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HIGH YIELD DIVIDEND NEWSLETTER

HIGH-YIELD IDEA CYRUSONE CONSIDERS SELLING ITSELF

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

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"INVESTOR INTEREST IN DATA CENTER AND COLOCATION REITS IS ON THE RISE, AND WE INCLUDE TWO HIGH QUALITY NAMES IN THIS SPACE IN OUR HYDN PORTFOLIO, CYRUSONE (CONE) AND DIGITAL REALTY TRUST (DLR). THE NEXT FEDERAL OPEN MARKET COMMITTEE ('FOMC') IS SCHEDULED FOR NOVEMBER 2-3 AND THAT MEETING WILL LIKELY LEAD TO THE FED BEGINNING TO TAPER ITS $120 BILLION MONTHLY ASSET PURCHASE PROGRAM (REFERRED TO AS QUANTITATIVE EASING) LATER THIS MONTH."

– CALLUM TURCAN

Image Shown: *Shares of CyrusOne, an idea included in our High Yield Dividend Newsletter portfolio, are on a modest upward climb of late. The data center real estate investment trust ('REIT') is reportedly considering putting itself up for sale, though we like the REIT's income generation upside regardless of whether a sale does materialize as its outlook continues to improve after posting stellar performance during the first half of 2021.*

By Callum Turcan

Reportedly, CyrusOne (CONE)---**2.6% yield**---is actively exploring a potential sale according to *Reuters*. The data center real estate investment trust ('REIT') has experienced significant turnover in its top ranks over the past couple of years which we will cover briefly, as that likely set the stage for the potential sale.

Should CyrusOne decide not to sell itself, we would still be fans of its business model, growth runway, improving outlook, and income generation potential. As we covered in our article *High Yielding Idea CyrusOne Beats Estimates and Raises Guidance* [included in the September 2021 edition of our High Yield Dividend Newsletter], **the data center REIT recently boosted its full-year guidance for 2021 on the back of its strong performance during the first half of this year.**

In conjunction with its second quarter earnings report, CyrusOne raised its quarterly dividend by a penny up to $0.52 per share or $2.08 per share on an annualized basis.

CyrusOne continued to perform well in the third quarter of 2021 (reported on October 28) when it beat both consensus top- and bottom-line estimates. Additionally, the REIT **raised its full-year revenue and non-GAAP normalized funds from operations ('FFO') guidance for 2021 in conjunction with that earnings report.**

Why an Asset Sale May Be in the Works

Rumors regarding whether CyrusOne would put itself up for sale have circulated in the past. Back in October 2019, former CEO Gary Wojtaszek noted during the REIT's third quarter of 2019 earnings call that (emphasis added):

> *"As you may be aware, several media outlets have reported, and some of you have speculated that we have, we're in discussions with various third parties regarding a potential sale of the company.* ***We are not currently pursuing a sale of the company.*** *We remain focused on our strategy and creating long-term shareholder value."*

This is important to note because Mr. Wojtaszek resigned from the CEO role in February 2020, with Tesh Durvasula taking over as interim CEO (please note that Mr. Durvasula was set to exit CyrusOne before this event took place in the wake of widespread layoffs at CyrusOne) until Bruce Duncan was tapped for the top spot in June 2020. However, in July 2021, CyrusOne's board decided "to separate" from Mr. Duncan, replacing him with the REIT's co-founder David Ferdman who is currently CyrusOne's interim CEO and President.

In early 2020, CyrusOne announced it was laying off roughly 12% of its workforce due to changing market dynamics in the data center market. Within that news announcement, CyrusOne noted that Mr. Durvasula (then President of CyrusOne's European operations) would leave the company in March 2020 as part of the REIT's restructuring process (though Mr. Durvasula ended up staying a few months longer by becoming the REIT's interim CEO).

The reasoning behind the layoffs and broader corporate restructuring largely had to deal with demand from "hyperscale" data center customers, namely large cap tech companies such as Amazon Inc (AMZN) and Microsoft Corporation (MSFT) with enormous cloud computing operations, slowing down (at the time) in regions where CyrusOne operated.

However, **demand for data centers is once again surging** as the coronavirus ('COVID-19') pandemic accelerated longstanding secular trends such as the proliferation of e-commerce, cloud computing, collaboration (such as teleconference activities), and productivity (with an eye towards meeting the needs of remote workforces) operations--activities that require data centers and related offerings to function. Big data analytics and AI activities, along with the nascent autonomous driving industry, represent other key sources of data demand going forward. That, in turn, drives up the need for additional data center facilities, which is good news for CyrusOne.

QTS Realty Trust, another data center REIT, agreed to be sold to funds controlled by Blackstone Inc (BX) through an all-cash transaction valued at ~$10 billion when including debt in June 2021. That offer involved a nice premium (roughly 21%) to QTS Realty Trust's stock price before the news broke. Should CyrusOne pursue an outright sale, infrastructure funds and private equity names may be quite interested in its assets. CyrusOne had ~55 data center facilities worldwide, including one recovery center, at the end of June 2021 across 16 markets including 11 US cities, London (UK), Dublin (Ireland), Singapore (Singapore), Frankfurt (Germany), and Amsterdam (Netherlands).

Digital Realty Trust Inc (DLR), another data center REIT that we are big fans of (shares of DLR are also included as an idea in both our High Yield Dividend Newsletter portfolio), sold a portfolio of 11 data centers in Europe to a CapitaLand sponsored REIT for ~USD$0.7 billion in cash in March 2021.

For reference, CapitaLand Group is headquartered in Singapore and focuses on real estate properties. **There clearly is ample demand out there for data center properties, and the industry is supported by powerful secular growth tailwinds which underpins its promising long-term growth outlook.** CyrusOne's asset base could be attractive to a larger company with sizable data center properties, infrastructure funds, or private equity firms.

Concluding Thoughts

We are keeping a close eye on these developments and related headlines, though we stress that nothing is for certain at this point. A potential sale of CyrusOne remains just rumor and speculation, though after doing some digging, there are several viable reasons to believe an outright sale could materialize.

Recent capital market activities indicates that CyrusOne has been able to tap debt and equity markets at attractive rates in recent quarters, and we expect that will continue to be the case going forward. That, in turn, will enable CyrusOne to fund its growth ambitions while making good on its payout obligations. CyrusOne's cash flow growth outlook is steadily improving, and its development pipeline is robust, which will enable the REIT to capitalize on rising data center demand seen across the world.

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

Philip Morris International Boosts Dividend, Cost Structure Improving

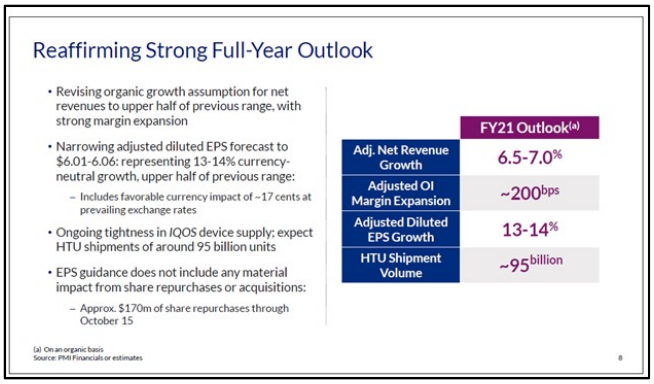

Image Shown: *An overview of Philip Morris International Inc's guidance for 2021.* ***Image Source:*** *Philip Morris International Inc – Third Quarter of 2021 IR Earnings Presentation*

By Callum Turcan

On October 19, Philip Morris International Inc (PM)---**5.3% yield**---reported third quarter 2021 earnings that beat both consensus top- and bottom-line estimates. The firm narrowed its reported diluted EPS estimate for 2021 in conjunction with the report, which saw the midpoint of its guidance move marginally lower. However, Philip Morris International's non-GAAP currency-neutral adjusted diluted EPS forecast for 2021 now calls for 13%-14% growth over 2020 levels, which is an improvement from its previous guidance calling for 12%-14% growth.

In the graphic up above at the start of this article, Philip Morris International provides an overview of its guidance for 2021 **with an eye towards its strong forecasted non-GAAP adjusted revenue growth and impressive forecasted non-GAAP adjusted operating margin expansion.**

We liked what we saw in Philip Morris International's latest earnings update and continue to view its income generation potential quite favorably. Shares of PM are included as an idea in our High Yield Dividend Newsletter portfolio.

Earnings Update

In the third quarter of 2021, Philip Morris International reported that its GAAP revenues grew by 9% year-over-year, its GAAP gross profit grew by 10% year-over-year, and its GAAP operating income grew by 6% year-over-year. The company's popular IQOS heated tobacco unit ('HTU') offering continued to sell well, upside that was complemented by the ample pricing strength at its traditional cigarette business (includes the Marlboro brand, excluding sales in markets in the US and China). Growth in the shipment volumes of its HTU offerings offset declines in the shipment volumes of its traditional cigarettes, resulting in company-wide shipment volume growth of 2% on a year-over-year basis last quarter.

During the tobacco giant's latest earnings call, management noted that supply chain hurdles weighed negatively on the sales of the firm's IQOS offering, with an eye towards the semiconductor shortage. Management noted that "at this stage, semiconductor supply forecasting remains volatile so we assume the tight supply situation will persist into the first half of 2022" and that the firm is doing what it can to optimize supplies.

