

PALOS

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Weekly Commentary

Issue No. 39 | September 25, 2023

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By Charles Marleau CIM[®] and William Mitchell CIM[®]

BCE: An Enticing 7% Dividend Yield

Montreal-based BCE Inc. (BCE-TSX, BCE-NYSE) is Canada's largest communications services company, operating in three segments: wireless, wireline and Bell Media. BCE provides local, long distance and wireless telephone services, high-speed wireless internet, and media (cable TV and Bell Fibe) to residential and business customers in the Atlantic provinces, Quebec, Ontario, Manitoba, and Northern territories. Bell Media, which is the smallest in terms of revenues, is comprised of conventional and specialty TV channels, radio stations, as well as digital and traditional advertising. BCE also holds an estimated 37% ownership position in Maple Leafs Sports and Entertainment (MLSE) and an 18% slice of the Montreal Canadiens.

On BCE's Q2/2023 earnings call on August 3, President and CEO Mirko Bibic pointed to "resilient performance" including a 3.5% growth in Q2 consolidated revenue and a 2.1% improvement in adjusted EBITDA compared to Q2/2022, despite headwinds from a "difficult" advertising environment and rising interest expenses due to higher rates. Management reconfirmed guidance for the full year (2023) citing a favorable cash flow trajectory and lower capex in the second half (2H). In the first half, BCE accelerated spending as the company strives to reach 9 million fibre locations by 2025. The "high mark" on capex occurred in 2022 and spending will continue to decline in 2023 and continue to decline through 2025.

There are other catalysts. Immigration trends, service bundling, improving media margins and the move to digitalization should offer some momentum into 2H as investments in the future begin to pay dividends. Speaking of dividends, we've heard some "noise" recently surrounding the sustainability of BCE's record of continually growing the dividend. Since May 1, when shares closed at CAD\$65.45, the stock has fallen by almost 18%. With this decline in share price, the dividend yield, which is simply calculated by dividing the annual dividend by the stock price, currently hovers around 7.2%. Recently, the dividend payout has been running above 100% of free cash flows although the shortfall is expected to mitigate along with falling capex, expected normalization of interest rates and future revenue growth.

Except for a temporary suspension of the dividend during the Great Financial Crisis (GFC) of 2008, the company has grown its dividend every year without exception. This includes 2020 when the Covid pandemic seriously impacted financial markets. A recent research report from National Bank Financial Markets stated that BCE's dividend yield surpassed 7.0% only twice in the last fifteen years; once during early stages of the

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GFC and again in March 2020 as the Covid pandemic picked up steam. In both instances, the stock price rose by over 25% in the ensuing 12-month period.

BCE shares closed last Friday at a level last seen in the throes of the pandemic (Q4/2020). Although we recognize that rising interest rates have an impact on interest rate sensitive companies, we are also cognizant of the fact that interest rate hikes are very likely to be close to a peak despite central bankers continuing to emphasize a “higher for longer” policy. We believe inflationary pressures are subsiding and this strengthens our conviction that further rate hikes are “off the table.” Currently, the 5-year annual dividend growth rate stands at 5.09% (source: Bloomberg) and we see no reason why BCE would discontinue its respected reputation as a “dividend grower”. We believe BCE shares are attractively valued. The Palos Income Fund, the Palos Equity Income Fund, and the Palos-Mitchell Alpha Fund currently hold shares of BCE.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$8.21	4.34%
Palos Equity Income Fund - RRSP	PAL101	\$6.67	3.26%
Palos WP Growth Fund - RRSP	PAL213	\$10.83	-12.92%
Palos-Mitchell Alpha Fund ³	PAL300	\$10.35	30.87%
S&P TSX Composite (Total Return with dividends reinvested)			4.51%
S&P 500 (Total Return with dividends reinvested)			13.87%
S&P TSX Venture (Total Return with dividends reinvested)			0.12%
Chart 2: Market Data ¹			Value
US Government 10-Year			4.43%
Canadian Government 10-Year			3.91%
Crude Oil Spot			US \$90.03
Gold Spot			US \$1,927.20
US Gov't10-Year/Moody BAA Corp. Spread			166 bps
USD/CAD Exchange Rate Spot			US \$0.7417

¹ Period ending September 22nd, 2023. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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PALOS

1 Place Ville Marie, Suite 1670
Montreal (QC) H3B 2B6, Canada

T. +1 (514) 397-0188
F. +1 (514) 397-0199

4711 Yonge Suite 504
Toronto, Ontario M4T 2V7

T. +1 (647) 276-0110
F. +1 (647) 343-7772

www.palos.ca