Investors Alley

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The Dividend Hunter

# 2015 Kicks Off with Uncertainty and Volatility

Fellow Investor,

As far as income stock prices go, January was an exasperating month. The market has a good day, your share prices are up and it seems that things have turned around. Then the next day, the market falls and all your gains evaporate and then some. Then there are days when the market is down and income stocks are up, yeah! But the next day the market recovers and those same income stocks fall, without much of a visible reason. With so many forces pulling at the market – strong dollar, interest rates, low crude prices – it is possible that 2015 may be a year of increased volatility and hair pulling.

So once again, I will restate the focus here at The Dividend Hunter: Steady and growing dividend payments. The philosophy and strategy is that over time, the share prices of those companies that can grow their distributions to investors will also see share price gains – it just make take some time.

## In This Issue



I use a large number of spreadsheets to record and track price, yield and distribution information on hundreds of stocks, including my newsletter portfolios. With The Dividend Hunter spreadsheet, I started a page to show year-to-date returns for those stocks that were in the recommendations portfolio at the end of 2014. With all of the price gyrations discussed above, I am pleasantly surprised to report that on average, The Dividend Hunter recommendations are up 3.05% through January 29.

| Symbol | Portfolio Add | 12/31 Price | Divs Earned | Current Price | Total Return |
|---|---|---|---|---|---|
| STWD | 05/30/14 | $23.24 | $0.4800 | $23.92 | 4.99% |
| SFL | 05/30/14 | $14.12 | | $13.89 | -1.63% |
| OAK | 05/30/14 | $51.83 | | $55.40 | 6.89% |
| VTR | 05/30/14 | $71.70 | | $80.52 | 12.30% |
| MIC | 05/30/14 | $71.09 | | $71.46 | 0.52% |
| MAIN | 06/27/14 | $29.24 | $0.1700 | $28.99 | -0.27% |
| ARCX | 07/30/14 | $17.06 | | $18.41 | 7.91% |
| NRZ | 07/30/14 | $12.77 | $0.3800 | $12.75 | 2.82% |
| HASI | 08/28/14 | $14.23 | $0.2600 | $13.70 | -1.90% |
| SMM | 08/28/14 | $23.98 | | $21.56 | -10.09% |
| MEMP | 09/30/14 | $14.59 | | $17.18 | 17.75% |
| LGCY | 09/30/14 | $11.43 | $0.6100 | $9.72 | -9.62% |
| EPR | 10/30/14 | $57.63 | $0.2850 | $65.06 | 13.39% |
| TCPC | 10/30/14 | $16.78 | | $15.76 | -6.08% |
| OKS | 12/01/14 | $39.63 | | $41.34 | 4.31% |
| STAG | 12/31/14 | $24.50 | | $26.20 | 6.94% |

# The Dividend Hunter

The most notable condition in the higher yield stocks space right now is the market reaction to changes in the price of crude. Energy stock prices are moving up and down with every 5 cent change in the spot price of crude oil, no matter how much a company's revenues are not crude oil dependent. A couple of midstream MLPs in our portfolio are down on the price of crude, but their business prospects are little changed. Even the two crude oil and natural gas price dependent upstream MLPs on the list have maintained distribution rates for another quarter. Many if not most of the MLPs and other income stocks I follow will report earnings in February. It will be a busy month for me, reading and listening to conference calls. I will keep you and the other subscribers up to date on any news that will have a meaningful effect on our investment recommendations.

On a next to final note, in this issue I am executing a stock swap, substituting new recommendation Kinder Morgan, Inc. for Ventas, Inc. At this point, Ventas has been a big winner for the portfolio, which has pushed the yield down to less than 4%. Later in this issue, I show how selling Ventas and buying Kinder Morgan will increase both the yield and dividend growth in your portfolio. Just to be clear, we've closed out our Ventas position effective market close January 30, 2015.