Looking farther ahead, management had favorably things to say regarding Philip Morris International's cost structure enhancement initiatives (emphasis added, moderately edited):

> ***"Our significant effort on manufacturing and supply chain efficiencies are also bearing fruits with around $450 million of gross productivity savings benefit.*** *This was accompanied by robust SG&A efficiencies with our adjusted year-to-date marketing, administration, and research costs, 40 basis points lower as a percentage of adjusted net revenue on an organic basis.*
>
> *This reflects the ongoing digitalization and simplification of our business processes including our IQOS commercial engine and more efficient ways of working partly offset by increased commercial investment in Q3. With SG&A saving[s] of more than $200 million before inflation and reinvestment, this mean[s] we have generated over $650 million in overall growth efficiencies year-to-date.* *[Continued on next page]*

[Continued from previous page] ***This is strong progress toward the combined target of $2 billion for… 2023*** *[off of 2020 levels as noted back during the company's 2021 Investor Day Event]." --- Emmanuel Babeau, CFO of Philip Morris International*

We appreciate that Philip Morris International is steadily improving its cost structure, though note that some of these savings are being directed towards R&D investments as the firm aims to grow its non-nicotine sales over the coming years. Recent acquisitions are supporting Philip Morris International's efforts on this front.

In the third quarter of 2021, Philip Morris International acquired OtiTopic and Fertin Pharma, and the firm is in the process of completing its acquisition of Vectura Group now that it owns a controlling stake in the company (~97% as of the end of September 2021). **These deals are expected to assist Philip Morris International in its bid to develop a sizable pharmaceutical and consumer health business**, something we covered in detail in our *Update on High-Yielding Philip Morris* article *[included in the October 2021 edition of our High Yield Dividend Newsletter]*. We are intrigued by these efforts, though these are still early days.

Concluding Thoughts

On the back of its strong performance seen during the first three quarters of 2021, **Philip Morris International raised its quarterly dividend to $1.25 per share starting in the third quarter of this year (up 4% on a sequential basis).** We view Philip Morris International as a rock-solid high-yielding income generation idea with ample room for payout growth upside.

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

High Yielding UMH Properties has a Compelling Growth Story

Our **November 2021 High Yield Spotlight** is UMH Properties Inc (UMH)---**3.2% yield**---a public equity real estate investment trust ('REIT') that owns over 125 manufactured home communities across approximately ten states (and growing) in the US including New Jersey, New York, Ohio, Pennsylvania, Tennessee, Indiana, Maryland, Michigan, Alabama, and South Carolina. These communities include roughly 24,000 developed homesites and provide affordable housing offerings to households at a time when home prices have skyrocketed across the country, even though the coronavirus ('COVID-19') pandemic. This dynamic will likely lead to rental rates continuing to grow at a robust pace going forward.

UMH Properties has been aggressively expanding its footprint over the past decade. Back in 2009, UMH Properties' portfolio consisted of just under 30 manufactured home communities with ~6,800 homesites, a portfolio that has grown approximately four-fold since then. In 2021, UMH Properties entered markets in Alabama and South Carolina via acquisition activity and plans to enter new markets going forward, including Florida. To support its future organic development activities, UMH Properties has built up a land portfolio of roughly 1,800 acres.

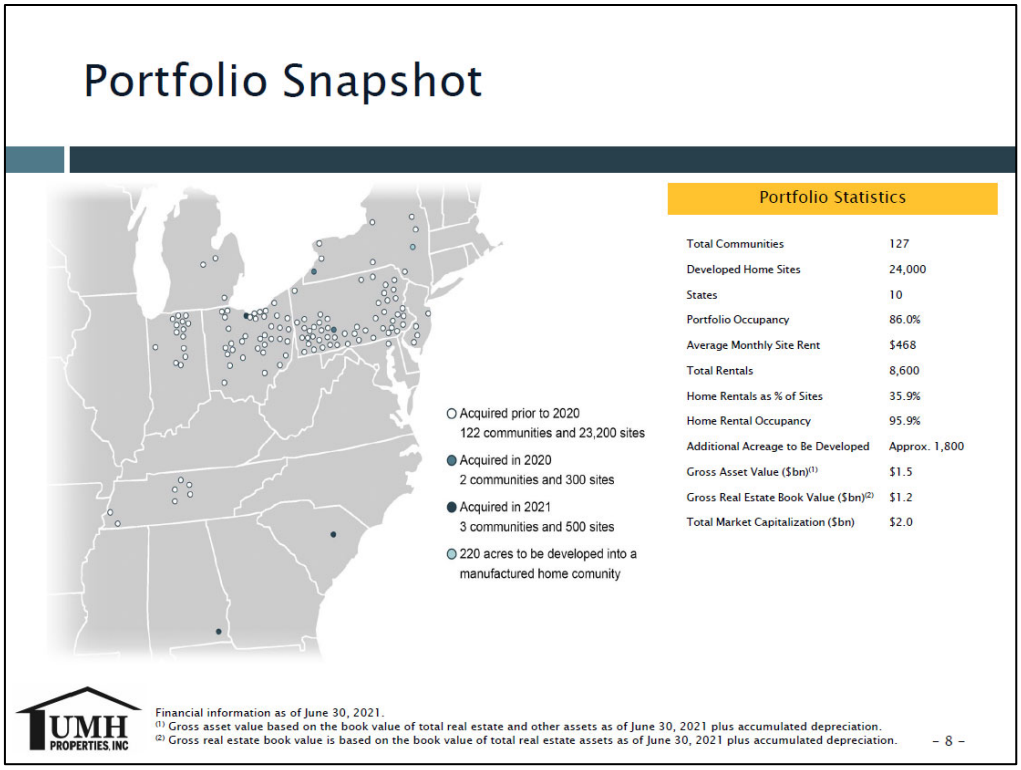

Image Shown: *An overview of UMH Properties' portfolio, which is centered in the Midwest and Atlantic Coast markets. In 2021, UMH Properties expanded into markets in Alabama and South Carolina via acquisitions.* ***Image Source:*** *UMH Properties – August 2021 IR Presentation*

Here we will highlight some of the key attributes of UMH Properties' business model. The REIT owns the underlying land of its manufactured housing communities along with related assets such as utility connections, common area amenities, streets, lighting, and "other capital improvements" and is also responsible for enforcing community guidelines and providing relevant maintenance services.

Customers lease the underlying land (referred to as homesites) from UMH Properties that sit below their manufactured housing units, which in many instances are owned by the customer. UMH Properties' wholly-owned taxable REIT, UMH Sales and Finance, facilitates the sale of manufactured homes in its communities and provides financing services. During the second quarter of 2021, UMH Properties "financed 63% of our home sales, and our portfolio now has a principal balance of $49.2 million at a weighted average interest rate of 7.1%" according to management commentary provided during the related earnings call.

UMH Properties also leases manufactured homes as part of its sizable rental operations. In these instances, UMH Properties leases out both the underlying land and the relevant manufactured homes to its customers. **At ~8,600 homesites, UMH Properties' rental operations represent a little over one-third of its total homesites, and these operations are an effective way to ensure the REIT is generating income from as many of its homesite locations as possible.**

As of the end of June 2021, **UMH Properties' rental operations had an average occupancy rate of 95.9%.** We would like to stress here that this figure is higher when excluding its performance in Alabama and South Carolina, markets that UMH Properties only recently began operating in. Given that it will take some time to ramp up its occupancy rates in new markets, there is room for upside here. UMH Properties notes that its average monthly rent (includes both home and site rent charges) is just over $800 across its rental property portfolio, which is rather reasonable for its target customer base.

Portfolio and Rental Capacity by State

	Total Communities	Total Developed Sites No.	Total Developed Sites %	Average Occupancy	Average Monthly Site Rent	Total Rentals No.	Total Rentals %	Average Rental Occupancy	Average Monthly Home Rent (1)
Pennsylvania	51	7,784	32.5%	85.3%	$491	2,703	31.4%	95.4%	$824
Ohio	37	6,932	28.9%	85.0%	$421	2,548	29.6%	96.5%	$759
Indiana	14	3,992	16.6%	86.9%	$425	1,701	19.8%	96.5%	$801
New York	8	1,346	5.6%	86.4%	$564	439	5.1%	98.2%	$939
Tennessee	7	1,784	7.4%	93.4%	$468	842	9.8%	96.4%	$810
New Jersey	4	1,006	4.2%	96.4%	$661	46	0.5%	97.8%	$987
Michigan	3	740	3.1%	84.6%	$463	261	3.0%	93.9%	$795
Alabama	1	195	0.8%	32.3%	$175	34	0.4%	52.9%	$610
South Carolina	1	142	0.6%	44.4%	$195	30	0.4%	80.0%	$548
Maryland	1	62	0.3%	98.4%	$531	-0-	N/A	N/A	N/A
Total (2)	**127**	**23,983**	**100.0%**	**86.0%**	**$468**	**8,604**	**100.0%**	**95.9%**	**$804**

UMH PROPERTIES, INC

(1) Includes home and site rent charges.
(2) Information as of June 30, 2021.

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Image Shown: *We are impressed with the average occupancy rate performance of UMH Properties' rental operations. The REIT does a solid job maximizing the income generation potential of its property portfolio by utilizing its rental operations to ensure homesites stay occupied.* ***Image Source:*** *UMH Properties – August 2021 IR Presentation*

UMH Properties is meeting an underserved need, which in turn supports its cash flow growth outlook. Its occupancy rates have been strong in recent years, something we expect will continue over the coming years. The REIT's ability to push through future rental pricing increases is underpinned by its solid occupancy rates and the lack of affordable housing options. As it concerns asset expansion opportunities, home construction in the US has not kept pace with household formation for decades, resulting in an enormous need for additional housing capacity. Organic growth projects and acquisitions can be utilized to expand UMH Properties' portfolio in an economical manner that generates value for shareholders.

