Valuentum Securities, Inc. 6/1/2021 Edition 4, Volume 6

HIGH YIELD DIVIDEND NEWSLETTER

CROWN CASTLE IS A GREAT INCOME GROWTH IDEA

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

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"SHARES OF VARIOUS CELL TOWER, DATA CENTER, AND SELF-STORAGE REAL ESTATE INVESTMENT TRUSTS HAVE PERFORMED QUITE WELL OF LATE. THAT INCLUDES SEVERAL IDEAS WITHIN THE HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO SUCH AS CROWN CASTLE, CUBESMART, DIGITAL REALTY, AND PUBLIC STORAGE. WE VIEW THE HYDN PORTFOLIO AS WELL-POSITIONED TO NAVIGATE THE REOPENING OF THE DOMESTIC AND INTERNATIONAL ECONOMIES GOING FORWARD."

– CALLUM TURCAN

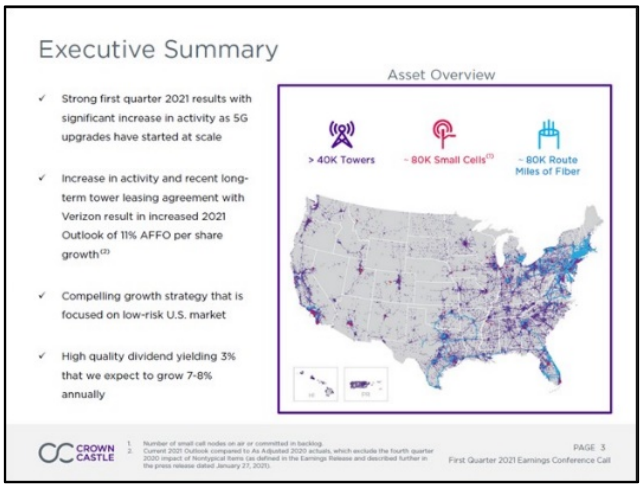

Image Shown: *Crown Castle International Corp has an expansive portfolio of shared wireless infrastructure assets that covers every major market in the US.* ***Image Source:*** *Crown Castle International Corp – First Quarter of 2021 IR Earnings Presentation*

By Callum Turcan

Crown Castle International Corp (CCI) is a high-quality real estate investment trust ('REIT') that focuses on shared wireless infrastructure assets. Its expansive portfolio includes 40,000+ towers, ~80,000 route miles of fiber, and ~80,000 small cell nodes. According to Crown Castle, it has a presence in every major US market. **Shares of CCI yield ~2.8% as of this writing.**

Over the long haul, Crown Castle aims to grow its dividend per share and adjusted funds from operations ('AFFO') per share (an imperfect but useful non-GAAP metric) by 7%-8% annually. Crown Castle's adjusted Dividend Cushion ratio (taking its ability to tap capital markets into account) sits comfortably above parity at 1.5, indicating its forward-looking

dividend strength is rock solid. Recent debt issuance activity and the strong performance seen at shares of CCI of late indicates Crown Castle continues to retain solid access to capital markets at attractive rates.

We are huge fans of Crown Castle and include the REIT as an idea in the High Yield Dividend Newsletter portfolio given its nice yield and promising payout growth outlook. Looking ahead, the ongoing buildout of 5G wireless infrastructure in the US, the Internet of Things ('IoT') trend, and the potential emergence of smart cities supports the outlook for data demand and ultimately Crown Castle's ability to grow its cash flows. Crown Castle's contracts generally are long term in nature and come with rent escalators and other provisions that are favorable for the REIT.

Earnings Update

On April 21, Crown Castle published first-quarter 2021 earnings that missed consensus top-line estimates but beat consensus AFFO per share estimates. The REIT's 'site rental revenues' rose 5% year-over-year in the first quarter as the uplift from new leasing activity and contractual rent escalations offset the negative impact of tenant non-renewals. We appreciate the REIT's resilient performance in the face of headwinds arising from the coronavirus ('COVID-19') pandemic.

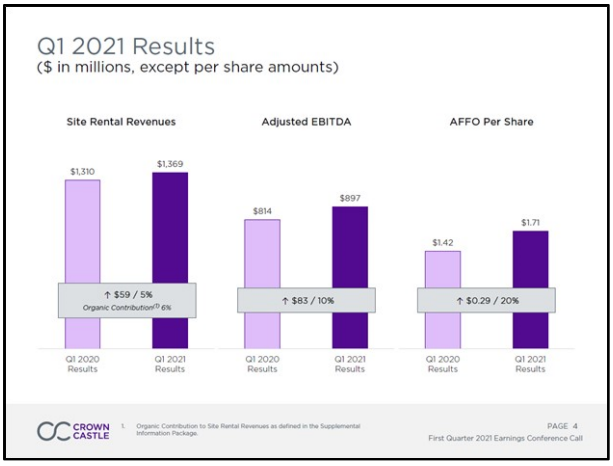

Image Shown: *An overview of Crown Castle's financial performance in the first quarter of 2021.* ***Image Source:*** *Crown Castle International Corporation – First Quarter of 2021 IR Earnings Presentation*

Crown Castle generated $0.3 billion in free cash flow in the first quarter of this year, though it remains a capital-market dependent entity given its large net debt load (~$19.6 billion at the end of March 2021 inclusive of short-term debt and excluding restricted cash) and substantial payout obligations (which totaled $0.6 billion in the first quarter). Being capital-market dependent means Crown Castle needs to retain access to debt and equity markets, ideally at attractive rates, to keep making good on its payout obligations while managing its debt maturities and capital expenditure requirements (among other things).

Most importantly, **Crown Castle raised its full-year guidance for 2021 during its first quarter earnings report** as you can see in the upcoming graphic down below. When adjusting for the impact the T-Mobile US Inc (TMUS) merger with Sprint (Completed in April 2020) had on Crown Castle's financial performance due to the cancellation of certain contacts, along with other factors, Crown Castle now expects its per share AFFO to grow by 11% this year at the midpoint of guidance (up from 10% previously). Additionally, Crown Castle now sees its site rental revenues growing by 7% this year at the midpoint, up from 4% previously.

	Full Year 2021			
			Midpoint Growth Rate Compared to Prior Year Actual[b]	
(in millions, except per share amounts)	Current Outlook Midpoint	Change to Midpoint from Prior Outlook[a]	As Reported	As Adjusted[c]
Site rental revenues	$5,695	+$140	7%	7%
Net income (loss)[d]	$1,084	+$87	3%	30%
Net income (loss) per share—diluted[d,e]	$2.50	+$0.20	6%	37%
Adjusted EBITDA[d]	$3,757	+$150	1%	10%
AFFO[d,e]	$2,946	+$40	2%	14%
AFFO per share[d,e]	$6.79	+$0.10	—%	11%

(a) As issued on January 27, 2021. See "*Full Year 2021 Outlook*" below for our previous full year 2021 Outlook.
(b) See "*Full Year 2021 Outlook*" below for our full year 2020 actual results.
(c) As Adjusted growth rates exclude the impact of the cancellation of certain small cells previously contracted with Sprint Corporation and a reduction in staffing that occurred in fourth quarter 2020 (collectively "Nontypical Items"), as further described in our press release dated January 27, 2021 and reconciled in "*Non-GAAP Financial Measures, Segment Measures and Other Calculations*" herein.
(d) 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.
(e) Attributable to CCIC common stockholders.

Image Shown: *An overview of Crown Castle's updated 2021 guidance published in conjunction with its first quarter earnings report.* ***Image Source:*** *Crown Castle – First Quarter of 2021 Earnings Press Release*

Please note that when T-Mobile cancelled ~5,700 small cell node contracts that Crown Castle had secured with Sprint (an action T-Mobile notified Crown Castle that it was going to pursue in December 2020), that prompted T-Mobile to accelerate the payment of all of the related contractual obligations to Crown Castle along with the relevant capital costs that had already been incurred. Crown Castle noted that "the majority of the cancelled small cells were not yet constructed and, upon completion, would have been located at the same locations as other T-Mobile small cells" in its fourth quarter 2020 earnings press release.

