DECEMBER 2019

Cardinal Update

Yield vs Growth and the New Global Income Portfolio

We have launched a new portfolio for clients who are more focused on income generation: the Global Income Portfolio.

Rest assured, our approach to this new portfolio does not drift away from our tried-and-true investment philosophy. All companies that Cardinal invests in, regardless of the portfolio, must pay a dividend. From here, the stock selection process is not as simple as it may seem. For a higher dividend yielding portfolio such as this one, you might expect our process to start by sorting a list of dividend paying companies and simply buy the highest yielding ones. We take a much more meticulous approach.

First, we are keenly focused on the quality of the dividends above all else. This means conducting in-depth research to understand how the dividend is funded. Does the company predictably generate cash flows in excess of what it needs to maintain its competitive position? Has this competitive position resulted in growing free cash flow or profitability and will it reliably extend into the future?

This is because all dividend yields are not created equal. In a majority of cases, dividend yields are a byproduct of company circumstances and market forces. Some companies pay out very little of their profits in the form of dividends as they see ample opportunities to reinvest. Others are in a more mature industry and pay out a majority of their profits to investors. And in the case of very high dividend yields, it could actually be a signal of a troubled future for the company and its dividend. Finally, a company's ability to grow the dividend over time is another extremely important factor for Cardinal. A couple of examples from our portfolios will help to illustrate.

DIVIDEND GROWTH: ALIMENTATION COUCHE TARD

On the low end of dividend yields, we own Alimentation Couche Tard (ATD), North America's largest convenience store and fuel retailer. ATD's current dividend yield is well under 1% as the company pays out just 10% of its earnings to shareholders as dividends. It is a clear example of a company reinvesting a majority of free cash flow or profits into growth opportunities, rather than returning it to investors. ATD has a long, successful history of acquiring new convenience store locations and dramatically improving their operations. The yield is low today, but the tradeoff is that over the past 5 years the company has been very successful in its acquisition strategy resulting in 20% annual earnings growth and 23% per year dividend growth. This dividend growing stock is a great fit for our Canada Plus portfolio and clients who have a long term investment goal of growth.

DIVIDEND YIELD: CT REIT

On the high end of dividends is CT REIT, the landlord for a majority of Canadian Tire's stores. CT REIT's current dividend yield is over 5% and it pays out 75% of its free cash flow as distributions to shareholders. CT REIT has contractual annual rent escalation and an alliance with Canadian Tire to buy and develop real estate. This opportunity set is much slower to develop than ATD's and as such the company does not need to retain a lot of its free cash flow in order to grow. The dividend yield is high, but the tradeoff is that over the past 5 years free cash flow per share has increased at 5.1% annually and distributions per year have increased by 3.2%. This REIT is a new addition for our Global Income portfolio, and ideal for clients that are looking for yield without sacrificing on quality.

ATD vs CT REIT is an extreme example of the differences in growth vs yield. Yet despite their differences, the common thread is the work we've done to understand the businesses and gain comfort in the respective companies' ability to continue to pay and grow their dividends. This is emblematic of the new Global Income Portfolio. The yield is higher than our other portfolios in order to provide an increased stream of dividends to clients, agnostic of market ups and downs, without chasing high yields just for the sake of it.

DIVIDEND INCREASES

Canadian Tire Corp.	9.6%
Merck & Co.	10.9%
Siemens AG	2.6%
Sun Life Financial	4.8%
TELUS Corp.	3.6%

(During the period November 1 to November 30, 2019)

Unless otherwise noted, the source of all data in this Update is Bloomberg and Cardinal. This Update is prepared for general informational purposes only. Statements about future performance may not be realized and past performance is not a guarantee of future performance. Cardinal does not guarantee the accuracy or completeness of the information contained herein, nor does Cardinal assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. The information and opinions contained herein are subject to change without notice.

© 2019, Cardinal Capital Management, Inc.
ALL RIGHTS RESERVED. NO USE, TRANSMISSION OR REPRODUCTION WITHOUT PERMISSION.

400-1780 WELLINGTON AVENUE • WINNIPEG, MANITOBA • R3H 1B3 • WWW.CARDINAL.CA

CARDINAL CAPITAL MANAGEMENT, INC.