperformed all other product categories in Q3, even against a difficult prior year sales comparison.* ***Going forward, we expect to realize additional benefits from DG Fresh*** *as we continue to optimize our network, further leverage our scale, deliver an even wider product selection and build on our multi-year track record of growth in cooler doors and associated sales.*
>
> ***With regards to our cooler expansion program, during the first three quarters, we added more than 52,000 cooler doors across our store base.*** *In total, we expect to install approximately 65,000 additional cooler doors in 2021, the majority of which will be in high capacity coolers.*
>
> ***Turning now to an update on our expanded health offering,*** *which consists of about 30% more feet of selling space and nearly 400 additional items as compared to our standard offering.* ***This offering was available in nearly 800 stores at the end of Q3 with plans to expand to approximately 1,000 stores by year-end.*** *Looking ahead, our plans include further expansion of our health offering with the goal of increasing access to basic health care products and ultimately services over time, particularly in rural America." --- Jeff Owen, COO of Dollar General*

Back in July 2021, Dollar General announced that it had hired its first chief medical director, and we now have a slightly better idea of what the company's efforts regarding its healthcare push might be. Within that press release, the firm noted its effort in this area "will include an increased assortment of cough and cold, dental, nutritional, medical, health aids and feminine hygiene products across many of its Dollar General stores." We are keeping a close eye on Dollar General's healthcare-related initiatives. Dollar General has been testing out larger store concepts (in terms of square feet of retail space) which is helping set the stage for its efforts here.

*Best Idea Dollar General Announces …*continued on next page

Best Idea Dollar General Announces **...from previous page**

Concluding Thoughts

We are big fans of Dollar General. The discount retailer has several big initiatives underway to extend its growth runway while boosting per store sales and enhancing its margins. Shares of DG have been treading water over the past few months after surging during the 2020 calendar year, though we still room for significant capital appreciation upside potential going forward. The company is a tremendous free cash flow generator.

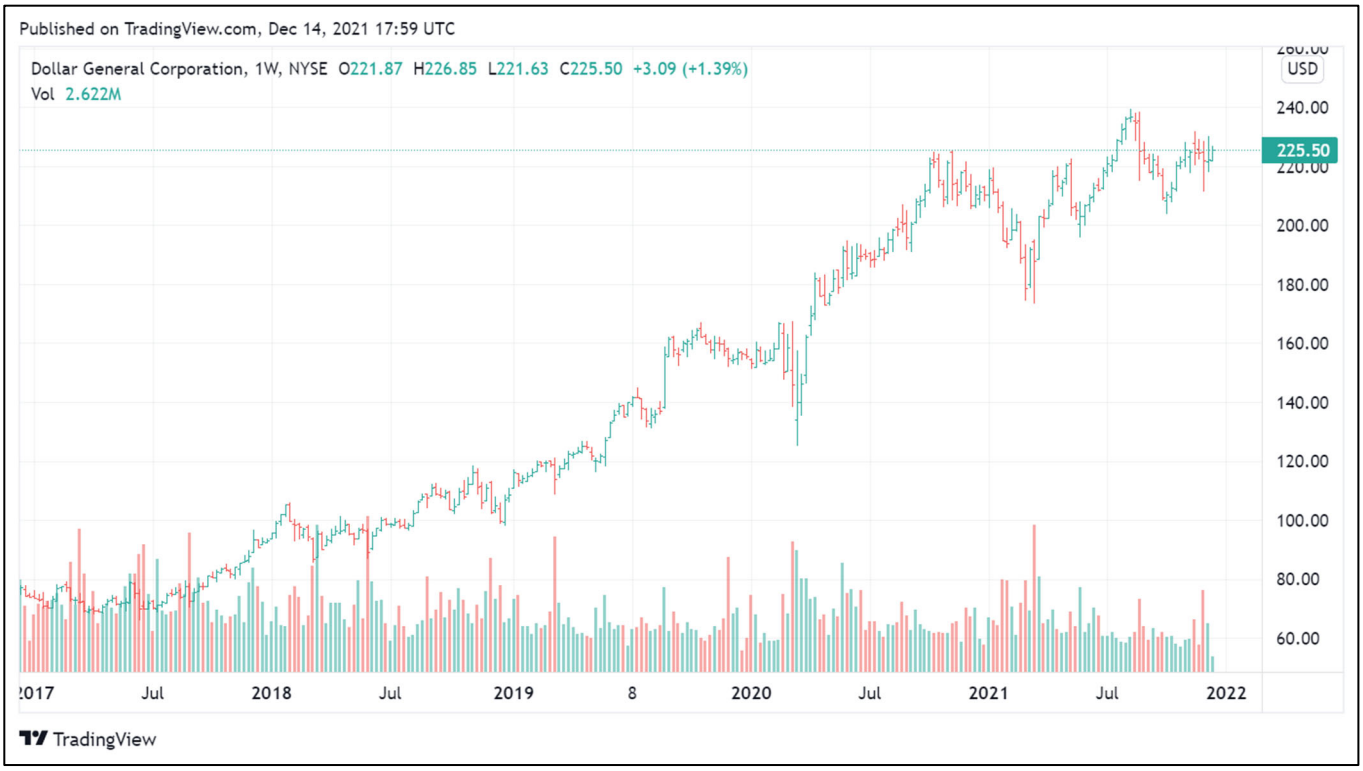

Image Shown*: Shares of Dollar General, an idea in our Best Ideas Newsletter portfolio, have steadily shifted higher over the past five years. New strategic initiatives that aim to grow its sales of higher margin non-consumable products and expand its physical store footprint into its first international market, Mexico, should help keep the momentum going in the right direction. We continue to view Dollar General's outlook quite favorably.*

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

Cisco Systems Posts Solid Earnings Update; Supply Chain Hurdles Impacting Near Term Outlook

Image Source: *Cisco Systems Inc – First Quarter of Fiscal 2022 IR Earnings Presentation*

By Callum Turcan

On November 17, Cisco Systems Inc (CSCO) reported first quarter earnings for fiscal 2022 (period ended October 30, 2021) that missed consensus top-line estimates but beat consensus bottom-line estimates. Supply chain headwinds were a major obstacle for Cisco Systems last fiscal quarter. Looking ahead, supply chain bottlenecks should steadily improve going forward as global health authorities continue to work towards bringing the coronavirus ('COVID-19') pandemic to an end worldwide. As of this writing, shares of CSCO yield ~2.6%, and we include Cisco Systems as an idea in our Best Ideas Newsletter portfolio.

