RAYMOND JAMES | CHRIS RAPER & ASSOCIATES

The Opportunity Update – Wednesday, June 14th, 2017

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Track #1: Introduction - The Skinny

Hi, this is Chris Raper, Senior Vice President & Portfolio Manager, Private Client Group of Raymond James Ltd. & co-founder of **The Dividend Value Discipline™**. Welcome to **The Opportunity Update**, which is being recorded for you in Victoria, BC on Wednesday, June 14th, 2017. Here is what we are going to cover today:

You are now listening to **Track #1: The Introduction**, where I give you the skinny on what I am going to talk about.

On **Track #2: The Markets - Growth Sans Trump** I will follow my usual course and update you on our favourite leading economic indicators: the price of copper and semiconductor index, and being a Canada domiciled investor, speak to the oil and gas complex (where it is getting so bad, it's getting good - at least from an investment perspective) and the closely related Canadian dollar. Then I will speak how the Trump Bump has become the Trump Dump, while pointing to the global growth that is happening despite the Whitehouse hysteria.

On **Track #3: The Dividend Value Discipline™ - Rhubarb or Strawberry?** that's an obvious summer twist akin to the family reunion where Aunt Sally asks you what kind of pie you want and you respond with "both please". Likewise, when we have to choose between investee companies that are growing by disrupting their industry and/or aggregating their way to faster growth, our preference is "both please". If you are not sure what that means, stick with me, we'll tackle that shortly and give you live examples as we walk through our new acquisitions since the last recording - namely Bank of the Ozarks, Skyworks Solutions Inc. and Starbucks Corp.

On **Track #4: The Wrap Up - A La Mode SVP**, I will review the key takeaways from each track and give you some insight on how we intend to put the ice cream on both slices of pie through the summer months.

Track #5: Postscript I is where I walk you through our core investment program, **The Dividend Value Discipline™**, its methodology, return objectives and all-in costs. This track is primarily for the benefit of potential clients who are being introduced to us by way of this recording. By the time you are done listening you will know what makes the process unique vis-à-vis our competition and whether or not you are interested in pursuing it any further. Not interested, not interested right now, and let's talk further are all perfectly acceptable answers.

Track #6: Postscript II is again for the benefit of prospective clients. It will give you some insight on what to expect during our initial meeting, where we both want to answer the question, "Is there a fit between our services and your needs?"

In terms of legal requirements – the opinions that are expressed on this recording are mine. They may differ from those of Raymond James Ltd.

I am also required to tell you that Raymond James Ltd. is a member of the Canadian Investor Protection Fund. That is a good thing, and if you are interested in those details, please ask me or any one of our relationship managers the next time we speak.

I also want you to recognize that some of the things I am going to say today are going to be proven wrong. It is an inevitable part of this business. It is also important to recognize you don't have to be right all the time, to do well. You just have to be more right than most or conversely, less wrong than most. When we are wrong, our intent is to acknowledge it quickly and adjust accordingly - we try to keep our losses small.

Finally, regarding investment jargon, when I say I am bullish, it means I expect things to go up; when I say I am bearish, it means I expect things to go down. Likewise, north means up and south means down. When I speak about rent cheques, I am speaking about income, primarily dividends. You will also hear me using the term disruptor, which is our moniker for those companies that are disrupting or re-inventing the way business is done in their particular market, and thereby able to grow at rates far beyond the rate of the economy. Think of Wal-Mart twenty years ago and Amazon today. You will also hear me use the term aggregator, which is our moniker for those companies that have a systemized approach to acquiring smaller competitors as a means to fuel their growth. Said growth is the path to increasing dividends or in our language, growing rent cheques. If you catch me using industry jargon beyond that, I invite you to call me out. Send an email to the office and the team will let me know, usually with considerable gusto!

That’s a wrap on the skinny, and off we go to Track #2.

Track #2: The Markets - Growth Sans Trump

Let's start with our economic weather vanes. We track the price of copper because copper goes into almost every manufactured good you can think of. The theory is a rising copper price translates to better economic growth, whereas the converse is also true. Here's the recent history: on the December recording, copper was trading at $2.58 per pound, March at $2.69, and as of an hour ago, $2.59. For your further reference, please be aware that prior to the Trump election, copper had spent most of 2016 sub $2.30 per pound. Our take is that notwithstanding the paralysis of the Trump economic agenda, demand for copper remains well above last year and that has to be a good thing! Similarly, when we look to the raw material of the developed economies - semiconductors, we note that the Philadelphia Semiconductor Index (symbol $SOX) is currently at 1,090 versus 980 in March and ~900 on the December recording...it was 600 in the early months of 2016. Anyway you shake it, economically speaking; this too is a good thing. In short, both indicators are pointing towards better economic growth and we are seeing that in all of ancillary data. Furthermore, we are really encouraged with broadening of that growth. It is no longer just a U.S. story. The Asian economies are growing and even Europe is finally getting in on the action.

