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HIGH YIELD DIVIDEND NEWSLETTER

Several High-Yielding Stocks Are Looking Pretty Tempting

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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"DURING THE PAST FEW WEEKS, WE HAVE WITNESSED ABNORMAL TRADING ACTIVITY, PARTICULARLY AT HEAVILY-SHORTED STOCKS. WE THINK SYSTEMIC RISKS ARE INCREASING, PARTICULARLY AS LOSSES AT SOME HEDGE FUNDS HAVE REPORTEDLY BEEN STAGGERING. THE DIVERSIFIED NATURE OF THE IDEAS INCLUDED IN THE HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO BETTER ALLOWS INCOME-SEEKING INVESTORS TO RIDE OUT THE STORM."

– CALLUM TURCAN

Image Source: *3M Company – Fourth Quarter of 2020 Earnings IR Presentation*

By Callum Turcan

Before getting into the earnings reports from several interesting high-yielding stocks that reported recently, let's first take a look at a couple reports from stocks in the High Yield Dividend Newsletter portfolio, starting with AT&T Inc's (T)---**7.3% yield**. On January 27, AT&T reported fourth quarter earnings for 2020 that beat both consensus top- and bottom-line estimates. AT&T added 1.5 million net postpaid phone plans and 2.2 million net prepaid phone plans to its 'Communications' operations while its broadband

business added more than 1 million net customers in 2020.

Net subscriber losses at its pay TV division continued last year. Reportedly, AT&T is considering selling off a stake in DirecTV as it seeks to pivot towards growth opportunities and away from offerings in secular decline.

AT&T reported that its total HBO and HBO Max subscriber base stood at almost 61 million worldwide, including roughly 41 million in the US, last quarter. **We appreciate that AT&T is starting to experience strong subscriber growth at its video streaming services** with the firm's fourth quarter earnings press release noting that "HBO Max activations [have doubled] since end of third-quarter 2020." Furthermore, AT&T noted that its video streaming subscriber growth was running well ahead of its internal expectations.

In 2020, AT&T generated a whopping $27.5 billion in free cash flow while spending $15.0 billion covering its dividend obligations. Though AT&T's debt load remains enormous, the company's stellar free cash flow generating abilities makes that burden manageable, in our view. We continue to like exposure to AT&T in our High Yield Dividend Newsletter portfolio.

The coronavirus ('COVID-19') pandemic generated substantial headwinds for the global economy in 2020 and for most businesses large and small, save for many firms operating in the IT sector. However, several large industrial and telecommunications companies are reporting that the outlook for 2021 looks quite bright, relatively speaking, as ongoing vaccine distribution efforts indicate the pandemic will be brought to an end sooner than expected.

3M (MMM) -- Dividend Yield: ~3.4%

The industrial conglomerate 3M Company (MMM) beat both consensus top- and bottom-line estimates when it reported fourth quarter earnings for 2020 on January 26. 3M has a meaningful personal protective equipment ('PPE') business and has raced to keep up with elevated demand due to the COVID-19 pandemic, though demand for some of its other offerings have faced meaningful headwinds of late.

From 2019 to 2020, 3M's GAAP revenues were broadly flat as growth at its 'Safety and Industrial,' 'Health Care' and 'Consumer' business operating segments offset the steep decline seen at its 'Transportation and Electronics' segment. When excluding divestment gains from its operating income, 3M's non-GAAP adjusted operating income rose by 11% year-over-year in 2020 due to gross margin expansion (enabled in part via economies of scale due to its strong organic sales growth) and moderate reductions in its operating expenses.

Looking ahead, 3M aims to grow its total sales by 5%-8% annually in 2021, with annual organic currency-neutral growth forecasted at 3%-6%. The firm expects its EPS will come in between $9.20-$9.75 this year, a meaningful increase from its adjusted non-GAAP EPS of $8.74 in 2020 (3M posted $9.25 in diluted EPS on a GAAP basis in 2020).

In a supplement financial information segment included in its earnings press release, the company noted it generated $6.7 billion in "adjusted" free cash flow in 2020. 3M spent $3.4 billion covering its dividend obligations and $0.4 billion buying back its stock in 2020, both activities of which were fully covered by its adjusted free cash flows. **Management aims for the firm to post a free cash flow conversion rate of 95%-105% this year as the company forecasts it will generate $5.1-$6.0 billion in free cash flow in 2021.** We caution that 3M exited 2020 with a net debt load of $13.8 billion (inclusive of current marketable securities and short-term debt).

As of this writing, shares of 3M yield a nice ~3.4% and are trading around our fair value estimate of $175 per share. The company's Dividend Cushion ratio is near parity (~1), earning 3M a "GOOD" Dividend Safety rating. We factored in strong forecasted dividend growth over the coming years into 3M's Dividend Cushion and Dividend Safety metrics, as 3M earns an "EXCELLENT" Dividend Growth rating. **We're big fans of 3M's free cash flow generating abilities which should enable the firm to stay on top of both its net debt load and dividend obligations going forward.**

Raytheon Technologies (RTX) -- Dividend Yield: ~2.9%

Aerospace and defense giant Raytheon Technologies Inc (RTX) also beat both consensus top- and bottom-line estimates when it reported fourth quarter earnings for 2020 on January 26. **The COVID-19 pandemic weighed negatively on its performance last year, though management expects things are beginning to turn around now.**

In 2021, Raytheon Technologies forecasts it will post $63.3-$65.4 billion in sales and $3.40-$3.70 in adjusted non-GAAP EPS, compared to the $56.6 billion in GAAP revenues and $2.73 in adjusted non-GAAP EPS the firm generated in 2020. **Additionally, the company aims to**

generate $4.5 billion in free cash flow and plans to spend at least $1.5 billion buying back its stock this year.

Raytheon Technologies exited 2020 with a large net debt load of $23.0 billion (inclusive of short-term debt) which will make navigating the potential rebound in commercial aircraft production a more difficult task. The firm's 'Pratt & Whitney' business operating segment produces jet engines, helicopter engines and auxiliary power units for both civilian and military aerospace purposes.

In 2020, this segment saw its sales and adjusted operating profit tank as demand from civilian customers for its aerospace-related services and spare parts fell off a cliff, though the segment's military sales offered a bit of a reprieve. A similar story played out at Raytheon Technologies' 'Collins Aerospace' business operating segment which is an aerospace supplier to both civil and military customers (offerings include cabin seating, lighting, and engineering solutions, oxygen systems, water and waste management systems, among various other offerings).

The company's 'Raytheon Intelligence & Space' and 'Raytheon Missiles & Defense' business operating segments performed quite well, relatively speaking, as domestic defense spending remained robust last year. **We expect domestic defense spending will continue to be robust going forward**, and additionally, the outlook for defense spending levels globally is supported by rising geopolitical tensions. As Raytheon Technologies' civil-facing businesses recover while its defense-facing businesses continue to perform well, its financial performance should post a significant rebound this year assuming global health authorities are eventually able to bring the COVID-19 pandemic under control now that vaccine distribution activities are underway.

Shares of RTX yield ~2.9% as of this writing. Raytheon Technologies has a Dividend Cushion ratio of 1.9, earning the firm a "GOOD" Dividend Safety rating, and please note these metrics incorporate our assumptions that the firm's dividend will grow at a moderate pace going forward. We give the company a "GOOD" Dividend Growth rating. As of this writing, shares of RTX are trading in the lower bound of our fair value estimate range, indicating shares are fairly valued when considering the headwinds its commercial aerospace operations are currently facing.

Verizon Communications (VZ) -- Dividend Yield: ~4.6%

Telecommunications giant Verizon Communications Inc (VZ) also beat consensus top- and bottom-line estimates when it reported fourth quarter earnings on January 26. **In the fourth quarter, Verizon noted its wireless business had 703,000 retail postpaid net additions with growth coming from both its consumer-facing and business-facing segments.** Additionally, Verizon's Fios internet provider business had 92,000 net additions in the fourth quarter.

For all of 2020, Verizon's GAAP revenues declined by 3% and its GAAP operating income dropped by 5% year-over-year. Verizon's revenues were held down by a sharp drop in its 'wireless equipment revenues' though its 'service revenues and other' was broadly flat. **Reductions in its operating expenses were not enough to offset reduced economies of scale and incremental costs relating to the COVID-19 pandemic.**

Looking ahead, **Verizon expects its financial performance will rebound this year**, supported by the adoption of 5G wireless technologies. Management forecasts Verizon will post "service and other revenue growth of at least 2 percent, including total wireless service revenue growth of at least 3 percent" in 2021, along with $5.00-$5.15 in adjusted non-GAAP EPS. For reference, Verizon posted $4.90 in adjusted non-GAAP EPS in 2020.

In 2020, Verizon remained a free cash flow machine, generating ~$21.6 billion in free cash flow (including 'acquisitions of wireless licenses' within the capital expenditure calculation) while spending $10.2 billion covering its dividend obligations (Verizon did not appear to spend a significant amount buying back its stock during this period). This year, Verizon expects to spend $17.5-$18.5 billion on capital expenditures as it continues to bulk up its 5G wireless infrastructure in the US.

At the end of 2020, Verizon had a net debt load of $106.9 billion (inclusive of short-term debt) which weighs negatively on its forward-looking dividend coverage, though the firm's strong cash flow profile makes that burden manageable for now when including its ability to tap capital markets at attractive rates. Verizon has a Dividend Cushion ratio of 0, earning the firm "VERY POOR" Dividend Safety and Dividend Growth ratings (note that the Dividend Cushion ratio is a dividend health ranking tool much like a corporate credit rating). **Shares of VZ yield ~4.6%** as of this writing and are trading in

the lower bound of our fair value estimate range, indicating the firm is fairly valued at this time.

Concluding Thoughts

As we head into 2021, many firms (particularly those outside of the IT sector) expect their financial performance will improve significantly going forward after a challenging 2020. We remain optimistic that global health authorities will eventually be able to bring the COVID-19 pandemic under control, aided by vaccine distribution efforts, which underpin our expectations that the world economy will be able to recover and then expand going forward. **Our fair value estimate on S&P 500 stands at 3,530-3,920.**

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

Fourth Quarter Bank Earnings Roundup: MS, GS, BAC, C, WFC, JPM

By Brian Nelson, CFA

Executive Summary: *Though we're generally cautious on banking business models due to arbitrary nature of cash-flow generation within the banking system and the difficulty in valuing such entities on the basis of a free-cash-flow-to-the firm framework, we like Morgan Stanley--and its return on tangible equity of 17.7% during the fourth quarter of 2020 speaks to solid economic-value creation. Goldman's annualized return on total equity (ROTE) was an impressive 22.5% during its fourth quarter, helping drive the full-year measure to 11.1% for 2020.* ***We continue to view the banking system more as utility-like serving as an extension of the federal government, and as such, we generally don't think they'll be able to muster above-average returns in the longer-run.***

Citigroup remains among our least favorite banking entities. Wells Fargo used to be a well-run bank, but consumer perception has certainly changed with its "fake account scandal" that cost it $3 billion to settle criminal and civil charges. JP Morgan's return metrics were solid like Morgan Stanley's and Goldman's, with return on equity (ROE) coming in at 19% and return on total common equity (ROTCE) coming in at 24% in the quarter. The banking system remains on stable ground.

Morgan Stanley (MS)

On January 20, Morgan Stanley (MS) reported fourth-quarter earnings that revealed revenue growth of 25.6%, and pre-tax income expansion north of 62%. Net income soared to $1.81 per share in the quarter, up from $1.30 in the year-ago period. Full year 2020 net revenue set a record of $48.2 billion compared with $41.4 billion in the year-ago period. Here's what CEO James Gorman had to say in the press release:

> (Morgan Stanley) produced a very strong quarter and record full-year results, with excellent performance across all three businesses and geographies. I am extremely proud of how our employees came together to support each other and our communities and deliver for our clients in an incredibly challenging year. (Morgan Stanley's) unique business model continues to serve us well as we further execute on our long-term strategy with the acquisitions of E*TRADE and Eaton Vance. We enter 2021 with significant momentum, and I am very confident in our competitive position and our opportunities for continued growth.

