

## A Fast Start to Our Full First Quarter

Fellow Investor,

I started the day with my regular digest of market news and all I can say is, "BAM!" Portfolio holding **Tallgrass Energy GP LP (NYSE:TEGP)** just announced a 21% dividend increase to be paid in May, and back in January, the TEGP dividend was boosted by 20%. This news got me so excited I had to put it into the opening paragraph. Further down in the newsletter I will go into more detail. Also in April, we had a 14% annual dividend increase announcement from **Tanger Factory Outlet Centers Inc. (NYSE:SKT)**.

Two weeks ago, I was invited to make a presentation at a private, invitation only, investor conference. Although I always get a lot of compliments on my presentations, I will admit that I think I receive more than my share of new information out of watching other presentations and talking to the attendees. The more I talk to other investors about different approaches to stock market investing, the more I become convinced that the Automatic Income Machine strategy is pretty unique and will provide well above average total returns through a range of stock market up and down cycles.

April 1st marks the start of our first full quarter to track the Automatic Income Machine model portfolio results. The strategy is about investing in shares of companies that I forecast will grow dividends at a double-digit annual rate. Mathematically, and if you look at longer-term historical results, average annual total returns should end up near the dividend growth rate plus the dividend yield. Compounding with dividend reinvestment can help push returns higher.

To measure the results produced by the strategy, quarterly dividends earned from the model portfolio will be my primary tracking metric. Q2 2016 will give us our baseline dividend earnings from which these measurements start. I look forward to sharing the results with you quarter after quarter and year over year.

In relevant news to the Automatic Income Machine strategy, *The Wall Street Journal* just reported that the top two mutual funds for the year ending at the close of the 2016 first quarter were the Federated Strategic Value Dividend fund (SVAAX), and the Integrity Dividend Harvest Fund (IDIVX). During an ugly 12-month period in the market, the Federated fund returned 11.4% and the Integrity fund generated 10.8% to investors.

To quote from the article: "But to end up in the Winners' Circle in the first quarter of 2016, you needed to have a portfolio stuffed with securities carefully selected for their ability to pay outsize dividends and increase them over time." The Automatic Income Machine portfolio includes stocks with both higher yields and higher dividend growth potential than the types of stocks owned by these two funds. So, what I hope you take away from this quote and

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statistic is a confidence in the ability of the investing strategy that we are undertaking to deliver consistent and outsized returns year after year.

In this issue, I discuss the investment thesis of a pair of the Automatic Income Machine holdings and recommend an additional investment into one of them.

Don't forget, we have our first live strategy session coming up next week. It will take place on Wednesday, April 20th at 7:00 p.m. eastern time. There's a link below for registration so please sign up ahead of time, and we can send you the strategy session link as we get closer to the date.

If you have specific questions, ideas, or concerns that you would like me to address, please email them to me at [tim.plaehn@investorsalley.com](mailto:tim.plaehn@investorsalley.com). I will make sure to address them and love to hear what's on your mind.

To register for the session, please click the link below.

[Click Here to register for our first live strategy session.](#)



Best Regards,

Tim Plaehn

Editor

*Automatic Income Machine*

## New Residential Investment Corp.

Most of the Automatic Income Machine portfolio companies are low yield, high expected dividend growth rate stocks. The one exception is **New Residential Investment Corp (NYSE:NRZ)**. NRZ is a stock that yields almost 16% (and above that amazing yield on the occasional market swoon) even though the company keeps growing both free cash flow and the dividend rate. The valuation makes no sense to me, but as long as I see the business continue to grow and I get paid a 4% dividend every quarter, I plan to make a nice mid-teens or better return from this stock.

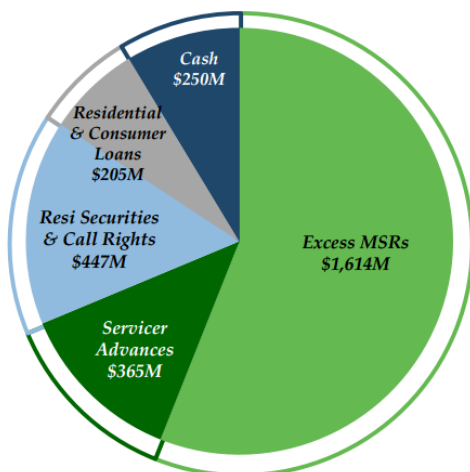
New Residential Investment is a finance REIT involved primarily in residential mortgage financing. This classification is probably why the company is valued to yield in the mid-teens. NRZ is not like the wealth eroding, highly-leveraged portfolios of agency mortgage-backed securities (MBS) REITs. New Residential invests in and owns a portfolio of excess mortgage servicing rights, servicing advances, and residential securities with attached call rights.

