

BMO Dividend Fund

Quarterly Commentary



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The 7 Effective Habits of Dividend Compounders

"The best way to predict the future is to create it"--Abraham Lincoln

Dividend Achievers, Aristocrats, Kings are all terms for businesses that have paid out consecutive dividend increases year in and year out for very long periods of time. These are the types of businesses that stand the test of time and make for sound investments vs trying to time 'get rich' trades linked to making macro bets such as economic re-openings and Fed (U.S. Federal Reserve Board) policy direction which have become a fixture of equity investing since COVID-19. Since the S&P/TSX hit the 2020 low the S&P/TSX Dividend Aristocrats have struggled to keep pace with lower quality and cyclical businesses given the emotionally charged and short termed nature of investors. Oddly enough, companies that have cut their dividends in the past have been outperforming the steady growers. Over the longer term, however, quality dividend growth prevails as a steady wealth building strategy.

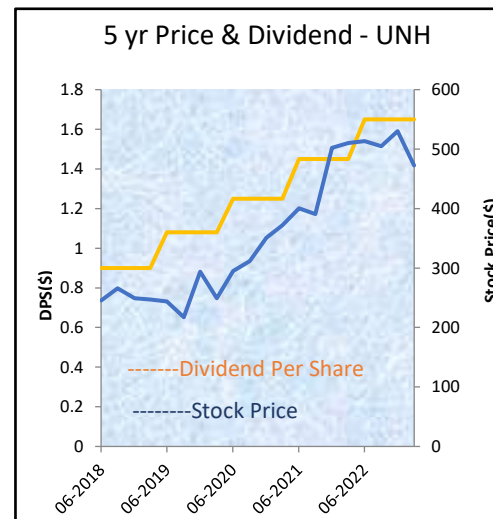
At the end of the day, we are looking for businesses that can generate more predictable cash flow streams, earn sustainably higher returns on capital, and create a variety of profitable growth avenues. How do companies do this? What is the secret sauce? While there are no perfect companies 100% of the time, we have come to realize that there are consistent traits of outperforming businesses that tend to transcend industry categories or GIC (Global Industry Classification Standard) classifications and deliver above average returns over the long haul. Namely, they tend to

- Build real competitive advantages that win profitable market share
- Compete to be differentiated and build true customer value
- Have loyal customers
- Enjoy pricing power and recurring revenues
- Dare to take offensive risks at opportune moments
- Lead on product and service innovation in an effort to reduce disruption risks
- Deploy capital in value enhancing ways

Three companies within the BMO Dividend Fund that are forging their own destiny and exemplify these traits are:

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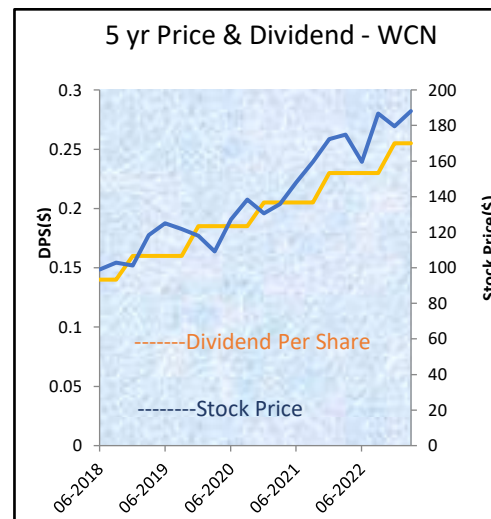
UnitedHealth Group Inc. (UNH-US) is the largest managed care organization (MCO) in the world, a true juggernaut managing critical healthcare benefits to over 46 million Americans. UNH is an exemplary dividend compounder benefitting from its massive scale advantage. Currently, UNH holds leading and expanding market share positions in Medicare Advantage and Commercial health insurance, while holding a major market share position in Medicaid. Market leadership is paramount given that economies of scale allow UNH to leverage their fixed cost base over a larger membership as well as the ability to negotiate better unit volume discounts at care providers which is ultimately a win for its customers and the entire health care system. UNH's scale advantage has been built both organically through strong customer alignment and value-added product offerings as well as through selective M&A. The company has been focused on building out the Optum business, which is a collection of complementary healthcare services assets including primary care facilities, a pharmacy benefit manager (PBM), and healthcare IT services. Optum is value accretive to UNH as it diversifies revenue sources, improves the moat of the core insurance platform, and provides UNH with a lever for long-term margin expansion and growth. Replicating this business would be very difficult for a peer to do given the time, capital, and asset scarcity hurdles involved. UNH benefits from a recurring revenue business model, adding an element of business predictability that we value as investors. The health insurance business involves collecting premiums on a recurring basis from members and earning a spread net of underwriting costs. Gross membership churn is minimal, with retention very high at 90%+ across its insurance lines. Half of the total earnings base comes from the core health insurance business, where membership across all 3 insurance lines has compounded at a CAGR of 8.2% since 2004. We continue to expect strong levels of membership growth into the future given the secular demand dynamics behind lines like Medicare Advantage. These dividend compounder attributes in combination with an undemanding valuation attract us to the opportunity at UNH.



