

Research
Yields
Success



Expected Corporate Payout as the Ultimate Driver of Stock Returns

BOUTHILLIER CAPITAL (B-CAP)

Disclaimer: B-CAP utilizes the methodology outlined in this white paper to manage its Defence investment strategy, a long-only equity portfolio designed to capitalize on sustainable dividend growth.

**Bouthillier Capital (B-CAP) is a portfolio manager registered with the AMF and the OSC.
The firm aims to earn competitive return for investors, primarily by fostering innovative investment strategies.**

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INTRODUCTION

B-CAP prides itself on an independent, unbiased, and informed investment approach. Our [Defence strategy](#), rooted in thorough research and theory, capitalizes on sustainable dividend growth. This long-only mandate targets liquid, large-cap dividend-paying firms globally, aiming specifically for T1 firms (here referencing our research) with robust growth potential. Unconstrained by benchmarks, our quantitative+ selection process combines fundamental metrics with qualitative assessments, including economic moat and ESG factors. With over three years since its inception, Defence has accumulated a track record that showcases its promising results, briefly outlined in the [final chapter](#). Further insights await in the subsequent sections of this paper.

ABSTRACT

This study employs a dividend signaling model to analyze corporate dividend policies, validating findings through historical backtesting. We establish that high-profit, high-investment opportunities companies typically adopt a low-dividend, high-growth policy. Our issuer scoring method suggests quality is associated more with dividend growth pace than dividend yield levels. Dividend-paying stocks consistently outperform non-dividend counterparts with lower volatility in American and Canadian markets. While distinction among US quintiles of dividend yields is relatively weak, Canadian data indicates notable outperformance in the "High" dividend group and a decline in the "Extreme" group. The "No Div No Cut" portfolio from the S&P 500 exhibits exceptional returns attributed to innovative, growth-oriented firms, here acknowledging a longevity bias in the selection. Companies that have reduced dividends in the last 12 months underperformed the market. Firms with notable share reductions demonstrate strong market performance, while net-share-issuing non-dividend-paying stocks fare the worst. Combining dividends and buybacks into a total payout measure supports high-yielding stocks. Higgin's sustainable growth model (g^*) emerges as a robust indicator for future growth potential, showing a linear relationship with market returns. Companies exhibiting improving ROE ratios tend to enjoy stronger market returns. TSX backtesting at $g^* > 40\%$ yields the strongest outperformance vs all scenarios tested. Expected corporate payout emerges as a key driver of stock returns, informing investment strategies such as the B-CAP Defence strategy, which incorporates sustainable dividend growth principles for durable returns.

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DIVIDEND SIGNALING AS THE FOUNDATION OF AN INVESTMENT FRAMEWORK

Dividends are widely recognized for their multifaceted contributions to investment portfolios, serving as a stabilizing force by providing consistent returns, cushioning against capital losses, dampening portfolio volatility, and mitigating the risk of overvaluation. Additionally, dividends play a pivotal role in mitigating agency conflicts between managers and shareholders by aligning interests and curbing managerial discretion in fund allocation. Moreover, the initiation of dividend payments often signals a company's transition into a more mature operational phase, signaling stability and resilience, factors that are integral for long-term survival.

This perspective, rooted in prudence, underscores the trust and preference bestowed upon dividend-paying stocks, particularly by risk-averse and seasoned investors. Notably, during market downturns, investors exhibit an increased propensity towards dividend-paying stocks, surpassing considerations of quality and industry dynamics.¹

Transitioning from investor sentiment to corporate decision-making, Kaplan and Perez-Cavazos (2020)² present a comprehensive dividend signaling model, which we will identify as KPC. This framework categorizes firms based on their profitability and investment prospects, offering insights into dividend policies and their implications.

Distribution of Firm Types Across Profitability and Investment Opportunity Quadrants, Based on KPC Methodology

		Investment Opportunities	
		low	high
Profitability	high	3	1
	low	4	2

Let us delineate four distinct corporate archetypes based on our characterization. Type 1 (T1) firms epitomize enduring entities characterized by high-quality innovation and sustained compound growth. Type 2 entities operate within dynamic industries catering to expansive end markets, albeit constrained by narrow profit margins. Type 3 enterprises, often referred to as "cash cows," operate within mature industries where modest growth prospects result in surplus cash exceeding profitable reinvestment opportunities. Lastly, as a representative example, Type 4 companies exemplify entities operating with antiquated and less efficient manufacturing infrastructure, such as producing toilet paper from outdated facilities compared to their more technologically advanced counterparts.

Empirical evidence substantiates a model wherein profitable firms with limited investment prospects (T3) distinguish themselves from less profitable counterparts (T4) through dividend levels. T3 entities exhibit higher dividend yields, willingly indicating sustainably robust earnings compared to T4 counterparts. Type 3 firms incur significant costs in disseminating information

¹ Kathleen Fuller & Michael Goldstein, Do Dividends Matter More in Declining Markets? (2010) *Journal of Corporate Finance*, Vol. 17, No. 3, June 2011, pp. 457-473

² Zachary Kaplan & Gerardo Perez-Cavazos (2020) *Investment as the Opportunity Cost of Dividend Signaling*

regarding profit sustainability, while Type 1 entities abstain from such practices. Firms with attractive investment opportunities (T1 & T2) prioritize reinvestment over dividends and often refrain from paying one. This aligns with the concept of opportunity cost: significant payouts could hinder their ability to capitalize on these prospects. Here, low dividends can signal the presence of these opportunities to the market, potentially enhancing firm valuation. Moreover, T1 firms face minimal risk of being misperceived as T4 entities by the investment community. Conversely, for the remaining T3 & T4, a reduction in dividend (nominal amount or its growth rate) implies a decline in earnings potential.