The mortgage servicing investments are a portion of the fees those companies that service home loans collect from every single mortgage in their respective books of business. New Residential makes investments that can generate mid-teens returns without the use of a lot of leverage. This chart below shows the company's expected annual returns from the different investment types.

I have closely followed New Residential Investment since it was spun off by **Newcastle Investment Corp. (NYSE:NCT)** in May 2013. Over those three years, the company has grown its quarterly dividend (reverse split adjusted) by 31% and has paid several special dividends to stay within the REIT minimum distribution rules. For 2015, the company grew core earnings per share by 22% and increased the dividend by 11%. 2015 fourth quarter core earnings were \$0.52 per share compared to the \$0.46 dividend.

The New Residential management team continues to position itself to take a bigger and bigger share of the

**Net Investment (As of 12/31/15) <sup>(2)</sup>**



**Net Investment & Targeted Lifetime Net Yield**

(\$ in mm)

	As of 9/30/15 <sup>(1)</sup>	As of 12/31/15 <sup>(2)</sup>	Targeted <sup>(2)</sup> Lifetime Net Yield*
Excess MSR's (Net of Debt)	\$1,485	\$1,614	12 – 20%
Servicer Advances	\$514	\$365	20 – 25%
Residential Securities & Call Rights	\$434	\$447	15 – 20%
Residential & Consumer Loans	\$121	\$205	20%+
Cash	\$348	\$250	15%

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mortgage servicing fees out of the multi-trillion dollar residential mortgage business. Even with a 16% stock yield, the company can still find investment opportunities that pay better than buying their own shares.

The current dividend rate has been paid for the last four quarters, so we have a good possibility of a penny or two increase with the next dividend announcement comes in May. To me, NRZ should be an 8% yielding stock. Someday the market might think so to, and the share value will double from the current \$11.60 share price if that happens. Until then, we are going to collect those 4% dividends every quarter and reinvest them into NRZ or another Automatic Income Machine portfolio stock.

This month's investment is to buy additional shares in NRZ. The model portfolio cash position is 33 percent of the total. The recommended purchase is to buy an additional 5% in NRZ shares. The model portfolio holds 1,400 shares, so I will be adding 70 new shares using the closing value on today's date, April 14<sup>th</sup>, 2016.

## Tallgrass Energy GP LP

As I noted in the introduction, portfolio stock **Tallgrass Energy GP LP (NYSE:TEGP)** has increased its dividend by 20% for each of the last two quarters. TEGP is currently the best example of a unique feature of publicly traded partnerships that can result in truly eye-popping free cash flow growth.

Tallgrass Energy GP LP owns the general partner interests in the publicly traded master limited partnership (MLP) **Tallgrass Energy Partners LP (NYSE:TEP)**. TEP owns and operates natural gas and crude oil pipelines. In the typical MLP structure, the general partner interests are 2% of the total partnership units, and the limited partner interest make up the other 98%.

However, whoever owns the 2% GP interest has complete control over how the MLP is managed and operated. LP unit holders are only entitled to receive the distributions declared by the partnership board of directors. With many MLPs, the general partner also owns incentive distribution rights which are commonly referred to as IDRs. These rights incentivize the general partner to grow the distributions paid to the LP unit owners. The higher the LP distribution gets, the greater the portion of the MLP's cash flow that is paid as IDRs to whoever holds the IDR interests. At the bottom of the page is the IDR table for Tallgrass Energy Partners.

Tallgrass Energy GP holds the 2% GP stake, the IDRs, and 20 million TEP LP units. All of TEGP's cash flow is derived from distributions made by Tallgrass Energy Partners.

