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HIGH YIELD DIVIDEND NEWSLETTER

UNDERSTANDING THE FREE CASH FLOW SHORTFALL IN THE MASTER LIMITED PARTNERSHIP SPACE

With the recent acceleration of master limited partnership (MLP) simplification transactions, we find it appropriate to revisit the internally-generated cash flow shortfall present throughout much of the space. The table below provides a breakdown of traditional free cash flow (cash from operating activities less all capital spending) relative to distributions paid, as well as a measure of the elevated financial leverage often found within the group.

> "NAVIGATING THE MLP SPACE IS UNAVOIDABLE IN THE LAND OF 'HIGH YIELD DIVIDENDS' NO MATTER IF WE LIKE IT OR NOT."
> – BRIAN NELSON, CFA

We think it is worth noting that the two entities at the top of this list in terms of traditional free cash flow coverage of distributions paid have significantly reduced their distributions in recent years. Kinder Morgan's (KMI), now a C-Crop, annual dividend per share of $0.50 in 2017 was less than its final *quarterly* dividend of $0.51 in 2015, though it has already returned to

Updated May 31, 2018 - Calendar 2017 - $mil

	Adjusted Reported EBITDA	Cash from Operating Activities (CFO)	Total Capital Expenditures	Dividends, Distributions	Free Cash Flow after Dividends, Distributions	Net Debt	Net Debt/ Adj EBITDA
Kinder Morgan (KMI)	7,198.0	4,601.0	-3,188.0	-1,318.0	95.0	37,579.0	5.2
Plains All American (PAA)	2,082.0	2,499.0	-1,026.0	-1,386.0	87.0	9,883.0	4.7
Tallgrass Energy Partners (TEP)	678.0	579.1	-145.1	-392.9	41.1	2,145.2	3.2
DCP Midstream (DCP)	1,017.0	896.0	-375.0	-552.0	-31.0	4,551.0	4.5
Holly Energy Partners (HEP)	344.7	238.5	-44.8	-241.1	-47.4	1,499.5	4.3
EQT Midstream Partners (EQM)	689.5	650.6	-301.6	-432.2	-83.2	1,164.8	1.7
Andeavor Logistics (ANDX)	1,031.0	709.0	-208.0	-661.0	-160.0	4,052.0	3.9
Boardwalk Pipeline (BWP)	838.5	637.0	-708.4	-102.2	-173.6	3,669.2	4.4
Magellan Midstream (MMP)	1,302.9	1,108.7	-558.7	-803.2	-253.2	4,348.4	3.3
Buckeye Partners (BPL)	1,113.9	888.4	-433.3	-753.7	-298.7	4,908.3	4.4
Western Gas Partners (WES)	1,061.0	901.5	-675.0	-814.9	-588.4	3,385.9	3.2
MPLX LP (MPLX)	2,004.0	1,907.0	-1,411.0	-1,127.0	-631.0	6,940.0	3.5
Spectra Energy Partners (SEP)	1,331.0	1,610.0	-1,928.0	-1,276.0	-1,594.0	8,356.0	6.3
Williams Co (WMB)	4,531.0	2,556.0	-2,399.0	-1,814.0	-1,657.0	20,036.0	4.4
Enterprise Products (EPD)	5,615.3	4,666.3	-3,147.9	-3,619.1	-2,100.7	24,498.4	4.4
Enbridge (ENB)[1]	10,317.0	6,584.0	-9,076.0	-4,246.0	-6,738.0	64,593.0	6.3
Energy Transfer (ETP)	6,712.0	4,485.0	-8,335.0	-3,898.0	-7,748.0	32,788.0	4.9
Energy Transfer Equity (ETE)	7,320.0	4,429.0	-8,444.0	-3,971.0	-7,986.0	43,748.0	6.0

1) currency in terms of CAD

significant growth in the quarterly payout and expects to continue growing the dividend at a robust rate in the near term. Plains All American (PAA) has undergone a simplification transaction, and its quarterly distribution has been cut twice to its current level of $0.30 per share from the $0.70 per share distribution paid in the third quarter of 2016.

The rapid increase in simplification transactions across the MLP space supports our ongoing thesis that the master limited partnership business-model has its share of flaws and may not be sustainable over the long haul. The massive discrepancies of internally-generated cash flow and distributions to limited partners, general partners, and non-controlling interests speak to this idea of unsustainability, and we continue to warn against investors relying on industry-specific measures of cash flow--namely distributable cash flow, which ignores growth capital spending--as an appropriate evaluation of the health of the businesses and the income streams they generate.

Master Limited Partnership Simplifications on the Rise

With the announcement of three separate master limited partnership simplification transactions on May 17 alone, we must revisit our thesis that the business structure may not be in it for the long haul.

At Valuentum, we continue to believe the master limited partnership (MLP) business model is at risk over the long haul, and recent news from the space only seems to support the notion that the MLP model we once knew may be fading more quickly than some had expected. If there is nothing inherently wrong with the structure of MLPs, then the rate at which simplification transactions are occurring would certainly be an alarming development, but we continue to point to factors such as the need for robust levels of outside capital financing for growth and an industry-wide preference for selective cash flow measures that do not properly account for capital needed for growth but prop up lofty yields and distribution-based valuation as key causes for concern.

The detachment of fundamentals and analysis in the space may finally be coming to an end, but the acceleration of simplification transactions, which we had originally highlighted as a long-term concern, is due in part to the FERC ruling that MLPs are no longer allowed to receive credit for income taxes they do not pay. Nevertheless, the core of our thesis is based on the idea that MLPs should not be treated, valued, or analyzed differently than typical corporates, which is supported by the FERC's ruling to eliminate the MLP tax allowance, in our opinion.

Three different simplification transactions were announced May 17, which we will address later in this note, but they are only a fraction of the restructuring activity we have seen thus far in 2018. Let's take a quick look at some of those deals.

Terra Nitrogen was swallowed by its general partner, Terra Nitrogen GP, which is a subsidiary of CF Industries (CF).

Legacy Reserves (LGCY) announced that it is working to transition to a C-Corp with the goals of attaining a less complicated balance sheet and enhanced ability to raise capital.

NuStar (NS) announced its merger plans with general partner NuStar GP Holdings (NSH), along with the elimination of its incentive distribution rights and a cut in its quarterly distribution.

Tallgrass Energy Partners (TEP) will be acquired by its general partner Tallgrass Energy GP (TEGP) and eliminated its incentive distribution rights, which is aimed at reducing its cost of capital.

Archrock (AROC) will acquire the remaining units it does not already own in Archrock Partners LP (APLP) in a deal designed to increase dividend coverage, improve its credit profile, simplify its capital structure, and lower its cost of capital.