> I B-CAP's Breakdown

Building upon hypotheses formulated and validated by prior researchers, our study extrapolates the following quadrants, dividing the stock universe by levels of dividend yield and dividend growth:

Distribution of Firm Types Across Dividend Yield and Growth Quadrants, Based on Insights from KPC

		Dividend Growth	
		low	high
Div. Yield	high	3	<i>1 can but refrains</i>
	low	1, 2, 4	1, 2

As committed portfolio managers, our primary aim is to develop competitive and innovative investment strategies. Accordingly, our objective in this study is to identify and evaluate Type 1 firms as potential investment candidates. While these high-margin, fast-growth entities possess the versatility to fit into any quadrant, our signaling model suggests they are inclined to refrain from offering high dividend yields, and may even opt not to pay dividends altogether.

In light of this, where should our focus lie? The lower-left quadrant, characterized by either no or low dividends, encompasses a diverse range of corporate profiles, spanning from weak to robust. One proposed approach to distinguish Type 1 firms within this region is to filter based on operating growth rates, thereby effectively screening out Type 4 entities.

the most straightforward quadrant for identifying T1 may be the lower-right corner of low-div. yet fast-growing stocks

Alternatively, the most straightforward quadrant for identifying Type 1 firms may be the lower-right corner, comprising low-dividend yet fast-growing stocks. Here, selecting companies with high and sustainable corporate margins becomes paramount. Interestingly, this quadrant also boasts the highest representation of Type 1 firms, accounting for 50% if all firm types were equally represented in the universe.

Furthermore, employing a simple scoring system reveals several key insights: 1) no significant differentiation between dividend yields, 2) enhanced corporate profiles correlated with

dividend growth, and 3) the highest average score observed within the low-dividend, fast-growth quadrant.

Proportion of T1 Per Quadrant

		Dividend Growth	
		low	high
Div. Yield	high	0%	NA*
	low	25%	50%

Note: Represents the proportion of each quadrant's constituents that is described as type 1 firms.

* Stocks potentially paying fast-growing and high dividends would be T1, representing 100% of the quadrant.

Score per Quadrant

		Dividend Growth		Avg
		low	high	
Div. Yield	high	67%	NA*	67%
	low	58%	83%	71%
Avg		61%	83%	

Note: Based on a simple scoring methodology where T1=3 points (maximum), T4=1 and the rest gets 2 points. Type-weighted score and average.

* Stocks potentially paying fast-growing and high dividends would be T1 and score 100% here.

Our research involved conducting backtests on the constituents of the S&P 500 index, utilizing the established factors of Indicated Dividend Yield and Dividend Per Share 5-Year Geometric Growth Rate. It's important to note that our analysis excludes companies that do not pay dividends, as dividend growth data is unavailable for such entities. Portfolios were constructed with equal weighting, comprising the top and bottom 50th percentiles, and were rebalanced quarterly over a 24-year period, concluding in February 2024.

The findings reveal that two divergent quadrants demonstrated superior performance: stocks characterized by low dividend yield and slow growth, as well as their counterparts featuring high yield and fast growth.

Cumulative Return per Quadrant

		Dividend Growth*		Avg
		low	high	
Div. Yield*	high	876	1184	1030
	low	1197	878	1037
Avg		1036	1031	

Note: Total cumulative return.

* Effectively carving out non-dividend stocks.

Sharpe Ratio per Quadrant

		Dividend Growth*		Avg
		low	high	
Div. Yield*	high	0.53	0.58	0.56
	low	0.56	0.52	0.54
Avg		0.55	0.55	

Note: Calculates the excess return over the risk free rate (3M UST), per unit of volatility (standard deviation of returns). The higher, the better.

Acknowledging the potential mis-categorization inherent in dividing the dividend-paying universe at the 50th percentile line, we sought to refine our analysis by partitioning the same underlying universe using quintiles (i.e., 20th percentile). This approach aims to concentrate the groups more effectively, thereby enhancing the factors under consideration.

clearer outperformance for stocks exhibiting high dividend growth

The results obtained from these more "extreme" portfolios reveal a clearer outperformance for stocks exhibiting high dividend growth, with a slight advantage observed for those with low dividend yields.

Cumulative Return per Extreme*

		Dividend Growth		Avg
		low	high	
Div. Yield	high	432	1007	720
	low	544	967	755
Avg		488	987	

Note: Total return.

* Using top/bottom quintile instead of 50th percentile.

Sharpe Ratio per Extreme*

		Dividend Growth		Avg
		low	high	
Div. Yield	high	0.36	0.49	0.43
	low	0.38	0.49	0.44
Avg		0.37	0.49	

Note: Calculates the excess return over the risk free rate (3M UST), per unit of volatility (standard deviation of returns). The higher, the better.

* Using top/bottom quintile instead of 50th percentile.

These findings are consistent with the signaling theory investigated in this study. In the subsequent section, we will delve deeper into the historical elucidation of market returns, examining the impact of different cash flows distributed to shareholders.

