DivGro

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Dear fellow investor

Three years and five months of strongly rising dividends

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

- 118 consecutive correctly predicted dividend increases.[2]
- Average dividend increase of 15.20%.[3]
- 117 investor families in the fund.
- One institutional investor.
- 13 quarterly distributions paid, including three annual increases. Most recent distribution increase of 11.5%.
- Core underlying USD return of 37.18% net, or a compounded annual return of 9.69% net.[4]
- AUD return of 33.23% net, or a compounded annual return of 8.76% net.[5]
- 63 years of continuous empirical validation of the underlying Gordon / MIT dividend growth model.
- 116 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]	118
Average dividend increase	15.20%

[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 January 2023.
[5] As of 15 January 2023.
[6] Correctly predicted in advance by the proprietary DivGro system, from 15 August 2019 onwards.

Return since inception - cumulative (net)[7]	
USD	37.18%
AUD	33.23%

Return since inception - annualized (net)[8]	
USD	9.69%
AUD	8.76%

A measure of progress and psychological fortitude

As we have addressed many times before, the conventional reason for favoring a dividend growth strategy such as ours is because of the well understood and widely accepted Gordon Growth Model. As a reminder, Gordon's formula stipulates that the sustainable rate of change in a company's dividend will be reflected over time and at various points in time by an approximately equal rate of appreciation in the company's share price.

In other words, if for example, a company (or a portfolio comprising such companies) sustains a rate of dividend growth in the order of 12-15% per year, the expected return over time per Gordon's formula is a total return approximating (and powered by) this rate of dividend increase. Since this formula holds over time and at various points in time, this means that at other points in time, total returns, because of the vagaries of short-term share price movements, may exceed or trail the returns projected by the rate of increase of the underlying dividends.[9]

Since inception, as we convey each and every week,[10] DivGro has consistently produced dividend increases across our portfolio at an average rate of 15.2% per dividend, per company, per year, made up of a series of 118 discrete, consecutive dividend increases.[11]

Gordon's model is grounded entirely in stock price and portfolio return expectations, i.e. if one achieves the desired dividend increases, then capital returns should follow. It is important to highlight that this model was not derived in the common academic way of starting with a hypothesis and then seeing whether it works in practice. Instead, Gordon and his Nobel Prize winning colleagues exhaustively analyzed the empirical data from which they then deduced a model which was best able both to explain the data backwards and could be most reliably used for forward predictions.

[7] Net of fees and expenses, inclusive of distributions, as of 15 January 2023.
[8] Net of fees and expenses, inclusive of distributions, as of 15 January 2023.
[9] For a more detailed analysis please see our previous letters; specifically our May 2021 and February 2022 letters.
[10] Via our unique Weekly Dividend Progress emails. To receive these please subscribe here.
[11] Simple average, see dividend track record attached at the end of this letter.

Nevertheless, Professor Gordon, as a purely quantitative practitioner and theorist, did not consider any behavioral aspects or attributes beyond the strictly formulaic dividend and resulting price-driven outcomes of his strategy. But at DivGro, while we rest on Gordon's significant insights, we compliment his purely mathematical analysis by including the perhaps even more important behavioral benefits which can accrue from an expertly implemented dividend growth approach when it is also combined with our unique and innovative feedback framework.

As we have conveyed on multiple occasions, a dividend growth strategy is both backwards and forwards looking. **Grounded in consistently rising physical cash payments, each dividend receipt reconfirms the integrity of business results achieved to date (looking backwards), while each dividend increase rebases our cash flow higher and lifts us and our companies one rung further up on our collective compounding journeys (looking forwards).**

Distilling this real progress into one clear, understandable, and measurable variable allows us to communicate and instill among investors a true business owner mindset. When conveyed and reinforced weekly, this helps create a sense of emotional rootedness and connection in the face of the never-ending cycle of market vicissitudes, and simultaneously shortens the so called long-run into manageable short-run intervals.

By encouraging the physical receipt of quarterly distributions, in cash, and which have risen every year since inception by at least a double-digit percentage, together with weekly snippets of dividend growth progress, DivGro is replicating for our investors the attachment that private business owners generally develop when they experience their own consistent and strongly rising dividend streams.