Alliance Resource Partners (ARLP) and Alliance Holdings GP (AHGP) announced a series of simplification transactions intended to simplify the organization's structure and increase investor transparency while attracting a broader investor base.

EQT Midstream Partners (EQM), EQT GP Holdings (EQGP), and Rice Midstream Partners LP (RMP) announced a midstream streamlining transaction that includes the purchase of Rice Midstream's incentive distribution rights by EQT GP Holdings and efficiency gains that should offset the need for a not immaterial amount of incremental capital.

Though no official announcement has been made, Boardwalk Pipeline Partners (BWP) CEO Stanley Horton has suggested general partner Loews (L) may take the MLP private.

We are not here to dissect the strategic rationale of these transactions.

We continue to be of the opinion that the majority of the businesses underlying master limited partnerships are sound and core to our economy (US energy production is strong and organic growth projects are prevalent), but their complex organization structures and industry-specific manner of operating and valuation are not sustainable over the long haul, in our view. The proliferation of simplification transactions across the MLP space seems to support this notion as organizations continue to work to reduce their cost of capital, a factor that is extremely important to entities that are dependent on outside funding.

With that in mind, let's dig in to the three freshest simplification announcements. A little more than a year after the Williams family's double equity raise and distribution cut, "MLPs: Williams' Double Equity Raise," general partner Williams Companies (WMB) has agreed to acquire the remaining units of Williams Partners (WPZ) it does not already own, which is ~26% of the limited partner, for a premium of just over 6% of Williams Partners' May 16 close price.

Williams Companies will issue 382.5 million shares in the proposed transaction, and Williams Partners unithodlers will receive 1.494 shares of the general partner for each unit owned, assuming the deal closes before Williams Companies' third quarter dividend record date. If the transaction closes as scheduled, Williams Partners' unithodlers will receive five payouts in calendar 2018, which management estimates equates to a ~15% increase over its previously expected distributions in the year. The 2018 payout projection was near the top of a list of highlights for Williams Partners unitholders provided by management, but the team made no effort in explaining what the dividend will look like in 2019 and beyond compared to the limited partner's current distribution.

Williams Companies' current annualized dividend of $1.36 per share implies an annual payout of ~$2.03 for Williams Partners unitholders after considering the exchange ratio (1.494 x 1.36). It appears as though there will be a meaningful reset of the payout for the MLP's unitholders following the unique case of 2018. A 15% increase (management expects 10%-15% annual dividend growth in 2019 after the ~13% increase in 2018) from $1.36 reveals an annualized dividend of ~$1.56 per share for 2019. Assuming the proposed transaction closes as scheduled, this implies a payout of ~$2.34 per share for Williams Partners' unitholders in 2019, which compares unfavorably to its current distribution of $2.46 per unit.

Enbridge (ENB), the largest energy infrastructure company in North America, announced that it will acquire all of the outstanding equity securities of Spectra Energy Partners (SEP), Enbridge Energy Partners (EEP), Enbridge Energy Management (EEQ) and Enbridge Income Fund Holdings (TSX: ENF). Enbridge announced in December 2017 that it was assessing a potential streamlining and simplification of its organizational structure, and management points to the recent reversal in FERC policy as a cause of its decision as the ruling would weakened Enbridge Energy Partners' and Enbridge Energy Management's credit profiles and viability as financing vehicles for Enbridge's growth. Direct ownership in Enbridge and an enhanced dividend growth profile were also offered as key rationales for the simplification from the point of view of the to-be-acquired entities.

Enbridge also notes that in order for Enbridge Energy Partners to retain its investment grade credit ratings, the MLP would have to raise a significant amount of equity at an unattractive cost of capital and materially cut its distribution in early 2019, which would come on top of its previous distribution cut in 2017. However, the announced simplification transaction includes an implied dividend cut for unitholders. Enbridge Energy Partners will receive 0.3083 share of Enbridge for each unit owned, and the two entities' most recent quarterly payouts were $0.35 (EEP) and $0.671 (ENB). The exchange ratio implies a reset of its quarterly payout to ~$0.21 (0.3083 x 0.671), which is not immaterial even if dividend growth prospects are enhanced as a result of the transaction.

The third simplification transaction announced May 17 comes from Cheniere Energy (LNG) and Cheniere Energy Partners (CQH). Cheniere Energy is offering

0.45 of its share per share of Cheniere Energy Partners in a tax-free exchange. The proposal offered no guidance regarding future dividend payments, but Cheniere Energy does not currently pay a dividend. Shares of Cheniere Energy Partners currently yield more than 7%. Cheniere Energy already owns ~92% of Cheniere Energy Partners.

Recent actions taken by master limited partnerships only seem to reaffirm our thesis that the complex business structure is not sustainable over the long haul. The need for access to outside capital may never totally go away, but if the typical structure of MLPs is an attractive one, then why must so many simplification transactions be pursued?

This will not be the end of the simplification movement either, and while some who prefer to champion the business model over objective analysis may point to smaller operators simplifying as not representative of the attractiveness of the structure, Williams and Enbridge will not be the last of the high-profile names to consolidate. For example, the Energy Transfer (ETE, ETP) family is evaluating its organizational structure and points to late 2019 as a potential timeline for an internal restructuring transaction.

Valuentum members should not be surprised by any of the recent developments in the MLP space, and the recent regulatory change (FERC ruling) has only accelerated what we had originally pointed to as a long-term concern.

Adapted from the April edition of the High Yield Dividend Newsletter: **Then Why Do We Include a Couple MLPs in the Simulated Newsletter Portfolio?**

In the past, we highlighted the Tallgrass Energy family's ongoing evaluation of an ownership restructuring transaction, and it has already completed its review process. Tallgrass Energy GP (TEGP) will acquire Tallgrass Energy Partners (TEP) in a taxable stock-for-unit transaction that will result in Tallgrass Energy Partners unitholders receiving two Tallgrass Energy GP shares for each unit owned. Tallgrass Energy GP will change its name to Tallgrass Energy LP, trade under the symbol TGE, and be taxed as a corporation. As a result of Tallgrass Energy GP's material deferred tax asset, the to-be-formed entity does not expect to pay federal income taxes for at least ten years.

As with the vast majority of MLP-GP roll-ups we've witnessed in recent years, the move is aimed at eliminating the general partner's incentive distribution rights. However, what sets this simplification transaction apart from many recent similar transactions is the sustainment of the quarterly distribution to Tallgrass Energy Partners common unitholders, which is in part a result of the non-dilutive effect of the transaction as it requires no additional outside financing. Concurrent with the deal announcement, Tallgrass Energy Partners' first quarter 2018 distribution per unit was raised to $0.4875, and Tallgrass Energy GP's first quarter 2018 dividend per share was raised to $0.975, or exactly twice the rate of the limited partner. The transaction is expected to close in the second quarter of 2018.