CASH FLOWS ARE THE ULTIMATE DRIVERS OF STOCK RETURNS

Utilizing corporate payouts as the principal determinant of performance offers several advantages within investment frameworks. Notably, the value of a stock is derived from the present value of cash flows, rather than earnings, with total payouts serving as a measure of a stock's distributable cash flow. Furthermore, cash flows, unlike earnings, are not subject to accounting measures and may be less susceptible to manipulation or fluctuations.

long-term regression analyses indicate that total yield exhibits superior predictive power compared to traditional metrics such as P/E and Dividend Yield

dividend-paying growth stocks, particularly within the Smid-Cap segment, have exhibited superior returns with lower volatility compared to non-dividend payers

Empirical findings suggest that changes in valuation play a pivotal role in explaining short-term variance in real returns, while their significance diminishes over longer time horizons. Long-term regression analyses indicate that total yield exhibits superior predictive power compared to traditional metrics such as P/E and Dividend Yield. Additionally, the cyclically-adjusted total yield model (CATY) emerges as a promising alternative to the commonly used CAPE ratio.^{3 4}

Research by Conover et al. (2016) underscores the risk-reducing benefits of investment strategies centered on dividend-paying stocks across various investment styles.⁵ Non-dividend stocks collectively demonstrate weaker performance and higher standard deviation. Notably, portfolios composed of high dividend-paying stocks consistently outperform those comprising extreme dividend payers. Over more than five decades, dividend-paying growth stocks, particularly within the Smid-Cap segment, have exhibited superior returns with lower volatility compared to non-dividend payers. This previous conclusion is consistent with Arnott and Asness (2003), who found that low dividend payout expressed as a ratio to trailing earnings do not imply higher future earnings growth; they advocate for a positive relationship between payout ratio and future real earnings growth.⁶ However, they used a broad equity sample not accounting for firm-specific investment opportunities, an opportunity cost introduced in KPC. In essence, KPC refines Arnott and Asness's findings by demonstrating that investment opportunities can be a crucial factor influencing the payout-growth relationship.⁷

The gradual shift from dividends to buybacks, commencing in 1982 with the SEC's "safe harbor" rule, has resulted in buybacks surpassing dividends in recent corporate payout trends. While buybacks offer greater flexibility for short-term adjustments, they are more sensitive to fluctuations in a company's earnings. Consequently, long-term regression analyses demonstrate

³ Philip U. Straehl & Roger G. Ibbotson (2017) The Long-Run Drivers of Stock Returns: Total Payouts and the Real Economy, Financial Analysts Journal, 73:3, 32-52, DOI: 10.2469/faj.v73.n3.4

"The results of the predictive regressions show that over the longer sample periods, starting in 1881 and 1901, CATY is at least as predictive as CAPE, exhibiting a slightly higher R2 and a similarly significant coefficient. However, over the sample starting in 1970, when buybacks became prevalent, CATY is significantly more predictive than CAPE, with an R2 of 6.44% compared with CAPE's 2.28%. Over 1970–2014, the t-statistic for the coefficient of CATY is 1.70, which is marginally significant compared with an insignificant t-stat of -0.99 for CAPE. Thus, our analysis suggests that CATY is a viable alternative to a traditional valuation measure such as CAPE."

⁴ For more information on the cyclically adjusted price-to-earnings ratio (CAPE), you may visit this [section on Wikipedia](#).

⁵ C. Mitchell Conover, Gerald R. Jensen & Marc W. Simpson (2016) What Difference Do Dividends Make?, Financial Analysts Journal, 72:6, 28-40, DOI: 10.2469/faj.v72.n6.1

⁶ Robert D. Arnott & Clifford S. Asness (2003) Surprise! Higher Dividends = Higher Earnings Growth, Financial Analysts Journal, 59:1, 70-87, DOI: 10.2469/faj.v59.n1.2504

⁷ KPC introduced investment as the opportunity cost, making a nuance between those companies with low vs high growth opportunities. In this sense, Arnott & Asness relationship works in a subset predominantly comprised of KPC-inspired low opportunity firms.

stronger predictive power when employing cyclically adjusted 10-year averages of total payout yield (ref CATY), as noted by Straehl & Ibbotson (2017).

> I B-CAP's Breakdown

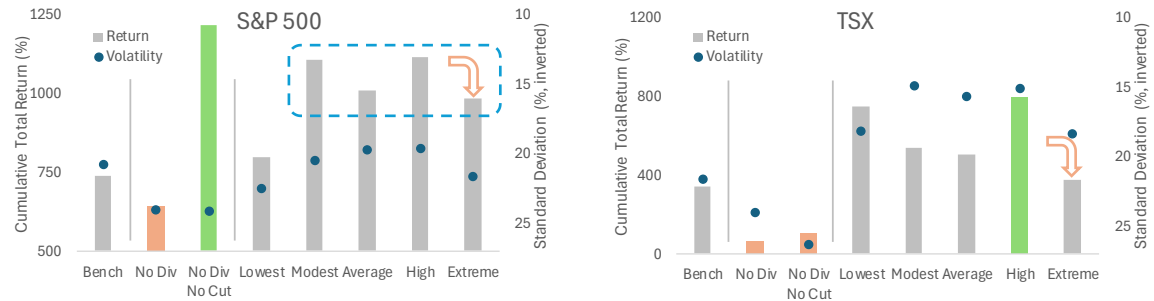
Our research entailed testing multiple scenarios utilizing datasets from the S&P 500 and the TSX spanning the past 24 years, culminating in February 2024. Backtests were conducted to rebalance the universe based on specific fundamental financial parameters, with quarterly rebalancing into equally-weighted quintiles or groups.

