



The Top 10 Dividend Stocks to Buy This Summer

A Special Research Report from **The Dividend Hunter**

Introduction

By Tim Plaehn

To start off, my time as a licensed stock broker and financial planner eventually led to work writing on a wide range of investment and financial topics for websites like The Motley Fool, MarketWatch, Chron.com, Zack's, and Seeking Alpha. My experience, knowledge and focus on income investing led to my selection as the editor of The Dividend Hunter and 30 Day Dividends from Investors Alley.

As I interact with investors who comment on my stock articles, contact me directly or subscribe to our newsletter services, I have found that there are several areas of either confusion or a desire for more information on several topics concerning buying stocks to produce an above average yield income stream. Here are several concepts or strategies that I use to analyze and select income stocks. The goal is to earn a higher yield over time and protect portfolio values against large losses.

- **Spread your investments across the alphabet soup of pass-through stock market sectors.** These types of stocks including REITs, MLPs, BDCs, and CEFs are formed under tax rules that eliminate or minimize corporate income taxes at the company level and allow more income to be paid as dividends to investors. Diversifying across the alphabet provides safety and stability. However, each type of income stock requires its own set of analysis tools.
- **Yield vs. Growth fulcrum.** It is an easy job to screen for the highest yield stocks and then dump some money into shares currently paying 10% or more. However, there are two problems with this approach.

First, a high yield is a direct indicator of risk, and many investors have been seriously burned by buying high yield shares and then suffering serious losses when the dividend gets significantly cut.

Second, you want to have a major portion of your income portfolio invested in income stocks that will increase the dividends over time. There is always a balance between current yield and the projected dividend growth rate. Each of us must decide where to invest along this spectrum and also search out those stocks that pay higher yields for a certain growth rate.

- **Understand the tax ramifications of your income investments.** Depending on the type of stock you buy the dividends may be fully taxable, qualify for a special lower tax rate or be classified wholly or partially as a non-taxable return of capital. There are also longer term tax considerations revolving around short or long-term capital

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gains taxes or leaving shares to your heirs. A great income investment for an investor in one tax bracket may not be so attractive for an investor paying taxes at a different bracket rate.

The 10 dividend stocks listed here were chosen to provide a balanced list covering the different types of income stock investments. When reviewing and selecting stocks to be highlighted and tracked in our [The Dividend Hunter](#) and [30 Day Dividends](#) newsletters a range of industry and stock type analysis tools are employed to select those stock market investments that provide the best return potential in their respective categories.

Master Limited Partnerships

Master limited partnerships (MLPs) are the result of a tax structure that allows energy and minerals focused companies to function as publicly traded partnerships. As an investor you buy units in an MLP and earn distributions. Units trade just like corporate stock shares and distributions can be viewed as tax advantaged dividends. MLPs do not pay corporate taxes and pass the majority of free cash flow along to investors as distributions. Two MLPs and a related company start this list of 10 income stocks.

With a market cap of \$20 billion, **Plains All American Pipeline (NYSE: PAA)** is one of the largest MLP and infrastructure companies in the U.S. The company owns an extensive portfolio of energy transport and storage facilities and equipment including:

- 18,150 miles of crude oil and fuels pipelines
- 120 million barrels of liquids storage
- 97 billion cubic feet of natural gas storage
- Facilities to handle 235,000 barrels per day of energy liquids fractionation
- 8.5 billion cubic feet per day of natural gas processing capacity
- 24 crude oil and natural gas liquids rail facilities
- 7,400 crude and NGL railcars
- 840 truck tractors and 1,700 liquids trailers
- 60 tug boats and 130 barges

Plains All American Pipeline puts these assets to work using long term, fee-based contracts. The company generates three-quarters of its annual revenues from the transportation and storage of crude oil. Fee-based business also accounts for about 75% of revenues. The remaining quarter of the company's revenues come from the supply and logistics services provided with trucks, trailers and railcars. This portion generates earnings from a combination of fees and margins generated by buying oil in one region and selling for higher prices at the other end of the transport.

