Valuentum Securities, Inc. **10/1/2018** Edition 10, Volume 1

HIGH YIELD DIVIDEND NEWSLETTER

AWESOME HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO PERFORMANCE

Simulated Idea	Symbol	Weighting	Initiation Date	Entry Price	Dividends Received	Current Price (9/20 close)	Hypothetical Gain / Loss	Est Div Yield
CORE								
Alerian MLP ETF	AMLP	5.0%	8/1/2018	10.91	0.21	10.83	1.16%	7.60%
Global X SuperDividend ETF	SDIV	5.0%	12/29/2017	21.78	1.04	20.43	-1.44%	7.29%
Global X SuperIncome Preferred ETF	SPFF	10.0%	12/29/2017	12.16	0.56	11.94	2.83%	7.14%
iShares International Select Dividend ETF	IDV	5.0%	12/29/2017	33.79	0.91	33.31	1.28%	4.75%
iShares MSCI Australia ETF	EWA	5.0%	12/29/2017	23.17	0.43	22.37	-1.59%	4.39%
iShares U.S. Preferred Stock ETF	PFF	5.0%	12/29/2017	38.07	1.43	37.10	1.21%	5.57%
Invesco Senior Loan Portfolio	BKLN	5.0%	12/29/2017	23.04	0.60	23.19	3.24%	3.80%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	12/29/2017	67.25	2.62	68.49	5.74%	5.82%
EQUITY								
AmeriGas Partners	APU	5.0%	12/29/2017	46.23	2.85	40.37	-6.51%	9.53%
BP PLC	BP	5.0%	12/29/2017	42.03	1.82	44.57	10.36%	5.69%
Digital Realty Trust	DLR	5.0%	12/29/2017	113.90	3.03	121.84	9.63%	3.31%
Enterprise Products Partners	EPD	5.0%	12/29/2017	26.51	1.28	29.01	14.27%	5.93%
Magellan Midstream Partners	MMP	5.0%	12/29/2017	70.94	2.82	68.88	1.06%	5.49%
Omega Healthcare Investors	OHI	5.0%	12/29/2017	27.54	1.98	32.81	26.33%	7.98%
Public Storage	PSA	5.0%	12/29/2017	209.00	6.00	205.02	0.97%	3.87%
Realty Income Corporation	O	5.0%	12/29/2017	57.02	1.76	57.27	3.52%	4.58%
Tallgrass Energy LP	TGE	5.0%	12/29/2017	25.70	1.35	23.13	-4.74%	6.99%
Closed Positions								
Government Properties Income Trust	GOV	5.0%	12/29/2017	18.82	0.86	12.63	-28.32%	Closed 5/1/18
Landmark Infrastructure Partners	LMRK	5.0%	12/29/2017	18.10	0.74	14.55	-15.55%	Closed 5/4/18
Senior Housing Properties	SNH	5.0%	12/29/2017	19.15	0.78	15.67	-14.10%	Closed 5/1/18

Current price as of 9/20/18 close, according to Yahoo Finance
Dividend yield according to Yahoo Finance as of 9/24/18.
The simulated High Yield Dividend Newsletter portfolio is not a real money portfolio. Simulated results/performance is hypothetical.
There is risk of substantial loss investing in high yield instruments. Please contact your personal financial advisor before making any investment decisions.

The image above shows the performance of the individual ideas within the simulated High Yield Dividend Newsletter portfolio through September 20, 2018. Each idea's hypothetical gain/loss measure includes dividends received as cash and not reinvested.

It's hard not to get excited about the consistency of strong performers across the simulated High Yield Dividend Newsletter portfolio. We don't like to brag, but members may be interested to see the performance of the individual ideas within the simulated portfolio since its inception at the beginning of 2018. As we write frequently about, high yield dividend investing within equities comes with heightened risk, which makes the capital preservation of the ideas within the simulated portfolio all the more notable despite a few ideas that offered a modest overall headwind out of the gates.

The 'Core' of our simulated High Yield Dividend Newsletter portfolio, which consists of some of our top

considerations for income via diversified exchange traded funds (ETFs), has delivered consistently solid performance, both in terms of yield and capital preservation. Best performers in this area include the ProShares High Yield - Interest Rate Hedged ETF (HYHG), an idea we like due to its lower level of interest rate sensitivity relative to short-term bonds, and the Global X SuperIncome Preferred ETF (SPFF), which has benefited from its strong dividend yield of more than 7.1%. Investors should note the "double" weighting of the SPFF, as the additional exposure to the high income generation of the ETF fits well with the goals of the simulated portfolio.

Omega Healthcare (OHI) stands out as the big winner across the simulated portfolio, up more than 25%, as it appears to be navigating issues with some of its top operators well, but it still carries a notable amount of risk as its recent success with respect to divestitures must be followed with prudent capital allocation of the proceeds. Other notable performers in the 'Equity' portion of our simulated High Yield Dividend Newsletter portfolio include Enterprise Product Partners (EPD), BP (BP), and Digital Realty Trust (DLR). Enterprise Product Partners' record-setting second quarter helped it hike its distribution for the 56th consecutive quarter, and the MLP should continue to benefit from the rising demand for exports of the products and byproducts its pipeline network delivers.

"WHEN IT COMES TO THE HIGH-YIELD DIVIDEND PROCESS, ONE OF THE HALLMARKS OF A GOOD ONE IS CAPITAL PRESERVATION, AND WE DON'T THINK ANYBODY DOES IT BETTER THAN US. WE HAVE A LONG TRACK RECORD TO THIS EFFECT, EVEN DATING PRIOR TO THE RELEASE OF THE INAUGURAL HIGH YIELD DIVIDEND NEWSLETTER -- FROM OUR WARNINGS ON KINDER MORGAN (KMI) TO GENERAL ELECTRIC (GE) AND BEYOND." – BRIAN NELSON, CFA

BP has benefited from higher energy resource pricing, and its solid second quarter results helped give it the confidence to raise its quarterly dividend for the first time in nearly four years. Though Digital Realty's dividend yield is relatively low for the simulated High Yield Dividend Newsletter portfolio, we continue to like the REIT's positioning to capitalize on robust data center demand in the years ahead. It continues to scoop up attractive assets to do so, most recently adding exposure to the rapidly digitizing Latin America region via the purchase of a Brazilian data center provider. Members can view our closing statements for Government Properties Income Trust (GOV), Landmark Infrastructure Partners (LMRK), and Senior Housing Properties (SNH) at the following links.

GOV, SNH (May edition of the newsletter) -- pdf: https://www.valuentum.com/downloads/20180502_1/download

LMRK (email notification, May 4): http://campaign.r20.constantcontact.com/render?m=1110817109903&ca=4f639a59-4b25-4c23-b151-132133e4e824

When it comes to the high-yield dividend process, one of the hallmarks of a good one is capital preservation, and we don't think anybody does it better than us. We have a long track record to this effect, even dating prior to the release of the inaugural High Yield Dividend Newsletter -- from our warnings on Kinder Morgan (KMI) to General Electric (GE) and beyond.

Just a reminder: Many of you took advantage of our introductory offer in October of last year, and your renewal price will be the same as that introductory offer. You can rest assured that you have locked in that annual rate for as long as you are a member to the High Yield Dividend Newsletter. Your renewal may be coming up in the next few months.

Midstreams Going C-Corp, Should SEC Disallow the Measure Distributable Cash Flow?

Key Takeaways

It's important to differentiate the concept of enterprise free cash flow valuation and the idea of capital-market dependence.

The uncertainty of the MLP business model remains, as it is clear operators are shunning the MLP business model preferring C-Corps instead.

