Investors Alley

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The Dividend Hunter

An Investment Approach for a Crappy Stock Market

Fellow Investor,

If you are like me, you don't like the feeling of pulling up your brokerage account overview and seeing red, as in lower share prices.

Maintaining our cool and not giving into the urge to sell when the markets are down is one of the most important traits to have when investing in the stock market. The whole investment philosophy of The Dividend Hunter takes out the worries about short term stock price swings. And you know I mean declines, since none of us complain about the value of our shares when they go up.

I would like to repeat again that what we strive for here at The Dividend Hunter is to find those stocks that will provide steady and growing dividends.

I would like you to visualize your dividend stream as a steady line, moving up at a slight slope.

In This Issue

This line is the primary focus and allows you to not put much focus on the graphic representation of the ups and especially the down periods with share prices in the stock market. I believe that the current average 7.5% yield on The Dividend Hunter portfolio recommendations is a very attractive cash flow return when the stability and safety of those dividends are included in the evaluation. The yield you would be earning if you bought when the stocks were first recommended would be just slightly lower at 7.06%. For those of us investing to generate an above average dividend income stream, stock market drops like we experienced in mid-October are tremendous buying opportunities. If you buy when these dividend stocks are cheap, your income stream line slopes ever higher.

For those subscribers using the Monthly Dividend Paycheck Calendar, I am sure you will be interested in the monthly paying REIT covered as one of this month's recommended stocks. If you are not familiar with the calendar, you can find it under the Special Reports tab on your Member's page on the Investors Alley website. Or click here to download your copy right now.

As I write this, the 2014 third quarter earnings season is moving into high gear. Most of our portfolio companies will report their Q3 results early in November. My biggest expectation is that continued positive news from these companies will be a catalyst for share price increases. I am not expecting much in the way of dividend increases at this time, but we already have one announced bonus dividend to be paid in December. With most of the stocks we currently list in the portfolio, dividend increases will start to come in the first quarter of next year. Watch for more from me as these are announced.

On a personal note, I enjoy trying new – to me – wines and earlier this month my wife and I made a short excursion to the Fairplay wine district in the California Sierra foothills. The district is in Eldorado County, southeast of Placerville, CA. I was surprised at the isolation of the area, which requires you to drive through 25 miles of Sierra forests to get into the very sparsely populated Fairplay area. Once you arrive, there are about 25 small wineries in an area covered by about 20 miles of driving around curving mountain roads. We visited four. All in all, it was a very enjoyable experience. We tried and bought some very good wines. We also tried some others that were not so good and this being northern California we enjoyed great weather. And it is always fun to be able to interact directly with the winery owners and wine makers. If you would like to know which wineries were our favorites or have one of your own in the Fariplay region, drop me an email.

To close, November will bring lots of news about our portfolio stocks and the many others I research for possible future inclusion in The Dividend Hunter portfolio. It will be a good month for dividend payments, so I hope your brokerage account cash balances fatten up nicely.

Land, fly or die,

Tim Plaehn
Editor
The Dividend Hunter

P.S. I've been invited to speak at the Trader's Expo on Wednesday, November 20th Caesar's Palace in Las Vegas. I'll cover a number of trading strategies for getting short term gains from dividend stocks, including the "counter covered call" and "coiled spring" strategies that I use in my 30 Day Dividends service. If you're in the Las Vegas area or plan to be there or even within a reasonable driving distance, feel free to come for the presentation and a chance for us to meet up afterward. The conference is free, but registration is required. You can get all the details by clicking here.

EPR Properties (NYSE: EPR)

I review and research a large number of dividend paying stocks. Even though I try to methodically work through my databases of MLPs, REITs and other high-yield stocks, sometimes an interesting, yield focused investment option just falls into my lap. **EPR Properties (NYSE: EPR)** is one such investment. This mid-cap REIT has a dominant position in a smaller sector of commercial real estate, pays an attractive yield that has been increased at an above average rate, and pays monthly dividends.