Assuming the deal closes in the second quarter of 2018, and we see no reason why this should not be achievable at this point, Tallgrass Energy management estimates that current Tallgrass Energy Partners unitholders will realize distribution growth of ~5%-8% in 2018, and the consolidated corporation will have a coverage ratio greater than 1.2x. Prior to the transaction, the limited partner was projecting 7%-10% distribution growth for 2018, and it reported a 1.28x distribution coverage ratio in the fourth quarter of 2017. However, this transaction is not geared towards the realization of near-term income growth for investors. The reduced cost of capital resulting from the restructuring should enhance the to-be-formed entity's competitiveness in executing growth projects and future M&A transactions to fuel long-term income generation.

All things considered, we tend to agree with Tallgrass management's rationale for the simplification transaction. Enhanced long-term growth prospects and more streamlined corporate governance are clear positives, and the elimination of incentive distribution rights more clearly aligns management's interests with those of the common shareholder, something that is often overlooked in the evaluation of the typical MLP structure. That the transaction will not result in an implicit distribution reduction for current unitholders is icing on the cake as Tallgrass Energy Partners' current double-digit yield may offers an attractive level of income for investors.

Also worth noting is that upon completion of the transaction, both MLPs in the High Yield Newsletter simulated portfolio, Tallgrass and Magellan Midstream Partners (MMP), do not have incentive distribution rights in their ownership structure. Not only do both of these MLPs offer investors potentially compelling income generation, but such a characteristic allows them to compete effectively with larger rivals for incremental capital to be used to fund future growth projects.

Though both have considerable risks because they are still MLPs, we think Tallgrass and Magellan are relatively better positioned than peers to continue delivering high levels of income to investors. It's important to note that these entities, however, are not immune to broader market malaise, pressure across the energy complex due to volatile energy resource pricing, or the rising interest rate environment that impacts their respective intrinsic values.

Member question: "In the high yield newsletter you mention "both" MLP's referring to TEP and MMP. You also show EPD in the hypothetical portfolio, do you view this particular company differently? Thanks!"

Valuentum: We think Enterprise Product Partners (EPD) can be viewed in a similar light to both Tallgrass Energy and Magellan Midstream. The MLP eliminated what remained of its general partners' incentive distribution rights (50% of IDRs were eliminated in 2002) in a non-taxable transaction via the waiving of ~$322 million in distributions during the period 2011-2015. Similar to the recent TEP transaction, this did not include an implicit distribution cut for common unitholders. In other words, it, too, has a relatively simple ownership structure. Also, Enterprise Product Partners holds investment-grade credit ratings (BBB+/Baa1), and its historical industry-specific coverage metrics have been solid, even though we're not particularly fond of the use of distributable cash flow.

A version of this article was emailed to High Yield Dividend Newsletter members May 4.

HIGH YIELD ALERT -- UNDERSTANDING PRICE RISK

We Removed Some of the Riskiest Entities from the Simulated High Yield Dividend Newsletter

I want you to learn about a unique risk innate to the high yield space like the back of your hand. I'll explain the "information contained in prices" and talk about what you should be on the lookout for, the "avalanche effect."

I received a question from a dear member of ours, and I think it may be helpful that I share the response. The question had to do with why we removed a couple high yielding equities from the simulated High Yield Dividend Newsletter portfolio in the latest edition, namely Senior Housing Properties Trust (SNH) and Government Properties Income Trust (GOV). At the time of this email release, May 4, we also removed Landmark Infrastructure Partners (LMRK) today, too, for the same reason that we will soon discuss. We think the risk described below makes the high yield space uniquely different than other equity strategies, and I want you to know about this risk like the back of your hand, so you are not surprised by anything.

Part of our process, especially that with respect to high yield ideas, involves paying very close attention to market movements. The market price of a stock can offer a signal that there may be something else impacting our thesis on the company more heavily than we originally anticipated. This could happen in situations when we may be too aggressive, or even too conservative, with our forecasts and the corresponding fair value estimates. Some may call what I'm trying to explain, "the information contained in prices." The market, for example, can be "wrong" at times, but sometimes the market price can also offer clues to help assess risks that may not have been extensively presented within the GAAP fundamentals.

However, there's another very relevant reason why market price activity is so critical to high yield ideas, and this is the big risk I want you to know about. Within the high yield space, in particular, the market price itself is a key component of the fundamental dividend/distribution thesis of the company given the capital-market dependency of many constituents. During the Financial Crisis, for example, we saw how helpful using pricing information was when banking stocks sold off aggressively despite items in their financial statements that may have suggested the moves may have been unwarranted. Their price declines then depleted their ability to raise equity, creating an "avalanche effect," and self-perpetuating weakness, at the very time that access to the capital markets was needed.

Similarly, from our perspective, the decline in the share prices of ideas in high yield space directly impacts their ability to raise funds, and as a result, impacts their credit strength, and therefore the strength of their dividend/distribution, revealing a similar potential risk as that of banking equities under stress needing to shore up their own capital positions, for example. Said differently, there is an increased likelihood of an "avalanche effect" in the high yield space (REITs, MLPs and the like) than in other arenas, per se. This is in contrast to many lower-yielding, cash-rich corporates that can cover cash dividends paid with free cash flow, meaning that they do not need continued access to the capital markets, and their market prices (as a proxy for access to external financing) may not be as important of a fundamental consideration with respect to the dividend/distribution. For high yield ideas, however, capital-market dependence risk remains very real for them given the relationship of their dividends to free cash flow generation, and as a result, their share prices offer important indicators to overall financial health.

The need for continued access to the capital markets for many in the high yield space is why, with respect to high yield ideas, we pay the most attention to credit quality, as offered by the rating agencies, and share-price movements, as equity is a key source of funding, too. Perhaps said plainly, the decline in the share prices of Senior Housing Properties Trust (SNH), Government Properties Income Trust (GOV), and Landmark Infrastructure Partners (LMRK) represent one of the key reasons for their removal (we're

removing LMRK today), given the corresponding depleted potential for capital-raising opportunities (as a result of the share price decline). Share-price activity is often beyond the control of a company, so to a meaningful degree, the health of the payout of a high-yield entity's dividend/distribution is also in part beyond its control, given the need for ongoing debt or equity capital, in most high-yield cases.