Though we're generally cautious on banking business models due to the arbitrary nature of cash-flow generation within the banking system and the difficulty in valuing such entities on the basis of a free-cash-flow-to-the firm framework, we like Morgan Stanley--and its return on tangible equity of 17.7% during the fourth quarter of 2020 speaks to solid economic-value creation. Shares trade at 1.64x tangible book equity and roughly in-line with our $65 per share fair value estimate. **The bank yields ~2.1% at the time of this writing.**

Goldman Sachs (GS)

On January 19, Goldman Sachs (GS) reported solid fourth-quarter performance that came in ahead of the consensus estimate for revenue and earnings. Net revenue advanced 17.9% in the period, while fourth-quarter GAAP earnings per share of $12.08 beat expectations by a sizable margin. Goldman's annualized return on total equity (ROTE) was an impressive 22.5% during the fourth quarter, helping drive the full-year measure to 11.1% for 2020. Here's what CEO David M. Solomon had to say about recent performance:

> It was a challenging year on many fronts, and I am deeply proud of how our people helped clients respond to the economic disruption brought on by the pandemic and the extreme market volatility experienced over the past months.
>
> Our people responded admirably to a series of professional and personal challenges, while working from home or in offices that were reshaped dramatically. Thanks to their

> perseverance, we were able to help clients navigate a difficult environment, and, as a result, achieved strong results across the franchise, while advancing our strategic priorities.
>
> We hope this year brings much needed stability and a respite from the pandemic, but we remain ready to handle a wide range of outcomes and are poised to meet the needs of our clients.

Goldman's book value per share stood at $236.15 at the end of the year, up 8.1% from last year's mark. Shares are trading at ~$276 per share at the moment, implying a price-to-book ratio of 1.17x. The high end of our fair value estimate for Goldman Sachs stands at ~$270, just below where shares are trading, but we're not going to pull the trigger on the company anytime soon. **Goldman yields ~1.8% at the time of this writing.**

Bank of America Corp. (BAC)

On January 19, Bank of America (BAC) reported fourth-quarter results that didn't stack up favorably against the performance of its peers in this market environment. Revenue, net of interest expense, fell 10% in the quarter and pre-tax pre-provision income dropped to $6.2 billion from $9.1 billion, despite lower credit loss provisions. Diluted earnings per share fell to $0.59 in the period from $0.74 in the fourth quarter of 2019. Management remains positive, however. Here's what CFO Paul Donofrio had to say in the press release:

> Despite one of the worst economic environments in modern memory, we ended the year stronger than before the health crisis and well positioned to support our clients. We grew deposits by $361 billion, improved our capital ratios and increased liquidity to record levels, exceeding loans.
>
> Because of the responsible way we have operated the company over many years, we were able to support the economy by raising $772 billion in capital on behalf of clients, invest in our franchise and still be in a position to return $4.8 billion in capital to our shareholders in the first quarter of 2021 in the form of common stock repurchases and dividends.

Bank of America had been an idea in the Dividend Growth Newsletter portfolio in the past, but we removed the company June 11, 2020. We continue to view the banking system more as utility-like serving as an extension of the federal government, and as such, we generally don't think they'll be able to muster above-average returns in the longer-run.

We still include diversified exposure to the financial sector in the Best Ideas Newsletter portfolio via the Financial Select Sector SPDR (XLF), but only for diversification purposes. That said, our fair value estimate for Bank of America stands at $35 per share, comfortably above where shares are trading, but fundamentals at the bank just aren't as attractive as we had once hoped. **Its yield stands at ~2.4%.**

Citigroup Inc. (C)

As with Bank of America, Citigroup (C) didn't quite fare as well as its peers during the fourth quarter, results released January 15. Revenue dropped to $16.5 billion in the period from $18.4 billion in the prior-year quarter and net income per share fell to $2.08 from $2.15 per share. Citigroup remains among our least favorite banking entities. CEO Michael Corbat had a lot to say about performance during 2020 in the press release:

> We ended a tumultuous year with a strong fourth quarter. As a sign of the strength and durability of our diversified franchise, our revenues were flat to 2019, despite the massive economic impact of COVID-19. For the year, we generated $11 billion in net income despite our credit reserves increasing by $10 billion as a result of the pandemic and the impact of CECL.
>
> We remain very well capitalized with robust liquidity to serve our clients. Our CET 1 ratio increased to 11.8%, well above our regulatory minimum of 10%. Our Tangible Book Value per share increased to $73.83, up 5% from a year ago. Given the Federal Reserve decision regarding share repurchases as we have excess capital we can return to shareholders, we plan to resume buybacks during the current quarter.
>
> Looking back, I am proud of the progress the firm has made since I became CEO. We have streamlined our consumer business and embraced the shift to digital so we can serve our clients the way they want to be served. We have re-established Citi as a go-to bank for our institutional clients through our global network.
>
> Before the pandemic slowed our progress, we had steadily improved our returns and dramatically increased the return of capital to our shareholders. Notably, we went from having a one penny dividend to returning over $85 billion

> in capital since 2013 and we have reduced our share-count by 30%. Jane has a great foundation to build upon and I am certain great things are in store for Citi and all its stakeholders.

Citigroup yields ~3.5% at the time of this writing, but we don't view it as a particularly strong dividend payer (that's likely why the market assigns it a higher yield than its rivals, too – more risk to the payout). Our fair value estimate of the bank stands at $50 per share, well below the $60 mark where shares are currently trading. Return on average common equity came in at just 5.9% during 2020, suggesting ongoing value-destruction at the bank, justifying a fair value estimate below its tangible book value of $73.83 per share. Citigroup continues to struggle.

Wells Fargo (WFC)

Wells Fargo (WFC) reported fourth-quarter results January 15 that were roughly in-line with what we were expecting. However, as with Bank of America and Citigroup, revenue fell in the period, but the bank managed to drive diluted earnings per share a bit higher, to $0.64 (better than consensus expectations). The modest improvement in the bottom line, however, was driven more by a reversal in credit loss provisioning.

This, however, still failed to drive return on equity (ROE) and return on total common equity (ROTCE) to solid double-digit levels, with both coming in at just 6.4% and 7.7% in the quarter, respectively. While Morgan Stanley and Goldman put up double-digit returns during the period, Wells continues to struggle to put some of its past pitfalls behind it. Here's what CEO Charlie Scharf had to say in the press release:

> Although our financial performance improved and we earned $3.0 billion in the fourth quarter, our results continued to be impacted by the unprecedented operating environment and the required work to put our substantial legacy issues behind us.
>
> Our agenda is clear, and we are making progress. We have prioritized and are moving forward on our risk and control buildout – the recently terminated BSA/AML consent order is just one of many, but it is an important step forward; we have a new management team in place; the disciplines we use to manage the company are completely different than one year ago; we have clarified our strategic priorities and are exiting certain non-strategic businesses; and we have identified and are implementing a series of actions to improve our financial performance.
>
> With a more consistent broad-based recovery and as we continue to press forward with our agenda, we expect you will see that this franchise is capable of much more.

Wells Fargo used to be a well-run bank, but consumer perception has certainly changed with its "fake account scandal" that cost it $3 billion to settle criminal and civil charges. We don't like Wells' corporate governance history, and while we note the bank is working to right the ship, we're not fans of the banking sector, itself, let alone a bank that has not treated its customers right. **Shares yield a modest ~1.3%**, and our fair value estimate rests below its share price.

J.P. Morgan (JPM)

J.P. Morgan (JPM) reported fourth-quarter results January 15 that came in better than expected thanks largely to a reversal of credit costs. The bank's return metrics were solid like Morgan Stanley's and Goldman's, with return on equity (ROE) coming in at 19% and return on total common equity (ROTCE) coming in at 24% in the quarter. CEO Jamie Dimon had a lot to say about recent performance, which we show in the image:

Jamie Dimon, Chairman and CEO, commented on the financial results: *"JPMorgan Chase reported strong results in the fourth quarter of 2020, concluding a challenging year where we generated record revenue, benefiting from our diversified business model and dedicated employees. While we reported record profits of $12.1 billion, we do not consider the reserve takedown of $2.9 billion to represent core or recurring profits – essentially reserve calculations, while done extremely diligently and carefully, now involve multiple, multi-year hypothetical probability-adjusted scenarios, which may or may not occur and which can be expected to introduce quarterly volatility in our reserves. While positive vaccine and stimulus developments contributed to these reserve releases this quarter, our credit reserves of over $30 billion continue to reflect significant near-term economic uncertainty and will allow us to withstand an economic environment far worse than the current base forecasts by most economists."*

Dimon added: *"In Consumer & Community Banking, deposits grew 30% or over $200 billion driven primarily by growth in the Federal Reserve's balance sheet and the continuation of modest market share gains. Within our consumer lending franchise, auto and retail mortgage originations were both up more than 20%. Consumer spending continued to recover, as reflected in combined debit and credit card spend being up for the full quarter. The Corporate & Investment Bank delivered another impressive quarter with growth in Global Investment Banking fees of 34% and Markets revenue of 20%. With a record quarter, Commercial Banking earned $3.3 billion of investment banking revenue in 2020, surpassing its previous $3 billion long-term target. In Asset & Wealth Management, AUM grew 17% due to higher asset values and net inflows of over $190 billion into long-term and liquidity products over the last twelve months."*

Dimon concluded: *"We ended the year with a CET1 ratio of 13.1% (vs. 12.4% at the beginning of the year) and capital above $200 billion, providing us with meaningful capacity to further invest in our business and communities, while returning capital to our shareholders. This increase in capital was **after** raising over $2 trillion of credit and capital for our consumer and institutional clients around the world, which includes nonprofits and U.S. government entities, including states, municipalities, hospitals and universities and adding net $12 billion to credit reserves. We also hold $1.4 trillion of cash and marketable securities, which is currently over $450 billion in excess of what is required. We opened branches in new markets, improved our digital capabilities, and made acquisitions that will enhance our product offerings and deepen our engagement with our customers. We also continued to invest in our communities – for example, through our initial commitments to support those most impacted by the pandemic and our longer-term commitment to advance racial equality and promote economic growth. Our earnings power and healthy capital position also provide us the flexibility to pay dividends and return excess capital to shareholders through share repurchases. I want to end by thanking our frontline colleagues and those working from home who quickly adapted to the pandemic and safely helped our clients, customers, communities and governments."*

Image Source: *JP Morgan's fourth-quarter earnings press release.*

It's hard not to like a company with CEO Jamie Dimon at the helm, but our fair value estimate of JP Morgan stands at $120 per share (below where shares are trading hands at the time of this writing), so we don't think it is a bargain at current levels. **That said, the bank yields ~2.8%, which may be attractive to some investors given its fortress balance sheet.**

Regardless of the income opportunity present, JP Morgan remains one of the strongest of the Big 6 banks, in our view, and while other banks may be struggling to keep up, the banking sector as a whole remains healthy, especially considering what could have happened had the Fed and Treasury not stepped in to calm the markets during the COVID-19 crisis in February/March 2020.

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

HIGH YIELD SPOTLIGHT

Genuine Parts is a High Yielding Dividend Aristocrat on the Rebound

Our **February 2021 High Yield Spotlight Idea** is Genuine Parts Company (GPC)---**3.4% yield**---which primarily distributes automotive and industrial replacement parts, along with related materials, through its global network. Genuine Parts serves customers in 14 countries through ~10,400 locations which includes distribution centers, warehouses, and retail outlets (both company-owned and independent locations). Roughly two-thirds of its annual sales comes from its 'Automotive' business and the remainder coming from its 'Industrial' business. North America represents about three-quarters of its annual revenues.