Source - Morningstar Direct.
Data as of March 31, 2023

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Waste Connections (WCN-T) provides non-hazardous waste collection and related services. While seemingly a simple business, when we peel back the onion, WCN exemplifies many of the aristocratic traits we look for in a business. The company focuses in rural/franchise markets where there is typically little-to-no competition. Furthermore, the company often owns strategically located landfills that enhance the service level and productivity of its collection services. These landfills are very difficult to replicate by competitors given the significant regulatory and environmental requirements of these assets. Whether the customer is a municipality, a business, or a residential homeowner, waste collection is a vital service that is needed yet interestingly represents a tiny fraction of one's cost (and often times is an invisible cost). WCN's collection services generate highly recurring revenues by virtue of its mission critical nature. Furthermore, the pricing power of the company is significant. WCN has long term contracts which allow the company to price ahead of inflation. Inflation is the friend of WCN and this has been the hallmark of the company over the past few years as demonstrated by the notable price increases throughout the pandemic. Waste Connections is an exceptional business but what makes this company an aristocrat is its ability to deploy capital in value enhancing ways. Aside from paying a dividend, the company deploys significant capital towards consolidating the highly fragmented waste industry. The company has continually redeployed capital significantly above its conservative guidance on M&A. In addition, the company is investing in biogas recapture facilities at its landfill sites. These recapture facilities bolster very strong project IRRs (Internal Rate of Return) and boosts the company's environmental impact from an ESG perspective. We believe WCN is one of the best run companies within our portfolio and is led by a strong and conservative leadership team. WCN is an aristocrat in the truest sense and has been a long-term holding in the dividend fund.

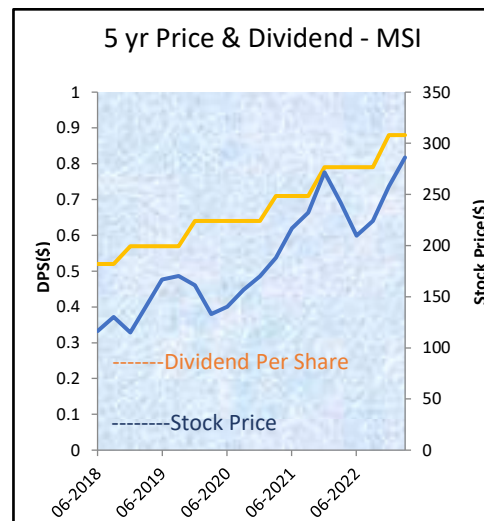


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Motorola Solutions (MSI-US) is in the business of saving lives and its leading-edge communications, video products, and accompanying software solutions for first responders, governments and corporations are difference makers. Emergency professionals in the field, along with 911 call centres, depend on the reliability of the firm's mobile phones, video equipment, and integrated command centre software to make critical decisions and to manage the end-to-end processing of inbound calls. The unique nature of their product suite and customers creates high switching cost advantages thus highlighting the defensive nature of its business model which tends to work well in a variety of macroeconomic environments. Most importantly, these attributes have been translating into substantial increases in the company's financials with free cash flow generation increasing to \$1.5 billion in 2022, underpinning the qualitative characteristics that we seek in companies that are part of the Dividend Fund. One of the attributes that we appreciate at MSI is the ability of the company to lead through innovation which when combined with smart M&A, such as Avigilon Corp in 2018, creates even better solutions, expands use cases, and extends its ecosystem. AI is also being used to further enhance the value of its product suite with the ultimate goal of reducing response time and delivering safer outcomes. MSI continues to be a great example of a business that not only treats shareholders well, but also all stakeholders, including its customers and the communities it serves. Lastly, the management team at MSI understands capital allocation and applies a disciplined criteria to reinvesting in the business, in addition to making selective and value-added acquisitions, opportunistic share repurchases, as well as returning capital to shareholders in the form of dividends.



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