According to work from Global X Funds, now 40% of the energy infrastructure market cap consists of C-Corps, up considerably from just 15% at the end of 2014.

Though many simplifications have come with implied distribution cuts, the primary reason for the rise in C-Corps across the midstream space has been the rationalizing of excess MLP valuations to enterprise free cash flow assessments.

We encourage the SEC to consider disallowing the use of distributable cash flow, as it is confusing to investors.

I think one of the more inspirational people in finance is Vanguard's Jack Bogle. His story about what he had to overcome to explain to the investment community the benefits of index funds is a great one. When Bogle launched the first index fund decades ago, it could probably be described as nothing short of a failure, at least in today's terms. Index funds, at the time, were called un-American, brokers and even Fidelity's Chairman Edward C. Johnson III argued that nobody would want just "average returns," and Vanguard in its early days didn't even have enough money to invest in all the stocks of the S&P 500 Index in their exact proportions. The initial index fund on the S&P 500 Index held just 280 stocks.

But that didn't stop Jack Bogle. The old guard is fierce to defeat any new idea because the status quo is so valuable to it. Creative destruction is often only welcomed when the incumbent is doing the innovation, as new ideas, particularly in the field of finance, face tremendous opposition from those that are resistant to change. "Bogle's folly" (i.e. the index fund) is now arguably among the most successful product idea launches in the history of the markets, with indexed assets accounting for ~30-40% of all fund assets today.

In corporate finance, the challenge for others to embrace new ideas is no different. Those that were in the finance business for 30 or 40 years or longer in the 1970s simply couldn't believe that such a product like an index fund would be successful, and this resistance to new ideas has been a staple to incumbents that have grown comfortable with the status quo, as for many years the lack of change made them wealthy. Wall Street is mighty, but the skeptics can be proven wrong, and Jack Bogle is but one instance.

We've been commenting on master limited partnerships (MLPs) for as long as I can remember at Valuentum. Depending on an MLP's price, we can be either bullish or bearish on their investment opportunities, and we change our mind as a result. We believe that valuation should be the key determinant in assessing a company's investment merits. The question "What is a company worth?" should be the key question in anyone's thesis.

We can't expect our readers to have read all our work on MLPs during the past several years, which have spanned Seeking Alpha, our website, Tumblr and syndication providers including Barron's and even others we may not know about, but there is one thing that cuts through it all: enterprise discounted cash flow valuation. Valuing a company on a free-cash-flow-to-the-firm basis is as accepted method of valuation as any that I know. I would argue that it is even the standard by which any other valuation process is measured against.

In mid-2015, when we presented the idea that midstream equities should be valued the same way as any other company, the opposition to this very basic idea was tremendous. All companies generate operating cash flow and all companies have growth and maintenance capital spending, and capital raised in the marketplace is still shareholder capital regardless of the business model attached to it. Enterprise free cash flow valuation is a universal concept.

Most of the midstream MLPs in mid-2015, in our view, were being valued on the basis of distributable cash flow, which is merely a proxy for their distribution (yield), and many had been systematically assessed on a

price-to-distributable cash flow (P/DCF) basis or dividend discount model on artificially-elevated payouts. Distributable cash flow is not to be confused with discounted cash flow, though both go by the acronym DCF. The marketplace, in applying distributed cash flow or distribution analysis, was ignoring the concept that growth capital associated with driving future distributable cash flow is also shareholder capital. Said differently, in the valuation context, MLPs were getting a free pass on new equity/debt issuance, and only through an enterprise free cash flow model could such a dynamic be exposed.

It's important to differentiate the concept of enterprise free cash flow valuation, as in the case of our view that most midstream MLPs were overvalued in mid-2015 (their prices were trading above what we thought was fair value), and the idea of capital-market dependence (their operating cash flow does not cover all capital spending and all distributions). During the Financial Crisis of late last decade, "10 Years Since the Fallout," one of the key lessons I learned was that the risk of capital-market dependence can be a wrecking ball to equity prices. When times get tough, the bottom simply falls out for those equities requiring new capital, and this fallout in capital-market dependent entities is what we got ahead of prior to the collapse in MLPs.

Energy resource prices had been plummeting in 2015, and while others were saying that midstream equities were immune to such price movements due to their volume-based contracts and other defenses, we had argued that the health of a midstream entity's customer base matters and therefore makes midstream equities significantly more tied to energy resource prices than what others thought at the time. Said differently, in the event credit market conditions were to deteriorate even further as a result of reduced credit quality across the energy space, MLP equity prices would get walloped… and they did, and we were right. But it's important to understand that MLP prices, in their fallout, have merely adjusted from systematic overvaluation (on the basis of distributable cash flow and the dividend discount model) to fair valuation with respect to enterprise free cash flow.

KMI Rating History	Price	Fair Value	VBI
25-May-18	$15.89	$20.00	6
26-Jan-18	$18.77	$20.00	6
22-Sep-17	$19.27	$20.00	3
21-Jul-17	$20.69	$20.00	6
9-Jun-17	$19.08	$20.00	3
24-Feb-17	$21.24	$20.00	3
29-Aug-16	$21.92	$20.00	6
5-Aug-16	$20.36	$21.00	6
8-Apr-16	$17.94	$21.00	6
22-Jan-16	$15.34	$20.00	5
7-Dec-15	$15.72	$20.00	5
29-Oct-15	$27.20	$26.00	5
14-Aug-15	$33.96	$29.00	3
19-Jun-15	$39.54	$29.00	1

Image Source: Valuentum

For example, when we made our call on Kinder Morgan (KMI) in mid-2015, we had valued the shares at $29 each, and the company registered a 1 on the Valuentum Buying Index, one of the worst ratings (as shown in the image above). Shares converged to our fair value estimate later in the year, and we've held the line with our views on Kinder Morgan's intrinsic value being ~$20 per share for nearly 3 years now. What we believe that we witnessed in Kinder Morgan was a systematic correction in the market's valuation of the company. MLPs reacted the same way, converging to valuations that captured the real cost of growth capital spending. When we speak of enterprise discounted cash flow valuation, this dynamic of overvalued-versus-undervalued is what we're talking about.

Additionally, Kinder Morgan cut its dividend in late 2015. There were myriad factors that drove the dividend cut, but to us, getting ahead of the announcement rested primarily in free cash flow analysis, which while connected, remains distinct from enterprise free cash flow valuation (also a key component of our theses), the method to arrive at an intrinsic value. Where enterprise free cash flow analysis focuses on generating a fair value estimate for shares, capital-market dependence analysis focuses on evaluating how dependent a company is on external capital to keep funding its business model. We generally evaluate market dependence in assessing whether operating cash flow (from the cash flow statement) covers both capital spending (both growth and maintenance) and distributions/dividends paid.

When it came to Kinder Morgan and most MLPs in mid-2015, they were considerably capital-market

dependent at a time when the energy complex was starting to feel the pain from falling energy resource prices. Not only were they exposed to deteriorating credit conditions in this regard, but their equity prices were also significantly overvalued on the basis of a tried-and-true enterprise discounted cash flow framework, which considers the concept that growth capital is shareholder capital and the timing of such capital deployment (outflows) matters. It was a perfect storm that led to the collapse of Kinder Morgan and MLPs.

How did we get ahead of this, and why was our thesis so unique? For starters, we apply an enterprise free cash flow model systematically across our coverage universe, so we think we have a better chance of identifying market outliers across industries and sectors than others focusing purely on one industry or a sector, or just a handful of them. Second, the lessons from the Financial Crisis with respect to banks were clear. Stocks that were capital-market dependent during the Financial Crisis were punished, and we believed that with energy resource prices falling, putting into question the health of independents, which were customers of MLPs, the writing was on the wall for a big fallout.

