Valuentum Securities, Inc. 9/1/2020 Edition 3, Volume 9

HIGH YIELD DIVIDEND NEWSLETTER

CyrusOne is a High-Quality Data Center REIT

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

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"AT&T INC (T), ONE OF OUR HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO HOLDINGS, IS ONCE AGAIN CONSIDERING DIVESTING ITS DIRECTV BUSINESS ACCORDING TO REPORTS IN THE WSJ. WE WILL UPDATE OUR MEMBERS ON THE STORY AS NEW INFORMATION MATERIALIZES."

– CALLUM TURCAN

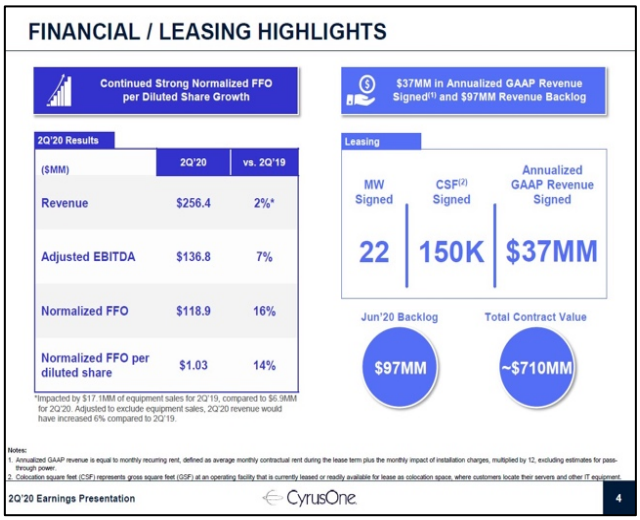


Image Shown: *CyrusOne Inc's financials and near-term growth outlook held up well during the ongoing pandemic, all things considered.* ***Image Source:*** *CyrusOne Inc – Second Quarter of 2020 IR Earnings Presentation*

By Callum Turcan

One of the newest additions to our High Yield Dividend Newsletter portfolio is CyrusOne Inc (CONE), a data center real estate investment trust ('REIT'). Demand for data centers has been extremely strong during the ongoing coronavirus ('COVID-19') pandemic as employees are often working from home (driving up demand for productivity programs which in turn is driving up data consumption worldwide) while demand for data-hungry video streaming services has surged. **Over the long haul, we like the outlook for the industry, and more broadly, we prefer companies supported by secular growth tailwinds.**

Shares of CONE yield ~2.5% on a forward-looking basis as of this writing after management pushed through a 2% per share sequential dividend increase during CyrusOne's second quarter earnings report (growing the REIT's quarterly per share payout to $0.51 from $0.50 previously). Though shares of CONE carry a more modest yield compared to traditional high yield plays, we view its dividend growth trajectory quite favorably.

When factoring in CyrusOne's apparent ability to tap equity markets for funds (a task made easier by the strong technical performance of CONE seen year-to-date), we give the REIT an adjusted Dividend Cushion ratio of 2.0 which earns CyrusOne a "GOOD" Dividend Safety rating. For reference, the numerator in our Dividend Cushion ratio is the REIT's forecasted free cash flows over the next five full fiscal years, while the denominator is the REIT's forecasted dividend obligations during this period. Balance sheet considerations are also factored in (with net cash added to the numerator and vis-versa for net debt). Please note those proprietary metrics assume CyrusOne pushes through decent per-share dividend increases on an annual basis over the coming years, which is why we give the REIT a "GOOD" Dividend Growth rating.

Quarterly Update

CyrusOne reported second-quarter 2020 earnings on July 29 that saw the REIT's normalized funds from operations ('FFO') per share grow by 14% year-over-year, hitting $1.03. The REIT's total normalized FFO grew by 16% year-over-year while its weighted-average common shares outstanding grew by 2% year-over-year during this period. While FFO is an imperfect metric, it gives REIT investors a baseline when analyzing the trajectory of a REIT's financial performance, and **we strongly appreciate CyrusOne's resilience during the initial phases of COVID-19.**

Management reiterated CyrusOne's previous guidance for 2020 during the firm's latest earnings report for every key item except development-related (or growth-related) capital expenditures. CyrusOne increased its capital expenditure expectations for 2020 to capitalize on the REIT's improving growth outlook which we will cover in just a moment. In the upcoming graphic at the top of this page on the right-hand side, please note CyrusOne forecasts it will generate $3.75-$3.90 in normalized FFO per share this year, up from $3.63 in 2019. As an aside, CyrusOne's current full-year guidance calls for marginally less revenue and adjusted EBITDA than forecasted in February 2020 (the REIT has adjusted its 2020 guidance at least a couple times this year so far), though its normalized FFO per share forecast remained the same.

REVISED 2020 GUIDANCE

Category ($MM except for Normalized FFO)	Previous 2020 Guidance	Current 2020 Guidance
Total Revenue	$1,010 - 1,045	$1,010 - 1,045
Lease and Other Revenues from Customers	$865 - 890	$865 - 890
Metered Power Reimbursements	$145 - 155	$145 - 155
Adjusted EBITDA	$525 - 550	$525 - 550
Normalized FFO per diluted common share	$3.75 - 3.90	$3.75 - 3.90
Capital Expenditures	$750 - 850	$850 - 950
Development[1]	$735 - 830	$835 - 930
Recurring	$15 - 20	$15 - 20

Note:
1. Development capital expenditures include the acquisition of land for future development.

2Q'20 Earnings Presentation CyrusOne 17

Image Shown: *CyrusOne is confident in its near-term financial trajectory, which we appreciate given the hurdles created by the ongoing pandemic.* ***Image Source:*** *CyrusOne – Second Quarter of 2020 IR Earnings Presentation*

CyrusOne's leasing activity has been quite favorable this year. The REIT noted during its latest earnings call that it experienced strong lease pricing on enterprise deals as it moved deeper into the "hyperscale" side of the data center space (generally speaking, these are deals often signed with very large cloud computing service providers). Management noted that "leasing was well diversified across markets and industry verticals [last quarter], which has also been a long-term trend and reflects the broad appeal of our platform. Hyperscale companies accounted for 72% of revenue signed in the quarter" and **we would like to stress here that the REIT's apparent lease pricing strength during a pandemic highlights how important CyrusOne's asset base is as it concerns supporting the digital economy.**

Additionally, management mentioned that "nearly 90% of leases signed had an interconnection component" last quarter which was "driven by a couple of factors: the first being the expansion of ecosystems within our data centers, resulting in additional demand for cross connect." **Scale in the data center industry brings about new revenue generating opportunities**, with CyrusOne's interconnection revenues growing by 15% year-over-year in the second quarter (the REIT's GAAP revenues were up 2% year-over-year during this period). For reference, interconnection services provides data centers access to multiple internet service providers ('ISP') and a direct physical contact point between servers. The REIT highlights its strong leasing performance last quarter in the upcoming graphic at the top of the next page (on the left-hand side).

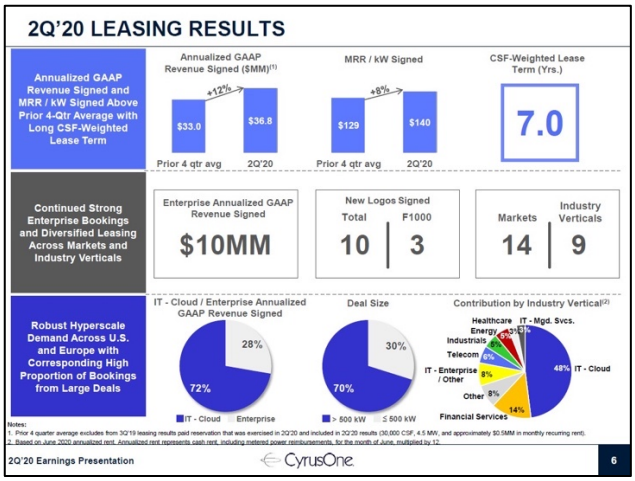
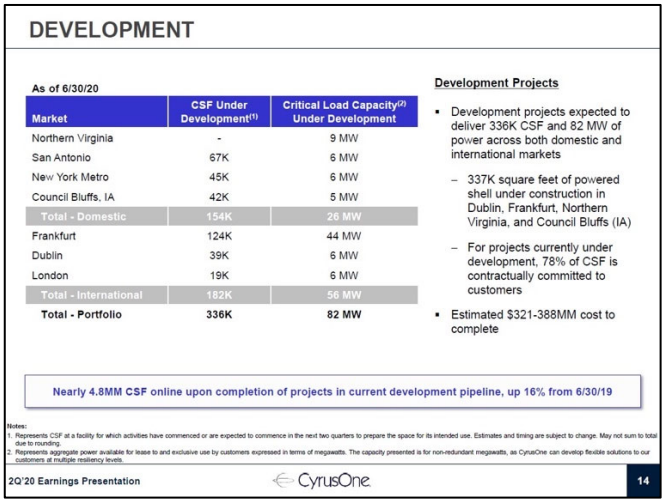


Image Shown: *CyrusOne had plenty of success signing leases at favorable rates with large enterprises last quarter.* ***Image Source:*** *CyrusOne – Second Quarter of 2020 IR Earnings Presentation*

Growth

As mentioned previously, CyrusOne recently boosted its development-related capital expenditure expectations for 2020. Management cited strong leasing activity seen during the first half of the year for justifying the move. In the upcoming graphic down below, CyrusOne highlights the various projects the REIT is working on. **CyrusOne is focused on establishing and growing its presence major metropolitan markets in the US and Western Europe.** Additionally, CyrusOne is pursuing projects in Council Bluffs, Iowa. Please note Council Bluffs is home to some of Alphabet Inc's (GOOG) (GOOGL) Google segment's data center operations, which has been steadily growing in the region over the past decade.



Market	CSF Under Development(1)	Critical Load Capacity(2) Under Development
Northern Virginia	-	9 MW
San Antonio	67K	6 MW
New York Metro	45K	6 MW
Council Bluffs, IA	42K	5 MW
Total - Domestic	154K	26 MW
Frankfurt	124K	44 MW
Dublin	39K	6 MW
London	19K	6 MW
Total - International	182K	56 MW
Total - Portfolio	**336K**	**82 MW**

- Development projects expected to deliver 336K CSF and 82 MW of power across both domestic and international markets
  - 337K square feet of powered shell under construction in Dublin, Frankfurt, Northern Virginia, and Council Bluffs (IA)
  - For projects currently under development, 78% of CSF is contractually committed to customers
- Estimated $321-388MM cost to complete

Notes:
1. Represents CSF at a facility for which activities have commenced or are expected to commence in the next two quarters to prepare the space for its intended use. Estimates and timing are subject to change. May not sum to total due to rounding.
2. Represents aggregate power available for lease to and exclusive use by customers expressed in terms of megawatts. The capacity presented is for non-redundant megawatts, as CyrusOne can develop flexible solutions to our customers at multiple resiliency levels.

Image Shown: *An overview of CyrusOne's development portfolio.*
Image Source: *CyrusOne – Second Quarter of 2020 IR Earnings Presentation*

In the upcoming graphic down below, CyrusOne highlights that most of the collocation space ('CSF') under development had already been pre-leased as of the end of June 2020. This provides for greater clarity on the trajectory of CyrusOne's financials and underpins its growth strategy (the REIT can grow its asset base knowing that there are tenants out there ready to start paying rent and other fees as soon as its projects are completed).

