ValueInvestor INSIGHT

December 31, 2015

The Leading Authority on Value Investing

Between the Cracks

"The majority of those who invest in technology are not value investors," says David Barr, who has done an excellent job of taking advantage of that fact.

INVESTOR INSIGHT

David Barr
PenderFund Capital Management

Investment Focus: Seeks overlooked, still-high-potential companies when the market is skeptical of their potential or just hasn't done a good job of assessing it.

As a venture capitalist in the early 2000s, David Barr learned some hard lessons about corporate survival. "Our companies that survived and thrived weren't that different from a product perspective from the ones that blew up," he says. "What separated the winners was a focus on profitability and conservative balance sheets. A lesson well learned."

Still focused on small companies with a technology bent – but now publicly traded – Barr has earned a net annualized 19.2% since launching PenderFund's flagship Small Cap Opportunities Fund in 2009, vs. 7.3% for the S&P/TSX Capped Composite Index. He's finding opportunity today in such diverse areas as surveillance systems, telecom networks, financial services and patent management.

PENDER
PenderFund Capital Management Ltd.

Pender is an independent, employee-owned, value-based investment firm located in Vancouver, Canada.

We have the following investing philosophy:

- **Small and nimble funds** allow us to be opportunistic and access unique investments that can be rewarding for investors.
- **Concentrated portfolios of value-based investments** can generate superior long-term, risk-adjusted returns.
- **Aligned** managers show greater conviction and act with heightened vigilance of both risks and opportunities.

@penderfund

PenderFund Capital Management

Inside this Issue

FEATURES

Investor Insight: David Barr
Mining the neglected before the market takes notice and finding upside in Avigilon, RDM Corp., Sandvine and Wi-Lan.

Investor Insight: Gabelli Funds
Seeing value, and catalysts, in EchoStar, Allergan, Edgewell, CVS Health, United Natural Foods and Madison Square Garden.

Uncovering Value: New Senior
Why is this advantaged business getting so little respect?

Uncovering Value: Energy XXI
Pursuing a cigar-butt idea in a quality-obsessed market.

Editor's Letter
Sharing some terrifically bad ideas for the coming year.

INVESTMENT HIGHLIGHTS

INVESTMENT SNAPSHOTS	PAGE
Allergan	10
Avigilon	13
CVS Health	9
EchoStar	7
Edgewell Personal Care	3
Energy XXI	19
Madison Square Garden	6
New Senior Investment	18
RDM Corp.	16
Sandvine	14
United Natural Foods	4
Wi-Lan	15

Other companies in this issue:
BSM Technologies, Chemed, CRH Medical, Discovery Communications, Dish Network, Espial Group, General Mills, Kraft Heinz, Maxim Power, Pfizer, TIO Networks, Valeant Pharmaceuticals, Vivendi, Whole Foods

Investor Insight: David Barr

David Barr of Vancouver's PenderFund Capital Management explains his contrarian approach to technology investing, where he seeks an analytical edge, which sector he's always shunned is getting interesting, the unconventional reason he keeps portfolio cash on hand, and what he thinks the market is missing in Avigilon, Sandvine, Wi-Lan and RDM Corp.

Small-cap, technology-focused investors don't tend to tout their value-investing chops. Why have you found that a comfortable position?

David Barr: We're looking to invest in areas where we can develop an analytical edge. One way to do that is by investing in small- and micro-cap companies where there aren't so many people paying close attention to their every move. We also think we can find an edge in technology-related businesses, an area in which we've developed expertise and have a valuable network, and one in which a lot of aggressive momentum investors are trying to play the quarters. That can cause volatility that we try to take advantage of by focusing on the underlying long-term health of the business when others only care about what just happened.

There are a lot of value investors out there who say they won't invest in technology because they can't understand the source of competitive advantage and because business models can be disrupted quite quickly. We don't disagree with those concerns, but try to mitigate the risks by the types of companies in which we invest. For example, we focus on business-to-business companies, often with a software component, whose revenue models tend to be fairly stable and whose competitive advantages can deepen over time. Technologies that help businesses run more efficiently and cost-effectively or that lend increased desirability to end products are hard to replace.