Major Deals

In November 2020, Crown Castle signed a major agreement with DISH Network Corp (DISH) to support the company's 5G wireless ambitions after DISH Network acquired Boost Mobile in July 2020 (a former Sprint prepaid brand). DISH Network aims to build out its own standalone 5G wireless network in the US over the coming years as it seeks to become a major US wireless service provider. Its agreement with Crown Castle involves DISH Network leasing space up to

20,000 of the REIT's cell towers. In the meantime, DISH Network is utilizing T-Mobile's wireless network via a long-term arrangement.

Additionally, Crown Castle announced a new long-term agreement with Verizon Communications Inc (VZ) in January 2021. This agreement involves Verizon leasing out 15,000 small cell nodes from the REIT over the next four years (with the initial lease term running for ten years once the small cell node is installed).

These strategic partnerships have favorably augmented Crown Castle's growth runway and provide greater visibility as it concerns the REIT's future cash flow performance, given the stable and long-lasting nature of these contracts under most circumstances, save for events like major merger and acquisition activities.

Management Commentary

During Crown Castle's first quarter 2021 earnings call, management had this to say (emphasis added):

> *"Turning back to our focus on generating superior long-term returns,* ***one of our core principles of our strategy is to remain U.S. only, because we believe it represents the best market for wireless infrastructure ownership since it has the most attractive growth profile and the lowest risk.***
>
> *And we believe this dynamic of higher growth and lower risk will continue into the future which is why we expect our U.S.-based strategy to drive significant returns for our shareholders.*
>
> *Starting with the higher growth we see in the U.S., the demand for our shared infrastructure offering across towers, small cells and fiber is tied to the* ***robust demand for mobile data in the U.S. which continues to increase by more than 30% annually.***
>
> *Because the outlook is so compelling, the U.S. wireless market continues to attract a disproportionate amount of global capital investment. This is likely due in part to the fact that the durability and scale of wireless data growth in the U.S. has repeatedly outperformed expectations." – Jay Brown, President and CEO of Crown Castle*

By sharpening its operational focus and securing meaningful long-term partnerships with the leading players in the space, Crown Castle aims to generate substantial shareholder value (ROIC ex-goodwill > WACC). Historically, Crown Castle has done a stellar job on this front, and we expect this will continue to be the case going forward. Crown Castle is a top-notch REIT with ample room for upside, in our view, and we appreciate its focused business model.

Concluding Thoughts

We like Crown Castle as an idea in the High Yield Dividend Newsletter portfolio given its promising payout growth trajectory, solid business model, and bright outlook. The recent strategic arrangements Crown Castle secured with DISH Network and Verizon will go a long way in supporting the REIT's cash flow growth trajectory over the coming years. Crown Castle has been firing on all cylinders of late and the high end of our fair value estimate range sits at $210 per share of Crown Castle. Shares trade for ~$186 at the time of this writing.

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

AT&T Right Sized Dividend, WarnerMedia Joining Forces with Discovery

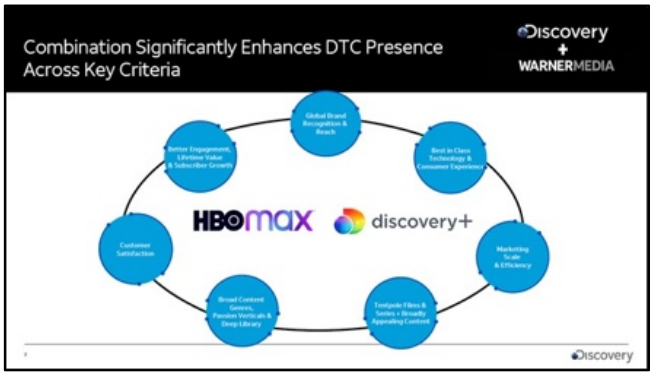

Image Shown: *AT&T Inc's WarnerMedia unit is joining forces with Discovery Inc. This transaction, if it goes through as planned, will create another giant in the video streaming services industry.* ***Image Source:*** *Discovery Inc – Discovery Joining Forces with WarnerMedia IR Presentation*

By Callum Turcan

Despite the upcoming rightsizing of its dividend payout in light of a pending spin-off, the telecommunications and media giant AT&T Inc (T) continues to be one of our favorite income generation ideas. We're not making any changes to the newsletter portfolios at this time, and **the recent news indicates AT&T's balance sheet is about to improve significantly.**

Major Transaction

On May 17, AT&T announced a major transaction with Discovery Inc (DISCA) that involves AT&T using a Reserve Morris Trust transaction to merge its WarnerMedia unit with Discovery, **effectively separating AT&T's telecommunications, fiber optic, and pay-TV provider operations from its media and entertainment division** (AT&T is also divesting a minority stake in its pay-TV business).

AT&T shareholders would own 71% of the pro forma company's equity and Discovery shareholders would own the remaining 29% equity stake. As an aside, this deal is expected to consolidate Discovery's multiple share class structure to just one share class. Here is a summary of the transaction (from the press release):

> The combination will be executed through a Reverse Morris Trust, under which WarnerMedia will be spun or split off to AT&T's shareholders via dividend or through an exchange offer or a combination of both and simultaneously combined with Discovery. The transaction is expected to be tax-free to AT&T and AT&T's shareholders.
>
> In connection with the spin-off or split-off of WarnerMedia, AT&T will receive $43 billion (subject to adjustment) in a combination of cash, debt securities and WarnerMedia's retention of certain debt. The new company expects to maintain investment grade rating and utilize the significant cash flow of the combined company to rapidly de-lever to approximately 3.0x within 24 months, and to target a new, longer term gross leverage target of 2.5x-3.0x.

AT&T and Discovery aim to close the transaction by the middle of 2022, though regulatory approvals are required, and Discovery shareholders still need to approve the deal. Both AT&T and Discovery's board of directors have approved the transaction. Looking ahead, AT&T expects to have a 2.6x net debt to adjusted EBITDA ratio after the deal closes (due to the ~$43 billion in considerations AT&T expects to receive as noted above) and is targeting a leverage ratio less than 2.5x by the end of 2023. Please note AT&T has a leverage ratio of 3.1x at the end of the first quarter of 2021, **highlighting how this transaction is expected to have a powerful impact on its financial strength by significantly improving its leverage ratio.**

Here, we would like to note that AT&T intends to right-size its dividend after the spinoff given that WarnerMedia is quite a large part of its business, which in our view, is a reasonable move. AT&T noted that the firm expects to have an annual dividend payout ratio (annual dividend obligations divided by its annual free cash flows) of 40%-43% once the deal closes with its free cash flow expected to be in the $20+ billion range (or ~$8.6+ billion in cash dividends versus ~$15 billion previously). Furthermore, AT&T noted that once deleveraging activities were complete, it may consider sizable share repurchases (in the medium-term, this indicates that the pace of AT&T's share buybacks will likely remain subdued).

New Media and Video Streaming Giant

Combining Discovery with WarnerMedia will create a media, entertainment, and video streaming services powerhouse. HBO Max (part of WarnerMedia) and Discovery+ (part of Discovery)--two nascent video streaming services that are beginning to gain some real traction as it concerns paid subscriber growth--**will be supported by a vast content library and the ability to invest enormous sums towards high-quality and engaging original content.** Here is a quick summary of the pro forma company (from the press release):

> The "pure play" content company will own one of the deepest libraries in the world with nearly 200,000 hours of iconic programming and will bring together over 100 of the most cherished, popular and trusted brands in the world under one global portfolio, including: HBO, Warner Bros., Discovery, DC Comics, CNN, Cartoon Network, HGTV, Food Network, the Turner Networks, TNT, TBS, Eurosport, Magnolia, TLC, Animal Planet, ID and many more.

By 2023, AT&T and Discovery forecast that the entity will generate ~$52 billion in annual revenues and ~$14 billion in adjusted EBITDA, along with an industry-leading free cash flow conversion rate. **Cost synergies are expected to come in at ~$3 billion per year as the enlarged firm continues to scale key direct-to-consumer offerings, namely the HBO Max and Discovery+ videos streaming services.** For instance, when it comes to launching HBO Max in additional markets around the globe, those activities could be supported by Discovery's existing infrastructure. When it comes to content creation, the combined company will have the capacity to invest vast sums towards original TV shows and movies, aided by the expected cost savings (which frees up cash that can be used to further invest in the business).

