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HIGH YIELD DIVIDEND NEWSLETTER

New Add: AT&T AGAINST THE (MEDIA) WORLD

AT&T is building a next-generation media conglomerate with plans to take on heavyweights such as Netflix. The company continues to generate a robust free cash flow stream, but its Dividend Cushion ratio is materially impacted by its massive debt load. Management is making deleveraging a priority while it continues to keep its focus trained downfield at its strategic goals. **We're adding AT&T as an idea in the simulated High Yield Dividend Newsletter portfolio.**

Key Takeaways

We're adding AT&T as an idea in the simulated High Yield Dividend Newsletter portfolio. The company offers a compelling dividend yield and has potentially meaningful capital appreciation upside potential.

AT&T's Dividend Cushion ratio is weighed down by its massive debt load, but free cash flow coverage of its cash dividend obligations has been solid. Management is making deleveraging a priority as it keeps its focus on long-term strategic moves.

The recent acquisition of Time Warner will be used to create a direct competitor with Netflix, but AT&T is focusing on developing meaningful advertising relationships to account for the shortfall in advertising technology in the premium video content space.

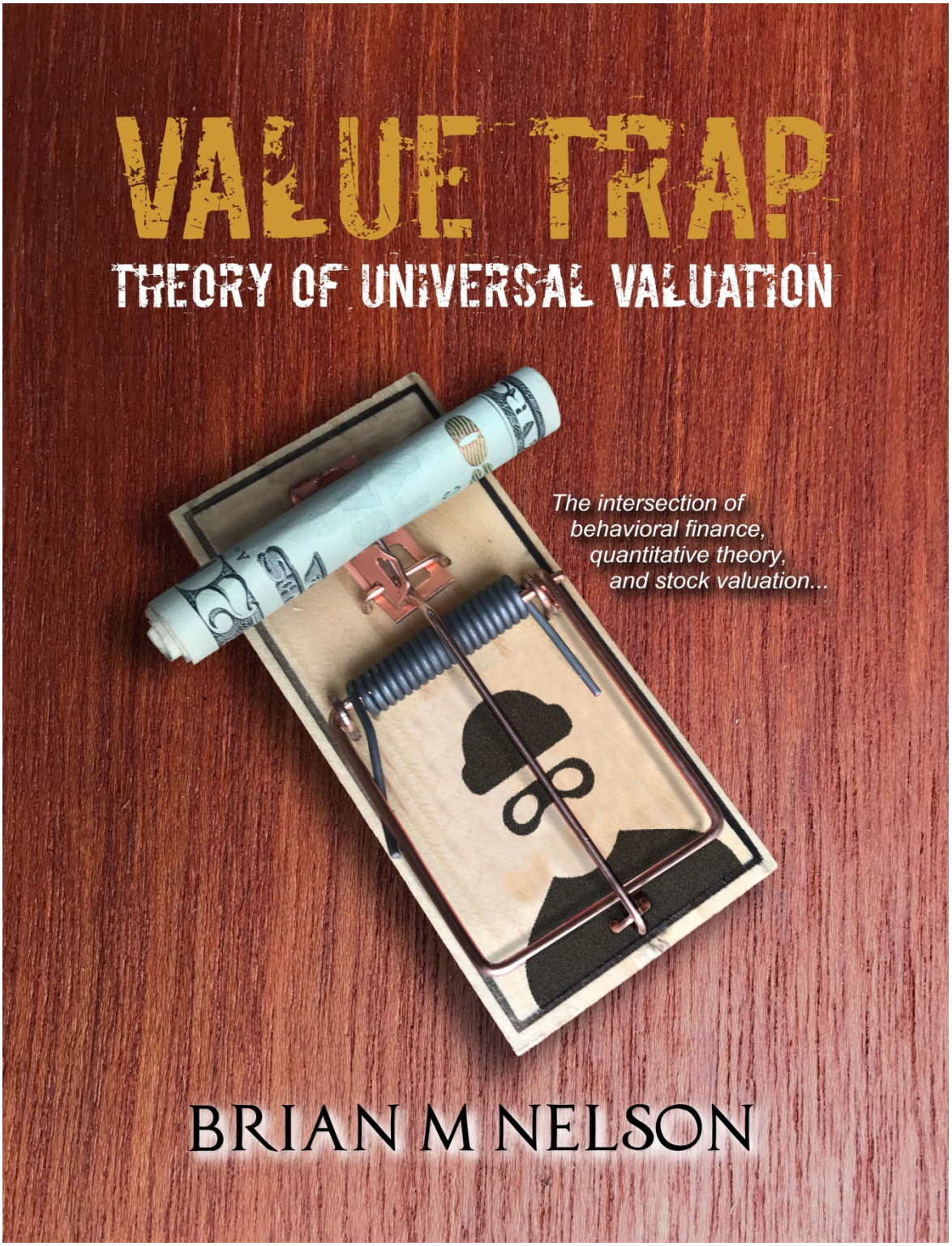
Third Quarter Earnings

Shares of wireless and entertainment giant AT&T (T) faced notable selling pressure following the release of its third quarter results October 24. The drop was due in part to top-line weakness in its 'Entertainment Group' and 'Business Wireline' businesses as linear video subscribers and legacy wireline service revenues continued to decline, which may be casting doubt over the new-age media 'conglomerate' and its debt-fueled growth strategy. Consolidated revenues advanced 15.3% to $45.7 billion thanks in large part to the Time Warner acquisition, but declines in domestic video and legacy wireline services were enough to catch investors' attention. Its 'Entertainment Group' EBITDA margin was hit by one-time items as the company hopes to stabilize profitability levels in the segment for 2019, and it expects margin stability in the 'Business Wireline' segment to help it achieve its previously announced guidance for earnings per share of ~$3.50 and free cash flow generation guidance of ~$21 billion.

AT&T reported 16.6% year-over-year growth in free cash flow generation in the third quarter thanks in part to 14.3% growth in cash flow from operations, and free cash flow of $14.4 billion through the first three

"WE VALUE SHARES, WHICH YIELD AN EYEBROW-RAISING 6.4% AS OF THIS WRITING, AT $38 EACH, AND WE'RE ADDING THE IDEA TO THE SIMULATED HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO IN HOPES OF TAKING ADVANTAGE OF THE ATTRACTIVE VALUATION, WHICH HAS ADDITIONAL UPSIDE POTENTIAL IF LONG-TERM STRATEGIC MOVES PAN OUT ACCORDING TO MANAGEMENT'S PLAN, WHILE COLLECTING SOME HEFTY DIVIDEND CHECKS." – KRIS ROSEMANN

COMING SOON!



"IF I HAVE WRITTEN THIS BOOK IN THE FASHION AS I ENDEAVOR, I WANT EVERY SENTENCE, EVERY PARAGRAPH TO BE WORTH YOUR WHILE. I HOPE THIS TEXT STANDS THE TEST OF TIME AND EVEN SHAPES THE FUTURE." – BRIAN NELSON, CFA

quarters of the year has been more than sufficient in covering cash dividends paid of less than $10 billion. Though the number of moving parts in its business in recent years may complicate things, free cash flow coverage of dividends has been similarly solid as it averaged nearly $17.7 billion in free cash flow over the past three years, which compares favorably to annual run rate cash dividend obligations of just over $12 billion.

AT&T's Dividend Cushion ratio currently sits in negative territory (-0.2 at last check) due to its massive net debt load, which sat at ~$175 billion as of the end of the third quarter, and management continues to make deleveraging a priority as it targets a net debt-to-EBITDA ratio of 2.8x at the end of 2018 (on ~$170 billion in net debt) and 2.5x by the end of 2019 (on ~$150 billion in net debt).