We also pay an inordinate amount of attention to downside protection as opposed to just focusing on future growth. I started out in the business in venture capital in 2000 and learned the importance of strong balance sheets and buying with a margin of safety when investing in small technology companies. Leadership is also critical here: we're looking for conservative management that underpromises and overdelivers and is content to grow more slowly if that means more profitably and safely.

When you invest over the long term, your return will approximate the return of the underlying businesses you invest in. That makes companies that sell technology products and services attractive candidates, because they can be addressing big growing markets and are often capable of high operating leverage and strong margins. If we can find them at what we consider value prices, it only improves our overall chances of success.

ON POTENTIAL:

We're OK investing in emerging businesses if we truly understand the operating leverage that's been created.

Can you give some examples of where you've gained an "analytical edge"?

DB: We're very often trying to understand the impact of key developments on a business ahead of the reported financial results. Two summers ago our shares in TIO Networks [TNC:CN] were trading around 25 Canadian cents and the company was perceived to have little or no growth potential. But we saw upside not only in an acquisition TIO was in the process of making, but also from the fact that TIO had an existing customer relationship with a division of AT&T, and AT&T was in the process of acquiring Cricket Wireless. All of that signaled the potential for significant new business and improved profitability, both of which happened. This wasn't difficult-to-uncover information, but because the company was so small there just weren't many people making the effort. [*Note*: TIO shares currently trade at C$2.25.]

Another typical situation we think we can understand well is when the internal tradeoff is being made between increasing margins and reinvesting in the business. If you're a saw-mill company and you want to grow your business, you build another saw mill. That goes through the cash-flow statement as capital spending and you have a big asset on your balance sheet that gets amortized over time. In the technology world a lot of R&D goes through the income statement, which depresses short-term profitability in anticipation of long-term benefit. We're perfectly fine investing in emerging businesses that are at break-even or about to be if we truly understand the operating leverage that has been created. Many investors want to see more of a track record of profitability first.

We've been shareholders of BSM Technologies [GPS:CN], which sells systems for the remote monitoring of fleets in rail, trucking, governmental and construction vertical markets. In this market we believe it takes C$25-30 million in annual revenue before you start to benefit from scale and your margins and profitably start to increase. BSM had just reached that point on its own when it announced over the summer it was merging with another player in the market, Webtech Wireless, which was of comparable size and at a similar inflection point. Now with the two companies together – the deal closed in October – we see even more potential for profits to significantly increase. The market so far doesn't seem to agree. [*Note*: At a recent C$0.87, BSM shares are down 45% in the past year.]

Sometimes we just think the market is overreacting to news. In its latest quarter Espial Group [ESP:CN], which sells software used in the delivery of digital televi-

sion services, reported record revenues and cash flows, but mentioned that one large customer in North America was shifting its product-development strategy in a way that might impact Espial. As we dug into it, we concluded the change had more to do with timing, if anything. But some sell-side analysts reported the company had "lost" the customer and the shares have gotten hit – we think inappropriately – demonstrating how skittish the market is right now. It's not like this is an overly speculative company – the book of business is relatively stable and there's C$1.50 per share in current assets built into the current share price of only C$2.30. We increased our position significantly.

What outside of technology interests you?

DB: In addition to technology, we typically look at companies in healthcare, consumer products and specialty finance. These are areas in which we can get up to speed quickly and where we're more likely to find businesses that can compound internal capital at the mid-teens rate we want to see.

But we're always looking for ways to make money for our investors and that sometimes can mean investing in only a decent business, where the stock is so cheap that just from the discount closing we can earn our required rate of return. We'd love for the entire portfolio to be in long-term compounders, but these close-the-discount ideas usually make up about 30% of the portfolio.

A current example?

DB: Maxim Power [MXG:CN] is a power-generation company with assets in the northeastern U.S., in Alberta, Canada and in France. The business generates decent cash flow, but it's really sub-scale and the market has shown no interest in giving the stock more than a distressed valuation. So the company can't raise more equity to expand and just kind of goes along locked in no-growth mode.

The book value of the company, which we consider a conservative measure of intrinsic value, is around C$5.50 per share, while the current stock price is just under C$3. In the end, we think this very likely gets sold in the next 12 to 24 months and that discount to intrinsic value closes.

Forgive the profiling, but is it unusual as a Canadian to have little interest in resource-based companies?

