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HIGH YIELD DIVIDEND NEWSLETTER

Covering Self-Storage REIT Public Storage's Cumulative Preferred Shares

Latest Changes to High Yield Dividend Newsletter
Weighting Changes: 5.0% Reduction in SJB (Reducing Weighting to 2.5%) – June 1
Added: 5.0% to VDC – June 1

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"KEY MONETARY BODIES HAVE PROVIDED CAPITAL MARKETS WITH AN IMMENSE AMOUNT OF SUPPORT DURING THESE HARROWING TIMES, THOUGH FEARS OVER A SECOND WAVE OF COVID-19 INFECTIONS ARE GROWING."

– CALLUM TURCAN

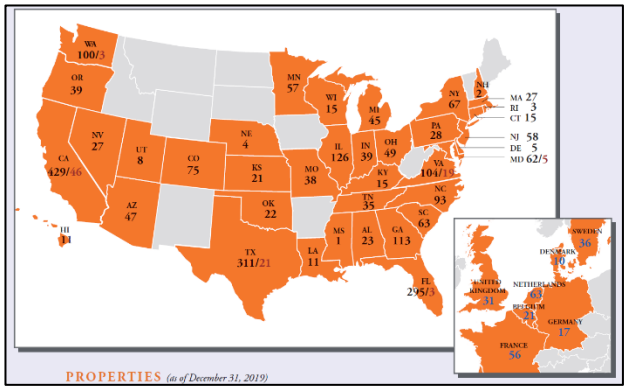

Image Source: *Public Storage Inc – 2019 Annual Report*

By Callum Turcan

Dear members,

One of our favorite high yield names is the self-storage real estate investment trust ('REIT') Public Storage Inc (PSA). Shares of Public Storage's common stock **yields ~4.2%** as of this writing and most of its self-storage operations are in the US.

We like the secular growth tailwinds that support the self-storage industry in the US and we like the ability for many players in the industry, including Public Storage, to generate sizable free cash flows which is uncommon for most REITs. While the ongoing coronavirus ('COVID-19') pandemic will create headwinds for Public Storage, it appears very well-positioned to ride out the storm.

We include shares of PSA in our High Yield Dividend Newsletter portfolio and would like to draw our member's attention towards one of Public Storage's preferred share issuances in this note.

Public Storage's 5.60% Cumulative Preferred Share of Beneficial Interest Series H (PSA.PRH) is a cumulative preferred series that cannot be redeemed prior to March 11, 2024. On or after March 11, Public Storage has the right to redeem those preferred securities at $25,000 per preferred share which is equal to $25 per depository share. Each depository share is worth 1/1,000th of a cumulative preferred share, and as of this writing, depository shares are trading at a modest premium to their redemption value.

As a cumulative preferred issue, investors have greater assurances that Public Storage will make good on its dividend obligations. Investors in Public Storage's preferred securities are at the front of the line when it comes to dividend payouts (and are pari passu with the REIT's other preferred securities). If Public Storage decides to miss a payment dividend payment on its preferred cumulative shares, investors still need to be made whole before common dividends can be paid out. Here's a key excerpt from the prospectus:

> *Except as set forth in the preceding sentence, unless full distributions on the Preferred Shares have been paid for all past distribution periods, no distributions (other than in Common Shares or other shares of beneficial interest issued by us ranking junior to the Preferred Shares as to distributions and upon liquidation) shall be declared or paid or set aside for payment, nor shall any other distribution be made on the Common Shares or on any other shares of beneficial interest issued by us ranking junior to or on a parity with the Preferred Shares as to distributions or upon liquidation.*

We are highly confident Public Storage will be able to continue making good on both its preferred and common dividend obligations going forward. Public Storage is a capital market dependent entity and needs to constantly taps both debt and equity markets to raise funds. Those funds are used to cover its expansion plans, to refinance upcoming debt maturities, and make good on its dividend obligations (though historically, Public Storage has been a very free cash flow positive entity, which we really appreciate).

From 2017 to 2019, Public Storage generated ~$1.6 billion in annual free cash flows on average, defining free cash flows as net operating cash flows less 'payments for capital expenditures to maintain real estate facilities' and 'payments for development and expansion of real estate facilities' for 'costs incurred during the period' and 'costs incurred in previous periods.' During this period, Public Storage allocated ~$1.6 billion per year towards 'distributions paid to preferred shareholders, common shareholders, and restricted share unitholders' **which its average annual free cash flows came close to fully covering.** Public Storage's 'distributions paid to noncontrolling interests' has historically been negligible.

PUBLIC STORAGE
STATEMENTS OF CASH FLOWS
(Amounts in thousands)

	For the Years Ended December 31,		
	2019	2018	2017
Cash flows from operating activities:			
Net income	$ 1,525,651	$ 1,717,223	$ 1,448,465
Adjustments to reconcile net income to net cash flows from operating activities:			
Gain due to Shurgard public offering	-	(151,616)	-
Gain on real estate investment sales	(341)	(37,903)	(1,421)
Assets damaged due to hurricanes	-	-	3,286
Depreciation and amortization	512,918	483,646	454,526
Equity in earnings of unconsolidated real estate entities	(69,547)	(103,495)	(75,655)
Distributions from retained earnings of unconsolidated real estate entities	73,259	109,754	53,749
Foreign currency exchange (gain) loss	(7,829)	(18,117)	50,045
Share-based compensation expense	25,833	69,936	37,548
Other	7,699	(5,791)	2,346
Total adjustments	541,992	346,414	524,424
Net cash flows from operating activities	2,067,643	2,063,637	1,972,889
Cash flows from investing activities:			
Payments for capital expenditures to maintain real estate facilities for:			
Costs incurred during the period	(175,981)	(127,966)	(111,631)
Costs incurred in previous periods	(11,331)	(13,005)	(8,964)
Payments for development and expansion of real estate facilities for:			
Costs incurred during the period	(203,331)	(281,240)	(289,238)
Costs incurred in previous periods	(81,351)	(58,792)	(48,055)
Acquisition of real estate facilities and intangible assets	(437,758)	(181,020)	(285,279)
Distributions in excess of retained earnings from unconsolidated real estate entities	11,630	91,927	-
Proceeds from sale of real estate investments	762	54,184	6,103
Net cash flows used in investing activities	(897,360)	(515,912)	(737,064)
Cash flows from financing activities:			
Repayments on notes payable	(1,920)	(1,784)	(1,701)
Issuance of notes payable, net of issuance costs	496,900	-	992,077
Issuance of preferred shares	1,059,156	-	561,177
Issuance of common shares	33,564	12,525	42,500
Redemption of preferred shares	(1,050,000)	-	(922,500)
Cash paid upon vesting of restricted share units	(12,162)	(12,347)	(14,092)
Acquisition of noncontrolling interests	(35,000)	-	(14,425)
Contributions by noncontrolling interests	4,148	1,720	2,484
Distributions paid to preferred shareholders, common shareholders and restricted share unitholders	(1,608,749)	(1,612,680)	(1,630,347)
Distributions paid to noncontrolling interests	(6,672)	(7,022)	(7,392)
Net cash flows used in financing activities	(1,120,735)	(1,619,588)	(992,219)
Net cash flows from operating, investing, and financing activities	49,548	(71,863)	243,606
Net effect of foreign exchange translation	(13)	(171)	(126)
Increase (decrease) in cash and equivalents, including restricted cash	$ 49,535	$ (72,034)	$ 243,480

Image Shown: *The line-item underlined in blue represent Public Storage's net operating cash flows, the line-items highlighted by the red markings represent Public Storage's capital expenditures, and the line-items highlighted by the green markings represent Public Storage's preferred and common dividend payouts.*
Image Source: *Public Storage – 2019 Annual Report*

Public Storage exited the first quarter of 2020 with ~$0.7 billion in cash and cash equivalents on hand versus ~$2.4 billion in total debt. The company's liquidity position is enhanced by its $0.5 billion revolving credit facility that matures in April 2024, which had no outstanding borrowings against it at the end of March 2020 (though a modest amount of letters of credit were posted against the facility at the end of this period).

Public Storage's debt maturities appear manageable given the REIT's ability to generate sizable free cash flows and high likelihood that it retains quality access to capital markets at attractive rates (seen through its recent 4.625% Cumulative Preferred Share of Beneficial Interest Series L offering).

PUBLIC STORAGE
NOTES TO FINANCIAL STATEMENTS
March 31, 2020
(Unaudited)

	Coupon Rate	Effective Rate	Amounts at March 31, 2020 Principal	Unamortized Costs	Book Value	Fair Value
			($ amounts in thousands)			
U.S. Dollar Denominated Unsecured Debt						
Notes due September 15, 2022	2.370%	2.483%	$ 500,000	$ (1,287)	$ 498,713	$ 493,176
Notes due September 15, 2027	3.094%	3.218%	500,000	(3,944)	496,056	480,725
Notes due May 1, 2029	3.385%	3.459%	500,000	(2,799)	497,201	490,203
			1,500,000	(8,030)	1,491,970	1,464,104
Euro Denominated Unsecured Debt						
Notes due April 12, 2024	1.540%	1.540%	110,005	-	110,005	110,091
Notes due November 3, 2025	2.175%	2.175%	266,227	-	266,227	266,574
Notes due January 24, 2032	0.875%	0.978%	550,026	(6,332)	543,694	509,269
			926,258	(6,332)	919,926	885,934
Mortgage Debt, secured by 27 real estate facilities with a net book value of $104.8 million	4.010%	3.984%	26,772	-	26,772	27,128
			$ 2,453,030	$ (14,362)	$ 2,438,668	$ 2,377,166

Image Shown: *Public Storage's debt maturity schedule is staggered and manageable, in our view.* ***Image Source:*** *Public Storage – 10-Q SEC filing cover the first quarter of 2020*

Management noted that the self-storage REIT's rent collections held up well during the early stages of the pandemic in the US. Here is what Public Storage's management team had to say during the firm's first quarter 2020 quarterly conference call held back in early-May (emphasis added):

> *"[Public Storage's] April rent collections were very consistent with prior year, and that is consistent with what we saw in 2009.* ***We've collected about 95% of our April rent at this point****, which is right in line with where we were last year at this time. So, as the duration of this pandemic elongates and we react to where we go from here, could very likely put more pressure on the consumer. And we'll have to monitor that as we go forward. But at this point, collections are very much in line." --- Tom Boyle, CFO of Public Storage*

The self-storage REIT put out a 8-K SEC filing in early-June highlighting that its occupancy rate (on a square foot basis) stood at 94.0% on May 31, 2020, up from 93.6% on May 31, 2019, though please note that includes delinquent locations whose auction was delayed (namely due to the pandemic). Additionally, Public Storage noted that "we have observed no material degradation in rent collections in the two months ended May 31, 2020" which we appreciate. However, Public Storage also noted in the 8-K SEC filing that its 'annual contract rent per occupied square foot' fell by 1.9% year-over-year as of the end of May 2020.