Since going public in May 2013 (I think we have a trend here), Tallgrass Energy Partners has worked the MLP system to perfection. At the time of the IPO, there were two parts to the Tallgrass enterprise. Tallgrass Development is a private partnership that acquires and develops crude oil pipelines, natural gas pipelines, and other energy infrastructure assets.

Incentive Distribution Rights ⓘ					
General Partner Tallgrass Energy GP		Min Qtrly Dist \$0.28750		Latest Qtrly Dist \$ 0.64	
	Low	High	LP Unitholders	GP Units / IDRs	
Tier1	\$0.287500	\$0.304800	98.00%	2.00%	
Tier2	\$0.304800	\$0.353600	85.00%	15.00%	
Tier3	\$0.353600	\$0.431300	75.00%	25.00%	
Tier4	\$0.431300		50.00%	50.00%	

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## “TDEV” Tallgrass Development (Private)

### ASSET INCUBATOR

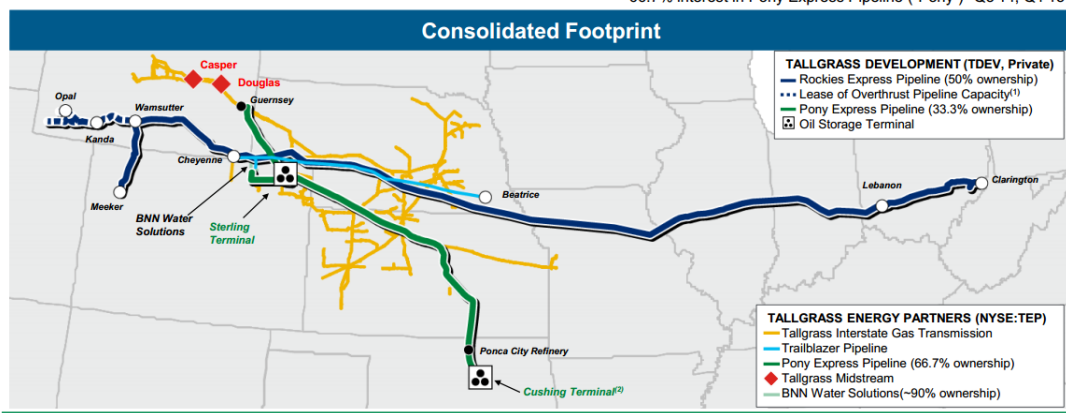
- **Private partnership**
  - Formed by management, Kelso, and EMG
  - Acquired assets from Kinder Morgan in November 2012
- **Current holdings**
  - 50% interest in Rockies Express Pipeline (“REX”)
  - 33.3% interest in Pony Express Pipeline (“Pony”)
  - Tallgrass Terminals (“Terminals”)
  - 6.4 million TEP LP units

## “TEP” Tallgrass Energy Partners (NYSE:TEP)

### LONG-TERM OPERATING VEHICLE

- **Public partnership**
  - Completed \$313 million IPO in May 2013
  - Acquired ~\$1.5 billion in dropdowns from TDEV, issued ~\$900 million in common equity and raised DPU by ~102% since IPO
- **Current holdings**

– Tallgrass Interstate Gas Transmission (“TIGT”)	Acquired
– Tallgrass Midstream (“TMID”)	IPO
– Trailblazer Pipeline (“Trailblazer”)	Q2’14
– ~90% interest in BNN Water Solutions (“BNN”)	Q2’14, Q2’15
– 66.7% interest in Pony Express Pipeline (“Pony”)	Q3’14, Q1’15



The developed assets are then sold in manageable bites to Tallgrass Energy Partners. In the MLP world, these sales are called "drop downs," and the asset is priced to ensure the MLP will generate growing free cash flow and can increase the distributions to LP units each and every quarter. Through 2015, Tallgrass Development had completed three drop down transactions to Tallgrass Energy Partners. The chart above gives an overview of the assets owned by each side as of Fall 2015.

To summarize, Tallgrass Development brings projects online until they are generating a sufficient amount of revenue. A percentage or all of a revenue producing asset is transferred to the public MLP through a drop down sale. Tallgrass Energy Partners manages the transferred assets to provide the energy infrastructure services to customers and can continue to grow revenues through the additional energy transport contracts.