Overview

Last fiscal quarter, Cisco Systems' GAAP revenues rose 9% year-over-year, hitting $12.9 billion, supported by strong growth in its 'Internet for the Future,' 'Optimized Application Experiences,' and 'Secure, Agile Networks' segments. **The company's GAAP operating income rose 34% year-over-year last fiscal quarter,** hitting $3.4 billion, aided by revenue growth and a sharp reduction in its 'restructuring and other charges' expense line-item. Cisco Systems' GAAP diluted EPS came in at $0.70 last fiscal quarter, up 37% year-over-year.

Its non-GAAP gross margins weakened year-over-year last fiscal quarter (its total non-GAAP gross margin hit 64.5% in the first quarter of fiscal 2022, down ~130 basis points year-over-year, with the non-GAAP gross margins of both its product and service offerings weakening somewhat during this period) as inflationary headwinds and logistical bottlenecks weighed negatively on its performance.

*Cisco Systems Posts Solid Earnings …*continued on next page

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The guidance Cisco Systems provided for the second quarter of fiscal 2022 came in a bit lighter than what Wall Street wanted. Cisco Systems expects to post 4.5%-6.5% year-over-year revenue growth and $0.80-$0.82 in non-GAAP EPS in the current fiscal quarter. As noted previously, supply chain hurdles were cited as a key headwind. Its non-GAAP gross margin guidance for the current fiscal quarter stands in at 63.5%-64.5%, down sequentially at the midpoint of guidance though still a strong figure.

Cisco Systems maintained (compared to guidance put out during its fourth quarter of fiscal 2021 earnings update) **its full-year revenue forecast for fiscal 2022 that calls for 5%-7% annual growth and $3.38-$3.45 in non-GAAP EPS.** In fiscal 2021 (period ended July 31, 2021), Cisco Systems reported $3.22 in non-GAAP EPS. At the midpoint of its fiscal 2022 guidance, Cisco Systems expects its non-GAAP EPS will rebound by 6% this fiscal year versus fiscal 2021 levels.

There were some bright spots in Cisco Systems' latest earnings update as its management team noted that "remaining performance obligations and annualized recurring revenue ['ARR'] both grew 10% year over year with product ARR growth of 21% providing more predictability and visibility to our long-term growth" within its latest earnings press release. Building up its recurring revenue streams is a major focus for Cisco Systems, and the firm laid out its strategy on this front during a big investor day event in September 2021.

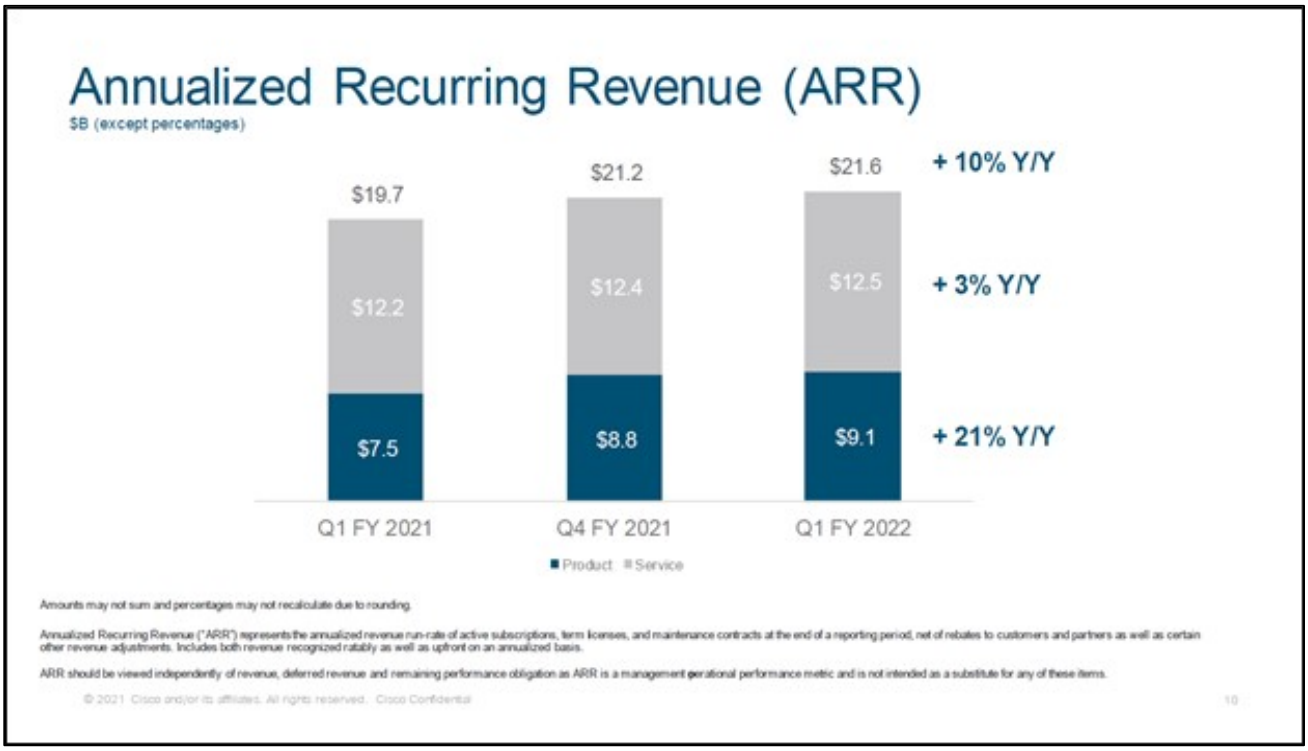


Image Shown: *Cisco Systems continues to grow its recurring revenue streams, providing greater visibility as it concerns its future cash flow performance.* ***Image Source:*** *Cisco Systems – First Quarter of Fiscal 2022 IR Earnings Presentation*

Cisco Systems Posts Solid Earnings ...continued on next page

Cisco Systems Posts Solid Earnings ...from previous page

Financials Remain Rock-Solid

During the first quarter of fiscal 2022, Cisco Systems generated $3.4 billion in net operating cash flow and spent $0.1 billion on its capital expenditures, **resulting in $3.3 billion in free cash flow.** The company spent $1.6 billion covering its dividend obligations and another $0.3 billion buying back its stock through its repurchase program last fiscal quarter (the firm also spent $0.1 billion towards 'shares repurchased for tax withholdings on vesting of restricted stock units' in the fiscal first quarter). Both of these activities were fully covered by Cisco Systems' free cash flows.