Business Overview

EPR functions as a triple-net lease (NNN) REIT. With this model, the tenants that lease the properties owned by EPR are responsible for all of the operating costs like taxes, utilities and maintenance. EPR's job is to collect the rent checks. Typically, NNN leases are long term, for 10 years or more, with built-in rent escalations. The different triple net REITs own a range of property types including retail, office, industrial and warehouse. The combination of long-term, escalating rental rate contracts with the coverage of most property ownership expenses by the tenants make the triple net REITs one of the more stable REIT sectors.

EPR Properties separates itself from the triple net REIT pack by the focused types of properties the company owns. The EPR assets can be divided into the three categories of Entertainment, Recreation, and Education. Here are the assets currently owned in each category:

Entertainment

- 125 Megaplex Theaters
- 9 Entertainment Retail Centers, which include eight theaters
- 5 Family Entertainment Centers

Recreation

- 14 Metro Ski Parks
- 4 Water Parks
- 8 Golf Entertainment Complexes

Education

- 53 Public Charter Schools
- 2 Early Childhood Centers

As a triple net lease, EPR owns all of these properties, which are then leased out to third-party operators or tenants. The focus specialties of the REIT are long-lived business with growing revenues. For example, the gross proceeds of movie theaters have grown by 4% to 5% per year on average for the last 25 years. Currently, the company generates 70% of its net operating income from the entertainment holdings, with the other two sectors evenly splitting the other 30%. There are over 6,000 charter schools in the U.S., but there is over a 1 million and growing backlog of students who want to attend a private charter school. And in the recreation segment, EPR has partnered with industry leader TopGolf as the tenant and operator of the golf complexes.

EPR uses its expertise in three market sectors to aggressively grow the size of the property portfolio. New properties are acquired with a "build to suit" agreement. Before acquiring a property and building the structure, EPR will have a binding lease agreement in hand from the end user of the property. The system works for both EPR and its tenants, who want to focus on their own business operation, such as a theater complex or golf center, and not spend corporate resources on the real estate development side. For all of

2014, EPR expects to invest $550 to $600 million into new properties. This amount will be evenly split between the three sectors. The capital spending is up from about $400 million in 2013, and $300 million in 2012. During the third quarter earnings conference call, management noted that the company had 18 charter schools and 11 golf complexes under construction. The earnings supplement also show five entertainment properties in development.

Investment Results and Potential

The EPR growth model has done well for investors. The annual dividend rate has been growing by 7% to 8% for the last five years. Even with that attractive growth rate, EPR shares still yield over 6%. EPR Properties finances its growth with a 40/60 debt to equity funding split. The company has an investment grade credit rating, which keeps borrowing costs low.

The narrow focus of the properties owned by EPR plus a perception that the industries the properties support have more risk than history actually shows. The narrow focus allows EPR to be an expert in these areas and generate attractive returns by providing "no brainer" real estate solutions to support the tenant companies growth plans. EPR Properties should produce above average total returns compared to its triple net REIT peers. I am pleased to be adding this quality REIT to The Dividend Hunter's recommendations list.

If EPR follows its past pattern, the monthly dividend will be increased in January.

Recommendation: Buy EPR up to $57 to lock in at least a 6% yield.

Making Sense of Cash Flow Analysis for REITs and MLPs

The common stock analysis tools of earnings per share, P/E ratios, and dividend payout ratios do not work well – OK, not at all – for the higher yield pass through types of stocks like REITs and MLPs. The tax structures and general nature of the assets owned allow many of these companies to take non-cash write-offs, and as a result the earnings per share numbers often significantly under report the cash an MLP or REIT generates and is available to pay out as distributions or dividends. So you have a better understanding of how to evaluate these stock market investments, I will cover how I look at the numbers published by the various types of income stocks.

Big Picture with EBITDA

Both master limited partnership (MLP) and real estate investment trust (REIT) companies typically report and emphasize their earnings before interest, taxes, depreciation, and amortization – EBITDA. This number can be viewed as the operating income or business profits of the company. Think of EBITDA as revenues minus cost of goods sold and regular business expenses. This metric – EBITDA – shows you the overall profitability of a company's business operations. Unless you are analyzing a variable results business, such as one of the variable distribution MLPs, you want to see the EBIDTA growing over time, comparing the recent quarter or year with the year earlier same period.

