January 6, 2014

Dear Friends of Coho Partners:

The 2013 year was fantastic for domestic equities, with the broader averages appreciating more than 30%. When returns are this generous, our conservative investment style tends to lag, but happily, we were able to capture nearly this entire advance. Strong stock selection nearly offset a modestly unfavorable drag from our overweight in some of the more defensive sectors, which underperformed the averages. Specifically, Consumer Staples and Integrated Energy, which we term "demand defensive" sectors trailed the market. Turnover remained low for our investment strategy, but when we made portfolio adjustments this year, each decision was driven by valuation as opposed to any deterioration in the operating strategies of our companies. We sold and trimmed certain holdings that had done particularly well and whose valuations had become less attractive and we added to new and existing holdings, which had not performed as well, but where the underlying fundamentals remained strong and our confidence in their future earnings continued to be high.

The outsized advance this year has put some pressure on valuations, but we are still seeing opportunities. The multiple on trailing earnings increased again, ending the year at 17x, up from ~ 14x at the beginning of 2013 and from 12x at the most recent major low in 2011. We believe this multiple expansion has been driven by continued benign inflation expectations, low interest rates, greater investor confidence in the economy and the markets along with stronger money flows into equities vs. fixed income. The absolutely massive quantitative easing (QE) from the Fed has certainly played an important role across most aspects of this multiple revision as well. In December, the Federal Reserve officially began its QE "taper" by reducing its monthly bond purchases by $10 billion. The markets reacted well to this news despite the increase in yield for the benchmark ten year Treasury. The ten year Treasury's yield moved from 2.74% at the beginning of the month and finished the year at 3.02%. We would anticipate interest rates moving higher in 2014, but as long as the yield on the ten year stays under 5%, we believe there is room for equities to advance.

Looking back on 2013, our companies performed well and they rewarded shareholders with dividend increases. Table 1 details our holdings as of year-end and the dividend increases. We should note that during 2013, we eliminated Abbvie, Colgate and Nike all based on valuation but each of those companies also increased their dividend in 2013. All of our holdings, with the exception of Abbott Labs increased their dividend in 2013. Abbott Labs, which separated into two independent companies on January 1, 2013, held off their traditional first quarter increase, but they did announce a sizeable 57% increase in November. This new rate will be effective in the first quarter of 2014. As for the dividend outlook for 2014, we are pleased with the recent increases by some of our holdings that will be effective in the first quarter of 2014. Once again we would expect all of these companies to increase their dividend in 2014. Dividend increases for the S&P 500 have also been large the past few years, but remember that the dividend for this index was $28.38 in 2008 before it fell to $22.41 in 2009. Thus the most recent annualized five year dividend growth has been 5.7% for the index vs double digits for our portfolio.

TABLE 1
DIVIDEND INCREASES

	2011 Div.	2012 Div.	2013 Div.	2014 Div. (1)
Abbott Labs	1.88	0.56	0.56	0.88
ADP Inc.	1.44	1.58	1.74	1.92
Air Products	2.23	2.50	2.77	
Amgen	0.56	1.44	1.88	2.44
Becton Dickinson	1.64	1.80	1.98	2.18
Chevron/Texaco	3.09	3.51	3.90	
Conoco Phillips	2.53	2.64	2.70	
Cullen Frost	1.83	1.90	1.98	
CVS/Caremark	0.50	0.65	0.90	1.10
Illinois Tool Works	1.38	1.46	1.56	
IBM	2.90	3.30	3.70	
Int'l Flavors & Fragrances	1.16	1.27	1.41	
JNJ	2.25	2.40	2.59	
Lorillard	1.73	2.07	2.20	
Lowes	0.50	0.60	0.68	
Marsh & McLennan	0.86	0.91	0.96	
Microchip Tech.	1.38	1.40	1.42	
3 M (Minn Mining)	2.20	2.32	2.54	3.42
Occidental Petroleum	1.76	2.08	2.46	
Omnicom Group	0.95	1.15	1.50	
Philip Morris Int'l	2.69	3.16	3.49	
Procter & Gamble	2.06	2.21	2.37	
Royal Dutch Shell	3.36	3.44	3.60	
Smucker (JM)	1.84	1.96	2.20	
State Street	0.55	0.90	1.02	
Sysco Corp.	1.04	1.08	1.12	1.16
UnitedHealth Group	0.61	0.80	0.99	
S&P 500	26.43	31.25	34.99	

(1) New indicated rate for 2014

Our companies continue to generate significantly more cash than they need to support all their operating initiatives. These shareholder friendly managements tend to use this extra free cash flow to consistently repurchase treasury shares. Table 2 shows the net repurchases of all of our companies for 2012 and for the nine month period ending September 30, 2013. Negative numbers equate to a reduction in the share count and positive numbers indicate an addition to the outstanding share base. Clearly the vast majority of these companies do reduce their outstanding share count each and every year and we like this. We believe that companies that can annually increase their dividend and simultaneously reduce their share count will ultimately create shareholder value. This assumes that these activities are funded out of internally generated cash flows, which would validate the operating strategy for the company. We believe this is the case for all of our companies.

