Valuentum Securities, Inc. 8/1/2020 Edition 3, Volume 8

HIGH YIELD DIVIDEND NEWSLETTER

We Recently Made Some Changes to the High Yield Dividend Newsletter Portfolio

Latest Changes to High Yield Dividend Newsletter
Weighting Changes: *NEW* 2.5% Reduction in PM and T (Reducing Weighting to 5.0% each) – July 21
Removed: *NEW* BP and SJB – July 21 Added: *NEW* 5.0% to Both CCI and CONE (5.0% each) – July 21

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"PIVOTING TOWARDS HIGH-YIELDING COMPANIES THAT ARE BETTER SUITED TO DEAL WITH THE COVID-19 PANDEMIC IS PRUDENT, IN OUR VIEW, AS DEMAND FOR DATA CENTERS AND TELECOMMUNICATIONS INFRASTRUCTURE REMAINS STRONG."

– CALLUM TURCAN

Ticker	Previous Weighting	Weighting Change	New Weighting
T	7.5%	-2.5%	5.0%
PM	7.5%	-2.5%	5.0%
SJB	2.5%	-2.5%	0.0%
BP	2.5%	-2.5%	0.0%
CONE*	0.0%	5.0%	5.0%
CCI*	0.0%	5.0%	5.0%
*Recently Added High Yield Dividend Newsletter Portfolio Holding			

Image Shown: *A look at recent changes in the High Yield Dividend Newsletter portfolio.*

By Callum Turcan

Please note a version of this article was emailed out to members on July 21.

Hello everyone,

On July 21, we made a few changes to the High Yield Dividend Newsletter ('HYDN') portfolio. First, we removed the 2.5% weighting in both BP plc (BP) and ProShares Short High Yield ETF (SJB).

We like BP's solid operational execution during the past few years (turning new developments online ahead of schedule and under budget) and recent divestment proceeds (exiting Alaska and selling off its international petrochemical business) will help support its near-term funding needs. **However, the outlook for raw energy resource prices remains lackluster at best and dire at worst.** Weak prices for raw energy resources will continue to weigh on BP's cash flow generating abilities due to its large upstream division (oil & gas extraction activities), so we are transitioning to income-generating ideas better able to deal with the ongoing coronavirus ('COVID-19') pandemic.

Pivoting now to SJB, **the potential for a sustained blowout in the spread between high yielding debt securities and US Treasuries seems to have been contained by actions by the Fed**, which included buying US corporate bonds for the first time in the Fed's history. Massive intervention in US credit markets by the Fed has limited the damage caused by the pandemic. Though we caution that there will be many road bumps ahead, especially with COVID-19 infection rates rising in parts of the US, it appears US credit markets have largely stabilized during these challenging times.

We no longer see a need to keep including SJB as a hedge in the High Yield Dividend Newsletter portfolio, and instead we allocated the former 2.5% weighting in SJB along with the former 2.5% weighting in BP to new opportunities. Additionally, we trimmed 2.5% off the 7.5% weighting in both AT&T Inc (T) and Philip Morris International Inc (PM), meaning that T and PM now each have a 5.0% weighting in the HYDN portfolio going forward.

Though we remain optimistic in AT&T's plan to improve its cost structure (supporting its future free cash flow generating abilities) and the rollout of Philip Morris International's heated tobacco offering IOQS in the US (a smokeless tobacco product that has been approved by federal regulators, and as an aside, the product can now be marketed as a "reduced exposure" tobacco product), **we think it is prudent to increase the HYDN portfolio's exposure to firms better able to cope with the "new normal."**

The work-at-home trend led to a surge in data demand worldwide as online video communications became the new way for coworkers and managers to communicate with each other. Streaming video entertainment services became ever-more popular as households stayed home and watched TV instead of going out. This dynamic supports the near- and long-term growth outlook for data centers, and the real estate investment trusts ('REITs') that invest in data centers are well-positioned to capitalize on this trend. We include Digital Realty Trust Inc (DLR) at a 5.0% weighting in the HYDN portfolio (DLR has performed very well year-to-date as of late-July), and **wanted to grow the HYDN portfolio's exposure to this space.**

On July 21, we added a 5.0% weighting in CyrusOne Inc (CONE) to the HYDN portfolio using the proceeds from the aforementioned portfolio changes. For reference, Digital Realty Trust and CyrusOne both invest in carrier-neutral data centers that they lease out under long-term contracts. Additionally, both REITs also provide related services such as property management and monitoring customer computer equipment to some of their tenants.

CyrusOne's dividend coverage is rock solid (the REIT has an adjusted Dividend Cushion ratio of 2.0 and a "GOOD" Dividend Safety rating). **Though shares yield ~2.5% as of this writing, which is on the "low" side in the high yield world, the data center REIT has been aggressively increasing its payout (in a sustainable manner) during the past few years**, and we expect aggressive payout growth to continue going forward (which will likely push its yield more firmly into the high yield category over time).

CyrusOne's European expansion strategy supports its long-term growth outlook. **Including another data center REIT in the HYDN portfolio better positions the portfolio to ride out COVID-19.**

Additionally, we added a 5.0% weighting in Crown Castle International Corp (CCI), a REIT that owns and leases shared communications infrastructure in the US including 40,000+ towers, ~70,000 small cells on air or under contract and ~80,000 route miles of fiber that support telecommunications networks. **Shares of CCI yield ~2.9% as of this writing.** We appreciate Crown Castle's resilience in the face of COVID-19 as the REIT maintained its long-term dividend growth outlook (7%-8% annual growth) during its first quarter of 2020 earnings call.

The REIT's sustaining capital expenditures consume just ~2% of its revenues, and recent debt issuance indicates Crown Castle retains quality access to debt markets at attractive rates (and equity markets as well, given its strong technical performance of late). **In our view, Crown Castle is very well-positioned to capitalize on the coming transition to 5G telecommunications networks in the US and management remained optimistic on the REIT's outlook during its first quarter conference call.**

Given its high quality cash flow profile and attractive access to capital markets, we are confident in Crown Castle's dividend coverage on a forward-looking basis.

COVID-19 has fundamentally altered the high yield landscape, and we view it as prudent to pivot towards high yielding firms that are supported by secular growth tailwinds (rising data and data center demand worldwide, the transition to 5G telecommunication networks in the US) to ride out the storm while still generating meaningful income streams. Please let us know if you have any questions.

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

AT&T Remains Free Cash Flow King, Though Deleveraging Efforts Are Getting Tougher

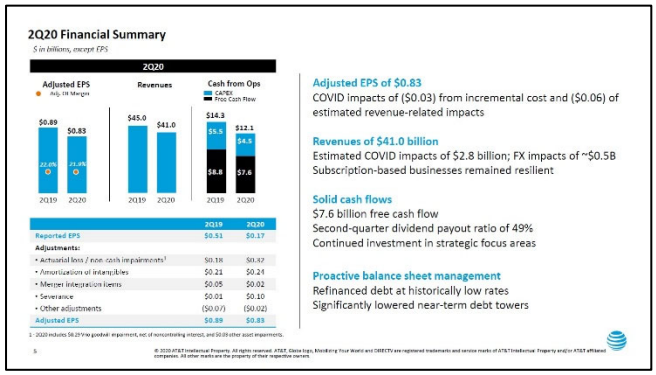

Image Shown: *AT&T Inc continued to be a free cash flow cow last quarter, though the ongoing pandemic created headwinds for its various businesses.*
Image Source: *AT&T Inc – Second Quarter of 2020 IR Earnings Presentation*

By Callum Turcan

The ongoing coronavirus ('COVID-19') pandemic has created some very serious headwinds for AT&T Inc (T), **but that did not stop the telecommunications and entertainment giant from being incredibly free cash flow positive last quarter.** On July 23, AT&T reported its second quarter 2020 earnings report and we remain confident in the firm's ability to keep making good on its dividend obligations going forward. Shares of T yield ~7.1% as of this writing, and we continue to include shares of AT&T in our High Yield Dividend Newsletter portfolio.

Quarterly Overview

AT&T's GAAP revenues moved lower by 9% year-over-year in the second quarter of 2020 as the firm dealt with headwinds created by COVID-19. The company also took a $2.3 billion asset abandonment and impairment charge last quarter, which along with headwinds facing its revenues resulted in the firm's GAAP operating income turning significantly lower on a year-over-year basis.

Last quarter, the company's 'Communications' segment (wireless, cable, internet) held up quite well, relatively speaking. AT&T added 225,000 net subscribers to its fiber internet business while it continued to roll out its wireless FirstNet offering. Its wireless subscriber base held fairly steady last quarter, though "accrued disconnects" built up as AT&T was part of the Federal Communication Commission's ('FCC') Keep Americans Connected Pledge. That program involved AT&T keeping subscribers connected through June 30, 2020, during the first part of the pandemic even if those subscribers stopped paying, among other initiatives.

Looking at AT&T's prepaid wireless service, Cricket Wireless, management noted that this offering added 135,000 net subscribers last quarter. At its postpaid wireless service, AT&T would have added 190,000 net subscribers last quarter when excluding the 340,000 subscribers that were counted as disconnects. Please note that this (the 340,000 subscribers) figure includes those that were still on AT&T's service though had stopped paying (due to the FCC pledge). Subscriber churn was down at both wireless operations which we appreciate (record-low at its prepaid service, down at its postpaid service even when including the disconnect accrual).

AT&T's Communications segment reported that the firm continues to lose premium TV subscribers at its 'Entertainment' unit, which were down 886,000 net last quarter (this includes AT&T's DirecTV business). Strength at AT&T's 'Business Wireline' unit helped offset that weakness as the Business Wireline unit posted margin expansion and a stable revenue profile (especially when factoring out a recent divestment). Cost management initiatives at this unit have started to yield real results, which we appreciate.

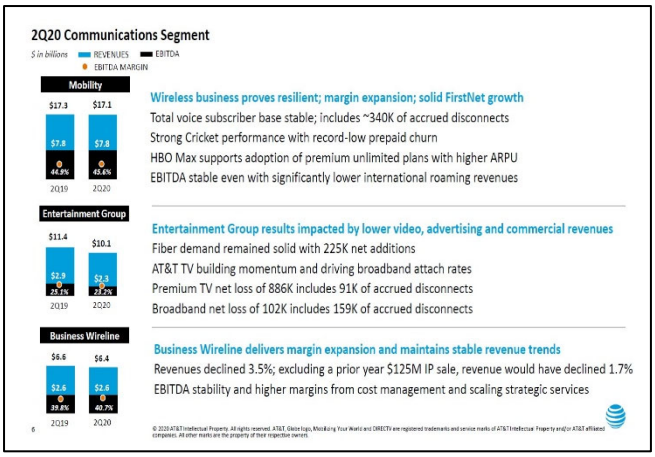

Image Shown: *An overview of how AT&T's Communication segment performed last quarter.* ***Image Source:*** *AT&T – Second Quarter of 2020 IR Earnings Presentation*

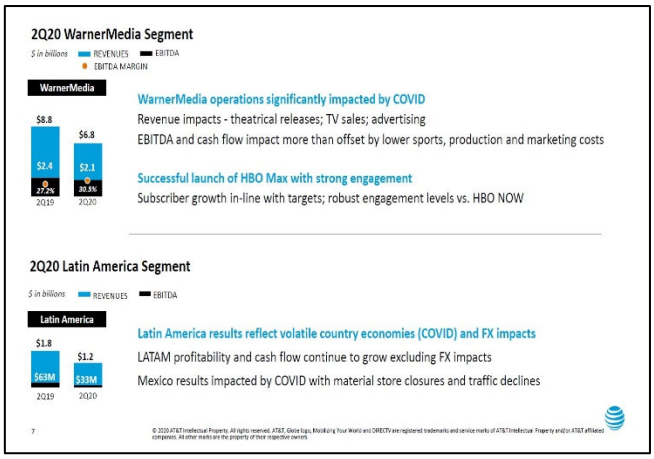

Image Shown: *An overview of how AT&T's WarnerMedia and Latin America segments performed last quarter.* ***Image Source:*** *AT&T – Second Quarter of 2020 IR Earnings Presentation*

For reference, please note FirstNet is billed as a national wireless communications platform built from the ground up for public safety needs. AT&T built the network with First Responder Network Authority through a public-private partnership. As of December 2019, FirstNet had over one million connections, and management noted the build out of FirstNet was going better than expected during AT&T's latest earnings call:

> *"The FirstNet build continues to run ahead of plan. We expect additional network benefits as our 5G build is expected to reach nationwide coverage today. The network and the entire FirstNet team has done a great job in building out our 5G network."*

Pivoting now to AT&T's 'WarnerMedia' and 'Latin America' business segments, those segments both reported a sharp drop in their revenues last quarter due to the pandemic versus the same period a year-ago. For WarnerMedia, the delay of theatrical releases and a sharp drop in advertising were cited as reasons for declining sales.