Since 1970s, the production of manufactured homes has become heavily standardized and regulated in the US, which for UMH Properties ensures that its housing offerings can meet the needs of its customers and that these housing offerings have reasonably long lifespans. While there is a negative perception out there regarding manufactured housing, that is beginning to change, in our view. The production of manufactured housing units is a space Warren Buffett is quite bullish on, and his insurance and industrial conglomerate Berkshire Hathaway Inc (BRK.A) (BRK.B) is heavily invested in the space.

Looking ahead, UMH Properties intends to grow its rental business by adding 800-900 sites to these operations every year, after adding ~1,100 sites to this business over the past year (as of the end of June 2021). UMH Properties sees room to add ~7,300 homesites across the roughly 1,800 acre land parcels sitting in its portfolio, with room for additional upside by securing leases on homesites that are currently not leased out. At the end of June 2021, UMH Properties had ~3,500 vacant lots to fill across its portfolio according to an August 2021 IR Presentation, which includes properties that are not associated with its rental operations (at least not at this time). During the REIT's second quarter of 2021 earnings call, management noted that:

> *"Same-property occupancy increased 280 basis points or 658 occupied sites over last year. Same-property occupancy is now 87.1% and same-property rental home occupancy is 96.3%." --- Anna Chew, VP and CFO of UMH Properties*

We appreciate the strong occupancy rates seen across UMH Properties' portfolio, with over 87% of its same-store homesites occupied as of the end of June 2021. Given that housing prices have boomed over the past few years and rental rates are on the rise, it would be reasonable to assume that UMH Properties' occupancy rates will continue to trend higher going forward as the REIT offers a compelling value proposition to households. Upgrades and improvements to its manufactured home communities should help on this front. **The REIT's total occupancy rate has been steadily trending higher since 2016, rising from 81.0% to 86.0% as of the end of the second quarter of 2021, with room for upside.** Its growing rental operations should provide support here as well given the stellar occupancy rates UMH Properties has put up on this front in recent years.

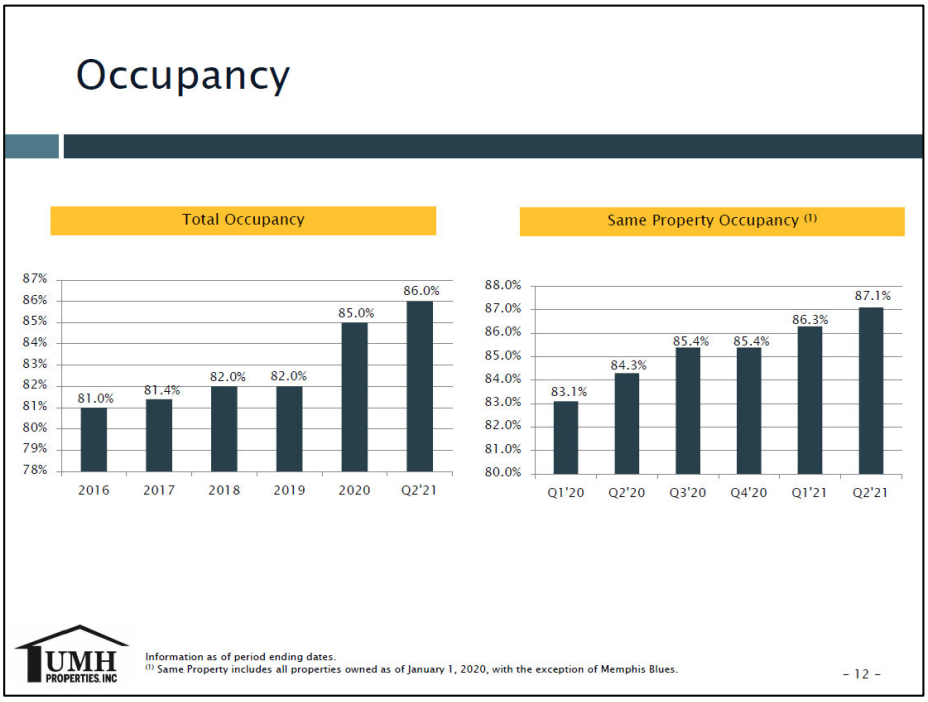

Image Shown: *The total occupancy rate across UMH Properties' portfolio has been on the rise since 2016. Its rental operations should enable UMH Properties to continue bolstering its company-wide occupancy rates going forward.* ***Image Source:*** *UMH Properties – August 2021 IR Presentation*

The REIT has done a stellar job growing the net operating income ('NOI') of its property portfolio, aided by its ability to push through consistent annual rental rate increases while effectively managing its cost structure. During the first half of 2021, the REIT's 'community NOI' was up almost 15% year-over-year as growth in its 'rental and related income' outstripped growth seen at its 'community operating expenses' which we really appreciate. **Organic growth opportunities can be incredibly accretive to shareholder value generation, and given its ample pricing power, UMH Properties should be able to continue steadily growing the NOI from its existing property portfolio with relative ease going forward.**

Same Property Net Operating Income

(in thousands)	For Three Months Ended				For Six Months Ended			
	6/30/2021	6/30/2020	Change	% Change	6/30/2021	6/30/2020	Change	% Change
Community Net Operating Income								
Rental and Related Income	$ 38,653	$ 34,936	$ 3,717	10.6%	$ 76,769	$ 69,201	$ 7,568	10.9%
Community Operating Expenses	15,742	14,722	1,020	6.9%	31,255	29,461	1,794	6.1%
Community NOI	$ 22,911	$ 20,214	$ 2,697	13.3%	$ 45,514	$ 39,740	$ 5,774	14.5%

Community Metrics	6/30/2021	6/30/2020	% Change
Total Sites	23,021	23,000	0.1%
Occupied Sites	20,042	19,384	658 sites, 3.4%
Occupancy %	87.1%	84.3%	280 bps
Number of Properties	122	122	N/A
Total Rentals	8,387	7,702	8.9%
Occupied Rentals	8,079	7,333	10.2%
Rental Occupancy	96.3%	95.2%	110 bps
Monthly Rent Per Site	$471	$454	3.7%
Monthly Rent Per Home Including Site	$805	$777	3.6%

UMH PROPERTIES, INC

Same Property includes all properties owned as of January 1, 2020, with the exception of Memphis Blues.

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Image Shown: *UMH Properties has done a stellar job growing the NOI of its existing property portfolio, highlighting its rock-solid operational execution seen of late.* ***Image Source:*** *UMH Properties – August 2021 IR Presentation*

During the first half of 2021, UMH Properties generated $0.42 per share in non-GAAP normalized funds from operations ('FFO'), up from $0.32 per share in the same period last year. While an imperfect metric, normalized FFO per share provides a snapshot of a REIT's ability to maintain and grow its payout in the near term. The REIT's quarterly dividend on its common stock currently sits at $0.19 per share.

On an annualized basis, using its first half of 2021 performance as a benchmark, UMH Properties has an FFO payout ratio (dividends per share divided by its normalized FFO per share) of ~90%. While that is at the upper end of things, the REIT is growing like a weed. Its normalized FFO came in at $0.22 per share in the second quarter of 2021 (up 29% year-over-year) and using that figure as a benchmark would result in an FFO payout ratio of ~86%. **Going forward, we expect UMH Properties' FFO payout ratio will steadily shift lower as the REIT continues to grow.**

As a REIT, **UMH Properties generally generates negative free cash flows as its capital expenditures exceed its net operating cash flow due to its growth ambitions. UMH Properties' net operating cash flows are quite stable and averaged ~$49 million per year from 2018-2020 while its annual capital expenditures averaged ~$65 million during this period.** The REIT exited 2020 with run rate payout obligations (common plus preferred dividend obligations) of $59 million. As an aside, the REIT has occasionally repurchased a negligible amount of its common stock in the past, though common stock repurchases are not currently a capital allocation priority for UMH Properties.

To refinance its debt maturities, fund its dividend payouts, and finance its growth ambitions, **UMH Properties needs to tap capital markets for funds (ideally at attractive rates) as it is a capital market dependent entity**. At the end of June 2021, UMH Properties had $90 million in cash and cash equivalents on hand along with $115 million in marketable securities. The REIT prefers to invest a sizable chunk of its cash-like position into REIT equities to maximize the income generation potential of its balance sheet. UMH Properties had $466 million in mortgages payable and $64 million in loans payable at the end of June 2021, though **we view its net debt position as manageable given its sizable liquidity position on hand and the stable nature of its net operating cash flows.**

The REIT has been utilizing its strong stock price performance of late to raise funds at attractive rates through its at-the-market ('ATM') equity issuance program. **Additionally, UMH Properties has been retiring higher cost preferred equity by utilizing its ATM proceeds and by mortgaging its manufactured home communities, effectively reducing its cost of capital and improving its capital structure according to recent management commentary.**

UMH Properties intends to continue pursuing acquisitions going forward. Here is what UMH Properties had to say regarding potential deals in Florida (representing an expansion into a new state) and its near term outlook during the REIT's second quarter of 2021 earnings call (emphasis added):

> *"High-quality communities are trading at or above replacement value. As a result of this elevated pricing, we have decided that now is the time to build or buy new communities from developers.* ***We have entered into a contract to purchase 1 all-age community in Florida that is currently being developed. We also have an executed letter of intent and are working towards contract on another development deal in Florida.*** *These communities will contain a total of 366 developed sites for a total purchase price of approximately $38.4 million. The communities will be highly amenitized with clubhouses, pools, bocce ball, pickleball, splash pools, dog parks and more. To fund these acquisitions, we are considering all options, including potential joint ventures with institutional investors.*
>
> ***UMH can generate similar earnings growth for the foreseeable future by filling our 3,400 vacant sites, obtaining our 4% rent increases, increasing the volume and profitability of our home sales, expanding our communities and growing our finance business.*** *The continued improvement in our operating results will drive significant earnings growth, but the reduction of our cost of capital will be equally, if not more beneficial." --- Samuel Landy, President and CEO of UMH Properties*

The REIT views its growth outlook quite favorably, and management stressed during UMH Properties' second quarter of 2021 earnings call that the production rate of manufactured homes would need to pick up the pace to keep up. UMH Properties' development pipeline is robust and supports its cash flow growth outlook.

