# The Dividend Value Discipline™
# Quarterly Market Commentary
# 2nd Quarter 2017 (Q2) – as of June 30th

On July 1st, we marked 150 years as a nation and post the requisite family BBQ, time with friends and the fireworks, Canadian investors can be forgiven if they are in a little less celebratory mood. To wit, February 2017 finally saw the S&P/TSX Composite Index best its all-time high of 15,685 (set back in September 2014) by a mere 258 points, only to see it once again turn south and close at 15,182 on June 30, 2017. Put another way, that's nearly three years of underwater performance, which will test the resolve of even the most patient investors. Furthermore, it has been a frustrating first half of 2017, with the previously-cited S&P/TSX Composite Index pegging in at a loss of 0.7%.

Despite Canada's S&P/TSX Composite Index being down for the first half of 2017, fully-invested accounts within **The Dividend Value Discipline™** had gains of roughly 1.5%, in part due to our U.S. stock exposure. But even there, we experienced currency headwinds of some 3.5% for the first six months … and what a wild ride it has been! We started the year with our loonie at 74.46 cents U.S., saw it peg a low of 72.48 in early May, and then close out June at 77.12. At the time of writing, the portfolio is roughly 50% U.S. dollar-denominated.

As you know, our ***"buys only mandate"***, coupled with differences in start dates and timing of cash flows means that no two accounts are exactly alike – your individual results can be found on **The Progress Monitor**. As always, all return figures are net of fees.

Of course, the objectives for **The Dividend Value Discipline™** remain unchanged:

- Income every month
- Buy only those securities which become attractive on a go-forward basis
- Returns of +8% net to you each and every year

To the latter point, the +8% is not a guarantee, nor can we expect to make it to 4% precisely at the halfway mark of the year. Like our nation, there will be troubled times and there will be times that we exceed beyond our expectations. Those that persevere generally get rewarded.

Our focus on acquiring aggregators and/or disruptors as a means to sustainable double-digit dividend growth, and in turn, the driver of higher long-term returns, continues. You can find a refresher on the aggregators and disruptors concept in May's edition of **The Strategist**, which you can find here: http://bit.ly/StrategistMay2016.

Our efforts yielded four new upgrades (acquisitions) to the portfolio for the quarter, and they are as follows:

In late April, we bought an initial stake in mobile connectivity enabler **Skyworks Solutions Inc.**, a company that has a vision of "connecting everyone and everything, all the time". They engineer, produce and sell all the "bits" that make mobile devices work: Wi-Fi receivers, antenna tuners, power management chips, amplifiers, quad GSM chips, GPS trackers, and the like. When you think about how fast mobile is growing (streaming video) and where it is going (the autonomous car, which will gobble up 2,500 times more data than the average person uses today), their addressable market is massive. In short, Skyworks provides solutions to move all that traffic around. Management-wise, long tenures are evident, as

is performance-oriented compensation, and the company has been recognized as one of the top places to work by the *Boston Globe* and *Orange County Register*. Moat-wise, Skyworks has scale and intellectual property advantages with over 2,600 patents. We see continued growth being driven by "aggregation" and tailwinds from two secular trends – the continuous sophistication of smartphones and strong growth in the "Internet of Things". It is not a stretch to say they are the leading (maybe even disrupting!) the mobile connectivity business.

Our next program upgrade was Little Rock, Arkansas-based **Bank of the Ozarks Inc.**, an extraordinary aggregator of smaller banks that operates in nine U.S. states and has over 250 branches. Culture runs deep at Bank of the Ozarks under the capable leadership of CEO George Gleason, who bought controlling interest of the firm in 1979 at age 25 and appointed himself Chairman of the Board and CEO. From humble beginnings, Gleason's personal commitment to excellence has generated phenomenal growth while keeping profitability, loan quality, and capital efficiency well above the industry averages. There is a consistent history of buying smaller tuck-in acquisitions that adds to their low-cost deposit base, and we certainly don't see that slowing down. Moat-wise, they stand apart from their competitors with exceptional customer service and special expertise in real estate lending – so specialized that they suffered little in the 2008 real estate collapse, which bodes well for the future. The rent cheque (i.e. dividend) continues to grow at strong double-digit rates. In fact, it seems they are overtly focused on growing the dividend, as they have increased it in each of the last 27 quarters. Talk about rent cheques that grow!