Empirical analyses reveal that dividend-paying stocks have consistently generated alpha with lower volatility compared to non-dividend paying stocks, across both American and Canadian markets. While discerning differences between quintiles remain somewhat indistinct in the US, the Canadian market exhibits a notable outperformance among the "High" dividend group, with a significant decline observed in the "Extreme" dividend group.

Type 1 firms are notably prevalent in the US market. (They) often opt to retain all earnings to self-fund their developmental initiatives

Remarkably, the "No Div No Cut" portfolio derived from the S&P 500 index has exhibited the most robust returns, surpassing dividend-paying stocks by more than 200% in cumulative returns. We attribute this phenomenon to the innovative landscape of the US market, characterized by a substantial presence of growth-oriented yet dominant firms. As elucidated in the signaling model referenced earlier, Type 1 firms are notably prevalent in the US market. These firms, boasting strong growth prospects, often opt to retain all earnings to self-fund their developmental initiatives as extensively as possible.

Cumulative Total Return by Level of Dividend Yield, S&P 500 vs TSX: 24 Years, LC



Note: The term "No Div No Cut" refers to companies that have abstained from distributing dividends in their most recent filing, as well as throughout the preceding five years. However, it can be argued that excluding companies lacking a minimum of five years of financial history introduces a longevity bias.

A long-short dividend yield strategy, implemented by buying the top quintile and shorting the lowest quintile of the S&P 500 index, as modeled in Bloomberg over the past 15 years, yielded a negative cumulative return. Notably, the information coefficient indicates that the factor selection lacks statistical significance. It is essential to highlight that this test encompassed non-dividend stocks, which naturally comprised the "short" leg.

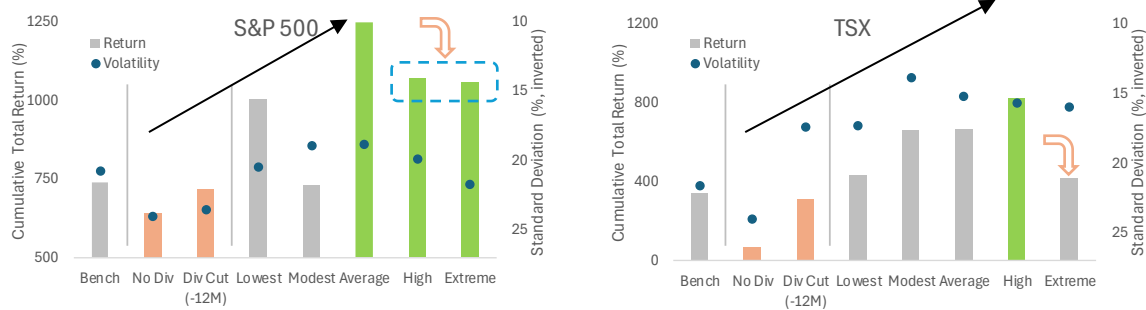
Conversely, our examination of the small-cap Russell 2000 index, as discussed in the literature, revealed a reversal of conclusions. Here, a higher dividend yield proved to be advantageous, particularly evident in its Growth stocks subset, with even stronger significance.

Applying the same long-short strategy to the TSX model yielded profits at a statistically significant level. In the case of the S&P 500, imposing sector controls marginally enhanced returns but remained negative. Conversely, the sector-neutralized version of the strategy on the TSX demonstrated a near-zero return, suggesting substantial allocation points generated in Canada.

returns exhibit enhancement commensurate with historical div. growth

Consistent with expectations from the signaling model, returns exhibit enhancement commensurate with historical dividend growth. Similar to the "Extreme" dividend yields in Canada, the strongest quintile of growth failed to yield improved returns or mitigate risk, thus advocating for an optimal focus on the "High" dividend category.

Cumulative Total Return by Dividend 5-Year Growth, S&P 500 vs TSX: 24 Years, LC



Note: For the sake of respecting the spirit of the analysis, Quintiles exclude companies that have cut their dividend over the last 12 months. This "Neg 1Y Div g" group, whatsoever its 5-year dividend growth rate, underperformed the benchmark and every quintile.

Share buybacks, also known as "normal-course issuer bids" (NCIB) in Canada, have witnessed a surge in popularity over the past three decades. Among the constituents of the S&P 500 index, approximately 440 companies reported engaging in buybacks (of at least \$5 million) over the last two years, indicating widespread adoption among Corporate America, even surpassing dividends in frequency.