Please note that there are some downside risks to keep in mind here. A weak domestic economy would weigh negatively on the REIT's ability to push through rental price increases and maintain its occupancy rates. The capital market dependent nature of UMH Properties' business model means the REIT needs to retain constant access to debt and equity markets to keep making good on its payout obligations. **We caution that UMH Properties was forced to cut its divided back in 2008 in the wake of the Great Financial Crisis ('GFC').** However, a lot has changed since then.

In our view, UMH Properties is well-positioned to navigate exogenous headwinds, though the REIT's growth runway is facing near term hurdles as it concerns securing manufactured housing units to sell. Supply chain hurdles should eventually abate as the world is steadily putting the worst of the COVID-19 pandemic behind it. The REIT's financials are rock-solid, and its operational execution has really impressed of late with an eye towards its rising occupancy rates and increases in its same-property NOI.

UMH Properties is a great enterprise with a compelling growth story. **We like UMH Properties as our High Yield Spotlight for November 2021, and we expect that the REIT will steadily grow its payout alongside its earnings going forward.** The REIT is a stellar income generation idea in the current environment.

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

PepsiCo Flexes Its Pricing Power

Image Shown: *PepsiCo Inc is adeptly navigating various inflationary, labor, and logistical hurdles. Investors have started to warm back up to the name and its impressive pricing power over the past several months.*

By Callum Turcan

On October 5, beverage and snack giant PepsiCo Inc (PEP)---**2.7% yield**---reported third-quarter earnings for fiscal 2021 (period ended September 4, 2021) that beat both consensus top- and bottom-line estimates. **PepsiCo also raised its full-year guidance for fiscal 2021 in conjunction with the report.**

Earnings Snapshot

The firm's GAAP revenues grew by 12% year-over-year and its GAAP operating income climbed higher 5% year-over-year in the fiscal third quarter. **Strength at PepsiCo's snacks and beverage business in the Americas, Africa, Middle East, and Asia was key, particularly as it concerns growing PepsiCo's operating income, as its business in Europe faced meaningful inflationary pressures.**

Its outperformance in key markets around the world last fiscal quarter gave PepsiCo the confidence to push through a nice guidance boost. PepsiCo's new guidance for fiscal 2021 shifted its expected non-GAAP organic revenue growth higher by 200 basis points versus its previous guidance, while its non-GAAP adjusted EPS forecasts left the door open for potential upside:

For fiscal year 2021, the Company now expects to deliver approximately 8 percent organic revenue growth (versus our previous guidance of 6 percent), at least 11 percent core constant currency EPS growth (versus our previous guidance of 11 percent), and at least 12 percent core EPS growth (versus our previous guidance of 12 percent).

In our view, **it appears that strong organic volume growth and meaningful pricing increases** (two concepts we will cover in just a moment) **are enabling PepsiCo to hold the line as it concerns its forecasted bottom-line performance.** PepsiCo expects to post non-GAAP core EPS of $6.20 in fiscal 2021 versus $5.52 in fiscal 2020.

Pricing Increases and Organic Volume Growth

PepsiCo is facing major supply chain hurdles and inflationary headwinds. The firm's performance in the fiscal third quarter was heavily aided by net pricing increases as one can see in the upcoming graphic down below. Organic volume growth came in relatively strong at most of PepsiCo's segments in the wake of these pricing increases, indicating demand for PepsiCo's offerings remains robust. At its Quaker Foods North America segment, meaningful net pricing increases combined with the fading effects of the "pantry stockpiling" effect seen last year in the wake of the coronavirus ('COVID-19') pandemic saw this segment's organic volumes shift lower year-over-year last fiscal quarter.

PepsiCo, Inc. and Subsidiaries
Reconciliation of GAAP and Non-GAAP Information
Organic Revenue Growth Rates
12 and 36 Weeks Ended September 4, 2021
(unaudited)

	12 Weeks Ended 9/4/2021					
		Impact of			Impact of	
Net Revenue Year over Year % Change	Reported % Change, GAAP Measure	Foreign exchange translation	Acquisitions and divestitures[a]	Organic % Change, Non-GAAP Measure[b]	Organic volume[c]	Effective net pricing
Frito-Lay North America	6 %	(0.5)	—	5 %	1	4
Quaker Foods North America	2 %	(1)	—	1 %	(4)	4.5
PepsiCo Beverages North America	7 %	(0.5)	—	7 %	3	4
Latin America	27 %	(8)	—	19 %	6	13
Europe	9 %	—	—	8 %	6	2.5
Africa, the Middle East and South Asia	33 %	(8)	(5)	20 %	12	8
Asia Pacific, Australia and New Zealand and China Region	27 %	(7)	(5)	15 %	12	3
Total	12 %	(2)	(1)	9 %	4	5

Image Shown: *PepsiCo is turning to meaningful net pricing increases to offset inflationary headwinds, and its organic volume growth has held up relatively well so far in the wake of those pricing increases.* ***Image Source:*** *PepsiCo – Third Quarter of Fiscal 2021 Earnings Press Release*

We are impressed with the organic volume growth PepsiCo put up last fiscal quarter in Latin America, Africa, the Middle East, and Asia when taking net pricing increases into account. PepsiCo's North American operations (excluding its Quacker Foods segment) also put up decent organic volume growth in the wake of meaningful net pricing increases. During PepsiCo's latest earnings call, management had this to say in response to a question from an analyst on inflationary headwinds, pricing increases, and how that would impact PepsiCo's bottom-line (emphasis added):

> *"I think I would think about it this way; obviously, we've given you some pretty specific guidance in terms of where we would expect EPS to land for Q4. You know that we fore advise by 6 months to 9 months,* ***those hedges that we had in the beginning of the year are starting to roll off, the new ones that are in place are higher costs.***
>
> *We had shared on the last call, as well as in the prepared remarks today that* ***we expect to be able to price through the inflation that we're facing whether it be commodities inflation or other types of operating expense inflation.*** *Some of that pricing occurred in the summer, much more of it is occurring in the fall in the beverage business and substantially all of it for 2021 in the snack food business is occurring really as we speak during these weeks right now.*
>
> *You also know that we forwarded by that 6 months to 9 months out, so we will have a better handle on where exactly 2022 costs are going to land as we get into the first quarter of 2022. And I would expect this to price a bit more to be reflective of some of that sort finalization of costs during the course of 2022.* ***So Q4, some of the pricing coming through, the balance of it coming in Q1 of 2022, and the EPS guidance is reflective of all of that."*** *--- Hugh Johnston, Vice Chairman, Executive VP, CFO of PepsiCo*

Given PepsiCo's strong organic volume growth performance in the wake of recent pricing increases, it appears that consumers around the world are still willing to pay up for its products. **Management intends to capitalize on this dynamic by pushing through additional pricing increases going forward** as communicated in the above statement.

Innovation remains key here. PepsiCo is working with Boston Beer Company Inc (SAM) to produce an alcoholic version of PepsiCo's popular Mountain Dew beverage, dubbed HARD MTN DEW, which is expected to have a 5% alcohol content by volume. This agreement was announced back in August 2021 and highlights PepsiCo's focus on making the most of its top tier properties. Other innovations include the launch of Doritos Flamin' Hot Limon and Doritos Cool Ranch chips that was announced back in January 2020, along with other products such as zero sugar offerings of its Mountain Dew beverages and Lay's Cheddar Jalapeño chips which are relatively new additions to PepsiCo's product lineup.

Financial Snapshot

The firm intends to spend $5.8 billion covering its dividend obligations in fiscal 2021 and $0.1 billion buying back its stock. PepsiCo noted that its share repurchase program for this fiscal year had been completed and that the firm did "not expect to repurchase any additional shares for the balance of [fiscal] 2021" in its latest earnings press release.

PepsiCo generated $4.4 billion in free cash flow during the first three quarters of fiscal 2021 while spending $4.3 billion covering its dividend obligations and another $0.1 billion buying back its stock. **We appreciate management taking their foot off of the gas pedal as it concerns share repurchases given that PepsiCo exited the fiscal third quarter with a net debt load of $34.4 billion (inclusive of short-term debt).** Shares of PepsiCo are trading in the upper bound of our fair value estimate range as of this writing (the top end of our fair value estimate range sits at $162 per share of PEP).

