DivGro

DivGro Pty Ltd
AFSL 238198 (CAR No. 1277044)
ABN 41 633 109 789
Level 10, Hudson House
131 Macquarie Street
Sydney NSW 2000
info@divgro.com.au

31 August 2022

Dear fellow investor

Three years of strongly rising dividends

To date we have reached several important milestones:[1]

- 105 consecutive correctly predicted dividend increases.[2]
- Average dividend increase of 15.62%.[3]
- 113 investor families in the fund.
- One institutional investor.
- 11 quarterly distributions paid, including three annual increases. Most recent distribution increase of 11.5%.
- Core underlying USD return of 41.83% net, or a compounded annual return of 12.35% net.[4]
- AUD return of 36.86% net, or a compounded annual return of 11.03% net.[5]
- 62 years of continuous empirical validation of the underlying Gordon / MIT dividend growth model.
- 95 weeks of real-time dividend progress reporting, enabling participants to feel the power of a dividend prediction machine in action.

Performance summary:

Dividend performance	
Consecutive dividend increases[6]	105
Average dividend increase	15.62%

[1] Past performance is not necessarily indicative of future results. Please see additional important disclaimers on the last page.
[2] See dividend track record attached at the end of this letter.
[3] Simple average, see dividend track record attached at the end of this letter.
[4] As of 15 August 2022.
[5] As of 15 August 2022.
[6] Correctly predicted in advance by the proprietary DivGro system, from 15 August 2019 onwards.

Return since inception - cumulative (net)[7]	
USD	41.83%
AUD	36.86%

Return since inception - annualized (net)[8]	
USD	12.35%
AUD	11.03%

Built to last

We have written before, but reiterate, that for an investor to succeed, only two things are needed:

(1) Identify a handful, or a few handfuls, of very good (or at least good enough) businesses which are built to last, and

(2) Develop a mindset which enables these to be held for the duration required to reap the rewards that these are built to deliver.

DivGro looks to solve (1) by focusing exclusively on businesses which possess certain important and hard to replicate privileges, and a shareholder-oriented mindset, which together translate into the ability and willingness to pay and raise their dividends consistently and sustainably.

DivGro looks to solve (2) by broadcasting the simplicity, clarity, and understandability of this methodology, together with a unique experiential journey, encompassing weekly dividend progress updates as well as the receipt of quarterly distributions in cash.

Having reached the three-year milestone, we think the foundations are in place to continue to deliver both essential requirements long into the future.

The past three years have thrown an unusual array of challenges at both companies and investors. We believe our portfolio has withstood admirably - both from a price standpoint, and more importantly, from a business perspective, each of our portfolio companies is bigger, stronger, more dominant within its marketplace, and critically, sends a much higher dividend our way than this time three years ago.

We highlight that, while we have made a few changes at the margin, the portfolio has been largely unchanged throughout, save for dynamically reweighting positions from time to time. We believe this illustrates that our company selection methodology has proven its mettle, especially when tested under fire.

Our go-to summary statistic which demonstrates our companies' enduring strength – and which we highlight each and every week – is that our holdings have delivered us 105 dividend increases since inception, averaging above 15% per annual dividend increase.[9]

[7] Net of fees and expenses, inclusive of distributions, as of 15 August 2022.
[8] Net of fees and expenses, inclusive of distributions, as of 15 August 2022.
[9] See dividend track record attached at the end of this letter.

To reiterate, our core belief, resting on the famed Gordon Growth Model, is that to produce consistent dividend increases of such magnitude, our companies' businesses must be performing internally approximately equally well.

Perhaps DivGro's most distinctive characteristic is our system of recalibrating the so called long-term into manageable one-week and one-quarter intervals, and broadcasting, through our weekly dividend progress updates, what we consider to be the most important, quantifiable, meaningful, and easy to understand metrics. In so doing, our overriding objective is to make DivGro the go to home for above average returns that are easier to hold.