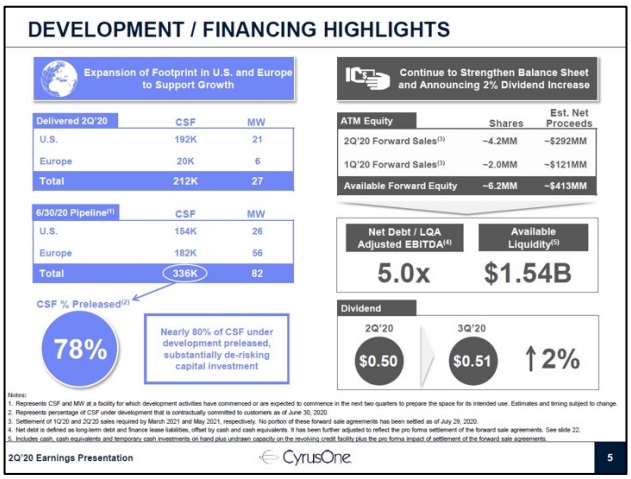


Image Shown: *CyrusOne had already preleased the majority of its collocation space under development as of the end of June 30, 2020.*
Image Source: *CyrusOne – Second Quarter of 2020 IR Earnings Presentation*

Financing Concerns

As a REIT, CyrusOne has not historically been free cash flow positive. From 2017 to 2019, CyrusOne used a combination of net operating cash flows, equity issuances, and debt issuances to cover its hefty capital expenditures and dividend obligations. CyrusOne must retain constant access to capital markets at (ideally) attractive rates to keep making good on its dividend obligations and its growth ambitions. In January 2020, the operating partnership of CyrusOne and its wholly-owned financing subsidiary issued out €0.5 billion in 1.450% senior Euro notes due 2027, highlighting its ability to tap debt markets at attractive rates.

Please note that most of CyrusOne's capital expenditures are spent on projects relating to growing its asset base as its reoccurring (or maintenance) capital expenditures represent just a sliver of its total capital investments. For instance, the REIT forecasts that its 2020 maintenance-related capital expenditures will represent just 2% of its total capital investments at the midpoint of guidance. In the upcoming graphic on the top of the next page on the right-hand side, we highlight the nature of CyrusOne's cash flows and financing needs, with key line-items underlined in red.

CYRUSONE INC.
Consolidated Statements of Cash Flows

IN MILLIONS For the Year Ended December 31,	2019	2018	2017
Cash flows from operating activities:			
Net income (loss)	$ 41.4	$ 1.2	$ (83.5)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	417.7	334.1	258.9
Provision for bad debt expense	1.7	2.6	0.2
Unrealized gain on marketable equity investment	(65.6)	(9.9)	—
Realized gain on marketable equity investment	(66.7)	—	—
Foreign currency and derivative losses, net	7.5	—	—
Proceeds from swap terminations	3.6		
Loss on asset disposals	0.4	—	—
Impairment loss on real estate	0.7	—	58.0
Loss on early extinguishment of debt	71.8	3.1	36.5
Interest expense amortization, net	5.0	4.0	4.2
Stock-based compensation expense	16.7	17.5	14.7
Deferred income tax benefit	(7.5)	—	—
Operating lease cost	20.3	—	—
Other	0.2	(0.6)	1.5
Change in operating assets and liabilities:			
Rent and other receivables, net and other assets	(74.2)	(80.2)	(64.3)
Accounts payable and accrued expenses	(0.8)	3.0	29.3
Deferred revenue and prepaid rents	15.6	34.5	34.0
Operating lease liabilities	(22.1)	—	—
Net cash provided by operating activities	365.7	309.3	289.5
Cash flows from investing activities:			
Investment in real estate	(876.4)	(865.7)	(914.5)
Asset acquisitions, primarily real estate, net of cash acquired	—	(462.8)	(482.3)
Proceeds from sale of equity investments	199.0	—	—
Equity investments	(3.8)	(12.6)	(100.0)
Proceeds from the sale of real estate assets	1.3	—	—
Net cash used in investing activities	(679.9)	(1,341.1)	(1,506.8)
Cash flows from financing activities:			
Issuance of common stock, net	357.2	699.6	705.7
Dividends paid	(210.4)	(181.1)	(145.7)
Proceeds from revolving credit facility	656.7	688.3	1,037.3
Repayments of revolving credit facility	(182.5)	(647.4)	(1,275.0)
Proceeds from unsecured term loan	—	1,300.0	350.0
Repayments of unsecured term loan	(200.0)	(900.0)	—
Proceeds from senior notes	1,197.4	—	1,217.8
Repayments of senior notes	(1,200.0)	—	(474.8)
Payment of debt extinguishment costs	(72.0)	—	(30.0)
Payment of deferred financing costs	(9.4)	—	(16.7)
Payments on finance lease liabilities	(2.9)	(9.5)	(9.8)
Interest paid by lenders on issuance of the senior notes	—	—	2.7
Tax payment upon exercise of equity awards	(9.3)	(5.2)	(6.9)
Net cash provided by financing activities	324.8	944.7	1,354.6
Effect of exchange rate changes on cash, cash equivalents and restricted cash	2.7	(0.4)	—
Net increase (decrease) in cash, cash equivalents and restricted cash	13.3	(87.5)	137.3
Cash, cash equivalents and restricted cash at beginning of period	64.4	151.9	14.6
Cash, cash equivalents and restricted cash at end of period	$ 77.7	$ 64.4	$ 151.9

Image Shown: *CyrusOne has historically tapped both equity and debt markets for funds to cover its growth spend while making good on its dividend obligations.* ***Image Source:*** *CyrusOne – 2019 Annual Report*

During the first half of 2020, CyrusOne utilized its at-the-market ('ATM') equity issuance program and forward equity sales to raise funds. In the upcoming graphic down below, CyrusOne notes it had a little over $0.4 billion in "remaining proceeds available" at the end of June 2020 through its forward equity sales.

CyrusOne Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (unaudited)
(in millions of dollars, except per share)

The following table represents a summary of forward sale of equity of our common stock for the six-month period ended June 30, 2020 (in thousands):

Offering Program	Forward Shares Sold/(Settled)	Net Proceeds Received	Remaining Proceeds Available[1]
Total as of December 31, 2019	**1.6**	**$ —**	**$ 96.5**
March 9, 2020 Forward Offering - Sales	2.0	—	123.4
May 13, 2020 Forward Offering - Sales	1.4	—	98.7
May 26, 2020 Forward Offering - Sales	1.4	—	98.7
May 29, 2020 Forward Offering - Sales	1.4	—	98.7
November 29, 2019 Forward Offering settlement	(1.6)	96.5	(96.5)
Total as of June 30, 2020	**6.2**	**$ 96.5**	**$ 419.5**

(1) As of June 30, 2020, the total estimated proceeds, net of adjustments for (i) a floating interest rate factor equal to a specified daily rate less a spread, (ii) the forward purchasers' stock borrowing costs and (iii) scheduled dividends adjustments is $413.2 million subject to further adjustment when the forward offerings are settled as described above.

Image Shown: *CyrusOne uses forward equity sales to fund its growth spend and for other financing needs.* ***Image Source:*** *CyrusOne – 10-Q SEC filing covering the Second Quarter of 2020*

CyrusOne also has a $3.0 billion unsecured revolving credit facility that is made up of a term loan that matures March 2023 (with the option for two one-year extensions), a revolving credit line that matures March 2024 (with the option for one 12-month extension), and a term loan that matures March 2025. The terms of these facilities were amended back in March 2020. At the end of June 2020, the firm had ~$1.1 billion in total remaining borrowing capacity on its revolving credit facility, all of which was available through its revolving credit line due March 2024.

In the upcoming graphic down below, **CyrusOne highlights that the REIT does not have any meaningful amounts of debt coming due until 2024**, assuming extension options are utilized.

STRONG BALANCE SHEET / DIVIDEND INCREASE

Key Credit Highlights

Gross Asset Value[1]: ~$8.0B ↑13% vs. 6/30/19

Net Debt[1] to LQA Adj. EBITDA: 5.0x | 4.9x Ex. ASC 842

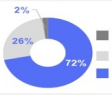
Weighted Avg. Remaining Debt Term: 5.9 years

No debt maturities until Nov'24[2]

Available Liquidity[3]: $1.54B

% Unsecured[4]: 100%

Capital Structure



ATM Equity

Equity to manage leverage in targeted range with forward equity to fund requirements

	Shares	Est. Net Proceeds
2Q'20 Forward Sales[6]	~4.2MM	~$292MM
1Q'20 Forward Sales[6]	~2.0MM	~$121MM
Total Forward Equity	**~6.2MM**	**~$413MM**

Long-Term Debt

L-T Debt	Amt. ($MM)	Interest Rate	Maturity Date
Revolver - EUR[7]	89.8	E+100 bps	Mar'25[2]
Revolver - GBP[8]	37.0	G+100 bps	Mar'25[2]
Revolver - USD[9]	203.0	L+100 bps	Mar'25[2]
Term loan[10,11]	1,100.0	L+120 bps	Mar'25[2]
USD senior notes	600.0	2.900%	Nov'24
EUR senior notes[12]	561.5	1.450%	Jan'27
USD senior notes	600.0	3.450%	Nov'29
Total[13]	$3,191.3	2.05%[14]	

Dividend Increase

2Q'20 $0.50 → 3Q'20 $0.51 ↑2%

Notes:
1. Gross asset value is defined as total assets plus accumulated depreciation. Net debt is defined as long-term debt and finance lease liabilities, offset by cash and cash equivalents. It has been further adjusted to reflect the pro forma impact of settlement of the forward sale agreements. The estimated impact of the adoption of ASC 842 on adjusted EBITDA for the last quarter annualized is $15.8MM. Please refer to slide 22 of this presentation for reconciliation of Net debt.
2. Assuming exercise of 12-month extension option on revolving credit facility and exercise of two 12-month extension options on $400MM term loan tranche.
3. Includes cash, cash equivalents and temporary cash investments on hand plus undrawn capacity on the revolving credit facility plus the pro forma impact of settlement of the forward sale agreements.
4. Excludes finance lease liabilities of $28.8MM.
5. Based on 6/30/20 closing price of $72.75.
6. Forward sales agreements with an aggregate sales price of $292MM and $121MM settled by March 2021 and May 2021, respectively. No portion of these forward sale agreements has been settled as of July 29, 2020.
7. EUR amount outstanding is USD equivalent of 650MM. Interest rate based on EURIBOR. Interest rate as of 6/30/20: 1.00%.
8. GBP amount outstanding is USD equivalent of 130MM. Interest rate based on GBP LIBOR. Interest rate as of 6/30/20: 1.10%.
9. Interest rate based on USD LIBOR. Interest rate as of 6/30/20: 1.16%.
10. $500MM of $1,100MM synthetically converted into 645.1MM pursuant to USD-EUR cross currency swap; $300MM swapped pursuant to USD floating to fixed interest rate swap.
11. Interest rate as of 6/30/20: 1.36%; weighted average interest rate pursuant to swaps: 1.40%.
12. Amount outstanding is USD equivalent of 650MM.
13. Excludes adjustment for deferred financing costs and unamortized bond discounts.
14. Weighted average interest rate calculated using lower interest rate on swapped amount.