At the end of the first quarter of fiscal 2022, Cisco Systems had $23.3 billion in cash, cash equivalents, and short-term investments on hand versus $0.5 billion in short-term debt and $9.0 billion in long-term debt. **The company exited the fiscal first quarter with a fortress-like balance sheet as it had a net cash position of $13.8 billion** (inclusive of short-term debt). Cisco Systems has ample financial firepower to continue growing its dividend, buying back its stock, investing in its business, and making strategic acquisitions (the firm spent $0.3 billion on 'acquisitions, net of cash and cash equivalents acquired and divestitures' last fiscal quarter).

Concluding Thoughts

We continue to like Cisco Systems. The company's near-term guidance came in a bit soft, though its longer-term growth outlook remains bright as it pivots towards recurring revenue streams. **Its pristine balance sheet and stellar free cash flow generating abilities are still intact, and Cisco Systems is still guiding for decent revenue and non-GAAP EPS growth this fiscal year** as enterprises, governments, and other entities resume major IT projects that were delayed by the COVID-19 pandemic. Secular growth tailwinds and ample financial firepower should enable Cisco Systems to navigate near-term supply chain hurdles.

We recently updated our cash flow valuation model covering Cisco Systems, and its updated fair value estimate sits at $62 per share. **As shares of CSCO are trading at a discount to their fair value estimate as of this writing, we are supportive of management utilizing the company's financial strength to buy back meaningful amounts of Cisco Systems' stock.** We also expect that Cisco Systems will push through sizable payout increases over the coming fiscal years as its updated Dividend Cushion ratio sits at a nice 2.9, earning the firm an "EXCELLENT" Dividend Safety rating and the company also has an "EXCELLENT" Dividend Growth rating.

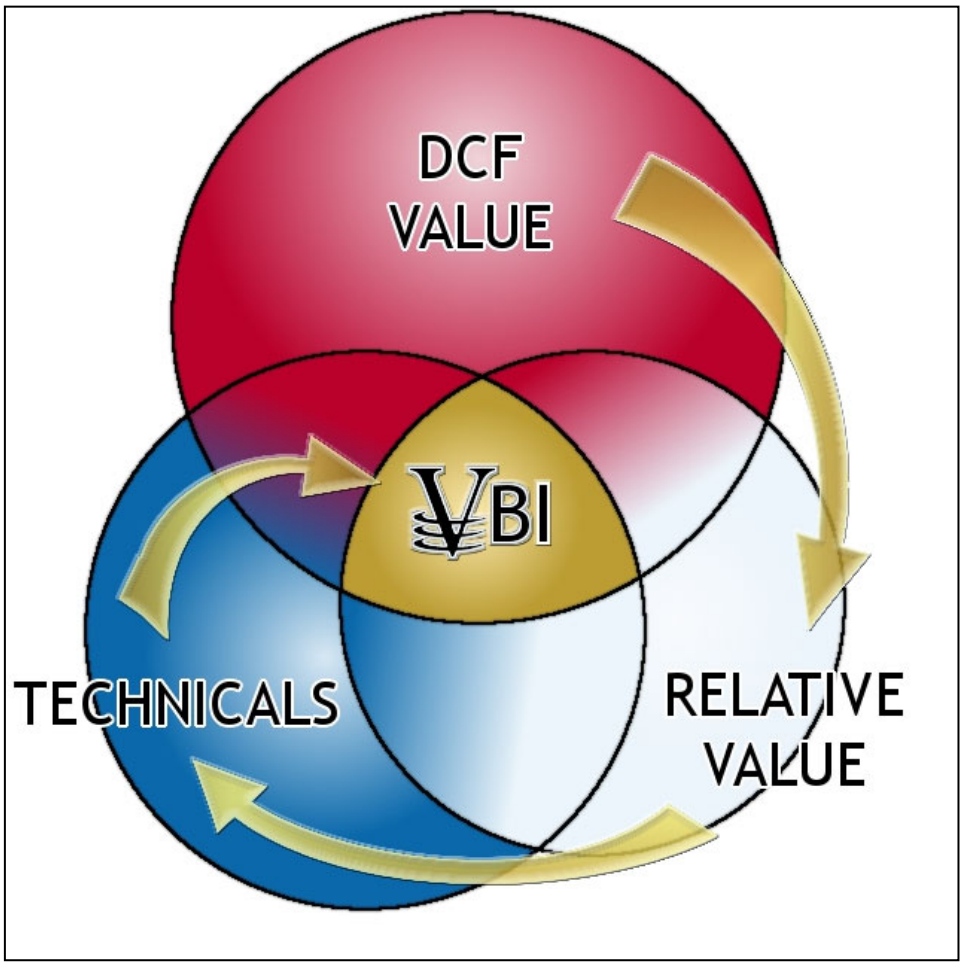
***Disclosure**: Callum Turcan does not own shares in any of the securities mentioned above.*

Our Methodology – The Valuentum Buying Index (VBI)