A piggybank with a twist

To keep things simple – we want grandparents to be able to relay the strategy to their 10-year-old grandchildren and vice versa (we are very pleased so many of our investor families involve multi generations) – we focus our weekly updates on dividend increases and actual dividend receipts.

Importantly, the nature of our companies is that they typically pay us only a relatively small part of their profits. This means that the part not paid to us is held back by our companies to reinvest further into wonderful businesses for our benefit, on our behalf. In a typical example, it's as if when they pay us $1 in dividends, they retain $2 in a 'piggybank' with our names on it. But this is no ordinary piggybank! Instead of sitting there passively, our money in this piggybank is applied inside our businesses, at rates of return typically higher than 20% per year. In our experience, this 'piggybank' compounding effect is one of the best and most predictable sources of exceptional returns.

We referenced this phenomenon previously in our August 2021 letter.[10] We wrote about Lowe's which pays out in dividends approximately 30% of profits, meaning about 70% is retained by them on our behalf as shareholders. Lowe's has been able to consistently earn very high returns on these 'piggybank' savings year after year, and in 2022 for example, expects to exceed 36%.[11]

It is this reinvestment dynamic that powers Lowe's' ability to raise its dividend so strongly and sustainably. Applying the famous Gordon Growth Model which we have covered in detail previously, if Lowe's can keep raising its dividend so strongly, its share price will follow this upwards trajectory over time.

Below is a snapshot highlighting the 'piggybank' effect across a selection of our current larger holdings.

Company Name	Latest Dividend Increase	Payout Ratio[12]	Reinvested In 'Piggybank'	Return On Invested Capital[13]
Lowe's	31.25%	25.81%	74.19%	37.91%
Microsoft	10.71%	24.93%	75.07%	34.71%
Zoetis	30.00%	25.98%	74.02%	18.55%
Visa	17.19%	21.27%	78.73%	25.12%

[10] Our 15 August 2021 letter is available here.
[11] Lowe's reaffirmed 2022 full year guidance on Q2 2022 earnings call, 17 August 2022.
[12] Most recent reported quarter, data per YCharts.
[13] Most recent reported quarter, data per YCharts.

Watsco	12.82%	59.38%	40.62%	23.33%
Average	20.39%	31.47%	68.53%	27.92%

As made evident, with approximately one third of profits being paid out as quarterly dividends - helping keep us grounded on the upward dividend path - the two thirds reinvested (or 'piggybanked'), on average, is earning us around 28%. With reinvestment opportunities at high internal returns such as these, we are confident our companies can continue to sustain attractive dividend increases long into the future, and that per the Gordon Growth Model these increases will ultimately be rewarded with roughly commensurate share price increases.

Playing to win?!

As illustrated above, dividend growth investing is powerful both financially and psychologically. Since financial and psychological reinforcement are so important, we tend towards outstanding, dominant companies which pay us a component of their rising profits and reinvest the balance at high rates of return to keep our dividend growth process intact. The best candidates which reflect these attributes tend to be established, predictable and proven winners, albeit often deemed effective but unexciting.

This is not dissimilar from a century old debate in rugby. Does one play to entertain, or to win?

Players and crowds love open, running rugby, where the focus is on scoring tries - as many and as imaginative as possible. Of course, aiming for such tries is no guarantee that these will be scored. In fact, the more ambitious the attempt, the more room for errors to creep in, and indeed most such attempts don't materialize in tries but rather fail (otherwise very few scrums would take place). So, playing to entertain may not exactly gel with playing to win.

It is openly acknowledged that players and fans alike regard as boring or even negative when teams revert to scoring points by kicking (penalties or drop goals) instead of attempting to mobilize the opportunity towards scoring tries, even though these same players and fans would reluctantly concede that kicking for goal is more likely to be rewarded with points.

In fact, even the rules of the game have evolved to incentivize the scoring of more tries, as evidenced in the table below.

