OUR DIVIDEND GROWTH NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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"Albert Einstein is reported to have called compound interest the "eighth wonder of the world," but dividend growth investing has the potential to offer long-term investors so much more!"

– Brian Nelson, CFA

Dividend Growth Ideas: AAPL, CSCO, *DIV*, DKS, XLE, HD, HON, IDV, *JEPI*, LMT, MSFT, ORCL, MCD, RSG, SDY, UNH, XLV

3 Substantial Benefits of Dividend Growth Investing

By Brian Nelson, CFA

There are three primary benefits of a well-executed dividend growth strategy, one that is carried out with prudence and care and one that pays careful attention to the intrinsic value of the stock and its critical cash-based components. Albert Einstein is reported to have called compound interest the "eighth wonder of the world," but dividend growth investing has the potential to offer long-term investors so much more! Let's explain.

1) Reinvested Dividends Compound Over Time

Over the past decade, I have grown to appreciate the compounding dynamics of reinvested dividends on appreciating stocks even more than historical studies have revealed. The strategy of dividend growth investing not only benefits from the reinvestment of dividends into the purchase of new stock, but it also benefits from the higher dividend payments on an ever-increasing number of shares owned by the investor. This results in a compounding dynamic that is even better than that of compound interest, which is calculated on the fixed starting principal and the accumulated interest from prior periods like that on a bond, for example.

Let's assume we have two securities. We have a bond that pays an annual interest rate of 3%, and it experiences compound interest over a period of 35 years. We also have a stock that pays a starting dividend yield of 3% and increases its dividend payment 3% per annum over the next 35 years. All proceeds from the dividends are reinvested to

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

The simulated Dividend Growth Newsletter portfolio can be found on page 5 of each monthly Dividend Growth Newsletter.

3 Substantial Benefits of Dividend Growth Investing...from previous page

***Image**: Dividend growth stocks, as measured by the SPDR S&P Dividend ETF (SDY), have been stable amid volatile market conditions the past several years.*

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purchase new shares, and the stock's price advances at a modest 3% annual rate over this time period. Did you know that after 35 years, the total value of the shares due in part to dividend growth compounding was nearly 3 times greater than the bond generating compound interest and nearly 8 times greater than their starting value. If Albert Einstein loved compound interest, we wonder what he might have thought about dividend growth investing!

2) Generating a High Yield on Cost

There's more to the dividend growth strategy than just the compounding dynamics of reinvested dividends, too. Investors can achieve a very attractive income yield on cost for retirement. The income yield on cost is generally calculated as the current annual dividend rate of the stock divided by the original cost basis of the stock. For example, for the same hypothetical company in the example above--the one that started paying a dividend yield of 3% and that increased it 3% each year for 35 years--the yield on cost for the investor would have grown to over 8%! That's significantly higher than the starting 3% yield, and it may be high enough to fund a very nice retirement. What's more, the company only increased its dividend 3% per year to achieve that nice yield on cost, and there are many stocks on the market today that are poised to increase their payouts at a much faster pace in the coming decades, in our view.

3) Exposure to the Strongest Companies

In general, companies that pay dividends and seek to grow them over time are often ones that are competitively advantaged and generate strong and growing free cash flows. This is where we think we add tremendous amounts of value in the process. Our Dividend Cushion ratio forecasts a company's future expected free cash flows and considers its balance sheet to assess whether a company has the capacity to keep paying a growing dividend long into the future.

Since our inception, we've used Microsoft Corp (MSFT) as the quintessential example of the type of long-term dividend growth stocks we like. **In our inaugural Dividend Growth Newsletter, released January 2012, we assigned Microsoft a portfolio weighting of 8%, the highest among constituents. At the time, its share price was $25.96 while it paid an annualized dividend of $0.80 per share. Microsoft's shares are now trading for $325+ each (up 12+ fold), and its annual dividend rate is now $2.72 (more than tripling), reflecting a yield on cost of nearly 10.5%.** By any measure, this long-term dividend growth idea has been a home run!

Concluding Thoughts

Our team combines our extensive knowledge of enterprise valuation (i.e. the discounted cash flow process), its cash-based intrinsic value components, competitive advantages, long-term secular growth trends, technical/momentum indicators and yield/income considerations to highlight what we think will be some of the strongest dividend growth companies and most resilient business models in the years to come. We calculate forward-looking Dividend Cushion ratios for key companies in our coverage and provide a simulated newsletter portfolio in each edition of the Dividend Growth Newsletter (see page 5 of this edition). We hope you continue to enjoy the many features of our service!

Dividend Growth Ideas Apple, Microsoft, Cisco, Oracle, and Republic Services Have Soared So Far in 2023