We value shares, which yield an eyebrow-raising 6.4% as of this writing, at $38 each, and **we're adding the idea to the simulated High Yield Dividend Newsletter portfolio** in hopes of taking advantage of the attractive valuation, which has additional upside potential if long-term strategic moves pan out according to management's plan, while collecting some hefty dividend checks.

Legacy Business Breakdown

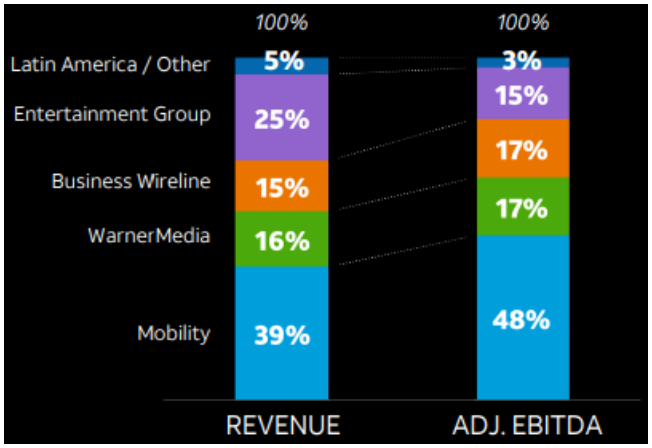


Image Source: AT&T investor presentation

AT&T's 'Mobility' segment is the core of its business as it accounts for 39% of revenue and 48% of adjusted EBITDA, and management points to solid revenue and EBITDA growth and a high quality phone subscriber base--it has 2.7 million smartphones added since the third quarter of 2017--as highlights of the business. In addition, it is confident in its position in the race to 5G as it is currently laying the groundwork for its next-generation network.

AT&T is looking for stability in terms of EBITDA performance in its 'Entertainment Group,' which is facing secular declines in its linear TV business but experiencing growth in its broadband business as strategic investments weigh on margins. The company is working to evolve its video product to fit the consumption habits of a new generation of consumers with its DIRECTV NOW offering, a mobility-focused WatchTV offering, an evolving content lineup with smaller, value-based video packages, and the lapping of its two-year price lock promotion in its traditional DIRECTV and U-verse offerings. Cost initiatives are also expected to help boost EBITDA performance.

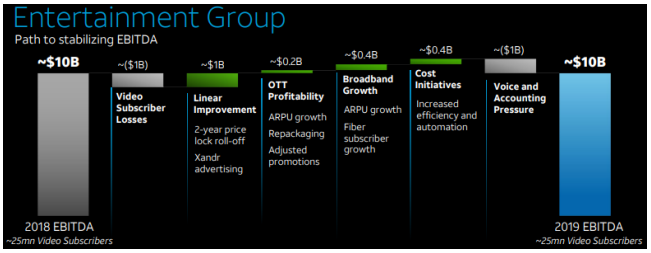


Image Source: AT&T investor presentation

'Business Wireline' is another business segment where AT&T is looking for stability in terms of EBITDA performance moving forward as it battles legacy revenue declines. Cost efficiencies are a key focus as it works to improve margin performance to offset the aforementioned top-line pressure. The FirstNet wireless broadband network dedicated to public safety is a highlight of the segment as it was able to operate at 90% or better of normal performance in areas affected by the recent impact of Hurricane Michael.

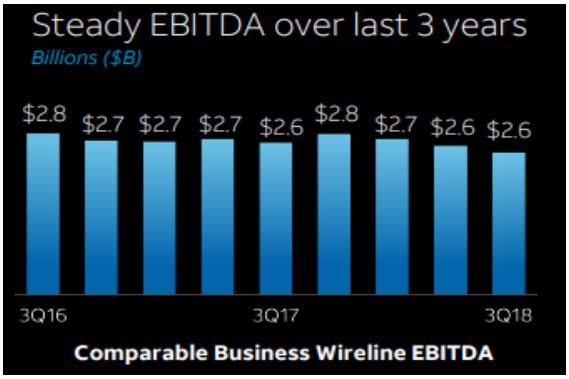


Image Source: AT&T investor presentation

WarnerMedia: A Netflix Killer?

AT&T's WarnerMedia business is critical to its future plans as a next-generation media conglomerate as the entertainment industry rapidly shifts towards digital consumption and spending, and it is planning to take Netflix (NFLX) head on. The company plans to launch a streaming service in beta in the fourth quarter of 2019 that will have three levels: 1) entry level focused on movies; 2) premium and popular original programming and blockbuster movies; and 3) a combination of the first two tiers along with an additional extensive library of WarnerMedia and licensed content.

Management believes this direct-to-consumer offering complements WarnerMedia's existing businesses well, is good for its distribution partners, will enable expanded reach and growing subscriber bases, and perhaps most importantly will capture data and analytics to inform new products and enable better monetization. This strategy is built around four key aspects of what should make for a successful new-age media business by growing engagement, penetration, average revenue per user, and the reach of AT&T as a whole, and its war with Netflix may come via a totally different strategy. The company may very well spend up for premium content, but it is focusing on pleasing advertisers, which may be a result of being able to observe and improve on Netflix's path, which was one built on pleasing the consumer with a low-cost subscription model.

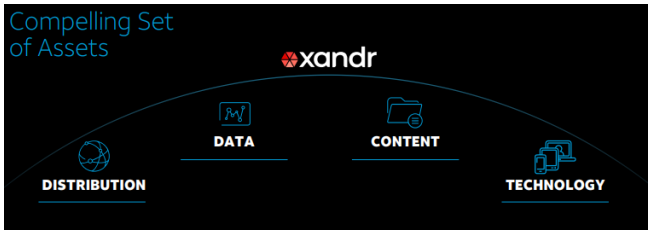


Image Source: AT&T investor presentation

AT&T is likely to begin pulling the content it now owns from Netflix as the contracts expire in coming years, giving it a leg up in creating original content or holding more leverage in negotiation with Netflix. Let's also not forget about the tearing down of net neutrality earlier this year, which may very well give AT&T another leg up as it offers its wireless customers the ability to stream DIRECTV NOW content on mobile devices without it counting toward data caps in mobile plans. Such deals are likely to only become more aggressive as we move forward, and consumers with wireless or home Internet service from AT&T may only find it increasingly more difficult to resist the new content avenue. While that number may not be enough to scare Netflix, the convenience and power of the packaging potential should.

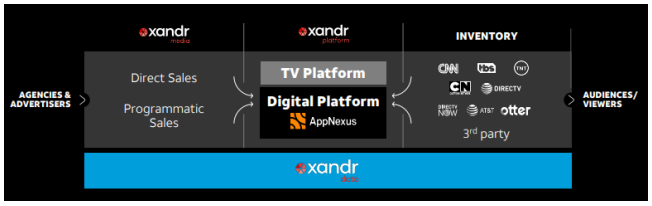


Image Source: AT&T investor presentation

AT&T is betting on its ability to take advantage of the explosion an evolution of advertising technology on its to-be-launched platform as it observes the underdevelopment of major players in premium TV and video. In the past, ads were bought on a limited number of platforms that had broad reach in hopes of hitting the targeted consumer, but since then digital advertising was born and an explosion of platforms have sent advertisers searching for the best avenue through which to find their targeted consumers. AT&T believes it has assembled the proper assets to deliver what advertisers want.

