Valuentum Securities, Inc. 11/1/2019 Edition 11, Volume 2

HIGH YIELD DIVIDEND NEWSLETTER

Two High Yield Dividend Ideas Moving on Up!

Latest Changes to High Yield Dividend Newsletter
Previously Added: 5% in CubeSmart (CUBE), 5% in Utilities SPDR (XLU) – August 22

INSIDE THIS ISSUE

1 Two High Yield Dividend Ideas Moving on Up!
3 For Your Radar: Rogers Communications (RCI): Canada's Telecom, Cable, and Media Giant
6 *Analysis*: Caterpillar (CAT) Misses Estimates and Revises Guidance Downwards
9 *Analysis*: Waste Management's Dividend Well-Covered with Free Cash Flow
10 **Spotlight: *NEW* Covering Gladstone Land Corporation (LAND), the Farmland REIT**
14 Bank Earnings Roundup
21 The High Yield Dividend Newsletter Portfolio
22 Screen of the Month – The Financially-Healthiest Dividend Payers Yielding Over 2%
23 Dividend Report Page 2 – Tapestry Inc (TPR)

"ON OCTOBER 30, THE FEDERAL RESERVE PUSHED THROUGH YET ANOTHER 25 BASIS POINT INTEREST RATE CUT. GOING FORWARD, THE MOENTARY BODY SIGNALED THAT FUTURE RATE CUTS WERE FAR LESS LIKELY GIVEN CURRENT MACROECONOMIC CONDITIONS" – CALLUM TURCAN

Image Shown: *AT&T continues to surge higher this year as shares of T converge towards their intrinsic value, a process supported by recent activist investor activity directed towards the company.*

By Callum Turcan and Brian Nelson, CFA

AT&T

Please note a version of this article was emailed out to subscribers on October 28.

On October 28, **AT&T Inc** (T) --- 5.4% yield --- reported third-quarter 2019 earnings, and the market clearly liked what the company had to say. Shares of AT&T are trading near ~$38 as of this writing as the company's stock price continues converging towards its intrinsic value, in our view. Our fair value estimate for AT&T stands at $40 per share, with room for upside, and we continue to like the firm in our High Yield Dividend Newsletter portfolio.

In 2020, AT&T is targeting 1%-2% revenue growth, adjusted (non-GAAP) EPS of $3.60-$3.70, a flat adjusted EBITDA margin with 2019 levels, around $28.0 billion in free cash flows, a dividend payout ratio

as a percentage of free cash flows in the low-50% range, and $5.0-$10.0 billion in asset monetization. Some quick notes on this outlook: top line growth will likely pick up pace as the coming 5G rollout gets underway (with mass consumer adoption in the US representing a 2020s story), free cash flows are expected to remain rock solid next year, **and AT&T will retain enough "excess" free cash flow (free cash flow less dividend payments) to continue moving forward with meaningful deleveraging activities.**

The telecommunications and media entertainment juggernaut has already begun to pursue meaningful divestments. AT&T very recently agreed to sell its majority equity stake in Central European Media Enterprises Ltd. (CETV) for $1.1 billion, its wireless and wireline operations in Puerto Rico and US Virgin Islands for $1.95 billion, and management wants to communicate that more deals are on the way. **These proceeds will go towards debt reduction and share buybacks, especially if activist investor Elliott Management gets its way.** As things stand today, AT&T has committed to using 50%-70% of its excess free cash flows to repurchasing shares, with the goal being to retire ~70% of the shares issued to fund its purchase of Time Warner.

By 2022, AT&T is targeting $30.0-$32.0 billion in free cash flow, which will be accompanied by modest dividend growth, with management seeking to lower the firm's dividend payout ratio (as a percentage of free cash flows) below 50% during this period. Deleveraging activities will help drive down AT&T's net-debt-to-adjusted-EBITDA ratio to 2.00x-2.25x by 2022. Net-debt-to-adjusted_EBITDA stood at 2.66x at the end of the third quarter of 2019, indicating there's plenty of room to go on this front.

Revenue growth is expected at 1%-2% CAGR through 2022, with adjusted (non-GAAP) EPS expected to grow to $4.50-$4.80 by 2022. We like AT&T's focus on improving its profitability metrics, with management targeting a 200 basis point expansion in the company's adjusted EBITDA margin through 2022, which is expected to hit 35%. Cost rationalizations combined with the launch of its new streaming service HBO Max will likely play key roles here.

To better stick with its current strategy, AT&T announced it would consider one potential new director at its next board meeting and another new potential director in 2020. Furthermore, the company committed to not pursue any more major acquisitions over the next few years. **We liked what we saw in AT&T's latest earnings report and think the market is beginning to seriously take note.**

Philip Morris International

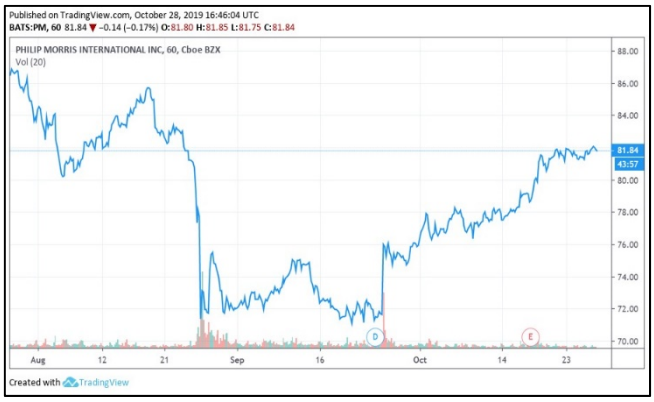


Image Shown: *Shares of Philip Morris International are recovering after fears over its potential merger with Altria Group faded away when it became clear no such deal would materialize. The market was primarily worried about the terms Philip Morris International might agree to regarding the potential pro forma ownership for each firm's shareholder base, and not the underlying reasoning behind the tie-up itself.*

Back on October 18, we covered Philip Morris International Inc's (PM) --- 5.8% yield --- third-quarter 2019 earnings report that was published a day earlier. Since then, shares of PM have only continued to climb higher, and we see that as a sign investors are beginning to factor in the company's stellar free cash flow profile. Philip Morris International is included in our High Yield Dividend Newsletter portfolio.

As an aside, the recent controversies regarding vaping in the US and more specifically, Juul Labs, may work in Philip Morris International's favor. Its own alternative smoking products are markedly different (in taste, heating method, and targeted demographics) than the Juul offering with an eye towards Philip Morris International's IQOS offering that recently launched in the US. Philip Morris International's alternative tobacco products and the pricing power of its traditional cigarette brands supports its free cash flow trajectory

over the coming years and offers room for upside should IQOS sell well.

When it comes to Philip Morris International's dividend coverage, while we give the firm a Dividend Cushion ratio of 0.8x, please note we adjusted its Dividend Safety rating to GOOD (from POOR, which is normally what a sub-1.25x Dividend Cushion ratio would earn) and our reasoning is straightforward: The free cash flow profile of Philip Morris International is simply stellar ($6.1 billion in free cash flows during the first three quarters of 2019) which fully covered $5.3 billion in dividend payments during this period, and furthermore, the company does not allocate a meaningful amount of its free cash flows towards share repurchases. Total debt of $31.8 billion, inclusive of short-term debt, at the end of September 2019 is somewhat offset by $6.5 billion in cash and cash equivalents.

When considering Philip Morris International's 'A-rated' investment grade credit ratings and its strong free cash flow profile, we see that debt burden as easily manageable. As a company that sells tobacco products, Philip Morris International is somewhat insulated from a slowdown in global economic activity as its products have relatively inelastic demand and tend to be high up on the spending priorities of tobacco consumers. We think Philip Morris International carries solid dividend coverage and should be a major beneficiary of a lower interest rate environment. Our fair value estimate for shares of PM stands at $77, with room to climb higher as the top end of our fair value estimate range sits at $92 per share.

Altria Group Inc (MO) carries a Dividend Cushion ratio of 1.0x, but we assign it a POOR Dividend Safety rating due to concerns regarding the value of its 35% stake in Juul Labs (with US regulators aggressively cracking down on the company) and its ~45% stake in marijuana firm Cronos Group Inc (CRON), which could change should Altria exercise its warrants to buy a larger stake in Cronos.

The greater likelihood of future volatility in Altria's free cash flows, with an eye towards downside risks (stemming from greater regulatory scrutiny of vaping products in particular, and the lack of clarity regarding Cronos' future free cash flows), represents the main reason why we didn't adjust Altria's Dividend Safety rating upwards as we did with Philip Morris International. We continue to like Philip Morris International more than Altria in part for this reason.

Concluding Thoughts

We continue to like the resurgence in AT&T's shares of late. The company is rapidly converging to our $40 per share fair value estimate, and as the company divests assets and pursues deleveraging, its dividend growth profile is enhanced. Shares already yield an enticing 5.3%, too. Philip Morris has rallied considerably since it broke deal talks with Altria, and we believe the company has a relatively lower business risk profile than Altria. Both Philip Morris and Altria have Dividend Cushion ratios below the 1.25x threshold, or GOOD threshold, but given more positive overall trends at Philip Morris, we prefer the company over Altria at this time.

Disclosure: *Brian Nelson and Callum Turcan do not own any of the securities mentioned above.*

For Your Radar: Rogers Communications: Canada's Telecom, Cable, and Media Giant

By Callum Turcan

Rogers Communications Inc (RCI) --- 3.3% yield --- is a Canadian telecommunications, cable, and entertainment company headquartered in Toronto. The company's wireless business is by far its largest, generating 60% of its 2018 revenues and 67% of its adjusted EBITDA that year. Roger Communications' cable business (TV, internet, landline) is its second biggest, followed up by its media business which includes partial ownership of the Toronto Blue Jays. **Wireless and cable revenues represent the bulk of Roger Communications' operations and its cash flows, which support a steady dividend growth trajectory.**

When publishing the firm's third quarter 2019 earnings, Rogers Communications' revised its 2019 guidance downward as the adoption of an unlimited data plan weakened wireless revenue due to reduced data overage charges. Additionally, wireless equipment revenue

underperformed expectations. The company is now targeting flat revenue growth (down from high single-digit growth), a 3%-5% increase in adjusted EBITDA, and a $0.1-$0.2 billion increase in free cash flows this year on an annual basis. The company plans to allocate ~$0.15 billion less towards capital expenditures than previously forecasted to bolster its free cash flows.

