AUGUST 2020

Cardinal Update

Strength That You Can Bank On

The current global crisis has created challenges for the broader economy, which in turn, has led to weakness in the share prices of Canadian banks. Coincidentally, Canadian bank shares recently traded down to lows last seen in the Global Financial Crisis, which also represents the last period of great stress the Canadian banks have gone through. Despite reaching comparable valuation levels, we remain heartened by the position of strength the Canadian banks are in both on an absolute basis and in relative comparison to this period.

First, despite a build-up of provisions that took place in Q2 and will continue in Q3, net charge-offs remain at relatively low levels compared to what has been reserved for. While we recognize that the write-off of a loan lags the recognition of a loss on the balance sheet, (i.e. under current accounting rules) banks actually need to reserve for losses in advance of when they incur the actual losses. There will be even further allowances built up in the coming quarters, so we are encouraged by the coverage the banks will have to absorb losses.

Second, the Canadian bank balance sheets are in a considerably better position than they were amidst the last crisis. Tangible common equity for the Big 6 Canadian banks has risen to $260B currently from $85B at the end of 2009, and is $44 versus $15 on a per share basis. This represents the tangible income generating assets of the banks. Following a similar trend, regulatory capital is in a far stronger position despite progressively more stringent capital rules having been introduced over the years. So in addition to the allowances to absorb losses, we believe this layer of excess capital will help to absorb any additional losses without threatening the viability of the banks.

Third, compared to the Global Financial Crisis, various fiscal stimulus programs have been introduced that have targeted both consumers and businesses directly, including the Canada Emergency Response Benefit ("CERB"), Canada Emergency Wage Subsidy ("CEWS"), and Canada Emergency Commercial Rent Assistance ("CECRA"). This is in addition to some of the monetary actions taken by the Bank of Canada to support liquidity in the financial system. We believe that these government programs will ultimately help to mitigate the losses that will be incurred by the banking system as it helps to partially bridge the population through unemployment back to reemployment as the economy reopens.

While we concede that there are countless uncertainties that reside ahead with respect to the path that the current global health crisis will take, we are confident in the ability of the Canadian banks to navigate this period of uncertainty. Lastly, while things could obviously change, given the circumstances and potential intervention by the regulator, our confidence in the Canadian bank's relative strength means that we do not anticipate any risk to current Canadian bank dividend payouts.

COMPANY FOCUS – HONEYWELL

Honeywell is a diversified industrial company with a high-quality management team and a proven track record of consistent performance over the long-run. Honeywell's strong balance sheet helps protect the company during downturns, such as the COVID-19-related one we are currently experiencing, and also presents growth opportunities via acquisitions.

The COVID-19 pandemic has created challenges in Honeywell's businesses that are exposed to the aerospace and energy industries. Honeywell manufactures aerospace parts for both original equipment manufacturers as well as for aftermarket replacement and thus the sharp decline in air traffic has pressured this segment. Weakness in the oil and gas end-markets has also been a headwind for Honeywell as they produce catalysts, adsorbents, and equipment for the industry.

While parts of Honeywell's business are facing pressures, the current environment has also created opportunities. They have a warehouse automation business that is thriving as social distancing and the shift to e-commerce drive accelerated orders. Honeywell has also dramatically expanded its personal protective equipment manufacturing capacity in order to meet the significant increase in demand.

The dividend has been increased at an 11.5% compounded annual growth rate over the last 10 years and the dividend yield is currently 2.4%.

DIVIDEND INCREASES

Walgreens Boots Alliance Inc.	2.2%

(During the period July 1 to July 31, 2020)

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

CARDINAL CAPITAL MANAGEMENT, INC.