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HIGH YIELD DIVIDEND NEWSLETTER

HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO EARNINGS ROUNDUP

Market volatility returned in a notable way in the month of October, and the high yield arena is inherently full of risk. However, underlying fundamentals of a number of our high yield ideas have remained solid. Let's take a look at a number of earnings reports.

There are countless measures by which to evaluate where the market may go next, and many, if not most, of them seem to be completely arbitrary and detached from fundamentals. The 16 down days in the S&P in the month of October were the most for any month since 1970 and the third most since the S&P was born in 1928, according Schwab's Liz Sonders, and the month marked the first time since October 2008 that the proportion of losing days for the S&P 500 hit 70%. On the other hand, there have been 11 other months (outside of October 2018) in which the S&P 500 was down 7%+ while consumer confidence was at a one-year high, and every other time the S&P was higher six months later, according to SentimenTrader.

The moral of the story is not that either of the above points are wrong but rather to keep a level head in this age of over saturation of information. The aforementioned statistics might be interesting enough to get you several dozen likes on Twitter (TWTR), but there is not one iota of useful analysis done in either case. While the market environment clearly plays an important role in how your holdings perform, perhaps more so for those that are dependent upon capital market access as many in the high yield arena are, analysis of underlying fundamentals should always trump headline grabbing statistics on broad and vague market returns.

Part of what is inherently flawed in relying on backward-looking data is the fact that every new instance in the markets provides a unique set of forward-looking expectations that drive investor action. No two sets of forward-looking expectations are exactly the same. Will the S&P 500 be higher than today's levels six months from now? Perhaps, but it won't be because the index's return in the month of October was down 7%+ while consumer sentiment was at a one-year high. It will be because investor expectations for the future performance of those businesses at that time are higher than it is today. Each of those 11 other instances in which the S&P moved higher six months later had their own unique drivers. Correlation does not equal causation. Its statistics 101.

We've reiterated our position on the high yield space time and time again over the past ten months: high yield inherently means high risk. This may have been truer

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than often in recent weeks, which have seen a notable return to market volatility, and the high yield space may very well be more exposed to potential pitfalls than any other segment of the market, not the least of which is the threat of rising interest rates. Not only are underlying valuations at risk of downward pressure via a rising benchmark interest rate, but more risky, lofty equity yields become less attractive as fixed income yields move higher.

Nevertheless, a number of our simulated High Yield Dividend Newsletter ideas are performing well, thanks in part to underlying fundamentals remaining strong. A stabilized crude oil market has meant solid growth for a number of ideas, including diversified energy giant BP (BP) and midstream operators Enterprise Products Partners (EPD) and Magellan Midstream Partners (MMP). Though these are two of our favorite MLPs on the market, we must reiterate that their payouts remain dependent on access to the capital markets. We're not expecting such access to dry up in the near term, but investors ignoring the long-term risks of such dependence will do so at their own peril.

We've added exposure to the REIT space this month via Iron Mountain (IRM), a firm whose core information storage business is facing saturation in the developed world but has growth opportunities in adjacent markets, not the least of which is data center ownership. We like management's diversification and growth market exposure targets, but execution risk will be material as it works to achieve 2020 goals. Digital Realty's (DLR) third quarter report was met with selling pressure despite bookings coming in at the second-highest quarterly level in its history and guidance being reiterated, perhaps as a result of broader concerns over the tech space given its customer ties.

We're not rushing to reduce equity exposure in the simulated High Yield Dividend Newsletter portfolio, but we are preaching caution--not fear. With that, let's take a quick look at some of the third quarter reports of our simulated High Yield Dividend Newsletter portfolio idea.

BP's Earnings Double; Now Expects to Fund US Shale Purchase with Cash Only

BP's (BP) third quarter results impressed investors as underlying replacement cost profit of $3.8 billion more than doubled that of the year-ago period and was the highest quarterly result in more than five years thanks to material bottom-line growth from its Upstream operations and Rosneft, in which it holds a near-20% stake. Reported oil and gas production came in at 3.6 million barrels of oil equivalent per day, and new projects ramping helped drive upstream underlying production, which excludes Rosneft and adjusts for portfolio changes and pricing effects, rose 6.8% on a year-over-year basis. Rosneft production in the quarter was 1.2 million barrels of oil equivalent per day, good for 2.8% growth over the comparable period of 2017.

BP recently raised its dividend for the first time in five years, and we expect recent bottom-line momentum to continue as the company brings higher-margin barrels into production through more efficient execution. The $10.5 billion acquisition of BHP's (BHP) US shale assets transform its position in US onshore, and management tabs this as a key part in its strategy to growing distributions to shareholders. The company had previously planned to finance the acquisition in part with stock, but its recent financial performance has given it the confidence to complete the deal with only cash. It will still pursue the $5-$6 billion divestment program that is linked to the transaction, but the proceeds will now be used to repay debt.

Through the first three quarters of 2018, BP has succeeded in covering cash dividends paid (nearly $5 billion) with traditional free cash flow ($5.3 billion), but its debt load continues to weigh on its Dividend Cushion ratio, which currently sits at 0.7. The company's stock carries a dividend yield of ~5.7% as of this writing, and we value shares at $46 each.

Digital Realty Remains Fundamentally Strong; Ancillary Items Impact Shares

Digital Realty (DLR) reported impressive top-line growth of 26% on a year-over-year basis in its third quarter report, released October 25, and core funds from operations per share climbed to $1.63 from $1.51 in the year-ago period. The REIT also turned in its second-highest level of quarterly bookings in its history, trailing only the second quarter of the year, and management remains quite optimistic regarding its entry

into the Brazilian market via its acquisition of Ascenty in partnership with Brookfield Asset Management (BAM).

Management reiterated its guidance for a number of metrics in its quarterly report, including core FFO per share at $6.55-$6.65, 'same-capital' cash net operating income growth of 1%-3%, rental rates on renewal leases (GAAP basis) at a mid-single-digit growth rate, and total revenue of $3-$3.2 billion. It did raise expectations for debt issuance in the year to $1.2-$1.8 billion from $0.65-$1 billion, and the REIT ended the third quarter with a net debt-to-EBITDA ratio of 5.2x. Its adjusted Dividend Cushion ratio, which gives credit for access to the capital markets, checks in at 1.6, and shares yield just over 3.9% as of this writing.

