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Dear fellow investor

A great first year

DivGro's mission is to be the go-to home for investors seeking above average returns that are easier to hold. Thank you for investing alongside us and continuing to both introduce new investors and add meaningfully to your existing investment in the fund.

The portfolio captured 37 dividend raises with an average dividend increase of 13.92%.[1] The Fund's gross underlying return in USD was 15.52%, the underlying return in USD net of fees and expenses was 14.50%.[2] These are strong results in any context, so much more so in the difficult recent environment.

We do not benchmark our fund against any index, but for those in our investor community who do, we are confident the DivGro Fund performed much better than your likely comparator.

Aside from both absolute and relative performance, we want to reemphasize the importance of attaining and broadcasting our sequence of 37 consecutive and meaningful dividend increases. We are convinced that the visibility of this process, together with the on-time quarterly distributions to you are mission-critical tools in settling investors' minds and enabling investors to stay on course and reap the benefits.

Because of this unique duality of investor benefits – psychological and financial – we are convinced this holistic approach is an ideal home for one's investable assets. We believe that we are the first and only

[1] See dividend track record table attached at the end of this letter.
[2] See overleaf for a more detailed performance breakdown.

fund in Australia, and likely globally, to have retained a team of psychologists to help us advance these dual benefits.

Our investors know that we think in US Dollar terms. We happen to be based in Australia and take investor applications in Australian Dollars. However, most of the companies that meet our exacting quality thresholds are based in the USA and their businesses are denominated in USD. Our portfolio currently comprises 33 companies, of which 31 are priced in USD and pay us dividends in USD.[3] Accordingly, we track our performance – change in dividends and long-term change in price – in USD terms. We break out our results into underlying, or core, results in USD, and then report our AUD results also, without taking too much of a view as to currency fluctuations. As you know, soon after receiving your investment dollars in AUD we convert them into USD. Similarly, after we collect our USD dividends, we convert these back into AUD to be paid out to you.

Performance summary: 15 August 2019 to 31 July 2020[4]

Dividend performance	
Number of dividend increases	37
Average increase	13.92%

Unit price performance[5]	Gross	Net
Performance (underlying), USD	15.52%	14.50%
Performance, AUD	9.58%	8.62%

It is no coincidence that the average change in dividends and the increase in the fund's value are so similar. For dividend paying companies, over the long arc of time the price of a security is expected to move roughly in line with the change in its dividend. Therefore, for outstanding companies such as ours, we expect our capital to grow over the long-term almost in lockstep with our dividend increases.

COVID-19 update

The pandemic has obviously been a very testing investment environment – we would not have chosen this as a backdrop to open a funds management business. However, on the plus side, it has provided a perfect litmus test to showcase the distinction between robust dividend payers and raisers relative to others. Not all sources of income are equal; many have simply evaporated under pressure. Conversely, as our investors would know, our MIT sourced dividend-growth system has delivered for over 60 years and continues to do so now. There are many reasons for why dividend-growth companies continue to outperform – they are qualitatively better across most important metrics, including for example financial strength, superior competitive positioning, high quality and more aligned management etc. There are very

[3] Our other two positions are denominated and pay dividends in GBP and HKD.
[4] The DivGro Fund opened to investors on 15 August 2019.
[5] Inclusive of distributions.

few companies able to continue paying and increasing dividends during this crisis – most of these exceptional companies are either held in this fund or are on our watchlist. This is possibly best captured by Geoff Martha – Medtronic's CEO: "at a time when a lot of our competitors… are raising capital, we're raising our dividend. And I think that speaks to two things… our financial health and the strength of our balance sheet as well as our commitment to shareholders".[6]

As a further concrete example of outstanding companies being able to pay and raise dividends, especially recently, in July we recorded our 37th consecutive dividend increase – this time from MSCI increasing the quarterly dividend from $0.68 to $0.78 per quarter, or an increase of 14.71%.