We've also received a question regarding Tallgrass Energy Partners' (TEP) ability to raise capital following its simplification transaction. As the to-be-combined entity transitions to a C-Corp, it expects to realize a much lower cost of equity capital via the elimination of its incentive distribution rights (IDRs), as well as attract a broader base of investors. Though management has not provided explicit guidance as to how it will continue to fund its business, this rationale suggests the equity markets will continue to be a source of capital for the company. At the end of the first quarter of 2018, TEP had more than $925 million in available capacity on its revolving credit facility, and its leverage ratio was 3.1x as calculated according to its credit agreement. TEP's long-term target leverage ratio is 3x-4x, which indicates the company has ample capacity to fund acquisitions and organic growth projects in the near term.

It may seem like we're not long-term investors or that we're moving too quickly with respect to ideas, but within the high-yield space, share-price activity is about as fundamental as it gets, given that new equity capital is a key source of funding for the dividend/distribution, in many high-yield situations. Because the accelerated price declines at Senior Housing Properties Trust (SNH), Government Properties Income Trust (GOV), and Landmark Infrastructure Partners (LMRK) happened during the past few months, it offered new, fundamental information to our thesis on them relative to the inaugural newsletter. High yield, in our view, is synonymous with high risk, and when it comes to equities that are very capital-market dependent as many in the high-yield space are, their share price activity is very important to pay attention to.

Shares of Landmark Infrastructure Partners (LMRK) have faced some selling pressure for the majority of 2018, but the pressure has intensified more recently due in part to the merger announcement of Sprint (S) and T-Mobile (TMUS), both of which are key tenants of Landmark. T-Mobile and Sprint accounted for 12% and 10% of Landmark's total revenue in 2017, respectively. Whether or not the deal gets done is far from a certainty (the two companies have had merger plans broken up twice in recent years), but Landmark is likely to feel a negative impact should the companies succeed in coming together. Here's what management has to say on the matter in its most recent 10-K:

> *Significant consolidation among our tenants in the wireless communication industry (or our tenants' sub-lessees) may result in the decommissioning of certain existing communications sites, because certain portions of these tenants' (or their sub-lessees') networks may be redundant. For example, T-Mobile's acquisition of MetroPCS (completed in 2013), Sprint's acquisition of the remaining interest in Clearwire (completed in 2013), and AT&T's acquisition of Leap Wireless (completed in 2014). The loss of any one of our large customers as a result of joint ventures, mergers, acquisitions or other cooperative agreements may result in (1) a material decrease in our revenue, (2) an impairment of the value of our real property interests, or (3) other adverse effects to our business.*
>
> *Quote source: Landmark 2017 10-K*

While we were aware of the multitude of risk factors present in Landmark's business when including it in the simulated High Yield Dividend Newsletter, including a lofty debt load, tight distribution coverage, and a convoluted ownership structure, the developments related to the pending Sprint-T-Mobile deal, which is expected to close no later than the first half of 2019, have pushed its risk factors too high for our preference. The potential for the deal to lead to a material decrease in revenue or an impairment of its property values should not be taken lightly, especially in the context of the high yield arena.

The high-yield space is off to a very rocky start in 2018, but so is most of the market, and rising interest rates remain a key risk to the space for a number of reasons, not the least of which is the potential trade-off to lower-risk government paper in the event risk-free rates rise to higher levels. We continue to emphasize the concept of diversification within the high yield space, and we've been mighty pleased with how well the 'Core" ideas have held up, despite some pressure in "Equity" positions. We'll look to add more ideas to the "Core" portion of the portfolio to replace the recent removals. If you have any questions, please let us know.

UNCERTAINTY OF ITALY'S POLITICAL FUTURE WEIGHING ON GLOBAL INVESTORS' MINDS

Italy holds ~$2.7 trillion in public debt, and global investors are worried that a new government could implement policies that would weaken the country's credit status. Though a sovereign debt crisis does not seem probable at this point, bond markets are suggesting that risks are rising.

We do not want investors to be worried by events unfolding in Italy (EWI) of late, as they may not be any more significant than the impact of Brexit (EWU) on equity market returns during the past few years. We can't cast a blind eye to developments either, however, as Italy's sovereign debt is not-at-all small by any country's standards (it's the third-largest in the world), and the political uncertainty is contributing to modest unrest in the sovereign credit markets.

We think investors have started to guard themselves against a very, very small probability of an adverse event that may cause contagion within the global banking system but given the long duration of Italy's credit profile (its average debt maturity is ~7 years), we're not sure the probability of a liquidity crisis is meaningful at the moment, even if expectations for continued deterioration of credit health cannot be ruled out.

Here are the rating agencies' latest stances on Italy's sovereign debt, courtesy of Reuters:

> *Moody's has placed Italy's "Baa2" rating on review for a possible downgrade, citing pledges in a government pact signed by the anti-establishment 5-Star Movement and the far-right League to increase spending, cut taxes and scrap a key 2011 pension reform.*
>
> *S&P's affirmed Italy at "BBB" on April 27, warning that the rating would come under pressure if a new government strayed from the path of budgetary improvement or unwound past reforms.*

Given rising sovereign bond yields on Italy's debt, it is clear the credit markets are already reacting negatively to political developments in the country, and while a downgrade by the rating agencies may do nothing more than confirm the market's moves, any further downgrades won't be positive by any stretch given the corresponding increase in borrowing costs on a rather large sovereign debt position. Italy's two-year bond yield had been unusually low at -0.172% (negative 0.172%) at the start of May, and it now yields ~0.981%.

According to Moody's, Italy has a "very high public debt ratio of over 130% of GDP," and by any measure of risk, the country's cost of borrowing should probably be much higher than it currently is, even after the recent rise (negative interest rates made little sense, in our view). We don't think investors should overreact to the developments in any way, however, and we continue to monitor news flow regarding the implications of a new government in Italy, implications on its sovereign credit quality, the health of the euro as a currency, and the composition of the European Union.

Italy is the third-largest economy in the Eurozone and eighth-largest in the world, with nominal GDP of $2.05 trillion in 2018. The country is the eighth-largest exporter in the world, with Germany (EWG), France (EWQ), and the US (SPY) as its top three trading partners. The country's economy was among the most negatively impacted by the combination of the credit crunch of the last decade and the European debt crisis that subsequently followed. – source: Valuentum.

MORTGAGE REITS STILL RISKY ENTITIES IN OUR VIEW

Structure of the Residential/Mortgage REIT Industry

The residential REIT industry consists of REITs that own and manage housing, multi-family and apartment communities as well as mortgage REITs that invest in agency securities in which the principal and interest payments may be guaranteed by the government. The industry has been materially impacted by recent changes in the lending landscape, defaults, credit losses, and significant liquidity concerns during the recent global financial crisis.