Over 85% of Digital Realty's debt is of the fixed rate variety, helping guard against a rising interest rate environment, but that does not mitigate the inherent risk-reward trade off often seen in income-generating stocks as fixed income yields rise. A rising benchmark interest rate also poses a headwind to equity prices via a reduction in underlying valuations, all else equal, and Digital Realty certainly isn't immune to this as shares have faced pressure of late despite its solid third quarter report. The company may also have been punished as a result of expectations for rental rates on renewal leases to be slightly negative in the full year 2018 on a cash basis, but management continues to point to demand outstripping supply in key markets such as Northern Virginia and Europe. Shares of Digital Realty are currently trading roughly in line with our fair value estimate of $102.

Strong Volumes Drive Enterprise Products Partners

Enterprise Products Partners (EPD) reported its third quarter earnings October 31, and robust volumes across its system led to 16 operational and financial records in the quarter. Its NGL segment reported record volumes for pipelines, marine export terminals, fractionation, and fee-based processing, and its crude oil pipelines and propylene business reported near record volumes. Adjusted EBITDA in the period jumped nearly 44% from the year-ago period to $1.9 billion, and net cash flow from operations more than tripled from the comparable period of 2017.

The MLP was able to deliver positive free cash flow generation in the quarter, but it came in at only $495 million, which was a significant improvement over the third quarter of 2017, but not enough to cover cash distributions paid in the period. Management is quick to note that its distribution coverage ratio, which makes use of the flawed industry-specific measure distributable cash flow, came in at 1.7 in the third quarter, but investors must note that Enterprise Products' distribution remains dependent on access to the capital markets. The third quarter of 2018 marked its 20th anniversary as a public company as well as its 20th year of increasing cash distributions. Enterprise Products Partners' adjusted Dividend Cushion ratio, which gives it credit for access to capital markets, currently sits at 2, and units yield ~6.4% as of this writing.

Iron Mountain Raises 2018 Guidance

Recent addition to the simulated High Yield Dividend Newsletter portfolio, Iron Mountain (IRM), faced a bit of selling pressure following its third quarter report, released October 25, but management remained confident in its business as it raised revenue and adjusted funds from operations (AFFO) growth guidance for the full-year 2018. Total revenue advanced 12.4% on a year-over-year and constant dollar basis as a result of recent data center acquisitions, and adjusted EBITDA grew 14.8% from the year-ago period in constant dollars thanks to the aforementioned data center purchases, as well as flow through from revenue management programs, improvement in 'Service' margins, and cost synergies from the Recall acquisition.

AFFO growth checked in at 8.8% on a year-over-year basis in the third quarter, but management raised its full year guidance to a range of 13%-16% from 5%-13%. Revenue growth is now expected to be 9%-11% compared to prior expectations for 7%-9% growth. The REIT raised its dividend for the fourth quarter by 4% from the same time a year earlier, which is in line with its expectations for a 4% CAGR in dividends per share through 2020.

Magellan Midstream Raises Full Year Guidance

Magellan Midstream Partners (MMP) reported significantly higher net income in the third quarter of 2018 thanks to the sale of a portion of its ownership

interest in BridgeTex Pipeline Company, and its 'Refined Products' segment reported operating margin of roughly $215 million, a $41 million increase over the year-ago period, thanks to mark-to-market adjustments in hedging contracts and an increase in fee-based activities. Total revenue advanced 11.4% on a year-over-year basis in the quarter, and adjusted EBITDA advanced 14.5% from the comparable period of 2017 to $359 million.

Distributable cash flow, the flawed, industry-specific measure, grew nearly 20% on a year-over-year basis to ~$282 million, and management raised its full-year 2018 distributable cash flow guidance to $1.12 billion from $1.1 billion previously. It also raised its expectations for diluted net income per limited partner unit to $5.70 from prior guidance of $4.10, and the MLP remains committed to delivering roughly 8% distribution growth in 2018, which it expects to support with a distribution coverage ratio of 1.25x on the year. Looking ahead to 2019 and 2020, Magellan is targeting annual distributable cash flow growth in the range of 5%-8%, and such growth should translate into a similar rate of annual distribution growth as management works to maintain a distribution coverage ratio of 1.2x

We must remind investors that Magellan's ~6.3% yielding distribution is dependent upon continued access to the capital markets, and it declared a ~2% increase to its quarterly payout in late October. The MLP's adjusted Dividend Cushion ratio currently sits at 1.2, and we value units at $69 each.

Realty Income Raises Payout and Bottom-Line Guidance; Credit Rating Gets a Boost

Realty Income (O) turned in a strong third quarter report after the close October 31 as its top line advanced 10.2% from the year-ago period and AFFO advanced 5.2% on a year-over-year basis. "The Monthly Dividend Company" as it has become known, also raised its dividend in September by 3.9% from the same time a year earlier, which marked its 84th consecutive quarterly dividend increase and the 98th increase in its payout since 1994.

The REIT's portfolio of commercial real estate continues to perform well and boasted occupancy of 98.8% at the end of the quarter compared to 98.7% and 98.3% a quarter and a year earlier, respectively. Same-store rents on properties under lease advanced 1% in the quarter from the year-ago period, and its weighted average remaining lease term sat at 9.3 years at the end of the quarter. During the quarter, S&P raised Realty Income's credit rating to 'A-' from 'BBB+,' which placed it among a select group of REIT with more than one 'A' rating, and this helped it recast and expand its revolving credit facility to $3 billion from $2 billion at favorable terms.

In addition to raising its dividend, Realty Income raised its full-year AFFO per share guidance as a result of ongoing strength in its business. It now expects the measure to be in a range of $3.18-$3.21, which represents year-over-year growth of 4%-5%, compared to previous guidance of $3.16-$3.21. Shares of the REIT are currently changing hands just above our fair value estimate of $58 and yield ~4.4% as of this writing. We continue to be big fans of its income generating potential, though we note ongoing growth in the payout remains dependent upon access to capital markets, which will benefit from its recent credit rating upgrade.

Enterprise Products Partners: Midstream Giant Marching Towards Greater Income Security

In this evaluation of Enterprise Products Partners (EPD), let's highlight the master limited partnership's major issues, then evaluate how management seeks to make things right. This will provide an overview of what exactly might be holding the MLP back and how upside might be generated moving forward.

The Problems

Valuentum members know to be wary when MLPs trumpet out their quarterly distribution coverage ratios, one of the favorite non-GAAP metrics in the midstream world. These coverage ratios make use of the industry-specific measure distributable cash flow, which is deeply flawed as if fails to take growth-related capital expenditures into account.