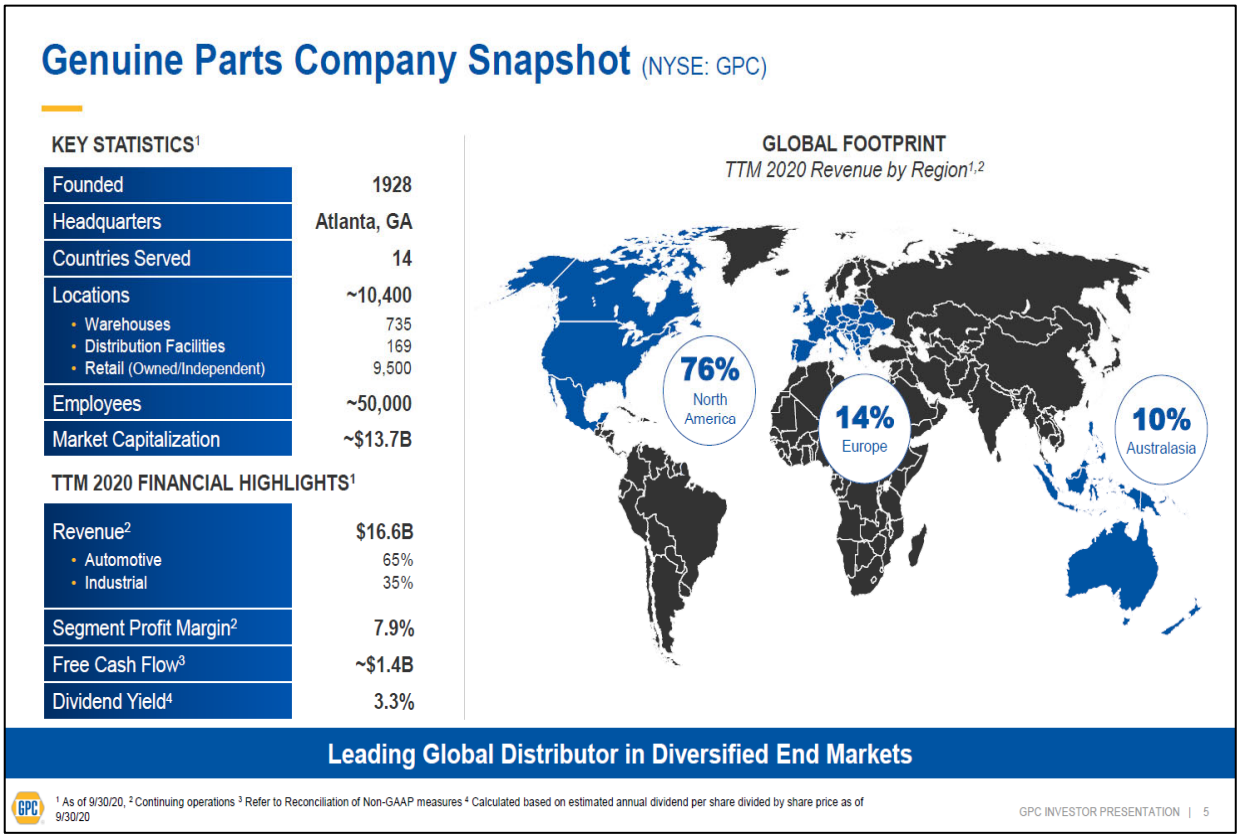


Image Shown: *An overview of Genuine Parts' global footprint and operational highlights.* ***Image Source:*** *Genuine Parts – November 2020 IR Presentation*

Over the past decade, Genuine Parts has simplified its corporate structure (going from four business operating segments down to two segments), made significant improvements to its digital operations (creating a 'Digital Center of Excellent' and bulking up its digital analytical capabilities) and broadened its geographical focus (expanding into Europe). Going forward, the company plans to continue to keep its operational focus trained on its main automotive and industrial businesses while expanding its presence in its three core geographical markets (North American, "Australasian," and European markets). **The company's management team sees this strategy favorably augmenting its growth runway while allowing the firm to keep control and potentially improve its cost structure over the coming years.**

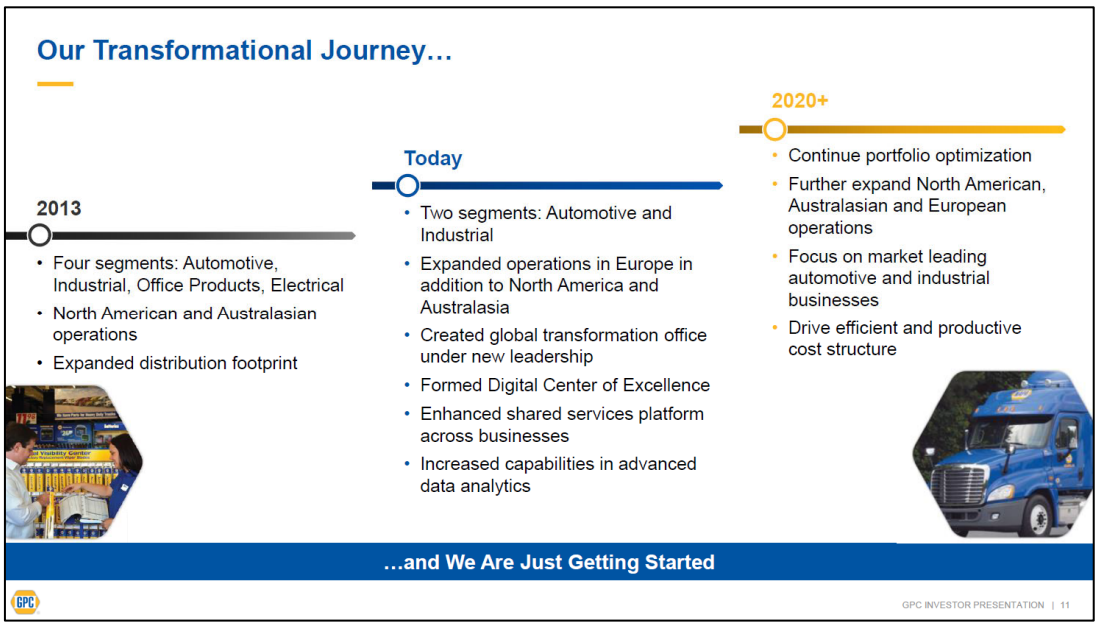


Image Shown: *A look at Genuine Parts' transformation over the past decade and what the company plans to focus on going forward.* ***Image Source:*** *Genuine Parts – November 2020 IR Presentation*

Historically, Genuine Parts' corporate strategy has planned out quite well and we expect that to continue to be the case going forward. The company's revenues and adjusted EBITDA (a non-GAAP metric) steadily climbed higher from 2009 to 2019, before the coronavirus ('COVID-19') pandemic hit, as you can see in the upcoming graphic down below. **While Genuine Parts' financial performance faced significant headwinds in 2020 due to the COVID-19 pandemic, we expect the company will rebound strongly going forward** as global health authorities work to put an end to the public health crisis, aided by ongoing vaccine distribution efforts.

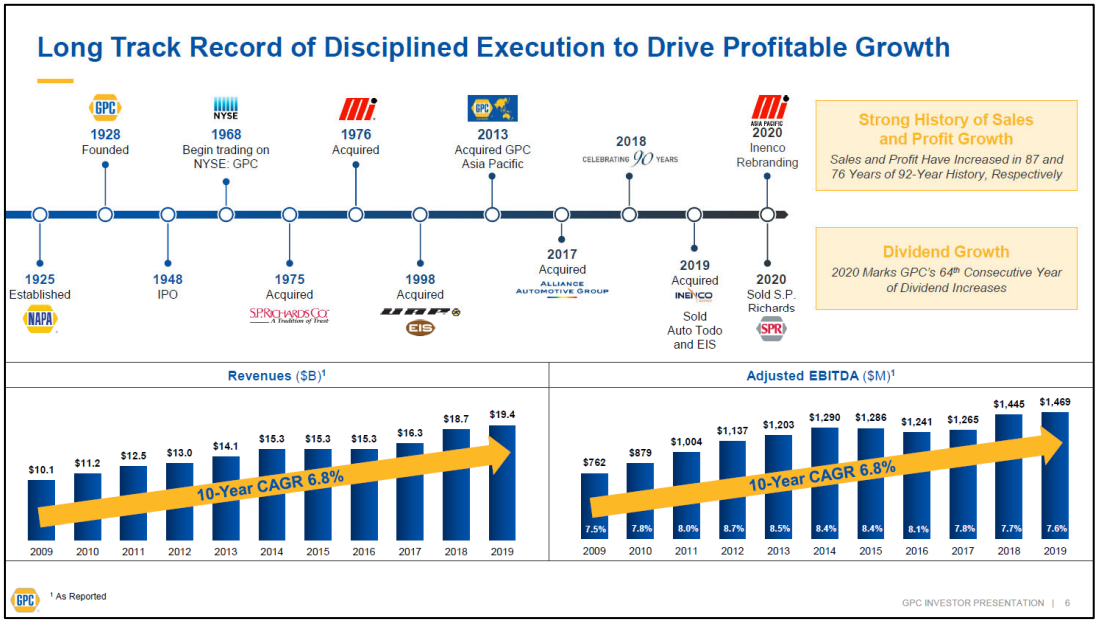


Image Shown: *Genuine Parts saw its financial performance steadily improve from 2009 to 2019, before the pandemic hit, and we see room for additional upside going forward as global health authorities work to put an end to the ongoing public health crisis.* ***Image Source:*** *Genuine Parts – November 2020 IR Presentation*

During the first three quarters of 2020, Genuine Parts' GAAP revenues fell by 7% year-over-year, which when combined with a large goodwill impairment charge saw its GAAP net income turn negative during this period. The pandemic created significant headwinds for its business that were hard to navigate, **though Genuine Parts remained incredibly free cash flow positive. The company generated $1.3 billion in free cash flow during the first three quarters of 2020** on the back of favorable working capital movements (which added $0.7 billion to its net operating cash flows during this period). The company spent $0.3 billion covering its dividend obligations and $0.1 billion buying back its stock during the first three quarters of 2020, and these activities were fully covered (and then some) by its strong free cash flows.

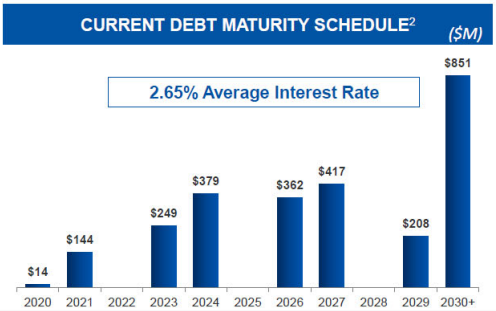
Here we would like to stress that the company's financials showed signs of a significant turnaround materializing in the third quarter of 2020. While its GAAP revenues declined modestly in the third quarter on a year-over-year basis, its GAAP gross profit grew which when combined with operating expense reductions allowed its GAAP operating income to climb higher by 15% year-over-year. In our view, Genuine Parts' improving financial performance should enable the firm to stay on top of both its dividend obligations and its net debt load going forward.

At the end of September 2020, the firm had a net debt load of ~$2.0 billion (inclusive of short-term debt) and plenty of liquidity. The firm had ~$0.9 billion in cash and cash equivalents on hand at the end of September along with significant remaining credit capacity made available via its revolving credit facilities. Genuine Parts has a well-staggered debt maturity schedule as you can see in the upcoming graphic down below. **We appreciate its investment grade credit rating (Baa1/BBB).** Moody's Corporation (MCO) rated Genuine Parts' credit rating for the first time in October 2020, giving the firm a Baa1 rating with a stable outlook.