Public Storage's near-term performance could potentially face headwinds from the ongoing pandemic with an eye towards potential pressures facing its rent collections, occupancy rates, and rental rate increases (which were put on hold through the second quarter of this year).

That being said, **the self-storage REIT appears on track to continue generating substantial free cash flows, carries a nice liquidity position, has a manageable debt maturity schedule, maintains solid investment grade credit ratings (A2/A), and appears to continue have solid access to capital markets at attractive rates.** While these are volatile times, we are confident that Public Storage possess the financial and operational capacity to ride out the storm with its common and preferred dividend payouts intact.

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

Warren: Four Ways to Play the Market at This Juncture

In this piece, we examine where the economy and stock markets have been recently, where we are now, and where we are going next. We also highlight four key ways to play this volatile market. We think this is a helpful way to think about overall portfolio construction, especially so that one does not overly expose themselves to a particular set of risks that could come to fruition—like an extended downturn in the economy or a rapid discovery of a vaccine for Covid-19 on the other hand.

By Matthew Warren

Macro Matters

When you turn on the television to the stock channel, there is a tremendous amount of discussion about where we are now and where we are headed next. While it always pays to focus on individual companies, industries, and stock selection like we do here at Valuentum, I can understand the fascination with trying to handicap the economy and the overall markets at this stage. Afterall, we are in a situation where sizable tail risks (both very good and very bad outcomes) have been present on both sides of normal.

It pays to take notice when the overall market is frothy on the one hand or undervalued on the other. This can be capitalized on by going underinvested and taking on protection on the one hand, or going fully invested in high quality, high growth and/or high beta stocks on the other hand.

The market is also currently very bifurcated with beaten down COVID-tainted names on the one hand, and high-flying, strong secular growth stocks on the other hand. The COVID-affected stocks are trading with tremendous volatility even on an intraday basis at times, meaning that those making macro-economic oriented bets on these names can make or lose a lot of money in a short space of time.

Where Have We Been?

So where have we been most recently? At my last writing on macro subjects in the first part of March, we were descending into what looked very much like another financial crisis.

All asset classes were rapidly trading lower and liquidity was drying up even in large, critical markets such as the U.S. long-dated Treasury market. Bid/ask spreads were wide and asset prices were gapping all over the place (but mostly lower). That is when the Federal Reserve and US Congress and Treasury stepped in with all the big guns.

Instead of bringing out the artillery piecemeal over time, everything was thrown at the market all at once. The Federal Reserve is now pumping massive amounts of liquidity into all key markets, even down to the fallen angels--or previously (recently) investment grade companies, now rated at junk status.

Congress approved multiple stimulus packages amounting to trillions of dollars in the form of enhanced unemployment checks, stimulus checks to US households, and (forgivable) loans to all shapes and sizes of businesses.

Image Shown: *The S&P 500 has rallied back considerably since the depths of March.*

To say that the market responded would be an understatement. In fact, I would argue that the market immediately ruled out a worsening of the developing severe financial crisis as well as the possibility of another great depression, which material probabilities were very much on the table barring the massive intervention that took place.

Essentially, all asset markets rallied substantially off the March lows, and a self-reinforcing positive cycle emerged, with households topped up with some cash and corporations able to raise equity funding and roll over bond funding once again. Even the most leveraged, low quality companies can roll over their debt, with only a few exceptions that have moved into the bankruptcy courts such as Hertz Global Holdings (HTZ) and JC Penney Co. Inc. (JCP).

Where Are We Now?

So that is the recent past, which involved violent swings and lots of opportunities to lose and make money as an investor. Where are we now? In some ways, the current situation is unchanged. Current economic events are

being shaped in very large part by the progression of the COVID virus and the collective response to this pandemic.

While the initial move to quarantine in effect shut down very large portions of the economy, the move to reopen various state and country economies (all happening at various speeds) marks a return to growth mode, so a dramatic improvement from staring into the abyss. There are signs that unemployment is now declining from the highest levels since the Great Depression and that consumer spending is bouncing in May.

Four Ways to Play the Rally

I would bucket stocks into four groups at this point.

There are the previously mentioned secular growth companies that are not overly affected by the pandemic and its economic impacts in the first place. Companies like Facebook Inc (FB), Alphabet Inc (GOOGL), PayPal Holdings Inc (PYPL), and many software as a service companies. There is even a subset of this group that perversely benefitted from the pandemic – companies like Teladoc Health Inc. (TDOC), DocuSign Inc (DOCU), certain growth-oriented pharma and biotech companies that are now also targeting vaccines and/or therapeutics for COVID-19.

The fair value estimates of these companies largely stayed stable or even increased during what are incredibly tough times for the many unemployed. **This speaks to strong moats, large economic castles, and strong secular tail winds of growth.** These companies benefit from lower financing costs and a lower discount rate (cost of capital) applied in a discounted cash flow model. These are good companies to own at the right price and over the long term in general. These are the companies that fill the bulk of the larder in our newsletter portfolios.

The second bucket of companies are directly and substantially impacted by the COVID-19 virus. It is companies like airlines (JETS), cruise operators, casinos, gyms, movie theaters, concert promoters, sports teams, leagues, or facilities, and the like. Not only have these companies been directly affected by quarantine measures, but consumers themselves are unlikely to participate in these activities to varying degrees for the foreseeable future – until there is an approved and effective vaccine and/or therapeutic to get COVID-19 under control.

As the quarantines are removed, some wild and wooly consumers will come rushing back to these favorite pastimes, but others will hold back until COVID-19 is effectively knocked out. It is hard to predict whether some of these types of companies can operate profitably at partial capacity.

I would argue that, especially in the case of weak or questionable balance sheets and cash flow streams, investing in these companies is very much akin to gambling. You are betting that the many shots on goal for a vaccine or therapeutic will play out very rapidly (vaccines usually take years to come to fruition; but there is clearly a monumental global effort afoot regarding Covid 19) or that these companies will be able to raise equity and roll over debt at favorable prices. Very much a gamble.

The third bucket of companies are those that are affected by the economic impact caused by COVID-19, as opposed to being impacted by the virus itself. Companies in this bucket can be either weak or strong in terms of moat and economic castle. They are generally referred to as cyclicals. They run the gamut in terms of industries, but some key examples would be banks, industrials, and consumer discretionary companies.

There are several key questions when it comes to investing in these companies, making it a very difficult place to tread, though the potential rewards can be high. Does the company have a strong balance sheet? How prolific is the free cash flow generation at this weaker point in the cycle? Is there staying power to get to the other side with current shares outstanding (no risk of dilution at an unknown price), considering the spectrum of potential magnitude and duration of this economic downcycle? What is the valuation baking in regarding the prospects to first survive and then thrive in a more normalized economic environment?

As you can tell, these are more akin to trading tunas as opposed to eating tunas. That said, there will be some solid doubles and even home runs that emerge from this

bucket. The fourth and final bucket of companies is what the market typically refers to as defensives. These are firms whose prospects are not overly impacted by the economic cycle.

Some examples would include consumer staples firms, utilities, and steady-eddy pharmaceutical companies. A subset of these companies have also benefitted (mostly temporarily) from the COVID-19 outbreak – such as large chain grocers and general merchandise stores, and staples companies that sell products like home-cooked food and cleaning supplies through these channels.

Defensive companies often trade with higher multiples than the average company due to scarcity value and a lower assigned cost of capital. With the Federal Reserve pumping liquidity into the markets and dropping the cost of financing and cost of capital across the board, and with so many companies affected by either the virus or the downturn in the economy, many of these companies are trading with heroic P/E multiples at this juncture. While some of these valuations will bear out, we suspect there will be a come down for some of the stocks in this space, especially once COVID-19 is effectively defeated and the economy fully normalizes.

Where Are We Going from Here?

Now that we have delineated how we see the recent past and the present setup, where are we likely headed to from here? Barring a substantial selloff and loss of confidence in the Fed and the Treasury/Congress (something we regard as unlikely), we have likely put in the bottom back in March. **The US Congress and Federal Reserve must remain "All In" until the economy rebounds to trend for this assumption to hold.**

However, that does not mean we will not have volatility as the COVID-119 virus continues to plague our country and the world. **Case counts and hospitalizations are now rising in many parts of the country as we exit quarantine at various paces in various states.** This of course was to be suspected, especially as it now appears that summer weather does not seem to be having much of an impact in knocking down the numbers of infected.

As mentioned previously, we think some consumers will rush headlong out of their houses and back to their normal activities, with or without the masks and social distancing that are being recommended by the health experts. Many others will remain more cautious in their activities and therefore spending patterns.

