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HIGH YIELD DIVIDEND NEWSLETTER

Digital Realty's Growth Outlook Improving, Shares Near All-Time Highs

Latest Changes to High Yield Dividend Newsletter
Weighting Changes: 2.5% Reduction in BP, EPD, MMP (Bringing Each Weighting Down to 2.5%) – April 1
Added: 7.5% to SJB – April 1

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"ON APRIL 29, THE FEDERAL RESERVE MADE IT CLEAR THAT U.S. INTEREST RATES WOULD REMAIN LOW FOR A SUSTAINED PERIOD OF TIME TO BOLSTER ECONOMIC ACTIVITY IN THE WAKE OF THE ONGOING PANDEMIC."

– CALLUM TURCAN

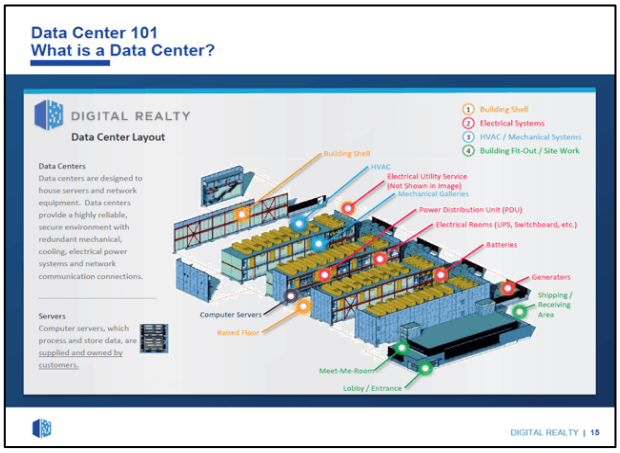

Image Source: *Digital Realty Trust Inc – March 2020 IR Presentation*

By Callum Turcan

Please note a version of this article was emailed out to members on April 9.

Dear members,

Digital Realty Trust Inc (DLR) is a holding in the High Yield Dividend Newsletter portfolio, and its shares have performed quite well of late with DLR trading near all-time highs as of late-April. **Year-to-date, DLR is up ~25% while the S&P 500 (SPY) is down ~9% as of this writing on April 30.** Demand for data centers is surging as the ongoing coronavirus ('COVID-19') pandemic is forcing households to stay indoors, which in turn is increasing demand for video streaming services, telecommunications offerings, and other activities that are voracious consumers of data which speaks favorably to Digital Realty Trust's outlook.

During these harrowing times, we hope members and their loved ones are staying safe as we ride out the pandemic. Shares of DLR yield roughly ~3.0% as of this writing.

Data Demand

Anecdotally, there's a lot of signs out there that data demand has exploded over the past several weeks. For instance, Microsoft Corporation (MSFT) reported a near eight-fold surge in demand for its cloud-based Teams offering in Italy during the month of March. Facebook Inc's (FB) WhatsApp messaging service saw a double-digit increase in its usage in March according to a study conducted by Kantar, a consulting and research firm.

Additionally, Kantar reported that usage of Facebook's namesake social media site and Instagram (owned by Facebook) also appeared to have surged in March as the pandemic spread across the world, forcing households and individuals to stay inside (and thus turn to apps and social media to stay connected with friends, family, loved ones, and the world at-large).

A Growing Global Footprint

With that in mind, let's pivot now to one of Digital Realty's big acquisitions. The real estate investment trust ('REIT') recently moved deeper into Europe in a big way with the completion of its acquisition of InterXion in March 2020, a deal we see as generating meaningful shareholder value over time. Digital Realty's CEO, A. William Stein, had this to say in the press release:

> *"We are pleased to have closed our combination with InterXion… This powerful combination builds upon Digital Realty's established foundation of serving market demand for colocation, scale and hyperscale requirements in the Americas, EMEA and Asia Pacific and leverages InterXion's European colocation and interconnection expertise, enhancing the combined company's capabilities to enable customers to solve for the full spectrum of data center requirements across a global platform.*
>
> *The combination of our two organizations establishes a global platform that we believe will significantly enhance our ability to create long-term value for customers, shareholders and employees of both companies."*

When the deal was announced in October 2019, it was valued at $8.4 billion by enterprise value. What we like about the deal is Digital Realty's new position in 13 major European metropolitan markets (including Frankfurt, Amsterdam, Paris, and Marseille) across 11 countries. Digital Realty had a material presence in London, UK, and Dublin, Ireland, before the deal closed and moving deeper into Europe allows for the REIT to tie those operations in with the operations of its recently acquired assets. As part of Digital Realty's European strategy, the REIT opened another data center in Dublin on March 5, 2020, to capitalize on what the company described as a coming European tech boom (from the press release):

> *"[Digital Realty] announced today the official opening of its Clonshaugh data centre, the latest facility in its portfolio of data centres in Dublin, Ireland. The data centre, which represents a €70 million investment, follows the company's previous €200 million investment in the Dublin data centre market, culminating in the opening of its Profile Park campus last May. The new Clonshaugh facility supports the growth of Dublin's technology ecosystem, which is predicted to experience a multibillion euro technology boom over the next decade, according to a new study commissioned by Digital Realty and conducted by Development Economics."*

The upcoming graphic down below highlights Digital Realty's growing global footprint. On April 7, 2020, Digital Realty announced it had commenced operations at its third data center in Singapore, the city-state.

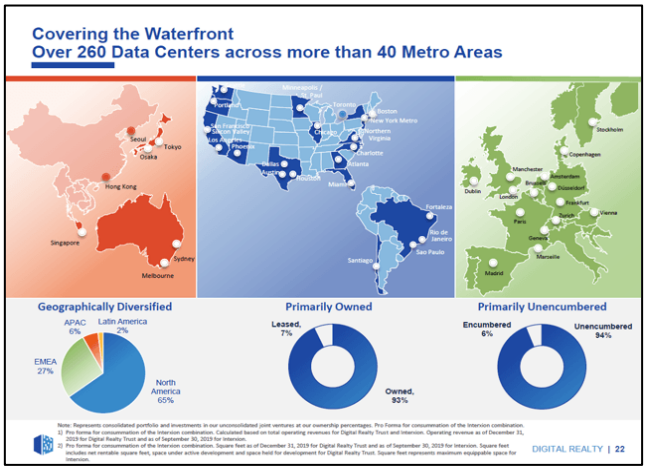

Image Shown: *A look at Digital Realty's growing global footprint.* ***Image Source:*** *Digital Realty – March 2020 IR Presentation*

Furthermore, please note the REIT is also working towards establishing a presence in India to extend its growth runway, as Asia represents another prime growth opportunity.

Underpinning Digital Realty's growth runway (specifically as it relates to the potential European data demand boom) is the rollout of 5G and the rise of artificial intelligence, the Internet of Things ('IoT'), and blockchain technologies (as cited in the press release). This is true for the world at-large as well.

Data demand growth stemming from the "cocooning" of households aside, **Digital Realty is taking the long-term view here and sees numerous secular tailwinds supporting its various data center investments.** Additionally, we want to stress that the rise of semi-autonomous and more importantly, autonomous vehicles should also create a lot of incremental data demand over the coming years and decades.

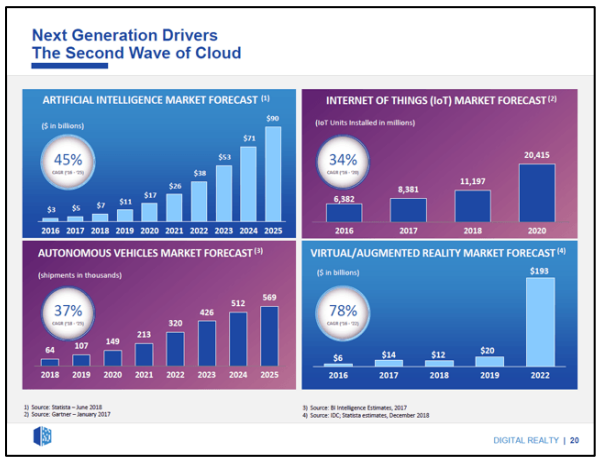

Image Shown: *Secular growth tailwinds support forecasts calling for rising data demand over the coming years and decades.* ***Image Source:*** *Digital Realty – March 2020 IR Presentation*

Financial Considerations

2019 was a relatively tough year for data center REITs, particularly Digital Realty given it had a lot of lease expirations last year (~22.5% of its annualized revenue that year), and one of the bright spots in early-2020 (according to Digital Realty's management team back in February 2020) was that certain metropolitan areas were still seeing rental price increases (particularly those that were supply constrained).

With that dynamic in mind, considering demand for data has likely skyrocketed since then, **there's room for optimism as it relates to potential rental rates increases** in both key metropolitan areas (which Digital Realty now has greater exposure to) and elsewhere. That's likely why shares of Digital Realty have performed so well of late, in our view.

In the graphic down below, please note that Digital Realty does have a meaningful amount of lease expirations in 2020-2022 (however, still significantly less than 2019 levels on an annual basis). **While that was previously considered a burden, now it's an opportunity** assuming rising global data demand translates into annual cash rental rate increases at the higher end of Digital Realty's guidance (which sits at 2%-4% on a long-term basis). Please note that Digital Realty's annual cash rental rates actually decreased in 2019, so **a return to growth is a bigger positive than first appearances would suggest.** The decrease in the REIT's cash rental rates last year ended up being less than management had initially forecasted (down a tad over 1% versus expectations for a high single-digit decrease), and most importantly, **equities trade on future expectations not historical performance.**

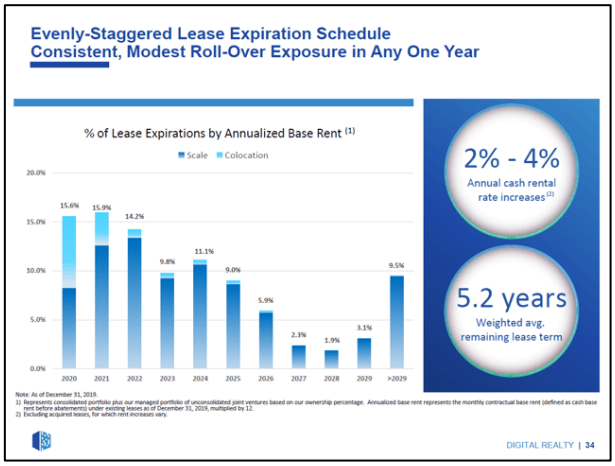

Image Shown: *It's possible that Digital Realty will be able to win over meaningful annual cash rental rate increases when its current leases expire as demand for data centers is likely quite strong right now, which supports its cash flow growth outlook.* ***Image Source:*** *Digital Realty – March 2020 IR Presentation*

Digital Realty has solid investment grade credit ratings (BBB/Baa2/BBB) and the REIT utilizes equity issuances to raise funds, a task made much easier given its strong stock price performance of late.

Historically, that has included using at-the-market equity issuance programs. Given its strong stock price performance, on top of its investment grade credit ratings, it appears Digital Realty retains access to capital markets at attractive rates (both debt and equity markets). As a capital-market dependent company (the REIT must retain access to capital markets at all times to refinance its maturing debt load, for general corporate purposes, and to fund its growth ambitions), Digital Realty needs to make sure its growth plans don't stretch its balance sheet too thin. As of the end of 2019, Digital Realty had a balanced maturity schedule which we appreciate, as you can see in the upcoming graphic down below.

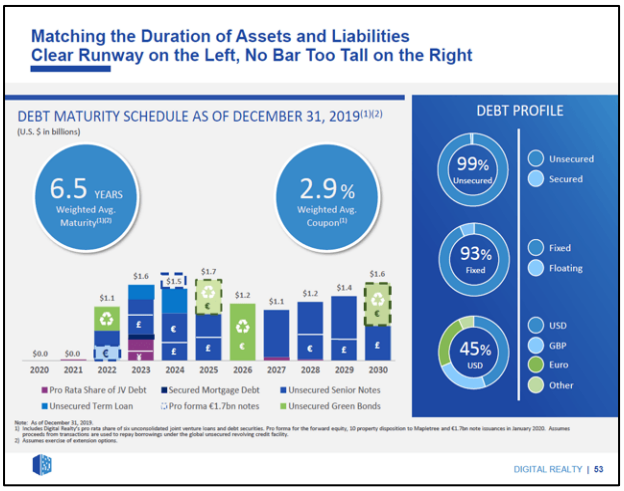

Image Shown: *Digital Realty's debt maturity schedule was balanced at the end of 2019. Given that the REIT didn't have a material amount of maturities until 2022 as of the end of last year, the firm is well-positioned to ride out the current storm.* ***Image Source:*** *Digital Realty – March 2020 IR Presentation*

Concluding Thoughts

We continue to like Digital Realty in the High Yield Dividend Newsletter portfolio. **The REIT's strong stock price performance of late is a sign that investors are becoming increasingly optimistic of Digital Realty's growth outlook, which in part is supported by the expected return of positive cash rental rate growth (organic growth) this year.**

Digital Realty is set to report its first quarter earnings for 2020 after the market closes on May 7, and management will likely provide investors with some concrete information on how the ongoing pandemic is impacting its operations, financials, and global data & data center demand.

We'll continue to provide our members with coverage of this interesting dividend growth play, and we expect to increase our fair value estimate of DLR materially upon the next update.

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

Philip Morris International is Ready to Ride Out the Storm

Image Source: *Philip Morris International Inc – First Quarter of 2020 Earnings IR Presentation*

By Callum Turcan

On April 21, High Yield Dividend Newsletter portfolio holding Philip Morris International Inc (PM) reported first-quarter earnings for 2020 which beat both top- and bottom-line consensus estimates. Shares of PM currently yield ~6.2% as of this writing, and we view that payout as well-covered given the resilience of Philip Morris International's free cash flows and business model (demand for tobacco and tobacco products is inelastic), along with the firm's ability to tap its revolving credit lines and potentially debt markets if needed. Management pulled the firm's full-year guidance for 2020 and instead offered guidance for the second quarter, given the lack of clarity over macroeconomic conditions in light of the ongoing coronavirus ('COVID-19') pandemic.

Quarterly Overview

The pandemic will hurt Philip Morris International's performance in the near term due to the negative impact COVID-19 and the slowdown of the global economy are having on disposable incomes. Historically, **Philip Morris International has been extremely effective at raising prices on its products** to offset secular demand declines for cigarettes (in particular, the negative effect lower cigarette volumes can have on the firm's financial performance).