In our view, PepsiCo would be wise to pare down its net debt load over time. The firm is a stellar free cash flow generator with a stable business model that apparently has ample pricing power, and we expect PepsiCo will be able to stay on top of that burden going forward while continuing to make good on its dividend obligations. PepsiCo had a $6.9 billion cash, cash equivalents, and short-term investments balance at the end of the fiscal third quarter, providing the firm with ample liquidity to manage its near-term funding needs.

Concluding Thoughts

Inflationary headwinds, labor constraints, and logistical hurdles are wreaking havoc across the globe, though PepsiCo appears to be fully capable of adeptly navigating these obstacles. The firm possess ample pricing power, aided by its focus on innovation in the beverages and snacks industry. PepsiCo is a tremendous cash flow generator in almost any operating environment. Over the long haul, we expect the global economy will be able to push past recent headwinds, though meaningful hurdles remain.

Image Shown: *An overview of PepsiCo's brand portfolio.* ***Image Source:*** *PepsiCo – 2021 CAGNY IR Presentation*

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

IBM Provides Investors with a Major Update

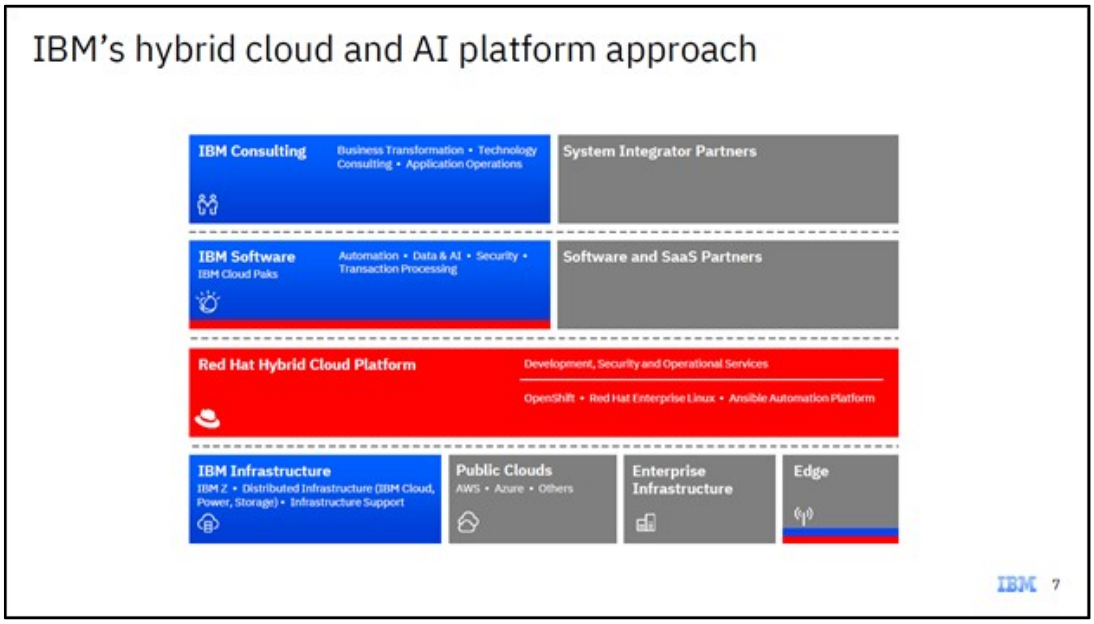


Image Source: *International Business Machines Corporation – October 2021 IR Presentation*

By Callum Turcan

While still a major enterprise, International Business Machines Corporation (IBM)---**5.3% yield**---is no longer the tech juggernaut it used to be and hasn't been a leading tech company for over a decade. The company recognizes this and back in October 2020, IBM announced that it planned to "separate its Managed Infrastructure Services unit of its Global Technology Services division into a new public company" that will be called Kyndryl. By the end of 2021, this tax-free spinoff is expected to be complete (shares of Kyndryl will be spun off to IBM shareholders). In October 2021, IBM provided a major update to its shareholders covering its medium-term financial outlook, key operational updates, and what to expect going forward as it concerns its dividend policy, areas that we are going to cover in this article.

Overview

Kyndryl is built around offering "hosting and network services, services management, infrastructure modernization, and migrating and managing multi-cloud environments." IBM views the managed infrastructure services provider industry (which Kyndryl is catering to) as a $500 billion market opportunity, though this industry has a lackluster outlook and is full of competitors. For instance, F5 Networks Inc (FFIV) caters to this industry, though in recent years F5 Networks has acquired several firms in the realm of cybersecurity and cloud-computing services to improve its growth outlook (I, II, III) as it recognizes the various limitations of its legacy businesses.

Back in 2019, IBM acquired Red Hat through a deal with an equity value of ~$34 billion that significantly grew IBM's exposure to the hybrid cloud computing industry. **IBM views the hybrid cloud platform space as a $1 *trillion* and growing opportunity with a promising outlook that houses ample upside for IBM to capitalize on.**

Red Hat was billed as a "leading provider of enterprise open source software solutions, using a community-powered approach to deliver reliable and high-performing Linux, hybrid cloud, container, and Kubernetes technologies. Red Hat helps customers integrate new and existing IT applications, develop cloud-native applications, standardize on (its) industry-leading operating system, and automate, secure, and manage complex environments." By joining forces with Red Hat, IBM was able to significantly improve its hybrid cloud operations which ultimately set the stage for IBM to jettison its legacy businesses (those included in its pending Kyndryl spinoff).

Going forward, IBM is focused on developing its open hybrid cloud platform, AI and data analytics capabilities, automation offerings, cybersecurity operations, consulting business (covering business, strategy, and technology), and more. **IBM's new business model will be built around providing software and cloud-based solutions to its clients.** The upcoming graphic down below highlights how IBM's post-separation revenue mix will shift heavily towards software and consulting services, offerings with juicy margins and promising growth outlooks. IBM's post-separation recurring revenue streams will be ~65% weighted towards software versus ~45% currently.

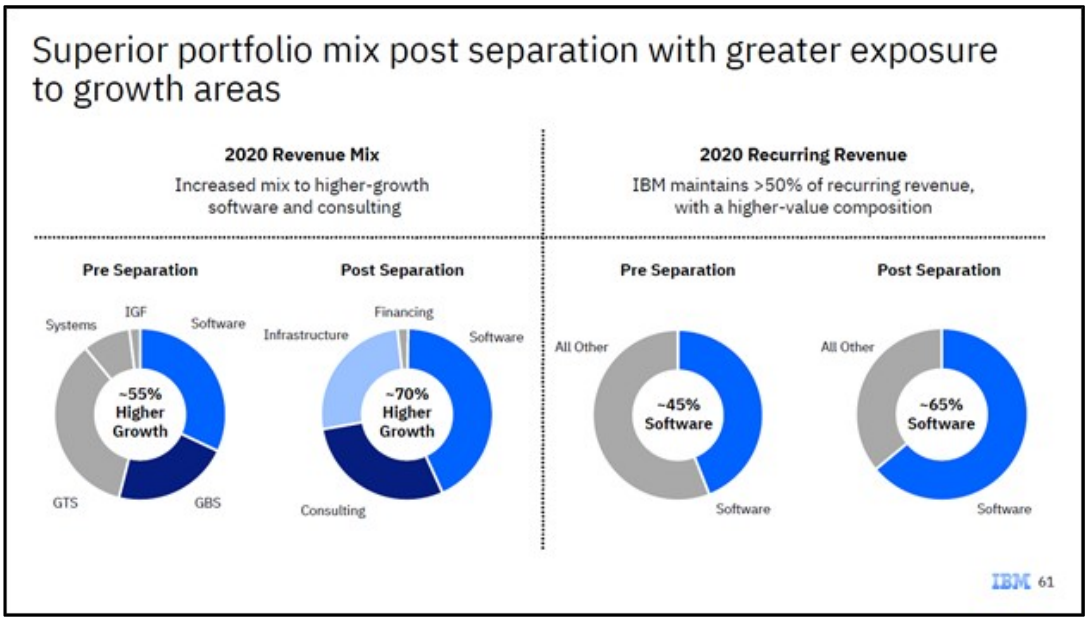


Image Shown: *IBM intends to shed its legacy business so it can pivot towards its lucrative software and cloud-based solutions offerings that have promising growth outlooks.* ***Image Source:*** *IBM – October 2021 IR Presentation*

The upcoming graphic down below breaks down IBM's software revenue by category. Transaction processing, Ret Hat offerings, automation, and data & AI represent the four major categories, though its security and health offerings are also intriguing. **Cybersecurity is a huge growth market as malevolent cyber actors are on the rise worldwide.**