This will impact the second and third bucket of companies for the near future. That is until one of the many shots on goal trickles (or hopefully gets slammed) into the net. Currently, many of the smartest people and well financed companies in the world are working on vaccines and therapeutics. We suspect that this will allow us to get a handle on the disease before too many months (god forbid years) go by. When this does happen, look out as asset prices and the economy will likely jump into a higher gear.

The stimulus from the Fed and Treasury will need to be rolled back in a tricky dance, hopefully not disrupting the party. But that is another strategy piece for a (future) happier time.

Meanwhile, let us root on our scientists and the funds from financiers, philanthropists, and governments that are backing them. Be careful investing in companies with weak cash flows and stretched balance sheets on the one hand or overvalued defensive companies on the other.

Stay safe out there!

Disclosure: *Matthew Warren 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: American Electric Power Company Inc (AEP) is a High Quality Regulated Utility

Our **July 2020 High Yield Dividend Newsletter Spotlight** is American Electric Power Company Inc (AEP)---**3.5% yield**---as we appreciate the company's shift towards regulated utility businesses over the past two decades. American Electric Power primarily owns transmission and distribution electric utilities with operations in roughly a dozen states across the US. **Regulated utilities generate very stable cash flow streams, even during harrowing times such as these.** American Electric Power offers income seeking investors a stable stream of dividends as we ride out the ongoing coronavirus ('COVID-19') pandemic.

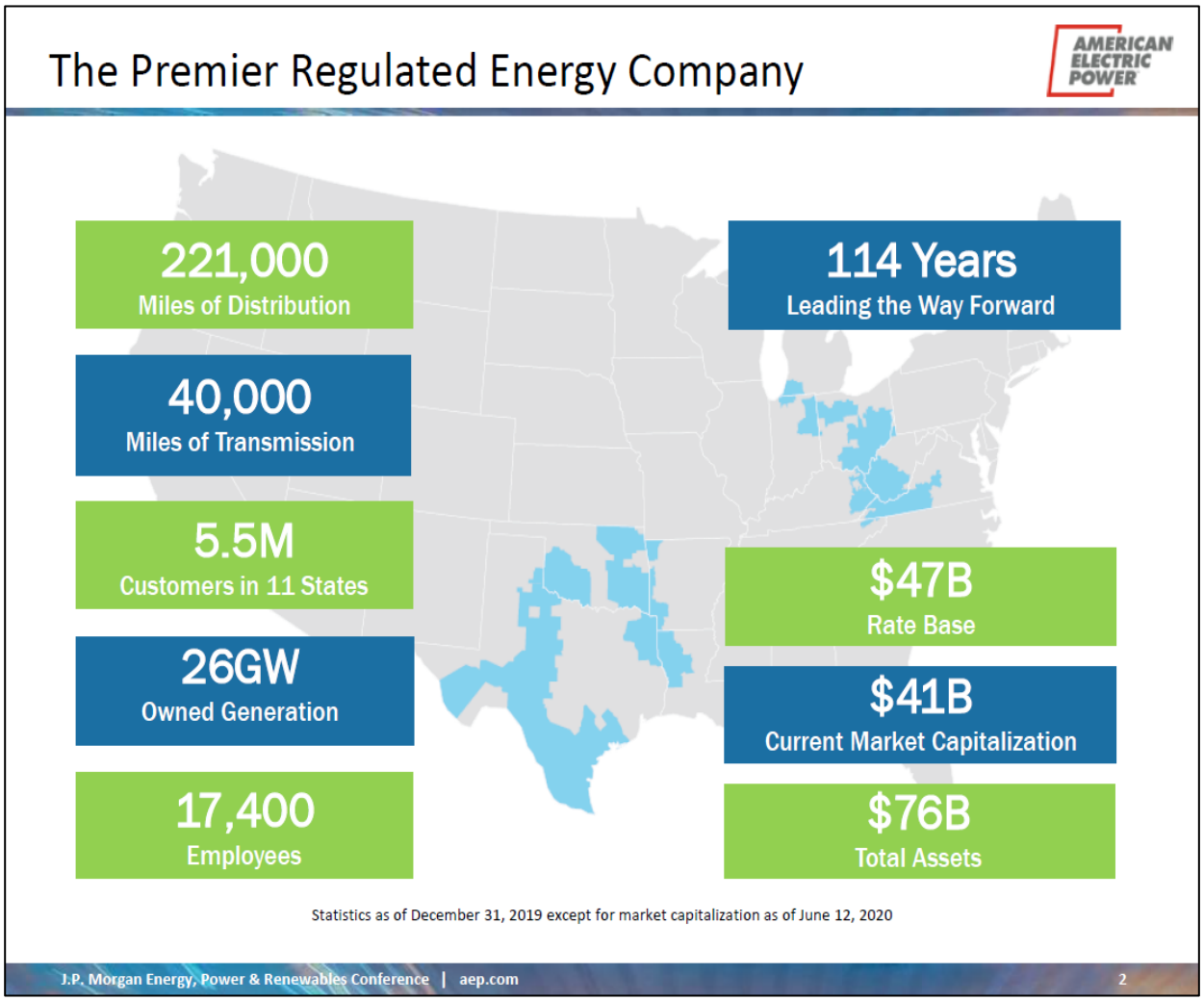

Image Shown: *An overview of American Electric Power's asset base.* ***Image Source:*** *American Electric Power – June 2020 IR Presentation*

American Electric Power (BBB+/Baa1) and its various subsidiaries all carried quality investment grade credit ratings as of May 1, 2020, as you can see in the upcoming graphic at the top of the next page. Utilities need to maintain investment grade credit ratings as they are capital market dependent entities, meaning they need to retain constant access to debt and equity markets to raise funds to cover hefty capital investments, dividend obligations, and to refinance debt maturities.

AEP Credit Ratings

AMERICAN ELECTRIC POWER

Company	Moody's Senior Unsecured	Moody's Outlook	S&P Senior Unsecured	S&P Outlook
American Electric Power Company Inc.	Baa1	N	BBB+	S
AEP, Inc. Short Term Rating	P2	S	A2	S
AEP Texas Inc.	Baa1	N	A-	S
AEP Transmission Company, LLC [1]	A2	S	A-	S
Appalachian Power Company [2]	Baa1	S	A-	S
Indiana Michigan Power Company [2]	A3	S	A-	S
Kentucky Power Company	Baa3	S	A-	S
AEP Ohio	A2	N	A-	S
Public Service Company of Oklahoma	A3	N	A-	S
Southwestern Electric Power Company	Baa2	S	A-	S
Transource Energy [3]	A2	S	NR	NR

[1] AEP Transmission Co. received a senior unsecured debt rating of A- from Fitch. The rating outlook is Stable.

[2] In conjunction with the unenhanced VRDN remarketings, APCo and I&M both received short term credit ratings of A-2/P2 from S&P and Moody's, respectively.

[3] NR stands for Not Rated.

Ratings current as of May 1, 2020

J.P. Morgan Energy, Power & Renewables Conference | aep.com 44

Image Shown: *We appreciate American Electric Power's investment grade credit ratings (senior unsecured stands at BBB+/Baa1) as of May 1, 2020.* ***Image Source:*** *American Electric Power – June 2020 IR Presentation*

From 2017 to 2019, American Electric Power generated negative free cash flows each year due to its large capital investments (the utility's net operating cash flows averaged $4.6 billion annually during this period). **Historically speaking, American Electric Power has preferred to use debt markets to raise funds as its equity issuances have been modest in recent years.** The utility's weighted average outstanding diluted share count rose by less than 1% from 2017 to 2019.

Moody's Corporation (MCO) placed American Electric Power's credit rating on negative watch back in November 2019 as the credit rating agency forecasted American Electric Power would take on more leverage than previously expected to fund its planned capital investments. Please note American Electric Power's credit rating from Moody's (Baa1 for senior unsecured notes) is a couple of notches above investment grade. **Considering the relatively "safe" nature of the future cash flows generated by rate regulated utility operations, we see the company retaining its investment grade credit ratings going forward.** Furthermore, management noted during the firm's first quarter 2020 conference call that the utility was cutting its operating expense and capital expenditure forecast this year to improve its financial position and maintain its credit metrics (emphasis added):

> *"In response to these circumstances [mild weather and the COVID-19 pandemic],* ***we have taken action to reduce untracked operations and maintenance expenses by an additional $100 million****, resulting in a positive expectation of $0.17 per share for the year. The net result of load, weather and O&M reductions would have a negative $0.09 per share impact for the year,* ***leaving us inside but in the lower half of the original operating earnings guidance range.***
>
> *We realize moratoriums on disconnects and the economic impact to our customers may have on our cash receipts. In response to this,* ***we have initiated a shift of $500 million of capital expenditures out of 2020 to be placed into the future years of 2021 to 2024.*** *As we made these deferrals, we were mindful of customer and reliability impacts. In fact, about $200 million of these investments were in our competitive renewables business and about $100 million were corporate investments. The shifts can be ramped up or down going forward in response to how events play out in real time.* ***With this moderate level of capital shifting, we are able to reaffirm our 5% to 7% long term growth rate off of our original 2019 operating earnings guidance range.****" --- Brian Tierney, CFO of American Electric Power*

American Electric Power's growth budget is heavily focused on expanding the rate base of its "wires" businesses, represented by transmission and distribution systems for electricity. These are primarily if not entirely regulated utility operations. American Electric Power works with the relevant state utilities commission (or similar agency) to set the financial guidelines of its regulated electric utility operations. Please note the rate base is the value of the assets that the utility in question can earn a specified return on investment on. **By growing its rate base, American Electric Power is effectively growing its future revenue generation potential and thus its future potential cash flow streams.**

The utility expects to spend around $33.0 billion from 2020 – 2024 on its capital investments as you can see in the upcoming graphic down below, **almost 80% of which is going to growing the rate base of its distribution and transmission operations.** Please note this guidance does not include potential capital expenditures relating to the 'North Central Wind' developments which could represent an investment opportunity of up to ~$2.0 billion (to acquire strategic stakes in three windfarm projects in Oklahoma that are expected to come online in 2020 and 2021).

