

# Dividend Growers

*High dividends are not the only criterion for good dividend-oriented investments. Juliette John, portfolio manager of the Bissett Dividend Income Fund, is utilizing a proprietary screening system in pursuit of sound businesses that are poised for steady, long-term dividend growth at a reasonable price.*

## What is the history of the fund and the company?

Bissett Investment Management is a Calgary-based, wholly owned operating division of Franklin Templeton Investments. We were acquired by Franklin Templeton in 2000 but the firm was started back in 1982 to manage money for high net worth individuals. We continue to have, via Franklin Templeton Investments, a sister company exposure to high net worth individuals, however Bissett focuses primarily on mutual funds and institutional asset management. Bissett has separate equity research and security selection from other Franklin Templeton fund families. The Bissett Dividend Income Fund was launched in 1988.

## What is your investment management style?

Our investment style is defined as growth at a reasonable price. We look for companies that have demonstrated an element of earnings growth to their history and to their long-term potential; however, we do not feel that we need to be chasing growth in terms of valuation by buying overvalued investments. We believe that, through our bottom-up research process, we can identify securities growing at decent rates in the long-term, and that we have the discipline to stay away from overpaying for that growth.

In the Dividend Income Fund, we are looking for companies that are paying back their shareholders by way of dividends, or, in other words, we're looking for dividend growth over time. The dividend growth is an important part of the total return for us. We do not necessarily own the highest dividend paying securities listed; we are looking for companies that do have a good element of dividends to their total return. We feel

that, over the long-term, we will be rewarded for going against the trend to some extent as trends tend to focus more on capital appreciation. Our primary focus is on fundamental strength of the balance sheet, looking for stable-to-growing cash flows and dividend stability, along with the potential for dividend growth over time. By doing so, we expect to benefit from maintaining our style and being clear that we're not going to chase returns and follow what the market tends to be favoring at any given time.

We are disciplined investors. One of the characteristics that identifies Bissett as a money manager is that we pay close attention to what we are trying to accomplish, which is to deliver better-than-average total returns over time, average being relative to the peer group, with less-than-average levels of volatility. Furthermore, we do not stray from our investment philosophy. Short time periods may be rather challenging to be measured based on what momentum factors can be driving the index at any particular point in time. However, in the long-term, we believe in our investment style and we remain committed to consistency.

## Do you invest in both Canadian and U.S. companies?

### What is the portfolio breakdown?

We look at companies in the U.S. as the universe of companies in Canada is limited and too concentrated. When you look at the makeup of the S&P/TSX Composite, we have a substantial amount of securities in the Financials and in the resource sectors including the Energy and Materials sectors. Outside of those groups the selection is narrow, so we look outside of Canada to help improve the diversification of our portfolio.



**JULIETTE JOHN** joined Bissett Investment Management (formerly Bissett & Associates) in 1994. She has held several positions within the firm including Equity Trader and Equity Analyst. Currently, John is involved in the management of equity, balanced and preferred share portfolios. Together with the other members of the Investment Team, she is responsible for Canadian equity research, preferred shares and analysis. John is the Lead Manager for yield-oriented equity portfolios including Bissett Dividend Income Fund, Bissett Canadian Dividend Fund and is the Lead Manager for the majority of separately managed accounts.

John graduated from the University of Calgary with a Bachelor of Commerce degree in 1992 and earned her Chartered Financial Analyst designation in 1998.

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When we are not invested in certain sectors in Canada, we manage to get some exposure to those sectors, such as Consumer Staples, outside of the country. For example, in the United States, we have a broader universe and we hold names like General Mills, as well as Procter & Gamble, which have very solid histories of long-term payment of dividends, as well as growth of dividends.

The areas that we invest in this particular fund include common shares. In addition to that, we have some exposure to income trusts too. Since we want to make sure that we see an element of growth from either the dividend or the distribution, income trust securities play a low role in our portfolio because they do not tend to be noted for growing their distributions over time. They are typically identified as investments that harvest cash and are not as growth oriented as we would like them to be.