However, the segment's EBITDA margin grew due to a sharp declining its operating expenses. Regarding AT&T's Latin American businesses, a decline in foot traffic and foreign currency headwinds were cited as major hurdles. In the upcoming graphic at the top right of this page, AT&T highlights how its WarnerMedia and Latin American business segments performed during the second quarter of 2020.

Going forward, WarnerMedia should benefit from the launch of HBO Max in late-May 2020. Initially, AT&T is pricing the video streaming service at $14.99 per month, the same price as its HBO NOW offering. Additionally, HBO Max is being offered for free to many of HBO's current customers.

In the future, AT&T will likely increase the monthly subscription price of HBO Max as it is making billions of dollars in investments in original content for the new streaming service, on top of the additional content HBO Max comes with that HBO Now does not.

Management noted that there were potential synergies here as it relates to AT&T's wireless business and HBO Max, such as offering a free HBO Max subscription to those with an AT&T Unlimited Elite wireless plan (according to AT&T's website). AT&T noted that HBO Max helped the firm's internet broadband business by enhancing its ability to grow its subscriber base.

We continue to be very excited in the potential for HBO Max to gain a sizable paying subscriber base. At the end of the second quarter, AT&T notes it had 36.3 million HBO and HBO Max subscribers, up from 34.6 million at the end of last year. Management intends on launching an ad-supported version of HBO Max next year. The reoccurring revenue streams generated by video streaming services allows for quality cash flow profiles.

Financial Update

At the end of June 2020, AT&T had $16.9 billion in cash and cash equivalents on hand versus $15.6 billion in short-term debt and $154.4 billion in long-term debt. **Deleveraging remains the long-term goal given AT&T's large net debt load, though COVID-19 will make that a trickier task in 2020.** AT&T's net debt load grew by ~$1.0 billion from the end of 2019 to the end of June 2020, hitting $152.0 billion at the end of last quarter.

The company continued to be a free cash flow cow during the first half of 2020, generating $11.5 billion in free cash flow that fully covered $7.5 billion in dividend obligations, though $5.5 billion in share repurchases during this period were covered in part by its balance sheet. Please note AT&T announced it was suspending its share repurchase program back in March 2020. Management expects AT&T's dividend payout ratio, defined as its dividend obligations divided by its free cash flows, will be in the low 60s% range this year.

During AT&T's latest quarterly conference call, the company noted that it would consider how to proceed with its capital allocation strategy during an upcoming corporate strategy meeting in September. Management made sure to communicate to investors that it is too early to tell when the company would restart its share buyback program. The company expects to invest ~$20.0 billion in gross capital expenditures this year as it builds out its 5G network in the US.

On the plus side, AT&T continues to get paid in a timely manner as its account receivables balance (net of related allowances for credit losses) dropped from $22.6 billion at the end of 2019 to $19.1 billion at the end of June 2020.

Its allowance for credit losses grew by $0.4 billion during this period, hitting $1.6 billion at the end of June, which seems reasonable given the economic backdrop. We appreciate that AT&T has been able to continue collecting what it is owed during the pandemic (from most of its customer base), **highlighting the resilience of its business model.** AT&T retains quality access to credit markets and has tapped debt markets in the recent past to restructure its debt maturity schedule.

In the upcoming graphic down below, management provides an overview of AT&T's recent refinancing efforts. **The company is contemplating additional non-core asset divestments to help it pare down its large net debt load**, though such activities will have to contend with general uncertainty created by the pandemic.

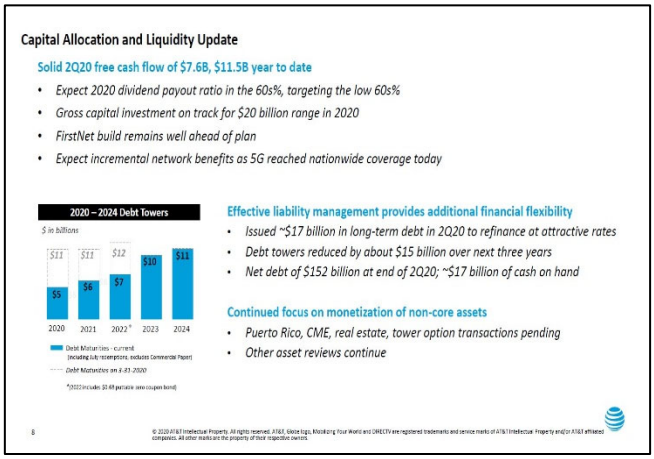

Image Shown: *AT&T's debt maturity schedule over the next several years is manageable, in our view, after taking recent refinancing efforts into account.* ***Image Source:*** *AT&T – Second Quarter of 2020 IR Earnings Presentation*

Here are a few choice comments from management that were given out during AT&T's latest earnings call (emphasis added):

> *"We launched Max with six new originals. All were found in the top 25 viewed series on the platform.* ***By August, we'll have 21 new original series on Max which we expect to sustain our near term acquisition efforts.*** *Like everyone else in the industry, we're working on ways to resume production and we hope to see that engine start to fire back up next month…*
>
> *One month after launch, HBO Max had about 3 million retail subscribers and 4.1 million subscribers had activated their Max accounts. Of those, more than 1 million were wholesale subscribers through AT&T. As you might expect, we're seeing more rapid activation with subscribers who are active users of HBO digital offers, but we still have work to do to educate and motivate the exclusively linear subscriber base and we'll continue to work with our wholesale partners to drive these activation rates.* *[Continued on next page…]*

[Continued from previous page…]

> ***We're also bundling HBO Max with some of our premium wireless and fiber plans. We're seeing a positive pull-through that's at or better than the wireless unlimited plan step-up assumptions we shared with you in October.*** *You will recall this coupled with the 5G handset upgrade cycle is one of the key drivers to growing wireless service revenues in the latter half of the year.*

Management stressed that AT&T remains committed to working together with companies like Amazon Inc (AMZN) that have yet to sign a deal covering the distribution of the HBO Max video streaming service. AT&T stated during the earnings call that it has "tried repeatedly to make HBO Max available to all customers using Amazon Fire devices, including those customers that have purchased HBO via Amazon. Unfortunately, Amazon has taken an approach of treating HBO Max and its customers differently than how they've chosen to treat other services and their customers" and so far, no deal between AT&T and Amazon covering HBO Max has been signed.

AT&T has a deal covering the distribution of HBO Max with firms like Apple Inc (AAPL) and Alphabet Inc (GOOG) (GOOGL), among many others. Should AT&T and Amazon reach a deal, that would significantly improve the subscription growth outlook for HBO Max.

Concluding Thoughts

Given the company's strong cash flow profile, we have confidence that AT&T should be able to keep making good on its dividend obligations going forward, though we caution that the pandemic has weighed negatively on its near-term outlook given its hefty net debt load. We would like the company to stick with its deleveraging efforts, which management aims to achieve in part through non-core asset sales. Back in October 2019, AT&T announced it was selling its Puerto Rican and US Virgin Islands wireless business for just under $2.0 billion in cash. AT&T also announced it had $2.0 billion in pending sales covering other assets including real estate and towers in the works.

Additionally, **management aims to generate meaningful cost savings and other operational synergies in the coming years** which will enhance AT&T's outlook given the potential for meaningful cost structure improvements (which could generate ~$6.0 billion in savings over the next three years).

Please note that we trimmed AT&T's weighting in the High Yield Dividend Newsletter portfolio back in July 21 due to the headwinds created by COVID-19. The company needs to retain access to capital markets at attractive rates to refinance its debt obligations going forward, which has been the case so far during the pandemic.

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: Pfizer Inc (PFE) Increases Guidance and Targets Meaningful Cost Savings

Our **High Yield Spotlight Idea for August 2020** is pharmaceutical giant Pfizer Inc (PFE)---4.0% yield---as we like its resilient business model in the face of the ongoing coronavirus ('COVID-19') pandemic and its strong cash flow profile. Pfizer established a joint-venture at its consumer health business last year and intends on establishing a joint-venture at its off-patent and generics business this year (which will improve Pfizer's balance sheet for reasons we will cover later on). **Both moves are expected to unlock material cost savings which we appreciate.** Pfizer raised its guidance for fiscal 2020 during its fiscal second quarter earnings report (period ended June 28, 2020) as sales of its therapeutics have held up relatively well in the face of the pandemic. In the upcoming graphic down below, Pfizer highlights how it has been dealing with COVID-19.

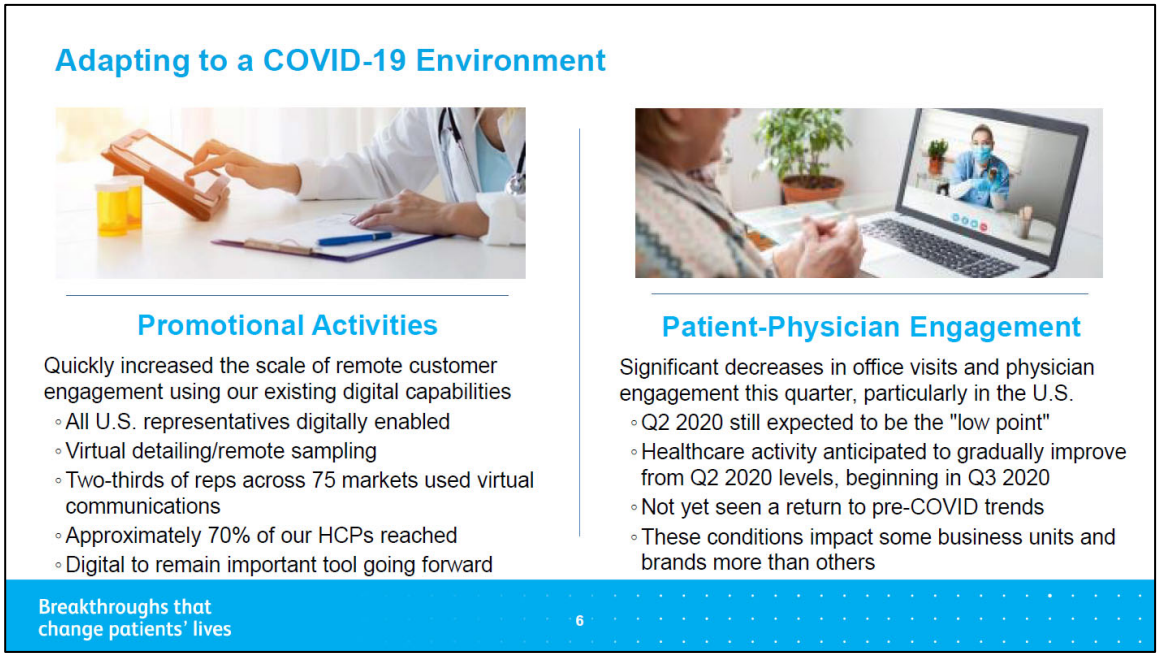

Image Shown: *Some of the ways Pfizer is adapting to the ongoing COVID-19 pandemic.* ***Image Source:*** *Pfizer Inc – Second Quarter of Fiscal 2020 IR Earnings Presentation*

Back in July 2019, Pfizer and Mylan NV (MYL) announced that Pfizer's Upjohn unit would combine with Mylan, creating a global giant in the generic pharmaceutical space. Upjohn primary owns Pfizer's off-patent drugs and Mylan built its operations around the generics pharmaceutical business. **The combination is expected to unlock $1.0 billion in annualized synergies by 2023.** After the deal closes, which is now expected to occur during the fourth quarter of 2020 (the pandemic delayed closing), the new firm plans to initiate a quarterly dividend at the beginning of its first full quarter. Shareholders of Pfizer are expected to own 57% of the combined company's equity and shareholders of Mylan are expected to own 43% of the combined company's equity once the deal closes.

Prior to the deal closing, Upjohn is expected to issue $12.0 billion in debt (most of which has already been issued) and **the gross proceeds will be retained by Pfizer via a large special dividend.** The new company is expected to start off with $24.5 billion in total debt outstanding at closing, with a debt to adjusted EBITDA ratio of 2.5x.

During Pfizer's latest earnings call, the firm noted Upjohn recently tapped credit markets in the US and Europe, raising $7.5 billion in US-denominated debt and EUR$3.6 billion in Euro-denominated debt. Those funds are expected to "almost entirely fund the $12 billion dividend to be paid to Pfizer once Upjohn is separated" and additionally, management noted Pfizer's Upjohn unit posted strong sales of Lipitor (treats high levels of cholesterol and triglyceride) and Norvasc (treats high blood pressure and chest pain) in China last fiscal quarter.