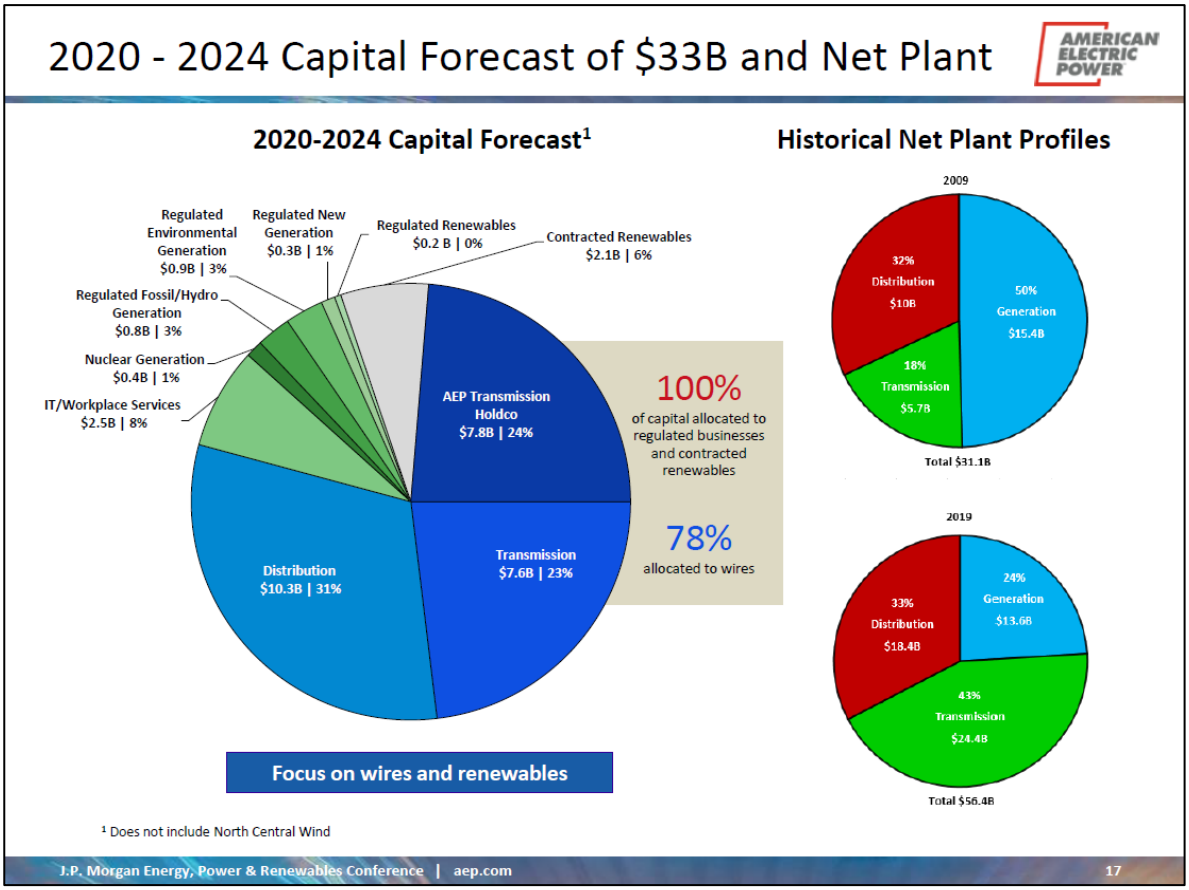

Image Shown: *From 2009 to 2019, American Electric Power's 'Generation' operations dropped from half of its 'net plant profile' to less than a quarter as the firm aggressively grew its 'Distribution' and 'Transmission' operations.* ***Image Source:*** *American Electric Power – June 2020 IR Presentation*

These capital investments are expected to drive significant rate base growth over the coming years, which in turn will grow American Electric Power's annual cash flows. Cost saving measures, which we will cover in just a moment, further enhances the utility's outlook. **Over the long-term, American Electric Power is targeting 5% - 7% EPS growth on an annual basis through a combination of rate base growth, cost containment efforts, and limited equity issuances.** Short-term headwinds aside, American Electric Power plans to continue marching forward with its growth ambitions, made possible through its solid access to capital markets.

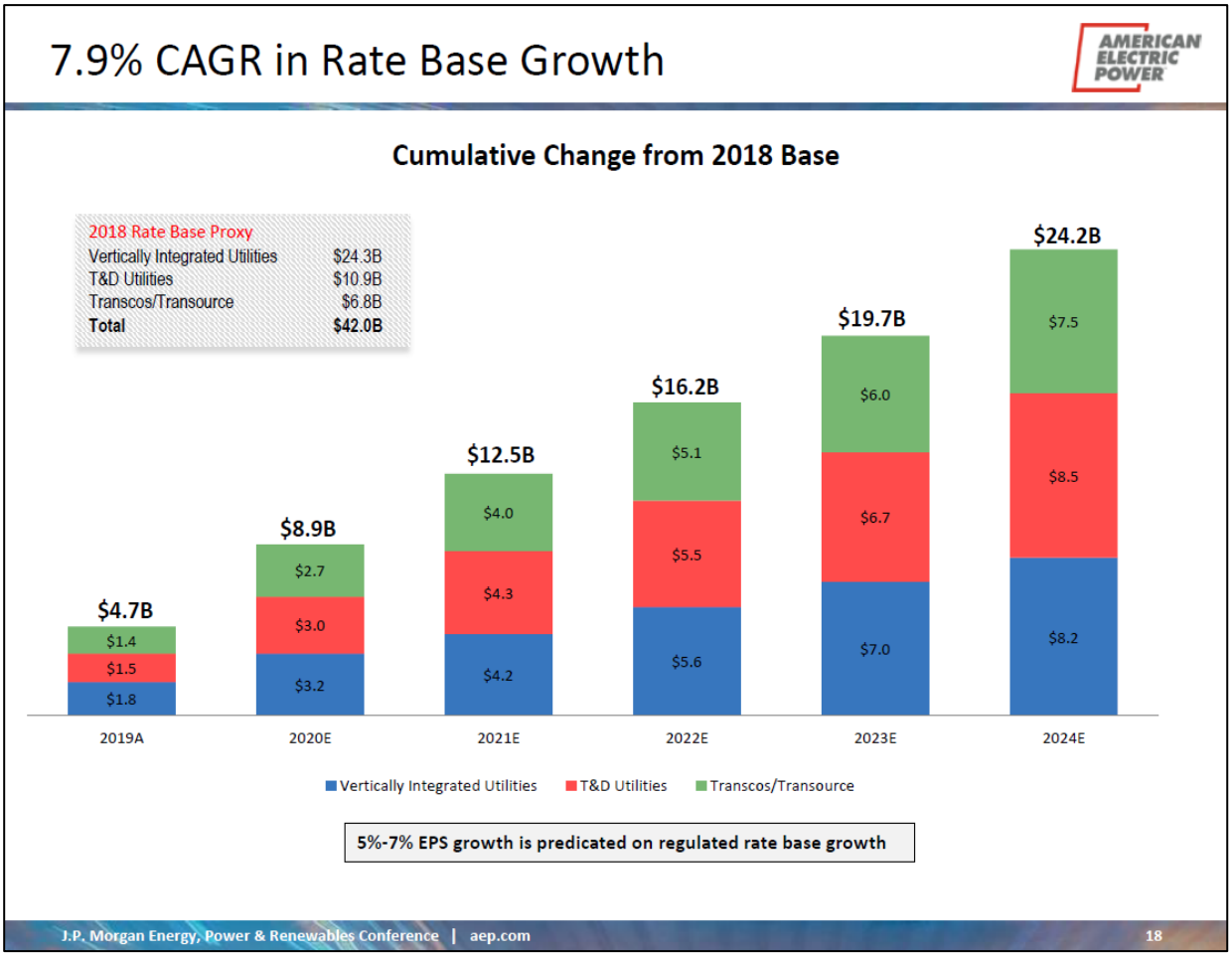

Image Shown: *American Electric Power expects its rate base will grow materially through the mid-2020s which supports its revenue growth outlook. Combined with ongoing improvements in its cost structure, the utility forecasts that it will grow its long-term EPS by 5% - 7% annually.* ***Image Source:*** *American Electric Power – June 2020 IR Presentation*

While the ongoing pandemic is negatively impacting American Electric Power's operations, the firm still expects to land within its full-year guidance (though now at the bottom of the range). American Electric Power forecasts that relatively strong demand growth from its residential customers will offset some of the expected declines in demand from its commercial and industrial customers this year, as you can see in the upcoming graphic at the top of the next page. Please note that mild weather negatively impacted American Electric Power's first quarter financial performance. Most importantly, **American Electric Power expects to spend $2.7 billion on operation and maintenance ('O&M') expenses in 2020, down from $3.1 billion in 2019.** We appreciate that American Electric Power reiterated its full-year guidance for 2020 and made adjustments to improve its cost structure to help make that possible.