Since Barron's prominently published our work on Kinder Morgan and MLPs in mid-2015, more than 60 MLPs have cut their distributions and many of them have rolled up or simplified their business operations. The uncertainty of the MLP business model remains, as it is clear operators are shunning the MLP business model preferring C-Corps instead. In August 2014, Kinder Morgan set the trend in MLP rollups, and the number of rollups have only continued, "Master Limited Partnership Simplications on the Rise," including ArchRock Partners (APLP), Tallgrass (TEP), Williams (WPZ), Spectra (SEP), and Enbridge (EEP). According to work from Global X Funds, now 40% of the energy infrastructure market cap consists of C-Corps, up considerably from just 15% at the end of 2014.

Will every current MLP convert to a C-Corp? It's possible. But as with anything, there will always be late movers, and many MLPs are still watching to see if the C-Corp conversions will be successful in generating better reception from the market community. Everything takes time, and our time horizon on our call is long term. What is telling, however, is that many new issues for midstream assets have chosen the C-Corp route. Diamondback Energy (FANG) announced an IPO for their midstream entity, Rattler Midstream (RTLR) that, while structured as an MLP, will be taxed as a C-Corp. Apache Corp (APA) and Kayne Anderson (KYN) announced that they are creating a brand new C-Corp entity Atlus Midstream, according to Global X.

On August 24, Enbridge (ENB) announced that it would buy Spectra Energy Partners. This followed the Energy Transfer Equity (ETE) and Energy Transfer Partners (ETP) tie up, "ETE-ETP Rollup and Implied Distribution Cut." Consolidations continue to slowly eliminate the MLP model. Though many simplifications have come with implied distribution cuts, the primary reason for the rise in C-Corps across the midstream space has been the rationalizing of excess MLP valuations to enterprise free cash flow assessments, eliminating distributable cash-flow (yield) based pricing, something we warned about in mid-2015 when we stated that growth capital was not being properly accounted for within the MLP valuation construct:

> In summarizing the reasoning behind the use of the C-Corp structure, Kevin McCarthy, an executive at Kayne Anderson stated, "MLPs are no longer getting a premium valuation compared to C-Corps. There's been a lot of C-Corp conversions in the space. And we think for this type of asset, the market will place a premium on something that's a C-Corp rather than something that's paying out all this cash flow and having to come to the market to fund growth." In other words, the MLP tax structure is no longer favored in today's dynamic environment, with preference being given to the more flexible and accessible C-Corp structure. Given the uncertainty that has plagued MLPs over the past few years and how much the business model has changed in such a short period of time, it's difficult to argue against that thinking. – Source: Global X

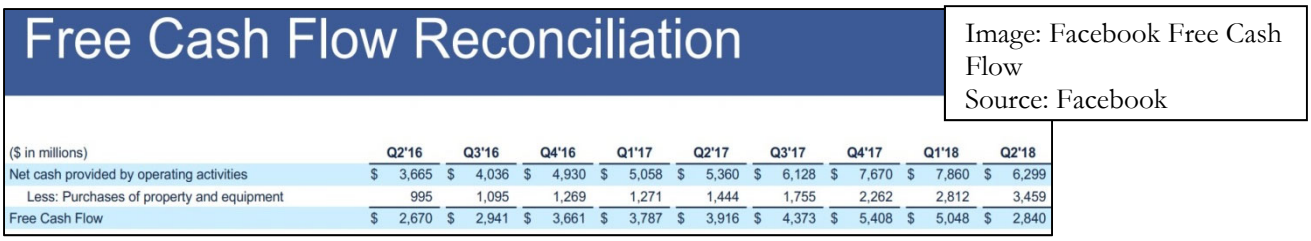
As summarized above, the story of the demise of the MLP model seems rather simple, in our eyes. From where we stand, the MLP model was used primarily as a financing mechanism that could raise equity for the corporate umbrella at a price that was reflective of a yield-based valuation, or one that is effectively priced on

the concept of distributable cash flow (not on an enterprise discounted cash flow basis). Distributable cash flow is an industry specific term that ignores growth capital spending, but includes the net income within the measure that is driven by growth capital spending, "MLP Speak: A Critique of Distributable Cash Flow." This imbalance, in our view, translated into equity unit prices for MLPs of bubble proportions that eventually popped as the energy resource markets began to swoon in late 2015 and early 2016, and funding dried up.

Since then, many midstream companies have become more transparent, better explaining their capital-market dependency to shareholders. For example, in the ENB/SEP press release from August 24: "MLPs are dependent on consistent access to the capital markets at a reasonable cost of capital to grow their distributions." It seems there should be no further doubt that MLPs are funding their distributions in part from the external capital markets. Generally speaking (and absent the concept of negative yielding debt on corporates), the lowest cost form of capital is generated from internal funds (operating cash flow), and such funds are allocated to the highest-return projects (growth capital spending). Once operating cash flow is exhausted from all capital spending, including growth-related endeavors, external capital issuance, which is higher cost funding, is then allocated as support for the distributions of MLPs.

The concept of traditional free cash flow is a well-understood measure. It is generally defined as cash flow from operations less all capital spending. It's important to note that when it comes to valuation processes, all companies have maintenance and growth capital spending, and even some ultra-efficient technology companies could have lower maintenance spending profiles than midstream pipeline entities (so the maintenance-versus-growth capital spending ratio varies across sectors, but it is not different for MLPs in the eyes of valuation). There are myriad examples of companies that use free cash flow in reporting, as measured by cash from operations less all capital spending, including Facebook (FB) and even research provider Morningstar (MORN).

There are variants of free cash flow representation, too, and while we generally do not like situations where companies deviate from cash flow from operations less all capital spending as the measure of free cash flow in disclosures, the concept of cash flow from operations less all capital spending remains the key relationship in assessing free cash flow. For example, Exxon Mobil (XOM) includes 'Proceeds associated with Asset Sales' in the calculation of free cash flow, as shown in the image below, something that we'd prefer not to be in there. Though we have our preferences, the construct is the same in assessing operating cash flow less all capital spending in arriving at free cash flow.



Free Cash Flow Reconciliation

($ in millions)	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18	Q2'18
Net cash provided by operating activities	$ 3,665	$ 4,036	$ 4,930	$ 5,058	$ 5,360	$ 6,128	$ 7,670	$ 7,860	$ 6,299
Less: Purchases of property and equipment	995	1,095	1,269	1,271	1,444	1,755	2,262	2,812	3,459
Free Cash Flow	$ 2,670	$ 2,941	$ 3,661	$ 3,787	$ 3,916	$ 4,373	$ 5,408	$ 5,048	$ 2,840

Image: Facebook Free Cash Flow
Source: Facebook

Cash provided by operating activities	$ 69.8	$ 55.7	25.3%	$ 129.7	$ 102.2	26.9%
Capital expenditures	(18.0)	(19.0)	(5.3%)	(35.6)	(33.3)	6.9%
Free cash flow	$ 51.8	$ 36.7	41.1%	$ 94.1	$ 68.9	36.6%

Image: Morningstar Free Cash Flow
Source: Seeking Alpha

(billions of dollars)	2Q 2018
Cash Flow from Operations	7.8
Proceeds associated with Asset Sales	0.3
Cash Flow from Operations and Asset Sales	8.1
PP&E Adds / Net Investments & Advances	(5.4)
Free Cash Flow	2.7

Image: Exxon Mobil Free Cash Flow
Source: Exxon Mobil

The SEC, too, has commented specifically on free cash flow, a measure that deducts for all capital spending, not just maintenance capital spending. In the SEC's May 2016 guidelines for free cash flow, it reads (Question 102.07) in response to a question that defines free cash flow as cash flow from operations…less capital expenditures: "Companies should also avoid inappropriate or potentially misleading inferences about its usefulness. For example, "free cash flow" should not be used in a manner that inappropriately implies that the measure represents the residual cash flow available for discretionary expenditures, since many companies have mandatory debt service requirements or other non-discretionary expenditures that are not deducted from the measure." The guidelines make a lot of sense to us.

