Valuentum Securities, Inc. 5/1/2021 Edition 4, Volume 5

HIGH YIELD DIVIDEND NEWSLETTER

THE HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO CONTINUES TO DELIVER THROUGH THICK AND THIN

Latest Changes to High Yield Dividend Newsletter
Removed: *NEW* EWA – April 27 Added: *NEW* SPYD – April 27

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"ON APRIL 27, WE REMOVED THE ISHARES MSCI AUSTRALIA ETF (EWA) FROM THE HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO AND REPLACED IT WITH THE SPDR PORTFOLIO S&P 500 HIGH DIVIDEND ETF (SPYD). THE MOVE HAS INCREASED THE ESTIMATED FORWARD-LOOKING YIELD OF THE HYDN PORTFOLIO. PLEASE NOTE THAT WE MAY FURTHER TWEAK THE NEWSLETTER PORTFOLIO IN THE COMING MONTHS."

– CALLUM TURCAN

Image Shown: *Over the past six months, the iShares MSCI Australia ETF has been on a nice upward climb. On April 27, we removed EWA from our High Yield Dividend Newsletter portfolio and added the SPDR Portfolio S&P 500 High Dividend ETF to the newsletter portfolio. This move improved the estimated forward-looking yield of the newsletter portfolio, and we plan to make further tweaks over the coming months.*

By Brian Nelson, CFA

A version of this article was emailed to members of April 27.

Trust you are doing great!

Back on April 27, we made a small **change to the High Yield Dividend Newsletter portfolio. We removed the iShares MSCI Australia ETF (EWA) and added the SPDR Portfolio S&P 500 High Dividend ETF (SPYD) in its place.**

The move provided a boost to the forward estimated dividend yield of the overall portfolio, while offering exposure to some of the highest-yielding equities in the S&P 500 at a very low gross expense ratio.

As of April 28, the SPDR Portfolio S&P 500 High Dividend ETF had a 30 Day SEC Yield of ~3.9%, which is a nice bump relative to the EWA that was included previously. **On a trailing twelve-month basis, the SPYD yielded ~4.7%.**

With the markets showing considerable strength since the March 2020 doldrums, we plan to make a few more tweaks to the High Yield Dividend Newsletter portfolio in the coming months **to continue to bolster its estimated forward dividend yield.**

When it comes to the equity portion of the High Yield Dividend Newsletter portfolio, we want to stick with best-of-breed REITs and MLPs -- REITs that can cover dividend payments with traditional free cash flow and MLPs that aren't stretching their capex budgets.

AT&T (T) may be **one of the best risk-reward ideas** when it comes to high yield dividend investing at this time, and while the company has a huge net debt position, management seems to be focused on all the right things -- growing free cash flow and deleveraging.

We continue to like a diversified approach when it comes to high yield dividend investing with exposure across ETFs that span asset classes, from preferreds to institutional leveraged loans and beyond. We generally like to hold no less than 15-20 ideas within the High Yield Dividend Newsletter portfolio at any time. Further concentration beyond that is a big hazard, in our view.

In a too-concentrated approach, it would only take one or two major dividend payers to slash or suspend their dividends to really wreak havoc on one's income stream. We were very pleased with how the High Yield Dividend Newsletter portfolio handled the COVID-19 crisis, where the newsletter portfolio kept a solid income stream flowing.

There are two big rules when it comes to high yield dividend investing: **1) Stay diversified and 2) pick your spots wisely using traditional financial statement analysis.** There's a lot of non-GAAP measures when it comes to REITs and MLPs from adjusted funds from operations (AFFO) to distributable cash flow (DCF) and beyond, but when push comes to shove, the GAAP balance sheet and traditional free cash flow assessments reign supreme. We define free cash flows as net operating cash flows less capital expenditures. Non-cancellable financial obligations need to be monitored as well.

As you know, dozens of REITs slashed their payouts during the COVID-19 crisis, despite having strong AFFO coverage beforehand, and dozens of MLPs cut their payouts during the 2015/2016 meltdown, despite having strong DCF coverage beforehand. **Stick with traditional financial statement analysis, and don't always take management's word regarding the safety of the payout.**

We're available for any questions.

Disclosure: *Brian Nelson owns shares in SPY, SCHG, QQQ, DIA, VOT, and IWM. Brian Nelson's household owns shares in HON, DIS, HAS.*

Good News From Yielding AT&T

Image Source: *AT&T*

A version of this article was emailed to members of April 22.

By Brian Nelson, CFA

On Thursday, April 22, AT&T (T) reported solid first-quarter results that gave the market confidence that it can make good on its payout to shareholders. The company offers high yield dividend investors an attractive risk-reward profile given its healthy earnings (and free cash flow) coverage of the dividend, in our opinion.

During the period, AT&T's consolidated revenue advanced 2.7% while adjusted diluted earnings per share came in at $0.86 versus $0.84 in last year's quarter. Operating cash flow leapt 12% **while free cash flow soared to $5.9 billion, up by more than half over the same tally in the year-ago period.** Here's what CEO John Stankey had to say about the quarter in the press release:

> We continued to excel in growing customer relationships in our market focus areas of mobility, fiber and HBO Max. [Continued on next page]

[Continued from previous page] We had another strong quarter of postpaid phone net adds, higher gross adds, lower churn and good growth in Mobility EBITDA. We also continue to increase penetration in markets where we offer fiber broadband and we're moving quickly to deploy more fiber. HBO Max continued to deliver strong subscriber and revenue growth in advance of our international and AVOD launches planned for June.

AT&T's 2021 guidance calls for consolidated revenue expansion to be in the 1% range, and adjusted EPS to be roughly even with 2020 performance. Subscriber growth at AT&T's HBO offering, with an eye towards its nascent HBO Max video streaming service, continues to pick up steam according to management. **Free cash flow generation expected in the $26 billion range for 2021 should handily cover expected cash dividends paid in the year, anticipated at ~$15 billion based on our forecasts within our discounted cash flow model.**

AT&T's dividend payout ratio in the quarter of 63.5% is a big improvement, and management expects its full-year total dividend payout ratio in the high 50%s range. The company doesn't garner a high Dividend Cushion ratio because of its large net debt position, but **free cash flow generation should allow AT&T to keep paying the dividend for the foreseeable future.**

We view the Dividend Cushion ratio as a ranking mechanism of dividend health, much like a credit rating ranks credit health. The higher the ratio, the healthier the dividend payout, in most cases. In general, we prefer dividend growth equities that have large net cash positions because a huge net cash load can provide a much-needed backstop to support the dividend during tough times.

AT&T's net debt stands at a whopping $168.9 billion, however -- though we note its annualized net debt to adjusted EBITDA of ~3.1 is risky but not terrible for its size. By the end of this year, management expects its net debt to be ~$154 billion. Investors should be aware of the risks that a huge net debt position brings to the dividend during times of tough credit, which often coincides with broad-based economic weakness and reduced consumer spending.

Concluding Thoughts

We liked AT&T's first-quarter results and outlook for 2021 that calls for free cash flow generation to be well in excess of expected cash dividends paid for the year. Investors should be aware of its hefty net debt position, but with a ~7% dividend yield, the company may be hard to pass up for high yield dividend focused investors. We plan to make some tweaks to our valuation model following this report, but our fair value estimate of $34 per share remains unchanged at this time.