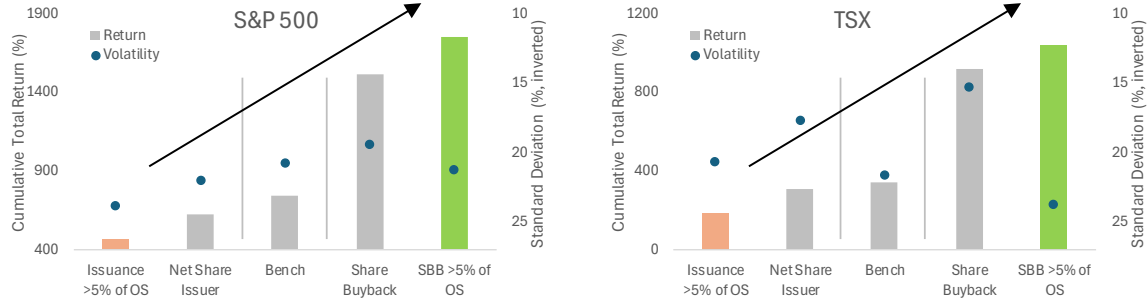
Empirical analysis reveals that buybacks exhibit significantly higher volatility as a payout method, experiencing reductions of over 50% during recessionary periods, compared to more modest declines of about 10-20% observed with dividends. The recent introduction of a 1% tax on net buybacks in 2023 may explain the recent deviation from the mean, with quarterly buybacks averaging approximately 0.5% of market value last year, compared to the 20-year average of 0.75%. However, due to the inherent volatility of time series data and the limited perspective and foresight available, it is premature to definitively assert a permanent shift in issuers' preferences.

Despite the recent slowdown, the pace of quarterly buybacks remains substantial, outpacing cash distribution by approximately \$50 billion or 30%. Our analysis underscores the efficacy of screening based on the level of 5-year annualized rate of change in the issuer's Outstanding Shares, which has demonstrated compelling evidence in favor of share buybacks.

compelling evidence in favor of share buybacks



Cumulative Total Return by Outstanding Shares 5-Yr Change (%), S&P 500 vs TSX: 24 Years, LC



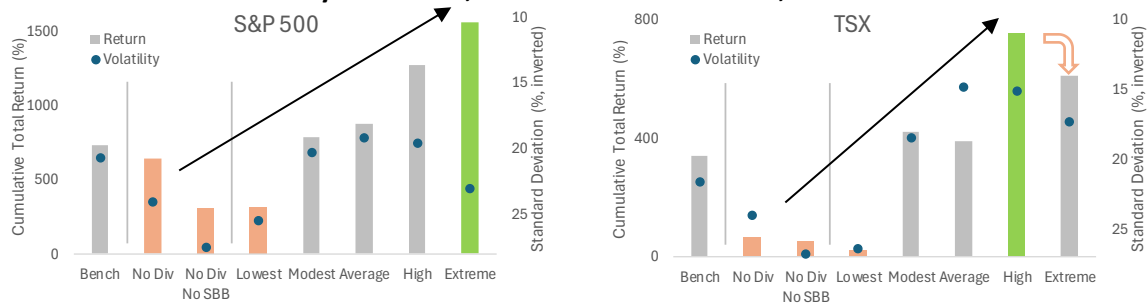
Note: Rate of change in Outstanding Shares (OS) calculated as annualized 5-year change. Negative = net share buyback (SBB).

Total payout encompasses both dividends and buybacks, representing the annual cash flows “paid out” to shareholders as a direct remuneration. Often termed as shareholder yield or total yield (TY) when expressed as a ratio to market cap, it provides a comprehensive measure of the idiosyncratic return realized by investors. Total yield conveys richer information compared to dividend yield alone, encompassing a broader spectrum of issuer actions. Our analysis reveals that this financial metric emerges as the most predictive of changes in expected returns⁸ and yields some of the most robust total returns over the 24-year period under scrutiny.

(TY) emerges as the most predictive of changes in expected returns and yields some of the most robust total returns



Cumulative Total Return by Total Yield, S&P 500 vs TSX: 24 Years, LC



In the next section, our focus shall adjust from historical to future growth.

⁸ Corroborated by Jacob Boudoukh, Roni Michaely, Matthew Richardson & Michael R. Roberts, 2007. "On the Importance of Measuring Payout Yield: Implications for Empirical Asset Pricing," Journal of Finance, American Finance Association, vol. 62(2), pages 877-915

SUSTAINABLE GROWTH AND THE CASE FOR FINANCIAL PERFORMANCE

Total payouts per share (adjusted for share decrease from buybacks) exhibit growth aligned with economic productivity, as evidenced by Straehl & Ibbotson (2017). This macroeconomic relationship suggests to us that, on a micro level, more productive companies benefiting from growth opportunities (hence with higher rates of return on investment) should experience faster growth in their total payout per share.⁹

The concept that profit margin is among the variables within an interdependent system explaining a company's sustainable sales growth was proposed by Robert Higgins as early as 1977.¹⁰ According to his perspective, achieving optimal growth is not merely about accepting all average-risk investment opportunities yielding a return above the firm's cost of capital; management must navigate tradeoffs between growth and capital to achieve financial targets. Higgins' model posits a positive relationship between sustainable sales growth (referred to as g^*) and several variables, including profit margin, retention rate, leverage, and asset turnover. In his

contemporary academic textbook titled "Analysis for Financial Management," in the Managing Growth chapter, the sustainable growth equation is succinctly summarized as Return on Equity (ROE) multiplied by the retention rate ($b = 1 -$ dividend payout ratio expressed as a % of income).