2020 Financial Outlook

AMERICAN ELECTRIC POWER

2020 Earnings Guidance Range

$4.25 - $4.45

	Revised 2020 Load Growth Projections
Residential	3.0%
Commercial	(5.6%)
Industrial	(8.0%)

	2020 Guidance		Impact on EPS
	EEI	Revised	
Retail Sales Growth	0.5%	(3.4%)	($0.15)
Q1 2020 Weather	-	($71M)	($0.11)
Untracked O&M	$2.8B	$2.7B	$0.17
Capital Expenditures	$6.3B	$5.8B	NA
		Total	($0.09)

Items that would **positively** impact management's view:

- Strong V-shaped economic recovery
- Mitigation of coronavirus infections
- Further increase in residential sales and less than anticipated decrease in commercial and industrial sales
- Warmer summer weather
- Additional O&M savings achieved

Items that would **negatively** impact management's view:

- Prolonged U-shaped economic recovery
- Increased coronavirus infection rates
- Residential, commercial and industrial sales lower than projected
- Mild weather
- Higher storm-related O&M expense

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Image Shown: *An overview of American Electric Power's 2020 guidance.* ***Image Source:*** *American Electric Power – June 2020 IR Presentation*

Management expects the utility will generate $4.25 - $4.45 in EPS this year, which even at the lower bound still represents growth over the company's 2019 performance. Last year, American Electric Power posted $3.80 in GAAP EPS and $4.24 in non-GAAP EPS. As mentioned previously, mild weather negatively influenced American Electric Power's first quarter financial performance, and weather patterns for the rest of 2020 could have a significant positive/negative impact on its operations.

Stay-at-home orders have and continue to drive up demand for electricity in residential areas while putting downward pressure on electricity demand from commercial and industrial customers in most parts of the US. American Electric Power expects that there will be "some tapering off" in residential demand during the second half of 2020, while commercial demand will stage a "modest improvement through the remainder of the year." Demand from industrial customers is expected to gradually improve as the US economy reopens, though please note that the reopening process will be a wild and unpredictable ride.

One key consideration as it relates to the utility's revenue generation abilities is that roughly 30% of its industrial sales are generated by the oil and gas industry, which has been hit particularly hard by the pandemic due to the related declines in prices for raw energy resources. While demand from upstream (resource extraction) energy companies is expected to come under pressure in the near-term, American Electric Power sees that being offset (at least partially) by increased demand from midstream (pipeline, storage) and downstream (refineries, petrochemical plants) companies.

American Electric Power announced an additional $0.1 billion reduction in its expected 2020 O&M expenses during its first quarter earnings report. That came on top of the $0.3 billion in forecasted O&M expense savings (versus 2019 levels) American Electric Power had already identified through a series of promising initiatives. **These initiatives could potentially save American Electric Power a lot of money by improving its cost structure over time, and as brought up previously, these cost saving measures represent a big reason why the utility forecasts its EPS will continue growing this year.**

One of those cost saving and efficiency enhancing initiatives involves using drones to assess storm damage, conduct land surveys, and inspect transmission systems, among other things. Another initiative involves utilizing data analytics and digital tools to optimize maintenance activities while also detecting potential meter tampering to protect its revenue generation abilities. Part of American Electric Power's cost savings drive involves rationalizing the size of its workforce over time. In the upcoming graphic down below, American Electric Power highlights both the historical and expected improvements in its cost structure.

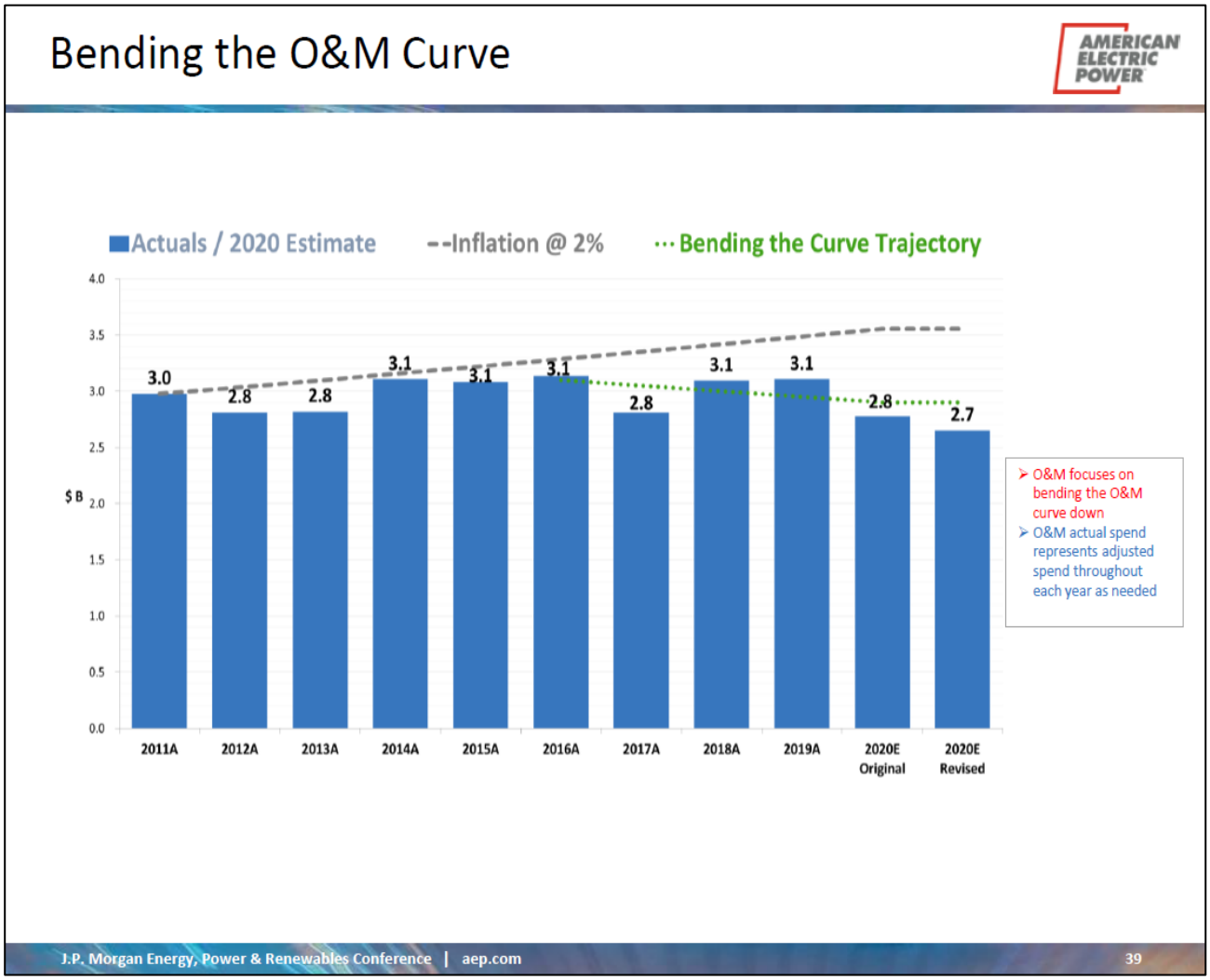

Image Shown: *American Electric Power is bringing down its annual O&M expenses which in turn is bolstering its cash flow growth trajectory.* ***Image Source:*** *American Electric Power – June 2020 IR Presentation*

At the end of the first quarter of 2020, American Electric Power had approximately $1.6 billion in cash and cash equivalents on hand on top of an additional $1.3 billion in borrowing capacity under its $4.0 billion revolving credit facility due June 2022. That was stacked up against $4.5 billion in short-term along with $25.8 billion in long-term debt at the end of March 2020, highlighting American Electric Power's need to tap debt markets again. The utility's liquidity position as of the end of March 2020 is depicted in the upcoming graphic down below. American Electric Power enhanced its liquidity position by fully drawing down a new $1.0 billion 364-day term loan the firm took out last March.

Net Available Liquidity

AEP manages liquidity by maintaining adequate external financing commitments. As of March 31, 2020, available liquidity was approximately $2.8 billion as illustrated in the table below:

		Amount	Maturity
Commercial Paper Backup:		(in millions)	
	Revolving Credit Facility	$ 4,000.0	June 2022
	364-Day Term Loan	1,000.0	March 2021
Cash and Cash Equivalents		1,554.6	
Total Liquidity Sources		6,554.6	
Less:	AEP Commercial Paper Outstanding	2,709.6	
	364-Day Term Loan	1,000.0	
Net Available Liquidity		$ 2,845.0	

Image Shown: *A look at American Electric Power's liquidity positioned as of the end of March 2020.* ***Image Source:*** *American Electric Power – 10-Q SEC filing covering the first quarter of 2020*

During the utility's latest quarterly conference call held in early-May, management noted the firm's "commercial paper balances have dropped to $1.6 billion and [American Electric Power's] liquidity position has increased to $3.1 billion" which we appreciate. Given that the Fed has aggressively intervened in US corporate credit markets, and the stable nature of American Electric Power's cash flow profile (even during harrowing times such as these), **the utility should be able to continue refinancing its upcoming debt maturities at attractive rates.** On May 14, 2020, American Electric Power published an 8-K SEC filing that noted the firm was issuing out $0.5 billion in 3.700% Senior Notes due 2050.

American Electric Power has a solid history of dividend increases over the past 15 or so years, though we caution that the firm cut its dividend in 2003 due to problems at its wholesale energy trading and merchant power businesses. Since then, **American Electric Power has fundamentally rebuilt its asset base around transmission and distribution systems and greatly reduced its exposure to the generation side of the electric utilities business.** Going forward, the company is targeting an annual per share dividend of $2.80 in 2020 which represents modest growth over its 2019 payout.