Durable Balance Sheet and Ample Liquidity

BALANCE SHEET SUMMARY[1]	($B)
Cash / Cash Equivalents	$0.9
Accounts Receivable	$2.0
Inventory	$3.4
Total Assets	**$13.5**
Accounts Payable	$4.0
Total Debt	$2.9
Total Liabilities	**$10.4**
Working Capital[3]	$1.4

LIQUIDITY PROFILE[1]	($B)
Total Credit Capacity[4]	$4.8
Less Total Debt:	($2.9)
Unused Credit Capacity	$1.9
Cash	$0.9
Total Available Liquidity	**$2.8**
Total Debt to Adj EBITDA	**2.2x**



- Fixed and variable-rate debt maturing 2021-2034
- In compliance with debt covenants as of September 30, 2020; **negotiated more favorable covenants, effective May 1, 2020**
- Total debt to adjusted EBITDA improved from 2.5x at June 30, 2020
- Liquidity strengthened in Q3; **~$2.8 billion available liquidity**
- GPC Credit Rating – Baa1/BBB (Moody's/S&P)

Ample Liquidity to Withstand Challenging Economic Environment

[1] As of 9/30/2020 [2] Excludes revolver [3] Working capital is defined as current assets less current liabilities [4] Total credit capacity represents total committed capacity under the revolving credit facility plus the amount of all other debt outstanding

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Image Shown: *Genuine Parts has a strong financial position and ample liquidity. The firm should be able to stay on top of its maturing debt while continuing to meet its dividend obligations going forward.* ***Image Source:*** *Genuine Parts – November 2020 IR Presentation*

Genuine Parts views its total addressable market ('TAM') standing at north of $430 billion, primarily represented by its TAM opportunity in North America. In the event a major infrastructure-oriented fiscal stimulus package gets signed into law in the US, that would likely provide Genuine Parts with a major medium-term growth catalyst. Even if no infrastructure-oriented fiscal stimulus package materializes in the US, Genuine Parts' outlook and TAM would still be quite promising.

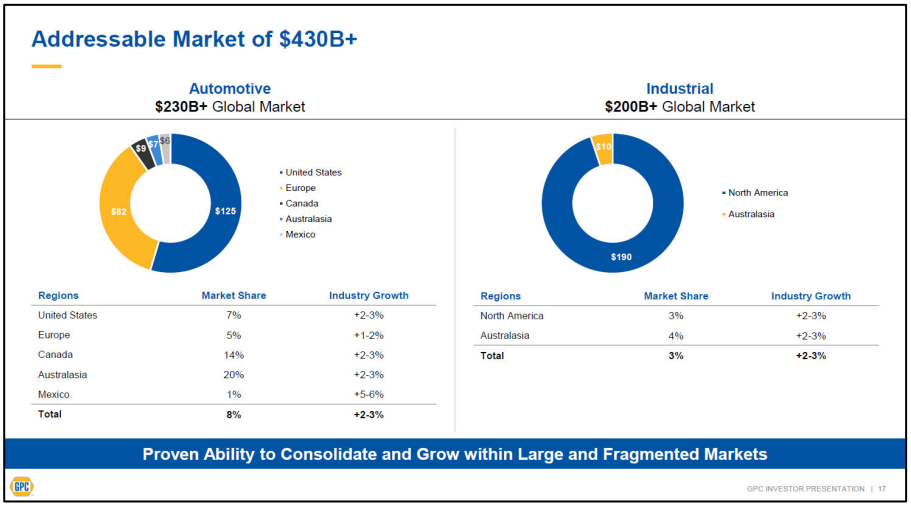

Image Shown: *Genuine Parts views its TAM opportunity standing at north of $430 billion.* ***Image Source:*** *Genuine Parts – November 2020 IR Presentation*

We are big fans of Genuine Parts' commitment to its dividend. Back in February 2020, the firm pushed through a 4% year-over-year dividend increase. **Genuine Parts is a Dividend Aristocrat that has pushed through 60+ consecutive years of dividend growth.** Management aims for the company is achieve a payout target of 50%-55% of its annual profits. On a forward-looking basis, we view Genuine Parts' dividend coverage strength favorably as its Dividend Cushion ratio (the numerator in this calculation is its forecasted future free cash flows over the next five full fiscal years less its net debt position, not inclusive of short-term debt, with the denominator represented by its forecasted dividend obligations over the next five fiscal years) stands at 1.1 earning Genuine Parts a "GOOD" Dividend Safety rating. Please note these metrics incorporate our expectations the firm will grow its per share payout going forward.

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

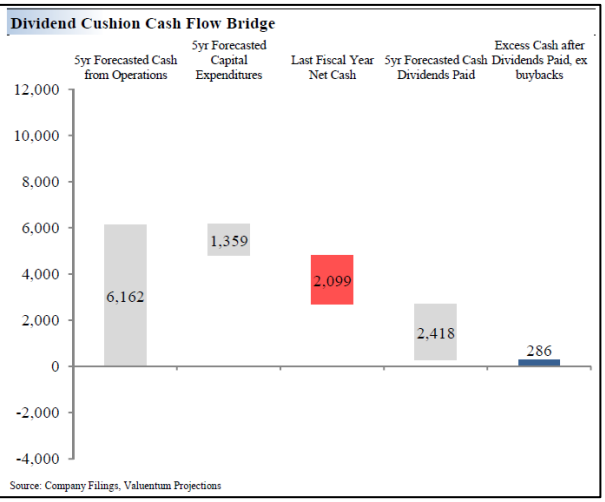

Image Shown: *A cash flow waterfall of Genuine Parts' impressive Dividend Cushion ratio.*

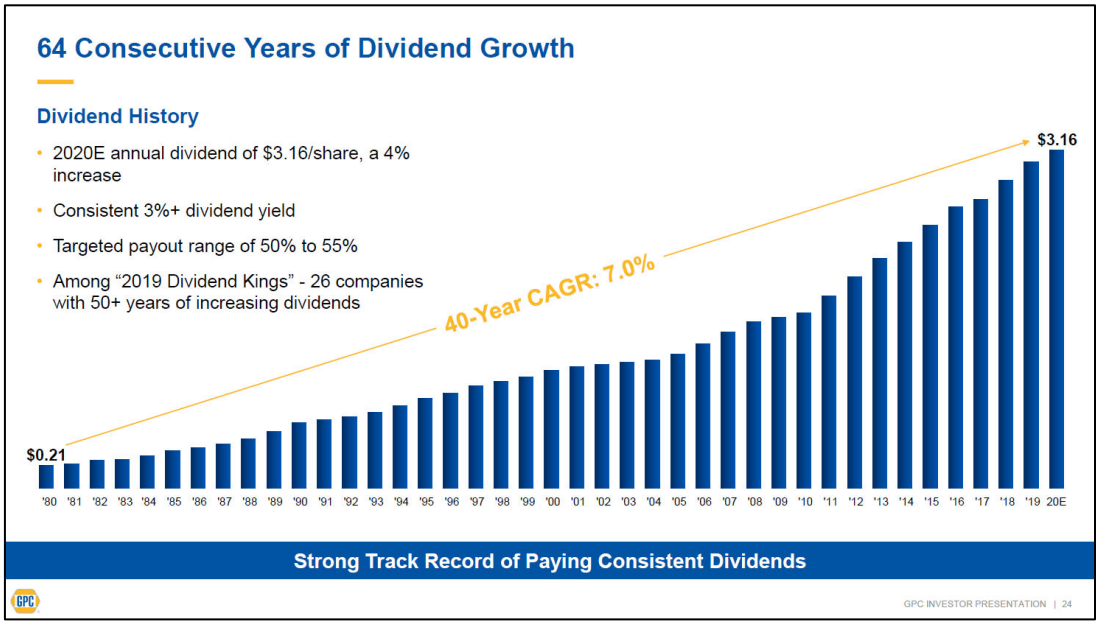

Image Shown: *Genuine Parts is a Dividend Aristocrat.* ***Image Source:*** *Genuine Parts – November 2020 IR Presentation*

There are some downside risks to be aware of here. For instance, if new variants of the COVID-19 virus prove to be resistant to the various vaccines that have been authorized for emergency use, global health authorities may find it difficult to put an end to the public health crisis. Additionally, Genuine Parts' net debt load weighs negatively on its forward-looking dividend coverage. While manageable, should exogenous headwinds build, Genuine Parts could find it difficult to manage both its refinancing needs and its dividend obligations going forward.

With that in mind, recent data from Moderna Inc (MRNA) indicates its COVID-19 vaccine (which has been approved for emergency use in the US and elsewhere) is effective at treating variants of the virus from the UK and from South Africa. Moderna also noted it would test out whether a booster shot of its vaccine would help in combating these virus variants going forward.

Furthermore, we are optimistic that Genuine Parts will be able to retain access to capital markets at attractive rates to refinance maturing debt given its strong investment grade credit ratings and impressive free cash flow generating abilities. The well-staggered nature of its debt maturity schedule will make future refinancing activities a significantly easier task. In October 2020, the firm issued out $0.5 billion in 1.875% senior notes due 2030 at just over 99% of par, highlighting its ongoing ability to tap credit markets at attractive rates.

Genuine Parts is a great company with a solid business model and strong financial position. The company is well-positioned to keep making good on its dividend obligations going forward, supported by its high-quality cash flow profile and promising long-term growth outlook. While 2020 was a harrowing year, the company is entering 2021 on an upswing. Genuine Parts plans to report its fourth quarter earnings for 2020 on February 17 which will be followed up by an earnings conference call. We expect management will have plenty of positive things to stay regarding Genuine Parts' outlook, keeping near-term headwinds in mind as we wait for the COVID-19 pandemic to be brought under control. We like Genuine Parts as our February 2021 High Yield Spotlight Idea.

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

Walgreens Sells European-Focused Wholesale Pharmaceutical Distribution Business to AmerisourceBergen

Image Shown: *Walgreens Boots Alliance Inc is undergoing a major transformation. Part of that strategy involves divesting its European wholesale pharmaceutical distribution business, Alliance Healthcare, to its strategic partner AmerisourceBergen Corporation.* ***Image Source:*** *Walgreens Boots Alliance Inc – Fourth Quarter and Full Year Fiscal 2020 IR Earnings Presentation*

By Callum Turcan

On January 6, Walgreens Boots Alliance Inc (WBA)---**3.7% yield**---announced it had reached a deal with AmerisourceBergen Corporation (ABC)---**1.7% yield**---to sell the "the majority of" its European-focused wholesale pharmaceutical distribution business, Alliance Healthcare, for about $6.5 billion ($6.275 billion in cash along with 2 million shares of ABC). Please note that Walgreens already owns a sizable stake in AmerisourceBergen as the former owned ~28% of the latter's outstanding shares as of August 31, 2020. The deal is expected to close by the end of AmerisourceBergen's fiscal 2021 (at the end of September 2021).