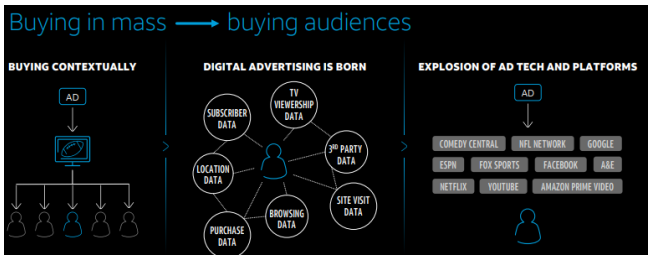


Image Source: AT&T investor presentation

In September 2018, AT&T formed a real-time advertising marketplace, xandr, for advertisers and publishers with relevant, automated, and measurable advertising capabilities. It will use the unique insights from its millions of video, mobile, and broadband customers to try to help these advertisers to deliver the right message at the right time on any device across its asset base. These data-driven insights will be combined

with real-time feedback on advertising campaign performance to only further optimize the reach of the advertiser. AT&T has the assets in distribution, data, content, and technology, but now it must find a way to scale the platform along with third parties. xandr currently has nearly $7 billion in annualized revenue.

Synergy Expectations and 2019 Outlook

	2019
FREE CASH FLOW	$26B range
DIVIDEND PAYOUT	High 50s %
NET DEBT TO ADJ. EBITDA	2.5x range
GROSS CAPITAL INVESTMENT[1]	$23B range
ADJ. EPS GROWTH %[2]	Low single digits

Image Source: AT&T investor presentation

AT&T continues to expect to realize $2.5 billion in total synergies from the Time Warner acquisition by the end of 2021 with $1.5 billion coming via cost synergies and another $1 billion via revenue synergies. Roughly $0.7 billion of these synergies are expected by the end of 2019, which helps drive its projections for adjusted earnings per share growth in the low-single-digits and free cash flow generation of $26 billion in the year. Management also expects to hit a payout ratio in the high 50s, which leaves enough wiggle room for it to leave the annual dividend at its current rate of $2.00, assuming it achieves its $3.50 adjusted EBITDA target in 2018.

BP Bets Big On Upstream Growth To Rise Above The Fray

Oil markets are once again seesawing, with WTI and Brent down roughly one-third since their early-October highs. BP plc (BP) is taking the necessary measures to ensure its 6.1% dividend yield remains safe during these turbulent times as the market anxiously waits for possible action from OPEC+.

Financial Overview

During the first nine months of 2018, BP generated $19.0 billion in net operating cash flow (including a $1.1 billion working capital build after adjusting for inventory holding gains and excluding $2.9 billion in Gulf of Mexico oil spill payments) while spending $10.7 billion on organic capital expenditures, $1.5 billion on acquisitions (this includes only $0.5 billion of BP's $10.5 billion purchase of BHP Billiton's (BHP) unconventional assets), $0.3 billion on share buybacks, and $5.1 in cash dividend payments to shareholders and non-controlling interests. All things considered, $19.0 billion in net operating cash flow was more than enough to cover $17.6 billion in total cash outlays. It is important to note, however, that a number of these outlays are one-time in nature, such as acquisitions, or at the complete discretions of management, such as share buybacks.

However, it is important to take into account BP's scrip dividend. During the first three quarters of 2018, BP issued out $1.1 billion in equity in lieu of cash payments to its shareholders. BP's is still covering total cash outlays with internally-generated cash flow after taking that into account (assuming those dividends would have been paid in cash), but it is also clear BP is just on the cusp being free cash flow positive. Due to the fickle nature of raw energy resource prices, BP's cash flow profile could easily become more untenable.

BP realized an average price of $66.11 per barrel of liquids (namely oil and condensate) sold during the first three quarters of 2018, up from $47.87 per barrel of liquids sold in the same period last year. As WTI and Brent prices have since crashed down to the $50s, BP's cash flow profile will undoubtedly face pressure and management will have to reassess its uses of cash. At last check, BP's Dividend Cushion ratio sat at 0.7,

indicating some risk remains, but the figure has improved in a material way in recent years.

Relief Regardless of Oil Prices Movements

One potential area of relief for BP, regardless of where energy resource prices end up, will come from smaller cash outlays relating to BP's Gulf of Mexico spill payments stemming from the 2010 disaster. Those payments drained $3.3 billion from BP's pre-tax operating cash flow during the first nine months of 2018, which was way above the forecast management released during the second quarter of 2017. After taking tax considerations into account, BP spent $2.9 billion on its Gulf of Mexico spill payments during the first nine months of 2018.

Management initially thought BP would spend $2.0 billion covering its Gulf of Mexico legal obligations in 2018, but due to the company recording an additional $1.7 billion charge in the fourth quarter of 2017, that guidance was no longer relevant. BP will spend $1.0 billion this year paying off the additional obligation, which is largely why the cash outlays have been higher than expected.

However, BP should see its cash outlays move significantly lower starting next year. In 2017, management forecasted that BP's Gulf of Mexico spill payments would move down to around $1.0 billion by 2019 on an annual basis. Management said this during BP's second quarter of 2017 conference call:

"Deepwater Horizon cash payments were $4.3 billion in the first half and are expected to be between $4.5-5.5 billion for the full year [for 2017]. Total Deepwater Horizon cash payments are then estimated to fall to around $2 billion in 2018, and to step down to a little over $1 billion per annum from 2019 onwards."

While this guidance may have changed somewhat due to the late-2017 charge, most of that additional obligation will already be paid off by 2019. This indicates that BP will likely save ~$2.0 billion in 2019 versus 2018, assuming management's forecast holds true. That won't necessarily be enough to offset a weaker crude oil pricing environment, but it is important to keep in mind that BP has ways to enhance its operating cash flow generation beyond simply hoping for the market to turn in its favor. However, readers should note that the payments related to the oil spill were excluded in the financial overview completed above.

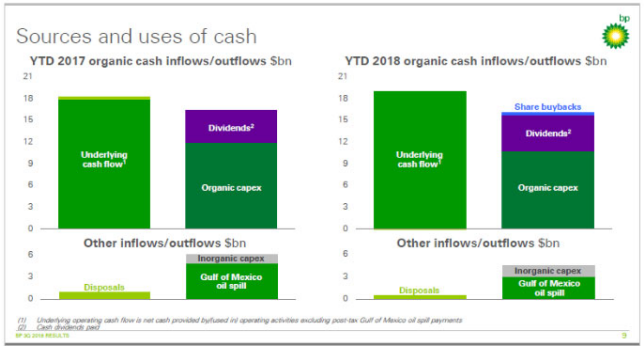


Image Source: BP plc presentation

Downstream Hedge

One of the biggest advantages large integrated oil & gas companies have over their smaller upstream-oriented peers is the ability to benefit from regional pricing differentials that often are the bane of upstream firms. A perfect example of this can be seen through the economics of BP's Whiting Refinery in Whiting, Indiana, which happens to be located right next to Chicago, IL.

After completing a major modernization project back in 2013, the refinery can now process up to 430,000 barrels of crude per day. More importantly, the refinery can process several hundred thousand barrels of heavy sour oil per day, the type of crude produced in Alberta's oil sands region. It is important to note that only complex refineries that have undergone extensive and expensive upgrades can handle heavy sour oil types (while simple refineries can handle light sweet oil volumes). Complex refineries have specialized equipment that can remove the high levels of sulfur from the refined petroleum products.

