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HIGH YIELD DIVIDEND NEWSLETTER

Two High-Quality REITs Report Earnings: Crown Castle and Digital Reality

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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"WE CONTINUE TO BE HUGE FANS OF THE SELF-STORAGE REIT INDUSTRY. PUBLIC STORAGE, AN IDEA INCLUDED IN THE HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO, POSTED STELLAR FINANCIAL AND OPERATIONAL PERFORMANCE IN 2020. THE OUTLOOK FOR THE SELF-STORAGE INDUSTRY REMAINS INCREDIBLY BRIGHT, IN OUR VIEW."

– CALLUM TURCAN

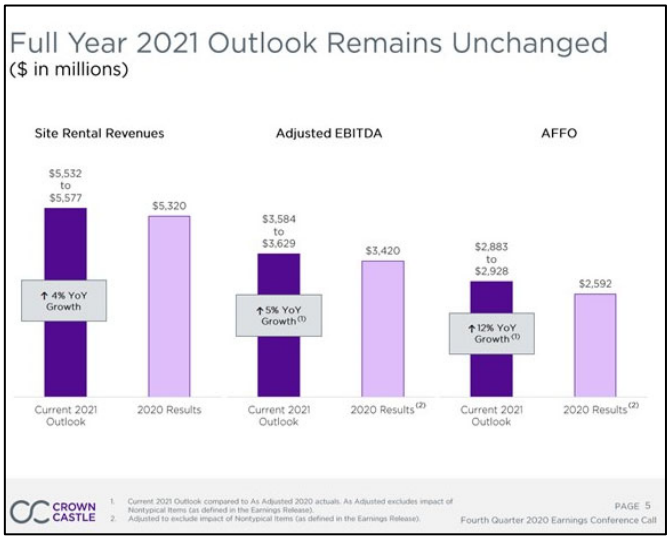


Image Shown: *Crown Castle International Corp. forecasts that its core financial metrics will continue to grow in 2021.* ***Image Source:*** *Crown Castle International Corp. – Fourth Quarter of 2020 IR Earnings Presentation*

By Callum Turcan

Searching for lofty yields in a low interest rate environment comes with substantial risks as high yields can sometimes be more indicative of the expected headwinds facing the company or entity in question rather than an excellent risk-reward opportunity. We published an article back in September 2020 titled *High Yield Dividend Income Investing in a Time of Need* that highlighted our thoughts on this issue and why we think investors in high-yielding enterprises need to keep their guards up.

All yields--even of the same level--are not created equal as each company has different cash-flow characteristics and business model risks. For example, real estate investment trusts ('REITs') that own economic interests in malls, movie theaters, restaurants, and corporate offices were hit hard by the coronavirus ('COVID-19') pandemic as daily routines were upended worldwide. Shares of Simon Property Group Inc (SPG), the giant mall and shopping center REIT, are recovering but have still significantly underperformed the Vanguard Real Estate Index Fund ETF (VNQ) since the start of 2020 as of the middle of February 2021.

On the other hand, shares of Crown Castle International Corp. (CCI), a cell tower REIT, and the Digital Realty Trust Inc (DLR), a data center REIT, have held up well since the start of 2020 as both firms operate in realms that are supported by secular growth tailwinds. **We include both CCI and DLR in the High Yield Dividend Newsletter portfolio.**

These are two high-quality REITs with promising outlooks. The rollout of 5G wireless networks in the US underpins Crown Castle's bright outlook as demand for small cells, which are an essential part of 5G wireless networks, remains incredibly strong. Digital Realty's outlook is supported by the transition towards cloud computing operations due to the rising need for data centers and interconnectivity services worldwide.

Let's dig into their latest respective earnings reports.

Crown Castle (CCI)

On January 27, Crown Castle---**3.4% yield**---reported fourth quarter earnings for 2020 that beat consensus bottom-line estimates but missed consensus top-line estimates. **On a full-year basis, the REIT's 'site rental revenues' and adjusted funds from operations ('AFFO') per share continued to trend in the right direction last year.** Economies of scale and the favorable nature of its contracts with tenants (long-term deals with escalators) underpins our expectations that Crown Castle's operating margins will steadily improve over the coming years, supporting its cash flow growth outlook.

Crown Castle grew its 'site rental revenues' (a non-GAAP metric) by 4% in 2020 on an annual basis. Management noted the REIT experienced very strong growth for its small cells offerings and decent growth for its towers and fiber solutions offerings last year during the firm's latest earnings call. Additionally, Crown Castle reported that its non-GAAP AFFO per share grew by 7% year-over-year in 2020 on an "as adjusted" basis (meaning this AFFO per share metric was further adjusted to remove "nontypical items"). Management recently commented that mobile data demand in the US was up 30% last year (on what appears to be an annual basis).

The REIT has been steadily securing new strategic partnerships to extend its growth runway as wireless network operators scale up to meet surging data demand. For instance, Crown Castle signed a new long-term deal with Verizon Communications Inc (VZ) on January 27 that involves Crown Castle supporting the buildout of Verizon's 5G wireless network. The press release noted that "Verizon has committed to lease 15,000 new small cells from Crown Castle over the next four years" with each small cell lease agreement having an initial ten-year term once installed. In Crown Castle's fourth-quarter 2020 earnings press release, the firm noted "(it) meaningfully increased (its) backlog of small cells committed or under construction to approximately 30,000" with its recent agreement with Verizon being key here.

Crown Castle also signed a long-term deal with DISH Network Corporation (DISH) that was announced back in November 2020. The deal involves DISH Network leasing "space on up to 20,000 [of Crown Castle's] communication towers" and utilizing Crown Castle's fiber infrastructure. Please note that after DISH Network entered the US wireless space last year through its acquisition of Boost Mobile, the company is now working on building out its own 5G wireless network.

These deals with Verizon and DISH Network more than offset the backlog losses that arose when T-Mobile US Inc (TMUS) ended up cancelling ~5,700 small cells that Crown Castle had contracted with Sprint, after T-Mobile acquired Sprint last year. According to recent management commentary, Crown Castle had yet to construct most of those small cells. Crown Castle was financially compensated as part of this termination which involved the REIT receiving payment for the relevant capital costs it had incurred along with the acceleration of the relevant contractually owed rent payments. Management stressed that the cancellation of these orders would not stymie Crown Castle's small cells growth trajectory during the REIT's latest earnings call.

Crown Castle maintained its full-year guidance for 2021 during its latest earnings update. On an annual basis, its guidance calls for modest single-digit site rental revenue growth and double-digit AFFO per share growth this year at the midpoint of its forecasts (on an "as adjusted" basis). Management stressed that Crown Castle's recent deals with Verizon and DISH Network would largely not be reflected in the REIT's 2021 performance.

The REIT sees strong organic growth for its small cells offerings continuing into 2021 according to recent management commentary, with organic growth for its towers and fiber solutions offerings expected to come in nicely as well this year. Crown Castle's guidance is highlighted in the upcoming graphic down below.

(in millions, except per share amounts)	Midpoint of Current Full Year 2021 Outlook	Full Year 2020 Actual	Full Year 2021 Growth Rates (Outlook at the Midpoint)		Full Year 2020 Growth Rates[a]	
			As Reported	As Adjusted[d]	As Reported	As Adjusted[d]
Site rental revenues	$5,555	$5,320	4%	4%	4%	4%
Net income (loss)[b]	$997	$1,056	(6)%	20%	23%	(3)%
Net income (loss) per share—diluted[b][c]	$2.30	$2.35	(2)%	26%	31%	2%
Adjusted EBITDA[b]	$3,607	$3,706	(3)%	5%	12%	4%
AFFO[b][c]	$2,906	$2,878	1%	12%	21%	9%
AFFO per share[b][c]	$6.69	$6.78	(1)%	10%	19%	7%

(a) See "*Results for the Year*" below for our 2019 actual results.
(b) See "*Non-GAAP Financial Measures, Segment Measures and Other Calculations*" for further information and reconciliation of non-GAAP financial measures to net income (loss), as computed in accordance with GAAP.
(c) Attributable to CCIC common stockholders.
(d) As Adjusted growth rates exclude the impact of certain fourth quarter 2020 items that were not previously contemplated in our 2020 Outlook, as described further in "*Recent Developments*" and reconciled in "*Non-GAAP Financial Measures, Segment Measures and Other Calculations*" herein.

Image Shown: *The ongoing rollout of 5G wireless networks in the US supports Crown Castle's growth outlook.* ***Image Source:*** *Crown Castle – Fourth Quarter o 2020 Earnings Press Release*

On February 8, Crown Castle announced it had priced $1.0 billion in 1.050% Senior Notes due 2026, $1.0 billion in 2.100% Senior Notes due 2031, and $1.25 billion in 2.900% Senior Notes due 2041 at just below par. At the end of 2020, Crown Castle had a net debt load of ~$19.0 billion (inclusive of 'current maturities of debt and other obligations' and 'debt and other long-term obligations' but not including restricted cash on hand) and that comes on top of hefty operating lease liabilities. **Though Crown Castle generated $1.4 billion in free cash flows in 2020, the number did not fully cover $2.2 billion in dividend and distribution obligations during this period** (including payouts on its preferred securities).

Please note that **as a capital-market dependent entity, Crown Castle needs to retain constant access to debt and equity markets to refinance its debt load, fund its growth endeavors and keep making good on its payout obligations.**

In our view, the REIT should be able to keep tapping capital markets at attractive rates going forward, aided by its ability to generate free cash flows in almost any environment. Generally speaking, most REITs do not generate sizable (or any) free cash flows due to their hefty capital expenditure requirements (one of the reasons we are big fans of Crown Castle).

Here is what Crown Castle's management team had to say regarding the REIT's financial position during its latest earnings call (emphasis added):

> *"As it relates to the balance sheet, we finished the year with approximately four times debt to EBITDA on a last quarter annualized basis, which includes the net benefit from the non-typical items discussed earlier. Adjusting to include those items as onetime impacts that are not annualized, our leverage would have been approximately five times.*
>
> *During 2020,* ***we improved our balance sheet flexibility by extending the weighted average maturity by nearly two years, reducing our average borrowing cost by 40 basis points*** *and reducing our leverage to our target of approximately five times.*
>
> *Looking forward, our expectation for 2021 capital expenditures remains unchanged at approximately $1.5 billion. We expect we will be able to once again fund this discretionary capital with free cash flow and incremental borrowings, consistent with our investment-grade credit profile." --- Daniel Schlanger, Executive Vice President and Chief Financial Officer of Crown Castle*

Please note that it appears Crown Castle's capital expenditures are expected to decline modestly in 2021 versus 2020 levels (when the REIT spent $1.6 billion on capital expenditures) according to guidance (furthermore, the REIT's capital expenditures were down significant in 2020 versus 2019 levels). **Management maintained that Crown Castle's long-term goal is to grow its per share payout by 7%-8% per year during the REIT's latest earnings call.**

During its third quarter of 2020 earnings report, Crown Castle grew its quarterly payout by 11% sequentially. We continue to like exposure to Crown Castle in our High Yield Dividend Newsletter portfolio.