Most midstream entities include maintenance capital expenditures in their coverage metrics, but that represents only a sliver of their actual cash outlays on investing activities. During the first half of 2018, Enterprise Products spent $139 million on "sustaining

capital expenditures," and the MLP removed that amount from its distributable cash flow generation figure, which came in at $2.8 billion during that period. However, the firm spent $2.1 billion on total capital expenditures over that timeframe. That includes sustaining capital expenditures and $235 million in acquisitions, with the remainder being capital expenditures for growth projects currently under development.

Take a look at this excerpt from its second quarter press release: *"Enterprise reported distributable cash flow of $1.4 billion for the second quarter of 2018, which provided 1.5 times coverage of the $0.43 per unit cash distribution and resulted in $491 million of retained distributable cash flow. Likewise, distributable cash flow of $2.8 billion for the first six months of 2018 provided* ***1.5 times coverage of the aggregate $0.8575 per unit cash distribution and resulted in $948 million of retained distributable cash flow. Retained distributable cash flow is available to reinvest in growth capital projects and reduces our need to issue additional equity."***

Saying that Enterprise Products "retained" cash during the first half of this year is absurd, and investors must be very careful in identifying exactly what kind of cash flow management is talking about in any given case. According to its second quarter 10-Q filing for 2018, Enterprise Products spent $2.1 billion on capital expenditures and acquisitions and $1.8 billion on distributions to unitholders. Taken together, the $3.9 billion in cash flow outlays vastly exceeded the $2.7 billion in operating cash flow the firm generated over this period.

To be fair to Enterprise Products Partners, this is a pervasive problem across the entire midstream oil and gas industry. In short, most midstream firms (save a few) pay out almost all of their operating cash flow to investors each quarter. That leaves very little internally-generated cash flow left to fund expansive growth budgets, forcing midstream firms to constantly tap into capital markets for growth spending.

From the end of 2013 to the end of 2017, Enterprise Products' outstanding LP (limited partner) units grew from 1.9 billion to 2.2 billion. The MLP sold units through secondary issuances (including at-the-market issuances) and issued out units under its DRIP (distribution reinvestment program) in lieu of distributing cash back to investors.

As Enterprise Products simultaneously increased both its outstanding LP unit count and increased the distribution it was paying per unit, the company's cash distributions paid to LP unitholders grew to $3.6 billion in 2017 from $2.4 billion in 2013. On a per unit basis, Enterprise Products' distribution grew to $1.68 in 2017

ENTERPRISE PRODUCTS PARTNERS L.P.
UNAUDITED CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS
(Dollars in millions)

	For the Six Months Ended June 30, 2018	For the Six Months Ended June 30, 2017
Operating activities:		
Net income	$ 1,598.7	$ 1,437.0
Reconciliation of net income to net cash flows provided by operating activities:		
Depreciation, amortization and accretion	889.3	808.8
Asset impairment and related charges (see Note 14)	16.8	25.2
Equity in income of unconsolidated affiliates	(238.0)	(201.8)
Distributions received on earnings from unconsolidated affiliates	227.6	205.1
Net gains attributable to asset sales	(1.4)	--
Deferred income tax expense	10.0	0.7
Change in fair market value of derivative instruments	459.0	(43.9)
Change in fair market value of Liquidity Option Agreement	16.4	24.1
Gain on step acquisition of unconsolidated affiliate (see Note 11)	(39.4)	--
Net effect of changes in operating accounts (see Note 17)	(228.5)	82.1
Other operating activities	(12.7)	(2.4)
Net cash flows provided by operating activities	2,697.8	2,334.9
Investing activities:		
Capital expenditures	(1,921.1)	(1,113.1)
Cash used for business combinations, net of cash received (see Note 11)	(149.7)	(191.4)
Investments in unconsolidated affiliates	(45.9)	(24.1)
Distributions received for return of capital from unconsolidated affiliates	25.9	24.8
Proceeds from asset sales	2.6	3.2
Other investing activities	(1.4)	2.0
Cash used in investing activities	(2,089.6)	(1,298.6)
Financing activities:		
Borrowings under debt agreements	38,566.4	33,307.8
Repayments of debt	(37,437.0)	(33,639.3)
Debt issuance costs	(24.3)	--
Cash distributions paid to limited partners (see Note 8)	(1,847.3)	(1,757.8)
Cash payments made in connection with distribution equivalent rights	(8.6)	(7.2)
Cash distributions paid to noncontrolling interests	(28.3)	(23.1)
Cash contributions from noncontrolling interests (see Note 8)	206.9	0.3
Net cash proceeds from the issuance of common units (see Note 8)	261.0	757.2
Other financing activities	(25.8)	(27.8)
Cash used in financing activities	(337.0)	(1,389.9)
Net change in cash and cash equivalents, including restricted cash	271.2	(353.6)
Cash and cash equivalents, including restricted cash, at beginning of period	70.3	417.6
Cash and cash equivalents, including restricted cash, at end of period	$ 341.5	$ 64.0

Image Source: Enterprise Products Partners second quarter 2018 10-Q

from $1.37 in 2013, meaning the midstream firm's total distributions paid rose by 48.8% but investors only received a 22.8% increase in distribution per unit.

Over this same time period (2013-2017) Enterprise Products' debt load grew to $24.6 billion from $17.2 billion as it turned to the debt market to fund its growth spending. This rising debt load led to significantly higher interest expenses, which grew to $985 million in 2017 from $803 million in 2013, and this only further saps cash flow generation.

If the MLP were to continue on its path of not retaining enough cash and continually diluting its existing investors from potential upside, its distribution may have been cut along with that of many of its peers, but that has not been the case. Enterprise Products has three levels to pull to rectify its situation: containing its spending levels, growing cash flow generation (a product of new assets coming online), and putting an end to its reliance on the capital markets (a product of the first two levers working in tandem).

Stop the Hemorrhaging

In the fall of 2017, Enterprise Products reduced its quarterly distribution growth rate from half a cent each quarter to a quarter of a cent. The goal was to bring its per unit distribution increases down to a more manageable level so Enterprise Products' cash flow generation could catch up over time. To a large portion of the investing community, this decision turned Enterprise Products into an income story with minimal growth prospects in the medium term as far as yield is concerned.

