PENDER
CANADIAN OPPORTUNITIES FUND

MANAGERS COMMENTARY – Q1 2019 - AMAR PANDYA & DAVID BARR

"Well that escalated quickly"

Investors may be feeling symptoms of vertigo with the significant volatility exhibited by the market in the last couple quarters. As the headlines almost boastfully state, 2018 capped off the worst December since the Great Depression, while January's market recovery was the strongest since 1980. The lost decade in the TSX we referred to at the end of Q4 is now just an inferior and unexceptional decade of returns. What may get lost in the sensationalizing of the short-term market ebbs and flows can affect our emotions and increase the risk of acting on those emotions. With a small number of the market's best days and months driving nearly all returns, the risk of not being invested in the market can have a detrimental impact to long-term wealth creation.

We're clearly not smart enough to get the timing of the market's ups and downs right, so we disregard market timing and apply a long-term focus. Being resigned to the knowledge that we can't control short-term prices allows us to put greater focus on understanding the businesses we own or want to own and refining our estimate of their intrinsic value. While we're not completely immune to the emotions caused by short-term losses in value, we endeavor to see a decline in price without any corresponding change in the underlying business as an opportunity to own more of a business we like at an even better value.

Patiently waiting for springs to uncoil

Despite the strong year-to-date performance in the Canadian market, when we look at our weighted portfolio holdings today, relative to the beginning of the year, the difference between their share prices and our estimate of their intrinsic value remains nearly as wide. This is due to our large weighting in high quality, but currently out of favour, compounders or "coiled spring" holdings, which have lagged on share price performance, but have continued to grow their intrinsic value. While the timing to narrow the gap between price and our estimate of value is uncertain, we're surprised to find there's a similar level of expected value in our portfolio today as during the market trough at the start of the year.

"Remove child before washing" There's value in a label

CCL Industries Inc. exemplifies the type of a high-quality, high-conviction compounder we love to own and continues to be a top holding in the Pender Canadian Opportunities and Pender Value Funds. Despite its $11B market cap, the company remains relatively under the radar due to the lackluster, but essential (and highly profitable), nature of its business, and control of the company remaining with its founding family. In addition to the family-controlled stake limiting liquidity in the stock, it also aligns and incentivises management to focus the company's capital allocation strategy on long-term growth.

As the world's largest label company with a global footprint and scale, CCL is a key partner for the world's leading consumer goods companies who require local-market services as they launch new products and expand into new geographies. CCL's technology and innovation focus exposes the company to the fastest growing segments of the specialty packaging sector supporting sustainable above-industry growth. The global label industry remains highly fragmented and is largely composed of small privately-owned companies which CCL can accretively acquire and integrate. Acquisitions have been key to CCL's growth, but their consolidation strategy is prudent, proven and repeatable, with management being patient and opportunistic while avoiding auctions and competitive processes.

Label Peelers Redemption

An example of CCL's innovation can be found with beer labels. When recycling a typical beer bottle, the glued-on paper beer label will need to be sprayed off with high pressured hot water and chemical caustics. This process is time consuming, costly and creates water pollution from the adhesives and inks on the label, which run off with the water. CCL developed and patented WashOff peel labels, a plastic label which easily washes off with the ink staying on the label, shrinks to reduce waste and boasts a premium look. This innovation is a win-win for everyone, it saves recycling costs due to lower water, chemical and energy consumption, CCL can charge a premium for the product which can be easily absorbed by the cost savings it generates, the environment benefits from less waste, and flagrant label peelers can rejoice taking off the whole label with a single pull. Higher returns, less waste, beer…clearly this is something the Pender team can get behind.

A strategic acquisition completed in 2017 exposed the company to input prices from oil derived resins which dampened earnings in 2018. But, the company recently renegotiated contracts with its customers rectifying this issue going forward. With a top tier management team, a strong balance sheet, sustainable competitive advantages and persistent, growing cash flows, we believe the company is well positioned for growth with an attractive valuation.

Portfolio Updates

We were active during the quarter, exiting several positions and concentrating the Fund further into our highest conviction investments. The Fund had 27 holdings at the end of Q1, down from 36 at the end of Q4, with the top 10 positions in the Fund making up 53% of the portfolio. We continue to find no shortage of highly compelling investment opportunities, including both high quality compounders and opportunistic close the discount investments. However, in the current market environment, our preference is towards high quality secular growth businesses.

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