Keeping the deconsolidation of its Canadian subsidiary Rothmans, Benson & Hedges ('RBH') in mind, **Philip Morris International was able to push through a 7.7% year-over-year increase in its combustible tobacco pricing last quarter** with COVID-19 having just a tiny impact on its ability to do so. **However, going forward that will likely change in the short-term.**

In the long run, Philip Morris International should retain its ability to push forward with meaningful price increases given its strong brand power and the relative inelastic demand curves of tobacco products.

Last quarter, the company's cigarette shipment volumes were down 4.4% while its heated tobacco unit ('HTU') shipment volumes were up 45.5% on a year-over-year basis, allowing for its total cigarette and HTU shipment volumes to slip by just 1.2% year-over-year. Heated tobacco offerings like IQOS (which does not stand for anything) are becoming increasing popular worldwide and offer a way for Philip Morris International to mitigate secular demand declines for traditional cigarettes. When removing the negative impact from the deconsolidation of RBH, Philip Morris International's total cigarette and HTU shipment volumes moved lower by just 0.6% year-over-year last quarter.

Even more importantly, **HTUs now make up almost 10% of Philip Morris International's total shipment volumes**, a figure that has grown substantially since 2015 when HTUs made up less than 1% of its total shipment volumes, as you can see in the upcoming graphic down below.

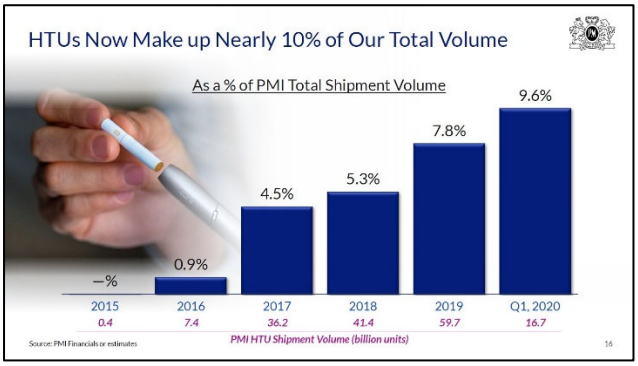

Image Shown: *Philip Morris International is leaning on HTUs to offset secular demand declines for its traditional cigarette offerings.* ***Image Source:*** *Philip Morris International – First Quarter of 2020 Earnings IR Presentation*

While Philip Morris International is marketing its IQOS product in numerous markets worldwide, in the US the firm is working with Altria Group Inc (MO) to market the product, which for reference, launched in the US last year. So far, the product has had a decent amount of success, keeping in mind that COVID-19 is likely to slow those efforts in the near term in the US and elsewhere (according to management commentary within Philip Morris International's earnings report).

In the upcoming graphic down below, please note the growing popularity of Philip Morris International's IQOS offering. Over time, products like IQOS should allow for HTUs to continue growing as a percentage of Philip Morris International's total shipment volumes, offsetting volume declines at its traditional cigarette offerings which in turn **supports the company's cash flow outlook.** Philip Morris International is now seeking regulatory approval from the US Food and Drug Administration ('FDA') to sell its IQOS 3 heated tobacco device in the US, having already won regulatory approval to sell other versions of its IQOS device in the country.

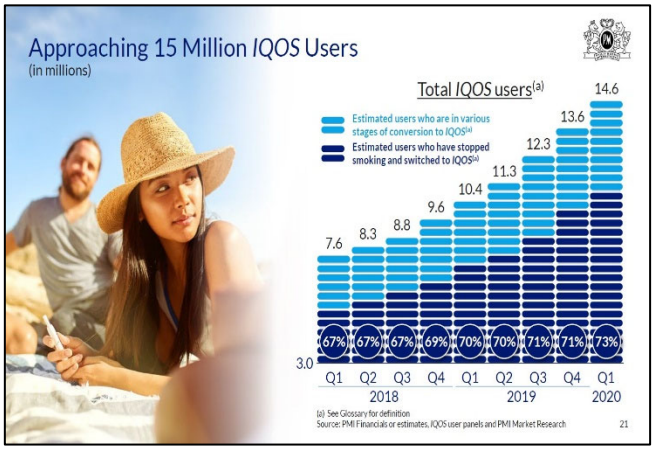

Image Shown: *Philip Morris International's IQOS product is experiencing nice adoption levels worldwide, and there's ample room for that adoption rate to continue climbing higher now that Altria is marketing the offering in the US.* ***Image Source:*** *Philip Morris International – First Quarter of 2020 Earnings IR Presentation*

On a GAAP basis, Philip Morris International's net revenues rose by 6% year-over-year to $7.2 billion in the first quarter of 2020 while its operating income surged 36% to $2.8 billion **due in part to a meaningful reduction in the firm's corporate overhead expenses.** Its GAAP diluted EPS jumped by over 34% to $1.17 year-over-year last quarter.

Please note Philip Morris International reported that it remains on track to achieve $1.0 billion in cost management efficiencies by 2021, which we appreciate as that will improve its cash flow profile. Foreign currency headwinds were present in the first quarter, and management expects those headwinds to persist through the second quarter.

Going forward, management is reducing Philip Morris International's capital expenditure expectations for 2020 from $1.0 billion previously down to $0.8 billion, which should better allow for free cash flow generation in the face of exogenous headwinds. In the upcoming graphic down below, management provides guidance for Philip Morris International's expected second quarter performance, keeping in mind that COVID-19 is forecasted to have a big impact on its financials this year.

Introducing Quarterly Guidance Given Reduced Visibility on Full-Year Outlook

- Withdrawing full-year 2020 guidance (issued February 6th) due solely to uncertainty related to COVID-19 pandemic
- Introducing quarterly guidance (one quarter forward), given comparatively better short-term visibility
- Expect weak underlying Q2 (as previously flagged), exacerbated by most pronounced impact of COVID-19:
  - Forecast reported diluted EPS to be in a range of $1.00 to $1.10
  - Assumes 12 cents of unfavorable currency impact, at prevailing exchange rates
  - Assumes unfavorable COVID-19-related impacts of:
    - 10 cents for distributor and trade inventory movements, mainly related to the reversals from Q1, 2020
    - 9 cents for lost Duty-Free sales, net of domestic sales recapture, assuming no recovery in global travel
    - 5 to 15 cents for the delay in Indonesia minimum price enforcement and other COVID-19-related factors, including temporary reductions in daily consumption and down-trading in certain developing markets
  - Assumptions also reflect currency-neutral net revenue decline of approximately 8% to 12%, wholly attributable to COVID-19-related factors, including lower IQOS device sales

Source: PMI Financials or estimates

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Image Shown: *A look at Philip Morris International's expectations for the second quarter of 2020 and the impact COVID-19 is estimated to have on the firm's financial performance.* ***Image Source:*** *Philip Morris International – First Quarter of 2020 Earnings IR Presentation*

Cash Flow and Balance Sheet Update

Philip Morris International continued to be a free cash flow cow during the first quarter of 2020 as one can see in the upcoming graphic near the top of this page. The firm generated over $1.1 billion in net operating cash flow and spent less than $0.2 billion on capital expenditures last quarter, allowing for over $0.9 billion in free cash flows.

Please note that the firm experienced a very large working capital build last quarter which depressed its net operating cash flow by over $1.2 billion in the first quarter.

Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(in millions of dollars)
(Unaudited)

	For the Three Months Ended March 31,	
	2020	2019
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Net earnings	$ 1,987	$ 1,464
Adjustments to reconcile net earnings to operating cash flows:		
Depreciation and amortization	241	240
Deferred income tax (benefit) provision	(24)	(94)
Asset impairment and exit costs, net of cash paid (Note 18)	(48)	17
Cash effects of changes in:		
Receivables, net	116	4
Inventories	(575)	237
Accounts payable	(65)	(7)
Accrued liabilities and other current assets	(662)	(855)
Income taxes	(54)	(251)
Pension plan contributions	(23)	(17)
Other	218	503 (1)
Net cash provided by operating activities	1,111	1,241
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES		
Capital expenditures	(170)	(324)
Investments in unconsolidated subsidiaries and equity securities	(2)	(24)
Deconsolidation of RBH (Note 19)	—	(1,346) (2)
Net investment hedges	684	91
Other	2	7
Net cash provided by (used in) investing activities	514	(1,596)

Image Shown: *Philip Morris International has relatively low capital expenditure requirements, which supports its ability to generate meaningful free cash flows.* ***Image Source:*** *Philip Morris International – 10-Q filing for the first quarter of 2020*

For reference, Philip Morris International generated $9.2 billion in free cash flow in 2019 while spending $7.2 billion on its dividend payments. The company's ~$0.9 billion in free cash flows last quarter didn't fully cover its ~$1.8 billion in first quarter dividend payments, as one can see in the upcoming graphic down below; however, we don't see that as a sign of the firm's long-term fundamentals weakening given the aforementioned working capital build.

Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Continued)
(in millions of dollars)
(Unaudited)

	For the Three Months Ended March 31,	
	2020	2019
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES		
Short-term borrowing activity by original maturity:		
Net issuances (repayments) - maturities of 90 days or less	$ 1,097	$ (167)
Issuances - maturities longer than 90 days	25	989
Long-term debt repaid	(3,641)	(2,137)
Dividends paid	(1,828)	(1,780)
Sale (purchase) of subsidiary shares to/(from) noncontrolling interests	2	—
Other	(204)	(56)
Net cash used in financing activities	(4,549)	(3,151)
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(191)	(28)
Cash, cash equivalents and restricted cash (3):		
Increase (Decrease)	(3,115)	(3,534)
Balance at beginning of period	6,865	6,620
Balance at end of period	$ 3,750	$ 3,086

Image Shown: *Philip Morris International does not repurchase a significant amount of its stock on an ongoing basis and instead prefers to allocate its free cash flows towards meeting its dividend obligations.* ***Image Source:*** *Philip Morris International – 10-Q filing for the first quarter of 2020*

At the end of March 2020, Philip Morris International carried a nice liquidity position that is supported by its undrawn revolving credit facilities that had $7.5 billion in borrowing capacity, according to management during the firm's latest quarterly conference call. Here's a look at those revolving credit facilities as of February 6, 2020, according to its 2019 Annual Report (there have been some big changes to its revolving credit lines since then that we'll cover in just a moment).

At February 6, 2020, our committed credit facilities were as follows:

(in billions)

Type		Committed Credit Facilities
364-day revolving credit, expiring February 2, 2021	$	2.0
Multi-year revolving credit, expiring February 28, 2021		2.5
Multi-year revolving credit, expiring October 1, 2022		3.5
Total facilities	$	8.0

Image Shown: *Philip Morris International's revolving credit lines provide the firm with ample access to liquidity, however, one of those facilities has seen its maturity date pushed back to 2025, materially improving the company's financial standing.* ***Image Source:*** *Philip Morris International – 2019 Annual Report*

As of February 6, 2020, those revolving credit lines matured in 2021 and 2022, however, please note this key excerpt from Philip Morris International's 2019 Annual Report (emphasis added):

> *All but the $2.0 billion 364-day revolving credit facility in the table above [the table that is included just above this segment] require us to maintain a ratio of consolidated earnings before interest, taxes, depreciation and amortization ("consolidated EBITDA") to consolidated interest expense of not less than 3.5 to 1.0 on a rolling four-quarter basis.*
>
> *At December 31, 2019, our ratio calculated in accordance with the agreements was 11.2 to 1.0. These facilities do not include any credit rating triggers, material adverse change clauses or any provisions that could require us to post collateral. We expect to continue to meet our covenants. The terms "consolidated EBITDA" and "consolidated interest expense," both of which include certain adjustments, are defined in the facility agreements previously filed with the U.S. Securities and Exchange Commission.*
>
> ***We plan to replace our existing $2.5 billion multi-year revolving credit facility, expiring February 28, 2021 with a new $2.0 billion revolving credit facility expiring February 10, 2025 [please note it appears this replacement strategy went through, given that Philip Morris International's total borrowing capacity under all of its revolving credit lines dropped from $8.0 billion as of February 6, 2020, to $7.5 billion as of the end of its first quarter of 2020].*** *The new credit facility, which is expected to close on February 10, 2020, will not include the consolidated EBITDA to consolidated interest expense ratio covenant discussed above.*

Additionally, Philip Morris International has a commercial paper program which provides the firm with additional access to liquidity as needed. Management provided an overview of the firm's financial status in the upcoming graphic down below.

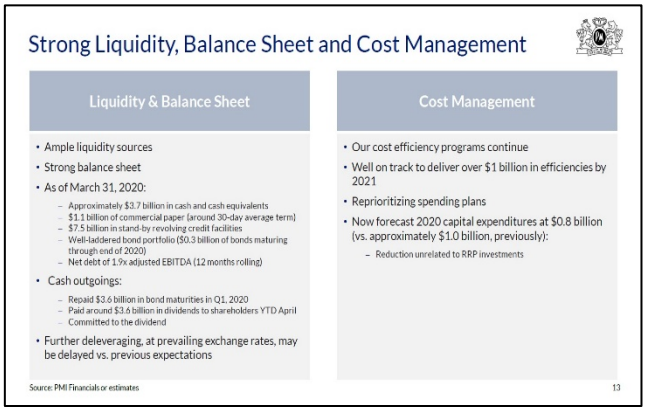

Image Shown: *Philip Morris International maintains a solid financial position that can be utilized to ride out the pandemic.* ***Image Source:*** *Philip Morris International – First Quarter of 2020 Earnings IR Presentation*

The company exited the first quarter of this year with over $3.7 billion in cash and cash equivalents on hand, which was down from levels seen at the end of 2019 as the firm paid off debt. As of February 6, 2020, Philip Morris International carried high quality investment grade credit ratings (A2/A/A) and the firm should retain access to capital markets at attractive rates. Historically, the firm has preferred to utilize debt markets to raise funds, and additionally, the company has not historically issued out or repurchased a meaningful amount of its common stock.

Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(in millions of dollars)
(Unaudited)

	March 31, 2020	December 31, 2019
ASSETS		
Cash and cash equivalents	$ 3,746	$ 6,861
Trade receivables (less allowances of $19 in 2020 and $20 in 2019)	2,785	3,080
Other receivables	549	637
Inventories:		
Leaf tobacco	2,012	2,052
Other raw materials	2,155	1,596
Finished product	4,878	5,587
	9,045	9,235
Other current assets	736	701
Total current assets	16,861	20,514
Property, plant and equipment, at cost	13,700	14,446
Less: accumulated depreciation	7,593	7,815
	6,107	6,631
Goodwill (Note 4)	5,284	5,858
Other intangible assets, net (Note 4)	1,850	2,113
Investments in unconsolidated subsidiaries and equity securities (Notes 11&14)	4,390	4,635
Deferred income taxes	1,113	1,153
Other assets	1,889	1,971
TOTAL ASSETS	$ 37,494	$ 42,875

Image Shown: *Philip Morris International's liquidity position is enhanced by its revolving credit facilities, which were undrawn as of the end of its first quarter of 2020.* ***Image Source:*** *Philip Morris International – 10-Q filing for the first quarter of 2020*

From the end of 2019 to the end of March 2020, Philip Morris International's total debt load (inclusive of short-term debt) shrank from over $31.0 billion to under $28.4 billion as one can see in the upcoming graphic down below. However, its net debt load grew by a tad over $0.4 billion during this period as its cash balance was drawn down. The firm's net debt to adjusted EBITDA (on a trailing twelve-month basis) ratio stood at ~1.9x at the end of the first quarter of 2020, roughly flat versus its leverage ratio at the end of 2019.

Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Balance Sheets (Continued)
(in millions of dollars, except share data)
(Unaudited)

	March 31, 2020	December 31, 2019
LIABILITIES		
Short-term borrowings (Note 10)	$ 1,438	$ 338
Current portion of long-term debt (Note 10)	1,933	4,051
Accounts payable	2,073	2,299
Accrued liabilities:		
Marketing and selling	645	666
Taxes, except income taxes	5,058	5,837
Employment costs	783	1,042
Dividends payable	1,832	1,831
Other	2,011	1,973
Income taxes	811	796
Total current liabilities	16,584	18,833
Long-term debt (Note 10)	24,999	26,656
Deferred income taxes	838	908
Employment costs	3,560	3,634
Income taxes and other liabilities	2,576	2,443
Total liabilities	48,557	52,474
Contingencies (Note 8)		
STOCKHOLDERS' (DEFICIT) EQUITY		
Common stock, no par value (2,109,316,331 shares issued in 2020 and 2019)	—	—
Additional paid-in capital	1,992	2,019
Earnings reinvested in the business	30,984	30,987
Accumulated other comprehensive losses	(10,774)	(9,363)
	22,202	23,643
Less: cost of repurchased stock (552,210,107 and 553,421,668 shares in 2020 and 2019, respectively)	35,146	35,220
Total PMI stockholders' deficit	(12,944)	(11,577)
Noncontrolling interests	1,881	1,978
Total stockholders' deficit	(11,063)	(9,599)
TOTAL LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY	$ 37,494	$ 42,875

Image Shown: *Philip Morris International paid down some of its debt in the first quarter of 2020, however, its net debt position still grew due in part to its working capital build depressing its net operating cash flows last quarter.* ***Image Source:*** *Philip Morris International – 10-Q filing for the first quarter of 2020*

Operational Update

Philip Morris International continues to have a favorable view on its ability to meet global tobacco demand during the pandemic, at least as of April 2020. Management noted in the earnings press release that the "large majority" of the company's manufacturing facilities are "currently operational" around the world, and that includes all of its HTU-oriented factories which we can appreciate (given the need to maintain its growth momentum in that space). Its supply chain continues to operate relatively smoothly, as the company has "sufficient access to the inputs for its products" which is especially important given that Philip Morris International needs its key suppliers to maintain operations as well in order to keep producing new finished products.

Some of the company's cigarette production capabilities have been forced temporarily offline, and as of its earnings report, those facilities accounted for about one-fifth of Philip Morris International's total cigarette production capacity around the globe. Due to the company's well-disciplined inventory management system, **the firm has enough finished product on hand to meet global demand for the foreseeable future** as of its earnings report according to the press release (though logistical concerns in certain regions are being monitored):

> *Based on current sales trends, there are adequate inventories of PMI finished goods, on average across all markets, of over two months for heated tobacco units, over three months for tobacco heating devices, and over one and a half months for cigarettes.*
>
> *While government-related restrictions have led to complexities in the company's route-to-market in select geographies, PMI does not currently anticipate out-of-stock situations in any major operating income markets and generally expects consumers to have adequate access to its products.*
>
> *In certain emerging markets, potential difficulties for some smaller general trade outlets could lead to temporary localized out-of-stock situations given less developed route-to-market infrastructures.*

Management is confident Philip Morris International will bounce back strongly once the worst of the pandemic passes (from the firm's latest quarterly conference call):

> *"With social isolation measures placing day-to-day life on hold for much of the world's population, this temporarily impacts our operating environment.*
>
> *The most direct effect is on Duty-Free sales due to reduced travel, with additional impacts from delayed IQOS user acquisition and regulatory price enforcement in Indonesia. In total this is likely to have a negative impact on our 2020 currency-neutral performance, with recent exchange rate movements a further drag…*
>
> *We are confident the strong momentum on IQOS user acquisition shown in recent quarters will start to resume as restrictions ease. In the meantime, our digital and commercial engine allows us to serve our existing adult consumers, maximize the conversion of adult smokers under the prevailing circumstances, and tailor our investments as required to optimize costs."*

Concluding Thoughts

Given the company's ample liquidity and access to liquidity levels, along with its solid cash flow profile and high quality investment grade credit ratings, we are optimistic Philip Morris International should be able to emerge on the other side of the pandemic with its dividend intact.

The successful of its HTU offerings is offsetting lower volumes at its traditional cigarette brands, aided by the company's ability to push through meaningful price increases.

Please keep in mind this dynamic is lending a tremendous amount of support to Philip Morris International's cash flow outlook, which is assisted by management's cost efficiency program. We continue to like the company as a holding in our High Yield Dividend Newsletter portfolio.

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

AT&T Has the Potential Resilience to Ride Out the Storm With Its Dividend Intact

Image Source: *AT&T Inc – First Quarter 2020 Earnings IR Presentation*

By Callum Turcan

High Yield Dividend Newsletter portfolio holding AT&T Inc (T) reported first-quarter 2020 earnings on April 22 that missed consensus top- and bottom-line estimates; however, management noted right off the bat that the ongoing coronavirus ('COVID-19') pandemic shaved $0.05 in EPS off of AT&T's performance. The cancellation of the 2020 NCAA Division I Men's Basketball Tournament and ongoing losses of its premium TV subscribers (a product of structural declines at DirecTV) weighed on AT&T's results last quarter. Shares of T yield ~6.8% as of this writing.

AT&T continued to generate meaningful free cash flows, keeping various headwinds in mind, as $8.9 billion in net operating cash flows fully covered $5.0 billion in capital expenditures (defined as 'purchase of property and equipment' plus 'interest during construction'), allowing for $3.9 billion in free cash flow which fully covered $3.7 billion in dividend payouts last quarter.

Overview

We continue to like AT&T's long-term outlook as its 'Wireless' division saw service revenues rise by 2.5% year-over-year, aided by 163,000 postpaid net subscriber additions and a modest reduction in postpaid net subscriber churn. This upcoming May 27, AT&T plans to launch its HBO Max streaming service, which should help the telecommunications and entertainment giant emerge from the pandemic with improving financial performance.

By leveraging its vast content library and major investments in original content, along with its existing HBO Now subscriber base (the cost of HBO Now and HBO Max to consumers will be the same at $14.99 per month initially to encourage greater usage of the offering, and HBO Now subscribers will get access to HBO Max at no additional cost), AT&T aims to build out a highly competitive streaming service that can compete with the likes of Netflix Inc (NFLX) in a more serious manner.

The pandemic shaved $0.6 billion off AT&T's top line, and foreign currency headwinds shaved another $0.3 billion off AT&T's performance last quarter as you can see in the upcoming graphic down below. Rising Wireless division revenues combined with the uplift from the launch of HBO Max should help AT&T grow over time, offsetting declines at its legacy premium TV division (namely DirecTV subscribers). Management remains committed to generating various cost and operational efficiencies to improve AT&T's company-wide cost structure going forward.

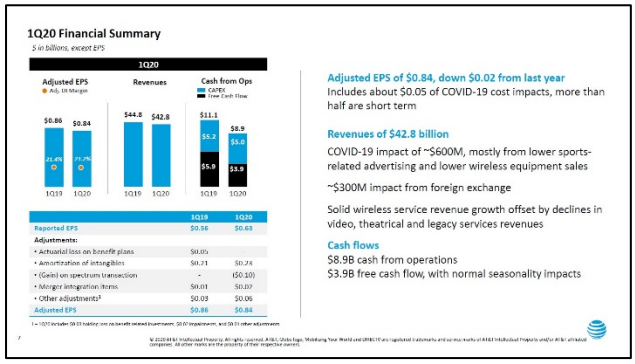

Image Shown: *AT&T's financial performance came under fire from COVID-19 and foreign currency headwinds in the first quarter of 2020.* ***Image Source:*** *AT&T – First Quarter 2020 Earnings IR Presentation*

Financial Update

Due to AT&T's share buybacks and pressures on its top line last quarter, the firm's net debt load grew $151.0 billion at the end of 2019 to $154.3 billion at the end of March 2020. This is largely why the firm announced it had suspended its $4.0 billion accelerated share buyback program with Morgan Stanley (MS) in mid-March. Additionally, on April 6, AT&T entered into an agreement with Bank of America Corporation (BAC) for a $5.5 billion term loan to be used for general corporate purposes.

With that in mind, **please note AT&T exited March 2020 with $10.0 billion in cash and cash equivalents on hand versus $17.1 billion in debt maturing within a year.** While AT&T's free cash flows could potentially help grow its cash balance in the near-term (assuming share buybacks continue to be suspended), the company recognized it needed to bolster its liquidity position in the face of upcoming debt maturities and as its top-line faces pandemic-related pressures (and due to the need to allocate a lot of free cash flow to its dividend obligations).

AT&T exited the first quarter with a net-debt-to-adjusted EBITDA ratio of ~2.6x, and the long-term goal is to bring that down to 2.0-2.25x by the end of 2022 (as of its Q4 2019 earnings report). Depending on how long the pandemic lasts, achieving that guidance may get tougher, but continuing to suspend share repurchases would go a long way in helping AT&T improve its balance sheet. Management pulled AT&T's full-year guidance for 2020 during the firm's first quarter 2020 earnings report, and during AT&T's latest quarterly conference call, management noted that the firm had suspended share buybacks. Here's what management had to say about COVID-19 and AT&T's financial position during that conference call (emphasis added):

> *"It's impossible to overstate the impact of COVID-19 on all of us. I expect it will have long-lasting implications for many things we used to take for granted, like how we congregate, work, travel, and interact. The economic impact has been swift and there is no consensus on how long this downturn lasts. A lot hinges on when and how we open things back up, when do we have sufficient testing and protocols in place so people feel comfortable returning to work or school or even going shopping.*
>
> ***Bottom line, we have very little visibility into the broader economic situation, which makes it impractical to provide detailed financial guidance at this time.*** *But here's what we've done and what you can expect. As you know,* ***we've suspended share retirements****. We have a strong cash position, a strong balance sheet, and our core businesses are solid and generating good cash flow.*

We're sizing our operations to reflect the new economic activity level, and ***we're leaning into our cost and efficiency initiatives.***

As a result, you should expect the following. We will continue investing in our critical growth areas, like 5G, broadband and HBO Max. ***We remain committed to our dividend. In fact, we finished last year with our dividend as a percent of free cash flow a little over 50%. And even with the current economic crisis, we expect the payout ratio in 2020 to be in the 60s*** *[up from previous guidance expecting a payout ratio in the 50s, but still manageable], and we're targeting the low end of that range, which is a very comfortable level for us.*

And last, we'll continue to pay down debt and maintain high-quality credit metrics." --- Randall Stephenson, Chairman and CEO of AT&T

In the upcoming graphic down below, AT&T provides an overview of its liquidity position and its debt maturity schedule over the coming years.

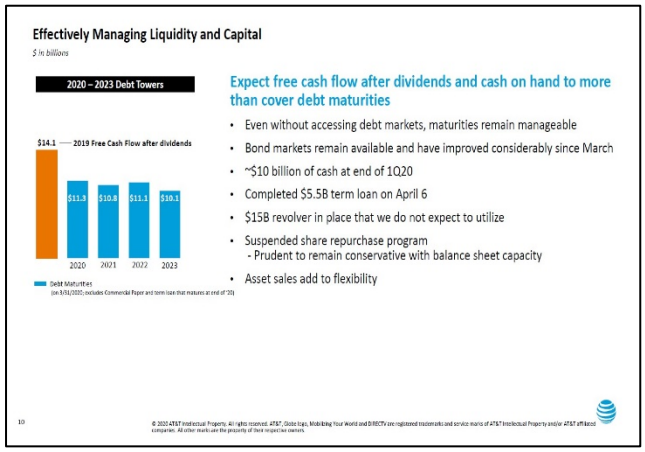

Image Shown: *AT&T's possess the liquidity levels and access to liquidity required to ride out the storm while both making good on its dividend obligations and paying off or refinancing its upcoming debt maturities.* ***Image Source:*** *AT&T – First Quarter 2020 Earnings IR Presentation*

AT&T has total borrowing capacity of $15.0 billion under two revolving credit facilities that should provide the firm with the additional liquidity needed to ride out the storm with its dividend intact, assisted by the proceeds generated by its aforementioned term loan.

Here's some information on those credit facilities, from AT&T's 2019 Annual Report:

We use credit facilities as a tool in managing our liquidity status. In December 2018, we amended our five-year revolving credit agreement (the "Amended and Restated Credit Agreement") and concurrently entered into a new five-year agreement (the "Five Year Credit Agreement") such that we now have two $7,500 [in millions of USD] revolving credit agreements totaling $15,000 [in millions of USD]. The Amended and Restated Credit Agreement terminates on December 11, 2021 and the Five Year Credit Agreement terminates on December 11, 2023. No amounts were outstanding under either agreement as of December 31, 2019.

The firm also mentioned that asset sales could be used to improve its balance sheet and liquidity position. We'll have more to say on AT&T's financials when the firm publishes its 10-Q filing covering the first quarter of 2020 with the SEC.

Concluding Thoughts

The telecommunications and entertainment giant is hunkering down, and we appreciate that the firm is pivoting towards covering the dividend and putting the enterprise in a position to better pay down its large total debt load by suspending share repurchases. The upcoming launch of its HBO Max streaming service will provide the firm with an incremental revenue growth catalyst that should help bolster its cash flows, at least on the margins. **A combination of AT&T's recent term loan agreement and existing revolving credit facilities, along with cash on hand and material free cash flows, should allow AT&T to ride out the storm with its dividend intact.** Longer term, the launch of nationwide 5G services and meaningful cost savings programs will significantly improve AT&T's already impressive cash flow profile.