For those using the Monthly Dividend Paycheck Calendar, be sure to get this month's update that includes our two new additions, removal of Ventas, and updates to other stocks' ex-dividend and payment dates. Click here for your copy.

Finally, on February 6, I will be making a presentation at the MoneyShow in Orlando. I have also been asked to participate on a Q&A panel of dividend stock experts. If you are going to the MoneyShow or in the Orlando area, I hope to meet up with you. Bring some friends! Click here for more.

Land, fly or die,

Tim Plaehn
Editor
*The Dividend Hunter*

# Kinder Morgan, Inc. (NYSE: KMI)

2014 was a transformative year for Kinder Morgan, Inc. (NYSE:KMI). Launched with an IPO just three years ago in February 2011, Kinder Morgan had been operating as the management company of a range of energy assets, some owned at the Kinder Morgan corporate level and a large portion of assets held by several Kinder managed MLPs. Kinder Morgan Energy Partners – KMP – had been a major leader in the use of the master limited partnership structure as a way to build a large energy company that produced a steadily growing income stream for investors. With a significant distribution increase every year since its 1996 inception, Kinder Morgan Energy Partners produced a 24% average annual compounded total return for investors over almost two decades.

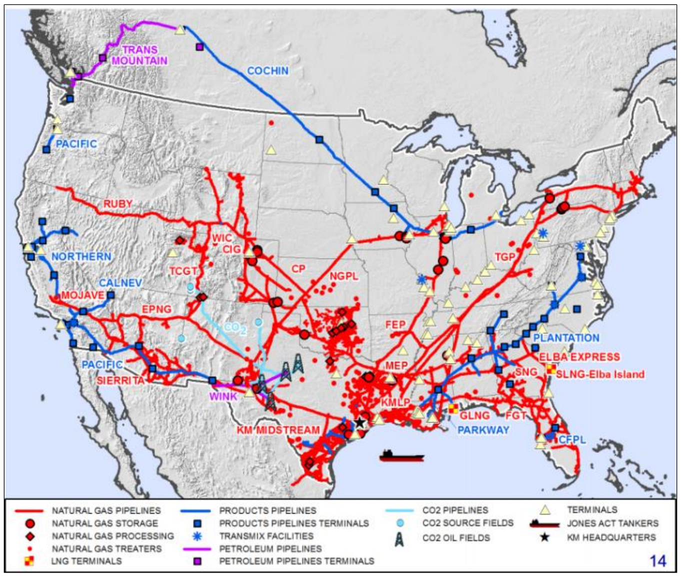
However, over the past couple of years, the size of Kinder Morgan Energy Partners and some financial limitations of the MLP structure for long established partnerships resulted in a slowing growth pattern for KMP, Kinder Morgan, Inc., and El Paso Pipeline Partners – the other large MLP controlled by Kinder Morgan. Analysts, including myself with several articles on the topic, covered the problems facing the Kinder Morgan multi-company conglomerate and questioned whether the company could ever regain its place as a top-tier growth midstream energy player. In August 2014, Kinder Morgan shocked the energy world with the announcement that the two MLPs – Kinder Morgan Energy Partners and El Paso Pipeline Partners – would be bought out and rolled up into Kinder Morgan, Inc. A major leader in the use of the MLP structure was converting to 100% corporate structure. This restructuring will allow Kinder Morgan to again be a top dividend income growth stock, and it is time to add KMI to The Dividend Hunter recommendations list.

**Tremendous Asset Base**

Kinder Morgan is an energy company that generates most of its revenues from the infrastructure side of the energy sector. Here is a list of current assets and services:

- Largest natural gas network in North America: Owns an interest in and/or operates 67,000 miles of natural gas pipeline which are connected to every important U.S. natural gas resource play, including: Eagle Ford, Marcellus, Utica, Uinta, Haynesville, Fayetteville and Barnett.
- Largest independent transporter of petroleum products in North America: Transport 2.4 million Bbl/day.
- Largest transporter of $CO_2$ in North America: Transport 1.4 Bcf/day of $CO_2$.
- Largest independent terminal operator in North America: Own an interest in or operate 180 liquids and dry bulk terminals. 136 million Bbls domestic liquids capacity. Handle 83 million tons of dry bulk products.
- Only Oil sands pipe serving West Coast: Transports 300,000 Bbl/day to Vancouver and Washington State. Proposed expansion takes capacity to 890,000 Bbl/d.