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As an MLP, Plains All American Pipeline offers an infrastructure investment that pays an attractive distribution yield with steady year-over-year growth in the distribution rate per unit. With the U.S. Energy Information Agency forecasting 20-plus years of future growth in domestic oil and gas production, this company fills the very important need to move crude oil from the drilling regions to the refineries. Plains All American Pipelines also provides pipeline transport of crude oil from Canada to the U.S. refineries. If the Keystone XL pipeline is approved and built, it will be years before the pipeline competes with Plains and projected growth in Canada's oil production will more than take up the extra capacity.

This MLP offers a conservative way for investors to get started with MLP investing. The company provides the combination of an attractive yield, steady and even more attractive distribution growth, and a conservative management philosophy.

PAA currently yields 4.3% and has increased the distributions paid to unit holders by a compounded 8.4% over the last 10 years. For the next couple of years, PAA management has provided guidance of 10% distribution growth per year.

In 2013, the company generated enough free cash flow to cover the distributions by 1.3 times, so you can count on that 10% increase. A steadily growing distribution will result in a share price that also increases over time.

As a result, you can expect an average annual total return of about 15% from PAA, and a large portion of that return will be tax-advantaged cash distributions into your brokerage account cash balance.

Vanguard Natural Resources LLC (NASD: VNR) provides a distinctly different income focused investment compared to Plains All American Pipelines. While PAA is an energy midstream company providing transport and processing services, Vanguard Natural Resources is an upstream MLP, earning revenue from oil and natural gas produced at the company's wells. The upstream sector of energy production is also referred to as exploration and production (E&P): drilling wells in search of oil and gas and selling the production from successful wells.

As investments, the upstream MLPs differ significantly from their corporate peers. Upstream partnerships focus on the production side, buying properties with producing wells, drilling fill-in wells to maintain production and generate a steady stream of free cash flow that can be paid to investors as distributions. Planned oil and gas production will be hedged for several years into the future, locking in the cash flow needed to pay investors even if gas and oil prices decline.

As an upstream MLP, Vanguard Natural Resources functions under what I call a "running in place" business model. The production rates from oil and gas wells decline over time and to maintain cash flow new wells must be either drilled or acquired. In a recent presentation Vanguard states that the decline rates in the six basins where the company

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operates range from 7.4% to 15.5% per year. To offset the declines, a portion of revenues must be reinvested into drilling and well rehabilitation on existing properties.

In addition, the Vanguard Natural Resources management team constantly evaluates production assets for acquisition. The company screens up to 150 purchase opportunities per year, makes a bid on about 40 and ends up buying between 2 and 8, in most years just 2 or 3. Acquisitions are financed with a combination of debt and cash raised from the issuance of new partnership units – equity capital. This business model requires an upstream MLP to grow in market cap, assets owned, and proven reserves just to maintain a moderate level of annual distribution growth to investors. In fact, many of Vanguard's upstream MLP competitors struggle just to maintain level dividend payments year over year even as the companies' assets grow and grow.

Since there is not much room for error in the upstream MLP game, the skills and policies of the management team set apart the best investments, including my pick: Vanguard Natural Resources, from the rest of the pack. Here are some of the items that place Vanguard as a top income investment choice.

- Disciplined acquisition strategy: bidding on 40 opportunities to typically win 2 or 3 per year means that Vanguard is not over-paying for the new assets it needs to grow production and cash flow on a per unit basis.
- In 2014 the company started a capital growth program to partner with drilling operators to bring in new wells in low risk, proven geologies.
- Hedging strategy allows profits to the upside on oil and gas prices while protecting cash flow to the downside.
- Vanguard is a low cost operator compared to the averages for upstream MLPs. Low cost means more revenue drops to the free cash flow line.
- A proven history of distribution growth. The amount paid to unit holders has increased every year since the Vanguard IPO in 2006.

Vanguard Natural Resources currently yields 7.85%. Since the company is organized as an MLP, most if not all of the distributions come to you as non-taxable income. In 2013, the company switched to monthly distribution payments, provided a more useful income stream into your brokerage account and also reducing the volatility of the share price. You can expect distributions to increase at a moderate 3% to 4% percent per year. That steady growth coupled with the high current, monthly yield make VNR a great income stock investment.