By Valuentum Analysts

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

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



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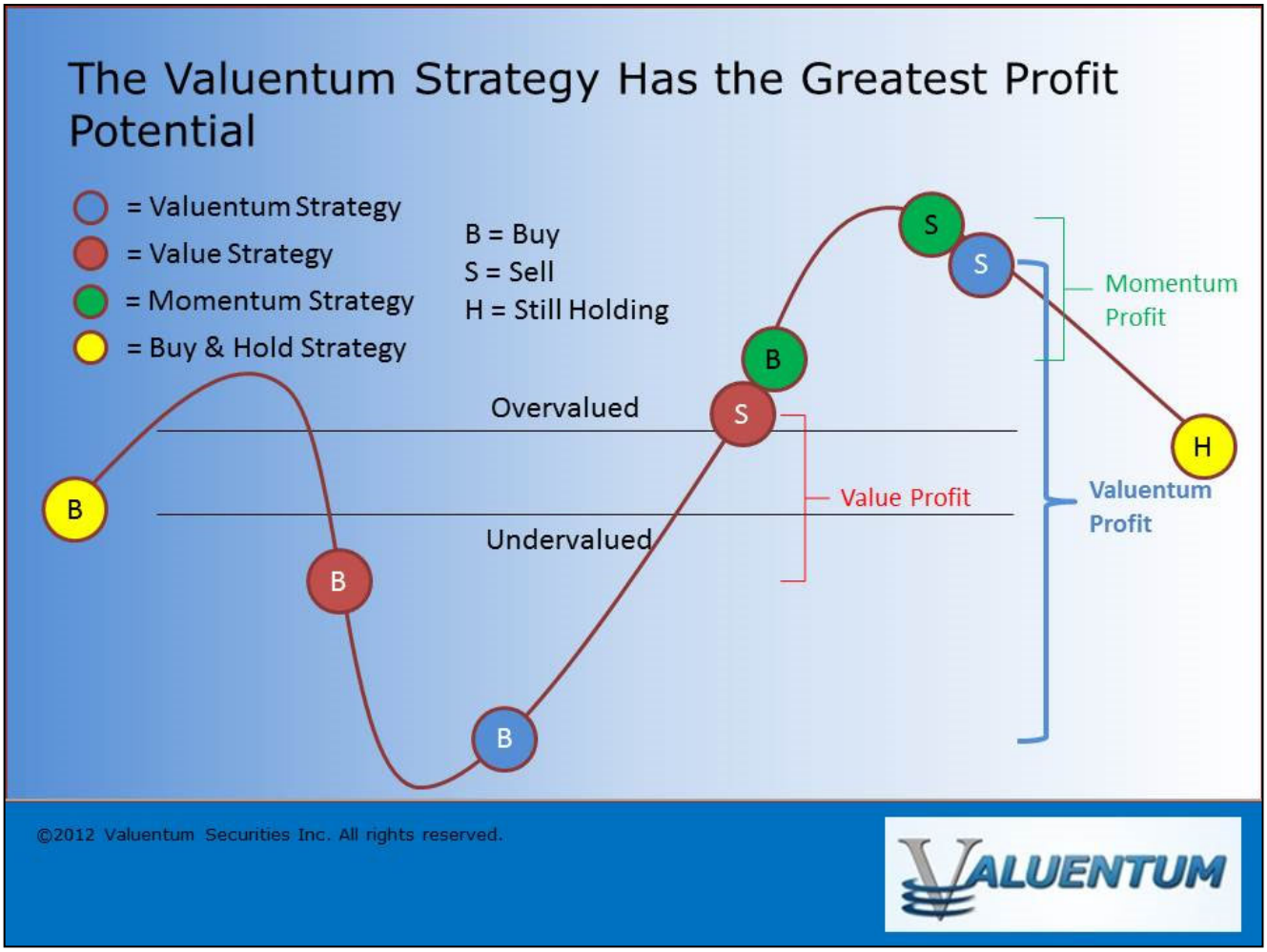
Our Methodology – The Valuentum Buying Index continued from previous page

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

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

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



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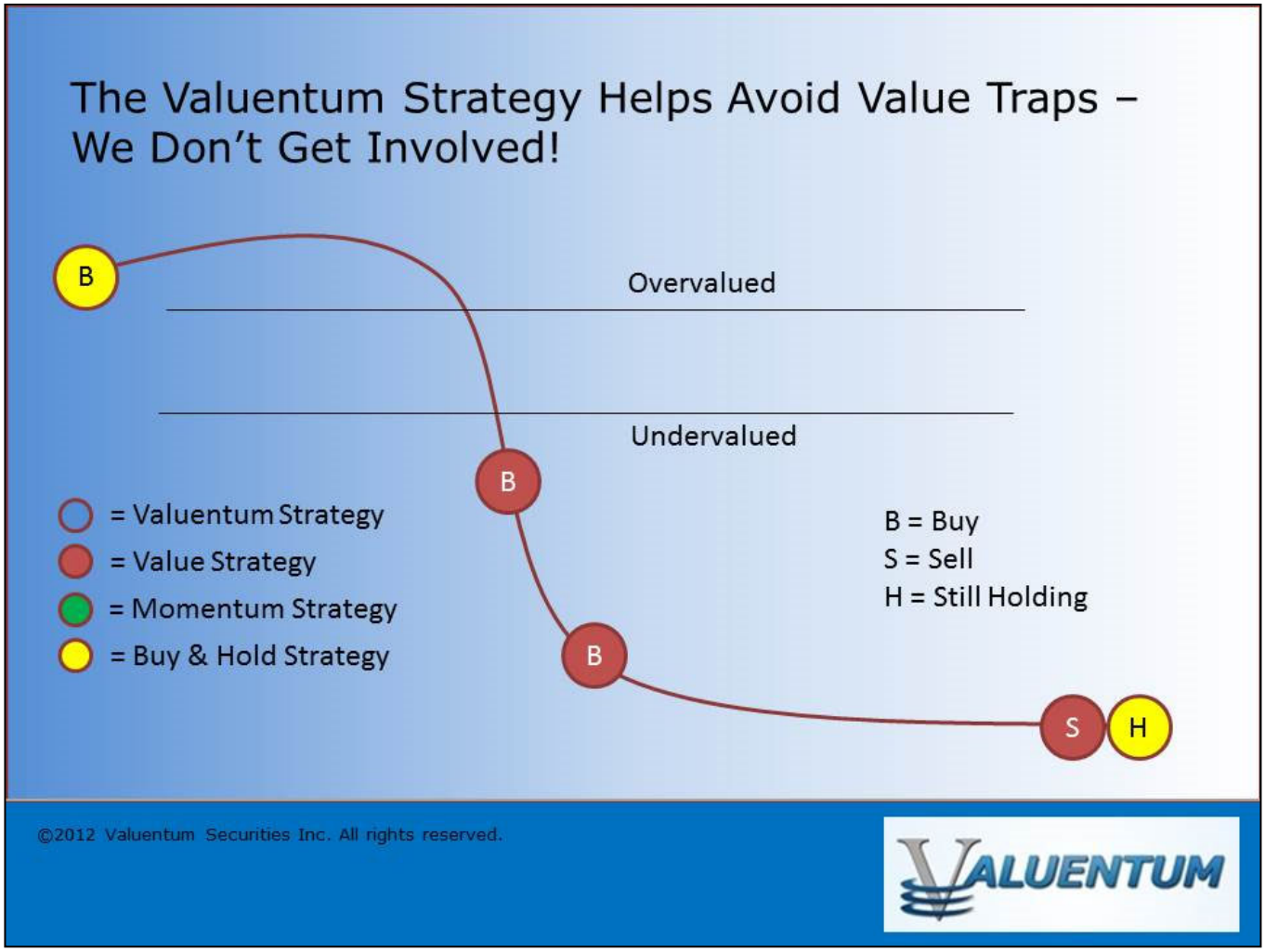
Furthermore, we think Valuentum subscribers are less likely to be involved in so-called value traps because we demand material revenue and earnings growth for firms to earn a 10 on the Valuentum Buying Index. Value traps often occur as a result of secular declines in a firm's products or services, resulting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