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

[Please see next page for a summary of portfolio activity during 2019.]

Tracking the High Yield Dividend Newsletter	Price -- 12/31/2018 or at open*	Interim Dividends	Price -- 12/31/2019 or at close**
CORE			
Alerian MLP ETF (AMLP) -- *removed* November 18	8.73	0.78	7.83
Added 2.5pts of AT&T (T) -- November 18	*39.21*	-	39.08
Added 2.5pts of Philip Morris (PM) -- November 18	*84.57*	1.17	85.09
Global X SuperDividend ETF (SDIV)	17.10	1.54	17.69
Global X SuperIncome Preferred ETF (SPFF)	11.03	0.71	11.74
iShares International Select Dividend ETF (IDV)	28.71	1.73	33.57
iShares MSCI Australia ETF (EWA)	19.25	0.90	22.64
iShares U.S. Preferred Stock ETF (PFF)	34.23	2.00	37.59
Invesco Senior Loan Portfolio (BKLN)	21.78	1.11	22.82
ProShares High Yield -- Interest Rate Hedged (HYHG)	62.09	3.97	65.44
Utilities Select Sector SPDR (XLU) -- *added August 22*	*61.61*	0.99	64.62
Vanguard Real Estate ETF (VNQ) - *added April 1*	*85.91*	2.53	92.79
EQUITY			
AT&T (T)	28.54	2.04	39.08
BP PLC (BP)	37.92	2.46	37.74
CubeSmart (CUBE) -- *added August 22*	*35.13*	0.65	31.48
Digital Realty Trust (DLR)	106.55	4.32	119.74
Enterprise Products Partners (EPD)	24.59	1.76	28.16
Iron Mountain (IRM) -- *removed August 1*	32.41	1.22	29.97
Magellan Midstram Partners (MMP)	57.06	4.04	62.87
Omega Healthcare Investors (OHI) -- *removed March 1*	35.15	0.66	34.72
Philip Morris (PM) -- *added August 1*	*82.41*	2.34	85.09
Public Storage (PSA)	202.41	8.00	212.96
Schlumberger*, added January 18, removed August 1*	*43.00*	1.00	38.07
Realty Income Corporation (O) -- *removed April 1*	63.04	0.68	72.03
Tallgrass Energy LP (TGE) -- *removed August 1*	24.34	1.59	18.25

* As shown in the January 2019 edition of the High Yield Dividend Newsletter, or price at entry point

** Price as of December 31, 2019, or price at close

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

High Yield Spotlight: Healthcare Realty Trust Inc (HR) is a High Quality Healthcare REIT

Our **May 2020 High Yield Dividend Newsletter Spotlight** is Healthcare Realty Trust Inc (HR)---4.1% yield--- a healthcare real estate investment trust ('REIT') that primarily invests in outpatient medical facilities in the US. The REIT owns an economic interest in over 200 properties spread out across over two dozen states, with 94% of those catering to medical office and outpatient needs. 88% of its properties are located next to hospital campuses, and the main focus is medical office buildings whose need is underpinned by geographical proximity to the facilities of major healthcare providers.

We like Healthcare Realty Trust due to; the resiliency of its business model (its cash flows are generated from high quality healthcare providers and its asset base is hard to replace), its investment grade credit ratings (Moody's [MCO] reaffirmed the REIT's Baa2 unsecured credit rating in May 2019 with a stable outlook, which was upgraded back in September 2015), its quality access to liquidity and capital markets, and its cash flow profile (unlike most REITs, Healthcare Realty Trust has historically been free cash flow positive). In our view, Healthcare Realty Trust possess the means to ride out the ongoing coronavirus ('COVID-19') pandemic. The recent drop in the share price of HR (keeping in mind shares have started recovering) provides a potential opportunity for long-term investors. In the upcoming graphic down below, Healthcare Realty Trust highlights its asset base and operational focus.

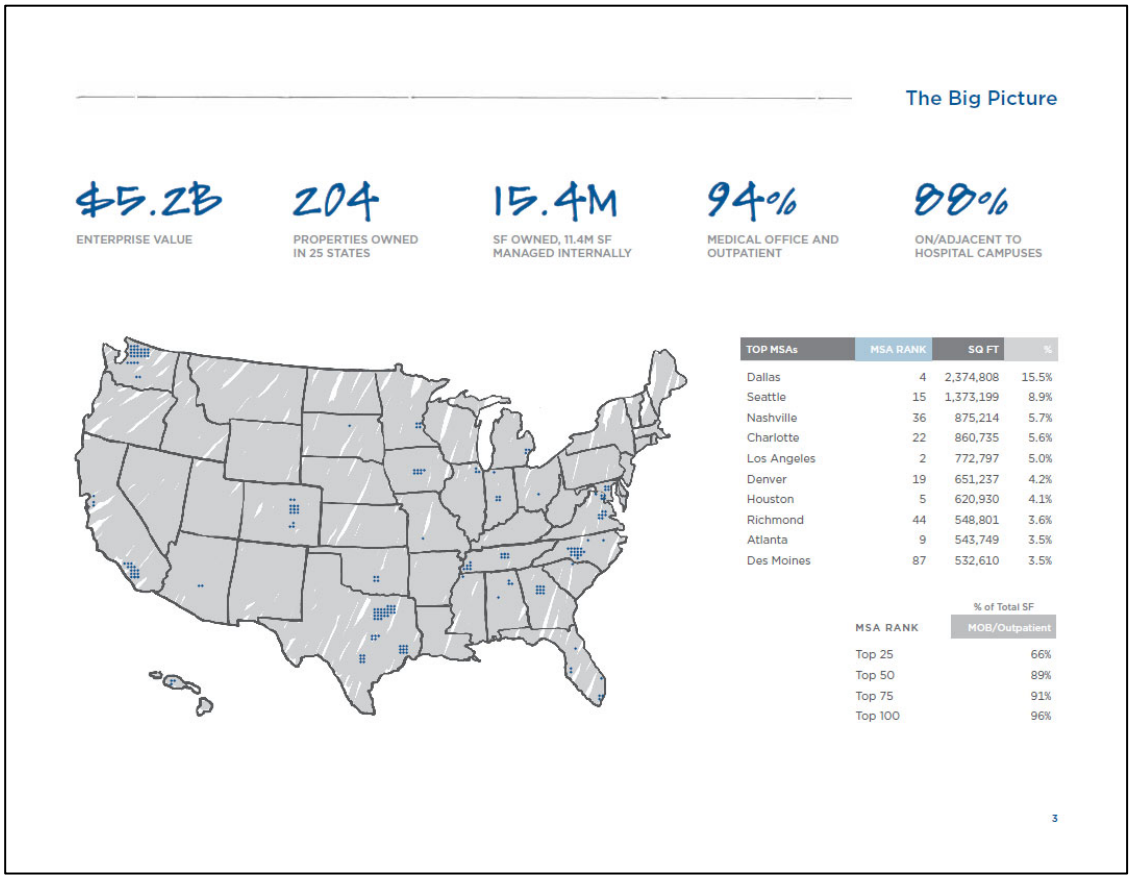

Image Shown: *An overview of Healthcare Realty Trust's asset base.* ***Image Source:*** *Healthcare Realty Trust – April 2020 IR Presentation*

Medical office buildings located near major healthcare centers are near irreplaceable assets, and as you can see in the upcoming graphic down below, this is where Healthcare Realty Trust has been aggressively expanding over the past decade. While various forms of senior housing properties (including assisted-living, skilled-nursing and independent-living facilities) were a focus in the past, the REIT sold off its senior living facilities portfolio in 2007 (as an aside, it paid a special dividend in conjunction with that divestment) to pivot towards medical office buildings and specialty inpatient facilities. We like the move as it reduces Healthcare Realty Trust's operatorship risk as many operators in the space were facing problems long before the start of the pandemic reared its ugly head.

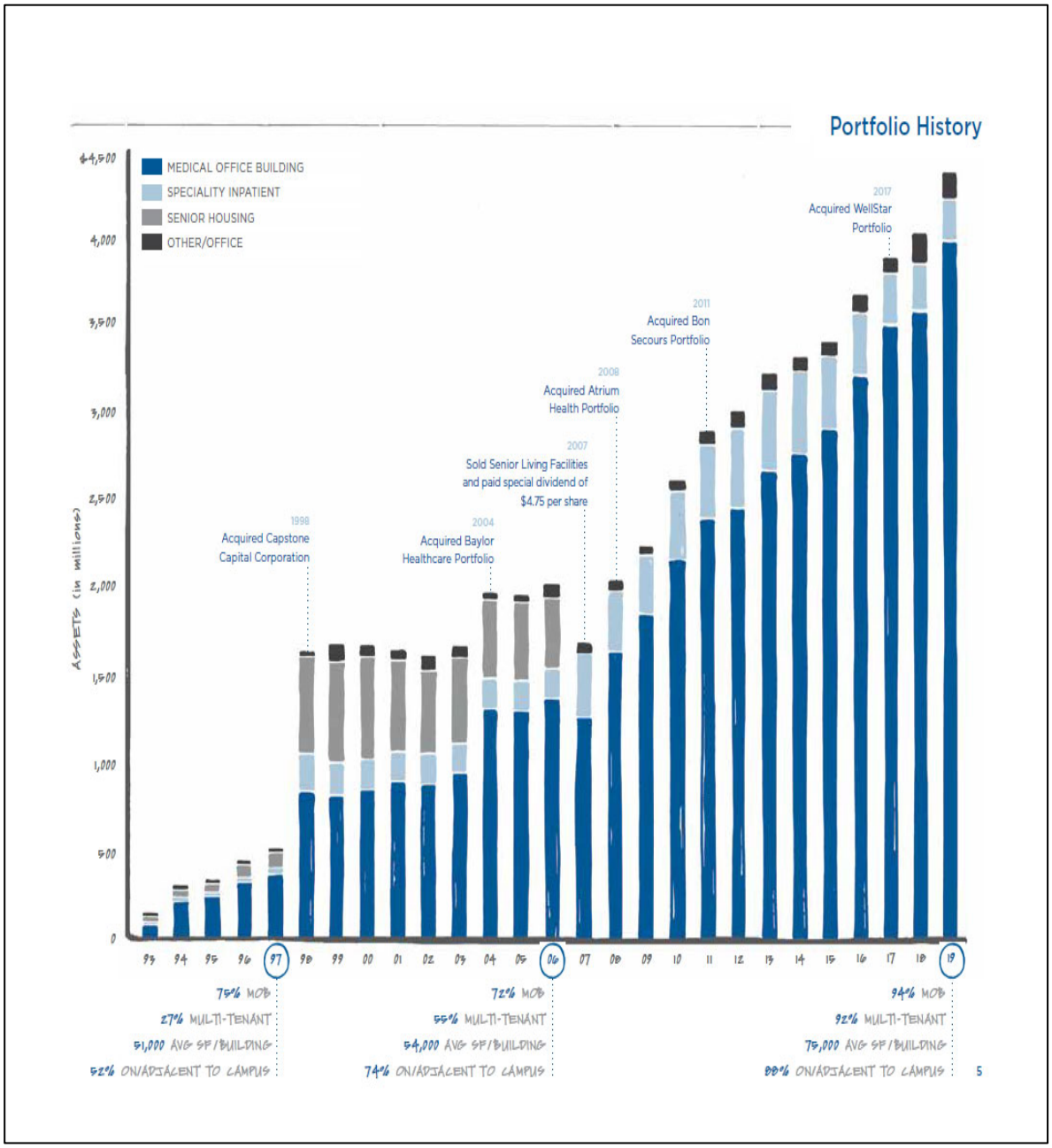

Image Shown: *Healthcare Realty Trust has fundamentally altered its asset base over the past decade and a half, which we appreciate as those changes put the firm in a better position to ride out the storm.* ***Image Source:*** *Healthcare Realty Trust – April 2020 IR Presentation*

Healthcare Realty Trust's occupancy rate is solid, and it has been able to retain a lot of its tenants due to the very strategic and essential nature of its property portfolio. In the fourth quarter of 2019, its average occupancy rate stood at 89.3% and for the full-year, its same-store cash net operating income ('NOI') grew by 2.9% on a trailing twelve-month basis. Contractual price increases, relatively high occupancy rates, and high tenant retention rates (which came in at 86.6% in the fourth quarter of 2019 and 87.4% for the full-year) **have been key to generating same-store cash NOI growth**, and that's highlighted in the upcoming graphic down below.

