Investors Alley

November 2015 Vol. 2 Issue 6

The Dividend Hunter

Why Cash Flow Positive Investing Works

Fellow Investor,

In case you missed it, the stock market had an official correction that appears to have bottomed with a pretty big sell-off on September 28 and a subsequent big up day on September 30. At the bottom, the average total return in The Dividend Hunter portfolio was down over 10%. The month of October produced a 6.5% recovery in portfolio values, with several dividends to be earned in early November.

In This Issue

The second half of October was the start of the third quarter earnings release season. Over the last two weeks and for about three more weeks, I will be reading lots of earnings press releases and listening in on the management earnings discussion conference calls. So far, results have been as expected or better. The businesses of our portfolio companies continue to operate profitably and grow cash flow. The fear of higher interest rates seems to be the primary cause of share price declines of higher yield stocks outside of the energy sector. With a one-quarter percent rate increase expected from the Fed, those fears seem a bit overblown. I am happy to take advantage of the situation and buy more shares at lower prices and with higher yields.

The energy sector stocks continue to be quite volatile, with share prices moving up and down each day based on what the spot price of crude is doing. I am starting to see more news articles talking about sub $50 oil for "years.” The natural 5% to 8% annual decline in global energy production combined with severe cutbacks in capital spending means that at some point the markets are going to wake up one day and see that demand is greater than supply.

At that point the U.S. based energy producers will be in the driver's seat. Around the world, projects to develop new crude oil production take years, to even decades to bring on line. A U.S. shale oil well can be drilled and begin producing in less than one month. The trigger for the turnaround will be when we see significant reductions in the weekly crude oil storage numbers. Those events will probably not happen until late spring or early summer next year.

This month I am very pleased to add a utilities sector investment to the portfolio. At this point in the portfolio development, one of my primary goals is to diversify across more sectors of the economy and still find investments that pay well above average yields.

The Dividend Hunter

Recently I watched an interview of Ray Dalio, the founder and chairman of Bridgewater Associates, a very successful money management and hedge fund firm. Dalio makes a pretty good argument that the overall stock market returns will average just 3% per year for the next decade. If you are interested you can see the video excerpt here: **http://www.bloomberg.com/news/videos/2015-09-16/ray-dalio-lower-asset-returns-are-certain-**

To me this makes The Dividend Hunter average yield of close to 8% combined with my forecast average annual dividend growth of 7% look like a very attractive long-term strategy to beat the markets.

If you're following the Monthly Dividend Paycheck Calendar be sure to get the November update; just **CLICK HERE to get a copy**.

Land, Fly or Die,

Tim Plaehn
Editor
The Dividend Hunter

EPR Properties: A Step Above Its Competitors

I first recommended **EPR Properties (NYSE: EPR)** one year ago in the November 2014 issue of The Dividend Hunter. 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. In a very tough market for REITs, EPR has performed well with more growth and higher dividends to come.

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 rest of the triple net REIT pack by the highly 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, with the number owned a year ago in parentheses:

Entertainment

- 128 Megaplex Theaters (125)
- 9 Entertainment Retail Centers, which include eight theaters (9)
- 6 Family Entertainment Centers (5)

Recreation

- 10 Metro Ski Parks (14)
- 5 Water Parks (4)
- 12 Golf Entertainment Complexes (8)

Education

- 64 Public Charter Schools (53)
- 7 Early Childhood Centers (2)
- 1 Private School (0)

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 64% of its net operating income (down from 70% last year) from the entertainment holdings, with the other two sectors evenly splitting the other 30%. Currently adding education properties is the primary growth focus. There are over 6,000 charter schools in the U.S., but there is an over 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, golf center or charter school, and not spend corporate resources on the real estate development side. For all of 2015, EPR expects to invest $575 to $625 million into new properties. This amount will be evenly split between the three sectors.

With its 2015 third quarter earnings report the company provided an initial 2016 capital spend budget of $600 to $650 million. 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 26 charter schools and seven golf complexes under construction. The earnings supplement also show three 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 6% to 8% for the last six 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.

That real estate sector 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. This stock should be a core holding for the income focused investor. I am looking forward to another dividend increase starting in January 2016. The new divided rate will be announced in mid-January with an end of the month ex-dividend date and payment in mid-February.

Recommendation: Buy EPR up to $60.50 to lock in at least a 6% yield.