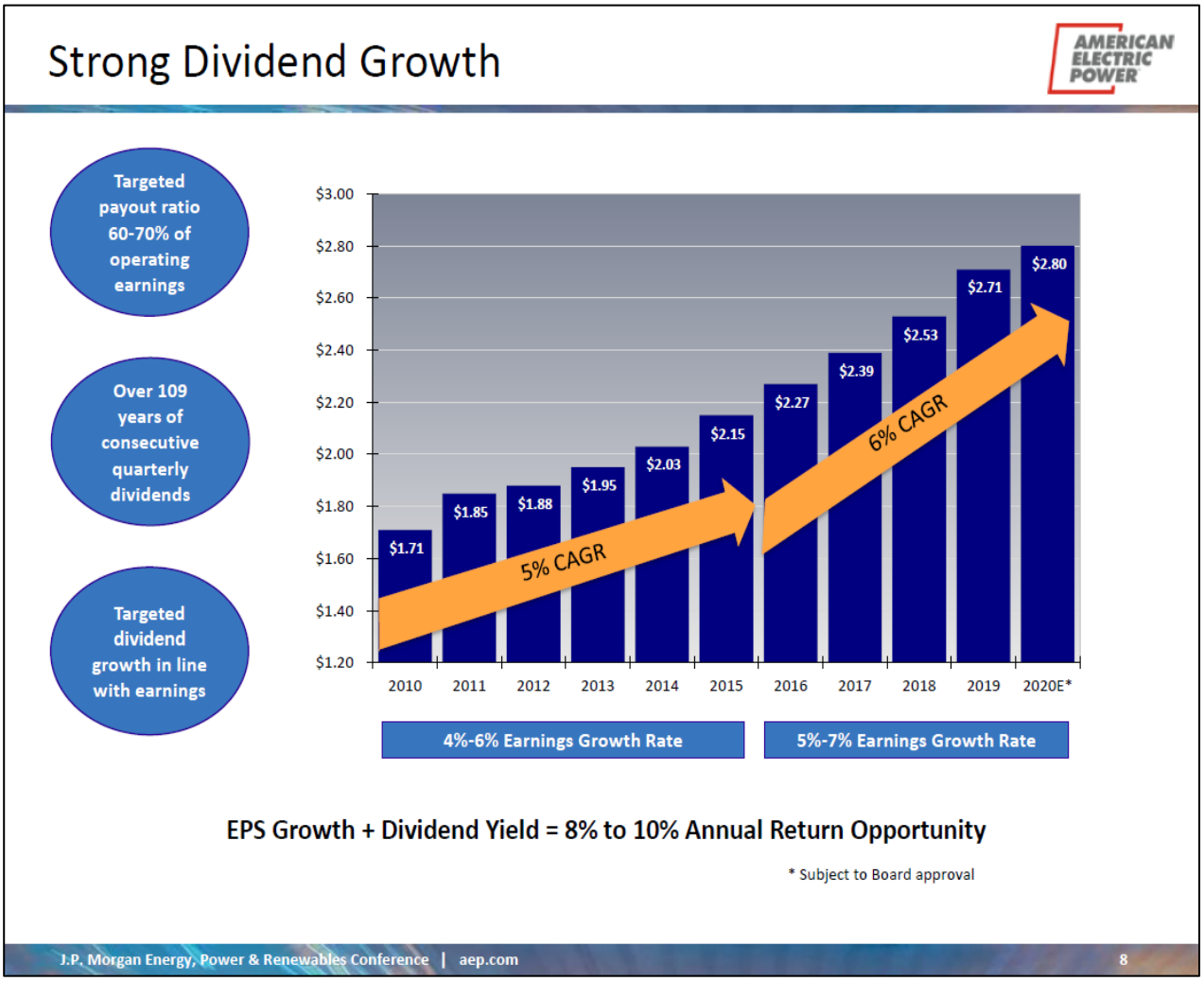

Image Shown: *Since fundamentally rebuilding its business model around its regulated transmission and distribution electric utilities over the past two decades, American Electric Power's dividend growth trajectory has improved materially on the back of stronger dividend coverage.* ***Image Source:*** *American Electric Power – June 2020 IR Presentation*

Based on its EPS forecasts for 2020, American Electric Power is targeting an EPS dividend payout ratio (dividend per share divided by EPS) of approximately 63%-66% this year. Combined with expected improvements in its cost structure, its comfortable liquidity position, ongoing access to capital markets (debt markets in particular), the stable nature of the regulated utility's cash flow profile, and expected rate base growth, American Electric Power should be able to continue making good on its dividend obligations going forward. We like American Electric Power's shift towards its wires business and view the utility as well-positioned to ride out the storm created by COVID-19. Our fair value estimate for shares of AEP sits at $90, well above where AEP is trading at as of this writing.

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

Essential Utilities Reinvents Its Business Model

Essential Utilities Inc (WTRG)---**2.2% yield**---is an interesting income generation idea. In March 2020, the utility completed its all-cash ~$4.3 billion acquisition of Peoples (a natural gas distribution utility). For reference, the company formerly known as Aqua America changed its name to Essential Utilities on February 3rd, 2020. This deal created two platforms for growth (water/wastewater and natural gas distribution utilities) and diversified Essential Utilities' revenue mix. In the upcoming graphic down below, you can see the strategic rationale for the acquisition.

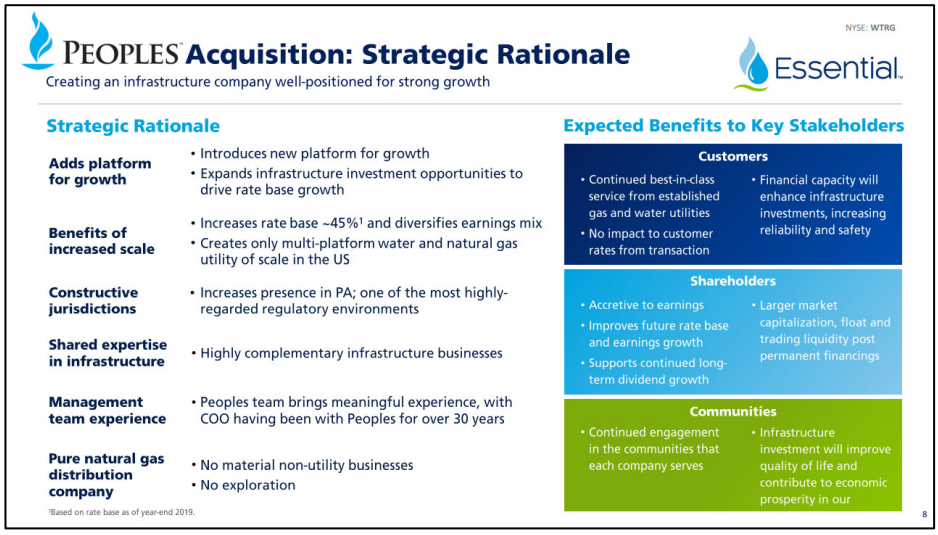

Image Shown: *An overview of why the water utility company previously known as Aqua America, now known as Essential Utilities, acquired the natural gas distribution utility Peoples.* ***Image Source:*** *Essential Utilities 2020 Investor Day*

Essential Utilities defines its core competencies as infrastructure investment, regulatory affairs, and operational excellence. These three skills sets are equally valuable in the larger water business as in its newly acquired natural gas distribution business. Essential Utilities is in the business of building and/or maintaining plants and underground pipes from source to the customer's end location. In the upcoming graphic down below, you can see how the business breaks down in terms of its geographic customer profile and rate base (water versus gas).

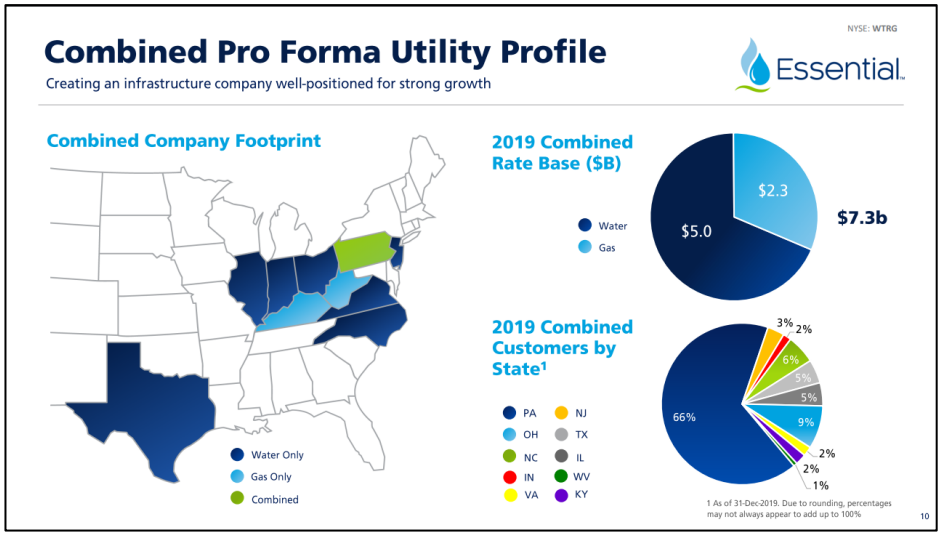

Image Shown: *An overview of Essential Utilities' asset base.* ***Image Source:*** *Essential Utilities 2020 Investor Day*

Sources of Growth

As organic customer count growth is limited in most parts of the country including much of the utility's footprint, revenue growth comes from two distinct sources. One is making a rate case to the relevant state utilities commission to cover growing operational and maintenance expenses along with incremental capital expenditures to maintain and upgrade the system. The rate base is the value of the assets that a utility like Essential Utilities can earn a specified return on investment on. **An example of this is that a large portion** (2,700 miles of bare steel and cast-iron pipe) **of Essential Utilities' new gas lines** (acquired through its purchase of Peoples) **are due for replacement, which creates a potential growth driver via rate base increases over the next 15-plus years.**

The other way to grow is via acquisitions, a strategy that the firm has historically had plenty of successful with. Quite often, they are buying water distribution (and wastewater) assets from a municipality. Generally speaking, these are utilities whose assets have experienced a meaningful lack of investment over the past several years. Once in the fold, **Essential Utilities makes the case to the state regulators that serious rate base increases are needed to properly fund the necessary investments to bring various assets up to best practice standards.**

While the acquired assets might underperform financially in year one relative to the investment made, these deals typically work out well once the capital expenditures and revenue enhancements are locked in within a couple of years. In the upcoming graphic down below, you can see how all of these deals built up Essential Utilities water/wastewater business as of the end of 2019.