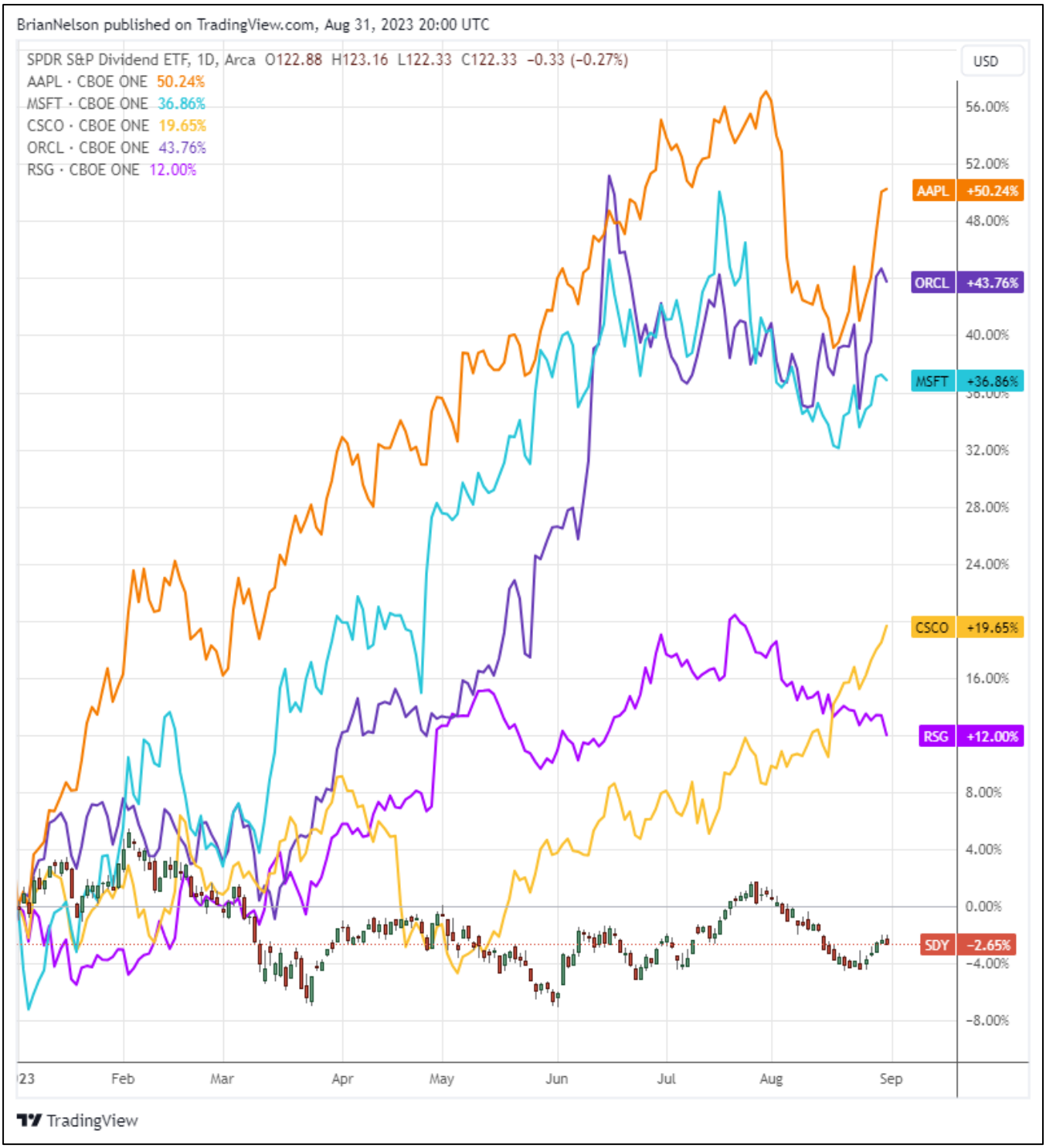

***Image**: Many of our top dividend growth ideas have beaten a broader dividend growth index by quite the margin so far in 2023.*

The Dividend Growth Newsletter Portfolio

By Valuentum Analysts

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

DIVIDEND GROWTH IDEAS -- as of September 1, 2023

Company Name	Yrly Div's Paid ($) / Shr	Dividend Yield %	Fair Value Estimate	Dividend Cushion Ratio	VBI Rating	Price/FV	Last Close	% of Portfolio
S&P Dividend ETF SPDR (SDY)	3.19	2.60%	-	-	-	-	122.25	8.0%-12.0%
JPMorgan Equity Premium Income ETF (JEPI)	5.57	9.99%	-	-	-	-	55.59	8.0%-12.0%
Global X SuperDividend U.S. ETF (DIV)	1.24	7.32%	-	-	-	-	16.90	8.0%-12.0%
Cisco (CSCO)	1.56	2.72%	$53.00	2.67	6	1.08	57.35	5.0%-7.0%
Energy Select Sector SPDR ETF (XLE)	3.21	3.61%	-	-	-	-	88.92	5.0%-7.0%
Health Care Sector SPDR ETF (XLV)	2.09	1.55%	-	-	-	-	133.21	5.0%-7.0%
iShares Int'l Select Dividend (IDV)	1.92	7.26%	-	-	-	-	26.33	5.0%-7.0%
Lockheed Martin (LMT)	12.00	2.68%	$440.00	1.71	6	1.02	448.35	5.0%-7.0%
Microsoft (MSFT)	2.72	0.83%	$307.00	3.82	6	1.07	327.76	5.0%-7.0%
Oracle (ORCL)	1.60	1.33%	$113.00	0.93	6	1.07	120.39	5.0%-7.0%
Apple (AAPL)	0.96	0.51%	$167.00	8.67	5	1.12	187.87	3.0%-4.0%
Dick's Sporting Goods (DKS)	4.00	3.44%	$160.00	2.21	3	0.73	116.34	3.0%-4.0%
Home Depot (HD)	8.36	2.53%	$287.00	0.99	6	1.15	330.30	3.0%-4.0%
Honeywell Intl (HON)	4.12	2.19%	$195.00	2.06	3	0.96	187.94	3.0%-4.0%
McDonald's Corp (MCD)	6.08	2.16%	$300.00	0.60	3	0.94	281.15	3.0%-4.0%
Republic Services (RSG)	2.14	1.48%	$154.00	2.19	5	0.94	144.13	3.0%-4.0%
UnitedHealth Group (UNH)	7.52	1.58%	$515.00	3.09	4	0.93	476.58	3.0%-4.0%
Cash								~0%-5%

UR = Under Review

Last close and dividend per share information for equities retrieved from Seeking Alpha, Yahoo Finance. Dividend yield information for ETFs retrieved from Seeking Alpha, Yahoo Finance.

