# Special Report: Unique Investment Opportunities in the Current Market

![Value Line Investment Education](image)

**Institutional Decisions**

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**Insider Decisions**

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**Capital Structure as of 3/29/15**

| Total Debt | $18,983 mill. Due in 5 Yrs $7,090 mill. |
| LT Debt | $14,938 mill. |
| LT Interest | $90.4 mill. |

**Value Line Investment Education**

Smart research. Smarter investing.
How to Find a Growth Stock

Growth investors typically look to the future of a company when selecting an equity for their portfolios. Although the past is important for background, it matters only to the extent that it helps identify those companies that have shown the most progress over time and that possibly have additional room for growth.

*The Value Line Investment Survey®* makes finding growth-oriented stocks easy. In fact, in each week’s *Summary & Index*, we publish a screen entitled “Highest Growth Stocks” (page 39). To be included, a company’s annual growth of sales, cash flow, earnings, dividends and book value must together have averaged 10% or more over the past 10 years and be expected to average at least 10% in the coming three to five years. *Note: Using the Value Line Sample Report, these figures can be found within the Historical Array, Estimates & Projections, and Annual Rates box, which are labeled 26, 15, 22, 21, and 23, respectively.*

This screen typically yields about 100 results. The stocks that are listed are all included in *The Value Line Investment Survey*, which provides complete coverage and analysis on approximately 1,700 equities. This universe accounts for approximately 90% of the total market capitalization of all stocks traded on U.S. exchanges.

With 100 results, more specific criteria are needed to reduce that list to a more manageable level. That is where Value Line’s proprietary Ranking System for Timeliness™ can help. The Value Line Timeliness Rank, a computer generated metric, measures the probable relative price performance of a stock for the year ahead on an easy-to-understand scale from 1 (Highest) to 5 (Lowest). Components used in the calculation of a rank include the trends of earnings and prices, and earnings surprises. All data are known and actual.

A quick way to narrow down the list of suitable investments is to focus only on those stocks with Timeliness ranks of 1 (Highest) or 2 (Above Average). Although the historical performance of such selections has been impressive, there is no guarantee that stocks ranked 1 or 2 will outperform the market as expected. On the Sample Report, a stock’s Timeliness Rank can be found at the top right hand corner (Item 1).

Once the list has been greatly reduced by selecting stocks ranked 1 and 2 for Timeliness, growth investors ought to take a look at the stocks’ Safety™ Ranks (Item 1). This is a measurement of potential risk associated with individual common stocks. It is computed by averaging the Price Stability score and the company’s Financial Strength grade, which can be found in the Ratings box at the bottom right of each Value Line report (Item 19). Safety Ranks range from 1 (Highest) to 5 (Lowest). Conservative investors should try to limit their purchases to equities ranked 1 (Highest) and 2 (Above Average) for Safety, while stocks receiving a rank of 3 (Average) or lower are appropriate for more aggressive accounts.

Like the Timeliness Rank, the Safety Rank is an especially useful tool for eliminating undesirable selections. Examining the Capital Structure box (Item 25) to ensure that there isn’t too much debt on the balance sheet of a company is important, as well.

Another key component is the Projections box (Item 29). This shows the 3- to 5- year projected high and low price range, the cumulative percentage gain that would result compared with recent share price levels, and the annualized total return, which takes into account share-price gains and dividend payments expected over that time frame. Value Line analysts create the projected price range, which is shown visually by the dotted lines to the far right of the Graph (Item 11), by first multiplying the 3- to 5-year projected earnings per share by the projected average annual price/earnings multiple. This single point is then calculated into a range based on the company’s Safety rank. Note that stocks with better Safety ranks (i.e. 1 or 2) possess narrower ranges.
The percentage gains are then compared to the Value Line median appreciation potential (commonly referred to as the VLMAP) for all approximately 1,700 companies (found on the front cover of each week’s Summary & Index). Clearly, selecting stocks with higher appreciation potential than the Value Line median is preferable for growth investors.

In addition to the numerical data, an investor can gain further insight into the prospects of a company by reading the analyst commentary (Item 17). There, a reader will find a plain English discussion of what has happened recently at the company, what is likely to happen over the near term, and what might transpire over the long term.

For those growth investors who want even more direction, we suggest a thorough look at each week’s Selection & Opinion. Within this 12 page document, we provide four actively managed 20-stock Model Portfolios. We recommend that growth investors focus on Model Portfolio 1. To qualify for purchase in the portfolio, a stock must have a Timeliness Rank of 1 or 2 and a Financial Strength rating of at least B+. If a stock’s Timeliness rank falls to 3, or lower, that issue is automatically removed.

