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ASSET MANAGEMENT

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DIVIDEND FOCUS
A 30-YEAR FOCUS ON QUALITY

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The assertions in this paper are based on Fenimore Asset Management's opinion. Fenimore Asset Management is manager of the FAM Funds.

Highlights Include:

- Fenimore focuses on investing in quality because we believe it gives an investor the highest probability of achieving long-term financial goals.
- We have observed that, over long periods of time, public markets provide the most rewards to companies that best sustainably grow their earnings power and have attractive returns on capital.
- A company that is prudently growing their dividend is likely growing their long-term earnings power as well, and thus serves as a proof point that we are focused on the right business.

SUSTAINED DIVIDEND GROWTH

Since its founding in 1974, Fenimore has focused on investing in quality businesses because we believe it gives an investor the highest probability of achieving their long-term financial goals. For the Dividend Focus strategy — celebrating its 30th anniversary — we use sustained dividend growth as an objective signal that a company might have the quality characteristics we seek.

30 YRS FAM DIVIDEND FOCUS FUND

Quality Endures

At Fenimore, a commitment to quality is at the foundation of everything we do. It starts with our associates and carries through to our relationships with investors and engagement with the communities around us. Importantly, it also shapes our investment philosophy and the types of businesses in which we seek to invest.

For the last 30 years, the Dividend Focus strategy has defined quality through a consistent set of business attributes, including durable competitive advantages, strong balance sheets, disciplined capital allocation, and the ability to reinvest earnings at an attractive rate to support long-term dividend growth. These traits have historically been associated with superior long-term shareholder returns and lower risk of permanent impairment.[1] When we evaluate an investment for Fenimore's quality hurdle, it is an assessment of the dynamic interplay between a company's moat and its durability, management's capital allocation skills, and the attractiveness of the business's economics.

While trying to buy the very best companies (at attractive prices) might seem like an obvious playbook, its execution requires discipline, patience, and a long-term perspective. Periods of market volatility have a history of exposing shorter-term dislocations — even for quality businesses — and modern market structures have amplified this. We believe the rise of passive investment options and the increasing prevalence of levered, short-term trading strategies have created an environment where there are simply fewer investors focused on long-term fundamentals. Furthermore, the rise of retail participation with "fear of missing out" behavior can exacerbate dislocations between price and intrinsic value. These market dynamics can create opportunity but also require discipline to not be influenced by them. Therefore, we remain focused on long-term compounding as the primary driver of performance.

While investment strategies and market narratives move in and out of favor, we have observed that, over long periods of time, public markets provide the most rewards to the companies that best sustainably grow their earnings power and have attractive returns on capital.

Evidence Supporting the Quality-Focused Approach

> *We've really made the money out of high-quality businesses. Over the long term, it's hard for a stock to earn a much better return than the business which underlies it earns.*
>
> *If the business earns 6% on capital over 40 years and you hold it for that 40 years, you're not going to make much different than a 6% return – even if you originally buy it a huge discount. Conversely, if a business earns 18% on capital over 20 to 30 years, even if you pay an expensive looking price, you'll end up with a fine result.*
>
> *So, the trick is getting into better businesses. And that involves all of these advantages of scale that you could consider momentum effects.*
>
> ***- Charlie Munger***
> ***USC Business School Speech 1994***

[1] *Paul Hogan, CFA®, "Dividend Growth for the Long Term" (Fenimore Asset Management, 2016).*

While there is ample empirical evidence supporting that our focus on quality works (including many of the greatest equity investment performance track records over the past 50 years),[2] famous market commentator Michael Mauboussin reinforced this with a study that highlighted some key points.[3] Mauboussin segmented the market into five buckets, with a score of 5 (the best) being in the top quintile of businesses as measured by ROIC (return on invested capital) and a score of 1 being in the lowest quintile. He then looked at how moving from one quintile to another affected the total shareholder return one could expect.

We learn a few important points from this study:

1. Focusing on the high-quality businesses (measured by ROIC) has, on average, led to strong returns, especially relative to the S&P 500 Index's long-term average annual return of 9% to 10%.[4] Businesses that sustain top-quintile ROIC (starting in the top quintile {5} and ending in the top quintile) have delivered average annual 3-year returns of 20% over the last few decades (green shade), while those that stayed in the bottom two ROIC quintiles generated 3-year shareholder returns ranging from slightly negative to +6% annualized (red shade).