This portfolio is not a real money portfolio. Data as of August 31, 2023

Goal:

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

Every subscriber has different goals and different risk tolerances, so where before in the newsletter portfolios, we would outline the specific percentage weighting, we think providing weighting ranges makes much more sense. For example, depending on someone's risk tolerances, a larger cash position in an overheated market may be prudent. On the other hand, the longer one's time horizon, perhaps a smaller cash position may make more sense. The Dividend Cushion ratios are so important, so please stay up to date with them. By our estimates, the efficacy of the Dividend Cushion ratio in warning about dividend cuts is roughly 90%. We're available for any questions.

The midpoints of our respective weighting ranges approximately sum to 100% to reflect the range of possible combinations that may result in various allocations.

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

Not Expecting Much From Consumer Staples Stocks

By Brian Nelson, CFA

Within the discounted cash-flow [DCF] modeling process (also known as enterprise valuation, or the free cash flow to the firm model), there are two primary sources of cash-based intrinsic value: net cash on the balance sheet and future expected enterprise free cash flows. The sum of net cash on the balance sheet and the present value of future enterprise free cash flows divided by weighted average diluted shares outstanding results in a fair value estimate per share, which then can be divided by earnings to arrive at a value-derived price-to-earnings (P/E) ratio. Only when this value-derived P/E ratio is compared to the price-observed P/E ratio—the latter calculated as price divided by estimated earnings--can a company then be considered undervalued or overvalued.

It is not the absolute level of the price-observed P/E ratio that matters, but rather how the value-derived (DCF-derived) P/E ratio compares to the price-observed P/E ratio--or more simply, how the fair value estimate per share compares to a company's price per share. P/E ratios, on an absolute basis (how high or low they are), have significant shortcomings when it comes to assessing valuation. Not only do they largely ignore the net cash position a company may have on the balance sheet, but they also ignore the long-term duration of future expected free cash flows. Stocks that have huge net cash positions on the balance sheet and tremendous future expected free cash flow generation tend to justifiably have comparatively high value-derived P/E ratios, **while those that have huge net debt positions on the balance sheet and modest future expected free cash flows tend to have justifiably low value-derived P/E ratios.**

Stocks such as Apple (AAPL), Microsoft (MSFT), and Alphabet (GOOG) (GOOGL), as just a few examples, deserve to have significantly higher valuation multiples. These companies have significant net cash on the balance sheet and strong expectations of future free cash flow. That's why in part we're huge fans of big cap tech and the stylistic area of large cap growth, even though many in these areas have above-market valuation multiples. On the other hand, many entities in the consumer staples (XLP) space may not necessarily deserve elevated multiples. As of July 28, FactSet estimates that the consumer staples sector has a forward estimated price-observed P/E ratio of more than 20 times. We'd expect entities with this multiple to have huge net cash positions and tremendous secular growth prospects, but while strong earnings growth may be achievable for some in this group, expansion expectations are modest by comparison.

Let's take Kellogg Company (K) as an example. The firm has total debt liabilities of ~$6.74 billion and just $308 million in cash (resulting in a net debt position of $6.43 billion), while its reported diluted earnings per share has fallen to $1.90 in the year-to-date period ending July 1, 2023, from $2.19 in the same period a year ago. On an adjusted basis, Kellogg's earnings per share is expected to decline 1%-2% on a currency-neutral basis for the year while free cash flow so far in 2023 has also fallen due to weakening operating cash flow and higher capital spending.

Please see *Not Expecting Much From Consumer Staples Stocks...*on next page

Not Expecting Much From Consumer Staples Stocks ...from previous page

Kellogg Company and Subsidiaries
Reconciliation of Non-GAAP Amounts - Net Debt

(millions, unaudited)	July 1, 2023	July 2, 2022
Notes payable	$ 461	$ 320
Current maturities of long-term debt	1,199	854
Long-term debt	5,078	5,838
Total debt liabilities	6,738	7,012
Less:		
Cash and cash equivalents	(308)	(323)
Net debt	$ 6,430	$ 6,689

Image: *Kellogg is representative of many consumer staples equities that have net debt positions.*
Image Source: *Kellogg's second-quarter press release*

Yet, shares of Kellogg are trading at 16x current-year's expected earnings. If entities like Kellogg can garner a 16x multiple with their comparatively unattractive cash-based characteristics, what type of P/E multiple is then fair for a stock with a huge net cash position, substantial free cash flow generation, and tremendous secular growth prospects? Is it 30, 50, or more? That's what the DCF helps solve. Clearly, we're not interested at all in Kellogg's shares (it has a poor Dividend Cushion ratio, too) at this time, nor will we have any interest in its pending breakup into two separate companies--its snacking business Kellanova and WK Kellogg Co, its North American Cereal business.

Most consumer staples equities are burdened with substantial net debt positions, while their long-term growth prospects are relatively muted. Their free cash flow generation may be robust, but most of their excess cash flow is absorbed by dividend liabilities that mitigate their capital appreciation potential. [Remember, when it comes to the payment of a dividend, the stock price is adjusted down by the payment on the ex-dividend date. The dividend is capital appreciation that otherwise would have been achieved had the dividend not been paid.] Clorox (CLX) has long-term debt of $2.48 billion and cash of $367 million. Long-term debt at Kraft Heinz (KHC) stands at $19.37 billion, while it has cash of $947 million. Debt, less cash and cash equivalents, at Colgate-Palmolive (CL) stands at $7.9 billion.

Though consumer staples equities have shown tremendous resilience in the face of adversity and their dividend yields can make sense in certain portfolios, the group is overflowing with net debt positions, meager long-term growth prospects, and free cash flow generation that is largely absorbed by growing per-share dividend liabilities. On the other hand, big cap tech and large cap growth have tremendous net cash positions and substantial future expected free cash flow generation, paving the way for what could be considerable long-term return potential. As with the last decade, we expect cash-based sources of intrinsic value to prevail, and for that, we continue to point to big cap tech and large cap growth as areas for consideration, even when it comes to dividend growth potential. We don't want the "dividend" tail to wag the "total return" dog.