DB: My general view is that you're too reliant on accurately forecasting the underlying commodity price to credibly arrive at what cash flow from the business is going to be three to five years out. My crystal ball on commodity prices remains broken.

ON CONCENTRATION:

If we were just buying cheap stocks off of screens, I'd probably own 80 to 100 stocks at around 1% each.

That said, when we look at where commodity prices are and at the state of the market for high-yield debt, I will admit to being intrigued by some of the opportunities in the distressed debt of natural-resource companies. We're not comfortable going there yet, but could imagine in the next 12 months finding attractive prospective returns in debt instruments where the analysis will be very much the same as if we were buying stocks.

How generally do you arrive at estimates of intrinsic value?

DB: We typically build out a cash-flow model over the next two to three years and then apply a relevant multiple based on what we believe a strategic buyer would pay for the business in the open market. That isn't just a theoretical exercise – most of the time we actually believe the company would make a very attractive takeover candidate. So far we have a pretty good batting average: with a portfolio of between 20 and 30 positions at any given time, an average of just under six per year have been acquired since we launched our small-cap fund in mid-2009.

Our hurdle is to expect at least a 15% annual rate of return on our purchase price over three to five years. As I mentioned earlier, that can come from varying combinations of intrinsic-value growth and the closing of the value discount.

You mentioned holding 20 to 30 positions at a time. Why that level?

DB: The top 20 usually account for about 80% of the portfolio, with the remainder in smaller positions as we're entering or exiting. It basically comes down to our wanting to understand companies and their businesses well enough to have an analytical edge, something that would be much harder for us to do with a more diversified portfolio. If we were just buying cheap stocks off of valuation screens, I'd probably own 80 to 100 stocks at around 1% each.

How do you manage cash?

DB: We consider cash a strategic asset, allowing us to take advantage of the volatility in small- and micro-cap stocks. If I can't pound the table to buy something, I'll just sit there with cash. We've had more than 20% of the portfolio on average in cash since inception, but as volatility has picked up lately we've been putting money to work and the current cash level is around 14%.

Another reason I keep cash on hand is to avoid having to decide about what to sell every time I want to buy something. In general, I think the fewer decisions you have to make the better off you are.

You invest primarily in Canada, where you're based, and in the U.S. How do you manage currency risk?

DB: We're not too concerned when the Canadian dollar is overvalued relative to the U.S. dollar, which was the case early on for our small-cap fund. We believe it's fairly valued at somewhere between 80

and 85 U.S. cents. It's below that today, but not enough for us to be hedged.

You closed your small-cap fund when it got to around C$125 million in assets. That's a hard thing for most money managers to do in a business with the operating leverage this one has.

DB: You sound like my CEO and CFO! I understand all the counterarguments, but we want to keep assets low enough that we can still make meaningful investments in very small market cap companies where we have a greater chance of having an analytical edge. Right now we think that's the case with assets capped at around C$125 million.

Walk through your investment thesis for Canadian surveillance-systems company Avigilon [AVO:CN].

DB: The company was founded in 2004, went public in 2011, and is a provider of high-definition video-surveillance systems, which continue to rapidly replace analog closed-circuit TV systems and also are attracting new customers as security concerns rise around the world. Revenue has increased over the past five years at better than 60% a year, to C$340 million in the past 12 months.

What the company has done well is create an end-to-end solution. The part of the business that involves capturing quality HD video with cameras can get commoditized fairly quickly, but Avigilon's systems are also state-of-the-art when it comes to the more challenging part of filing, storing and then actually making sense of all the data and putting it to practical use. They've spent some US$100 million securing patents over the past few years in the data-analytics space, which we expect to help drive continued competitive advantage and to help generate a larger recurring-revenue stream going forward.

Another big advantage of selling complete solutions is that the company can largely bypass traditional reseller channels. That allows it to keep some of that margin for itself and also to share it with customers through lower pricing on what is a better product.

Describe the competitive set.

DB: It's a very large global market – estimated at $18 billion a year and expected to grow at double-digit rates for the next five to ten years – but remains quite fragmented. Bigger players include Axis, a Swedish company that was bought by Canon earlier this year, Panasonic, Flir Systems and China's Hikvision. Most competitors specialize in one area or another, from providing front-end cameras to providing back-end software. Based on our research, Avigilon is still the technology leader when it comes to end-to-end solutions.