With that in mind, there is a huge difference between what heavy sour oil in Alberta is valued at compared to light sweet oil supplies in Cushing, Oklahoma (which forms the West Texas Intermediate benchmark). Heavy sour oil supplies in Alberta are valued based on the Western Canadian Select benchmark, which is trading at a $40 per barrel discount to WTI for January 2019 deliveries. While the futures curve indicates that the WCS-WTI differential will steadily decline to $28 per barrel by December 2019, it is worth noting that it was only a year ago that the differential was closer to $20 a

barrel (the WCS-WTI differential has traded between $10-20 a barrel over the past several years before the blowout in 2018).

As the Whiting Refinery has ample access to very cost-advantaged crude oil supplies, the asset tends to yield very strong crack spreads year-round. Petroleum product prices are heavily influenced by movements in Brent, so in this case, BP gets to have its cake and eat it too--the firm can buy cheap oil supplies yet sell petroleum products at prices based on an oil-pricing benchmark trading at a huge premium to WCS.

While gasoline crack spreads have been lackluster due to America (and other parts of the world) processing larger volumes of lighter oil grades (which created a glut in the gasoline market), diesel crack spreads have been quite strong for a similar reason (due to the world not having enough heavier crude types to refine to produce distillates). The Whiting Refinery can refine heavy oil into material amounts of kerosene due to the refinery running a heavier crude slate, which can then be converted to diesel and jet fuel.

Alberta's provincial government has taken several dramatic steps to reduce the WCS-WTI differential, a strategy that involves ordering rail cards and encouraging production curtailments in the oil sands patch, but even that can only go so far. Crude-by-rail transportation costs are significantly more expensive than pipeline transportation options. This means there will always be a wide WCS-WTI differential as long as the marginal cost of transporting oil from Alberta down to the US Gulf Coast via rail is around $20 per barrel. BP should continue to be a major beneficiary of the WCS-WTI differential, and has plans to further expand the refining capabilities of its Whiting Refinery.

BP has two other refineries in America; the 160,000 bpd BP-Husky Toledo Refinery in Ohio, which is a joint-venture between BP and Husky Energy (HUSKF), and the 236,000 bpd Cherry Point Refinery in Washington State. Downstream operations are a key way BP can offset the losses from a lower oil price environment as crack spreads tend to rise when feedstock prices move lower, but there are limits to this natural hedge.

Production Growth Resulting From Solid Operational Execution

BP has been excelling at operational execution, and that is why its oil & gas production has been steadily climbing upwards even in the face of large production decline from mature fields in its portfolio. Excluding production from Rosneft (RNFTF), BP has grown its oil & gas production from 2.2 million barrels of oil equivalent per day during the third quarter of 2015 to 2.5 million barrels of oil equivalent per day by the third quarter of 2018.

This organic production growth is the result of BP consistently bringing upstream projects online on-time and on-budget over the past few years. One of its biggest accomplishments was starting up the first phase of the Shah Deniz 2 development in July 2018, as natural gas supplies produced in the Caspian Sea started flowing to Turkey. Bringing this giant $28 billion project online on-time and on-budget is crucial to ensuring BP earns a decent return on its investment, and that commercial-sized gas deliveries to Europe can start-up in earnest by 2020 (when Phase 2 of the Shah Deniz 2 development is expected to be completed).

BP has also been able to bring several key projects online way ahead of schedule, such as the Atoll development in Egypt which came online seven months early in February 2018 for 33% less than expected. Another example of this can be found in the Gulf of Mexico, as BP completed the Thunder Horse expansion project four months ahead of schedule in October 2018 for 15% less than the expected.

As an aside, BP's share of Rosneft's production (BP owns just under 20% of Rosneft) is around 1.1 million barrels of oil equivalent per day. Higher oil prices in recent quarters have sharply increased Rosneft's contribution to BP's bottom line and cash flow generation.

BP's production trajectory looks very promising as production at its recently completed developments (especially the Shah Deniz 2 project) is ramped up and new producing properties are turned online. The Clair Ridge project reached first-oil in November 2018, and over the next two years will be ramped up to its peak production capacity of 120,000 barrels of crude oil production per day gross. BP recently increased its stake in the Clair oil field up to 45.1% after an asset trade deal

with ConocoPhillips (COP), making it entitled to a larger share of that upside.

There are numerous upstream growth developments currently under construction that BP has a large economic stake in. As BP's current slate of upstream growth projects stretches into the early-2020s, if not later, the recent uptick in its production levels isn't just a one-off event. Consistent oil & gas production growth is one big thing that differentiates BP from several of its peers who have struggled to maintain their production bases in the face of natural production declines.

Unconventional Additions to the Portfolio

BP has decided that in order to ensure the company can continue delivering on its production growth promises, it needs a sizeable stake in America's unconventional oil & gas industry. In order to get its foot in the door, BP purchased BHP Billiton's unconventional assets in America for $10.5 billion. That deal added 190,000 barrels of oil equivalent per day net to BP's production base. BP expects to realize $350 million in pre-tax synergies on an annual basis when the asset integration process is completed. Below is a look at the assets BP is acquiring (or has already acquired, as the deal was expected to close on October 31, 2018).

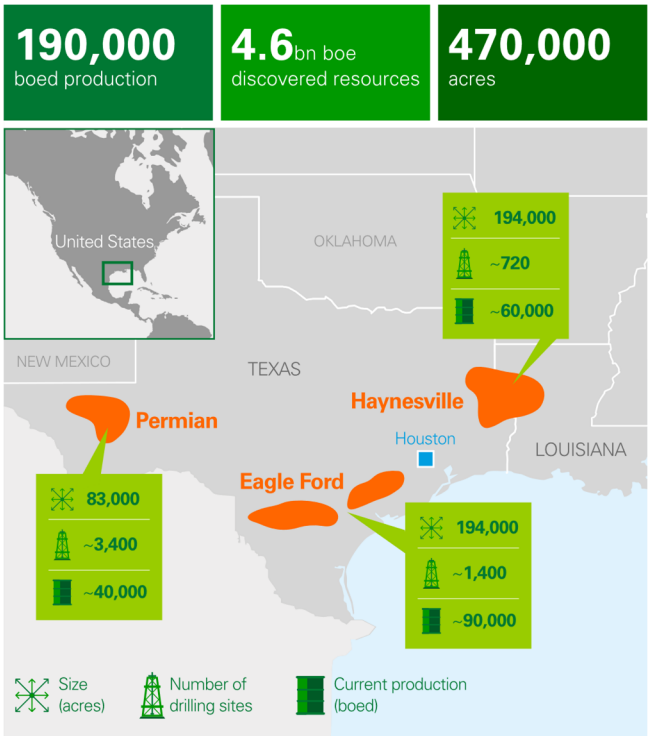


Image Source: BP plc

The Eagle Ford and Permian Basin assets are the real prizes here, with the Haynesville shale effectively representing a long-term call option on American natural gas prices. Upstream players have found that Eagle Ford and Permian wells can still earn a nice return when the operator is able to realize at least $50 per barrel of oil.

As oil produced in the Eagle Ford has access to ample pipeline takeaway capacity and Louisiana Light Sweet pricing, which fetches a nice premium to WTI, it would make sense for BP to ramp up development activity in the play if WTI stays above $50 a barrel.

Whether or not BP wants to aggressively develop its Permian Basin position is a different matter, as the company needs access to pipeline capacity that is still under construction. Management may delay ramping up BP's Permian production if oil prices don't improve, as the discount Permian oil production gets relative to WTI (known as the Midland-WTI differential) is expected to range between $5-9 a barrel for most of 2019.