Brookfield Infrastructure Partners LP (NYSE: BIP) is technically not a master limited partnership, but the company is organized as a publicly traded partnership (PTP) and this investment offers an income producing opportunity that will diversify your portfolio away from the energy sector focus of the MLP universe. Brookfield Infrastructure

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Partners lives up to its name by owning a variety of infrastructure assets that throw off steady and growing income streams. Brookfield further diversifies with ownership of assets all over the world, providing exposure to economies outside of North America. Here is a list of the company's current assets:

Utility Related Assets

- 6,500 miles of electricity transmission lines in North and South America. Provides power to 98% of Chile.
- 85 million tons of coal handling capacity. Handles 20% of global seaborne metallurgical coal exports.
- Regulated electricity and natural gas business for 2.1 million customers in South America.

Transport Assets

- Sole rail freight network in SW Australia with 3,100 miles of track.
- 2,000 miles of urban and interurban toll roads in Brazil and Chile. Personal note: I lived for 6 years in South America and toll roads are often the only available driving routes. Plus the toll rates are increased at least twice a year.
- 30 port terminals in the U.S., the U.K. and Europe. One of U.K.'s largest port services providers.

Energy Assets

- 9,500 miles of natural gas transmission pipelines, mostly in the U.S. 300 billion cubic feet of gas storage in the U.S. and Canada.
- District energy services providing heating and cooling services to urban centers of Toronto, New Orleans and Houston. Gas fired plants can provide up to 2 million pounds per hour of steam for heating. Unique deep water draw systems provide for cooling.

Brookfield Partners differs from the typical publicly traded partnership by retaining a large portion of free cash flow (funds from operations: FFO) to use as growth capital. Instead of the typical 85% to 90% payout of FFO, Brookfield pays out 60% and reinvests the rest to generate growth. Stated growth target is 5% to 9% per year of distribution growth. However, the most recent increase was a 10% bump.

Brookfield Infrastructure Partners currently yields 4.6%. The business structure is set up so that the partnership earns dividends and interest from subsidiaries rather than generate business income on its own. This means that BIP units will not produce unrelated business income and can be owned in tax-deferred accounts such as IRAs.

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While Brookfield Partners may not yield as much or project as much growth, the company provides an important diversification cog in an income focused portfolio.

View **Navios Maritime Partners LP (NYSE: NMM)** as the high-yield, contrarian play in this group of income stocks. In exchange for a near 10% yield, you are taking a bet that the global dry bulk and container shipping market has seen or is near the bottom of shipping's nearly decade long bear market. The conservative structures of Navios Partners finances and vessel contracts currently provides two to three years of dividend stability and this window of time to determine if fortunes have turned for the shipping industry.

Navios Partners currently owns 27 and leases in three cargo ships that the company leases out on long term contracts. The company has built a stable, cash-flow oriented business by acquiring the most attractive vessels and contracts developed by parent and sponsor company, Navios Maritime, Inc. (NYSE: NM).

As of the first quarter of 2014, the remaining average lease term was 3.2 years and 81% of contracted revenue was on charters of five years or longer. Note that a longer term charter by the very length of term is projected to generate more revenue. In reality, 18 of Navios Partners' vessels come off lease between April 2014 and December 2015. Of that group, 10 are coming off leases with rates below current lease rates and the overall average is below current market lease rates. However, the longer term contracts expiring in 2016 through 2023 are at daily lease rates on average double the current re-lease rate for similar vessels.

Last year, Navios Maritime and Navios Partners restructured its lease payments insurance coverage, canceling the insurance in exchange for a cash payment of about \$100 million from the insurers. That cash helped Navios navigate 2013, which was especially tough, cash flow wise. Currently the company is positioned to maintain the current dividend rate for at least the next couple of years, while the markets can observe the results of the releasing of ships coming off contract. The goal for an investment in Navios Maritime Partners is to see new leases coming onto the income statement at higher rates, growing EBITDA each quarter and eventually, a resumption of dividend increases. There should be ample warning that these events are not coming to pass and shares can be sold before there is a dividend cut.