Free Cash Flow

MLPs use the term distributable cash flow – DCF – and REITs call it funds from operations – FFO – to report the cash actually available to pay distributions. The basic formula is to take EBITDA and subtract the actual cash interest and taxes payments. Also subtracted will be how much the company will spend to maintain its assets, facilities or buildings. This expense may go by maintenance capital expenditures (capex) or sustaining capex. In each earnings report a company will show what expenses were subtracted from EBITDA to get the reported DCF/FFO amount. The DCF/FFO is the actual cash available out of which to pay distributions to investors, not the net income: it's the money that they pay your dividends with.

From the total amount of DCF/FFO, you want to find and look at the per share amount of the cash available for distribution. Use the per share amounts to compare the cash flow generated to the current dividend rate. The per share DCF/FFO also shows you if the company is growing cash flow on a per share basis. REITs and MLPs will issue equity shares or units to help pay for growth projects. While total EBITDA and DCF will grow as this money is put to work, it is important to see that the growth drops all the way down to the per share level. A company that shows lots of EBITDA growth but nothing at the per share level is not producing growth that will benefit investing share owners.

Coverage Ratios

REITs and MLPs typically report the ratio of distributions to free cash flow differently. A REIT will report the percentage of FFO that is paid out as dividends. For example, an 80% payout ratio means the dividend rate will pay 80% of the FFO as dividends to share owners. MLPs use a coverage ratio. So an MLP that pays out 80% of DCF would report that result as a 1.25 times distribution coverage ratio. Danger signals should be heeded with a REIT pays more than 100% of FFO or an MLP has a payout ratio of less than 1.0x.

Considerations to Consider

EBITDA, DCF and FFO are non-GAAP numbers and each company can decide how it will define them as related to its own business operations. For example, The Dividend Hunter portfolio holding Ventas, Inc. (NYSE: VTR) does not report EBITDA. Instead it starts with "Net income attributable to common stockholders" from the income statement and then applies adjustments to determine FFO, what it calls "normalized" FFO and normalized FFO per share. The important point is to find the place in the quarterly earnings report where the company defines its non-GAAP metrics and go through how those numbers are calculated. Once you understand how a company arrives at its DCF/FFO amounts, you can start comparing from earnings period to earnings period.

TCP Capital Corp. (Nasdaq: TCPC)

If you are investing for income, it can be hard to not notice the very attractive and steady yields paid by business development companies (BDCs). With **Main Street Capital Corp. (NYSE: MAIN)** already in our portfolio I have been working through the rest of the group to find one more to add to the list, providing some diversification to our holdings from this unique sector of finance companies. Before I discuss this month's recommendation I want to re-iterate my BDC overview discussion from the MAIN recommendation article.

Looking for a Gold Nugget Among the River Rocks

A skeptical view of the two dozen BDCs would be that these are companies with low credit ratings borrowing money and selling shares so they can lend to smaller companies with worse credit metrics. The result is that the major risk to BDCs is a negative economic credit event that would prevent BDCs from borrowing or refinancing and that causes the portfolio clients to default on their obligations to pay the BDCs. This event occurred in the form of the 2008-2009 financial crisis and the surviving BDCs claim to have learned the lesson.