Position: Long EPR

Why Cash Flow Positive Investing Works

This last week I listened to a local real estate expert on an investment focused radio show. The discussion was about owning rental properties. I thought some of the points made were good lessons for income stock investors.

The real estate guy's main point is that property investors need to have positive cash flows. This means that rental income needs to exceed expenses like mortgage payments, taxes, upkeep and repair expenses. If a property has positive cash flow, the real estate investors does not panic when property prices decline as they did during the financial crisis. Even though in the local area, property values are just now getting back to where they were a decade ago, the cash flow positive investor did not need to panic and generated an income right through the housing price collapse and recovery.

The point was expanded to cover that an investor who was not cash flow positive would often panic and sell when housing prices went down. With a negative cash flow and falling property values, it would be very difficult both mentally and financially to stay with a deeply underwater (value-wise) property. In the real estate investing world the negative cash flow investor who was counting on value increases instead lost everything and often ended up in bankruptcy.

For us as income stock investors, we are always cash flow positive. Our focus is not on stock prices, but on the dividend income stream. It is a different mindset and one I like to repeat regularly. Stock prices will go up and down, but if you own dividend stocks that will grow those quarterly or monthly payouts, you will see both cash flow and share values increase over the longer term.

Reaves Utility Income Fund

For a variety of reasons, the universe of higher yielding stocks are primarily focused on the finance, commercial property, and energy infrastructure economic sectors. Most of The Dividend Hunter recommendations are out of these sectors. For this reason, I am always on the lookout for higher yield investments that will diversify the portfolio holdings across additional economic sectors.

Utility companies have long been viewed as safe haven dividend stocks. These are the highly regulated companies that provide electric power, natural gas, and water to homes and commercial customers. The regulatory agencies approve the rates a utility charges. Rates are set so that the utility can cover the infrastructure spending to maintain and upgrade its assets and then earn a fixed rate of return above the necessary capital spending. The locked in regulated profit margins gives a high level of cash flow predictability.

As a result utility stocks are favored as steady and moderate dividend growth payors. I have not to date included any utility focused investments in The Dividend Hunter recommendations because yields have been low compared to stocks out of the other sectors. For example, the **Utilities Select Sector SPDR ETF (NYSE:XLU)** yields about 3.5%, well below my Dividend Hunter usual minimum of 4%. So I was pleased to discover the **Reaves Utility Income Fund (NYSE:UTG)**, which gives utility sector exposure and a current 6% yield.

The S&P utility sector makes up just over 3% of the S&P 500 universe. There are about 80 listed U.S. based utility companies. As I noted earlier, the utility sector is also highly regulated by both the states and the federal government. As a result, the sector is not glamorous, with few examples of out-performance, or crashing and burning. The sector has been much less volatile than the overall market, with Yahoo Finance showing 3 and 5-year beta statistics of 0.37 and 0.19, respectively. If you are unfamiliar, here is the definition of beta from Investopedia:

"…you can think of beta as the tendency of a security's returns to respond to swings in the market. A beta of 1 indicates that the security's price will move with the market. A beta of less than 1 means that the security will be less volatile than the market. A beta of greater than 1 indicates that the security's price will be more volatile than the market. For example, if a stock's beta is 1.2, it's theoretically 20% more volatile than the market."

Reaves Asset Management

Reaves has about $2.5 billion of assets under management. The company was formed in 1961 and has performance results going back to the 1970's. Services include separately managed accounts, a utilities and energy infrastructure mutual fund, a utilities focused ETF and a closed-end fund, the Reaves Utility Income Fund. The company uses a bottom up investment approach built on long-term and ongoing relationships with utility management teams and also with the regulators.

I recently interviewed one of the portfolio managers at Reaves, Jay Rhame, and he noted that the Reaves Jersey City offices are on the route from Wall Street to the Newark International Airport. Utility company management teams make sure they include a stop at the Reaves location when they visit NYC to pitch their companies to the big Wall Street firms. With its sole focus on the utility sector, Reaves has a very deep understanding of the operations and financial results of all of the companies in the group.

The Fund

As of the end of September 2015, UTG held positions in 62 different stocks. About 55% of the portfolio is traditional electricity, gas and water utilities. The fund also owns telecom stocks like AT&T, media companies like Time Warner cable, and energy and utility infrastructure companies as smaller percentages of the portfolio. As is typical for a closed-end fund UTG uses a moderate amount of leverage to increase its dividend cash flow. Currently leverage is at 24%. In dollar terms, the fund has an asset capitalization of $880 million and the leverage allows it to own $1.17 billion of assets.