Management noted that over 1 million subscribers were now on the Rogers Infinite plan, which seeks to solve the problem concerning low data usage in Canada on a relative basis. During the firm's third quarter 2019 conference call, management noted that wireless data usage in Canada is only a third of that in the US on a comparative basis.

The goal is to get more of Rogers Communications' wireless customers onto unlimited data plans to boost long-term reoccurring revenue streams, at the expense of near-term performance. We think this strategy will behoove the company's free cash flows quite significantly, especially when combined with ongoing cost rationalization strategies. Here's what management had to say during the conference call;

> *"Data overage fees currently represent roughly 5% of wireless service revenue. In the third quarter, our results were impacted by approximately $50 million in reduced overage fees given customer adoption of these new plans. By this time next year, we expect to eliminate overage revenue by over 80%. In parallel, data use is expected to grow and so is recurring ARPU [average revenue per user]. By the second half of 2020, we expect to return to ARPU growth reflecting a markedly faster transition than the unlimited experience south of the border.*
>
> *For those trying to draw a parallel to the U.S. market of a few years ago, our entry price for unlimited plans was set at a significantly different point and therefore we believe we will return to overall growth more quickly. As Canada's largest wireless provider we chose to lead this change. We believe this move was inevitable and it was the right time before we ramp into a 5G world."*

Please note that Rogers Communications has met or exceeded its guidance in the recent past, including in 2018 as you can see in the graphic that follows. The most recent miss isn't indicative of Rogers Communications' core business weakening, but management underestimating the efficacy of its strategy to get more Canadian's on unlimited data plans.

Management is still targeting a significant expansion in the firm's adjusted EBITDA margin, and for reference, **Rogers Communications' adjusted EBITDA margin rose by 130 basis points in 2018 versus 2017 levels. The firm's wireless margins are more than double its cable margins.** Beyond cost rationalization strategies, Rogers Communications' company-wide margins should simply grow alongside its wireless business. The firm is also targeting meaningful margin improvement at its cable business by the end of 2021.

2018 ACHIEVEMENTS AGAINST GUIDANCE

The following table outlines guidance ranges that we had previously provided and our actual results and achievements for the selected full-year 2018 financial metrics.

(In millions of dollars, except percentages)	2017 (restated)[1]	2018 Guidance Ranges	2018 Actual		Achievement
Consolidated Guidance [2]					
Revenue	14,369	Increase of 3% to 5%	15,096	5.1%	✓
Adjusted EBITDA [3]	5,502	Increase of 7% to 9%	5,983	8.7%	✓
Capital expenditures [4]	2,436	2,650 to 2,850	2,790	n/m	✓
Free cash flow [3]	1,685	Increase of 5% to 7%	1,771	5.1%	✓

Image Source: *Rogers Communications – 2018 Annual Report*

In late-October, Rogers Communications announced it was going to redeem all of its $0.9 billion in 4.7% Senior Notes due 2020 by issuing out $1.0 billion of 3.7% Senior Notes due 2049. **Please note that not only does the company clearly retain access to capital markets, but it does so at very attractive rates.**

Rogers Communications has quality investment grade credit ratings across the board (BBB+/Baa1/BBB+) with stable outlooks. While the downward shift in its guidance for 2019 saw shares of RCI move lower, the company's financials are still quite strong.

The firm's leverage has been climbing upwards of late, with Rogers Communications' adjusted net debt to adjusted EBITDA ratio rising from 2.5x at the end of 2018 to 2.8x at the end of September 2019.

Rogers Communications' ended 2017 with a leverage ratio of 2.7x, indicating that its current leverage levels are within historical norms, but we would like to see

that trend downwards over the coming quarters. Please note that net debt positions compete with future dividend payouts for free cash flows.

At the end of the third quarter of 2019, the company had $17.8 billion in adjusted net debt (~$16.0 billion in net debt under traditional definitions) which management describes in detail through the upcoming graphic:

Reconciliation of adjusted net debt and debt leverage ratio

(In millions of dollars)	As at September 30 **2019**	As at January 1 2019	As at December 31 2018
Current portion of long-term debt	**1,400**	900	900
Long-term debt	**14,879**	13,390	13,390
Deferred transaction costs and discounts	**138**	114	114
	16,417	14,404	14,404
Add (deduct):			
Net debt derivative assets	**(1,660)**	(1,373)	(1,373)
Credit risk adjustment related to net debt derivative assets	**(79)**	(75)	(75)
Short-term borrowings	**1,708**	2,255	2,255
Current portion of lease liabilities	**219**	190	–
Lease liabilities	**1,435**	1,355	–
Cash and cash equivalents	**(262)**	(405)	(405)
Adjusted net debt	**17,778**	16,351	14,806

Image Source: *Rogers Communications – Third Quarter 2019 Earnings Report*

In 2017-2018, Rogers Communications generated $1.5 billion in annual free cash flows on average which handily covered $1.0 billion in average annual dividend payments. **We like the company's free cash flow profile given the sticky nature of recurring wireless and cable revenue streams.** Rogers Communications' needs to retain access to capital markets to refinance its debt load and to fund its investments in 5G over the coming years, and that's a task made significantly easier when having a quality free cash flow profile.

Pushing wireless customers towards unlimited data plans and the expected increases in ARPU that management sees as kicking in late next year should augment Rogers Communications' free cash flow growth trajectory. Management noted Roger Communications' rollout of unlimited data plans will help cut the firm's costs as well. In the third quarter, Rogers Communications' added 103,000 net postpaid and 27,000 net prepaid subscribers to its wireless operations. Wireless ARPU was held down due to the aforementioned transition strategy.

The company has also been promoting its data overage protection programs to encourage greater data consumption by removing fears of overage fees (effectively, encouraging customers to fully utilize their data limits each month as part of a bigger strategy that seeks to boost mobile data consumption in Canada).

Rogers Communications other bright spot is its internet offering within its cable segment. Here's what management had to say during the firm's latest quarterly conference call;

> *"Turning to cable, we grew revenue by 1% this quarter and adjusted EBITDA by 2%. Our internet offering performed strongly and continues to be a key driver for our cable business. Internet revenue grew 7% this quarter, reflecting the movement of internet customers to higher speed and usage tiers and a larger internet subscriber base.*
>
> *We remain uniquely positioned to meet customer demand for faster speeds and higher data with our ability to offer Ignite gigabit internet across our entire cable footprint. In Q3, we recorded 41,000 net subscriber additions -- net internet subscriber additions, a 6,000 improvement compared to the prior year. This reflects the 17th consecutive quarter of increasing internet penetration rates. In addition, internet ARPU continue to grow year-over-year."*

When it comes to downside risks, Rogers Communications' landline business will continue to fade into irrelevancy and in the near-term, reduced data overage revenues will pressure wireless revenues (largely by weakening wireless ARPU over the next few quarters). **However, that pales in comparison to the risks posed by the potential political and regulatory landscape after the October 2019 federal election in Canada.**

The Liberal Party of Canada, led by Prime Minister Justin Trudeau, was the clear winner during the October 2019 election, taking 157 seats in the House of Commons (down 20 from its 2015 performance). That's below the majority threshold of 170 seats, meaning the Liberal Party will need support from other parties to govern, such as the New Democratic Party (won 24 seats in 2019) led by MP Jagmeet Singh.

Mr. Singh has called for capping internet and cell phone subscription prices in Canada, and in the event the Liberal Party seeks support from the New Democratic Party (something that's viewed as very likely), it's

conceivable that this issue will arise. Political and regulatory risks are naturaly hard to gauge, but this particular "known unknown" needs to be kept in mind.

We caution that should the federal government of Canada move to limit wireless and Internet rates, that would negatively impact Rogers Communications' ability to grow. Such an event, if it were to materialize, likely won't hurt the company's financial status down to its core but reflects a significant regulatory hurdle that clouds its outlook.

Rogers Communications has a nice dividend growth runway ahead of it, supported by a quality free cash flow profile, margin expansion, and a lower interest rate environment, but regulatory concerns and near-term weakness need to be kept in mind.

Disclosure: *Callum Turcan does not own any of the securities mentioned above.*

Analysis: Caterpillar Misses Estimates and Revises Guidance Downwards

By Callum Turcan

Image Source: *Caterpillar Inc – Third quarter 2019 IR presentation*

On October 23, **Caterpillar Inc** (CAT) -- 3.0% yield -- posted third-quarter 2019 earnings with both its top- and bottom-line performance falling well short of consensus expectations. Furthermore, management revised the firm's adjusted (non-GAAP) EPS guidance for 2019 down to $10.90-$11.40 from $12.06-$13.06 previously, quite the reduction. Please note this represents Caterpillar's second earnings guidance reduction so far this year. When a company is routinely cutting guidance, that speaks very poorly for its outlook. Shares of CAT yield ~3% as of this writing.

Caterpillar's weak performance is about much more than just the industrial equipment supplier, it speaks unfavorably to the state of the global industrial economy. Our fair value estimate for Caterpillar stands at $156 per share.

Revenue Growth Disappearing

Management has adjusted Caterpillar's production schedules and inventory management systems to better match demand expectations as dealers are winding down their own inventories in the face of slowing demand. Dealer inventories decreased by $0.4 billion in the third quarter of 2019, hurting Caterpillar's top line performance, versus the $0.8 billion inventory build in the same quarter last quarter. Caterpillar's CEO Jim Umpleby noted in the earnings press release:

> *"Our volumes declined as dealers reduced their inventories, and end-user demand, while positive, was lower than our expectations."*

During the third quarter of 2019, Caterpillar's consolidated GAAP revenues declined by almost 6% year-over-year, hitting $12.8 billion. **When looking at just its 'Machinery, Energy & Transportation' (or 'MET') segment, Caterpillar's sales dropped by over 6% year-over-year.** The firm recorded modest revenue growth at its 'Financial Products' segment last quarter on a year-over-year basis.

During the first three quarters of 2019, Caterpillar's consolidated GAAP revenues were up just a fraction of a percent on a year-over-year basis, with both its 'MET' and 'Financial Products' segments reporting growth. To provide some contrast, Caterpillar's consolidated GAAP revenues surged by 42% from 2016 to 2018, with the vast majority of that coming from its 'MET' segment.