# The Dividend Hunter




With the merger complete, Kinder Morgan is the third largest energy company in North America with an $85 billion market cap and $125 billion enterprise value. Revenues and profits are not closely tied to energy commodity prices, with 85% of projected 2015 revenue fee-based, and 94% fee-based or hedged. Kinder Morgan expects to generate $8.2 billion of EBITDA in 2015. This is a serious midstream energy company.

**Record of Hitting Distribution Growth Guidance**

A hallmark of Kinder Morgan business operations has been the company's willingness to provide detailed guidance on its annual forecast including dividends and distributions, and then hitting or exceeding that guidance. Between KMI and KMP, annual distribution guidance has been provided 19 times. Out of that list, the guidance was missed once, coming up one penny short of the projected per share payments to investors. The guidance distributions were hit exactly 7 times and guidance distributions were exceeded 11 times. When Kinder Morgan publishes its expected dividend payments to investors, there is a very high probability that the guidance will be met or exceeded.

**Using MLP Model for Growth**

Even though Kinder Morgan is now 100% a corporate entity, management's growth model sticks with the tried-and-true growth MLP formula. This means KMI will operate somewhat differently than your typical dividend paying corporation.

Kinder Morgan will pay out the majority of free cash flow as dividends to investors.

Growth projects will be funded with a combination of new equity – common shares – issuance and debt.

KMI currently has a $17.6 billion backlog of identified growth projects. About $4.4 billion will be spent on growth capital expenditures in 2015.

The backlog is several billion higher than at the start of 2014, even as $5.8 billion was spent on growth and acquisition projects in 2014.

Kinder Morgan has generated an average annual return of 11.5% to 14% on its invested capital over the last half-dozen years. The new corporate structure has reduced the cost of growth capital to about 3.3%, down from 9%. The difference between the cost of capital and the investment returns provides the cash to grow the dividends paid to investors.

The project backlog, detailed planning, locking up customer commitments before starting new projects, and combined with Kinder's historical results to bring on new projects at the projected return rates has allowed Kinder Morgan to now commit to a dividend growth path through 2020.

**Superior Dividend Growth Projections Plus Attractive Current Yield.**

For 2014 KMI investors earned dividends of $1.74 per share. Based on the last quarterly dividend of $0.45 (KMI increases its dividend rate every quarter) and a current share price just above $40, the stock yields 4.45%. Kinder Morgan management has committed to increase the dividend by 15% in 2015, to a total of $2.00 per share. This puts a forward yield of 5.0% on the stock. Expect the dividend to increase each quarter to total the $2.00 over the next four quarterly payments.

After 2015, Kinder Morgan expects to grow the dividend by at least 10% per year through 2020. With this dividend growth rate, investors will be earning about $3.20 per share in 2020, an 8% yield on the current share price. With its newly restructured business and growth plans, KMI provides a hard to beat combination of current yield and visible six years worth of dividend growth.

**Recommendation: Buy KMI up to $43, for an approximate 5% yield in 2015 and growing in future years.**

## Recommended Stock Swap Math

In this month's newsletter, one previous recommendation, Ventas, Inc. (NYSE:VTR) is being removed from the recommendations list. Ventas has been a great investment since it was added to our recommendations last June with a 20% plus total return for investors since that time. This REIT remains as a great company, but I believe that the share price has gotten ahead of itself. At the time VTR was added to The Dividend Hunter portfolio it carried a 4.6% yield. Now, even with an 8% dividend increase in December, VTR yields just 3.9%. The current low yield does not fit in with The Dividend Hunter mandate for above average yields combined with dividend growth prospects.