In mid-June, we acquired a stake in **Starbucks Corp.**, where the growth in new stores is currently tracking at three per day. One of those three is in China, a market that management expects will eventually outgrow its U.S. presence, which currently generates 80% of its revenue. That's only part of the growth story. Historically, we can look back and see that the company has aggregated its growth with the purchase of companies/brands such as Teavana, Tazo, Seattle's Best Coffee, Evolution Fresh, La Boulange and Verismo. More importantly, their digital strategy is disrupting the way drinks are delivered. By using their app on your mobile phone, you can pre-order, pay, and your drinks will be waiting for you when you arrive. As you might expect, they also upsell you with rewards or questions like "Would you like a fresh pastry with that for $1.99?" You hit "yes, please" and the spend-per-customer-visit just went up. Out of the gate, the app was so successful when it went live, it overwhelmed the staff and they had to slow down its full deployment to get the kinks sorted out. We see that as a good problem to have. Culture-wise, the company is famous for their training and support of higher learning and they pegged an outstanding 88 points out of 100 on our culture score. Rent cheque-wise, the dividend has been growing at 25% per annum over the last five years and the latest increase was just that, 25%. Assuming that continues (and we think it can), that means it doubles every three years or so.

Finally, in late June, we acquired a stake in integrated oil producer/refiner **Suncor Energy Inc.**, where we have been biding our time waiting for the energy news to get so bad that it's good. That patience allowed us to acquire Suncor with more than a 3% dividend. Even through the tough sledding of the oil and gas market over the last three years, Suncor has managed to raise its dividend at an annualized rate of 32%. More importantly, management has demonstrated considerable street smarts, acquiring assets on the cheap when the industry is in a tailspin – the most recent examples being Canadian Oil Sands in February 2016 and Petro-Canada in March 2009. Dare we call that opportunistic aggregation? Moat-wise, the multi-decade resource base translates to no exploration risk, allowing the company to concentrate on reducing cost per barrel of oil produced. Their latest estimate of oil sands cash operating costs is below $23 CDN per barrel. The refinery business also buffers some of the cyclicality. Management-wise, we note seasoned tenure for most executives and a bias to hiring from within. The proof is in what they do, and when you stack Suncor up against its peers, you will find it rests in the top quartile across most measures that matter to shareholders.

That concludes the portfolio upgrades, and to fund those upgrades, there obviously had to be some sells. We sold the highly cyclical and exceedingly well-managed **Valero Energy Corp.**, notching a 3.65% gain this time around. We would be happy to own Valero again at some point. **VF Corp.** was also sold, over concerns about a waning business model, pegging a 4.51% loss. We were disappointed in their last quarterly earnings report and their long tenured (but freshly minted) CEO, Steve Rendle, has done little to articulate a better path forward. **Hormel Foods Corp.** was cut loose, notching a loss of 6.64% because we saw far more upside in investing in Bank of the Ozarks. Our most painful sell was **W.W. Grainger, Inc**.,

where we notched an 11% loss. This former e-commerce innovator of industrial supply has been out-innovated and is trying to make up lost ground by cutting prices and making it up on volume. For us, this is a no-win strategy, so we take our lumps and move on.

If the losses mentioned above seem discouraging, please keep in mind what you are not seeing in this report – that is, the stocks in the portfolio that have not been eliminated and are doing exceedingly well, i.e. **Dollarama** with a ~57% gain, **Marsh & McLennan Companies** at ~+47%, **CCL Industries** at ~+42%, and **Microsoft** at ~+32% (none of these figures include dividends).

The table below reflects every dividend-paying company held within **The Dividend Value Discipline™**. The median 3-year dividend CAGR (compound annual growth rate) is 14%, which translates to a "double" every 5.3 years. Using our apartment block analogy, what is the chance that someone could pry (buy) you out of an apartment building that you owned if your rent cheque was going up at 14% per annum?

