Valuentum Securities, Inc. 7/1/2019 Edition 2, Volume 7

HIGH YIELD DIVIDEND NEWSLETTER

Something Irking in REIT-Land

Prior changes to simulated High Yield Dividend Newsletter
Added: 10% in Vanguard Real Estate ETF (VNQ)
Removed: Huge winner in Realty Income (O)
Watching: AT&T (T), Australia ETF (EWA) Iron Mountain (IRM), Schlumberger (SLB)

INSIDE THIS ISSUE

1 Something Irking in REIT-Land
2 Chevron's Permian Opportunity, Outsize Dividend Yield
5 National Resources' Improving Financials Contend Against Major Potential Downside Risks
9 **Spotlight: *NEW*** Royal Dutch Shell (RDS.A) (RDS.B) Posts Tremendous Cash Flow Improvement as Asset Base Transformed Post-BG Group Acquisition
14 Business Development Companies
21 **Value Trap Wins Awards!**
22 The High Yield Dividend Newsletter Portfolio
23 Screen of the Month – The Financially-Healthiest Dividend Payers Yielding Over 2%
24 Dividend Report Page 2 – Boeing Company (BA)

© 2019 Valuentum. All rights reserved. Reproduction by any means is prohibited.

THERE'S SOMETHING IRKING IN REIT-LAND. SOME ARE SAYING THAT IT IS BECAUSE THE FED WON'T BE AS AGGRESSIVE IN LOWERING RATES…BUT A DOVISH FED IS A DOVISH FED… WITH THE 10-YEAR TREASURY NOW ~2%, SOMETHING IS NOT LINING UP WITH THE REIT SECTOR'S PERFORMANCE." – BRIAN NELSON, CFA

Image Source: Vanguard REIT ETF (VNQ) has significantly underperformed the S&P 500 since mid-2015.

By Brian Nelson, CFA

REITs, as measured by the Vanguard REIT ETF (VNQ) can't seem to catch a break. Since the middle of 2015, they have significantly underperformed the broader market, and we would have expected the group to rally hard on more dovish Fed commentary in recent months, but the reality is the market is making new highs but REITs have swooned the past few weeks or so.

There's something irking in REIT-land. Some are saying that it is because the Fed won't be as aggressive in lowering rates as some had been expecting, but a dovish Fed is a dovish Fed. We can look to the mall REITs for some pockets of secular weakness, but with the 10-year Treasury now ~2%, something is not lining up with the REIT sector's performance. We're on high alert.

Aside from more diversified exposure in the Vanguard REIT ETF (VNQ), we have three ideas in the High Yield Dividend Newsletter portfolio that are REITs, namely Digital Realty (DLR), Iron Mountain (IRM) and Public Storage (PSA). Iron Mountain has hit somewhat of a rough patch since it reported results in April, Digital Realty is bumping up against all-time highs, and we love Public Storage's traditional free cash flow generation, but it seems investors are looking for new places for yield, albeit perhaps only on the margin.

It's not the master limited partnership (AMLP) area either. MLPs have been a bloodbath since we warned about the business model in mid-2015, and while we've identified some of our favorites, including Enterprise Products Partners (EPD) and Magellan Midstream (MMP), many investors have been shying away from the tax complexities of owning MLPs. The chart below shows how ugly the picture has been with MLPs in recent years, their performance on the bottom.

Image Source: The Alerian MLP ETF (AMLP) has vastly underperformed the S&P 500 since mid-2015.

We think many high yield investors have been focusing on other areas, and as we ramp up our idea generation for the back half of 2019, we plan to talk more about preferred's, closed end funds, mREITs and business development companies (BDCs). In fact, we welcome you on a deep dive on BDCs on page 14 of this newsletter. One of our favorite BDCs is Main Street Capital (MAIN), and we hope you have a read of this fascinating entity.

We're always available for any questions, and thank you for your membership!

Chevron's Permian Opportunity, Outsize Dividend Yield

Image Source: Chevron Corporation – IR Presentation

By Callum Turcan

Last year, the storied energy giant Chevron Corporation (CVX) produced 2.9 million barrels of oil equivalent per day on average and the company ended 2018 with 12.1 billion BOE in proved reserves on a net basis. Chevron's upstream production base climbed by 13% from 2016 to 2018 while its proved reserves increased 8% during this period, led by growth at its Permian Basin operations. Management intends on growing Chevron's downstream presence to support rising Permian crude oil volumes. We would like to draw attention to Chevron's Permian operations as we see that having an outsized influence on its growth trajectory. Shares of CVX yield 3.8% as of this writing and are trading modestly over the midpoint of our fair value range.

Texas-sized Ambitions

On May 1, Chevron completed its purchase of Petróleo Brasileiro S.A.'s (PBR) small Pasedena refinery in Texas for $0.35 billion (excluding working capital). As an aside, Brazil's state-run energy company is usually referred to as Petrobras. Chevron acquired the Pasadena refinery and its capacity to refine 110,000 barrels of light oil per day primarily to support its upstream production growth trajectory in the Permian Basin. Unconventional development opportunities in Southeast New Mexico and West Texas, where the Permian is located, are easily repeatable across several plays including the Wolfcamp, Avalon/Leonard, Bone Spring, Spraberry, and others.

Readers should keep in mind these plays are made up of shale (i.e. Wolfcamp), sandstone (i.e. Bone Spring), and other geological formations. As of its June 2019 update, Chevron had an economic interest in 2.2 million net acres in the Permian Basin, 1.7 million of which were prospective for those unconventional plays in the Midland and Delaware sub-basins. A combination of operated and non-operated development activity within the Permian is expected to add 0.5 million BOE/d to Chevron's upstream production base by 2023 from first quarter 2019 levels on a net basis. That's an enormous amount of raw energy resource production, a product of Chevron's upstream Permian volumes marching towards 1 million BOE/d net by the mid-2020s as you can see below.

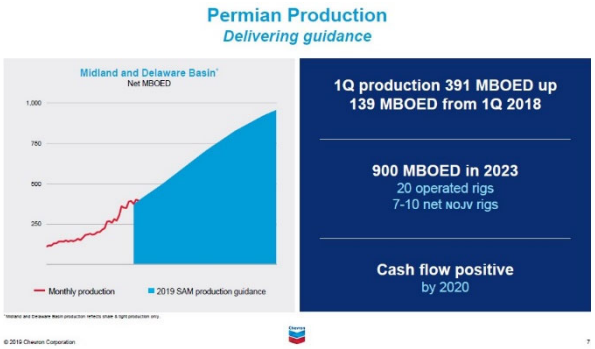


Image Shown: A vast well location inventory stretched across millions of acres in the Permian supports Chevron's upstream growth trajectory, which we see as powerful and large enough to have a very material impact on its company-wide results. Image Source: Chevron – IR Presentation

In America, Chevron now owns four refineries (including the Pasadena purchase) and two of those are situated in California. Those two Californian refineries receive crude produced in the state, volumes from Alaska, some domestic sources by rail, and international volumes delivered via marine vessel. Readers should keep in mind Chevron's downstream presence in California isn't set up to handle a meaningful amount or any volume from its Permian operations, those upstream volumes generally find their way down to the US Gulf Coast.

West Texas Light is a crude grade with a relatively high API rating (between 40 – 50) and a relatively low amount of sulfur by weight (less than 0.5%). Chevron needs refining capacity that can handle light sweet oil barrels as its unconventional Permian oil output falls within that category, but its California refineries are set up to process large amounts of heavier crudes (the type that is locally produced, which has much lower API ratings and greater concentrations of sulfur). For many reasons, Chevron cannot utilize its downstream presence in California to support its upstream Permian growth story. The Jones Act is another consideration, as that largely prevents Chevron from being able to economically ship oil by marine vessel from Texas to California (in summary, the Jones Act drives up domestic transportation costs by marine vessel if that vessel is moving from US port to US port).

Chevron's other American refinery is situated in Pascagoula, Mississippi. That facility has the capacity to refine 332,000 barrels of crude per day, making it substantial downstream asset if the crack spreads (refining margins) are cooperative. However, this refinery is out of reach of most of the oil pipelines directly servicing the Permian Basin and numerous other "hot" upstream plays (such as the Eagle Ford in Texas or the STACK/SCOOP in Oklahoma), meaning it doesn't have ample access to cost-advantaged crude supplies. The facility is dependent on more expensive sources of supply, relatively speaking, than refineries located in Texas. International oil volumes, domestic volumes by barge or rail, and other crude sources are likely used at the Pascagoula refinery (for competitive purposes, only so much information can be given regarding downstream operations). Most importantly, Pascagoula is out of reach of the Permian.

Not having a refinery that could easily tap into Chevron's growing Permian volumes represented the main impetus behind management deciding to acquire the Pasadena refinery. Note that the city of Pasadena is located right next to Houston along the US Gulf Coast, and that downstream operations in Texas tend to realize some of the strongest crack spreads in America. Particularly those with easy access to foreign markets.

America's pricing benchmark for crude oil supplies, West Texas Intermediate, trades at a material discount to Brent, which is the benchmark for international oil supplies. That differential stands at $7/barrel for August 2019 deliveries as of this writing. While oil barrels along the US Gulf Coast fetch better prices (based on Houston WTI or Louisiana Light Sweet pricing), selling

crude domestically usually isn't in an upstream company's best interests. By refining those volumes, Chevron is bypassing the WTI-Brent differential and capturing some nice downstream margin as well. Readers should be aware that the discount Permian oil volumes in West Texas receive relative to WTI, known as the Midland-to-WTI differential, has largely disappeared after ample new pipeline takeaway capacity came online over the past year. If that differential were to reappear, Chevron is now in a much better position to circumvent that potential downside risk.

Potential Downstream Expansion

Going forward, management noted that the Pasadena refinery is supported by its access to the Houston Ship Channel, 5.6 million barrels of storage tank capacity, interconnections to existing crude oil & refined product pipeline systems, and 143 acres of "vacant land" at or near the facility. Having access to the Houston Ship Channel enables Chevron to reach overseas markets where prices for refined products tend to be much stronger. Not only does this bypass the differential problem on the upstream front, but this new asset should provide a nice uplift to Chevron's downstream operations as the Pasadena refinery's crack spreads should be quite strong assuming it matches the performance of other refineries in the region.

Due to the sizable upstream oil volumes Chevron is pumping out of the Permian and the enormous amount of energy infrastructure either under construction or already operational in the great state of Texas, the Pasadena refinery has access to all the cost-advantaged crude and sources of demand that it could ever need. As this refinery supports a key part of Chevron's upstream growth story and offers it a great way to expand its downstream operations (which generate more consistent financial performance relative to the volatile performance of upstream operations), we would be very supportive of Chevron leveraging this new asset to generate additional growth opportunities. That could include Chevron investing in a new CDU, crude distillation unit, at the facility among other things to expand the crude throughput capacity of the Pasadena refinery. We caution that 110,000 barrels per day makes the facility relatively small.

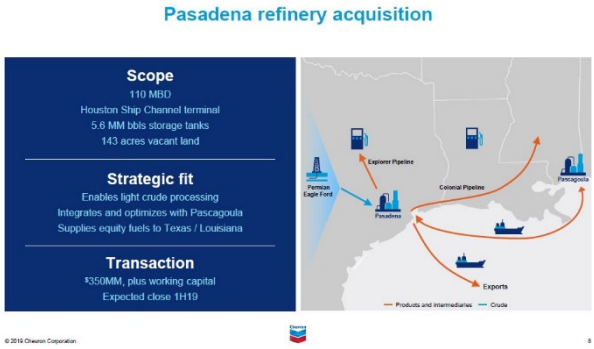


Image Shown: An overview of Chevron's new Pasadena refinery near Houston, Texas. Image Source: Chevron – IR Presentation

Exxon Mobil Corporation (XOM) is adding a third CDU to its Beaumont refinery, which is also in Texas, in a development that will add ~300,000 barrels per day in crude throughput capacity to the facility. Like Chevron, Exxon Mobil is pursuing this downstream expansion to both support its growing upstream operations in the Permian (where Exxon Mobil is a very big player) and capitalize on the strong economics Texas refineries can generate.