However, when we think about the SEC's guidelines for free cash flow, a punitive metric that deducts for all capital spending, it becomes questionable whether distributable cash flow, because it does not deduct for growth capital spending, is a useful measure at all. After all, the general partner determines a discretionary reserve with respect to distributions, distribution coverage ratios vary quarter-to-quarter and are not fixed at 1, more than 60 MLPs have opted to cut their distributions since we warned about their business models in mid-2015, and many have chosen to pursue business-model simplification initiatives, rolling up subsidiaries and adjusting their payouts along the way. Yet, distributable cash flow continues to set MLP distribution policy, enabling "yield," which then may drive equity "valuations," something that we believe contributed to the bubble in early 2015 (see here on how traditional enterprise valuation can be used to value MLPs).

Critically, if traditional free cash flow should not be viewed as a measure representing "the residual cash flow available for discretionary expenditures," including dividend policy (which is discretionary), some may reason that distributable cash flow should probably not be used either to set MLP distribution policy, itself discretionary to a large degree. We applaud the SEC's move to caution companies on how they present free cash flow, and we're hoping that we may eventually see a systematic measure of free cash flow as a mandatory release for all companies--hopefully one as simple and straightforward as cash flow from operations less all gross capital spending (companies sometimes like to use net capital spending). The transparency and consistency that this one move would make across the financial markets would be phenomenal, and we hope one day we will see this. One thing is clear though: if free cash flow, which deducts for all growth spending, is not a good measure of residual cash flow, distributable cash flow should probably not be allowed at all.

Why now does enterprise free cash flow valuation make sense for MLPs? There are a number of ways to account for business performance across various business structures, whether an entity is a corporate, REIT, or master limited partnership, but cash flow will always be cash flow. In finance (and in valuation), a business, for example, cannot be worth more or less than the present value of its future enterprise free cash flows, adjusted for its net balance sheet (a net debt or a net cash position), as well as any other "hidden" factors (e.g. an overfunded pension)--no matter if the entity is structured as a corporate, a real estate investment trust (REIT) or a master limited partnership. The prices of these entities may become disconnected from their intrinsic value, if for example, "yield-based pricing" (systematic valuation on distributable cash flow) is pursued in an ultra-low interest rate environment, but value will always be value, distinct from price. A dollar of free cash flow generated by a retailer is a dollar generated by a software company is a dollar generated by a midstream entity. The present value of dollars coming in versus dollars going out forms the basis of any valuation context.

As mentioned previously, every company has both growth and maintenance spending, and the drivers behind the composition of any entity's value are the same, differentiated only with respect to magnitude and duration. In this respect, all midstream MLPs are similar, even if the magnitude and duration behind the composition of their value drivers are different. Said plainly, many pipeline companies may have relatively low maintenance capital spending, all else equal, but so do many software companies and other asset light entities, too. Many capital-light operations do not have tremendous growth capital spending, as fixed cost investment is not a core driver behind the earnings stream, but midstream entities do. The midstream space almost encourages analytical thinking on a project-by-

project basis, which is great with respect to NPV (net present value) considerations, but all projects roll up into a cumulative forward trajectory of net free cash flow (cash flow from operations less all capital spending) for each and every entity and form the basis of a value estimate for each and every entity.

That an industry has designated the term distributable cash flow to mean one thing does not change the theoretical view that, hypothetically, distributable cash flow, in a more encompassing non-MLP-specific context, could even be further up the income statement, as in revenue (a rather extreme hypothetical, but one that illustrates the subjective nature of the industry's term). As by definition, the industry's measure of distributable cash flow backs out growth capital spending, but doing so may be no logically different in substance than revenue, for example, being perhaps an even more aggressive form of "distributable cash flow," if one backs out all costs. In both cases, any traditional free cash flow shortfalls, as measured by cash flow from operations less all capital spending, would be made up by floating new debt or equity to keep paying an outsize distribution/dividend, as is already the case with respect to the master limited partnership model, in our view. Cash flow from operations less all capital spending is often less than cash dividends paid each year for MLPs, and the shortfall is made up in the financing section of the cash flow statement as new debt or new equity.

We've used the rather extreme concept of labeling 'revenue' as some unrealistic measure of distributable cash flow to illustrate a point. Not only must growth capital spending and costs be considered in the valuation context, but it becomes clear that there is a tremendous amount of subjectivity involved in the industry's term, distributable cash flow (especially with respect to capital market access). In the eyes of an enterprise free cash flow model (FCFF, free cash flow to the firm), however, business entities of all types are treated similarly, and the enterprise free cash flow generated by the business, in aggregate, is considered, on a net basis (inclusive of outflows related to growth spending). The timing of cash flows matter in the enterprise free cash flow process, and so does the balance sheet (net debt is not a good thing). For those focused on value-contributions of each individual project of a pipeline operator as only being incremental, what may be helpful is to consider an MLP as one big project, one big NPV calculation, and therefore, one enterprise free cash flow model, where the timing of net enterprise cash flows matter, in aggregate. In the image below, we show the link between the industry-specific metric distributable cash flow and the basic construct of an enterprise free cash flow model.

Master Limited Partnership Valuation

It has become common practice to value master limited partnerships on a Price to Distributable Cash Flow (DCF) basis. However, such a valuation technique, if not supported by an enterprise free cash flow process (1), is susceptible to systematic overvaluation when comparable company analysis is applied.

The following formula links enterprise free cash flow valuation to the P/DCF multiple, showing how the latter is a function of the former, much like enterprise free cash flow valuation *derives* the P/E multiple. The numerator is the standard function used in corporate valuation, while the denominator is an MLP's forward distributable cash flow.

Note how the timing of large capital expenditures (negative) and outsize net debt positions (negative) impact the intrinsic worth of capital-intensive and debt-heavy MLPs.

Forward Price / Distributable Cash Flow (P/DCF) Ratio Derived

$$\frac{\left[\sum_{t=0}^{\infty} \frac{A(t)}{(1+d)^t} - B(0) - C(0) + D(0)\right] \Big/ E(0)}{F(1)}$$

where A (t) is an Enterprise Free Cash Flow (1) at year t,

B (0) is a Total Debt at time 0,

C (0) is a Preferred Stock at time 0,

D (0) is a Total Cash at time 0,

E (0) is Weighted Average Diluted Shares Outstanding at time 0,

F is Distributable Cash Flow per Share, and

d is Weighted Average Cost of Capital (WACC).

(1) Enterprise free cash flow, or free cash flow to the firm (FCFF), is calculated as earnings before interest after taxes less net new investment (total capital spending less total depreciation) +/- working capital changes.