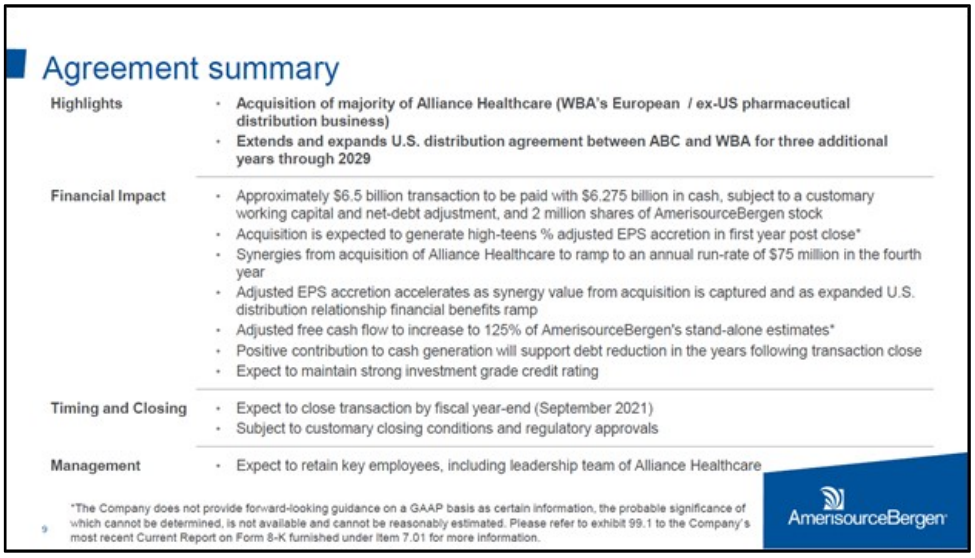

Image Shown: *An overview of the deal covering Walgreens' divestment of Alliance Healthcare to AmerisourceBergen.* ***Image Source:*** *AmerisourceBergen – January 2021 IR Acquisition Transation Presentation*

In conjunction with the deal, Walgreens and AmerisourceBergen extended their existing pharmaceutical distribution agreement by three years to 2029 and committed to work together to locate additional opportunities where both firms could unlock incremental upside (particularly in the realm of sourcing, logistics and distribution). Here is a brief explanation of the agreement between Walgreens and AmerisourceBergen (from Walgreen's Fiscal 2020 Annual Report):

> *In March 2013, Walgreens, Alliance Boots GmbH ("Alliance Boots") and AmerisourceBergen Corporation ("AmerisourceBergen") announced various agreements and arrangements, including a ten-year pharmaceutical distribution agreement between Walgreens and AmerisourceBergen pursuant to which the Company sources branded and generic pharmaceutical products from AmerisourceBergen in the United States and an agreement which provides AmerisourceBergen the ability to access generic pharmaceutical products through the Company's global sourcing enterprise, Walgreens Boots Alliance Development GmbH. In May 2016, certain of these agreements were extended for three years and are now expected to expire in 2026 [please note this strategic partnership has since been extended to 2029].*

Furthermore, Alliance Healthcare UK will remain the distribution partner of Boots (pharmacy chain with a large presence in Europe that is owned by Walgreens) until 2031. **Walgreens and AmerisourceBergen expect to realize $150 million in total run-rate synergies within four years after the deal closing as they build up their strategic partnership further**, with those synergies expected to be shared equally between both firms. Both parties seem to be getting a good deal out of this transaction, in our view.

Image Shown: *AmerisourceBergen and Walgreens aim to generate meaningful run-rate synergies through this transaction.* ***Image Source:*** *AmerisourceBergen – January 2021 IR Acquisition Transaction Presentation*

Proceeds to Help Walgreens Invest in Its Core Business

Walgreens intends to use the divestment proceeds to invest in its core retail pharmacy business. Also, on January 6, Walgreens announced it had accelerated its investment in VillageMD, which operates primary care clinics. First, some background information on that partnership is required to understand its significance.

Back in July 2020, Walgreens announced it would invest $1.0 billion towards VillageMD's equity and convertible debt, including a $0.25 billion equity investment that was completed that same month. The current goal is to add 600-700 VillageMD locations to Walgreens' stores across more than 30 US markets within the next four years, and the related primary care providers will be recruited by VillageMD. Please note that Walgreens appears to have stepped up its ambitions with VillageMD with this recent announcement (Walgreens initially aimed to add 500-700 VillageMD locations to its stores over the next five years, now the midpoint has been raised and Walgreens shaved a year off that timeline).

As of January 6, Walgreens had completed $0.75 billion of its total investment in VillageMD. By the end of the summer of 2021, the partnership aims "to open the next 40 full-service primary care clinics in Texas, Arizona and Florida." **We are intrigued by the deal given that it will provide Walgreens with a way to differentiate itself from its competitors and could drive up recurring foot traffic.** However, please note that Walgreens expects the divestment of its Alliance Healthcare unit "will be slightly dilutive in the current financial year" though it "will be accretive longer-term." These endeavors are ultimately about Walgreens fundamentally shaking up its business model to improve its cost structure and long-term outlook.

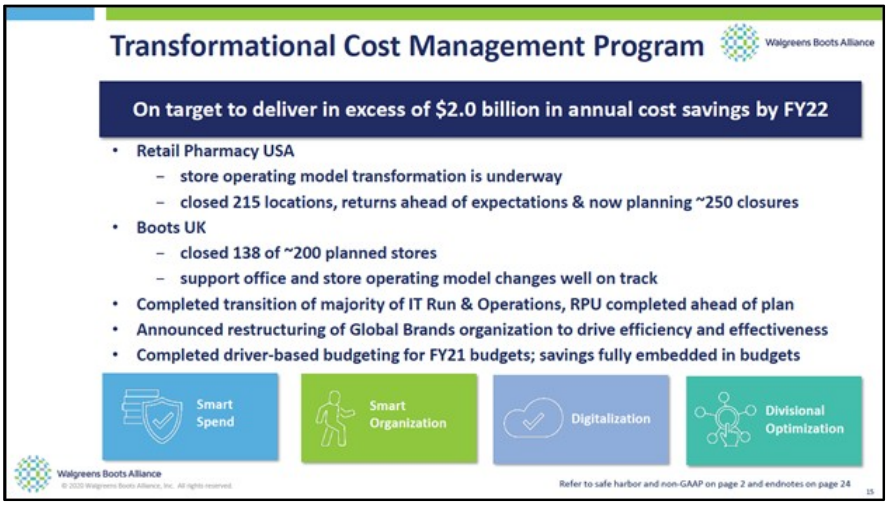

Image Shown: *Walgreens expects to generate material annualized cost savings by fiscal 2022 through an ongoing strategic overhaul.* ***Image Source:*** *Walgreens Boots Alliance – Fourth Quarter and Full Year Fiscal 2020 IR Earnings Presentation*

AmerisourceBergen Gains Scale and Greater Exposure to Europe

For AmerisourceBergen, this transaction will give the firm a strong position in the wholesale pharmaceutical distribution space in the UK, Europe, and Northern Africa. Please note that ~33% of AmerisourceBergen's revenues in fiscal 2020 (period ended September 30, 2020) came from Walgreens, highlighting the company's dependence on its strategic partnership with Walgreens. The press release announcing the acquisition noted that the deal will "enhance AmerisourceBergen's scale and margin profile" and is expected to be accretive to AmerisourceBergen's adjusted (non-GAAP) diluted EPS in the first year after closing.

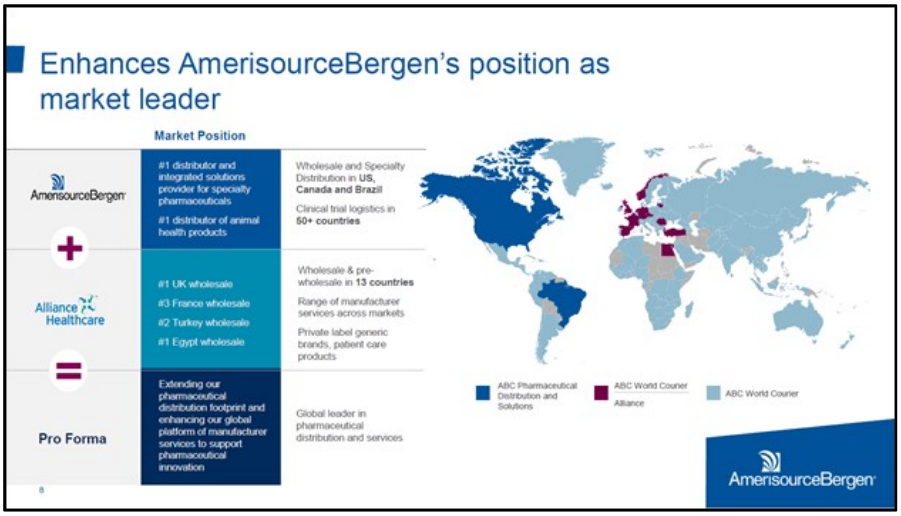

Image Shown: *AmerisourceBergen's global reach will improve materially once its deal to acquire Alliance Healthcare closes, with an eye towards its European presence.* ***Image Source:*** *AmerisourceBergen – January 2021 IR Acquisition Transaction Presentation*

AmerisourceBergen plans to use cash on hand and new debt financing to fund the deal. The company also noted that its free cash flow generating abilities should be positively impacted by the acquisition. Synergies, scale, and the ability to push deeper into Europe offers AmerisourceBergen multiple avenues for upside. **Once the deal closes, AmerisourceBergen plans to pare down its total debt load, aided by its improved cash flow profile.** We appreciate that AmerisourceBergen remains committed to maintaining its investment grade credit ratings.

Earnings Update

On January 7, Walgreens reported first quarter earnings for fiscal 2021 (period ended November 30, 2020) that saw its GAAP revenues grow by 6% year-over-year. Management highlighted growth at the firm's 'Retail Pharmacy USA' and 'Pharmaceutical Wholesale' business segments as being key here. However, Walgreens' gross margins shifted lower (down ~150 basis points year-over-year) last fiscal quarter and the modest year-over-year decline in its SG&A expenses only somewhat offset those headwinds.

Gross margin pressures came from reduced retail sales in the UK (largely a product of quarantine efforts) and increased fulfillment costs. The company reported a GAAP operating loss in the fiscal first quarter due to the negative equity earnings generated via its a strategic stake in AmerisourceBergen (accounted for as an equity method investment), **creating some noise in its financial performance given the decent underlying results generated by its core operations considering the headwinds facing the firm.** On a non-GAAP adjusted basis, Walgreens' reported $1.3 billion in operating income last fiscal quarter, down about 10% year-over-year.

Walgreens aims to improve its cost structure through its 'Transformational Cost Management Program,' a strategy that rests in part on rationalizing its store footprint in the US. In the long run, Walgreens' appears confident that its cost structure will improve significantly through this program. Management reiterated in the earnings press release that Walgreens aims to generate "low single-digit growth in adjusted earnings per share at constant currency rates" in fiscal 2021, keeping in mind this is a non-GAAP metric.

In the fiscal first quarter, Walgreens generated $0.8 billion in free cash flow while spending $0.4 billion covering its dividend obligations and another $0.1 billion buying back its stock during this period. The firm had ~$15.1 billion in net debt on the books (inclusive of short-term debt) as of the end of November 2020, though its pending divestment proceeds will help improve that picture. Furthermore, this picture does not include Walgreens' equity stake in AmerisourceBergen. Walgreens' equity method investments balance stood at $6.0 billion at the end of November, though please keep in mind this also includes the firm's stakes in other companies as well.

We would prefer Walgreens pare down its net debt load with its divestment proceeds given that net debt competes for capital against its future dividend obligations. The company's cash flow profile is stable, and it can generate free cash flows in almost any operating environment, meaning we view its net debt load as manageable for now. However, Walgreens noted it intends to invest at least a portion of its divestment proceeds towards growing its core pharmacy business.

Concluding Thoughts

In our view, the transaction between Walgreens and AmerisourceBergen should positively benefit both parties. Walgreens gets a nice cash infusion to help upgrade its core operations while AmerisourceBergen gains significant scale and greater exposure to European markets. The existing arrangements between Walgreens and AmerisourceBergen should assist both firms in realizing their targeted synergies, at least in theory, though the healthcare sector is inherently complex.