2Q'20 Earnings Presentation — CyrusOne — 15

Image Shown: *CyrusOne's financial position is strong and the REIT had ample access to liquidity at the end of June 2020.* ***Image Source:*** *CyrusOne – Second Quarter of 2020 IR Earnings Presentation*

At the end of June 2020, CyrusOne had $0.1 billion in cash and cash equivalents on hand versus $3.2 billion in total debt (inclusive of short-term debt and finance lease liabilities). We appreciate that the REIT has access to ample liquidity and that the firm does not have a significant amount of debt maturing for several years, providing it with ample flexibility to ride out the storm while still making major growth investments. Here is what management had to say regarding CyrusOne's financing needs and overall financial position during the REIT's latest earnings call:

> *"…During the second quarter, we executed forward sales through our ATM equity program, resulting in nearly $300 million in proceeds upon ultimate settlement. Combined with our first quarter ATM forward sales, we have a total of $413 million in available forward equity.*
>
> *On a pro forma basis, inclusive of the impact of this equity, our net debt to last quarter annualized EBITDA is five times and we have more than $1.5 billion in available liquidity including our undrawn revolver balance. With the projects in our development pipeline having a total completion cost of approximately $350 million at the midpoint, we have significant runway to fund potential capital requirements in support of leasing well into next year.*
>
> *During the quarter, we settled the forward-sale agreement that we entered into in the fourth quarter of 2019 and this resulted in net proceeds of approximately $97 million, which were used to pay down a portion of the amounts outstanding on our unsecured revolving credit facility." --- Diane Morefield, CFO of CyrusOne*

The data center REIT reported that its revenue backlog at the end of the second quarter of 2020 stood at $0.1 billion which was the "highest quarter-end backlog in the company's history and positions us very well for continued growth into 2021 and thereafter." We appreciate CyrusOne's strong performance during the initial phase of the pandemic. However, we caution that in 2019, Microsoft Corporation (MSFT) represented 21% of its revenues, highlighting its customer concentration risk.

On one final note, the REIT announced that Diane Morefield, CyrusOne's CFO, is stepping down with an effective retirement date of March 2021 during its latest earnings report. This move does not appear to reflect concerns with CyrusOne's outlook.

Concluding Thoughts

Shares of CONE have performed very well year-to-date and are up 28% as of this writing, before taking dividend considerations into account. We continue to like CyrusOne as a holding in our High Yield Dividend Newsletter portfolio. Additionally, Digital Realty Trust Inc (DLR) is another high-quality data center REIT that we include in our newsletter portfolios.

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

Philip Morris International Posts Solid Guidance, Cuts Costs

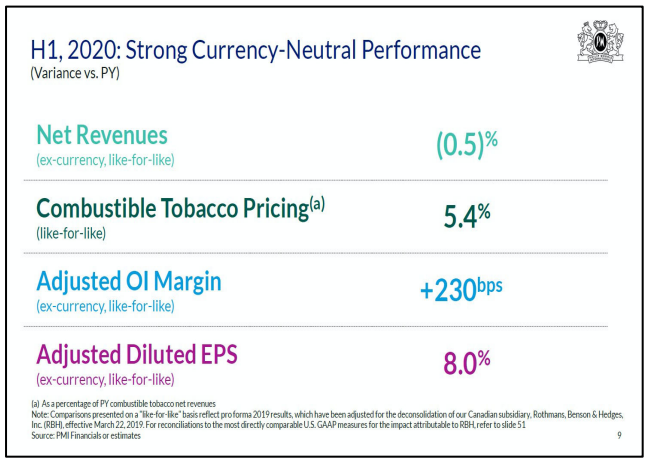


Image Shown: *Excluding foreign currency headwinds, Philip Morris International Inc's financials held up relatively well during the first half of 2020, all things considered with an eye towards the pandemic.* ***Image Source:*** *Philip Morris International Inc – Second Quarter of 2020 IR Earnings Presentation*

By Callum Turcan

The ongoing coronavirus ('COVID-19') pandemic has severely stressed consumer spending in countries all over the globe, and that includes spending on cigarettes and other tobacco products. For a major tobacco company like Philip Morris International Inc (PM), this dynamic weighs negatively on its near-term outlook, though the company is well-positioned to ride out the storm for several reasons. We continue to like Philip Morris International as a holding in the High Yield Dividend Newsletter portfolio, and shares of PM yield ~5.9% as of this writing.

Philip Morris International's dividend coverage on a forward-looking basis is decent and supported by its optimistic guidance (a rebound is expected during the second half of 2020), growing demand for its heated tobacco offerings (such as IQOS, which is not an acronym), high quality cash flow profile, ongoing access to capital markets at attractive rates (particularly debt markets), pricing power at its traditional cigarette brands (such as Marlboro), and its ample liquidity position at the end of June 2020.

However, **we caution that Philip Morris International's large net debt load, while manageable, weighs negatively against its dividend coverage strength.** We give Philip Morris International a "GOOD" Dividend Safety rating which factors in modest per share payout growth and expected future free cash flows over the next five full fiscal years, along with its large net debt load.

Strong Guidance with Caveats

Management expects Philip Morris International's financial performance will rebound in the second half of 2020 after taking a hit during the first half of the year (highlighted in the upcoming graphic down below), as communicated during the firm's second quarter 2020 earnings report published July 21.

H2, 2020: Gradual Underlying Improvement

EPS Growth Expected to Skew to Q4

Q3	• Sequential underlying improvement in net revenues and adjusted EPS • Performance impacted by: – Reversal of certain H1 effects – Phasing of certain S,G&A investments – Timing of 2020 pricing in certain markets • Adjusted EPS broadly in line with Q2
Q4	• Expect growth in adjusted EPS, further sequential improvement in net revenues: – Assume further underlying recovery in many markets – Stepped-up cost efficiencies to have greater impact

Source: PMI Financials or estimates

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Image Shown: *Philip Morris International expects to generate modest adjusted non-GAAP EPS growth this year on a currency neutral basis.* ***Image Source:*** *Philip Morris International – Second Quarter of 2020 IR Earnings Presentation*

First, some background. Please note Philip Morris International sells Marlboro-branded cigarettes outside the US (after getting spun out of Altria Group Inc [MO] back in March 2008) along with other tobacco products (such as the heated tobacco IQOS offering and other cigarette brands). **Excluding the US and China, Philip Morris International expects the global tobacco market will shrink by approximately 7%-9% this year.**

In particular, Philip Morris International expects duty free sales will be weak this year due to a decline in international travel, and weak in Indonesia as well due to a new pricing mechanism getting rolled out (minimum retail selling price requirements are expected to go into full effect by September 2020 at the earliest). These dynamics along with a general reduction in tobacco sales worldwide due to the pandemic are expected to play a leading role in pushing Philip Morris International's total shipment volumes down by 8%-10% this year, according to the company's forecasts.

Even with these headwinds in mind, Philip Morris International still expects to grow its non-GAAP adjusted diluted EPS this year versus 2019 levels when excluding foreign currency headwinds. **Please note that foreign currency headwinds are expected to be very material this year, which is why we always take adjusted guidance with a grain of salt.** Excluding foreign currency headwinds and other factors, Philip Morris International expects to grow its non-GAAP diluted EPS by 2%-5% this year as you can see in the upcoming graphic down below. **This growth is expected to be made possible by a sharp rebound in its financial performance by the fourth quarter of 2020.**

2020: EPS Guidance

($/share)

	Full-Year		
	2020 Forecast	2019	Adjusted Growth
Reported Diluted EPS	$4.84 to $4.99	$4.61	
- Tax items		(0.04)	
- Asset impairment and exit costs	0.04	0.23	
- Canadian tobacco litigation-related expense		0.09	
- Loss on deconsolidation of RBH		0.12	
- Russia excise and VAT audit charge		0.20	
- Fair value adjustment for equity security investments	0.04	(0.02)	
Adjusted Diluted EPS	$4.92 to $5.07	$5.19	
- Net earnings attributable to RBH		(0.06) [a]	
Adjusted Diluted EPS	$4.92 to $5.07	$5.13 [b]	
- Currency	0.31		
Adjusted Diluted EPS, excluding currency	$5.23 to $5.38	$5.13 [b]	2% to 5%

(a) Net reported diluted EPS attributable to RBH from January 1, 2019 through March 21, 2019
(b) Pro forma
Source: PMI Financials or estimates

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Image Shown: *Philip Morris International expects to generate modest adjusted non-GAAP EPS growth this year on a currency neutral basis.* ***Image Source:*** *Philip Morris International – Second Quarter of 2020 IR Earnings Presentation*

On a currency neutral basis, Philip Morris International expects its revenues will decline modestly this year, though when excluding its duty free and Indonesian operations the firm sees its revenues growing modestly this year.

Breaking this down, what the company appears to be communicating to investors is that outside of its duty free and Indonesian operations, and foreign currency headwinds, Philip Morris International's performance is holding up quite well in the face of the pandemic. Please note that those headwinds are material and cannot simply be swept under the rug, though we appreciate what management is attempting to communicate to investors.

Philip Morris International's outlook is supported by a few things including its dominant market position (the firm controls ~28% of the global tobacco market outside of the US and China), ability to push through price increases due to the inelastic nature of tobacco demand, and ongoing cost control measures. **Management is targeting $1.0 billion in annualized savings by 2021 through manufacturing cost reductions via productivity improvements and SG&A expense reductions.** Philip Morris International noted it was on track to achieving those cost savings during its latest earnings call.

During the first half of 2020, Philip Morris International's 'marketing, administration, and research costs' dropped by over 9% year-over-year. **Meaningful expense reductions allowed for the company's GAAP operating income to climb higher by over 5% though its GAAP revenues tumbled by a bit under 5% during this period.** We see a lot of potential for Philip Morris International to significantly improve its cash flow profile by keeping a lid on operating costs. The firm's GAAP net income rose by just under 3% during the first half of 2020

on a year-over-year basis, which we appreciate given the headwinds created by the pandemic.

Innovating in an Old Market

Where Philip Morris International is having the most success in terms of volume growth is at its heated tobacco segment. In particular, Philip Morris International's IQOS offering has been selling very well and winning over new users (generally users who previously smoked traditional cigarettes). During the second quarter of 2020, while Philip Morris International's cigarette shipment volumes were down 17.6% year-over-year, **its heated tobacco unit ('HTU') shipment volumes were up 24.3% year-over-year.** In total, the company's cigarette and HTU shipment volumes were down 14.5% year-over-year last quarter.

IQOS was designed and is marketed towards smokers of traditional cigarettes looking for a different way to consume tobacco and nicotine.

The IQOS offering should not be conflated with other non-traditional tobacco products that were allegedly targeted towards teens. On July 7, the US Food and Drug Administration ('FDA') gave Philip Morris Products permission to market IQOS as a "reduced exposure" product. Here is what management had to say on the issue during Philip Morris International's latest earnings call (emphasis added):

> *"We reached a truly historic milestone for IQOS, our mission and our future growth prospect on July 7 with the FDA's authorization of IQOS as a modified risk tobacco product. IQOS is the first electronic nicotine product to receive an MRTP [modified risk tobacco product] order. Following a review of our extensive scientific evidence package, the agency found that an exposure modification order for IQOS is appropriate to promote the public health in the United States, demonstrating that IQOS is fundamentally different product from combustible cigarette and a better choice for adults who would otherwise continue to smoke. The agency concluded that issuing the order for IQOS is expected to benefit the health of the population as a whole taking into account both user of tobacco product and person who do not currently use tobacco product.*
>
> *A critical enabler for the future growth of RRPs [reduced risk products] is the implementation of differentiated regulatory framework that can help encourage adults who would otherwise continue to smoke to instead switch to better alternatives, in line with the harm reduction principle. The authorization allows a version of IQOS to be marketed with information confirming the validity of our scientific studies with regard to the significant reduction of exposure to the harmful and potentially harmful chemicals contained in cigarette smoke. The FDA decision and subsequent comprehensive post-market controls and monitoring, focusing on use prevention provide an important example of how government and public health organization around the world can implement an inclusive, science-based approach to help rapidly shift adult smokers who would otherwise continue smoking to better options while simultaneously guarding against unintended consequences."*

Philip Morris International has a licensing agreement with Altria to market IQOS in the US, which has been slowly rolled out in the country. In the upcoming graphic at the top of this page on the left-hand side, Philip Morris International provides an overview of its IQOS product's growth trajectory in terms of its user base. Please note the growing percentage of the IQOS user base that were previously smokers of traditional cigarettes before transitioning to the heated tobacco offering.