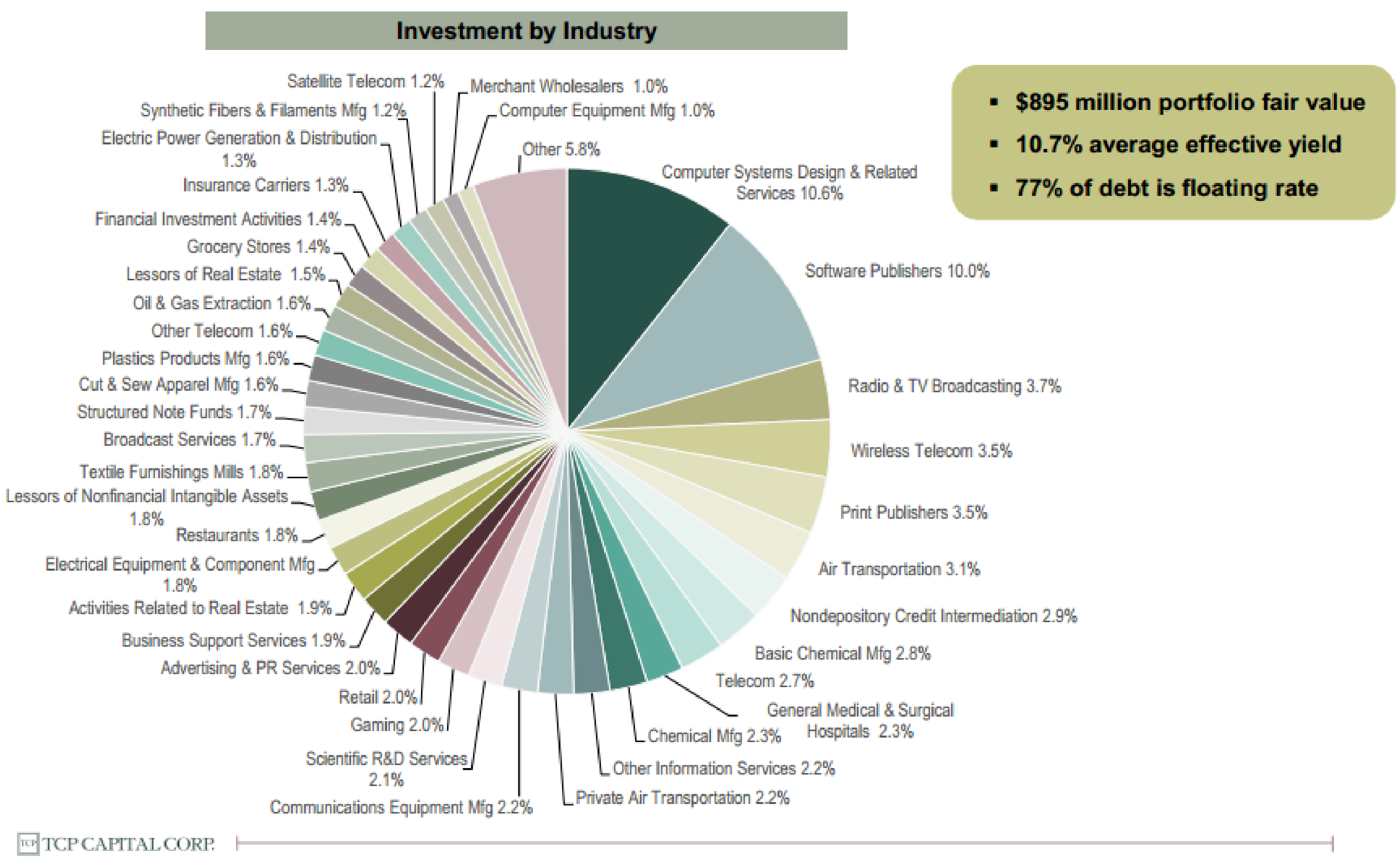
A large portion – about half – of the BDCs are mostly indistinguishable from each other. Venture capital and leveraged buyout firms are a major source of client companies. These firms feed debt financing business to the BDCs to get the loans necessary to grow or buy out the medium sized companies stalked by the venture capital types. This group of BDCs will do fine as long as the economy remains stable and the individual companies to not reach too deep into the junk credit drawer in a stretch for portfolio yield. Another smaller group of BDCs are the strugglers you will find in every type of asset and market sector. In general a problem BDC is indicated by either an 11% or 12% yield or has recently cut the dividend rate.