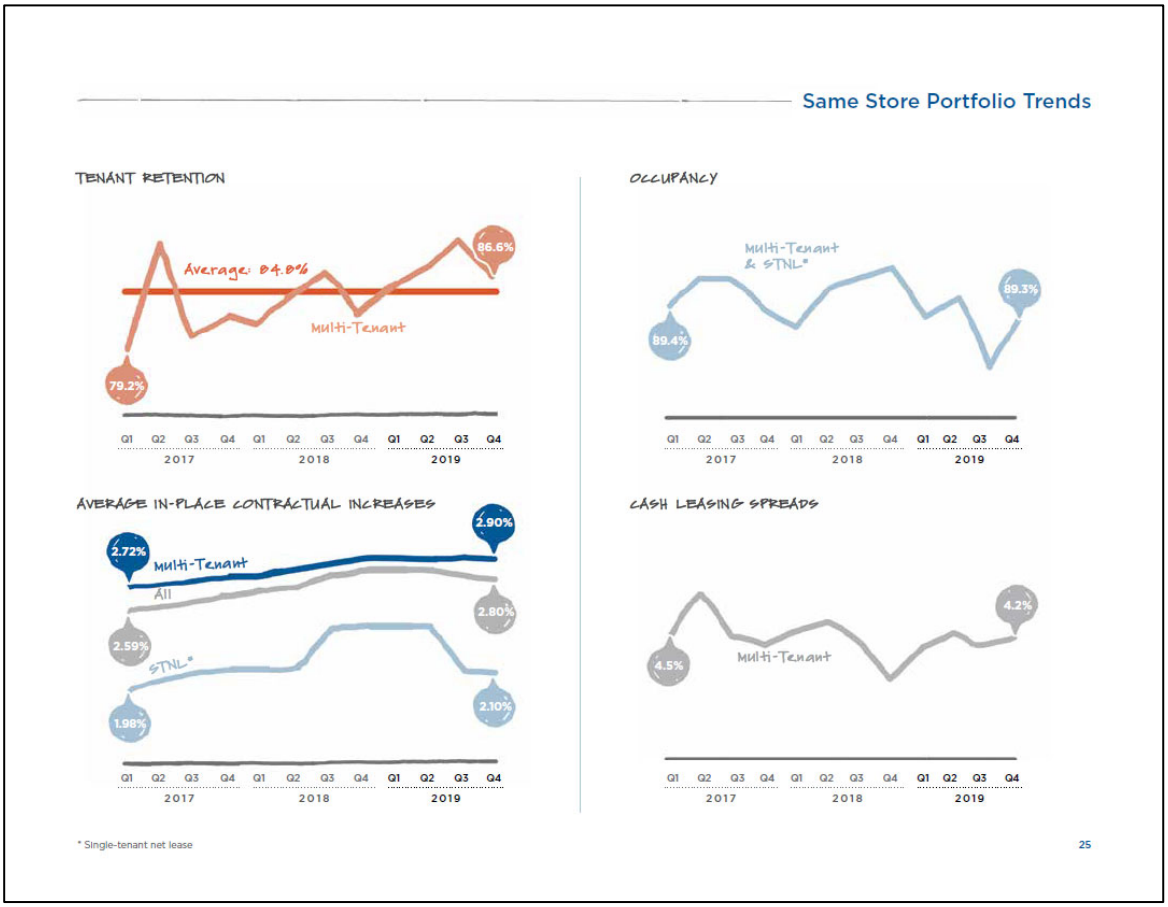

Image Shown: *Healthcare Realty Trust is not only growing by acquiring new properties, the REIT has also been quite successful historically in increasing the rent on its existing properties.* ***Image Source:*** *Healthcare Realty Trust – April 2020 IR Presentation*

Additionally, here's what management had to say about the REIT's same-store cash NOI growth during Healthcare Realty Trust's fourth quarter of 2019 conference call;

> *"On the operations front, trailing 12 months, same-store NOI increased 2.9% led by the reliably strong growth of our same-store multi-tenant properties at 3.2% and single tenant net leased properties at 1.8%. Single-tenant NOI growth is consistent with our expectations given that nearly 30% of the leases have non-annual escalators that have not had an increase in the past 24 months. NOI growth will remain at this level for the first three quarters of 2020 and increased in the fourth quarter with the next non-annual rent increase occurring in October." --- Kris Douglas, CFO of Healthcare Realty Trust*

While expected rent increases at its single-tenant property portfolio later this year will need to contend with the "new normal" and how that impacts its relationship with its tenants, those rent increases are built into the REIT's existing contracts.

Healthcare Realty Trust has historically been free cash flow positive, which we appreciate. From 2017 to 2019, its annual free cash flows averaged $106 million when defining its free cash flows as net operating cash flow less cash used in the 'development of real estate' and 'additional long-lived assets' which we view as the REIT's capital expenditures. The REIT's annual dividend obligations averaged $149 million during this period, **highlighting its ongoing need to retain continuous access to capital markets at attractive rates.**

Healthcare Realty Trust Incorporated
Consolidated Statements of Cash Flows
Amounts in thousands

	YEAR ENDED DECEMBER 31,		
	2019	2018	2017
OPERATING ACTIVITIES			
Net income	$ 39,185	$ 69,771	$ 23,092
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	177,859	164,201	142,472
Other amortization	3,013	3,000	3,879
Share-based compensation	12,275	10,691	10,028
Amortization of straight-line rent receivable (lessor)	(3,000)	(4,281)	(6,072)
Amortization of straight-line rent on operating leases (lessee)	1,537	1,519	1,497
Gain on sales of real estate assets	(25,101)	(41,665)	(39,524)
Loss on extinguishment of debt	—	—	44,985
Impairment of real estate assets	5,617	—	5,385
Loss (income) from unconsolidated joint ventures	19	(4)	(7)
Distributions from unconsolidated joint ventures	381	182	—
Provision for bad debts, net	—	60	159
Changes in operating assets and liabilities:			
Other assets, including right-of-use-assets	(8,573)	(3,998)	(2,156)
Accounts payable and accrued liabilities	2,752	4,731	(7,307)
Other liabilities	7,174	4,148	3,335
Net cash provided by operating activities	213,138	208,355	179,766
INVESTING ACTIVITIES			
Acquisitions of real estate	(380,274)	(104,312)	(274,668)
Development of real estate	(25,985)	(26,728)	(14,911)
Additional long-lived assets	(64,670)	(70,807)	(80,613)
Investment in unconsolidated joint ventures	—	—	(8,701)
Proceeds from sales of real estate assets	52,401	96,812	119,426
Proceeds from notes receivable repayments	—	8	19
Net cash used in investing activities	(418,528)	(105,027)	(259,448)
FINANCING ACTIVITIES			
Net borrowings on unsecured credit facility	31,000	73,000	82,000
Borrowings on term loan	50,000	—	—
Borrowings of notes and bonds payable	—	—	297,459
Repayments of notes and bonds payable	(13,857)	(19,850)	(5,829)
Redemption of notes and bonds payable	—	—	(442,774)
Dividends paid	(155,358)	(150,266)	(142,327)
Net proceeds from issuance of common stock	295,946	611	248,554
Common stock redemptions	(5,097)	(4,532)	(1,686)
Debt issuance and assumption costs	(4,589)	(125)	(4,007)
Payments made on finance leases	(379)	—	—
Net cash provided by (used in) financing activities	197,666	(101,162)	31,390
(Decrease) increase in cash and cash equivalents	(7,724)	2,166	(48,292)
Cash and cash equivalents at beginning of period	8,381	6,215	54,507
Cash and cash equivalents at end of period	$ 657	$ 8,381	$ 6,215

Image Shown: *Healthcare Realty Trust's net operating cash flow and line-items that represent its capital expenditures are underlined in red in the picture just above. The REIT has historically been free cash flow positive, though it remains dependent on access to capital markets to fund its real estate acquisitions and to refinance its debt load.* ***Image Source:*** *Healthcare Realty Trust – 2019 Annual Report*

Keeping Healthcare Realty Trust's capital market dependence in mind, please note that on March 4, 2020, the REIT announced it was issuing $300 million in 2.400% senior unsecured notes due March 2030 which were priced at 99.665% according to the press release. The firm appears to retain quality access to debt markets at attractive rates, and given the rebound in the REIT's share price, it appears Healthcare Realty Trust also maintains reasonable access to equity markets as well.

As you can see in the picture at the bottom of the last page (Page 16), the REIT has often turned to both debt and equity markets to raise funds including; issuing out $296 million in common equity, borrowing $31 million net from its unsecured credit facility, and borrowing $50 million from its term loan in 2019. The firm repaid $14 million of its notes and bonds payable last year, highlighting its net debt issuance.

Healthcare Realty Trust's liquidity position is supported by its $700 million unsecured revolving credit facility, which matures in May 2023 with two six-month extensions (the maturity date was extended back in May 2019 to its current maturity date, which we appreciate). At the end of 2019, that revolver had $407 million in remaining borrowing capacity as $293 million was drawn on the facility. The REIT's cash balance is negligible as it invests heavily in growing its asset base and pays out a generous divided, making this revolving credit facility an important way to fund its operations going forward. At the end of 2019, the firm had over $1.4 billion in total debt (inclusive of short-term debt) and a negligible amount of cash on hand, giving it a large net debt position.

We like the REIT's debt maturity schedule as it is very manageable, with no major senior note maturities due until 2023 as of the end of 2019. The REIT did have a modest amount of outstanding mortgage notes payable at the end of 2019, which can be managed through its revolving credit line and the proceeds from its aforementioned debt issuance in March 2020. Those mortgage notes have maturity dates that range from July 2020 to May 2040, as you can see in the upcoming graphic down below.

9. Notes and Bonds Payable

Dollars in thousands	DECEMBER 31, 2019	DECEMBER 31, 2018	MATURITY DATES	CONTRACTUAL INTEREST RATES	PRINCIPAL PAYMENTS	INTEREST PAYMENTS
Unsecured Credit Facility	$ 293,000	$ 262,000	5/23	LIBOR + .90%	At maturity	Monthly
Unsecured Term Loan due 2024 [1]	199,013	149,183	5/24	LIBOR + 1.00%	At maturity	Monthly
Unsecured Term Loan due 2026 [2]	—	—	6/26	LIBOR + 1.60%	At maturity	Monthly
Senior Notes due 2023 [1]	248,540	248,117	4/23	3.75%	At maturity	Semi-Annual
Senior Notes due 2025 [1]	248,522	248,278	5/25	3.88%	At maturity	Semi-Annual
Senior Notes due 2028 [1]	295,651	295,198	1/28	3.63%	At maturity	Semi-Annual
Mortgage notes payable [3]	129,343	143,208	7/20-5/40	3.31%-6.88%	Monthly	Monthly
	$ 1,414,069	$ 1,345,984				

Image Shown: *Healthcare Realty Trust has a very manageable debt maturity schedule.* ***Image Source:*** *Healthcare Realty Trust – 2019 Annual Report*

As it relates to Healthcare Realty Trust's normalized funds from operations ('FFO' and please note that this is an imperfect industry-specific metric), the REIT was able to grow its normalized FFO by ~2% year-over-year in 2019 and carried a dividend payout ratio (dividend per share divided by normalized FFO) of ~75% last year. That provides for a layer of security as it relates to its payout coverage, and additionally, our Dividend Cushion ratio for the REIT comes in at 2.2, earning the firm a "GOOD" Dividend Safety rating which highlights the expected future strength of Healthcare Realty Trust's dividend policy on a forward-looking basis.

Looking ahead, Healthcare Realty Trust has a meaningful amount of multi-tenant leases maturing this year, and those lease maturities will start to shift lower (as a percent of its leased square footage) in 2021 and 2022 as depicted in the upcoming graphic down below. While the COVID-19 pandemic has put a lot of pressure on the US healthcare system, including delaying a lot of surgeries that bring in plenty of money for hospitals and other types of healthcare providers (such as elective surgeries), numerous states are considering resuming elective surgeries and other healthcare treatments in the near future. More broadly, while the REIT's tenant base has likely seen their financials take a hit, federal aid combined with an improving operational outlook should allow Healthcare Realty Trust to renew a large portion of its upcoming lease maturities as has been the case historically. The recent strength seen in shares of HR is likely reflective of that reality, in our view.

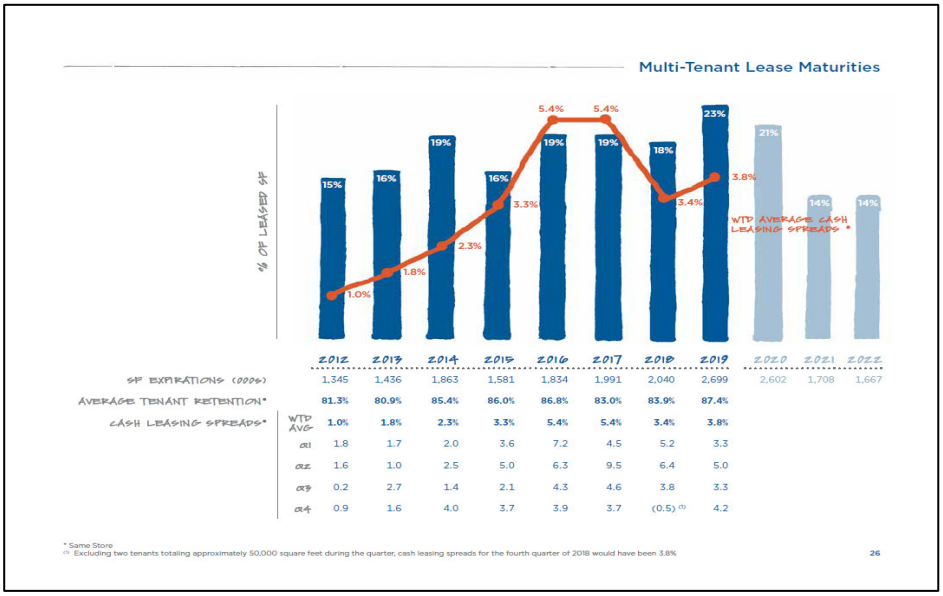

Image Shown: *While Healthcare Realty Trust has many of its multi-tenant leases maturing this year, the REIT should be able to renew a lot of those leases as has historically been the case.* ***Image Source:*** *Healthcare Realty Trust – April 2020 IR Presentation*

As it relates to Healthcare Realty Trust's single-tenant portfolio, management was very optimistic that the firm would be able to carry a near perfect (if not 100%) occupancy rate on that front during the REIT's fourth quarter of 2019 conference call;

> *"We anticipate occupancy within the single-tenant portfolio to remain at 100%. There's only one lease expiration this year, an 83,000 square foot on campus MOB [medical office building] in Des Moines and renewal discussions with the tenant indicate a favorable outcome." --- Kris Douglas, CFO of Healthcare Realty Trust*

Healthcare Realty Trust is well-positioned to ride out the storm. The healthcare REIT possess the liquidity, access to liquidity, and access to capital markets at attractive rates which are all required to navigate turbulent macroeconomic conditions. Having a manageable debt maturity schedule and being free cash flow positive is a sign of the REIT's financial strength. Federal aid to the US hospital system should improve the financial position of its tenants, and the necessary nature of its facilities lends support to its ability to renew upcoming lease maturities. The REIT will report its first quarter of 2020 earnings report on May 6 after the market close, and management will likely provide greater detail on how Healthcare Realty Trust intends to ride out the storm during the planned conference call the following day.

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

U.S. Bank Earnings Roundup

In alphabetical order by ticker: BAC, C, GS, JPM, MS, WFC

By Matthew Warren

Bank of America Retains Earnings Power and Healthy Balance Sheet

Growing pressure from Fed officials on banks to cut dividends, and any extremely-adverse scenario, as outlined by JPMorgan in its latest annual note, coming to fruition may suggest that no banking dividend may be completely safe in this environment. That said, assuming the US economy is able to avoid a prolonged depression-type scenario, Bank of America has the earnings power and balance sheet to withstand most probable scenarios and come out the other side continuing to nip at JPMorgan's heels for best in class US mega-bank. We are maintaining our recently reduced $28 fair value estimate of Bank of America.

Bank of America (BAC) posted ugly first-quarter results April 15. Though revenue of $22.77 billion exceeded the analyst consensus estimate by $190 million, bottom-line results of $0.40 per share missed consensus by $0.14. This was largely the result of a huge reserve build of $3.6 billion, in anticipation of large losses straight ahead resulting from a free-falling economy and rapidly escalating unemployment.