Although stock selection is a highly individual process, the above methodology is a good general guide for investors to use in their search for growth stocks. Note, however, that no company will be a perfect candidate, so some flexibility is necessary in the selection process.

On the following page, we provide a growth stock that illustrates the methodology described above.
United Parcel Service, Inc. (UPS) is the world's largest integrated air and ground package delivery company. It offers specialized transportation and logistics services. Service is offered throughout the U.S. and in over 220 other countries and territories. Domestic package operations accounted for 64% of '14 revenues; international (22%); supply chain & freight (16%). Fleet owned and leased (at 12/31/14): 649 planes and 106,000 ground vehicles. Has about 435,000 employees (over 62% unionized). Officers and directors own less than 1.0% of common stock; BlackRock Inc., 6.6%; Vanguard Group, 5.4%; State Street Corp., 4.1%. Current share price: $102.08. Telephone: 404-828-6000. Internet: www.ups.com.

United Parcel Service is performing in line with our expectations. First-quarter earnings per share of $1.12 were $0.02 above our estimate and 14% greater than the same period last year. The performance is mostly attributable to lower fuel prices. Revenue per package rose 4.3% year over year, as price increases offset a 200-basis-point reduction in fuel surcharges. The domestic segment reported revenue gains of 3.8%, as average daily package volume rose 2.4% on 12% growth in air service sales and a 7% increase in SurePost (lower-cost residential service) sales. Conventional ground shipment growth was a bit slower, as the company chose not to renew some lower-yielding contracts. International revenues grew 2.4% in constant-currency terms, and the operating margin was up 200 basis points thanks to higher revenue growth and pricing initiatives. The Supply Chain & Freight unit (transportation, distribution, and international trade & brokerage services) saw revenues rise 4.2%, excluding currency headwinds. The company is trying to streamline operations, UPS dropped the ball in each of the past two peak holiday seasons, due to understanding the first year and overstaffing the network. It hopes to avoid similar situations this year by investing in hub automation and route optimization technologies. Guidance calls for solid year-over-year improvement. U.S. domestic volume ought to rise around 3% with revenue growth at a slightly faster pace as base rates rise. Still, lower fuel surcharges are expected to restrict yields (price x weight), international revenue should increase 2%-3% excluding currency translation. All told, earnings per share ought to come in between $3.5% and $3.35, at a 6%-12% increase over 2013.

UPS is giving capital back to shareholders. It recently increased the dividend payout by 9%, to $0.73. This, combined with share repurchases, should bring its total contribution to shareholders above 100% of its cash flow. Momentum investors may want to take a look at these timely shares, and long-term price appreciation potential is slightly above average.

Kevin Downing  May 29, 2015
How to Find a Value Stock

For those commencing a search for value stocks, we suggest first examining the “Widest Discounts from Book Value” screen that is included in each week’s Summary & Index (page 34). This list includes stocks whose ratios of recent price to book value per share are lowest. Book value is common shareholders’ equity determined on a per-share basis. It includes both tangible assets, like receivables and inventory, as well as intangibles, like the value of patents and brand names, better known as goodwill. Any significant amount of intangibles will normally be indicated in the Footnotes section of the Value Line report (Item 20). If all assets could be liquidated at the value stated on the company’s books, all liabilities (such as accounts payable, taxes, and long-term debt) paid, and all preferred stockholders compensated, the book value is what would be left for common shareholders.

Value investors will typically seek out stocks that trade at or below book value. To get a rough estimate of how investors were valuing the company at its highest and lowest price points, one need only compare the stock’s book value per share found in the Historical Array (Item 26) in those years to the appropriate high or low annual prices found at the top of the graph (Item 9). The resulting ratios can be used to create a price range around book value per share for the “best” and “worst” case. This range can then be applied to the current book value per share to give an idea of the current valuation of the equity.

Note that it isn’t often that shares of a company in good financial shape, with good future prospects, will trade below book value. In fact, stocks are often “cheapest” when there is reason to be concerned about the future. And while book value provides some comfort as to what a company is worth, few want to own stock in companies on their way to bankruptcy because of a faltering business. This is why considering the future performance of a company is so important.