Permian crude oil production has skyrocketed since 2010, and we expect that to continue going forward based on current development plans, albeit at a slower pace. Combined with growing global demand for petroleum products, there appears to be more than enough room for several downstream expansions in the US Gulf Coast region (without ruining the current crack spread paradigm).

Financial Relevance

Chevron's net operating cash flow jumped from $12.7 billion in 2016 to $30.6 billion in 2018, largely due to a significant recovery at its upstream operations. In 2016, Chevron's domestic upstream unit posted a loss of $2.1 billion, which rebounded to a profit of $3.3 billion in 2018. Keep in mind we are referring to segment earnings here, which don't include material corporate-level costs. As a whole, Chevron's upstream income jumped from a $2.5 billion loss in 2016 to a $13.3 billion profit last year, with its international operations representing the bulk of that income.

Pivoting back to Chevron's domestic upstream operations. Rising crude oil prices were instrumental in this segment's recovery of course, but that shouldn't

cloud over how important rising Permian production volumes were as well. Those volumes tend to be quite economical, especially as large portions of Chevron's Permian acreage are either not burdened by royalties or those royalties are relatively modest. Some Permian upstream operators are forced to pay royalty owners 10 – 25% of the wellhead revenue (across the vast majority of their core acreage holdings), which can be very onerous in any oil price environment. Due to a combination of efficiency gains, cost reductions, economies of scale, and an enormous well inventory in the Permian Basin supporting strong production growth, we expect Chevron to continue growing its domestic upstream income generation capabilities over time at constant realized raw energy resource prices (keeping in mind that fluctuations in raw energy resource prices will always have an outsized influence over its financial performance).

From 2016-2018, Chevron's downstream income expanded 11% to $3.8 billion due to its domestic downstream income soaring 61% to $2.1 billion. Capitalizing on that success is a strategy we suport, and we expect Chevron to continue growing its domestic downstream income in the future as crack spreads allow. That growth will depend in part on Chevron expanding its crude throughput capacity, which ewe expect is quite likely within the medium-term (with an eye on potential developments at the Pasadena refinery).

Concluding Thoughts

Large oil & gas companies like Chevron are often sought after for their nice yields and promising growth prospects; however, the space has been undergoing a medium/long-term bust since late-2014. Chevron earned a return on invested capital, excluding goodwill, that was lower than its estimated weighted-average cost of capital in 2018 (its ROIC ex-goodwill were negative in 2016 and 2017). We don't expect that to change until fiscal 2020 at the earliest, under our baseline assumptions, but we do expect Chevron's financial performance (and returns) to improve materially through the early-2020s. That isn't enough to get use excited about Chevron's shares and its nice yield, but we are monitoring the space at-large.

Callum Turcan does not own shares of any company mentioned, but does own shares of BP plc (BP).

Natural Resources' Improving Financials Contend Against Major Potential Downside Risks

By Callum Turcan

Natural Resource Partners L.P. (NRP) – 5.1% yield – has seen its unit price crushed since 2011 as American coal production and consumption entered a period of terminal decline (especially for thermal coal). **We like the recent improvements in Natural Resource's financials but caution that operationally, there remains an enormous amount of potential downside risks readers need to be aware of. Units of NRP trade near the low end of our fair value range, but we think the market may be right with this one.** Natural Resource is a limited partnership that was founded in 2002 and focuses on domestic mineral rights, particularly for coal.

Overview

Natural Resource generated $279 million in revenue in 2018, down marginally from 2016 levels, while its GAAP net income attributable to common unitholders and the general partner rose by 13% during this period to $110 million.

However, due to aggressive dilution, Natural Resource's net income per share on a diluted basis dropped from $7.78 in 2016 to $6.76 in 2018. Natural Resource's income from continuing operations per share dropped from $7.28 to $5.90 during this period. **During the first quarter of 2017, Natural Resource had 14.9 million in weighted-average common units outstanding on a diluted basis, which surged to 20.2 million for the whole of 2018.**

In early-2017, Natural Resource issued out $250 million of a new 12.0% Class A Convertible Preferred Units along with warrants to purchase common units. The limited partnership also exchanged $241 million of senior notes due in 2018 for senior notes due in 2022 with a 10.5% coupon, which also entailed certain bondholders injecting $105 million into Natural Resource in return for additional senior notes. As the preferreds carried a coupon of 12.0% (half of which could be paid in addititional Preferred Units) while the

senior notes due 2022 carried a coupon of 10.5%, Natural Resource's cost of capital has historically been quite high.

Last year, 83% of Natural Resource's sales were generated by its 'Coal Royalty and Other' division with the remainder generated by its 'Soda Ash' division. **Keep in mind coal and coal-related acitivities represent the majority of Natural Resource's revenue.**

Natural Resource lumps together its coal royalties revenue with sales generated through overriding royalty interests in frac sand operations in Wisconsin and Texas (which likely are sand mines catering to the domestic oil & gas industry), overriding royalty interests in sand and gravel reserves in Washington, and revenue generated from its 51% stake in the BRP LLC joint-venture between Natural Resource and International Paper Company (IP). These operations don't appear to represent a material amount of that category's revenue.

At the end of 2018, the BRP JV owned 10 million mineral acres across 31 states, however, the "vast majority of those holdings "remain largely undeveloped" and no financial information was made readily available in either Natural Resource's or International Paper's 2018 10-K filings. BRP owns anything from mineral interests in oil & gas properties down in Louisiana to copper rights up in Michigan.

Coal Royalty and Other Segment

The following table represents the Partnership's Coal Royalty and Other segment revenues (including affiliates) by major source:

(In thousands)	Year Ended December 31, 2018
Coal royalty revenue	$ 129,341
Production lease minimum revenue	8,207
Minimum lease straight-line revenue	2,362
Property tax revenue	5,422
Wheelage revenue	6,484
Coal overriding royalty revenue	13,878
Aggregates royalty revenue	4,739
Oil and gas royalty revenue	6,608
Other revenue	1,837
Coal royalty and other revenues [1]	$ 178,878
Transportation and processing services revenue [2]	23,887
Total Coal royalty and other segment revenues	$ 202,765

Image Source: *Natural Resource Partners L.P.*

Natural Resource owns a 49% non-controlling interest in Ciner Wyoming, which consists of a trona ore mining and soda ash refinery in Wyoming's Green River Basin. Soda ash is used in the production of glass, paper, soaps, and detergents.

Ciner Resources L.P. (CINR) owns the remaining 51% interest in the Big Island Mine and Production Facility through its majority ownership of Ciner Wyoming, and acts as operator of the venture. Soda ash is a commodity that has a promising long-term trajectory, however, this only represents a sliver of Natural Resource's consolidated businesses.

Deleveraging Efforts

Near the end of last year, Natural Resource completed the sale of its construction aggregates business for $205 million, with those proceeds going towards deleveraging efforts. That move marked Natural Resource's exit from the construction aggregates business.

By the end of the first quarter of this year, Natural Resource had a net debt load of $475 million when defined as cash & cash equivalents less short- and long-term debt. At the end of 2017, that burden stood at $782 million so Natural Resource has shown meaningful progress on this front.

Moody's Corporation (MCO) upgraded Natural Resource's unsecured debt a speculative credit rating to Caa1 back in April 2019 with a stable outlook. As that remains well below investment grade, keep in mind Natural Resource still has a lot of work to do. Most importantly, Natural Resource has come a long way from its ~$1.1 billion net debt load at the end of 2016 but note that this deleveraging strategy was largely made possible through divestments and equity issuance.

When taking recent refinancing actions into account, management noted that Natural Resource had a consolidated debt to adjusted EBITDA ratio of 2.7x at the end of March 2019. For a firm with its level of risk, which we'll cover in a moment, we would like to see that move lower. Natural Resource issued out $300 million 9.125% Senior Notes due in 2025 to retire the aforementioned 10.5% Senior Notes due in 2022. Management is aggressively managing Natural Resource's maturity schedule in order to ensure the firm maintains enough liquidity.

We see Natural Resource's net debt load as manageable considering its net operating cash flow from continuing operations surged from $80 million in 2016 to $178 million in 2018 (averaged $124 million per year during

this period), while the entity doesn't have any material capital expenditures. Distributions to common unitholders and the general partner plus distributions to preferred unitholders came in at $53 million last year. Financially, Natural Resources is a mixed bag with upside but operationally, there are several major potential downside risks to be aware of.

Digging into the Weeds

Natural Resources' coal reserves are primarily located in the Appalachian Basin, the Illinois Basin, and the northern part of the Powder River Basin. **The US Energy Information Administration notes that American coal production declined in each of those three regions from 2014 to 2018, but the industry has experienced somewhat of a rebound since 2016 in terms of output.** Natural Resources was sitting on ~1.9 billion tons of coal reserves (proven plus probable) at the end of 2018, most of which is located in the Appalachian Basin. Keep in mind that 73% of those resources are represented by thermal coal, and the rest is metallurgic coal (we'll cover why that's an issue later).

Here is a quick breakdown of the nature of Natural Resources' coal royalty interests from its 2018 Annual Report. Note that Natural Resources' financials can be influenced by changes in commodity prices both in terms of realized price per ton of coal and in terms of production;

> *Under our standard royalty lease, we grant the operators the right to mine and sell our reserves in exchange for royalty payments based on the greater of a percentage of the sale price or fixed royalty per ton. Lessees calculate royalty payments due to us and are required to report tons of minerals removed as well as the sales prices of the extracted minerals…*
>
> *In addition to their royalty obligations, our lessees are often subject to minimum payments, which reflect amounts we are entitled to receive even if no mining activity occurs during the period. Minimum payments are usually credited against future royalties that are earned as minerals are produced… Because we do not operate any coal mines, our coal royalty business does not bear ordinary operating costs and has limited direct exposure to environmental, permitting and labor risks.*

Thermal coal is used by power plants as a fuel to produce electricity while metallurgic coal can be used to create good quality coke which is used in the production of steel. We caution that we are very pessimistic on the long-term outlook for thermal coal but are more optimistic on the long-term outlook for metallurgic coal.

It's unlikely that steel will become outdated for the foreseeable future, for the most part steel is one of civilization's essential building blocks, but there will come a time when thermal coal is no longer used in large quantities. There's a lot of debate on when that will be the case but what's known is that American coal production has fallen precipitously since 2008, declining by roughly a third according to the EIA. This is largely due to natural gas and renewables stealing away market share from coal in the power generation industry, and limits on how much coal America can export (some of those limits include local opposition at the ports that would handle those coal exports).

We expect natural gas and renewable energy sources will continue to steal away market share from coal in the domestic (and North American more broadly) power generation space while its unlikely exports would be able to pick up the slack (trade war concerns are one thing, local opposition to coal exports in cities home to major ports and shipping industries are another). Demand for metallurgic coal is largely cyclical and based on steel demand, with global infrastructure spending playing an outsized role.

Natural Resources gets most of its coal royalty revenue from metallurgical coal, even though almost three-quarters of its coal reserves are represented by thermal coal. Here is an excerpt from its first quarter 2019 earnings report;

> *Consistent with the prior year quarter, approximately 65% of NRP's coal royalty revenues and approximately 55% of its coal royalty production was derived from metallurgical coal during the three months ended March 31, 2019.*

Last year, Natural Resources' properties produced 27 million tons of coal in 2018, 54% of which was metallurgic. Using 2018 production figures as a baseline, Natural Resources' metallurgic coal reserves would last

for over 30 years. If production levels were to pick up, keep in mind those resources would deplete at a much faster pace.

Third-Party Risk

About one-tenth of Natural Resources' 'Coal Royalty and Other' revenue comes from coal transportation and processing assets, which are primarily located in the Illinois Basin. Natural Resources leases many of those facilities to Foresight Energy LP (FELP), which we view as a major risk due to Foresight Energy's very distressed financial state (weak current ratio, massive debt load), rising bankruptcy fears, and tanking stock price (the thermal coal miner received a listing warning from the NYSE). **If Foresight Energy goes under, that could adversely impact Natural Resources' financials in a meaningful way.**

In October 2018, a settlement was announced between Natural Resource and Foresight Energy that involved Foresight Energy paying Natural Resource $25 million among other things (such as extending and amending the terms of certain leases) "in consideration of disputed past due amounts." **We caution that Natural Resources is very exposed to Foresight Energy due to the coal miner representing a large portion of its coal transportation and processing revenue and a good chunk of its thermal coal royalty revenue.** The properties Natural Resource leased to Foresight Energy in the Illinois Basin produced 2.4 million tons of thermal coal last year.

