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Dear fellow investor

Celebrating our 50th (!) consecutive dividend increase

On December 2nd Stryker announced a 9.6% dividend increase – powered by 40 years of sales growth above 15% per annum.[1]

More importantly, this announcement represented DivGro's 50th (!) consecutive dividend increase.[2]

We love these dividend increases, all 50 of them!

Indeed, we are unaware of any investment house, anywhere, that over the same period was willing or able to commit in advance to showcasing any dividend upgrades on any stock, let alone across the entirety of their portfolio. Under normal circumstances we estimate the probability of forecasting 50 consecutive dividend increases (even independent of increase magnitude) as being extremely remote, let alone under crisis conditions such as the recent pandemic.

As our investors know, every dividend increase magnifies the cashflows we receive. While we love receiving this extra cash - who wouldn't - what is even more important is the hidden value creation implicit in this process. Specifically, our system unearths those rare and elite businesses which can reinvest most of their profits internally at extremely high rates of return, while sharing a sliver of their rising profits with us as dividends. Therefore, evidence of such dividend increases in our companies signifies a roughly proportional embedded uplift of underlying earning power which over time translates into roughly equal uplifts in share prices (as per the MIT inspired Gordon Growth Model).

[1] Stryker 2019 annual review.
[2] See dividend track record table attached at the end of this letter.

Since we last wrote, our system predicted and captured the following meaningful dividend increases:

Visa	6.67%	Cintas	10.20%	AbbVie	10.17%
CDW	5.26%	Air Lease	6.67%	Roper	9.76%
Nike	12.24%	Stryker	9.57%	Ecolab	2.13%
American Tower[3]	19.80%	Mastercard	10.00%	Zoetis	25.00%

Performance summary:

Dividend performance	
Consecutive dividend increases[4]	54
Average dividend increase	13.05%

Unit price performance (net of fees)[5]	
USD, annualized	20.49%
AUD, annualized	13.22%

Unusual times bring unusual opportunities

The crux of the DivGro system is that over time share prices rise proportionately with underlying increases in company dividends. From time to time, however, share prices might move faster or slower than the rate of change of their dividends which may create additional opportunities for our system to exploit.

A recent case in point:

Pre-pandemic we held a core position in Domino's Pizza (DPZ) which has been an outstanding dividend performer (see also DivGro Dividend track record #28, increase of 20%). Domino's share price rose sharply as the crisis unfolded, deemed to be a key winner due to its leadership in delivery. We chose to take an approximately 30% gain since the sharp price movement exceeded what we felt justified by our assessment of Domino's underlying dividend dynamics.

We redeployed into Medtronic (MDT) - a wonderful company - where the price was temporarily depressed due to elective surgeries being put on hold. Medtronic has demonstrated remarkable staying power throughout its existence. We took the view that because of Medtronic's privileged position in the medical devices space, together with its substantial cash holdings, it was near certain to navigate the pandemic successfully and continue to raise its dividend throughout. Essentially, the combination of a falling share price coupled with our expectation of continually rising dividends spelled opportunity in this case.

[3] Annualized, American Tower raises quarterly.
[4] Correctly predicted in advance by the proprietary DivGro system, from 15 August 2019 onwards.
[5] Inclusive of distributions, as of 30 November 2020.

Shortly after our investment, Medtronic announced its 43rd consecutive annual dividend increase (see also DivGro Dividend track record #36, increase of 7.4%) which helped catalyze the subsequent price appreciation over the following months. Once again, while Medtronic is the sort of quality company we could hold forever, its rapid rise of over 20% happened to coincide with a correction in the Domino's price. On this basis we exited a highly profitable position in Medtronic into a renewed holding in Domino's. Our assessment is that Domino's future dividend growth will materially outpace that of Medtronic, even though both Domino's and Msedtronic are priced at roughly similar valuations.

Of course, we gratefully collected our dividends from both Domino's and Medtronic during our holding periods. "

When the cartel is with your customer

Typically, cartels are understood to mean a set of arrangements where mostly manufacturers/suppliers collude to set prices artificially high to gouge all customers. The usual response from both customers and regulators is to view such arrangements extremely unfavorably and cartels are therefore generally deemed illegal.

In the case of Costco – which we have always held – an unusually interesting circumstance has arisen.