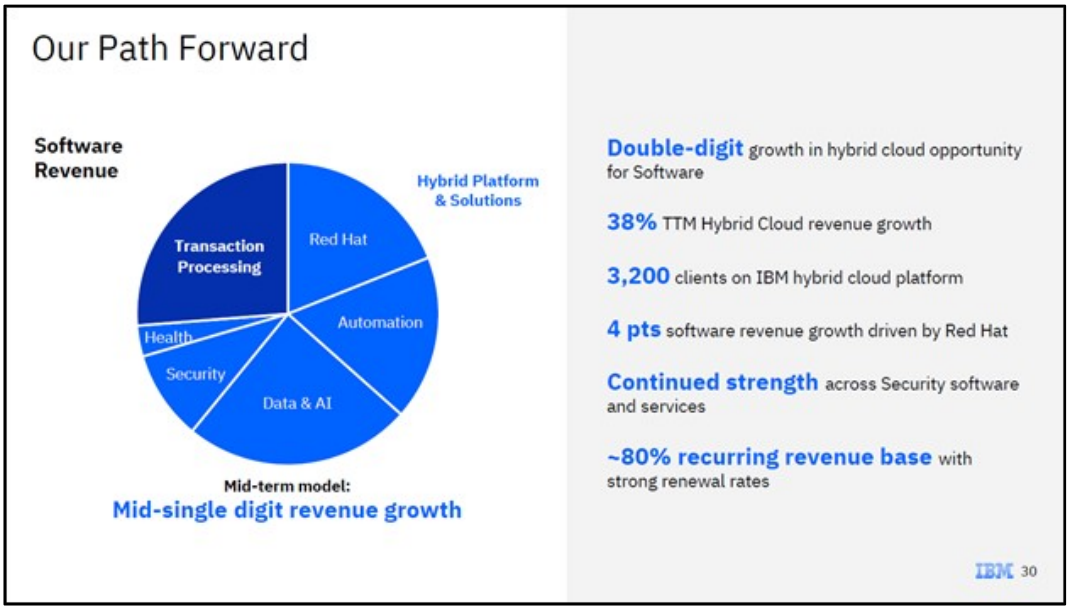


Image Shown: *An overview of IBM's software business profile.* ***Image Source:*** *IBM – October 2021 IR Presentation*

As it concerns IBM's consulting business, the upcoming graphic down below provides an overview of its revenue mix and recent performance. There are ample synergies to be had across IBM's business segments as it concerns potential cross-selling opportunities.

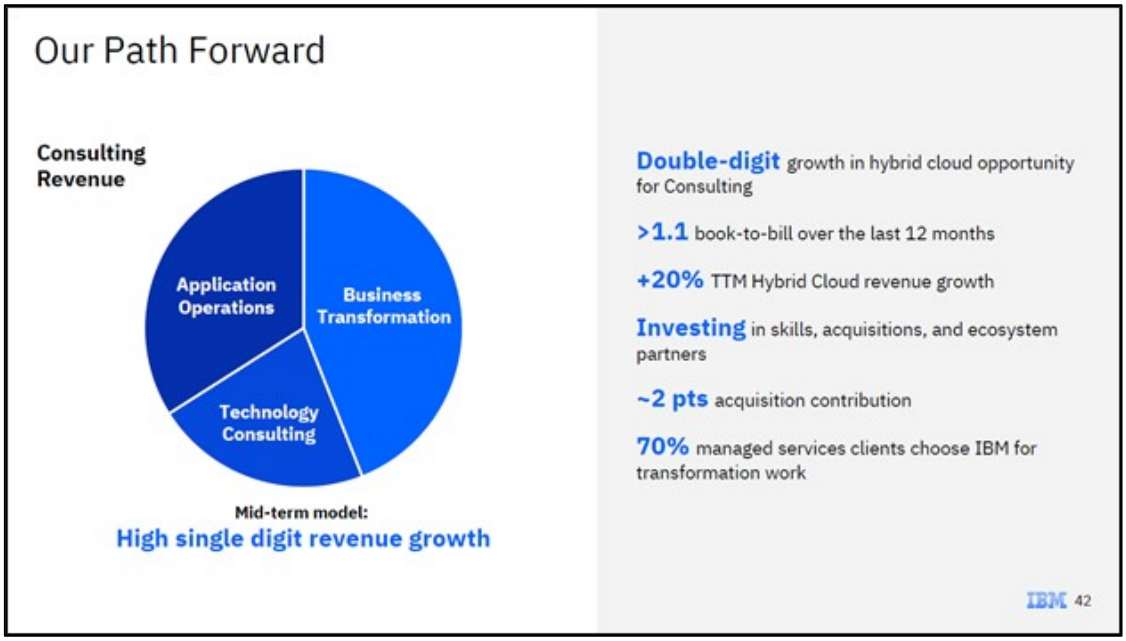


Image Shown: *An overview of IBM's consulting business profile.* ***Image Source:*** *IBM – October 2021 IR Presentation*

In the upcoming graphic down below, IBM highlights what its post-separation revenue and free cash flow performance would have looked like in 2020. Please note that IBM will continue to have a commercial relationship with Kyndryl, which will provide a one-off, sustainable boost to IBM's financial performance (particularly its revenue growth rate) in 2022. **We are impressed that IBM will remain a free cash flow generating powerhouse once the separation is complete.**

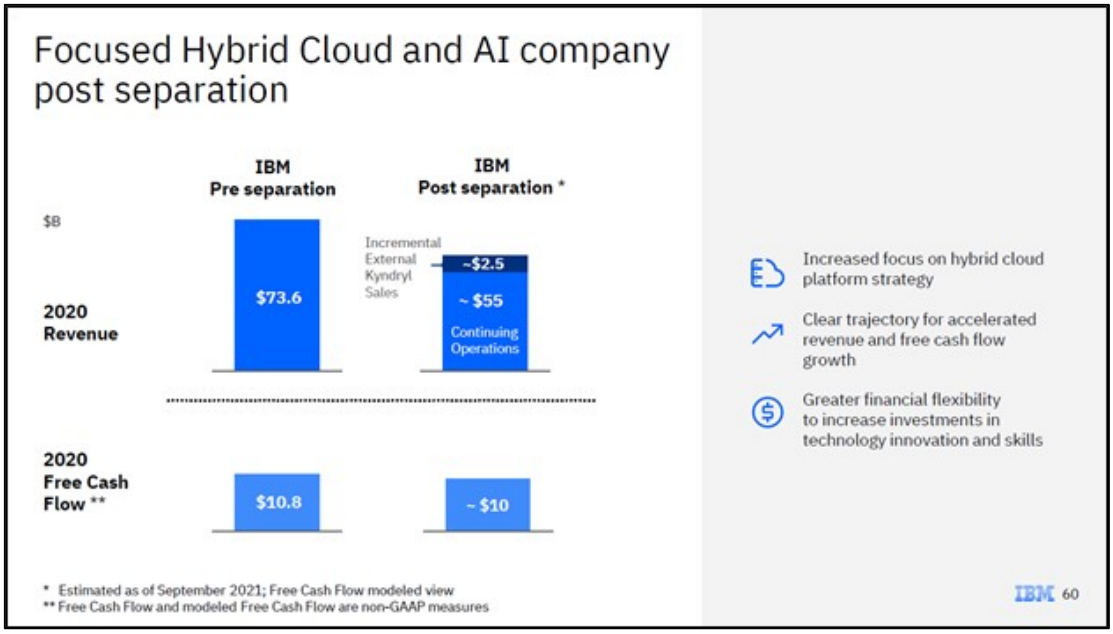
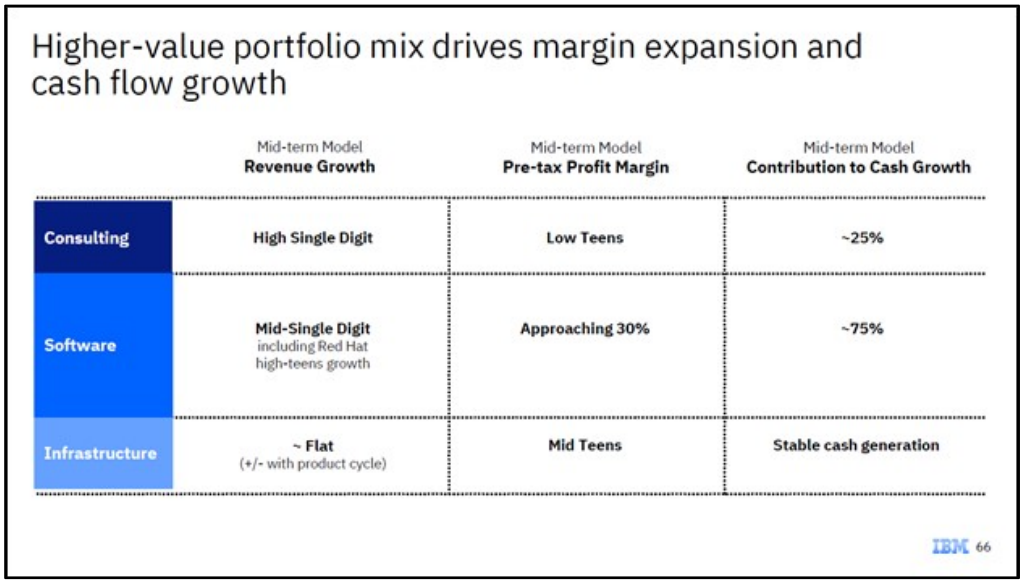


Image Shown: *IBM forecasts that it will remain a free cash flow generating powerhouse once it completes the spinoff of its legacy businesses.* ***Image Source:*** *IBM – October 2021 IR Presentation*

Impressive FCF Generation Capabilities, Stronger Growth Outlook

Looking ahead, IBM provided medium-term revenue and free cash flow growth forecasts along with margin guidance during its big investor event. These forecasts were broken down by its major business operating segments to paint a picture of how its business will evolve in the coming years. As part of its transformation, IBM consolidated its various reporting segments to four core business operating segments including 'Consulting,' 'Software,' 'Infrastructure,' and 'Financing.' **Its two core cash flow growth drivers going forward will be its Consulting and Software business segments, as its Infrastructure business is expected to tread water (post-separation, IBM will still retain a sizable IT infrastructure operation).**