The slowdown in 2019 signals a stark change in Caterpillar's growth trajectory, as the tailwinds from a rebound in mining activity post-2016 and bustling North American construction activity are being overwhelmed by trade war disruptions and ultimately a synchronized global slowdown in economic activity.

Demand softness from Caterpillar's core end customers (construction, raw energy resource extraction, agriculture, etc.) is feeding directly into subdued sales expectations, and when management eventually

provides 2020 guidance, that outlook will likely reflect this softness. Confidence is also key as dealers are reducing inventories over expectations of weaker future demand.

Furthermore, we caution that demand from the oil & gas industry will likely be very subdued going forward given consistently low raw energy resource prices and the need for upstream operators to scale back capital expenditures to live within their operating cash flows. Caterpillar sells the oil & gas industry various types of industrial equipment including compression, pumping, power, and transmission systems.

Due to dealers reducing their inventories and in light of weak demand expectations, management now sees Caterpillar's 2019 revenues falling short of its 2018 performance. Previously, Caterpillar was guiding for modest revenue growth this year versus 2018 levels. Caterpillar's CEO had this to say on the issue during the firm's third quarter 2019 conference call (emphasis added):

> *"…based on input from dealers and customers, we now expect fourth quarter end user demand to be about flat compared to the fourth quarter of 2018.* ***Based on our revised expectations for dealer inventory and end user demand, we now expect sales and revenues to be modestly lower for the full year versus our prior expectation of modest sales and revenue growth in 2019.*** *The global economic situation is very fluid due to a variety of factors. The decline in dealer inventory, along with our improved lead times, will position us to react quickly to positive or negative developments in the global economy during 2020."*

We view Caterpillar's production schedule and inventory management changes as largely defense maneuvers.

Maintaining Margins

Caterpillar is fighting back in the ways it can, namely by controlling expenses, and we really like management's commitment to preserving the firm's operating margins. While keeping in mind Caterpillar's financial statements can be a messy read given its large financial wing, the firm's consolidated GAAP operating margins were broadly flat in both the third quarter of 2019 and first three quarters of 2019 versus the same periods last year, respectively. **However, when looking at Caterpillar's non-GAAP 'MET' gross margins ('MET' revenues less cost of goods sold), the company has been experiencing pressure here.** Cost of goods sold as a percent of revenue climbed by ~100 basis points from the first three quarters of 2018 to the first three quarters of 2019, indicating Caterpillar's "core" gross margins are weakening somewhat in order to prop up its industrial equipment sales.

SG&A expenses fell by over 3% year-over-year, R&D expenses dropped by almost 6% year-over-year, and other operating expenses dropped by about 8% year-over-year during the first nine months of 2019. Declining profit at its subsidiaries and a modestly higher effective corporate income tax rate saw Caterpillar's consolidated GAAP net profit margin shift lower by over 30 basis points year-over-year during the first three quarters of 2019. Caterpillar's diluted GAAP EPS still marched higher by almost 4% year-over-year to $8.75 during the first nine months of 2019 due to the company reducing its outstanding diluted share count by over 5% year-over-year, a product of substantial share buybacks. During Caterpillar's third quarter 2019 conference call the firm's CEO noted:

> *"We maintained our operating profit margin percent despite lower volume and some continued pressure on manufacturing costs. We anticipate meeting the full year operating margin targets communicated during our Investor Day last May."*

Dividend Strength

At the end of September 2019, Caterpillar was sitting on $7.9 billion in cash and cash equivalents while its 'MET' segment carried a negligible amount of short-term debt along with $9.1 billion in long-term debt. Keep in mind Caterpillar's 'Financial Products' segment carries a substantial amount of total debt. **When removing the noise from its balance sheet, Caterpillar's financial position is quite strong and that's a key reason why its adjusted (keeping its 'Financial Products' segment in mind) Dividend Cushion ratio stands at 2.8x.**

However, unlike most firms that would normally earn a Dividend Safety ratio of EXCELLENT when carrying a Dividend Cushion ratio north of 2.75x, we give Caterpillar a GOOD Dividend Safety ratio given the risks its 'Financial Products' segment poses in the event of a downturn.

We define Caterpillar's free cash flows as net operating cash flows less 'capital expenditures – excluding equipment leased to others' and please note we value the firm's financial wing separately from its industrial operations. During the first nine months of 2019, Caterpillar's industrial division generated $3.8 billion in free cash flows, fully covering $1.6 billion in dividend payments. Additionally, the company spent $3.3 billion repurchasing its shares, but given rising exogenous headwinds, we think it would be best for Caterpillar to bulk up its balance sheet heading into 2020. That's unlikely to be the case, with Caterpillar's CEO noting this during the firm's third quarter 2019 conference call:

> *"During our Investor Day in May, we shared our intention to drive long-term shareholder value by returning substantially all of our Machinery, Energy & Transportation free cash flow to shareholders through a competitive dividend and a more consistent share repurchase plan…*
>
> *We also repurchased $1.2 billion of common stock in the third quarter. We continue to expect share repurchases during the second half of the year will be similar to the first half, which will reduce our total quarterly average diluted shares outstanding by about 9% since the first quarter of 2018."*

Some of Our Thoughts

Here's a summary of our thoughts on Caterpillar and the structure of its business model from our recently updated 16-page Stock Report covering the firm (can be accessed here):

> *Caterpillar makes construction and mining equipment, diesel and natural gas engines, industrial gas turbines and diesel-electric locomotives. The company also owns Caterpillar Financial Services (Cat Financial). The machinery giant's operations are tied to cyclical end markets, and results are not immune to geopolitical risks either. It is based in Deerfield, Illinois.Caterpillar's dealer network is a significant competitive advantage. Its reach is phenomenal, with ~50 dealers in the US and 120+ outside the US (serving ~190 countries).*
>
> *Mining equipment sales remain tied to expectations of commodity prices, and the period 2013-2016 is exemplary of the pain this can cause. Drivers of demand at Caterpillar of late include continued strength in the North American construction market, new equipment sales momentum in resource industries, and demand for rebuilds of well-serving equipment in the energy space. Higher material and freight costs have the potential to weigh on bottom-line results in the near term, but it expects to mitigate the impact of tariff-related costs.*
>
> *Caterpillar is quite effective at managing costs through the course of the economic cycle. Part of Caterpillar's strategy when faced with revenue declines is to manage the fall such that the decrease in operating profit is less than 30% of the decline in revenue. We also like the focus on driving strong inventory turns.Caterpillar Financial's exposure to weak credits in the mining and energy arenas will always have us concerned. The hidden captive finance arms across the broader machinery group may put surprising pressure on performance in the event of a downturn.*

We would like to stress that while Caterpillar is generally regarded as a maker of industrial equipment, its reliance on Cat Financial needs to always be taken into account.

Concluding Thoughts

Should the global economy show signs of stabilizing, particularly as it relates to industrial activity, Caterpillar would appear relatively cheap at ~$141 per share as of the end of the October 29 trading session. **Recent signs have not been promising.** Exports out of South Korea, a barometer for the global economy, continue to plummet while macroeconomic readings in the EU and North America are showing signs of a major slowdown materializing as we speak (particularly in the Eurozone, but that appears to be spreading to the US economy as well). China's economy continues to feel the heat from the US-China trade war. **The low end of our fair value**

estimate range stands at $125 per share of CAT, meaning that under more pessimistic assumptions, Caterpillar appears fairly valued as of this writing.

Disclosure: *Callum Turcan does not own any of the securities mentioned above.*

Analysis: Waste Management's Dividend Well-Covered with Free Cash Flow

By Brian Nelson, CFA

We continue to be huge fans of the garbage-collection business. In fact, we cannot remember a time when we didn't like the waste collection space. The group benefits from a relatively recession-resistant pick-up operation, and transfer and disposal assets that simply demand pricing power. The trash-taking industry is also notorious for its free-cash-flow generating prowess, and we don't think that will ever change. The latest data point as it relates to the health of the waste industry, and perhaps the general economy as well, came with **Waste Management's** (WM) --- 1.8% yield --- third-quarter results, released October 23.

The company's revenue advanced 3.8% thanks in part to strong all-in organic sales expansion in its collection and disposal operations (up 5.3%), and landfill pricing increases of 3.7%. Cash flow from operations surged 8.9% during the period, while free cash flow came in at $478 million, significantly higher than the $218 million of dividends it spent in the third quarter. Waste Management boasts a very solid Dividend Cushion ratio of 1.7x, and we continue to expect ongoing expansion in the payout. Here's what we have to say about its dividend in the company's Dividend Report:

> *We love Waste Management's business model. The company's asset base is quite diverse, and garbage pick-up and disposal will continue to be a necessary service, no matter what the future may hold. Its landfill operations boast significant barriers to entry due to regulatory requirements and stiff NIMBY (not-in-my-backyard) opposition. The collection side of its residential business is generally recession-resistant, though volatile commodity prices can cause swings in recycling revenue. In light of Waste Management's utility-like status, we give the company an extra boost in the calculation of its Dividend Cushion ratio. The company's net debt position is ominous, but we rate its 'Dividend Safety' as GOOD for now.*

As it relates to a read-through on the health of the economy, management emphasized that it continued to experience strong growth, "particularly in the segments of (its) business that reflect the resilience of the consumer." On the conference call, CEO James Fish noted that it has "good visibility" into the lines of business driven by the "consumer portion of the economy (commercial collection and MSW landfill volumes)," noting that "all indicators are pointing to continued strength." Waste Management did, however, note that the "portion of (its) business, driven by the industrial segment of the economy…the pace of growth is starting to moderate." Waste Management remains confident, nonetheless, as evidenced by its willingness to pursue M&A, with the pending acquisition of Advanced Disposal Services.

Concluding Thoughts

Waste Management is one of our favorite companies in our coverage universe, and the strength of its dividend is undeniable. The company's operations have performed quite well during the first nine months of 2019, and the executive team expects the momentum to continue into 2020. Management did express some caution as it relates to its industrial segment revenue but reiterated strength in consumer activity, and noted that, while its recycling (commodity-sensitive) business isn't as strong as it originally expected, it expects to achieve its "guidance range of adjusted operating EBITDA of $4.4-$4.45 billion, free cash flow of $2.025-$2.075 billion, and adjusted earnings per diluted share of $4.28-$4.38."