My intention with the removal of Ventas from The Dividend Hunter portfolio is to replace it with Kinder Morgan, Inc., one of this month's new stock recommendations. KMI currently offers both a higher yield and higher dividend growth potential than VTR. The KMI dividends should also have lower tax consequences than VTR's REIT dividends.

Now I would like to math out the benefits if VTR shares that were purchased when the REIT was first recommended would be sold now and the proceeds invested into KMI shares. For the math, I will use a 100 share initial purchase of VTR.

Initial investment: $6,688 (100 shares at $66.80 closing price on May 30, 2014 plus an $8 brokerage commission).

At the current dividend rate, plus an 8% increase in December, the 100 VTR shares would generate $322 in dividend income over the next year.

Selling VTR would produce proceeds of $8,032 (sale share price of $80.40 minus commission).

The VTR sale proceeds would let us buy 196 shares of KMI at $40.80 with some cash left over for lunch.

Based on the $2.00 per share in dividends KMI has forecast to pay in 2015, the newly purchased 196 shares will pay $392 in dividend income.

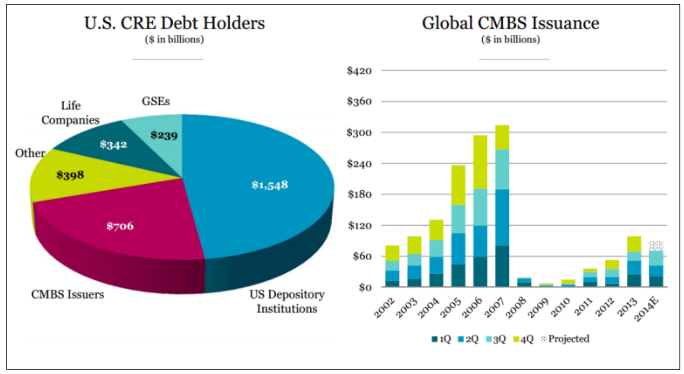
Selling VTR and reinvesting the proceeds in KMI results in a 22% increase in income for 2015, and a higher future dividend growth rate from the KMI shares. Nice!

If the VTR shares are held in a taxable brokerage account, short-term capital gains tax will be due on the gain from selling the VTR shares. At a 30% tax rate, the sale proceeds would be $7,629 after setting aside cash to pay the tax. This amount of capital would buy 187 shares of KMI. 2015 income from the KMI shares would be $374, a 16% improvement over the income the VTR shares would have paid.

From their current values, I believe the KMI share price has better prospects than VTR for share price gains over the next few years. That potential plus the higher cash dividend income shows how you can use above average capital gains in your dividend stocks to boost your portfolio income and future income growth potential.

# Blackstone Mortgage Trust (NYSE: BXMT)

Blackstone Mortgage Trust (NYSE:BXMT) is one of the two major financial REITs and operates as a commercial mortgage lender. The other major REIT in this small sector of the REIT universe is Starwood Property Trust (NYSE:STWD), one of the first holdings selected for The Dividend Hunter, featured in the June 2014 issue here and revisited in the December 2014 issue here. The two commercial mortgage REITs provide a one-two punch that will generate a current high yield and also growing dividends in your income stock portfolio.




**Blackstone Takes a Defunct REIT Off the Shelf**

The current business operations of Blackstone Mortgage Trust commenced in May 2013. Prior to that time, BXMT was a nearly defunct mortgage securities REIT managed by The Blackstone Group (NYSE:BX). Blackstone is a global leader in real estate investing, with over $136 billion of owned real estate and $78 billion of real estate debt. In 2013 Blackstone restructured BXMT to become a pure-play commercial mortgage lender.