Concluding Thoughts

While we appreciate Natural Resource's management team attempting to right the ship, particularly as it relates to deleveraging efforts, its exposure to thermal coal and the weak operators in this space pose a major risk to its medium- and long-term financial trajectory. We are staying far away from Natural Resource.

Disclosure: *Callum Turcan does not own shares in any of the securities mentioned above. Some of the companies written about in this article may be included in Valuentum's simulated newsletter portfolios. Contact Valuentum for more information about its editorial policies.*

High Yield Dividend Spotlight on Next Page >>

High Yield Spotlight: Royal Dutch Shell (RDS.A) (RDS.B) Posts Tremendous Cash Flow Improvement as Asset Base Transformed Post-BG Group Acquisition

Royal Dutch Shell plc (RDS.A) (RDS.B) --- 5.8%/5.7% yield, respectively --- has two class of shares with Class A shares subject to Dutch dividend withholding tax, while there is no Dutch dividend withholding tax on Class B shares. Please consult your tax specialist for additional information on the matter, as that is beyond the scope of this piece. **We want to draw your attention towards the Anglo-Dutch energy giant as the firm's financials have shown significant improvement since Shell's transformative acquisition of BG Group and its subsequent divestment program three years ago.**

> *"Higher oil and gas prices, combined with our ongoing work to improve the performance and competitiveness of our businesses, contributed to a sharp increase in cash flow from operating activities to $53 billion in 2018. We are on track with our outlook of annual free cash flow of between $30 billion and $35 billion by 2020, at a Brent crude oil price of $60 a barrel (real terms 2016). We delivered on our promises for the year, including completing our $30-billion divestment programme and starting up key growth projects, while maintaining discipline on capital investment. We paid our entire dividend in cash, further reduced our debt and launched our share buyback programme." - Ben Van Beurden, CEO of Royal Dutch Shell plc, comments made in Shell's 2018 Strategic Report*

Shell completed its ~$53 billion cash-and-stock purchase of BG Group in early-2016, which cemented the energy giant's position in Brazil's upstream space and Australia's liquified natural gas sector. That move saw Shell gain exposure to several significant offshore oil fields in Brazil, particularly within the Santos Basin.

As of February 2019, Shell's upstream Brazilian operations were supported by 15 FPSO (floating production storage offloading) facilities positioned across operated and non-operated oil & gas fields. Furthermore, the company noted that at least two additional FPSOs are expected to be brought online this year and next in Brazil (one of those will develop the Berbigão oil field as Shell acquired an economic interest in the field from BG Group). Including projects set to come online after 2020, Shell has an economic interest in seven additional upstream FPSO developments in Brazil. Readers should note that these are deepwater resources, located through at least ~5,000 feet of water and usually 10,000 – 20,000 feet of the Earth's crust. Shell's petroleum engineering expertise is essential to unlocking Brazil's upstream potential.

Shell and its partners that are participating in the Libra Producing Sharing Contract, which was signed back in December 2013, have big plans for the offshore Mero and Libra fields which are both covered by the Libra PSC. State-run energy firm Petrorbas (PBR) owns 40% of the venture and Shell has a 20% stake in the development. In late-2017, the *Pioneiro de Libra* FPSO with 50,000 barrels of crude production capacity per day started producing oil at the Libra field under an early phase production program.

By 2021, the first FPSO developing the neighboring Mero field is set to come online ("Mero 1"), with a near identical FPSO ("Mero 2") slated to be operational and producing hydrocarbons from the field by 2022. According to Shell, the Libra Consortium has eyes on four FPSOs developing the Mero oil field. The first two FPSO developments will have the capacity to produce 180,000 barrels of oil per day. Shell's Brazilian strategy should continue generating meaningful upstream growth through the mid-2020s and possibly beyond.

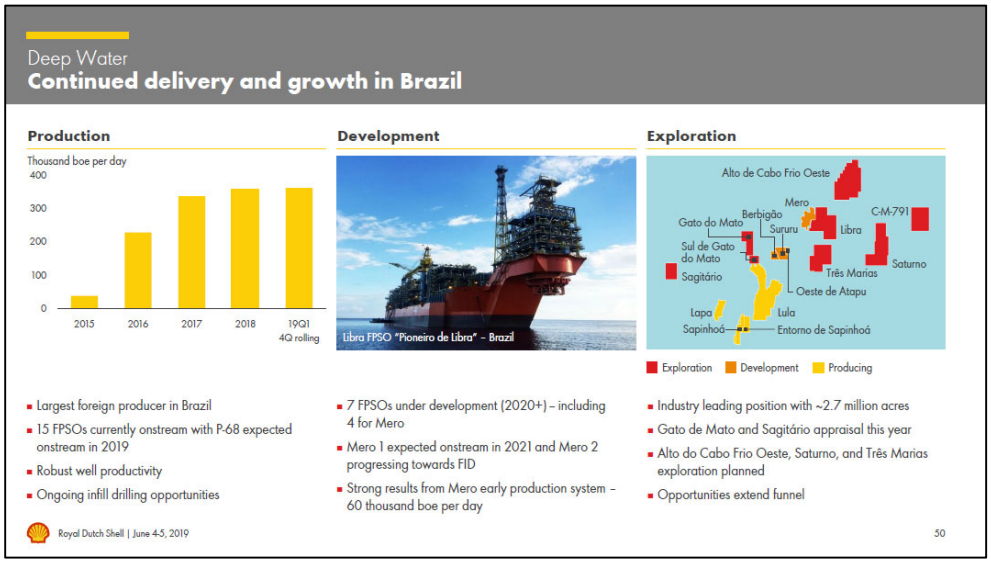


Image Shown: *Shell has aggressively grown its upstream Brazilian production since 2015, aided by its acquisition of BG Group.* ***Image Source:*** *Shell – June 2019 IR Presentation*

Pivoting to Australia, Shell has a material stake in the North West Shelf, Gorgon, and Queensland Curtis LNG export facilities. BG Group had a significant economic interest in the Queensland Curtis LNG export facility before being acquired by Shell. The energy giant's Australian LNG operations complements an extensive and growing natural gas portfolio, as Shell has economic interests in LNG export facilities and the related upstream operations all over the world.

Management is very optimistic on the long-term trajectory of the global natural gas market, particularly as it relates to demand for liquified natural gas. Going forward, Shell is taking lead at the Canada LNG project in British Columbia to meet expected demand growth in key Asian markets, particularly India, China, and Southeast Asia. That development, when completed, will have the capacity to export 14 million metric tons of LNG per year, which could be doubled in the future as market and geopolitical conditions allow.

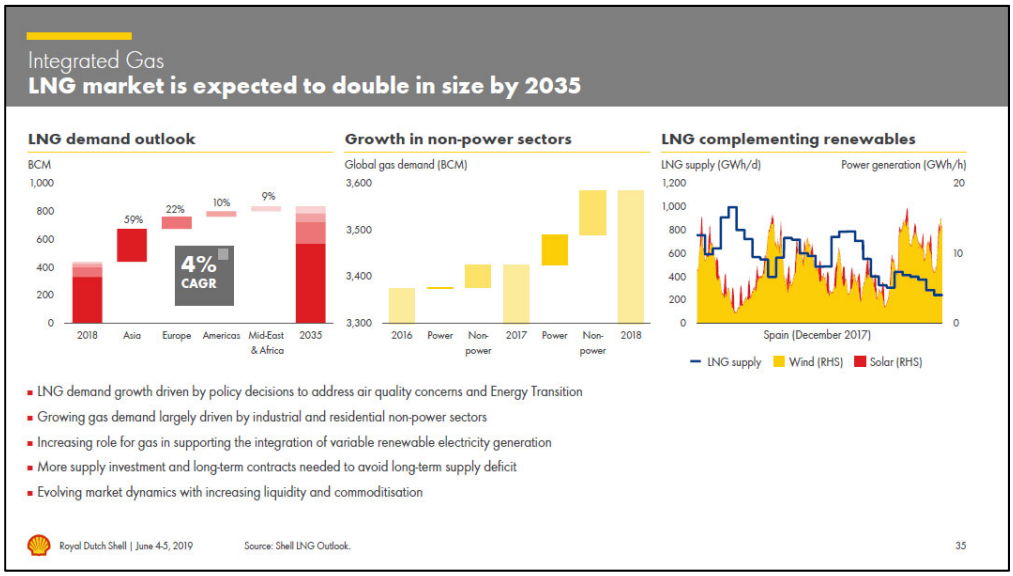


Image Shown: *Shell is very optimistic on the long-term outlook for global natural gas demand, which is expected to drive strong demand growth for liquified natural gas.* ***Image Source:*** *Shell – June 2019 IR Presentation*

To fund its purchase of BG Group, Shell divested ~$30.0 billion in what management deemed non-core assets from 2016 – 2018. Considering the sheer size of these asset sales, it's apparent that the purchase of BG Group and subsequent divestment program could be better described as Shell trading away operations no longer deemed attractive for better opportunities. So far, we are seeing the positive effects of its integration process and divestment program show up in Shell's financials in the form of better cash flow generation. Readers should note that Shell's asset sale program saw it divest most of its oil sands business in Canada, upstream operations in Denmark, Ireland and Norway, LNG assets in Malaysia, and numerous other ventures as you can see below.

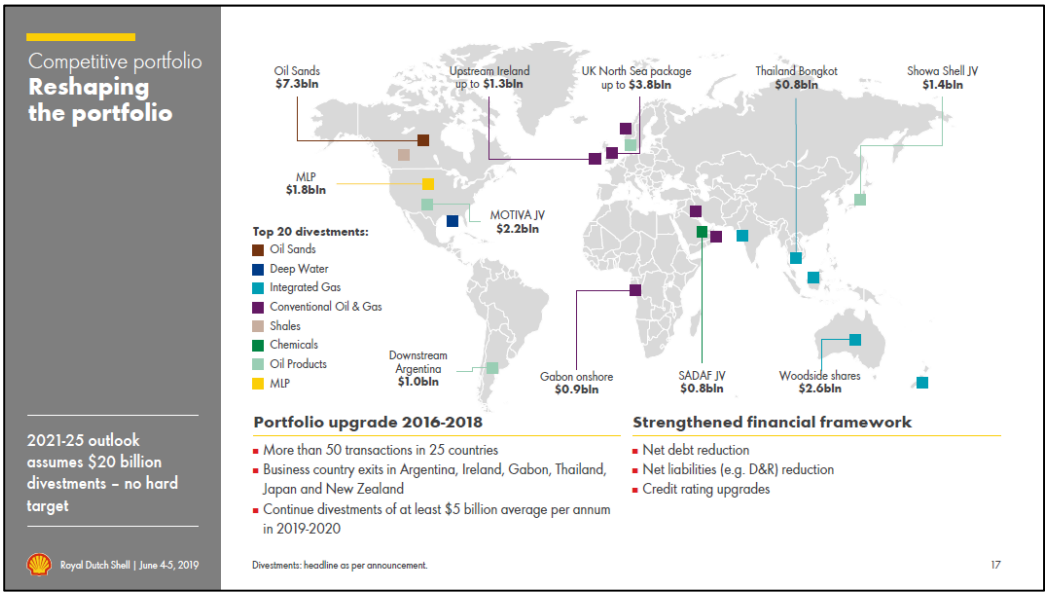


Image Shown: *Shell divested assets all over the world to help cover its purchase of BG Group.* ***Image Source:*** *Shell – June 2019 IR Presentation*

A combination of higher raw energy resource prices, a better asset base, and operational improvements brought on by the oil price bust of late-2014 (i.e. lower third-party rates for oil field services, reduced labor cost, well productivity gains, cheaper designs for large conventional projects, etc.) saw Shell's net operating cash flow surge from $20.6 billion in 2016 to $35.7 billion in 2017, climbing all the way up to $53.1 billion by 2018. Shell's capital expenditures averaged $22.0 billion during this three-year period, with the company spending $23.0 billion in 2018, allowing for $31.1 billion in free cash flow last year.