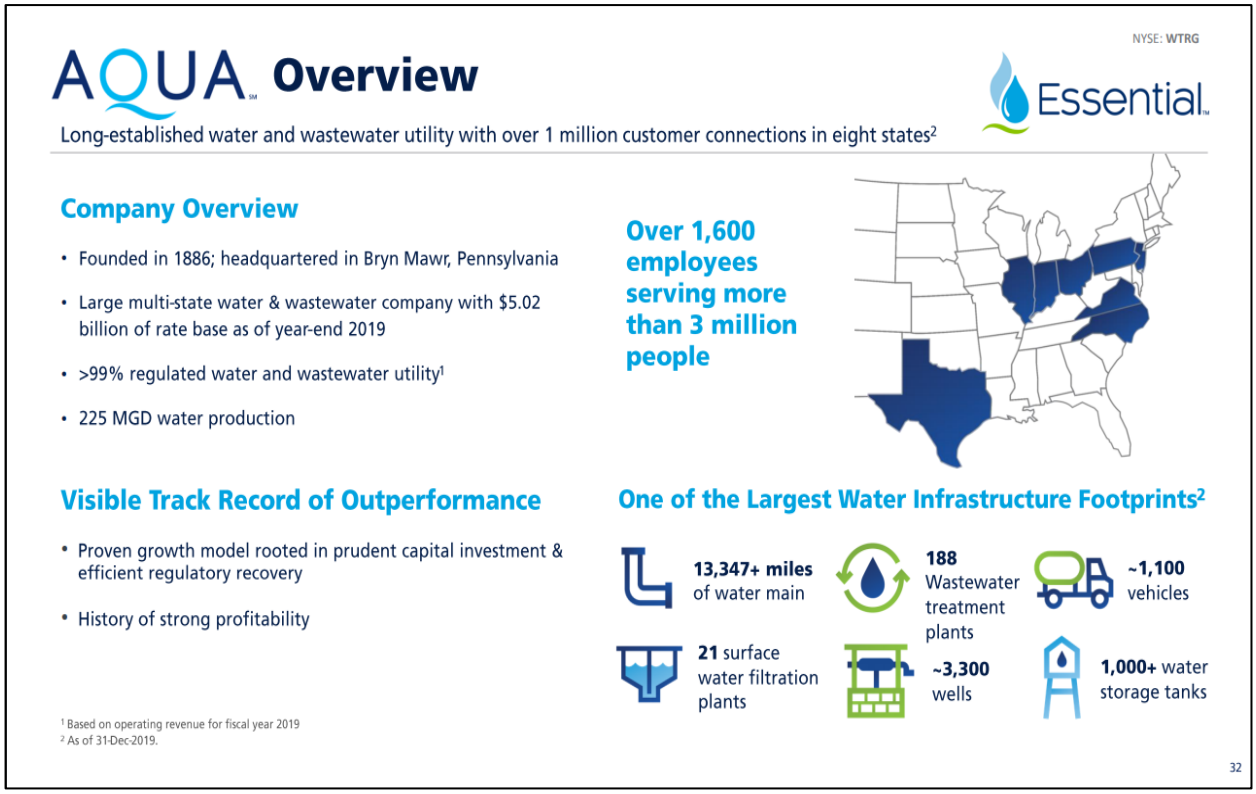

Image Shown: *An overview of Essential Utilities' water/wastewater business.* ***Image Source:*** *Essential Utilities 2020 Investor Day*

In recent fact, Essential Utilities recently announced the $276 Million Delcora acquisition, the largest municipal water deal in its history, which should close later this year. **Since 2015, Essential Utilities has closed 57 total deals, many of which were small tuck-in acquisitions.**

As you can see in the upcoming graphic down below, the Delcora acquisition overlaps and is adjacent to Essential Utilities' current footprint in Pennsylvania (acquiring new assets geographically close to its existing operations is often the goal).

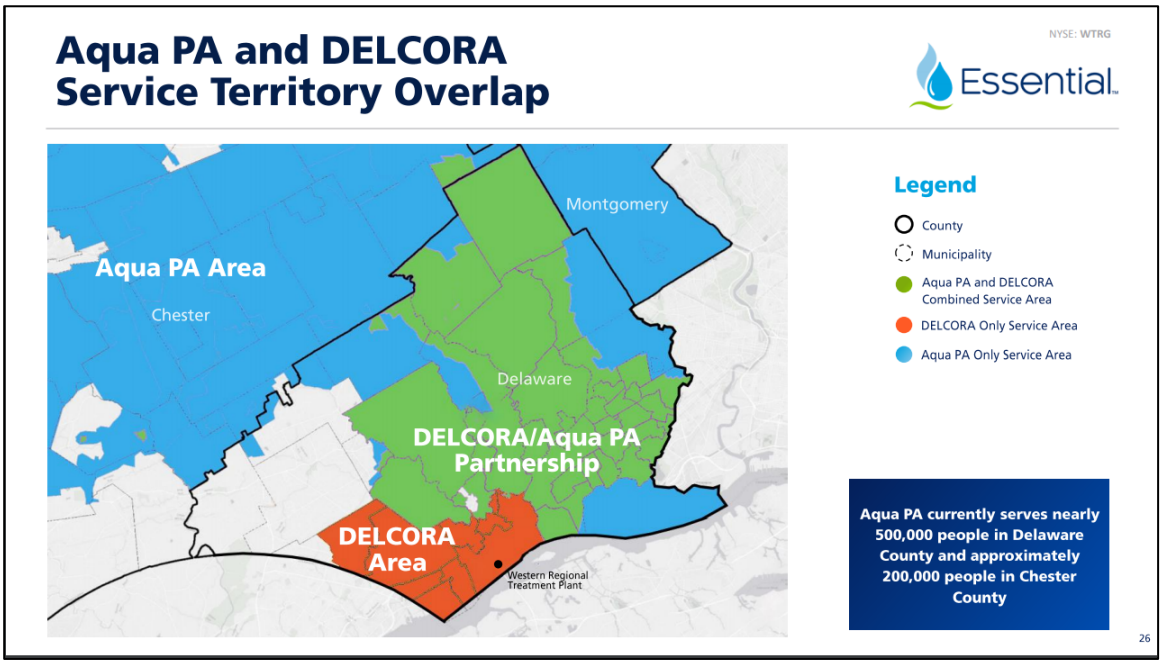

Image Shown: *Delcora's service territory overlaps and is adjacent to Essential Utilities' existing operations in the area.* ***Image Source:*** *Essential Utilities 2020 Investor Day*

The Regulatory Front

Given its broad multi-state footprint, Essential Utilities also has the regulatory experience and wherewithal to source deals in relatively friendly jurisdictions. This means that the state regulators tend to believe in the benefits of private versus public ownership and operation of water and natural gas distribution assets. It means they believe capital investments should be recouped with rate increases. They understand that by serving the small portion of non-paying residents (only 1% and change during the 2007-2009 Global Financial Crisis), those losses must be made up for by serving paying customers.

These market-friendly regulators also understand that investors expect a reasonable return on investment and that they can take their growth capital elsewhere. In reading through the investor materials for this company and listening to this year's investor day presentations, **it is clear from the body language of company managers that they think they are quite deft in the regulatory arena**, and we have no reason to disagree based on what we see in the financial results.

Huge Industry Tailwind

So, not only is Essential Services a good operator, savvy on the regulatory front, and active on the acquisition front, but there is a huge industry tailwind that plays in conjunction with the acquisition strategy. **There has been a massive underinvestment in water and wastewater infrastructure across the nation.** As municipalities come under financial pressure from the COVID-19 induced economic downturn, combined with the fact that so many have underinvested in plant and equipment, unloading these assets to a private operator makes an incredible amount of financial sense.

This huge opportunity, which you can see in the upcoming graphic down below, combined with a low risk business model and incredibly low cost of capital means that Essential Utilities and its water/wastewater peers all trade at about 30 times earnings, plus or minus. These firms can issue equity at attractive prices and issue extremely low cost debt to raise funds to buy up new utilities. Essential Utilities can tap capital markets for funds that are used to bring newly acquired utility operations up to speed (a process that includes securing rate case victories that enable the utility to increase the revenue and profit potential of the acquired assets).