The management and fee structure of a BDC can be a potential negative for investors looking for a high yield and stable return. Some BDCs are externally managed by large finance companies involved in a range of finance businesses. Management fees are set up as a fixed percentage of assets per year with extra fees earned when the dividend yield exceeds a certain percentage. It is not uncommon for the management fee to scrape off 3% of assets, which is a direct reduction of the income yield available to pay dividends to investors. One danger sign is a BDC that constantly grows the size of the company to generate large management fees but the dividends paid do not go up or increase at a very slow rate.

Reviewing individual BDCs by scrutinizing the negative factors leaves a very small number of companies that meet The Dividend Hunter standards for yield, dividend growth *and* safety.

Sticking to Conservative with TCP Capital

BDCs can provide a wide range of loan types including senior, junior, mezzanine debt and equity investments, ranging from safest to riskiest. **TCP Capital (NYSE: TCPC)**, our BDC addition this month, sticks almost exclusively – 97% of its portfolio – with senior debt investments. The remaining 3% are equity positions that can add a nice kicker to the net portfolio income. TCP's investments in about 75 companies are spread across a wide range of industries, as shown on this very busy pie chart from TCP Capital.



The Dividend Hunter

You may have noticed that 77% of the portfolio is floating rate debt, a nice hedge against higher rates and could produce higher net investment income. Of that 77%, about 90% of the loans have an interest rate floor, in case the Fed figures out a way to move rates even lower. At some point in the future, setting rate floors on loans may eventually look like a smart move. This portfolio will produce very good results in a higher interest rate environment. Overall, TCP Capital manages one of the more conservative loan portfolios in the BDC space.

TCP Capital is a newer BDC, with an IPO launch in April 2012. The company is externally managed by Tennenbaum Capital Partners, which has been operating in the middle market investing space for over 18 years. The management fee structure paid by TCP Capital to Tennenbaum is one of the most investor friendly – i.e. lower fees – in the BDC sector. It its short history to date, TCP has doubled the size of its investment portfolio to almost $900 million from $450 million.

The primary trait I desire from a BDC is a steady and stable dividend combined with either dividend growth or the regular payment of special dividends. Since inception, the regular TCPC dividend has been rock steady, increasing from $0.35 to $0.36 for the second quarter of 2013 and staying at that level. Also, along the way an additional four special dividends of $0.05 have been paid over the last two years. With the $0.36 quarterly dividend, TCPC currently yields 8.8%.

I am adding TCP Capital to The Dividend Hunter recommendations portfolio primarily because of the outlook for a high yield from stable dividends. The special dividends will just boost the total return over time.

Recommendation: Buy TCPC up to $17.

Portfolio Update

We have experienced a few weeks of the third quarter earnings season, with much more to come after November 1. Although I have only seen and reviewed a couple of full up earnings releases, several portfolio companies have made distribution or other announcements.

Both of the upstream MLPs in The Dividend Hunter Portfolio announced third quarter distributions. **Memorial Midstream Partners (Nasdaq: MEMP)** and **Legacy Reserves (Nasdaq: LGCY)** announced third quarter distributions equal to the second quarter payouts. Both pay in mid-November.

The drop in the price of crude resulted in a significant market sell off for the upstream MLPs. However, these two companies fully hedge their future production and the distributions should be secure until well into 2016. At the current unit prices, the yields on both are above 10%, making what I believe are attractive entry values.

For our closed-end fund holding, **Salient Midstream & MLP Fund (NYSE: SMM)**, the market drop was accompanied by a widening in the market price to net asset per share (NAV) spread. At the worst point in the market drop, the price to NAV discount widened to 20.55%, compared to the 52-week average of 7.8%. The discount has narrowed to 7%, but the MLP space is still down and SMM yields an attractive 5.3% and a dividend increase should be announced in November.

Although it is not official, management for portfolio holding **Hannon Armstrong Sustainable Infrastructure Capital (NYSE: HASI)** has indicated that the dividend will be increased by 18% to $0.26 per share in December. Just the move we were looking for.

Oaktree Capital Group (NYSE: OAK) announced a $0.62 distribution to be paid on November 13. OAK pays variable distributions, and this one is 7 cents higher than the second quarter payment.