Within the investing activities section of its cash flow statement Enterprise Products has three key line items: capital expenditures, cash used for business combinations net of cash received, and investments in unconsolidated affiliates. On those three activities, the company spent $6.0 billion in 2014, $5.1 billion in 2015, $4.2 billion in 2016, and $3.4 billion in 2017. During the MLP's 2018 second quarter conference call, Enterprise Products noted:

"We now anticipate spending $3.8 billion to $4 billion in capital expenditures for the full year and approximately $315 million on sustaining capital expenditures. We placed approximately $1.1 billion of growth capital projects into service during the second quarter of 2018 including the previously mentioned Orla 1 gas plant and our 9th fractionator in Mont Belvieu.

We currently have an additional $5.2 billion of projects under construction through 2020. The primary additions are increased capacity on Chinook upon startup from 250,000 barrel per day to 550,000 barrel per day project and the North Texas 36-inch natural gas pipeline expansion project."

During its third quarter 2017 earnings conference call, management mentioned that it planned to spend $2.5-$3 billion in capital expenditures in 2018, but its most recent commentary indicates its capital spending target for the year has risen to $4.2 billion. There are a number of reasons for Enterprise Products to spend more in 2018 than originally expected, namely the numerous opportunities the Permian Basin is creating for midstream entities. However, management could do a much better job in communicating its capital spending budget for the next few years. Past commentary indicates that the firm plans to spend between $2 and $3 billion annually, but when that will be the case remains to be seen.

Rising Cash Flow

The chart below offers a snapshot of net operating cash flow generated by Enterprise Products over the past four years and the level it was on pace to generate in 2018 as of the first half of the year (a figure based on the extrapolation of the firm's first half net operating cash flow generation of $2.7 billion). As you can see, Enterprise Products' cash flow growth came to a halt in 2015 and 2016, even as new cash flow generating assets were brought online. The culprit behind this stagnation was due to Enterprise Products being far more exposed to market prices than many had thought as the nature of many of its contracts were heavily influenced by market forces.

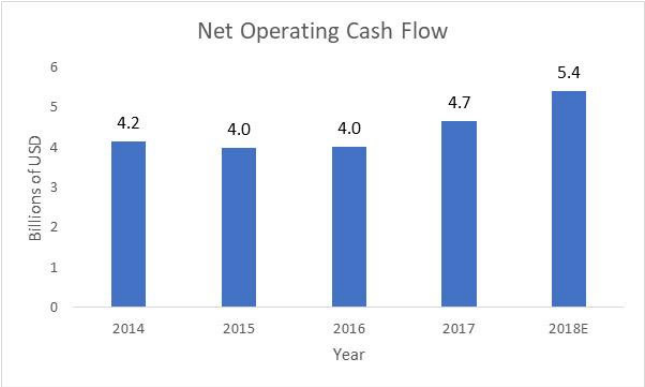

Image Source: Author's Calculations, SEC Filings

Enterprise Products has returned to growth in its net operating cash flow generation thanks in large part to it completing developments under construction and being able to take advantage of record high US hydrocarbon production, which bolsters utilization rates across its asset base.

Growth Ahead

Let's take a look at some noteworthy developments Enterprise Products either recently completed or will complete in the near future. The completion and subsequent expansion of the Midland-to-Sealy crude oil pipeline is a good place to start. After starting limited commercial activities late last year, the pipeline system is now capable of transporting 575,000 barrels of crude per day out of the Permian Basin to Enterprise Products' storage facilities in Sealy, Texas. From there, those barrels have access to domestic refineries along the Gulf Coast and international markets via export. Originally, the pipeline was going to have only 450,000 bpd of takeaway capacity, but market conditions heavily supported expanding this system.

Looking ahead, Enterprise Products plans to grow by expanding the export capacity out of its Enterprise Hydrocarbons Terminal along the Houston Ship Channel, adding additional fractionation capacity to its natural gas liquids hub in Mont Belvieu, Texas, and by growing its ability to cater to the needs of the upstream industry in the Permian Basin. The image below shows some of the Permian growth projects Enterprise Products has embarked on.

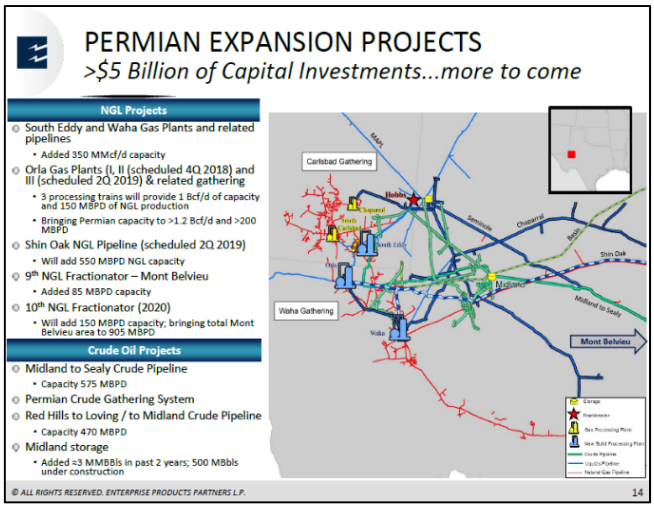

Image Source: Enterprise Products Partners September 2018 Presentation

As the negative effects of the oil price downturn dissipate and new cash flow generating assets are brought online, Enterprise Products is likely to see its net operating cash flow generation continue to trend higher over the next few years. The MLP may be a long way away from generating enough traditional free cash flow to cover all capital spending and distribution payments with internally-generated cash flow, but working in the right direction is as commendable a task as it can accomplish for the time being.

Putting It All Together

The third reason why Enterprise Products' payout may become notably safer outlined previously is the MLP no longer needing to tap capital markets to satisfy growing capital spending and/or distributions. This would require management to make good on the promises made to investors last year and cut capital expenditures down to less than $3 billion by 2020. In conjunction with the announcement that Enterprise Products' distribution growth was getting cut in half in nominal terms, management also stated that it would consider unit buybacks once traditional free cash flow generation returned. The timeline was vague, perhaps intentionally so, but it appears that these buybacks could begin by 2020 or 2021.

Let's dig into the steps management is taking to make that plan possible. First, Enterprise Products reduced its capital expenditures and slowed the growth of its distribution to bring total cash outflows down to more

manageable levels. Secondly, Enterprise Products revived its cash flow generation by continuing to bring new assets online, by realizing stronger utilization rates across its asset base, and through various bolt-on acquisitions. Investors should note that the second step involves a degree of a cooperating market environment, which is never guaranteed in the sometimes volatile energy space. The third and final step requires continued spending restraint and continued cash flow growth, as that will culminate into Enterprise Products no longer needing to tap capital markets for funds.