Significance for AT&T

This move comes on the heels of AT&T announcing a deal with TPG Capital to sell a minority interest in a new entity, DIRECTV, which will house its US pay-TV operations (DIRECTV, AT&T TV and U-verse video services), back in February 2021. **Effectively, AT&T is pivoting towards its core business, providing wireless and fiber services to customers in the US.** These moves will allow AT&T to invest more towards its 5G telecommunications infrastructure while steadily growing its fiber optic Internet service provider business, two attractive areas with ample room for growth in the coming years.

Here is what AT&T had to say on its outlook (from the press release):

> Expected increased capital investment for incremental investments in 5G and fiber broadband. The company expects annual capital expenditures of around $24 billion once the transaction closes. AT&T expects its 5G C-band network will cover 200 million people in the U.S. by year-end 2023. And the company plans to expand its fiber footprint to cover 30 million customer locations by year-end 2025.

In the recent past, AT&T has done a stellar job adding wireless and fiber customers to its business, and we expect the firm to continue outperforming on this front going forward. For instance, in the first quarter of 2021, AT&T reported 823,000 net postpaid adds (including 595,000 net postpaid phone adds), 207,000 net prepaid phone adds, and 235,000 net AT&T Fiber adds.

The expansion of AT&T's 5G wireless infrastructure will not be cheap, and the firm has already spent handsomely building out these operations. AT&T launched nationwide 5G wireless services in the US last year. Considering the vast technological improvements 5G technology offers over 4G technology, AT&T should be able to continue enticing retail customers, enterprises, and government entities to make the switch, which supports its revenue growth outlook and ultimately the firm's ability to make these large investments. AT&T Fiber is marketed to more 14.5 million customer locations, and the goal is to aggressively expand the customer service area of this business going forward.

Concluding Thoughts

We view AT&T's growth outlook quite favorably. Though HBO Max was intended to complement its wireless operations (bundling HBO Max with 5G wireless services to ideally create "stickier" revenue streams), AT&T can still bundle its various wireless services with video streaming services just as it is currently doing. Many of AT&T's competitors, including Verizon Communications Inc (VZ) and Comcast Corporation (CMCSA), are doing the same thing. **AT&T's pivot to its core operations is a welcome sign.**

Though the market was disappointed by the announcement, we see this as a major positive for AT&T as the company will be able to significantly improve its balance sheet while sharpening its operational focus and enhancing its cash flow growth outlook.

For WarnerMedia and Discovery, the pro forma firm will be in a much stronger competitive position as it seeks to build up a vast paid subscriber base at its core video streaming services.

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

High-Yielding Arbor Realty Trust is Quite Intriguing

Our **June 2021 High Yield Spotlight** is Arbor Realty Trust Inc (ABR)---**7.5% yield**---as we are big fans of its unique business model in the real estate investment trust ('REIT') space. **Management's commitment to rewarding income seeking shareholders (seen via recent payout increases), Arbor Realty's rock-solid performance during the first quarter of 2021, and the company's improving outlook underpin its intriguing income generation opportunity for investors.** As a capital market dependent entity, it is essential for Arbor Realty to maintain access to debt and equity markets, ideally at attractive rates. Recent debt and equity issuances indicate that this is the case, but first let us cover Arbor Realty's business model.

Arbor Realty is structured as an internally-managed REIT. The REIT invests in various real estate financial products and provides direct lending services for a variety of real estate assets (including multifamily, senior housing, health care, and other commercial properties). The company has two core business segments: Structured Loan Origination and Investment Business ('Structured Business') and Agency Loan Origination and Servicing Business ('Agency Business'). Virtually all of Arbor Realty's business is conducted through Arbor Realty Limited Partnership, which Arbor Realty is the general partner of. The firm also has some taxable REIT subsidiaries as well.

In its 2020 Annual Report, Arbor Realty notes that its goal is "to maximize the difference between the yield on our investments and the cost of financing these investments, to grow the stable earnings associated with the servicing portfolio of our agency platform, to generate cash available for distribution and facilitate capital appreciation." Management provides an overview of Arbor Realty's business model and the potential synergies that it creates in the upcoming graphic down below.

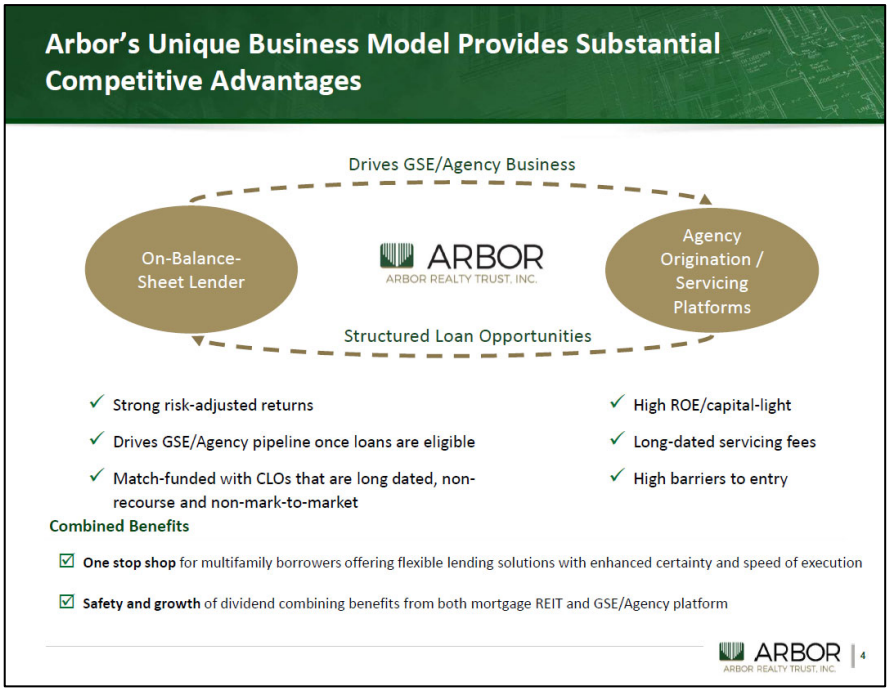

Image Shown: *An overview of how Arbor Realty sees its business model generating competitive advantages.* ***Image Source:*** *Arbor Realty – November 2020 IR Presentation*

The REIT's Structured Business unit primarily invests in structured finance assets (such as bridge and mezzanine loans) along with equity securities in various commercial real estate markets. Additionally, this unit invests in real estate joint-ventures, directly in real estate properties, and other real estate assets. In the upcoming graphic down below, Arbor Realty provides an overview of its loan and investment portfolio within its Structured Business segment as of March 31, 2021.

ARBOR REALTY TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
March 31, 2021

Note 3 — Loans and Investments

Our Structured Business loan and investment portfolio consists of ($ in thousands):

	March 31, 2021	Percent of Total	Loan Count	Wtd. Avg. Pay Rate (1)	Wtd. Avg. Remaining Months to Maturity	Wtd. Avg. First Dollar LTV Ratio (2)	Wtd. Avg. Last Dollar LTV Ratio (3)
Bridge loans (4)	$ 5,804,705	93 %	302	4.93 %	15.8	0 %	75 %
Preferred equity investments	224,872	4 %	14	7.00 %	47.2	64 %	89 %
Mezzanine loans	204,471	3 %	29	6.63 %	38.2	25 %	80 %
Other loans (5)	29,383	<1 %	2	4.57 %	56.8	0 %	69 %
	6,263,431	100 %	347	5.06 %	17.8	3 %	76 %
Allowance for credit losses	(147,300)						
Unearned revenue	(45,794)						
Loans and investments, net	$ 6,070,337						
	December 31, 2020						
Bridge loans (4)	$ 5,022,509	92 %	263	5.09 %	16.2	0 %	76 %
Preferred equity investments	224,928	4 %	14	7.07 %	49.8	64 %	89 %
Mezzanine loans	159,242	3 %	29	7.40 %	45.0	32 %	82 %
Other loans (5)	68,403	1 %	22	4.95 %	74.8	0 %	69 %
	5,475,082	100 %	328	5.23 %	19.2	4 %	77 %
Allowance for credit losses	(148,329)						
Unearned revenue	(40,885)						
Loans and investments, net	$ 5,285,868						