Date[14]	Try	Conversion	Penalty	Drop Goal	Goal from Mark
1886–1891	1 point	2 points	3 points	3 points	—
1891–1894	2 points	3 points	3 points	4 points	4 points
1894–1904	3 points	2 points	3 points	4 points	4 points
1905–1947	3 points	2 points	3 points	4 points	3 points
1948–1970	3 points	2 points	3 points	3 points	3 points

[14] Scoring system after the administration of the game was taken over by the IRFB – now known as World Rugby.

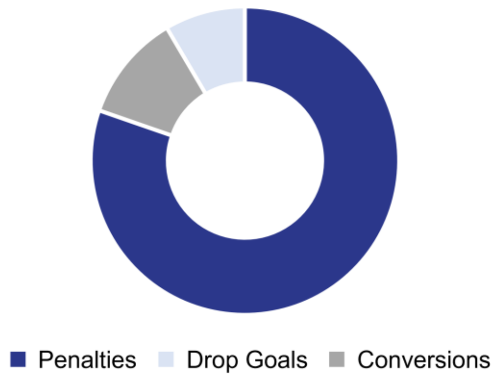
1971–1977	4 points	2 points	3 points	3 points	3 points
1977–1991	4 points	2 points	3 points	3 points	—
1992–present	5 points	2 points	3 points	3 points	—

Notwithstanding the efforts of the rule makers, as well as the preference of players, crowds and broadcasters alike – to maximize entertainment via scoring more tries – in practice, when the primary consideration is winning rather than simply playing or watching, teams inevitably revert to a tried and tested gameplan geared to more reliably delivering a winning formula.

Consider the history of Rugby World Cup finals, where the stakes are high, and the priority is to win at all costs. Teams quickly revert to a playbook where every single available point scoring opportunity on offer is taken by the highest probability alternative: kicking at goal. In the table below, both sides, not only the winning team, in every game bar one, scored the majority, and often all their points, by goal kicking.

Year[15]	Teams	Total Points	Points Kicked
1987	New Zealand v France	38	58%
1991	Australia v England	18	78%
1995	South Africa v New Zealand	27	100%
1999	Australia v France	47	79%
2003	Australia v England	37	73%
2007	England v South Africa	21	100%
2011	France v New Zealand	15	33%
2015	New Zealand v Australia	51	51%
2019	England v South Africa	44	77%

For the purists who may contend that conversions were a material part of this, we point out this is clearly not the case. Only 11% of the points scored by kicking goals were conversions, with 89% penalties and drop goals.



Clearly, when winning becomes paramount, the allure and excitement of the try is quickly forgotten and

[15] Tries in the 1987 and 1991 World Cup worth 4 points.

instead substituted for the best risk adjusted option which is to always attempt to kick at goal for every possible point on offer.

Teams are clearly maximizing the likelihood of victory, dull though this conclusion might appear.

In fact, analyzing the 2015 Rugby World Cup, The Economist found the expected value of an attacking scrum inside an opponent's 22 is 0.91 points, and for an attacking lineout just 0.72 points.[16] Since the tournament's penalty goal success rate was 78.01%, and a penalty being worth 3 points, it implies kicking for goal was about 2.5x more productive than venturing for a try. So, the article concludes "you should call for the kicking tee 99 times out of 100".

There is a further benefit to taking advantage of any available point scoring opportunities on offer. It is commonly understood that while a team is scoring, whatever the increments, players and fans alike feel an enhanced sense of comfort and confidence. Conversely, when attempts for tryscoring fail repeatedly, the exact opposite is experienced in that teams tend towards greater desperation to score which tends to magnify the occurrence of mistakes.

In investing, where the stakes are always high, the right approach would seem to be the one that matches the approach teams take in Rugby World Cup finals. As we have shown, teams uniformly default to the route which provides the highest probability of a good outcome. The investment parallel of this is exemplified by a dividend growth approach such as ours, where the reliability and consistency of rising dividends is prioritized. Not only does this keep the income scoreboard ticking (which per the Gordon model also drives share prices higher over time), but it simultaneously keeps the investor's mindset on-side.