Digital Realty (DLR)

On February 11, Digital Realty---**3.3% yield**---beat both consensus top- and bottom-line estimates. The data center REIT's (non-GAAP) core funds from operations ('FFO') on a per share basis slipped in 2020 versus 2019 levels in part due to headwinds from the COVID-19 pandemic and in part due to headwinds created by the expiration of legacy contracts.

Digital Reality's core FFO per share dropped 7% year-over-year in 2020, though its financial performance staged a strong rebound in the final

quarter last year (its core FFO per share was down less than 1% year-over-year in the fourth quarter).

Digital Realty issued full-year guidance for 2021 during its latest earnings report, which calls for the firm's financial performance to rebound meaningfully going forward. The REIT forecasts its core FFO per share will reach $6.40-$6.50 in 2021, up from $6.22 in 2020. **Management noted that renewal activity last quarter indicated Digital Realty was seeing signs of some pricing strength in certain areas** during the REIT's latest earnings call. As one can see in the upcoming graphic down below, Digital Realty expects its financial performance will steadily improve throughout 2021.

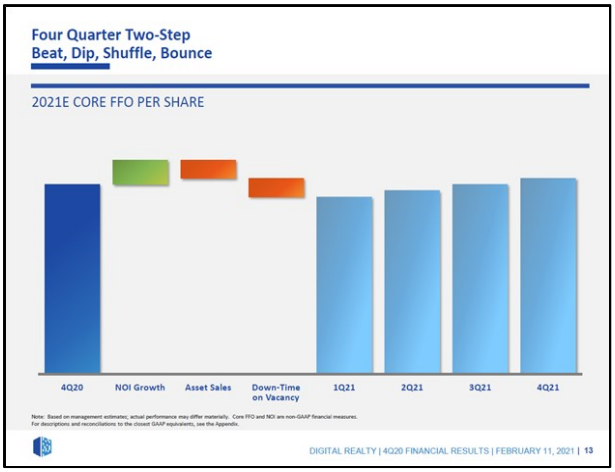


Image Shown: *Digital Realty's financial performance is expected to rebound in 2021.* ***Image Source:*** *Digital Realty – Fourth Quarter of 2020 IR Earnings Presentation*

At the end of 2020, Digital Realty's debt load was substantial as its net debt to adjusted EBITDA ratio stood at 6.1x. When Digital Realty publishes its 10-K SEC filing covering 2020, we will have more to say on its financial position, though **we caution that Digital Reality is also a capital-market dependent entity.** In January 2021, Digital Realty announced it had priced €1.0 billion in 0.625% Guaranteed Notes due 2031 at just below par.

Going forward, the REIT should be able to continue tapping capital markets at attractive rates, in our view, **aided by expectations that its financial performance will rebound this year.** The REIT last increased its quarterly payout in the first quarter of 2020, which marked the 15th consecutive year that Digital Realty had grown its common dividend according to the related press release. **We continue to like exposure to Digital Realty in the High Yield Dividend Newsletter portfolio.**

Concluding Thoughts

To avoid many of the risks inherent when seeking out high-yielding income generating opportunities, we focus on locating firms with resilient business models that can churn out meaningful cash flows in almost any environment. Crown Castle and Digital Realty Trust are two high-quality REITs with nice yields and promising outlooks.

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

Earnings from Our Two Favorite Midstream MLPs: EPD and MMP

Image Source: *Enterprise Products Partners L.P. – Fourth Quarter of 2020 IR Earnings Presentation*

Please note a version of this article was emailed out to members on February 14.

In Alphabetical Order by Ticker: EPD, MMP

By Callum Turcan

The energy market is recovering and that speaks favorably towards the midstream side of the oil & gas industry. Midstream companies operate pipelines, storage facilities, processing plants, marine terminals, gathering systems and other energy infrastructure assets. As global health authorities work to bring an end to the coronavirus ('COVID-19') pandemic, aided by ongoing vaccine distribution efforts, that should enable North American raw energy resources production to post a sustained recovery.

For reference, raw energy resources include crude oil, natural gas, and natural gas liquids (such as propane, butane, and ethane).

North American energy production took a big hit from the pandemic as global energy demand tanked. An eventual recovery in refined petroleum product demand, when the world can return to pre-pandemic activities, should help reverse that trend by providing a tailwind to raw energy resource pricing. Rising raw energy resources pricing, if sustained, would support greater investment towards the upstream side of the industry (operations involve extracting raw energy resources from the ground).

The precipitous decline in raw energy resources pricing seen during the first half of 2020 prompted private operators to reduce their capital expenditure expectations while the OPEC+ oil cartel last year agreed to hold a significant amount of supply off the market through 2022. Near-term crude futures have recently moved back towards the ~$60 per barrel range due to a combination of supply reductions and signs that demand is recovering.

Our two favorite companies in the midstream industry are Enterprise Products Partners L.P. (EPD) and Magellan Midstream Partners L.P. (MMP), two master limited partnerships ('MLPs') that we include as ideas in the High Yield Dividend Newsletter portfolio. Both companies recently reported fourth quarter earnings for 2020, and we will cover key highlights from those reports in this note.

Enterprise Products (EPD)

When Enterprise Products---**8.4% yield**---reported its fourth quarter earnings for 2020 on February 3, **the firm noted it generated $2.7 billion in free cash flow (under Enterprise Products' definition of free cash flow) last year, which was up 8% from 2019 levels.** The company has not yet published its 10-K SEC filing covering 2020 as of this writing and did not include a cash flow statement in its latest earnings report, so we will have more to say on Enterprise Products' financial performance in the future. **Enterprise Products substantially reduced its capital expenditures last year and intends to continue scaling back its capital expenditures going forward**, a strategy management reiterated during the firm's latest earnings call.

During that earnings call, management noted the MLP currently has $3.6 billion in projects currently under construction that will come online over the next two years. The firm expects to spend $1.6 billion on growth-related capital expenditures this year, which is expected to fall down to $0.8 billion in 2022, according to recent management commentary. However, Enterprise Products may decide to sanction additional growth developments, though management stressed the MLP's growth-related capital expenditures would not exceed $2.0 billion in 2021.

Please note the firm also intends to spend $440 million on its sustaining (or maintenance) capital expenditures this year according to recent management commentary, which includes $115 million on scheduled turnaround activities at some of its petrochemical (and other) facilities. As an aside, Enterprise Products has been steadily repurchasing a relatively modest amount of its units of late, including ~$200 million worth of unit buybacks in 2020.

Enterprise Products' net operating cash flows and operating income were down by 10% and 17% year-over-year, respectively, last year as volumes across its operations plummeted. Even in the final quarter of 2020, most of Enterprise Products' operations were seeing subdued utilization rates (compared to year-ago levels) though things are clearly improving. In the third quarter of 2020, Enterprise Products reported that its 'NGL, crude oil, refined products & petrochemical pipeline volumes' stood at 6.0 million barrels per day on average, which had recovered to an average of 6.5 million barrels per day by the fourth quarter of 2020.

Looking ahead, Enterprise Products is well-positioned to significantly grow its free cash flows, if the firm continues to keep a lid on its capital expenditures. At the start of 2021, Enterprise Products grew its annualized payout marginally, which represented its 22nd consecutive year of annual distribution increases according to recent management commentary. **We continue to like exposure to the midstream MLP in our High Yield Dividend Newsletter portfolio.**

Magellan Midstream (MMP)

On February 2, Magellan Midstream---**9.8% yield**---reported fourth-quarter earnings for 2020. As with Enterprise Products, Magellan Midstream's financial and operational performance faced significant headwinds last year due to the COVID-19 pandemic.

Transportation volumes across Magellan Midstream's crude oil and refined petroleum products pipelines plummeted in 2020 versus 2019 levels, which saw its GAAP revenues and GAAP operating income shift lower by 11% and 14% last year, respectively, on a year-over-year basis. Magellan Midstream divested some of its marine terminal operations in 2020, which weighed somewhat on its performance as well.

By the fourth quarter of 2020, things had started to rebound with Magellan Midstream's distillate transportation volumes up year-over-year and its gasoline transportation volumes *only* down modestly year-over-year. The company's crude oil transportation volumes were still down versus year-ago levels in the fourth quarter, though Magellan Midstream's storage business was performing quite well with average storage volumes up meaningful year-over-year last quarter. Its aviation fuel transportation volumes were also significantly lower versus year-ago levels in the final quarter of 2020 as commercial air travel activity was and continues to be subdued, though ongoing COVID-19 vaccine efforts should eventually change that picture.

Magellan Midstream aims to continue pushing its capital expenditures lower going forward according to management commentary given during the MLP's latest earnings call. Last year, Magellan Midstream spent $355 million on growth-related capital expenditures and that figure is expected to fall to $75 million this year, though management noted that the firm may increase its growth-related capital expenditures this year up to around $100 million if new growth projects are sanctioned.

Additionally, **Magellan Midstream expects its maintenance-related capital expenditures will decline from roughly $100 million in 2020 to around $85 million this year.**

Capital expenditure reductions will go a long way in improving Magellan Midstream's cash flow profile by better enabling the company to generate free cash flows. As an aside, the MLP has been steadily buying back its units of late (management noted the firm spent $277 million buying back its units last year in Magellan Midstream's latest earnings call). The firm did not provide a cash flow statement in its latest earnings press release and had not yet published its 10-K SEC filing covering 2020 as of this writing. We will have more to say on Magellan Midstream's financial performance in the future.