| | Company | Annual Rent Cheque | Yield | 1-Year Dividend Growth | 3-Year Dividend CAGR | 5-Year Dividend CAGR | Years to Double Rent Cheque* | Aggregator/ Disruptor? | Consecutive Years of Increase | Rent Cheque Increased in last 12m? |
|---|---|---|---|---|---|---|---|---|---|---|
| 1 | SKYWORKS SOLUTIONS INC | $1.12 | 1.18% | 7.7% | 47.4% | n/a | 1.8 | Disruptor | 2 | ✔ |
| 2 | CCL INDUSTRIES INC CL B | $0.46 | 0.71% | 15.0% | 27.9% | 24.1% | 2.8 | Both | 15 | ✔ |
| 3 | LOWES COMPANIES INC | $1.64 | 2.10% | 30.2% | 26.0% | 22.3% | 3.0 | Aggregator | 54 | ✔ |
| 4 | CUBESMART | $1.08 | 4.46% | 20.0% | 25.2% | 20.2% | 3.1 | Aggregator | 5 | ✔ |
| 5 | STARBUCKS CORP | $1.00 | 1.72% | 25.0% | 24.4% | 22.7% | 3.2 | Both | 6 | ✔ |
| 6 | TJX COMPANIES INC | $1.25 | 1.75% | 26.3% | 23.1% | 23.2% | 3.3 | Both | 20 | ✔ |
| 7 | CVS HEALTH CORP | $2.00 | 2.48% | 17.6% | 22.1% | 25.1% | 3.5 | Aggregator | 9 | ✔ |
| 8 | EXPEDIA INC | $1.12 | 0.76% | 12.0% | 19.3% | 20.5% | 3.9 | Disruptor | 5 | ✔ |
| 9 | INTUIT INC | $1.36 | 1.03% | 9.7% | 18.4% | 17.0% | 4.1 | Disruptor | 6 | ✔ |
| 10 | CANADIAN NATIONAL RAILWAY | $1.65 | 1.58% | 10.0% | 18.2% | 17.1% | 4.2 | Neither | 5 | ✔ |
| 11 | SHERWIN WILLIAMS CO | $3.40 | 0.96% | 1.2% | 15.6% | 16.9% | 4.8 | Aggregator | 38 | ✔ |
| 12 | PEYTO EXPLORATION & DEVELOP CO. | $1.32 | 5.62% | 0.0% | 14.5% | 17.1% | 5.1 | Neither | 0 | |
| 13 | BANK OF THE OZARKS | $0.70 | 1.45% | 11.1% | 14.2% | 22.9% | 5.2 | Aggregator | 7 | ✔ |
| 14 | AMERISOURCEBERGEN CORP | $1.46 | 1.54% | 5.4% | 13.6% | 19.5% | 5.4 | Neither | 12 | ✔ |
| 15 | NIKE INC | $0.72 | 1.23% | 9.1% | 12.9% | 13.9% | 5.7 | Disruptor | 9 | ✔ |
| 16 | AMPHENOL CORP | $0.64 | 0.88% | 10.3% | 12.5% | 25.0% | 5.9 | Aggregator | 5 | ✔ |
| 17 | DOLLARAMA INC | $0.44 | 0.36% | 12.8% | 12.4% | 15.9% | 5.9 | Disruptor | 6 | ✔ |
| 18 | MARSH & MCLENNAN COS INC | $1.50 | 1.92% | 15.4% | 12.3% | 10.8% | 6.0 | Aggregator | 7 | ✔ |
| 19 | MICROSOFT CORP | $1.56 | 2.29% | 6.1% | 10.7% | 13.5% | 6.8 | Both | 13 | ✔ |
| 20 | STANTEC INC | $0.50 | 1.54% | 10.6% | 10.6% | 10.8% | 6.9 | Disruptor | 4 | ✔ |
| 21 | SUNCOR ENERGY INC | $1.28 | 3.41% | 10.3% | 7.9% | 20.7% | 9.2 | Neither | 1 | ✔ |
| 22 | GREAT WEST LIFECO INC | $1.47 | 4.19% | 6.1% | 6.0% | 3.6% | 11.9 | Aggregator | 2 | ✔ |
| 23 | BANK OF NOVA SCOTIA (THE) | $3.04 | 3.91% | 4.1% | 5.9% | 6.3% | 12.1 | Disruptor | 6 | ✔ |
| 24 | CONSTELLATION SOFTWARE INC** | $5.21 | 0.79% | 0.0% | 0.0% | 0.0% | n/a | Aggregator | 0 | |
| 25 | CAMECO CORPORATION | $0.40 | 3.39% | 0.0% | 0.0% | 0.0% | n/a | Neither | 0 | |
| 26 | ARC RESOURCES LTD | $0.60 | 3.54% | -7.7% | -20.6% | -12.9% | n/a | Neither | 0 | |

*Based on 3-year Dividend CAGR (Compound Annual Growth Rate) - as of July 4, 2017
**Constellation Software's dividend rate is in USD ($1.00 per quarter), but the payments are made in CAD and therefore vary with currency fluctuations

By far, the most commonly asked question over the last 90 days has been the same question we had in Q1 – what about Trump? Meaning, what kind of impact is the Washington chaos going to have on our investments? We see the answer as largely unknowable and prefer to put our efforts into finding companies that will continue ***disrupting and aggregating*** their way to ***ever-increasing rent cheques***, regardless of who is in the White House. We believe that we have made considerable progress on that front over the last 90 days and look forward to sharing the results in the coming months.

**Blessings to you and your family for a great Canadian summer,**

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