(1) "Weighted Average Pay Rate" is a weighted average, based on the unpaid principal balance ("UPB") of each loan in our portfolio, of the interest rate required to be paid monthly as stated in the individual loan agreements. Certain loans and investments that require an additional rate of interest "accrual rate" to be paid at maturity are not included in the weighted average pay rate as shown in the table.
(2) The "First Dollar Loan-to-Value ("LTV") Ratio" is calculated by comparing the total of our senior most dollar and all senior lien positions within the capital stack to the fair value of the underlying collateral to determine the point at which we will absorb a total loss of our position.
(3) The "Last Dollar LTV Ratio" is calculated by comparing the total of the carrying value of our loan and all senior lien positions within the capital stack to the fair value of the underlying collateral to determine the point at which we will initially absorb a loss.
(4) As of March 31, 2021 and December 31, 2020, bridge loans included 59 and 38, respectively, of SFR loans with an aggregate UPB of $445.0 million and $309.2 million, respectively, of which $131.2 million and $88.1 million, respectively, was funded.
(5) As of March 31, 2021, other loans included 2 variable rate SFR permanent loans with an aggregate UPB of $29.4 million. As of December 31, 2020, other included 22 SFR permanent loans with an aggregate UPB of $68.4 million.

Image Shown: *An overview of Arbor Realty's investment portfolio at the end of March 2021 and the end of December 2020.* ***Image Source:*** *Arbor Realty – 10-Q SEC filing covering the first quarter of 2021*

Pivoting now to Arbor Realty's Agency Business, this segment originates, sells, and services multifamily finance products, and originates and sells finance products through commercial mortgage backed security ('CMBS') programs (also referred to as conduit programs). This unit also originates and services permanent financing loans referred to as "private label" loans. The firm pools and securitizes these private label loans and sells off certifications in those securities to third-party investors, though it retains servicing rights and the certificates covering the bottom tranche (highest risk) of these securities are retained by the company. In the upcoming graphic at the top of the next page, Arbor Realty provides an overview of its Agency Business and the related servicing revenue as of March 31, 2021.

Note 6 — Mortgage Servicing

Product and geographic concentrations that impact our servicing revenue are as follows ($ in thousands):

March 31, 2021				
Product Concentrations			**Geographic Concentrations**	
Product	**UPB (1)**	**Percent of Total**	**State**	**UPB Percentage of Total**
Fannie Mae	$ 19,073,504	75 %	Texas	15 %
Freddie Mac	4,795,228	19 %	New York	10 %
FHA	796,133	3 %	North Carolina	9 %
Private Label	726,918	3 %	California	9 %
SFR - Fixed Rate	63,299	<1 %	Florida	7 %
Total	$ 25,455,082	100 %	Georgia	6 %
			New Jersey	5 %
			Other (2)	39 %
			Total	100 %
December 31, 2020				
Fannie Mae	$ 18,268,268	74 %	Texas	16 %
Freddie Mac	4,881,080	20 %	New York	9 %
FHA	752,116	3 %	North Carolina	9 %
Private Label	726,992	3 %	California	9 %
Total	$ 24,628,456	100 %	Florida	7 %
			Georgia	6 %
			New Jersey	4 %
			Other (2)	40 %
			Total	100 %

(1) Excludes loans which we are not collecting a servicing fee.
(2) No other individual state represented 4% or more of the total.

Image Shown: *An overview of Arbor Realty's Agency Business.* ***Image Source:*** *Arbor Realty – 10-Q SEC filing covering the first quarter of 2021*

On May 7, Arbor Realty reported first quarter 2021 earnings that saw it post $0.55 in diluted EPS on a GAAP basis. **This represented a major turnaround from its performance in the same period in 2020**, when large provisions for loss sharing and credit losses saw Arbor Realty post a net loss of $0.54 per diluted share on a GAAP basis. Continued growth at Arbor Realty's government-sponsored enterprise ('GSE) agency platform, impressive performance at its private label business and Structured Business segment (with an eye towards strong growth in its investment portfolio), and "superior execution in our liability structures" were cited by management as reasons for the REIT's outperformance during its latest earnings call.

Provisions for loss sharing (net of recoveries) shrank substantially year-over-year while provisions for credit losses (net of recoveries) flipped to a gain in the first quarter. The outlook for the US economy is improving in the wake of ongoing coronavirus ('COVID-19') vaccine distribution efforts and the related easing of lockdown measures, something that should provide a major uplift to Arbor Realty's performance going forward. Furthermore, the outlook for interest rates is improving as the public health crisis is slowly being brought under control in the US, providing additional support to Arbor Realty's outlook. According to the US Centers for Disease Control and Prevention ('CDC'), over half of US adults are now fully vaccinated from COVID-19.

Arbor Realty reports a non-GAAP 'distributable earnings' metric to provide an overview of its underlying financial performance. In the first quarter of 2021, it posted $75 million in distributable earnings (up 86% year-over-year) and $0.52 in distributable earnings per share (up 68% year-over-year). **The substantial improvement in its financial performance combined with its improving outlook gave Arbor Realty the confidence to increase its quarterly dividend to $0.34 per share (up 13% year-over-year) in conjunction with its latest earnings report.**

Arbor Realty has now increased its payout over the past ten consecutive years and the firm's payout ratio (dividends divided by distributable earnings) is relatively low at ~65% (as of its first quarter performance and current payout rate) according to management commentary provided during the REIT's latest earnings call.

Retaining access to capital markets, ideally at attractive rates, is a necessity for Arbor Realty's business model as we noted previously. In the first quarter of 2021, the REIT issued out 7 million shares of its common stock which raised over $108 million in net proceeds for Arbor Realty. The REIT also issued out $175 million in aggregate principal of 5.00% senior unsecured notes due 2026 in the first quarter. Both the equity and debt issuances were to fund general corporate purposes and to make investments. During Arbor Realty's latest earnings call management noted that (emphasis added):

> *"In fact, once this capital is fully deployed, we estimate it will be $0.06 to $0.08 accretive to annual earnings rate.* ***And for every $100 million of capital we raise in the future at these prices, we estimate we will grow our annual earnings and dividend by an additional $0.02 to $0.03 a share."*** *--- Ivan Kaufman, President and CEO of Arbor Realty*

Looking ahead, the 14% growth in its investment portfolio seen in the first quarter is expected to provide a nice uplift to Arbor Realty's net interest income going forward. The company originated 55 loans totaling just under $1.1 billion in the first quarter, most of which was represented by multifamily bridge loans. Management cited "very few delinquencies and extremely low forbearances" as sources of strength at its "multifamily focused portfolios" in the first quarter and that its residential business performed well.

Father out, Arbor Realty is incredibly excited about the potential upside the single-family rental market offers. Here is what management had to say on the issue during Arbor Realty's latest earnings call (emphasis added):

> *"A little over a year ago,* ***we made a commitment to build out a premier single-family rental platform. We believe the single-family rental space is as big as the multifamily lending market*** *and is a phenomenal business with enormous opportunities in the bridge, permanent lending and build-to-rent products.*
>
> *We made considerable progress in growing out this platform and are committed to being a leader in the space.* ***We are very pleased with the significant growth we are seeing in our pipeline of opportunity by leveraging off of our existing originations capacity and capabilities.***
>
> *In the first quarter, we closed $162 million of single-family rental product and currently have well over $1 billion of additional deals in our pipeline making us very optimistic about the growth in this segment of our business. We also believe we are the leader in the single-family build-to-rent space, which provides us with opportunities to originate construction, bridge and permanent loans on the same transactions. Again,* ***we are very excited about the growth in this platform and are confident this business will be a significant driver of yet another income stream further diversifying our lending platform."*** *--- President and CEO of Arbor Realty*

Arbor Realty has a robust pipeline and diversified income streams within the real estate realm. We caution that the company's capital-market dependence represents a major risk to its business model and ability to keep making good on its dividend obligations going forward. Should capital markets freeze up for any reason, that would create enormous headwinds for the REIT and Arbor Realty's flexibility to handle such a situation would be quite limited. However, **we expect Arbor Realty will retain access to capital markets at attractive rates going forward given recent debt and equity issuances along with its improving outlook.** The upcoming graphic at the top of the next page highlights Arbor Realty's prudent approach to the asset management business.