When the growth in its outstanding unit count comes to a halt (save for only marginal issuances relating to the firm's DRIP and equity-based compensation) and its interest expenses stop rising, Enterprise Products will finally be in a balanced fiscal position. This will lead to the company being able to buyback some of its units, which reduces total quarterly distribution payments to unitholders, making larger per unit distribution increases more viable and sustainable over the long-haul.

Conclusion

As of this writing, Enterprise Products Partners boasts a dividend yield of ~6.4% and has a viable plan to improve the safety and growth potential of its quarterly distribution, but as we have illustrated in this piece, it remains tied to energy resource pricing to a degree. While distribution growth may not be as robust as it had been in years past (as a result of management tempering its growth expectations), the MLP is free cash flow positive as of the first half of 2018, which is more than we can say for a number of its peers. We plan to continue highlighting Enterprise Products Partners in the simulated High Yield Dividend Newsletter portfolio for the time being as it continues to progress on its turnaround strategy.

Adding Iron Mountain to the Simulated High Yield Dividend Newsletter Portfolio

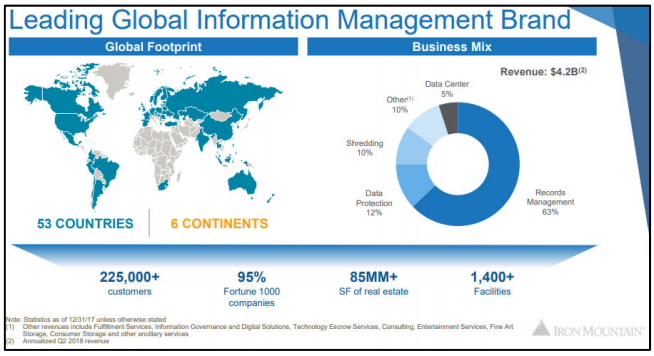

Image source: Iron Mountain investor presentation

Iron Mountain (IRM) is a real estate investment trust (REIT) that provides storage and information management solutions around the globe. We currently value shares, which have a dividend yield of ~7.4% as of this writing, at $32 each. Moody's rates the REIT's credit at Ba3, which is junk territory, and the health and future growth of its dividend is dependent upon access to capital markets, a notion that is reflected in its unadjusted Dividend Cushion ratio of -1.08. Iron Mountain's adjusted Dividend Cushion ratio, which gives it credit for access to capital markets, currently sits just above parity.

Iron Mountain owns the leading market position in the North America storage and information management market, and its May 2016 acquisition of rival Recall helped enhance its global footprint. The REIT boasts a large recurring revenue stream via its storage rental revenue, which accounts for 81% of its gross margin, and its strong brand and market share give it notable pricing power that helps drive its impressive EBITDA margins, which have expanded nicely of late.

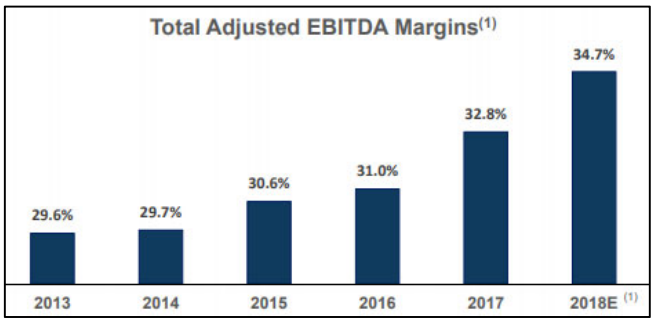

Image source: Iron Mountain investor presentation

Management expects its 2020 targets for shifting revenue mix to further accelerate its EBITDA growth as it works to achieve a 70/30 revenue split in terms of its developed/growth portfolio. Its developed portfolio consists of its legacy storage and services business North America and Western Europe and accounts for 82% of total revenue as of the first half of 2018, and its growth portfolio consists of emerging markets, data centers, and adjacent businesses. This growth portfolio is expected to deliver ~10% internal revenue growth, which should only drive overall revenue and EBITDA growth higher as it becomes a relatively larger portion of the overall business compared to the mature markets served via its developed portfolio.

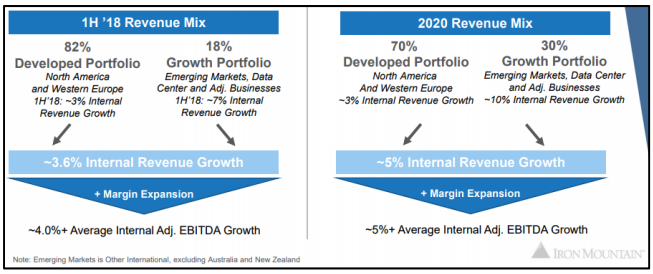

Image source: Iron Mountain investor presentation

The maturation of the storage and information management markets in North America and Western Europe is a key long-term risk to Iron Mountain's business and is a core reason for management's increased focus on diversification and its growth portfolio. The majority of its revenue comes from rental fees for storage of physical records and computer backup files and related storage service fees, and the potential decline of this business makes its move into the data center space a somewhat natural extension of its business. The REIT is looking to grow its data center business to ~10% of total EBITDA by 2020, compared to just ~5% of total revenue as of the second quarter of 2018, and its customer and box retention helps ease these mature market concerns as well. Its storage business boasts ~98% customer retention rates, and ~51% and ~35% of boxes stored 15 years and 22 years ago, respectively, still remain in storage today.

Despite these risks, Iron Mountain is confident in its outlook through 2020. It expects worldwide revenue to grow at a 6.7% CAGR in the period from 2017-2020, while adjusted EBITDA growth is being targeted at a 10.9% CAGR over the same time frame. Adjusted funds from operations (AFFO) growth over the 2017-2020 period is expected to be even higher at an 11.2% CAGR, and management expects a minimum dividend per share CAGR of 4% to result in a minimum dividend per share of $2.54 in 2020.

Meanwhile, the REIT is also aiming to deleverage its balance sheet as it is targeting a lease adjusted leverage ratio of ~5.5x at the end of 2018 and ~5.0x at the end of 2020 compared to 5.6x at the end of the second quarter of 2018, which was directly in line with the JP Morgan REIT Composite net leverage ratio at that time. We'd like to see an improved balance sheet--Iron Mountain's junk territory credit rating is due in part to its elevated leverage--but its debt maturity profile looks reasonable over the near term, as seen in the image below. This debt profile has the potential to change as management continues to enhance its growth portfolio in its efforts to deliver on its adjusted EBITDA targets.