As you can see in the graphic down below, revenue pressure from lower rates was only moderate and pre-tax, pre-provision income was only down 5% compared to the same period last year. But the $3.6 billion reserve build meant that net income was down 45%. The efficiency ratio backed up to 59% from 57% last year as expenses grew while revenue went slightly backwards. Return on tangible common equity dropped to 8.3% from 16% in last year's quarter.

1Q20 Financial Results [1]

Summary Income Statement ($B, except per share data)	1Q20	1Q19	$ Inc / (Dec)	% Inc / (Dec)
Total revenue, net of interest expense	**$22.8**	$23.0	($0.2)	(1) %
Provision for credit losses	**4.8**	1.0	3.7	N/M
Net charge-offs	***1.1***	*1.0*	*0.1*	*13*
Reserve build [2]	***3.6***	*0.0*	*3.6*	N/M
Noninterest expense	**13.5**	13.2	0.3	2
Pretax income	**4.5**	8.8	(4.2)	(48)
Pretax, pre-provision income [2]	***9.3***	*9.8*	*(0.5)*	*(5)*
Income tax expense	**0.5**	1.5	(0.9)	(64)
Net income	**$4.0**	$7.3	($3.3)	(45)
Diluted earnings per share	**$0.40**	$0.70	($0.30)	(43)
Average diluted common shares (in millions)	**8,863**	9,787	(925)	(9)

Return Metrics and Efficiency Ratio		
Return on average assets	**0.65** %	1.26 %
Return on average common shareholders' equity	**5.9**	11.4
Return on average tangible common shareholders' equity [2]	**8.3**	16.0
Efficiency ratio	**59**	57

Image Source: *Bank of America – First Quarter of 2020 Earnings Presentation*

When asked whether the bank would expect further reserve builds next quarter, management simply stated that it would depend on how the economic outlook progressed through the quarter. The executive suite also said that it is out-earning the dividend and that it expects to continue paying it. Both reserve builds and dividend health will of course depend on just how bad the economy gets while the globe tries to fight off the coronavirus. As one can see in the below graphic, total payments and credit/debit growth both decelerated markedly in March and into April.

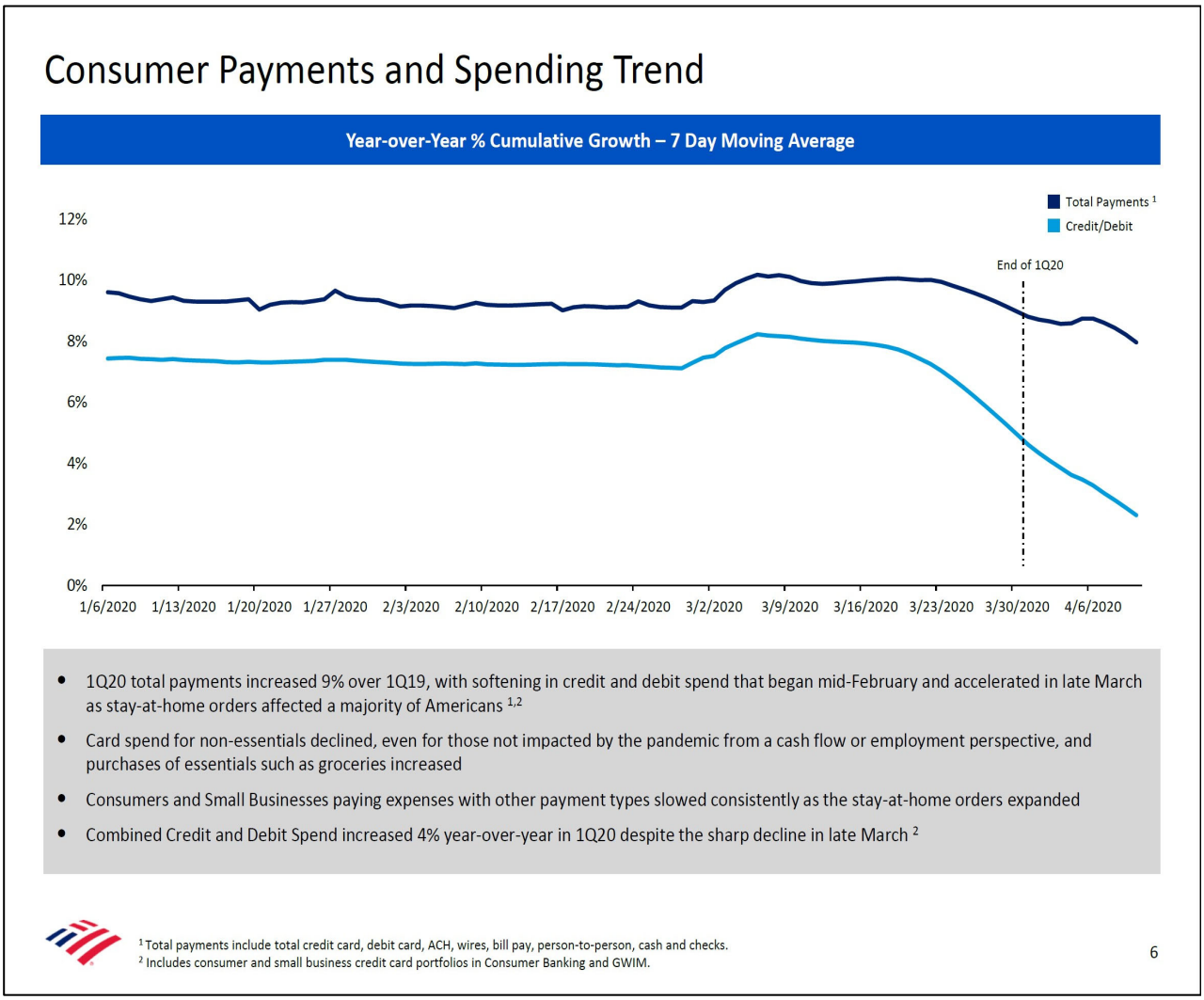

Image Source: *Bank of America – First Quarter of 2020 Earnings Presentation*

Concluding Thoughts

Growing pressure from Fed officials on banks to cut dividends, and any extremely-adverse scenario, as outlined by JPMorgan (JPM) in its latest annual note, coming to fruition may suggest that no banking dividend may be completely safe in this environment. That said, assuming the US economy is able to avoid a prolonged depression-type scenario, Bank of America has the earnings power and balance sheet to withstand most probable scenarios and come out the other side continuing to nip at JPMorgan's heels for best in class US mega-bank. We are maintaining our recently reduced $28 fair value estimate of Bank of America.

Citigroup Holding Up Fairly Well

As with its large banking peers, Citigroup posted ugly performance in the first quarter of 2020, results released April 15. While there are probably more losses to come in terms of reserve build and future charge offs, especially in the company's card business, Citigroup has held up reasonably well thus far in the early innings of this downcycle (and as compared to how poorly the bank fared during the Global Financial Crisis last time around).

As with its large banking peers, Citigroup (C) posted ugly performance in the first quarter of 2020, results released April 15. While the bank beat consensus estimates on the top line with revenue of $20.73 billion ($1.75 billion better than expected), it missed earnings expectations with earnings per share of $1.05, or $0.31 less than expected.

As one can see in the graphic down below, the biggest swing factor for Citigroup's bottom line was the $4.893 billion net loan loss reserve build, which catapulted earnings before taxes 48% lower despite revenues that were up an impressive 12% (thanks in large part to 39% revenue growth in both Fixed Income Markets and Equity Markets).

Citigroup – Summary Financial Results

($MM, except EPS)

	1Q'20	4Q'19	%Δ	1Q'19	%Δ
Revenues	**$20,731**	$18,378	13%	$18,576	12%
Operating Expenses	**10,594**	10,454	1%	10,584	0%
Efficiency Ratio	*51.1%*	*56.9%*		*57.0%*	
Operating Margin	*10,137*	*7,924*	*28%*	*7,992*	*27%*
Net Credit Losses	2,108	1,944	8%	1,948	8%
Net LLR Build / (Release)[1]	4,893	253	NM	20	NM
Other Provisions[2]	26	25	4%	12	NM
Credit Costs	**7,027**	2,222	NM	1,980	NM
EBT	**3,110**	5,702	(45)%	6,012	(48)%
Income Taxes	**576**	703	(18)%	1,275	(55)%
Effective Tax Rate	*19%*	*12%*		*21%*	
Net Income	**$2,522**	$4,979	(49)%	$4,710	(46)%
Return on Assets	*0.49%*	*0.99%*		*0.98%*	
Return on Tangible Common Equity[3]	*6.0%*	*12.4%*		*11.9%*	
EPS	**$1.05**	$2.15	(51)%	$1.87	(44)%
Average Diluted Shares	*2,114*	*2,167*	*(2)%*	*2,342*	*(10)%*
Average Assets ($B)	**$2,080**	$1,997	4%	$1,939	7%
EOP Assets (Constant $B)	**2,220**	1,907	16%	1,918	16%
EOP Loans (Constant $B)	**721**	684	5%	668	8%
EOP Deposits (Constant $B)	**1,185**	1,048	13%	1,009	17%

- Revenues
  - Up 12% YoY, primarily reflecting higher Fixed Income and Equity Markets revenues, as well as mark-to-market gains on loan hedges in ICG
- Expenses
  - Positive operating leverage
  - 27% YoY improvement in operating margin
- Credit Costs
  - Up YoY, including net LLR build of $4.9B reflecting the impact of changes in economic outlook on estimated lifetime losses under CECL[4]

Image Source: *Citigroup – First Quarter of 2020 Earnings Presentation*

While there are probably more losses to come in terms of reserve build and future charge offs, especially in the company's card business, the business model has held up reasonably well thus far in the early innings of this downcycle (and as compared to how poorly the bank fared during the Global Financial Crisis last time around).

Due to balance sheet growth, Citigroup's Common Equity Tier I ratio dropped to 11.2% from 11.8% last quarter, but with share buybacks suspended across the big banks, the bank might be able to hold its dividend in place as long as reserve builds don't take off from current levels. This point is very much economy dependent, however.

Though no bank dividend may be safe in this market environment, we are maintaining our recently reduced $63 fair value estimate, which is just below tangible book value of $71.52 per share. With a current quarter return on tangible equity of only 6%, the bank must successfully navigate the cycle and put up higher returns on the other side in order to justify our fair value estimate.

Goldman Sachs Exposed to Too Much Risk

Goldman Sachs posted a rough first quarter of 2020, results released April 15, just like its large bank peers. Regarding its on-balance sheet debt and equity investments, we remain very skeptical both about the marks on private equity and amortized cost debt, as well as the appropriateness of holding this size of assets on a leveraged bank balance sheet. In our view, it simply exposes the shareholders to too much risk, and we think these investments should be sold down to reduce risk.

Goldman Sachs (GS) posted a rough first quarter of 2020, results released April 15, just like its large bank peers. While the firm exceeded the consensus estimate on the top line with revenue of $8.74 billion, or $820 million more than expected, the bank's $3.11 of GAAP EPS missed consensus by $0.18. Annualized return on equity dropped to 6% in the quarter, suggesting the bank is likely to trade at a discount to its $214.69 tangible book value until the market gains confidence it will come out the other side posting stronger results.

As one can see in the graphic down below, the bank posted strong revenue growth in three of its four segments, but markdowns on on-balance sheet debt and equity positions meant that the Asset Management segment's revenue was actually negative in the quarter, to the tune of $96 million. The provision for credit losses also jumped substantially to $937 million. Expenses grew 10% while revenue went 1% backward, meaning efficiency ratios also moved in reverse, and net earnings were crushed, falling 46%.

Financial Overview

Financial Results

$ in millions, except per share amounts		1Q20	vs. 4Q19	vs. 1Q19
Investment Banking	$	2,184	6%	25%
Global Markets		5,163	48%	28%
Asset Management		-96	N.M.	N.M.
Consumer & Wealth Management		1,492	6%	21%
Net revenues	$	8,743	-12%	-1%
Provision for credit losses		937	179%	N.M
Operating expenses		6,458	-12%	10%
Pre-tax earnings		1,348	-42%	-50%
Net earnings		1,213	-37%	-46%
Net earnings to common	$	1,123	-35%	-49%
Diluted EPS	$	3.11	-34%	-46%
ROE[1]		5.7%	-3.0pp	-5.4pp
ROTE[1]		6.0%	-3.2pp	-5.7pp

Image Source: *Goldman Sachs – First Quarter of 2020 Earnings Presentation*

Regarding the on-balance sheet debt and equity investments, we remain very skeptical both about the marks on private equity and amortized cost debt, as well as the appropriateness of holding this size of assets on a leveraged bank balance sheet. In our view, it simply exposes the shareholders to too much risk, and we think these investments should be sold down to reduce risk. One can see the exposures detailed in the below graphic.

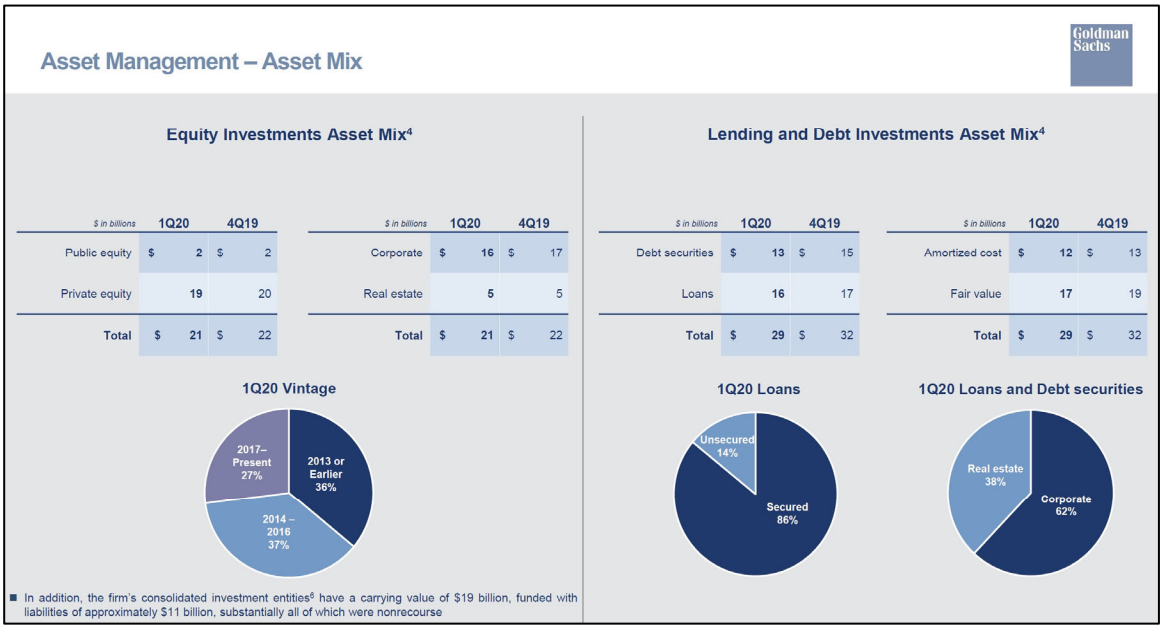

Image Source: *Goldman Sachs – First Quarter of 2020 Earnings Presentation*

These $50 billion of on-balance sheet investments can impact Goldman Sachs' $74.6 billion of Common Equity Tier I capital, meaning large swings in valuations could easily affect the strength of the balance sheet. It was concerns like these that really drove fear among stakeholders during the Global Financial Crisis. While there are not large piles of collateralized debt obligations ('CDOs') this time around, we still don't like the exposure. We are maintaining our recently reduced $140 fair value estimate at this time.