Looking ahead, management expects Magellan Midstream's non-GAAP adjusted EBITDA and distributable cash flow performance will be broadly flat this year versus 2020 levels. The firm intends to keep its payout flat at current levels through 2021 according to recent management commentary. Magellan Midstream is actively seeking improvements in its cost structure, a strategy that included the company offering early-retirement packages last year. **We continue to like exposure to Magellan Midstream in our High Yield Dividend Newsletter portfolio.**

Concluding Thoughts

The distribution yields on the units of both Enterprise Products and Magellan Midstream are quite lofty, and while we caution that these midstream MLP's have hefty net debt positions, they may be best-in-class. Still, both entities need to retain constant access to capital markets to refinance their debt burdens, ideally at attractive rates. **Declining capital expenditures and rising utilization rates, if realized, should go a long way in improving both firm's abilities to generate free cash flows this year and beyond.** In our view, we see Enterprise Products and Magellan Midstream being able to maintain their hefty payout obligations going forward.

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

Public Storage's Traditional Free Cash Flow Coverage of the Dividend Is Unique for a REIT

By Brian Nelson, CFA

Public Storage (PSA)---**3.4% yield**---reported better-than-expected fourth-quarter 2020 results February 24. For the period ending December 31, 2020, net income came in at $1.67 per common share, down from last year's level but mainly because of a non-operating negative impact related to forex on Euro denominated debt ($35.1 million). On an operating basis, **Public Storage's self-storage net operating income advanced $16.5 million year-over-year in the quarter**, which was only modestly offset by higher general and administrative expenses ($12.3 million).

Underlying business performance at Public Storage remains very healthy, in our view. **Core funds from operations (FFO) per share came in at $2.93 in the quarter, up 3.2% in the year-ago period (above the consensus forecast of $2.85).** The measure comfortably covers its regular quarterly dividend of $2 per share, as declared on February 16.

Here's what Public Storage's CEO Joe Russell had to say about the quarter and outlook for 2021:

> *At Public Storage, our focus on the health and safety of employees and customers, enhancing the industry's leading platform and brand, and utilizing unparalleled capital access to fund growth drove our success in 2020.* ***The outlook is favorable as we enter 2021.*** *[Continued on next page]*

[Continued from previous page] Public Storage is transforming the customer experience through innovation amidst strong consumer demand while executing on a robust external growth environment through property acquisitions, development, and redevelopment.

A big reason why we include Public Storage in the High Yield Dividend Newsletter portfolio has to do with the profile of its traditional free cash flow generation, which is superb especially when it comes to the REIT space. For example, during the past three fiscal years, inclusive of 2020, Public Storage's cash flow from operations has averaged $2.06 billion while capital expenditures (both to maintain and expand real estate facilities) have averaged ~$437 million--good enough for traditional free cash flow generation of ~$1.6 billion, on average, during the past three fiscal years.

Public Storage's traditional free cash flow generation has been roughly in line with its distributions paid to preferred shareholders, common shareholders and restricted share unitholders, showcasing strong dividend coverage on a GAAP basis. REITs that generate traditional free cash flow that fully cover dividend obligations are few and far between, and Public Storage manages to do so, even during difficult economic environments such as that during the COVID-19 crisis.

In light of Public Storage's core FFO coverage of the payout and its traditional free cash flow coverage of the payout, we think its dividend is about as healthy as any REIT's gets. **Public Storage is also one of the highest-rated REITs by the credit rating agencies**, with Standard & Poor's and Moody's assigning an A credit rating and A2 credit rating on its senior debt, respectively. We continue to like exposure to this rock-solid dividend-paying REIT in the High Yield Dividend Newsletter portfolio.

Disclosure: *Brian Nelson owns shares in SPY, SCHG, QQQ, and IWM.*

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

HIGH YIELD SPOTLIGHT

BHP Group's Stellar Outlook Underpinned by Surging Commodity Prices

Our **March 2021 High Yield Spotlight is BHP Group (BHP)**---**5.3% yield** on a forward-looking basis---as the global mining giant stands to benefit immensely from the sharp increases in commodity prices seen over the past year. BHP Group's business profile includes operations involved in the extraction of iron ore, copper, raw energy resources (oil and gas), thermal coal, metallurgic coal, and various other commodities (potash, nickel, zinc) from the ground. We want to stress here that BHP Group's iron ore, oil and gas, and copper operations are the bedrock of its asset base and outperformance on these fronts can have a powerful impact on BHP Group's company-wide cash flow generating abilities.

Prices for iron ore, copper, and raw energy resources have soared in recent quarters. Global industrial activity recovery stagged an impressive comeback last year after plummeting during the early months of 2020 in the wake of the coronavirus ('COVID-19') pandemic. According to a S&P Global Platts, a division of S&P Global Inc (SPGI), iron ore prices surged by over 120% from March 2020 to December 2020 while copper prices rose by over 65% from April 2020 to December 2020. Furthermore, the outlook for raw energy resources pricing has improved considerably of late as the OPEC+ cartel continues to hold a sizable amount of crude oil supplies off the market while demand for refined petroleum products is staging an uneven recovery.

BHP Group recently increased its interim dividend by 55% year-over-year, a move supported by its promising cash flow growth outlook. The mining giant pays out semi-annual dividends which historically have been volatile as the company's financial performance is heavily influenced by exogenous forces (i.e., volatile commodity prices). BHP Group uses the US dollar as a benchmark to set its dividend payouts. Over the past several fiscal years (its fiscal year has historically ended in June), the firm's ability to generate meaningful free cash flows has impressed and we expect that to continue being the case going forward.

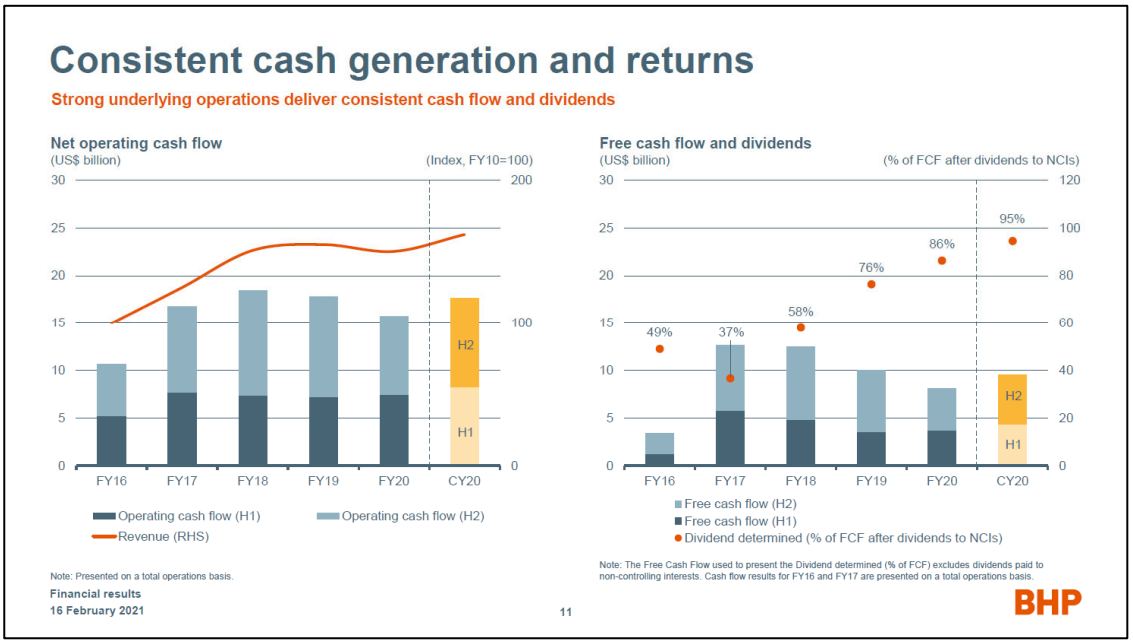
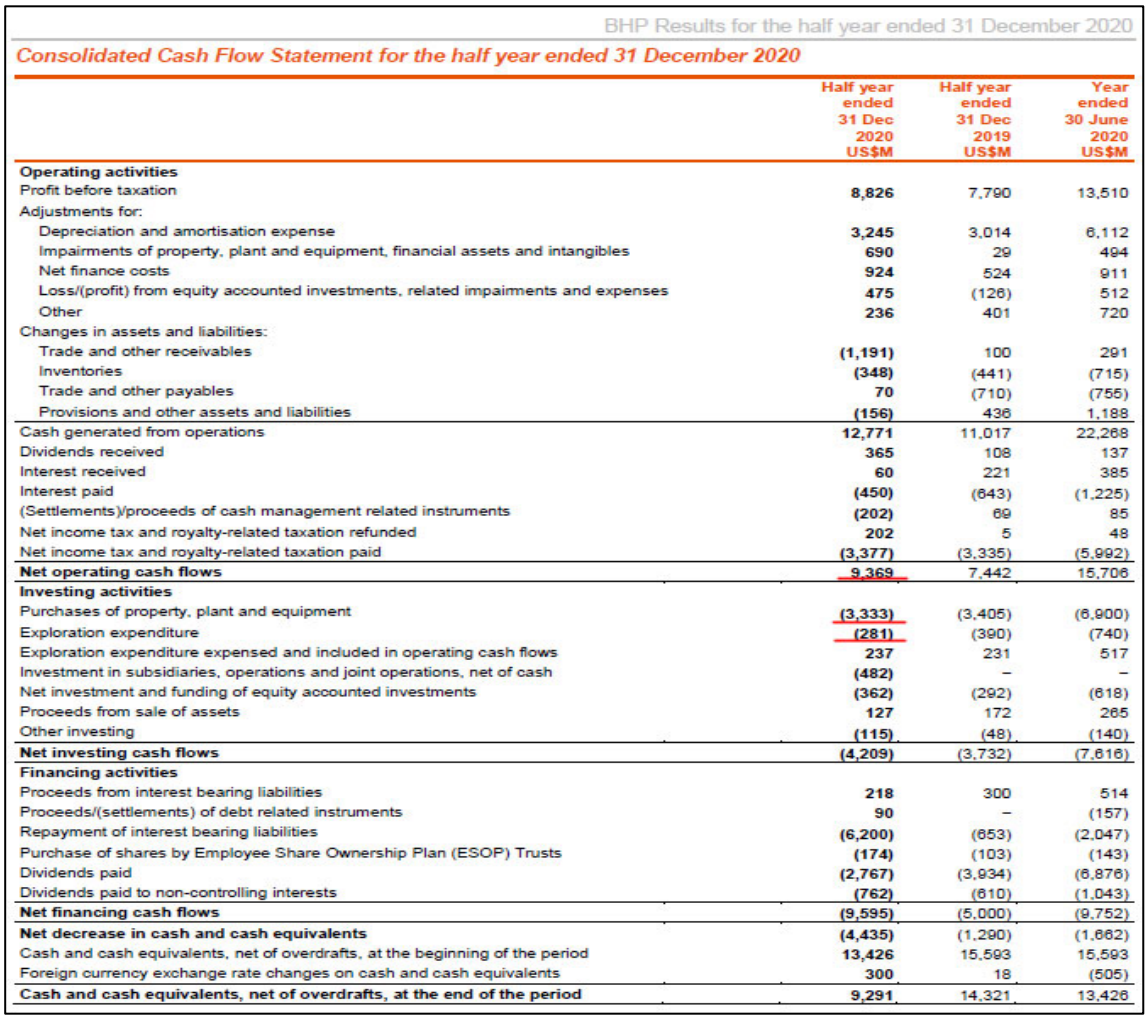


Image Source: *BHP Group – First Half of Fiscal 2021 IR Earnings Presentation*

BHP Group has a dual-listed corporate structure with two parent companies (BHP Group Limited and BHP Group Plc) that operate as if they were a single entity. The firm's global headquarters are in Melbourne, Australia, though it also has a sizable corporate office presence in London, UK. Please note that BHP Group (ticker BHP) has American Depositary Shares ('ADRs') listed on the NYSE with each ADR representing two ordinary shares of BHP Group Limited. BHP Group Plc (BBL) is listed on the NYSE with each ADR representing two ordinary shares of BHP Group Plc. **There are different tax and other implications to be aware of here as it concerns BHP and BBL.** BHP Group reports its earnings in US dollar terms on a semi-annual basis in accordance with IFRS accounting practices.