Apple's Looming 'Watch X' Likely a Game Changer in Smartwatches

By Brian Nelson, CFA

Apple (AAPL) is expected to do a refresh of its Apple Watch this year, but the changes won't be as significant to draw many to upgrade. However, as we look out to fiscal 2024 and fiscal 2025, exciting things could happen. According to a report from Bloomberg, the "Watch X," marking the 10th anniversary of the rollout of the first Apple Watch, is targeted to include a blood-pressure monitoring tool, among other upgrades. Not only do we think a blood-pressure monitoring tool will drive considerable adoption from many that do not have a smartwatch, but it could also drive a huge market share shift to the device from Samsung (SSNLF) (SSGFF) and Alphabet's Fitbit (GOOG) (GOOGL).

For starters, we think many individuals living an active lifestyle and/or those with hypertension may be very interested in adding the new device to their suite of consumer electronics. According to a report by Grand View Research, "the global blood pressure monitoring devices market size was estimated at USD 4.5 billion in 2022 and is projected to expand further at a compound annual growth rate (CAGR) of 9.4% from 2023 to 2030." By itself, people are becoming more and more interested in monitoring their health, and blood-pressure monitoring, in particular, is of considerable importance given that hypertension raises the risk of all sorts of diseases.

The World Health Organization estimates the number of people between the ages of 30-79 years living with hypertension has increased to 1.28 billion, up from 650 million in 1990. Though wealthy nations have experienced improvements in rates of hypertension, population growth and ageing have driven the advance, while a shift to lower- and middle-income countries has played a role. Apple continues to dominate the smartwatch category, with estimates indicating that the number of Apple Watch units sold hit ~53.9 million in 2022. If Apple can incrementally attract even a small percentage of people living with hypertension to adopt its "Watch X," we're looking at quite the earnings catalyst come 2024 or 2025, in our view.

A couple months ago, we noted that Apple's 'Vision Pro' could spell upside to its fiscal 2024 and fiscal 2025 numbers, and now it's looking likely that Apple could spark a huge jump in sales of its Apple Watch, after this year's iteration, if it able to successfully deliver on embedding blood-pressure monitoring technology to the "Watch X" (it has been reported the company has had trouble embedding this technology in the past). We continue to like Apple's cash-based sources of intrinsic value: its net cash position remains solid, and future expectations of enterprise free cash flow remain robust. We remain fans of shares.

Home Depot's Comparable Store Sales Continue Declines, Big Ticket Purchases Slow

Image: *Home Depot's shares have been resilient both pre- and post-COVID 19.*

By Brian Nelson, CFA

Home Depot (HD) is one of the most resilient companies across the retail arena. The firm weathered the Great Financial Crisis [GFC] well and it handled the vicissitudes of the COVID-19 pandemic and aftermath flowingly as it juggled supply chain issues, changing consumer buying preferences, and increased demand as consumers remodeled and upgraded their working and living spaces while cocooning at home. The company's second-quarter 2023 results, released August 15, came in better than expected, but comparable store sales fell 2% both in aggregate and in the U.S. Though comparable store sales declines improved from bigger declines in the first quarter, Home Depot's guidance for comparable sales to fall 2%-5% for all of fiscal 2023 indicates there may be some further year-over-year weakness ahead. We're sticking with Home Depot in the Dividend Growth Newsletter portfolio, however.

With 30-year mortgage rates advancing to ~7.51%, according to Bankrate, home buyers and real estate investors continue to be cautious, and while rising borrowing costs have not impacted housing prices negatively (yet), we may be seeing some reverberations in the home improvement market as homeowners slow the pace of big investments in their homes. The COVID-19 pandemic served as a huge catalyst for home improvement spending, pulling some demand forward, so many that poured thousands of dollars into remodeling efforts during the pandemic to expand working and living space don't have as much need for large upgrades at the present moment. That said, Home Depot noted that it continues to experience strength in categories associated with smaller projects but spending on bigger-ticket discretionary categories has faced pressure. 2023 may be a slow year for Home Depot, but the long term remains bright as consumers will continue to prefer larger living and working spaces, in our view, having cocooned at home throughout most of the COVID-19 pandemic.

Please see *Home Depot's Comparable Store Sales Continue Declines...*on next page

*Home Depot's Comparable Store Sales Continue Declines…*from previous page

Reaffirming Fiscal 2023 Guidance

	FY2023
TOTAL SALES AND COMP SALES	-2% to -5%
OPERATING MARGIN RATE	14.3% to 14.0%
EFFECTIVE TAX RATE	~24.5%
INTEREST EXPENSE	~$1.8B
DILUTED EPS	-7% to -13%