Maturities of long-term debt are as follows:

Year		Amount(1)
2018	$	146,300
2019		129,194
2020		378,447
2021		568,486
2022		856,361
Thereafter		5,052,268
		7,131,056
Net Discounts		(1,545)
Net Deferred Financing Costs		(86,240)
Total Long-term Debt (including current portion)	$	7,043,271

Image source: Iron Mountain 2017 10-K

As with the vast majority of high-yielding ideas, Iron Mountain's elevated yield comes with an elevated level of risk, and its ongoing success depends on access to the capital markets along with deft execution from management in areas such as capital recycling and balancing its use of debt and equity funding. We like its growing exposure to the high growth data center business, which should continue experiencing secular tailwinds, even as we note the long-term risks associated with its storage and information services business in developed markets. Execution risk is not immaterial, but if the REIT is able to execute on its current portfolio adjustments, it has the potential to be a significant generator of income for investors in the years ahead.

Midstream Energy Pounded, MLP Distribution Cut at Golar LNG Partners

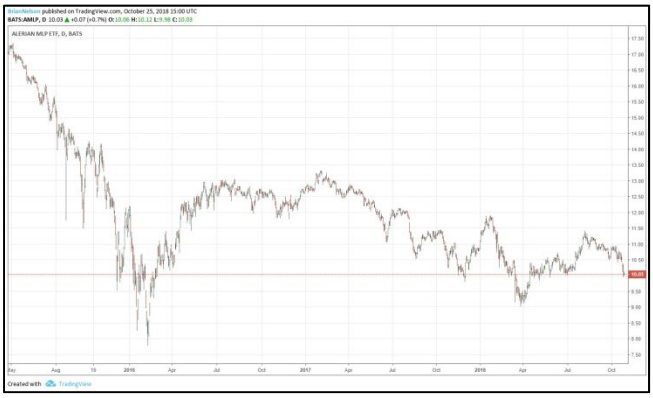

Image shown: The midstream MLP space continues to suffer. Performance of the group since mid-June 2015.

There aren't many calls that have been as large as Valuentum's was in midstream energy in mid-June 2015. Midstream energy equities comprised some $500-$600 billion in market capitalization at their peak, and our work was prominently highlighted in Barron's for all to see. Within the High Yield Dividend Newsletter, we've received great praise in continuing to highlight the risks of the space, but we can't change that high yield, itself, is risky, as almost by definition, it means that companies will have poor Dividend Cushion ratios.

This doesn't mean that you won't be able to find opportunities in the high yield space, or that you won't be able to generate sufficient yield from ideas, but it does mean that almost all of the ideas will have capital-market dependence risk as they are paying out more than what they can generate internally given their capital spending profiles. The construct of the Dividend Cushion ratio, for example, includes expected cash distributions or dividends paid in the denominator (which are quite lofty for high yielders), and net debt is a detraction from overall dividend health in the numerator. *The combination is quite punitive for high-yield dividend payers.*

We can't change that weak Dividend Cushion ratios and capital-market dependence risk is inherent to high-yield dividend investing. **It is what it is.** Almost by definition, an abnormally-high dividend yield means that coverage will be difficult over long periods of time, without external capital market assistance. Good analysis should keep this front and center for readers to understand. It's far more important to make sure readers are well-aware of all the risks because the good things tend to take care of themselves. A focus on the risks should account for 90% of your efforts with respect to your favorite ideas. Ask: how can your thesis go wrong?

There have been dozens of distribution cuts in the midstream energy space since we released our call in mid-June 2015, and Golar LNG Partners (GMLP) is the latest, cutting its payout October 24. The entity had been warning that its distribution coverage was not sufficient for some time, and investors were informed that its distribution had been placed under review, so there's really no surprise. Distribution coverage, even as measured by flawed industry-specific metrics of cash flow, came in at 0.32x and 0.56x in the first and second quarters of 2018 as a result of challenges in the floating storage regasification unit (FSRU) market.

In its distribution capacity review, the MLP has taken a cautious stance on the contract status and future rates applicable with respect to its FSRU Golar Igloo, and no future earnings were assumed with respect to the FSRU Golar Spirit. This level of caution, along with conservative assumptions related to its carriers that are exposed to spot and short-term markets, led the board of directors to conclude a 30% distribution cut was necessary. Golar is just the latest in a long line of MLPs that have cut their payouts since the midstream energy fallout in 2015. **On the other hand, we haven't had one equity dividend cut in the simulated Dividend Growth Newsletter portfolio and not one dividend cut in the simulated High Yield Dividend Newsletter portfolio! Adjusting for currency, we haven't had one dividend cut with respect to income ideas in the Exclusive publication either!**

Back to Golar. The MLP believes it is well positioned financially and upside to the distribution exists if the shipping market does better or if Golar Spirit finds employment, but it did not give an outlook for future distribution growth. As we've said time and time again, such growth remains dependent upon access to the capital markets, and units still yield more than 11% after the reduction in the distribution (still signaling outsize risk). Golar's unadjusted Dividend Cushion ratio was firmly in negative territory prior to the distribution cut, and our dividend report on the MLP was littered with warnings of management's lack of confidence in its own payout. Financial statement analysis matters, and high

yield is synonymous with high risk. Anybody that tells you otherwise is trying to sell you something.

Hi-Crush and EnLink Join Growing List of MLP Simplifications

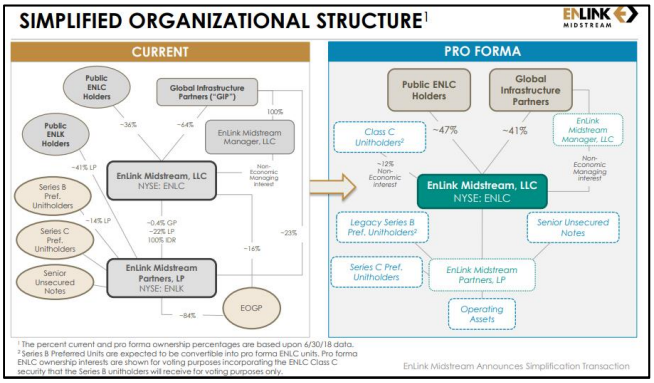

Image Source: EnLink transaction presentation

The ongoing trend of master limited partnership simplification transactions continued October 22 as proppant and logistics solutions provider Hi-Crush Partners (HCLP) acquired its general partner and slash its quarterly distribution to $0.225 per unit from $0.75 per unit. The now C-Corp used 11 million newly issued units to acquire Hi-Crush Proppants LLC for a total consideration of $96.25 million and eliminated its incentive distribution rights in doing so. Rationale cited for making the change is very similar to other similar transactions, including a lower cost of capital, wider appeal to a range of investors, enhanced financial flexibility, and improved corporate governance, among other factors. A soft frac sand market also played a role in Hi-Crush's decision, and the significant decrease in its quarterly payout reflects a renewed commitment to maintaining a reasonable balance sheet.