Disclosure: *Brian Nelson owns shares in SPY, SCHG, QQQ, DIA, VOT, and IWM. Brian Nelson's household owns shares in HON, DIS, HAS.*

Competition Is Heating Up for Intel

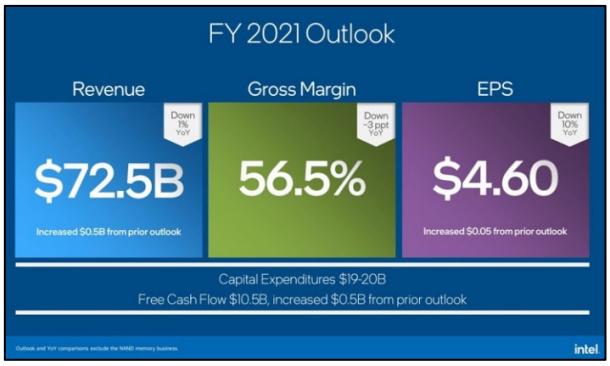

Image Shown: *Intel's outlook for 2021.* ***Image Source:*** *Q1 2021 Earnings Presentation*

By Brian Nelson, CFA

On April 22, Intel (INTC) reported first-quarter 2021 results that showed flat non-GAAP revenue performance, while non-GAAP earnings per share declined modestly. Shares of INTC yield ~2.4% as of this writing. **Intel has lost a bit of its edge** against Advanced Micro Devices (AMD) in recent years, and the market has been all over this (seen through the outperformance of shares of AMD over INTC over the past year).

Part of the reason why we had been huge fans of Intel in the past had to do with its Data Center Group (DCG), but **the segment posted revenue of $5.6 billion during the first quarter of 2021, down 20% on a year-over-year basis.**

As the world moves to the "cloud," we would expect this area to be more of a secular grower, so the lackluster performance raises some major red flags. Though management expects a return to growth soon, Nvidia's (NVDA) first data center CPU could make a sustainable bounce back more challenging for Intel. That said, Intel raised its full-year 2021 guidance and now expects non-GAAP revenue of $72.5 billion (up $500 million from prior guidance) and non-GAAP EPS of $4.60 (up $0.05 from prior guidance). Free cash flow is now expected to come in at $10.5 billion on the year, up $500 million from prior guidance. **We continue to remain cautious on shares**, though management painted an optimistic tone with respect to its outlook on the conference call:

> *We continue to see very strong PC demand with both TAM and our internal PC supply growing double-digits year-over-year, but we expect CCG (Client Computing Group) revenue to be more first-half-weighted than normal seasonality due to industry-wide supply constraints and the continuing ramp-down of modem and Apple Mac revenue.*
>
> *In data center, we expect increased demand in the second half as both cloud, enterprise and government segments return to growth.* ***Gross margin percent will be lower in the second half of the year****, predominantly due to increased 7-nanometer start-up costs and industry-wide supply constraints impacting client volume and mix. We expect increased R&D throughout the year as we invest in our roadmap and IDM 2.0 strategy* ***(1)****.*

Intel expects to continue to generate considerable free cash flow in 2021, well in excess of our expectations for its annual run-rate dividend payments of ~$5.5-$6 billion, and we fully expect it to make good on its payout. However, Intel's move to invest in foundries to compete more aggressively with TSMC (TSM) and Samsung (SSNNF, SSNLF) coupled with increased competition from AMD and Nvidia means **the company is walking on some thin ice from a competitive standpoint.** With multiple balls in the year, Intel may come up short on its ambitions.

Valuentum's Callum Turcan had the following to add: **"AMD has really been eating into Intel's server chip market share of late and now Nvidia is also looking to get into that arena; it is not a pretty picture for Intel given its manufacturing problems."** Though Intel's shares have held up since we removed them from the newsletter portfolios, we're expecting some bad news on the horizon. The company's large net debt position is yet another reason to be leary of the stock, even though free cash flow generation remains robust.

Concluding Thoughts

Intel has had a terrific run, but **we think bad news may be on the horizon.** The chip giant is juggling too many balls at the moment, and competition from the likes of AMD and Nvidia could result in some tough sledding in coming years. **We feel that a big miss is coming that may take the market by surprise later this year or in 2022.** Execution will be key, and Intel has its work cut out for it. The company's Dividend Cushion ratio stands above parity at 1.4.

> ***(1)*** *From the 10-Q: "On March 23, 2021, our CEO Pat Gelsinger announced our "IDM 2.0" strategy, the next evolution of our IDM model. IDM 2.0 combines three factors. First, we will continue to build the majority of our products in Intel fabs. Second, we expect our use of third-party foundry capacity to grow and to include manufacturing for a range of modular tiles on advanced process technologies. Third, we announced our plans to build a world-class foundry business with Intel Foundry Services, which will combine leading-edge process and packaging technology, committed capacity in the U.S. and Europe, and a world-class IP portfolio for customers, including x86 cores. To accelerate our IDM 2.0 strategy, we announced plans to invest $20.0 billion to build two new fabs in Arizona."*

Disclosure: *Brian Nelson owns shares in SPY, SCHG, QQQ, DIA, VOT, and IWM. Brian Nelson's household owns shares in HON, DIS, HAS.*

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

HIGH YIELD SPOTLIGHT

Whirlpool Offers Nice Yield with Strong Payout Coverage

Our **High Yield Spotlight for May 2021** is home appliance maker Whirlpool Corporation (WHR)---**2.4% yield**---as recent growth in Whirlpool's payout has made its yield more competitive. The Whirlpool brand remains strong in the realm of kitchen and laundry appliances. **We view the firm's forward-looking dividend coverage quite favorably, supported by its tremendous free cash flow generating abilities, as Whirlpool has a Dividend Cushion ratio of 1.7 (well above parity).** The company aims to spend ~3% of its net revenues on capital expenditures and another ~3% on R&D expenses going forward to stay competitive. When considering potential M&A endeavors, Whirlpool focuses on opportunities that could generate a high return on invested capital ('ROIC').

***Image Source: Whirlpool** – First Quarter of 2021 IR Earnings Presentation*

The firm's cash flow profile is attractive in large part due to its relatively modest capital expenditure requirements, making free cash flows easier to come by. **Whirlpool's long-term goal is to generate free cash flow equal to 6+% of its net sales.** From 2018-2020, Whirlpool's free cash flows averaged ~$0.8 billion per year versus ~$0.3 billion in annual dividend obligations on average during this period. This performance is made even more impressive when considering **Whirlpool generated $1.1 billion in free cash flow last year** even in the face of substantial headwinds from the coronavirus ('COVID-19') pandemic, while spending $0.3 billion covering its dividend obligations and another $0.1 billon buying back its stock in 2020.

Whirlpool announced that the firm had approved a 12% sequential increase in its quarterly dividend alongside an additional $2.0 billion in share buyback authorization on April 19. Going forward, we see room for Whirlpool to push through substantial payout increases on the back of its promising free cash flow growth outlook. **The biggest hurdle facing Whirlpool's dividend policy would likely be its net debt load, which stood at $2.8 billion at the end of March 2021** (inclusive of short-term debt). Whirlpool had over $2.4 billion in cash and cash equivalents on hand at the end of this period, providing it with ample liquidity.

By the end of the first quarter of 2021, Whirlpool had achieved its long-term leverage ratio of 2.0x or below, defined as gross debt divided by its "ongoing EBITDA" which is an adjusted non-GAAP EBITDA figure over the relevant trailing twelve month period. That figure stood at 1.9x by the end of March 2021 according to Whirlpool, which puts the firm in a better position to reward shareholders. Over the long haul, Whirlpool aims to pay out ~30% of its trailing twelve month adjusted earnings in the form of dividends while steadily buying back its stock.