Effectively, for a nominal annual fee, Costco has combined with its 105 million cardholders[6] to lean as aggressively and effectively as possible on its suppliers to offer the best merchandise at the lowest price. This is particularly unusual because most of Costco's suppliers are the global titans of consumer goods manufacturers. To enforce this peculiar dynamic, Costco first carries one and only one brand in each sub-category of merchandise so that suppliers' positions in Costco's warehouses is essentially all-or-nothing. The second step in this dynamic is Costco's annual 'reverse auction' whereby only the lowest price bidder wins the coveted spot in the sub-category (provided quality is regarded by Costco as sufficiently excellent).

When traditional supermarket rivals happen to source merchandise extremely sharply, they tend to add and keep this extra margin for themselves. Costco on the other hand, irrespective of how cheaply it sources its merchandise, never marks up its wares by more than 14%. The result is that Costco's warehouses – if viewed as a traditional retailer – are engineered to just break even after accounting for warehouse operating costs. This creates two distinctive outcomes that are extremely difficult (if not impossible) to challenge: 1) to compete on price rivals would need to run their businesses on a sub-economic basis, and 2) Costco's members (correctly) believe that Costco is truly looking after them by sourcing the best merchandise at the lowest possible price.

This unusually close bond between Costco and its 105 million 'partners' (members) has enabled the creation of the Kirkland home brand which is universally viewed as excellent. For qualification as a Kirkland supplier Costco requires a qualifying product to be at least 1% better than the next best branded good. This helps explain the otherwise unusual contradiction where a home brand product is even more desirable than the

[6] Costco Today presentation, 4th Quarter FY 2020.

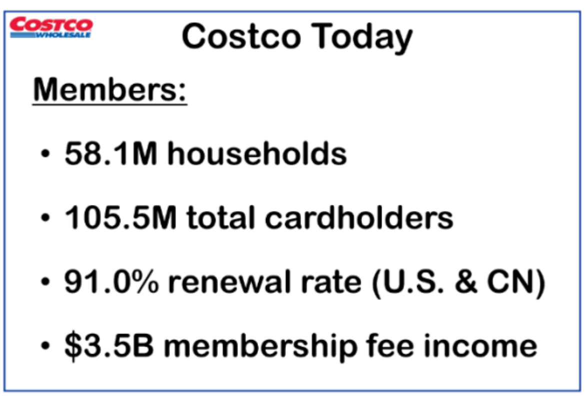
leading branded item in its category. As an example, a few years ago, the Kirkland golf ball became the rage in American golf clubs. When interviewed on Golf.com to explain the unusually high performance of the ball, CEO Craig Jelinek commented that "all Kirkland Signature products must be equal to or better than the national brands and must offer a savings to our members."[7]

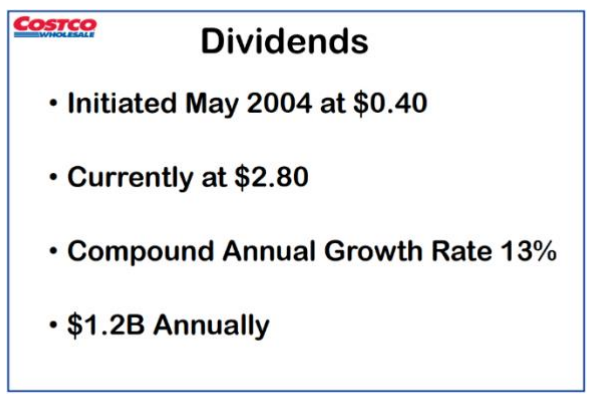
Indeed, Kirkland is fast becoming one of the world's best and biggest multi-category consumer goods brands.

In a further demonstration of the cartel-like bond between Costco and its members, consider the damage wreaked on American Express when it refused to improve its terms on the AmEx-Costco co-branded credit card. On the announcement of Costco dumping AmEx for a Citi-Visa card, American Express' stock fell the most in 5 years, while being forced to announce that it would impact 1 in 10 of their cards in circulation.[8]

By acting so diligently for and on behalf of its members, and by limiting its 'take' from this arrangement to a nominal annual fee, Costco is much more accurately described as a buying agent rather than an ordinary retailer. This also explains that although Costco has outperformed its sector for decades it is still generally (mis)understood by many analysts as a 'supermarket with a margin problem'.