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

Surveying the Clean Energy Landscape for Ideas: NextEra Energy

By Callum Turcan

NextEra Energy Inc (NEE)---**1.7% yield**---is **a giant in the green energy space** and owns two utility companies in the US along with a massive merchant power generation business (this segment is responsible for most of its green energy exposure). That includes Florida Power & Light Company, a rate-regulated electric utility firm with more than five million customer accounts in Florida and Gulf Power Company, which provides services to about 470,000 customers in eight counties in northwest Florida. NextEra Energy completed its acquisition of Gulf Power from Southern Company (SO) at the start of 2019 as part of a broader deal worth $6.475 billion when including the assumption of debt. As an aside, NextEra Energy recently completed a four-for-one stock split.

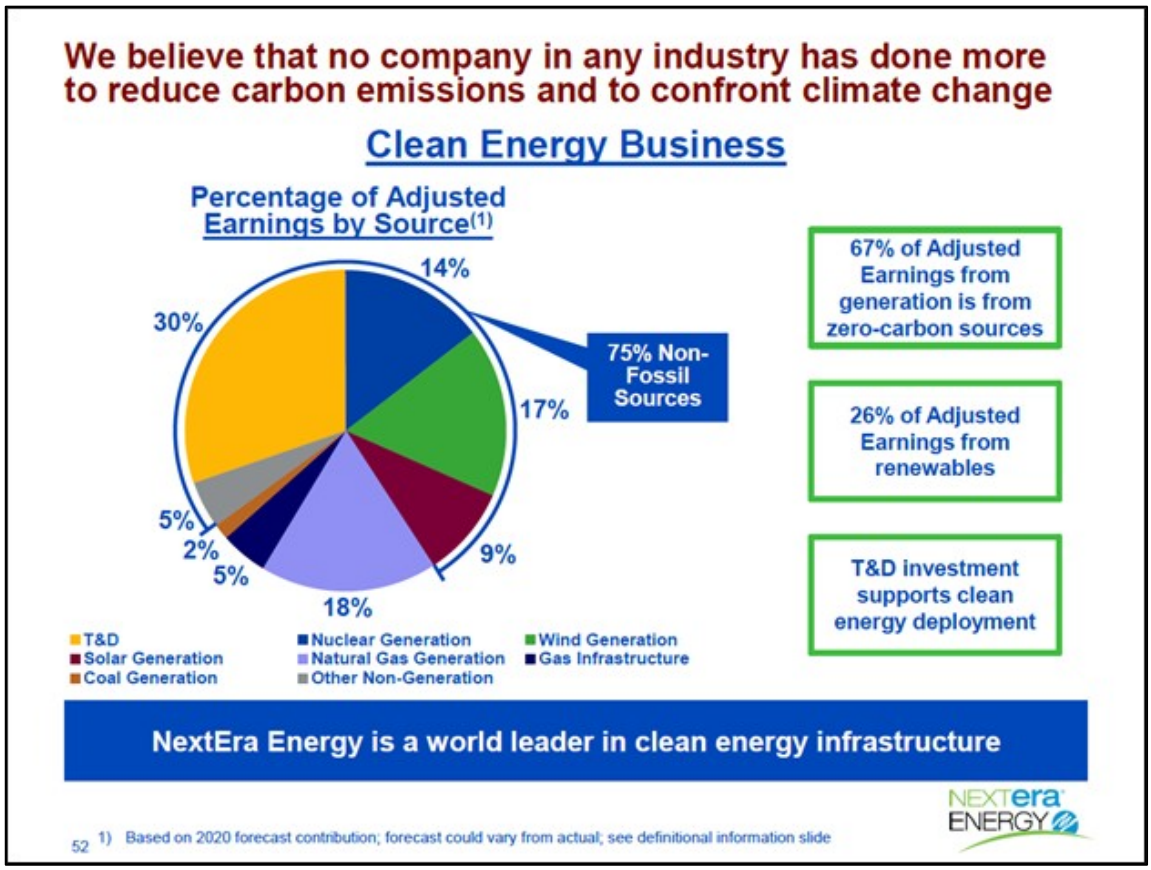

Image Shown: *NextEra Energy generates most of its adjusted earnings through transmission, distribution, nuclear power, and renewable energy operations. Please note that assumes its electric transmission and distribution systems are "green" assets.* ***Image Source:*** *NextEra Energy – November 2020 IR Presentation*

Pivoting now to NextEra Energy's massive merchant power spinoff NextEra Energy Partners LP (NEP)---**3.0% yield**---we caution **that the organizational structure is somewhat complex.** NextEra Energy, through its wholly-owned NextEra Energy Resources ('NEER') subsidiary, owns a large economic stake in NextEra Energy Operating Partners LP ('NEP OpCo') which is the entity that owns an economic interest in numerous renewable energy developments such as solar plants and wind farms across the US and Canada.

NextEra Energy Partners owned a 39.2% limited partner interest in NEP OpCo at the end of 2019 and NextEra Energy owned the remaining 60.8% limited partner interest at the end of this period. Alongside its limited partner interest, NextEra Energy Partners owns the non-economic general partner interest in NEP OpCo. NextEra Energy owns the general partner of NextEra Energy Partners via its wholly owned subsidiaries depicted in the upcoming graphic down below, and James Robo is the CEO of both NextEra Energy and NextEra Energy Partners.

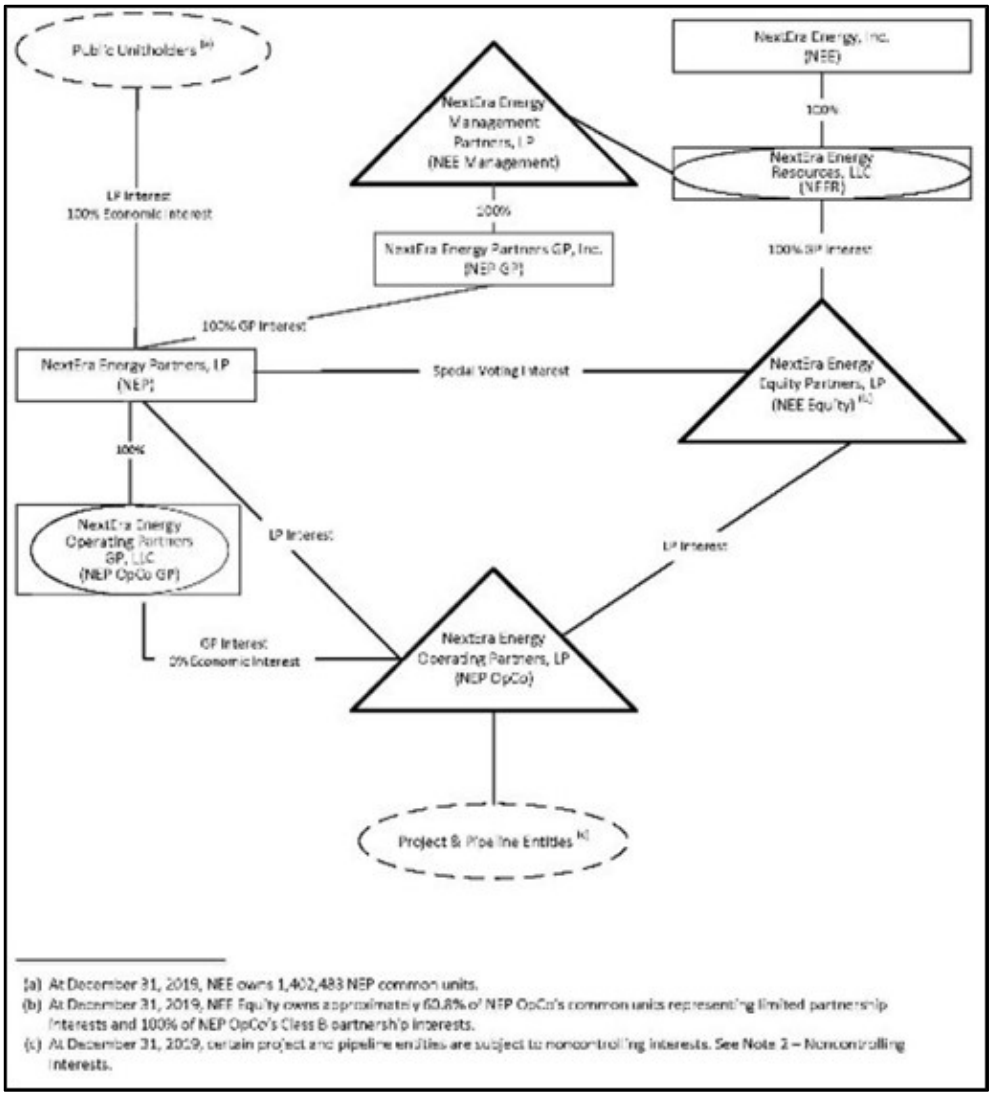

Image Shown: *An overview of the complex organization structure covering NextEra Energy and NextEra Energy Partners along with their various subsidiaries and limited partner economic interests.* ***Image Source:*** *NextEra Energy Partners – 2019 Annual Report*

The entire NextEra Energy family is closely aligned and effectively run by similar management teams, though past organization changes means NextEra Energy now accounts for its stake in NextEra Energy Partners in the equity method of accounting. Unitholders of NextEra Energy Partners could start appointing their own board of directors back in 2018 via past organization changes that among other things established a board of directors for NextEra Energy Partners.

During the past several years, the NextEra Energy family has built up a large portfolio of solar plants and wind farms. These are considered "intermittent" power plants, meaning that the assets cannot always supply significant amounts of electricity to the grid (if the sun is not shining and the wind is not blowing, etc.). **Battery storage investments are expected to change that dynamic over the coming years, aided by expected reductions in costs.**

Until then, these operations are supported by natural gas-fired power plants and nuclear power plants (these types of power plants are "baseload" generators that can operate continuously at a certain capacity, keeping maintenance concerns in mind). Additionally, NextEra Energy also has a modest amount of oil-fired power generation capacity (these are "peaker" plants used when electricity demand is elevated and wholesale rates are relatively high), though these assets are getting phased out for more economical power sources.

About two thirds of NEER's generation capacity is represented by wind (~16 GW) followed by solar (~3 GW), nuclear (~3 GW), and natural gas/oil (~2 GW) with operations in the US and Canada. This does not include power generation capacity at NextEra Energy's two Florida-focused utilities**. Looking ahead, NEER has a backlog of ~13 GW of wind and solar projects along with a sizable backlog of battery storage projects** as you can see in the upcoming graphic down below.