Some closed-end funds trade at significant discounts or premiums to their net asset value (NAV) which is the total fund assets divided by number of shares. Over the last 52 weeks, the average discount for UGT was 3.76% and the current (as of 10/30/15) discount is 2.0%. These are quite small discount numbers compared to the closed-end fund averages.

Investment Results

UTG launched in February 2004 and the fund has paid a dividend every month since. Yes this is a monthly dividend investment. The dividend has never been reduced and has been increased seven times in the last 11 years. The UTG dividends have always been 100% income without a return-of-capital – a tactic some closed-end funds use to support dividends that really have not been earned by the portfolio.

The bottom line with UTG is that you get a conservatively and expertly managed utility stock focused fund. Currently the yield is 6% with low to moderate dividend growth potential and monthly dividends.

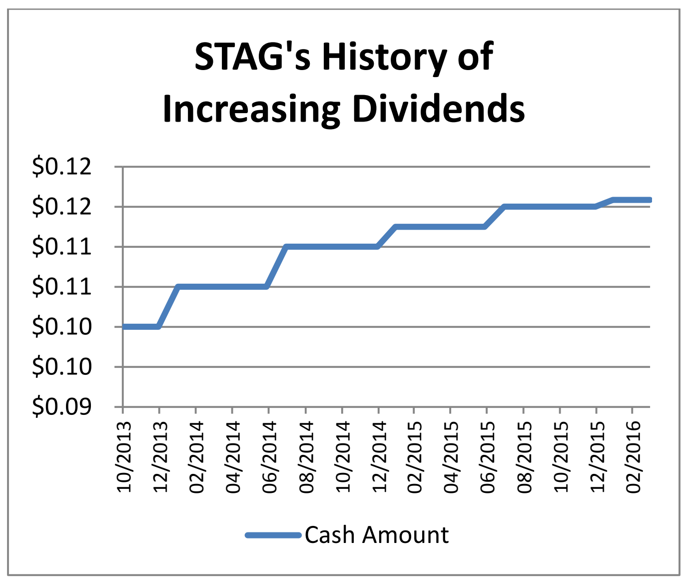
Recommendation: Buy and accumulate UTG as long as the yield is above 6%.

Portfolio Update

With earnings season in full swing, there has been plenty of news from portfolio companies, including many dividend increases. Even more earnings and dividends will be announced in November.

Blackstone Mortgage Trust Inc (NYSE:BXMT) reported net income of $0.72 per share for the third quarter, well above the new, higher $0.62 quarterly dividend. From the earnings call remarks, investors can expect the current dividend rate to stay in effect.

Stag Industrial Inc (NYSE:STAG) reported strong third quarter results with core FFO of $0.39 per share, compared to the $0.345 paid in dividends. The dividend rate was increased modestly to $1.39 annualized, up from the current $1.38. The new rate starts in January. Total dividend growth for the last year is 3.7%.



EPR Properties (NYSE:EPR) reported third quarter results and adjusted FFO per share for the quarter and first nine months of 2015 were up 8% and 9%, respectively. We should get a nice dividend increase in January.

Kinder Morgan (NYSE:KMI) reported third quarter earnings in line with expectations. The KMI dividend was increased by 2 cents or 4.1% to $0.51. Remember that the KMI dividend increases every quarter. Management reduced forecast annual dividend growth to a range of 6% to 10% through 2020. Previously the growth forecast had been 10% per year.

The **InfraCap MLP ETF (NYSE:AMZA)** announced and paid a $0.515 dividend per share. The fund has been steady with one-half cent or 1% dividend increases every quarter.

Main Street Capital Corporation (NYSE:MAIN) declared a $0.275 per share special dividend to be paid in December. MAIN has been very regular with semi-annual dividend payments on top of the regular and growing monthly dividends.

Ventas Inc. (NYSE:VTR) reported earnings above market expectations and increased its FFO per share guidance. The market was not impressed and the VTR share price has been dropping. This is one of the great dividend growth companies in the U.S. and the current share value of about $53 will seem like a tremendous bargain in a couple of years.