When BHP Group reported earnings for the first half of fiscal 2021 (six month period ended December 31, 2020) its underlying attributable profit rose by 16% year-over-year and its net operating cash flow jumped higher by 26% year-over-year. **Rising commodity prices were key here.** Stronger iron ore and copper prices added $4.2 billion to BHP Group's adjusted EBITDA in the first half of fiscal 2021 versus the same period the prior fiscal year. BHP Group's underlying EBITDA hit $14.7 billion in the first half of fiscal 2021 (up 21% year-over-year). Please note that while the outlook for its oil & gas assets has improved considerably of late, this segment put up lackluster financial results in the recent past.



BHP Results for the half year ended 31 December 2020

Consolidated Cash Flow Statement for the half year ended 31 December 2020

	Half year ended 31 Dec 2020 US$M	Half year ended 31 Dec 2019 US$M	Year ended 30 June 2020 US$M
Operating activities			
Profit before taxation	8,826	7,790	13,510
Adjustments for:			
Depreciation and amortisation expense	3,245	3,014	6,112
Impairments of property, plant and equipment, financial assets and intangibles	690	29	494
Net finance costs	924	524	911
Loss/(profit) from equity accounted investments, related impairments and expenses	475	(126)	512
Other	236	401	720
Changes in assets and liabilities:			
Trade and other receivables	(1,191)	100	291
Inventories	(348)	(441)	(715)
Trade and other payables	70	(710)	(755)
Provisions and other assets and liabilities	(156)	436	1,188
Cash generated from operations	12,771	11,017	22,268
Dividends received	365	108	137
Interest received	60	221	385
Interest paid	(450)	(643)	(1,225)
(Settlements)/proceeds of cash management related instruments	(202)	69	85
Net income tax and royalty-related taxation refunded	202	5	48
Net income tax and royalty-related taxation paid	(3,377)	(3,335)	(5,992)
Net operating cash flows	9,369	7,442	15,706
Investing activities			
Purchases of property, plant and equipment	(3,333)	(3,405)	(6,900)
Exploration expenditure	(281)	(390)	(740)
Exploration expenditure expensed and included in operating cash flows	237	231	517
Investment in subsidiaries, operations and joint operations, net of cash	(482)	–	–
Net investment and funding of equity accounted investments	(362)	(292)	(618)
Proceeds from sale of assets	127	172	265
Other investing	(115)	(48)	(140)
Net investing cash flows	(4,209)	(3,732)	(7,616)
Financing activities			
Proceeds from interest bearing liabilities	218	300	514
Proceeds/(settlements) of debt related instruments	90	–	(157)
Repayment of interest bearing liabilities	(6,200)	(653)	(2,047)
Purchase of shares by Employee Share Ownership Plan (ESOP) Trusts	(174)	(103)	(143)
Dividends paid	(2,767)	(3,934)	(6,876)
Dividends paid to non-controlling interests	(762)	(610)	(1,043)
Net financing cash flows	(9,595)	(5,000)	(9,752)
Net decrease in cash and cash equivalents	(4,435)	(1,290)	(1,662)
Cash and cash equivalents, net of overdrafts, at the beginning of the period	13,426	15,593	15,593
Foreign currency exchange rate changes on cash and cash equivalents	300	18	(505)
Cash and cash equivalents, net of overdrafts, at the end of the period	9,291	14,321	13,426

Image Shown: *The line-items underlined in red in the above graphic highlight BHP Group's net operating cash flows and capital expenditures during the six month period ended December 31, 2020.* ***Image Source:*** *BHP Group – First Half of Fiscal 2021 Earnings Press Release with additions from the author*

During the six-month period ended December 31, 2020, BHP Group generated $5.8 billion in free cash flow when defining total capital expenditures as 'purchases of property, plant and equipment' plus 'exploration expenditure.' BHP Group's free cash flows fully covered $3.5 billion in total dividend payments to common shareholders and non-controlling interests made during this period. Additionally, BHP Group spent $0.2 billion on the 'purchase of shares by Employee Share Ownership Plan (ESOP) trusts' during the final six months of calendar year 2020. BHP Group's strong cash flow profile is highlighted in the graphic at the bottom of the previous page.

Over the long haul, BHP Group is targeting a net debt load at the lower end of its $12.0-$17.0 billion target range. BHP Group had a $13.4 billion net debt load at the end of December 2020, inclusive of short-term debt, with its $9.3 billion in cash and cash equivalents on hand offering the firm ample liquidity.

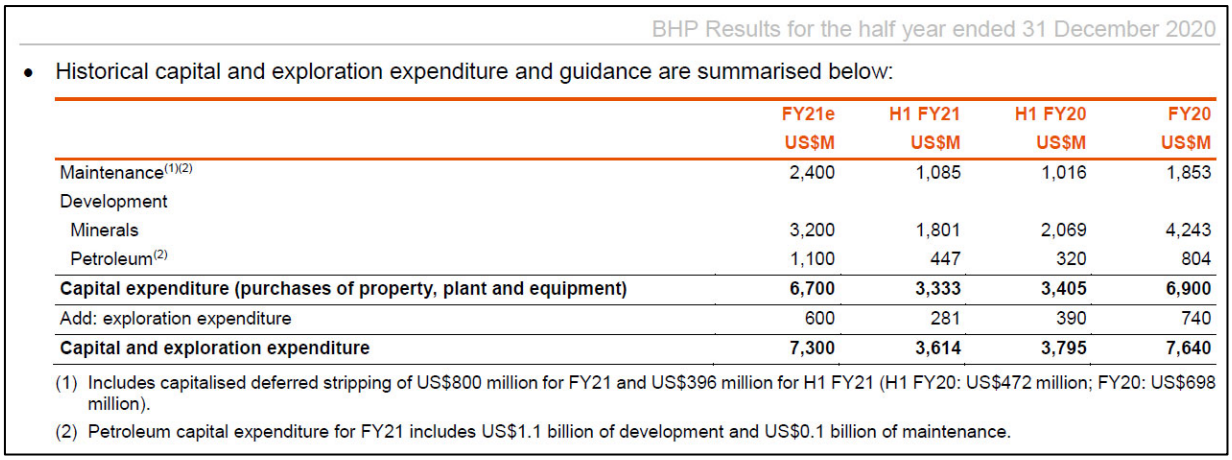
Financial Report

Consolidated Balance Sheet as at 31 December 2020

	Notes	31 Dec 2020 US$M	30 June 2020 US$M Restated
ASSETS			
Current assets			
Cash and cash equivalents		9,291	13,426
Trade and other receivables		4,573	3,364
Other financial assets		227	84
Inventories		4,511	4,101
Current tax assets		295	366
Other		113	130
Total current assets		19,010	21,471
Non-current assets			
Trade and other receivables		270	267
Other financial assets		2,269	2,522
Inventories		1,159	1,221
Property, plant and equipment		73,711	72,362
Intangible assets	2	1,508	1,574
Investments accounted for using the equity method		2,094	2,585
Deferred tax assets		3,178	3,688
Other		34	43
Total non-current assets		84,223	84,262
Total assets		103,233	105,733
LIABILITIES			
Current liabilities			
Trade and other payables		5,663	5,767
Interest bearing liabilities		3,560	5,012
Other financial liabilities		237	225
Current tax payable		1,184	913
Provisions		2,631	2,810
Deferred income		86	97
Total current liabilities		13,361	14,824
Non-current liabilities			
Trade and other payables		–	1
Interest bearing liabilities		19,159	22,036
Other financial liabilities		1,187	1,414
Non-current tax payable		173	109
Deferred tax liabilities	2	3,603	3,779
Provisions		12,128	11,185
Deferred income		199	210
Total non-current liabilities		36,449	38,734
Total liabilities		49,810	53,558
Net assets		53,423	52,175
EQUITY			
Share capital – BHP Group Limited		1,111	1,111
Share capital – BHP Group Plc		1,057	1,057
Treasury shares		(30)	(5)
Reserves		2,335	2,306
Retained earnings	2	44,449	43,396
Total equity attributable to BHP shareholders		48,922	47,865
Non-controlling interests		4,501	4,310
Total equity		53,423	52,175

Image Shown: *The line-items underlined in red in the above graphic highlight BHP Group's cash, short-term debt, and long-term debt figures as of December 31, 2020.* ***Image Source:*** *BHP Group – First Half of Fiscal 2021 Earnings Press Release with additions from the author*

In fiscal 2021, BHP Group intends to spend USD$7.3 billion on its capital expenditures (up USD$0.3 billion from previous guidance due to a stronger Australian dollar), which is down from the USD$7.6 billion it spent on capital expenditures in fiscal 2020 (period ended June 30, 2020). BHP Group is prioritizing its mining operations with its capital investment budget, as you can see in the upcoming graphic down below, though the company continues to make sizable investments in its oil & gas operations as well. In fiscal 2022, BHP Group forecasts that it will spend roughly USD$8.5 billion on capital expenditures (at current exchange rates).