The firms in this industry generally are not subject to federal taxes on their taxable income to the extent that they annually distribute all of their taxable income to stockholders. As a result of this business structure, many firms have elevated distribution yields, but almost all of them generate a return on tangible equity that is less than our estimate of their respective cost of capital (generally 10%). Further, almost all constituents in the group have distribution payout ratios higher than 1, revealing a significant dependence on the healthy functioning of the captial markets for new funding, which cannot be guaranteed and at times can become prohibitively expensive.

Further, the reliance on debt to finance properties exposes residential REITs to the risk that their future cash from operations may at some point in the future be insufficient to make required payments of principal and interest. Leverage, the amount of debt exposed to variable interest rates and future free cash flow generation need to be monitored very closely (as REIT distribution requirements limit available cash on the balance sheet). The success of a mortgage REIT depends heavily on its ability to acquire assets (agency securities) at favorable spreads over borrowing costs, which can rise materially in the event that short-term interest rates increase or the market value of its investments decline (margin calls are also possible).

Our research indicates that the highest-yielding firms in the group have a tendency of having the greatest amount of leverage (as measured by total assets divided by total shareholders' equity), the most aggressive business models, and offer the greatest level of risk to investors. Generally speaking, we're generally uncomfortable with 'asset/equity' leverage levels above the mid-single-digit range for any constituent in the group, given the long-term threats of a rising interest rate environment, which could significantly impair operations should income be exceeded by the expense incurred to finance investments. Firms that have had this leverage profile, as of our latest update, include American Capital (AGNC), Annaly Capital (NLY), Armour Residential (ARR), and New York Mortgage (NYMT). All things considered, the large distribution yields presented by some constituents in the group may not compensate investors for the tremendous risks inherent to their respective business models. – source: Valuentum.

Mortgage REIT Update

On May 2, Annaly Capital Management announced that it would acquire MTGE (MTGE) in a cash and stock transaction valued at $900 million. This followed news on April 26 that Two Harbors (TWO) agreed to purchase CYS Investments (CYS). As consolidation ensues in the space, many entities could be purchased at prices above trailing pricing averages or even to adjusted book value. We think betting on buyout premiums may be a loser's game, however, and it may make the most sense to continue to cast a cautious eye on the mortgage REIT arena, especially as interest rates look poised to rise.

- Brian Nelson, CFA President, Investment Research

- Kris Rosemann Head of Data, Associate Investment Analyst

Disclosure: Brian Nelson and Kris Rosemann do not own any shares of any securities mentioned in this newsletter. Please contact info@valuentum.com for more information regarding Valuentum's editorial policies.

THE SIMULATED HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO

Coming Soon: Valuentum will be adding a High Yield Dividend Watch List to the July edition and every issue after that! We continue to focus on idea generation, and we want to continue to add value.

We continue to be excited about the launch of the simulated High Yield Dividend Newsletter portfolio, the inaugural edition released January, 1, 2018. This is now the sixth edition of the newsletter! We've learned a lot in recent months about what works and what doesn't work for our members. Thank you for the feedback.

Many of our members continue to prefer the list-versus-weighting perspective across our simulated newsletter portfolios. It may also be true that a lot of new members won't feel like they have missed out on anything under a list-versus-weighting format, too, which has been a concern when brand new members see a simulated portfolio that has been around for half decade or longer.

Though we may calculate simulated performance of the High Yield Dividend Newsletter periodically, we don't think it is necessary to do so on a monthly basis. The list-and-weighting format facilitates a level of consistency across our newsletter products, and we may consider migrating the simulated High Yield Dividend Newsletter portfolio to a range-of-percentage-weightings, too, as we have with respect to both the simulated Best Ideas Newsletter portfolio and simulated Dividend Growth Newsletter portfolio.

The simulated High Yield Dividend Newsletter portfolio is presented each month in similar fashion (list and weightings) as that of the first edition. If you have any questions, comments, or concerns, please be sure to let us know at info@valuentum.com.

Idea	Symbol	Weighting	Est Annual Div's/Share ($)	Est Div Yield
CORE				
Global X SuperDividend ETF	SDIV	5.0%	1.47	7.04%
Global X SuperIncome Preferred ETF	SPFF	10.0%	0.88	7.45%
iShares International Select Dividend ETF	IDV	5.0%	1.51	4.55%
iShares MSCI Australia ETF	EWA	5.0%	1.03	4.56%
iShares U.S. Preferred Stock ETF	PFF	5.0%	2.08	5.58%
PowerShares Senior Loan Portfolio	BKLN	5.0%	0.83	3.63%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	3.86	5.78%
EQUITY				
AmeriGas Partners	APU	5.0%	3.80	9.19%
BP PLC	BP	5.0%	2.40	5.24%
Digital Realty Trust	DLR	5.0%	4.04	3.76%
Enterprise Products Partners	EPD	5.0%	1.71	5.92%
Magellan Midstream Partners	MMP	5.0%	3.75	5.36%
Omega Healthcare Investors	OHI	5.0%	2.64	8.61%
Public Storage	PSA	5.0%	8.00	3.78%
Realty Income Corporation	O	5.0%	2.63	4.93%
Tallgrass Energy Partners	TEP	5.0%	3.90	8.93%
		85.0%		**5.09%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 5/31/2018.