TABLE 1: Annual Returns for Beginning and Ending ROIC Quintiles, 1990-2022

		ENDING QUARTILE				
		(BEST) 5	4	3	2	(WORST) 1
BEGINNING QUARTILE	(BEST) 5	20%	7%	0%	-4%	-11%
	4	25%	14%	6%	0%	-10%
	3	28%	18%	10%	2%	-6%
	2	28%	20%	14%	6%	-5%
	(WORST) 1	33%	23%	15%	8%	-3%

** Source: Michael Mauboussin, FactSet, Counterpoint Global*

2. While it is true that capitalism incentivizes entrants to attack the moats of the highest quality companies, we have observed a fair amount of persistence in quality. Businesses that began the measurement period in the top quintile with a score of 5 had the greatest likelihood of maintaining that position by the end of the period (48% of companies that started with a 5 ended with a 5).

TABLE 2: Transition Rate from Beginning to Ending Quintiles, 1990-2022

		ENDING QUARTILE				
		(BEST) 5	4	3	2	(WORST) 1
BEGINNING QUARTILE	(BEST) 5	48%	19%	11%	8%	15%
	4	22%	31%	21%	14%	12%
	3	11%	23%	29%	23%	13%
	2	8%	15%	25%	33%	19%
	(WORST) 1	12%	11%	14%	22%	41%

** Source: Michael Mauboussin, FactSet, Counterpoint Global*

2 A. Frazzini, D. Kabiller, & L. Pedersen, "Buffett's Alpha" (National Bureau of Economic Research, 2013).

3 Michael J. Mauboussin & Dan Callahan, "ROIC and the Investment Process: ROICs, How They Change, and Shareholder Returns." (Counterpoint Global Insights, 2023).

4 FactSet as of 6/30/2026.

Being able to identify this ROIC persistence or those experiencing temporary ROIC declines are areas that align with the type of fundamental research that Fenimore conducts and are best exploited through a long investment horizon. Notably, these are also the areas that have produced the highest probability-adjusted returns [outcome + likelihood of success] over the last few decades (green shaded area in Table 3).

TABLE 3 (Table 1x2):
Probability-Adjusted Return, 1990-2022

		ENDING QUARTILE				
		(BEST) 5	4	3	2	(WORST) 1
BEGINNING QUARTILE	(BEST) 5	10%	1%	0%	0%	-2%
	4	6%	4%	1%	0%	-1%
	3	3%	4%	3%	0%	-1%
	2	2%	3%	4%	2%	-1%
	(WORST) 1	4%	3%	2%	2%	-1%

** Source: Michael Mauboussin, FactSet, Counterpoint Global*

Why Are We Obsessed with Dividends?

When investors often engage with us for the first time about the Dividend Focus strategy, they expect a discussion on yield or income and safety. While those considerations can matter, they are not the drivers of our approach. Our focus on dividends is rooted in the goal of finding businesses that meet our quality standards and are positioned to compound shareholder value over the long term. In our view, there are few better indicators of quality itself than a sound dividend growth policy. In our experience, a company that is prudently growing their dividend is likely growing their long-term earnings power as well, and thus serves as a proof point that we are focused on the right business.

Namely, we have been attuned to a company's ability to pay, sustain, and grow a dividend as a sign that:

1. The operation's moat is strong enough to support a return of capital in excess of what they need to reinvest in their business.
2. Its reinvestment opportunities have high incremental returns on capital, enabling both cash flow growth and capital return without an undue burden on the balance sheet.
3. It provides a guardrail on capital allocation, forcing management to fund only their most attractive opportunities while avoiding ROIC-dilutive overinvestment or empire building.

To be clear, dividends are not the only way to create shareholder value. Share repurchases, acquisitions, and balance sheet optimization can all be effective tools when executed well and in the right situations. We encourage management teams to pursue these avenues.[5] However, the success of these decisions is often dependent on timing and judgment and can take years to fully assess. In contrast, a growing dividend provides a more immediate and observable signal of a company's financial strength and capital discipline.

In this context, dividend growth is not the objective, but the outcome of investing in what we believe are high-quality businesses with durable economics and disciplined capital allocation. This philosophy has defined our Dividend Focus strategy for the past 30 years, with a distinct emphasis on mid-cap companies where we believe fundamental research can uncover underappreciated quality and long-term growth. We believe this unwavering focus on quality and long-term compounding continues to provide a differentiated and durable path to attractive long-term outcomes.

[5] *Hu et al., "The Income Component of Total Returns" (UC San Diego Rady School of Management Brandes Center, 2025). "Our work suggests investors prioritize cash-funded, recurring buybacks paired with steady dividends (net payout yield strategy) in pursuit of balanced long-term growth, income stability, and improved risk-adjusted returns."*

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