PENDER
Forward thinking. Finding value.

Pender Investment Conference 2019
Marking 10 Years of Investing the Right Way

To mark 10 years since the launch of our mutual funds, Pender took its annual Investment Conference to a new level, with additional due diligence sessions and a keynote speaker.

Culture First, everything else later

"The name on the front is more important than the name on the back" – Herb Brooks

Attendees at this years Pender Ideas Conference were treated to keynote speaker, former NFL General Manager and three-time Super Bowl winner, Michael Lombardi. Michael spent his football career as an executive, working alongside coaching legends including: Bill Walsh, Al David and Bill Belichick. He shared his experience and insights into what ingredients are required for an organization to succeed. If there was one overarching takeaway, it is clearly the importance of culture and leadership to build a successful organization. Looking at winning sports teams, the entire structure of the organization must be invested and committed in order to win. Every individual in the organization has a role and it is their responsibility to fulfill that role to the best of their abilities. The principles, culture and leadership required for a sports franchise to succeed are the same as those required to build and sustain any successful people-based business. It is the role of leadership to set the tone and create a culture where people are proud and willing to strive, prioritizing the goals of the organization ahead of their own. Michael articulated that successful organizations adopt a growth mindset where there is a desire to be challenged, a willingness to work for a collective result and an environment where mistakes are accepted as long there is a focus to learn and improve from them. A desire for continual learning, improvement and a focus on winning is key to the success of any organization. Whether it is the underdog football team or the upstart tech company ready to launch their latest product.

Stacking the odds in our favour with great people

The foundation of Pender was in Venture Capital and the focus on people and culture was highlighted as the primary factor for investment consideration in Maria Pacella's presentation on investing in Private Equity and Venture Capital. Given the limited track record of a product and, in many cases, the market for that product, it is important to look beyond the quantitative factors and focus on qualitative aspects like people, culture and strategic objectives. Our process can be broken down to three points along the investment cycle: Entry, execution and exit. A focus on people is inherent in all these stages of the investment process. At entry we are utilizing our network to source for qualified deal-flow, with a focus on identifying companies with a great founding team. Execution which is the longest period of the investment holding is focused on scaling the workforce, developing the product and identifying a market for the product. Challenges can always arise and it is possible to pivot the product and the market, but without the right team and culture, a company's ability to overcome these challenges is severely compromised. While an exit thesis is developed at the time of investment, once again it comes down to the quality of the management team to execute. Changes can occur along the way given the natural ebbs and flows of a growing a business. With an acquisition or IPO being the primary ways to exit, a reliance on good relationships with competitors and strategic investors, both at a board and management level, are necessary to crystalize value.

Finding the "easy games" of Credit

The "easy games" of credit investing aren't always that easy as Geoff Castle pointed out, but there are certain areas of focus within the credit space that are fertile hunting grounds for potential superior risk-adjusted returns. One of these areas of focus has been identifying discrepancies between a company's credit rating and its actual fundamental risk. This disconnect, between fundamental and perceived risk, can lead to opportunities to invest in a security that offers minimal risk but still provides a fair amount of yield. The risk adverse nature of credit markets can lead to investors overlooking the ample variety of opportunities which are inherent when companies are undergoing a restructuring. In many cases, a workout can be a significant driver of returns, assuming the risks, asset values and probabilities are carefully assessed prior to making an investment. These investments have a fair amount of risk but generally provide ample compensation for that risk, with stronger than perceived visibility to value. The capital structure of companies can also be ripe with opportunities. In some cases it is possible to identify tranches and classes of securities where risks are fairly similar but yields are considerably higher. This "easy game" of more yield for a similar level of risk has been a recent area of opportunity for the Pender Corporate Bond Fund.

Always change a winning game

"If we're all thinking alike, no one is thinking." – Bill Walsh

The rapid rise of passive investing over the past few years has created a dramatic change in the investment landscape with assets in passive US equity funds on track to overtake active funds soon. CIO Felix Narhi discussed the ways in which passive investing has changed the "game" of investing and the necessity to adapt to the environment to seek out and exploit the aberrations or "easy games" which have resulted from this shift. Mr. Lombardi mentioned that teams go into a game with a plan in place but need to adjust to their opponents and their environment, and it takes good leadership and a strong culture to make the necessary adjustments. Differentiation in thinking, strategy and actions are key to success as it is impossible to outperform if you are investing the same way as everyone else.

This reinforces the Pender credence of searching for an unfair advantage, which can be found in our sandbox of small, misunderstood and out of favour businesses. While sophisticated competition has intensified on large cap equities, the small and, more significantly, microcap universe remains ripe with attractive opportunities. A focus on identifying wealth transfers which we recently discussed and identifying opportunities where investors may be using rigid decision rules or have requirements that drive a trade decision, irrespective of fundamental value, are other "easy games" which can be played. Given the prominence of platform companies like Amazon, which have diverse and evolving businesses that are not categorizable into a single sector, analyzing businesses as a generalist and not as a specialist can also lead to an advantage. Successful investing in this environment of rapid technological change and disruption requires a culture which is flexible and adaptable while still being focused on obtaining more value than purchased while mitigating downside risk.

Looking for catalysts when things don't go according to plan

The Pender equity investment process is focused on identifying high quality companies with sustainable competitive moats and strong, proven management teams. Ideally these types of businesses can be acquired at a sizeable discount to intrinsic value and assuming things go according to plan, they compound capital for a long period of time. Unfortunately, for the vast majority of businesses, things don't go according to plan, as Dave Barr discussed. However all is not lost, and these situations create opportunities with close-the-discount investments. The market follows The Pareto Principle, or the 80/20 rule, with @20% of stocks driving @80% of the markets' long-term price appreciation. Ideally, you want to own those 20% of businesses. But there is still plenty of opportunity investing in some of the remaining 80% of stocks. But, it requires an ability to identify catalysts, perform deep due diligence to estimate intrinsic value and the discipline to invest only when paying a substantial discount to that estimate. This deep discount to value provides a margin of safety to compensate for any imprecision in estimation and the unexpected issues which may arise. Prior to investment, we focus on identifying a potential catalyst, assessing the probability of that catalyst forming, understanding how motivated the sellers of the businesses are and determining who the possible buyers would be. The "game" of catalyst investing requires a culture that is disciplined, nimble and easily adapts when conditions on the field shift and the facts change.

We all lose if we don't learn to play the long game

Games and competition are fundamental to nearly all aspects of life, including business. Success arises from applying the right strategies, having the right process and creating the right culture. After a week of listening to Mr. Lombardi, watching the NHL and NBA finals, listening to the Pender team use an exhaustive list of sports analogies, it is hard not to see the similarities between sport and investing. There are a lot of players, a lot of hitting and a lot of attrition, but you stay patient, you wait for the right opportunity and, every once in a while, you see the receiver, get that opening, take your chance, make the pass and…touchdown!

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