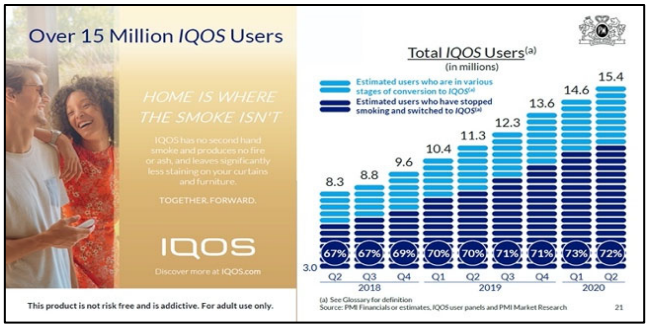

Image Shown: *IQOS continues to post steady user base growth which lends a tremendous amount of support to Philip Morris International's financial outlook, given the ongoing secular decline of traditional cigarette volumes in many markets.* ***Image Source:*** *Philip Morris International – Second Quarter of 2020 IR Earnings Presentation*

HTUs accounted for over 10% of Philip Morris International's total shipment volumes during the first half of 2020. Additionally, please note reduced risk products ('RRPs') represented almost a quarter of the firm's net revenues during the second quarter of 2020. As this segment becomes a larger part of its company-wide operations, **the firm could offset declining volumes of traditional cigarette shipments with shipments of HTU-related products.** Here is some key management commentary from the company's latest earnings call (emphasis added):

> *[Philip Morris International] delivered a robust performance in the first half of the year despite the unprecedented circumstances of the pandemic. Most importantly, the continued momentum of IQOS was*

excellent with an estimated 15.4 million users at the end of the second quarter. ***Our commercial model pivoted rapidly to digital and remote engagements, while preserving high rates of IQOS' user acquisition and brand retention.*** *With volumes of heated tobacco units growing 24% in Q2 2020 compared to the prior year, RRPs made up almost one quarter of our net revenues.*

In addition, after two very difficult months in the quarter due to the pandemic, our combustible business is now improving. Industry volumes started to recover in June and the beginning of July, reflecting the gradual easing of confinement in many countries. *The improvement was particularly driven by the EU, our largest region in term of net revenue and adjusted operating income. The main enduring headwinds linked to COVID-related restrictions are the absence of recovery in duty-free; and in Indonesia, where this is compounded by pricing dynamics. Economic uncertainty remains and we all hope for no major resurgence of the pandemic… [Continued on next page]*

[Continued from previous page] …the recovery of industry volume in June, notably in the higher-margin EU region, benefited our net revenues and margin. Second, IQOS user acquisition grew substantially in the same month with markets such as Russia back to pre-COVID rate and overall IQOS acquisition for the quarter only 35% below pre-pandemic levels…

…We expect a gradual underlying improvement in the combustible business coupled with continued robust growth for IQOS. The pandemic continues to present an uncertain operating environment with a potential for tightened restriction in localized areas. While not included in our guidance assumption, there also remain a non-negligible risk of a resurgence in the virus and the return of national lockdowns. The full economic fallout of the various restriction is also unclear."

Please note that Philip Morris International's guidance does not factor in the very real risk that a resurgence of COVID-19 infections in various regions could see quarantine efforts put back into place. That being said, we remain optimistic that one of a number of "shots on goal" will see a viable and safe COVID-19 vaccine or effective cure gets discovered relatively soon.

Before covering Philip Morris International's key financial updates, please take a look at the upcoming graphic down below. The company highlights the growing importance of its RRP business, which includes its IQOS offerings, with the segment's revenues growing from an immaterial part of its business back in 2014-2016 to a very material part of its business by the start of 2020. **Philip Morris International's financial outlook is supported by its ability to innovate in one of the oldest industries in the world (the tobacco industry), which underpins our confidence in its future cash flow generation potential.**

Image Shown: *Philip Morris International's RRP operations are steadily becoming a significant part of its overall business.* ***Image Source:*** *Philip Morris International – Second Quarter of 2020 IR Earnings Presentation*

Financial Update

In its 10-Q SEC filing covering the second quarter of 2020, the firm noted it had $29.6 billion in total debt at the end of June 2020 (including $2.6 billion in short-term debt) versus $4.2 billion in cash and cash equivalents. Its net debt to adjusted EBITDA ratio was ~2.0x at the end of this period (keeping in mind the company's adjusted EBITDA generation will likely improve going forward assuming the global economy continues to reopen and rebound) according to its 8-K SEC filing covering the second quarter of 2020.

Philip Morris International forecasts that it will generate at least $9.0 billion in net operating cash flow this year, and additionally, management expects the company will invest ~$0.7 billion towards capital expenditures in 2020. In 2019, Philip Morris International spent $7.2 billion covering its dividend obligations and generated $9.2 billion in free cash flow ($10.1 billion in net operating cash flow less $0.9 billion in capital expenditures). The firm did not repurchase a significant amount on share repurchases during this period, and historically, Philip Morris International has not bought back a significant amount of its stock or issued out a significant amount of stock.

It appears Philip Morris International expects it will continue being very free cash flow positive this year, in part due to its low capital expenditure requirements (the company does not need to make

major capital investments to generate meaningful revenues). The company forecasts its capital expenditures will fall moderately in 2020 versus 2019 levels. Given its high quality cash flow profile and ongoing access to capital markets, highlighted by Philip Morris International's ability to issue $0.75 billion in 1.125% Notes due 2023, $0.75 billion in 1.500% Notes due 2025, and $0.75 billion in 2.100% Notes due 2030 at the start of May 2020, we see the company's net debt load as manageable.

As of February 6, 2020, Philip Morris International had high quality investment grade credit ratings (A2/A/A). On top of the significant amount of cash and cash equivalents Philip Morris International had on hand at the end of June 2020 ($4.2 billion), the firm's liquidity position is further supported by $8.0 billion in total borrowing capacity under several revolving credit lines.

On a final note, please note the stable nature of Philip Morris International's market share in the global tobacco industry (excluding the US and China) in the upcoming graphic at the top of the next page on the left-hand side, which supports its ability to push through price increases.

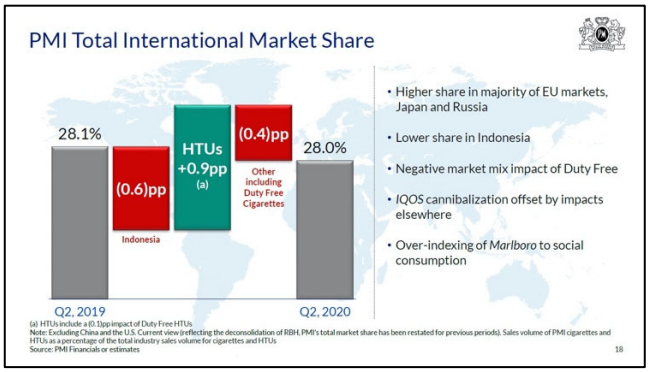

Image Shown: *We appreciate Philip Morris International's ability to maintain its market share in the global tobacco industry, excluding markets in the US and China.* ***Image Source:*** *Philip Morris International – Second Quarter of 2020 IR Earnings Presentation*

Concluding Thoughts

We continue to like Philip Morris International as a holding in our High Yield Dividend Newsletter portfolio and view its forward-looking dividend coverage as solid due to its impressive cash flow profile. While we would prefer the company chip away at its net debt load using its internally generated free cash flows to do so, that burden appears manageable as things stand today. **Philip Morris International is well-positioned to ride out the storm, and we appreciate management's cost cutting program.**

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

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

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

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

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

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

High Yield Spotlight: Healthcare Services Group Inc (HCSG) is a Diamond in the Rough

Our **High Yield Spotlight Idea for September 2020** is Healthcare Services Group Inc (HCSG)—3.9% yield—which provides laundry, housekeeping, dining, and nutrition services to healthcare providers in the US. That includes skilled nursing facilities, assisted living facilities, and hospitals. We like the impressive rebound in its financial performance over the past few years and the firm's resilience during the initial phases of the ongoing coronavirus ('COVID-19') pandemic. Though COVID-19 still poses a significant risk to its business, largely by negatively impacting the ability for its clients to pay for services rendered, elective surgeries have resumed in earnest in many US states and the CARES Act provided a large cash infusion to the domestic healthcare system (along with other benefits).

In 2019, 'Housekeeping' services generated ~49% of Healthcare Services Group's annual revenues while 'Dietary' services generated ~51% of its annual revenues. Healthcare Services Group generated ~16% of its 2019 revenues from Genesis HealthCare, indicating there is a level of customer concentration risk though replacing Healthcare Service Group's operations on short notice is no easy task. Healthcare Service Group operates in 48 states with a heavy focus on the Eastern half of the country, though the firm does have a significant presence along the West Coast as well as you can see in the upcoming graphic down below.

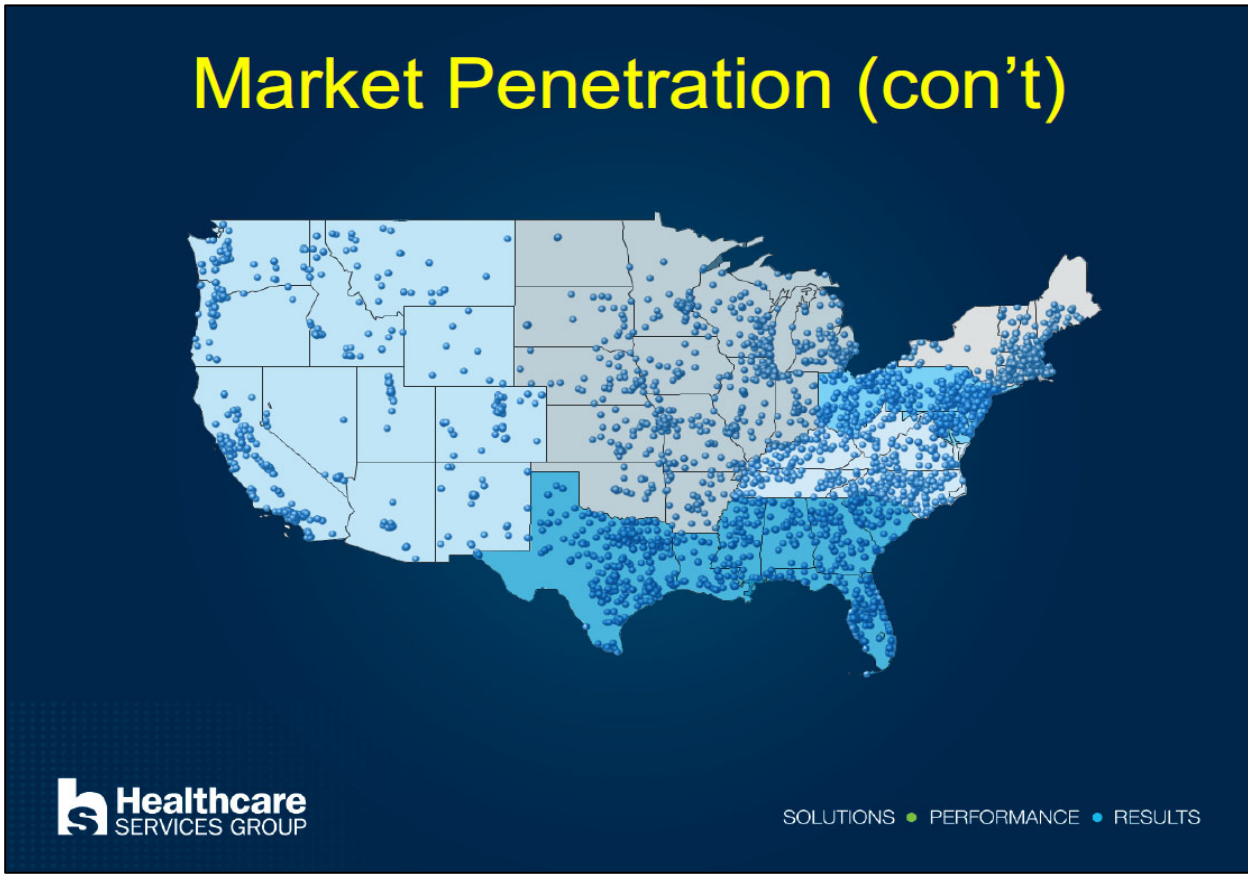

Image Shown: *An overview of Healthcare Services Group's asset base.* ***Image Source:*** *Healthcare Services Group – Second Quarter of 2020 IR Earnings Presentation*

As things stand today, Healthcare Services Group provides services to over 3,000 healthcare facilities. **The biggest market for Healthcare Services Group is hospitals, which is why the resumption of elective surgeries is especially important.** Elective surgeries are the big money makers for hospitals, meaning that if those surgeries can resume on an ongoing basis, the financial health of Healthcare Services Group's client base should improve significantly (generally speaking). This helps ensure Healthcare Services Group can continue getting paid in a timely manner. In the upcoming graphic down below, Healthcare Services Group provides an overview of its operational focus.