Activity in the Haynesville shale depends on where Henry Hub goes as it is a natural gas play. Operational improvements and structural cost savings have reduced the natural gas price required to breakeven in certain parts of the Haynesville down to $2.50 per thousand cubic feet. That is on an incremental well basis, when including corporate-level costs, Henry Hub needs to trade at or above $3.25 per Mcf in order to encourage BP to increase its Haynesville production.

Concluding Thoughts

BP plc is not immune to the decline in oil prices, but it does have several ways to mitigate the negative impact on its cash flow generation. Reductions in its annual Gulf of Mexico legal payments, stronger performance at its downstream division, solid operational execution, unconventional development opportunities in Tier 1 plays (the Eagle Ford and the Permian Basin), and rising oil & gas production will help BP plc shore up its cash flow profile over the medium term in the face of potentially lower crude oil realizations.

That alone won't be enough as fiscal restraint is also required. Management has pledged to keep BP's capital

expenditures to around $15 billion on an annual basis when oil prices are low, and the company can utilize its scrip dividend program to reduce its cash outlays in the medium term.

BP plc is taking the necessary moves to ensure it can sustain its generous 6.1% yield in a volatile oil pricing environment. As BP plc pays investors to wait around until things turn around, readers should note a key geopolitical event is coming up that could create sizeable movements in BP plc's stock price and more importantly, its fundamental financial position.

The JMMC (Joint OPEC-non-OPEC Ministerial Monitoring Committee), the OPEC+ advisory body, recommended that the oil cartel should reduce their collective production levels by 1.3 million barrels per day (versus October 2018 levels) during their meeting on November 29, 2019. With OPEC+ gathering on December 6 to discuss whether or not to embark on another production curtailment deal, it is possible oil prices could recover after the recent downward movement. Of course, if there is no deal, oil prices could collapse which is a risk that always needs to be kept in mind.

Due largely to Saudi Arabia's need for Brent to trade around $80 a barrel to balance its budget, many analysts expect a product curtailment agreement will soon be reached. However, questions remain on whether or not Russia will get on board. Nevertheless, we expect BP to continue taking appropriate measures and controlling the controllable portions of its cash flow profile.

Disclosure: Callum Turcan, the author of this piece, owns shares of BP plc (BP) and Royal Dutch Shell plc (RDS.B)

Checking for Cracks in the Credit Markets

The Invesco Senior Loan ETF (BKLN), the largest passive vehicle backed by senior loans, has been in the spotlight in recent weeks due to it experiencing notable outflows of assets as investors reassess the credit markets.

The ETF has been included as an idea in the simulated High Yield Dividend Newsletter portfolio since its inception at the beginning of 2018 as a play against the impact of rising interest rates. It seeks to track an index (S&P/LTSA US Leveraged Loan 100 Index) comprised of loans with floating rate coupons, which are locked only until the next rate reset date (typically quarterly). These loans are often less sensitive to changes in benchmark interest rates than fixed rate bonds due to this periodic reset of interest rates.

Another attractive characteristic of senior loans is their high setting in the capital structure of companies, but default rates are quite low and falling for the time being. According to Moody's, October 2018's US high-yield default rate came in at 3.16%, which compares favorably to the 3.46% rate of October 2017, and the credit rating agency expects the rate to fall even further to an average of roughly 2.1% in the third quarter of 2019. Nevertheless, potential adverse liquidity effects for the high yield space should not be ignored should interest rates move significantly higher, which would shrink profits by boosting debt servicing costs among other important factors such as the impact on domestic spending levels.

We're not cutting bait with the BKLN at this time as greater clarity into how the Fed is thinking about recent developments in the US economy and financial markets is likely to be provided in its December meeting, which should bring a fourth rate hike for 2018.

However, let's dig a little deeper into what is at play in the credit markets that might be driving the changes in sentiment surrounding the senior loan group. Investors are now reassessing recent commentary that suggests the Federal Open Markets Committee (FOMC, or Fed) will meaningfully adjust the trajectory of interest rate hikes in December 2018 and 2019 from previous consensus of one more hike in 2018 followed by two to three hikes in 2019. A number of factors are driving

these concerns, and are worth monitoring as they relate to the performance of the BKLN, which falls from favor for some investors in the event the trajectory of interest rate hike forecasts are dialed back, and the health of the overall economy and financial markets.

Increased uncertainty surrounding ongoing earnings growth from US corporates has impacted financial markets, including volatility in equities and poor performance from low- and medium-grade corporate bonds, and if fears over such earnings compression gain steam, the upside for benchmark interest rates in the country may very well be skewed towards the downside of what is being expected after the Fed's seemingly dovish turn. Industrial commodity prices have faced decline more recently, most notably crude oil, and if this trend continues, it will likely only support a change to the previously held-consensus trajectory of the Fed's rate hikes.

One need look no further than late 2015 and 2016 for evidence of this as the ongoing rout in commodity prices of those years kept the Fed from raising interest rates between its December 2015 and December 2016 rate hikes. Uncertainty surrounding a potential renewed production cut agreement from OPEC and other major producers, namely Russia, has played a meaningful role in the jittery crude oil market of late, and the results of OPEC's December meeting will materially impact the trajectory of crude oil prices in the near term.

FOMC Chairman Jerome Powell recently indicated that he was confident in the trajectory of the US economy--we tend to agree at the moment--and that equity prices are one of many factors taken into account by his committee. However, in a less-than-direct fashion, Chairman Powell is likely taking equity prices, or perhaps better stated as the Fed policy's impact on equity prices, into material consideration. Said differently, the Fed is not making policy decisions with the future trajectory of equity prices as a target, but it must at least consider the ripple effect its policy does have as it relates to the wealth effect of equity prices.

The Fed is paying close attention to domestic spending levels, which if contracted enough could impact corporate profits significantly enough to raise debt repayment issues. It is also worth noting at this juncture that the support from US tax reform is beginning to fade. This resulting risk of such a debt-repayment problem may be greater at this point in time than it has been in decades as the amount of Baa grade bonds sits at a record amount, and Baa3 bonds, which is the lowest rung of investment grade corporate bonds on Moody's credit rating scale, are at a record high as a percentage of outstanding US high-yield bonds. The latter figure is at 56.8% as of November 15, which is notably higher than the 32.5% mark prior to the Great Recession in addition to being markedly higher than the downturns of the early 2000s and 1990s.

The important connection to be made with the record number of Baa3 bonds is that a material and prolonged contraction in corporate earnings may lead to a record number of credit rating downgrades from the lowest rungs of investment-grade to junk territory. This flooding of the speculative grade bond market would then coincide with a material increase in the high yield default rate as a result of a prolonged downturn in corporate earnings, and this combination would likely drive corporate credit spreads meaningfully higher, potentially weakening systemic liquidity. Investors need look no further than late last decade to observe the impact of materially weakened systemic liquidity.

One of those potential "fallen angels" in the Baa credit space is conglomerate General Electric (GE), which continues to make headlines as a result of concerns over its massive debt load. The company held ~$115 billion in total debt as of the end of the third quarter of 2018, a material portion of which it built as a triple-A rated credit, which it held as recently as 2015. The now Baa1 credit rating it holds is already in danger of a potential downgrade, perhaps even into junk territory, as the company continues to sell assets to shore up its financial leverage, but such a massively sized downgrade, both in terms of sheer amount of debt, systematic connections with a wide range of financial institutions, and publicity, could send ripples through the credit markets.