Image Source: *Home Depot*

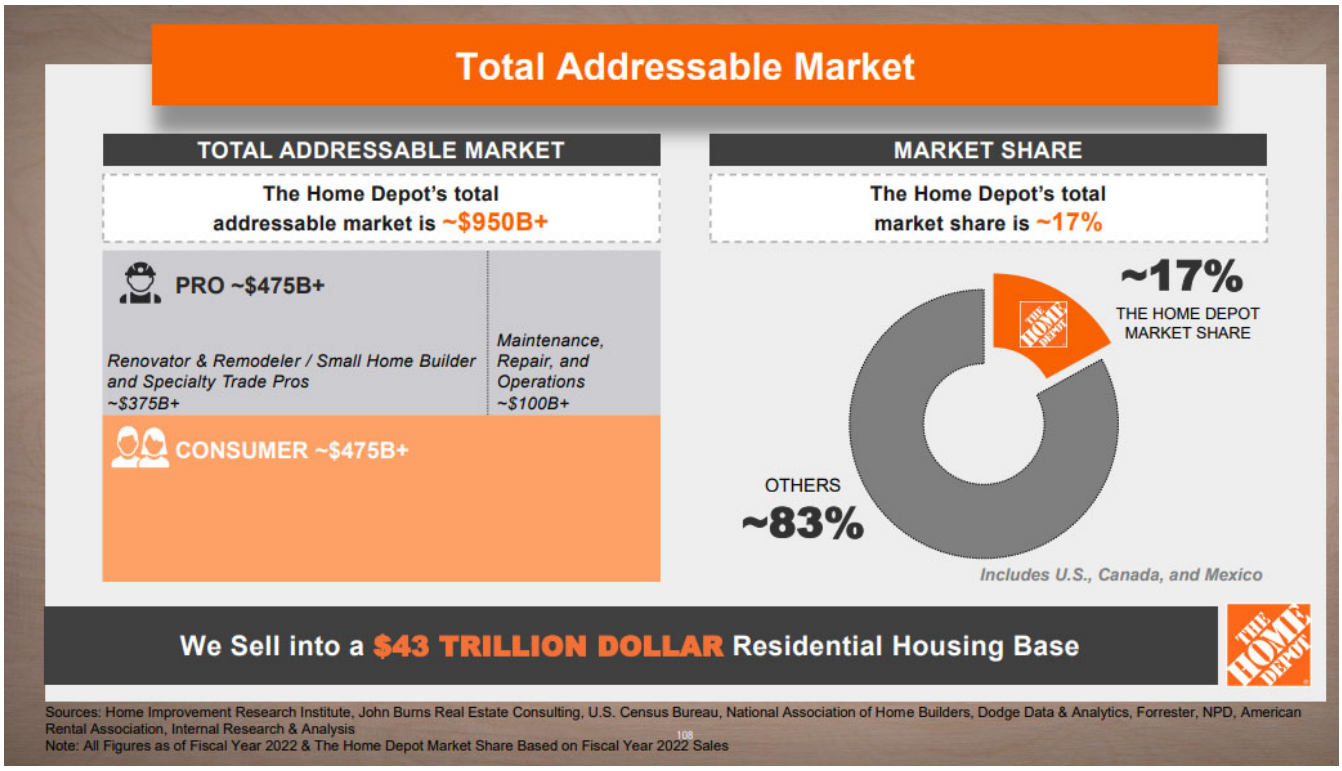

Image Source: *Home Depot*

Please see *Home Depot's Comparable Store Sales Continue Declines…*on next page

*Home Depot's Comparable Store Sales Continue Declines…*from previous page

For the second quarter, Home Depot's total net sales dropped 2%, while operating income fell 8.6%. Net earnings dropped 9.9% in the period, while buybacks slowed the year-over-year declines in diluted earnings per share to 7.9%. The drop in net earnings and diluted earnings per share on a year-over-year basis was slightly worse than the pace that Home Depot experienced during the first quarter of this year. The number of customer transactions fell 1.8% on a year-over-year basis in the second quarter, while average ticket prices were about flat from the same period a year. Home Depot retains a large net debt position, something we're not huge fans of, but free cash flow has surged during the first six months of the year, as working capital movements have been favorable. Net cash from operations increased to ~$12.2 billion from ~$7.18 billion during the first half of the year, while capital expenditures nudged up modestly to ~$1.7 billion from ~$1.5 billion in last year's period. For the first six months of 2023, free cash flow came in at ~$10.5 billion, up materially from ~$5.74 billion in the same period a year ago.