We appreciate the powerful impact this cash infusion will have on Pfizer's financials. Though the firm reported its fiscal second quarter earnings 2020 (period ended June 28, 2020) in late-July, Pfizer had not yet published its 10-Q SEC filing covering that period as of July 31 and did not provide its balance sheet or cash flow statements in its earnings press release. At the end of its fiscal first quarter (period ended March 29, 2020), Pfizer had $13.0 billion in cash-like assets on the books made up of cash, cash equivalents, short-term investments, and long-term investments. Please note its short- and long-term investments are primarily represented by available-for-sale debt securities. Pfizer ended the fiscal first quarter with $16.0 billion in short-term debt and $36.3 billion in long-term debt.

In our view, **Pfizer's net debt load is manageable considering the pending cash infusion from the Upjohn-Mylan transaction and Pfizer's strong cash flow profile.** From fiscal 2017 to fiscal 2019, Pfizer generated ~$13.0 billion in free cash flow on average per year. Pfizer paid ~$7.9 billion in cash dividends per year on average during this period. We give Pfizer a "GOOD" Dividend Safety rating given its Dividend Cushion ratio sits at a nice 1.6 (forecasted free cash flows over the next five full fiscal years, less its net debt load, with that figure then divided by its forecasted dividend obligations during this period). Please note we forecast that Pfizer will increase its per share payout by mid-single-digits annually over the coming fiscal years, which our Dividend Cushion ratio takes into account.

During the first half of fiscal 2020, Pfizer generated $23.8 billion in GAAP revenues. Though down 10% year-over-year, Pfizer's financials held up relatively well in the face of the pandemic. Strong sales growth of its Eliquis (treats and prevents blood clots) and Ibrance (treats certain types of breast cancer) offerings supported Pfizer's financial performance. Additionally, the launch of Vyndaqel and Vndamax which are used to treat "the cardiomyopathy of wild-type or hereditary transthyretin-mediated amyloidosis ('ATTR-CM') in adults to reduce cardiovascular mortality and cardiovascular-related hospitalization" last fiscal year further supported Pfizer's performance. In the upcoming graphic down below, Pfizer highlights which drugs performed well last fiscal quarter.

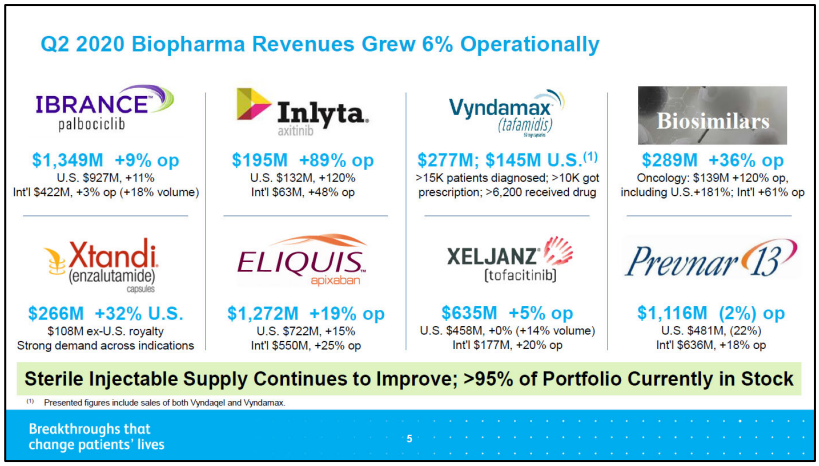

Image Shown: *Pfizer reported strong sales growth across a range of its therapeutic offerings last fiscal quarter.* ***Image Source:*** *Pfizer Inc – Second Quarter of Fiscal 2020 IR Earnings Presentation*

Removing the impact from Pfizer's consumer health joint-venture with GlaxoSmithKline Inc (GSK), which was formerly established in August 2019, Pfizer's revenues were down just 3% year-over-year during the first half of fiscal 2020. As an aside, **the joint-venture with GlaxoSmithKline is expected to yield GBP$0.5 billion in annual cost savings by 2022**, with one-quarter of those savings expected to be reinvested back into "the business to support innovation and other growth opportunities." GlaxoSmithKline owns 68% of the joint-venture's equity and Pfizer owns the remaining 32% equity stake.

Pfizer's income from continuing operations before taking corporate income taxes into account fell just 7% year-over-year during the first half of fiscal 2020, hitting $7.8 billion. Share repurchases reduced its outstanding diluted share count fell by almost 2% year-over-year during this period. Please note Pfizer's financial performance during the first half of fiscal 2020 was held down by $0.4 billion in restructuring charges and acquisition-related costs.

Pfizer and BioNTech SE (BNTX) are working together to develop a COVID-19 vaccine using messenger RNA biotechnology, with candidate BNT162b2 leading the way. On July 27, the venture announced it had started Phase 2/3 human clinical trials that will evaluate the safety and efficacy of the vaccine candidate BNT162b2. If successful, the venture could supply 100 million doses of the vaccine in 2020 and ~1.3 *billion* doses of the vaccine by the end of 2021. Pfizer noted the venture plans to charge $19.50 per dose (particularly in developed markets) and the goal is to offer the vaccine on a not-for-profit basis. The venture may sell the vaccine at a cheaper rate in developing markets.

Furthermore, the US federal government has already committed to providing the venture with $1.95 billion to help fund the program and to acquire 100 million doses if the vaccine proves to be safe and effective. The US federal government also has the option to acquire 500 million additional doses if needed. Pfizer and BioNTech still need to win approval from the US Food and Drug Administration ('FDA'), which the venture may seek as early as October 2020. **We are impressed with the speed that the venture has progressed with their COVID-19 vaccine program, though it is far from certain whether the vaccine will prove safe and effective.**

One important consideration is that Pfizer thinks the COVID-19 vaccine may be needed past 2022. This could mean that the potential vaccine will have longer legs in terms of revenue generation than expected. While Pfizer and BioNTech are unlikely to make needle moving profits from their COVID-19 vaccine candidate, it is worth keeping in mind that the venture is preparing for any outcome. Beyond the potential COVID-19 vaccine, **Pfizer recently launched four Phase 3 clinical trial for other drug candidates**, with management having this to say during Pfizer's latest earnings call:

> *"In addition to our COVID-19 vaccine program, we recently started four, I repeat, four Phase 3 studies for vaccines, but we hope we'll make meaningful contributions to the lives of people everywhere. These include: two studies of the 20-valent pneumococcal conjugate vaccine candidate; evaluating a four dose series in infants starting [at] two months of age; a study – a Phase 3 study of our respiratory syncytial virus vaccine candidate; RSV pref F, in pregnant women to evaluate the safety and efficacy of the candidate in infants born to immunized pregnant women as compared with placebo; and a Phase 3 study of the pentavalent meningococcal vaccine candidate, ABCWY, in adolescents and young adults to assess the safety, tolerability and immunogenicity of the vaccine candidate in adolescents and young adults to assess the safety, tolerability and immunogenicity of the vaccine candidate compared with licensed meningococcal vaccines." --- Albert Bourla, CEO and Chairman of Pfizer*

What makes these clinical trials important is that each drug candidate potentially offers Pfizer a new way to grow and maintain its revenues.

Pfizer's current drug portfolio is performing well, and that strength allowed management to boost Pfizer's full-year guidance for fiscal 2020 during its latest earnings report as you can see in the upcoming graphic down below.

2020 Financial Guidance for New Pfizer[1] and Upjohn[1]

NEW PFIZER[1]	Current Guidance	Previous Guidance	Difference
Revenues	$40.8 to $42.4 billion	$40.7 to $42.3 billion	+$0.1 billion
Adjusted IBT Margin[1]	Approximately 37.0%	Approximately 37.0%	No Change
Adjusted Diluted EPS[1]	$2.28 to $2.38	$2.25 to $2.35	+$0.03
Operating Cash Flow	$10.0 to $11.0 billion	$10.0 to $11.0 billion	No Change

UPJOHN[1]	Current Guidance	Previous Guidance	Difference
Revenues	$8.0 to $8.5 billion	$8.0 to $8.5 billion	No Change
Adjusted EBITDA[1]	$3.8 to $4.2 billion	$3.8 to $4.2 billion	No Change

Raised New Pfizer[1] Revenue and Adjusted Diluted EPS[1] Guidance Ranges; Reaffirmed All Components of Upjohn[1] Financial Guidance

[1] See Slide 18 and 19 for definitions and for additional information regarding Pfizer's 2020 financial guidance

Breakthroughs that change patients' lives

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Image Shown: *Pfizer raised its guidance during its latest earnings report.* ***Image Source:*** *Pfizer Inc – Second Quarter of Fiscal 2020 IR Earnings Presentation*

Here is what Pfizer's management team had to say about the firm's improving outlook during the company's latest earnings call (emphasis added):

> *"Broadly speaking,* ***we anticipate an ongoing gradual global recovery from the macroeconomic and health care impacts experienced during the second quarter of 2020 beginning in Q3 of 2020.*** *The guidance also assumes we'll be able to continue to operate our manufacturing and supply chain without material disruption and that we will continue investing in potential treatments and vaccines against COVID-19 throughout 2020 but does not include any revenues for a COVID-19 vaccine candidate given that it has not yet been approved.*
>
> *With that in mind, let's take a look at our guidance…* ***Beginning with total company, we are raising our guidance range for revenues by $100 million and our guidance range for adjusted diluted EPS by $0.03 based on the strength and resiliency we see in our business and the dedication of our colleagues despite the challenges inherent in operating during this current global pandemic.*** *We are reaffirming all of the components of our 2020 financial guidance for total company. I want to point out that although changes in foreign exchange rates since mid-April have marginally benefited our full year outlook for revenue and adjusted diluted EPS, today's guidance increases are not primarily driven by changes in foreign exchange." --- Frank D'Amelio, CFO of Pfizer*

We appreciate the guidance boost. **Combined with the cost savings Pfizer is targeting with its partners at its two aforementioned joint-ventures, the company's outlook is quite bright.** The Upjohn-Mylan deal will give Pfizer a large (net) cash infusion and should allow the firm to focus more of its attention towards its various growth opportunities. Pfizer's large net debt load is a concern, though we view that burden as manageable given its strong cash flow profile, improving cost structure, recent guidance boost, and its resilient financial performance in the face of the ongoing pandemic. **Pfizer is well-positioned to ride out the storm with its dividend intact.**

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

US Banks Earnings Roundup

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

By Matthew Warren

Bank of America is Working Through a Difficult Time

When putting all the puzzle pieces together, we see Bank of America facing the headwinds of low rates and sizable credit provisioning with relative ease thanks to its substantial pre-tax, pre-provision earnings power. As long as the economy doesn't get drastically worse from here, long term investors will benefit from normalized valuations on more normalized earnings in the not-too-distant future.

Bank of America (BAC) posted difficult second quarter results July 16, though it beat analyst consensus estimates on both the top and the bottom lines. As you can see in the upcoming graphic down below, total revenue was down 3% compared to last year while net income was down 52% thanks to substantial provisioning for future credit losses.

2Q20 Financial Results [1]

Summary Income Statement ($B, except per share data)	2Q20	2Q19	$ Inc / (Dec)	% Inc / (Dec)
Total revenue, net of interest expense	**$22.3**	$23.1	($0.8)	(3) %
Provision for credit losses	**5.1**	0.9	4.3	N/M
Net charge-offs	***1.1***	*0.9*	*0.3*	*29*
Reserve build [2]	***4.0***	*(0.0)*	*4.0*	N/M
Noninterest expense	**13.4**	13.3	0.1	1
Pretax income	**3.8**	9.0	(5.2)	(58)
Pretax, pre-provision income [3]	***8.9***	*9.8*	*(0.9)*	*(9)*
Income tax expense	**0.3**	1.6	(1.3)	(83)
Net income	**$3.5**	$7.3	($3.8)	(52)
Diluted earnings per share	**$0.37**	$0.74	($0.37)	(50)
Average diluted common shares (in millions)	**8,768**	9,560	(792)	(8)

Return Metrics and Efficiency Ratio		
Return on average assets	**0.53** %	1.23 %
Return on average common shareholders' equity	**5.4**	11.6
Return on average tangible common shareholders' equity [3]	**7.6**	16.2
Efficiency ratio	**60**	57

Note: Amounts may not total due to rounding. N/M = not meaningful.
[1] 2Q20 provision for credit losses, allowance for credit losses and related credit metrics in this presentation reflect the Company's adoption of the new accounting standard on current expected credit losses (CECL) effective January 1, 2020. For more information, see important presentation information on slide 34.
[2] For more information on reserve build, see note A on slide 31.
[3] Represent non-GAAP financial measures. For more information on pretax, pre-provision income and a reconciliation to GAAP, see note B on slide 31. For important presentation information about these measures, see slide 34.