Arbor Asset Management

Dedicated asset management platform with strong credit history and extensive experience in mitigating risk and modifying and working out assets through all cycles

Loan Surveillance
- Proactively oversee loans requiring a heightened level of surveillance and attention
- Continual dialogue with investors and borrowers regarding loan level issues, plans for resolution and exit strategies
- Develop and review action plans to address watchlist items, highlight drivers of loan rating migration and corrective action steps

Risk Management
- Aggressive approach to mitigating risk for loans in monetary default or that require increased attention and focus
- Promptly determine cause of delinquency and whether a workout is feasible
- Continuously service these loans to mitigate risk exposure and realize maximum recoveries

Agency Portfolio Management
- Actively manage and maintain the credit quality of the performing loan portfolio
- Routine contact with borrower, including review of financials and property inspections
- Monitor for potential refinancing opportunities
- Perform periodic risk ratings to identify the need for heightened surveillance

Structured Asset Management
- Proactive, hands-on approach to the daily oversight of all structured loans from origination to payoff
- Detailed monitoring of properties to ensure compliance with borrower's loan terms, business plan and stabilization
- Hands-on customer service throughout the life loan cycle and through permanent financing

ARBOR
ARBOR REALTY TRUST, INC.

Image Shown: *An overview of how Arbor Realty seeks to operate its asset management platform and what its core goals are.* ***Image Source:*** *Arbor Realty – November 2020 IR Presentation*

We view Arbor Realty's income generation potential quite favorably and its business model appears to have significant competitive advantages along with room for meaningful synergies. Investors are clearly warming up to the REIT's improving outlook and promising growth story as you can see in the upcoming graphic down below. **We like Arbor Realty as our High Yield Spotlight for June 2021.**

Image Shown: *Shares of ABR are on a nice upward climb as investors continue to warm up to Arbor Realty's improving outlook, in our view.*

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

Utility PPL Is Pursuing a Major Transformation and Has a VBI Rating of 9

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

By Callum Turcan

PPL Corporation (PPL) operates several utilities in the US and the UK, though the company is in the process of selling its UK utility business (Western Power Distribution) to National Grid plc (NGG). When including the assumption of approximately GBP£6.6 billion in debt, this deal has a transaction value of roughly GBP£14.4 billion and is expected to generate about USD$10.2 billion in net cash proceeds for PPL.

Additionally, as part of this arrangement, PPL will acquire National Grid's Rhode Island utility business in the US (Narragansett Electric Company). When including the assumption of approximately USD$1.5 billion in debt, this deal has a total transaction value of around USD$5.3 billion, and some of the cash proceeds from PPL's UK divestment will go towards funding the acquisition.

For reference, Narragansett Electric Company serves 780,000 customers in Rhode Island and provides electricity transmission and distribution, and gas distribution services. Western Power Distribution is the UK's largest electricity distribution business. **Both of these businesses represent high-quality utility operations with promising growth outlooks, underpinned by robust capital investment pipelines.**

In our view, this arrangement represents a win-win for both parties. Specifically for PPL, the net cash infusion will improve its balance sheet strength while exiting the UK will simplify its corporate structure and sharpen PPL's operational focus. The sale of Western Power Distribution is expected to close in the coming months, while the sale of Narragansett Electric Company is expected to close by the first quarter of 2022. For National Grid, this further strengthens its UK presence and complements its existing portfolio in the country while better enabling the company to grow its asset base over the long haul.

Earnings Update

Let's talk about recent fundamental performance. PPL reported first quarter 2021 earnings on May 6 that missed both consensus top- and bottom-line estimates. However, we appreciated that PPL's management team communicated that the sale of its UK utility business was on track to close by the end of July and that its acquisition of National Grid's Rhode Island utility business was on-track to close by the end of March 2022. PPL incurred meaningful expenses relating to these transactions last quarter as it prepares itself for the future.

Last quarter, PPL's GAAP revenues rose by 4% year-over-year though its GAAP operating income dropped 2% year-over-year. However, **its earnings from ongoing operations rose by 6% year-over-year**, aided by strong performance at its regulated Kentucky utility operations, where electricity sales in gigawatt hour ('GWh') terms were up by almost 7% year-over-year, and steady performance at its regulated Pennsylvania utility operations, where electricity sales in GWh terms were up a bit over 4% year-over-year.

PPL's underlying performance remained strong in the first quarter of 2021. The firm even generated $0.2 billion in free cash flow last quarter. Given its bloated balance sheet (i.e., large net debt load), hefty capital expenditure requirements, and sizable dividend obligations (it spent $0.3 billion covering its dividend last quarter), **PPL needs to retain constant access to capital markets**, ideally at attractive rates. We expect this not to be a problem in light of the large pending cash infusion from the aforementioned transactions with National Grid, and thanks to PPL and its subsidiaries having strong investment grade credits as you can see in the upcoming graphic down below.

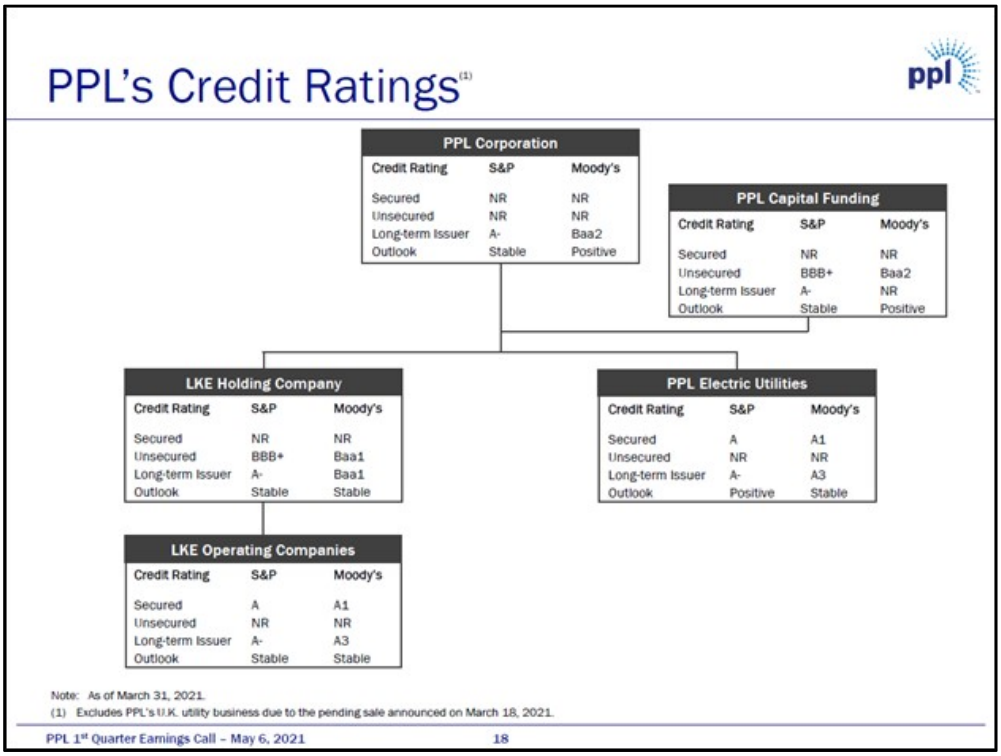

Image Shown: *PPL and its subsidiaries have rock-solid investment grade credit ratings, supporting their ability to tap capital markets at attractive rates.* ***Image Source:*** *PPL – First Quarter of 2021 IR Earnings Presentation*

Medium-Term Outlook

Going forward, PPL intends to grow its rate regulated utilities in the US through its sizable capital expenditure program through the middle of the 2020s (and likely beyond). Its capital expenditure expectations as things stood in early May 2021 can be viewed in the upcoming graphic down below, though please note that once it acquires Narragansett Electric Company, this forecast will likely change.