The appliance maker's outlook is incredibly bright. **When it reported first quarter earnings on April 21**, which smashed past both consensus top- and bottom-line expectations, **Whirlpool raised its full-year guidance for 2021.** Now Whirlpool expects to post adjusted EPS of $22.50-$23.50 in 2021, up from $19.00-$20.00 previously. Its free cash flow forecast for 2021 was revised up to ~$1.25 billion from greater than $1.0 billion previously, a welcome sign. This upside was largely due to Whirlpool raising its full-year adjusted net sales guidance to 13% from 6% previously, though this does not include the expected impact from future foreign currency movements but this forecast does assume that Guangdong Galanz Household Appliances Manufacturing Co.'s ('Galanz') partial tender offer for Whirlpool China closes in the second quarter of 2021.

Back in August 2020, Galanz offered to acquire no less than 51% and no more than 61% of Whirlpool China's equity. For reference, Whirlpool China is a majority-owned subsidiary of Whirlpool that is listed on the Shanghai Stock Exchange. Whirlpool expects to receive ~$150 million from this deal according to management commentary during the firm's latest earnings call.

As of the first quarter of 2021, Whirlpool's fastest growing (in terms of revenue growth) and largest geographical segment was its North American business which generated over half of its revenues and the lion's share of its adjusted EBIT during this period. Simplifying its business model and corporate structure while pivoting towards geographical segments that Whirlpool has a stronger position in, like North America, is a smart decision in our view.

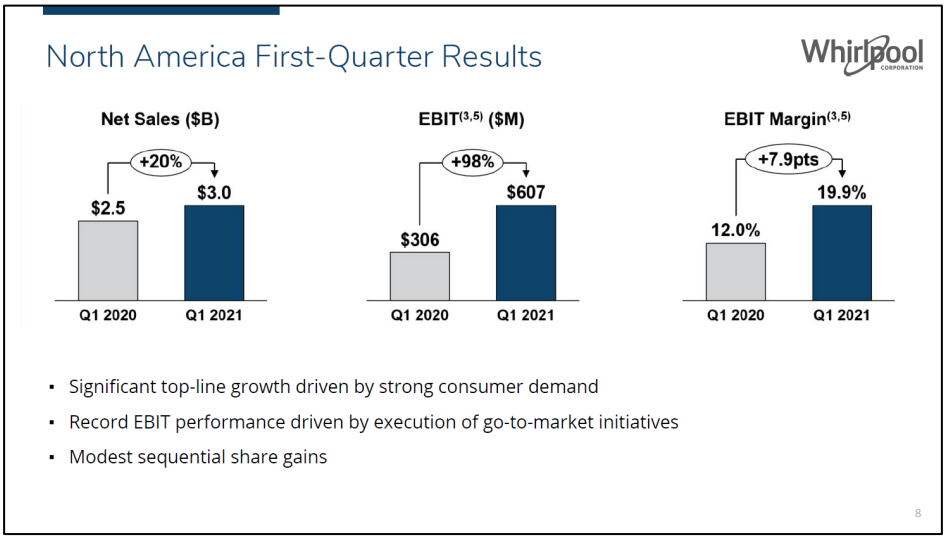

Image Source: *Whirlpool – First Quarter of 2021 IR Earnings Presentation*

In the upcoming graphic at the top of the next page, Whirlpool provides its outlook regarding how it views the home appliance industry progressing through 2021. Please note the strong expected EBIT margins and sales growth in North America.

2021 Regional Guidance

Whirlpool CORPORATION

	Industry		EBIT %	
	Previous	Current	Previous	Current
North America	4 - 6%	6%+	15%+	15.5%+
Europe, Middle East & Africa	2 - 4%	unchanged	2.5%+	unchanged
Latin America	2 - 4%	unchanged	7%+	~8%
Asia	6 - 8%	unchanged	2%+	5%+*
Total	**~4%**	**5%**	**9%+**	**~10%**

*Assumes the partial tender offer by Galanz for majority ownership of the Whirlpool China business is successfully closed in Q2 2021

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Image Source: *Whirlpool – First Quarter of 2021 IR Earnings Presentation*

We view Whirlpool's guidance boost quite favorably and its ongoing restructuring initiatives should help continue to improve its financial performance over the long haul. The firm embarked on a series of cost cutting measures in 2020 in response to the COVID-19 pandemic (including workforce reductions), **though management noted Whirlpool would face headwinds (at least in the near-term) from higher input prices as raw materials costs (such as steel and resin) are on the rise.** With that in mind, better pricing strategies are expected to provide a powerful uplift to Whirlpool's margins going forward, with an eye towards cost based pricing strategies.

During the firm's latest earnings call, management noted that Whirlpool "announced significant cost based price increase in various countries across the globe ranging from 5% to 12%" in response to various supply chain hurdles. Management aims for Whirlpool to have a ~10% adjusted EBIT margin this year, up from previous guidance calling for a ~9% adjusted EBIT margin. **Pricing strength is also indicative of strong underlying demand for Whirlpool's home appliance offerings.** The upcoming graphic down below highlights both Whirlpool's near- and long-term goals.

Updated 2021 Guidance

Whirlpool CORPORATION

	PROFITABLE GROWTH		MARGIN EXPANSION		CASH CONVERSION	
LONG-TERM GOALS	~3% ANNUAL ORGANIC NET SALES GROWTH		~10% ONGOING EARNINGS BEFORE INTEREST AND TAX, % OF NET SALES		6%+ FREE CASH FLOW AS % OF NET SALES	
2021 GUIDANCE*	Net Sales ~$22B	YoY Change 13%**	Ongoing EBIT Margin(1) ~10%	YoY Change ~90 bps	Free Cash Flow(2) ~$1.25B	FCF as % of Net Sales ~5.7%

Increased full-year ongoing EPS range from $19.00 - $20.00 to $22.50 - $23.50

*Note: guidance assumes the partial tender offer by Galanz for majority ownership of the Whirlpool China business is successfully closed in Q2 2021
**Does not include the impact of currency

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Image Source: *Whirlpool – First Quarter of 2021 IR Earnings Presentation*

Over the long haul, Whirlpool aims to generate ~3% annual organic net sales growth which is roughly in line with expected global economic growth during "normal" times. Whirlpool's free cash flow generating abilities should benefit from a combination of expected organic sales growth, various margin-preserving measures (with room for margin expansion upside), and the modest nature of its capital expenditure requirements to maintain a certain level of revenues.

There are some risks to this high yield story, however, with an eye towards rising raw materials and other input prices. Management expects these headwinds will peak in the third quarter of this year, though should cost inflation pressures turn out to be bigger than expected, that could weigh on Whirlpool's outlook. Another concern has to do with Whirlpool's net debt load and its other non-cancellable long-term liabilities, such as its pension plan and lease liabilities. However, we view those burdens as manageable given Whirlpool's favorable outlook and strong free cash flow generating abilities. Finally, investors should be aware that Whirlpool's share repurchasing program competes for capital against its dividend payout.

Moody's Corporation (MCO) and Fitch both rate Whirlpool's senior unsecured credit rating as investment grade (Baa1/BBB) with a stable outlook. Both rating agencies reaffirmed their credit rating for Whirlpool on April 26 after Whirlpool announced it was issuing debt to retire its upcoming June 2021 maturities.