2

Image Shown: *Summary of Bank of America's 2Q2020 results.* ***Image Source:*** *Bank of America 2Q2020 Earnings Presentation.*

Of note, the bank's return on tangible common shareholders' equity in the quarter of 7.6% was only a bit behind industry bellwether JPMorgan's 9% in the same quarter. We think this is a near-term marker that Bank of America continues to close the gap with the industry's best large bank.

Moving onto the breakdown of segment metrics in the upcoming graphic down below, one can see that the crown jewel of consumer banking is currently under substantial pressure due to outsized provisioning--especially in the credit card space. One can also see that, much like at industry peers, global markets business performance was a standout performer as volatile markets led to substantial trading revenues, especially in FICC (Fixed income, currencies, and commodities). Investment banking was also quite strong in the quarter, as clients bulked up their liquidity positions to withstand the Covid-19 pandemic.

Bank of America			
	2Q20	1Q20	2Q19
Consumer Banking			
Allocated Capital ($B)	38.5	38.5	37.0
Return on average allocated capital (%)	1%	19%	36%
Efficiency Ratio	60	49	45
Global Wealth & Investment Management			
Allocated Capital ($B)	15.0	15.0	14.5
Return on average allocated capital (%)	17%	23%	30%
Pretax margin	19	23	29
Global Banking			
Allocated Capital ($B)	42.5	42.5	41.0
Return on average allocated capital (%)	7%	1%	19%
Efficiency Ratio	44	50	44
Global Markets			
Allocated Capital ($B)	36.0	36.0	35.0
Return on average allocated capital (%)	21%	19%	12%
Efficiency Ratio	50	54	65

Image Shown: *Bank of America's segment metrics.* ***Image Source:*** *Analyst collection of figures from Bank of America's 2Q2020 Earnings Presentation.*

We include the next graphic down below simply to highlight how provisions for credit losses are running well ahead of current charge offs. This is a trend that we are seeing across the industry. Bank income statements are notoriously pro-cyclical, meaning that they amplify both the good and the bad times thanks to the existing accounting rules.

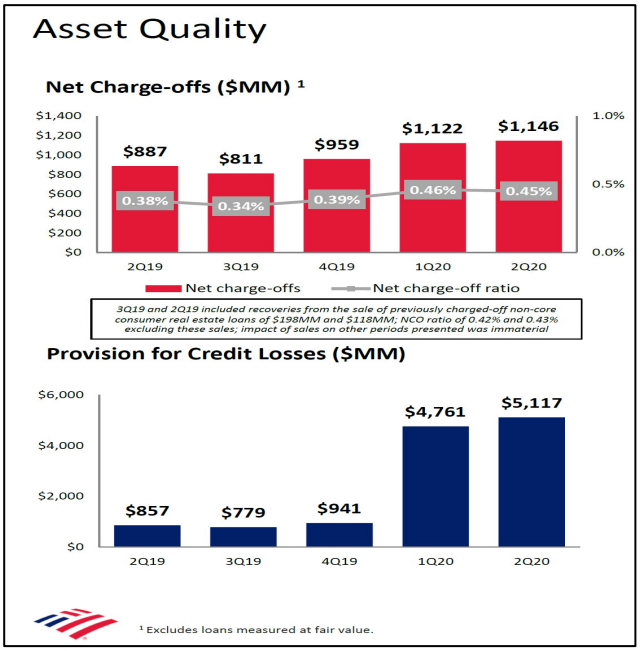


Image Shown: *High levels of provisions are being put in place ahead of expected net charge-offs coming down the road.* ***Image Source:*** *Bank of America 2Q2020 Earnings Presentation*

As you can see in the following quote from Bank of America CFO Paul Donofrio, company management is adamant that they have employed strict underwriting over the past decade since the Great Financial Crisis. Time will tell as this economic downturn (caused by the Covid-19 health crisis) proceeds to completion:

> *"Our net charge-off ratio under this year's stress test was once again the lowest of our peers and has been the lowest in seven of the last eight years. Total net charge-offs this quarter were $1.1 billion or 45 basis points of average loans. Net charge-offs rose $24 million from Q1 with an uptick in commercial losses mostly offset by lower consumer losses.*
>
> *Provision expense was $5.1 billion. Our reserve build of $4 billion reflects a weaker economic outlook since the end of Q1, which impacted expected future losses. While we saw increases in commercial reservable criticized exposures, impacted by the virus, overall credit thus far has been better than expected as NPLs only rose modestly versus our expectations."*

Aside from credit costs, Bank of America is also facing some near-term pressure on its efficiency ratio (see upcoming graphic down below) due to the revenue pressure that largely stems from low interest rates direct negative impact on net interest income. As company management has done a great job controlling costs during the past several years, we expect efficiency ratios to improve once again on the other side of this pandemic.

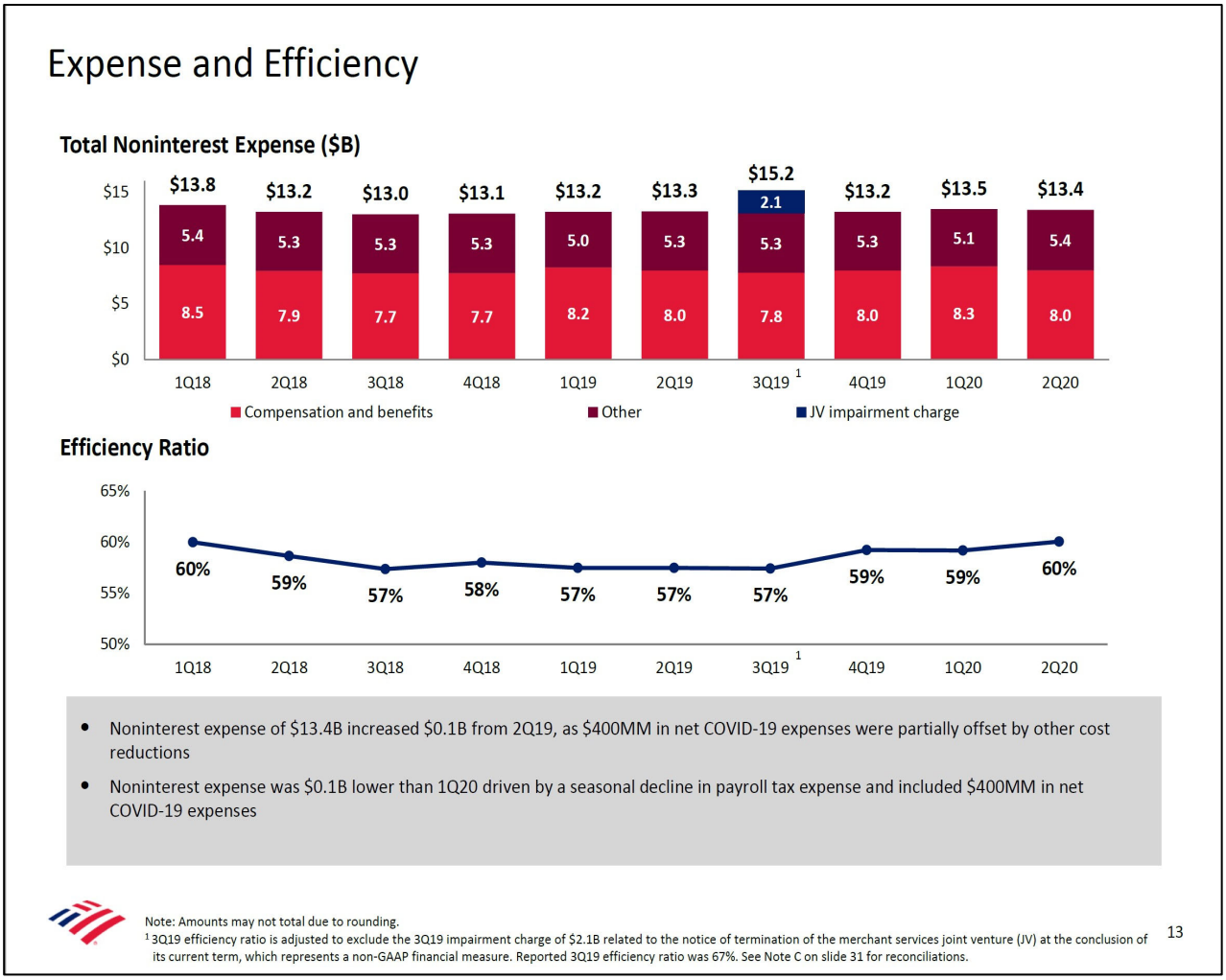


Image Shown: *Decent cost control combined with revenue pressures have unfortunately meant slightly higher efficiency ratios.* ***Image Source:*** *Bank of America 2Q2020 Earnings Presentation.*

Aside from the intelligence gained regarding Bank of America itself, one can also garner some insight into the broader macro economy from the upcoming graphic down below. Since Bank of America customers represent approximately $3 *trillion* of annual spending, the below trends should be given some weight. As you can see, total spending is nearly at year-ago levels in June, having been way down year over year back in April.

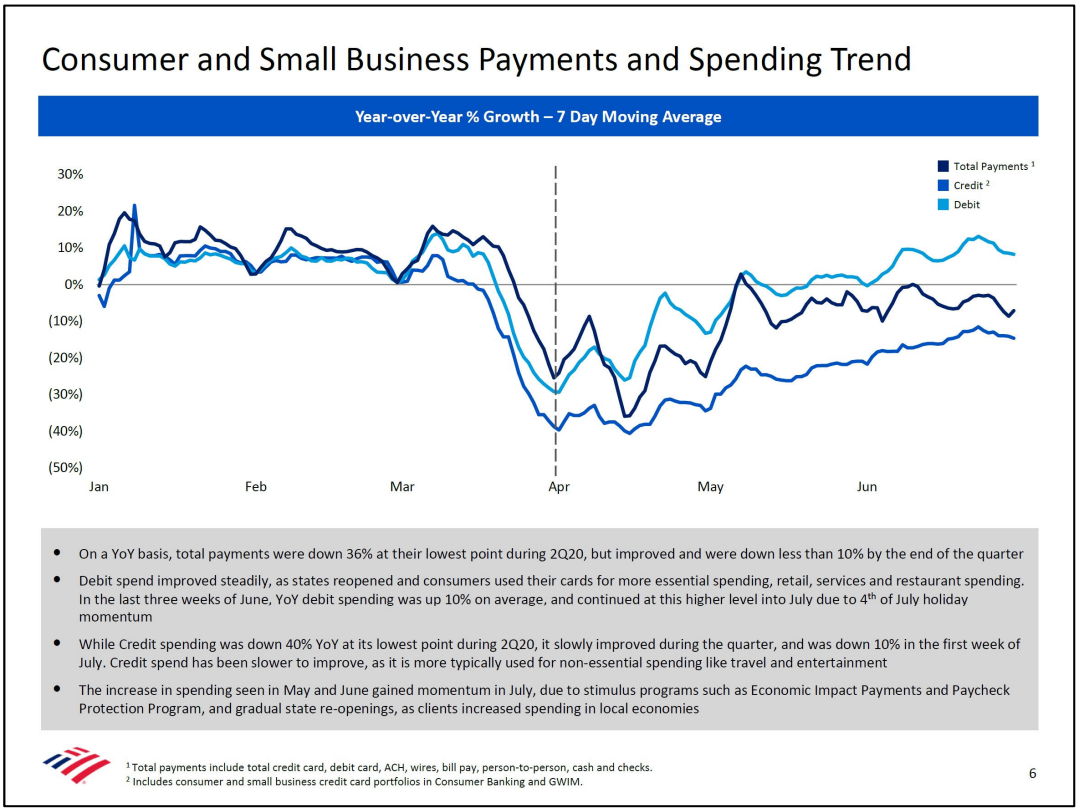


Image Shown: *Bank of Consumer and Small Business Payments and Spending Trends show a nice bounce off of the April lows.* ***Image Source:*** *Bank of America 2Q2020 Earnings Presentation.*

When putting all the puzzle pieces together, we see Bank of America facing the headwinds of low rates and sizable credit provisioning with relative ease thanks to its substantial pre-tax, pre-provision earnings power. As long as the economy doesn't get drastically worse from here, long term investors will benefit from normalized valuations on more normalized earnings in the not-too-distant future. We're not interested in owning any bank at this time, however.

Citigroup Navigating the Banking Downturn Fairly Well

All in all, we think Citigroup management is doing a decent job of navigating this economic downturn. The shares trade at a discount to tangible book value. We think a large part of the reason for this is that this is a very complex bank, operating across a wide variety of products and geographies. If the team can make it through this downcycle without any skeletons coming out of the closest, we think the stock has the potential to re-rate higher.