At the end of 2008, our portfolio mix was about 52% of Canadian common shares and about 18% in U.S. common shares. The remaining portion was in fixed income, and we have about 2% cash balance. That leaves us with about 70% to 75% of the portfolio invested in equities and about 25% in fixed income.

Of the fixed income, we hold about 22% in investment grade corporate debt. We tend to focus more on corporate debt in order to get yield pick up over government issues. Our strategy in the corporate side is to focus on the fundamental strength of the issuer, ensuring that they are investment grade issues and eventually putting together a diversified portfolio of high quality corporate bonds. Additionally, we hold about 3% of the portfolio in preferred shares.

#### **Why do you primarily focus on the dividend paying ability of the company as part of your investment strategy?**

We feel strongly that a company in a position to pay a dividend, which has shown a willingness to do so over time, is also a company that is more disciplined in the way it utilizes its cash flows. Once a company declares a dividend, it is almost expected that it will continue to do so in the future. Dividends are very highly regarded as an indicator of how

comfortable a company feels, how strongly the company feels in its prospects and its ability to continue to operate profitably over time. To sum it up, dividends are a good indicator of the financial strength of a company.

We find that Consumer Staples companies in the United States are good examples of companies that have been able to deliver those types of expectations for several years, while raising their dividends on an annual basis. Investors have come to expect annual dividend increases from these companies, which also suggests that the company feels positive about its longer-term prospects. The growth rate of the dividend will always vary over time and from one company to another.

Presently, we are in an environment where companies are opting more to either preserve cash and not raise dividends or cut their dividends. In some cases, those dividend cuts are quite understandable. If they are highly cyclical industries or cyclical businesses where the cycle has turned against them entirely, they may feel that it is better to take the payout ratio to a more sustainable level than to raise debt to pay the dividend. However, for the more stable, defensive and seasoned businesses, we have seen that dividends continue to be paid and in fact rise.

In the Canadian portion of the portfolio, TransCanada Corporation, an energy transmission company, raised their dividend when they reported their fourth-quarter earnings. We have also seen companies in similar sectors, in some of the utility businesses in particular, raise their dividends recently. These higher dividends indicate the safe growth nature of these companies. They have lower levels of growth relative to companies that were leading in the cycle during the bull market like the more cyclical Energy and Materials companies. Yet, they are some of the steadily growing companies that, over the long term, pay dividends and tend to be the ones that deliver the better levels of earnings growth rates.

The dividend growth rate provides us with important information value. First, it provides us with the belief that the company feels confident

in their long-term prospects in that they are willing to pay dividends to shareholders. While it gives us better-than-average total return potential as we are already capturing some dividends as a percentage of total returns or not fully reliant on capital returns, it also presents us with evidence of historical periods where dividend growers tend to outperform non-dividend payers or non-dividend growers, delivering better-than-average earnings per share growth.

#### **How do you distinguish among companies that do pay dividends?**

First and foremost, we pay close attention to the dividend payout ratio. Companies that have a more cyclical element to their earnings should not be paying out a high amount of dividends as a percentage of their earnings. For example, General Motors' earnings are cyclical and the business is also a capital heavy business.

We are looking for companies that have a stable earnings profile so the earnings variability is low. Companies like that can afford to have a higher level of dividend payout ratio because they have a fairly good idea of what their earnings are going to be looking ahead. A utility company may be in a category that has higher levels of earnings stability and better earnings predictability. This company can likely carry a higher debt burden and/or pay a higher dividend. A company that is more cyclical in nature should probably be paying out less of a dividend relative to its earnings given the earnings cyclical.

Many studies have tracked the share price performance of companies ranked by dividend policy. Over long time periods, companies that have raised their dividends regularly have been among the strongest performers. In our view, companies that have a history of raising their dividends are typically of high quality, they are seasoned businesses with solid franchises and they are able to allocate their cash flows in a disciplined fashion.