Whirlpool still appears to retain solid access to capital markets at attractive rates, and proceeds from the partial divestment of its stake in Whirlpool China should further strengthen its balance sheet. **The company's outlook is incredibly promising, its free cash flow generating abilities are impressive, and we view Whirlpool's forward-looking dividend coverage quite favorably.** After its latest dividend increase, Whirlpool's yield is now respectable with room for upside via future payout increases. Whirlpool has a Dividend Cushion ratio of 1.7, well above parity and we see room for the company to aggressively increase its payout going forward. **We like Whirlpool as our High Yield Spotlight for May 2021.**

Substantial Margin Expansion

Whirlpool CORPORATION

(Approximate impact)	Q1
2020 Ongoing EBIT Margin[5]	**6.2%**
Price/Mix	+5.75
Net Cost*	+3.75
Raw Material Inflation	-2.25
Marketing & Technology Investments	-0.50
Currency	-0.75
2021 Ongoing EBIT Margin	**12.4%**

*Inclusive of Fixed Cost Takeout, Ongoing Cost Productivity (Including Conversion and Freight & Warehousing), Volume Leveraging and Restructuring Benefits.

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Image Source: *Whirlpool – First Quarter of 2021 IR Earnings Presentation*

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

Banks Holding Up Well, Some Feel Pain from Archegos Capital Collapse

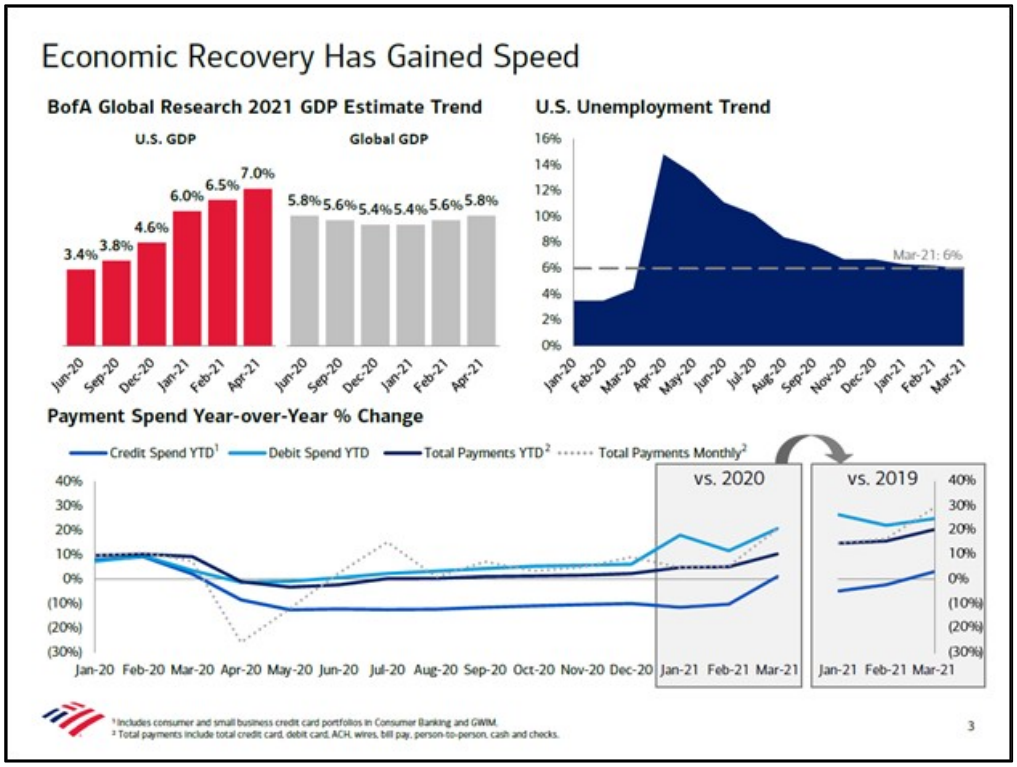

Image Shown: *Bank of America Corporation has an optimistic view towards the ongoing US economic recovery.* ***Image Source:*** *Bank of America Corporation – First Quarter of 2021 IR Earnings Presentation*

By Callum Turcan

Earnings season is now underway!

In this article, we cover the performance of two large US banks and the problems facing one major European bank in light of losses stemming from Archegos Capital Management blowing up. **Large reserve releases last quarter--due to the US economy holding up better than expected--during the coronavirus ('COVID-19') pandemic played an outsized role in bolstering the financial performance of key US banks after these institutions recorded large reserve builds in 2020.** Net interest margins ('NIM') continue to face headwinds from the low interest rate environment, though noninterest related income (such as income generated from wealth management, investing banking, and other activities) at several banks has come in strong (aided by favorable capital market conditions).

The surge in special purpose acquisition companies ('SPACs') going public in the US has been a boon for investment banking operations, though as we noted in a recent article, many of these SPACs are not great for investors. As the US economy continues to recover, aided by ongoing COVID-19 vaccine distribution efforts and the easing of social distancing restrictions (along with the uplift provided by massive fiscal stimulus packages), the outlook for interest rates should improve, though in the near term, rates are likely to remain subdued according to commentary from Fed chairman Jerome Powell. Whether a large infrastructure stimulus package materializes in the US over the coming months is a key consideration.

Bank of America

Bank of America Corp (BAC) reported first quarter 2021 earnings on April 15 that beat both consensus top- and bottom-line estimates. **The bank generated $0.87 in GAAP EPS last quarter, more than double year-ago levels though there is a lot of noise in the numbers.** Net interest margins continued to face headwinds from the low interest rate environment in the first quarter, though strength at its wealth management and investment banking business bolstered Bank of America's performance.

Please note **Bank of America's bottom-line benefited from a large reserve released in the first quarter of 2021** as the company set aside more than it needed in 2020 to cover potential losses (in the first quarter of 2020, Bank of America's profit took a hit from a large reserve build). As the outlook for the domestic economy continues to improve, the bank now expects its loan losses will be smaller than originally feared.

1Q21 Financial Results

Summary Income Statement ($B, except per share data)	1Q21	4Q20	$ Inc / (Dec)	1Q20	$ Inc / (Dec)
Total revenue, net of interest expense	$22.8	$20.1	$2.7	$22.8	$0.1
Provision (benefit) for credit losses	(1.9)	0.1	(1.9)	4.8	(6.6)
Net charge-offs	*0.8*	*0.9*	*(0.1)*	*1.1*	*(0.3)*
Reserve build (release)[1]	*(2.7)*	*(0.8)*	*(1.9)*	*3.6*	*(6.3)*
Noninterest expense	15.5	13.9	1.6	13.5	2.0
Pretax income	9.2	6.1	3.0	4.5	4.6
Pretax, pre-provision income[2]	*7.3*	*6.2*	*1.1*	*9.3*	*(2.0)*
Income tax expense	1.1	0.6	0.5	0.5	0.6
Net income	$8.1	$5.5	$2.6	$4.0	$4.0
Diluted earnings per share	$0.86	$0.59	$0.27	$0.40	$0.46
Average diluted common shares (in millions)	8,756	8,785	(29)	8,863	(107)

Return Metrics and Efficiency Ratio			
Return on average assets	1.13 %	0.78 %	0.65 %
Return on average common shareholders' equity	12.3	8.4	5.9
Return on average tangible common shareholders' equity[2]	17.1	11.7	8.3
Efficiency ratio	68	69	59

Note: Amounts may not total due to rounding.
[1] For more information on reserve build (release), see note A on slide 28.
[2] Represent non-GAAP financial measures. For more information on pretax, pre-provision income and a reconciliation to GAAP, see note B on slide 28. For important presentation information about these measures, see slide 31.