-- THE HIGH YIELD DIVIDEND SPOTLIGHT IS ON THE NEXT PAGE --

High Yield Spotlight: Covering Gladstone Land Corporation (LAND), the Farmland REIT

Gladstone Land (LAND) --- 4.5% yield --- is an externally-managed real estate investment trust that owns over 100 farms across ten states (WA, OR, CA, AZ, CO, KS, TX, MI, NC, and FL). The REIT pays out a monthly distribution and elected to be taxed as a REIT starting in 2013. Back in 2004, Gladstone Land sold off its agricultural operating business to focus solely on leasing out its farmland properties to third-party tenants. Gladstone Management Corporation acts as the adviser and Gladstone Administration LLC acts as the administrator of the REIT.

Gladstone Land generally leases out farmland and in certain instances, facilities that support farming operations, on a triple-net basis whereby the operator covers most (if not all) of the operating expenses. That includes drought insurance, maintenance expenses, and other operating costs. **Management cites Gladstone Land's properties as being worth over $835 million in its latest relevant press release, keeping in mind the REIT acquired various assets during the third quarter.** The REIT will report third quarter 2019 earnings after the market closes on November 6. **Gladstone Land has its eyes set on potential expansion opportunities in at least four additional states (NJ, VA, SC, and GA).**

More recently, the REIT has aggressively expanded in California after announcing that it was acquiring a pistachio orchard in August, a farm (that grows berries among other crops) in September, and a vineyard that same month. Gladstone Land also mentioned that its pistachio orchard acquisition was the smaller of a two-part deal, with the second transaction expected to close during the fourth quarter of 2019. Additionally, Gladstone Land acquired farmland in Nebraska that grows cash crops like corn and soybeans in October. That farmland is being converted into an organic operation, a transformation that should be completed by 2021, with part of that development involving the construction of grain drying and storage facilities. All of these aforementioned deals are secured by long-term leases with third-party operators.

On October 21, Gladstone Land provided an update on its lease renewal progress for 2020. The REIT announced it had secured renewals at two of its larger properties (one in California and one in Florida) which were going to expire in 2020. Those two properties accounted for just under half of Gladstone Land's annualized revenues in terms of leases that are expiring next year (not to be confused with company-wide annualized rental revenues). **Not only do these renewals ensure that those cash flow streams continue rolling on in, but Gladstone Land was able to increase its rental rates.** Management mentioned that combined, these new lease agreements with add $496,000 of additional net income to the REIT's bottom-line on an annualized basis, a ~15% increase versus the prior lease agreements.

While Gladstone Land has traditionally been focused on annual row crops (i.e. berries, vegetables), the REIT has ventured out into farms that grow permanent crops (i.e. almonds, blueberries, pistachios, and wine grapes) and commodity crops (i.e. corn, soybeans and other types of beans) since its IPO back in 2013. The REIT plans to grow its permanent crop exposure, and to a significantly-lesser extent, its commodity crop exposure (depending on how the US-China trade war plays out), along with making investments in facilities that cater to farming needs. Gladstone Land's acquisitions in California showcase this growth strategy in action, with a clear preference for greater permanent crop exposure. **The REIT prefers acquiring family-owned farms in the $2-$50 million price range, utilizing a combination of debt and equity issuances to do so.**

Readers should note that Gladstone Land's growth ambitions have come at a price, and that relates to the REIT's non-existent free cash flows as you can see in the upcoming graphic. REITs are capital-market dependent entities, meaning they require constant access to debt and equity markets to fund their cash flow outspends. Any disruption to that paradigm can have severe consequences for the company, its creditors, and especially its equity holders.

GLADSTONE LAND CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	For the year ended December 31,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 2,766	$ (34)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	9,375	7,237
Amortization of debt issuance costs	582	524
Amortization of deferred rent assets and liabilities, net	(398)	(278)
Bad debt expense	153	150
(Gain) loss on dispositions of real estate assets, net	(5,532)	21
Property and casualty loss	194	—
Loss on write-down of inventory	1,094	—
Changes in operating assets and liabilities:		
Crop inventory and Other assets, net	(3,151)	(1,904)
Accounts payable and accrued expenses and Due to related parties, net	1,942	1,923
Other liabilities, net	3,383	(1,124)
Net cash provided by operating activities	10,408	6,515
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of new real estate assets	(71,436)	(127,835)
Capital expenditures on existing real estate assets	(22,605)	(5,211)
Proceeds from dispositions of real estate assets	132	3,834
Maturity of short-term investment	—	682
Change in deposits on real estate acquisitions and investments, net	100	(1,115)
Net cash used in investing activities	(93,809)	(129,645)

Image Shown: *Gladstone Land is not free cash flow positive.* ***Image Source:*** *Gladstone Land – 2018 Annual Report*

CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of preferred and common equity	74,417	41,907
Offering costs	(4,186)	(1,977)
Payments for redemptions of OP Units	(523)	(2,569)
Borrowings from notes and bonds payable	68,594	108,685
Repayments of notes and bonds payable	(23,455)	(7,906)
Borrowings from lines of credit	29,900	58,400
Repayments of lines of credit	(39,800)	(64,950)
Payment of financing fees	(675)	(881)
Dividends paid on Series B cumulative redeemable preferred stock	(379)	—
Distributions paid on common stock	(8,274)	(6,369)
Distributions paid to non-controlling interests in Operating Partnership	(426)	(710)
Net cash provided by financing activities	95,193	123,630

Image Shown: *Gladstone Land continues to maintain access to capital markets at attractive rates.* ***Image Source:*** *Gladstone Land – 2018 Annual Report*

We caution that the REIT is highly levered, a strategy underpinned in theory by the stability of land prices. **The value of the REIT's farmland properties is heavily influenced by expectations of future agricultural prices.** At the end of June 2019, Gladstone Land carried a net debt load of $322 million. The REIT has done a good job managing that burden by securing fixed interest rates in a low rate environment, with room for upside by refinancing future maturities at modestly lower rates as the US Federal Reserve continues to cut rates (future rate cuts are less certain after the October FOMC meeting). We see Gladstone Land continuing to maintain access to capital markets at attractive rates going forward.

During the second quarter of 2019, Gladstone Land secured an additional $53 million in long-term borrowings from four different lenders at an effective weighted-average interest rate of 4.04%. Please note Gladstone Land continued to be free cash flow negative during the first half of 2019. When excluding its revolving credit line ($75 million in capacity, negligible amount drawn as of the end of June 2019) and Series A Preferred Stock ($29 million carrying value at end of June 2019, mandatory redemption in September 2021), Gladstone Land's debt load carried a weighted-average effective interest rate of 3.59% with a weighted-average maturity of 10.0 years at the end of the second quarter. As you can see in the upcoming graphic, most of that burden doesn't mature until the mid-2020s or later.

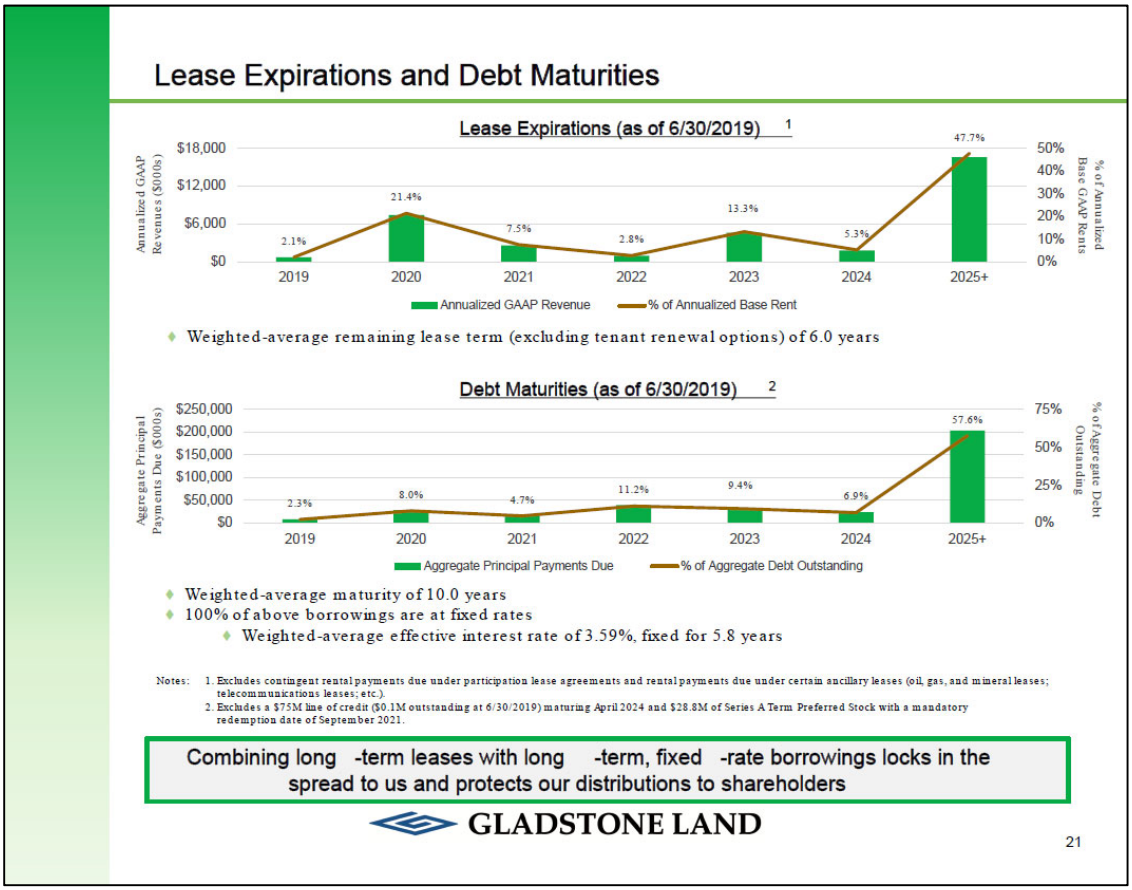


Image Shown: *Gladstone Land has a very manageable debt maturity schedule.* ***Image Source:*** *Gladstone Land – August 2019 IR Presentation*

Additionally, it's important to keep in mind that after 2020, Gladstone Land doesn't have a significant amount of lease expirations until 2023 as you can see in the previous graphic. While lease renewals that result in higher rental revenues behoove Gladstone Land, there's always the chance that those leases aren't renewed.