Navios Maritime Partners currently yields 9.2% on a 44.25 cent dividend that has not been increased for two years and that was only a quarter penny increase. Investors receive a form 1099-DIV from Navios instead of the typical schedule K-1 sent out by most publicly traded partnerships. 1099s are much easier to handle on your tax return.

Business Development Corporations

Business Development Companies (BDCs) are another source of stable, high yield dividends. Following is one that will put some extra income into your brokerage account:

Ares Capital Corporation (NASD: ARCC) is organized under special tax rules as a business development company (BDC). The laws governing a BDC require the company to focus its business on providing debt and equity financing for small to mid-sized corporations. Think of a BDC as a combination of a venture capital firm and a business bank. If the company meets the tax code requirement to pay out 90% of net income as dividends to investors, a BDC does not pay corporate income taxes, reducing one big (the 35% corporate tax rate) level where the government can suck away investment earnings.

Of the two dozen BDCs, Ares Capital stands out as the largest, with a \$5.2 billion market cap. The large size allows the company to diversify its portfolio, and as of March 31, 2014 Ares Capital carried debt or equity contracts with 195 different companies. Ares provides a range of financing options and the quarter-end portfolio consisted of 45% first lien senior secured loans, 15% second lien senior secured loans, 24% of the company's pooled senior secured loan program, 5% senior subordinated debt, and the remaining 11% was preferred and other equity positions. The bottom line is that Ares Capital is the senior lender on 85% of the securities in its portfolio, putting it first in line if one of the client companies runs into financial difficulty.

Ares Capital combines the high-yield, pass-through tax characteristics, safety of the dividend, and distribution growth that are the cornerstones of the investments I select as income stock recommendations. A dividend has been paid every quarter since the company's initial public offering in 2004. In 2009, when many BDCs ran into serious financial difficulty and suspended dividend payments, Ares Capital reduced its dividend to \$0.38 from \$0.42, maintaining a high payout to investors. The current quarterly rate of \$0.38 per share has been paid since mid-2012. However, four bonus dividends totaling \$0.20 per share have also been paid out over the last two years.

With a high-yield, high-payout stock investment, an important analysis check is to see if the company has the required free cash flow to cover and maintain the dividend rate. In 2013 Ares Capital generated net investment income of \$1.71 per share, covering the dividend payments by 112%. ARCC has a current yield of 8.5% and investors can expect slow to moderate growth in the dividend payments. The slower growth rate is compensated for with the high current yield and bonus dividend payments.

Real Estate Investment Trusts

Real Estate Investment Trusts (REITs) operate under pass-through tax rules and own commercial real estate or are involved in the financing of residential or commercial real estate. REITs diversify your portfolio away from the corporate business world and into real estate. The following two REITs cover both the commercial property ownership and the property financing side of the world of REITs:

Stag Industrial Inc.(NYSE: STAG) represents an undiscovered income stock that the type of top down analysis I use can separate true above average opportunities from the pack of sometimes much more popular stocks in the same categories.

Just three years out from its IPO Stag Industrial has already built an enviable track record and carved its own niche in the commercial real estate space. This small-cap REIT will soon be well entrenched in the mid cap space.

Stag purchases and owns single tenant, class B industrial properties in secondary markets. This strategy allows the company to purchase with less competition and generate higher yields than on the class A properties desired by the larger industrial property REITs. Since the IPO, Stag has acquired 134 properties with an average cost of \$7 million. The total portfolio now consists of 212 properties spread over 34 states in the warehouse and light manufacturing sectors.

By focusing on the higher returns from class B commercial space in the hinterlands, Stag actually puts itself into a more stable financial position. Earning a higher yield from leases means that the company can outperform its peers with a lower level of leverage from debt. Stag's debt to EBITDA ratio is 4.7 times compared to a 6.5 times average for its peers. A lower ratio means higher cash flow coverage to pay interest on the debt and generate free cash flow out of which to pay dividends.

The type of properties covered by Stag lends itself to continued growth for the foreseeable future. With its superior financial strength the company can go into markets across the country and compete against less financially strong local commercial property owners. Staying in the secondary markets helps keep Stag from competing against larger, deep pocket REITs and other money management firms.