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Image Shown: *Bank of America's bottom-line received a massive boost in the first quarter of 2021 due primarily to a large reserve release, money previously set aside for potential loan losses. The US economy has fared better than initially expected so far during the COVID-19 pandemic and with vaccine distribution efforts now well underway, there is room to keep the momentum going in the right direction. Image Source: Bank of America – First Quarter of 2021 IR Earnings Presentation*

According to its latest earnings presentation, Bank of America is experiencing a steady decline in "early stage credit card delinquencies" which relates to accounts that are 89 days (or fewer) past due. **The bank communicated to investors that if current trends hold, its net charge offs from its credit card business should move lower in the near-term.** Savings built up by many households and corporations during the pandemic saw Bank of America's deposits surge higher last quarter versus year-ago levels.

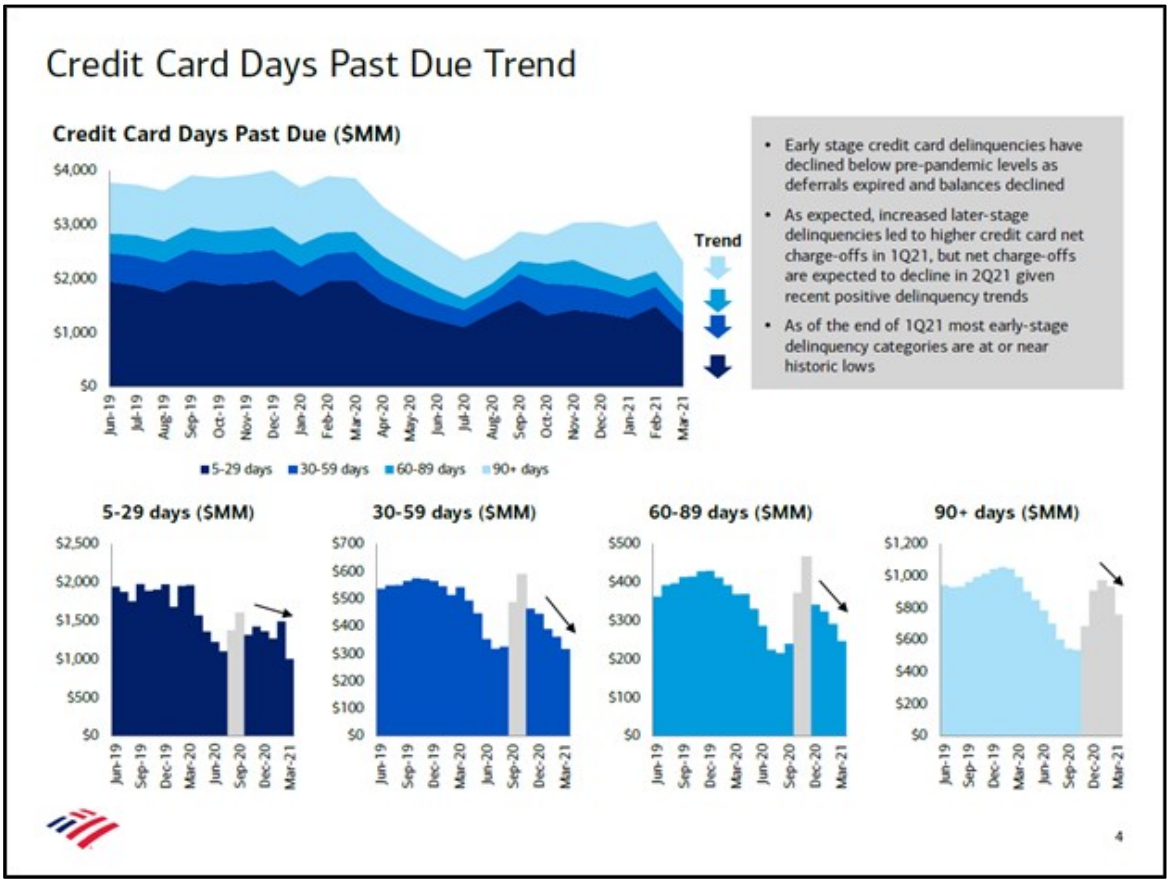

Image Shown: *Bank of America's credit card delinquency rates are trending in a positive direction.* ***Image Source:*** *Bank of America – First Quarter of 2021 IR Earnings Presentation*

Bank of America's digital operations continue to see growing levels of user engagement. From the first quarter of 2018 to the first quarter of 2021, its digital household adoption percentage grew from 61% to 70%. The bank's virtual financial assistant, known as Erica, has surged in popularity over the past couple of years.

On April 15, Bank of America also announced that it had authorized $25.0 billion in share repurchases, though in the near-term, Bank of America will need to comply with pandemic-related regulations set by the Fed regarding capital allocation decisions. **At the end of March 2021, Bank of America had a common tier one equity ('CET1') ratio of 11.8%, well above the 9.5% requirement.**

We continue to view Bank of America as one of the best banks out there. As of this writing, shares of BAC yield ~1.8%. On a final note, as it concerns the collapse of Archegos Capital Management, Bank of America appears to have largely dodged that bullet.

Credit Suisse Group

The Switzerland-based bank Credit Suisse Group AG (CS) was not so lucky. When the company published its first quarter 2021 earnings on April 22, its GAAP revenues were up 31% year-over-year in Swiss Franc terms (abbreviated as CHF) due to strength at its wealth management and investing banking businesses (according to the firm's 2020 Annual Report, Credit Suisse reports its financial results in accordance with US GAAP accounting practices). However, Credit Suisse still reported a sizable GAAP net loss last quarter due to a large provision for credit losses as the bank expects to take a CHF$4.4 billion charge (approximately USD$4.8 billion based on exchange rates seen in the middle of April 2021) from the collapse of Archegos Capital Management.

Counterparty risk in the financial services sector always needs to be monitored.

Credit Suisse suspended its share buyback program at the end of March 2021 in light of the massive charge and also intends to reduce its dividend. The bank is also dealing with problems related to certain supply chain finance funds and Greensill Capital, which recently filed for bankruptcy. Though Credit Suisse changed portions of its corporate structure and management team in the wake of these crises, more will likely need to be done to stabilize the ship. **We continue to view the banking landscape in the US much more favorably than the banking landscape in Europe.**

JPMorgan

On April 14, JPMorgan Chase & Co. (JPM) reported first quarter 2021 earnings that beat both consensus top- and bottom-line estimates. As was the case with Bank of America, JPMorgan recorded a large reserve release last quarter which played an outsized role in its GAAP net income rising many-fold over year-ago levels (when its performance was weighed down by large reserve builds). **JPMorgan's home lending business performed quite well last quarter as the number of loan originations grew ~40% year-over-year, and this segment of its business also benefited from a reserve release.**

1Q21 Financial highlights

ROTCE[1]	CET1 capital ratios[2]	Net payout LTM[3]
29%	Std. 13.1%; Adv. 13.7%	37%

- 1Q21 net income of $14.3B and EPS of $4.50
  - Excluding significant items[4], net income of $10.6B, EPS of $3.31 and ROTCE of 21%
  - Managed revenue of $33.1B[5,6]
  - Expense of $18.7B[6] and managed overhead ratio of 57%[5]
- Balance sheet
  - Loans[7,8]: average loans of $1.0T up 1% YoY and 2% QoQ
  - Deposits: average deposits of $2.2T up 36% YoY and 5% QoQ
  - Basel III CET1 capital of $206B[2]
    - Standardized CET1 capital ratio of 13.1%[2]; Advanced CET1 capital ratio of 13.7%[2]
- Capital returned to shareholders
  - Common dividend of $2.8B or $0.90 per share
  - $4.3B of common stock net repurchases in 1Q21[9]

Significant items ($mm, excluding EPS)

	Pretax	Net income	EPS
Firmwide credit reserve release	$5,204	$3,955	$1.28
Contribution to Firm's Foundation	(550)	(287)	(0.09)

[1] See note 3 on slide 11
[2] Represents the estimated common equity Tier 1 ("CET1") capital and ratio for the current period. See note 1 on slide 12
[3] Last twelve months ("LTM"). Net of stock issued to employees
[4] See note 2 on slide 11
[5] See note 1 on slide 11
[6] See note 6 on slide 12
[7] Includes the impact of loans originated under the Paycheck Protection Program ("PPP")
[8] See note 7 on slide 12
[9] Includes the net impact of employee issuances. See note 4 on slide 12

1

JPMORGAN CHASE & CO.