Turning to the oil and gas complex, most of you will be aware that we have been in the "difficult to get excited" camp for some time now. We remain of the opinion that OPEC's effectiveness will wane over time and the frustration of individual OPEC members will only grow as they cut their supply, and consequently their revenues, only to see that same barrel of oil replaced and sold by somebody else (least of all an American) but that is exactly what is happening. Sooner or later they will start to cheat on their production quotas and supply will grow. Contrast that bearish view with the following: the fast money crowd/hedge funds are back to selling oil they don't own in hopes of buying it back cheaper. These speculative oil shorts are notorious for all piling on the wrong side of the boat, and they have recently piled on. When we look at the sector's investor sentiment, it is pessimistic in the extreme. Those latter two factors are actually bullish. Bottom line, we have a bearish supply side argument yet we have the contrarian position on the short sellers and sentiment - what gives? What gives is the demand side of the equation. When we look to total U.S. product inventories, we see that they have now been below the five year average for the last 15 weeks. Accordingly, our take is that demand is growing faster than supply at a time when investor sentiment is negative in the extreme and the complex has sold off by some 20% from its year-to-date high. Those conditions don't come along that often, so it won't surprise you that we upped our exposure in Arc Energy and Peyto last week, and may do more in the weeks ahead. While we are not raging oil bulls you can certainly mark us down for "so bad, its getting interesting".

That lead us the to the closely related Canadian dollar, which marked a new 52 week low in early May at $0.7254 and almost scratched the $0.7600 level this morning. Assuming we have the oil price direction right, we could see our loonie getting to the $0.77 USD level before I am back to you in September, but I wouldn't hold out for that. If I needed to buy U.S. cash, I would do it today. Like oil, I expect the ride to be a choppy one and our loonie looks deeply overbought in the short term, thus vulnerable to a pullback.

Let's recap thus far – copper up and significantly above 2016 levels, the $SOX up big time and oil demand is robust. All of these things point to a growing global economy notwithstanding the Whitehouse shenanigans and Trump's stalled economic agenda which included tax reform, repeal or replacement of Obamacare, and a huge spend on infrastructure. On those three fronts he might be batting 100 at best. As I outlined on the last recording, Trump Expectations Appearing Real, the so called Trump Bump was bound to wane as investors who bid up U.S. financials, energy stocks, and a host of others that were to benefit from proposed policy changes now find themselves underwater and are looking to sell - so much so that we are happy to take a few of them off their hands.

To quote Buffett again "If you mix your politics with your investment decisions, you're making a big mistake."

We are now off to Track # 3.

Track #3: The Dividend Value Discipline™ – Rhubarb or Strawberry?

Before I get to our summer twist, I need to inform you about a change in format. Our normal course for this track has been to review both the new companies added and those that have been eliminated from the program and the rationale for those decisions. Starting today, we will no longer be reviewing the eliminations in this broadcast format. Here's why: all of the recordings get posted to our website and the distribution list goes well beyond our client base. That makes it at least plausible for someone to "freeload" on our work while our clients pay. That just strikes us as wrong. We will also gain a few minutes of recording time to share the new investee companies' story. Please note that clients will continue to get emails on the buys and the sells decisions with the concluding rationale and results thereof.

With that preamble out of the way, let's get to rhubarb or strawberry, i.e. do you prefer a company aggregating its way to a higher rent cheque, or disrupting its way to higher rent cheque? Both please, and here are some are some live examples.

With the stalled Trump agenda, U.S. financials sold off and we were able to buy Little Rock, Arkansas based **Bank of the Ozarks Inc.** (OZRK), 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 Chief Executive Officer. From humble beginnings (I think they had two branches at the time), Gleason's personal commitment to excellence has generated phenomenal growth while keeping profitability, loan quality, and capital efficiency well above industry average. There is a consistent history of buying smaller tuck-in acquisitions which 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 continues to grow at strong double-digit rates. In fact, it seems they are overtly focused on growing the dividend, i.e. the company has increased its quarterly cash dividend in each of the last twenty-seven quarters. Please note that most companies make that decision once a year. In the same ilk, the firm just raised some $300 million in another secondary stock offering which tells me there is more aggregation in the works. Reading the research prepared by our analyst group, I can't help but wonder if we just hired the Warren Buffett of banking.