BHP Results for the half year ended 31 December 2020

- Historical capital and exploration expenditure and guidance are summarised below:

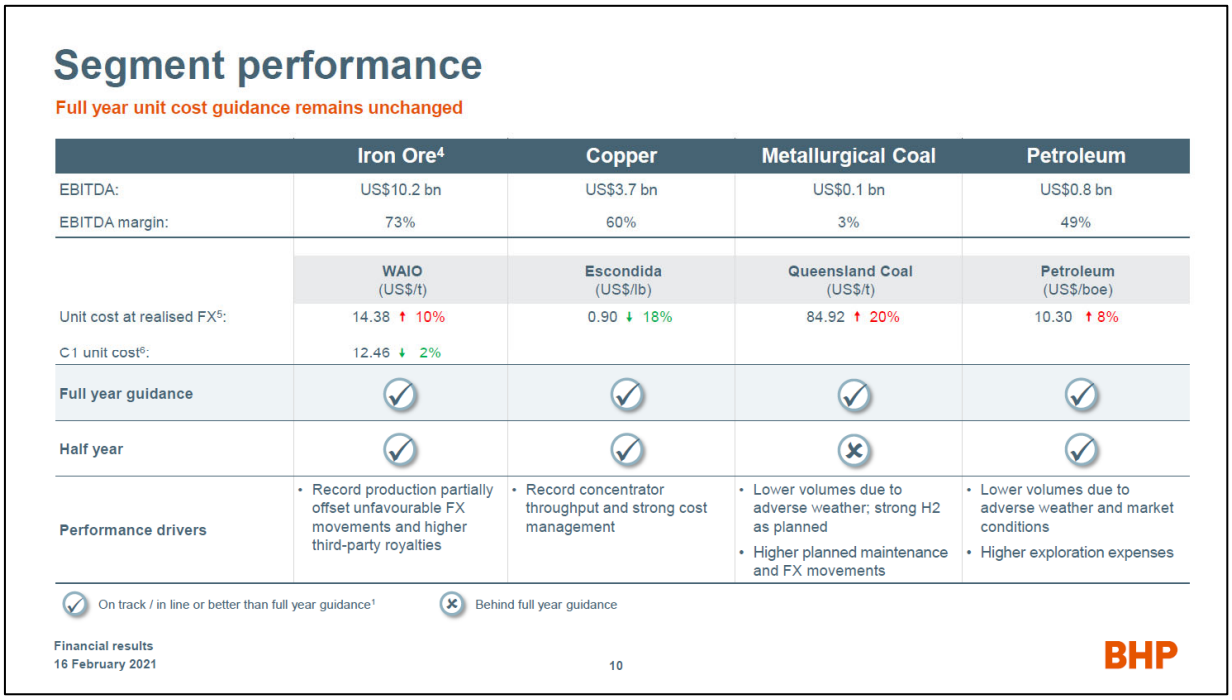
	FY21e US$M	H1 FY21 US$M	H1 FY20 US$M	FY20 US$M
Maintenance[1][2]	2,400	1,085	1,016	1,853
Development				
Minerals	3,200	1,801	2,069	4,243
Petroleum[2]	1,100	447	320	804
Capital expenditure (purchases of property, plant and equipment)	**6,700**	**3,333**	**3,405**	**6,900**
Add: exploration expenditure	600	281	390	740
Capital and exploration expenditure	**7,300**	**3,614**	**3,795**	**7,640**

(1) Includes capitalised deferred stripping of US$800 million for FY21 and US$396 million for H1 FY21 (H1 FY20: US$472 million; FY20: US$698 million).

(2) Petroleum capital expenditure for FY21 includes US$1.1 billion of development and US$0.1 billion of maintenance.

Image Source: *BHP Group – First Half of Fiscal 2021 Earnings Press Release*

Historically, BHP Group has generated stellar adjusted EBITDA margins (which came in at ~59% during the first half of fiscal 2021) and we expect that to continue to be the case going forward. Solid operational execution and a focus on high-quality assets were key here, with its 'iron ore,' 'copper' and 'petroleum' segments leading the way as you can see in the upcoming graphic down below.



Segment performance

Full year unit cost guidance remains unchanged

	Iron Ore[4]	Copper	Metallurgical Coal	Petroleum
EBITDA:	US$10.2 bn	US$3.7 bn	US$0.1 bn	US$0.8 bn
EBITDA margin:	73%	60%	3%	49%
	WAIO (US$/t)	Escondida (US$/lb)	Queensland Coal (US$/t)	Petroleum (US$/boe)
Unit cost at realised FX[5]:	14.38 ↑ 10%	0.90 ↓ 18%	84.92 ↑ 20%	10.30 ↑ 8%
C1 unit cost[6]:	12.46 ↓ 2%			
Full year guidance	✓	✓	✓	✓
Half year	✓	✓	✗	✓
Performance drivers	• Record production partially offset unfavourable FX movements and higher third-party royalties	• Record concentrator throughput and strong cost management	• Lower volumes due to adverse weather; strong H2 as planned • Higher planned maintenance and FX movements	• Lower volumes due to adverse weather and market conditions • Higher exploration expenses

✓ On track / in line or better than full year guidance[1] ✗ Behind full year guidance

Financial results
16 February 2021

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BHP

Image Source: *BHP Group – First Half of Fiscal 2021 IR Earnings Presentation*

BHP Group has also done a stellar job as it concerns its historical return on capital employed ('ROCE') performance as you can see in the upcoming graphic down below. For reference, BHP Group divested its onshore oil & gas business to BP plc (BP) back in 2018, and the financial performance of those former operations are not included in the below graphic. Its Western Australia Iron Ore ('WAIO'), Antamina (open pit copper and zinc mine in Peru) and Escondida (open pit copper mine in Chile) operations generated incredible ROCE during the first half of fiscal 2021. Please note that BHP Group acts as operator of the WAIO and Escondida assets, though its stake in the Antamina operation represents a non-operated asset.

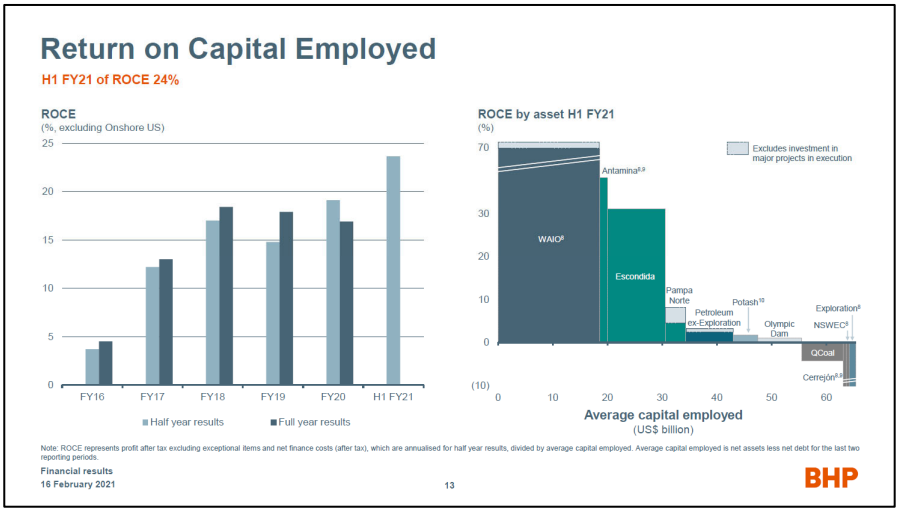

Image Source: *BHP Group – First Half of Fiscal 2021 IR Earnings Presentation*

Currently, BHP Group is working on divesting some of its metallurgic coal (used by blast furnaces in the steelmaking process) and thermal coal (used to produce electricity at coal-fired power plants) assets as it seeks to pivot towards opportunities with more promising long-term outlooks (such as copper and nickel). BHP Mitsui Coal, a joint-venture between BHP Group and Mitsui & Co Ltd (MITSF) whose operations include two open pit metallurgic coal mines in Australia, is a potential divestment opportunity. Additionally, BHP Group is working on divesting its economic interest in the New South Wales Energy Coal ('NSWEC') operation which includes an open pit thermal coal mine in Australia, and its economic interest in the Cerrejón operation in Colombia which includes an open pit thermal coal mine with integrated rail and port operations.

In BHP Group's latest earnings press release management noted the firm's divestment efforts were "progressing, with extensive due diligence being undertaken to assess both demerger and trade sale opportunities." **We view BHP Group's portfolio optimization process favorably**, particularly as the long-term outlook for thermal coal assets is dour given global efforts to limit consumption of the fossil fuel and considering ample supply is readily available. Additionally, as you can see in the above graphic, these assets have put up weak ROCE performance of late.

BHP Group has several risks that income seeking investors should be aware of. Its capital expenditure requirements are quite meaningful, it is heavily exposed to volatile commodity pricing movements, it has a meaningful net debt position, and its dividend obligations are significant. In our view, BHP Group has a solid handle on its debt load given its ample liquidity on hand, ability to generate sizable free cash flows, its promising growth outlook, and the staggered nature of its debt load as you can see in the upcoming graphic at the top of the next page. Potential divestment proceeds will help BHP Group manage expected increases in its capital expenditures come fiscal 2022 and its growing dividend obligations, especially as some of these assets generate minimal cash flows though they require continuous maintenance-related investments.