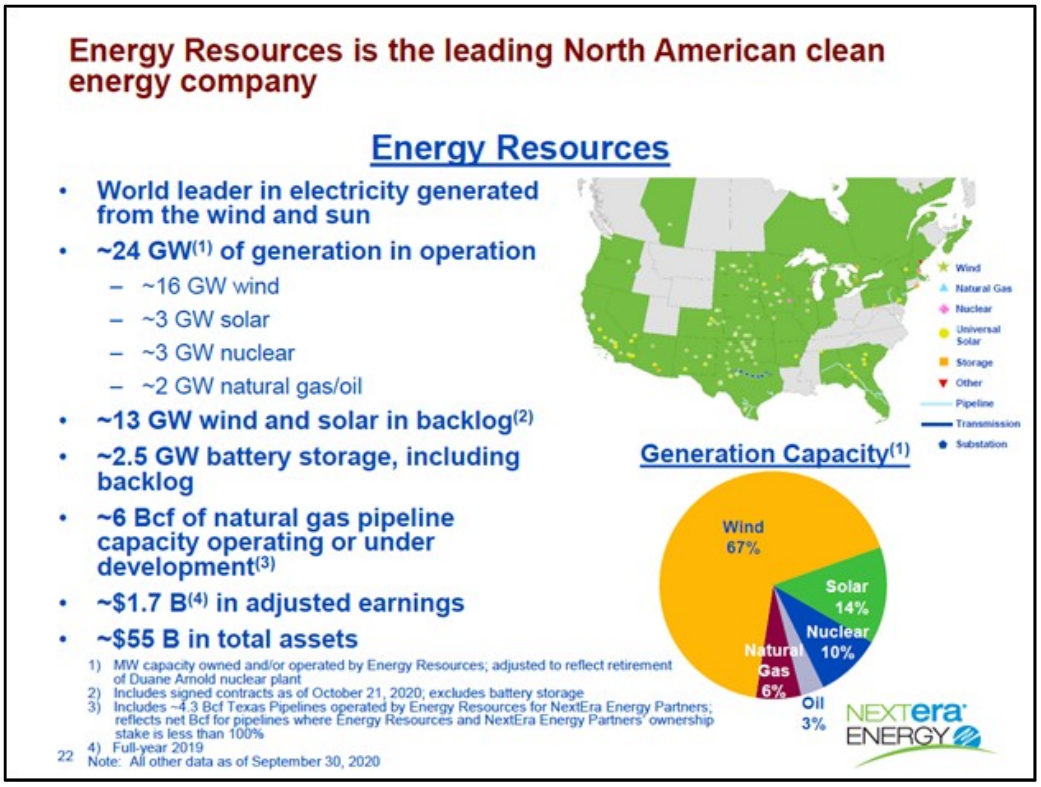

Image Shown: *An overview of NEER's operations as of the end of September 2020.* ***Image Source:*** *NextEra Energy – November 2020 IR Presentation*

As it concerns Florida Light and Power, NextEra Energy intends to grow its solar power generation mix at the electric utility from 2% in 2019 to 16% by 2029 according to the company's forecasts. This will be made possible through large capital investments as NextEra Energy intends to have the utility spend $23-$25 billion on capital investments during for the 2019-2022 period alone.

Additionally, **nuclear power is expected to remain a large part of Florida Light and Power's operations**, generating 22% of its power mix in 2019 which is forecasted to fall modestly to 20% by 2029. Natural gas is expected to remain the single largest source of power generation at the utility by 2029, as it was in 2019. Pivoting to Gulf Power, NextEra Energy intends to have the utility invest significant sums towards developing solar power plants over the coming years as well (including ~$0.3 billion during the 2020-2021 period).

During the past several years, NextEra Energy has been shutting some of its coal-fired power plants and converting others to run on natural gas, particularly in Florida. Due to the "fracking" boom in America, domestic natural gas (UNG) prices are quite low, which makes modern natural gas-fired combined cycle power plants more economical than older coal-fired power plants

By 2022, NextEra Energy intends to combine its two Florida utilities into a single electric utility system. This should help the company better realize economies of scale, allowing it to drive down certain operating expenses. In the view of NextEra Energy, **the company sees the North American renewable energy market growing at a brisk pace in the coming years** as one can see in the upcoming graphic at the top of the next page. **Given the firm's expansive asset base, ample access to capital, and operational prowess, we view NextEra Energy as incredibly well-positioned to capitalize on this upside.**

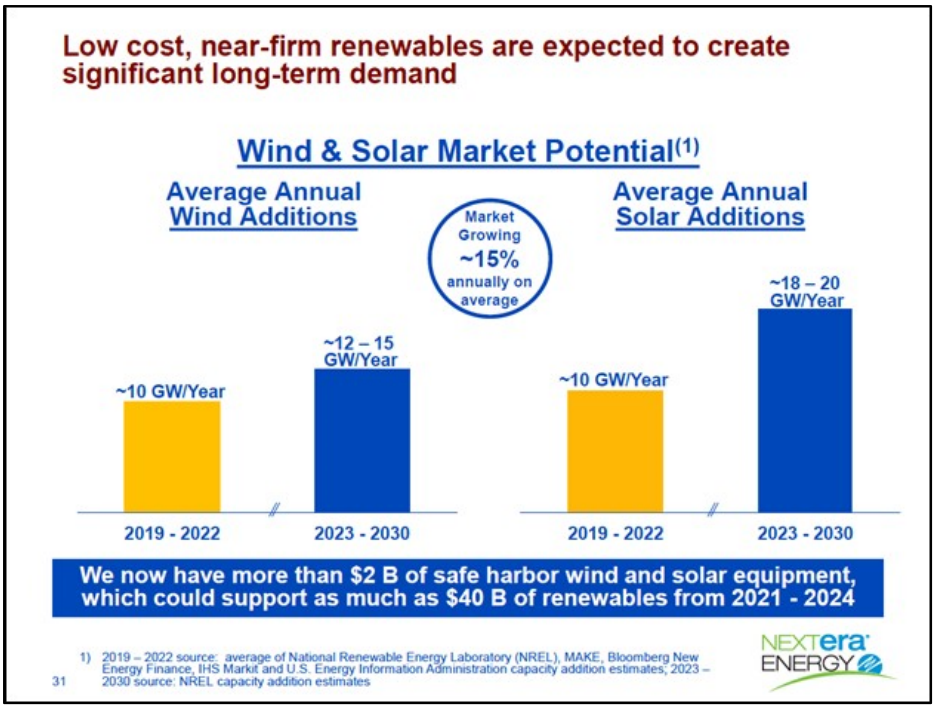

Image Shown: *Demand for renewable energy in North America is expected to grow at a brisk pace going forward.* ***Image Source:*** *NextEra Energy – November 2020 IR Presentation*

Beyond companies, government, utilities, and other enterprises seeking to appear "green" by making renewable energy investments, **sharp reductions in the levelized cost of electricity ('LCOE') during the past decade have made these power generation projects significantly more viable.** Subsidies, particularly on the federal level, along with long-term power purchase agreements ('PPAs') with favorable pricing terms have further enhanced the economics of these projects. There is room for further LCOE reductions going forward, and if realized, those reductions would continue to shift the economics of renewable energy projects in the right direction.

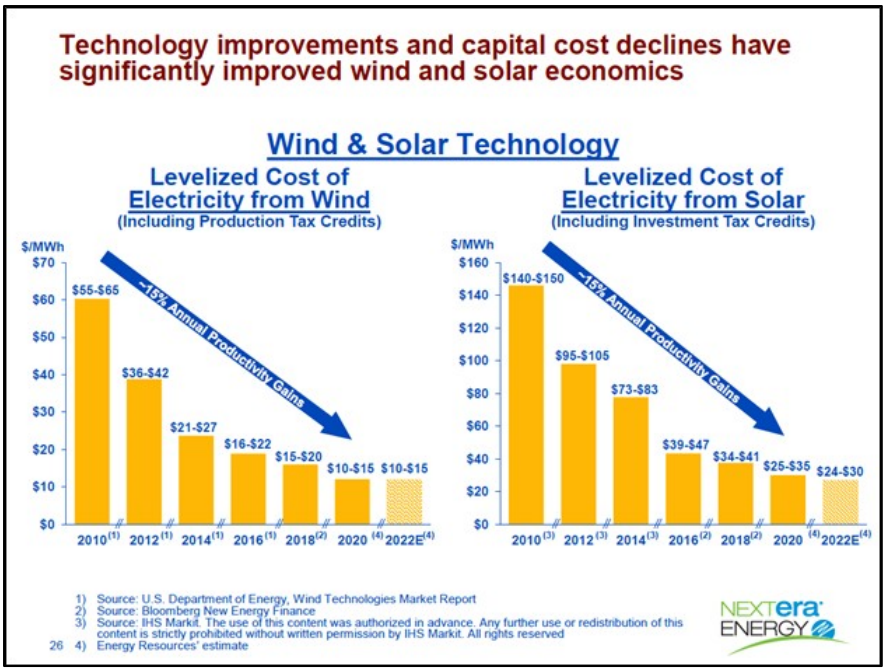

Image Shown: *Solar plants and wind farms have become far more economical over the past decade with room for additional upside.* ***Image Source:*** *NextEra Energy – November 2020 IR Presentation*

Putting this all together, NextEra Energy views its expansive growth runway driving its adjusted (non-GAAP) EPS significantly higher over the coming years. The firm recently increased and extended its EPS growth guidance, and these forecasts are underpinned by the major capital investment programs the NextEra Energy family has planned over the coming years. **NextEra Energy expects to deploy ~$60 billion in capital during the 2019-2022 period across its various entities after investing ~$90 billion in capital during the 2010–2019 period.**

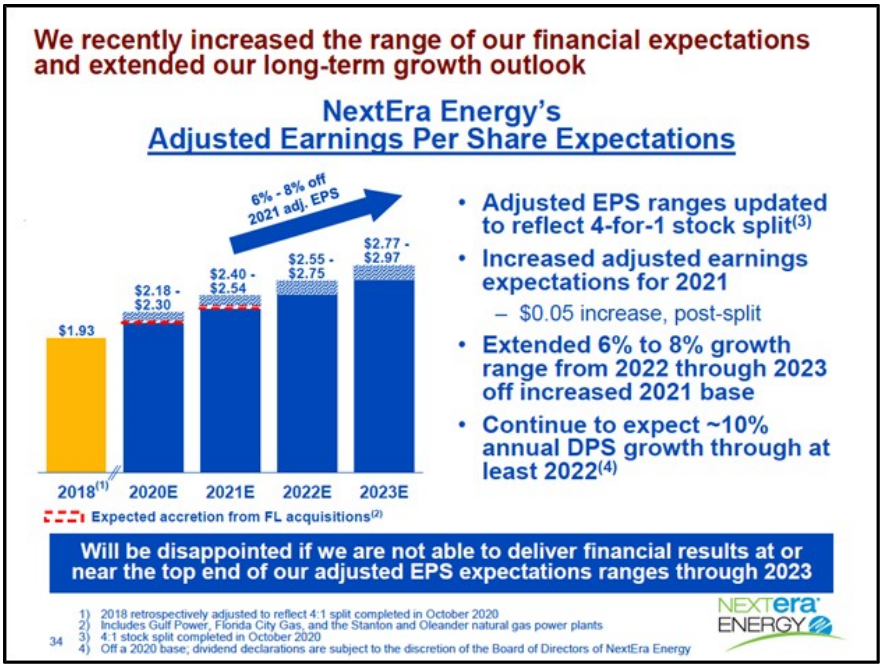

Image Shown: *NextEra Energy expects its adjusted (non-GAAP) EPS will grow meaningfully on an annual basis over the coming years.* ***Image Source:*** *NextEra Energy – November 2020 IR Presentation*

NextEra Energy is optimistic that battery storage operations will continue to become more economical in the medium-term. Being able to economically store power from intermittent supplies of renewable energy would be a game changer for the green energy space.

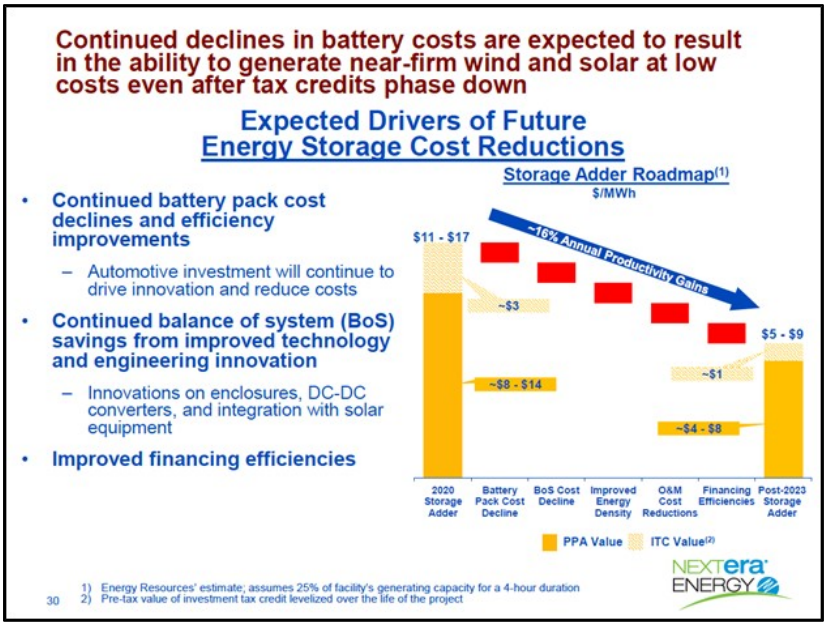

Image Shown: *NextEra Energy lays out why it sees battery storage costs moving lower going forward by highlighting where the savings and efficiencies will come from.* ***Image Source:*** *NextEra Energy – November 2020 IR Presentation*

The company is also intrigued by its hydrogen upside, which is more of a long-term story, though **we appreciate that NextEra Energy's management team is viewing its growth runway in terms of decades**, not months or years. Upside on this front will come from electric utility-related needs, EVs, the industrial sector, and the transportation space as you can see in the upcoming graphic down below.