So far at DivGro we have mainly described the dividend growth attributes which we believe upgrade and improve an investor's pathway to better install the emotional equilibrium required to stay on track. Revisiting our August 2021 letter:

"In the preface to Ben Graham's seminal book The Intelligent Investor, Warren Buffett wrote:

to invest successfully over a lifetime does not require a stratospheric IQ, unusual business insights or inside information. What's needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding the framework. This book precisely and clearly prescribes the proper framework. You must supply the emotional discipline.

Buffett loaded the emotional heavy lifting squarely on every individual investor, most of whom, in reality, are unable and unwilling to [successfully] bear this heavy burden."[12]

It doesn't matter how attractive any prospective investment return may be if the investor is simply unable to stay the course to ultimately get there. DivGro was specifically, and we believe uniquely, crafted to help solve for this (near) universal shortcoming.

[12] DivGro August 2021 letter to investors.

A (hidden) competitive edge

In recent years we have been expanding our thoughts regarding the impact of accelerated dividend growth on a company's wider group of stakeholders, and its competitive arena.

It is obvious that a consistently growing dividend becomes extremely supportive to the owners of the company. For a more detailed explanation for how and why this applies, please refer to our previous letters.[13]

Less obvious, but no less important, is the impact that a consistently rising dividend has on a wider set of stakeholders, including employees (both current and prospective), suppliers, creditors, rating agencies, financiers, and the wider community in which these companies tend to operate.

Simply put, in the eyes of suppliers, creditors and rating agencies, a rising dividend, especially a faster rising dividend, signifies that business is progressing particularly well and that the company expects this trajectory to continue. This makes perfect sense because dividend payments, especially rising dividend payments, are discretionary, therefore implying all preceding business matters have already been satisfied in full. Further, for companies with attractive reinvestment opportunities such as ours, this means that these growth investments have already been fully funded.

With a dividend increase signifying strong fundamental progress, suppliers become more comfortable in expanding their relationship, which will often encompass further financial investment on the supplier's part, perhaps also extending improved terms, while rating agencies tend to improve their credit ratings, thereby clearing a path to more flexible funding.

Implicitly, for the dividend raising company these dynamics shift the cost of business incrementally in its favor. While any such improvement may be barely discernible when viewed in real-time, when accumulated over decades these subtle shifts compound into significant business advantages.

Whereas suppliers, bankers and other creditors are generally wary of most businesses – it is not uncommon for great dividend raisers to increasingly enjoy superior terms, exclusive supply of products and the cheapest debt as they progress along the dividend raising path.

Indeed, by way of example, barely a quarter passes without Home Depot, held in the Fund since inception, detailing another supplier which has voluntarily agreed to exclusivity over their latest and greatest product line.

Employees, both current and prospective, invariably keep front of mind their job security and career prospects. We believe that in the eyes of employees there is no single stronger reassurance than the visibility of a strongly rising dividend. In announcing dividend increases, many of the best companies often attribute their expanding dividend success directly to the dedication and commitment of their employees.

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[13] Previous letters can be accessed here.

Costco, for example, which we have held since inception, deliberately overcompensates its employees relative to industry peers as a direct and public inducement towards greater loyalty and longevity, resulting in its remarkably low employee turnover which would otherwise cause significant search, on-boarding and training costs, the costly reality for most of Costco's competitors.

Lowe's meanwhile, which we have also held since DivGro's inception, habitually coincides its dividend increase announcements with relatively extravagant displays of morale boosting bonus awards to its front-line hourly associates in what it terms its 'Winning Together' program.

We believe that employees are acutely aware of their employer's dividend progress, and at least at the margin, strong dividend increases are conspicuous flags denoting job security and career progression.

Conversely, and more commonly, it is easy to imagine the drop in morale at companies which suddenly reduce or scrap their dividends. It doesn't require much employee foresight to see the dividend go first and expect to be next. Indeed, such an employee is much more likely to spend their day searching job listings than delighting customers.