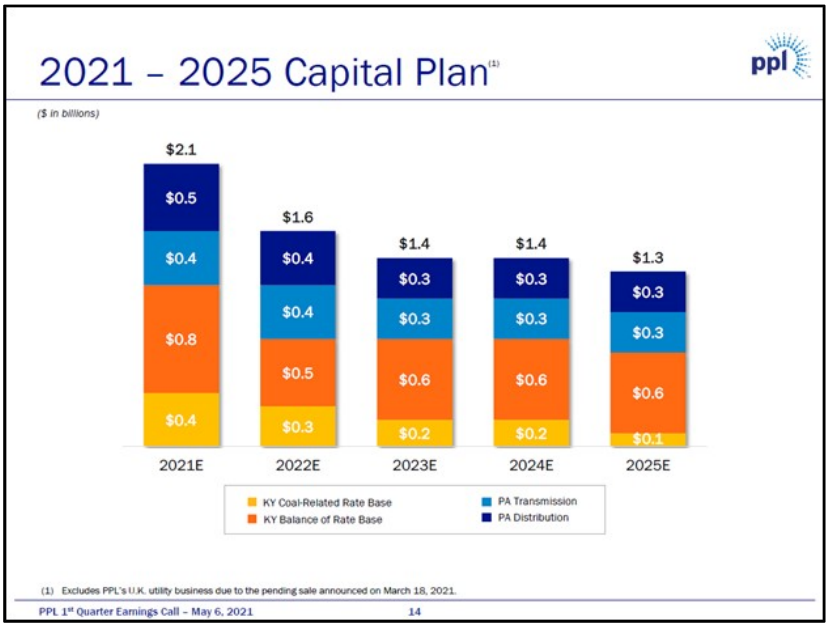

Image Shown: *An overview of PPL's planned capital expenditures from 2021-2025.* ***Image Source:*** *PPL – First Quarter of 2021 IR Earnings Presentation*

PPL expects these planned capital expenditures will grow its rate base from $19.1 billion in 2020 to $20.9 billion by 2025, representing growth north of 9% during this period. Expansion at PPL's non-coal related regulated utility operations in Kentucky is expected to offset projected declines in the rate base of its coal-related regulated utility operations in the state. In Pennsylvania, PPL aims to grow the regulated rate base of its distribution and transmission operations. **PPL's capital investment pipeline is robust.** Renewable energy investments are expected to play a leading role going forward, and the addition of Narragansett Electric Company is forecasted to create new growth opportunities in the distribution and transmission realm as well.

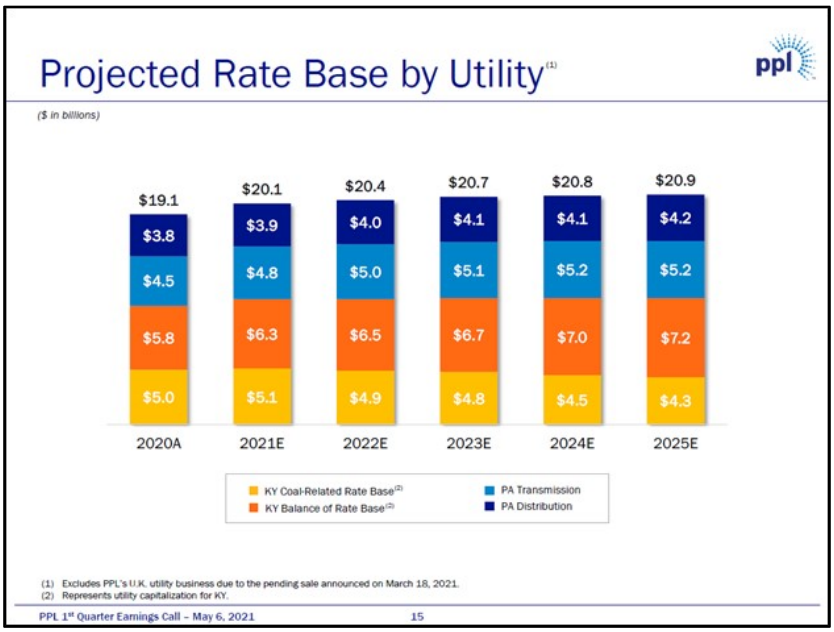

Image Shown: *PPL's robust capital investment pipeline and planned capital expenditures are expected to steadily grow the regulated rate base at its various US utilities over the coming years.* ***Image Source:*** *PPL – First Quarter of 2021 IR Earnings Presentation*

When its deals with National Grid close, PPL expects its US regulated rate base to grow to around ~$22.0 billion. Looking ahead, we are interested to see how PPL intends to improve its growth trajectory and overall operations once the company is focused solely on the US.

Thoughts from Our Utility Coverage

We recently updated our utility models, which cover both PPL and National Grid along with more than a couple dozen other publicly-traded utilities. Here is what we had to say on PPL regarding its forward-looking dividend coverage and payout policy overall (emphasis added):

> **PPL's major transactions with National Grid should go a long way in improving its earnings profile, growth outlook, and the strength of its balance sheet. Once these deals close, management is targeting a post-transaction payout ratio of 60%-65%.** Expected growth in PPL's rate base is expected to drive its earnings growth over the long haul, which in turn supports the company's dividend growth trajectory. PPL has solid investment grade long-term issuer credit rating (Baa2/A-) with stable outlooks, aided by the stable nature of its regulated utility business. **The company expects its earnings growth rate will be competitive with its peers once the deals close.** PPL does not see the need for material equity issuances for the foreseeable future. Some of the transaction proceeds may go towards growth endeavors and/or share repurchases.
>
> Most large public utility holding companies have unadjusted cash-flow-derived Dividend Cushion ratios below 1, indicating that future expected free cash flows over the near term are completely absorbed by net debt obligations and future expected dividend payments. Utilities' high dividend payout ratios (dividends paid per share divided by earnings per share) and elevated capital outlays--both of which prevent the buildup of cash on the balance sheet--coupled with the ballast of hefty debt obligations, which are higher on the capital structure than any equity concerns, prevent most utilities from receiving a healthy Dividend Cushion ratio, a pure financial-statement based comprehensive assessment of the coverage of the dividend.

PPL has a weak unadjusted Dividend Cushion ratio, and its adjusted Dividend Cushion ratio is underwhelming, though that does not mean we expect the utility to cut its payout in the near term. **Regulated utility operations have incredibly stable cash flow profiles**, which makes managing large net debt loads while continuing to make good on sizable dividend obligations possible, as long as the utility in question retains access to capital markets. As noted previously, PPL is targeting a post-transaction payout ratio of 60%-65% and intends to grow its payout in line with its earnings per share growth, a reasonable strategy, in our view.

Concluding Thoughts

After updating our valuation models for the utility sector, **PPL recorded a VBI of 9** and we are keeping a close eye on the firm. Our fair value estimate for PPL sits at $45 per share. As of this writing, shares of PPL yield ~5.8%. **The utility's outlook is bright**, and we are excited by its potential upside once the pending transactions with National Grid are complete.

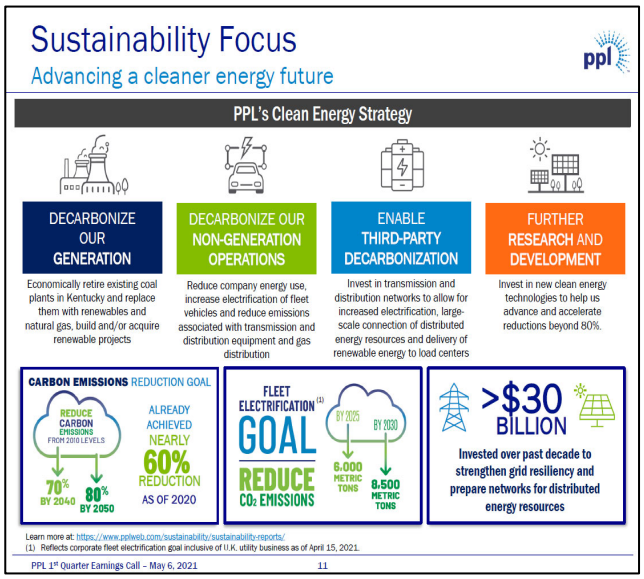

Image Shown: *PPL is placing a greater emphasis on its green energy investments going forward as the regulatory landscape for utilities operating in the US and elsewhere continues to change.* ***Image Source:*** *PPL – First Quarter of 2021 Earnings IR Presentation*

3 Strong Dividend Payers to Consider Within Consumer Staples

By Brian Nelson, CFA

Dividend growth may never go out of style. For one, there are tremendous compounding benefits to investing in dividend growers over the long haul, "3 Substantial Benefits of Dividend Growth Investing." A focus on traditional cash-based sources of intrinsic value and dividend health is therefore essential to avoid tragic dividend cuts in your portfolio.