Stag Industrial currently yields 5.45%. This is significantly better than the 3.9% average of the 50 largest property owning REITs. You can also expect about 5% per year dividend growth from this REIT, providing a double digit plus average annual total return. As a final bonus for the income investor, **in October 2013, Stag went to a monthly dividend policy**. You can expect the current 10.5 cents per month dividend to increase in January.

Blackstone Mortgage Trust (NYSE: BXMT) operates in the exclusive sector of commercial real estate mortgages and debt securities. While there are about 30 REITs focused on mortgage financing, the majority participate in one way or more in

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residential mortgage lending. Commercial property lending requires specialized skills and industry contacts, leaving only three or four REITs that make a business lending against commercial properties. Overall, the commercial real estate lending space has few serious players and there exist tremendous opportunities for an aggressive company to pick up business.

In May 2013 the Blackstone Group (NYSE: BX) "re-IPO'd" a moribund REIT managed by Blackstone that had been winding down a pre-financial crisis originated pool of collateralized debt obligations (CDO's). With a reverse split to bring the share price from \$2.50 to \$25, Blackstone changed the focus to the commercial real estate lending market.

For Blackstone Mortgage Trust, the relationship with Blackstone Group provides a distinct competitive advantage. Blackstone's Real Estate Partners equity investment platform has over \$81 billion of assets under management. The commercial RE lending platform, Blackstone Real Estate Debt Strategies, has over \$9 billion under management. These internal platforms managed by Blackstone can feed opportunities to the externally traded but also managed Blackstone Mortgage Trust REIT.

The commercial RE lending market provides several sources of new loan business. Property sales are growing with \$355 billion worth changing hands in 2013. At the same time, large commercial banks holding commercial mortgages are looking to deleverage their portfolios with less of this type of business on the books. Blackstone states that the large European banks have 450 billion euros of commercial lending that they plan to unwind. As a final bonus, commercial mortgages usually have interest only payments with 5 year terms. Existing loans need to be refinanced on a regular basis.

Blackstone Mortgage uses a moderate (for real estate lenders) amount of leverage to boost loan yields into double digit territory. As one example, the company made a 70% or \$89 million loan on a hotel valued at \$127 million. The loan rate was LIBOR + 4.5%. From its credit line, Blackstone borrows \$67 million at L+2.25 leaving Blackstone with \$22 million of equity in the loan or three times leverage. The leverage allows the company to earn three times the 2.25% spread plus the full 4.5% add over Libor for a total loan yield of LIBOR + 11.25%. After management fees and expenses, the loan will generate an 8% to 8.5% return on the invested equity capital. Also, Blackstone ties the rates of all new loans to Libor, so if interest rates rise, so will the company's interest earnings. Management states that a 1% increase in short term rates will result \$0.25 per share in additional net income.

Blackstone Mortgage Trust has a current yield of 6.6%. **The dividend was increased for the March 2014 payment**, but that was just the second full payout since the reorganization. I expect this REIT to grow the dividend again in 2015, but do not yet have an estimate on the size of the increase.

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Moving away from the pass-through business structures of partnerships and REITS, **BGC Partners, Inc. (NASDAQ: BGCP)** employs some of the features of a partnership to provide a high yield to investors with tax advantaged dividends. The share price of this financial services company tends to follow the U.S. banking index. However, the dividends have been stable since the end of the financial crisis and should continue into the foreseeable future.

BGC is a financial services firm providing broker-dealer (your stock brokerage account is with a broker-dealer) services in the wholesale brokerage markets. The company handles the brokerage needs for banks and trading firms. The company handles trading in equities, debt securities, options, derivatives and foreign currency exchange. The company has started to operate and expand its services into energy commodities trading. BGC operates on a global basis, with offices in over 20 cities around the globe. 40% of BGC's financial services revenues come from outside the U.S.

In 2010, BGC started to expand into commercial real estate services. Since then the company has made five acquisitions of real estate brokerage and property management firms. Now BGC has almost 900 brokers and sales people in over 50 cities. For the trailing four quarter through the first quarter of 2014, real estate accounted for 36% of revenue.

