DM Monthly Report

MARCH 2017

PORTFOLIO ACTIVITY

In February, we sold our holdings in Jean-Coutu Group (see description to right) and opened a new position in Prairie Sky Royalty Ltd., an energy company with high quality royalty interests across Western Canada.

FEATURE STOCK
Apple Computer (AAPL)

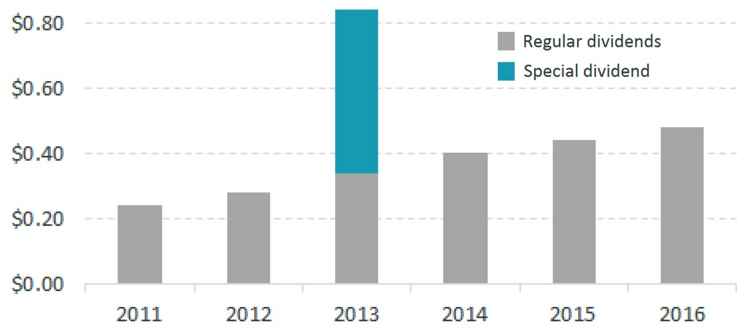
Following a lackluster 2016, AAPL shares have surged so far this year, gaining more than 20% in just over two months. In fact, the stock accounted for 123 of the 1000 Dow points as the index leapt from 20,000 to 21,000 between January 25th and the beginning of March. During the same interval, Warren Buffett revealed that AAPL is now Berkshire Hathaway's second largest portfolio position and its holdings amount to 2.5% of outstanding shares. In its recent earnings release, AAPL reported that it sold a record 78.3 million iPhones during the holiday quarter, even though the company wasn't able to meet demand for the very popular and high margin 7 Plus version. Despite this volume growth, switching from older models to the 7 was actually lower than previous conversions. This has some analysts predicting that the iPhone 8, due out this summer, could release a powerful wave of pent up demand.

PARTING WITH A PORTFOLIO FAVOURITE

Though we regularly rebalance equity mandates - *trimming names that we feel have gotten ahead of themselves and adding capital to those whose price is temporarily under estimating fundamentals* - we don't frequently sell positions outright. After extensive research and time spent with management, our goal is always to let value compound over as long a period as possible. There are four occasions, however, when we'll fully liquidate a position: (1) if our original investment thesis breaks down, (2) if the company becomes subject to an unfavourable regulatory or management change, (3) if we find a compellingly better use of portfolio capital, or (4) if the stock rises to such a degree that price significantly exceeds our estimate of intrinsic value. We recently sold our position in JeanCoutu Group (PJC) for the second reason, as the pharmacy franchisor faces potentially adverse changes to the province's drug pricing structure.

We first acquired shares of PJC in DM Canadian Equity six years ago when we were attracted to its stable cash flow stream and disciplined approach to capital deployment. The company is structured as a franchise operation, with roughly 3/4 of earnings flowing from a relatively stable and growing stream of royalties on underlying pharmacy sales and the other 1/4 generated through the manufacture of generic drugs. Management devoted a good portion of cash flow to share buybacks and dividend growth (see bar chart below), which helped to drive an annualized total return of nearly 13% during our time of ownership. Unfortunately, however, the drug pricing environment previously enjoyed by PJC could be about to change as the Quebec government gets set to implement its "Bill 81", an act that aims to reduce the cost of certain medications. Though it is uncertain whether the bill will be applied to its most adverse effect, our recent meeting with PJC management in Montreal confirmed that the change would have a material negative impact on both the company's top line and its margins. With this level of uncertainty surrounding the stock, we felt that our most prudent course was to exit the position in favour of more attractive opportunities.

PJC dividend history - *past 6 years*



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