In the U.S., commercial real estate debt is a $3.2 trillion market. Banks hold slightly under half of that debt, with the remainder held by a range of financial entities including government sponsored entities – GSEs – life insurance companies, and commercial MBS packagers. These days the banks are much less active and much more conservative in their service of commercial real estate lending compared to the go-go, pre-financial crisis years.

The right side of the chart at the top right of the page from Blackstone Mortgage Trust shows the drop-off in commercial lending since 2007 and the slow but steady recovery of commercial mortgage lending over the last four years.

With the large commercial banks mostly staying away from any commercial real estate lending that has any semblance of risk, there is plenty of potential business for lean, flexible and creative lenders like Blackstone and Starwood. New commercial real estate mortgages may be needed when a property is sold, when one is remodeled or rehabilitated, when a new property is built. Also, commercial mortgages typically have five-year, interest-only terms, so there is significant refinance activity. The result is that there is plenty of opportunity for new commercial mortgage origination business in the U.S. and also in Europe.

Blackstone Mortgage makes commercial mortgage loans of $50 million to $500 million. Company guidelines are for a conservative 60% to 80% loan-to-value. As of November 2014, the portfolio had a weighted average LTV of 64%. Blackstone Mortgage works in loan sizes where there is little competition and the company requires borrowers to retain a healthy portion of a property's equity. Since 2013, when the REIT was refocused on the commercial lending market, the average loan size has been $89 million. The REIT makes mortgage loans across the U.S. and Europe with the current loan portfolio weighted about 60% weighted to New York, California and the U.K.

# The Dividend Hunter

The secret sauce for the Blackstone Mortgage growth opportunities is the company's management by and relationship with The Blackstone Group. Since Blackstone is one of the premier commercial real estate operators in the world, Blackstone Mortgage gets first (and possibly the only) crack at supplying the financing for any real estate deals put together by Blackstone's other entities.

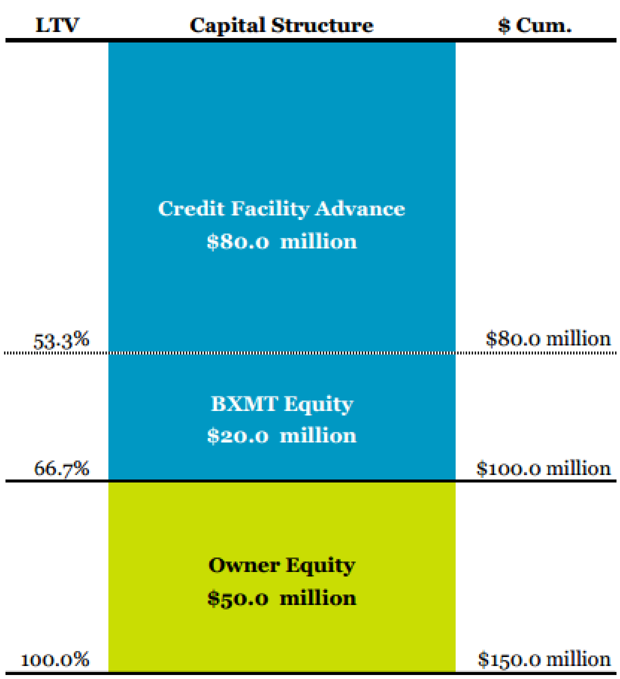
**The Investment Story**

Blackstone Mortgage makes only variable rate loans. 100% of the company's net book value is backed by floating rate loans. The minimum rate for borrowers is Libor plus 3.5%, with most loans at a higher rate, based on the borrower risk. At the end of the 2014 third quarter, the mortgage portfolio yield was at Libor + 4.97%. Blackstone Mortgage's all-in borrowing costs are Libor plus 1.7% to 2.0%, resulting in a minimum 2% plus spread, up to over 3%, on the portion of a loan Blackstone chooses to finance. Blackstone's borrowing is matched term, index and currency to originated loans. With each new loan, Blackstone retains a portion as an equity investment and finances the balance. In an example loan shown in the graphic below, Blackstone shows that by borrowing 80% of a new Libor + 4% mortgage and retaining 20%, the equity investment portion generate a Libor plus 7.5% to 8.5% net return.