EnLink Midstream (ENLC) and its limited partner EnLink Midstream Partners (ENLK) announced a simplification transaction in which unitholders of EnLink Midstream Partners will receive 1.15 common units of EnLink Midstream for each unit owned and EnLink Midstream's incentive distribution rights in its limited partner will be eliminated. A simplified corportate structure, lower cost of capital, increased public float, and enhanced trading liquidity were all noted as positive benefits of the deal, and an increase in financial flexibility is projected to aid management's ability to execute its growth plan.

Sustainable distribution growth of 5%+ annually for at least three years following the closing of the transaction (expected in the first quarter of 2019), but current holders of EnLink Midstream Partners will see their current annual dividend per unit reduced to ~$1.23 (1.15 x $1.07) from $1.56 as a result of the deal. EnLink will continue to operate under the ticker 'ENLC,' and management expects significant improvement in distribution coverage and material support for its plans to self-fund the equity portion of a majority of growth capital expenditures. Reliance on external financing is expected to be reduced, not eliminated, and management expects all three ratings agencies to affirm its current credit ratings (BBB-/BB+/Ba1).

- Brian Nelson, CFA
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Disclosure: Brian Nelson and Kris Rosemann do not own any shares of any securities mentioned in this newsletter. Callum Turcan 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	8.33%
Global X SuperDividend ETF	SDIV	5.0%	1.54	7.96%
Global X SuperIncome Preferred ETF	SPFF	10.0%	0.85	7.40%
iShares International Select Dividend ETF	IDV	5.0%	1.61	5.17%
iShares MSCI Australia ETF	EWA	5.0%	0.99	4.73%
iShares U.S. Preferred Stock ETF	PFF	5.0%	2.04	5.65%
PowerShares Senior Loan Portfolio	BKLN	5.0%	0.89	3.86%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	3.95	5.92%
EQUITY				
AmeriGas Partners	APU	5.0%	3.80	10.17%
BP PLC	BP	5.0%	2.46	5.77%
Digital Realty Trust	DLR	5.0%	4.04	3.82%
Enterprise Products Partners	EPD	5.0%	1.73	6.41%
Iron Mountain	IRM	5.0%	2.44	7.72%
Magellan Midstream Partners	MMP	5.0%	3.91	6.38%
Omega Healthcare Investors	OHI	5.0%	2.64	7.87%
Public Storage	PSA	5.0%	8.00	3.88%
Realty Income Corporation	O	5.0%	2.65	4.33%
Tallgrass Energy LP	TGE	5.0%	1.86	8.57%
		95.0%		**6.07%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 11/1/2018.

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

OIL & GAS PIPELINE EQUITIES IN OUR COVERAGE UNIVERSE

Company Name	Symbol	Est. Dividend Yield	Div Cushion	Div Growth	Div Safety	Div Track Record	Est. Forward Payout Ratio	Leverage	VBI	Fair Value Estimate	Economic Castle
Buckeye Partners	BPL	14.5%	0.9	VERY POOR	POOR	HEALTHY	173.0%	HIGH	3	$40.00	Unattractive
Golar LNG Partners	GMLP	11.1%	UR	VERY POOR	POOR	RISKY	148.6%	HIGH	3	$16.00	Unattractive
Energy Transfer Partners	ETP	10.5%	1.3	VERY POOR	VERY POOR	HEALTHY	215.2%	HIGH	3	$24.00	Neutral
NuStar	NS	9.4%	1.1	VERY POOR	POOR	RISKY	129.1%	HIGH	3	$27.00	Unattractive
Spectra Energy Partners	SEP	8.6%	1.3	GOOD	GOOD	HEALTHY	93.8%	HIGH	4	$39.00	Neutral
Holly Energy	HEP	8.6%	1.3	EXCELLENT	GOOD	HEALTHY	154.7%	HIGH	5	$31.00	Attractive
Western Gas	WES	8.4%	1.7	EXCELLENT	GOOD	HEALTHY	213.5%	HIGH	3	$48.00	Neutral
DCP Midstream	DCP	7.5%	2.2	GOOD	GOOD	HEALTHY	278.3%	HIGH	3	$43.00	Neutral
Enbridge	ENB	6.4%	1.7	EXCELLENT	GOOD	HEALTHY	180.4%	HIGH	3	$40.00	Neutral
Enterprise Product Partners	EPD	6.1%	2.0	GOOD	GOOD	HEALTHY	105.7%	HIGH	4	$30.00	Neutral
Magellan Midstream	MMP	6.0%	1.2	EXCELLENT	GOOD	HEALTHY	93.9%	HIGH	3	$69.00	Attractive
Plains All American	PAA	4.9%	-0.8	VERY POOR	VERY POOR	RISKY	84.9%	HIGH	4	$26.00	Attractive
Kinder Morgan	KMI	4.5%	1.1	GOOD	GOOD	RISKY	88.7%	HIGH	3	$24.00	Neutral

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-

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

payment risk.

Issuer	Weighting	Credit Rating	Coupon Rate
BURGER KING	1.96%	BB-/NR	4.49%
Charter Communications Operating	1.94%	BBB-/BA1	4.25%
CENTURYLINK, INC.	1.92%	BBB-/BA3	4.99%
Grifols Worldwide	1.83%	BB+/BA2	4.47%
CHANGE HEALTHCA	1.74%	B+/BA3	4.99%
Avolon	1.63%	BBB-/Ba1	4.28%
Level 3 Financing Inc	1.57%	BBB-/BA1	4.53%
Caesars Resort Collection	1.54%	BB/BA3	4.99%
VALEANT PHARMACEUTICALS INTL, INC	1.51%	BB-/BA3	5.28%
RPI Finance Trust	1.47%	BBB-/Baa3	4.39%
Dell International LLC	1.44%	BBB-/Baa3	4.25%
Western Digital	1.42%	BBB-/Baa2	3.79%
Dell International LLC	1.39%	BBB-/BAA3	4.00%
Transdigm Inc	1.35%	B+/Ba2	4.74%
Sprint Communications Inc	1.34%	BB-/BA2	4.75%
ASURION	1.27%	B+/Ba3	5.24%
Stars Group (US) Co-Borrower	1.26%	BBB-/BAA2	5.89%
Petsmart Inc.	1.24%	CCC/B3	5.28%
Western Digitial	1.22%	BBB-/Baa2	4.04%
Las Vegas Sands	1.19%	BBB-/Ba1	3.99%
Prime Security Services	1.19%	BB-/Ba3	4.99%
Endo	1.18%	BB/Ba2	6.38%
Hilton Worldwide Finance, LLC	1.16%	BBB-/Baa3	4.03%
Asurion LLC	1.14%	B+/Ba3	5.24%
SS&C Technologies, Inc.	1.14%	BB/BA3	4.49%
DaVita HealthCare Partners Inc.	1.14%	BBB-/Baa3	4.99%
Almonde Inc	1.12%	B-/B2	5.89%
Crown Finance US, Inc	1.11%	BB-/B1	4.74%
Bass Pro Group	1.08%	B+/B1	7.24%
First Data	1.07%	BB/Ba2	4.29%