While relaxing financial constraints and increasing leverage can potentially enhance growth prospects, it also introduces additional risks borne by the firm, prompting potential concerns. An alternative approach involves reducing cash flow to shareholders. A company growing at a pace below its high g^* rate finds itself in a favorable position regarding corporate management: it possesses sufficient capital to meet its investment needs, allowing for considerations such as increasing liquid assets, reducing leverage, or augmenting dividends. In cases where the company is growing rapidly (albeit below g^*) while maintaining the value of existing assets without accruing unreasonable leverage, future profit growth and therefore dividend growth may accelerate. Simple dividend discount models, among others, would posit a higher price valuation to such a favorable scenario (reflected in the lower " $k - g$ " denominator).

the sustainable growth (g^) equation is succinctly summarized as $ROE \times b$. A company growing at a pace below its high g^* rate finds itself in a favorable position regarding corp. mgmt*

> I B-CAP's Breakdown

We have previously demonstrated that faster dividend growth and higher total payout yields have generated the strongest historical returns. While identifying companies currently meeting these criteria may seem relatively straightforward, the sustainability of these metrics holds greater importance for investors. Indeed, the net present value of cash flows is inherently focused on future prospects. The theoretical model developed by Higgins aligns seamlessly with the concept of constant dividend growth rate (g) commonly utilized in the Gordon growth model, wherein g is defined as ROE multiplied by b .¹¹

However, the use of ROE presents certain limitations upon initial examination, including distortions stemming from minimal book equity values observed in approximately 15 S&P 500

⁹ We would conclude that this accelerated growth, in turn, is anticipated to generate stronger total market returns.

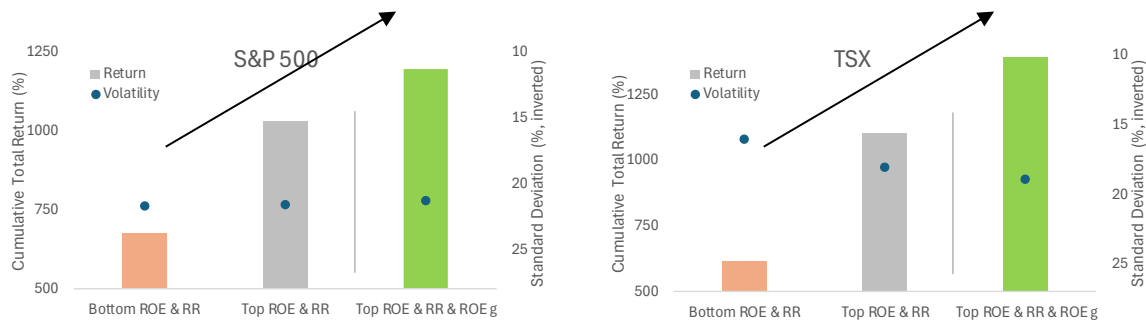
¹⁰ Robert C. Higgins (1977), How Much Growth Can a Firm Afford? Financial Management, Vol. 6, No. 3 (Autumn, 1977), pp. 7-16

¹¹ For more information on the dividend discount model (DDM), you may visit this [section on Wikipedia](#).

constituents and omissions arising from negative equity values found in around 30 other S&P 500 constituents. Opting instead for Return on Invested Capital (ROIC) enlarges the subset but introduces its own set of drawbacks, which appear to be more detrimental. Firstly, ROIC as a standalone metric lacks comprehensive perspective as it disregards the firm’s cost of capital, thus omitting considerations related to economic value added. Secondly, referencing the renowned DuPont ROE formula, ROIC solely incorporates Commercial and Industrial operational ratios, while ROE offers a more holistic assessment of a company’s financial performance by incorporating elements such as financing structure (leverage and interest coverage) and taxation. Our evaluation of ROIC as a singular determinant of market performance revealed its non-significance in both Canadian and American stock markets, suggesting its exclusion from our analytical framework.

Through backtesting on both the S&P 500 and the TSX index, focusing on simultaneous weak/strong ROE and dividend rankings yielded robust outperformance for the stronger issuers. Furthermore, investing in firms that have concurrently exhibited improvements in their ROE ratio over the past five years has proven to enhance returns. Building upon the literature surrounding g^* , extending in time this ROE enhancement is anticipated to enable firms to deliver accelerating sales, profit, equity, and total payout, thus creating uniquely favorable conditions desired by investors. Notably, these results are particularly pronounced in Canada, where returns not only surpass those from American counterparts but also significantly outperform any previous findings.

Cumulative Total Return by g^* Candidates, S&P 500 vs TSX: 24 Years, LC



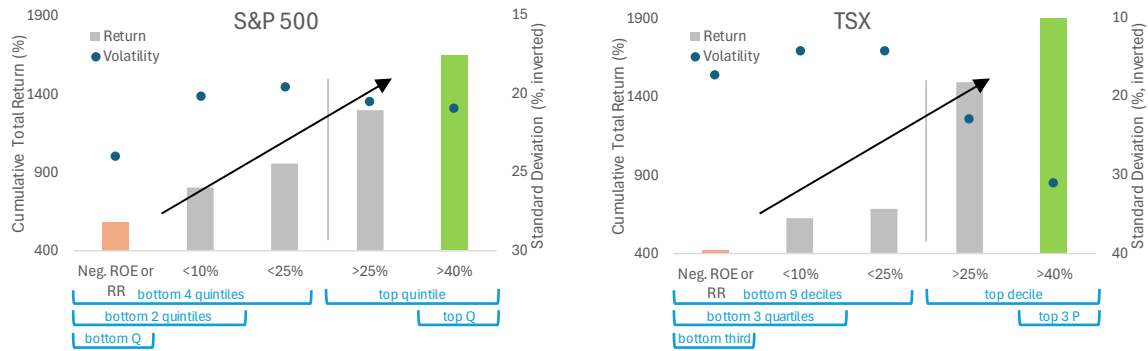
Note: Showing companies falling simultaneously in top/bottom two quintiles of return on equity (ROE) and retention rate (RR). The added ROE g variable denotes positive ROE 5-year historical growth.