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



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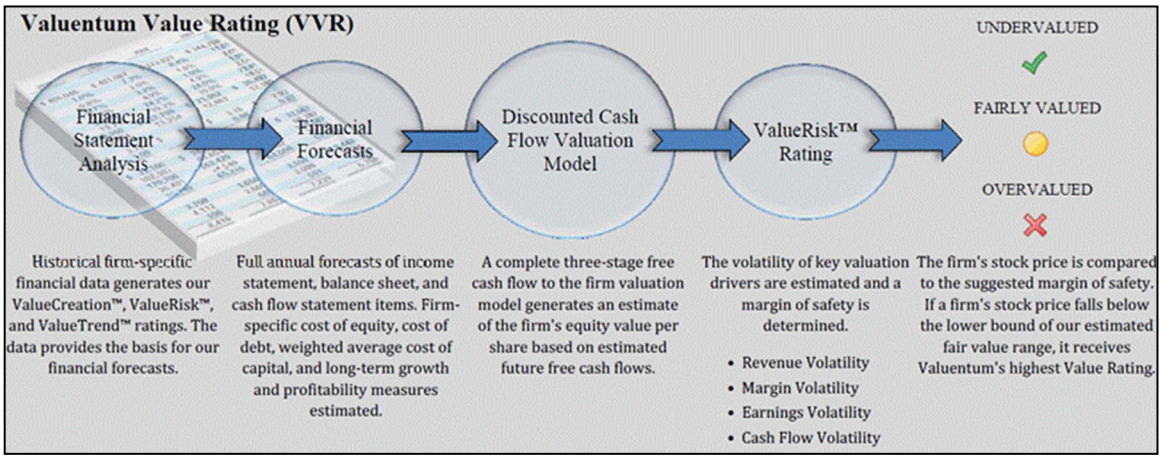
Let's walk through the three investment pillars of our stock-selection methodology.

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

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



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

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

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

Our Methodology – The Valuentum Buying Index continued on next page

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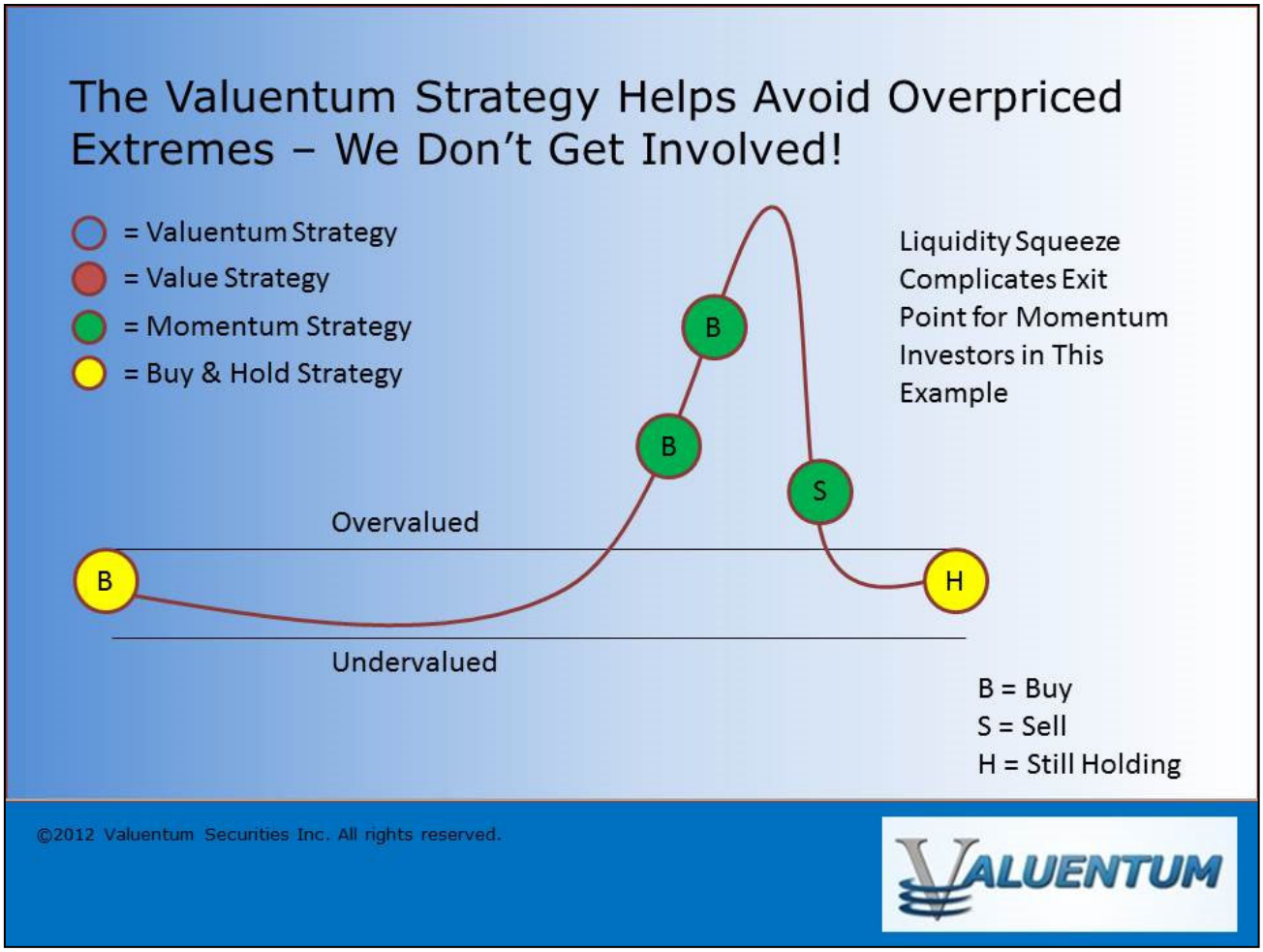