The heightened risk brought about by a record percentage of US corporate debt rated one notch above junk territory ultimately means that equities may be increasingly sensitive to rising interest rates compared to prior situations of similar ilk. This in turn means that while the Fed may not be directly concerned with the impact of its policy on equity prices, many of the factors that it considers go hand-in-hand with drivers of equity

prices. All things considered, if recent fears over the sustainability of future corporate earnings are more than a transient issue raised in the latter months of 2018, the upside for benchmark interest rates in the US is likely well below that of the recent consensus.

Yet another potential wildcard at play in the interest rate world is the potential influence of President Trump, who has publicly and harshly criticized Chairman Powell for what Trump perceived as Powell's role in the recent market sell-off and change of strategy at General Motors (GM). We would like to think that President Trump's comments have no impact on how the Fed looks at its policy for the future trajectory of interest rates, but the fact that such a reversal in its recent commentary took place so near to the timing of the criticism has us both second guessing that notion as well as concerned about the ongoing inflation of a potential bubble fueled by low interest rates.

We're keeping a close eye on the Fed's commentary as it relates to the factors outlined in the text above, both in terms of the near-term performance of the equity markets and the long-term health of the US economy. These are unprecedented times, a cliché that may always be true but reverberates even more so now, and we continue to urge investors not to rely on backward-looking data and analysis to form their opinions of the future. A number of the risks outlined in this one piece alone may not have been at play quite this simultaneously at any point in the history of modern finance, but that history can help shape how we look at the potential developments of the future, when applied appropriately. There is no "all else equal" in the real world, so keep your rear-view mirror clean and your thoughts looking ahead!

High Yield Earnings Roundup

AmeriGas Partners Finishes Fiscal 2018 on Solid Note

Simulated High Yield Dividend Newsletter portfolio idea AmeriGas Partners (APU) reported fourth quarter results for fiscal 2018 November 13, and the MLP expects to continue its recent momentum into its fiscal 2019. In the full fiscal year, adjusted EBITDA grew 10% on a year-over-year basis to $605 million thanks in part to a 4% rise in retail volume that was largely a result of weather being closer to normal compared to fiscal 2017, and a 19% increase in the average cost of propane was not enough to keep management from expanding retail margins slightly as higher volumes and cost efficiencies offset the negative impact of higher prices. The MLP added ~3,000 new locations to its retail business, and National Account volume grew 11% over fiscal 2017 levels.

AmeriGas delivered record volume and earnings results in its AmeriGas Cylinder Exchange (ACE) and National Accounts programs, and margins benefited from ongoing reduction of distribution costs, optimized delivery routing, and the deployment of technology-enabled solutions that enhance the customer experience. Investors must be aware, however, of the sensitivity of AmeriGas' business to prices of propane. Not only can higher propane prices eat into its margins, but higher propane costs also tend to make consumers more conservative and conscious of their use, which weighs on demand and top-line performance. The potential for unpredictable weather patterns to have a material impact on quarterly and/or annual performance is a key risk as well.

Looking ahead to fiscal 2019, AmeriGas expects adjusted EBITDA to be $610-$650 million based on normal weather patterns over the past 15 years, and adjusted earnings per share guidance for the fiscal year comes in a range of $2.75-$2.95 compared to $2.74 in fiscal 2018. Key drivers of earnings growth include another year of expected normal weather, utility customer additions and rate base growth, having a full year of its three recently acquired gathering systems in its 'Midstream & Marketing' segment, and continued growth in its 'International LPG' business and energy marketing. ACE and National account growth is expected as well, as is continued M&A activity, and management reiterates its ongoing use of technology to reduce operating costs.

As an MLP with a lofty payout, AmeriGas' distribution is dependent upon access to the capital markets as free cash flow of ~$309 million in fiscal 2018 came up short in covering cash distributions paid of ~$403 million in the year. We expect this access to remain sufficiently open in the near-term, though the aforementioned risks have the potential to impact this availability. Units of AmeriGas yield roughly 11% as of this writing, and 2018

marks the 31st consecutive year in which it has raised its payout.

Omega Healthcare Delivers on Expectations

Omega Healthcare (OHI) appears to have put the bulk of its material tenant-caused headaches behind it as management stated in its third quarter report, released November 5, that it expects to conclude the sale/transition process of its legacy Orianna facilities in the next few months. Shares of Omega have performed extremely well for most of 2018 after being punished in late 2017 and early 2018 as concerns over whether or not troubled tenants would cause it to cut its dividend. The company was forced to place Orianna on a cash basis, meaning it could not account for contractual rents until the cash was received, a sign of a severely troubled operator.

However, with each passing quarter, Omega reported progress in its transitions and sales of Orianna-operated facilities, and the REIT reiterated its 2018 adjusted funds from operations guidance in a range of $3.03-$3.06 in its third quarter report. With the declaration of a $0.66 fourth quarter dividend, Omega has delivered on the projection it made for maintenance of the payout at current levels when it issued guidance for the year, a projection many market observers met with great skepticism. Management expects to return to its historical growth model in 2019 as acquisitions are once again expected to outpace dispositions as it puts the Orianna situation in the rear-view mirror.

A notable degree of execution risk remains as Omega gets back to work in deploying capital from its disposition program in growth acquisitions, and the REIT believes that its labor costs and occupancy rates will continue to face near term industry headwinds. An aging demographic continues to bode well for Omega, and it expects the new patient driven payment model reimbursement model that will begin in 2019 will be a positive for the skilled nursing facility industry in the back half of 2019 and into 2020. We continue to like shares of Omega Healthcare, but its dividend remains dependent upon adequate access to capital markets. Shares yield ~7.1% as of this writing.

Public Storage Continues to Battle Supply Growth

Self-storage giant Public Storage (PSA) reported third quarter earnings October 30, and it continues to turn in low revenue growth as supply concerns persist. The REIT reported same store facilities revenues growth of 1.2% in the third quarter on a year-over-year basis, driven primarily by higher realized annual rent per occupied square foot as square foot occupancy for same store facilities fell by 60 basis points from the year-ago period to 94%. Higher property taxes helped drive cost of operations for same store facilities higher by 2.8%, but self-storage net operating income, which includes non-same store facilities, advanced roughly 2.1% on a year-over-year basis. Core funds from operations (FFO) advanced 3.4% from the year-ago period to $2.70.

After being relatively subdued for a decade or so, self-storage supply has ramped significantly since 2016 as development spreads have been favorable due in part to low interest rates. Management expects new supply coming onto the market in 2019 to be roughly equal to that of 2018, but it estimates that this figure is roughly double that of the amount of supply brought to market in 2016, which it believes is roughly double the average annual supply of the period of relatively subdued supply growth prior to that. It is important to note that the self-storage market is a very localized one, and supply/demand constraints can vary materially from market to market.

Shares of Public Storage are currently changing hands in the upper half of our fair value range, and its adjusted Dividend Cushion ratio, which gives it credit for continued access to the capital markets, sits at 1.4. Shares yield ~3.8% as of this writing.

Beware of GameStop's Massive Yield

Video game retailer GameStop (GME) boasts a double-digit dividend yield, but this is not by design. The company's share price continues to be punished as its business faces secular decline. While video game retailers may not be regular customers in the high-yield space, its story may very well be a good example of the pitfalls of chasing over-extended yields.