However, as of the end of the second quarter of 2019, 100% of Gladstone Land's properties were leased. In our view, the most crucial lease renewals are its near-term expirations given the headwinds facing American farmers as a result of ongoing trade wars. Whether that be China sharply scaling down imports of American agricultural products or the growing tensions between the US and the EU, there was arguably a greater chance for the two aforementioned leases (that have since been renewed) to not get extended. The fact that those leases weren't just extended but saw Gladstone Land's rental revenues increase is a nice positive sign in the face of serious exogenous headwinds.

Where Gladstone Land suffers is its weak distribution coverage in terms of either adjusted funds from operations ('AFFO') or free cash flows (which again, are negative). In 2017, Gladstone Land generated $0.556 in AFFO per share while spending $0.524 per share in distributions, leaving a little buffer in place. In 2018, Gladstone land generated $0.514 in AFFO per share, which fell short of $0.532 in distributions per share. Dilution weakened Gladstone's per share distribution coverage on an AFFO basis, with the REIT's diluted weighted-average shares outstanding rising almost 29% from 2017 to 2018.

In the first quarter of 2019, Gladstone Land generated $0.133 in AFFO per share while spending the same amount on total dividend payouts. During the second quarter, Gladstone Land generated $0.125 in AFFO per share while spending $0.134 per share on total dividend payouts (up marginally on a sequential basis). This is partially due to Gladstone Land utilizing substantial equity issuances to fund its growth trajectory, with its diluted weighted-average shares outstanding up 20% sequentially in the second quarter. There's no buffer here for Gladstone Land to push through material payout increases until its AFFO per share shifts meaningfully higher. Recent acquisitions and favorable lease renewals will help change this picture, but we caution that Gladstone Land's payout coverage isn't great.

Gladstone Land tends to trade in a band around its NAV based on its historical stock price performance. Management posts the REIT's NAV in the press releases that accompany each quarterly update. NAV per common share stood at $11.61 during the second quarter of 2019, down from $12.30 in the first quarter of 2019 and $12.88 at the end of 2018. **We'll have a better look at Gladstone Land's performance and its growing asset base in the coming quarters, but we caution that for now, it appears the REIT is largely a play on whether a concrete trade deal is reached between the US and China.**

Valuation of Farms

- While most REITs do not disclose the fair value of their properties, we provide updated valuations of our farms in our quarterly filings with the SEC to show the estimated fair value of our farmland portfolio
- At least once every three years, we will generally have each of our farms appraised by an independent, third -party agricultural appraiser
  - We use appraisers who are certified by a society of agricultural appraisers and are trained in the methods used by farm appraisers
  - During the periods between appraisals, the farmland values are determined by our valuation staff, using updated market data obtained from third-party appraisal reports on other properties in the same regions
- As of June 30, 2019, the fair value of our farmland portfolio was determined as follows:

Valuation Method	Number of Farms	Total Fair Value ($M)	% of Total Fair Value
Purchase Price	16	$ 134.3	20.1%
Third-Party Appraisal	74	533.2	79.9%
Total	90	$ 667.5	100.0%

GLADSTONE LAND

22

Image Shown: *How Gladstone Land obtains a fair value for its farmland properties.* ***Image Source:*** *Gladstone Land – August 2019 IR Presentation*

Disclosure: *Callum Turcan does not own any of the securities mentioned in the article above.*

Bank Earnings Roundup

By Matthew Warren and Brian Nelson, CFA

The big six US banks reported third quarter earnings in October, and they generally came in better than the street had expected. While lower interest rates at both the short and long end of the curve caused some pressure on net interest margins, it seemed to have less of an effect than feared. This, however will be an ongoing story, with rate cuts continuing with the October Federal Reserve meeting. **Even more helpful for the comparisons was the fact that investment banking and trading revenue finally faced easier comparisons versus the prior year. So, instead of double-digit declines of late, these revenue streams were flat to up for most players.** All of the banks continue to pump out the vast bulk of their earnings into dividends and share buybacks, returning substantial sums of cash to shareholders. Wells Fargo leads the pack in terms of outright dividend yield at 4.0% as of this writing. What follows are the individual bank earnings write ups from the week of the actual earnings reports.

JPMorgan Continues to Go from Strength to Strength

On October 15, **JPMorgan** (JPM) posted third-quarter earnings of $2.68 per share, ahead of the average analyst estimate of $2.45. Revenue of $30.06 billion advanced 8.1% compared to the same period last year and $1.7 billion ahead of consensus. Basically, the company managed to overcome very muted expectations for the quarter. Shares of JPM yield 2.9% as of this writing.

Return on tangible common equity continued along at a high level of 18%, versus 17% in the same quarter last year. Importantly, the overhead ratio improved to 55% from 56% last year. The balance sheet remains very strong with a common equity Tier 1 ratio of 12.3%, up slightly sequentially. Loans were flat compared to last year but were up 3% excluding loan sales in Home Lending–where the economics of holding mortgages on the balance sheet aren't overly attractive. Average bank-wide deposits were up an impressive 5% compared to last year, pointing to the strength of the deposit franchise.

Consumer & Community Banking[1]

$mm

		$ O/(U)	
	3Q19	2Q19	3Q18
Revenue	$14,259	$426	$969
Consumer & Business Banking	6,688	(109)	303
Home Lending[2]	1,465	347	159
Card, Merchant Services & Auto	6,106	188	507
Expense	7,290	128	308
Credit costs	1,311	191	331
Net charge-offs (NCOs)	1,261	(59)	181
Change in allowance	50	250	150
Net income	$4,273	$99	$187

Key drivers/statistics ($B)[3]

Equity	$52.0	$52.0	$51.0
ROE	32%	31%	31%
Overhead ratio	51	52	53
Average loans	$459.5	$467.2	$479.6
Average deposits	694.0	690.9	674.2
Active mobile customers (mm)	36.5	35.4	32.5
Debit & credit card sales volume	$282.2	$281.5	$259.0

- Average loans down 4% YoY
- Average deposits up 3% YoY
- Active mobile customers up 12% YoY
- Client investment assets up 13% YoY
- Credit card sales up 10% YoY
- Merchant processing volume up 11% YoY

[1] See note 1 on slide 10
For additional footnotes see slide 11

Financial performance

- Net income of $4.3B, up 5% YoY; revenue of $14.3B, up 7%
  - Higher NIR driven by Home Lending production and auto lease volumes, and higher NII in Card and CBB
- Expense of $7.3B, up 4% YoY, predominantly driven by investments in the business and higher auto lease depreciation, partially offset by expense efficiencies and lower FDIC charges
- Credit costs of $1.3B, up $331mm YoY
  - Card: higher NCOs; $200mm reserve build vs. $150mm in 3Q18
  - Home Lending: $100mm reserve release vs. $250mm in 3Q18
  - Business Banking: $50mm reserve release

Key drivers/statistics ($B) – detail by business

	3Q19	2Q19	3Q18
Consumer & Business Banking			
Business Banking average loans	$24.2	$24.3	$24.1
Business Banking loan originations	1.6	1.7	1.6
Client investment assets (EOP)	337.9	328.1	298.4
Deposit margin	2.47%	2.60%	2.43%
Home Lending			
Average loans	$213.4	$224.7	$242.9
Loan originations[4]	32.4	24.5	22.5
EOP total loans serviced	774.8	780.1	798.6
Net charge-off/(recovery) rate[5]	(0.09)%	(0.06)%	(0.21)%
Card, Merchant Services & Auto			
Card average loans	$158.2	$153.7	$146.3
Auto average loans and leased assets	83.1	83.6	83.2
Auto loan and lease originations	9.1	8.5	8.1
Card net charge-off rate	2.95%	3.24%	2.91%
Card Services net revenue rate	11.40	11.48	11.50
Credit Card sales volume[6]	$193.6	$192.5	$176.0
Merchant processing volume	380.5	371.6	343.8

4 JPMORGAN CHASE & CO.

Image Source: *3Q19 Financial Results Presentation*

The Consumer & Community Banking Segment remains JPMorgan's largest segment by earnings and by far the crown jewel of the bank (see image from the previous page, Page 14). The division put up a 32% ROE compared to 31% in last year's quarter, as the overhead ratio improved to 51% from 53%. Loans were up 4% and deposits up 3% in the segment, while net charge offs remained very benign in this elongated business cycle. Clearly, job gains combined with above-inflation wage gains continue to propel the consumer forward, and consumer banking is floating along nicely on the same tide.

JPMorgan CEO Jamie Dimon admitted plainly that the current benign credit losses are better than through-the-cycle averages during the conference call. He also acknowledged that revenues will come under pressure when the down cycle eventually hits. Until that time, JPMorgan is going from strength to strength, and this bank is clearly well positioned to take market share from weaker hands when the downcycle ultimately arrives. The high end of our Fair Value Range stands at $125 per share.

Wells Fargo's 4%+ Dividend Yield Offers Support to Shares

On October 15, **Wells Fargo** (WFC) reported third-quarter results that showed revenue up 0.3% to $22.01 billion, which beat consensus estimates by $690 million. Earnings came up short with non-GAAP EPS of $1.07 missing by $0.11 and GAAP EPS of $0.92 missing by $0.31. The adjusted figure excludes a $1.6 billion (0.35/share) discrete litigation accrual (related to previously disclosed retail sales practices matters) and a $1.1 billion (0.20/share) gain from its previously-announced sale of its Institutional Retirement and Trust Business. Shares of WFC yield 4.0% as of this writing, the highest in the group as mentioned previously.

Net interest margin compressed from 2.94% in last year's quarter to 2.66% in this year's quarter, due to the lower interest rate environment and assets repricing lower more quickly than deposits. Deposits grew only 2% year over year, much slower than JPMorgan's (JPM) 5% growth rate.