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II. The Valuentum Buying Index Incorporates A Forward-Looking Relative Value Assessment

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

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

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

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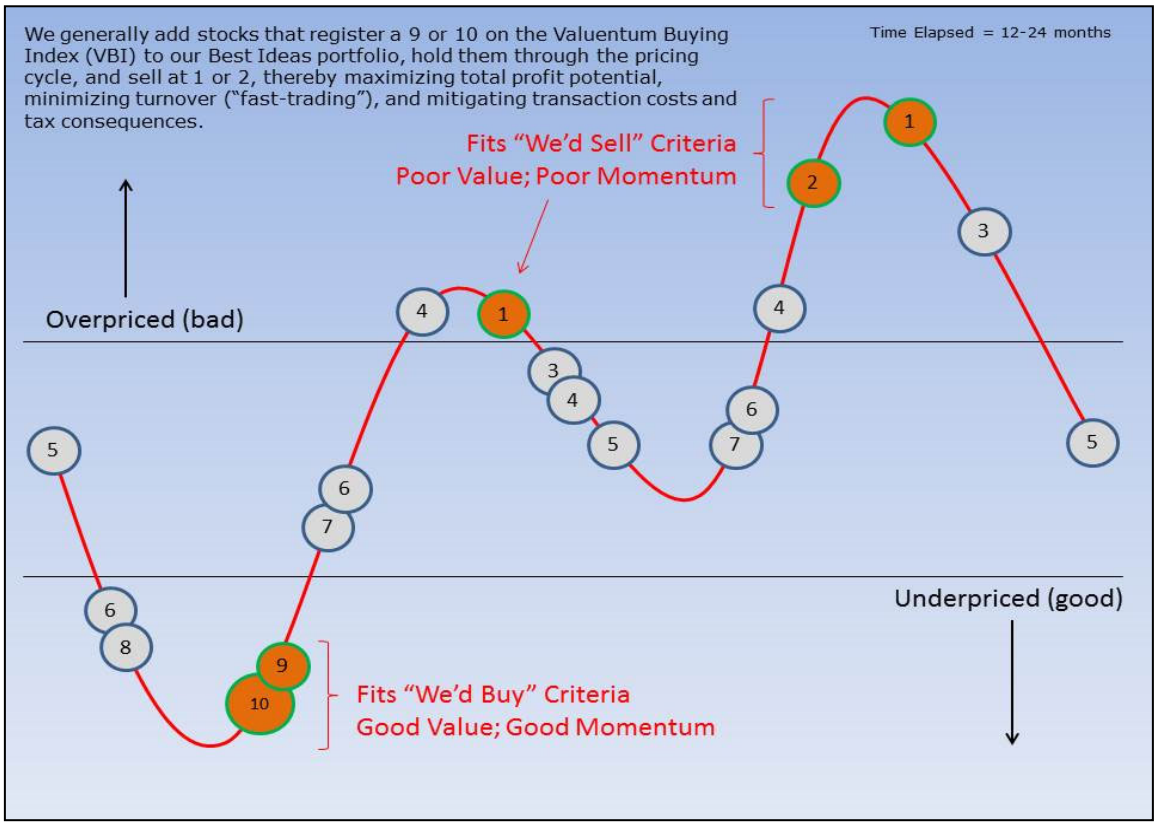
Rigorous valuation analysis and technical analysis are not mutually exclusive, and we believe both can be used together to bolster idea generation. An evaluation of a stock's moving averages, relative strength, upside-downside volume, and money flow index are but a few considerations we look at with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