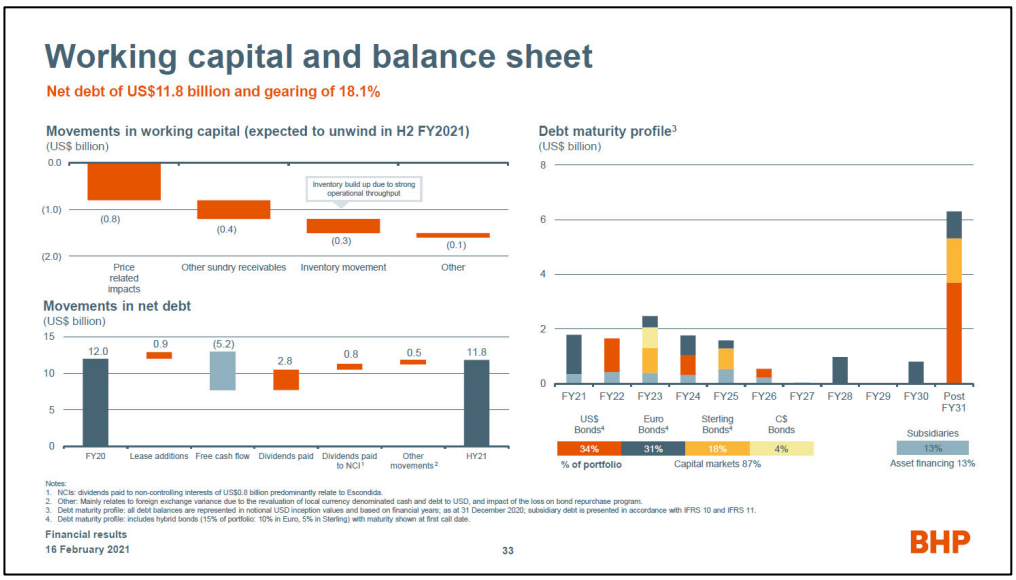

Image Source: *BHP Group – First Half of Fiscal 2021 IR Earnings Presentation*

As it concerns the Samarco iron ore mine in Brazil, which is a 50/50 JV between BHP Group and its partner Vale SA (VALE), production activities are scaling back up after the asset was forced offline several years ago. Back in 2015, the Fundão tailings dam broke and the lethal disaster forced the Samarco mine offline and the JV partners to seek legal settlements with the affected communities and the Brazilian government. More recently, the JV has been able to resume operations at the asset after completing major repairs at the facility and after securing various legal settlements, though legal activities continue (the legal saga is far from over, but BHP Group and Vale have made serious headway on this front).

In the upcoming graphic down below, BHP Group provides an overview of the situation as of early-2021. The resumption of iron ore pellet production at the Samarco JV should provide a powerful tailwind for BHP Group's financial performance going forward, especially considering the stellar pricing for iron ore seen of late. Please note that BHP Group and Vale reached a deal with Brazilian prosecutors based in the state of Minas Gerais back in 2018 (financial details were not disclosed).

Image Source: *BHP Group – First Half of Fiscal 2021 IR Earnings Presentation*

Pivoting here, BHP Group is targeting meaningful per unit cost reductions at its Escondida mining operation going forward, aided by the implementation of its BHP Operating System ('BOS') practices and due to more cost effective renewable energy contracts coming into force in fiscal 2022. At the BHP-operated Pampa Norte asset, copper cathode is produced from the open pit Cerro Colorado and Spence mines in Chile. Recently, BHP Group completed a sizable growth development at its Spence mine (first copper was achieved in December 2020) which provides the mining giant with another powerful near-term growth catalyst.

As it concerns the firm's petroleum business, BHP Group is seeking upside from liquids production as assets that primarily produce crude oil tend to be more lucrative than assets that primarily produce natural gas. BHP Group owns a minority stake in the BP-led Mad Dog 2 project in the US Gulf of Mexico which is expected to be completed in calendar year 2022. Once operational, the Mad Dog 2 development will produce up to 140,000 barrels of crude oil per day on a gross basis at its peak. During BHP Group's first half of fiscal 2021 earnings update, management noted the project was on schedule and on budget.

BHP Group incurred meaningful incremental expenses as the firm contended with headwinds arising from the COVID-19 pandemic. As global health authorities work towards putting an end to the public health crisis, aided by ongoing COVID-19 vaccine distribution efforts, those incremental expenses should eventually dissipate. This will provide BHP Group will another favorable tailwind in the medium-term.

We view BHP Group's outlook favorably and expect the company to be able to continue making good on its hefty dividend obligations going forward. The firm's cash flow growth trajectory is underpinned by ongoing cost structure improvements, portfolio optimization efforts, major developments that have recently come online or will in the near-term, and the favorable pricing outlook for various commodities including iron ore, raw energy resources, and copper. BHP Group should be able to refinance its debt maturities at attractive rates over the coming years, aided by its improving financial position and potential divestment proceeds. **We like BHP Group as our High Yield Spotlight for March 2021.**

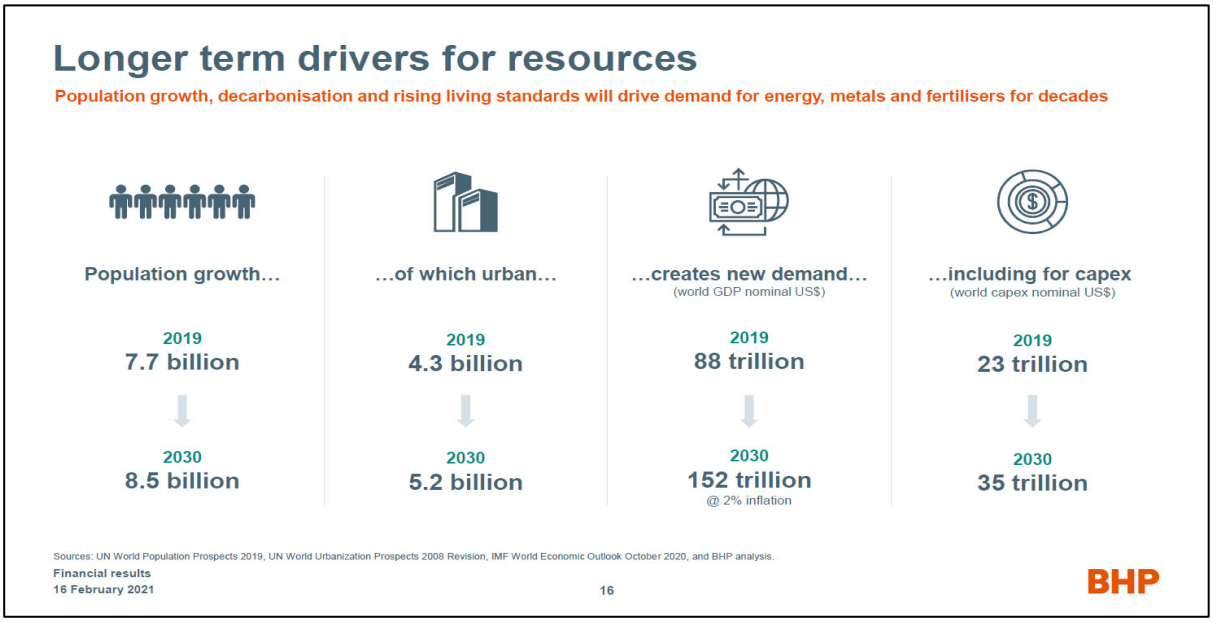

Image Source: *BHP Group – First Half of Fiscal 2021 IR Earnings Presentation*

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

Philip Morris International Issues Favorable Guidance

Image Shown: *Philip Morris International Inc's growth outlook rests heavily on its ability to grow its non-traditional cigarette sales volumes, and so far, the tobacco giant has put up tremendous performance on this front. Additionally, pricing power at its conventional cigarette business is also key, as that helps offset headwinds arising from secular declines in its annual cigarette shipment volumes.* ***Image Source:*** *Philip Morris International Inc – 2021 Investor Day Presentation*

By Callum Turcan

During its 2021 Investor Day presentation held on February 10, tobacco giant Philip Morris International Inc (PM)---**5.6% yield**---reaffirmed its 2021 diluted EPS guidance and issued longer term guidance that was quite promising. The seller of Marlboro brand cigarettes in international markets (excluding the US and China) has historically offset headwinds that arise from secular declines in its annual cigarette shipment volumes through its impressive pricing power (made possible through the largely inelastic demand curve of tobacco products).

However, **more recently the company has been quite successful growing its unconventional tobacco product sales including its heated tobacco unit ('HTU') offerings.** Its IQOS offerings (IQOS is not an abbreviation) is considered a HTU product and that offering has proven to be quite popular.

Rising HTU sales volumes and significant pricing power at its traditional cigarette offerings supports Philip Morris International's outlook, and we continue to like the company as an idea in our High Yield Dividend Newsletter portfolio. The top end of our fair value estimate range sits at $91 per share of Philip Morris International, moderately above where shares of PM are trading at as of this writing. **Philip Morris International has also been actively pursuing improvements in its cost structure.** That strategy involves the firm focusing on generating manufacturing productivity gains and locating SG&A expense reductions, though digital investments and other endeavors are also important here.

Unconventional Tobacco Product Sales Outlook

The upcoming graphic down below highlights the enormous opportunity Philip Morris International is targeting via its IQOS and other HTU offerings. These unconventional tobacco offerings are targeted towards consumers seeking to quit smoking traditional cigarettes and attempt to replicate the conventional cigarette smoking experience. In 2020, Philip Morris International's HTU shipment volumes were up roughly 28% year-over-year.

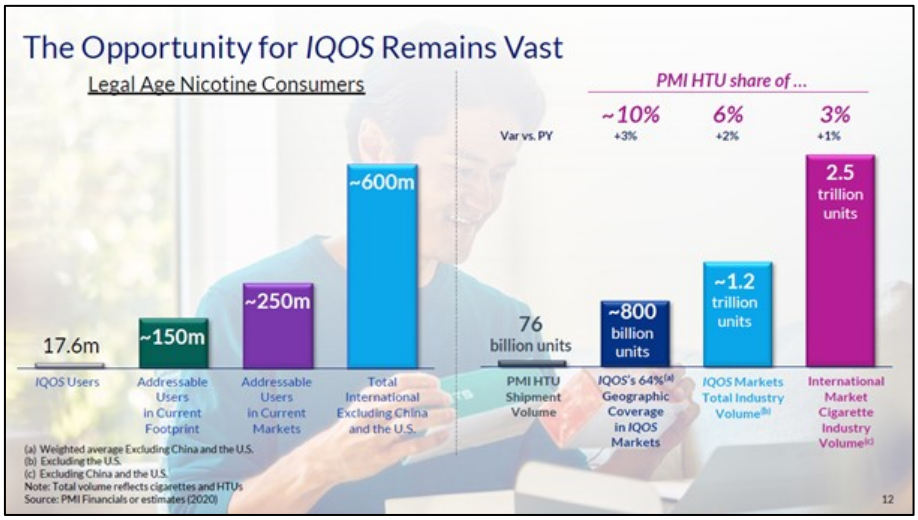

Image Shown: *The market opportunity for Philip Morris International's HTU offerings is enormous.* ***Image Source:*** *Philip Morris International – 2021 Investor Day Presentation*

In the upcoming graphic down below, Philip Morris International provides an overview of the retail value of the global tobacco market (excluding China and the US) as of 2020 and where the firm expects the industry to experience significant growth going forward. The growth rate in the retail value of HTU and e-vapor tobacco offerings are expected to significantly outpace broader growth in the retail value of tobacco products in the relevant markets over the next five years, according to Philip Morris International.