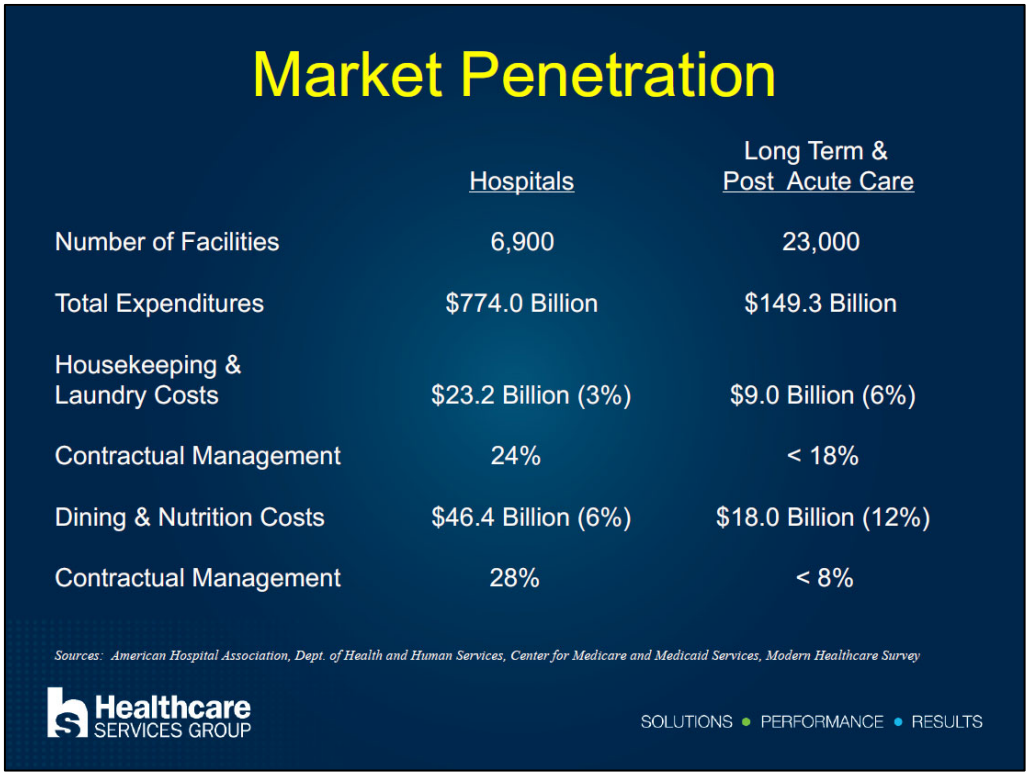

Image Shown: *Healthcare Services Group's biggest addressable market is hospitals.* ***Image Source:*** *Healthcare Services Group – Second Quarter of 2020 IR Earnings Presentation*

From 2017 to 2019, Healthcare Services Group experienced a stellar recovery in its cash flow profile. The company's net operating cash flows grew from $8 million to $94 million while its capital expenditures edged modestly lower during this period. **That allowed for Healthcare Services Group's annual free cash flows to grow to levels that fully covered its annual dividend obligations**, as you can see in the upcoming graphic down below. Please note that the firm has not historically repurchased a significant amount of its stock.

Year	2017	2018	2019
Net Operating Cash Flow	7,630	80,031	93,581
Capital Expenditures	5,397	4,940	4,368
Free Cash Flow	2,233	75,091	89,213
Dividend Payments	55,244	57,201	58,951
FCF Less Dividend Payments	-53,011	17,890	30,262

Image Shown: *Healthcare Services Group posted a sharp improvement in its free cash flows from 2017 to 2019 which we appreciate.* ***Image Source:*** *Author, with data from Healthcare Services Group's 2019 Annual Report*

Looking ahead, Healthcare Services Group should be able to maintain its strong cash flow profile, keeping risks posed by the ongoing pandemic in mind. During the first half of 2020, the firm generated $91 million in free cash flow while spending $30 million covering its dividend obligations. Please note that the company benefited from a favorable working capital movement relating to the deferral of payroll tax payments made possible through the CARES Act, which bolstered its net operating cash flows by approximately $15 million in the second quarter. Management expects this dynamic will continue to benefit the firm's cash flow profile over the next two quarters, though we caution that those taxes eventually need to get paid. As has been the case in the past, Healthcare Services Group did not repurchase a significant amount (or any) of its stock during the first half of 2020.

At the end of June 30, 2020, Healthcare Services Group had $170 million in cash, cash equivalents, and current marketable securities on hand with no debt on the books. **Its pristine balance sheet is an immense source of strength during these harrowing times and represents another key reason why we view the firm's dividend coverage on a forward-looking basis quite favorably.** The upcoming graphic down below showcases Healthcare Services Group's net cash position, which could be used as a source of funds to make good on its dividend obligations, though its free cash flows have held up well in the face of the pandemic.

Healthcare Services Group, Inc.
Consolidated Balance Sheets
(in thousands, except per share amounts)
(Unaudited)

	June 30, 2020	December 31, 2019
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 78,109	$ 27,329
Marketable securities, at fair value	92,318	90,711
Accounts and notes receivable, less allowance for doubtful accounts of $74,882 and $45,726 as of June 30, 2020 and December 31, 2019, respectively	295,261	340,930
Inventories and supplies	33,677	36,517
Prepaid expenses and other assets	24,176	20,245
Total current assets	523,541	515,732
Property and equipment, net	28,558	28,820
Goodwill	51,084	51,084
Other intangible assets, less accumulated amortization of $21,383 and $19,300 as of June 30, 2020 and December 31, 2019, respectively	20,270	22,353
Notes receivable — long–term portion, less allowance for doubtful accounts of $9,104 and $6,667 as of June 30, 2020 and December 31, 2019, respectively	41,868	46,992
Deferred compensation funding, at fair value	37,217	37,247
Deferred income taxes	34,150	20,364
Total assets	$ 736,688	$ 722,592
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	$ 59,369	$ 54,418
Accrued payroll, accrued and withheld payroll taxes	50,494	36,413
Other accrued expenses	13,904	16,489
Borrowings under line of credit	—	10,000
Income taxes payable	20,922	8,075
Accrued insurance claims	24,806	23,256
Total current liabilities	169,495	148,651
Accrued insurance claims — long-term portion	68,212	64,366
Deferred compensation liability	37,211	37,621
Lease liability — long-term portion	12,083	11,649
Commitments and contingencies (Note 15)		
STOCKHOLDERS' EQUITY:		
Common stock, $0.01 par value; 100,000 shares authorized; 75,732 and 75,557 shares issued, and 74,421 and 74,149 shares outstanding as of June 30, 2020 and December 31, 2019, respectively	757	756
Additional paid-in capital	277,482	270,614
Retained earnings	176,268	195,455
Accumulated other comprehensive income, net of taxes	4,042	2,919
Common stock in treasury, at cost, 1,311 and 1,408 shares as of June 30, 2020 and December 31, 2019, respectively	(8,862)	(9,439)
Total stockholders' equity	449,687	460,305
Total liabilities and stockholders' equity	$ 736,688	$ 722,592

Image Shown: *Healthcare Services Group retained a pristine balance sheet as of June 30, 2020, with its cash-like line-items underlined in red up above. Please note the firm did not have any debt on the books at the end of this period.* ***Image Source:*** *Healthcare Services Group – 10-Q SEC filing covering the second quarter of 2020 with additions from the author*

In the short-term, the company's management team is taking a caution approach to growth and the operating environment in general given the disruptions caused by COVID-19. Until a COVID-19 vaccine is discovered, and we are encouraged by the progress being made at the many "shots on goal," Healthcare Services Group will continue to operate in a capricious environment.

The company reported that its GAAP revenues during the first six months of 2020 fell by 4% year-over-year, hitting $901 million, though its GAAP operating income rose by 79% year-over-year during this period, hitting $55 million. Healthcare Services Group's top-line faced pressures due to the negative impact COVID-19 is having on its customer base, and **management responded by trimming expenses which we really appreciate.** Both 'costs of services provided' and SG&A expenses moved lower year-over-year during this period.

Demographic tailwinds, namely the "greying of America" and the expected growth in the 80+ age category in the US (both in nominal terms and as a percent of the total population), are expected to support demand for the company's services with an eye towards assisted living facilities and skilled nursing facilities. Healthcare Services Group's management team had this to say on the company's long-term outlook during the firm's latest earnings call (emphasis added):

> *"As we continue to navigate this crisis we will continue to assess the impact of COVID-19 on our business and our industry including the trends we're seeing with regard to lower census and increased cost.* ***It's important to recall that prior to the onset of the pandemic sector fundamentals were improving*** *on the heels of positive trends around occupancy, reimbursement and lease costs and while COVID-19 has presented the industry with its share of near-term challenges we've been very encouraged by the swift and decisive federal and state agency actions to financially support providers in combating this crisis and we continue to see that support be put to good use on the front lines.* ***We believe that due to its needs-based nature and multi-decade demographic tailwind the industry's pre-pandemic state of more favorable operating trends will return post pandemic."***
> *--- Theodore Wahl, President and CEO of Healthcare Services Group*

Healthcare Services Group has marginally raised its per share dividend every quarter of this year so far, indicating management is confident in the firm's near-term outlook. From the end of 2019 to August 2020, the firm's per share payout grew by about 2%. Since initiating divided payments back in 2003, **Healthcare Services Group has increased its per share payout 68 quarters in a row.**

For reference, the company stopped paying out common dividends in the early-1990s (from 1989 to 1991, the firm had an annual common dividend program according to data from its website). Given that Healthcare Services Group and the landscape it operates in has changed significantly since the early-1990s, we see management's ongoing commitment to income seeking investors as sustainable and likely to continue going forward. Here is what management had to say on the issue during the firm's latest earnings call (emphasis added):

> *"We're pleased with the ongoing strength of our balance sheet and the ability to support the business while continuing to return capital to HCSG shareholders. We announced yesterday that the Board of Directors approved an increase in the dividend to $0.20375 per share payable on September 25, 2020.*
>
> ***The cash flows and cash balances supported and with the dividend tax rate in place for the foreseeable future the tax dividend program continues to be the most tax efficient way to get free cash flow and ultimately maximize return to the shareholders.*** *This will mark the 69th consecutive cash dividend payments since the program was instituted in 2003 and the 68th consecutive quarterly increase that's now a 17-year period that's included four 3-for-2 stock splits.* *[Continued on next page]*

[Continued from previous page] We recognize the dividend is important to our shareholders and we've increased it in line with our performance track record." --- Matthew McKee, Chief Communications Officer of Healthcare Services Group

We like Healthcare Services Group's pristine balance sheet, quality cash flow profile, commitment to its dividend policy, and its long-term outlook. During the initial phases of the pandemic, the company's financials held up relatively well and we expect that Healthcare Services Group's strong financial performance will continue going forward. If new headwinds arise or existing headwinds grow stronger, Healthcare Services Group can utilize its net cash position to keep making good on its dividend obligations. Longer term, Healthcare Services Group's outlook is very promising due to favorable demographic changes supporting demand for its services. The company's extensive geographic reach in the US should allow for the firm to continue growing its client base over time, though the pandemic has created short-term headwinds on this front.