Image Source: Valuentum

The numerator is a short-form construct of an enterprise free cash flow model, which takes the present value of a company's earnings before interest, after taxes, less net new investment (or enterprise free cash flow) and divides that by units outstanding. The denominator is the industry specific term distributable cash flow for next year. The formula above therefore derives the value that should be placed on the business via the enterprise free cash flow construct, and then this value estimate helps to inform what multiple of forward expected distributable cash flow should be applied to units. In short, the enterprise free cash flow derives the distributable cash flow multiple that should be placed on the business, which differs from the price-observed distributable cash flow multiple that is taken by dividing a unit's price by its future distributable cash flow, for

example. The reason why using an enterprise free cash flow model in valuation is so important for MLPs is that, if one applies only a distributable cash-flow relative analysis or pursues "yield-based" pricing considerations, one is opening the door to systematic overvaluation tendencies, as which occurred during the middle of 2015 when we made our call.

Conclusion

From where we stand, the MLP-specific term distributable cash flow is an arbitrary one, and all entities, whether they are a corporate, REIT, or MLP have both growth and maintenance spending, the magnitude the only difference. In an extreme case to illustrate the point of how subjective distributable cash flow as a metric is, revenue could even be considered a form of distributable cash flow, with any cash shortfalls relative to any dividend/distribution made up by external capital market issuance. An enterprise discounted cash flow model derives the price-to-distributable cash flow metric that should be placed on each MLP's units, and systematic mispricings could occur if investors solely rely on relative distributable cash-flow analysis or "yield-based" pricing considerations. We encourage the SEC to consider disallowing the use of distributable cash flow, as it is confusing to investors.

When we released these ideas in mid-2015 more broadly, we didn't expect everybody to agree with us, similar to what Jack Bogle encountered when he first introduced the index fund to the investment community. Energy investors have been using distributable cash flow arguably for decades, but enterprise free cash flow valuation remains a tried-and-true method that considers all the cash inflows and outflows of the business, unlike distributable cash flow (and yield) which is rather arbitrary and excludes key growth capital spending. Within an enterprise discounted cash flow valuation model, the dividend is a symptom not a driver of value, and by extension, so is distributable cash flow and yield, both symptoms of value (not drivers). We continue to believe that investors should cast a cautious eye on the MLP business model, if only because of its considerable capital-market dependency risk, which could pose challenges in the event of tightening external capital market conditions.

GlaxoSmithKline: Turnaround in Progress?

Image shown: GlaxoSmithKline's share-price performance since early 2014

Key Takeaways

GlaxoSmithKline may be poised to enter an earnings trough should key product Advair faces pending generic competition.

CEO Emma Walmsley is engineering a turnaround with multiple achievable targets, but the success of her tenure ultimately depends on the success of the company's clinical pipeline.

The stock's generous dividend yield is compelling, and the potential for capital appreciation exists if cost saving initiatives are well executed and improved clinical success occurs.

GlaxoSmithKline: A History of Strategic Blunders

GlaxoSmithKline (GSK) is currently paying the price for years of misguided leadership after former CEO Sir Andrew Witty left the company in utter shambles upon his departure in March 2017. Recent years at GSK have been marred by a string of high profile clinical flops coupled with a smattering of bribery scandals that sapped the management team's attention away from drug development as it was forced to placate issue after issue.

The drug discovery process remains an imperfect art as promising molecules can fail in clinical trials due to unforeseen side effects developing. However, our issue with GSK is the series of costly phase 3 flops, which we view this as an indication of poor internal controls as phase 3 trials tend to be much larger and far more costly to conduct than earlier stages of development. Though the risks of a drug still in clinical development should

never be understated prior to receiving approval, a well-designed slate of phase 2 trials can often eliminate a notable degree of risk.

The slate of relatively poor clinical performance has left GSK with a dearth of near-term products to drive top-line growth, and the lack of a compelling clinical pipeline coupled with the bribery scandal paved the way for Witty to exit the company, in our opinion.

Enter New CEO Emma Walmsley

GSK tabbed Emma Walmsley in April 2017 to replace the "retired" Witty. Walmsley is an internal candidate whose most notable experience came from her time leading GSK's Consumer Healthcare joint venture with Novartis. Walmsley appears to be a well-qualified choice in light of Witty's short sighted move to trade GSK's early stage oncology assets to acquire a stake in Novartis' (NVS) consumer healthcare division, which resulted in aforementioned joint venture, along with a full takeover of Novartis' vaccines business. Under terms of the deal, Novartis paid GSK $16 billion in cash for its oncology assets with GSK subsequently paying ~$7.1 billion for the vaccine business and a 63.5% stake in the newly formed consumer healthcare JV. Instead of reinvesting the upfront proceeds of the deal back into its business, GSK launched a B share scheme to return the capital to shareholders.

As a result of Witty's gambit, the company is repositioned towards lower margin/higher turnover products, which made Walmsley an optimal candidate to run the new GSK. She is intimately aware of the strengths of the new JV, which was a crucial consideration as Novartis held a put to offer to sell its stake in the JV back to GSK. Novartis executed this right in June of 2018, resulting in GSK paying Novartis $13 billion to gain full control of the business.

Respiratory

GSK possess an enviable lineup of respiratory products headlined by the mainstay asthma treatment Advair. The respiratory segment remains GSK's key franchise, but the pending introduction of a generic version of Advair continues to weigh on sentiment as the product has lost patent protection. GSK remains fortunate thus far the generic industry has not produced an acceptable substitute as it has bought GSK additional time for its new product suite to establish itself.

GSK introduced a new dry powder version of its mainstay respiratory treatments via the new Ellipta dry powder device. The goal is to provide a more consistent dose to the patient while layering on additional patent protection as the generic manufacturers will have to duplicate not only the medication but the delivery system which has thus far bedeviled attempts at a proper generic substitute for Advair.

The Ellipta product suite, including Trelegy, generated £509 million in the second quarter of 2018 versus £590 million for Advair. The spread between the two products continues to narrow which likely helped embolden management to raise 2018 guidance on a constant exchange rate (CER), but the potential entry of a generic substitute for Advair required two sets of guidance to be issued. The company expects 4-7% earnings growth CER (prior -3% to flat CER) if a generic competitor for Advair hits the market October 1, and earnings growth of 7-10% at CER is expected if a generic version of Advair does not hit the market in 2018 (prior 4-7% CER).

GSK remains at least in part dependent on sales of Advair to help drive earnings growth, however, as the Ellipta suite continues to grow, and fierce competition from AstraZeneca's (AZN) Symbicort has led to a year-over-year sales drop of 24% at CER for Advair in the first six months of 2018. We view the pending introduction of a generic version of Advair as a "clearing event" for GSK as it may very well signify the onset of an earnings trough.

HIV

GSK's 'HIV' segment remains a source of growth despite the space being highly competitive. However, GSK can retain share while generating growth as the overall market of affected patients continues to grow, and the company just released a doublet sold under the trade name Juluca in an attempt to carve out a further niche in the industry. The growth trajectory will not be easy as Gilead Sciences' (GILD) Biktarvy continues to take share, but GSK's main source of defense of its market share is Tivicay, which posted 25% revenue growth at CER. The most notable takeaway, in our view,

is that Tivicay is not seeing material pressure from patients switching to Biktarvy. GSK's top selling HIV treatment remains Triumeq, but it is seeing some competitive pressure from Biktarvy. The product still managed to post 9% year-over-year sales growth at a CER in the second quarter of 2018, which was the first full quarter with Biktarvy on the market, but this growth for Triumeq marked a deceleration from a 20% CER growth rate in the first quarter of the year.

GSK continues to invest in additional R&D in HIV with impressive data posted on Cabotegravir as a long acting injectable treatment for HIV. GSK is aiming to combine Cabotegravir with Rilpivirine to form a potential effective long acting doublet therapy. GSK is pushing the doublet thesis, which, based on the anemic sales data of Juluca, is meeting stiff resistance form prescribers who continue to prefer triple-therapy to avoid potential drug-resistance. There may be a path forward for such a long acting therapy, especially for the patient class that is non-compliant with therapy, but those that tend to be non-compliant may find the need to make an appointment and receive a shot as a burden.