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

Putting It All Together - the Valuentum Buying Index

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

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



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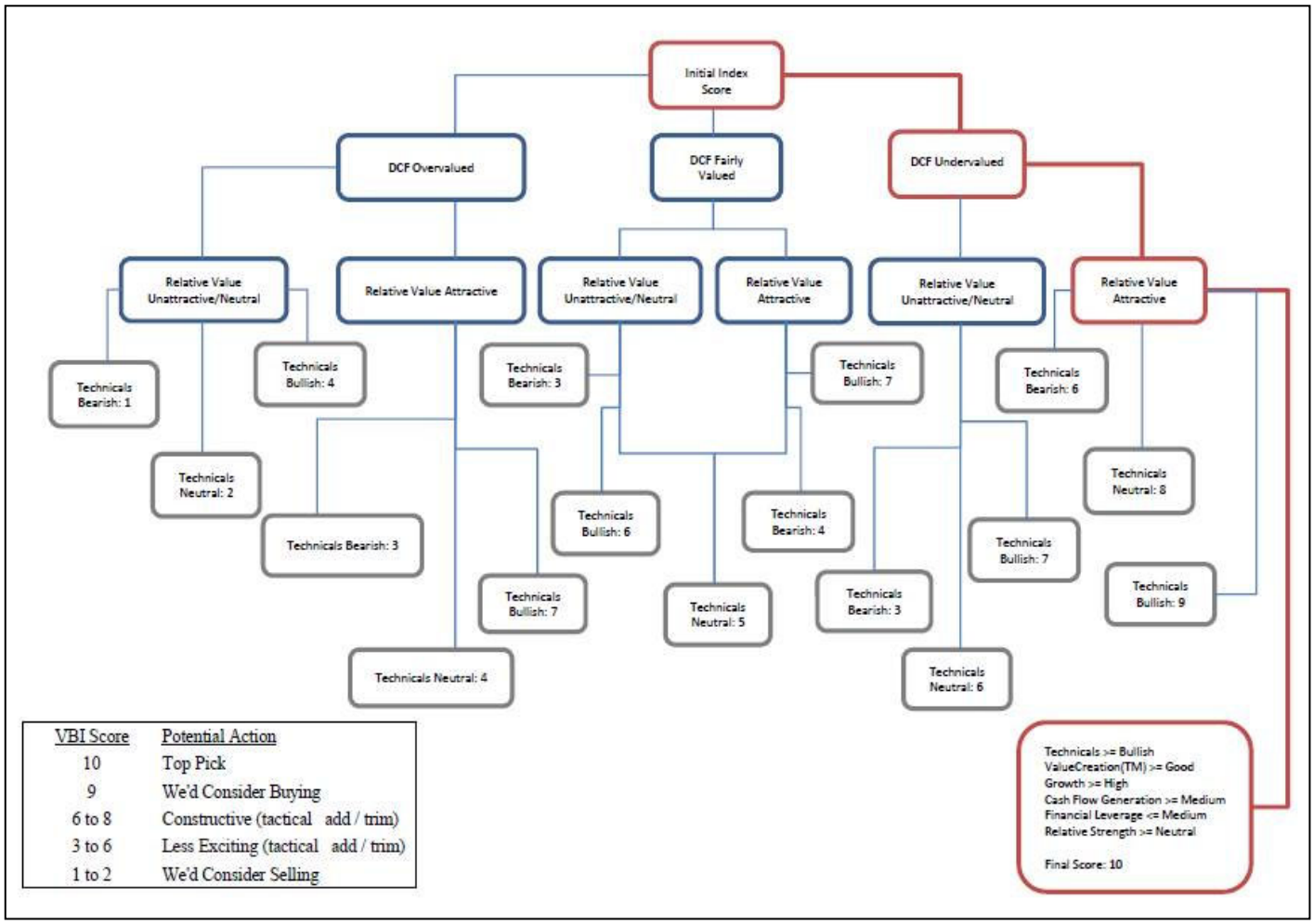
Our Methodology – The Valuentum Buying Index **continued from previous page**

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

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

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



VBI Score	Potential Action
10	Top Pick
9	We'd Consider Buying
6 to 8	Constructive (tactical add / trim)
3 to 6	Less Exciting (tactical add / trim)
1 to 2	We'd Consider Selling

Illustration for educational purposes only.

About the Fair Value Range

By Valuentum Analysts

Understanding the Fair Value Range and Why It's Important

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

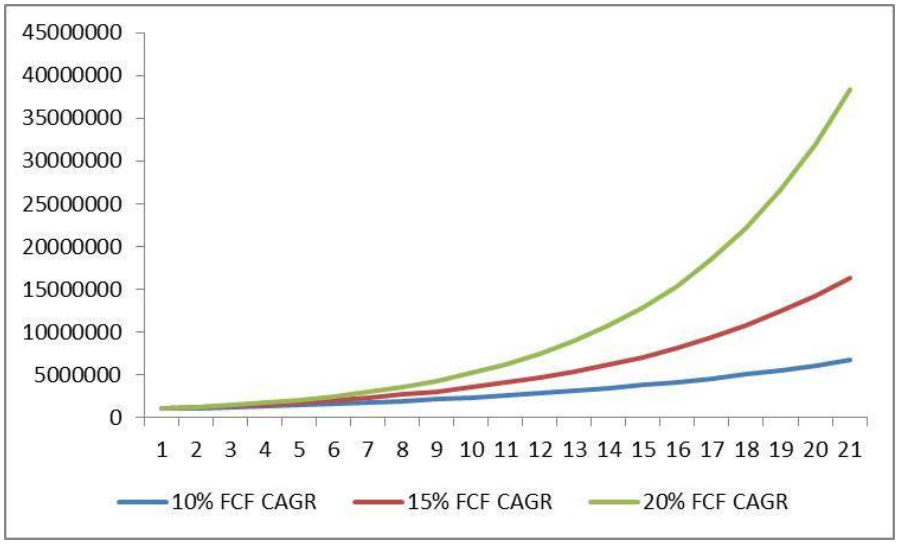
One of the most important concepts of the Valuentum methodology (and valuation in general) is the understanding that the value of a company is a range of probable valuation outcomes, not a single point estimate. Even well-seasoned stock analysts are guilty of saying that a company's shares are worth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

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

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

But why the large range in many cases?