Image Shown: *An overview of Healthcare Services Group's growth strategy.* ***Image Source:*** *Healthcare Services Group – Second Quarter of 2020 IR Earnings Presentation*

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

European Bank Earnings Roundup

In alphabetical order by ticker: BNPQF, DB, LYM, SAN, UNCRY

By Matthew Warren

BNP Paribas is One of the Stronger Banks in an Overtraded European Landscape

While some of the stronger global banks like BNP Paribas are showing that they can take the economic fallout from COVID-19 on the chin while maintaining some degree of earnings power and protecting strong capital levels, other banks with lesser earnings power and balance sheets are falling prey to this cycle with losses and lower capital levels. From our perspective, it is simply easier to find non-bank operating companies with strong moats, sound balance sheets, and visible free cash flow growth into the future. Be careful investing in banks!

On July 31, BNP Paribas (BNPQF) put up a reasonable set of results in the second quarter, considering the global pandemic's substantial impact on the economy. As you can see in the upcoming graphic down below, group revenues were actually up 4%, but net income was down 6.8% due to substantially higher cost of risk (bad loans expected). The bank managed very impressive cost control so far this year, which bodes well for results on the other side of the pandemic.

Group BNP Paribas – 1H20

€m	2Q20	2Q19	2Q20 / 2Q19	1Q20	2Q20 / 1Q20	1H20	1H19	1H20 / 1H19
Group								
Revenues	**11,675**	**11,224**	**+4.0%**	**10,888**	**+7.2%**	**22,563**	**22,368**	**+0.9%**
Operating Expenses and Dep.	-7,338	-7,435	-1.3%	-8,157	-10.0%	-15,495	-15,884	-2.4%
Gross Operating Income	**4,337**	**3,789**	**+14.5%**	**2,731**	**+58.8%**	**7,068**	**6,484**	**+9.0%**
Cost of Risk	-1,447	-621	n.s.	-1,426	+1.5%	-2,873	-1,390	n.s.
Operating Income	**2,890**	**3,168**	**-8.8%**	**1,305**	**n.s.**	**4,195**	**5,094**	**-17.6%**
Share of Earnings of Equity-Method Entities	130	180	-27.8%	95	+36.8%	225	314	-28.3%
Other Non Operating Items	106	29	n.s.	395	-73.2%	501	652	-23.2%
Non Operating Items	**236**	**209**	**+12.9%**	**490**	**-51.8%**	**726**	**966**	**-24.8%**
Pre-Tax Income	**3,126**	**3,377**	**-7.4%**	**1,795**	**+74.2%**	**4,921**	**6,060**	**-18.8%**
Corporate Income Tax	-746	-795	-6.2%	-411	+81.5%	-1,157	-1,462	-20.9%
Net Income Attributable to Minority Interests	-81	-114	-28.9%	-102	-20.6%	-183	-212	-13.7%
Net Income Attributable to Equity Holders	**2,299**	**2,468**	**-6.8%**	**1,282**	**+79.3%**	**3,581**	**4,386**	**-18.4%**
Cost/income	**62.9%**	**66.2%**	**-3.3 pt**	**74.9%**	**-12.0 pt**	**68.7%**	**71.0%**	**-2.3 pt**

- Very positive jaws effect
- Operating expenses include for €1,284m almost all taxes and contributions for the year (including in particular the contribution to the Single Resolution Fund) under IFRIC 21 "Taxes" standard[1]
- Corporate Income tax: average tax rate 24.6% in 1H20 (21,5% in 1H19)
- Operating divisions:

(1H20 vs. 1H19)	At histocoral scope & exchange rates	At constant scope & exchange rates
Revenues	**+1.1%**	**+1.9%**
Operating expenses	0.0%	0.0%
Gross operating income	**+3.2%**	**+5.9%**
Cost of risk	+103.0%	+107.6%
Operating income	**-20.6%**	**-18.1%**
Pre-tax income	**-20.0%**	**-17.2%**

1. See slide 78

BNP PARIBAS The bank for a changing world Second quarter 2020 results | 44

Image Shown: *BNP Paribas's second quarter results held up better than many global bank peers.* ***Image Source:*** *BNP Paribas 2Q2020 Earnings Presentation*

With a return on tangible equity of about 8% in the quarter, it is clear that BNP Paribas is one of the better banks in Europe in terms of financial metrics. In part, this is due to how global the bank actually is, operating in geographies around the world. It is also important to note that the bank benefitted from a standout performance by its Corporate and Institutional Banking Unit in the quarter, which is expected to (and management guided to) taper off going forward. Essentially, bank customers around the world issued a lot of equity, bonds, and convertibles in the second quarter in order to add liquidity to their balance sheets and term out their debt maturities, so as to reduce risk. This bonanza especially accrued to the stronger global investment banks (IBs), most of which are domiciled in the United States, but BNP is one of the strongest IBs in Europe, which you can see in the upcoming graphic down below. **Segment revenues were up 33.1% in the quarter and pre-tax income was up a whopping 50%. As this activity normalizes, BNP and other global banks will count on their loan loss provisioning to come down in order to put up better numbers as we move through the economic cycle.**

Corporate and Institutional Banking – 1H20

€m	2Q20	2Q19	2Q20 / 2Q19	1Q20	2Q20 / 1Q20	1H20	1H19	1H20 / 1H19
Revenues	**4,123**	**3,099**	**+33.1%**	**2,953**	**+39.7%**	**7,076**	**6,107**	**+15.9%**
Operating Expenses and Dep.	-2,220	-1,997	+11.2%	-2,393	-7.2%	-4,612	-4,459	+3.4%
Gross Operating Income	**1,904**	**1,102**	**+72.7%**	**560**	**n.s.**	**2,463**	**1,648**	**+49.5%**
Cost of Risk	-319	-24	n.s.	-363	-12.1%	-682	-56	n.s.
Operating Income	**1,585**	**1,078**	**+47.0%**	**197**	**n.s.**	**1,781**	**1,591**	**+11.9%**
Share of Earnings of Equity-Method Entities	-3	5	n.s.	3	n.s.	0	7	n.s.
Other Non Operating Items	6	-25	n.s.	2	n.s.	7	-26	n.s.
Pre-Tax Income	**1,587**	**1,058**	**+50.0%**	**202**	**n.s.**	**1,789**	**1,572**	**+13.8%**
Cost/Income	53.8%	64.4%	-10.6 pt	81.0%	-27.2 pt	65.2%	73.0%	-7.8 pt
Allocated Equity (€bn)						24.3	21.3	+14.2%

- **Revenues: +15.9% vs. 1H19**
  - Growth in all three business lines: Global Markets (+23.1%), Corporate Banking (+12.9%) and Securities Services (+7.7%[1])
  - Strong increase in volumes driven by the meeting of clients' specific, crisis-related needs (financing, interest-rate and currency hedges, reallocation of resources, etc.)
- **Operating expenses: +3.4% vs. 1H19**
  - Contained increase in connection with the strong growth in business
  - Highly positive jaws effect due to cost-saving measures
- **Cost of risk: strong increase vs. 1H19**
  - Impact in particular of ex-ante provisioning of expected losses on the cost of risk and some specific files
- **Allocated equity: +14.2% vs. 1H19**
  - Increase related to the very strong growth in activity and volumes, as well as impact of the market volatility on risk-weighted assets computation

1. Excluding the positive impact of a specific transaction in 2Q19

BNP PARIBAS The bank for a changing world Second quarter 2020 results | 68

Image Shown: BNP Paribas Corporate and Institutional Banking had a stellar quarter. **Image Source:** BNP Paribas 2Q2020 Earnings Presentation

Concluding Thoughts

While some of the stronger global banks like BNP Paribas are showing that they can take the economic fallout from COVID-19 on the chin while maintaining some degree of earnings power and protecting strong capital levels, other banks with lesser earnings power and balance sheets are falling prey to this cycle with losses and lower capital levels. Some US banks like Wells Fargo (WFC) and Capital One (COF) have cut dividends and all the largest US banks have cut out share buybacks as a group decision (we think likely influenced by regulators behind closed doors). European banks have cut out all share buybacks and dividends as a result of pressure from the European Central Bank.

Aside from pressure on capital returns to shareholders, banks around the world are also being pressured to make government-backed loans to consumers and businesses and offering moratoriums on payments in many cases. Only time will tell how these moratoriums will play out in terms of ultimate migration into bad loans. The reality is that only the highest quality banks are investible, and even then it is hard to double down during a financial crisis, when one doesn't know how high the flood will ultimately crest. From our perspective, it is simply easier to find non-bank operating companies with strong moats, sound balance sheets, and visible free cash flow growth into the future.

Deutsche Bank is Muddling Along, Aiming for Self Help

Q2 2020 Group financial highlights
In € m, unless stated otherwise

		Q2 2020	Change in % vs. Q2 2019	Change in % vs. Q1 2020
Revenues	Revenues	6,287	1	(1)
	Revenues ex specific items(1)	6,269	3	(0)
Costs	Noninterest expenses	5,367	(23)	(5)
	Adjusted costs ex. transformation charges(2)	4,923	(8)	(10)
Profitability	Profit (loss) before tax	158	n.m.	(23)
	Adjusted profit (loss) before tax (3)	419	(1)	39
	Profit (loss)	61	n.m.	(7)
	RoTE (%)(4)	(0.6)	23.7 ppt	(0.3) ppt
Risk and Capital	Provision for credit losses (bps of loans)(5)	69	54 bps	25 bps
	CET1 ratio (%)	13.3	(16) bps	42 bps
	Leverage ratio (%, fully loaded)	4.2	24 bps	20 bps
Per share metrics	Diluted earnings per share (in €)	(0.15)	(91)	n.m.
	Tangible book value per share (in €)	23.31	(5)	0

(1) Specific items detailed on slide 33
(2) Transformation charges of € 95m in Q2 2020, € 351m in Q2 2019 and € 84m in Q1 2020
(3) Detailed on slide 36
(4) Throughout this presentation post-tax return on tangible shareholders' equity is calculated on net income after AT1 coupons. Tangible shareholders' equity Q2 2020: € 49.4bn, Q2 2019: € 53.8bn and Q1 2020: € 49.7bn
(5) Q2 2020 provision for credit losses annualized as % of loans gross of allowances for loan losses (€ 442bn as of 30 Jun 2020), 57bps of loans annualizing H1 2020 provision for credit losses

Deutsche Bank
Investor Relations
Q2 2020 results
29 July 2020
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Image Shown: *Deutsche Posted Meager Second Quarter Results.* ***Image Source:*** *Deutsche Bank 2Q2020 Earnings Presentation*

While Deutsche Bank is working on a five-pillar self-help plan with the goal of an 8% return on tangible equity by 2022, and seems to be making some progress on these fronts, the fact that the end goal is so timid shows just how overbanked the German and greater European markets are. The CEO is calling for consolidation in the medium term, but it cannot come fast enough, especially for those banks with very little in the way of earnings power, which must deal with a pandemic and the broad effect on the economy and the client base in the meantime.