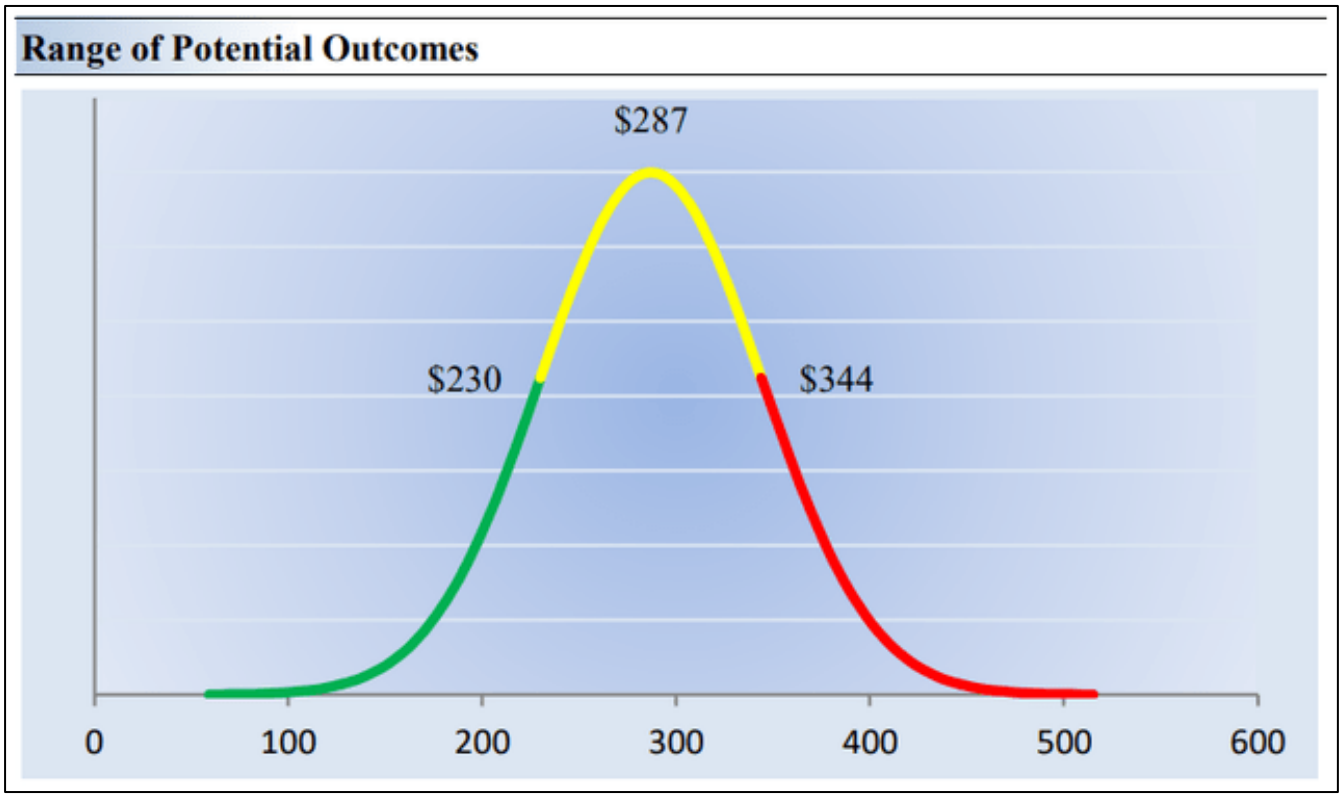

Image: *Our fair value estimate range of Home Depot. Shares of Home Depot are trading at the high end of the range at ~$330 per share at the time of this writing.*

All told, Home Depot's quarterly results were fine, and we continue to like the world's largest home improvement retailer for the long haul. The performance did show weakness in bigger ticket items, which may be concerning for more discretionary purchases across the broader retailing space, but overall July retail sales reported by the Commerce Department remained strong, coming in at a 1% increase, excluding autos, better than the consensus forecast. Home Depot authorized a new $15 billion buyback program, which should continue to support its stock, and while shares are trading near the high end of our fair value estimate range, we won't be making any changes to its position in the Dividend Growth Newsletter portfolio. The company has a forward estimated dividend yield of ~2.5% at the time of this writing.

Dick's Sporting Goods Struggles with Shrink in Second Quarter; Sticking with It Long Term

***Image**: Dick's Sporting Goods has been a strong performer the past couple years, outperforming the S&P 500.*

By Brian Nelson, CFA

Dividend growth investing continues to face pressure during 2023 as investors have migrated to entities with strong net cash positions, solid free cash flow generation and secular growth prospects, many ideas of which can be found in the areas of big cap tech (XLK) and large cap growth (SCHG). The SPDR S&P Dividend ETF (SDY), which includes high-yielding Dividend Aristocrats, is down ~2.5% so far in 2023 on a price-only basis and is roughly flat over the past year, also on a price-only basis. With interest rates on the rise, the tradeoff between owning a certificate of deposit at the local bank yielding north of 5% and dividend growth equities with 2-3% dividend yields becomes a much more challenging proposition. Nonetheless, we still like the merits of dividend growth investing in the long run.

Please see *Dick's Sporting Goods Struggles with Shrink in Second Quarter*...on next page

*Dick's Sporting Goods Struggles with Shrink in Second Quarter…*from previous page

Some of our favorite dividend growth ideas in the Dividend Growth Newsletter portfolio include Cisco (CSCO), Microsoft (MSFT), Oracle (ORCL), Apple (AAPL), and Republic Services (RSG). **Cisco is up ~20% year-to-date, Microsoft is up ~37% year-to-date, Oracle is up ~44% year-to-date, Apple is up ~50% year-to-date, and Republic Services is up ~12% year-to-date.** These dividend growth ideas are trouncing the basket of high-yielding Dividend Aristocrats. With big cap tech and large cap growth powering the market higher during 2023, it's been great having this type of exposure within the Dividend Growth Newsletter portfolio, and we hope you have enjoyed it, too. Other traditional dividend growth areas such as utilities (XLU) and real estate investment trusts (VNQ) are down ~11%+ and flat so far this year, respectively, so we've been doing a good job picking the right spots in 2023 following outperformance in 2022, which was a very challenging year for many.

That said, sometimes there's an idea that does really well and then it comes back down to earth, and that's what has happened to Dick's Sporting Goods (DKS) during the past several months. After a strong run so far in 2023, during the trading session August 22, the company has given up all of its gains so far in 2023, and now is down ~4% so far this year, trailing the SPDR S&P Dividend ETF by roughly a percentage point. As we wrote previously, the concern across brick-and-mortar retail these days is shrink, perpetuated in part by organized retail crime. As people cocooned at home and online purchases soared during the COVID-19 pandemic, organized retail crime seemed to balloon as stolen items could easily be sold quickly online. Retailers continue to work to mitigate shrink with varying degrees of success.

Image: *Dick's Sporting Goods*

Please see *Dick's Sporting Goods Struggles with Shrink in Second Quarter…*on next page

Dick's Sporting Goods Struggles with Shrink in Second Quarter ...from previous page

