April 1, 2014

Dear Friends of Coho Partners:

There was a wide gap in performance between the S&P 500 and the Russell 1000 Value this month, as many of the large "growth" companies came under near term selling pressure. This was most notable in the biotechnology and large technology/internet related companies. As such, the S&P 500 rose 0.8% and the Russell 1000 Value advanced 2.4%. We beat the S&P 500, but we lagged the Russell 1000 Value because our portfolios are less exposed to Financials. Essentially all of our outperformance over the S&P 500 came from stock selection with our Healthcare and Technology holdings doing particularly well

For the first quarter, the markets recovered from a slow start in January to post consecutive monthly advances that ultimately produced a positive quarterly return. We were competitive with the benchmarks, as we modestly outperformed the S&P 500 but trailed the Russell 1000 Value. During the quarter, our Healthcare remained strong and our holdings plus our overweight to the sector helped. This was partially offset by our having no exposure to Utilities, which was the best performing sector.

We were unusually active in March as we added two new companies to the portfolio: PetSmart and Walmart, and we eliminated our ConocoPhillips position. Additionally, we trimmed our Omnicom and United Health holdings and added to our Occidental Petroleum position. The net impact from this repositioning is that we were able to maintain overall portfolio yield, but we lowered both the overall portfolio's P/E and its beta. As always, the purpose was to improve prospective returns while simultaneously reducing risk. The rationale for these actions is explained below.

PetSmart has underperformed over the past year on declining comparable store sales which has exacerbated concerns that consumers will switch their pet food and ancillary pet product buying habits away from brick and mortar stores to more online purchases. We believe these concerns are overblown and this provided a buying opportunity. E-commerce is too small to be moving the needle currently, and disintermediation in the pet supply market is more difficult versus other retailers. Services (grooming, training, boarding, and veterinarian) and pet acquisition are natural traffic drivers the internet can't provide, and the weight of pet food is not conducive to aggressive pricing due to shipping costs. We expect double digit dividend growth along with meaningful share repurchases, all being funded from internally generated cash flow for many years to come.

As for Walmart, we believe they will be successful in expanding their small format stores – Neighborhood Markets and Walmart Express. These new store formats are designed to capture consumer “fill-in trips” vs. the more typical weekend “stock-up trips” at the much larger supercenters. These smaller format stores should have competitive advantages over existing dollar stores. Walmart’s pricing should be lower and they will offer fuel, pharmacy and a wider variety of fresh food. As such, we see Walmart as a low beta, defensive stock with high single digit EPS potential, which when added to the dividend yield, has a long term outlook for better than 10% annual returns.

Within the Energy sector, we eliminated ConocoPhillips based on valuation. We are very encouraged about the operating and financial strategies articulated by Occidental’s new CEO, Steve Chazen. Specifically, by spinning off the California operations into a separately traded company, Occidental will receive a one-time dividend in the range of $4 to $5 billion. Beyond this, Occidental will likely monetize its remaining stake in Plains GP Holdings (PAGP) which should generate an additional $4 billion. Finally, they can also divest certain mid-continent assets which could add another $2 to $5 billion. All of these proceeds will be used for share repurchase. Following these transactions, the company will be smaller but faster growing. Importantly, the company intends to maintain its dividend level following these divestitures, and it is committed to maintaining its historic double-digit dividend growth profile.

Year to date, thirteen of our twenty-seven holdings have increased their indicated dividend rate for 2014 and we expect another seven of our holdings to do the same in April when they hold their annual shareholders meeting. The majority of these increases have been greater than 10% and we remain confident that the income growth for the year should be double digits as well.

Once again the list of concerns for investors continues to grow. From our vantage point, we prefer to remain conservative in our approach and we have tried to identify companies whose business models are reasonably impervious to economic shocks or dislocations. To that end, our companies generally provide a product or service where demand is unchanged due to changing economics. This leads to consistent growth with high recurring revenue streams supported by underleveraged balance sheets. These characteristics are very much appreciated during downturns and yet they remain attractive during advancing times.

The year has a long way to go, but we believe we are well positioned for what is always an uncertain future.

Please do not hesitate to call us with questions or concerns about our outlook or your portfolio.

Sincerely,

Peter A. Thompson　　　　Brian L. Kramp, CFA

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