We haven't yet asked about your general take on management. Is that a key part of the thesis here?

DB: In general we'd argue that management at small companies has a disproportionate influence on outcomes. So it's extremely important that we believe they have high integrity, are careful stewards of capital and have fully aligned interests with shareholders.

Avigilon's CEO, Alex Fernandes, was previously very successful in building and then selling a digital camera and software company serving the scientific-imaging and machine-vision markets. He owns 10% of the company and since taking it public has overseen 18 straight quarters of profitable growth. There's been some

INVESTMENT SNAPSHOT

Avigilon
(Toronto: AVO:CN)

Business: Designs, manufactures and markets network-based video surveillance systems and access-control equipment used in a variety of security applications worldwide.

Share Information
(@12/30/15, Exchange Rate: $1 = C$1.3875):

Price	**C$13.86**
52-Week Range	C$11.20 – C$25.62
Dividend Yield	0.0%
Market Cap	C$602.5 million

Financials (9 mo. FY2015, annualized):

Revenue	C$347.0 million
Operating Margin	9.0%
Net Profit Margin	8.6%

Valuation Metrics
(@12/30/15):

	AVO:CN	Russell 2000
P/E (TTM)	17.7	152.8
Forward P/E (Est.)	13.6	17.9

AVO:CN PRICE HISTORY

THE BOTTOM LINE

The company's complete-solution product offer positions it well in a large security-related global market that David Barr believes can grow at double-digit rates for at least several more years. If he's right that it can capture 5% of the market within five years, at 2x his revenue estimate at that point the shares would trade at roughly triple the current price.

Sources: Company reports, other publicly available information

turnover in top management that worries people, but we consider it a function of a demanding leader who knows clearly where he wants to go and isn't afraid to bring in new people with the skill sets needed to get there. That to us is not a problem.

What do you believe the shares, now just under C$14, are more reasonably worth?

DB: Recent takeouts in the space have been done at around 3x revenue – more relevant to smaller businesses starting to hit their inflection points – and at anywhere from 15x to 23x EV/EBITDA for more mature businesses. For perspective, on trailing numbers Avigilon trades at 1.8x revenue and 12x EV/EBITDA.

So while we think we're getting a significant discount today, the growth potential here makes this even more interesting. We believe the company can capture up to 5% of the global market over the next five years, which would make it a C$1 billion-revenue company. Put a 2x multiple on that and the share price would be three times what it is today, or around C$45. We get to a similar level if we apply to our out-year estimates a 15-18x EV/EBITDA multiple. We don't think that's out of line – Canon paid something like 23x to buy Axis and get into this business.

Sandvine [SVC:CN] is one of those technology companies for which it's hard at first glance to figure out what they do. Before explaining why you like the stock, describe the business.

DB: It is absolutely true that the jargon in these businesses can make them more confusing than they actually are. We often find that a contributing reason for stocks being cheap is that small companies run by technologist founders don't do a good job of communicating to the market.

Sandvine's hardware and software provide two basic solutions to telecom-service providers. One is to help reduce the "traffic jams" that are inevitable as bits and bytes move over a network by allowing the network service provider to know specifically where the data is coming from and where it's going to. That would allow, for example, a telco to slow down a subscriber who's downloading the entire *Star Wars* franchise in ultra-high definition or to speed up a subscriber who's watching Netflix during prime time.

Sandvine technology also enables network providers to create more customized service plans. Say subscribers want an inexpensive pre-paid plan that provides only unlimited mobile Facebook access for $5 per month. Or say company X wants to offer "toll-free" access to its app without users having to use up data under their data plans. The service provider in these cases needs to know in real time what plan a specific phone has and where it does and doesn't have access. Sandvine's solutions answer these questions and route traffic accordingly.

Doesn't speeding up and slowing down applications run afoul of net-neutrality regulations?

DB: It can, and that association has been a headwind for Sandvine's stock. But the company years ago started shifting its emphasis away from so-called traffic optimization – some of which remains perfectly acceptable from a net-neutrality standpoint – more toward service-creation applications. Five years ago optimization made up over 50% of Sandvine's revenues and service creation was less than 20%. Today those numbers are 21% from optimization and 57% from service creation.