Cash dividends paid to common shareholders came out to $15.7 billion last year, on top of $3.9 billion in common share buybacks. **These capital allocation decisions were easily covered by free cash flow. Some excess cash was added to the balance sheet, a move we are supportive of.** Management intends to complete Shell's current $25.0 billion share buyback program by the end of 2020, but we caution that we would be more supportive of additional deleveraging activities first. $7.5 billion of that program had been completed as of May 25, 2019, according to a note made in Shell's June 2019 IR presentation.

Shell is investing heavily in conventional projects and is less at risk of the "shale treadmill" than some of its peers. The shale treadmill is the result of high production decline rates (as high as 70% in the first year) from horizontal wells that are hydraulically stimulated (known colloquially as "fracking"), forcing upstream operators to continuously invest more and more each year to offset those declines. While net operating cash flow growth may be quite easy to generate, the required capital expenditures to maintain that production makes free cash flow much harder to realize.

That isn't to say that there aren't unconventional upstream opportunities out there worth pursuing, the Permian comes to mind (particularly for a handful of energy majors that bought in cheaply many years ago and aren't burdened by onerous royalties), but we want to stress that Shell's corporate profile is one built around long-life assets. Shell has exposure to the unconventional upstream space, including a nice foothold in the Permian, but that remains a relatively small part of its company-wide upstream profile for now. There doesn't appear to be much demand from Shell to pursue a splashy shale purchase;

> *"And I appreciate the heightened level of interest of potential acquisitions in the shale space given all the activity. At this point in time, I really don't want to signal anything with respect to appetites nor potential structures. Anything would be speculative and not necessarily helpful. If anything arises at the right moment in time, we will let you know.* ***I think that the important thing is to signal that we – as I said, we're committed to our financial framework, we've got the right portfolio today, we don't need to do M&A. If we do it, it will be value accretive and it will be within the context of our financial framework.****" – Jessica Uhl, Shell's CFO, during the first quarter 2019 conference call*

Going forward, Shell plans to divest another $5.0 billion in assets this year and next in order to help further its ongoing deleveraging program while also buying back shares. Last April, Shell announced that it was selling its stake in the offshore Caesar Tonga field in the US Gulf of Mexico for almost $1.0 billion. In June, Shell put out a press release stating it was selling a handful of Albertan gas fields and the related sour gas processing plants for ~$0.15 billion according to the Financial Post. At the end of March 2019, Shell had $21.5 billion in cash & cash equivalents on hand versus $15.4 billion in debt coming due within a year and $77.2 billion in long-term debt, good for a net debt position of $71.1 billion (only down marginally from $73.3 billion at the end of 2016). Here is another key excerpt covering why Shell's deleveraging strategy may look less effective at first glance than expected (for reference, Shell's net debt load stood at $50.1 billion at the end of 2018);

> *"****Our gearing increased, as mentioned earlier, from 21.9% to 26.5% in line with our expected increase as a result of the accounting change. We now recognize operating lease liabilities on the balance sheet, resulting in higher debt and capital employed and, therefore, increasing the quoted gearing percentage.*** *And while our gearing might fluctuate from quarter-to-quarter, the underlying trend on gearing is moving in the right direction, and we're progressing towards our 20% target on a pre-IFRS 16 basis or 25% on a post-IFRS 16 basis." – Shell's CFO during the firm's first quarter 2019 conference call*

Moody's Corporation (MCO) reaffirmed Shell's investment grade credit rating at Aa2 with a stable outlook back in March for its unsecured debt. The recent uptick in global oil prices combined with lower global interest rates should help Shell manage that burden, but again, we would be more supportive of additional deleveraging over share buybacks.

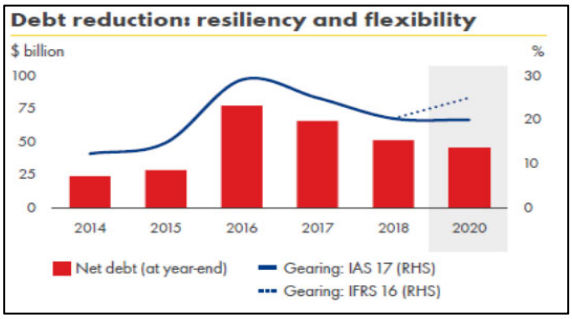


Image Shown: *A look at Shell's deleveraging strategy over the past few years.* ***Image Source:*** *Shell – June 2019 IR Presentation*

By 2020, Shell aims to be in a position to generate $30 - 35.0 billion in free cash flow assuming Brent averages $60 per barrel. Management expects Shell's capital expenditures to come in at $25 – 30.0 billion in 2019 – 2020, indicating the company is targeting roughly $60.0 billion a year in net operating cash flow at $60 Brent. That roughly 13% more net operating cash flow than Shell generated last year, keeping in mind that fluctuations in raw energy resource prices and working capital movements make any forecast relating to the performance of an oil & gas company highly speculative. As of this writing, Brent stands at ~$65 for September 2019 deliveries and there's room for upside due to recent geopolitical events.

We like Shell's improving free cash flow profile and deleveraging efforts. Its dividend is well protected, but we caution that Shell's financials would become strained in the event of a prolonged period of very low raw energy resource prices due to its hefty net debt load. **Further deleveraging efforts will be supported by expected divestment proceeds and free cash flow generation, especially considering the OPEC+ cartel has indicated the group wants to extend current production curbs through at least the end of 2019.**

Saudi Arabia and Russia signaled at the G-20 summit in Japan late-June 2019 that they were supportive of a six to nine month extension of the current deal that at full compliance would remove 1.2 million barrels of daily oil production off the market (compliance has been exceeding that due in part to outperformance from Saudi Arabia). Combined with ongoing production declines at Iran and Venezuela, the global oil market is getting a lot tighter and that should work in Shell's favor. Add in an accommodating lower interest rate environment, vastly improved asset base due to a multi-year transformation, and Shell's income potential looks intriguing.

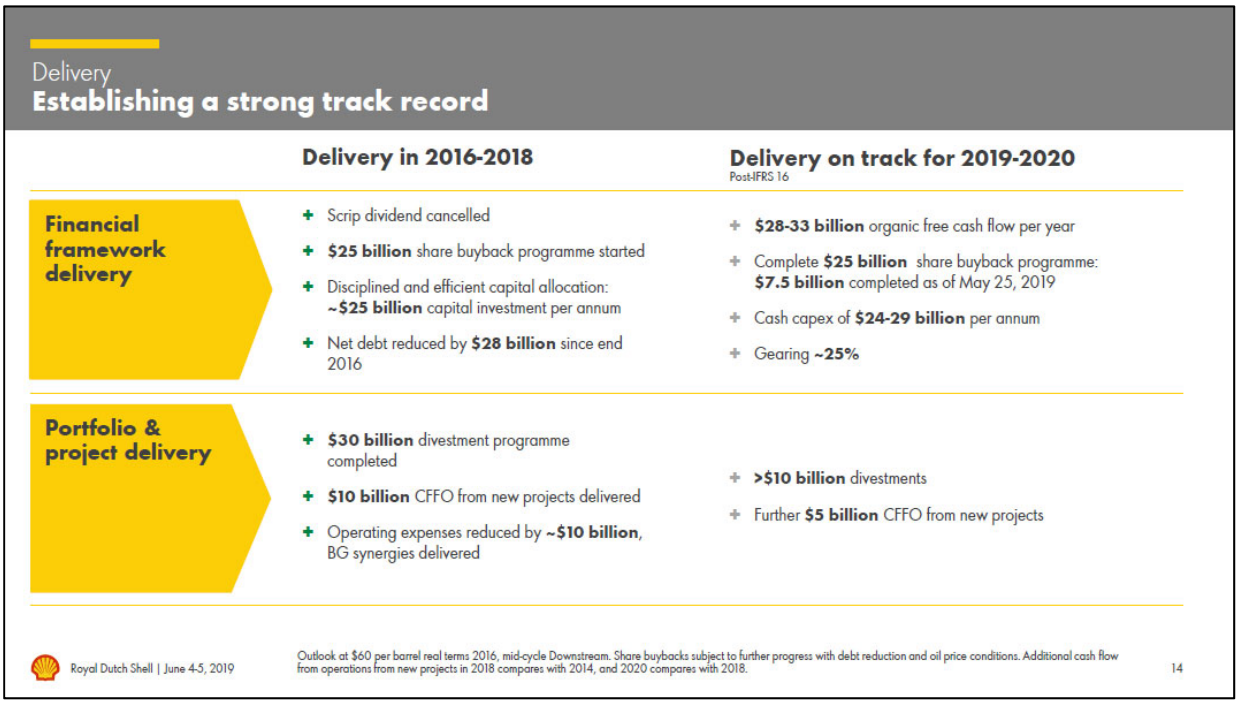


Image Shown: *Shell's long-term goals and recent events that are material to its capital allocation decisions.* ***Image Source:*** *Shell – June 2019 IR Presentation*

Disclosure: *Callum Turcan does not own shares in any of the securities mentioned above. Contact Valuentum for more information about its editorial policies.*

What About BDCs?

By Matthew Warren

Business Development Companies, or BDCs, are often considered by dividend investors as a result of their quite sizable dividend yields, as compared to the overall market. **In this piece, let's take a look at how these companies operate and then also compare some important metrics between the various players.** First, let's looks at the upcoming slide from Prospect Capital, which highlights some important differentiating features of BDCs.

PROSPECT CAPITAL

PUBLICLY TRADED BDCs

TOPIC	KEY CHARACTERISTICS
INVESTMENT STRATEGY	► Current-yielding credit investments primarily in middle-market companies ► To a lesser extent, other current-yielding investments
REGULATION	► Regulated as a Business Development Company ("BDC") under Investment Company Act of 1940 ► Generally BDCs elect to be treated as a Regulated Investment Company ("RIC") for U.S. federal income tax purposes
INVESTMENTS LIMITATIONS	► Generally, at least 70% of a BDC's assets must be investments in U.S. non-financial sector operating companies that either have (a) no class of securities listed on a national securities exchange (i.e., private) or (b) a market cap less than $250 million
LEVERAGE LIMITATION(1)	► 1:1 debt-to-equity ratio (i.e. gross asset coverage must be at least 200%)
DIVERSIFICATION REQUIREMENTS(2)	► At least 50% of a BDC's assets must consist of securities of an issuer in which the BDC owns less than 10% of the voting stock and in which the investment is less than 5% of the value of the BDC's assets
INCOME RESTRICTIONS(2)	► At least 90% of BDC income must be from investment sources such as interest, dividends, and gains / losses associated with investments in equity, debt, or other securities
DISTRIBUTION REQUIREMENTS(2)	► Must distribute at least 90% of taxable income to avoid U.S. federal income tax on all taxable income ► Not subject to U.S. federal income tax on the income and net capital gains distributed to stockholders (provided that the above distribution requirement is met)
VALUATION	► Must mark portfolio to fair value on a quarterly basis for GAAP(3) purposes

(1) Effective 3/23/2018, the Small Business Credit Availability Act permits a BDC to change its asset coverage ratio from 200% to 150%.
(2) Above criteria apply to BDCs that elect RIC treatment for U.S. federal income tax purposes
(3) GAAP is defined as Generally Accepted Accounting Principles.

27

Image Source: *Prospect Capital Investor Presentation*

Importantly, please know that you will need to consult a tax professional to determine how to treat the various dividends and return of capital from BDCs. Let's take a look at this graphic down below from Prospect Capital, which highlights the growth in BDCs over the past 10 years of mostly benign economic conditions.