The strength of BGC as an income investment is the ownership structure. 33% of unrestricted shares are owned by employees, executives and directors. 44% are in public hands. The individuals running BGC have the same at stake, and probably count on their dividends as much, as investors who own shares in their brokerage firm. Revenues for BGC have not always moved upward and there have been periods where growth was negative. However, the company manages cash flow to keep the dividend secure.

BGC Partners currently yields 6.4%. Management has stated that the dividend rate is secure for the foreseeable future. However, management has also noted that it plans to increase shareholder value by growing revenue through additional income streams and reinvest excess cash flow into share buy backs. Investors should not expect dividend growth. However, company success should result in share price appreciation.

Closed-end Funds

The final type of income stock covered here will be closed-end funds (CEFs). Although CEFs are first cousins to mutual funds, these investments provide some features and advantages that will enrich the income focused investor. CEF shares trade on the stock exchanges and you buy and sell them like any other type of stock or publicly traded partnership.

Attached to a CEF are two important share prices. The market price is the one you see quoted on the screen of your brokerage account or favorite financial website. A fund

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will also calculate a daily net asset value (NAV) which is the portfolio value divided by the shares outstanding. If the CEF was liquidated, investors would receive the NAV value in cash. An interesting phenomenon is that CEF shares often trade at significant discounts to the reported NAV. This effect works to boost the yields earned by investors compared to the yield actually earned on the fund portfolio.

I use CEFs for several purposes.

First the funds provided access to a portfolio of certain types of securities without having to review and select individual securities. Also, a CEF provides diversification in an account that is too small to justify the ownership of a dozen or more stocks.

Second, the change of the price/NAV discount can be worked to build value. I have my favorite CEFs locked away in my head as ammunition for the next market correction or even a bear market. When that happens the price to NAV discount will spring wide open allowing investors to buy quality, income paying assets at a deep discount to their current value: it will be like stealing when the market recovers and the discount narrows back to normal levels.

The final two stocks recommended here are CEFs:

The **LMP Capital and Income Fund Inc. (NYSE: SCD)** owns a portfolio of MLPs, REITs, utilities and convertible securities. The fund carries a moderate 20% level of leverage which further boosts the dividend yield. As you can see, the fund covers the range of income producing stocks. Over the last year, the share price has traded at an average 10.2% discount to NAV, with a range of 5% discount to 12.6%. At NAV the fund yields 5.7%, but with the discount the market price yield is 6.3%. This CEF would be a great investment recommendation for that person in your life that is not into buying individual stocks but likes the idea of an investment with a 6% yield, professional management and holding securities in the most attractive income focused sectors of the stock market.

The **Cohen & Steers Total Return Realty Fund Inc (NYSE: RFI)** is a REIT holding fund that provides a 7% dividend compared half that yield paid by the large REIT ETFs. A portion of that distribution yield is derived from capital gains on fund holdings, so this fund works to convert lower yield, faster growth REITs into current income. The top 10 holdings of this fund contain REITs that I know are quality investments but do not meet the narrow yield plus growth criteria that I require to recommend an individual stock. Historically, RFI trades at a small 1% to 3% discount to NAV. That discount currently has widened to 8.7%, making the shares especially attractive.

A Final Word about Income Investing

Finding stocks like the ones we covered in this report isn't hard, but it requires attention and the time commitment to finding every reason why **not** to buy a stock even more than the reasons to consider one. Look, there are 10 stocks in this report but there were literally several hundred that I started with.

Fortunately, this is my job. It's what I do for most of my waking hours. But what about you? Do you really want to be spending 40, 50, or more hours a week – every week – doing stock research?

Or would you rather be enjoying life on your terms, paid for with the income and profits on stock research done for you?

Now there are no freebies in life and I'm not suggesting you give up doing *any* of your own research, but why start from scratch every time? Why risk getting the research wrong?

I've recently finished a short video explaining how my dividend and income service, *The Dividend Hunter*, works...how I do my research, how I decide which stocks get in and which never see the light of day, how the service makes money for you in good markets and bad, and how to make sure you're always pulling in a steady stream of income.

So if you have a few minutes today (right now) [click here](#) to check out the video. It explains everything.

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