A case study of outperformance

Perhaps this year-end letter is an opportunity to explain why our companies have outperformed generally, and throughout the pandemic specifically.

Consider the case of Home Depot (HD). By way of background, investors would be familiar with the fact that one of our first investments in the fund was in Lowe's Companies (LOW), with its record of consecutive dividend increases dating back to 1961 at an average rate above 15% per annum annualized. This translated into Lowe's recording investment returns of multi-thousand times and both HD and LOW will have been among the best investments of all time. We discussed our investment in Lowe's and its extraordinary dividend legacy in a write up in the AFR,[7] and LOW has doubled in price since our last purchase.

Shortly after our first Lowe's purchase we also initiated an investment into Home Depot. As the COVID-19 crisis unfolded we quickly increased our position, making it our largest holding, and it remains so today.

Home Depot controls approximately 15%[8] of the home improvement and hardware market in North America, with Lowe's controlling about 10%.[9] While there are many thousands of competitors, no one competitor is very meaningful. Due to the disproportionate scale and cost advantages, together both HD and LOW effectively dictate their competitive landscape, i.e. if HD and LOW wanted to damage or destroy competitors, they could do so overnight by dropping prices. They would remain highly profitable themselves, but their competitors would collapse. HD and LOW's suppliers are completely dependent on them as their largest sales channel, while their customers are highly fragmented and completely dependent on them as well.

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[6] Medtronic CEO Geoff Martha presenting at Bernstein 36th Annual Strategic Decisions Conference, 29 May 2020.
[7] *Yield Hunt in Uncertainty*, Australian Financial Review, 6 May 2020 - [https://www.afr.com/wealth/personal-finance/where-to-hunt-for-dividends-in-an-uncertain-world-20200429-p54obd].
[8] Home Depot 2019 annual report.
[9] Lowe's Companies Strategy and Performance Overview presentation, 31 January 2020.

The underlying market for home improvement must grow because much of it (e.g. paint, lights, fertilizer etc) simply wear out or run out and must be replaced on a predictable timetable, while new build construction is a bonus. Therefore, even though the underlying market grows at (only) about 5% a year, these incredibly favorable dynamics allow HD and LOW to grow sales ahead of market by gradually taking market share from competitors, while operating leverage, efficiency gains and the ability to invest capital internally at extremely high rates of return combine to generate mid-teen earnings and dividend growth. This has been the case for decades and their seemingly impregnable positions suggests to us an expectation of this continuing into the far-reaching future. Reinforcing this argument is the low-value, low-margin, awkward to deliver product profile, and the customer tendency to want to touch and feel the merchandise, especially the pro customer. Due to this, both HD and LOW only recently transitioned online on their own terms and are already two of the largest global online retailers.[10] We think these factors reduce the likelihood of an Amazon-type threat. Furthermore, neither HD nor LOW has shown any propensity to compete directly with each other, over many years, neither in terms of location nor price.

It so happens that both HD and LOW have been substantial beneficiaries of the crisis and we have profited very handsomely from these holdings.

Introduction to the concept of privilege

Indeed, we think the HD/LOW dynamic is illustrative of an incredibly favorable industry structure we internally refer to as privilege. This is a circumstance where due to known supply and demand side factors, one or sometimes two of the leading incumbents effectively exert unfair power and set the rules of the game, allowing continued extreme profitability which would otherwise soon be competed away.

We love this kind of special circumstance because whenever it arises a business is able to defend itself from competitors – providing us with a genuine business margin of safety – while at the same time being able to create unfairly high sustainable profitability. We think that when we find these exceptional situations we stand to make 15-20% per year for a very long time. Often a rapidly increasing dividend points towards this, and we think we have identified several such prospects. We have been building meaningful positions in these wonderful companies and look forward to sharing these insights with interested investors.[11]

A note on timing

Some investors remain on the sidelines, hoping to time their entry just right. While we always exercise valuation discipline, we find that being in the right company/investment is generally even more important, especially as the time horizon extends. For the long-term investor, a company's ability to invest a portion -

[10] According to a May 2020 report by eMarketer, Home Depot is the 5th largest e-commerce business by sales volume in the US.