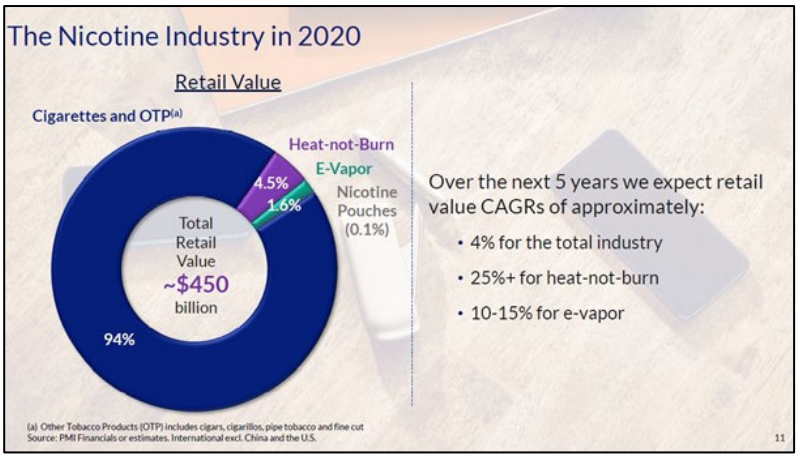

Image Shown: *Traditional tobacco offerings, namely cigarettes, continue to dominate the industry in terms of market share though that will slowly change over time.* ***Image Source:*** *Philip Morris International – 2021 Investor Day Presentation*

Promising Guidance

Philip Morris International reaffirmed its 2021 diluted EPS guidance of $5.90-$6.00 during its 2021 Investor Day presentation (based on currency exchange rates as of early-February 2021). That represents approximately 14%-16% growth over 2020 levels (the firm posted $5.16 in GAAP diluted EPS last year). Scale at its HTU business combined with broader corporate-level cost reductions is expected to provide a tailwind to Philip Morris International's operating margins going forward.

The tobacco giant aims to post net revenue growth north of 5% CAGR and diluted EPS growth north of 9% CAGR on an organic basis from 2021-2023. Management provides an overview of the firm's 2021-2023 forecasts in the upcoming graphic down below. Additionally, management also noted during the company's recent presentation that **Philip Morris International expects to generate ~$35 billion in net operating cash flow from 2021-2023** at current exchange rates.

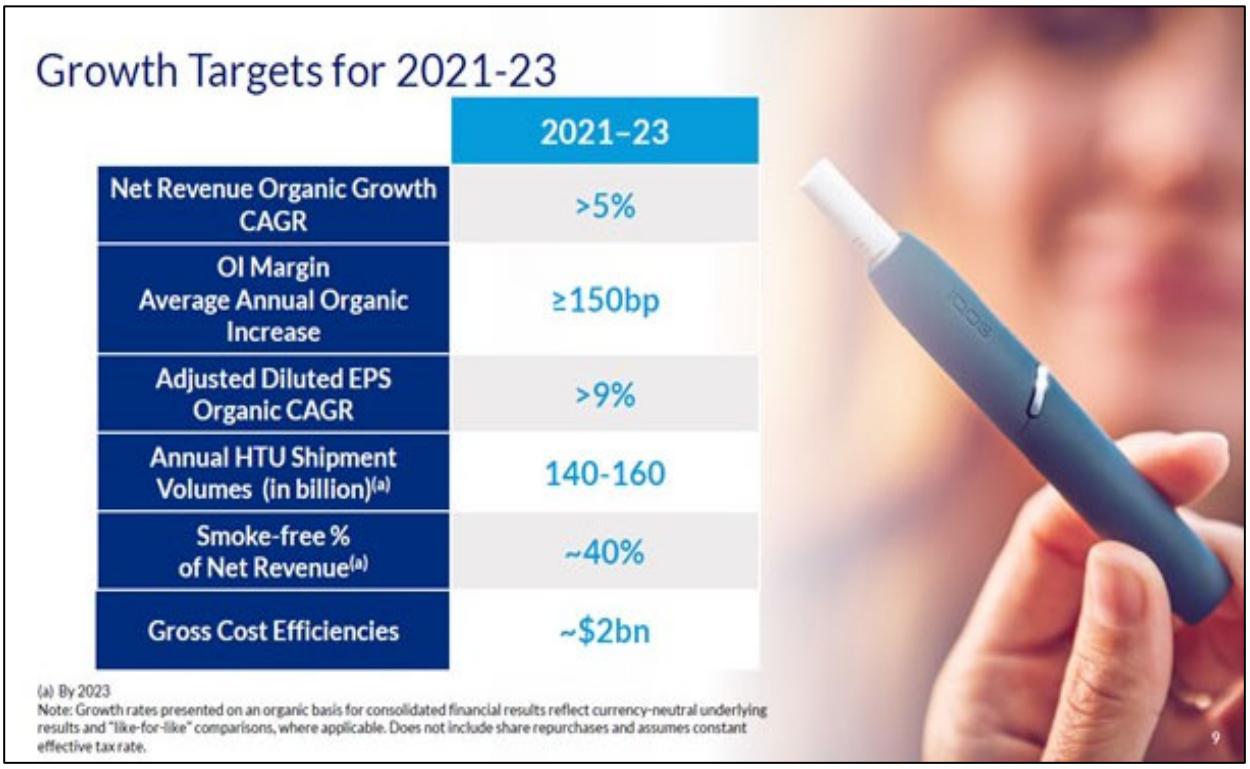

Image Shown: *Philip Morris International's medium-term guidance is quite promising, in our view.* ***Image Source:*** *Philip Morris International – 2021 Investor Day Presentation*

On February 4, Philip Morris International posted fourth quarter earnings for 2020 that beat both consensus top- and bottom-line estimates. The company generated $9.2 billion in free cash flow last year, broadly flat versus 2019 levels, while spending $7.4 billion covering its dividend obligations. Historically, Philip Morris International has not spent a significant amount (or any) towards buying back its stock.

Given that the High Yield Dividend Newsletter portfolio focuses on locating high-quality ideas with juicy yields, we appreciate that Philip Morris International prioritizes its dividend obligations and key growth investments (though its capital expenditure requirements remain relatively modest) above another uses of capital (such as major acquisitions and share repurchases).

At the end of 2020, the company had $7.3 billion in cash and cash equivalents on hand versus $3.4 billion in short-term debt and $28.2 billion in long-term debt. We view Philip Morris International's net debt load as manageable given its ability to generate significant free cash flows in almost any environment and its impressive outlook. The firm has ample liquidity on hand and should be able to manage both its dividend obligations and refinancing needs going forward.

Concluding Thoughts

Philip Morris International did a solid job navigating major exogenous headwinds during 2020 and was still able to churn out gobs of free cash flow. **We appreciate management's promising guidance and continue to like exposure to Philip Morris International and its lofty yield in the High Yield Dividend Newsletter portfolio.** The company's financial position and cash flow outlook remains rock-solid.

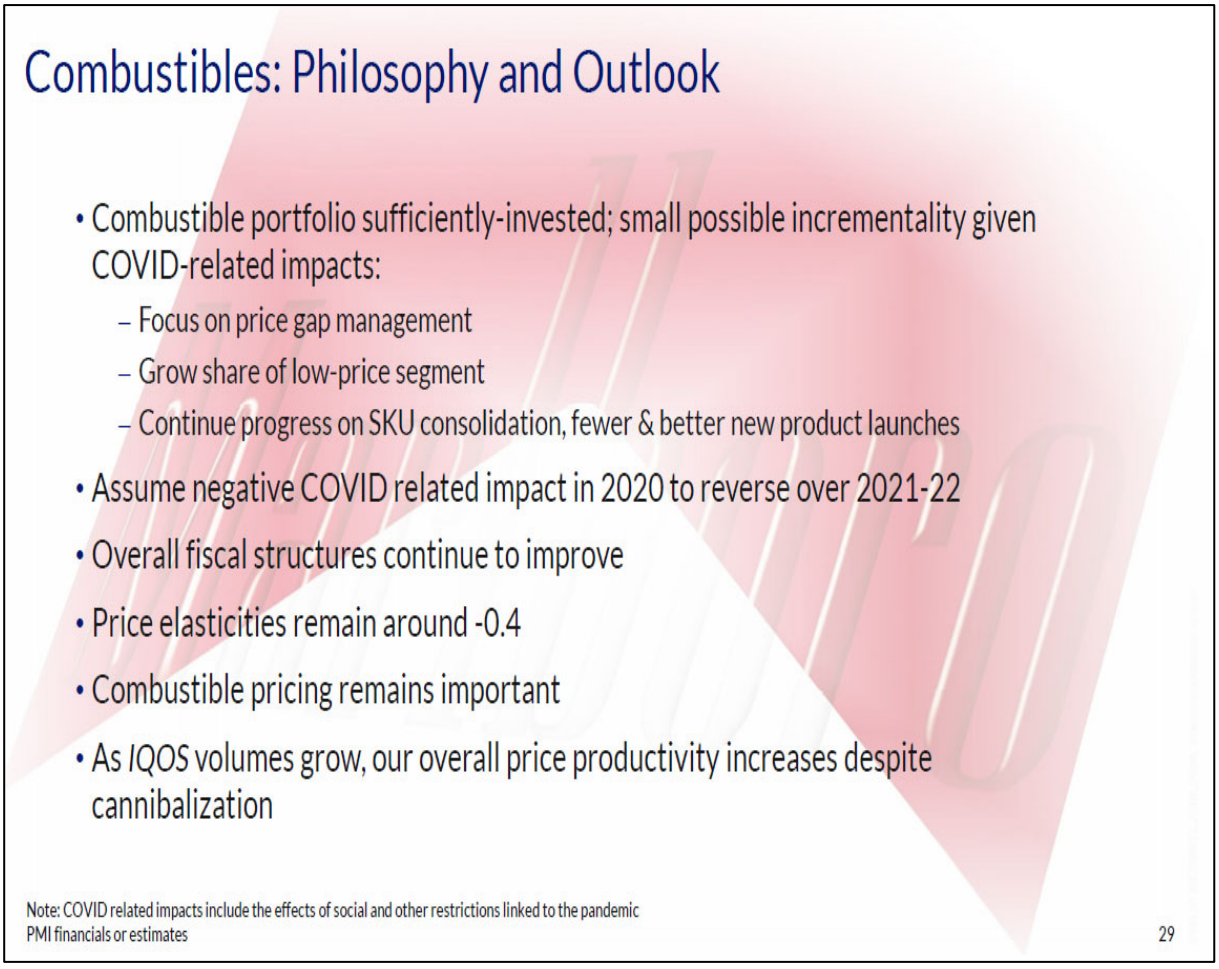

Image Source: *Philip Morris International – 2021 Investor Day Presentation*

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

Mondelez Capturing Share, Generating Strong Free Cash Flow

Image Source: *Mondelez International Inc – November 2020 IR Presentation*

By Callum Turcan

On January 28, snacks giant (generates most of its annual revenues from biscuits, chocolates, gum and candy) Mondelez International Inc (MDLZ)---**2.4% yield**---reported fourth quarter earnings for 2020 that beat both consensus top- and bottom-line estimates. Management noted in the earnings press release that the firm "enter[ed] 2021 in a strong position financially and in the marketplace which gives us confidence that we can deliver on our long-term growth targets in 2021 and beyond."