Macquarie Infrastructure Partners (NYSE: MIC) announced a third quarter distribution of $0.98, up 3.5% from the second quarter payout. The distribution will be paid on November 14. MIC has been the best performer in The Dividend Hunter portfolio and the company continues to run on all cylinders.

Mainstreet Capital Corp. (NYSE: MAIN) announced a special dividend of $0.275 per share to be paid in December. A nice bonus on top of MAIN's monthly pay 6.6% yield.

New Residential Investment Corp. (NYSE: NRZ) completed a 1 for 2 reverse stock split. As a result you would own half as many shares worth twice as much. A reverse split does not affect your holdings value or the investment potential of NRZ.

Ventas, Inc. (NYSE: VTR) did announce its third quarter results, which were very positive. Funds from operations (FFO) for the quarter came in at $1.12 per share, up 9% from a year earlier and providing 1.54 times coverage on the dividend. Last year VTR announced an 8% dividend increase in December and I am looking for a similar increase in the per share payout this year.

Current Portfolio

Company	Entry Date	Entry Price	Recent Price	Buy Up To	Annual Div	Proj. Yield	Cash Return
TCP Capital Corp. (TCPC)	10/30/14	$16.51	$16.51	$17.00	$1.44	8.80%	N/A
EPR Properties (EPR)	10/30/14	$55.64	$55.64	$57.00	$3.42	6.00%	N/A
Memorial Production (MEMP)	09/30/14	$22.02	$21.11	$23.00	$2.20	9.50%	0.00%
Legacy Reserves (LGCY)	09/30/14	$29.68	$21.41	$30.00	$2.44	8.00%	2.06%
Salient Midstream & MLP Fund (SMM)	08/28/14	$31.23	$27.14	See 09/14 issue		4.70%	0.00%
Hannon Armstrong Sustainable Infrastructure Capital (HASI)	08/28/14	$14.49	$13.84	$15.00	$0.88	6.00%	1.52%
New Residential Investment (NRZ)	07/30/14	$6.08	$12.33	$6.25	$0.70	11.00%	2.88%
Arc Logistics Partners (ARCX)	07/30/14	$25.10	$12.86	$28.00	$1.55	8.00%	1.59%
Main Street Capital (MAIN)	06/27/14	$32.51	$31.67	$32.50	$1.98	6.00%	2.06%
Starwood Property Trust (STWD)	05/30/14	$24.39	$22.43	$25.00	$1.92	7.80%	3.94%
Ship Finance International (SFL)	05/30/14	$18.46	$17.04	$19.00	$1.64	8.50%	4.43%
Oaktree Capital Group (OAK)	05/30/14	$50.66	$46.50	$56.00	$3.92	6.50%	1.10%
Macquarie Infras. Company (MIC)	05/30/14	$61.48	$70.59	$63.50	$3.75	6.00%	1.55%
Ventas (VTR)	05/30/14	$64.94	$67.99	$65.00	$2.90	4.50%	2.17%

Notes:

Entry price is determined by the last "Ask" price at the closing of the market on the day before publication. Recent price is determined by the last "Ask" price at the closing of the market on the day before publication; most recent update 10/30/14. Annual Div is the dividend payment as declared by the company and made publicly available. It is as of the closing of the market on the day before publication. Total Returns include share price appreciation and dividend payments to provide a more accurate assessment of returns in that investment. We make no guarantee that any company in the portfolio will continue dividend payments. For a more detailed look at the portfolio, log on at www.investorsalley.com.

Announcements

Join me at Caesar's Palace for the Trader's Expo on Wednesday, November 19th for my presentation, "Using Dividend Centric Trading Strategies for Short Term Gains" where I'll share my two core strategies for earning double digit gains on dividend stocks between ex-dividend dates. The presentation begins at 8:30 a.m. It's free to attend, but registration is required. Click here for more.

The Monthly Dividend Paycheck Calendar has been updated for November including additions of this month's new stocks and adjustments to ex-dividend and payment dates. Log on at www.investorsalley.com or click here for your copy.