Ian Cooke, CFA on behalf of the QV Investment Committee

QV Investors Inc.

Home Capital Group Update

We had to confront an investment gone wrong in Home Capital Group this week. Home Capital is a lending business with a large presence in the Canadian mortgage market. We have followed Home Capital for most of QV's existence and have owned Home Capital shares in a number of our Canadian equity strategies. We had been impressed with the company's credit performance throughout the years, especially during the financial crisis. We thought solid loan performance, stable funding access and attractive returns on equity, even in difficult periods, were signs of a quality company.

Shares came under pressure last Thursday after allegations were released by Ontario's securities regulator claiming that the company misled investors on disclosures about an internal mortgage investigation several years ago. We immediately addressed our concerns via a conference call with several Home Capital board members. We encouraged swift steps to enhance governance and stabilize confidence in the company.

The next morning, QV and the general investing public were provided with assurances from Home Capital that it was on solid ground. The company pre-released quarterly results and stated:

"As these preliminary first-quarter numbers show, the business is robust and on the right track. We continue to build momentum… Home Capital is a fundamentally strong company, built on a solid foundation."

On Monday morning of this week, the company released another statement, which outlined some initial steps to improve governance. More assurances were provided that the company remained profitable and robust.

Although we felt these were steps in the right direction, we weren't satisfied. More needed to be done. We submitted to the board a letter that we had drafted over the weekend, asking for additional measures to improve governance perceptions while demonstrating strong liquidity and access to funding. We also stressed the importance of maintaining run-off value and asked that they engage a third party to assess strategic alternatives. To be clear, we had already come to the conclusion that this was a failed investment on our part. In no way do we strive to create value for our clients through letters to a board calling for requests of this nature.

Although our investment thesis was broken, we believed inherent equity value remained. To us, the best way forward was to maintain an investment while Home Capital's board considered our recommendations and acted on their fiduciary duties. What we didn't realize was that it was already too late.

Through prior analysis, we felt that there was minimal risk of a traditional run on deposits at Home Capital. With CDIC insurance in place for depositors and over $2 billion in liquid assets consisting of cash and other investments at the end of last year, we thought they had sufficient liquidity. We were wrong.

On Wednesday, only 48 hours after the company's latest reassurances, it was disclosed that there was, in essence, a run on Home Capital deposits. According to a company release, deposits had declined over the past month and accelerated in the recent week. The outflow of deposits was worse than any stress test that Home Capital or QV was prepared for.

To provide emergency liquidity, the company reached an agreement in principle for a one year credit line at exorbitant rates, wiping out a large portion of the company's earnings power. Included in the transaction was a $100 million upfront fee. We later learned that this deal was struck with an organization led by a Home Capital board and risk committee member.

We made an investing mistake in Home Capital. We have made a number of investing mistakes over the years and this certainly won't be the last. However, given the way events have transpired, this situation feels more painful than most.

This episode with Home Capital highlights the importance of portfolio diversification. Home Capital was approximately a 1-2% weight in the portfolios that owned it. Total losses on this investment quarter to date in the accounts that held it range from approximately 0.75%-1.5%.

Perhaps the central lesson in all of this is the importance of candor in communications with stakeholders. Without an appropriate level of openness, confidence quickly erodes. Home Capital's underlying business was profitable throughout the years. None of that mattered once confidence had been shattered. Although a case can be made for deep value in the stock, the business has failed to demonstrate the qualities and execution we expect. We have exited the investment.

Our commitment to providing excellence in investing and communication to our clients persists. If you have any further questions for us related to this matter, please do not hesitate to contact us at any point.