Regarding credit quality, the charge-off rate held pretty flat just under 30 basis points (0.30%). This reflects the benign credit environment from the elongated upcycle we have enjoyed in the US, now in its 11th year.

Clearly, Wells Fargo's missteps have meant that the bank hasn't fully harvested the gains from this up cycle. There was a lot of talk on the earnings call about whether Wells is at the 'end of the beginning' or the 'beginning of the end' of all the changes and expenses it has been forced to take on board by the Fed to improve its operating and compliance infrastructure.

Wells new CEO Charles Scharf starts next week, and we expect him to take a full inventory of the current situation, and we'd hope he will soon take the opportunity to describe what additional work is required to satisfy regulators. His experience at Visa (V), JPMorgan, and Bank of New York Mellon (BK) will come in handy as he tries to right this ambling ship. The core franchise at Wells Fargo is still strong, and we think once the regulators are satisfied with operational and oversight improvements, the bank will again be able to operate on the front foot in with respect to digitalization and going after its fair share of the market. Wells' broad footprint and national scale make it well positioned to fight with the big boys.

Wells Fargo's lack of a sizable investment bank and trading operations is a bit of a Rorschach Test for analysts and investors. On the one hand, it makes it harder to compete for business from the largest of large corporates, since it is not a full one stop shop. On the other hand, it means higher-quality earnings from bread-and-butter banking and reduced exposure to the wildly cyclical and low return world of investment-banking and trading. Given Wells Fargo's impressive dividend yield, we think the shares of WFC have a floor beneath them, barring any additional scandals coming to light–something we think is unlikely at this stage. Our Fair Value Estimate remains $52 per share.

Citigroup Lags Peers in Key Metrics

Cititgroup's (C) third-quarter report, released October 15, showed revenue of $18.57 billion, which beat consensus by $30 million and non-GAAP EPS of $1.97 which beat by $0.02. GAAP EPS of $2.07 beat by $0.12. Revenue in the quarter was up only 1%, as currency headwinds lowered overall reported growth rates. The efficiency ratio worsened slightly to 56.3% from 56.1% in last year's quarter. On this key metric, the bank lags its money center peers. **Similarly, it lags peers with respect to return on tangible common equity (ROTCE), too, which came in at 12.2% in the quarter, though this metric has improved markedly under the current management team.** Shares of C yield 2.8% as of this writing.

Earnings before taxes were down 1%, but a lower tax rate meant net income was up 6%. Ten percent fewer shares outstanding thanks to buybacks meant that earnings per share were up a whopping 20%, highlighting what outstanding excess capital return that share buybacks at around tangible book value can do for the shareholders.

End-of-period loans grew 4% in the quarter versus last year and end-of-period deposits grew an impressive 9%. The bank is having success converting US branded credit card holders, getting them to open savings and transactional accounts, with two thirds of those openings taking place away from its 6 core US geographic (footprint) markets. This shows the power of its credit card relationships and rewards programs, and it also shows the disruptive nature of digital banking. Citigroup plans to roll out similar programs to gather transactional and deposit banking accounts with its co-branded credit card accounts soon.

Citigroup remains well capitalized with a 11.6% Common Equity Tier 1 Capital Ratio, but there isn't room to lever up. Management has recently expressed less optimism about reaching its previously stated goal of reaching a 13.5% ROTCE in 2020, and the market consensus has them coming up short of the same goal. Operating leverage has helped the bank improve this metric by several percentage points in the past few years, but it appears that the cost-cutting road is getting increasingly difficult. Now more revenue dependent in improving its return metric, this leaves the bank also counting on the 11-year economic upcycle to continue. It is therefore unsurprising that this bank trades right near its tangible book value of $69.03 per share. Our Fair Value Estimate remains $71 per share.

Buffett Favorite, Bank of America a Bargain

"If Bank of America can continue to narrow the return on capital gap to JPMorgan, we expect its shares will grow into our $35 fair value estimate." – Matthew Warren

On October 16, **Bank of America** (BAC) reported third-quarter results that showed adjusted EPS of 75 cents per share, as compared to the average analyst estimate of 68 cents per share, and 66 cents in the year-ago quarter. The adjustment was for the previously announced $2.1 billion pre-tax impairment charge related to Bank of America's investment in its merchant services joint venture from 2009, which negatively impacted EPS by 19 cents per share. The bank plans to create this capability in-house going forward. Shares of BAC yield 2.3% as of this writing.

Total revenue was flat compared to last year while adjusted net income was up 4% and adjusted diluted EPS was up 14%. The firm's share count fell 8% year over year thanks to its massive share buyback program. The bank's efficiency ratio came in flat at 57%, while its return on tangible common shareholders' equity was an impressive 15.6%. After 18 quarters of positive operating leverage, Bank of America just barely missed extending that streak to 19 quarters. We would characterize cost control as solid, nonetheless. **The bank's capital levels remained robust with a common equity Tier 1 ratio of 11.4%, the same as this time last year.**

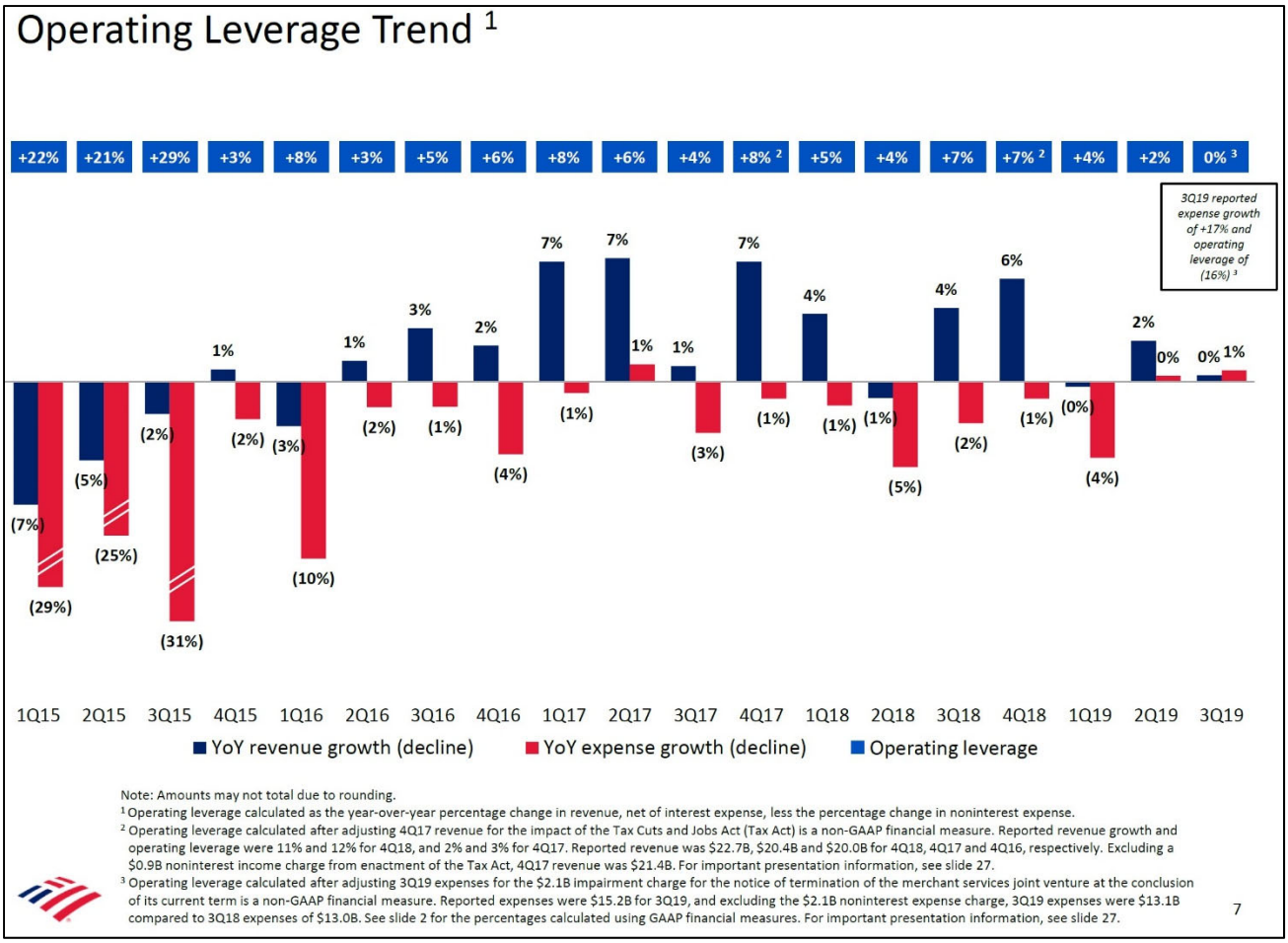


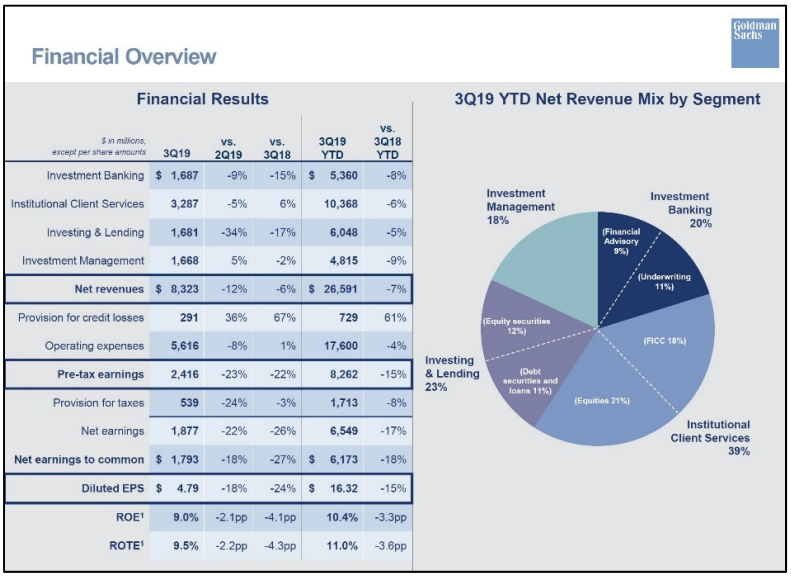
Image Source: *Bank of America Earnings Presentation*

Although net interest margins were under pressure from the lower interest rate environment (both long and short ends of the curve), total corporation deposits advanced 4%, as were total loans and leases. In a 2% real- and roughly-4% nominal-GDP-growth world, these figures show that the bank is holding or gaining market share as compared to the total banking system.