Image Shown: *A snapshot of JPMorgan's performance during the first quarter of 2021.* ***Image Source:*** *JPMorgan – First Quarter of 2021 IR Earnings Presentation*

JPMorgan's NIM continued to face headwinds from the low interest rate environment last quarter, though strength at its investment banking and wealth management business helped offset those headwinds (similar to Bank of America's performance in the first quarter). **At the end of March 2021, JPMorgan had a standardized CET1 ratio of 13.1%** and during its latest earnings call, management communicated to investors that additional share buybacks were on the horizon. JPMorgan's management team also noted that the bank's digital platform performed quite well last quarter during the company's latest earnings call as "approximately 50% of new checking and savings accounts were opened digitally--that's up more than 10 percentage points year-on-year."

Looking ahead, JPMorgan has a positive view towards the US economic outlook as consumer sentiment and credit/debit card activity is starting to return to pre-pandemic levels according to the bank. **Commentary from major US banks underpins our view that the US economic recovery is on a positive trajectory, and we continue to view JPMorgan as one of the best banks out there alongside Bank of America.** Shares of JPM yield ~2.3% as of this writing.

Corporate & Investment Bank[1]

$mm

		$ O/(U)	
	1Q21	4Q20	1Q20
Revenue	$14,605	$3,253	$4,602
Investment Banking revenue	2,851	354	1,965
Wholesale Payments	1,392	(35)	(22)
Lending	265	72	(85)
Total Banking	4,508	391	1,858
Fixed Income Markets	5,761	1,811	768
Equity Markets	3,289	1,300	1,052
Securities Services	1,050	(3)	(24)
Credit Adjustments & Other	(3)	(246)	948
Total Markets & Securities Services	10,097	2,862	2,744
Expense	7,104	2,165	1,149
Credit costs	(331)	250	(1,732)
Net income	$5,740	$391	$3,755

Key drivers/statistics ($B)[2]

Equity	$83.0	$80.0	$80.0
ROE	27%	26%	9%
Overhead ratio	49	44	60
Comp/revenue	30	17	30
IB fees ($mm)	$2,988	$2,558	$1,907
Average loans[3]	182.5	165.0	164.0
Average client deposits[4]	705.8	683.8	514.5
Merchant processing volume ($B)[5]	425.7	444.5	374.8
Assets under custody ($T)	31.3	31.0	24.4
ALL/EOP loans ex-conduits and trade[6]	2.06%	2.54%	1.11%
Net charge-off/(recovery) rate[6]	(0.02)	0.27	0.17
Average VaR ($mm)[7]	$99	$91	$58

[1] See note 1 on slide 11 and note 5 on slide 12
For additional footnotes see slide 13

Financial performance

- Net income of $5.7B, up 189% YoY; revenue of $14.6B, up 46%
- Banking revenue
  - IB revenue of $2.9B, up 222% YoY
    - IB fees, up 57%, reflecting higher fees across products
    - YoY comparison benefited from an $820mm bridge book[8] markdown in 1Q20
  - Wholesale Payments revenue of $1.4B, down 2% YoY
  - Lending revenue was $265mm, down 24% YoY, predominantly driven by mark-to-market gains on hedges of accrual loans in the prior year
- Markets & Securities Services revenue
  - Markets revenue of $9.1B, up 25% YoY
    - Fixed Income Markets revenue of $5.8B, up 15% YoY, predominantly driven by Securitized Products and Credit, largely offset by Rates and Currencies & Emerging Markets
    - Equity Markets revenue of $3.3B, up 47% YoY, driven by strong performance across products
  - Securities Services revenue of $1.1B, down 2% YoY
- Expense of $7.1B, up 19% YoY, predominantly driven by higher revenue-related compensation partially offset by lower legal expense
- Credit costs: net benefit of $331mm, driven by reserve releases

6

JPMORGAN CHASE & CO.

Image Shown: *JPMorgan's corporate and investment banking businesses performed quite well last quarter.* ***Image Source:*** *JPMorgan – First Quarter of 2021 IR Earnings Presentation*

Final Thoughts

We continue to view Bank of America and JPMorgan as best of breed in the banking space. Investors are keeping a close eye on developments regarding a potential infrastructure stimulus package materializing in the US, which could involve potential changes in the US corporate tax code as well, though nothing is for certain at this point.

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

Structural Changes in the Airline and Aerospace Business

Image Source: *Valuentum*

By Brian Nelson, CFA

The coronavirus pandemic ("COVID-19") has fundamentally changed how companies do business. Zoom Video (ZM) has made in-person meetings largely redundant while innovative digital-agreement firms such as DocuSign (DOCU) have only contributed to the "anywhere economy." Though there may be pent-up demand for in-person meetings and handshake agreements as the number of vaccinations for COVID-19 increase across the globe, many businesses may grow to permanently embrace the "anywhere economy" for its efficiencies and cost savings. **This will impact the long-term trajectory of business air travel demand, in our opinion, with implications on the normalized intrinsic values of airlines (JETS), jet makers, and the aerospace supply chain.**

During most of the past decade, we have been bullish on the secular trend of air travel growth and aerospace demand given the vast backlog of unfulfilled aircraft deliveries at the airframe makers Boeing (BA) and Airbus (EADSY), but a once-in-a-century pandemic and the preferences of coming generations have changed our take. For example, during the COVID-19 pandemic, many baby boomers that never spent much time on a computer bought their first items on Amazon (AMZN) last year, while others learned to schedule their grocery pick-ups at Walmart (WMT) to avoid potential exposure to the virus. The convenience of staying at home for just about everything wasn't fully appreciated or socially accepted until COVID-19 made it so. Many baby boomers will continue the behaviors they learned to embrace during the coronavirus pandemic, but this may be ancillary to our assessment of the values of airlines, jet makers, and the aerospace supply chain.

Demographic Shifts and Changing Consumer Preferences to Impact Business Travel Demand

As we look out to air traffic and aerospace demand in the coming decades, it's impossible to ignore the demographic shifts and the changing consumer preferences that come with them. As baby boomers take advantage of new

technologies to make their lives easier, millennials "grew up" in the digital age and find such technologies indispensable to their lives, with most millennials preferring impersonal interactions through digital means. For example, a millennial today may have no problem ordering Domino's (DPZ) from an app on their iPhone, while their parents may still call up the local pizza shop to order and then drive to pick up the pizza themselves and pay with cash. The takeaway, of course, is not so much that food-delivery companies Grubhub (GRUB), DoorDash (DASH) and Uber (UBER) Eats (Postmates) will fundamentally change the manner that we order and get our meals, but rather it is the idea that coming generations will prefer much more impersonal interactions within business processes than the generations before them.