It is dividend related nuances such as these which might not be obvious but are obviously important.

More than just an annual announcement

We haven't written previously about the effect that a relatively more aggressive, relatively unexpected (at least insofar as the competition is concerned) dividend increase can have on the competitive landscape.

Consider the case of two prominent competitors which completely dominate their relevant markets, are ubiquitous, and for generations have spent a great deal of time and effort jostling to outplay each other.

Coca-Cola (Coke) and Pepsico (Pepsi) boast two of the longest and most successful dividend growth records in existence, of 60 and 50 consecutive years respectively.

Throughout their storied histories, Coke has consistently lead Pepsi in the original core cola business, prompting Pepsi to become nimbler and more creative to compete better. Examples include Pepsi's clever and aggressive 'Pepsi Challenge' taste test campaigns which ultimately pushed Coke into its disastrous 'New Coke' misadventure, shifting the Pepsi portfolio into the quick service restaurant space, and tilting towards the snack food business in which Pepsi is now the dominant global leader.

It is worth also mentioning that DivGro has previously held an investment in Pepsi, as well as an investment in its quick service restaurants spinoff YUM! Brands (which in turn houses businesses such as KFC, Taco Bell and Pizza Hut).

In the table below are Coke and Pepsi's recent dividend increases:

Coca-Cola (KO)		Pepsico (PEP)	
Announcement	Increase	Announcement	Increase
17 Feb 2022	4.8%	3 May 2022	7.0%
18 Feb 2021	2.4%	4 May 2021	5.1%
20 Feb 2020	2.5%	5 May 2020	7.1%
22 Feb 2019	2.6%	30 Apr 2019	3.0%
15 Feb 2018	5.4%	1 May 2018	15.2%
16 Feb 2017	5.7%	2 May 2017	7.0%
18 Feb 2016	6.1%	3 May 2016	7.1%
19 Feb 2015	8.2%	5 May 2015	7.3%
20 Feb 2014	8.9%	6 May 2014	15.4%
Average	5.2%	Average	8.2%

Their respective increases are mainly rangebound within a few percentage points of each other. However, from time to time, it can't go unnoticed that Pepsi raises its dividend by roughly double Coke's magnitude, and interestingly we note that Pepsi typically announces its dividend increases a few months after Coke's announcement.

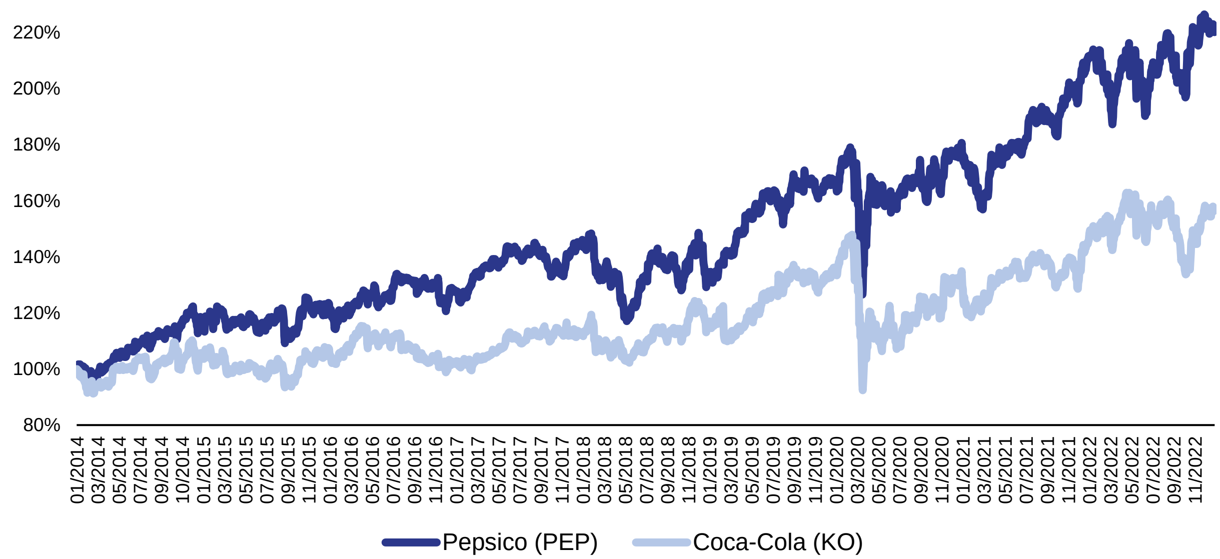
Companies don't operate in isolation, particularly in the case of fierce rivals, and our contention is that when Pepsi – given its proclivity towards creative disruption – hikes its dividend by roughly double Coke's dividend increase, it is doing so deliberately, and at least in part to outmaneuver Coke. The ability to raise dividends more rapidly is a direct consequence of a business that is performing better, and Pepsi can do so (while Coke is more constrained) largely because of its dominance in the faster growing snack food industry.

