cardinal UPDATE

MAY 2013

DIVIDEND INCREASES

CSX Corp.	7.1%
Exxon Mobil Corp.	10.5%
IBM Corp.	11.8%
Kellogg Co.	4.5%
PNC Financial	10.0%
Suncor	53.8%

(During the period: April 1 – 30, 2013)

RULE #1: BUY QUALITY

What could be more obvious than this Cardinal Rule? For many of the purchases we make in life, quality is an important consideration. But Quality can be very subjective. To some, Harley Davidson and Mercedes-Benz are the epitome of Quality, while other aficionados would swear by Yamaha and Hyundai. So, what does the Cardinal Rule "Buy Quality" actually mean?

In our investment world, Quality is both a quantitative and qualitative concept. First, a company must have a solid history of increasing cash flow, and given their industry sector, must have a very safe balance sheet. Why would someone buy a company that is unprofitable or laden with debt? These factors should be obvious, but we are often amazed at the companies that are perceived as high-quality, despite a sporadic history of earnings or a huge exposure to debt in their capital structure.

If the financial analysis – the quantitative examination – is supportive, then we next consider the qualitative factors, and here is where the creative aspect comes in. Why is the company consistently profitable? What advantage do they have over their competitors that give them a leg-up (think branding like Coca-Cola), or is it something engrained in the entire industry that makes them all profitable (think of our Canadian banking oligopoly buffered by government regulation). How sustainable is that advantage going forward? This is a key factor of a high-quality investment. Apple, for example, may make very high quality products, but does that necessarily make it a quality company. It is unlikely they will be making the same products in ten years. Will they dominate as they do today, and as Sony did in yesteryear, or will Apple join Sony in the has-been ranks?

Our definition of Quality is not short-term in nature, but is very much a long- term attribute. We want to be owners in companies that we have good reason to believe will still be dominant ten years from now, not just ten months from now. With the long-term sustainability we are looking for comes the likelihood of long-term dividend growth, and as any Cardinal client knows, that is our goal – long-term growth in dividend income. With dividend growth, comes sustainable cash-flows to support client incomes, and as history has generally shown, higher dividends also means more value. More value, sooner or later, means higher share prices. Quality pays.

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COMPANY FOCUS

CN RAIL

Canadian National Railway was officially created by the government on June 6, 1919, but its roots trace back to 1899. Today the company is worth over $41 billion and earned $2.7 billion in 2012.

We own CN for its business mix, pricing power, global and international revenues, industry leading operational efficiency, high barriers to entry, free cash flow, and rising dividends.

CN's tri-coastal network connects the ports on the Pacific Ocean, the Atlantic, and the Gulf of Mexico and serves as a competitive advantage. Global sales accounted for 32% of 2012 revenues, while 46% of revenues were tied to the U.S and cross-border trade with Canada, and 22% were attributed to domestic Canada.

Our outlook for CN remains vibrant. Growth in volume is anchored by their intermodal business. The flexibility offered by railroads has led to a booming crude-over-rail business which should supplement pipelines over the long term. CN is poised to double this business in 2013.

CN is targeting a dividend payout close to 35%. We therefore expect dividend growth to exceed earnings per share growth in the near future with the next increase expected in early 2014. CN has increased its dividend 17 consecutive times since the company's IPO in 1995, registering a compound annual growth rate of 15%.

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