A well-designed dividend growth approach requires companies that are built to last and prosper enduringly. DivGro implements this by frequently targeting companies which dominate seemingly mundane and more predictable niches, areas of the investment universe which perhaps counterintuitively have resulted in outstanding long-term performance, as well as an increasing probability of continuing to win well into the future.

Many other strategies, as well as common investor inclination, tend to chase glorious tries, irrespective of how psychologically challenging those pathways might be. DivGro instead aims to continue to accumulate our dividend increases consistently and reliably, thereby exploiting each 3-point scoring opportunity on offer. Having crossed our three-year milestone, we continue to believe DivGro's dividend growth approach provides the most compelling combination of high returns together with a psychologically <u>compatible path to actually get there.</u>

Thank you to all our dividend growth minded investors, and in particular to those among you who frequently refer more families our way.

Sincerely,

Jonathan and Barney

[16] *Why Rugby Teams Should go for Penalties not Tries*, The Economist, 16 October 2015.

Administrative update

In light of the growing number of investors in the fund, we have recently appointed Apex Fund Services to undertake a number of administrative and compliance functions for the DivGro Fund. Apex is a global leader in the fund administration space with 50 offices globally and more than 10,000 employees. You will shortly begin to receive communications from Apex on DivGro's behalf which will arrive from ssg.aus@apexfs.com so please add this email address to your safe sender lists.

DivGro Fund dividend increases

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%
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%
55	11-Dec-20	ABT	25.00%
56	19-Jan-21	CTAS	6.76%
57	27-Jan-21	SPGI	14.93%
58	27-Jan-21	MKTX	10.00%
59	01-Feb-21	YUM*	6.38%
60	04-Feb-21	CME*	5.88%
61	09-Feb-21	MCO*†	10.71%
62	11-Feb-21	WSO	9.86%
63	17-Feb-21	SHW*	23.13%
64	22-Feb-21	SBAC	24.73%
65	23-Feb-21	HD	10.00%
66	24-Feb-21	DPZ*†	20.51%
67	04-Mar-21	AMT	14.81%
68	14-Apr-21	COST	12.86%
69	04-May-21	POOL	37.93%
70	21-May-21	0700*†*	33.33%
71	27-May-21	LOW	33.33%
72	27-May-21	AMT	15.45%
73	08-Jun-21	HEI	12.50%
74	27-Jul-21	MSCI*†*†	33.33%
75	27-Jul-21	CTAS	26.67%
76	28-Jul-21	WING	21.43%
77	14-Sep-21	MSFT	10.71%
78	15-Sep-21	TXN	12.75%
79	16-Sep-21	AMT	14.91%
80	29-Sep-21	SBUX*	8.89%
81	26-Oct-21	V	17.19%
82	10-Nov-21	ROP	10.22%
83	18-Nov-21	NKE	10.91%
84	30-Nov-21	MA	11.36%
85	07-Dec-21	ZTS	30.00%
86	10-Dec-21	ABT	4.44%

87	12-Dec-21	SYK	10.32%
88	16-Dec-21	AMT	14.88%
89	26-Jan-22	MKTX	6.06%
90	09-Feb-22	EVO.ST	108.82%
91	10-Feb-22	MCO	12.90%
92	10-Feb-22	WSO	12.82%
93	22-Feb-22	HD	15.15%
94	28-Feb-22	SPGI	10.39%
95	28-Feb-22	SBAC	22.41%
96	01-Mar-22	DPZ	17.02%
97	11-Mar-22	AMT	12.90%
98	13-Apr-22	COST	13.92%
99	04-May-22	POOL	25.00%
100	19-May-22	AMT	12.60%
101	27-May-22	LOW	31.25%
102	25-Jul-22	MSCI	20.19%
103	26-Jul-22	CTAS	21.05%
104	27-Jul-22	WING	11.76%
105	23-Aug-22	INTU	14.71%
		Average	**15.62%**

* represents companies no longer held in the DivGro Fund portfolio.
† represents companies reintroduced as a holding in the DivGro Fund.
American Tower figures are annualized.

Important disclaimer

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