SCREEN OF THE MONTH – RETAIL AND HEALTHCARE REITS WITHIN OUR COVERAGE UNIVERSE

Company Name	Symbol	Est. Div. Yield	Div Cushion	Div Growth	Div Safety	Div Track Record	VBI	Fair Value Estimate	Economic Castle
DDR	DDR	10.2%	0.3	VERY POOR	VERY POOR	RISKY	3	$9.00	Neutral
Omega Healthcare	OHI	9.8%	1.0	VERY POOR	POOR	HEALTHY	7	$31.00	Attractive
Spirit Realty	SRC	8.9%	-	-	-	HEALTHY	7	$8.00	Neutral
Kimco Realty	KIM	7.8%	0.7	VERY POOR	POOR	RISKY	4	$16.00	Neutral
Tanger Factory	SKT	6.9%	0.6	POOR	POOR	HEALTHY	4	$22.00	Attractive
WP Carey	WPC	6.5%	0.6	VERY POOR	POOR	HEALTHY	3	$64.00	Attractive
Ventas	VTR	6.4%	1.3	GOOD	GOOD	HEALTHY	3	$53.00	Neutral
HCP	HCP	6.4%	1.0	VERY POOR	POOR	RISKY	6	$27.00	Attractive
Welltower	WELL	6.3%	1.3	GOOD	GOOD	HEALTHY	3	$56.00	Neutral
LTC Properties	LTC	6.0%	0.7	VERY POOR	POOR	HEALTHY	3	$46.00	Attractive
Retail Properties of America	RPAI	5.6%	0.2	VERY POOR	VERY POOR	HEALTHY	3	$11.00	Neutral
Macerich	MAC	5.2%	-1.0	VERY POOR	VERY POOR	RISKY	3	$50.00	Neutral
Realty Income Corp	O	5.0%	0.6	GOOD	GOOD	HEALTHY	6	$56.00	Neutral
Simon Property	SPG	4.8%	0.9	POOR	GOOD	RISKY	3	$169.00	Attractive
Taubman	TCO	4.5%	-0.2	VERY POOR	VERY POOR	HEALTHY	3	$63.00	Neutral
Universal Health Realty	UHT	4.4%	1.2	VERY POOR	POOR	HEALTHY	3	$55.00	Neutral
GGP	GGP	4.3%	0.3	POOR	VERY POOR	RISKY	3	$24.00	Attractive
Healthcare Realty Trust	HR	4.3%	1.0	VERY POOR	POOR	RISKY	3	$24.00	Neutral
Digital Realty Trust	DLR	3.9%	0.6	EXCELLENT	GOOD	HEALTHY	3	$96.00	Neutral
CorSite Realty	COR	3.8%	1.0	GOOD	GOOD	HEALTHY	6	$90.00	Neutral
Regency	REG	3.8%	0.3	VERY POOR	VERY POOR	RISKY	3	$62.00	Neutral
CyrusOne	CONE	3.7%	-1.0	POOR	POOR	HEALTHY	3	$52.00	Neutral
Federal Realty	FRT	3.5%	0.1	VERY POOR	VERY POOR	HEALTHY	3	$100.00	Neutral
SL Green	SLG	3.4%	-0.5	VERY POOR	VERY POOR	RISKY	3	$81.00	Neutral

SCREEN OF THE MONTH – OIL & GAS PIPELINES

Company Name	Ticker	Market Cap (USD-mil)	Investment Style	DCF Valuation	Relative Valuation	ValueCreation™	ValueRisk™	ValueTrend™	Technicals	Relative Strength
Boardwalk Pipeline	BWP	2,643	MID-CAP VALUE	FAIRLY VALUED	NEUTRAL	POOR	HIGH	POSITIVE	BEARISH	WEAK
Buckeye Partners	BPL	5,140	MID-CAP VALUE	FAIRLY VALUED	NEUTRAL	POOR	LOW	POSITIVE	BEARISH	WEAK
DCP Midstream	DCP	7,238	MID-CAP VALUE	FAIRLY VALUED	NEUTRAL	GOOD	MEDIUM	NEGATIVE	BULLISH	STRONG
Enbridge	ENB	47,860	LARGE-CAP BLEND	FAIRLY VALUED	UNATTRACTIVE	POOR	MEDIUM	NEGATIVE	VERY BEARISH	WEAK
Energy Transfer Partners	ETP	20,214	LARGE-CAP VALUE	FAIRLY VALUED	UNATTRACTIVE	POOR	MEDIUM	NEGATIVE	BULLISH	WEAK
Enterprise Product Partners	EPD	60,040	LARGE-CAP VALUE	FAIRLY VALUED	UNATTRACTIVE	POOR	MEDIUM	NEGATIVE	BULLISH	STRONG
Holly Energy	HEP	2,026	MID-CAP VALUE	FAIRLY VALUED	NEUTRAL	EXCELLENT	LOW	NEGATIVE	BULLISH	WEAK
Kinder Morgan	KMI	35,435	LARGE-CAP VALUE	FAIRLY VALUED	UNATTRACTIVE	POOR	HIGH	POSITIVE	BULLISH	WEAK
Magellan Midstream	MMP	15,680	LARGE-CAP VALUE	FAIRLY VALUED	ATTRACTIVE	EXCELLENT	MEDIUM	NEGATIVE	BULLISH	STRONG
NuStar	NS	2,009	MID-CAP VALUE	FAIRLY VALUED	NEUTRAL	POOR	MEDIUM	NEGATIVE	BULLISH	WEAK
Plains All American	PAA	17,423	LARGE-CAP VALUE	FAIRLY VALUED	ATTRACTIVE	POOR	HIGH	POSITIVE	VERY BEARISH	STRONG
Spectra Energy Partners	SEP	9,474	MID-CAP VALUE	FAIRLY VALUED	ATTRACTIVE	POOR	LOW	NEGATIVE	NEUTRAL	WEAK
Western Gas	WES	7,416	MID-CAP CORE	FAIRLY VALUED	NEUTRAL	POOR	MEDIUM	NEGATIVE	BULLISH	STRONG

Note: The Dividend Cushion ratio and qualitative assessments in the table above may change following the date of this publication. Please be sure to access the website at www.valuentum.com for more information. Please also note that Valuentum publishes both an adjusted Dividend Cushion ratio and an unadjusted Dividend Cushion ratio. Many of the equities included in this table have substantial equity-price and dividend-payment risk.

DIVIDEND REPORT PAGE 2 – MAGELLAN MIDSTREAM (MMP)

Magellan Midstream MMP FAIRLY VALUED

Buying Index™ 7 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Attractive	$53.00 - $85.00	HEALTHY	GOOD / 1.2	EXCELLENT	5.47%

Assessment of Company Dividend Strategy

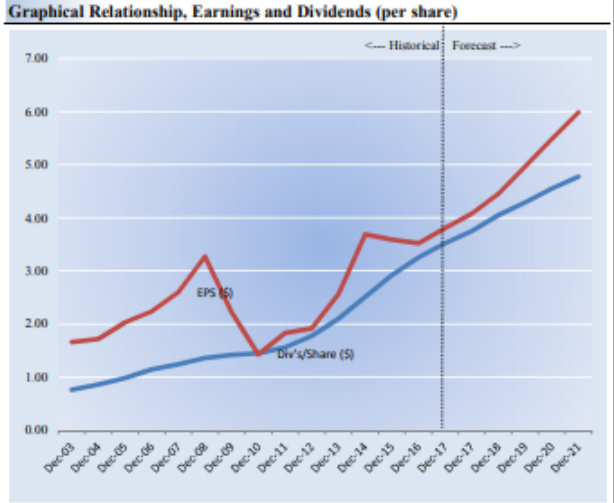
Key Strengths

Magellan likes to point out that it is an investment-grade MLP with no incentive distribution rights, allowing it a lower cost of capital. Its portfolio is rather diversified between refined products (~59% of operating margin), crude oil (~33%) and marine storage (~8%). As with many of its peers, the MLP notes that it expects future fee-based, low-risk activities to comprise a high percentage of its operating margin. Though economic returns on such investments should be watched closely, the company continues to evaluate more than $500 million of potential growth projects on top of the $1.7 billion projects in progress for 2018-2020. Magellan is targeting 8% distribution growth in 2018 and distribution coverage of 1.2x through 2020.