Next up was **Skyworks Solutions Inc.** (SWKS), an enabler of mobile connectivity and an innovator of high performance semiconductors connecting people, place and things. If you are wondering what that really means, tear off the back cover of your smartphone and stare into the bits that make it work.

In there you will find a Wi-Fi receiver, an antenna tuner, a power management chip, an amplifier, a quad GSM chip, a GPS tracker and a few other bits that I can't even pronounce. A lot of those components were engineered by Skyworks - and it really doesn't matter what brand of smartphone you are carrying. Now think about that concept and expand it every mobile device or service that you can think of, be it streaming audio/video like Spotify, social media like Facebook, or an autonomous car - the latter of which will gobble up 2,500 times more data than the average person uses today. In short, Skyworks provides solutions to move all that traffic around. Their vision is "connecting everyone and everything, all the time." Our take is that we should recognize just how fast that market is growing.

Management-wise, Board Chairman, David Aldrich has led the company since it became a public company in 2002. Likewise, CEO Liam Griffin has been around since the company's genesis as well. All in, the average executive tenure is 13 years. Compensation is "performance-oriented" and the median stock ownership is 3.2 times total compensation. They scored a respectable 78 points out of 100 on our proprietary culture rating system and it seems that their employees agree with recent Best Place to Work awards from the Boston Globe and Orange County, amongst others.

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 Internet of Things. It is not a stretch to say they are the leading, maybe even disrupting the mobile connectivity business. We are enthused to see the rent cheque ramping up and expect to see more of the same in the future. The payout ratio is a modest 20%, so lots of runway left on that front.

The last of the new buys happened just this week with our purchase **Starbucks Corp. (SBUX)** - a company that needs little in the way of introduction. When this name was first brought to my attention, I have to confess, I was a little skeptical. I wondered just how many more Starbucks locations there could possibly be. While there may have some truth of that bias in North America, it turns out the world and especially Asia, can absorb a whole lot more Starbucks stores - and that's only part of the growth story. To wit, they are opening three new stores a day and one of them is in China. 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 good problem to have.

What about the culture? I am glad you asked. There are over 300,000 people who put on the green apron each week. Most of them are happy to be there and the company is famous for their training and support of higher learning, i.e. the Starbucks College Achievement Plan. Management-wise, the recently retired CEO, Howard Schultz, took the company public in 1992, with 165 stores operating – today they are north of 23,000. Kevin Johnson since took the reins having been with the organization a relatively short eight years. Median executive tenure is 15 years. All in, Starbucks hit 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. If that happens, what do you think the chance is that the stock price is the same as it is today 3 years from now? How about 6 years from now? Interesting fun fact: the U.S. makes up 81% of Starbucks sales, some $3.4 billion, and in their last investor presentation they stated that their China business will eventually overtake their U.S. business...I guess they do have room to expand.

That completes the new additions to the program and we are off to Track #4.

Track #4: The Wrap Up - A La Mode SVP

First the takeaways:

Track #1: Introduction – The Skinny: A reminder, the opinions that are expressed on this recording are mine. They may differ from those of Raymond James Ltd. Please recognize some of what I told you is going to turn out to be wrong and when it becomes evident we are wrong, our intent is to acknowledge it quickly and adjust accordingly. The strategy is to keep the inevitable losses small and let the winners run.

Track #2: The Markets - Growth sans Trump - We started with our leading economic indicators, where both copper and the semiconductor index are pointing to further economic expansion and oil demand is definitely growing. Globally, we are seeing better growth and it is broadening, especially Asia and to a lesser extent, Europe. The Trump Bump is moving towards the Trump Dump and we see that as an opportunity to buy some of the companies that ran away from us right after the U.S. election.

Track #3: The Dividend Value Discipline™ - Rhubarb or Strawberry? - When it comes to aggregators or disruptors as a means to higher rent cheques, our preference is for both. While Bank of the Ozarks is more of the former, you can certainly make the case that Skyworks and Starbucks have both attributes fueling their growth. Our job is to find more like them and our research team continues to focus on doing just that.