Image Source: *Dick's Sporting Goods*

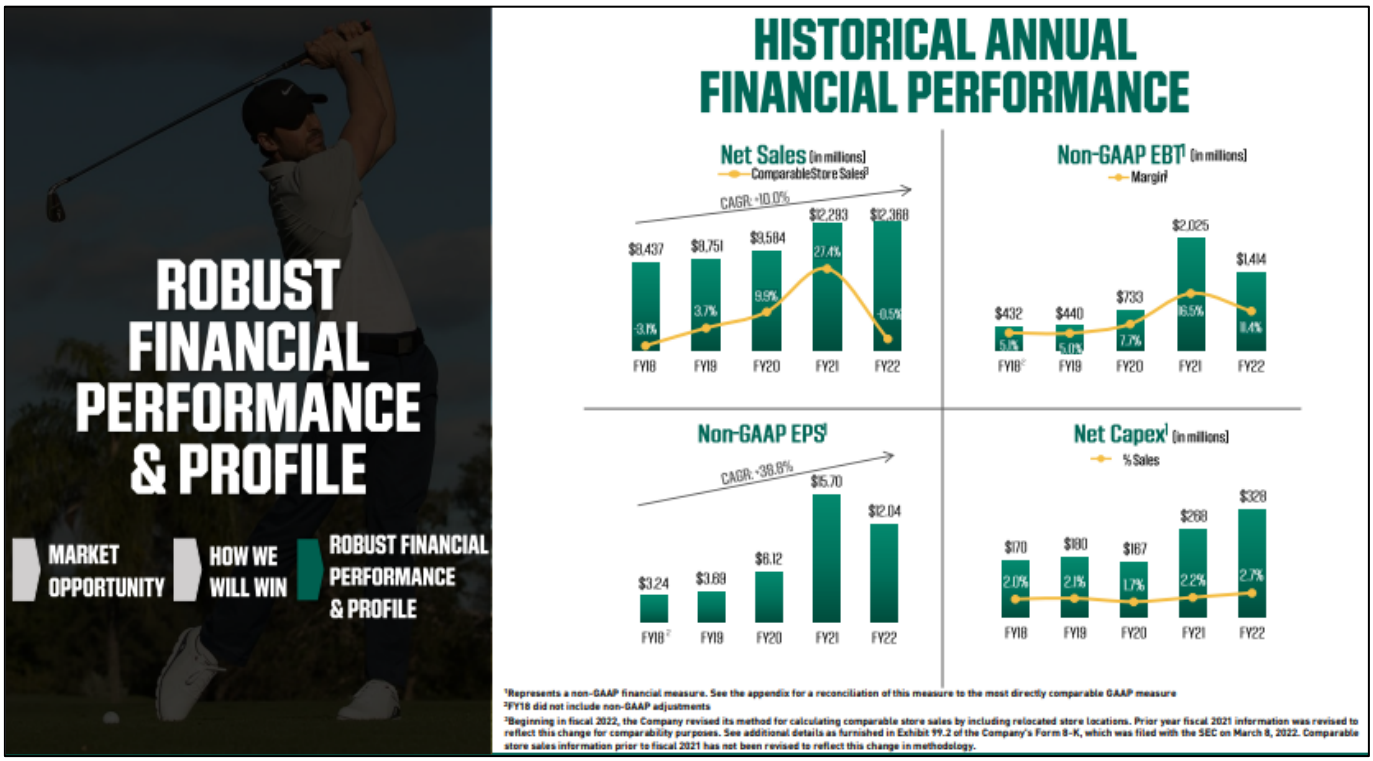

Image Source: *Dick's Sporting Goods*

Please see *Dick's Sporting Goods Struggles with Shrink in Second Quarter* ...on next page

Dick's Sporting Goods Struggles with Shrink in Second Quarter ...from previous page

Unlike big dividend growth winners such as Cisco, Microsoft, and Oracle, which are higher weightings (5%-7%) in the Dividend Growth Newsletter portfolio, Dick's Sporting Goods has a smaller 3-5% weighting and fills a more diversifying role with respect to retail. That said, the sporting goods retailer's second-quarter results (ending July 29, 2023) missed top-line consensus expectations by a small margin, but the miss on the bottom line was a bit more pronounced due to concerns over shrink. Dick's Sporting Goods, however, still delivered 3.6% sales expansion in the period while quarterly comparable store sales increased 1.8% (an improvement from the 5.1% decline in last year's quarter), as it reiterated its 2023 comparable store sales target of "flat to positive 2%." The company's full-year 2023 outlook for diluted earnings per share now stands at $11.33-$12.13 (was $12.90-$13.80), implying shares are trading at about 10x current-year earnings.