On July 14, Citigroup (C) posted a difficult second-quarter set of results, though the firm did manage to beat analyst consensus estimates on both the top and bottom lines. Outsize revenue gains in investment banking and FICC (fixed income, currencies, and commodities) markets (trading) helped on one hand, while sizable provisions for upcoming credit losses dented the bottom line on the other hand. As shown in the graphic at the top of the next page, revenues advanced 5% compared to last year, while net income fell 73%.

Citigroup – Summary Financial Results

($MM, except EPS)

	2Q'20	1Q'20	%Δ	2Q'19	%Δ	1H'20	%Δ
Revenues	**$19,766**	$20,731	(5)%	$18,758	5%	**$40,497**	8%
Operating Expenses	**10,415**	10,594	(2)%	10,500	(1)%	**21,009**	(0)%
Efficiency Ratio	*52.7%*	*51.1%*		*56.0%*		*51.9%*	
Operating Margin	*9,351*	*10,137*	*(8)%*	*8,258*	*13%*	*19,488*	*20%*
Net Credit Losses	2,206	2,108	5%	1,963	12%	4,314	10%
Net ACL Build / (Release)(1)	5,603	4,893	15%	111	NM	10,496	NM
Other Provisions(2)	94	26	NM	19	NM	120	NM
Credit Costs	**7,903**	7,027	12%	2,093	NM	**14,930**	NM
EBT	**1,448**	3,110	(53)%	6,165	(77)%	**4,558**	(63)%
Income Taxes	**131**	576	(77)%	1,373	(90)%	**707**	(73)%
Effective Tax Rate	*9%*	*19%*		*22%*		*16%*	
Net Income	**$1,316**	$2,522	(48)%	$4,799	(73)%	**$3,838**	(60)%
Return on Assets	*0.23%*	*0.49%*		*0.97%*		*0.36%*	
Return on Tangible Common Equity(3)	*2.9%*	*6.0%*		*11.9%*		*4.5%*	
EPS	**$0.50**	$1.05	(52)%	$1.95	(74)%	**$1.56**	(59)%
Average Diluted Shares	*2,084*	*2,114*	*(1)%*	*2,289*	*(9)%*	*2,103*	*(9)%*
Average Assets ($B)	**$2,267**	$2,080	9%	$1,979	15%	**$2,173**	11%
EOP Assets (Constant $B)	**2,233**	2,235	(0)%	1,957	14%	**2,233**	14%
EOP Loans (Constant $B)	**685**	726	(6)%	678	1%	**685**	1%
EOP Deposits (Constant $B)	**1,234**	1,193	3%	1,030	20%	**1,234**	20%

Note: Totals may not sum due to rounding. NM: Not meaningful. ACL: Allowance for Credit Losses. Constant dollar excludes the impact of foreign exchange translation into U.S. dollars for reporting purposes and, as used throughout this presentation, is a non-GAAP financial measure. For a reconciliation of constant dollars to reported results, please refer to Slide 34.

(1) Includes credit reserve build for loans and provision for credit losses on unfunded lending commitments.

(2) Includes provisions for credit losses on benefits and claims, HTM debt securities and other assets.

(3) Return on Tangible Common Equity (RoTCE) is a non-GAAP financial measure. For a reconciliation to reported results, please refer to Slides 33 and 34.

4 citi

Image Shown: *Summary of Citigroup's 2Q2020 Results.* ***Image Source:*** *Citigroup 2Q2020 Earnings Presentation*

Of note, there was a lot of discussion on the second-quarter conference call about provisioning now for credit losses later. There is a new standard called CECL (current expected credit losses), which means that every quarter banks are supposed to make allowances for future credit losses based on their judgment about the future state of the economy (including key metrics like GDP and especially unemployment). If that view worsens from one quarter to the next, then you get a lot of additional provisioning, just as what happened at Citigroup and its peers during the second quarter of 2020. As shown in the upcoming graphic down below, net credit losses (NCLs) and 90-day-plus past dues are only just starting to climb, even though the economy tanked going back to the March/April timeframe.

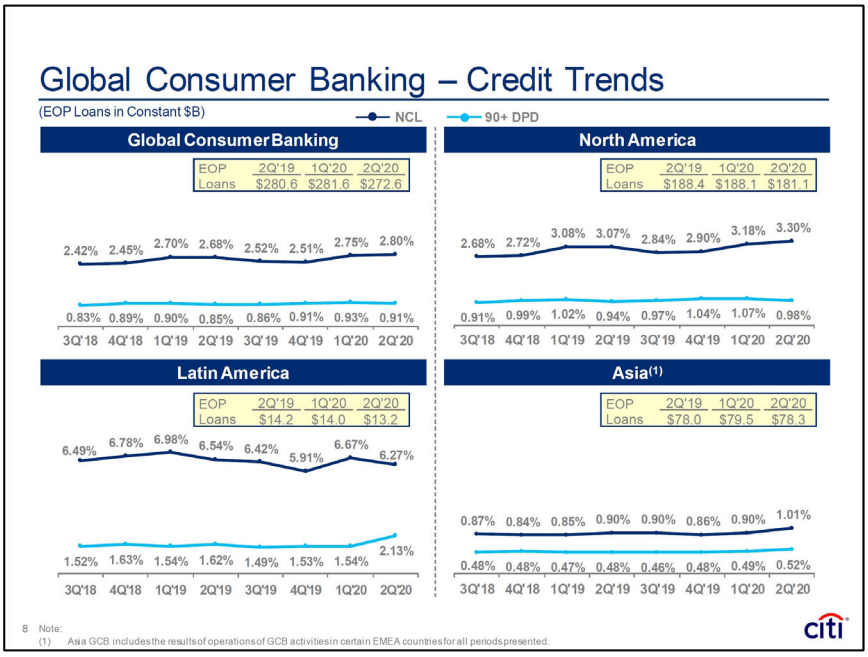


Image Shown: *Credit charge-offs and delinquencies are just starting to tick up around the world, as forbearance and government stimulus have prevented a worse outcome thus far.* ***Image Source:*** *Citigroup 2Q2020 Earnings Presentation*

That said, **there are a lot of positives, including the stimulus from Congress/Treasury and the Federal Reserve, that have prevented greater charge-offs in this early stage of this down cycle.** There was also talk later in the call that consumer losses will likely come to fruition down the road whether later this year or into 2021. The below quote from CEO Mike Corbat on the second-quarter earnings call describes the situation fairly well:

> *"…I think that what we're seeing is that the extraordinary actions of the Fed and the Treasury leave not just ours but industry models kind of wanting for more insight. But we've never seen this type of action whether it's the checks people receive, whether it's payroll protection 500 plus billion, whether it's the holiday in terms of income tax payments, but we're actually seeing a consumer in the US that actually kind of goes into this and it's not all even but in pretty good shape.*
>
> *Savings rates are up, obviously spending levels are down. Mark talked about some of the delinquencies and some of the positive things that we're seeing there in terms of the buckets and the roll rates. It's early but again I think as we look at a potential spike back up in some areas obviously over the weekend stimulus round two came on the table. It seems to be bipartisan and so it's likely we're going to get more from that and so again* ***I think those things give us, I won't say comfort but give us I think a good a view based on what we've been through in terms of the consumer in particular to be able to withstand some of these variations and contagion rates as we go forward."***

What about the longer-term outlook? As one can see in the upcoming graphic down below, Citigroup management has done a tremendous job improving its efficiency ratio (managing its cost structure relative to revenues) during the past four years. While this year the bank will experience some pressure as management is guiding revenues to be slightly down for the year (as investment banking and market activity normalizes in the back half) and for costs to be roughly flat, so a slight step back in efficiency ratio can only be expected in a year like this.

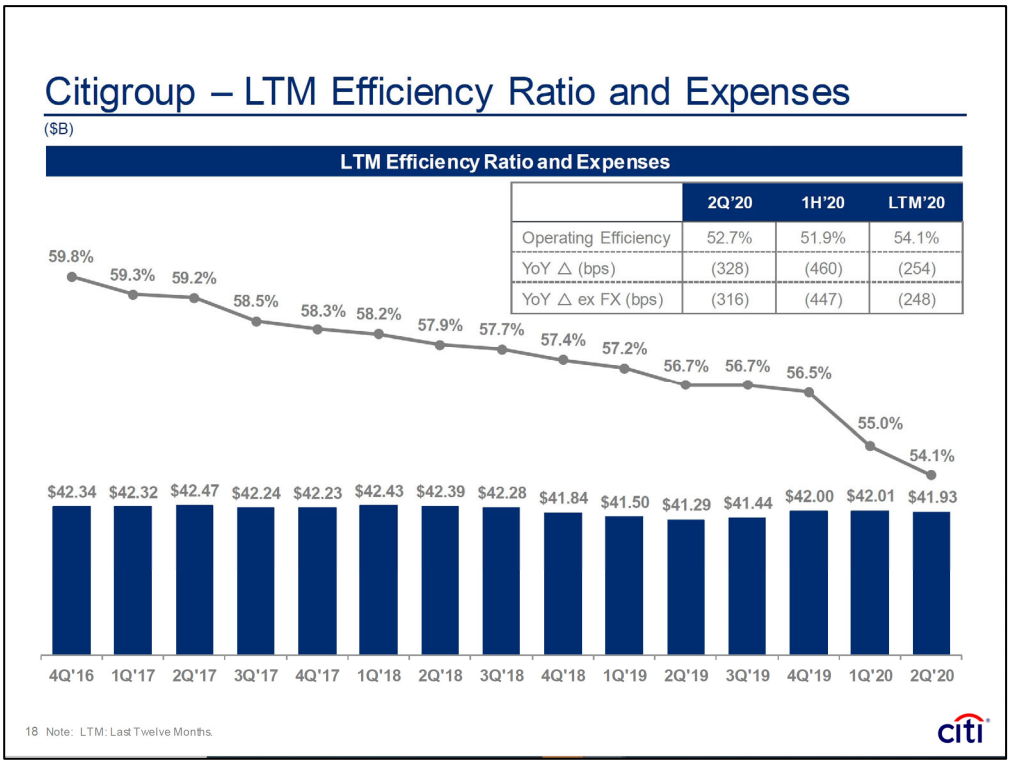


Image Shown: *Citigroup has been improving its efficiency ratio steadily over the past 4 years.* ***Image Source:*** *Citigroup 2Q2020 Earnings Presentation*

All in all, we think Citigroup management is doing a decent job of navigating this economic downturn. The shares trade at a discount to tangible book value. We think a large part of the reason for this is that this is a very complex bank, operating across a wide variety of products and geographies. If the team can make it through this downcycle without any skeletons coming out of the closest, we think the stock has the potential to re-rate higher.

Goldman Posts a Blowout Quarter

While we still do not like the private ($17 billion) and public equity ($3 billion) positions on Goldman's balance sheet, we acknowledge that the firm is working them lower through sales and that the bank is aiming to increase managed funds instead. This move is overdue and will help reduce the risk profile of the firm. Though the quarter showed the massive revenue potential of Goldman when markets are at fairly high levels and with extreme volatility, it is difficult to value these earnings streams, given the notoriously volatile nature of the key segments of investment banking and markets (trading).

Goldman Sachs (GS) posted blowout second-quarter results July 15 thanks to its notoriously volatile Markets and Investment Banking segments, surging past analyst consensus estimates for both the top and bottom-line figures. Bottom line results would have been better, but for significant credit loss provisioning and litigation expenses. As you can see in the upcoming graphic down below, net revenues were up 41% compared to last year while net earnings to common was up only 2% due to the above-mentioned drags on the bottom line.