Three dividend growers that we do not include in the Dividend Growth Newsletter portfolio but that have recently-reported calendar first-quarter 2021 earnings and may be worth considering in a diversified equity portfolio are Kellogg(K), Colgate-Palmolive (CL) and Clorox (CLX). These three entities are household names and have long dividend growth track records. Though each has a net debt position, all three generate sufficient traditional free cash flow coverage of the payout to keep the dividend growing.

Kellogg's Net Debt Is Large, But Free Cash Flow Is Strong

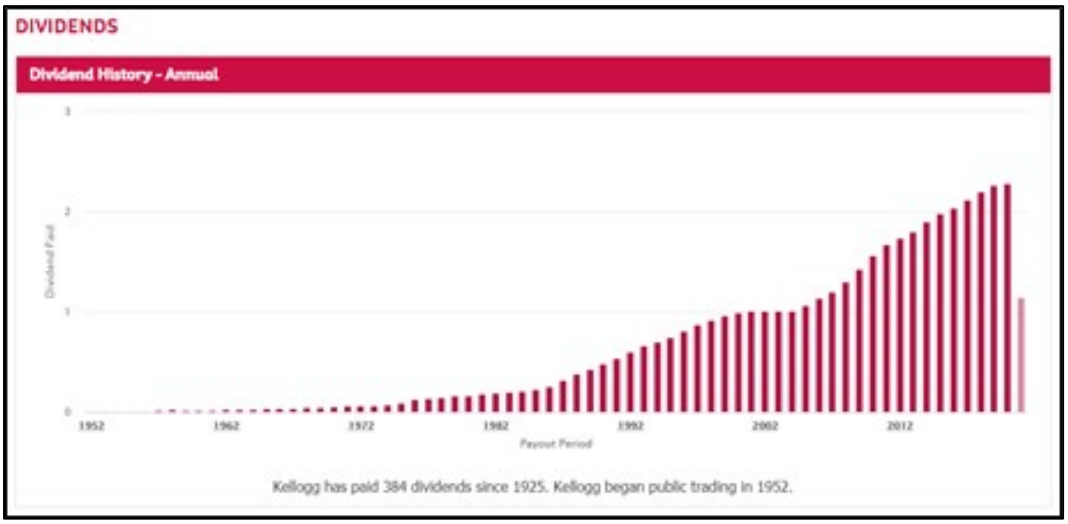

Image: *Kellogg has raised its dividend payout each year since 2005.* ***Image Source:*** *Kellogg.*

On April 30, Kellogg announced that it had declared a quarterly dividend of $0.58 per share, marking a 2% increase in the payout and the 386th dividend the company has paid to shareholders since 1925. **Kellogg has grown its dividend each year since 2005, and it's hard not to like the business model resiliency of this consumer staples powerhouse** that sells under the brands of Pringles, Cheez-It, Special K, Frosted Flakes, Pop-Tarts, Rice-Krispies, and the list goes on and on.

Kellogg's Dividend Cushion ratio is weighed down by its large net debt position (~$7.3 billion), relative to forecasted free cash flow. This relationship helps explain why its dividend ratings aren't as strong as other companies in our coverage. However, **we expect Kellogg to keep growing its dividend, albeit modestly, based on its traditional free cash flow coverage of the payout.** For example, during the past three fiscal years, Kellogg has generated average annual free cash flow of ~$1 billion, while annual cash dividends paid have averaged ~$750-$800 million over the same time period.

The company also noted that it generated better-than-expected free cash flow in the first quarter of 2021 when it reported results May 6. We don't expect big yearly dividend increases at Kellogg, which is why we don't include it in the Dividend Growth Newsletter portfolio, but it's hard not to like the company. **Shares of Kellogg yield ~3.5% at the time of this writing**, which could offer a decent risk-reward consideration for investors not too worried about its bloated net debt position.

Colgate-Palmolive Has Paid Uninterrupted Dividends Since 1895

On March 11, Colgate-Palmolive increased its quarterly cash dividend to $0.45 per share, marking a 2.3% increase versus the prior payout. Impressively, Colgate-Palmolive has been returning cash to shareholders in the form of a dividend payout since Grover Cleveland was President of the United States in 1895. **Colgate-Palmolive has also raised its dividend each year for the past 55+ years.** Now that is one mighty impressive track record!

Colgate's fundamentals are supported by its "dominate position in the oral care business, led by products sold under its namesake Colgate brand. Colgate is also a big player in the personal care market though its Palmolive, Softsoap, Speed Stick, and Sanex brands. Increasingly, Colgate is becoming a bigger player in the pet nutrition space through its Hill's brand. The company's growth trajectory is also underpinned by a growing global middle class, which is expected to increase significantly in size in coming years."

Unlike Kellogg, Colgate-Palmolive's net debt position isn't as large relative to our expectations of its future free cash flow generation, providing greater support to the dividend payout and a healthier Dividend Cushion ratio. **Where Kellogg's dividend payout as a percentage of traditional free cash flow has been ~75%, Colgate-Palmolive's is much better.** For example, Colgate-Palmolive has averaged ~$2.9 billion in annual free cash flow generation during the past three fiscal years, while its annual cash dividends paid have averaged about ~$1.62 billion.

This reflects an average annual dividend payout of ~55% of traditional free cash flow, offering much more excess cash to grow the dividend, buy back stock, or otherwise invest in other areas than Kellogg. Colgate-Palmolive ended the March quarter with a net debt position of $6.8 billion, which also is smaller than Kellogg's $7.3 billion tally. **Shares of Colgate-Palmolive yield ~2.2% at the time of this writing, and while the yield isn't as enticing as Kellogg's, Colgate-Palmolive's financials are in much better shape on a comparative basis.**

Clorox Is a Great Example of Why Fair Value Estimate Ranges Matter

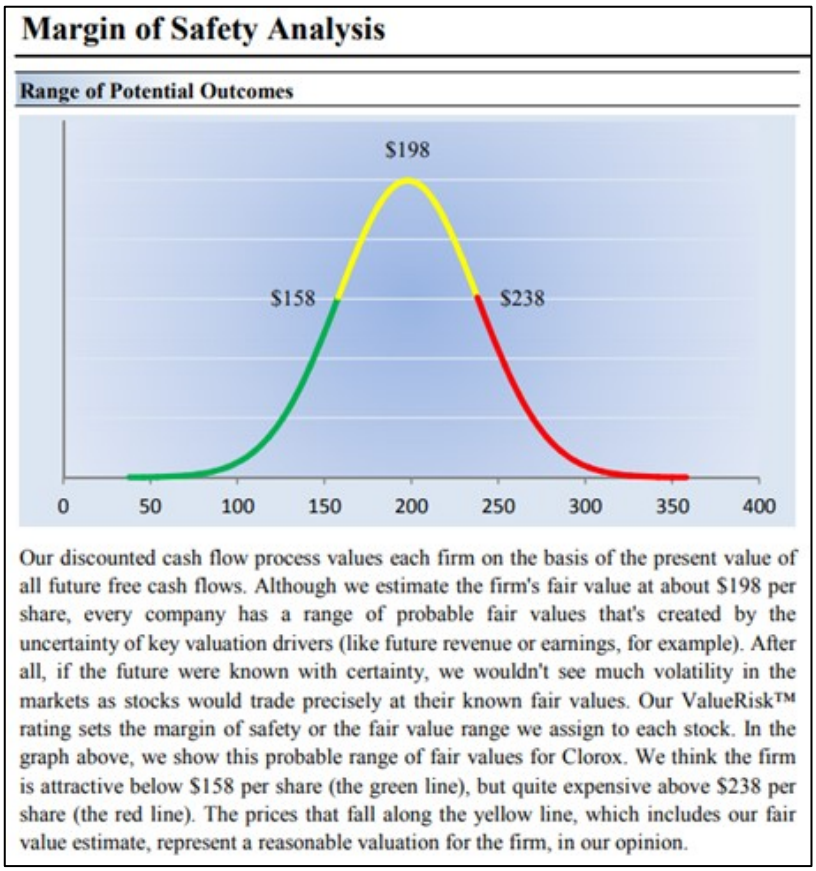

Image Shown: *Our fair value estimate range for Clorox.* ***Image Source****: Valuentum*

Clorox is a Dividend Aristocrat and has raised its dividend each year since 1977. The company's "portfolio of brands are giants of industry, including its namesake, Pine-Sol, Fresh Step cat litter, Kingsford, Hidden Valley, KC Masterpiece, and the list goes on; ~80% of its sales are generated from brands with a #1 or #2 share position. Clorox estimates that nine out of every ten US homes contain at least one of its products. The company aims to generate annual free cash flows of 11%-13% of its sales, aided by its cost savings program which has yielded meaningful results so far."