Higher-value portfolio mix drives margin expansion and cash flow growth

	Mid-term Model Revenue Growth	Mid-term Model Pre-tax Profit Margin	Mid-term Model Contribution to Cash Growth
Consulting	High Single Digit	Low Teens	~25%
Software	Mid-Single Digit including Red Hat high-teens growth	Approaching 30%	~75%
Infrastructure	~ Flat (+/- with product cycle)	Mid Teens	Stable cash generation

IBM 66

Image Shown: *IBM sees its Consulting and Software business operating segments representing its two core cash flow growth drivers post-separation.* ***Image Source:*** *IBM – October 2021 IR Presentation*

Management expects the new IBM will generate ~$35 billion in cumulative free cash flow from 2022-2024. Here is what IBM's management team had to say during the October 2021 investor event (emphasis added, lightly edited):

> *"**We have an improving business mix profile skewed more towards higher growth markets. We have a much higher value recurring revenue profile** and you combine that with a chance to reset and redefine our client relationships for incremental wallet share and it lends itself to an attractive financial model an investment thesis over the midterm horizon… [from] '22 to '24.*
>
> *Our IBM financial model, mid-single-digit revenue growth, top line and you combine that mid-single-digit growth top line with an improving mix profile and it naturally lends itself to operating margin leverage. **That operating margin leverage then translates into high single-digit free cash flow, $750 million of free cash flow growth generation per year.***
>
> *You now couple that with the baseline of $10 billion of free cash flow, you compound that free cash flow at high single digits and **that delivers $35 billion of cumulative free cash flow over the midterm horizon.** So from an investment thesis, **the new IBM, improving revenue growth profile, higher operating margin, a free cash flow yield that's very strong, lower capital intensity business and a higher return on invested capital overall."** --- Jim Kavanaugh, CFO of IBM*

IBM forecasts that its post-separation free cash flows will grow by ~$0.75 billion per year in the medium-term, representing a high single-digit annual growth rate. Forecasted mid-single-digit annual revenue growth, with an eye towards recurring revenues, along with expected favorable business mix shift are largely why management is confident IBM will remain a free cash flow generating entity in the coming years. Additionally, the relatively modest capital expenditure requirements of IBM's business, post-separation, to maintain a given level of revenues supports its ability to turn net income into free cash flow.

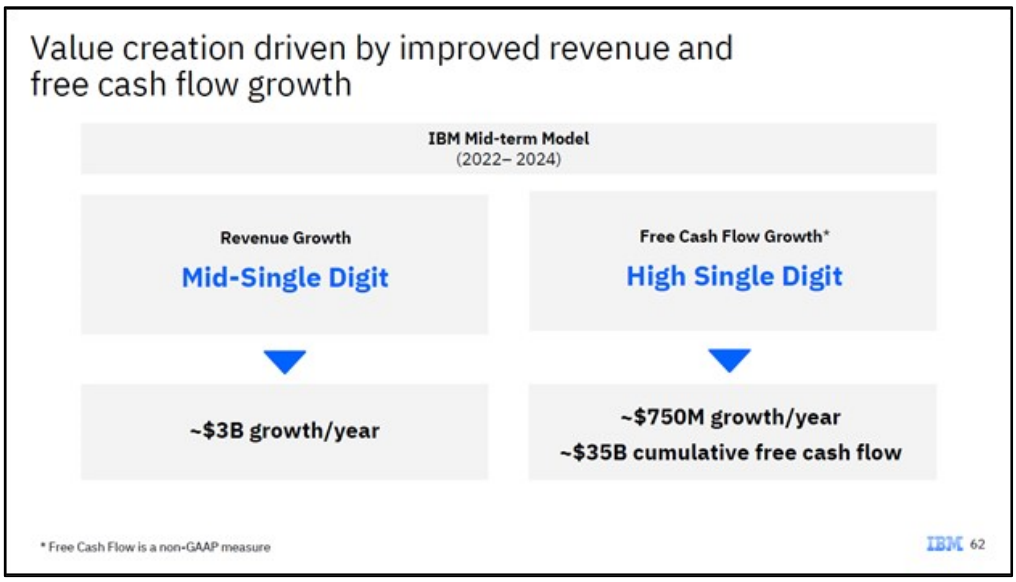


Image Shown: *IBM expects its annual free cash flows will grow at a nice clip post-separation due to expected revenue growth and a more favorable business mix.* ***Image Source:*** *IBM – October 2021 IR Presentation*

Balance Sheet Concerns

We caution that IBM exited September 2021 with **a total debt load of $54.5 billion** (inclusive of short-term debt) which was modestly offset by $8.1 billion in cash, cash equivalents, and current marketable securities on hand (exclusive of restricted cash and non-current 'investments and sundry assets'). **IBM, on a post-separation basis, will remain a stellar free cash flow generator, though its sizable net debt load weighs negatively on its financial flexibility.** IBM has a stellar 'A-rated' investment grade credit rating (A2/A-) and should retain solid access to capital markets at attractive rates going forward, particularly debt markets, which should support its future refinancing activities.

IBM aggressively repurchased its stock over the past decade, though going forward, we would prefer the company pare down its net debt load to improve its financial strength. However, that does not appear to be likely given how management referred to IBM's ability to take on more debt to fund shareholder returns during its latest investor event.

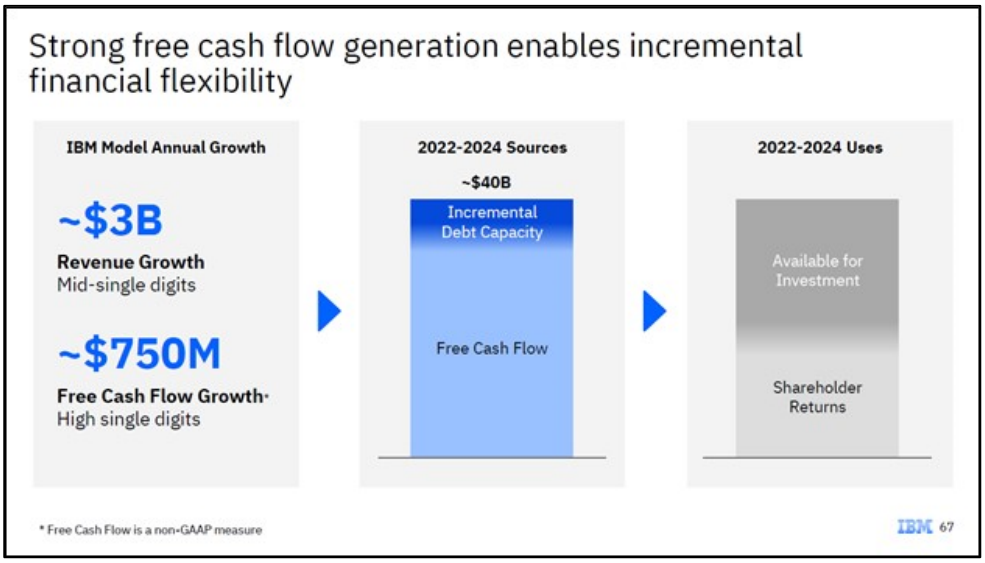


Image Shown: *It does not appear that debt reduction will be a core focus for IBM going forward as the firm cited its "incremental debt capacity" during its latest investor presentation, a sign IBM intends to further grow its already large debt pile.* ***Image Source:*** *IBM – October 2021 IR Presentation*

Dividend Consideration

Shares of IBM yield a nice ~5.3% as of this writing as noted previously, though that is primarily because its stock price has languished over the past decade. At ~$125 per share, IBM is currently trading around levels last seen in 2010 as of this writing. While we view IBM's dividend strength favorably as its stellar free cash flow generating abilities should enable the firm to stay on top of its future payout obligations and refinancing activities, its large net debt load remains one of our biggest concerns. Additionally, IBM's major business transformation comes with substantial execution risks.

IBM's growth outlook is improving due to its business transformation, though management would be wise to take a page from the successful tech behemoths out there such as Microsoft Corporation (MSFT), Alphabet Inc (GOOG) (GOOGL), and Facebook Inc (FB), which all have fortress-like balance sheets (i.e., enormous net cash balances).

Management had this to say regarding IBM and Kyndryl's dividend policy and financial strength during the firm's recent investor presentation (emphasis added, lightly edited):

> *"And I'll reiterate…* ***that we fully expect the initial combined dividend of IBM and Kyndryl to be no less than IBM's dividend today.*** *And finally, we are very comfortable at the capital structure we have today operating at a single A credit rating.* ***The high-value recurring business mix that we have within our company, you couple that with substantial liquidity pools and that strength of that balance sheet I talked about, we're right where we need to be in terms of leverage and capital structure."*** *--- CFO of IBM*

Please note that post-separation, IBM may moderately reduce its dividend as a standalone entity to reflect the lost cash flow from spinning off Kyndryl, though the combined dividend payout of both firms would remain at least the same as it is currently. However, given that IBM expects to remain very free cash flow positive post-separation, that may not end up being the case though things remain up in the air at the momentum. We are keeping an eye on the situation.

Concluding Thoughts

We are not interested in adding shares of IBM as an idea to any of our newsletter portfolios at this time, but only because we are already overweight large cap tech companies. IBM's transformation is intriguing, though we will need to see if the company can actually live up to its targeted revenue and free cash flow growth rates from 2022 onwards. Its large debt load is also worth watching closely.