GameStop boasts a Dividend Cushion ratio of 1.7, but it is one of a select few cases where we override the

Dividend Cushion ratio and assign it POOR ratings for both Dividend Safety and Dividend Growth Potential. Its dividend coverage metrics and overall financial position appear to be healthy, but we have material concerns over the long-term sustainability of its business model. Shares yield an eye-popping ~11.6% as of this writing.

Management said it had a solid showing on the shopping holidays of Black Friday and Cyber Monday, but it slashed its fiscal 2018 (ends January 2019) guidance anyway as it expects fiscal fourth quarter performance to come up short relative to prior expectations. Renewed expectations for sales to skew more towards hardware than previously anticipated were cited as a key reason for the guidance reduction, along with weakness in pre-owned sales. This is especially concerning for a retailer as the quarter includes the make-or-break holiday season, and the overly promotional environment in the broader retail space, brought about in large part by the ongoing proliferation of online shopping, is only further weighing on bottom-line results.

Total sales and comparable store sales guidance for the fiscal year remained unchanged at a decline of 2%-6% and flat to down 5%, respectively, but adjusted earnings per share guidance now comes in a range of $2.55-$2.75 compared to $3.00-$3.35 previously.

The company's free cash flow generation (averaging ~$400 million from fiscal 2015-2017) has been more than enough to cover annual run rate cash dividend obligations of ~$155 million for now. However, GameStop has had to significantly cut back on capital spending, or investments in its business to fuel future growth, to maintain ample free cash flow generation as cash flow from operations fell by more than one-third from fiscal 2015 to fiscal 2017. Free cash flow generation also fell by more than 33% over that time period, and capital expenditures cratered by 34.5%. It holds a net debt position of ~$663 million as of the end of the third quarter of fiscal 2018 compared to a net cash position just a few years earlier.

GameStop has been and still is undergoing a strategic review, and management has suggested that no changes are off the table, which gives additional reason for yield-hungry investors to pause when considering a position in the company. It has already agreed to sell its Spring Mobile business, which owns and operates 1,289 AT&T wireless stores, for $700 million, and more asset sales may still be coming. The deal is expected to close in the fourth quarter of 2018, and proceeds may be used to repay debt, fund share buybacks, or reinvest in core video game and collectible businesses for future growth.

The strategic review is additional cause for concern due to the fact that a lofty dividend yield is often the first use of cash to be abandoned or cut in times when management is looking to hold on to excess cash. GameStop has no trouble covering its annual dividend obligations with its current free cash flow generation, but if management truly has its eye on the long term, a dividend cut may come before it is absolutely necessary, making the situation all the more difficult to navigate. There may be an opportunity to collect a few fat dividend checks prior to a potentially disastrous situation unfolding for yield-hungry investors, but the elevated risk is enough to keep us from considering the company for the simulated High Yield Dividend Newsletter portfolio.

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Disclosure: Brian Nelson and Kris Rosemann do not own any shares of any securities mentioned in this newsletter. Callum Turcan owns shares of BP. 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%	0.81	8.49%
Global X SuperDividend ETF	SDIV	5.0%	1.55	8.09%
Global X SuperIncome Preferred ETF	SPFF	10.0%	0.84	7.45%
iShares International Select Dividend ETF	IDV	5.0%	1.61	5.20%
iShares MSCI Australia ETF	EWA	5.0%	0.99	4.76%
iShares U.S. Preferred Stock ETF	PFF	5.0%	2.04	5.79%
PowerShares Senior Loan Portfolio	BKLN	5.0%	0.90	3.99%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	3.93	5.98%
EQUITY				
AmeriGas Partners	APU	5.0%	3.80	10.23%
AT&T ***NEW***	T	5.0%	2.00	6.40%
BP PLC	BP	5.0%	2.46	6.10%
Digital Realty Trust	DLR	5.0%	4.04	3.51%
Enterprise Products Partners	EPD	5.0%	1.73	6.59%
Iron Mountain	IRM	5.0%	2.44	7.18%
Magellan Midstream Partners	MMP	5.0%	3.91	6.46%
Omega Healthcare Investors	OHI	5.0%	2.64	6.96%
Public Storage	PSA	5.0%	8.00	3.75%
Realty Income Corporation	O	5.0%	2.65	4.13%
Tallgrass Energy LP	TGE	5.0%	1.86	8.71%
		100.0%		**6.36%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 11/30/2018.

HIGH YIELDING EQUITIES IN OUR COVERAGE UNIVERSE

Company Name	Symbol	Industry	Dividend Yield	ValueRisk	Div Growth	Div Safety	Div Cushion	Div Track Record	Leverage
Stonemor	STON	Personal Services	31.1%	VERY HIGH	VERY POOR	VERY POOR	-0.7	RISKY	HIGH
Hi-Crush	HCLP	Industrial Minerals	22.6%	VERY HIGH	NMF	NMF	NMF	NMF	HIGH
Golar LNG Partners	GMLP	Oil & Gas Pipelines	16.5%	MEDIUM	VERY POOR	POOR	0.8	HEALTHY	HIGH
Buckeye Partners	BPL	Oil & Gas Pipelines	14.5%	LOW	VERY POOR	POOR	0.9	HEALTHY	HIGH
Pier 1	PIR	Specialty Retailers	14.1%	VERY HIGH	NMF	NMF	NMF	NMF	MEDIUM
R.R. Donnelley	RRD	Commercial Services	12.9%	VERY HIGH	VERY POOR	VERY POOR	-7.1	HEALTHY	MEDIUM
Pitney Bowes	PBI	Commercial Services	11.2%	VERY HIGH	VERY POOR	VERY POOR	-2.1	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
ADA-ES Inc	ADES	Pollution Controls	10.5%	HIGH	NMF	NMF	NMF	NMF	LOW
Energy Transfer Partners	ETP	Oil & Gas Pipelines	10.5%	MEDIUM	VERY POOR	VERY POOR	1.3	HEALTHY	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
Centurylink	CTL	Telecom Services - diversified	10.1%	MEDIUM	VERY POOR	VERY POOR	-3.3	RISKY	HIGH
AmeriGas Partners	APU	Utilities	9.6%	LOW	VERY POOR	POOR	0.2	HEALTHY	HIGH
NuStar	NS	Oil & Gas Pipelines	9.4%	MEDIUM	VERY POOR	POOR	1.1	RISKY	HIGH
Vodafone	VOD	Telecom Services - diversified	9.2%	HIGH	VERY POOR	VERY POOR	0.0	HEALTHY	HIGH
Tupperware	TUP	Containers & Packaging	9.0%	MEDIUM	VERY POOR	POOR	0.8	HEALTHY	MEDIUM
Omega Healthcare	OHI	REIT - Healthcare	8.8%	MEDIUM	VERY POOR	POOR	0.8	HEALTHY	HIGH
Spectra Energy Partners	SEP	Oil & Gas Pipelines	8.6%	LOW	GOOD	GOOD	1.3	HEALTHY	HIGH
Vector Group	VGR	Tobacco	8.6%	MEDIUM	VERY POOR	VERY POOR	0.1	HEALTHY	HIGH
Holly Energy	HEP	Oil & Gas Pipelines	8.6%	LOW	EXCELLENT	GOOD	1.3	HEALTHY	HIGH
Spirit Realty	SRC	REIT - Retail	8.5%	VERY HIGH	NMF	NMF	NMF	NMF	HIGH
Western Gas	WES	Oil & Gas Pipelines	8.4%	MEDIUM	EXCELLENT	GOOD	1.7	HEALTHY	HIGH
Frontline	FRO	Shipping	8.2%	VERY HIGH	NMF	NMF	NMF	NMF	HIGH
CoreCivic	CXW	Management Services	7.9%	MEDIUM	VERY POOR	POOR	0.8	RISKY	HIGH
Limited Brands	LB	Retail - Men's, Women's, Kids' Apparel	7.8%	MEDIUM	NMF	NMF	NMF	NMF	MEDIUM
Costamare	CMRE	Shipping	7.6%	VERY HIGH	NMF	NMF	NMF	NMF	HIGH
DCP Midstream	DCP	Oil & Gas Pipelines	7.5%	MEDIUM	GOOD	GOOD	2.2	HEALTHY	HIGH
Iron Mountain	IRM	Commercial Services	7.4%	MEDIUM	VERY POOR	POOR	1.1	HEALTHY	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 ALPS ALERIAN MLP ETF (AMLP)