Potential Weaknesses

Magellan is committed to maintaining a solid investment-grade rating, and at BBB+/Baa1, the MLP is one of the highest-rated among its peers. Distribution growth ahead of core business expansion will drive lower coverage in coming periods, and the MLP is leveraged, albeit not as much as peers. We doubt management will mess with its proven history of distribution expansion, and the MLP has a revolver should near-term needs warrant. It has advanced the quarterly payout for 60+ consecutive quarters since its IPO, but total debt outstanding stood at roughly $4.1 billion as of the third quarter of 2017. Magellan's cost of capital may be lower than some peers' thanks to the lack of incentive distribution rights, but it is still dependent on the capital markets.

Graphical Relationship, Earnings and Dividends (per share)

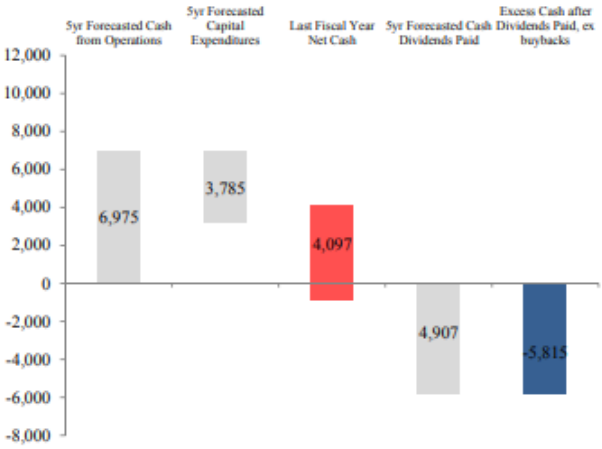


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

Dividend Cushion Cash Flow Bridge Evaluation

The Dividend Cushion Cash Flow Bridge, shown in the image to the right, illustrates the components of the Dividend Cushion ratio and highlights in detail the many drivers behind it. Magellan Midstream's Dividend Cushion Cash Flow Bridge reveals that the sum of the company's 5-year cumulative free cash flow generation, as measured by cash flow from operations less all capital spending, plus its net cash/debt position on the balance sheet, as of the last fiscal year, is less than the sum of the next 5 years of expected cash dividends paid. Because the Dividend Cushion ratio is forward-looking and captures the trajectory of the company's free cash flow generation and dividend growth, it reveals whether there will be a cash surplus or a cash shortfall at the end of the 5-year period, taking into consideration the leverage on the balance sheet, a key source of risk. On a fundamental basis, we believe companies that have a strong net cash position on the balance sheet and are generating a significant amount of free cash flow are better able to pay and grow their dividend over time. Firms that are buried under a mountain of debt and do not sufficiently cover their dividend with free cash flow are more at risk of a dividend cut or a suspension of growth, all else equal, in our opinion. Generally speaking, the greater the 'blue bar' to the right is in the positive, the more durable a company's dividend, and the greater the 'blue bar' to the right is in the negative, the less durable a company's dividend.

Raw, Unadjusted Dividend Cushion Cash Flow Bridge - Raw

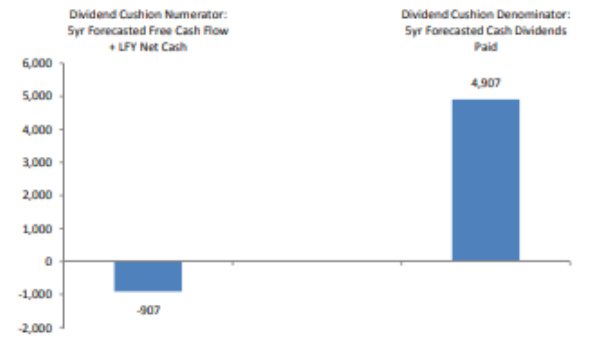


Source: Company Filings, Valuentum Projections

Dividend Cushion Ratio Evaluation

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

Raw, Unadjusted Dividend Cushion Ratio Deconstruction - Raw



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DIVIDEND REPORT PAGE 2 – ENTERPRISE PRODUCT PARTNERS (EPD)

Enterprise Product Partners EPD FAIRLY VALUED

Buying Index™ 6 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Neutral	$21.00 - $35.00	HEALTHY	GOOD / 1.9	GOOD	6.14%

Assessment of Company Dividend Strategy

Key Strengths

The credit rating agencies are huge fans of Enterprise Product Partners' debt, giving the MLP high marks at Baa1/BBB+, one of the highest among its peers. This gives it great flexibility to raise capital, and we generally like its simplified structure with no GP IDRs. Since its IPO in 1998, the company has completed $64 billion in organic growth projects and major acquisitions. In this light, there's not much that will derail the MLP's distribution. Enterprise Product Partners' 'distribution coverage ratio' has been at least 1.2x over the past 5 years, but we must emphasize that we are not fond of industry-specific coverage metrics. Its worth noting that distributable cash flow took a hit in 2016 as energy resource pricing remained suppressed.

Potential Weaknesses

Though management has worked diligently to extend its debt maturities, it's hard to overlook the tens of billions of dollars raised via debt since 2009. The MLP has ~$5.3 billion of capital growth projects under construction with more to come through 2019, and spending related to such projects will continue to weigh on free cash flows. Total debt sat at ~$24.6 billion as of the end of 2017. The past several years have been bolstered by non-core asset sales, and reinvestment risk remains a concern. Borrowing capacity on its revolver mitigates risk to a degree, but we would like to see more cash on the books. The firm's unadjusted Dividend Cushion ratio is the most appropriate measure of the risks of the payout, in our opinion, given its capital market dependence.

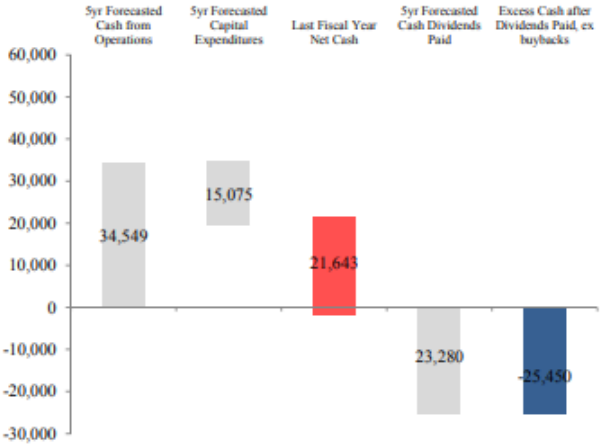
Graphical Relationship, Earnings and Dividends (per share)

The graph above shows the relationship between a firm's earnings per share and its dividends per share.