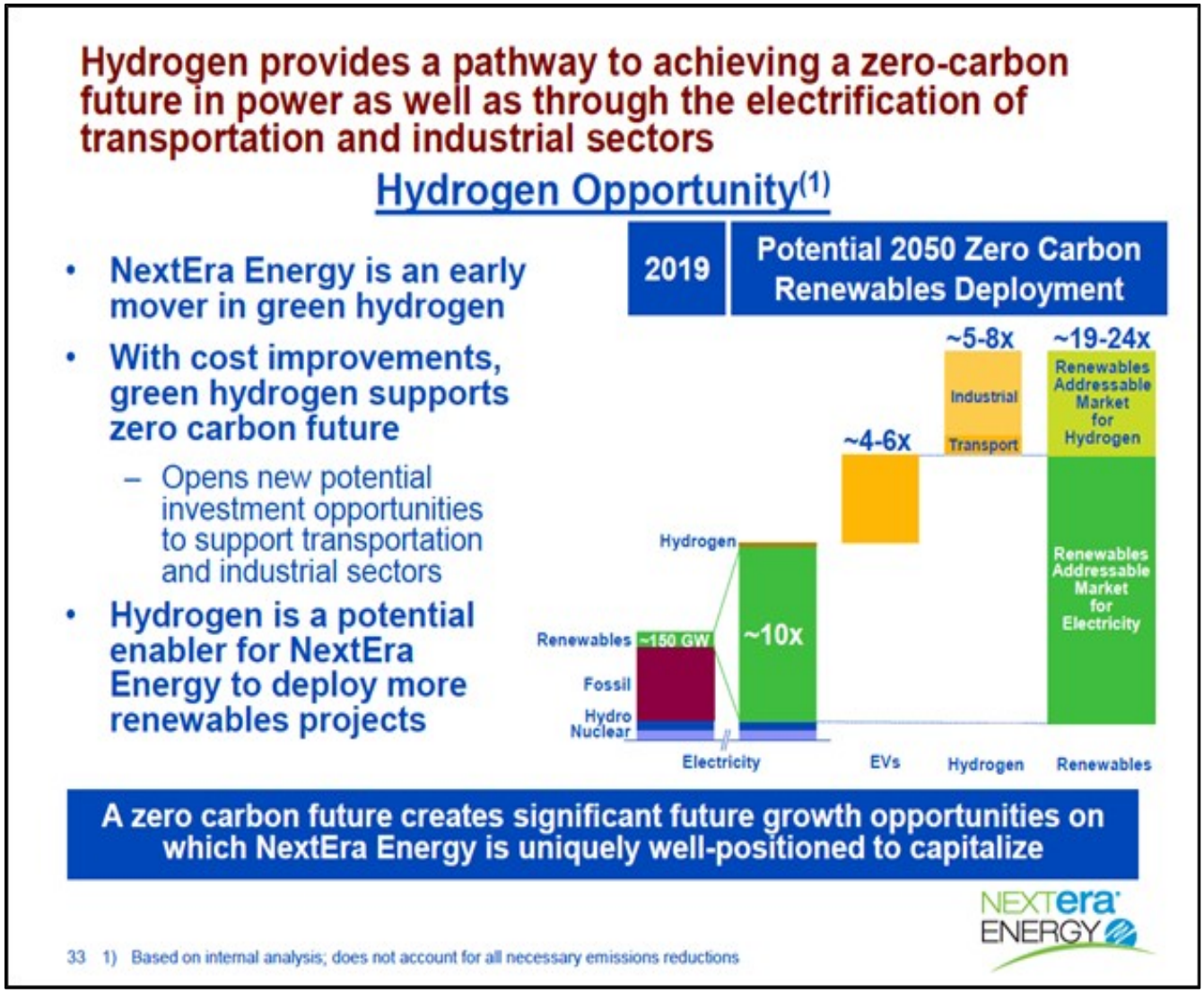

Image Shown: *NextEra Energy views its long-term hydrogen growth upside as enormous.* ***Image Source:*** *NextEra Energy – November 2020 IR Presentation*

Concluding Thoughts

NextEra Energy's growth runway is immense, and the company has done a tremendous job building up its power generation business over the past several years. For a utility, NextEra Energy's yield is relatively modest, largely a product of its stellar capital appreciation performance. We like Utilities Select Sector SPDR Fund (XLU)---**3.2% 30-day SEC yield**---in our High Yield Dividend Newsletter portfolio to gain broad exposure to the utility space and please note that NextEra Energy is by far the top weighted holding in XLU at ~18.5% as of January 28, 2021.

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

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

THE SIMULATED HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO

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

In many respects, the high yield dividend equity arena trades a lot like junk bonds, meaning that interest rates play a key role in how equities will perform. As interest rates fall, high yield stays in vogue, but as interest rates rise, many look elsewhere. This impacts pricing greatly.

We're laser focused on identifying high yielding stocks that have sustainable yields, and if the income stream becomes threatened, we won't hesitate to say goodbye to a name. The High Yield Dividend Newsletter portfolio is presented each month in similar fashion (list and weightings) as that of the first edition.

If you have any questions, comments, or concerns, please be sure to let us know at info@valuentum.com.

Idea	Symbol	Weighting	Est Div Yield
CORE			
PowerShares Senior Loan Portfolio	BKLN	5.0%	3.47%
iShares MSCI Australia ETF	EWA	5.0%	2.02%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	5.19%
iShares International Select Dividend ETF	IDV	5.0%	5.45%
iShares U.S. Preferred Stock ETF	PFF	5.0%	4.80%
Global X SuperDividend ETF	SDIV	5.0%	6.95%
Global X SuperIncome Preferred ETF	SPFF	10.0%	5.78%
Vanguard Consumer Staples ETF	VDC	5.0%	2.61%
Vanguard Real Estate ETF	VNQ	10.0%	3.92%
Utilities Select Sector SPDR	XLU	5.0%	3.17%
EQUITY			
AT&T	T	5.0%	7.27%
Crown Castle	CCI	5.0%	3.34%
CyrusOne Inc.	CONE	5.0%	2.80%
CubeSmart	CUBE	5.0%	3.90%
Digital Realty Trust	DLR	5.0%	3.11%
Enterprise Products Partners	EPD	2.5%	8.90%
Magellan Midstream Partners	MMP	2.5%	9.24%
Philip Morris	PM	5.0%	6.03%
Public Storage	PSA	5.0%	3.51%
Cash*	-	0.0%	0.00%
		100.0%	**4.60%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 2/1/2021. Est. Div. Yield information retrieved from SeekingAlpha, YF.

** Reflects federal funds target rate range*

Valuentum's Stock Dividend Research | Visit us at www.valuentum.com | Ratings as of 20-Nov-2020 | Data as of 18-Nov-2020

LyondellBasell LYB FAIRLY VALUED

Buying Index™ 7 Value Rating

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Attractive	$60.00 - $90.00	HEALTHY	POOR / -0.2	POOR	5.07%

Assessment of Company Dividend Strategy

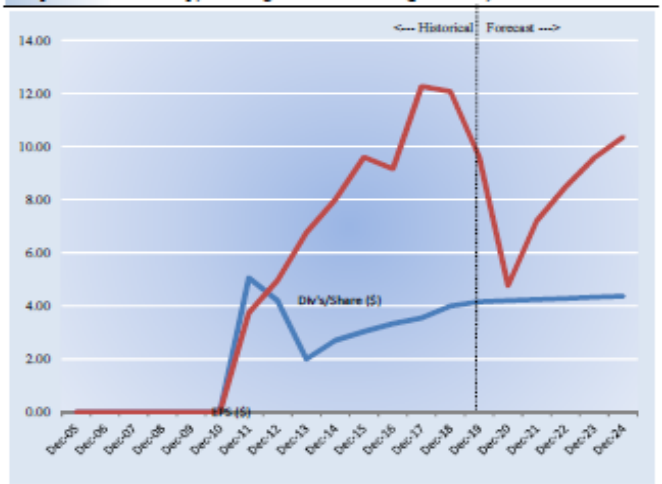
Key Strengths

LyondellBasell operates in the ultra-cyclical and volatile chemicals/refining business. Its operations are tied to the supply-demand balance of chemical/refining margins, which can be subject to wild swings. The commodity-based end markets it serves also makes it difficult for the company to carve out any sustainable competitive advantages. Despite the volatility, the firm has outstanding free cash flow generating ability, as it has averaged ~$3.1 billion in free cash flow over the past three years (2017-2019), and we are expecting continued strong performance in this area. Capital expenditures are expected to drop in 2020 versus 2019 levels, behooving its free cash flow prospects.

Potential Weaknesses

LyondellBasell's cyclical end markets are the largest cause of concern for the firm's dividend growth; it will be important to keep a watchful eye on chemical/refining margins. Though the firm's ability to generate sizable free cash flows should enable LyondellBassel to handle its debt load, the cyclicality of its business could provide some pressure to cash flows. Other capital allocation options could provide headwinds in the pace of future dividend growth as well, but M&A should not be a concern for the firm since it has strict requirements for the consideration of any deal. The COVID-19 pandemic has created significant near-term headwinds for its financial performance.

Graphical Relationship, Earnings and Dividends (per share)

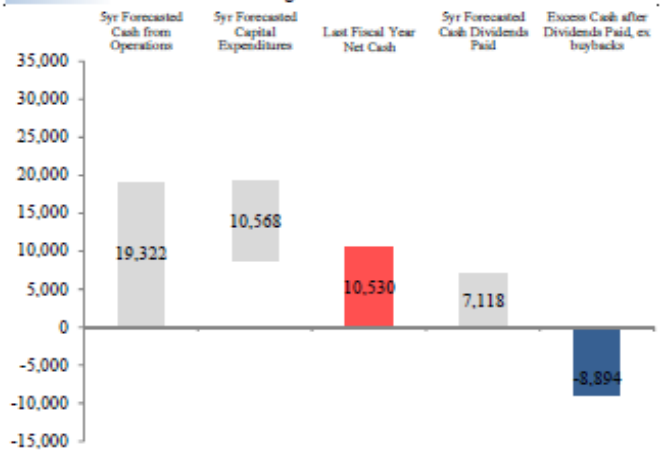


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

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. LyondellBasell'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

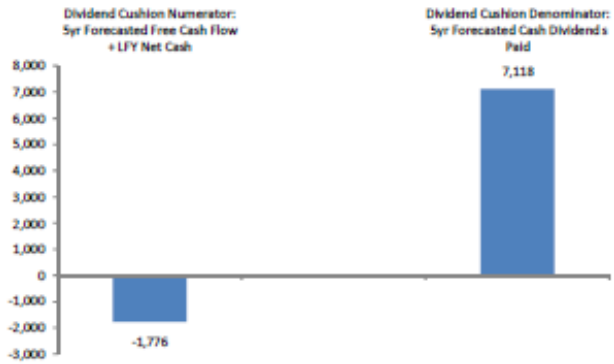


Source: Company Filings, Valuentum Projections

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, LyondellBasell'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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