Financial Overview

Goldman Sachs

Financial Results

$ in millions, except per share amounts	2Q20	vs. 1Q20	vs. 2Q19	2Q20 YTD	vs. 2Q19 YTD
Investment Banking	$ 2,657	22%	36%	$ 4,841	31%
Global Markets	7,176	39%	93%	12,339	59%
Asset Management	2,101	N.M.	-18%	2,005	-54%
Consumer & Wealth Management	1,361	-9%	9%	2,853	15%
Net revenues	$ 13,295	52%	41%	$ 22,038	21%
Provision for credit losses	1,590	70%	N.M.	2,527	N.M.
Operating expenses	8,400	30%	37%	14,858	24%
Pre-tax earnings	3,305	145%	6%	4,653	-20%
Net earnings	2,423	100%	-%	3,636	-22%
Net earnings to common	$ 2,247	100%	2%	$ 3,370	-23%
Diluted EPS	$ 6.26	101%	8%	$ 9.36	-19%
ROE[1]	11.1%	5.4pp	-pp	8.4%	-2.7pp
ROTE[1]	11.8%	5.8pp	0.1pp	9.0%	-2.7pp
Efficiency Ratio[3]	63.2%	-10.7pp	-1.5pp	67.4%	1.8pp

Financial Overview Highlights

- 2Q20 net revenues were significantly higher YoY, reflecting significantly higher net revenues in Global Markets and Investment Banking and higher net revenues in Consumer & Wealth Management, partially offset by lower net revenues in Asset Management
- 2Q20 provision for credit losses was significantly higher YoY, primarily due to:
  - Revisions to forecasts of expected deterioration in the broader economic environment (incorporating the accounting for credit losses under the Current Expected Credit Losses standard[5]), which resulted in increased provisions for wholesale loans and, to a lesser extent, consumer loans
  - Individual impairments related to wholesale loans during the quarter
- 2Q20 operating expenses increased significantly YoY, primarily due to:
  - Significantly higher compensation and benefits expenses, reflecting significantly higher net revenues
  - Significantly higher net provisions for litigation and regulatory proceedings
  - Higher expenses related to brokerage, clearing, exchange and distribution fees, reflecting an increase in activity levels
  - Higher expenses related to consolidated investments, including impairments

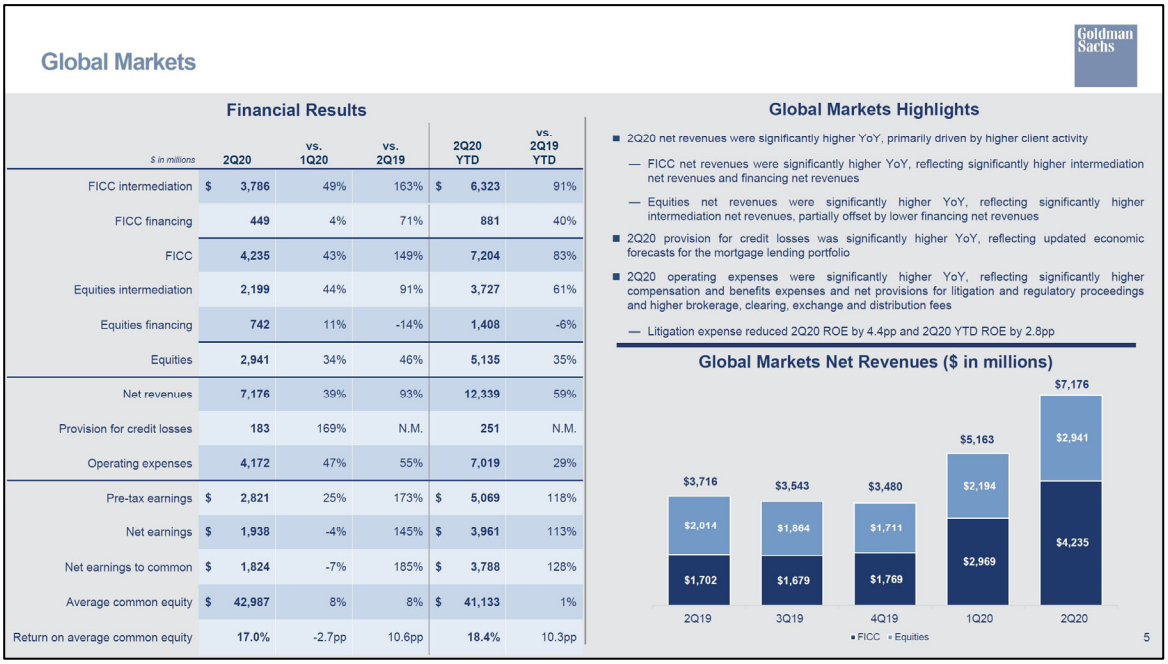
Litigation Impact	2Q20	2Q20 YTD
Diluted EPS	$ -2.60	$ -3.15
ROE	-4.5pp	-2.8pp
ROTE	-4.8pp	-2.9pp
Efficiency Ratio	+7.1pp	+5.1pp

3

Image Shown: *Goldman Sachs Results Breakdown by Segment.* ***Image Source:*** *Goldman Sachs 2Q2020 Earnings Presentation*

While investment banking revenue was up 36% (equity underwriting up 122% and debt underwriting up 93%) year over year, bottom line earnings in the segment were down 93% as this segment was battered by credit losses and litigation charges. Clearly though, Goldman benefitted from the massive industry tailwind of equity, convert, and bond offerings as clients shored up their balance sheets in the face of the ongoing Covid-19 pandemic.

The real star of the show in the quarter was Goldman's Global Markets Segment, with net revenues up 93% and net earnings to common up 185%. Frantic client trading, volatile markets, and wide bid-ask spreads all contributed to phenomenal trading revenue in the quarter, as you can see in the upcoming graphic down below. FICC (fixed income, currencies, and commodities) trading was the absolute standout performer, with revenue up 149% versus last year, as clients raised liquidity and termed out the debt on their balance sheets.



Global Markets

Financial Results

$ in millions	2Q20	vs. 1Q20	vs. 2Q19	2Q20 YTD	vs. 2Q19 YTD
FICC intermediation	$ 3,786	49%	163%	$ 6,323	91%
FICC financing	449	4%	71%	881	40%
FICC	4,235	43%	149%	7,204	83%
Equities intermediation	2,199	44%	91%	3,727	61%
Equities financing	742	11%	-14%	1,408	-6%
Equities	2,941	34%	46%	5,135	35%
Net revenues	7,176	39%	93%	12,339	59%
Provision for credit losses	183	169%	N.M.	251	N.M.
Operating expenses	4,172	47%	55%	7,019	29%
Pre-tax earnings	$ 2,821	25%	173%	$ 5,069	118%
Net earnings	$ 1,938	-4%	145%	$ 3,961	113%
Net earnings to common	$ 1,824	-7%	185%	$ 3,788	128%
Average common equity	$ 42,987	8%	8%	$ 41,133	1%
Return on average common equity	17.0%	-2.7pp	10.6pp	18.4%	10.3pp

Global Markets Highlights

- 2Q20 net revenues were significantly higher YoY, primarily driven by higher client activity
  - FICC net revenues were significantly higher YoY, reflecting significantly higher intermediation net revenues and financing net revenues
  - Equities net revenues were significantly higher YoY, reflecting significantly higher intermediation net revenues, partially offset by lower financing net revenues
- 2Q20 provision for credit losses was significantly higher YoY, reflecting updated economic forecasts for the mortgage lending portfolio
- 2Q20 operating expenses were significantly higher YoY, reflecting significantly higher compensation and benefits expenses and net provisions for litigation and regulatory proceedings and higher brokerage, clearing, exchange and distribution fees
  - Litigation expense reduced 2Q20 ROE by 4.4pp and 2Q20 YTD ROE by 2.8pp

Global Markets Net Revenues ($ in millions)

5

Image Shown: *Global Markets Segment Results Broken Down into Subsegments.* ***Image Source:*** *Goldman Sachs 2Q2020 Earnings Presentation.*

As to whether this level of activity can continue, many senior executives across the industry have been blatantly tamping down expectations. Goldman Sachs CEO David Solomon did that in the below quote from the quarterly earnings call, but also struck an optimistic tone at the same time about current levels of trading as compared to prior years:

> *"…in a period where there's enormous change and enormous volatility in markets, we became super busy because our clients are super busy. And the reason you see this pick up in activity is because there was a lot of activity from our clients. I don't necessarily view that as permanent… It's obviously very hard to predict, given the uncertain nature of the environment, how this would continue, I'd say up front, because I know it'll be a question from a number of you that* ***the activity levels that we saw at the end of March and in April, we're really extraordinary.***
>
> ***We've not seen the same level of activity over the course of the last five or six weeks, since the beginning of June, but I would say the activity levels over the last five or six weeks when looked at compared to activity levels in 2019, or 2018 still look pretty active. And so we continue to see clients very, very engaged in our markets business."***

While we still do not like the private ($17 billion) and public equity ($3 billion) positions on Goldman's balance sheet, we acknowledge that the firm is working them lower through sales and that the bank is aiming to increase managed funds instead. This move is overdue and will help reduce the risk profile of the firm. Though the quarter showed the massive revenue potential of Goldman when markets are at fairly high levels and with extreme volatility, it is difficult to value these earnings streams, given the notoriously volatile nature of the key segments of investment banking and markets (trading).

JPMorgan Reports Second Quarter, Notes Peculiar Times

There was a fair amount of discussion on JPMorgan's conference call about how the company (and the rest of the banking industry) are taking large provisions now for charge offs that they expect to come in the future. The future and the timing and magnitude of the eventual write-offs are quite murky indeed, which helps explain the volatility of banking shares in general, and especially for those institutions that might fall over in an "adverse scenario." JPMorgan is not one of those banks that is at risk. It stands on high ground in the industry thanks to its scale, diversification (a huge benefit this quarter), high quality management, and outsize earnings power as compared to many of its peers.

2Q20 Financial results[1]

$B, except per share data

	2Q20	$ O/(U) 1Q20	$ O/(U) 2Q19
Net interest income	$14.0	($0.6)	($0.6)
Noninterest revenue[2]	19.9	5.4	4.9
Managed revenue[1,2]	33.8	4.8	4.3
Expense[2]	16.9	0.2	0.7
Credit costs	10.5	2.2	9.3
Reported net income	$4.7	$1.8	($5.0)
Net income applicable to common stockholders	$4.3	$1.8	($4.9)
Reported EPS	$1.38	$0.60	($1.44)
ROE[3]	7%	4%	16%
ROTCE[3,4]	9	5	20
Overhead ratio – managed[1,3]	50	58	55
Memo: Adjusted expense[5]	*$16.8*	*$0.2*	*$0.6*
Memo: Adjusted overhead ratio[1,3,5]	*50%*	*57%*	*55%*

$B	2Q20	1Q20	2Q19
Net charge-offs	$1.6	$1.5	$1.4
Reserve build/(release)	8.9	6.8	(0.3)
Credit costs	$10.5	$8.3	$1.1

2Q20 Tax rate
Effective rate: 15.8%
Managed rate: 26.8%[1,6]

2Q20	ROE	O/H ratio
CCB	(2)%	54%
CIB	27%	41%
CB	(14)%	38%
AWM	24%	69%

Note: Totals may not sum due to rounding
[1] See note 1 on slide 16
[2] See note 11 on slide 16
[3] Actual numbers for all periods, not over/(under)
[4] See note 2 on slide 16
[5] See note 3 on slide 16
[6] Reflects fully taxable-equivalent ("FTE") adjustments of $837mm in 2Q20

4

JPMORGAN CHASE & CO.

Image Shown: *Overview of JPMorgan's 2Q2020 earnings.* ***Image Source:*** *JPMorgan 2Q2020 Earnings Presentation*

JPMorgan Chase & Co. (JPM) reported very impressive second-quarter results July 14, considering the backdrop of the COVID-19-caused economic downturn, beating analyst consensus estimates on both the top and bottom lines. As one can see in the graphic up above, managed revenue was actually up quite substantially thanks to dramatic gains in investment banking and markets activities. Net income (available to common stockholders) was of course down from last year to $4.3 billion due to a massive reserve build of $8.9 billion in the quarter.

Essentially what management indicated in the conference call was that they are weighing the downside scenarios quite heavily as compared to their base case. So, if the base case indeed comes to fruition, there would be room for release of some amount of allowance for loan losses. **While we would all hope a more-benign scenario plays out, JPMorgan management is actually preparing for the worst, and indicated that the board would even review cutting the dividend if the "adverse scenario" comes to fruition.**

	2Q20	1Q20	2Q19
Consumer & Community Banking			
Equity ($B)	52.0	52.0	52.0
ROE (%)	-2%	1%	31%
Overhead Ratio	54	54	51
Corporate & Investment Bank			
Equity ($B)	80.0	80.0	80.0
ROE (%)	27%	9%	14%
Overhead Ratio	41	59	58
Commercial Banking			
Equity ($B)	22.0	22.0	22.0
ROE (%)	-14%	2%	17%
Overhead Ratio	38	45	41
Asset & Wealth Management			
Equity ($B)	10.5	10.5	10.5
ROE (%)	24%	25%	27%
Pretax margin	24	24	27

Image Shown: *JPMorgan Key Metrics across segments.* ***Image Source:*** *Analyst collection of data from 2Q2020 Earnings Presentation*

Digging into the business segments in the graphic above, one can see that the usual crown jewel of 'Consumer & Community Banking' is under substantial pressure due to the aforementioned reserve builds—mostly against the credit card book. The savior in the quarter was the 'Corporate & Investment Bank,' which put up a stunning 27% return on equity in the period—closer to what you might normally see from the consumer bank. Management was quick to point out that this was due to outsized capital raising (both common, converts, and debt offerings) amongst the client base and outsize trading volumes and margins given the many dislocations in the market during the quarter. The executive suite guided for both of these revenue streams to normalize lower in the coming quarter, though these lines are notoriously hard to predict.