The Dividend Hunter

Current Portfolio: Buy / Accumulate

Stock	Entry Date	Entry Price	Recent Price	Status	Div. Earned	Current Yield	Cash Return
Reaves Utility Income Fund (UTG)	11/2/2015	$29.95	$29.95	Buy	$0.00	6.1%	0.0%
Aircastle Limited (AYR)	9/30/2015	$20.61	$22.73	Buy	$0.00	3.8%	0.0%
Ventas, Inc. (VTR)	8/31/2015	$55.02	$54.49	Buy	$0.73	5.4%	1.3%
MLP Distribution Growth Leaders (YGRO)	7/30/2015	$14.60	$12.28	Buy	$0.18	6.0%	1.2%
CyrusOne (CONE)	6/30/2015	$29.45	$36.77	Buy	$0.32	3.6%	1.1%
Williams Companies (WMB)	5/29/2015	$51.10	$39.57	Buy	$1.23	6.5%	2.4%
Hercules Tech. Growth Capital (HTGC)	4/30/2015	$13.90	$11.19	Buy	$0.62	11.1%	4.5%
RLJ Lodging Trust (RLJ)	3/31/2015	$31.31	$25.57	Buy	$0.66	5.2%	2.1%
InfraCap MLP ETF (AMZA)	3/31/2015	$21.51	$14.60	Buy	$1.53	13.9%	7.1%
Lexington Realty Trust (LXP)	3/2/2015	$10.78	$9.07	Buy	$0.51	7.5%	4.7%
Kinder Morgan (KMI)	1/31/2015	$29.20	$28.04	Buy	$1.66	8.8%	5.7%
Blackstone Mortgage Trust (BXMT)	1/31/2015	$41.05	$26.62	Buy	$0.97	7.5%	2.4%
Stag Industrial (STAG)	12/31/201	$24.50	$20.90	Buy	$1.14	6.6%	4.6%
EPR Properties (EPR)	10/30/201	$55.64	$57.53	Buy	$3.60	6.4%	6.5%
New Residential Investment (NRZ)**	7/30/2014	$12.16	$12.41	Buy	$2.02	14.8%	16.6%
Main Street Capital (MAIN)	6/27/2014	$32.51	$30.55	Buy	$3.31	7.1%	10.2%
Macquarie Infras. Company (MIC)	5/30/2014	$61.48	$79.85	Buy	$5.13	5.6%	8.3%
Ship Finance International (SFL)	5/30/2014	$18.52	$17.13	Buy	$2.52	10.3%	13.6%
Starwood Property Trust (STWD)	5/30/2014	$24.39	$20.46	Buy	$2.88	9.4%	11.8%

Current Portfolio: Hold

LinnCo LLC (LNCO)	04/30/15	$12.75	$2.45	Hold	$0.52	22.3%	4.1%
ONEOK (OKS)	12/01/14	$41.39	$32.46	Hold	$3.16	8.7%	7.6%
Legacy Reserves (LGCY)	09/30/14	$29.68	$4.18	Hold	$1.92	4.7%	6.5%
Memorial Production (MEMP)	09/30/14	$22.02	$5.80	Hold	$2.20	10.0%	10.0%
Hannon Armstrong Sustainable (HASI)	08/28/14	$14.49	$18.14	Hold	$1.26	7.2%	8.7%
Arc Logistics Partners (ARCX)	07/30/14	$25.10	$16.82	Hold	$2.06	6.5%	8.2%

Closed Positions

Stock	Entry Date	Entry Price	Close Price	Close Date	Div Earned	Total Return	Cash Return
TCP Capital Corp. (TCPC)	10/30/14	$16.51	$16.22	05/29/15	$0.77	2.91%	4.66%
Ventas (VTR)	05/30/14	$66.80	$80.52	01/30/15	$1.45	22.71%	2.17%
Oaktree Capital Group (OAK)	05/30/14	$49.98	$54.14	02/09/15	$1.17	10.66%	2.34%
Salient Midstream & MLP Fund (SMM)	08/28/14	$31.23	$21.67	03/31/15	$0.93	-27.64%	2.97%

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 11/02/15. Status denotes whether you should continue to accumulate shares, listed as "Buy" or should hold but not accumulated any more shares, listed as "Hold". 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. Current yield reflects the yield of the regular annual dividend payments (monthly or quarterly depending on the stock) in relation to its share price at thetime of publication. 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.