In December, Blackstone Mortgage increased its dividend to $0.52 per share, up from the $0.50 paid in October 2014 and $.048 paid for the preceding two quarters. As we move forward, continued dividend growth will come from a combination of continued portfolio growth and the potential for higher short term interest rates. With both its portfolio loan rates and borrowings indexed to Libor, Blackstone management explains that as rates increase, so will the net profit for the company. For example, a 1.0% increase in Libor would add $15 million or $0.26 per share in net interest income over the next year.

BXMT currently yields 7.1%, with the next quarterly dividend to be declared in March and Paid in April.

## Recommendation: Buy BXMT up to $30.




**Illustrative Loan Economics[a]**

| | |
|---|---|
| Whole Loan Yield[b] | L + 4.00% |
| Leverage: | |
| Advance Rate | 80.0% |
| All-in Cost[b] | L + 2.00% |
| Net Spread | 2.00% |
| Leverage Multiple | 4.0 X |
| Levered Spread | 8.00% |
| Base Return | L + 4.00% |
| Gross ROI | L + 12.00% |
| Less Overhead Allocations[c]: | |
| Management Fee | 1.50% |
| General & Administrative | 0.50% |
| Working Capital/ Equity Deployment | 2.50% - 1.50% |
| **Imputed Core ROE[d]** | **L + 7.50% - 8.50%** |

# Portfolio Update

In The Dividend Hunter recommendations portfolio, the different sectors are balancing each other out. In general the equity REITs have done well, finance REITs are doing OK, the BDCs are a mixed bag and the energy sector companies, including MLPs are struggling due to the drop in energy commodity prices. January and February are dividend and earnings announcement season and the news has been good for the month of January.

As discussed earlier, healthcare REIT **Ventas, Inc. (NYSE:VTR)** will no longer be listed as a portfolio holding. VTR has produced a 22% total return during its time in the portfolio. The recommendation is to take the capital gains and reinvest the sale proceeds into a higher yielding portfolio recommendation. I think that **Kinder Morgan, Inc. (NYSE:KMI)** is the best substitute.

Providing another quarter of relief and some more time to see what will happen with energy prices after the fall, both **Legacy Reserves (Nasdaq:LGCY)** and **Memorial Production Partners (Nasdaq:MEMP)** announced fourth quarter distributions at the same rate that they paid for the third quarter. The LGCY unit price has still fallen a few percent in January and is down 68% from when the MLP was added to the portfolio at the beginning of September. I am confident that the LGCY value will recover. The MEMP unit price gained 15% in January and now is down a relatively small 20%. Expect further recovery as management discusses their plans during the February earnings conference calls.

**EPR Properties (NYSE:EPR)** declared a new, higher monthly cash dividend to common shareholders. The dividend of $0.3025 per share is an increase of 6.1% over the prior year monthly rate.

**Stag Industrial (NYSE:STAG)** also increased its monthly dividend rate. The new dividend of $0.1125 per share is 2.3% higher than the previous dividend rate. STAG went ex-dividend on January 28. In 2014, STAG increased the dividend every six months.

**The Salient Midstream and MLP Fund (NYSE:SMM)** declared a "spillback dividend" of $0.197 per share. This is an extra dividend to payout earnings generated in 2014 above what was paid out with the regular quarterly dividends. SMM will pay its regular quarterly dividend in mid-February.

**Arc Logistics Partners (NYSE:ARCX)** announced its fourth quarter distribution of $0.41 per unit. This is the same rate paid for the third quarter. I will be listening to the conference call closely to find out management's plan for future distribution growth.