Due to the unusual cartel-like structure between Costco and its members, not only is Costco a favored place to shop (as evidenced by membership retention rates consistently above 90%)[9], it has also been an equally effective destination for an owner. As in the charts below, Costco has raised its regular quarterly dividend at a compounded annual rate of 13% since initiating its dividend in 2004. In addition, Costco has rewarded its owners with spectacular periodic 'special dividends' which often equate to several years of regular dividends in one tranche.





Costco FY2020 4th Quarter investor presentation

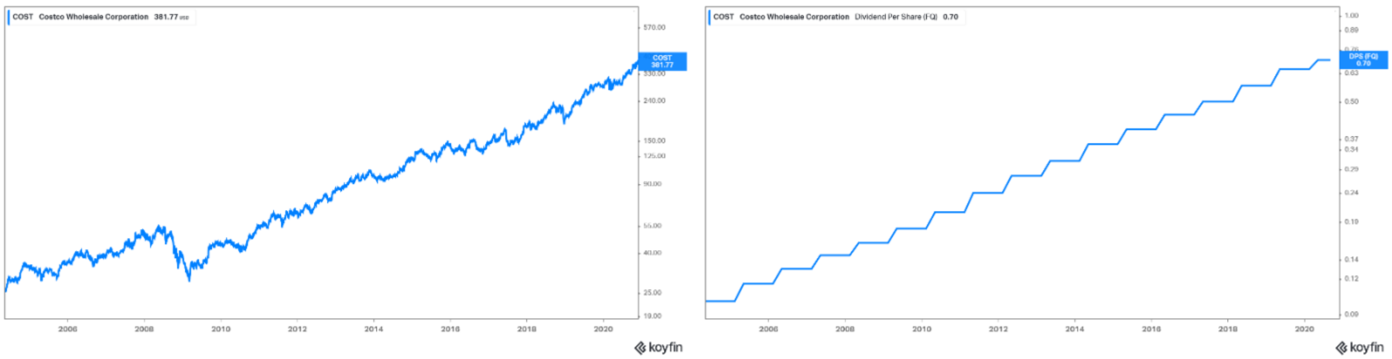
[7] Golf.com, 'Costco Tight-Lipped About Its Mysterious Golf Balls' 15 December 2016 https://golf.com/gear/costco-tight-lipped-about-its-mysterious-golf-balls/.

[8] Wall Street Journal, 'AmEx-Costco Divorce Shakes Up Card Industry' 12 February 2015 https://www.wsj.com/articles/american-express-to-lose-costco-exclusivity-1423746408.

[9] Costco Today presentation, 4th Quarter FY2020.

As we highlighted in our ***Weekly Dividend Progress*** update,[10] tomorrow we will receive another Costco ‘special promotion’ in the form of a $10 per share special dividend, equal to 14 quarters (!) of regular dividends.

Costco is a genuine dividend machine illustrating that by shifting our focus from erratic prices to more predictable dividend changes, we can keep counting our dividends while waiting for the price uplift to follow suit. (By the way, since initiating its dividend in 2004, $10,000 invested in Costco has become $141,000.)



Left: Costco price chart 10.5.2004 to 30.11.2020. Right: Costco dividend chart 10.5.2004 to 30.11.2020.

In summary, Costco is a cash machine expertly disguised as a supermarket.

Thanks again for your continued support.

Sincerely,

Jonathan & Barney

[10] DivGro Weekly Dividend Progress newsletter, 20 November 2020.

DivGro Fund dividend increases[11] [12]

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%
38	21-Aug-20	LOW	9.09%
39	10-Sep-20	AMT	20.00%
40	15-Sep-20	MSFT	9.80%

[11] * represents companies no longer in the DivGro Fund portfolio.
[12] † reintroduced as a holding in the DivGro Fund.

41	17-Sep-20	TXN	13.33%
42	30-Sep-20	SBUX	9.76%
43	23-Oct-20	V	6.67%
44	27-Oct-20	CTAS	10.20%
45	30-Oct-20	ABBV	10.17%
46	02-Nov-20	CDW	5.26%
47	09-Nov-20	AL	6.67%
48	12-Nov-20	ROP	9.76%
49	20-Nov-20	NKE	12.24%
50	02-Dec-20	SYK	9.57%
51	03-Dec-20	ECL	2.13%
52	03-Dec-20	AMT	19.80%
53	08-Dec-20	MA	10.00%
54	09-Dec-20	ZTS	25.00%
		Average	**13.05%**

Important disclaimer

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