Track #4: The Wrap Up - A La Mode SVP - Perhaps the easiest way to explain the "ice cream with my pie" is the way we look at some of our aggregator/disruptor companies. I spoke with a client earlier this week explaining our thinking on Expedia. Here's what I said: "I don't care who is running the Whitehouse, our bet is that Expedia is going to keep on disrupting and aggregating the online travel business globally, and that is going to lead to far higher rent cheques in the future. Furthermore, we expect those higher rent cheques to drive the stock price higher." That's how we intend to put the ice cream on the pie.

With that I will bid you a good summer adieu.

If you are a potential client being introduced to us by way of this recording, please take the time to listen to our refreshed Tracks #5 & #6.

To our clients, thank you for taking the time to listen. On behalf of the entire team here at Chris Raper & Associates, this is Chris Raper, wishing you good day and may God bless from Victoria, BC on Wednesday, June 14th, 2017.

Track #5: Postscript I – The Dividend Value Discipline™ Methodology

The first thing to note is that **The Dividend Value Discipline™** is core to everything we do – meaning if we were approached by a prospective client and we determined that our core investment process did not fit with their investment philosophy or their need, then we are not the right advisors for that particular client – there is no fit.

You should also be aware that nothing gets any more attention at our shop than this program. The lion's share of our client assets are allocated to the program, and that includes our most senior people, my family, and me. The takeaway is that my team and I have huge vested interest in ensuring the success of the program.

The process is discretionary, meaning we make all of the buy and sell decisions and report to you after the fact. Post a new purchase, our normal course is to send an email outlining the background of the company and the rationale for the decision, five business days after it settles to your account. When we close out a position, we also send an email outlining the result and our rationale.

Our objectives for the program are:

- Income every month - that can be paid out or reinvested;
- An acquisition process where we buy **only** those securities which become attractive on a "go forward" basis;
- Absolute returns of 8%+, each and every year.

Long term performance-wise, we started **The Dividend Value Discipline™** in the fall of 2002, and the average annualized return for all of the accounts that were opened that year (that are still in operation) is +7.94%, net of fees, as at the end of 2016. Throughout the course of our 14 calendar year history, we have had 13 years of positive returns and 9 years where we met or exceeded the +8% objective.

Those results have been achieved by focusing on three keys objectives, so let's walk through this with the illustration of a three legged stool.

The First Leg is Dividends

Every security that we buy must provide some form of income. We do that because income makes portfolios inherently less volatile, i.e. less chance of loss. The analogy I like to use is that of an apartment block versus a piece of raw land – it is a lot easier to hold onto the apartment block in a tough real estate environment when you are getting a rent cheque every month. Income drives stability and absolute returns.

The Second Leg is Value

Our research function is in-house. We were one of the first private client teams in the industry to have a dedicated analyst on staff and we add additional resources every year. Our objective was (and still is) to get to the truth. We do not want to depend on any outside analysts that we have little or no contact with. One of the great things about having an in-house investment team is that I can ask questions until I am satisfied that we have the right answers. We spend an inordinate amount of time studying the corporate culture. If you are interested in what that looks like, read ***Good to Great*** by Jim Collins – that is the yardstick we use to measure potential investments against. Another yardstick is the importance of wide economic moats. You can hear more on that subject by archiving the September 2013 edition of this recording on our website. We believe that the focus on great corporate culture and wide economic moats gives us an edge. Anecdotally, we can provide you with lots of evidence to support that. I remain convinced that having your own people who are totally dedicated to the investment process adds a lot of value not available at most other private client focused groups.

The more recent development in our strategy has been tackling the growth problem. History buffs will note that when we started the program in 2002, we had 5-year GICs yielding 5%, much better economic growth, and stocks benefiting from decreasing interest rates, whereas today we have 5-year GICs yielding only 2%, subpar economic growth, and the headwinds of rising interest rates. In short, the 8% is tougher to come by.

Accordingly, we spent late 2015 and 2016 tackling the "growth problem". We need to find companies that are growing far faster than the economy. As you would expect, we start within the normal confines of "has to pay a rent cheque, score well on the corporate culture front and have some sort of strategic advantage (the moat) that makes the company difficult to compete with". We then focus on those companies that have demonstrated their ability to grow their dividends at double-digit rates as a primary indicator of growth and capital gain potential. As we searched, we found that most such companies fell into one of two themes. They tend to be disrupting the existing marketplace with a better way of doing things or they tend to be aggregating their way to growth by buying smaller tuck-in acquisitions. More detail on our "disruptors and aggregators" themes can be found on the May 2016 edition of The Strategist which is archived on our website. I am happy to report we are currently bearing the fruit of those efforts.