At the very least, IBM shedding its legacy assets should result in an entity that can direct more attention and resources towards its major growth opportunities in the realm of hybrid cloud computing, AI and analytics, cybersecurity, and other offerings. Our fair value estimate for IBM sits at $133 per share, **indicating shares of IBM are about fairly valued at this time.**

Image Shown: *Shares of IBM have been moribund over the past decade.*

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

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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%	3.18%
SPDR Portfolio S&P 500 High Dividend ETF	SPYD	5.0%	5.03%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	4.67%
iShares International Select Dividend ETF	IDV	5.0%	5.49%
iShares U.S. Preferred Stock ETF	PFF	5.0%	4.40%
Global X SuperDividend ETF	SDIV	5.0%	7.68%
Global X SuperIncome Preferred ETF	SPFF	10.0%	5.67%
Vanguard Consumer Staples ETF	VDC	5.0%	2.48%
Vanguard Real Estate ETF	VNQ	10.0%	2.98%
Utilities Select Sector SPDR	XLU	5.0%	2.98%
EQUITY			
AT&T	T	5.0%	8.23%
Crown Castle	CCI	5.0%	3.26%
CyrusOne Inc.	CONE	5.0%	2.54%
CubeSmart	CUBE	5.0%	2.47%
Digital Realty Trust	DLR	5.0%	2.94%
Philip Morris	PM	5.0%	5.29%
Public Storage	PSA	5.0%	2.41%
Enterprise Products Partners	EPD	2.5%	7.94%
Magellan Midstream Partners	MMP	2.5%	8.47%
Cash*	-	0.0%	0.00%
		100.0%	**4.43%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 11/1/2021. 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 9-Oct-2021 | Data as of 8-Oct-2021

3M MMM FAIRLY VALUED

Buying Index™ 3 Value Rating

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Very Attractive	$169.00 - $253.00	HEALTHY	GOOD / 1.4	GOOD	3.35%

Assessment of Company Dividend Strategy

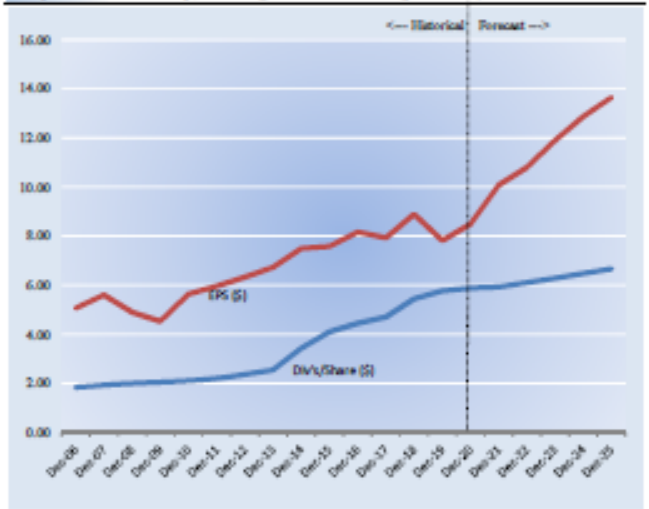
Key Strengths

The Dividend Aristocrat 3M has grown its annual dividend over the past 60+ consecutive years, though the firm has moderated the pace of its payout growth in recent years. We expect 3M will grow its dividend at a moderate pace over the coming years after pushing through robust payout increases during most of the 2010s decade. The company is a stellar generator of free cash flow and aims to post a free cash flow conversion rate of 90%-100% in 2021. 3M is dealing with sizable headwinds from inflationary pressures, labor and logistical constraints, and the COVID-19 pandemic. The firm is leaning on pricing increases to mitigate these hurdles to a degree.

Potential Weaknesses

Very few firms have the free cash flow profile of 3M, but significantly increased annual cash dividend obligations continues to make annual growth in the payout that much more difficult to cover. Currency headwinds may pose challenges in the near term, and recent efforts to restructure the business speak to a company with some slack in its operations. A net debt load doesn't help its dividend growth efforts, and management plans to allocate ~40% of its annual capital budget to acquisitions and share repurchases. The firm's total funds available in its budget include cash flow from operations (ex. R&D spend), cash on hand, and additional leverage.

Graphical Relationship, Earnings and Dividends (per share)

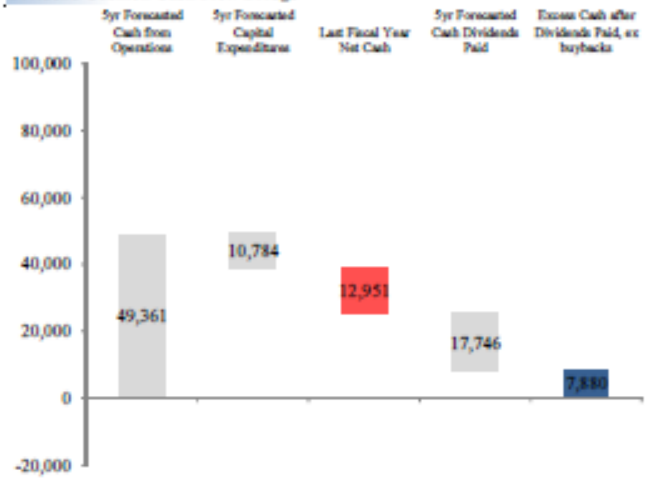


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

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. 3M's Dividend Cushion Cash Flow Bridge reveals that the sum of the company's 5-year cumulative free cash flow generation, as measured by cash flow from operations less all capital spending, plus its net cash/debt position on the balance sheet, as of the last fiscal year, is greater than the sum of the next 5 years of expected cash dividends paid. Because the Dividend Cushion ratio is forward-looking and captures the trajectory of the company's free cash flow generation and dividend growth, it reveals whether there will be a cash surplus or a cash shortfall at the end of the 5-year period, taking into consideration the leverage on the balance sheet, a key source of risk. On a fundamental basis, we believe companies that have a strong net cash position on the balance sheet and are generating a significant amount of free cash flow are better able to pay and grow their dividend over time. Firms that are buried under a mountain of debt and do not sufficiently cover their dividend with free cash flow are more at risk of a dividend cut or a suspension of growth, all else equal, in our opinion. Generally speaking, the greater the 'blue bar' to the right is in the positive, the more durable a company's dividend, and the greater the 'blue bar' to the right is in the negative, the less durable a company's dividend.

Dividend Cushion Cash Flow Bridge

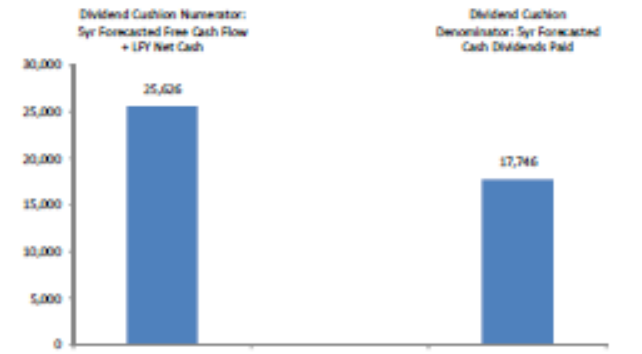


Source: Company Filings, Valuentum Projections

Dividend Cushion Ratio Evaluation

The Dividend Cushion Ratio Deconstruction, shown in the image to the right, reveals the numerator and denominator of the Dividend Cushion ratio. At the core, the larger the numerator, or the healthier a company's balance sheet and future free cash flow generation, relative to the denominator, or a company's cash dividend obligations, the more durable the dividend. In the context of the Dividend Cushion ratio, 3M's numerator is larger than its denominator suggesting strong dividend coverage in the future. The Dividend Cushion Ratio Deconstruction image puts sources of free cash in the context of financial obligations next to expected cash dividend payments over the next 5 years on a side-by-side comparison. Because the Dividend Cushion ratio and many of its components are forward-looking, our dividend evaluation may change upon subsequent updates as future forecasts are altered to reflect new information.

Dividend Cushion Ratio Deconstruction



DEFINITIONS

ValueCreation. This is a proprietary Valuentum measure. ValueCreation indicates the firm's historical track record in creating economic value for shareholders, taking the average difference between ROIC (without goodwill) and the firm's estimated WACC during the past three years. The firm's performance is measured along the scale of EXCELLENT, GOOD, POOR, and VERY POOR. Those firms with EXCELLENT ratings have a demonstrated track record of creating economic value, while those that register a VERY POOR mark have been destroying economic value.

ValueRisk. This is a proprietary Valuentum measure. ValueRisk indicates the historical volatility of key valuation drivers, including revenue, gross margin, earnings before interest, and enterprise free cash flow. The standard deviation of each measure is calculated and scaled against last year's measure to arrive at a percentage deviation for each item. These percentage deviations are weighted equally to arrive at the corresponding fair value range for each stock, measured in percentage terms. The firm's performance is measured along the scale of LOW, MEDIUM, HIGH, and VERY HIGH. The ValueRisk™ rating for each firm also determines the fundamental beta of each firm along the following scale: LOW (0.85), MEDIUM (1), HIGH (1.15), VERY HIGH (1.3).

ValueTrend. This is a proprietary Valuentum measure. ValueTrend indicates the trajectory of the firm's return on invested capital (ROIC). Firms that earned an ROIC last year that was greater than the 3-year average of the measure earn a POSITIVE rating. Firms that earned an ROIC last year that was less than the 3-year average of the measure earn a NEGATIVE rating.

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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