Vaccines

GSK's 'Vaccines' segment received a proverbial "shot in the arm" with the recent introduction of Shingrix for the treatment of shingles. The treatment protocol for Shingrix requires a two-injection process with the second shot to be completed within six months of the first administration of the vaccine. Unlike other vaccines such as Pfizer's (PFE) Prevnar 13, which is a one and done process, GSK can extract two payments per patient thus generating a higher overall net revenue per patient than Prevnar and its chief rival, Merck's (MRK) one and done Zostavax. Shingrix is considered a far superior treatment than Zostavax as sales of Zostavax have dropped considerably of late.

Unfortunately for GSK shareholders, the management team badly miscalculated the end demand for Shingrix as significant delays in shipping the vaccine hampered initial uptake. Walmsley has stepped up by devoting additional resources to the manufacturing of Shingrix along with its entire suite of vaccines. The company currently holds the crown as the preeminent supplier of vaccines, an enviable yet lower margin business than branded pharmaceuticals. We view GSK's leadership in vaccines as a worthy business endeavor considering the significant scale GSK possess, especially from a potential dividend growth perspective as the demand for vaccines remains stable.

Consumer Healthcare

GSK is in the midst of restructuring its 'Consumer Healthcare' segment with an eye towards cost cutting to improve margins. It has received $4+ billion bids for the Horlicks brand, but a strategic review of key brands and assets is ongoing. The JV with Novartis was likely not optimally structured from a headcount perspective, which has the potential to lead to material cost savings. The 'Consumer Healthcare' segment generated year-over-year sales growth of 2% at CER for the first six months of 2018, underscoring the steadiness of the group.

Clinical Pipeline

GSK's near-term pipeline remains devoid of promising treatments, but the longer-term product suite holds some promise. We are particularly intrigued by the potential of GSK 916 for the treatment of Multiple Myeloma as it posted data indicating a GSK 916 treated sub-group achieved an overall response of 60% versus 20-30% for the competing Kyprolis/Darzalex combo. Granted, the indication is fifth line, which is a notoriously difficult group to treat and has failed numerous previous rounds of therapy thus limiting initial uptake.

However, the goal here is to establish clinical superiority in the hard to treat population thus setting a baseline to fund additional research to expand the prescribing label up to and including first line treatment. Assuming the clinical data remains positive, the product is still a few years away from commercial launch. Ultimately, Walmsley's success as a CEO will hinge on the company's ability to restore the clinical viability of its pipeline.

Role of the Dividend

GSK's 5%+ dividend yield offers a compelling opportunity for income-seeking investors, and the company as currently configured has ample opportunity to restructure operations ('Consumer Healthcare' segment and Advair sales force), thus driving improved

margins and cash flow. The increased focus on profitability should only strengthen GSK's long-term ability to fund its generous quarterly dividend, which is well above typical yields found in the pharma space.

Shares are currently trading roughly in-line with our $40 per share fair value estimate, but its Dividend Cushion ratio remains just below parity due to a combination of a notable debt load and sizable dividend obligations. Investors must note, however, that GSK is a British company that pays the dividend in British pounds, which is converted to US dollars for holders of American depository receipts (ADRs). This means the net payout of the dividend may fluctuate as a result of currency concerns--a risk investors in GSK must ultimately become comfortable with.

Australian GDP, Crude Oil Prices, and Digital Realty Trust's Latin America Move

Australia's Second Quarter GDP Growth Easily Beats Expectations

In the inaugural High Yield Dividend Newsletter, released January 1, we highlighted our desire for attaining a degree of geographic diversification within the simulated portfolio, and the iShares MSCI Australian ETF (EWA) and its ~4.5% yield helped fill that role. Though the ETF may be tied to commodities more indirectly than its portfolio holdings breakdown suggests, the product still holds a nicely diversified portfolio spanning the nation's economy, which has grown nicely of late. The country's GDP grew a strong 3.4% in the second quarter of 2018, easily surpassing market expectations for 2.8% year-over-year growth and checking in at the highest rate in nearly six years.

The second quarter GDP reading marked Australia's 27th straight year without a recession thanks in large part to its proximity to China and the strong demand the Chinese economy continues to provide for Australia's natural resources. China alone accounts for roughly one-third of Australia's exports. Such a feat is increasingly impressive when considering the revolving door that has been the country's Prime Minister office; the ousting of Malcolm Turnbull earlier this year was the fifth such change in eight years.

Australia's strong second quarter GDP growth was driven in part by annualized population growth of 1.6%, a mark that is more than twice the average of the developed world thanks in part to an influx of migrants. This population growth helped make up for relative weakness in productivity as GDP per capital rose 1.8% in the quarter from the year-ago period. Key headwinds for the country moving forward include a drought that has ravaged its eastern farm belt, trade policy uncertainty given its close ties to China, and potentially declining home prices after a decade of appreciation. Interest rates in Australia are at historic lows, not unlike the rest of the developed world, and have been at that 1.5% mark since mid-2016. The Reserve Bank of Australia has signaled a steady policy ahead.

The iShares MSCI Australian ETF has the highest level of exposure to the Financial sector of the country, which checked in at roughly 38% of its market value as of September 21. Next in line is the Materials sector at just under 18%, followed by the Health Care space at ~9%. Four of the ETF's top six holdings come from the Financial sector, led by top holding Commonwealth Bank of Australia (CBA) at 9.3% and its third largest holding Westpac Banking Corp (WBC). Diversified mining giant BHP Billiton (BHP) is the ETF's second highest weighting, checking in at nearly 8% of the portfolio and accounting for roughly 45% of its Materials sector exposure.

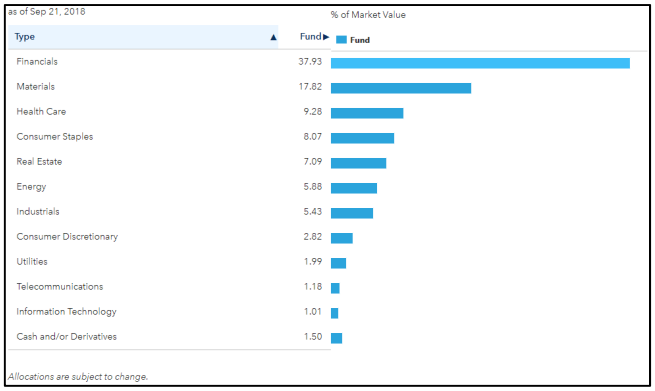


Image source: iShares

Geopolitical Issues and Crude Oil Prices

President Trump's recent call for OPEC to boost its output to help reel in crude oil prices (USO, OIL) was rejected as Brent crude touched a four year high in the final week of September. Saudi Energy Minister Khalid

al-Falih said his country has spare capacity but such a move is not necessary and may not be needed in 2019 either due to the potential for a significant increase in non-OPEC supply. OPEC recently raised its outlook for US oil output through 2023 and expects to lose further market share over that period, and the cartel projects non-OPEC supply would rise by 2.4 million barrels per day while global demand is expected to grow by 1.5 million barrels per day. Trade uncertainty between the US and China only adds to the murkiness surrounding the global crude oil markets, as do US sanctions on Iran.