The Third Leg is Discipline

Here I refer to the buy/sell decisions. We often identify extremely attractive value propositions and then delay the buying decision, why? Because, if you are the only guy in the world that sees it as undervalued, you can wait a very long time for the market to recognize that value – in other words, the stock price doesn't rise or worse, it goes down! Those are not comfortable situations so we try to avoid them. We buy when it is apparent that the market is starting to recognize the stock as undervalued. One of the most helpful indicators is positive relative strength – i.e. is the security in question starting to outperform its peer group and the market? Because if it isn't, there is little incentive in owning it. Sell decisions can be triggered by a number of things – when the company fails to materialize as expected, when a company's stock price exceeds what we believe it to be worth, negative relative strength, or when we find a better opportunity elsewhere. In reality it tends to be a combination of those factors.

Perhaps the most important part of the buy/sell discipline is the way we operate the program – we call it "The Buys Only Mandate". Unlike our competition, we only buy those securities which become attractively priced on a go-forward basis, meaning if you start today and your brother starts three months from now, your portfolios are going to be different in the short-term, and more closely aligned the longer you are in the program together. As rational as that might seem, most people do the exact opposite. Every time you buy a mutual fund, you buy a pro-rata share of an existing portfolio – by definition, you got the buys, the holds and the near sells. To us, that is not rational. Would Warren Buffett buy 100 companies in a single day? Were they all great value propositions? You should also be aware that most third party money management programs work exactly the same way – they buy the basket. Our objective is the protection of your hard earned money and we believe that the buys only mandate is consistent with that objective.

Other key points to the program: a fully invested account would normally have 20 to 25 positions in it, so we are relatively concentrated. Our fees are 1.75% per annum plus the GST or HST – it is tax deductible for non-registered accounts. Our target return is 8%+, net to you.

You should also know that when I buy for you, I buy for me. When I sell for you, I sell for me – same time, same price – and that statement also applies to our most senior people as well. Furthermore, every person on our team participates in our profit sharing plan, which means they have a vested interest in looking after you.

Generally speaking, we are looking to establish new relationships with new clients that have north of $1 million in investable assets. That said, I'm a lot more interested in where you are going, than where you are. If you have a credible plan to get to that number say within a three to five year period, we are very interested in meeting with you.

To conclude this track, if income and absolute returns are attractive to you, and you think that there may be a fit between your objectives and those of **The Dividend Value Discipline™**, then I would suggest a face to face meeting is in order. You can check out what to expect during that initial meeting by moving to Track #6 – “Is There a Fit”, and that is where we are going right now.

Track #6: Postscript II – "Is There a Fit?"

Our objective – and presumably yours – during the first meeting is to figure out whether or not we have a basis for an ongoing relationship. In essence, can we work together? If so, will it be mutually beneficial? Job one is to get your tough questions off the table, so we encourage people to ask whatever is on their mind. Our responsibility is to be forthright with our answers, regardless of what it is that you might want to hear.

Before we enter into any new relationship, one of the biggies we ask ourselves is, "can we add significant value?" To answer that question we need to learn some things about you, your family, your finances and what your ideal future looks like. If you are not really sure on the latter point, we have some thinking exercises that will take us through that process.

Next we will walk you through an a la carte menu of our services that are most applicable to you. We'll outline how we will report to you and who the key relationship people will be. You will also have a very clear picture of the costs involved.

Before you leave we'll outline how we see our program fitting with your situation, or not. We will not ask you for a go/no go decision at the meeting and quite frankly, we don't want to be pressed for a decision that day either. We'll schedule a meeting of the minds call, say a week out, and then mutually agree on the best course of action from there.

At the end of the day, we are in the business of keeping our clients' most challenging financial decisions consistent with their life goals. Our mission is ongoing progress towards those goals, and the result we seek is appreciative clients who are increasingly confident about their future.

So…if that process sounds engaging, I invite you to call and book some time. If you'd like further information, including access to our quarterly communication pieces, you can check us out on the web at www.chrisraper.com and send us an email from there.

This concludes "Is There a Fit".