From our dividend perspective, Pepsi is showcasing that its business is outperforming its rival's, enabling it to reward its shareholders with faster rising dividends. We are confident that Pepsi's more aggressive dividend increases do not go unnoticed by Coke and its stakeholders, and will prove at least slightly, perhaps even substantially, disruptive to various functions at Coke, such as investor relations, public relations, HR and perhaps most importantly, feed into future capital allocation decisions.

Given that Coke and Pepsi are viewed by many as such a close pairing, we expect investors to keenly focus on this disparity at each interval and want to know why this is the case. Investors, analysts, and the media will surely tire quickly of being told that Coke can't, or chooses not to, match Pepsi's dividend growth rate (or that it doesn't even matter since Warren Buffett continues to hold his Coke shares anyway).

We think that Pepsi's dividend actions are both ratifying its improved business performance in its recent past, and more importantly, signaling, at least to believers in the Gordon formula, that it anticipates continued strong performance in the future – both at the fundamental business level, and in time, in a corresponding performance from its share price.

If we compare Coke and Pepsi from the point of this relative dividend increase rate variance in 2014, whereby Pepsi's dividend has grown at almost double the rate of its rival's, their share prices have indeed corresponded to their respective rates of dividend increases, with Pepsi's significantly outperforming Coke's.



To reiterate, we think there is no better single indicator ratifying the past and underwriting strong prospects than a consistently strongly growing dividend.

We relate this case to demonstrate the predictive effect that the variance in relative dividend growth can provide, and to show that a company raising its dividend more rapidly than its rivals can have a disruptive effect, even when applied to some of the strongest and most successful companies in existence. We chose this case not for the purpose of suggesting anything negative about Coke (indeed, it has one of the longest running consecutive dividend growth records), but rather to highlight that even amongst companies as robust as Coke and Pepsi, relative dividend outperformance proves both impactful and predictive.

In this instance we have compared two very strong and successful companies, simply because their names and products are likely more familiar. A much more disruptive circumstance would almost certainly arise in the case of a dominant company using its dividend flexibility as a disruptive weapon against weaker, marginal, or highly fragmented competition.

Many of our portfolio holdings enjoy a competitive landscape where one or two dominant players can raise their dividends rapidly, against a backdrop of many small, fragmented and generally weak competitors who cannot. In these instances, we believe that our rapidly rising dividends incrementally cement and enhance our incumbents' competitive advantages – bringing their stakeholders progressively more on-side – while at the same time further undermining, and often destructively so, their weaker competitors' positioning with their own stakeholders who may question why their chosen industry player cannot keep up.

The ultimate emotional compass

The trajectory of a dividend is perhaps most instructive when times are tougher than normal.

Many dividend raising companies, including some illustrious strong dividend growers of the past, have more recently tended to increase their dividends by what appears to be the least amount possible to be able to maintain (or ‘get away with’) their unbroken annual dividend growth streak, and without overly upsetting their stakeholders, particularly their shareholders. Walmart and Colgate are likely familiar examples of dividend growth that has slowed dramatically in recent years.

However, in our search for the highest quality, faster growing dividend raisers of the present and future, it is particularly advantageous where a company – especially in an otherwise adverse market environment – chooses to raise its dividend by much more than that which would have satisfied shareholders and other stakeholders.