All in all, Bank of America's third quarter was pretty uneventful, if not boring. This is exactly what one wants to see at this point in the cycle, as credit quality remains benign 10 years and a bit into the current upcycle. The current management team continues to invest in both growth and efficiency, and we expect these actions will continue to bear fruit in the form of growth, cost control, and return on capital. If Bank of America can continue to narrow the return on capital gap to JPMorgan, we expect shares of BAC will grow into our $35 Fair Value Estimate.

More recently, our team took a deep dive into Bank of America's preferred equity, thesis highlighted in the Exclusive publication, a part of the Institutional membership level. We'd also like to note that Bank of America remains a Warren Buffett favorite, with the Oracle recently asking the Fed permission for Berkshire (BRK.B) to increase its stake in the bank to greater than 10% (it currently owns just shy of a 10% stake in the bank). We include Berkshire in the Best Ideas Newsletter portfolio, and by extension, we also have indirect exposure to Bank of America, which remains one of our favorite banks.

Goldman Sachs' Return Metrics Remain Subpar



Financial Overview

Financial Results

$ in millions, except per share amounts	3Q19	vs. 2Q19	vs. 3Q18	3Q19 YTD	vs. 3Q18 YTD
Investment Banking	$ 1,687	-9%	-15%	$ 5,360	-8%
Institutional Client Services	3,287	-5%	6%	10,368	-6%
Investing & Lending	1,681	-34%	-17%	6,048	-5%
Investment Management	1,668	5%	-2%	4,815	-9%
Net revenues	$ 8,323	-12%	-6%	$ 26,591	-7%
Provision for credit losses	291	36%	67%	729	61%
Operating expenses	5,616	-8%	1%	17,600	-4%
Pre-tax earnings	2,416	-23%	-22%	8,262	-15%
Provision for taxes	539	-24%	-3%	1,713	-8%
Net earnings	1,877	-22%	-26%	6,549	-17%
Net earnings to common	$ 1,793	-18%	-27%	$ 6,173	-18%
Diluted EPS	$ 4.79	-18%	-24%	$ 16.32	-15%
ROE[1]	9.0%	-2.1pp	-4.1pp	10.4%	-3.3pp
ROTE[1]	9.5%	-2.2pp	-4.3pp	11.0%	-3.6pp

3Q19 YTD Net Revenue Mix by Segment

Image Source: *Goldman Sachs 3Q2019 Earnings Presentation*

Goldman Sachs (GS) reported third-quarter results October 15. The bank missed analyst consensus estimates for revenue by $10 million, and GAAP EPS of $4.79 per share missed by $0.09. Overall firm revenues dropped 6% versus the year-ago period, operating expenses increased 1%, net earnings were down 26%, and diluted EPS tumbled 24%. The weakness was most pronounced in investment banking where revenues fell 15% versus last year's quarter and Investing & Lending where revenues plummeted 17%. Goldman Sachs generated a sub-par return on equity (ROE) of 9% (down 2.1 percentage points versus last year) and return on tangible equity (ROTE) of 9.5% during the quarter. Shares of GS yield 2.4% as of this writing.

While Goldman management tried to explain away the revenue weakness by pointing out that it is still leading many of the "league tables," the year-over-year comparisons did look weaker than its peers this quarter. Since quarterly comparisons can be noisy, one must watch over longer periods for the broader trend. Management also tried to explain the negative operating leverage by talking about its investment in platforms as opposed to people.

The bank is building out its retail platform Marcus as well as its institutional platform Marquee, as well as covering the expenses surrounding the launch of the Apple Card. Specifically, they put the ROE drag at 60 basis points (0.60%) in the quarter, with this year being the biggest investment year. Management will be giving a strategic update in January to dig into these issues in greater detail and to give more guidance about how analysts and investors can hold them accountable to these investment programs.

Our overall take on Goldman Sachs is that, given the lower amount of leverage the bank is able to employ under the current regulatory regime, it is very difficult for it to replicate the mid-to-high teens return on equity it put up in the go-go years leading up to the Global Financial Crisis. Goldman Sachs is now a bank holding company and is trying to add deposits to bring funding costs down toward those of their money-center peers. This is a difficult ask and a long road, though we note it has certainly made progress bidding up for deposits.

While lower leverage means less risk, we still don't like the equity holdings (private and public) sitting on the balance sheet of this leveraged institution. We also don't like the large exposures to investment banking and trading, two businesses that are highly cyclical, market dependent, and low return on capital. We are maintaining our $200 Fair Value Estimate at this time, and we won't be adding Goldman Sachs to any newsletter portfolio anytime soon. Bank of America remains our favorite big bank at the moment.

Morgan Stanley Could See Lower Capital Requirements

"...the Wealth Management and Investment Management segments...are the crown jewels at Morgan Stanley with returns on tangible equity of 37% and 36%, respectively, in the quarter. Flows are positive and market levels have been friendly, though that can change on a dime." -- Matthew Warren

On October 17, **Morgan Stanley** (MS) reported third-quarter results. The bank posted revenue of $10.03 billion, which was up 1.62% versus last year and $405.3 million ahead of consensus. Earnings came in at $1.27 per share, up 9% from last year, and were 15 cents ahead of consensus. The bank's efficiency ratio worsened to 73% from 71% last year, and it posted a return on equity (ROE) of 11.2% and return on tangible common equity (ROTCE) of 12.9% in the quarter. Morgan Stanley is very well capitalized with a common equity Tier 1 ratio of 16.2%. Shares of MS yield 3.1% as of this writing.

Morgan Stanley

Consolidated Financial Summary

(unaudited, dollars in millions)

	Quarter Ended			Percentage Change From:		Nine Months Ended		Percentage
	Sep 30, 2019	Jun 30, 2019	Sep 30, 2018	Jun 30, 2019	Sep 30, 2018	Sep 30, 2019	Sep 30, 2018	Change
Net revenues								
Institutional Securities	$ 5,023	$ 5,113	$ 4,929	(2%)	2%	$ 15,332	$ 16,743	(8%)
Wealth Management	4,358	4,408	4,399	(1%)	(1%)	13,155	13,098	--
Investment Management	764	839	653	(9%)	17%	2,407	2,062	17%
Intersegment Eliminations	(113)	(116)	(109)	3%	(4%)	(332)	(344)	3%
Net revenues	$ 10,032	$ 10,244	$ 9,872	(2%)	2%	$ 30,562	$ 31,559	(3%)
Non-interest expenses								
Institutional Securities	$ 3,716	$ 3,650	$ 3,373	2%	10%	$ 10,967	$ 11,263	(3%)
Wealth Management	3,120	3,165	3,205	(1%)	(3%)	9,486	9,587	(1%)
Investment Management	599	640	551	(6%)	9%	1,869	1,672	12%
Intersegment Eliminations	(113)	(114)	(108)	1%	(5%)	(328)	(343)	4%
Non-interest expenses [1]	$ 7,322	$ 7,341	$ 7,021	--	4%	$ 21,994	$ 22,179	(1%)
Income (loss) before taxes								
Institutional Securities	$ 1,307	$ 1,463	$ 1,556	(11%)	(16%)	$ 4,365	$ 5,480	(20%)
Wealth Management	1,238	1,243	1,194	--	4%	3,669	3,511	5%
Investment Management	165	199	102	(17%)	62%	538	390	38%
Intersegment Eliminations	0	(2)	(1)	*	*	(4)	(1)	*
Income (loss) before taxes	$ 2,710	$ 2,903	$ 2,851	(7%)	(5%)	$ 8,568	$ 9,380	(9%)
Net Income (loss) applicable to Morgan Stanley								
Institutional Securities	$ 1,073	$ 1,121	$ 1,120	(4%)	(4%)	$ 3,565	$ 4,204	(15%)
Wealth Management	962	953	913	1%	5%	2,839	2,703	5%
Investment Management	138	128	80	8%	73%	402	311	29%
Intersegment Eliminations	0	(1)	(1)	*	*	(3)	(1)	(200%)
Net Income (loss) applicable to Morgan Stanley	$ 2,173	$ 2,201	$ 2,112	(1%)	3%	$ 6,803	$ 7,217	(6%)
Earnings (loss) applicable to Morgan Stanley common shareholders	$ 2,060	$ 2,031	$ 2,019	1%	2%	$ 6,427	$ 6,861	(6%)

The End Notes are an integral part of this presentation. See pages 12 - 17 for Definition of U.S. GAAP to Non-GAAP Measures, Definition of Performance Metrics and Terms, Supplemental Quantitative Details and Calculations, and Legal Notice.

Image Source: *Morgan Stanley 3rd Quarter Earnings Presentation*

Fixed income underwriting and sales and trading were a source of strength in the Institutional Securities Business, but all underwriting and sales and trading businesses are notoriously volatile from quarter to quarter and year to year, **and the overall return on capital at 10% is lackluster indeed.** It is the Wealth Management and Investment Management segments, however, that are the crown jewels at Morgan Stanley with returns on tangible equity of 37% and 36%, respectively, in the quarter. Flows are positive and market levels have been friendly, though that can change on a dime.

The most interesting discussion on the conference call was that Morgan Stanley's management is expecting the Federal Reserve to alter its capital requirements for the firm with a greater focus on common equity Tier 1 ratio as opposed to a leverage ratio. The bank expects that the amount of capital it will be required to hold will be flat-to-down, though it wasn't willing to speculate as to the degree of the expected change.

Needless to say, less capital would mean greater leverage, and a higher return on capital. Assuming the market agrees with the Fed that the new requirements suffice as to the amount of capital, then we would expect a higher return on equity and a higher price-to-book ratio as a result (as future expected economic returns would theoretically be higher). This would be a positive for the shares, though again we would emphasize that the magnitude of the change is altogether unknown at this stage. We are maintaining our $45 Fair Value Estimate for now.