Revenue and earnings trends should not be ignored. If a Value Line analyst expects performance to fall off, an equity may appear “cheap” for a good reason. But if business trends are positive, then the stock may warrant further consideration. For a broader perspective, another place to look is Value Line’s Annual Rates box (Item 23). This shows growth projections for sales, cash flow, and earnings, among other items, for the coming three to five years. Clearly, the higher the percentages the better. But, for a value investor, it is important that projected numbers are at least on par with historical trends. Companies with projected slowdowns in growth or negative trends are likely to be laggards in the market.

While the 3- to 5-year projected book value per share (Item 15) can give an idea of what price range the company might trade within over the longer term, a more useful comparison for value investors would be comparing the current share price (Item 5) to the projected range (Item 29). This might paint a more accurate picture than looking at current price to book value alone.

Another method of valuation used here is based on the price of an equity and the earnings of the company. This considers the earnings projections of Value Line analysts (Items 15 and 22, respectively) and the historical premium investors are willing to pay for those earnings (Item 7). Calculating a P/E is simple math. It involves dividing the share price by a company’s earnings per share. The logic is that investors are willing to pay the resulting multiple for each dollar the company earns. A company’s Average Annual P/E is available in the Statistical Array (Items 26 and 15, respectively) and is displayed for each year.

Comparing a stock’s P/E ratio to that of the broader market or of its peers can be especially helpful. The median of estimated price/earnings ratios for all stocks with earnings can be found on the front cover of each week’s Summary & Index. A P/E of 10 would not imply undervaluation if the
broader market’s P/E is 9, but it would do so if the broader market's P/E is 19. Thus, as with book value, it is important to look more at the context of a company's performance and P/E valuation, considering how the current P/E relates to the historical trend, targeting those companies trading at P/E ratios at the low end of their historical range.

If the current P/E represents the historical low, it is important to take extra care. A company-specific problem may be driving the share price lower, so it may make sense to hold off on the investment or pass on that equity altogether. To gain a better understanding of what is going on at a specific company, consulting the analyst commentary (Item 17) is an important step.

Value Line analysts also create a projected P/E multiple for each company, three to five years out (Item 15), basing the estimate on historical P/E levels and expected financial results. Multiplying the projected earnings by the projected P/E creates a long-term price target.

Value Line analysts also create a 3- to 5- year projected Target Price Range by using a proprietary model based on a company’s Safety rank (Item 1). The better the Safety Rank the tighter the range around the target price. This range is visually represented on the Graph (Item 11) by the horizontal dotted lines and in number form in the Projections box to the left of the Graph (Item 29).

An additional method of valuation featured on the Value Line report is based on the Cash Flow Line (Item 4), which appears on the Graph. This line is created by multiplying a company’s Cash Flow per Share by a value that allows for a “best fit” with the company’s pricing information. It is a rough gauge of how the market has valued the company’s cash generating ability over the longer term. The multiple used is displayed in the Graph Legend (Item 2).

The line relies heavily on the analyst’s perspective of the company’s valuation, as it uses estimates. However, it can reveal interesting relationships between price and valuation. For example, there are times when a company’s shares will trade materially below the cash flow line. It is preferable to find companies where the cash flow line is stable, as a cash flow line that is falling suggests that there may be problems.

Although stock selection is a highly individual process, we’ve chosen a value-oriented issue that illustrates the methodology described herein.
Trinity Industries Inc. TRN

Trinity Industries reported better-than-expected first-quarter results. Key highlights:
- Revenue of $3.13 billion, topping the company’s $1.05 earnings estimate.
- The Railroad Group’s deliveries grew 13%, compared to a 10% increase in the railroad car count.
- The Marine Group’s revenue increased 6%, driven by higher volumes and better leasing rates.
- The Rail Group continues to post solid sales and margin growth, as expected.
- Management has raised 2015 earnings guidance from $4.45 to $4.65 per share.

**Company’s Financial Strength**
- Debt/Equity Ratio: 0.4
- Stock’s Price/Earnings: 15.4
- Price/Growth: 2.7
- Price/Earnings to Growth: 4.5