DIVIDEND REPORT PAGE 2 – MAGELLAN MIDSTREAM (MMP)

Valuentum's Stock Dividend Research | Visit us at www.valuentum.com | Ratings as of 19-Oct-2018 | Data as of 8-Oct-2018

Magellan Midstream MMP FAIRLY VALUED

Buying Index™ 3 **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	6.01%

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 (~54% of operating margin), crude oil (~38%) 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 $2.5 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 $4.5 billion as of the second quarter of 2018. 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.

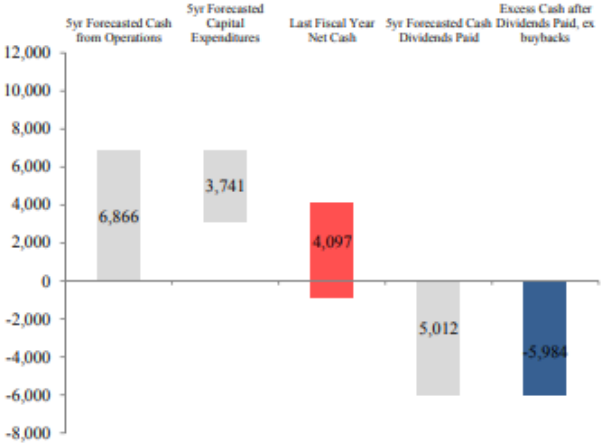
Graphical Relationship, Earnings and Dividends (per share)

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.

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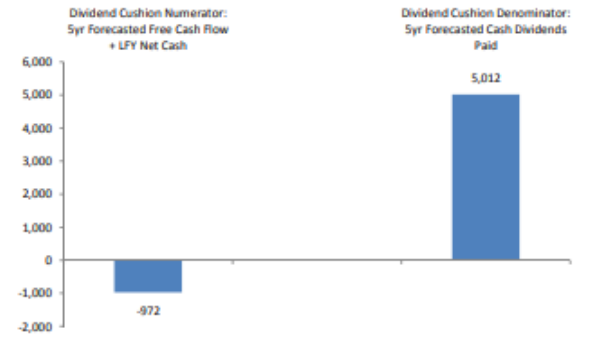

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DIVIDEND REPORT PAGE 2 – ENTERPRISE PRODUCTS PARTNERS (EPD)

Enterprise Product Partners EPD FAIRLY VALUED

Buying Index™ 4 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Neutral	$23.00 - $38.00	HEALTHY	GOOD / 2	GOOD	6.07%

Assessment of Company Dividend Strategy

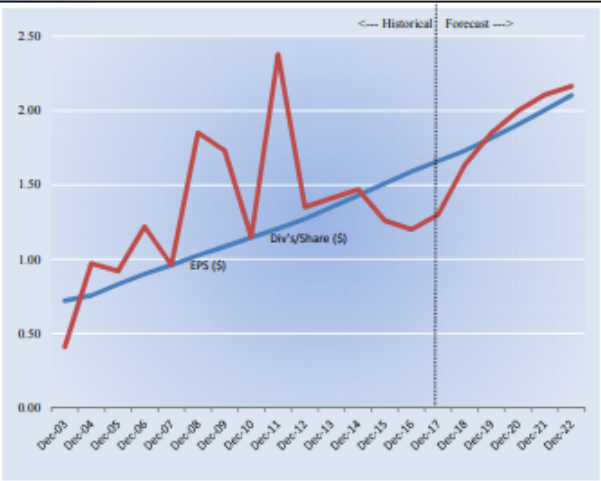
Key Strengths

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 ~$5.7 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)



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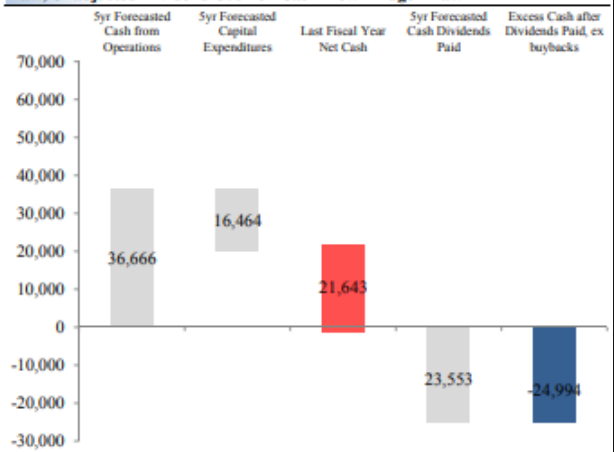

Source: Company Filings, Valuentum Projections

Dividend Cushion Ratio Evaluation

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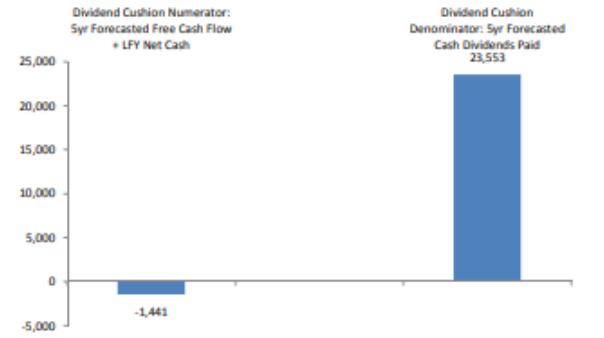
Raw, Unadjusted Dividend Cushion Ratio Deconstruction - Raw



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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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