During the height of the coronavirus ("COVID-19") pandemic, Clorox's shares were trading at euphoric levels thanks to pantry-stuffing driven demand and hit a 52-week high of $236 per share in July 2020. Our fair value estimate range, as shown in the image above, offers context for what we think would be a fair price to pay for shares, using the sensitivity of future fundamental forecasts within our discounted cash-flow valuation models as guidance. **Through most of 2020, we thought Clorox's shares were pricey, and they now have fallen to a more reasonable price of ~$185. Our current fair value estimate stands at ~$198.**

As with Kellogg and Colgate-Palmolive, Clorox has a net debt position, but more similar to Colgate-Palmolive, its net debt position is more manageable than Kellogg's relative to future expected free cash flow generation. At the end of fiscal 2020, Clorox held a net debt position of ~$1.9 billion, as it averaged traditional free cash flow generation of ~$950 million during the past three fiscal years, a measure heavily influenced by its robust ~$1.29 billion in free cash flow generation in fiscal 2020 (ending June 30, 2020).

Over the same three fiscal years, cash dividends paid averaged just ~$490 million. **This relationship means that Clorox's dividend payout as a percentage of its traditional free cash flow generation was in the low 50% range during the past three fiscal years, just a bit better than Colgate-Palmolive's but much better than Kellogg's.** During fiscal 2020, however, Clorox's dividend payout as a percentage of free cash flow was an impressive ~34%--or said another way, traditional free cash flow covered cash dividends paid 2.9x in fiscal 2020.

Clorox's more manageable net debt position and our forecasts for strong free cash flow relative to expected cash dividends paid to continue is why, in part, the company has a better Dividend Cushion ratio than that of Colgate-Palmolive and a much better Dividend Cushion ratio than that of Kellogg. Our future expected free cash flow forecasts help inform the fair value estimate range as shown in the image above, while they help rank dividend health as in these examples of Kellogg, Colgate-Palmolive and Clorox. **Clorox's shares yield ~2.5% at the time of this writing.**

Concluding Thoughts

Kellogg, Colgate-Palmolive, and Clorox offer investors solid exposure to the consumer staples space, while showcasing impressive track records with respect to dividend growth. Each has a net debt position, but all three generate traditional free cash flow in excess of cash dividends paid, meaning growth in each of their payouts should be expected.

Clorox has the highest Dividend Cushion ratio of 1.6 at this time (Kellogg's is 0.1, while Colgate-Palmolive's is 1.4), and as one might expect, Clorox's dividend growth prospects are the strongest out of this bunch. For example, Clorox raised its annual payout more than 7% during fiscal 2020, while both Kellogg and Colgate-Palmolive have had more modest dividend increases in recent years.

Evaluating the cash-based sources of intrinsic value helps one derive a fair value estimate range, as in the example of Clorox, while it helps rank dividend health and dividend growth, as shown in this group's respective Dividend Cushion ratios. All things considered, Kellogg, Colgate-Palmolive, and Clorox could be valuable additions to a diversified dividend growth portfolio.

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%	3.20%
SPDR Portfolio S&P 500 High Dividend ETF	SPYD	5.0%	4.50%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	4.86%
iShares International Select Dividend ETF	IDV	5.0%	3.79%
iShares U.S. Preferred Stock ETF	PFF	5.0%	4.57%
Global X SuperDividend ETF	SDIV	5.0%	6.63%
Global X SuperIncome Preferred ETF	SPFF	10.0%	5.65%
Vanguard Consumer Staples ETF	VDC	5.0%	2.54%
Vanguard Real Estate ETF	VNQ	10.0%	3.22%
Utilities Select Sector SPDR	XLU	5.0%	3.00%
EQUITY			
AT&T	T	5.0%	7.07%
Crown Castle	CCI	5.0%	2.81%
CyrusOne Inc.	CONE	5.0%	2.77%
CubeSmart	CUBE	5.0%	3.11%
Digital Realty Trust	DLR	5.0%	3.06%
Philip Morris	PM	5.0%	4.98%
Public Storage	PSA	5.0%	2.83%
Enterprise Products Partners	EPD	2.5%	7.62%
Magellan Midstream Partners	MMP	2.5%	8.34%
Cash*	-	0.0%	0.00%
		100.0%	**4.27%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 6/1/2021. 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 14-May-2021 | Data as of 14-May-2021

Leggett & Platt LEG 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	$38.00 - $60.00	HEALTHY	POOR / -0.4	POOR	2.98%

Assessment of Company Dividend Strategy

Key Strengths

Leggett & Platt has a tremendous track record of 50 consecutive years of dividend increases, as of 2021, which has been driven by its strong free cash flow generation and earned it a spot on the list of Dividend Aristocrats. Even more impressive is the fact that its operating cash flow has exceeded its dividends obligations and capital expenditures each year over the past 30+ years. The firm expects to continue boosting its annual dividend while pursing selective growth opportunities (including both organic growth endeavors and acquisitions) and using excess cash to repurchase shares. Leggett & Platt is targeting a payout ratio of ~50% of its earnings.

Potential Weaknesses

The strength of Leggett & Platt's dividend track record and management's ability to effectively operate within the means of its business make it difficult to find many weaknesses for its payout, but its recent acquisition of Elite Comfort Solutions has added to its net debt load and weighs on its Dividend Cushion ratio. Input costs can provide some headwinds to earnings, particularly the cost of steel. Approximately 75% of the company's total costs are variable. This variability offers limited visibility into future earnings. Acquisitions and share repurchases compete for capital against its dividend and could impact the pace of dividend growth at Leggett & Platt.

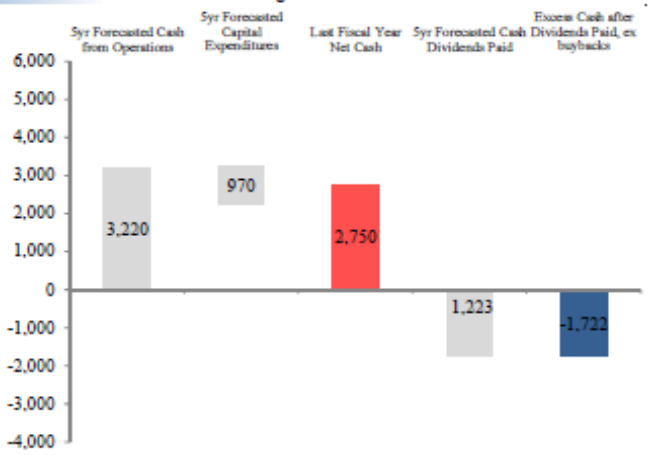
Graphical Relationship, Earnings and Dividends (per share)

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. Leggett & Platt'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

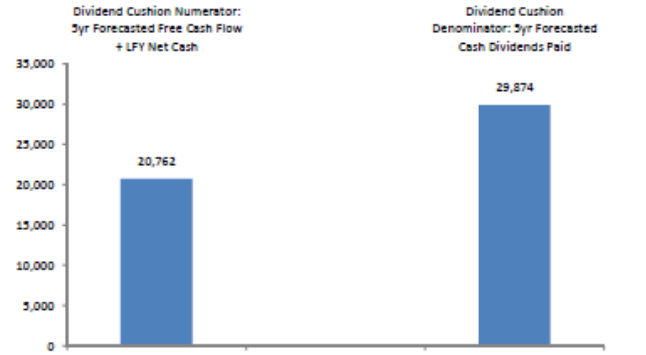


Source: Company Filings, Valuentum Projections

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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