[11] We have been incubating a complementary sub-strategy to harness these rare but potentially outstanding investments where we think we can generate supernormal returns of 15-20% over a very extended period. Please reach out directly if you would like more information on this.

(with the other portion coming our way as a dividend) - of the cash it generates at a very high rate of return within a powerful business franchise will generate far greater returns than any skillful timing.

Administrative update

We are in the process of finalizing the financial year-end tax statements which will be sent out soon.

We had originally intended to hold a year-end function to thank our investor community while at the same time showcasing some of our key investments. Unfortunately, due to the virus we have had to put this function on hold for now. For those investors who would nevertheless like this in-depth discussion, please reach out to schedule a meeting.

While the COVID-19 lockdown was at its most stringent we began experimenting with evening webinars to explain some key principles of dividend-growth strategies and the role of psychology in investing. These have been popular far beyond our expectations. Thank you to everyone who has participated and recommended these webinars to friends and family. We enjoy building the learning community around these webinars and hope that we can host some in-person sessions in the future. For now, we continue the online version about twice a month.

Concluding remarks

We opened the DivGro Fund on 15 August 2019 and have had an excellent first year, despite the challenging backdrop. We are very thankful to you for introducing new investors, supporting us and continuing to add meaningfully to your investment in the fund alongside us. Receiving cash monthly from existing and new investors allows us to continuously deploy capital into our best ideas and take advantage of temporary price dislocations to either build new positions or meaningfully add to existing ones at attractive prices.

We look forward to building on this first successful year long into the future!

Thanks again for your continued support.

Sincerely,
Jonathan & Barney

DivGro Fund dividend increases[12] [13]

Increase Number	Declaration Date	Company Ticker	Dividend Increase %
1	14-Sep-19	AMT	20.25%
2	18-Sep-19	MSFT	10.87%
3	19-Sep-19	MCD*†*	7.76%
4	19-Sep-19	TXN	16.88%
5	22-Oct-19	V	20.00%
6	29-Oct-19	CTAS	24.39%
7	30-Oct-19	SBUX	13.89%
8	31-Oct-19	CDW	28.81%
9	01-Nov-19	ABBV	10.28%
10	07-Nov-19	AL	15.38%
11	14-Nov-19	NKE	11.36%
12	15-Nov-19	ROP	10.81%
13	25-Nov-19	BDX*	2.60%
14	03-Dec-19	MA	21.21%
15	04-Dec-19	SYK	10.58%
16	04-Dec-19	ECL	2.17%
17	11-Dec-19	ZTS	21.95%
18	12-Dec-19	AMT	20.24%
19	13-Dec-19	ABT	12.50%
20	20-Jan-20	MTY.TO*	12.12%
21	24-Jan-20	YUM	11.90%
22	29-Jan-20	MKTX	17.65%
23	29-Jan-20	SPGI	17.54%
24	29-Jan-20	SCHW*	5.88%
25	05-Feb-20	CME	13.33%
26	06-Feb-20	ICE	9.09%
27	10-Feb-20	QSR	4.00%
28	20-Feb-20	DPZ*	20.00%
29	20-Feb-20	SBAC	25.68%
30	24-Feb-20	HD	10.29%
31	13-Mar-20	AMT	20.00%
32	01-Apr-20	WSO	10.94%
33	15-Apr-20	COST	7.69%
34	23-Apr-20	POOL	5.45%
35	19-May-20	AMT	19.57%
36	21-May-20	MDT	7.41%
37	28-Jul-20	MSCI	14.71%
		Average	**13.92%**

[12] * represents companies no longer in the DivGro Fund portfolio.

[13] † reintroduced as a holding in the DivGro Fund.

Important disclaimer

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