**Not all dividend paying companies have been good investments. For example, Citigroup, Bank of America, General Motors, AIG are only too few**

### to mention. What kind of selection criteria do you maintain in your portfolio?

Ultimately, we are fundamental investors and we consider it important to understand the businesses that we're investing in. There have been several companies in the past that have become market darlings rising to become large companies that, as a result, were being awarded a rich valuation multiple. If we do not fully understand the earnings model of the business we will not buy the security. With the work that we do at the outset to understand the business and then to feel comfortable that we are buying it at a reasonable valuation level, we do believe that we are protected to some extent from risk. There are always improvements that can be made at the company level. Over the course of a cycle, many companies have been able to develop better ways of managing their businesses as long as they are a strong management team. We hope that we are capable of identifying those types of companies.

As examples, our selection criteria include a stable history of profitability as evidenced by the return on equity, solid earnings growth over time, a dividend paid on the shares, evidence of dividend growth over time, free cash flow generation, a manageable balance sheet, reasonable valuation including on a price-to-earnings basis and on a dividend yield basis. These variables are considered relative to historical levels as well as against an investment's comparables.

### What is your research process?

We use a database to screen companies in the U.S. and in Canada as an initial monitoring mechanism to help us identify names based on criteria such as those noted above along with earnings momentum, earnings revisions and the dividend payout ratio. Additionally, our proprietary screen helps us not only identify new names but also monitor where our existing securities rank and whether any new securities are potential additions to the portfolio.

It is important to note that we are looking for characteristics that align over the entire portfolio with what we are trying to develop.


If the security seems to fit, we'll then analyze the financials and spend time understanding the business. Work will be done to determine whether the security adds value to the portfolio from a diversification point of view or whether the addition would improve the portfolio's overall characteristics. Otherwise, we may determine that we already have similar exposures in the portfolio and few incremental benefits would be realized by adding the name.

### What is the number of holdings in the portfolio and what are your benchmarks?

Currently, there are about 70 securities in the portfolio. The debt securities are about 20, split half-and-half between preferred shares and the debentures. There are about 30 Canadian equities and about 20 foreign equities. At Bissett, our preference is to have relatively tight portfolios because we don't believe you can add a lot of value by continually adding securities and that the best level of security holdings is probably at around 40 for each asset class.

We traditionally maintain low turnover in our portfolio as we do not think that one adds value by turning accounts. In 2008, our turnover was about 11%, which is consistent as our annual turnover rates are below 20% over several years.

### How do you manage risk?

We try to minimize the risk of buying securities by investing in stable growing companies. The investment thesis needs to be well-understood and we are only interested in buying securities to hold long-term. We do a lot of work at the outset to understand what drives the security. The dividend yield and our emphasis on valuation protects us from overbuying a security at a higher than reasonable level. The fundamental work that we do protects us from many of the market risks. We will sell a security or reduce exposure if we believe that the fundamentals have deteriorated, or if we think that valuation has become too expensive. 

## Bissett Dividend Income Fund

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 Inception 05/31/88 (Series F)  
 11/24/00 (Series A)

PORTFOLIO	
Total Net Assets*	\$361.68
Price per unit	\$20.84 (Series F) \$18.86 (Series A)
MER (at 12/31/08, incl. GST)	1.26% (Series F) 2.45% (Series A)

TOP COUNTRY WEIGHTINGS	
Canada	78.43%
United States	17.38%
United Kingdom	2.69%
Cayman Islands	0.28%

RISK (AGAINST S&P 500 DAILY REINV IX - 3 YEARS)	
Common Stock	71.21%
Fixed Income	23.51%
Preferred Stock	3.06%
Cash	1.22%

RETURNS VS. BALANCED INCOME BENCHMARK		
	Fund (Series F)	Benchmark
1 Year (Cum.)	-21.50%	-27.60%
3 Year (Ann.)	-6.70%	-6.90%
5 Year (Ann.)	-0.00%	-0.60%

RETURNS VS. BALANCED INCOME BENCHMARK		
	Fund (Series A)	Benchmark
1 Year (Cum.)	-22.50%	-27.60%
3 Year (Ann.)	-6.00%	-6.90%
5 Year (Ann.)	-1.30%	-0.60%

PORTFOLIO MANAGER	
Juliette John	1994

\*millions  
 02/29/2009; Source: Company Documents; Lipper

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