Digital Realty Trust Tapping into Latin American Market

Simulated High Yield Dividend Newsletter portfolio idea Digital Realty (DLR) is making a move in Latin America with its agreement to buy Ascenty, a leading data center provider in Brazil, for $1.8 billion. A subsidiary of Brookfield Asset Management (BAM) will contribute ~$613 million, or half of the necessary equity investment for a 49% stake in the JV that will eventually own the business. The move should increase Digital Realty's exposure to the significant growth potential of the Latin American data center market, which is driven in part by a growing working age population and rapid digitalization.

- 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. Alexander J. Poulos does not own any securities mentioned in the article he authored in this edition. Please contact info@valuentum.com for more information regarding Valuentum's editorial policies.

THE SIMULATED HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO

We continue to be excited about the launch of the simulated High Yield Dividend Newsletter portfolio, the inaugural edition released January, 1, 2018. 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 (see page 1), 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				
Alerian MLP ETF	AMLP	5.0%	0.83	7.72%
Global X SuperDividend ETF	SDIV	5.0%	1.51	7.39%
Global X SuperIncome Preferred ETF	SPFF	10.0%	0.86	7.23%
iShares International Select Dividend ETF	IDV	5.0%	1.55	4.75%
iShares MSCI Australia ETF	EWA	5.0%	0.99	4.48%
iShares U.S. Preferred Stock ETF	PFF	5.0%	2.09	5.62%
PowerShares Senior Loan Portfolio	BKLN	5.0%	0.88	3.79%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	3.93	5.74%
EQUITY				
AmeriGas Partners	APU	5.0%	3.80	9.62%
BP PLC	BP	5.0%	2.46	5.34%
Digital Realty Trust	DLR	5.0%	4.04	3.59%
Enterprise Products Partners	EPD	5.0%	1.72	5.99%
Magellan Midstream Partners	MMP	5.0%	3.75	5.46%
Omega Healthcare Investors	OHI	5.0%	2.64	8.06%
Public Storage	PSA	5.0%	8.00	3.97%
Realty Income Corporation	O	5.0%	2.65	4.66%
Tallgrass Energy LP	TGE	5.0%	1.71	7.25%
		90.0%		**5.39%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 9/30/2018.

We expect to increase our allocation to 100% soon, as we look to add to the Core component of the portfolio.

HIGH YIELDING EQUITIES IN OUR COVERAGE UNIVERSE

Company Name	Symbol	Industry	Dividend Yield	ValueRisk	Div Growth	Div Safety	Div Cushion	Div Track Record	Leverage
Hi-Crush	HCLP	Industrial Minerals	22.6%	VERY HIGH	NMF	NMF	NMF	NMF	HIGH
Golar LNG Partners	GMLP	Oil & Gas Pipelines	15.3%	MEDIUM	VERY POOR	POOR	0.9	HEALTHY	HIGH
Pier 1	PIR	Specialty Retailers	14.1%	VERY HIGH	NMF	NMF	NMF	NMF	MEDIUM
Buckeye Partners	BPL	Oil & Gas Pipelines	14.1%	LOW	VERY POOR	POOR	0.9	HEALTHY	HIGH
Energy Transfer Partners	ETP	Oil & Gas Pipelines	12.2%	MEDIUM	VERY POOR	VERY POOR	1.2	HEALTHY	HIGH
Centurylink	CTL	Telecom Services - diversified	12.0%	MEDIUM	VERY POOR	VERY POOR	-3.6	RISKY	HIGH
DDR	DDR	REIT - Retail	11.2%	HIGH	VERY POOR	VERY POOR	-1.2	RISKY	HIGH
Fred's Inc	FRED	Multiline Retail - discount	11.2%	VERY HIGH	NMF	NMF	NMF	NMF	LOW
Frontline	FRO	Shipping	10.7%	VERY HIGH	NMF	NMF	NMF	NMF	HIGH
NuStar	NS	Oil & Gas Pipelines	10.6%	MEDIUM	VERY POOR	POOR	1.1	RISKY	HIGH
Alliance Resource Partners	ARLP	Industrial Minerals	10.4%	HIGH	POOR	GOOD	1.7	RISKY	LOW
GameStop	GME	Specialty Retailers	10.2%	VERY HIGH	POOR	POOR	1.7	HEALTHY	LOW
AmeriGas Partners	APU	Utilities	9.6%	LOW	VERY POOR	POOR	0.2	HEALTHY	HIGH
Spectra Energy Partners	SEP	Oil & Gas Pipelines	9.5%	LOW	GOOD	GOOD	1.3	HEALTHY	HIGH
Holly Energy	HEP	Oil & Gas Pipelines	9.1%	LOW	VERY POOR	POOR	1.2	HEALTHY	HIGH
ADA-ES Inc	ADES	Pollution Controls	9.0%	HIGH	NMF	NMF	NMF	NMF	LOW
Omega Healthcare	OHI	REIT - Healthcare	8.8%	MEDIUM	VERY POOR	POOR	0.8	HEALTHY	HIGH
Vector Group	VGR	Tobacco	8.6%	MEDIUM	VERY POOR	VERY POOR	0.1	HEALTHY	HIGH
Spirit Realty	SRC	REIT - Retail	8.5%	VERY HIGH	NMF	NMF	NMF	NMF	HIGH
R.R. Donnelley	RRD	Commercial Services	8.3%	VERY HIGH	VERY POOR	VERY POOR	-6.6	HEALTHY	MEDIUM
Pitney Bowes	PBI	Commercial Services	8.2%	HIGH	VERY POOR	VERY POOR	-2.0	RISKY	HIGH
DCP Midstream	DCP	Oil & Gas Pipelines	7.7%	MEDIUM	GOOD	GOOD	2.0	HEALTHY	HIGH
Western Gas	WES	Oil & Gas Pipelines	7.4%	MEDIUM	EXCELLENT	GOOD	1.8	HEALTHY	HIGH
Iron Mountain	IRM	Commercial Services	7.3%	MEDIUM	VERY POOR	POOR	1.0	HEALTHY	HIGH
Vodafone	VOD	Telecom Services - diversified	7.2%	MEDIUM	VERY POOR	VERY POOR	0.3	HEALTHY	HIGH
CoreCivic	CXW	Management Services	7.2%	MEDIUM	VERY POOR	POOR	0.8	RISKY	HIGH

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.

SCREEN OF THE MONTH – TOP HOLDINGS OF THE ISHARES INTERNATIONAL SELECT DIVIDEND ETF (IDV)

Name	Ticker	Weight (%)	Sector	Country	Market Currency	Dividend Yield[1]
ASTRAZENECA PLC	AZN	5.43	Health Care	United Kingdom	GBP	3.58%
MACQUARIE GROUP LTD DEF	MQG	4.42	Financials	Australia	AUD	4.14%
ROYAL DUTCH SHELL PLC CLASS A	RDSA	3.28	Energy	United Kingdom	GBP	5.50%
COMMONWEALTH BANK OF AUSTRALIA	CBA	2.97	Financials	Australia	AUD	6.58%
GALLIFORD TRY PLC	GFRD	2.64	Industrials	United Kingdom	GBP	7.09%
SALMAR ASA	SALM	2.27	Consumer Staples	Norway	NOK	4.58%
VTECH HOLDINGS LTD	303	2.16	Information Technology	Hong Kong	HKD	6.91%
CANADIAN IMPERIAL BANK OF COMMERCE	CM	2.06	Financials	Canada	CAD	4.44%
ENI	ENI	2.03	Energy	Italy	EUR	5.15%
TOTAL SA	FP	2.02	Energy	France	EUR	4.75%
WESFARMERS LTD	WES	1.97	Consumer Staples	Australia	AUD	4.51%
GLAXOSMITHKLINE PLC	GSK	1.9	Health Care	United Kingdom	GBP	4.95%
SWEDBANK	SWED A	1.8	Financials	Sweden	SEK	6.03%
SSE PLC	SSE	1.71	Utilities	United Kingdom	GBP	8.41%
CASINO GUICHARD PERRACHON SA	CO	1.64	Consumer Staples	France	EUR	9.49%
AZIMUT HOLDING S.P.A.	AZM	1.61	Financials	Italy	EUR	7.22%
NATURGY ENERGY SA	NTGY	1.59	Utilities	Spain	EUR	5.53%
SES SA	SESG	1.49	Consumer Discretionary	France	EUR	4.50%
JM	JM	1.48	Consumer Discretionary	Sweden	SEK	5.92%
HENNES & MAURITZ	HM B	1.41	Consumer Discretionary	Sweden	SEK	3.27%