**Stock Price**
- 52-Week High: $22.12
- 52-Week Low: $12.50
- 52-Week Range: $17.60 - $22.12

**Earnings Predictability**
- Price Growth Persistence: 15
- Price Growth Consistency: 15

**Company’s Growth**
- Average Annual Revenue Growth: 15%
- Average Annual Earnings Growth: 12%

**Company’s Financial Health**
- Average Asset Turnover: 1.3
- Average Earnings Yield: 8.0%

**Company’s Operational Efficiency**
- Average Operating Margin: 11.5%
- Average Return on Total Capital: 9.0%

**Company’s Traders**
- Ace: (8% of stock)
- Capital: (7% of stock)
- Vanguard: (4% of stock)
- Blackrock: (3% of stock)

**Company’s Risk**
- Beta: 3.3
- Market Volatility: 3.3

**Company’s Income Quality**
- Cash Flow per Share: $0.75
- Dividends per Share: $0.62
- Free Cash Flow: $0.75

**Company’s Dividend Data**
- Dividend Date: April, July, October
- Ex-Dividend Date: May, August, November

**Company’s Dividend History**
- Dividends Have Been Paid: Yes
- Current Dividend: $0.15
- Dividend Growth: 3%

**Company’s Stock Performance**
- Year-to-Date: 15.5%
- 1-Year: 32.0%
- 5-Year: 57.3%
How to Find an Income Stock

The first issue that needs to be assessed is the relative importance of current income and dividend growth. More often than not, there is a tradeoff between the two—companies that pay growing dividends often have lower yields than those that pay a large, but rarely raised, dividend. Although current income and dividend growth investors have different goals in mind when selecting a stock, many of their concerns will be similar. In fact, many of the measures they examine will be the same.

Using *The Value Line Investment Survey* to find income stocks is quick and easy. First, each week’s Summary & Index includes a couple of screens to help the dividend-seeking investor get started. The “Highest Dividend Yielding Stocks” and “Highest Dividend Yielding Non-Utility Stocks” screens can be found on pages 32 and 38, respectively.

Using those lists, a potential investor will then want to focus on a company’s financial position. Clearly, it takes a certain amount of stability to pay consistent dividends. Value Line provides numerous measures of financial muscle, but one of the easiest to use is the proprietary Financial Strength rating (Item 19). Conservative investors should try to limit their purchases to equities with Financial Strengths preferably in the A range, but no lower than B+, which is average. They should also look for a Safety rank of 1, 2, or 3 (Item 1).

Stock Price Stability (Item 19) is a relative score based on the standard deviation of weekly percent changes in the price of a stock over the past five years. The scores go from 100 for the most stable to 5 for the least stable, in increments of five. Although the stock price of an investment may not be the most important component to consider for a dividend investor, one would want to avoid capital losses, as they would offset the income received from the investment.

Income-oriented investors should also focus on the Capital Structure (Item 25) and Current Position (Item 24) boxes. The Capital Structure box provides key data about a company’s finances, including debt and interest expense amounts. The proportion of long-term debt to total capitalization is provided in most cases (except for some industries such as utilities, which show it in the statistical array). For an income-oriented investor, a lower number here is better.

That said, a high level of debt isn’t necessarily a reason to avoid a dividend-paying stock. True, low levels of debt clearly allow more confidence in a company’s ability to pay dividends in both good times and bad, but some companies, such as utilities, can better handle high levels of debt because of recurring, and sometimes regulated, revenue streams. Also, industries that require large capital outlays, for such things as factories, may have few companies with low levels of debt. The Statistical Array (Item 26) provides additional data for comparison purposes.

The market capitalization of a stock (total value of the outstanding shares based on the market price per share) is another factor to note. Although small companies should not necessarily be dismissed, keep in mind that smaller dividend-paying companies are likely to have a heightened level of risk associated with their distributions.

Going back to the Ratings box (Item 19), one should also consider Price Growth Persistence and Earnings Predictability. Although not directly related to a company’s ability to pay dividends, these measures can help subscribers find companies that won’t keep them up at night. Both of these ratings range from 100 (Highest) to 5 (Lowest). Price Growth Persistence is a measurement of the historical tendency of a stock to show constant price growth compared to the average stock. Earnings Predictability is a measure of the reliability of an earnings forecast, based upon the stability of year-to-year comparisons. Clearly, the higher the scores, the better.
It is also relevant to examine both the Business Description (Item 16) and the Analyst Commentary (Item 17), to gain a better understanding of a particular company’s operations and prospects.

At this point, you should have a list of companies that have solid finances and reasonable prospects for the future. This is where those seeking high levels of current income diverge from those seeking a growing stream of income.

Those seeking a high level of current income typically look for stocks with high dividend yields. Determining what dividend level best suits one’s investment objective is essential, though. For example, dividend yields around 5% are fairly attractive. But as the figure approaches 10% (or above), the investor may wish to ask why the yield is so high. Market conditions also play a role, as a deep bear market can lift yields.