Dividend Cushion Cash Flow Bridge Evaluation

The Dividend Cushion Cash Flow Bridge, shown in the image to the right, illustrates the components of the Dividend Cushion ratio and highlights in detail the many drivers behind it. Enterprise Product Partners's Dividend Cushion Cash Flow Bridge reveals that the sum of the company's 5-year cumulative free cash flow generation, as measured by cash flow from operations less all capital spending, plus its net cash/debt position on the balance sheet, as of the last fiscal year, is less than the sum of the next 5 years of expected cash dividends paid. Because the Dividend Cushion ratio is forward-looking and captures the trajectory of the company's free cash flow generation and dividend growth, it reveals whether there will be a cash surplus or a cash shortfall at the end of the 5-year period, taking into consideration the leverage on the balance sheet, a key source of risk. On a fundamental basis, we believe companies that have a strong net cash position on the balance sheet and are generating a significant amount of free cash flow are better able to pay and grow their dividend over time. Firms that are buried under a mountain of debt and do not sufficiently cover their dividend with free cash flow are more at risk of a dividend cut or a suspension of growth, all else equal, in our opinion. Generally speaking, the greater the 'blue bar' to the right is in the positive, the more durable a company's dividend, and the greater the 'blue bar' to the right is in the negative, the less durable a company's dividend.

Raw, Unadjusted Dividend Cushion Cash Flow Bridge - Raw



Source: Company Filings, Valuentum Projections

Dividend Cushion Ratio Evaluation

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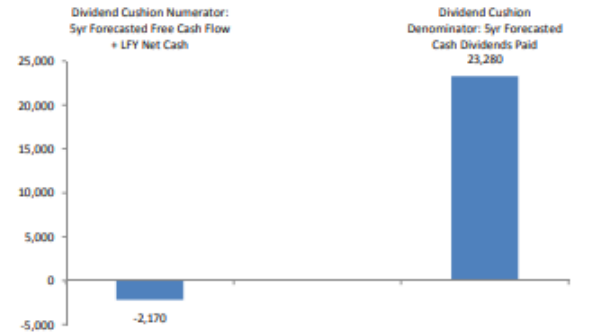

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DIVIDEND REPORT PAGE 2 – BP (BP)

BP BP FAIRLY VALUED

Buying Index™ 7 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Neutral	$31.00 - $55.00	RISKY	VERY POOR / 0.5	VERY POOR	5.24%

Assessment of Company Dividend Strategy

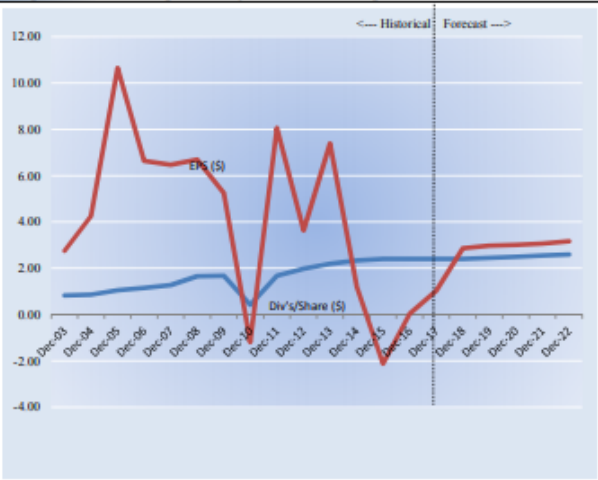
Key Strengths

The BP dividend growth proposition rests on management's ability to grow free cash flow through operating income expansion and capital discipline, the former more difficult in light of recent volatility in the energy resource price environment. Long term, BP is in good shape with projections showing that energy demand will rise by roughly 40% by 2035, a modest growth rate of 1.5% per year, but expansion nonetheless. Fossil fuels are expected to account for as much as four-fifths of the world's energy by that time. The company plans to keep capital spending at $15-$17 billion through 2021, and it expects its average breakeven point to be ~$50 per bbl in 2018 on a full dividend basis.

Potential Weaknesses

BP's miscue in the Gulf of Mexico halted its dividend payments, but the company resumed the payout in 2011. The firm expects to have production back to pre-spill levels by the end of the decade. BP is better positioned than pure upstream independents thanks in part to a downstream business that mitigates volatility in its E&P operations, to a degree. Divestitures have padded the balance sheet, and capital spending cuts have helped liquidity, but given the inherent volatility of energy resource prices, it's hard for us to say that BP's dividend is safe. Management is confident in its ability to organically cover dividend payments in the near term, but we caution against the risks of depending on commodity price stability for income.

Graphical Relationship, Earnings and Dividends (per share)



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Dividend Cushion Cash Flow Bridge

Source: Company Filings, Valuentum Projections

Dividend Cushion Ratio Evaluation

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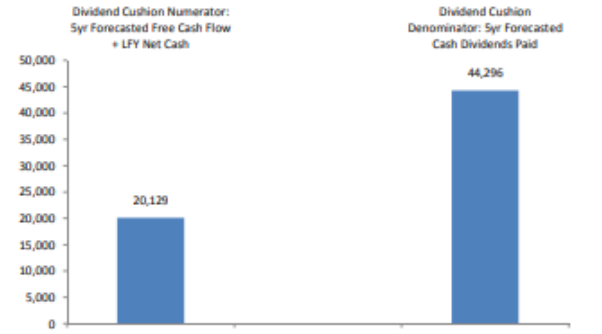
Dividend Cushion Ratio Deconstruction



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VALUENTUM

DEFINITIONS

ValueCreation. This is a proprietary Valuentum measure. ValueCreation indicates the firm's historical track record in creating economic value for shareholders, taking the average difference between ROIC (without goodwill) and the firm's estimated WACC during the past three years. The firm's performance is measured along the scale of EXCELLENT, GOOD, POOR, and VERY POOR. Those firms with EXCELLENT ratings have a demonstrated track record of creating economic value, while those that register a VERY POOR mark have been destroying economic value.

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).

ValueTrend. This is a proprietary Valuentum measure. ValueTrend indicates the trajectory of the firm's return on invested capital (ROIC). Firms that earned an ROIC last year that was greater than the 3-year average of the measure earn a POSITIVE rating. Firms that earned an ROIC last year that was less than the 3-year average of the measure earn a NEGATIVE rating.

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