Mondelez reported 3.7% net organic revenue growth in 2020, supported by favorable volume and pricing movements, and negatively impacted by product mix. The firm's GAAP revenues were up just under 3% year-over-year in 2020, held down by foreign currency headwinds.

Looking ahead, **Mondelez aims to generate 3% or greater organic revenue growth** (a non-GAAP figure), **high-single-digit adjusted EPS growth** (a non-GAAP figure), **and $3.0 billion or more in free cash flow this year.** Furthermore, Mondelez expects to benefit from material foreign currency tailwinds in 2021, which based on its current assumptions would add ~3% to the firm's net revenue growth and add $0.10 in adjusted EPS to its performance this year.

Mondelez has been prioritizing its digital investments of late, and so far, this strategy appears to be playing out favorable. During the firm's latest earnings call, management had this to say in response to an analyst's question regarding Mondelez's increased advertising expenses in the second half of last year (emphasis added, moderately edited):

> *"**So in terms of investments… we stepped it up particularly in the second half, but I think you've seen the material we called out that working media is growing 17%. We plan to keep the same level of increases in 2021.** So we are building on a continuous investment in working media which importantly comes together with improved ROI, which means high quality media we are putting behind our brands. **We are investing more in digital, which in general terms commands a little bit more ROI than other regular channels.** And third, again the essence of diverting nonworking media into working media improves the overall spending ROI. So there is a compounded effect between increasing investment and having a better return on what we spend.* *[Continued on the next page]*

[Continued from the previous page] And again… ***when we look at market and share in Q4 we didn't slow down overall for the company****, and what that means, is that, yes, we had clear advantages in terms of supply chain at the beginning of the crisis, but as the situation normalized for us and for other competitors,* ***people continued to favor our franchises to others.*** *And I think one of the drivers is clearly the fact that we have invested more, that we have more meaningful innovation and that we are activating effectively at point of sales." --- Luca Zaramella, CFO of Mondelez*

Mondelez appears confident that it will be able to maintain recent market share gains and possibly even further grow market share going forward, aided by a focus on digital advertising campaigns and improving its digital/e-commerce presence more broadly. Dirk Van de Put, CEO and Chairman of Mondelez, noted in the firm's latest earnings call that "if you look at the share gains that we incurred in the second quarter of '20. And then you look at what happened in Q3 and Q4, we - our share gains didn't fade, they remained quite strong" and followed that up with "the share gain in '20 was much higher than in 2019 where we also had a share gain" in response to an analyst's question.

Last year, Mondelez generated $3.1 billion in free cash flow, up marginally from the $3.0 billion the firm generated in 2019. Mondelez had a net debt position of $16.4 billion at the end of 2020 (inclusive of short-term debt), though that does not include the $6.0 billion in equity method investments the firm had on the books at the end of December 2020. Please note that Mondelez owned a sizeable equity stake in JDE Peets NV (JDEPF) and Keurig Dr Pepper Inc (KDP), among other firms, at the end of September 2020 and likely continued to own sizable positions in those firms at the end of 2020. **We view Mondelez's net debt load as manageable given its stable cash flow profile and the liquid nature of a large chunk of its equity method investments.**

Image Shown: *An overview of Mondelez's key brands and products.* ***Image Source:*** *Mondelez – November 2020 IR Presentation*

Shares of MDLZ are trading in the upper bound of our fair value estimate as of this writing, and the top end of our fair value estimate range sits at $60 per share. We prefer broad diversified exposure to the consumer staples space through Vanguard Consumer Staples Index ETF (VDC), and that ETF is included in our High Yield Dividend Newsletter portfolio. Mondelez was a top ten weighted holding in the VDC ETF as of the end of December 2020.

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%	3.42%
iShares MSCI Australia ETF	EWA	5.0%	2.02%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	5.12%
iShares International Select Dividend ETF	IDV	5.0%	5.23%
iShares U.S. Preferred Stock ETF	PFF	5.0%	4.90%
Global X SuperDividend ETF	SDIV	5.0%	7.23%
Global X SuperIncome Preferred ETF	SPFF	10.0%	5.81%
Vanguard Consumer Staples ETF	VDC	5.0%	2.63%
Vanguard Real Estate ETF	VNQ	10.0%	3.92%
Utilities Select Sector SPDR	XLU	5.0%	3.38%
EQUITY			
AT&T	T	5.0%	7.46%
Crown Castle	CCI	5.0%	3.42%
CyrusOne Inc.	CONE	5.0%	3.11%
CubeSmart	CUBE	5.0%	3.68%
Digital Realty Trust	DLR	5.0%	3.44%
Enterprise Products Partners	EPD	2.5%	8.44%
Magellan Midstream Partners	MMP	2.5%	9.86%
Philip Morris	PM	5.0%	5.71%
Public Storage	PSA	5.0%	3.42%
Cash*	-	0.0%	0.00%
		100.0%	**4.64%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 3/1/2021. Est. Div. Yield information retrieved from SeekingAlpha, YF.

** Reflects federal funds target rate range*

DIVIDEND REPORT PAGE 2 – GILEAD SCIENCES (GILD)

Valuentum's Stock Dividend Research | Visit us at www.valuentum.com | Ratings as of 9-Nov-2020 | Data as of 6-Nov-2020

Gilead Sciences GILD FAIRLY VALUED

Buying Index™ 4 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Attractive	$42.00 - $70.00	HEALTHY	GOOD / 2.1	EXCELLENT	4.60%

Assessment of Company Dividend Strategy

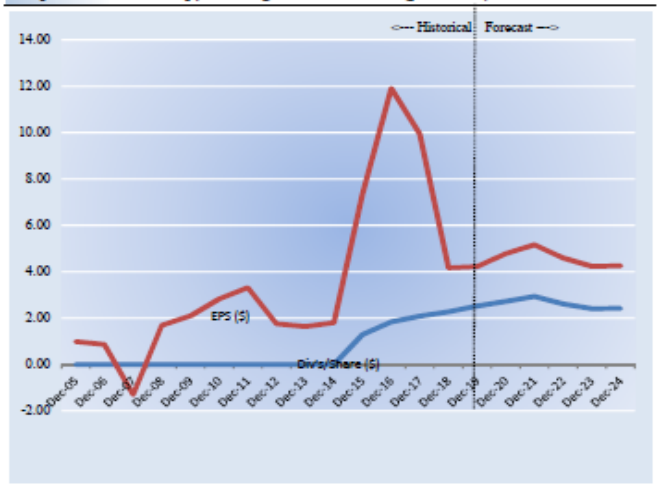
Key Strengths

Gilead's business has been transformed thanks to the success of its hepatitis-C cure. The company has a long history in developing HIV therapies, and it's working to develop more treatments. Free cash flow generation has been pressured alongside HCV revenue erosion, but the long-term health of Gilead's dividend will be dependent on advances across its pipeline, including hematology/oncology, cardiovascular and inflammatory diseases. We like the diversification and oncology presence the Kite Pharma (completed in October 2017) and Immunomedics (completed in October 2020) deals provides, even though both acquisitions impacted Gilead's balance sheet health.

Potential Weaknesses

Gilead's hepatitis-C franchise fueled the company's phenomenal free cash flow generation in the recent past, but competitive challenges have effectively truncated the opportunity, both with respect to pricing and volume. Political risk remains another key challenge for Gilead, as lawmakers continue to evaluate the pricing policies of drug makers. We weren't at all pleased to see Gilead expand its debt load, and we're not completely comfortable with share buybacks given questions over the sustainability of earnings. The company's HCV product concentration risk may give income investors reason for pause even if the financials look fine.

Graphical Relationship, Earnings and Dividends (per share)

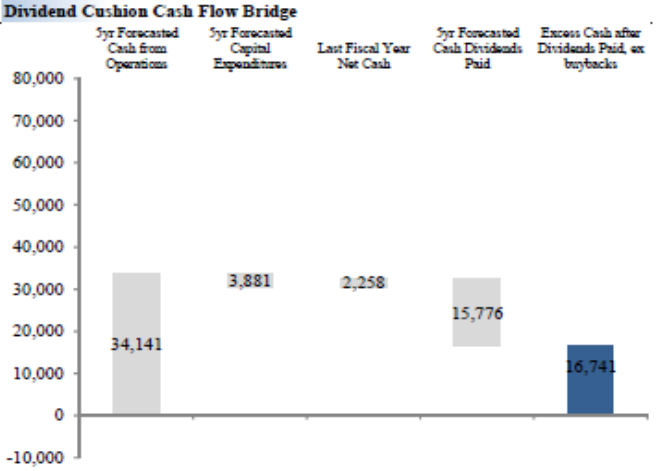


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

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. Gilead Sciences'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.

Dividend Cushion Cash Flow Bridge

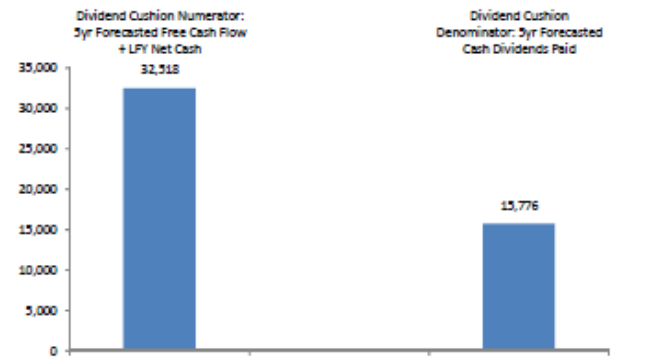


Source: Company Filings, Valuentum Projections

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, Gilead Sciences's numerator is larger than its denominator suggesting strong 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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