TABLE 2
NET SHARE REPURCHASES
(in millions)

	2012	9/30/2013	2012	9/30/2013
3M Company	$-1,192	$-2,166	-2.1%	-3.3%
Abbott Labs	$-514	$-1,386	-0.6%	-1.3%
Air Products	$-235	$-235	-1.3%	-1.3%
Amgen	-$3,319	$-564	-5.9%	-0.9%
ADP Inc.	$-412	$2,235	-1.6%	-0.8%
Becton Dickinson	$-406	$-406	-2.5%	-2.7%
Chevron	-$4,142	$-3,306	-2.0%	-1.6%
Conoco Phillips	-$4,960	$12	-5.1%	-0.0%
Cullen Frost	$10	$66	-0.0%	-0.0%
CVS/Caremark	$-3,494	$-1,841	-6.6%	-3.1%
Illinois Tool Works	$-1,737	$-848	-7.7%	-3.0%
IBM	$-10,455	$-7,236	-4.8%	-3.3%
Int'l Flavors & Frag.	$9	$-28	-0.0%	-0.5%
JNJ	$-10,199	$-779	-5.7%	-0.4%
Lorillard	$-573	$-566	-3.7%	-3.7%
Lowes	$-4,044	$-2,680	-12.7%	-6.7%
Marsh & McLennan	$-79	$-220	-0.5%	-1.2%
Microchip Tech.	$36	$22	-0.0%	-0.0%
Occidental Petrol.	$-498	$-37	-0.7%	-0.1%
Omnicom Group	$-1,137	$-571	-9.3%	-4.3%
Philip Morris Int'l	$-6,524	$-5,219	-4.8%	-3.7%
Procter & Gamble	$-2,537	$-2,198	-1.4%	-1.2%
Royal Dutch Shell	$-1,492	$-4,635	-1.4%	-4.7%
Smucker (J.M.)	$-362	$-165	-4.1%	-1.8%
State Street	$-899	$-1,643	-4.5%	-7.5%
Sysco Corp.	$-93	$-154	-0.5%	-0.8%
UnitedHealth Grp.	$-2,006	$-1,810	-3.7%	-3.3%

Source: Baseline

We are cautiously optimistic for 2014 for the markets. The economy is getting stronger and broader and if not quite at "escape velocity" (able to stand on its own), is at least getting closer. Consumers continue to heal, corporations are very profitable and flush with cash, and the government deficits are declining rapidly, despite the continued nonsense in Washington. Job growth has steadily picked up and several big areas such as autos and housing have shown real signs of life. We expect the Fed to keep a tight rein on interest rates even as growth accelerates and unless inflation somehow becomes unleashed, to the best of their ability, they will not allow rising rates to be the thing that squashes the recovery. And if indeed the economy does pick up, we would not be surprised to see good earnings growth again as despite already high margins, corporate expenses will likely remain tight, allowing for strong contributions to profits from any incremental increase in revenue growth. Valuations are clearly not as attractive as they were, but we feel they are not pre-emptively expensive either, at least given current levels of interest rates and expectations for inflation.

Risks include high near term levels of positive sentiment as many cautious investors have now jumped on the bandwagon. Many emerging economies have seen their growth stall, truncating what had been one of the best areas in global growth for many years. Western Europe, while showing some signs of life and slowly emerging from its crisis, is just barely breathing and therefore remains very vulnerable to further setbacks. Washington still has plenty of arrows in its quiver from which to snatch defeat from the jaws of victory. And ironically, a surprise in growth could lead to faster than expected Fed tapering, which could be deleterious to those aforementioned P/E multiples, which played such a positive role in 2013.

We will remain focused on identifying business models that tend to be reasonably impervious to exogenous factors. Our companies have well-articulated operating and financial strategies with managements that have consistently delivered against realistic long term goals.

2013 was a good year for our defensive equity strategy, nearly matching the performance of the overall market. We remain committed to producing outstanding risk adjusted returns with superior client service. To that end, we continue to reinvest back into the firm as we added new members to our team and we will look to add additional talent this year as well.

So in closing, we wish you the very best in 2014 and we thank you again for giving us the privilege of overseeing your assets. 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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