PROSPECT CAPITAL

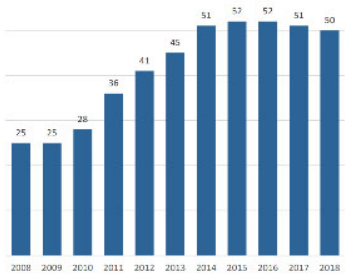
BDC PUBLIC MARKET LANDSCAPE

BDCs are benefitting from the reduction of capital provided by traditional lenders

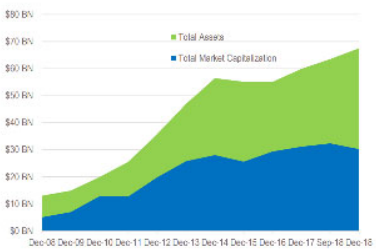
► Reduced bank lending driven by regulation and consolidation

► Post-crisis shift of institutional debt investor demand to larger credits with greater liquidity

Number of Public BDCs



Public BDC Group – Total Assets and Market Cap



Source: SNL

28

Image Source: *Prospect Capital Investor Presentation*

So, what exactly are BDCs? Business Development Companies are closed end investment vehicles that invest primarily in loans primarily to middle market companies. When you look at the asset side (left hand side) of the balance sheet, you will see first lien loans primarily for most of the BDCs, but you will also see second and subordinated debt in some portfolios. You will sometimes see preferred stock, structured debt, and quite often you will see equity investments that are paired with debt capital provided to the portfolio companies. When all goes to plan, the equity holdings serve as an upside kicker as the portfolio company successfully deleverages or otherwise gains in value. These gains are important in that they also can help offset credit losses on other portfolio holdings that go wrong.

Essentially, it is my view that BDCs are a bit like banks on steroids. Since they don't have deposits, the right-hand side of the balance sheet is comprised of bank lines of credit, subsidized SBA loans, bonds, and equity capital. Historically, BDCs have been leveraged one time, but that rule was just recently relaxed to allow BDCs to now be leveraged up to two times. In fact, many of the BDCs we looked at are in the process of going lower risk on the asset side of the balance sheet by holding more first lien loans and they are making the case to increase leverage as per the new rules. Increased leverage could easily equate to increased risk, so this is something to watch as the industry landscape is currently undergoing an experiment in increased leverage.

Back to the characterization of BDCs as banks on steroids. While banks have very low cost of funds due to low cost deposits, Business Development Companies average cost of borrowing looks like it is in the 5 and change percent range – MUCH higher than that of banks. They also earn MUCH more on their liabilities than banks do. The weighted average yield on BDC portfolios is most typically in the range of 10 and change percent. So how do you get such a juicy yield lending to what are usually claimed to be high quality portfolio companies. The answer is that the vast bulk of the capital lent by BDCs is for the purpose of management or leveraged buyouts or recapitalization of the balance sheet (swapping in debt to pay out special dividends on equity.)

In fact, most deals are sourced through Private Equity sponsors or Wall Street firms, while others result from a more direct relationship with the companies. Quite often, the portfolio companies are lent to over and over again. So, one can picture, that they are levered up to be bought out or to pay out to existing shareholders. The companies then hope to successfully deleverage their balance sheet, only to go through the same process all over again. This is a way for owners of middle market companies to strip equity value out of a company up front and then hope for the best as the company must then negotiate the economic and competitive landscape while carrying leverage which is usually in the ballpark of 5 and change times Debt/EBITDA and with EBITDA interest coverage of only 2 and change times. What does this mean in terms of risk and reward? Let's just say that for those that choose to invest in a BDC for their high yields, significant fear and stress will enter the equation if a severe recession or depression were to come along.

One can picture the revenue of the portfolio companies broadly declining in such a severe economic environment. With operating leverage, the income and cash flow hits are typically amplified. Interest coverage would drop and some portfolio companies would face debt distress. The equity holdings would be dented and wiped out first and then comes restructuring or bankruptcy. **More junior debt positions could easily be wiped out and senior loans might be restructured into lower value instruments or even converted into equity in the restructured company. Fear of these things coming to pass had BDC shares absolutely tanking during the Global Financial Crisis (GFC).**

The Federal Reserve obviously took rates down to zero, which along with other rescue efforts by the Treasury and Congress in the form of TARP bank recapitalizations, helped prevent the worst from actually coming to pass. Nonetheless, it took years for many BDC shares to recover to pre-crisis levels, and some never did recapture those previous lofty levels. In fact, I would state rather simply that owning Business Development Company shares carries an implicit bet against a depression from happening ever again. Buyer beware.

With that key risk laid bare, what are the characteristics of the soundest Business Development Companies? The best BDCs are well run with seasoned teams of leaders, deal originators, underwriters, legal, accounting, tax, and compliance. The best teams know how to identify a high-quality company that can handle such enormous debt loads through most environments that could occur.

They study the management team, competitive advantages, and study the fundamental risks the portfolio company faces. They lead deals instead of simply participating in syndicated deals. They set the terms of the loan along with the portfolio company and any sponsors. They know how to judge risk versus reward when investing. They take sizable equity stakes in portfolio companies alongside the loans. They assist the portfolio companies much like a private equity sponsor would do, and actually help to make portfolio companies better and stronger. The portfolios of the best BDCs are extremely diversified so that no one portfolio company gone wrong can dent the earnings and dividend power of the BDC itself.

If I were to pick one Business Development Company to highlight, it would be Main Street Capital (MAIN). Let's go through some of the most important metrics below to see why they bubble up to the top in terms of BDC quality. First off, you can see in the graphic down below that MAIN operates with a lean operating expense structure. Just as with a bank, this is important in terms of translating revenues into earnings and dividends.

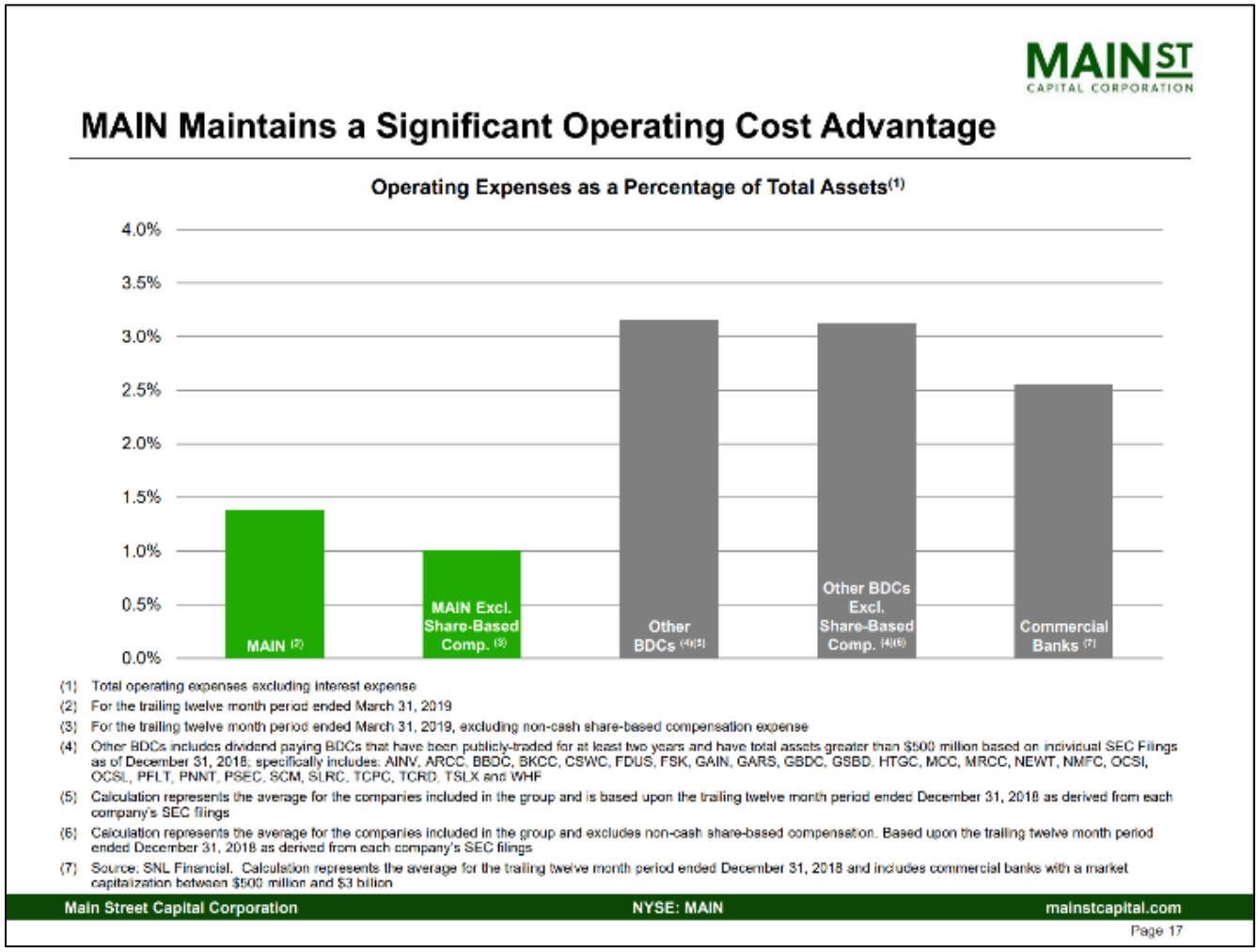


Image Source: *Main Street Capital Investor Presentation*

As you can see in the next graphic, MAIN's percent of economic profits paid to management is significantly lower than most of its peers. You can also see in the below graphic that the management teams of some BDCs are really hoarding much of the value creation they are able to generate!

MAIN ST CAPITAL CORPORATION

MAIN Maintains a Significant Operating Cost Advantage

BDC Manager Costs Relative to Total Economic Benefit Generated *(dollars in thousands)*

Dividend Paying BDCs Public for > 3 Years[1,4]	Management Structure	5 Year Total[1,2,3] Net Increase in Net Assets (Net Income)	Add back: Compensation and Adjmt Fees	Gross Economic Benefit Before Management Costs	% Economic Profits Paid to Management
MAIN	Internal	$ 682,919	$ 102,815	$ 785,734	13.1%
Apollo Investment Corporation	External	407,167	406,904	814,071	50.0%
Ares Capital Corporation	External	2,969,000	1,487,752	4,456,752	33.4%
Barings BDC, Inc.[4]	External	(37,457)	116,602	84,145	138.6%
BlackRock Capital Investment Corporation	External	103,133	124,608	227,041	54.7%
Blackrock TCP Capital Corp.	External	281,341	120,208	401,549	29.8%
Capital Southwest Corporation	Internal	222,833	39,074	261,907	14.9%
Fidus Investment Corporation	External	186,435	87,877	268,312	32.8%
FS KKR Capital Corp	External	1,083,663	450,566	1,534,229	29.4%
Garrison Capital Inc.	External	26,658	51,524	78,182	65.9%
Gladstone Investment Corporation	External	179,189	63,647	242,836	26.2%
Goldman Sachs BDC, Inc.	External	143,878	87,995	231,873	37.9%
Golub Capital BDC, Inc.	External	369,641	155,777	525,363	29.6%
Hercules Capital, Inc.	Internal	338,303	154,376	492,679	31.3%
Medley Capital Corporation[4]	External	(116,165)	137,873	21,708	634.9%
Monroe Capital Corporation	External	74,166	54,168	128,334	42.2%
New Mountain Finance Corporation	External	371,919	208,496	580,415	35.9%
Oaktree Specialty Lending Corporation[4]	External	(88,836)	303,037	214,201	141.5%
Oaktree Strategic Income Corporation	External	32,724	42,043	74,767	56.2%
PennantPark Floating Rate Capital Ltd.	External	136,322	45,533	181,855	25.0%
PennantPark Investment Corporation	External	228,899	180,900	409,799	44.1%
Prospect Capital Corporation	External	1,321,490	1,097,305	2,418,795	45.4%
Solar Capital Ltd.	External	360,653	164,283	520,936	31.6%
Stellus Capital Investment Corporation	External	89,856	57,171	147,027	38.9%
THL Credit, Inc.	External	63,634	83,228	146,862	56.7%
TPG Specialty Lending, Inc.	External	431,201	196,496	627,697	31.3%
WhiteHorse Finance, Inc.	External	139,794	95,413	235,207	40.6%
Peer Group Average[3]					38.2%

(1) Source: Public company filings
(2) Amounts represent the most recent five prior fiscal years ended for each respective company. For each applicable BDC not > 5 years past IPO, the first full fiscal year-end post-IPO was used as the starting point for this analysis as follows: FSK – 2015; GSBD – 2016 and TSLX – 2015.
(3) Includes all BDCs with total assets greater than $500 million as of December 31, 2018, with the exception of NEWT, which is excluded due to the non-traditional nature of their business plan and operations compared to most BDCs
(4) Peer Group Average excludes the effect of companies that had a net decrease in net assets which would significantly affect the overall average calculation; Peer Group Average would be 70.8% including these companies

Main Street Capital Corporation NYSE: MAIN mainstcapital.com
Page 18

Image Source: *Main Street Capital Investor Presentation*

You can also see in the upcoming graphic that Main Street Capital has been able to grow its dividend stream better than most of its peers. The dividends are also covered by Net Investment Income, speaking to the sustainability of the payout.