Deutsche Bank (DB) posted an unimpressive set of second-quarter results July 29, though the bank seems to be making some progress on its self-help initiatives. Revenue was up 1% versus last year thanks to booming investment banking results, but profits were only $61 million euros in the quarter. As one can see in the graphic above, there simply is not much earnings power under the hood at this bank (diluted earnings per share was negative in the quarter).

The upcoming graphic down below shows it was Deutsche Bank's Investment Bank that saved the performance in quarter, with revenue up 46% versus last year and nearly one billion euro of profit before tax. Unfortunately, this profitability was largely washed away by the Private Bank segment's loss as well as the Capital Release unit's loss. **This bank is not firing on all cylinders!**

Investment Bank
In € m, unless stated otherwise

		Q2 2020	Change in % vs. Q2 2019	Change in % vs. Q1 2020
Revenues	Revenues	2,654	46	13
	Revenues ex. specific items(1)	2,639	52	15
Costs	Noninterest expenses	1,329	(14)	(10)
	of which: Adjusted costs ex. transformation charges(2)	1,284	(7)	(12)
Profitability	Profit (loss) before tax	956	n.m.	54
	Adjusted profit (loss) before tax(3)	984	n.m.	64
	RoTE (%)(4)	11.5	9.2 ppt	3.8 ppt
Balance sheet (€ bn)	Loans(5)	80	15	(9)
	Leverage exposure	492	7	(7)
Risk	Risk weighted assets (€ bn)	129	7	(4)
	Provision for credit losses (bps of loans)(6)	182	156 bps	70 bps

Q2 2020 year-on-year comments
- Revenues significantly higher on strong client flows and market conditions
- Progress on strategic priorities: continued client re-engagement and IT application decommissioning
- Non-interest expenses declined on the absence of litigation expenses and adjusted cost reductions
- Adjusted costs excluding transformation charges lower driven by front office headcount reductions in 2019 and lower internal service cost allocations
- Repayment of client credit facilities drove reduction in leverage exposure and risk weighted assets in the quarter, partly offset by higher Market Risk RWA on higher volatility
- Significantly higher provision for credit losses primarily driven by COVID-19 related impairments

(1) Specific items detailed on slide 33
(2) Transformation charges of € 28m for Q2 2020, and € 14m for Q1 2020
(3) Detailed on slide 36
(4) Post-tax return on tangible shareholders' equity applying a 28% tax rate. Allocated tangible shareholders' equity Q2 2020: € 22.3bn, Q2 2019: € 21.5bn and Q1 2020: € 21.3bn
(5) Loans gross of allowances for loan losses
(6) Q2 2020 provision for credit losses annualized as % of loans (gross of allowances for loan losses), 152bps of loans annualizing H1 2020 provision for credit losses

Deutsche Bank
Investor Relations
Q2 2020 results
29 July 2020
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Image Shown: *Deutsche Bank Investment Bank Revenues were up 46% versus last year.* ***Image Source:*** *Deutsche Bank 2Q2020 Earnings Presentation*

While Deutsche Bank is working on a five-pillar self-help plan with the goal of an 8% return on tangible equity by 2022, and seems to be making some progress on these fronts, the fact that the end goal is so timid shows just how overbanked the German and greater European markets are. The CEO is calling for consolidation in the medium term, but it cannot come fast enough, especially for those banks with very little in the way of earnings power, which must deal with a pandemic and the broad effect on the economy and the client base in the meantime.

Concluding Thoughts

We've grown less and less excited about the prospects of the global banking system following COVID-19. There have been high-profile dividend cuts among the U.S. financials sector to shore up their capital bases, and more recently, the European Central Bank has asked that many of the European banks stop returning capital to shareholders until 2021. These days, the banking system is regulated to the point where the government is making, or at least pressuring many firm-specific decisions. In light of many of the government programs launched to support the economy during this pandemic, especially in the U.S., the banks have largely become extensions of government policy, for better or worse. We generally don't like the banking sector due to regulatory intervention, the arbitrary nature of their cash flows, and their lack of resilience during times of economic crises. We're steering far clear of Deutsche Bank.

Lloyds Banking Group is Struggling Against the Tide

Lloyds Banking Group's business model focused on being a "digitized, simple low risk, customer focused, U.K. financial services provider" sounds good on the surface, but uncertainty surrounding the U.K's recovery makes this bank much more risky than some of its U.S. counterparts, in our view. Investors should take note the inherent leverage and riskiness of any banking business model, and Lloyds is no exception.

On July 30, Lloyds Banking Group (LYG) reported a dismal set of results for the first half of 2020. Net income was down 16% and statutory profit after tax was only GBP 19 million. Revenues came under pressure due to lower rates and lesser customer activity, while the provision for loan losses put a huge dent in the bottom line. The bank benefited a bit from its prior investments across digital, and the company was active in participating in government-backed stimulus programs during the period.

Classification: Public

Performance impacted by lower rates, activity and economic outlook deterioration

LLOYDS BANKING GROUP

Net income	£7.4bn (16)%
Cost:income ratio (incl. remediation)	52.3% +6.4pp
Pre-provision operating profit[1]	£3.5bn (26)%
Impairment	£3.8bn
Statutory profit after tax	£19m
Statutory return on tangible equity	0.1% (11.4)pp
TNAV	51.6p (1.4)p
CET1 ratio	14.6%

- Net income of £7.4bn, down 16%, NIM of 2.59% impacted by rates and mix, other income of £2.5bn impacted by customer activity
- Total costs of £3.9bn, 4% lower, with BAU costs down 6%; cost:income ratio of 52.3%
- H1 2020 pre-provision operating profit of £3.5bn; business model provides significant loss absorbing capacity
- Impairment of £3.8bn, with £2.4bn in Q2, primarily reflecting updated economic outlook; significantly increasing reserves
- Statutory profit after tax of £19m
- TNAV of 51.6p driven by movements in pension surplus
- Balance sheet strength maintained with CET1 ratio of 14.6% including transitionals (13.4% excluding transitionals), up 81bps and accompanied by lower capital requirement

1 – Also described as Trading surplus in other documents.

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Image Shown: *Lloyds' first half results were pretty dismal indeed.* ***Image Source:*** *Lloyds 1H2020 Earnings Presentation*

Impairments were GBP 2.388 Billion in the second quarter versus GBP 1.430 Billion in the first quarter of this year, showing the increased sequential pressure on the P&L statement. Management is guiding for the full year impairment to be GBP 4.5 Billion to GBP 5.5 Billion, so a sequential improvement on a quarterly basis from here. This of course will depend on how the economy and the pandemic progresses from this point, which is hard for anyone to predict.

Per its slide deck (and as we have heard from other companies), the "economy is starting to return to growth alongside easing of lockdown measures." In particular, Lloyds noted that it was seeing a bounce during July in the areas of consumer spending and housing market activity, though it did note that the commercial recovery has been slower. Looking ahead to full-year 2020 numbers, the bank expects its net interest margin to remain "broadly stable," resulting in an annual measure of c.250 basis points.

Concluding Thoughts

Some of the stronger global banks are handling the difficulties surrounding COVID-19 quite well, but other banks are suffering with losses and lower capital levels. Lloyds Banking Group falls somewhere in the middle as it has strong capital levels, but little earnings power at this point during the economic cycle. Its business model focused on being a "digitized, simple low risk, customer focused, U.K. financial services provider" sounds good on the surface, but uncertainty surrounding the U.K's recovery makes this bank much more risky than some of its U.S. counterparts, in our view. Investors should take note the inherent leverage and riskiness of any banking business model, and Lloyds is no exception.

Santander Working Its Way Through the Pandemic

The underlying first-half results from Banco Santander are quite reasonable. We are impressed by how well the South American, Corporate & Investment Banking, and Wealth Management & Insurance segments are holding up in such a tough environment. In its large European operations, pressures that come from the whole continent being overbanked were evident, however.

On July 29, Banco Santander (SAN) reported first-half 2020 results. The bank is working its way through the pandemic, with total income down 8% in the first half and underlying attributable profit down 53%. While it took massive goodwill write downs in the quarter, these do not affect its capital levels, which are healthy and growing since last quarter end. As one can see in the upcoming graphic down below, loan loss provisions are the foremost cause of decline in underlying profits.

We delivered strong net operating income performance (+2% in constant euros), though profit affected by COVID-19 related provisions

EUR mn	H1'20	H1'19	% change Euros	% change Constant Euros
Net interest income	16,202	17,636	-8	0
Net fee income	5,136	5,863	-12	-4
Other income	1,180	937	26	26
Total income	22,518	24,436	-8	0
Operating expenses	-10,653	-11,587	-8	-2
Net operating income	11,865	12,849	-8	2
Loan-loss provisions[1]	-7,027	-4,313	63	78
Other results	-997	-957	4	12
Underlying PBT	3,841	7,579	-49	-44
Net capital gains and provisions	-12,706	-814	-	-
Attributable profit	-10,798	3,231	-	-
Underlying attributable profit[2]	1,908	4,045	-53	-48

Resilient customer revenue even with lower business activity

Strong performance in CIB in the quarter

Accelerating the reduction in our cost base

LLPs impacted by COVID-19 charges

Impairments arising from the deterioration of the macroeconomic scenario related to COVID-19

Santander

(1) Provisions overlay in Q1 was included in the net capital gains and provisions line, but has now been allocated by country in this line (LLPs).
(2) Excluding net capital gains and provisions

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Image Shown: *Santander's underlying attributable profit is down 53% in the first half of this year compared to last year.* ***Image Source:*** *Santander 2Q2020 Earnings Presentation*

While loan loss provisions are up substantially, non-performing assets are more "flattish," as a significant amount of loans are facing moratoria at the moment. While the bank is trying to make prudent assumptions regarding the ultimate loss content in these loans, it will ultimately depend on how the macro economy shakes out--which of course depends on how the pandemic plays out in coming months and years.

As we saw last quarter and again this quarter as one can see in the upcoming graphic down below, **the bank's South American operations continue to hold up better than many other geographies around the world. Santander's position in Brazil is quite impressive indeed. Even though it is facing more stringent regulations regarding overdraft-type loans, the bank is still able to put up a 17% return on tangible return on tangible common equity in the country.**

Group net operating income growth supported by our geographic and business diversification

H1'20 (vs. H1'19)	Net operating income (EUR mn)	Underlying attributable profit (EUR mn)	Contribution to Group's Underlying profit
Europe	4,314 -10%	1,075 -54%	35%
North America	3,301 +2%	617 -29%	20%
South America	5,093 +8%	1,383 -13%	45%
Global businesses			
SCIB	1,683 +32%	928 +23%	Enhancing our local scale with global reach
WM&I	605 +7%	427 +3%	

Santander YoY changes in constant euros
Underlying profit contribution excludes Corporate Centre (EUR -1,125 mn) and Santander Global Platform. South America's weight includes Uruguay & Andean Region (EUR 96 mn)
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Image Shown: *Santander's results were buoyed by South America, the Corporate & Investment Bank, and Wealth Management and Insurance units.* ***Image Source:*** *Santander 2Q2020 Earnings Presentation*

All told, if one looks past the more than $10 Billion EUR goodwill write down in the quarter, the underlying results at Santander are quite reasonable indeed. We are impressed by how well the South American, Corporate & Investment Banking, and Wealth Management & Insurance segments are holding up in such a tough environment. In its large European operations, however, you can see the pressures that come from the whole continent being overbanked.