1) Dividend yield in terms of home currency, according to Yahoo Finance

DIVIDEND REPORT PAGE 2 – BP (BP)

Valuentum's Stock Dividend Research | Visit us at www.valuentum.com | Ratings as of 21-Sep-2018 | Data as of 17-Sep-2018

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	$33.00 - $59.00	RISKY	POOR / 0.7	VERY POOR	5.59%

Assessment of Company Dividend Strategy

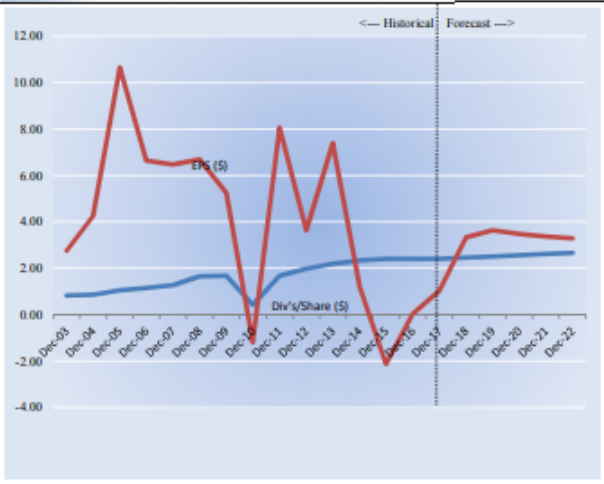
Key Strengths

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, which it expects to fall to $35-$40 per bbl by 2021.

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)

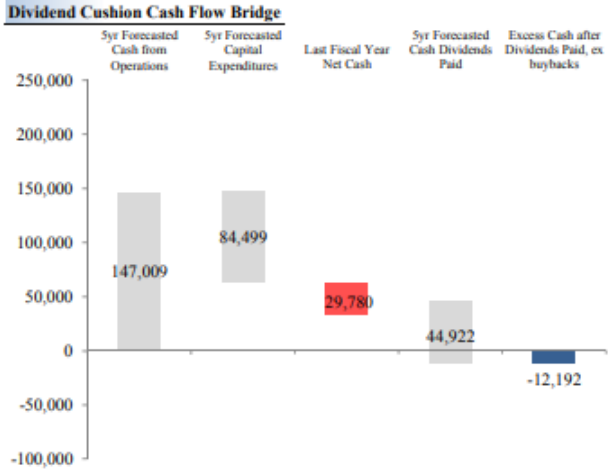


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

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. BP'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.

Dividend Cushion Cash Flow Bridge

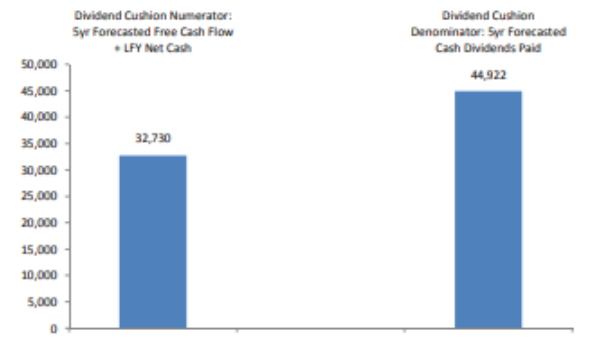


Source: Company Filings, Valuentum Projections

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, BP'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.

Dividend Cushion Ratio Deconstruction



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DIVIDEND REPORT PAGE 2 – OMEGA HEALTHCARE (OHI)

Digital Realty Trust DLR 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	$79.00 - $125.00	HEALTHY	GOOD / 1.6	EXCELLENT	3.34%

Assessment of Company Dividend Strategy

Key Strengths

Digital Realty Trust has rewarded its investors with a steady and growing dividend over the past decade or so as its dividend has grown at a ~12% CAGR since 2005. The firm is levered to long-term secular demand drivers via the use of its leased datacenters in the proliferation of the Internet, video, cloud, and mobile, and it holds investment grade credit ratings (Baa2/BBB/BBB). Its dividend policy stipulates that the company will pay out a minimum of 100% of taxable income via dividends and maintain a payout ratio of less than 90% of AFFO. FFO averaged more than $855 million from 2015-2017, well in excess of annual run-rate cash common and preferred dividend obligations of just over $715 million.

Potential Weaknesses

Real estate investment trusts pay out 90% of annual taxable income and therefore are unable to meaningfully reinvest internally-generated funds, resulting in external capital-market dependence. The weak internal cash-flow retention of most REITs translates into poor raw, unadjusted Dividend Cushion ratios, which could become severe during the depths of the real estate cycle. Even though a REIT's operating cash flow may be robust, the lack of cash accumulation on the balance sheet and the massive debt needed to purchase/develop new properties can become restrictive. The adjusted Dividend Cushion ratio, accounts for expectations of continued access to the capital markets, which while "normal," cannot be guaranteed in times of tight credit.

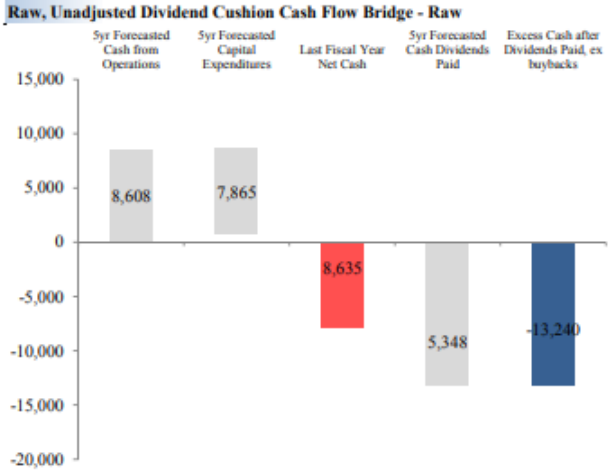
Graphical Relationship, Earnings and Dividends (per share)

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. Digital Realty Trust'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



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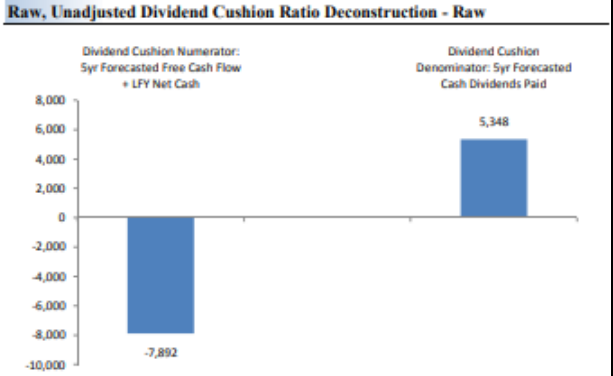

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DEFINITIONS

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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