The 'Commercial Banking' segment was the worst of the group and highlights why the long tail of thousands of US banks that focus on these activities are generally sub-par investments—with a very few notable exceptions. The 'Asset & Wealth Management' segment continued to shine with a mid-twenties return on equity capital. It's too bad that, despite being one of the largest asset managers in the world, it nearly gets lost in this enormous entity. Just to round out our commentary on JPMorgan's earnings, we thought we would highlight the below commentary from company CEO Jamie Dimon, in order to flesh out the strange nature of this macro-economic downturn:

> *"…just to amplify, in the normal recession, unemployment goes up, delinquencies go up, charges go up, home prices go down. None of that's true here. Incomes go down, savings go down. Savings are up, incomes are up, home prices are up. So, you will see the effect of this recession. You're not going to see it right away because of all the stimulus and the fact, 60% or 70% of the unemployed are making more money than they were making when they were working.* ***So, it's just very peculiar times.****"*

There was a fair amount of discussion on JPMorgan's conference call about how the company (and the rest of the banking industry) are taking large provisions now for charge offs that they expect to come in the future. The future and the timing and magnitude of the eventual write-offs are quite murky indeed, which helps explain the volatility of banking shares in general, and especially for those institutions that might fall over in an "adverse scenario." **JPMorgan is not one of those banks that is at risk.** It stands on high ground in the industry thanks to its scale, diversification (a huge benefit this quarter), high quality management, and outsize earnings power as compared to many of its peers.

Morgan Stanley Puts up a Tremendous Quarter

Morgan Stanley truly shined during this quarter of extreme volatility. While credit provisioning was higher year over year, Morgan Stanley simply does not have many of the credit exposures that are leading to huge multi-billion-dollar credit provisions at some of its money-center banking peers. Though its wealth management business' net income (applicable to Morgan Stanley) was down 10% year over year, and Investment Management was up only 20%, it was the Institutional Securities stunning 95% advance in net income that made this quarter a (temporary) gem of notable brilliance.

Morgan Stanley (MS) put up a tremendous quarter July 16, blowing away analyst consensus estimates on both the top and bottom lines. As you can see in the upcoming graphic down below, **the notoriously volatile 'Institutional Securities' segment had a blowout quarter**, driving the income growth as compared to the same quarter last year.

Morgan Stanley

Consolidated Financial Summary
(unaudited, dollars in millions)

	Quarter Ended			Percentage Change From:		Six Months Ended		Percentage
	Jun 30, 2020	Mar 31, 2020	Jun 30, 2019	Mar 31, 2020	Jun 30, 2019	Jun 30, 2020	Jun 30, 2019	Change
Net revenues								
Institutional Securities	$ 7,977	$ 4,905	$ 5,113	63%	56%	$ 12,882	$ 10,309	25%
Wealth Management	4,680	4,037	4,408	16%	6%	8,717	8,797	(1%)
Investment Management	886	692	839	28%	6%	1,578	1,643	(4%)
Intersegment Eliminations	(129)	(147)	(116)	12%	(11%)	(276)	(219)	(26%)
Net revenues	$ 13,414	$ 9,487	$ 10,244	41%	31%	$ 22,901	$ 20,530	12%
Non-interest expenses								
Institutional Securities	$ 4,984	$ 3,955	$ 3,650	26%	37%	$ 8,939	$ 7,251	23%
Wealth Management	3,538	2,982	3,165	19%	12%	6,520	6,366	2%
Investment Management	670	549	640	22%	5%	1,219	1,270	(4%)
Intersegment Eliminations	(133)	(145)	(114)	8%	(17%)	(278)	(215)	(29%)
Non-interest expenses [1]	$ 9,059	$ 7,341	$ 7,341	23%	23%	$ 16,400	$ 14,672	12%
Income (loss) before taxes								
Institutional Securities	$ 2,993	$ 950	$ 1,463	*	105%	$ 3,943	$ 3,058	29%
Wealth Management	1,142	1,055	1,243	8%	(8%)	2,197	2,431	(10%)
Investment Management	216	143	199	51%	9%	359	373	(4%)
Intersegment Eliminations	4	(2)	(2)	*	*	2	(4)	*
Income (loss) before taxes	$ 4,355	$ 2,146	$ 2,903	103%	50%	$ 6,501	$ 5,858	11%
Net Income (loss) applicable to Morgan Stanley								
Institutional Securities	$ 2,186	$ 757	$ 1,121	189%	95%	$ 2,943	$ 2,492	18%
Wealth Management	853	864	953	(1%)	(10%)	1,717	1,877	(9%)
Investment Management	154	78	128	97%	20%	232	264	(12%)
Intersegment Eliminations	3	(1)	(1)	*	*	2	(3)	*
Net Income (loss) applicable to Morgan Stanley	$ 3,196	$ 1,698	$ 2,201	88%	45%	$ 4,894	$ 4,630	6%
Earnings (loss) applicable to Morgan Stanley common shareholders	$ 3,047	$ 1,590	$ 2,031	92%	50%	$ 4,637	$ 4,367	6%

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

1

Image Shown: *Morgan Stanley's 2Q2020 Results Broken Down by Segment.* ***Image Source:*** *Morgan Stanley's 2Q2020 Earnings Supplement.*

So, let us take a closer look at the subsegments within the Institutional Securities segment. As you can see in the upcoming graphic down below, equity and fixed income underwriting and especially Fixed Income Sales and Trading were outrageously strong in the quarter.

Morgan Stanley

Institutional Securities

Income Statement Information, Financial Metrics and Ratios

(unaudited, dollars in millions)

	Quarter Ended			Percentage Change From:		Six Months Ended		Percentage
	Jun 30, 2020	Mar 31, 2020	Jun 30, 2019	Mar 31, 2020	Jun 30, 2019	Jun 30, 2020	Jun 30, 2019	Change
Revenues:								
Advisory	$ 462	$ 362	$ 506	28%	(9%)	$ 824	$ 912	(10%)
Equity	882	336	546	163%	62%	1,218	885	38%
Fixed income	707	446	420	59%	68%	1,153	826	40%
Underwriting	1,589	782	966	103%	64%	2,371	1,711	39%
Investment Banking	2,051	1,144	1,472	79%	39%	3,195	2,623	22%
Equity	2,619	2,422	2,130	8%	23%	5,041	4,145	22%
Fixed Income	3,033	2,203	1,133	38%	168%	5,236	2,843	84%
Other	(99)	240	41	*	*	141	58	143%
Sales and Trading	5,553	4,865	3,304	14%	68%	10,418	7,046	48%
Investments	36	(25)	194	*	(81%)	11	275	(96%)
Other	337	(1,079)	143	*	136%	(742)	365	*
Net revenues	7,977	4,905	5,113	63%	56%	12,882	10,309	25%
Compensation and benefits	2,952	1,814	1,789	63%	65%	4,766	3,608	32%
Non-compensation expenses	2,032	2,141	1,861	(5%)	9%	4,173	3,643	15%
Total non-interest expenses	4,984	3,955	3,650	26%	37%	8,939	7,251	23%
Income (loss) before taxes	2,993	950	1,463	*	105%	3,943	3,058	29%
Net income (loss) applicable to Morgan Stanley [1]	$ 2,186	$ 757	$ 1,121	189%	95%	$ 2,943	$ 2,492	18%
Pre-tax profit margin	38%	19%	29%			31%	30%	
Compensation and benefits as a % of net revenues	37%	37%	35%			37%	35%	
Non-compensation expenses as a % of net revenues	25%	44%	36%			32%	35%	
Return on Average Common Equity	19%	6%	10%			13%	11%	
Return on Average Tangible Common Equity [2]	20%	6%	10%			13%	11%	
Trading VaR (Average Daily 95% / One-Day VaR)	$ 60	$ 40	$ 46					

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.

5

Image Shown: *A Closer Look at Morgan Stanley's Institutional Securities Sub Segments.* ***Image Source:*** *Morgan Stanley 2Q2020 Earnings Supplement*

Underwriting was strong across the industry as clients raised massive amounts of liquidity to shore up their balance sheets to withstand potential downside scenarios associated with the COVID-19 induced economic downturn. While many firms initially pulled down their revolving credit lines, much of that liquidity was actually paid back by quarter end as equity, converts, and new debt offerings put in place longer dated and more stable capital.

As to the 168% year over year gain in fixed income sales and trading, this is what happens when investor clients seek out a strong counter party to navigate incredibly volatile markets. Based on industry revenue figures, it's clear that there was massive turnover of client portfolios as asset prices tanked starting back in March and then recovered so rapidly thereafter. The investment banking industry should send the Treasury and Federal Reserve a huge thank you letter for putting a bottom into these volatile markets and creating such a flurry of trading as asset markets recovered in such rapid fashion. As to whether this activity can continue apace, Morgan Stanley CEO tamped down expectations as did several other industry executives on this round of earnings calls:

> ***"So what does the future hold? Clearly, it will be challenging for the back half of 2020 to meet the record first half results and we expect advisory and macro trading to be significantly lower. That said, many parts of our business should continue to perform well."***

Morgan Stanley truly shined during this quarter of extreme volatility. While credit provisioning was higher year over year, Morgan Stanley simply does not have many of the credit exposures that are leading to huge multi-billion-dollar credit provisions at some of its money-center banking peers. Though its wealth management business' net income (applicable to Morgan Stanley) was down 10% year over year, and Investment Management was up only 20%, it was the Institutional Securities stunning 95% advance in net income that made this quarter a (temporary) gem of notable brilliance.

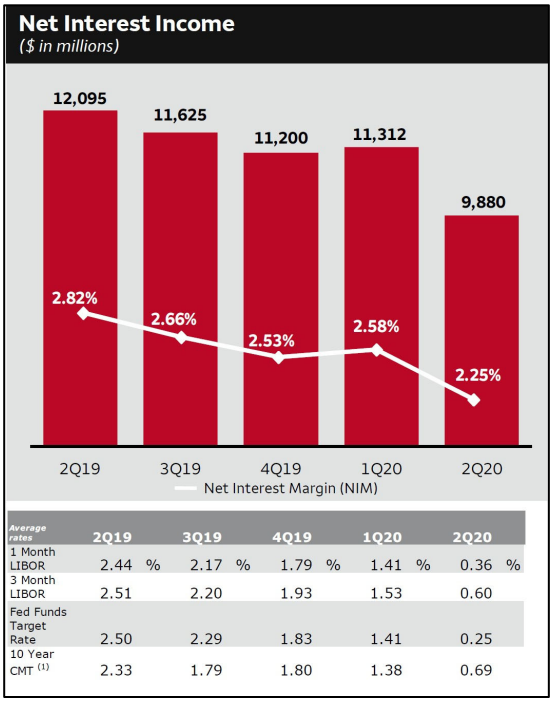
Wells Fargo Has Become An "Epic Disappointment"

Wells Fargo is so far out of line with its large US banking peers that it is truly competing with one arm tied behind its back. Or perhaps both arms. While some might try to be heroic and bet on a huge turnaround, we think it is more prudent to watch from the sidelines. What an epic disappointment this bank has become, so far a fall from grace as compared to when it used to be regarded as one of the best in class of the biggest US banks. What a shame!

Wells Fargo (WFC) delivered a stinker of a second quarter July 14, missing on both the top and bottom lines, **and cutting the dividend by 80%**--a move that helps the bank preserve capital as it continues to rack up losses during the COVID-19 pandemic and associated economic downturn.

Wells Fargo is facing pressure from all sides, as it continues to deal with the asset cap put in place by its regulators. Not only are revenues under pressure from low rates and a flattish yield curve (as one can see in the upcoming graphic down below), which dents net interest margins, but non-interest revenues are also under pressure from the effects of the economic recession we are facing.

Unlike other banks, Wells Fargo cannot grow its balance sheet to offset some of these revenue pressures. It is also a minor player in the investment banking and trading worlds, where revenues are growing rapidly the past couple quarters.



Average rates	2Q19	3Q19	4Q19	1Q20	2Q20
1 Month LIBOR	2.44 %	2.17 %	1.79 %	1.41 %	0.36 %
3 Month LIBOR	2.51	2.20	1.93	1.53	0.60
Fed Funds Target Rate	2.50	2.29	1.83	1.41	0.25
10 Year CMT (1)	2.33	1.79	1.80	1.38	0.69

Image Shown: *Wells Fargo net interest income is under pressure due to lower rates and a flat yield curve.* ***Image Source:*** *Wells Fargo 2Q2020 Earnings Supplement*

Aside from revenue pressure, the bank is also facing major cost pressure on multiple fronts. First and foremost, the bank is taking massive provisions to account for current and upcoming net charge-offs resulting from pressure on the consumer and commercial accounts alike. In the upcoming graphic down below, notice how much the provision has grown from last quarter, even though the bank is supposed to provision for losses through the cycle at each quarter end. This means Wells Fargo is either slow-walking the losses through the profit and loss statement, or that the economic and client specific outlook has deteriorated rapidly during the past 3 months. We suspect it is a bit of both.