JPMorgan Outlines Scenario Where Dividend Could Be Cut

JPMorgan posted a terrible first-quarter 2020 report April 14, missing analyst expectations (which are a wild guess in times like these) by a long shot. If the economy continues to worsen, JPMorgan's results will get uglier from here. On the earnings call, management indicated that second-quarter provisioning might be incrementally worse if the economy worsens. There is also room for deterioration in its Markets segment if trading activity dies down and one would expect the Asset & Wealth Management segment results to worsen if the markets are flat-to-down from here. The government rescue programs might also prove to be a temporary fix and consumer and business debt might just go bad later after an initial fix from stimulus funds received from the government. In the firm's annual letter, Chairman and CEO Jamie Dimon also painted the picture for how the dividend could possibly be cut if things turn out worse than the more adverse scenario that the firm is postulating as one potential outcome.

JPMorgan (JPM) posted a terrible first-quarter 2020 report April 14, missing analyst expectations (which are a wild guess in times like these) by a long shot. Earnings per share of $0.78 missed by $1.34 and revenue of $28.25 billion missed by $1.2 billion. Quarterly results were so dire that the company paid out more in dividends ($0.90/share) and share buybacks ($6 billion in net buybacks until buybacks suspended as of March 15) than it earned, which combined with balance sheet growth meant that the bank's common equity Tier 1 ratio dropped down to 11.5% from 12.4% at the end of 2019, which we still consider to be a robust level.

The main reason for the big earnings hit and miss of consensus estimates was a firmwide reserve build of $6.816 billion pre-tax, which amounted to $1.66 of missing EPS, as compared to what might have been if credit quality had remained as benign as it had been in recent periods. Other notable items were a $951 million credit adjustment in the Corporate and Investment Banking (CIB) segment on losses related to funding spread widening on derivatives and firmwide bridge book markdowns of $896 million (probably mostly levered loans and high yield debt caught up in the pipeline between originating and distributing—while the spreads jumped out wider).

End-of-period loans were up 6% year over year as more clients drew down their revolvers, but deposits were also up a whopping 23% year over year at the end of period, as much of this money (and other) liquidity was parked at this high-ground bank. Just to show how stark the change in the business environment was during the quarter, one needs to look no further than JPMorgan's debit and credit card sales volume year-over-year and merchant processing volume year-over-year in the two graphics down below.

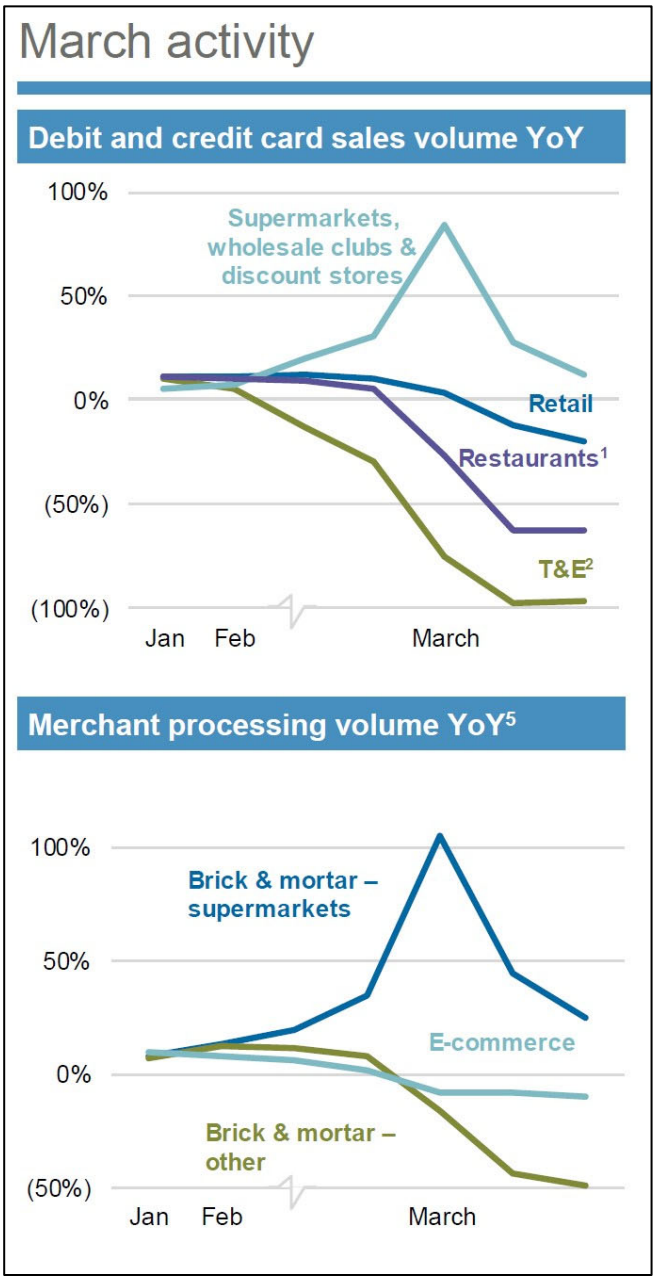

Image Source: *JPMorgan – First Quarter of 2020 Earnings Presentation*

As shown above, client spending on travel and entertainment ('T&E') dropped near zero as March progressed; restaurant spending dropped by more than half. Of interest, one can also see the spike in supermarkets, wholesales clubs, and discount stores as folks stocked up their pantries, before normalizing back to lower growth--more reflective of the channel shift from eating out to more meals at home. One can also see that e-commerce held up better in March than (brick & mortar – other) did, as cocooning at home was in full swing.

Aside from the drastically higher credit provisioning costs for expected upcoming bad debts, we also saw generalized revenue pressure from the lower-interest-rate effect on net interest margins and lower investment banking revenues as activity slowed. Higher markets activity from frenetic client trading during these volatile times was not enough to offset revenue pressure elsewhere. The broad revenue pressure also meant that efficiency ratios backed up to 57% from 55% in the same period last year. Return on equity dropped to 4% from 16% last year and return on tangible common equity dropped to 5% from 19% in last year's first quarter.

If the economy continues to worsen, JPMorgan's results will get uglier from here. On the earnings call, management indicated that second-quarter provisioning might be incrementally worse if the economy worsens. There is also room for deterioration in its Markets segment if trading activity dies down and one would expect the Asset & Wealth Management segment results to worsen if the markets are flat-to-down from here. The government rescue programs might also prove to be a temporary fix and consumer and business debt might just go bad later after an initial fix from stimulus funds received from the government.

In the firm's annual letter, Chairman and CEO Jamie Dimon also painted the picture for how the dividend could possibly be cut if things turn out worse than the more adverse scenario that the firm is postulating as one potential outcome. Here is the scenario that might cause a cut in the payout, according to the firm:

> *…we have run an extremely adverse scenario that assumes an even deeper contraction of gross domestic product, down as much as 35% in the second quarter and lasting through the end of the year, and with U.S. unemployment continuing to increase, peaking at 14% in the fourth quarter. Even under this scenario, the company would still end the year with strong liquidity and a CET1 ratio of approximately 9.5% (common equity Tier 1 capital would still total $170 billion). This scenario is quite severe and, we hope, unlikely. If it were to play out, the Board would likely consider suspending the dividend even though it is a rather small claim on our equity capital base. If the Board suspended the dividend, it would be out of extreme prudence and based upon continued uncertainty over what the next few years will bring.*

We are maintaining our $112 fair value estimate, which is just short of two times tangible book value of $60.71 per share. We think JPMorgan can earn middle to upper teens return on tangible capital through the course of most of the banking cycle, though it will have to fight through the difficult period ahead to prove this point yet again.

Morgan Stanley Stands Out Among Peers in First Quarter

Morgan Stanley posted difficult first-quarter 2020 results, released April 16, missing consensus estimates on both the top line and the bottom line. Return on average tangible common equity was 9.7% in the quarter, well above levels of just a few years back (and again better than large bank peers in the quarter), showing the progress that Morgan Stanley has made in improving its return profile.

Morgan Stanley (MS) posted difficult first-quarter 2020 results, released April 16, missing consensus estimates on both the top line (revenue of $9.49 missed by $330 million) and the bottom line (EPS of $1.01 missed by $0.14).

With that said, the results held up fairly well as one can see in the graphic down below, with net revenues down 8% year over year, and income before taxes down by 27%--better than its large bank peers. Return on average tangible common equity was 9.7% in the quarter, well above levels of just a few years back (and again better than large bank peers in the quarter), showing the progress that Morgan Stanley has made in improving its return profile.

Morgan Stanley

Consolidated Financial Summary
(unaudited, dollars in millions)

	Quarter Ended			Percentage Change From:	
	Mar 31, 2020	Dec 31, 2019	Mar 31, 2019	Dec 31, 2019	Mar 31, 2019
Net revenues					
Institutional Securities	$ 4,905	$ 5,054	$ 5,196	(3%)	(6%)
Wealth Management	4,037	4,582	4,389	(12%)	(8%)
Investment Management	692	1,356	804	(49%)	(14%)
Intersegment Eliminations	(147)	(135)	(103)	(9%)	(43%)
Net revenues	$ 9,487	$ 10,857	$ 10,286	(13%)	(8%)
Non-interest expenses					
Institutional Securities	$ 3,955	$ 3,929	$ 3,601	1%	10%
Wealth Management	2,982	3,419	3,201	(13%)	(7%)
Investment Management	549	909	630	(40%)	(13%)
Intersegment Eliminations	(145)	(133)	(101)	(9%)	(44%)
Non-interest expenses [1]	$ 7,341	$ 8,124	$ 7,331	(10%)	--
Income (loss) before taxes					
Institutional Securities	$ 950	$ 1,125	$ 1,595	(16%)	(40%)
Wealth Management	1,055	1,163	1,188	(9%)	(11%)
Investment Management	143	447	174	(68%)	(18%)
Intersegment Eliminations	(2)	(2)	(2)	--	--
Income (loss) before taxes	$ 2,146	$ 2,733	$ 2,955	(21%)	(27%)
Net Income (loss) applicable to Morgan Stanley					
Institutional Securities	$ 757	$ 1,034	$ 1,371	(27%)	(45%)
Wealth Management	864	889	924	(3%)	(6%)
Investment Management	78	317	136	(75%)	(43%)
Intersegment Eliminations	(1)	(1)	(2)	--	50%
Net Income (loss) applicable to Morgan Stanley	$ 1,698	$ 2,239	$ 2,429	(24%)	(30%)
Earnings (loss) applicable to Morgan Stanley common shareholders	$ 1,590	$ 2,085	$ 2,336	(24%)	(32%)

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 – First Quarter of 2020 Earnings Supplement*

As one can see above, the Wealth Management segment held up the best, while Institutional Securities had more cost and bottom-line pressure. Management has committed to no layoffs this year (despite lower investment banking activity, for example) in the face of the COVID-19 pandemic, so the bank will be focusing on cutting back on non-compensation expenses as it moves forward through the year.

Because Morgan Stanley is so reliant on market levels and activity, it is possible that results could come under further pressure as this pandemic-catalyzed recession unfolds. The bounce off the recent market lows, however, shows that the Federal Reserve's and Congress/Treasury's actions to reflate the economy and asset markets are very helpful to a firm like this.

It's also notable that Morgan Stanley hasn't closely followed closest peer Goldman Sachs (GS) in its drive to become more of a universal bank. While Goldman is pulling back on growth in credit card and unsecured lending, Morgan Stanley is instead sitting on low-risk home loans to very wealthy clients. Morgan Stanley's bigger concern is that its investment firm clients don't get caught up in too large of margin calls. While it was an issue in the quarter, it seems the size wasn't very material despite the wild market gyrations in the quarter. We are maintaining our recently reduced $31.50 fair value estimate.

Wells Fargo Faces Regulatory Pressure Amid an Enormous Bad Debt Cycle

Wells Fargo is facing the same enormous bad debt cycle ahead just like its big bank peers, but it is also carrying a ton of its own baggage at just the wrong time. Earnings had already been under pressure before the bad debt cycle had hit, and the bank is facing a very difficult regulatory situation, with a cap on total assets that has been in place since 2018. This is causing the bank to forgo revenue growth opportunities and make difficult tradeoffs to help existing customers over new customers. This means that Wells is competing with one arm tied behind its back; it has also meant substantially higher costs as the bank has done a ton of hiring to help deal with the regulatory issues. Now Wells is under (optical) pressure to retain employees. All of this has resulted in sliding earnings over the past four quarters.

Wells Fargo (WFC) posted very dismal first-quarter 2020 results April 14, missing analyst consensus estimates (wild guesses at times like these) on both the top and bottom lines. The bank's revenue of $17.72 billion missed by $1.58 billion and earnings of $0.01 missed by $0.52 per share. The biggest swing in earnings came from a $2.9 billion build in (provisioning for) reserves, which comes in anticipation of bad loans coming straight ahead based on an economy in free fall and rapidly rising unemployment.

As you can see in the graphic down below, provisions for upcoming credit costs have skyrocketed. The bank also posted a $950 million securities impairment on equity and debt securities that needed to be written down to reflect a mark to market. Since dividends and share buybacks (suspended as at March 15) were greater than earnings, and loan growth due to companies pulling down their credit revolvers, Wells Fargo's common equity Tier 1 ratio dropped to 10.7% from 11.1% at year end. We still view this as well capitalized.