The development company currently has over \$2 billion worth of projects in various stages of completion, providing plenty of opportunities for future drop downs. With this two company structure, TEP has been

a truly outstanding performer in the MLP space. In 2.5 years, the quarterly distribution has increased by 133%, or an average growth rate of 43% per year. The just announced distribution to be paid in May is 10% higher than the 2016 first quarter payout and up 35% compared to a year earlier.

Distributable cash flow covered the distribution by 1.36 times, a healthy coverage ratio for an MLP and in line with other high-growth MLPs. Tallgrass management has consistently over-delivered on distribution growth when the actual growth rates are compared to previous guidance estimates.

Tallgrass Energy GP came to market last year with a May 2015 IPO. As noted above, TEGP is the general partner for Tallgrass Energy Partners and owns the IDRs and 20 million TEP LP units. In more MLP jargon, TEP is in the 50% IDR split. This means to increase the distributions to the LP units, the IDR payment must increase by the same amount.

The TEP quarterly distribution was just increased by 6.5 cents, or \$4 million on the 61.6 million LP units outstanding. The IDR payment to TEGP will then also grow by \$4 million. Additionally, IDR payments grow as

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the number of LP units outstanding increases. In the MLP universe, drop down purchases are typically funded with a combination of new LP unit equity issuance and added debt. As a result, drop down transactions also result in IDR payment growth.

The way the math works out, in the 50% IDR split, the cash paid to the general partner will grow at two to three times the growth rate of the MLP LP unit quarterly distributions. Put bluntly, it is a very good thing to be the general partner and IDR holder of a growth focused MLP. That is why companies like **Phillips 66 (NYSE:PSX)**, **Valero Energy Corp. (NYSE:VLO)** and **Royal Dutch Shell plc (NYSE:RDS.A)** have spun off MLPs to hold their energy infrastructure assets and use the drop down system to generate high distribution growth rates on the MLP LP units. As individual investors, we just go along for the cash flow growth ride, either on the MLP or GP side, depending on the structure of the publicly traded companies.

The Tallgrass management team has indicated they expect at least 20% distribution growth on TEP units for at least the next several years. If that happens, the TEGP dividend will grow by something like 40% per year. As discussed earlier, the 10% TEP increase for the first quarter to be paid in May resulted in a 20% increase in the TEGP distribution. It is possible that the TEGP dividends will grow by an almost unbelievable rate over the next few years if the TEP distribution growth is above the 20% annual target.

With the TEGP shares yielding almost 5% on the new dividend rate, I will be satisfied with just 20% annual dividend growth over the next several years. As an additional bonus, due to the energy sector bear market, TEGP is trading at just 55% of the IPO share price.

Wait, as a final, final bonus, TEGP has elected to be taxed as a corporation (it gets lots of depreciation pass through from TEP, so will actually not pay much in taxes) so as investors we will receive a Form 1099 with tax information on our shares, not a Schedule K-1.

## Portfolio Update

March was the first full month for the Automatic Income Machine model portfolio. There are currently 11 stocks with equal weight initial investments. The average dividend yield is 5.2%, a nice cash flow stream for a strategy focused on growth. The current plan is to limit the portfolio to about 12 stocks. The number of high dividend-growth-rate companies in my database is around 50, so the top quarter of those should serve us well.

The portfolio is currently about 35% in cash. The cash position is high because the portfolio was just launched in February. As we make additional investments, the cash in the model portfolio will shrink. If you are starting a new portfolio following the Automatic Income Machine system, the start out guide you received when you enrolled will start your personal dividend growth portfolio with about two-thirds of the money invested in the portfolio stocks.

Because the portfolio was launched in mid-quarter, just two of the stocks went ex-dividend and paid after the launch and before the end of the quarter. **Aircastle Limited (NYSE:AYR)** and **Extra Space Storage, Inc. (NYSE:EXR)** both paid in March. As noted earlier, two stocks have announced second quarter dividends, **Tallgrass Energy GP LP (NYSE:TEGP)** and **Tanger Factory Outlet Centers Inc. (NYSE:SKT)**. Both came with dividend increases.