We expect this demographic-driven behavioral shift to have tremendous long-term implications on the trajectory of future air travel demand growth relative to pre-COVID-19 expectations. For future millennial CEOs that today are texting with their friends (instead of chatting on the phone) and using DoorDash to deliver lunch to their home (instead of ordering at the counter), we expect the adoption curve in the coming decades of disruptive business process solutions such as Zoom Video and DocuSign to be much easier--or even preferable. By 2030, it would not be surprising for most of business to be conducted almost entirely digital--from the intro call on Zoom Video or another web-based communications platform through signing the contract online with "category killer" DocuSign's eSignature. The in-person business meeting that requires cross-continent or intercontinental business air travel may be viewed more as a costly luxury when efficiencies and cost savings can be had through digital business processing. **Air travel will not go away (and it will still grow), but the future pace of expansion has certainly been disrupted.**

Air Travel Demand Will Make New Highs Again But Long Term Expectations Lower Than Pre-COVID-19

We expect air travel demand to recover from the doldrums of the COVID-19 crisis, just like it has recovered from every other calamity in the history of mankind from past wars to 9/11 to other avian flu outbreaks. We also expect the newfound wealth emanating from the stock market, new IPOs and SPACs, cryptocurrencies and other alternative asset-class inflation to provide a mitigating impact via increased leisure travel in the near term, but this more-cyclical component may not be sustainable to fully offset what we expect to be a structurally changed business air travel demand landscape over the long haul. Again, the emphasis is not that air travel demand won't recover or be larger than pre-COVID-19 levels in the coming years, but rather that the future trajectory of air travel growth over a future 20-year horizon or so has changed dramatically.

Though shares of airlines and the aerospace supply chain sold off considerably during the COVID-19 pandemic (and have bounced back somewhat), investors in airlines and the aerospace supply chain may still not fully appreciate this permanently altered dynamic. They may be betting on a "return to pre-COVID-19 normal" scenario, but "normal" for all intents and purposes may have been changed as a result of an acceleration of disruptive technologies. Perhaps our altered long-term view on airlines and aerospace is shared by Berkshire Hathaway's (BRK.A) (BRK.B) Warren Buffett. In August 2015, Berkshire announced it would shell out $37 billion for one of our favorite companies in the aerospace supply chain, Precision Castparts. The company makes vital metal castings for jet engines, and with one of the best CEOs in the business in Mark Donegan, we thought Warren Buffett made a savvy acquisition at the time.

However, in Berkshire's latest shareholder letter, the Oracle of Omaha noted:

> The final component in our GAAP figure – that ugly $11 billion write-down – is almost entirely the quantification of a mistake I made in 2016. That year, Berkshire purchased Precision Castparts ("PCC"), and I paid too much for the company. No one misled me in any way – **I was simply too optimistic about PCC's normalized profit potential.** Last year, my miscalculation was laid bare by adverse developments throughout the aerospace industry, PCC's most important source of customers. In purchasing PCC, Berkshire bought a fine company – the best in its business. Mark Donegan, PCC's CEO, is a passionate manager who consistently pours the same energy into the business that he did before we purchased it. We are lucky to have him running things. I believe I was right in concluding that PCC would, over time, earn good returns on the net tangible

> assets deployed in its operations. **I was wrong, however, in judging the average amount of future earnings and, consequently, wrong in my calculation of the proper price to pay for the business.** PCC is far from my first error of that sort. But it's a big one.

When it comes to asset write-downs, they reflect a permanent change in the long-term assessed value of the business, not one influenced by a cyclical dynamic or a one-time shock such as COVID-19, but rather as Warren Buffett puts it, an adjustment in "normalized profit potential." **The rest of the aerospace supply chain is not immune to similar dynamics either--and by extension, we believe the long-term normalized earnings power of the entire aerospace supply chain has been substantially reduced in similar fashion.** A confluence of factors ranging from the changing mix of leisure and business travel demand in the coming decades coupled with the cyclical tendencies of the financial health of airlines has now made investing in the aerospace supply chain tenuous at best. We do not fault Warren Buffett for his purchase of Precision Castparts. We loved the company in 2015 and 2016, too, but COVID-19 and accelerated disruptive technologies have changed the long-term game, whether we like it or not.

Honeywell Remains the Best Way to Play Aerospace In Our View

Our fair value estimate for jet-making giant Boeing stands at $234 per share, about in line with its share price at the time of this writing, but we're not interested in shares. Boeing's balance sheet is very unhealthy regardless of its credit rating, in our view, and it will be years before Boeing gets back to where it was before the 737 MAX calamity and COVID-19 crisis, if ever. We're also not interested in General Electric (GE). Though the troubled conglomerate is making progress in improving industrial free cash flow, pinpointing a fair value estimate for the conglomerate is far more art than science than we would prefer in a long-term investment consideration. The airlines, too, are more like trading vehicles than investments, and they now will be faced with headwinds from secular changes in the nature of business air travel.

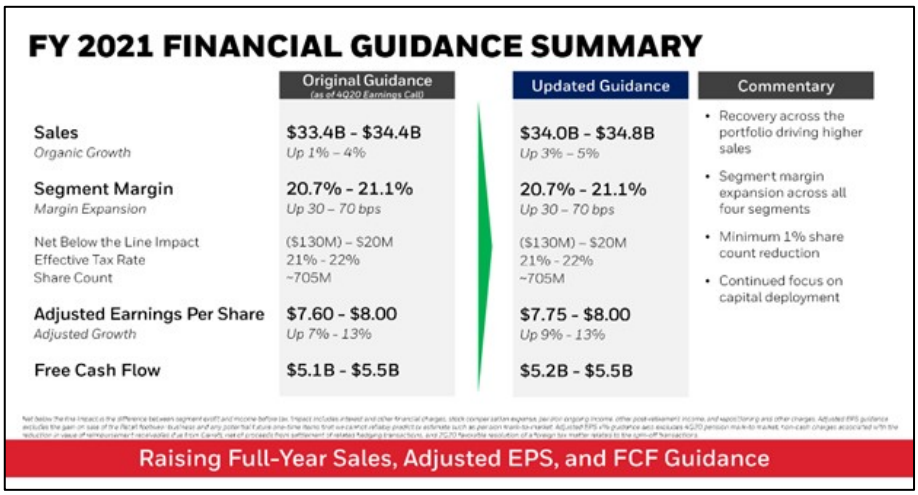

Image Shown: *Honeywell's expects a better-than-expected 2021.* ***Image Source:*** *Honeywell 1Q 2021 Earnings Presentation.*

We think the best way to gain exposure to aerospace is via Honeywell (HON). Honeywell is well-diversified with its 'Honeywell Building Technologies' and 'Safety and Productivity Solutions' business segments, which will help smooth out COVID-19 driven weakness in its 'Aerospace' division while providing exposure to the area for any potential upside should our and Warren Buffett's thesis on the aerospace supply chain come up short. We were pleased with Honeywell's first-quarter results, released April 23, and here's what management had to say about its outlook for 2021 in the press release:

> As a result of the company's first-quarter performance and management's outlook for the remainder of the year, Honeywell raised its full-year sales guidance and raised the midpoint of its adjusted earnings per share and cash

> flow guidance. Full-year organic sales growth is now expected to be in the range of 3% to 5%. Adjusted earnings per share is expected to be $7.75 to $8.00, up 15 cents from the low end of the prior guidance range. Operating cash flow is now expected to be in the range of $5.8 billion to $6.1 billion and free cash flow is now expected to be in the range of $5.2 billion to $5.5 billion.