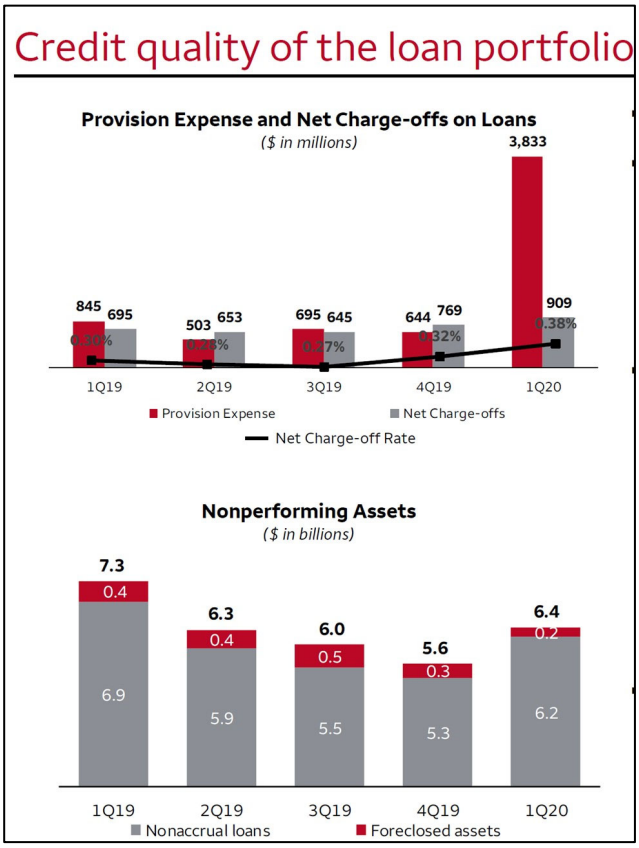

Image Source: *Wells Fargo – First Quarter of 2020 Earnings Presentation*

While Wells Fargo is facing the same enormous bad debt cycle ahead just like its big bank peers, it is also carrying a ton of its own baggage at just the wrong time. As you can see in the graphic down below, earnings had already been under pressure before the bad debt cycle had hit. The bank is facing a very difficult regulatory situation, with a cap on total assets that has been in place since 2018. This is causing the bank to forgo revenue growth opportunities and make difficult tradeoffs to help existing customers over new customers. This means that Wells is competing with one arm tied behind its back; it has also meant substantially higher costs as the bank has done a ton of hiring to help deal with the regulatory issues. Now Wells is under (optical) pressure to retain employees. All of this has resulted in sliding earnings over the past four quarters.

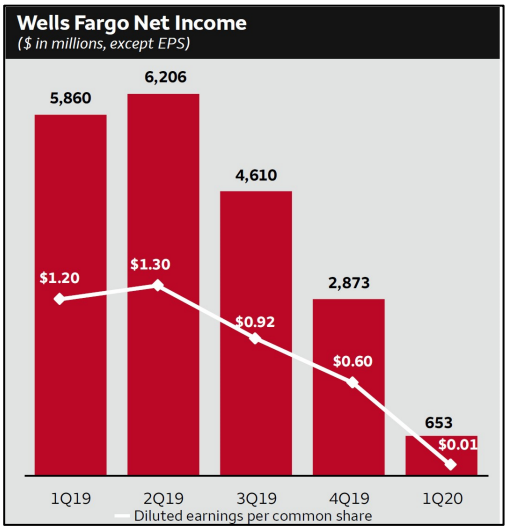

Image Source: *Wells Fargo – First Quarter of 2020 Earnings Presentation*

Though net interest margins (NIMs) ticked up slightly sequentially, they are down substantially year over year and non-interest revenue is under a great deal of pressure. Efficiency ratios (see graphic down below) are high and out of line with peer banks and the CEO Charlie Scharf admitted that it will be some time before they can cut costs in a meaningful way (other than revenue related costs that are in fact under pressure.)

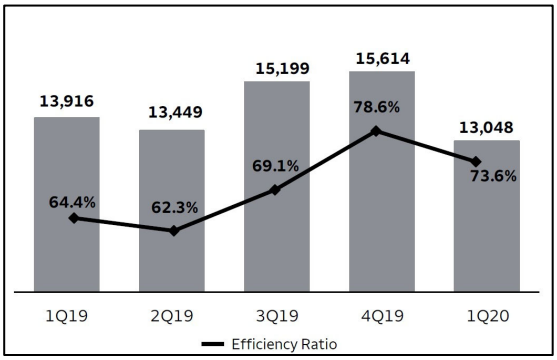

Image Source: *Wells Fargo – First Quarter of 2020 Earnings Presentation*

We are maintaining our recently reduced $36 fair value estimate, but the risks appear to the downside. We would also highlight that Wells Fargo's dividend might be at risk, since the bank is so dramatically underearning the payout right now, and we suspect the rest of the year will remain extremely difficult.

Disclosure: *Matthew Warren does not own shares in any of the securities mentioned above.*

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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 think the High Yield Dividend Newsletter portfolio positions us fairly well for whatever the market may throw at us, whether it's COVID-19 or another calamity. The newsletter portfolio is pretty well-diversified, and we've started to identify some pretty good individual equity ideas of late. That said, **high yield investing is inherently risky.**

In many respects, 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			
PowerShares Senior Loan Portfolio	BKLN	5.0%	5.28%
iShares MSCI Australia ETF	EWA	5.0%	5.95%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	6.98%
iShares International Select Dividend ETF	IDV	5.0%	9.74%
iShares U.S. Preferred Stock ETF	PFF	5.0%	6.27%
Global X SuperDividend ETF	SDIV*	5.0%	9.66%
Global X SuperIncome Preferred ETF	SPFF	10.0%	7.19%
Vanguard Real Estate ETF	VNQ	10.0%	4.54%
Utilities Select Sector SPDR	XLU	5.0%	3.52%
EQUITY			
AT&T	T	7.5%	6.83%
BP PLC	BP	2.5%	9.91%
CubeSmart	CUBE	5.0%	5.18%
Digital Realty Trust	DLR	5.0%	3.00%
Enterprise Products Partners	EPD	2.5%	10.14%
Magellan Midstream Partners	MMP	2.5%	9.99%
Philip Morris	PM	7.5%	6.27%
Public Storage	PSA	5.0%	4.31%
ProShares Short High Yield	SJB	7.5%	0.95%
Cash**	-	0.0%	0.00%
		75.0%	**5.97%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 5/1/2020. Est. Div. Yield information retrieved from YahooFinance.

** SDIV yield calculated as annualizing its most recent distribution. Source: Global X, https://www.globalxetfs.com/funds/sdiv/ (retrieved 5/1/2020)*

*** Reflects federal funds target rate range*

DIVIDEND REPORT PAGE 2 – ENBRIDGE INC (ENB)

Enbridge ENB FAIRLY VALUED

Buying Index™ 3 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record (in USD)	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Neutral	$23.00 - $39.00	HEALTHY	GOOD / 1.3	EXCELLENT	11.02%

Assessment of Company Dividend Strategy

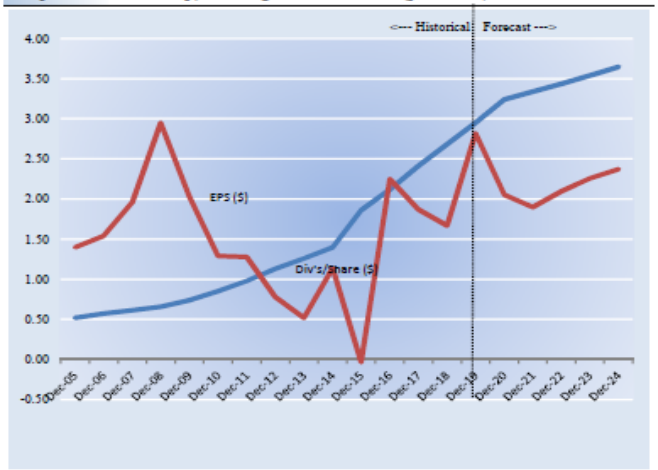
Key Strengths

Enbridge's 2017 merger with Spectra Energy and the corporate consolidation of its affiliates a year later created the largest energy infrastructure company in North America. The combined firm, now a C-Corp, retains a solid balance sheet, investment grade credit ratings, and access to capital. Enbridge owns and operates numerous long-haul pipelines that cater to Canada's oil sands region, which traditionally have had minimal throughput risks and minimal exposure to commodity prices. Enbridge is targeting a debt-to-EBITDA ratio of 4.5x-5.0x over the long term, and the measure stood at ~4.5x as of the end of 2019, down materially from over 6.0x seen at the end of 2016.

Potential Weaknesses

Though growth investment can be a good thing, given the sharp downturn in raw energy resource prices experienced at the beginning of 2020, Enbridge's massive growth capital program will be a huge cash drain on its financials in the near- to medium-term while potential exogenous risks are building (such as government mandated production curtailments in the oil sands patch, natural output declines, and reduction in demand for energy and utility products/services). Enbridge's capital expenditure expectations have come down materially in recent years, which we appreciate, but its growth ambitions need to be closely monitored going forward.

Graphical Relationship, Earnings and Dividends (per share)

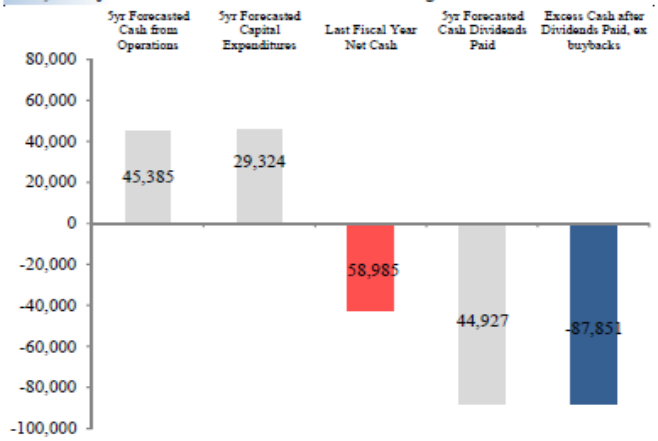


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

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. Enbridge's Dividend Cushion Cash Flow Bridge reveals that the sum of the company's 5-year cumulative free cash flow generation, as measured by cash flow from operations less all capital spending, plus its net cash/debt position on the balance sheet, as of the last fiscal year, is less than the sum of the next 5 years of expected cash dividends paid. Because the Dividend Cushion ratio is forward-looking and captures the trajectory of the company's free cash flow generation and dividend growth, it reveals whether there will be a cash surplus or a cash shortfall at the end of the 5-year period, taking into consideration the leverage on the balance sheet, a key source of risk. On a fundamental basis, we believe companies that have a strong net cash position on the balance sheet and are generating a significant amount of free cash flow are better able to pay and grow their dividend over time. Firms that are buried under a mountain of debt and do not sufficiently cover their dividend with free cash flow are more at risk of a dividend cut or a suspension of growth, all else equal, in our opinion. Generally speaking, the greater the 'blue bar' to the right is in the positive, the more durable a company's dividend, and the greater the 'blue bar' to the right is in the negative, the less durable a company's dividend.

Raw, Unadjusted Dividend Cushion Cash Flow Bridge - Raw

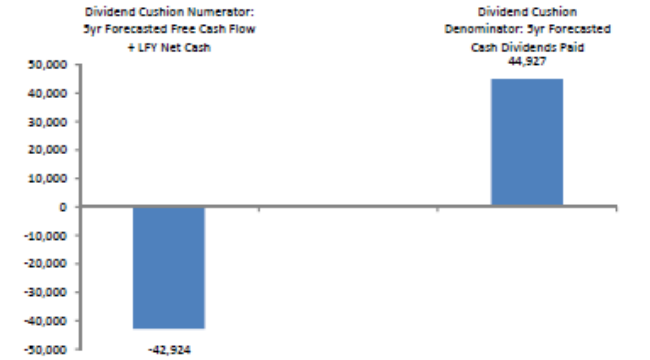


Source: Company Filings, Valuentum Projections

Dividend Cushion Ratio Evaluation

The Dividend Cushion Ratio Deconstruction, shown in the image to the right, reveals the numerator and denominator of the Dividend Cushion ratio. At the core, the larger the numerator, or the healthier a company's balance sheet and future free cash flow generation, relative to the denominator, or a company's cash dividend obligations, the more durable the dividend. In the context of the Dividend Cushion ratio, Enbridge's numerator is smaller than its denominator suggesting weak dividend coverage in the future. The Dividend Cushion Ratio Deconstruction image puts sources of free cash in the context of financial obligations next to expected cash dividend payments over the next 5 years on a side-by-side comparison. Because the Dividend Cushion ratio and many of its components are forward-looking, our dividend evaluation may change upon subsequent updates as future forecasts are altered to reflect new information.

Raw, Unadjusted Dividend Cushion Ratio Deconstruction - Raw



DEFINITIONS

ValueCreation. This is a proprietary Valuentum measure. ValueCreation indicates the firm's historical track record in creating economic value for shareholders, taking the average difference between ROIC (without goodwill) and the firm's estimated WACC during the past three years. The firm's performance is measured along the scale of EXCELLENT, GOOD, POOR, and VERY POOR. Those firms with EXCELLENT ratings have a demonstrated track record of creating economic value, while those that register a VERY POOR mark have been destroying economic value.

ValueRisk. This is a proprietary Valuentum measure. ValueRisk indicates the historical volatility of key valuation drivers, including revenue, gross margin, earnings before interest, and enterprise free cash flow. The standard deviation of each measure is calculated and scaled against last year's measure to arrive at a percentage deviation for each item. These percentage deviations are weighted equally to arrive at the corresponding fair value range for each stock, measured in percentage terms. The firm's performance is measured along the scale of LOW, MEDIUM, HIGH, and VERY HIGH. The ValueRisk™ rating for each firm also determines the fundamental beta of each firm along the following scale: LOW (0.85), MEDIUM (1), HIGH (1.15), VERY HIGH (1.3).

ValueTrend. This is a proprietary Valuentum measure. ValueTrend indicates the trajectory of the firm's return on invested capital (ROIC). Firms that earned an ROIC last year that was greater than the 3-year average of the measure earn a POSITIVE rating. Firms that earned an ROIC last year that was less than the 3-year average of the measure earn a NEGATIVE rating.

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