MAIN ST CAPITAL CORPORATION

MAIN Strategy Consistently Produces Differentiated Returns

Historical Monthly Dividend Growth and Coverage of Monthly Dividends with Earnings[1]

Dividend Paying BDCs Public for > 5 Years[2]	Monthly Dividends Per Share 2013	2014	2015	2016	2017	2018	5-YR CAGR	3-YR CAGR	Coverage? 2018 NII / Mo. Dividend
Main Street Capital Corporation	**$1.86**	**$2.00**	**$2.10**	**$2.18**	**$2.24**	**$2.30**	**4.29%**	**3.00%**	**113.4%**
Apollo Investment Corporation	2.40	2.40	2.40	2.25	1.80	1.80	-5.59%	-9.14%	98.9%
Ares Capital Corporation	1.52	1.52	1.52	1.52	1.52	1.54	0.26%	0.44%	105.8%
Barings BDC, Inc.	2.16	2.16	2.16	1.89	1.65	0.43	-27.50%	-41.61%	-0.3%
BlackRock Capital Investment Corporation	1.04	0.94	0.84	0.84	0.75	0.72	-7.09%	-5.01%	92.3%
BlackRock TCP Capital Corp.	1.43	1.44	1.44	1.44	1.44	1.44	0.14%	0.00%	110.3%
Capital Southwest Corporation	0.20	0.20	0.10	0.21	0.88	1.53	50.22%	148.25%	83.5%
Fidus Investment Corporation	1.52	1.52	1.54	1.56	1.56	1.56	0.52%	0.43%	91.1%
Garrison Capital Inc.	1.05	1.40	1.40	1.33	1.12	1.07	0.38%	-8.57%	94.3%
Gladstone Investment Corporation	0.63	0.72	0.74	0.75	0.77	0.80	4.92%	2.56%	20.3%
Golub Capital BDC, Inc.	1.28	1.28	1.28	1.28	1.28	1.28	0.00%	0.00%	100.8%
Hercules Capital, Inc.	1.11	1.24	1.24	1.24	1.24	1.24	2.24%	0.00%	96.4%
Medley Capital Corporation	1.46	1.48	1.20	1.04	0.70	0.46	-20.63%	-27.36%	27.9%
Monroe Capital Corporation	1.36	1.36	1.40	1.40	1.40	1.40	0.58%	0.00%	112.0%
New Mountain Finance Corporation	1.36	1.36	1.36	1.36	1.36	1.36	0.00%	0.00%	88.0%
Oaktree Specialty Lending Corporation	1.15	1.03	0.69	0.72	0.41	0.37	-20.29%	-18.82%	122.8%
Oaktree Strategic Income Corporation	N/A	1.00	1.30	0.90	0.76	0.60	N/A	-27.93%	114.6%
PennantPark Floating Rate Capital Ltd.	1.04	1.08	1.13	1.14	1.14	1.14	1.85%	0.44%	99.2%
PennantPark Investment Corp.	1.12	1.12	1.12	1.12	0.82	0.72	-8.46%	-13.69%	107.4%
Prospect Capital Corporation	1.28	1.33	1.05	1.00	0.93	0.72	-10.87%	-11.94%	120.6%
Solar Capital Ltd.	2.20	1.60	1.60	1.60	1.60	1.63	-5.82%	0.62%	108.7%
Stellus Capital Investment Corporation	1.36	1.25	1.36	1.36	1.36	1.36	0.01%	0.00%	104.4%
THL Credit, Inc.	1.43	1.36	1.36	1.29	1.08	1.08	-5.46%	-7.40%	98.8%
WhiteHorse Finance, Inc.	1.17	1.42	1.42	1.42	1.42	1.42	3.90%	0.00%	85.7%
Peer Group Average							**-2.13%**	**-0.60%**	**90.4%**

(1) Sources: Yearly dividends per share from individual company website, does not include supplemental dividends
(2) Includes all BDCs with total assets greater than $500 million as of December 31, 2018

Main Street Capital Corporation NYSE: MAIN mainstcapital.com
Page 23

Image Source: *Main Street Capital Investor Presentation*

In the graphic down below you can see that Main Street outperforms most of its peers in total return whether looking at NAV/share change plus dividends or total share price return plus dividends. These higher than peer returns reflect the quality of Main Street. This quality is also reflected by the fact that MAIN trades at a higher premium to NAV and lower dividend yield than most of its peers. **Main Street's superior performance has not gone unrecognized by the market. One benefit of this is that the BDC can issue shares at a premium to NAV when it needs the capital to grow.**

MAIN ST CAPITAL CORPORATION

MAIN Strategy Consistently Produces Differentiated Returns

Total Shareholder Returns are Better Indicator of Economic Value Creation for Shareholders

Dividend Paying BDCs Public for >2 Years[1]	Total Shareholder Return - Economic Value: Net Asset Value Per Share Beg[2]	12/31/18	Increase (Decrease) in NAV Per Share	Distributions Paid Per Share 2011-2018[3]	NAV Change Plus Distrib Per Share	Avg Ann'l Return as a % of Beg NAV[4]	Total Shareholder Return - Market Value: Closing Trading Price Per Share Beg[2]	12/31/18	Increase (Decrease) in Market Price	Distributions Paid Per Share 2011-2018[3]	Mkt Price Chg Plus Distrib Per Share	Avg Ann'l Return as a % Beg Mkt Price[5]
MAIN	13.06	24.09	11.03	19.48	30.51	29.2%	18.19	33.81	15.62	19.48	35.10	24.1%
Apollo Investment Corporation	29.19	19.08	(10.18)	19.05	8.89	3.8%	33.21	12.40	(20.81)	19.05	(1.76)	-8.7%
Ares Capital Corporation	14.92	17.12	2.20	12.30	14.50	12.1%	16.46	15.54	(0.92)	12.30	11.40	8.5%
Barings BDC, Inc.	12.09	10.98	(1.11)	16.62	15.51	16.0%	19.00	9.01	(9.99)	16.62	6.63	4.4%
BlackRock Capital Investment Corporation	9.62	7.07	(2.55)	7.27	4.72	6.1%	11.05	5.29	(5.77)	7.27	1.50	1.7%
BlackRock TCP Capital Corp.	14.71	14.13	(0.58)	8.88	8.25	9.3%	14.74	13.04	(1.70)	8.88	7.18	8.1%
Capital Southwest Corporation	34.21	18.43	(15.80)	4.80	(11.00)	-4.0%	9.33	13.22	3.89	4.80	16.70	19.0%
Fidus Investment Corporation	14.90	16.47	1.57	11.52	13.09	12.6%	12.57	13.69	(1.28)	11.52	10.24	11.3%
FS KKR Capital Corp.	9.83	7.84	(1.99)	3.37	1.38	3.5%	9.79	5.18	(4.61)	3.37	(1.24)	-3.2%
Garrison Capital Inc.	15.16	10.52	(4.64)	7.37	2.73	3.6%	13.88	6.43	(7.45)	7.37	(0.08)	0.1%
Gladstone Investment Corporation	9.09	12.53	3.53	5.54	9.47	13.1%	7.65	9.32	1.67	5.54	7.21	12.4%
Goldman Sachs BDC, Inc.	18.57	17.25	(1.32)	5.40	4.08	7.2%	19.00	18.38	(0.62)	5.40	4.78	8.4%
Golub Capital BDC, Inc.	14.74	15.97	1.23	10.69	11.92	10.1%	17.12	16.49	(0.63)	10.69	10.06	7.3%
Hercules Capital, Inc.	9.30	9.90	0.60	9.16	9.76	12.6%	10.35	11.05	0.69	9.16	9.85	13.9%
Medley Capital Corporation	12.57	5.61	(6.96)	7.05	0.09	0.8%	10.40	2.66	(7.74)	7.05	(0.69)	0.1%
Monroe Capital Corporation	14.54	12.66	(1.88)	8.32	6.44	7.4%	14.83	9.60	(5.23)	8.32	3.09	3.5%
New Mountain Finance Corporation	13.60	13.22	(0.38)	10.33	9.95	10.2%	13.43	12.56	(0.88)	10.33	9.45	9.9%
Oaktree Specialty Lending Corporation	10.44	6.19	(4.25)	6.83	2.58	3.1%	12.14	6.23	(7.91)	6.83	(1.08)	-1.1%
Oaktree Strategic Income Corporation	13.20	9.43	(3.67)	4.36	(1.32)	-1.1%	13.24	7.75	(5.49)	4.36	(0.94)	-1.4%
PennantPark Floating Rate Capital Ltd.	13.68	13.66	(0.02)	7.60	7.58	7.2%	10.30	11.57	1.27	7.60	8.87	12.3%
PennantPark Investment Corp.	11.14	9.05	(2.09)	8.21	6.12	6.3%	12.25	6.37	(5.88)	8.21	2.33	2.4%
Prospect Capital Corporation	10.75	9.02	(1.73)	8.76	7.03	9.2%	10.80	6.31	(4.49)	8.76	4.27	4.9%
Solar Capital Ltd.	22.73	21.75	(0.98)	14.43	13.45	7.4%	24.78	19.39	(5.39)	14.43	9.04	4.5%
Stellus Capital Investment Corporation	14.45	14.09	(0.36)	8.23	7.87	9.3%	16.31	12.95	(3.36)	8.23	4.87	5.0%
THL Credit, Inc.	13.05	9.15	(3.90)	10.33	6.43	5.9%	13.03	6.09	(6.93)	10.33	3.38	3.3%
TPG Specialty Lending, Inc.	15.53	16.25	0.72	6.55	7.27	11.9%	16.82	18.09	1.27	6.55	7.82	11.8%
WhiteHorse Finance, Inc.	15.30	15.35	0.05	8.27	8.32	9.3%	14.81	12.72	(2.09)	8.27	6.18	7.0%
Peer Group Average						7.4%						5.7%

(1) Includes all BDCs with total assets greater than $500 million as of December 31, 2018, with the exception of NEWT, which is excluded due to the non-traditional nature of their business plan and operations compared to most BDCs
(2) Represents either (a) 12/31/10 if BDC has been public > 8 years or (b) the first 12/31 date after IPO date. For each applicable BDC not > 8 years past IPO, the beginning 12/31 period is as follows: FDUS - 12/31/11; FSK - 12/31/14; GARS - 12/31/13; GSBD - 12/31/15; MCC - 12/31/11; MRCC - 12/31/12; NMFC - 12/31/11; OCSI - 12/31/13; PFLT - 12/31/11; SCM - 12/31/12; TCPC - 12/31/12; TSLX 12/31/14 and WHF - 12/31/12
(3) Represents either (a) dividends for full 8 years if BDC has been public > 8 years or (b) dividends from first full 12/31 calendar year-end after IPO date through 12/31/18. See footnote (4) on page 25 for details
(4) Calculation is (a) (i) Total NAV Change Plus Distributions Paid per Share divided by (ii) Beginning NAV divided by (b) number of years included in analysis (based upon IPO date)
(5) Calculation is (a) (i) Total Market Price Change Plus Distributions Paid per Share divided by (ii) Beginning Market Price divided by (b) number of years included in analysis (based upon IPO date)

Main Street Capital Corporation NYSE: MAIN mainstcapital.com
Page 25

Image Source: *Main Street Capital Investor Presentation*

The next graphic shows that while Main Street has in fact issued equity (at a premium) in order to grow, those efforts have been rewarded by the market. Hence, the capital has been put to good use in the portfolio, and it has been reflected in the share price.