Even with Honeywell's 'Aerospace' sales falling 22% during the first quarter, the company still managed to drive resilient earnings per share performance in the period and raise its full-year 2021 guidance thanks in part to considerable growth in its 'Safety and Productivity Solutions' segment, which benefits from personal protective equipment demand. When air travel and aerospace demand return to their "new normal" -- a "normal" that is different than what we expected the future to be like before COVID-19 -- Honeywell will still benefit. Unlike others, however, the company is not exclusively tied to aerospace as with other pure plays such as Boeing, nor is it as troubled as other diversified industrials with aerospace exposure such as GE, which continues to work hard to right the ship. **Relatively speaking, these considerations make Honeywell quite attractive of an aerospace and industrials idea, and its dividend is icing on the cake in this regard.**

Concluding Thoughts

The future profile for air travel demand will be negatively impacted in the long run (relative to pre-COVID-19 expectations) as increased leisure travel from the wealth effect may not completely offset reduced business travel growth impaired by digital solutions permanently disrupting the way companies conduct business. As with Warren Buffett, who recently wrote down the value of metal casting jet-engine supplier Precision Castparts (one of the best aerospace suppliers in the business), we believe intrinsic values of others in the aerospace supply chain have been permanently reduced as well.

We're staying away from airlines and aerospace with the exception of Honeywell, which offers diversified industrial exposure and a "call option" on a gradual aerospace recovery to a "new normal." **Honeywell showed with its first-quarter 2021 results that it can thrive in a business environment where aerospace demand may not live up to pre-COVID-19 long-term expectations.** Honeywell yields ~1.7% at the time of this writing.

Disclosure: *Brian Nelson owns shares in SPY, SCHG, QQQ, DIA, VOT, and IWM. Brian Nelson's household owns shares in HON, DIS, HAS.*

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Disclosure: *Unless otherwise noted, 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%	3.24%
SPDR Portfolio S&P 500 High Dividend ETF ***NEW***	SPYD	5.0%	4.66%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	5.03%
iShares International Select Dividend ETF	IDV	5.0%	3.93%
iShares U.S. Preferred Stock ETF	PFF	5.0%	4.65%
Global X SuperDividend ETF	SDIV	5.0%	6.63%
Global X SuperIncome Preferred ETF	SPFF	10.0%	5.69%
Vanguard Consumer Staples ETF	VDC	5.0%	2.59%
Vanguard Real Estate ETF	VNQ	10.0%	3.24%
Utilities Select Sector SPDR	XLU	5.0%	2.93%
EQUITY			
AT&T	T	5.0%	6.62%
Crown Castle	CCI	5.0%	2.81%
CyrusOne Inc.	CONE	5.0%	2.80%
CubeSmart	CUBE	5.0%	3.21%
Digital Realty Trust	DLR	5.0%	3.01%
Philip Morris	PM	5.0%	5.05%
Public Storage	PSA	5.0%	2.85%
Enterprise Products Partners	EPD	2.5%	7.82%
Magellan Midstream Partners	MMP	2.5%	8.79%
Cash*	-	0.0%	0.00%
		100.0%	**4.31%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 5/1/2021. Est. Forward 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 16-Apr-2021 | Data as of 15-Apr-2021

PepsiCo PEP 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	$108.00 - $162.00	HEALTHY	GOOD / 0.7	GOOD	2.88%

Assessment of Company Dividend Strategy

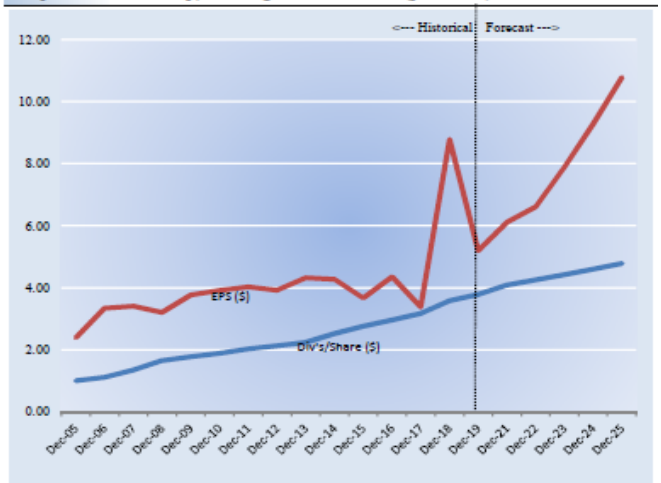
Key Strengths

It is hard not to like the reliability of Pepsi's business model, and such stability drives its impressively consistent free cash flow generating ability. Pepsi is a Dividend Aristocrat that has increased its dividend for 45+ consecutive years, and we are expecting the streak to continue, though at a slower pace than in the recent past. The company expects that both the global beverage and global snack markets will grow by mid-single-digits annually in the medium-term, and the company's international growth runway is immense. Pepsi is digitizing its supply chain and investing in automation to boost its operational efficiency and improve its cost structure.

Potential Weaknesses

Pepsi's fundamental strength is hard to poke holes in, and the firm's strength in North America is augmented by its exposure to potentially higher-growth emerging markets, though higher volatility in the latter is not uncommon. The company's large net debt load weighs negatively on its Dividend Cushion ratio, though Pepsi's ability to generate sizable free cash flows in almost any operating environment continues to impress. Pepsi historically has spent considerable sums buying back its stock which competes for capital against its dividend obligations. All things considered; investors can expect Pepsi to continue returning copious amounts of cash to shareholders.

Graphical Relationship, Earnings and Dividends (per share)

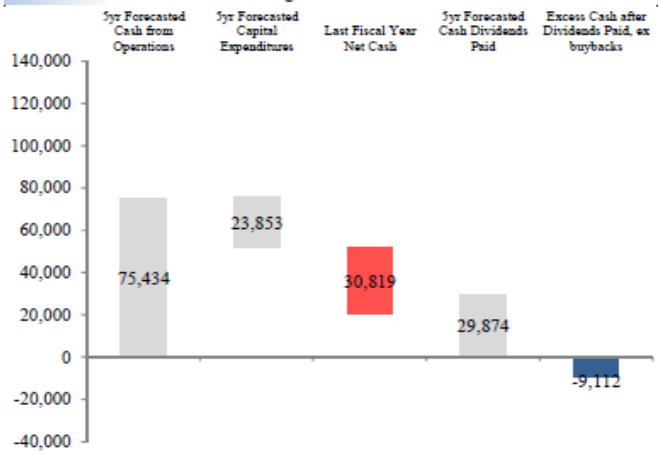


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

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. PepsiCo'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

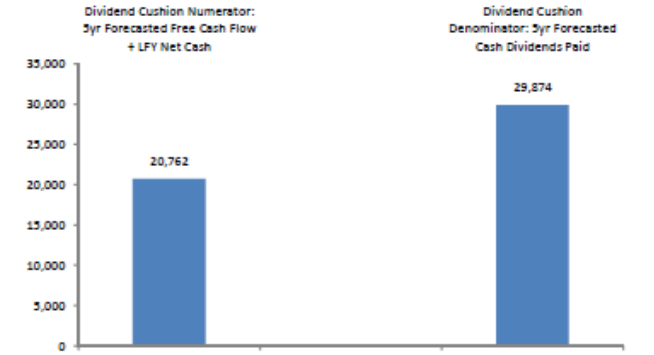


Source: Company Filings, Valuentum Projections

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, PepsiCo'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.

Disclosure: *Brian Nelson owns shares in SPY, SCHG, QQQ, DIA, VOT, and IWM. Brian Nelson's household owns shares in HON, DIS, HAS.*

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