a notable relationship, with the strongest g^ measurements yielding some of the highest cumulative total returns observed to date (...) particularly pronounced in the context of the TSX*

We can confidently extend our analysis based on this significant relationship. Our endeavor involved refining the investigation by measuring historical market returns across quintiles of g^* , considered a reliable barometer of a corporation’s future cash flows. To illustrate this concept using a lighthearted "real-world" analogy, recognizing a specific automobile as a Ferrari sports car on the Autobahn doesn't guarantee acceleration, but there are valid reasons to anticipate that it will outpace most other vehicles under similar conditions. The findings underscore a notable relationship, with the strongest g^* measurements yielding some of the highest cumulative total returns observed to date. This trend is particularly pronounced in the context of the TSX, where investing solely in stocks of companies exhibiting a g^* of 40% or higher, rebalanced quarterly over 24 years, has yielded a cumulative return of 1,907%,

surpassing the benchmark by over five times and outperforming any other S&P 500 grouping tested here. While the Canadian stock market may lack in innovation and size, it compensates with a robust presence of strong long-term serial compounders, many of which have capitalized on global expansion opportunities.

Cumulative Total Return by g*, S&P 500 vs TSX: 24 Years, LC



Note: The first grouping labelled “Neg. ROE or RR” is meant to accurately encompass those negative-g* companies.

Our findings highlight the critical role of sustainable (i.e., anticipated) corporate payout policy in influencing stock returns. We now present a concise overview of these central insights.

INVESTMENT SIGNALS IN A DYNAMIC MARKET: KEY TAKEAWAYS FOR INVESTORS

Our research holds several key implications for investors. Most importantly:

1. Future > Past
 - a. Valuation is about discounting cash flows
 - i. Shareholder payout is a source of idiosyncratic real return
 - b. g* is a good barometer of potential growth and a reliable indicator
 - i. ROE and ROEg are powerful fundamental metrics and robust predictors
 - c. Historical dividend growth is nevertheless a significant determinant
 - i. Aim high and avoid dividend cuts
2. Total Yield (TY) > Dividend Yield (DY)
 - a. TY incorporates share buyback (SBB)
 - i. SBB is more frequent and greater than dividends (within S&P 500)
 - ii. There is compelling investment evidence in favor of SBB
 - iii. SBB is more volatile: averaging TY (CATY) yields best results
 - b. DY is more nuanced
 - i. Do not shoot too high: “high” DY outperforms “extreme” DY
 - ii. Do not shoot too low: “Non Div” underperforms, especially on the TSX
 1. But S&P 500 “No Div No Cut” (filled with innovation, min 5-year of financial history) outperforms. Aim for high g*, econ. moats.
 - iii. In Canada, sector allocation explains DY stronger relationship

We present a proprietary investment framework integrating these research findings in the following section.

THEORY IN ACTION: B-CAP DEFENCE INVESTMENT STRATEGY

Since the inception of the Defence investment strategy in January 2021, our guiding principle at B-CAP has been the belief that dividend growth would outstrip dividend yield over extended timeframes. Instinctively, prioritizing sustainably robust future growth capitalizes on both quantitative and qualitative quality attributes. As such, we consider it the quintessential approach for long-term investment, embodying an all-weather strategy where resilient large-cap developed market compounders excel in their ability to expand.

The portfolio construction process is country and sector-agnostic, primarily employing a bottom-up approach. The manager employs quantitative filters to identify suitable large-cap listed companies, ensuring dividend growth sustainability by considering various factors such as historical and projected growth in revenue per share, profit margins, free cash flow, return on equity, and maintaining a reasonable debt level. Additionally, identifying companies with a strong competitive advantage within their respective industries is of paramount importance.

The Defence model adopts a long-term investment horizon of 5-10 years, focusing on stocks issued by large companies (with a minimum market capitalization of \$1 billion, with the majority exceeding \$5 billion) that demonstrate high potential for dividend growth. This approach prioritizes quality without compromising on factors such as creditworthiness, reputation, economic moat, and consideration of Environmental, Social, and Governance (ESG) aspects.

The results speak for themselves. As of the latest assessment, the portfolio's cash payout is projected to increase by approximately 10% over the next 12 months, twice as fast as the MSCI World High Dividend. Weighted averages of return on equity (ROE) and retention rate (b) exceed those of the benchmark by 150% and 50%, respectively, resulting in a combined g^* value of 24% (compared to 6% for the benchmark). Most strategy members operate at a high growth rate, albeit modest compared to their respective g^* . About half of the constituents show improvement in 5-year ROE, a higher proportion than that of the benchmark and superior to the S&P 500, its Growth segment, and its strong "No Div No Cut" group (as previously discussed). This instills confidence in both the sustainability of the overall growth profile and the firms' financial flexibility to capitalize on opportunities or withstand economic downturns.