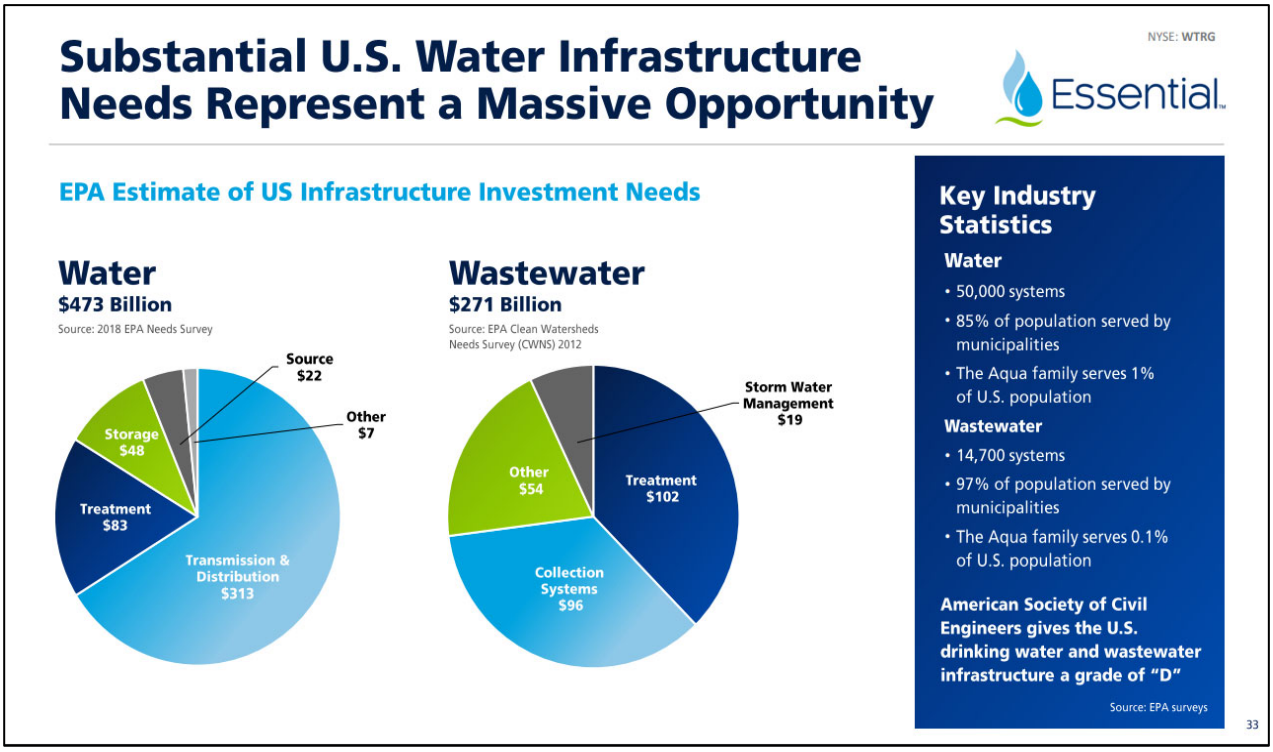

Image Shown: *An overview of the water infrastructure opportunity in the US.* ***Image Source:*** *Essential Utilities 2020 Investor Day*

Key Risks

So, what are the risks to this story? On the operational front, there is always the risk of major problems such as what has happened in various jurisdictions with water contamination or natural gas explosions. While we have confidence in the Essential Utilities team, the very fact that they are acquiring underinvested assets means that there is risk of such problems taking place before capital investment plans come to fruition to bring newly acquired operations up to proper safety standards.

There is also the risk that the industry's ability to fetch premium equity valuations disappears and that firms operating in the industry see their cost of capital including debt capital move higher. This would make it less advantageous in terms of funding new acquisitions and it would change the equation for value creation. The final risk we will point out is regulatory risk. What if one of their key states like their home state of Pennsylvania had a shift in the winds politically and regulatory wise? This could disrupt the sometimes-cozy nature of rate cases working out so well on the back of new capital injections into the business.

We think all three of these risks are relatively small and manageable to some degree. One example of managing risk is that Essential Utilities' water/wastewater segment tests and limits many more pollutants than what some regulators require and measure. Overall, we would argue that the risk profile of this business is MUCH LOWER than that of the average business on the stock exchange.

Concluding Thoughts

When we look at Essential Utilities, we see a company with competitive advantages and a long growth runway. In our view, this is a low risk company whose growth runway is underpinned by rate base growth which historically has been favorably augmented by acquisitions. The firm does not face the same level of commodity pricing risks that some other utilities face. Essential Utilities is primarily a toll taker whose business model is built on getting a mandatory service accomplished – mostly for residential customers that have very little in the way of bargaining power. Essential Utilities can pick and choose its regulators to some extent in terms of where it decides to acquire new assets. It also has the wherewithal to influence the regulators in the states where it currently operates.

As you can see from the firm's recent acquisitions on both the water/wastewater front and its new platform of natural gas distribution, the firm is not afraid of acquiring new growth opportunities while being cognizant of the need to integrate these assets properly. While Essential Utilities issued equity to raise cash to help fund the Peoples acquisition, its share price has still performed very well over the past five years. Similarly, the firm was able to issue new debt at extremely attractive yields just this year in the aftermath of the COVID-19 impact on the economy and the markets, so the firm appears to retain quality access to capital markets at attractive rates. With a payout ratio of about 65% and a yield of ~2.2%, we like Essential Utilities for its yield, long growth runway and income growth potential.

Image Shown: *Shares of WRTG have rallied over the past five years and are up sharply off their recent March 2020 lows, as of late-June 2020.*

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%	4.83%
iShares MSCI Australia ETF	EWA	5.0%	4.94%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	6.24%
iShares International Select Dividend ETF	IDV	5.0%	8.86%
iShares U.S. Preferred Stock ETF	PFF	5.0%	5.61%
Global X SuperDividend ETF	SDIV*	5.0%	8.12%
Global X SuperIncome Preferred ETF	SPFF	10.0%	6.38%
Vanguard Consumer Staples ETF	VDC	5.0%	2.52%
Vanguard Real Estate ETF	VNQ	10.0%	4.10%
Utilities Select Sector SPDR	XLU	5.0%	3.27%
EQUITY			
AT&T	T	7.5%	6.88%
BP PLC	BP	2.5%	10.81%
CubeSmart	CUBE	5.0%	4.89%
Digital Realty Trust	DLR	5.0%	3.15%
Enterprise Products Partners	EPD	2.5%	9.80%
Magellan Midstream Partners	MMP	2.5%	9.58%
Philip Morris	PM	7.5%	6.68%
Public Storage	PSA	5.0%	4.17%
ProShares Short High Yield	SJB	2.5%	1.04%
Cash**	-	0.0%	0.00%
		100.0%	**5.68%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 7/1/2020. 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 7/1/2020)*

*** Reflects federal funds target rate range*

DIVIDEND REPORT PAGE 2 – BHP GROUP (BHP)

BHP Billiton BHP FAIRLY VALUED

Buying Index™ 4 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Neutral	$34.00 - $56.00	RISKY	POOR / 0.8	VERY POOR	6.45%

Assessment of Company Dividend Strategy

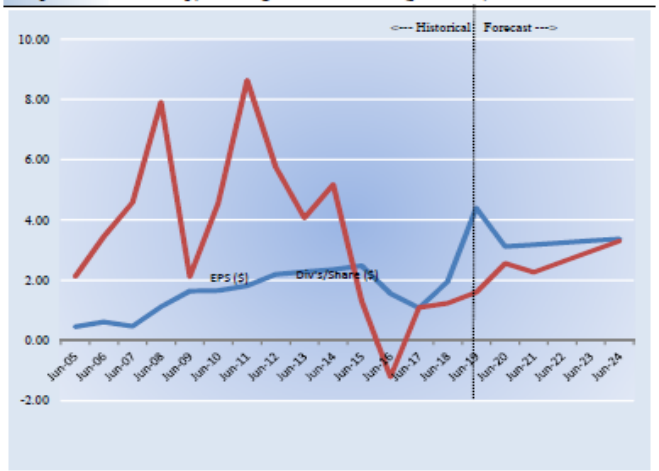
Key Strengths

BHP Group operates in a highly cyclical and commodity-price dependent industry. The company reduced its net debt load (inclusive of short-term borrowings) down to $9.1 billion at the end of June 2019 from $10.7 billion at the end of June 2018, aided by the $10.5 billion sale of its upstream shale assets in the US to BP through a deal that closed in Fall 2018. As most of those cash proceeds were distributed back to investors in the form special dividends and share buybacks, BHP's deleveraging efforts were limited. Getting out of the short-cycle upstream oil & gas space was the right call, as BHP is better suited for long-cycle endeavors with stronger potential free cash flows.

Potential Weaknesses

The cyclical nature of the mining industry applies significant pressure to the health of BHP Group's dividend, and the firm's large debt load only magnifies the ebbs and flows of the cyclical backdrop. Though BHP's cost cutting efforts have been effective to a degree, they may not be enough given weakening macroeconomic data of late. Rising trade tensions between US-China and elsewhere are putting a tremendous amount of downward pressure on commodity prices. BHP has cut its dividend in the past and remains very exposed to exogenous shocks without a net cash position to support its future payouts. Operational risks, such as tailings dam failures, are a major concern.

Graphical Relationship, Earnings and Dividends (per share)

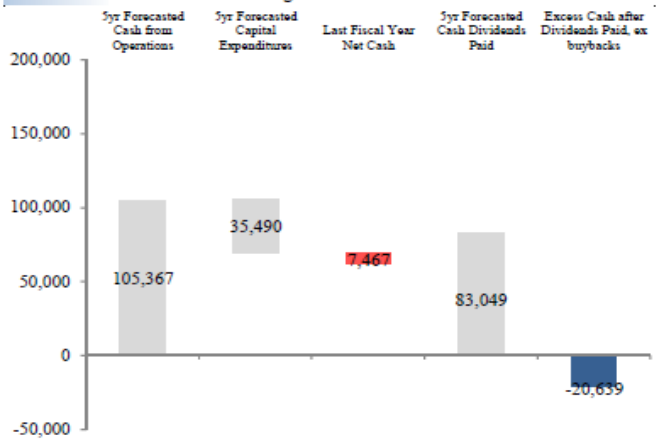


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

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

Dividend Cushion Cash Flow Bridge

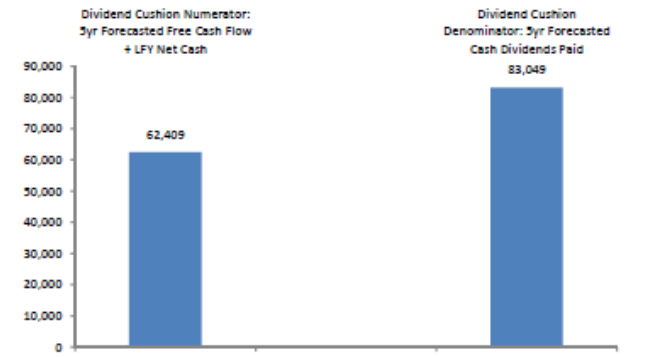


Source: Company Filings, Valuentum Projections

Dividend Cushion Ratio Evaluation

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

Dividend Cushion Ratio Deconstruction



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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