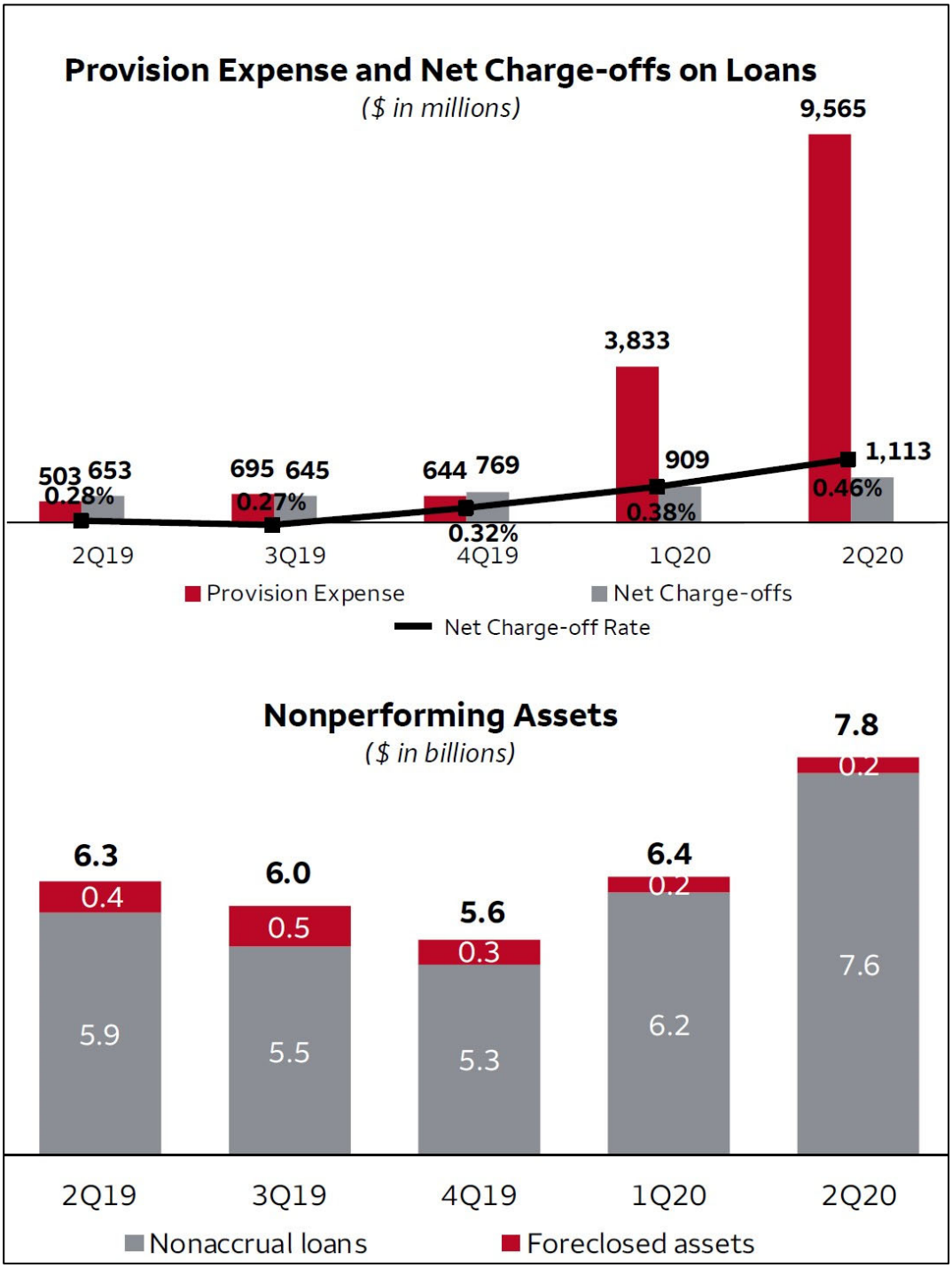


Image Shown: *Wells Fargo Provisions are skyrocketing in advance of increasing nonperforming assets and net charge-offs.* ***Image Source:*** *Wells Fargo 2Q2020 Earnings Supplement*

The other area of cost that has been a near constant source of trouble at Wells Fargo is in regards to its personnel cost and efficiency ratio. As one can see in the upcoming graphic down below, the bank's efficiency ratio has ballooned to 81.6%, which is a far cry worse than its large US banking peers. **This is roughly 30 percentage points worse in fact.** Management has now come out on the conference call and admitted to the fact that they need to cut out $10 billion out of a $54 billion cost base. **That is one Herculean task**--all while the regulators continue to pressure the bank to improve the quality of its controls and processes to prevent future problems like what has occurred in the recent past.

($ in millions)		2Q20	vs 1Q20		vs 2Q19
Noninterest expense					
Personnel [2]	$	8,911	7	%	5
Technology and equipment [2]		562	(20)		(12)
Occupancy [3]		871	22		21
Core deposit and other intangibles		22	(4)		(19)
FDIC and other deposit assessments		165	40		15
Operating losses		1,219	163		394
Outside professional services		758	4		(8)
Other		2,043	3		(14)
Total noninterest expense	**$**	**14,551**	**12**	**%**	**8**

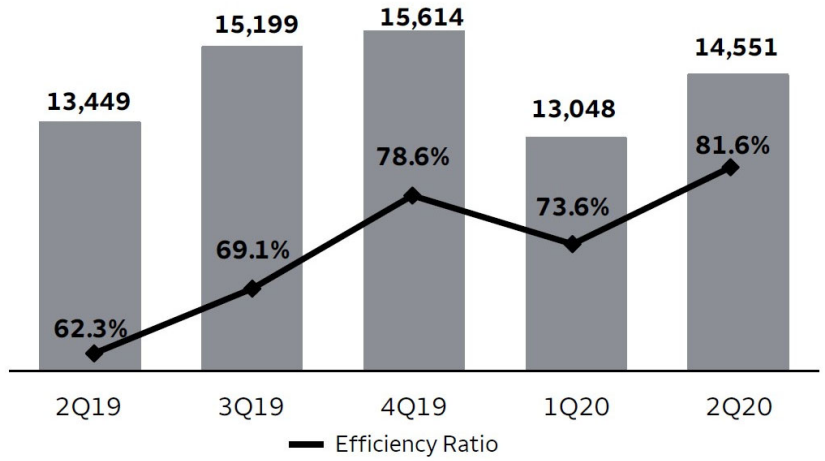


Image Shown: *Wells Fargo Personnel expenses are out of whack compared to peers, as is its efficiency ratio.* ***Image Source:*** *Well Fargo 2Q2020 Earnings Supplement*

Wells Fargo is so far out of line with its large US banking peers that it is truly competing with one arm tied behind its back. Or perhaps both arms. While some might try to be heroic and bet on a huge turnaround, we think it is more prudent to watch from the sidelines. What an epic disappointment this bank has become, a long fall from grace as compared to when it used to be regarded as one of the best in class of the biggest US banks.

What a shame!

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

Key Contributors

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

- Callum Turcan
Associate Investment Analyst
info@valuentum.com

- Matthew Warren
Independent Contributor
info@valuentum.com

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

THE SIMULATED HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO

We 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%	3.11%
iShares MSCI Australia ETF	EWA	5.0%	3.87%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	6.30%
iShares International Select Dividend ETF	IDV	5.0%	7.00%
iShares U.S. Preferred Stock ETF	PFF	5.0%	5.72%
Global X SuperDividend ETF	SDIV*	5.0%	8.63%
Global X SuperIncome Preferred ETF	SPFF	10.0%	6.53%
Vanguard Consumer Staples ETF	VDC	5.0%	2.71%
Vanguard Real Estate ETF	VNQ	10.0%	3.96%
Utilities Select Sector SPDR	XLU	5.0%	3.44%
EQUITY			
AT&T	T	5.0%	7.03%
Crown Castle ***NEW***	CCI	5.0%	2.82%
CyrusOne Inc. ***NEW***	CONE	5.0%	2.45%
CubeSmart	CUBE	5.0%	4.51%
Digital Realty Trust	DLR	5.0%	2.82%
Enterprise Products Partners	EPD	2.5%	10.10%
Magellan Midstream Partners	MMP	2.5%	9.94%
Philip Morris	PM	5.0%	6.04%
Public Storage	PSA	5.0%	4.05%
Cash**	-	0.0%	0.00%
		100.0%	**5.07%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 8/1/2020. 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 8/1/2020)*

*** Reflects federal funds target rate range*

DIVIDEND REPORT PAGE 2 – CYRUSONE (CONE)

CyrusOne CONE FAIRLY VALUED

Buying Index™ 6 Value Rating

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Neutral	$61.00 - $91.00	HEALTHY	GOOD / 2	GOOD	2.60%

Assessment of Company Dividend Strategy

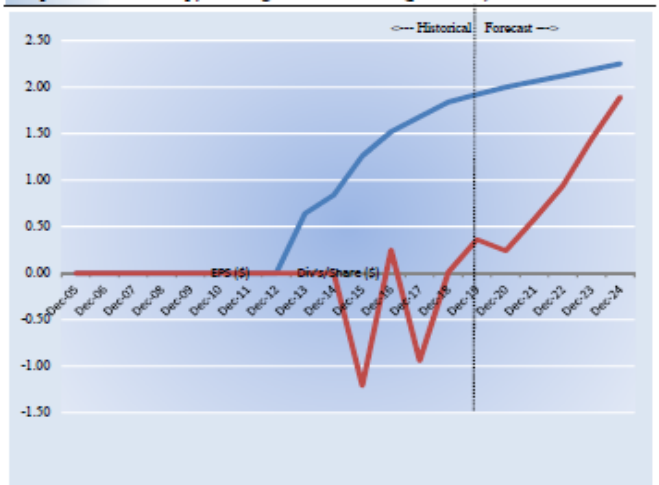
Key Strengths

CyrusOne has positioned itself nicely to take advantage of the secular trends surrounding the ever-evolving tech landscape as cloud and hybrid IT strategies continue to gain momentum. Some estimates suggest that by 2021, 94% of all workloads will run on some form of cloud environment. S&P Ratings upgraded CyrusOne's senior unsecured credit rating to an investment grade BBB- in September 2018, but its issuer credit rating remains in junk territory at BB+. Fitch initiated CyrusOne's unsecured and issuer credit rating at an investment grade BBB- in October 2019. We caution CyrusOne is capital market dependent and had ~$2.9 billion in total debt at the end of 2019.

Potential Weaknesses

Real estate investment trusts pay out 90% of annual taxable income and therefore are unable to meaningfully reinvest internally-generated funds, resulting in external capital-market dependence. The weak internal cash-flow retention of most REITs translates into poor raw, unadjusted Dividend Cushion ratios, which could become severe during the depths of the real estate cycle. Even though a REIT's operating cash flow may be robust, the lack of cash accumulation on the balance sheet and the massive debt needed to purchase/develop new properties can become restrictive. The adjusted Dividend Cushion ratio, accounts for expectations of continued access to the capital markets, which while "normal," cannot be guaranteed in times of tight credit.

Graphical Relationship, Earnings and Dividends (per share)



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

Dividend Cushion Cash Flow Bridge Evaluation

The Dividend Cushion Cash Flow Bridge, shown in the image to the right, illustrates the components of the Dividend Cushion ratio and highlights in detail the many drivers behind it. CyrusOne'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.

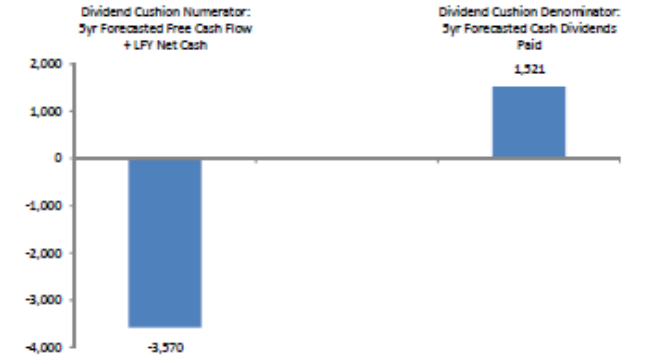
Raw, Unadjusted Dividend Cushion Cash Flow Bridge - Raw

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, CyrusOne'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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