Examining the Statistical Array (Item 26) is especially helpful here, paying special attention to actual dividends paid each year and the consistency of the distributions over time. The average annual dividend yield for each year gives a sense of the range in which it has trended.* A stock yielding 5% today that has historically traded at yields of 7% may be less desirable than a company that yields 5% today but has historically yielded 2.5%. The objective is to ensure that one doesn’t overpay for yield.

The 3- to 5- year projected average annual dividend yield (Item 15) can provide additional insight, giving guidance as to the current pricing of the shares and the analyst’s expectations for the future of the dividend. The “all dividends to net profits” figures are worth a glance, too. It is preferable to find companies whose earnings handily cover dividend payments. A 50% payout ratio, or lower, is usually ideal. However, some companies can handle higher percentages, such as utilities, and for others, such as Real Estate Investment Trusts (REITs), earnings are not a meaningful measure, making the payout ratio less useful to investors. In the end, remember that dividends are paid out of cash flow—not earnings. So, checking the dividends per share figure against cash flow per share (Item 15) would be wise.

Next review the Annual Rates box (Item 23). This box shows Value Line’s projections of growth for dividends, sales, cash flow, and earnings, among other items, for the coming three to five years. Clearly, companies with higher percentages are preferred, though for income investors, making sure the projected numbers are on par with, or better than, historical trends is of greater concern. Note that for those seeking current income, minimal dividend growth might be acceptable, with the caveat that dividend growth below the rate of inflation will erode your purchasing power over time. That’s fine if one expects capital appreciation to make up for that shortfall, but, often, stagnant dividends lead to stagnant share prices.

For those seeking growth of dividends, the expected yield level is likely to be much lower. In fact, when it comes to dividend growth, yields as low as 1% (maybe even less) can be acceptable. But, here, the decision process starts with the dividend growth rate.

Dividend growth on par with the historical inflation rate of about 3% should be the absolute minimum level for dividend growth investors. An income growth investor ought to also look to the Annual Rates box for historical trends and projected 3- to 5- year growth rates, targeting companies with increasing growth rates.

For those income investors who want even more direction, we suggest a thorough look at each week’s Selection & Opinion. Within this 12 page document, we provide four actively managed 20-stock Model Portfolios. We recommend that income investors focus on Model Portfolios 2 and 4. To qualify for purchase in Portfolio 2, a stock must have a yield that is in the top half of the Value Line Universe, a Timeliness Rank of at least 3, and a Safety Rank of 3 or better. To be a candidate for Portfolio 4, a stock must have a yield that is at least 1% above the median of the Value Line universe, a Timeliness Rank of at least 3, and a Financial Strength Rating of at least B+, or average.

Although stock picking preferences are unique to each investor, we’ve chosen an income-oriented issue that illustrates the methodology described herein.

*Sometimes a falling yield is a sign of better earnings and a rising stock price.
Verizon Communications Inc. VZ

**Business:** Verizon Communications was created by the merger of Bell Atlantic and GTE in June of 2000. It is a diversified telecom company with a network that covers a population of about 285 million, and provides service to 86.2 million. Verizon acquired MCI,0163; AT&T; Verizon Wireless. 2013 revenue breakdown: wireline (in mill.): $32,920,870; network access ($13,546,126); wireline access ($12,446,362); internet ($6,070,544); and on-line directory information. Has a wireline presence in 28 of 50 states and Washington D.C. and is a wireless presence in 38 states and D.C., operations in 19 countries. 2013 revenue breakdown: wireless (in mill.): 52.6%. 2013 revenue grew more than twice that of the Verizon service revenue growth for 2013 was 8.4%. The company has agreed to two significant asset divestitures over the last month or so. Indeed, the company is seeing strong demand for 4G LTE wireless services.

**Verizon has been quite busy over the last month or so.** The company has agreed to two significant asset divestitures and earmarked a portion of the proceeds to bolster shareholder value. More specifically, in early February, VZ inked a lease agreement with American Tower Corporation. Verizon has agreed to lease the rights to over 10,300 of its company-owned wireless towers to American Tower Corporation. The deal is pegged to outperform the market over the coming year. What’s more, Verizon stock has something for everyone. The issue is pegged to outperform the market over the coming year. What’s more, at the current quotation, its long-term capital appreciation potential is well above average. Finally, Verizon stock could well be the darling of income-seeking investors, as its dividend yield is more than twice that of the Value Line median.

**Kenneth A. Nugent March 20, 2015**

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**Value Line Investment Survey**

**Verizon Communications Inc. VZ**

**Pension Assets-12/14**

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**Income Stock**

**Verizon Communications Inc. VZ**

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