INVESTMENT SNAPSHOT

Sandvine
(Toronto: SVC:CN)

Business: Develops, markets and maintains network equipment and related analytical tools sold primarily to providers in North America of consumer wireless and broadband services.

Share Information
(@12/30/15, Exchange Rate: $1 = C$1.3875):

Price	**C$3.53**
52-Week Range	C$2.22 – C$4.57
Dividend Yield	0.0%
Market Cap	C$521.8 million

Financials (9 mo. FY2015, annualized):

Revenue	C$117.7 million
Operating Margin	15.5%
Net Profit Margin	18.2%

Valuation Metrics
(@12/30/15):

	SVC:CN	Russell 2000
P/E (TTM)	15.9	152.8
Forward P/E (Est.)	20.8	17.9

THE BOTTOM LINE

The company's technology enables providers of consumer wireless and broadband services to create the types of customized service plans that they increasingly see as critical to their business plans, says David Barr. At what he considers a fair private-market valuation of 12.5x EV/EBITDA on his 2016 estimates, the stock would trade at around C$6.

Sources: Company reports, other publicly available information

With the dramatic increase we expect in carriers looking to offer specialized data plans, those numbers should continue to diverge rapidly.

Another headwind I'd mention for the stock is the fact that the company has invested a ton of money in R&D over the past ten years to enhance and extend its technology. Gross margins are 75%, so it appears not to be competing on price, which usually happens when you're a technology leader. But we do believe the majority of that spend is over and the company is moving more into a harvesting phase as it grows its top line. That makes the idea more timely.

How are you looking at valuation with the shares at a recent C$3.50?

DB: The business can be lumpy, so the stock every couple of years gets hit by a couple of weak quarters in a row. That happened again over the summer and the shares got down to C$2.25, which was only 4.5x free cash flow. Even after recovering somewhat, they now trade at around 8x trailing EV/EBITDA.

When we look at comps, the fact that the business should still be able to grow at a double-digit rate, and that 40% of the market cap is in net cash, we think the private-market valuation is closer to 12.5x EBITDA on 2016 numbers. That translates into around C$6 per share. If we're right about their hitting an inflection point on profitability, the upside is even better.

Is your next idea, Wi-Lan [WIN:CN], what can less charitably be referred to as a patent troll?

DB: I would say the more objective description is that it's an intellectual-property licensing company. It developed some of that IP internally, some has been acquired in bulk through acquisition, and some comes from partnering with Bob the inventor who designed some great new technology in his garage. Their technologies run the gamut, but they tend to be strong in the memory market and in digital television.

The sector in general does have negativity around it right now. Much of that is driven by a U.S. litigation environment that has changed substantially over the past couple of years to favor operating businesses over pure IP-licensing companies in judgments on intellectual-property rights. The sentiment balance tends to run in cycles, but the current one isn't in Wi-Lan's favor.

Another key thing weighing on the shares is the fact that the company last month, in responding to the difficult patent-licensing environment, cut its dividend from 21 Canadian cents annually to 5 cents starting next year. That put selling pressure on the stock, both from angry shareholders who held it primarily for the dividend yield, and from the anticipation of a lot of shares coming on the market from one "Dividend Aristocrats" ETF in Canada having to unload its sizable stake. The stock price fell quickly from around C$3 to C$1.50.

With the shares having modestly rebounded to C$1.85, why do you still consider that reaction overdone?

DB: Whenever there's blanket selling like this we go back to the fundamentals. The company should generate on the order of C$61 million in operating free cash flow next year. That's from licensing agreements in place and doesn't envision any big settlements for new licensing deals signed out of the pipeline. They'll probably spend C$27 million or so on acqui-

INVESTMENT SNAPSHOT

Wi-Lan
(Toronto: WIN:CN)

Business: Develops and acquires patented technologies that it then looks to monetize by licensing them for use in the design and production of various products and services.