Disclosure: *Matthew Warren and Brian Nelson do not own any of the securities mentioned above.*

Key Contributors

- Brian Nelson, CFA
President, Investment Research
brian@valuentum.com

- Callum Turcan
Associate Investment Analyst
info@valuentum.com

- Matthew Warren
Independent Contributor
info@valuentum.com

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.*

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'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 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%	8.43%
Global X SuperDividend ETF	SDIV	5.0%	9.40%
Global X SuperIncome Preferred ETF	SPFF	10.0%	6.39%
iShares International Select Dividend ETF	IDV	5.0%	5.90%
iShares MSCI Australia ETF	EWA	5.0%	5.36%
iShares U.S. Preferred Stock ETF	PFF	5.0%	5.56%
PowerShares Senior Loan Portfolio	BKLN	5.0%	5.10%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	6.35%
Utilities Select Sector SPDR	XLU	5.0%	2.88%
Vanguard Real Estate ETF	VNQ	10.0%	3.12%
EQUITY			
AT&T	T	5.0%	5.30%
BP PLC	BP	5.0%	6.49%
CubeSmart	CUBE	5.0%	4.04%
Digital Realty Trust	DLR	5.0%	3.40%
Enterprise Products Partners	EPD	5.0%	6.80%
Magellan Midstream Partners	MMP	5.0%	6.36%
Philip Morris	PM	5.0%	5.75%
Public Storage	PSA	5.0%	3.59%
Cash*	-	0.0%	2.25%
		100.0%	**5.49%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 11/1/2019. Est. Div. Yield retrieved from YahooFinance.

** Reflects high end of federal funds rate*

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	Sector	Div Yield	Economic Castle	Multiplier
General Motors	GM	Consumer Discretionary	4.1%	Attractive	14.13
Honda	HMC	Consumer Discretionary	3.9%	Neutral	13.94
Chico's FAS	CHS	Miscellaneous	5.9%	Attractive	13.74
Gilead Sciences	GILD	Health Care	3.9%	Very Attractive	12.17
Fluor	FLR	Industrials	2.9%	Attractive	11.79
Guess	GES	Consumer Discretionary	2.7%	Attractive	11.33
Lear Corp	LEA	Consumer Discretionary	2.8%	Attractive	10.98
Hewlett-Packard	HPQ	Information Technology	3.7%	Attractive	10.84
Automatic Data Processing	ADP	Information Technology	2.1%	Very Attractive	10.36
Gap	GPS	Consumer Discretionary	6.0%	Attractive	10.25
Abercrombie & Fitch	ANF	Miscellaneous	3.1%	Attractive	10.17
Ralph Lauren	RL	Consumer Discretionary	2.8%	Attractive	10.08
Tapestry	TPR	Consumer Discretionary	5.2%	Attractive	9.95
Methode Electronics	MEI	Information Technology	1.6%	Attractive	9.75
Bristol-Myers Squibb	BMY	Health Care	3.4%	Very Attractive	9.29
American Eagle	AEO	Miscellaneous	2.6%	Attractive	9.19
Cheesecake Factory	CAKE	Consumer Discretionary	3.7%	Attractive	8.52
Total	TOT	Energy	5.1%	Neutral	8.27
Huntsman	HUN	Materials	2.7%	Attractive	8.25
Omnicom	OMC	Consumer Discretionary	3.5%	Unattractive	8.01
Dick's Sporting	DKS	Consumer Discretionary	3.0%	Attractive	7.96
QUALCOMM	QCOM	Information Technology	3.6%	Very Attractive	7.71
H&R Block	HRB	Consumer Discretionary	3.7%	Very Attractive	7.67
Walgreens Boots Alliance	WBA	Consumer Staples	3.3%	Attractive	7.64
AVX Corp	AVX	Information Technology	2.5%	Attractive	7.50
Manpower	MAN	Information Technology	2.4%	Attractive	7.47
Ford	F	Consumer Discretionary	6.5%	Neutral	7.47
Archer-Daniels-Midland	ADM	Consumer Staples	3.5%	Attractive	7.40
Amgen	AMGN	Health Care	3.1%	Very Attractive	7.37
Ethan Allen	ETH	Consumer Discretionary	4.0%	Unattractive	7.31
Cisco	CSCO	Information Technology	2.6%	Very Attractive	7.17
MKS Instruments	MKSI	Information Technology	0.8%	Attractive	7.15
Caterpillar	CAT	Industrials	2.9%	Very Attractive	7.14
McKesson	MCK	Health Care	1.2%	Very Attractive	7.07
Applied Materials	AMAT	Information Technology	2.0%	Very Attractive	7.01
Harley-Davidson	HOG	Consumer Discretionary	4.2%	Attractive	6.97
Cardinal Health	CAH	Health Care	4.2%	Attractive	6.95
Novartis	NVS	Health Care	3.0%	Attractive	6.93
AmerisourceBergen	ABC	Health Care	2.0%	Very Attractive	6.92
Paychex	PAYX	Information Technology	2.8%	Very Attractive	6.92
Apple	AAPL	Information Technology	1.3%	Highest Rated	6.91
Altria Group	MO	Consumer Staples	6.7%	Very Attractive	6.78
Johnson & Johnson	JNJ	Consumer Staples	2.9%	Attractive	6.73
KLA-Tencor	KLAC	Information Technology	2.4%	Very Attractive	6.69
Xerox	XRX	Industrials	3.2%	Attractive	6.69
Williams-Sonoma	WSM	Consumer Discretionary	3.4%	Attractive	6.69
Robert Half	RHI	Information Technology	1.9%	Very Attractive	6.66
Expeditors Intl	EXPD	Industrials	1.4%	Very Attractive	6.63
ABB	ABB	Industrials	4.4%	Attractive	6.62
Garmin	GRMN	Industrials	2.9%	Attractive	6.59

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, there may be stocks that are dealing with a secular shift toward digital consumption or navigating changing consumer preferences as millennials seek 'experiences' not 'things' (e.g. fashion). These may not be the best dividend growth stocks to consider. The Dividend Cushion is only one factor that we use in assessing the overall health of a company's dividend.

DIVIDEND REPORT PAGE 2 – TAPESTRY INC (TPR)

Tapestry TPR UNDERVALUED 27.2%

Buying Index™ 9 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Attractive	$33.00 - $49.00	HEALTHY	GOOD / 1.9	GOOD	5.20%

Assessment of Company Dividend Strategy

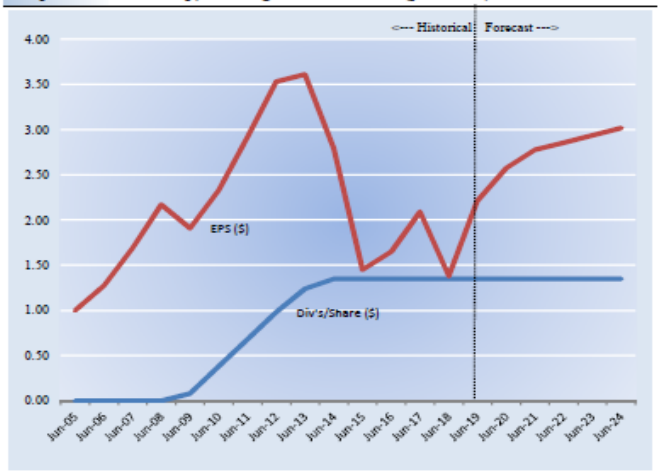
Key Strengths

Tapestry is not your typical dividend growth equity. It doesn't have the consecutive annual dividend-growth track record, for one, but fashion trends are as difficult to predict as the weather. Such a risk is now more pronounced after its balance sheet strength has eroded. The purchase of Stuart Weitzman depleted some of its balance-sheet strength, and the recent ~$2.4 billion cash deal for Kate Spade has flipped its net cash position to a net debt position. We like the $100-$115 million annual synergies target, and double digit accretion in fiscal 2019 bodes well for dividend potential. Free cash flow averaged $554 million over the past three fiscal years (2016-2018), more than enough to cover annual run rate cash dividend obligations of $384 million.

Potential Weaknesses

Changing fashion trends may be Tapestry's biggest risk as the company works to turn around its North American women's handbag business. Operating cash flow has been under pressure during the past few years, and the jury is still out on how effective the deal to scoop up the Stuart Weitzman brand will be in stemming the declines, especially after considering the impact it has had on operating margins thus far. Monitoring its North American business turnaround, the pace of sales in mainland China, and progress toward its operating-efficiency goals will be vital for income investors. We're keeping a much closer eye on free cash flow generation trends after the Kate Spade deal has impacted the cushion that existed on its balance sheet.

Graphical Relationship, Earnings and Dividends (per share)

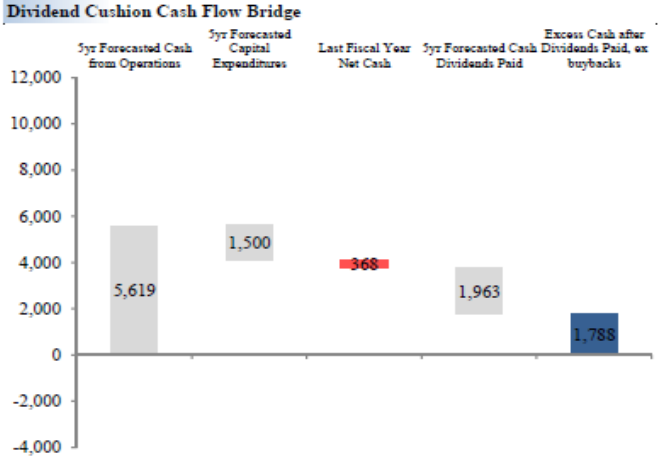


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

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. Tapestry'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

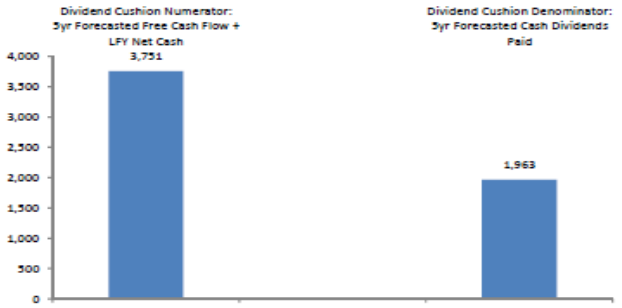


Source: Company Filings, Valuentum Projections

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, Tapestry'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.