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



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

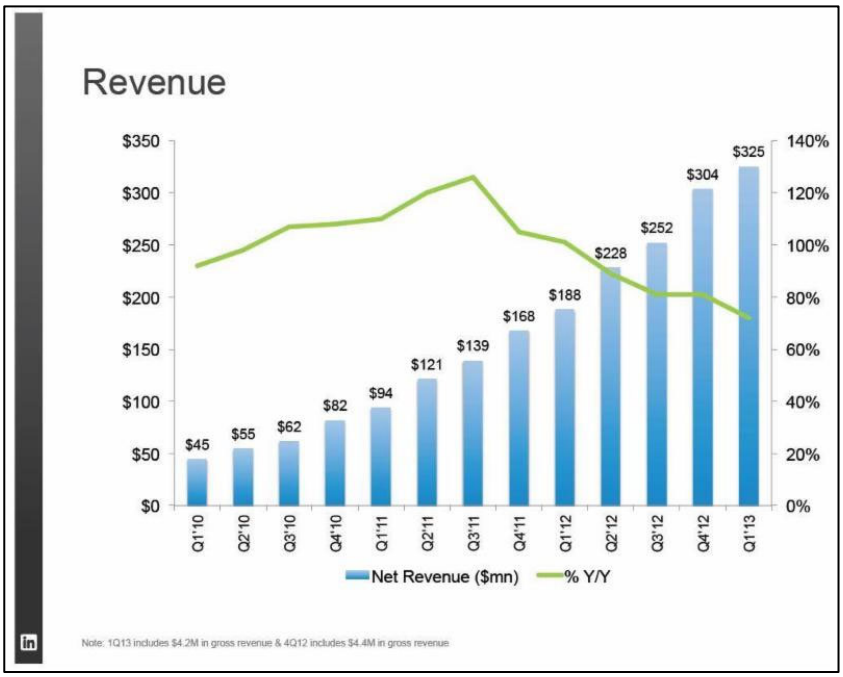

Image Source: LinkedIn

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

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

Shares collapsed in a huge way.

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

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

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

By Valuentum Analysts

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

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

The Valuentum Buying Index Has Checks and Balances

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

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

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

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

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

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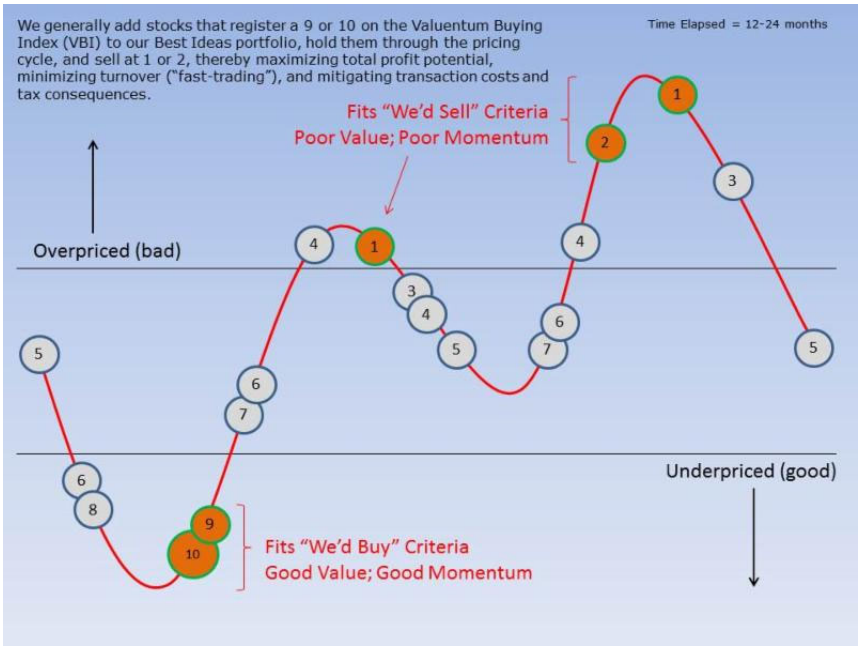
may be the secret to success in investing, a lot could have gone wrong with the temptation to do something each day. Obviously, we're very disciplined, but we also credit the portfolio outperformance to the VBI methodology itself. It is a very helpful tool.

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

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

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

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



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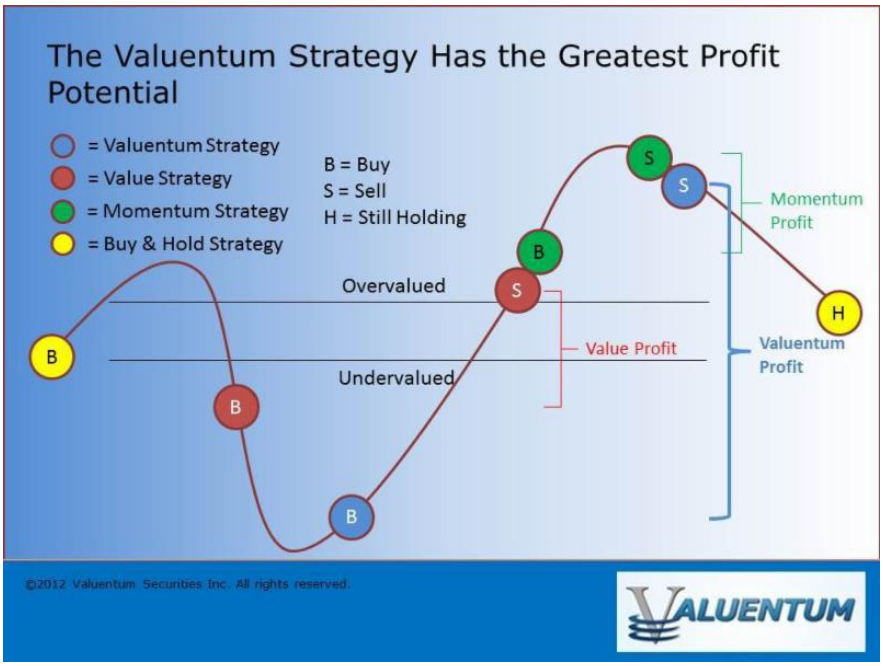
But why don't we churn our ideas by updating daily and trading a lot? Obviously, we don't think that's the secret to investment success. In quite the opposite approach, we strive to maximize profits on every idea that we pursue, with the understanding that momentum does exist and that prices over and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



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

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

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

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

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

Some Examples of the Valuentum Buying Index In Action

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

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

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

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

About Our Name

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

-- Warren Buffett, Berkshire Hathaway annual report, 1992

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

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