Share Information
(@12/30/15, Exchange Rate: $1 = C$1.3875):

Price	**C$1.83**
52-Week Range	C$1.30 – C$4.00
Dividend Yield	2.7%
Market Cap	C$221.0 million

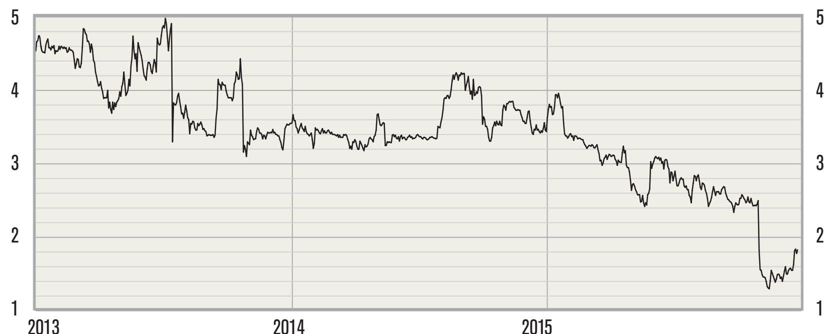
Financials (9 mo. 2015, annualized):

Revenue	C$102.4 million
Operating Margin	17.9%
Net Profit Margin	9.1%

Valuation Metrics
(@12/30/15):

	WIN:CN	Russell 2000
P/E (TTM)	9.0	152.8
Forward P/E (Est.)	n/a	17.9

WIN:CN PRICE HISTORY



THE BOTTOM LINE

In currently pricing the company's shares at a 25% free-cash-flow yield on enterprise value, the market is overreacting to the company's current difficult operating environment and its recent dividend cut, says David Barr. He believes that a private buyer could pay 8x EV/FCF for the shares, around C$3.10, and "still have a lot of value left on the table."

Sources: Company reports, other publicly available information

sitions, so true cash flow will be around C$34 million. The market cap is C$220 million and net cash is around C$86 million, so the enterprise value is C$134 million. On enterprise value, then, that implies a free-cash-flow yield of 25%.

Because free-cash-flow multiples are so high, I think the entire field of IP-licensing could be highly attractive to private equity. There are long-term contracts in place and cash flows are relatively predictable. At 8x enterprise value to free cash flow a buyer of Wi-Lan could offer a significant premium to current shareholders and still have a lot of value left on the table. At 8x current numbers, the shares would go for around C$3.10.

We've spent a lot of time looking at the company's patent portfolio and could put real blue-sky value on deals still to be done. But we don't really have to bother with that given the value here without it.

Describe the value you also see in micro-cap RDM Corp. [RC:CN].

DB: We often find it interesting when a company is undergoing a metamorphosis. RDM's traditional business is in digital imaging, selling equipment that banks use on-site to scan and deposit checks. That business is mature at best, but has generated 20% returns on capital and nice cash flow for reinvestment elsewhere.

Elsewhere in this case has meant into a payment-processing business, specifically the development of technology that allows the remote deposit of checks. A bank customer can send in a photo of a check and RDM's technology enables the automatic deposit of it into the customer's account. This business generates 75% gross margins with mostly recurring revenue. Because it's growing at more than 10% per year and is reaching scale, it has now become the primary driver of the company's revenues and profits.

With the emphasis financial institutions are putting on increased digitization to streamline processes, we expect companies like RDM with strong technology and a nicely growing installed base of customers to inevitably attract suitors. A company like NCR, which has had its share of stumbles recently, could swallow RDM easily and become an important player overnight in the remote-capture space.

At what price relative to today's C$4 market price could you imagine a takeout?

DB: We look at it on a sum-of-the-parts basis, valuing the traditional hardware business at 1x revenue and the payment-processing business at around 4x revenue. On trailing-12-month numbers, that works out to C$5.50 per share. And that intrinsic value should continue to grow, in our estimation by 10% or better per year.

In terms of financial flexibility, it's worth pointing out the strength of the balance sheet as well. Around 40% of the C$88 million market cap is currently in net cash.

How in general would you characterize your selling discipline?

DB: While we're relatively quick to sell close-the-discount ideas as they get close to intrinsic value – they're just too prone to painful round trips – we will trim back but are very slow to sell compounders. Even if they're at or somewhat beyond our estimate of intrinsic value, we're happy to hold on if the business can still compound at a mid-teens rate.

We try to be much more responsive when our investment thesis is breaking down. An example of that from earlier this year is CRH Medical [CRH:CN]. It

INVESTMENT SNAPSHOT

RDM Corp.
(Toronto: RC:CN)

Business: Provider of payment-processing and digital-imaging equipment and systems to banks, brokerage firms, property managers and various check-cashing outlets.