Company	Ticker	Weight	Credit Rating*	Dividend Yield
Magellan Midstream Partners LP	MMP	10.28%	Baa1	6.43%
Enterprise Products Partners LP	EPD	10.22%	Baa1	6.66%
Plains All American Pipeline LP	PAA	9.73%	Ba1	5.45%
Energy Transfer LP	ET	9.64%	NA	8.57%
MPLX LP	MPLX	9.44%	Baa2	7.55%
Buckeye Partners LP	BPL	4.45%	Baa3	9.92%
Western Gas Partners LP	WES	4.43%	Ba1	8.57%
EQM Midstream Partners LP	EQM	4.16%	Ba1	9.21%
Andeavor Logistics LP	ANDX	3.33%	Baa2 (UR)	11.02%
Tallgrass Energy LP	TGE	3.18%	Ba3	8.74%
DCP Midstream LP	DCP	3.08%	Ba2	9.07%
Spectra Energy Partners LP	SEP	2.98%	Baa2	8.47%
Phillips 66 Partners LP	PSXP	2.54%	Baa3	6.82%
Genesis Energy LP	GEL	2.45%	B1	9.83%
Antero Midstream Partners LP	AM	2.44%	Ba2	6.44%
Shell Midstream Partners LP	SHLX	2.39%	NA	8.06%
Enbridge Energy Partners LP	EEP	2.36%	Baa3	13.10%
NuStar Energy LP	NS	2.35%	Ba2	10.02%
EnLink Midstream Partners LP	ENLK	2.19%	Ba1	11.76%
TC PipeLines LP	TCP	1.67%	Baa2	8.40%

*Credit rating according to Moody's (UR) = Under Review
AMLP Expense fee 0.85%

DIVIDEND REPORT PAGE 2 – BP PLC (BP)

BP BP FAIRLY VALUED

Buying Index™ 7 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Neutral	$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.

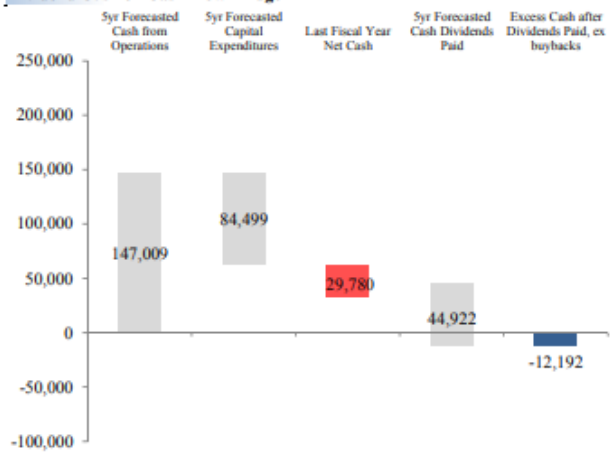
Graphical Relationship, Earnings and Dividends (per share)

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

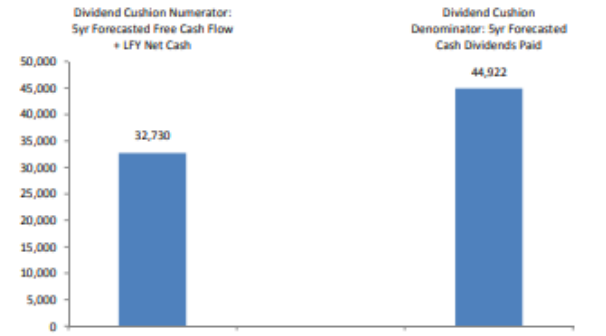


Source: Company Filings, Valuentum Projections

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)

Omega Healthcare OHI FAIRLY VALUED

Buying Index™ 4 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Attractive	$25.00 - $41.00	HEALTHY	POOR / 0.8	VERY POOR	8.77%

Assessment of Company Dividend Strategy

Key Strengths

Omega Healthcare is the largest skilled nursing facility focused REIT with nearly 975 operating facilities in its portfolio as of December 31, 2017. The company is currently slightly above its target leverage range of a debt-to-adjusted EBITDA ratio of 4x-5x, and it continues to aim for a target dividend payout ratio of less than 85% of adjusted funds from operations or less than 90% of adjusted funds available for distribution. The first quarter of 2018 marked the 22nd consecutive quarter of quarterly dividend increases, but it marked the end of the streak as management prudently sustained the payout. Adjusted funds from operations averaged ~$520 million annually from 2015-2017, slightly in excess of yearly run-rate cash dividend obligations of ~$503 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.

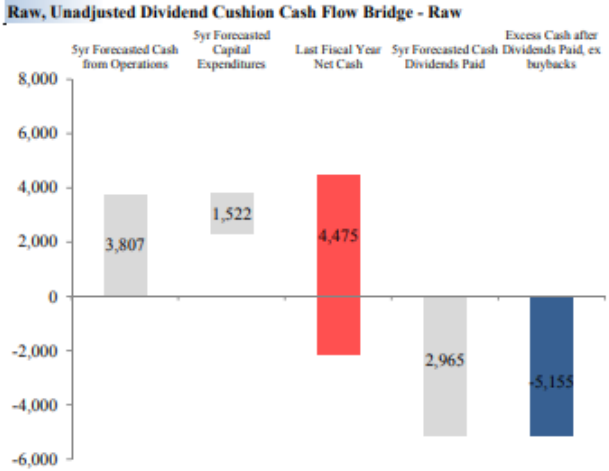
Graphical Relationship, Earnings and Dividends (per share)

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. Omega Healthcare'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

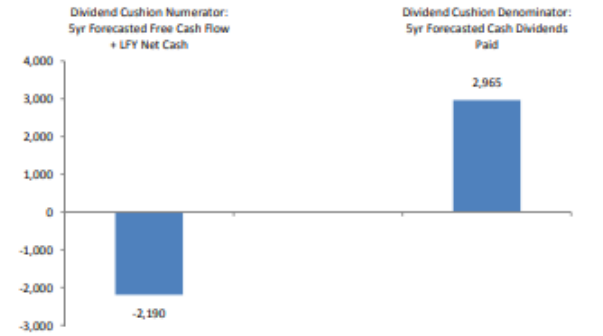


Source: Company Filings, Valuentum Projections

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, Omega Healthcare's numerator is smaller than its denominator suggesting weak dividend coverage in the future. The Dividend Cushion Ratio Deconstruction image puts sources of free cash in the context of financial obligations next to expected cash dividend payments over the next 5 years on a side-by-side comparison. Because the Dividend Cushion ratio and many of its components are forward-looking, our dividend evaluation may change upon subsequent updates as future forecasts are altered to reflect new information.

Raw, Unadjusted Dividend Cushion Ratio Deconstruction - Raw



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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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