Consider the cases of Cintas and Lowe’s, both DivGro holdings since inception:

Company Name	2021 Dividend Increase	2022 Dividend Increase
Cintas	26.7%	21.1%
Lowe’s	33.3%	31.3%

We believe that these companies’ shareholders, and their wider set of stakeholders, would have been entirely satisfied had they raised their dividends by a still impressive increment in the 12-15% range, particularly considering the more challenging business environment in which they were operating at the time. We contend that these companies are using their dividends as a flag to put their shareholders at ease, while demonstrating their conviction in their fundamental market power and their confidence of flourishing in any environment.

Companies like these recognize that while they may be unusually effective as wealth building machines, this on its own is insufficient because the path for an investor faced with constant noise from the financial media and moment-to-moment, largely random share price movements is not always as clear as the path seen through the eyes of those operating the company.

We find that often the most incisive examples or parallels emanate from the sports arena, which is why we sometimes use sport related examples to illustrate a point. Some of the very best dividend raising companies highlight their bond with their shareholders by exercising their dividend muscle and announcing unusually large dividend increases in moments that are otherwise difficult for investors to get through.

To imagine how these select companies relate to their shareholders, consider the legend of Llanelli, a small Welsh town which in 1972 took on the might of the touring New Zealand All Blacks. The result: Llanelli 9 –

New Zealand 3, is important, but Llanelli's skipper's legendary pre-match team talk is indicative of how the few great companies in which we seek to invest see themselves relative to their shareholder partners:

"I don't care what any of you have achieved… I am willing to give up all my caps, the Lions Tours, anything, for this one today…this is your club, it's my club…those people out there who have been at the ground since dawn… it's their club too. Your wives are up in the stands, they're here to support you; there are hundreds of kids in Llanelli this afternoon who won't get into the ground, they'll all be listening on radios at home or watching the match on the television. The whole town will want to know how the Scarlets are getting on against New Zealand. Those people who are here, and those that would like to be here but can't get in. It is their club too."[14]

Of course, no company can control its share price, nor the environment within which its shares trade. While most companies try to explain away their share price movements (offering limited, if any, reassurance), some of the very best dividend raisers behave in a manner suggesting they too understand the reassurance which can only be provided by a (real) cash dividend, and the even greater reassuring power accruing from a dividend increase of much more than would normally have been deemed sufficient. We believe that via the timing and magnitude of these significant dividend increases these special few companies are deliberately offering as much reassurance as is possible, in turn making themselves easier for shareholders to continue holding along their compounding journey.

While the specific decision-making process behind a company's dividend announcement is generally not disclosed, we nevertheless gain comfort from a large dividend increase in three ways: we feel the immediate positive impact of more cash received today; leading us to feel more psychologically and emotionally assured; and our stock's inherent value is rebased upwards (at least to us, per the Gordon formula) because of this enhanced current and expected cash flow profile.

Indeed, were Professor Gordon and his MIT colleagues still alive, we believe they would mark our dividend performance with an outstanding A+, and would mark the portfolio's price performance at this point in time with a very solid B+, but would also highlight their absolute conviction that if our dividend growth profile continues, they would have every confidence that the price performance would ultimately also score a corresponding A+.

Sincerely,

Jonathan and Barney

[14] Phil Bennett and Martyn Williams, *Everywhere for* Wales, 1981.

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%
106	15-Sep-22	TXN	7.83%
107	20-Sep-22	MSFT	9.68%
108	22-Sep-22	AMT	12.21%
109	20-Oct-22	WSO	11.36%
110	21-Oct-22	V	20.00%
111	10-Nov-22	ROP	10.08%
112	15-Nov-22	NKE	11.48%
113	6-Dec-22	MA	16.33%
114	7-Dec-22	SYK	7.91%
115	8-Dec-22	AMT	12.23%
116	8-Dec-22	ZTS	15.38%
117	9-Dec-22	ABT	8.51%
118	19-Dec-22	HEI	11.11%
		Average	**15.20%**

* 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.

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