MAIN ST CAPITAL CORPORATION

MAIN Strategy Consistently Produces Differentiated Returns

Preserving (or Increasing) Value through Economic Cycles? Declining NAV = Risk to Investors

Dividend Paying BDCs Public for > 5 years[1]	NAV / Share 12/31/2013	12/31/2018	% Growth (Decline)	5-YR CAGR	3-YR CAGR	Current NAV/ Cumulative Equity Capital Raised[2]
MAIN	$19.89	$24.09	21.1%	3.9%	4.3%	105%
Apollo Investment Corporation	25.71	19.03	-26.0%	-5.8%	-5.7%	51%
Ares Capital Corporation	16.46	17.12	4.0%	0.8%	1.3%	102%
Barings BDC, Inc.	16.10	10.98	-31.8%	-7.4%	-10.3%	64%
BlackRock Capital Investment Corporation	9.54	7.07	-25.9%	-5.8%	-11.4%	57%
BlackRock TCP Capital Corp.	15.18	14.13	-6.9%	-1.4%	-1.5%	83%
Fidus Investment Corporation	15.33	16.47	7.3%	1.4%	2.8%	110%
Garrison Capital Inc.	15.16	10.52	-30.6%	-7.0%	-9.0%	68%
Gladstone Investment Corporation	8.49	12.53	47.6%	8.1%	13.1%	125%
Golub Capital BDC, Inc.	15.23	15.97	4.9%	1.0%	0.2%	101%
Hercules Capital, Inc.	10.51	9.90	-5.8%	-1.2%	-0.1%	91%
Medley Capital Corporation	12.68	5.61	-55.8%	-15.0%	-17.6%	44%
Monroe Capital Corporation	13.92	12.66	-9.1%	-1.9%	-3.7%	90%
New Mountain Finance Corporation	14.38	13.22	-8.1%	-1.7%	0.4%	97%
Oaktree Specialty Lending Corporation	9.85	6.19	-37.2%	-8.9%	-9.7%	58%
Oaktree Strategic Income Corporation	15.07	9.43	-37.4%	-9.0%	-6.0%	75%
PennantPark Floating Rate Capital Ltd.	14.24	13.66	4.1%	0.8%	0.2%	98%
PennantPark Investment Corp.	10.80	9.05	-16.2%	-3.5%	0.1%	77%
Prospect Capital Corporation	10.73	9.02	-15.9%	-3.4%	-2.2%	82%
Solar Capital Ltd.	22.50	21.75	-3.3%	-0.7%	1.5%	93%
Stellus Capital Investment Corporation	14.54	14.09	-3.1%	-0.6%	2.2%	99%
THL Credit, Inc.	13.36	9.15	-31.5%	-7.3%	-10.1%	69%
WhiteHorse Finance, Inc.	15.16	15.35	1.3%	0.2%	4.8%	105%
Peer Group Average			-12.9%	-3.2%	-2.8%	83%

Note: MAIN NAV/Share growth primarily generated through retained earnings[3] (~25%) and accretive offerings (~75%)
Source: Individual company filings

(1) Includes all BDCs with total assets greater than $500 million as of December 31, 2018; excludes CSWC due to unusual dividend and equity capital activity in 2013
(2) As of December 31, 2018
(3) Retained earnings includes cumulative net investment income, net realized gains and net unrealized appreciation, net of cumulative dividends paid or accrued

Main Street Capital Corporation NYSE: MAIN mainstcapital.com
Page 26

Image Source: *Main Street Capital Investor Presentation*

Perhaps the most important metric for a BDC is the return on equity, which you can see in the upcoming graphic. Main Street has been consistently better than most of its peers on this front. Many peers are putting up abysmal ROEs in fact.

MAINST CAPITAL CORPORATION

MAIN Strategy Consistently Produces Differentiated Returns

Operating Efficiency and Superior Underwriting Produces Superior Returns

Dividend Paying BDCs Public for > 5 Years[2]	Annual Return on Equity (ROE)[1] 7-YR	5-YR	3-YR
MAIN [3]	13.0%	12.0%	12.4%
Apollo Investment Corporation	5.7%	2.9%	2.7%
Ares Capital Corporation	10.6%	10.0%	10.4%
Barings BDC, Inc.	3.0%	-1.1%	-5.9%
BlackRock Capital Investment Corporation	5.4%	3.1%	-4.0%
Blackrock TCP Capital Corp.	N/A	7.5%	7.8%
Capital Southwest Corporation	17.3%	5.9%	10.1%
Fidus Investment Corporation	16.5%	11.8%	12.8%
Garrison Capital Inc.	N/A	2.4%	0.0%
Gladstone Investment Corporation	14.3%	17.6%	21.1%
Golub Capital BDC, Inc.	12.2%	8.8%	8.5%
Hercules Capital, Inc.	9.8%	8.7%	9.0%
Medley Capital Corporation	-2.9%	-5.4%	-9.2%
Monroe Capital Corporation	N/A	7.1%	5.7%
New Mountain Finance Corporation	11.6%	8.4%	10.2%
Oaktree Specialty Lending Corporation	1.4%	-1.7%	-4.2%
Oaktree Strategic Income Corporation	N/A	2.0%	0.8%
PennantPark Floating Rate Capital Ltd.	10.5%	7.3%	7.8%
PennantPark Investment Corp.	8.0%	5.7%	9.2%
Prospect Capital Corporation	7.6%	6.8%	7.3%
Solar Capital Ltd.	10.8%	6.6%	8.9%
Stellus Capital Investment Corporation	N/A	9.5%	12.2%
THL Credit, Inc.	6.9%	3.2%	-0.1%
WhiteHorse Finance, Inc.	N/A	10.9%	14.9%
Peer Group Average	8.7%	6.0%	5.9%

(1) ROE calculated as Net Increase in Net Assets divided by average Net Asset Value for each respective measurement period through December 31, 2018
(2) Includes all BDCs (a) with total assets greater than $500 million and (b) at least 5 full years of operating history post IPO as of December 31, 2018, with the exception of NEWT, which is excluded due to the non-traditional nature of their business plan and operations compared to most BDCs.
(3) MAIN Net Increase in Net Assets in ROE calculation excludes impact from changes in fair value (unrealized or realized) relating to SBIC debentures

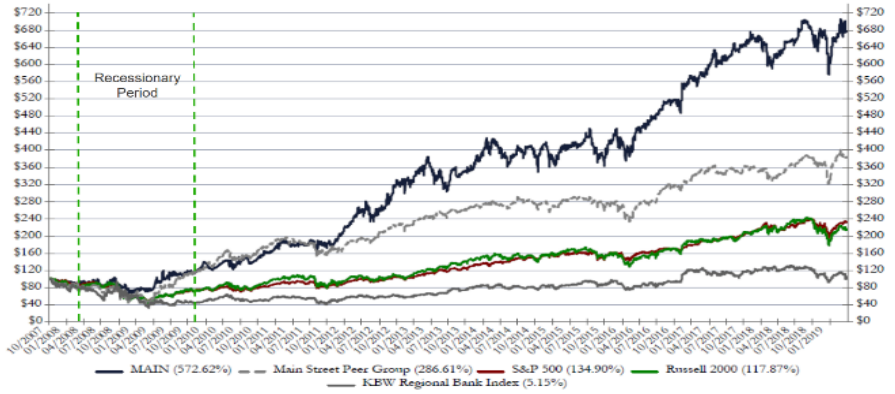
Main Street Capital Corporation NYSE: MAIN mainstcapital.com
Page 27

Image Source: *Main Street Capital Investor Presentation*

And finally, let's look at the share price scoreboard. Bear in mind that the upcoming graphic assumes all dividends are reinvested, which is not what a typical BDC income-oriented investor would do in practice. Nevertheless, you can see Main Street's outperformance against its BDC peer group and the broader market indices.

MAINST CAPITAL CORPORATION

MAIN Total Return Performance Since IPO



Notes:
(1) Assumes dividends reinvested on date paid
(2) The Main Street Peer Group includes all BDCs that have been publicly-traded for at least one year and that have total assets greater than $500 million based on individual SEC Filings as of December 31, 2018; specifically includes: AINV, ARCC, BKCC, CGBD, CSWC, FDUS, FSK, GAIN, GARS, GBDC, GSBD, HTGC, MCC, MRCC, NEWT, NMFC, OCSI, OCSL, PFLT, PNNT, PSEC, SCM, SLRC, TCPC, TCRD, TSLX, and WHF
(3) Main Street Peer Group is equal weighted
(4) Indexed as of October 5, 2007 and last trading date is March 29, 2019

Consistent market outperformance through various economic cycles

Main Street Capital Corporation NYSE: MAIN mainstcapital.com
Page 28

Image Source: *Main Street Capital Investor Presentation*

Despite the many positive comments on Main Street Capital, please don't forget where we started. BDCs really are like banks on steroids. If a very severe recession or outright depression were to come along, the leverage employed by BDC portfolio companies could simply be too much to bear if revenues were to decline more than what would be expected in a "normal" economic environment. BDC shareholders simply own this risk, which can be quite uncomfortable when things go south.

Disclosure: *Matthew Warren does not own any of the shares mentioned in this piece.*

Disclosure: *Brian Nelson, Callum Turcan, and Matthew Warren do not own any shares of any securities mentioned in their authored articles. Please contact info@valuentum.com for more information regarding Valuentum's editorial policies.*

Value Trap Wins Awards!

?

THE SIMULATED HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO

We can't begin to tell you how excited we are about the high yield space during 2019. We think we did pretty good during 2018 given the uncertainty regarding Fed policy, but as you've noticed since the December 2018 bottom in the market, high yield dividend equities have come roaring back!

We think this is the beginning of what could be a nice run in the space given a more "dovish" stance by Fed policy. We also think the High Yield Dividend Newsletter portfolio positions us fairly well for whatever the market may throw at us. We're pretty well-diversified, and we've started to identify some pretty good individual equity ideas of late.

The high yield dividend equity arena trades a lot like junk bonds, meaning that interest rates play a key role in how equities will perform. As interest rates fall, high yield stays in vogue, but as interest rates rise, many look elsewhere. This impacts pricing greatly.

We know there's a lot of competition in this area, but we're laser focused on identifying high yielding stocks that have sustainable yields, and if the income stream becomes threatened, we won't hesitate to say goodbye to a name. 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 Div Yield
CORE			
Alerian MLP ETF	AMLP	5.0%	8.19%
Global X SuperDividend ETF	SDIV	5.0%	9.63%
Global X SuperIncome Preferred ETF	SPFF	10.0%	6.85%
iShares International Select Dividend ETF	IDV	5.0%	5.82%
iShares MSCI Australia ETF	EWA	5.0%	5.39%
iShares U.S. Preferred Stock ETF	PFF	5.0%	5.92%
PowerShares Senior Loan Portfolio	BKLN	5.0%	4.77%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	6.34%
Vanguard Real Estate ETF	VNQ	10.0%	3.96%
EQUITY			
AT&T	T	5.0%	6.09%
BP PLC	BP	5.0%	5.90%
Digital Realty Trust	DLR	5.0%	3.67%
Enterprise Products Partners	EPD	5.0%	6.06%
Iron Mountain	IRM	5.0%	7.81%
Magellan Midstream Partners	MMP	5.0%	6.28%
Public Storage	PSA	5.0%	3.36%
Schlumberger	SLB	5.0%	5.11%
Tallgrass Energy LP	TGE	5.0%	10.09%
		100.0%	**6.10%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 6/1/2019. Est. Div. Yield retrieved from YahooFinance.

SCREEN OF THE MONTH – THE FINANCIALLY-HEALTHIEST DIVIDEND PAYERS YIELDING OVER 2%

The following is a list of stocks that have the highest multiplicative combination of their dividend yield and Dividend Cushion ratio, per our estimates. We exclude the business models of master limited partnerships and real estate investment trusts in this screen and focus exclusively on corporates. We also make a few other tweaks with respect to business model risk considerations.

Income investors have a lot to choose from, and this screen is one of our favorites -- it focuses on identifying the financially-healthiest dividend-payers with yields over 2%. We've overlaid the screen with an Economic Castle assessment to consider business-model risk, too!