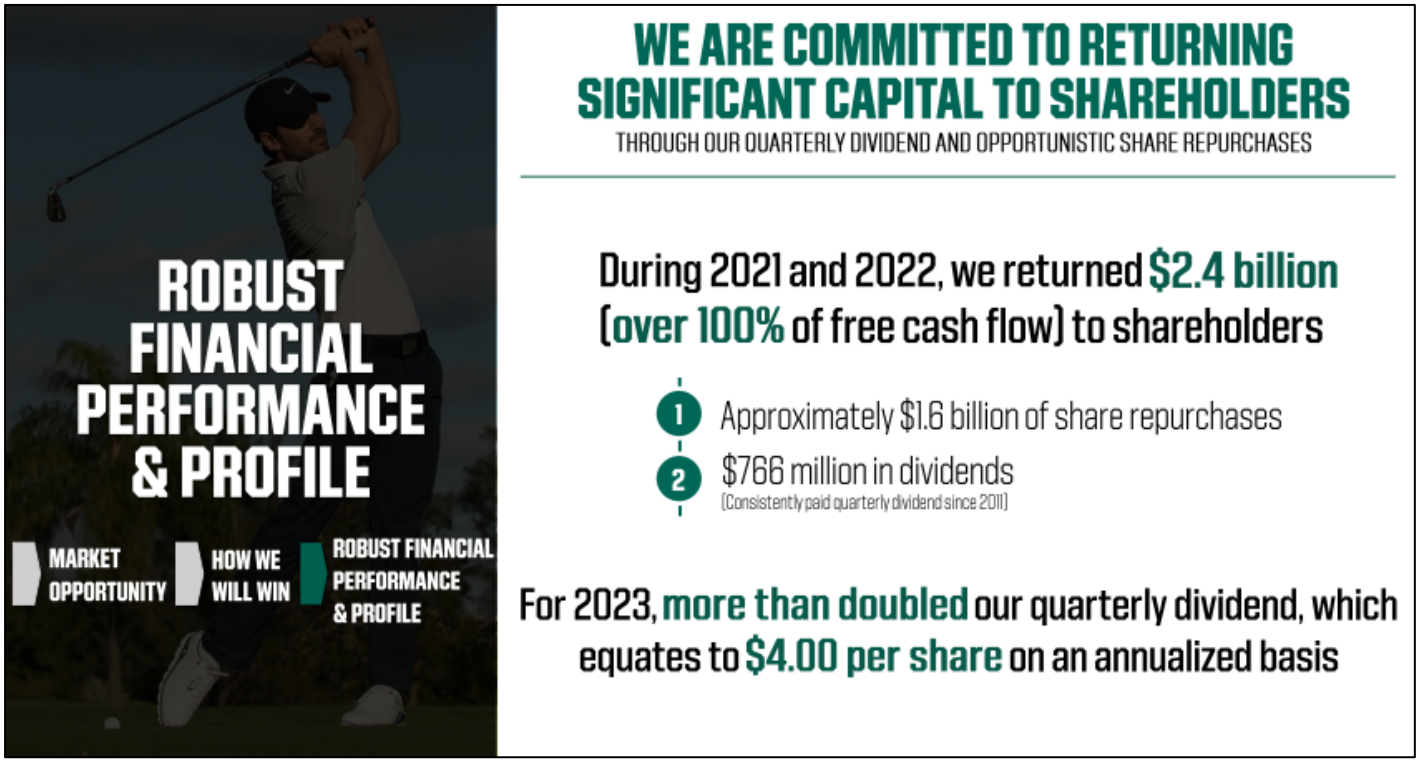

***Image Source**: Dick's Sporting Goods*

Dick's Sporting Goods' cash-based sources of intrinsic value remain resilient. The firm ended its second quarter with a modest net cash position, while free cash flow surged during the first half of 2023 (~$450 million versus -$65.9 million). We expect a modest decrease in our fair value estimate of Dick's Sporting Goods upon our next report update, but we won't be removing the company from the Dividend Growth Newsletter portfolio. Shrink is a big issue across brick-and-mortar these days, but we still want to have some retail exposure in the Dividend Growth Newsletter portfolio, and Dick's Sporting Goods fits the bill; Home Depot (HD) is another retail dividend growth consideration. Dick's Sporting Goods will continue to play an important diversifying role in the Dividend Growth Newsletter portfolio, particularly in the context of our favorite areas of big cap tech and large cap growth--which have done extremely well this year and have been well-represented across the newsletter portfolios.

ICYMI: Johnson & Johnson Belongs in the "Too Hard" Bucket

Image Source: *Johnson & Johnson*

By Brian Nelson, CFA

Johnson & Johnson (JNJ) recently entered the "too hard" bucket for us. We dropped J&J from the Best Ideas Newsletter portfolio and Dividend Growth Newsletter portfolio on March 13 of the year, as we lost interest in the company given the uncertainties surrounding talc liabilities and the Kenvue (KVUE) split-off. We prefer simplicity across our newsletter portfolios, and J&J's results have often been messy, to say the least.

Though J&J's second-quarter 2023 performance, released July 20, was a bit better, we no longer have much interest in the name, given its net debt position and contingent talc liabilities. We're also not interested in shares of its split-off Kenvue, having completely removed J&J from the newsletter portfolios prior to the split.

Please see *Johnson & Johnson*...on next page

***Johnson & Johnson*...from previous page**

***Image**: J&J's shares haven't performed well through the course of 2023.*

On July 24, J&J launched an exchange offer:

> Johnson & Johnson today announced its intention to split-off at least 80.1% of the shares of Kenvue Inc. through an exchange offer. Kenvue, formerly Johnson & Johnson's Consumer Health business, completed its initial public offering in May 2023. Through the planned exchange offer, Johnson & Johnson shareholders can exchange all, some or none of their shares of Johnson & Johnson common stock for shares of Kenvue common stock, subject to the terms of the offer. The exchange offer is expected to be tax-free for U.S. Federal income tax purposes.

Shares of Johnson & Johnson are down ~9% so far in 2023 in one of the biggest bull-market runs that we've seen in a while. Over the past month, shares of Kenvue Inc. have declined more than 2%. We maintain our prior opinion and believe it was the right move to remove J&J from the newsletter portfolios in March of this year. Whether J&J shareholders should exchange all, some, or none of their J&J shares for Kenvue shares may not be the right question, but rather whether investors have sufficient exposure to the areas of big cap tech and large cap growth.

We continue to believe the strongest areas of the market will remain big cap tech and large cap growth for the foreseeable future. Many of the current stock-market leaders, including Apple (AAPL), Alphabet (GOOG) (GOOGL) and Microsoft (MSFT), have tremendous cash-based sources of intrinsic value, with net cash overflowing on their balance sheets as they generate free cash flow that is several times that of J&J's. In J&J's second-quarter 2023 results, for example, free cash

About the Valuentum Dividend Cushion™ Ratio

By Valuentum Analysts

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

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

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

The Importance of Forward-Looking Dividend Analysis

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

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

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

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

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

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

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

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

The Valuentum Dividend Cushion Caught These Dividend Cuts in Advance

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

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

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

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

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

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

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

*About the Valuentum Dividend Cushion…*from previous page

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

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

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

Understanding Dividend Growth

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

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

About the Valuentum Dividend Cushion...**from previous page**

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

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

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

The Dividend Cushion Ratio Helps Income Investors

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

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

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

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

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

Valuentum Dividend Growth Newsletter: Volume 12, Issue 9

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

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

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

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

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

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

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

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

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

Brian Nelson owns shares in SPY, SCHG, QQQ, DIA, VOT, BITO, RSP, and IWM. Valuentum owns SPY, SCHG, QQQ, VOO, and DIA. Brian Nelson's household owns shares in HON, DIS, HAS, NKE, DIA, and RSP. Some of the other securities written about in this article may be included in Valuentum's simulated newsletter portfolios. Contact Valuentum for more information about its editorial policies.

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

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