**Oneok Partners (NYSE:OKS)** announced its fourth quarter distribution of $0.79 per unit. The 1.5 cent increase puts the distribution 1.94% higher than the third quarter payout. I expect the OKS distribution to grow by a steady 1.5 cents per quarter in 2015.

As I noted in the opening remarks, January was a positive month for The Dividend Hunter portfolio holdings. If we stay focused on the cash income streams, we will come out of the other side of these turbulent times in the market in good shape.

Please drop me an email note if you any questions concerning any of The Dividend Hunter portfolio holdings. I can be reached at tim.plaehn@investorsalley.com.

# Current Portfolio

| Stock | Entry Date | Entry Price | Recent Price | Buy Up To | Annual Div | Proj. Yield | Cash Return |
|---|---|---|---|---|---|---|---|
| Kinder Morgan (KMI) | 01/30/15 | $41.05 | $41.05 | $43.00 | $1.80 | 7.00% | |
| Blackstone Mortgage Trust (BXMT) | 01/30/15 | $29.90 | $29.90 | $30.00 | $2.08 | 4.50% | |
| Stag Industrial (STAG) | 12/30/14 | $24.86 | $26.20 | $25.50 | $1.35 | 5.50% | |
| ONEOK (OKS) | 11/28/14 | $44.08 | $41.34 | $45.60 | $3.10 | 6.80% | 1.91% |
| TCP Capital Corp. (TCPC) | 10/30/14 | $16.51 | $15.76 | $17.00 | $1.44 | 8.80% | 2.48% |
| EPR Properties (EPR) | 10/30/14 | $55.64 | $65.06 | $57.00 | $3.42 | 6.00% | 1.57% |
| Memorial Production (MEMP) | 09/30/14 | $22.02 | $17.18 | $23.00 | $2.20 | 9.50% | 2.50% |
| Legacy Reserves (LGCY) | 09/30/14 | $29.68 | $9.72 | $30.00 | $2.44 | 8.00% | 4.11% |
| Salient Midstream & MLP Fund (SMM) | 08/28/14 | $31.23 | $21.56 | See 09/14 issue | | 4.70% | 1.80% |
| Hannon Armstrong Sustainable Infrastructure Capital (HASI) | 08/28/14 | $14.49 | $13.70 | $15.00 | $0.88 | 6.00% | 3.31% |
| New Residential Investment (NRZ)** | 07/30/14 | $12.16 | $12.75 | $12.50 | $0.70 | 11.00% | 6.00% |
| Arc Logistics Partners (ARCX) | 07/30/14 | $25.10 | $18.41 | $28.00 | $1.55 | 8.00% | 3.23% |
| Main Street Capital (MAIN) | 06/27/14 | $32.51 | $28.99 | $32.50 | $1.98 | 6.00% | 4.48% |
| Starwood Property Trust (STWD) | 05/30/14 | $24.39 | $23.92 | $25.00 | $1.92 | 7.80% | 5.90% |
| Ship Finance International (SFL) | 05/30/14 | $18.46 | $13.89 | $19.00 | $1.64 | 8.50% | 4.43% |
| Oaktree Capital Group (OAK) | 05/30/14 | $50.66 | $55.40 | $56.00 | $3.92 | 6.50% | 2.34% |
| Macquarie Infras. Company (MIC) | 05/30/14 | $61.48 | $71.46 | $63.50 | $3.75 | 6.00% | 3.14% |

# The Dividend Hunter

## Closed Positions

| Stock | Entry Date | Entry Price | Close Price | Close Date | Div Earned | Total Return | Cash Return |
|---|---|---|---|---|---|---|---|
| Ventas (VTR) | 05/30/14 | $66.80 | $80.52 | 01/30/15 | $1.45 | 22.71% | 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 01/30/15. 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. Proj. Yield may deviate from current yield as it's based off the share price at the time of initiating the position, not the current share price. 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.

** NRZ entry price adjusted for 1 for 2 split on 10/20/14. Original entry price on 07/30/14 was $6.08.