Note: *The 'Multiple' in this list considers a company's dividend yield and Dividend Cushion ratio as a multiplicative combination. Though it is a robust and largely objective measure, there could be exogenous or secular dynamics that could impact the business, where a dividend may not be as strong as the financials indicate. This screen was included in the June edition of the Dividend Growth Newsletter.*

Company Name	Symbol	Div Cushion	Economic Castle	Multiplie
GameStop	GME	1.8	Attractive	31.29
General Motors	GM	3.4	Attractive	14.90
Chico's FAS	CHS	2.3	Attractive	13.74
Honda	HMC	3.7	Neutral	12.98
Gilead Sciences	GILD	3.1	Very Attractive	12.17
Fluor	FLR	4.1	Attractive	11.79
Chicago Rivet	CVR	3.9	Neutral	11.78
Guess	GES	3.9	Attractive	10.48
Automatic Data Processing	ADP	5.0	Very Attractive	10.36
Abercrombie & Fitch	ANF	3.3	Attractive	10.17
Cooper Tire & Rubber	CTB	8.1	Neutral	9.96
Methode Electronics	MEI	6.0	Attractive	9.75
Hewlett-Packard	HPQ	3.1	Attractive	9.74
Bristol-Myers Squibb	BMY	2.7	Very Attractive	9.29
Western Union	WU	2.1	Neutral	9.22
American Eagle	AEO	3.5	Attractive	9.19
Gap	GPS	2.3	Attractive	8.46
Caterpillar	CAT	2.8	Very Attractive	8.41
Gentex	GNTX	4.4	Attractive	8.37
Total	TOT	1.6	Neutral	8.27
Huntsman	HUN	3.0	Attractive	8.25
Ralph Lauren	RL	4.3	Attractive	8.19
Omnicom	OMC	2.3	Unattractive	8.01
Dick's Sporting	DKS	2.6	Attractive	7.96
Cummins	CMI	2.6	Attractive	7.94
Tapestry	TPR	1.9	Attractive	7.93
Foot Locker	FL	3.3	Attractive	7.74
QUALCOMM	QCOM	2.1	Very Attractive	7.71
Apple	AAPL	5.5	Very Attractive	7.69
H&R Block	HRB	2.1	Very Attractive	7.67
Archer-Daniels-Midland	ADM	2.3	Attractive	7.66
Walgreens Boots Alliance	WBA	2.3	Attractive	7.64
AVX Corp	AVX	2.9	Attractive	7.50
Manpower	MAN	3.1	Attractive	7.47
Lear Corp	LEA	4.1	Attractive	7.45
Newmont Mining	NEM	4.1	Neutral	7.40
Amgen	AMGN	2.4	Very Attractive	7.37
Ethan Allen	ETH	1.8	Unattractive	7.31
Rio Tinto	RIO	1.6	Neutral	7.19
Cisco	CSCO	2.8	Very Attractive	7.17
MKS Instruments	MKSI	8.9	Attractive	7.15
Taiwan Semiconductor	TSM	2.0	Attractive	7.14
McKesson	MCK	5.9	Very Attractive	7.07
Southwest	LUV	5.6	Attractive	7.02
Applied Materials	AMAT	3.6	Very Attractive	7.01
Cardinal Health	CAH	1.7	Attractive	6.95
Oracle	ORCL	4.5	Very Attractive	6.93
Novartis	NVS	2.3	Attractive	6.93
AmerisourceBergen	ABC	3.5	Very Attractive	6.92
Paychex	PAYX	2.4	Very Attractive	6.92

Note: The 'Multiple' in this list considers a company's dividend yield and Dividend Cushion ratio as a multiplicative combination. Though it is a robust and largely objective measure, there could be exogenous or secular dynamics that could impact the business, where a dividend may not be as strong as the financials indicate.

For example, **GameStop (GME)** is dealing with a secular shift toward digital gaming, while **Abercrombie & Fitch (ANF) and Guess (GES)** are navigating changing consumer preferences as millennials seek 'experiences' not 'things' (e.g. fashion). The Dividend Cushion is only one factor that we use in assessing the overall health of a company's dividend.

THIS LIST IS AS OF JUNE 1.

DIVIDEND REPORT PAGE 2 – BOEING COMPANY (BA)

Boeing BA FAIRLY VALUED

Buying Index™ 3 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Very Attractive	$257.00 - $407.00	HEALTHY	GOOD / 2.4	EXCELLENT	2.17%

Assessment of Company Dividend Strategy

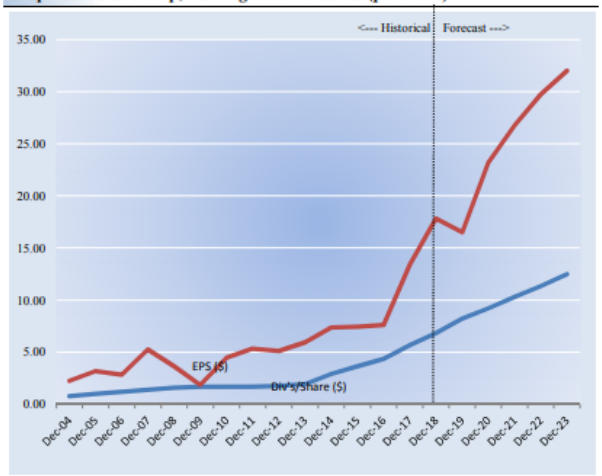
Key Strengths

Boeing continues to benefit from strength in commercial aircraft deliveries, which has paved the way for strong earnings and free cash flow generation. The aerospace giant has put the struggles of building the 787 Dreamliner behind it, and we expect the plane to continue to be a favorite among point-to-point airlines around the globe. A focus on cost reductions and productivity improvements will mitigate cyclicality to a degree, while defense awards will help to pad the other part of its portfolio. The company's massive backlog is simply incredible, and its cash flow generating capacity is top notch. Its dividend hike in late 2018 was certainly an impressive one, but we're not too fond of the $20 billion share repurchase program that came with it.

Potential Weaknesses

Boeing has its hands in a lot of things that could threaten the pace of dividend growth. Its commercial business will always be cyclical, and while the firm remains effectively 'sold out' for the foreseeable future, cancelations and delays with respect to deliveries could hurt growth. Terrorism that sidelines passenger travel and competing budget priorities that may cannibalize defense spending are other risks, and other geopolitical risks and trade policy uncertainty can impact its business. Share buybacks can absorb cash, but its balance sheet remains relatively healthy, evidenced by its 'A' credit rating. We'll be watching potential legal liabilities related to recent 737 MAX crashes, but its backlog supports its long-term outlook despite a cut in near-term production rates.

Graphical Relationship, Earnings and Dividends (per share)

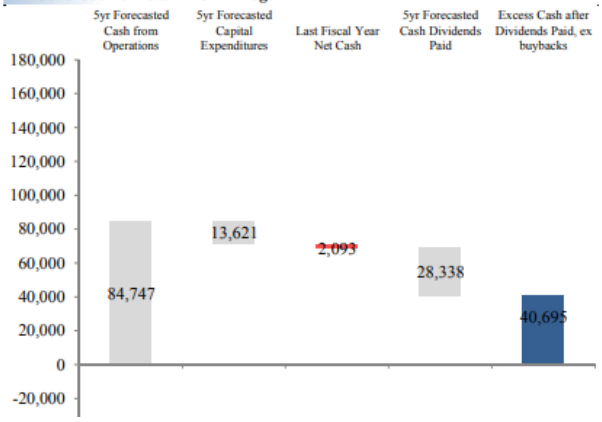


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

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. Boeing'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 greater 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

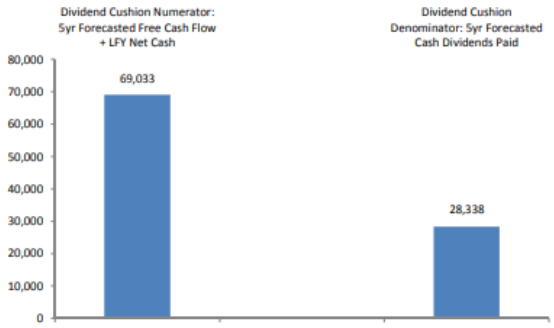


Source: Company Filings, Valuentum Projections

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, Boeing's numerator is larger than its denominator suggesting strong 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



The information and data contained in this report is not represented or warranted to be timely, complete, accurate, or correct. This report is for informational purposes only and should not be considered a solicitation to buy or sell a security. Before acting on any information in this report, you should consider whether the information is suitable for your particular circumstances and, if necessary, seek professional advice. Assumptions, opinions, and estimates are based on our judgment as of the date of the report and are subject to change without notice. Valuentum is not responsible for any errors or omissions or for results obtained from the use of this report. Redistribution is prohibited without written permission. To license Valuentum research, contact us at valuentum@valuentum.com.

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.

Copyright © 2019 by Valuentum, Inc. All rights reserved. No part of this publication may be reproduced in any form or by any means.

The information contained in the High Yield Dividend Newsletter or any report from Valuentum is not represented or warranted to be accurate, correct, complete, or timely. This newsletter is for informational purposes only and should not be considered a solicitation to buy or sell any security. No warranty or guarantee may be created or extended by sales or promotional materials, whether by email or in any other format. The securities or strategies mentioned herein may not be suitable for all types of investors. The information contained in this report does not constitute any advice, especially on the tax consequences of making any particular investment decision. This material is not intended for any specific type of investor and does not take into account an investor's particular investment objectives, financial situation or needs. This report is not intended as a recommendation of the security highlighted or any particular investment strategy. Before acting on any information found in this report, readers should consider whether such an investment is suitable for their particular circumstances, perform their own due diligence, and if necessary, seek professional advice. The sources of the data used in this report are believed by Valuentum to be reliable, but the data's accuracy, completeness or interpretation cannot be guaranteed. Assumptions, opinions, and estimates are based on our judgment as of the date of the report and are subject to change without notice. Valuentum is not responsible for any errors or omissions or for results obtained from the use of this report and accepts no liability for how readers may choose to utilize the content. In no event shall Valuentum be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the information contained in this document. Investors should consider this report as only a single factor in making their investment decision. Valuentum is not a money manager, is not a registered investment advisor, and does not offer brokerage or investment banking services. Valuentum has not received any compensation from the company or companies highlighted in this report. Valuentum, its employees, independent contractors and affiliates may have long, short or derivative positions in the securities mentioned herein. Information and data in Valuentum's valuation models and analysis may not capture all subjective, qualitative influences such as changes in management, business and political trends, or legal and regulatory developments. Redistribution is prohibited without written permission. Readers should be aware that information in this work may have changed between when this work was written or created and when it is read. There is risk of substantial loss associated with investing in financial instruments. Valuentum's company-specific forecasts used in its discounted cash flow model are rules-based. These rules reflect the experience and opinions of Valuentum's analyst team. Historical data used in our valuation model is provided by Xignite and from other publicly available sources including annual and quarterly regulatory filings. Stock price and volume data is provided by Xignite. No warranty is made regarding the accuracy of any data or any opinions. Valuentum's valuation model is based on sound academic principles, and other forecasts in the model such as inflation and the equity risk premium are based on long-term averages. The Valuentum proprietary automated text-generation system creates text that will vary by company and may often change for the same company upon subsequent updates. Valuentum uses its own proprietary stock investment style and industry classification systems. Peer companies are selected based on the opinions of the Valuentum analyst team. Research reports and data are updated periodically, though Valuentum assumes no obligation to update its reports, opinions, or data following publication in any form or format. Performance assessment of Valuentum metrics, including the Valuentum Buying Index, is ongoing, and we intend to update investors periodically, though Valuentum assumes no obligation to do so. Not all information is available on all companies. There may be a lag before reports and data are updated for stock splits and stock dividends. The portfolio in the High Yield Dividend Newsletter is hypothetical and does not represent real money. Past simulated performance, whether backtested or walk-forward or other, is not a guarantee of future results. Actual results may differ from simulated portfolio information being presented in this newsletter. For general information about Valuentum's products and services, please contact us at valuentum@valuentum.com or visit our website at www.valuentum.com.