As stipulated by the mandate, all members pay a dividend, with the portfolio's cash distribution yield averaging 1.5%. Furthermore, 75% of members have concurrently decreased their capital stock over the last 12 months, with the share buyback yield also averaging 1.5%. Importantly, our analysis considers several financial metrics on a per-share basis, reflecting net share buyback as well as the ultimate perspective of the shareholder. Sales per share estimated growth rate stands strong at 13%, nearly four times that of the benchmark. Coupled with durable economic moats, this core growth is poised to generate competitive long-term market returns.

The strategy's annualized return net of fees (aligned with conventional F-class fee structure) since inception (over three years ago) stands at +13%. This compound annual growth rate (CAGR) currently outpaces the benchmark (which returns are gross of fees) by 300 basis points per annum, while also surpassing other dividend-focused alternatives, such as the Aristocrats index from the US, Canada, and Europe. Compared to major equity benchmarks, B-CAP Defence leads against the




S&P TSX and the S&P Europe 350, while keeping pace with the S&P 500, a notable achievement considering the limited exposure to US markets (never exceeding 50% since inception), minimal exposure to the Information Technology sector (with little Semiconductors exposure), and no exposure to Oil & Gas companies.

More information available on our website: <https://b-cap.ca/en/strategies/#defence>

Bloomberg users may enquire about a see-through access to our Defence tickerized portfolio. Please IB Mathieu Bouthillier (MATBOUT2@bloomberg.net) for more information.

Overview of B-CAP Defence Investment Strategy as Seen in Bloomberg

Profile		Calculations Up-to-Date ⓘ		FIGI BBG0196R03N1	
B-CAP DEFENCE	MATHIEU BOUTHILLIER	Inception Date	01/26/21	Recent Events	9 ⓘ
Owner		Inception Price	100.00	Last Date Computed	03/14/24
Pricing #	0	Source of Price/NAV	Holdings	Market Value	1,483,281.63 ↓
Asset Class	Equity	Returns Model	MAC	Units	9,934.33 →
Currency	CAD	Workflow Management	Automatic	# of Holdings	47
Region (Holdings)	Americas	Historical Analytics Enabled	Yes	Portfolio of Portfolios	No
Benchmark	XDG GLOBAL QUALITY DIV				

Price/NAV GP »		Characteristics (as of 03/14/24)	
		Div Yld	1.52 ↑ BEst Div Yld 1.62 ↑
Prices		P/E	27.13 ↓ BEst P/E 20.75 ↓
Price/NAV	149.31 ↓ CAD 03/14/24	P/CF	23.32 ↓ BEst P/CF 16.78 ↓
52 Week High	150.71 CAD 03/07/24	P/B	4.15 ↓ BEst P/B 3.85 ↓
52 Week Low	121.22 CAD 03/17/23	P/S	2.72 ↓ EV/EBITDA 15.95 ↑
Risk (as of 03/14/24)		Current Ratio	1.26 →
Total Risk	11.22 ↓ Trk Err (Ex-ante) 6.61 ↑	Performance (as of 03/14/24)	
Factor Risk	10.84 ↓ VAR (Hist 1Y) 0.76 ↓	Total Return	Portfolio Benchmark Diff
Non Factor Risk	2.91 ↑ Coverage 100.00 →	1 Day	-0.23% -0.24% +0.01%
		Month to Date	+1.13% +1.34% -0.22%
		Year to Date	+9.13% +5.63% +3.49%
		1 Year	+23.10% +13.64% +9.46%
		Return Statistics (as of 03/14/24)	
		Standard Deviation	10.17 → Sharpe Ratio 1.53 →
		Information Ratio	1.31 → Raw Beta 0.92 →
		Tracking Error	6.60 →

Source: Bloomberg. As of COB 14-MAR-2024.



Total Return of B-CAP Defence vs Selected Dividend-Focused Peers*
Normalised to Inception = 100, Since Inception, Daily, CAD, Gross of Fees



* MSCI World High Dividend Yield Net Index, S&P 500 Dividend Aristocrats index, S&P/TSX Canadian Dividend Aristocrats USD Total Return, S&P Europe 350 Dividend Aristocrats index
 Source: Bloomberg. As of COB 13-MAR-2024.

Total Return of B-CAP Defence vs Selected Major Benchmarks*
Normalised to Inception = 100, Since Inception, Daily, CAD, Gross of Fees



Note: MSCI World Net Index, S&P 500 Total Return Index, S&P/TSX Composite Index Net Total Return, S&P Europe 350 Net Total Return Index.
 Source: Bloomberg. As of COB 13-MAR-2024.

Our contact details are available hereunder. You may reach B-CAP by email at info@b-cap.ca

Important notes:

Unless otherwise stated, the data underlying this research is available from Bloomberg, while datapoints, statistics, figures and charts have been calculated and annotated by B-CAP.

Unless otherwise stated, all market measurements such as total return and volatility are as of COB 29-FEB-2024.



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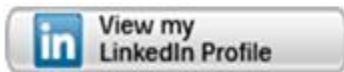
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The logo for Bouthillier Capital (B-CAP) is displayed in a large, stylized font. The letters are filled with a blue and white striped pattern. The logo is centered on a white rectangular background that is tilted slightly to the right. The background of the entire slide features a city skyline with various buildings of different heights and colors, ranging from light blue to dark grey.

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