Unicredit Struggles to Demonstrate Earnings Power

When one looks at individual bank interests and also the national champion nature of many banks that are closely tied to their home countries, it becomes difficult to picture how the overtraded European banking landscape will resolve itself. One scenario is perhaps by smaller banks coming together, though that might not really move the needle that much. We generally dislike the banking industry due to the arbitrary nature of its cash flows, weak economic returns, and highly regulated nature, and we think Unicredit may be one to avoid, in particular.

Unicredit (UNCRY) put up another measly quarter, results released August 6, this time with small positive underlying net profits of EUR 0.5 billion. Revenues were down 7.7% compared to last year's second quarter and underlying net profit was down a whopping 48.7%. As one can see in the upcoming graphic at the start of the next page, underlying return on tangible equity (RoTE) was a meager 4.1% in the quarter, well below the bank's cost of capital.

Underlying net profit of 0.5bn with a significantly improved risk profile

Executive summary – Group key figures

	2Q19	1Q20	2Q20	%Δ vs 1Q20	%Δ vs 2Q19	1H19	1H20	%Δ vs 1H19
Revenues, bn	4.5	4.4	4.2	-4.8%	-7.7%	9.3	8.5	-7.9%
Costs, bn	-2.4	-2.5	-2.4	-2.0%	-0.2%	-5.0	-4.9	-0.4%
CoR, bps	60	104	77	-26	+17	50	91	+40
Gross NPE, bn	34.4	24.9	23.7	-5.0%	-31.2%	34.4	23.7	-31.2%
Gross NPE ratio, %	7.0	4.9	4.8	-0.1p.p.	-2.2p.p.	7.0	4.8	-2.2p.p.
Underlying RoTE[1], %	8.2	-1.2	4.1	+5.4p.p.	-4.1p.p.	8.7	1.4	-7.3p.p.
CET1 MDA buffer, bps	201	436	481[(a)]	+44	+280	201	481[(a)]	+280
Tangible equity, EoP bn	51.1	51.2	51.1	-0.3%	+0.0%	51.1	51.1	+0.0%
Underlying net profit[2], bn	1.0	-0.2	0.5	n.m.	-48.7%	2.2	0.4	-82.9%

(a) Fully loaded. Comparable 2Q20 CET1 MDA transitional buffer 549bps.

6

The end notes are an integral part of this Presentation. See pages 57-63 at the back of this presentation for information related to the financial metrics and defined terms in this presentation

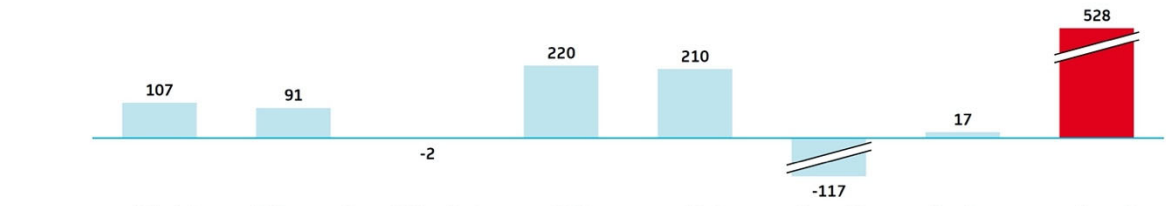
Image Shown: *Summary of Unicredit's 2Q2020 Results:* ***Image Source:*** *Unicredit 2Q2020 Earnings Presentation*

Not only is Unicredit struggling as a group, there are few highlights to speak of. As one can see in the upcoming graphic down below, Central and Eastern Europe ('CEE') was the only segment that came close to generating returns at the cost of capital. The bank is also struggling mightily in its home market of Italy (EWI), a country that has been ravaged by COVID-19. We have high hopes for better days ahead when one of the many vaccine "shots on goal" eventually comes through, however.

Diversified business model underpinning profitability

Group P&L - Underlying net profit

Underlying net profit[1] by division 2Q20, m



	CB Italy (a)	CB Germany (a)	CB Austria (a)	CEE (a)	CIB (a)	Group CC	Non Core	Group (b)
Underlying 1H20 RoAC[2]	2.3%	4.7%	-4.7%	8.0%	3.7%	n.m.	n.m.	

- All divisions except CB Austria returning to profitability already in 2Q20. CB Austria impacted by non recurring items related to financial investments
- CIB and CEE posting solid underlying net profit in the quarter

(a) Underlying 1H20 RoAC excluding IFRS9 macro scenario impairments[3]: CB Italy +7.3%, CB Germany +7.6%, CB Austria -1.1%, CEE +11.7%, CIB +6.4%.

9 (b) For the Group, underlying 1H20 RoTE is +1.4%. Underlying 1H20 Group RoTE excluding IFRS9 macro scenario impairments is +4.9%.

The end notes are an integral part of this Presentation. See pages 57-63 at the back of this presentation for information related to the financial metrics and defined terms in this presentation

Image Shown: *Segment Contribution of Unicredit's 2Q2020 Results.* ***Image Source:*** *Unicredit 2Q2020 Earnings Presentation*

Sadly, the bank's goals, as described by CEO Jean-Pierre Mustier in the quote below from the second-quarter earnings conference call, for return on tangible equity for 2021 of 6%-7% are also quite modest indeed:

> *"**We confirm our underlying net income target for 2021 of €3 billion to €3.5 billion, which is equating to our RoTE of 6% to 7%.** And as already said, we will reinstate our capital distribution plan for 2020 and onward subject to the ECB recommendation being extended targeting a distribution of 50% of underlying net profit."*

This leaves investors counting on better macroeconomic days ahead to drive better returns at the bank, but returns may continue to be weak relative to other more attractive banks, and especially relative to other capital-light industries and high-RONIC-generating powerhouses held within the newsletter portfolios. One must also hope the bank doesn't end up with another portfolio of run-off assets like the ones that it is currently working down.

As to the potential for mergers & acquisitions in European banking, Unicredit's CEO was quite clear on the call that they are not interested. They want to increase their 10-11% Italian banking share via organic growth and want to shrink employees and branches rather than adding to them via M&A.

Concluding Thoughts

When one looks at individual bank interests and also the national champion nature of many banks that are closely tied to their home countries, it becomes difficult to picture how the overtraded European banking landscape will resolve itself. One scenario is perhaps by smaller banks coming together, though that might not really move the needle that much. We generally dislike the banking industry due to the arbitrary nature of its cash flows, weak economic returns, and highly regulated nature, and we think Unicredit may be one to avoid, in particular.

Image Shown: *European banks and their stock prices have been hit hard by the pandemic.*

Disclosure: *Matthew Warren does not own 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%	4.65%
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%	8.49%
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%	6.98%
Crown Castle	CCI	5.0%	2.94%
CyrusOne Inc.	CONE	5.0%	2.44%
CubeSmart	CUBE	5.0%	4.17%
Digital Realty Trust	DLR	5.0%	2.88%
Enterprise Products Partners	EPD	2.5%	10.14%
Magellan Midstream Partners	MMP	2.5%	10.81%
Philip Morris	PM	5.0%	5.87%
Public Storage	PSA	5.0%	3.77%
Cash**	-	0.0%	0.00%
		100.0%	**5.13%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 9/1/2020. 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 9/1/2020)*

*** Reflects federal funds target rate range*

DIVIDEND REPORT PAGE 2 – JM SMUCKER (SJM)

Smucker SJM FAIRLY VALUED

Buying Index™ 3 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Attractive	$82.00 - $124.00	HEALTHY	POOR / 0.3	POOR	3.30%

Assessment of Company Dividend Strategy

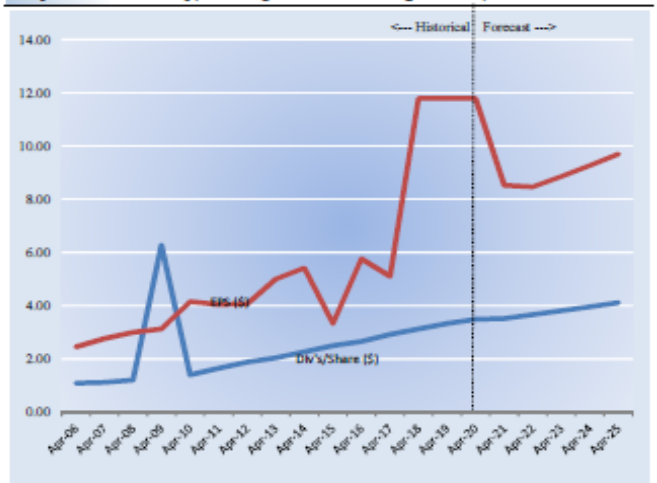
Key Strengths

Smucker's leading brand strength and track record of innovation are core drivers of its business. Since the dividend's inception in 1997, it has never been lowered and has been increased in each of the past ~15 consecutive years thanks to its strong free cash flow generation over the time period. The company has an increased priority to pay off its debt, and repayments should average ~$500 million annually. Smucker's debt/EBITDA is expected to fall from 4.1x in 2015 to 3.0x in 2021 (was 3.3x as of April 2020). While we like management's attention to financial leverage, such a priority has the potential to impact the pace of dividend expansion moving forward. We're keeping a close eye on both its debt load and deleveraging initiatives.

Potential Weaknesses

Smucker's dividend strength is not what it once was due to its inflated debt load related to recent acquisitions. The company recently re-introduced a share repurchase program, and it continues to work to pay down its debt obligations, which has the potential to impact the pace of dividend expansion moving forward. Smucker has stated it isn't changing its dividend policy and plans to maintain its current dividend payout ratio of ~45% of earnings. Smucker relies on an array of commodities to produce its food products. If commodity prices on key inputs were to drastically increase, Smucker could experience headwinds, but none perhaps strong enough to put its dividend in peril.

Graphical Relationship, Earnings and Dividends (per share)

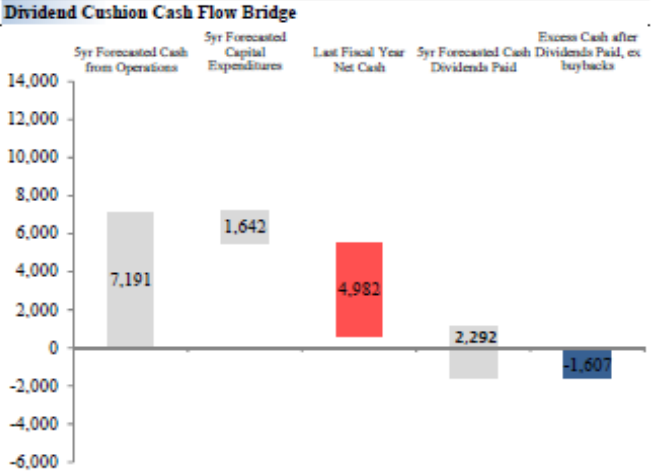


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

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. Smucker'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

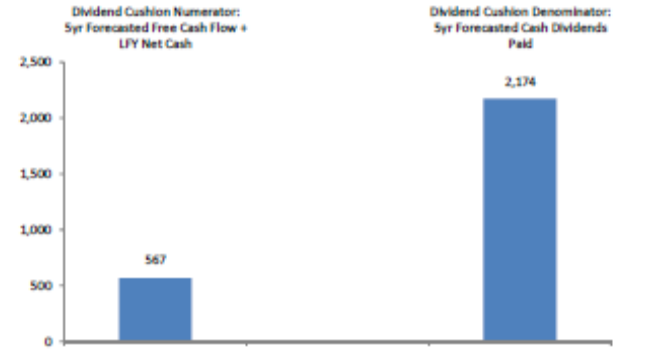


Source: Company Filings, Valuentum Projections

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, Smucker'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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