The portfolio value, including the cash position, increased by 5.97% in March. All of the stocks are in positive territory since the portfolio was established. There is some luck here, since I set up the holdings in mid-February to get the positions established before we launched Automatic Income Machine. At that time the stock market was in a strong correction, and I expected prices to continue to fall. However, the start date was actually quite close to the recent bottom. As a result TEGP and AYR show portfolio gains of 50% and 22% respectively because in mid-February they got stupidly

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cheap. I like stupidly cheap. That is one of the strengths of investing for dividend growth. It becomes a lot easier to pull the trigger and buy more shares when the markets get cheap, because we are basing investment decisions on yield and dividend growth potential. AYR at a 6% yield is a buy-all-day decision.

The Automatic Income Machine is not a frenetic trading system that will only serve to make your brokerage firm happy. It is very deliberate, and you may feel like things are moving too slowly at times. The goal is to generate real growth in our wealth over a period of years, and that rarely, if ever, happens by trying to move in and out of the market. My job is to help make money for you, not your broker.

Although there will be lots of back and forth communication between now and then, I look forward to the first newsletter after the end of the 2016 second quarter where we can look back on our dividend earning results. Then each quarter after that, we will have quantifiable dividend cash flow numbers with which to measure our success.

If you have any questions about the stocks in the portfolio or anything we covered in this month's issue feel free to write to me directly. My personal email address is [tim.plaehn@investorsalley.com](mailto:tim.plaehn@investorsalley.com).

And don't forget the live strategy session on April 20<sup>th</sup>. Just use the link at the end of the introduction section of this newsletter to confirm your attendance.

The table below is the updated 'Start Out Portfolio.' You can use this as a guide for deciding how many shares of each stock in the portfolio you should buy if you're new to Automatic Income Machine or just have more funds you want to put in the market.



Symbol	\$100,000.00	\$250,000.00	\$500,000.00	Yield
EXR	60	150	300	2.58%
CONE	135	338	675	3.49%
AYR	260	650	1,300	4.28%
EQM	75	188	375	3.83%
NRZ	480	1,200	2,400	15.56%
PSXP	100	250	500	2.97%
SLG	60	150	300	2.92%
TEGP	350	875	1,750	4.92%
SKT	160	400	800	3.54%
TLLP	130	325	650	6.83%
VTTI	300	750	1,500	6.19%
				5.19%
Share numbers put about 65% of listed portfolio amount to work.				

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## Current Portfolio

Stock	Entry Date	Entry Price	Shares Bought	Recent Price	Total Shares	Total Value	Dividends	Total Return
Extra Space Storage (EXR)	2/12/2016	\$81.39	175	\$91.49	175	\$16,010.75	\$103.25	3.15%
CyrusOne Inc. (CONE)	2/12/2016	\$35.76	400	\$43.81	400	\$17,524.00	-	10.28%
Aircastle Ltd. (AYR)	2/12/2016	\$17.37	800	\$22.74	800	\$18,192.00	\$192.00	23.85%
EQQT Midstream Partners	2/12/2016	\$67.47	200	\$73.65	200	\$14,730.00	-	5.19%
New Residential (NRZ)	2/12/2016	\$10.15	1,400	\$11.87	1,400	\$16,618.00	-	11.09%
Philips 66 Partners (PSXP)	2/12/2016	\$56.22	250	\$62.06	250	\$15,515.00	-	8.06%
SL Green Realty Corp. (SLG)	2/12/2016	\$81.01	175	\$98.90	175	\$17,307.50	-	17.19%
Tallgrass Energy GP (TEGP)	2/12/2016	\$11.22	1,250	\$17.49	1,250	\$21,862.50	-	42.37%
Tanger Factory Outlet Cent.	2/12/2016	\$30.23	500	\$36.82	500	\$18,410.00	-	12.37%
Tesoro Logistics LP (TLLP)	2/12/2016	\$38.27	400	\$44.87	400	\$17,948.00	-	16.76%
VTTI Energy Partners (VTTI)	2/12/2016	\$15.99	900	\$19.25	900	\$17,325.00	-	19.53%

Recent price is determined by the last "Ask" price at the closing of the market on the day before publication; most recent update 04/13/16.

#### 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 04/13/16. 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](http://www.investorsalley.com).

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