Share Information
(@12/30/15, Exchange Rate: $1 = C$1.3875):

Price	**C$3.98**
52-Week Range	C$2.75 – C$4.38
Dividend Yield	1.5%
Market Cap	C$87.7 million

Financials (FY2015):

Revenue	C$23.5 million
Operating Margin	19.4%
Net Profit Margin	22.6%

Valuation Metrics
(@12/30/15):

	RC:CN	Russell 2000
P/E (TTM)	15.7	152.8
Forward P/E (Est.)	n/a	17.9

THE BOTTOM LINE

With strong technology and a growing installed base of financial-institution customers looking to streamline their processes through digitization, the company is highly likely to attract suitors, says David Barr. Based just on trailing 12-month numbers, he arrives at a private-market estimate of share value that is nearly 40% above the current stock price.

Sources: Company reports, other publicly available information

had a relatively simple business selling a patent-protected treatment for the non-surgical removal of hemorrhoids, was growing 15% per year, traded at a 12% free-cash-flow yield and had one-quarter of its market cap in cash. Late last year it announced it was buying an anesthesiology-services business for what could amount to more than $70 million U.S., at a time when CRH's market cap was around $40 million U.S. So not only did the business mix change dramatically, the balance sheet also went from pristine to levered. Given the market's love affair with healthcare rollups at the time, we thought the valuation got quite a bit ahead of itself and took the opportunity to exit the position at around C$2.40. We made a good return and I wouldn't change my decision, but our sale timing could have been better. [*Note*: After hitting C$5.50 in August, CRH shares now trade at C$4.20.]

Describe an out-and-out mistake and what you learned from it.

DB: We owned shares in Loyalist Group [since renamed KGIC Inc.], which runs English-as-a-second-language schools across Canada. We bought the stock about a year ago, when it looked like a profitable business with accelerating growth. In the second quarter of this year it reported horrendous earnings as customer acquisition seemingly fell of a cliff, at least in part due to problems with sourcing agencies in Asia. That was just a business risk we hadn't fully appreciated – we recognized it, took our losses and moved on. If there's a lesson, it's a reminder with small- and micro-caps how important it is to vet all downside risks. If something goes wrong at Microsoft, it's probably not a big deal. If it happens at a small company like Loyalist Group, it can be all over.

ON PERFORMANCE:

If our record looks as good in five years, I imagine protecting ourselves on the downside will be a primary reason.

It's a marathon, not a sprint, but to what do you attribute your overall excellent performance so far?

DB: We started the fund in June 2009, so that was our first great idea, to invest at the bottom. People at the time said we were crazy, now they say we were lucky.

The fact that we've been so successful in identifying companies that have been acquired has been a tailwind, as has our lack of resource exposure. What stands out the most for me, though, is how well we've protected ourselves on the downside, both in terms of down-market capture and maximum drawdowns. If our record still looks as good five years from now, I imagine keeping that up will be one of the primary reasons. VII

Disclaimer

The foregoing is a reprint of an article that appeared in Value Investor Insight's December 31, 2015 issue. It is being provided to you solely for informational purposes only. PenderFund Capital Management Ltd makes no representations as to the accuracy or completeness of the foregoing information. This material is not and should not be construed as an offer, solicitation or recommendation to buy or sell any security, nor should information contained herein be relied upon as investment advice. The information herein is not intended to provide, and should not be relied upon for, accounting, legal or tax advice or investment recommendations. Opinions and information included herein are as of the date indicated, and are subject to change. Such information is not intended to be and should not be construed as a forecast of future events, or a guarantee of future results.

Distribution of this information to any person other than the person to whom this information was originally delivered is unauthorized and any reproduction of these materials, in whole or in part, or the disclosure of any of its contents is prohibited.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the simplified prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in net asset value and assume reinvestment of all distributions and are net of all management and administrative fees, but do not take into account sales, redemption or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. This communication is intended for information purposes only and does not constitute an offer to buy or sell our products or services nor is it intended as investment and/or financial advice on any subject matter and is provided for your information only. Every effort has been made to ensure the accuracy of its contents. Certain of the statements made may contain forward-looking statements, which involve known and unknown risk, uncertainties and other factors which may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.