

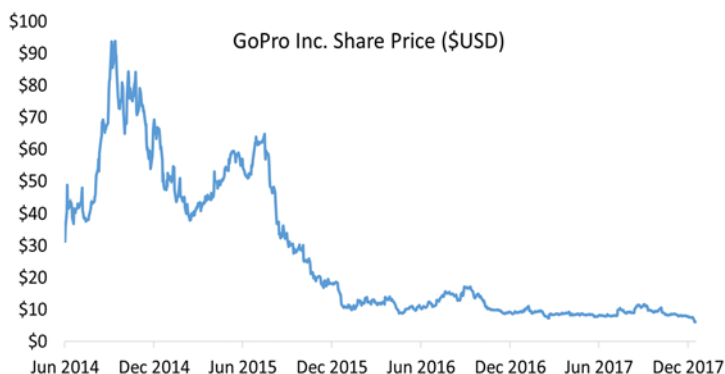
QV UPDATE

Weekly Commentary | January 12, 2018
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No Thrill Seekers Here

GoPro Inc. made headlines this week after providing a negative corporate update. Best known for producing trusty all-weather, all-terrain cameras, GoPro was once viewed as a business with high growth potential. In 2014, the stock was highly sought after and had tripled in value only a few months after its initial public offering. Since then, reality has lagged expectations and the company's market capitalization has dwindled from a peak of \$12 billion to less than \$1 billion.



Source: Capital IQ

In this week's update from the company, management reported fourth quarter sales that were more than 20% below initial expectations, in addition to negative impacts from promotional discounting. In response to weaker than expected demand, GoPro is also planning to lay off ~250 employees. Furthermore, management announced it will be taking a write down on its aerial camera division, an area that was previously expected to help diversify the company's product line.

Operating in a niche market can have its benefits, especially if there are barriers to entry or other favourable competitive dynamics. At QV, we are often wary of one product companies because of the concentration risks involved. Much like investing, we often prefer our companies to take somewhat of a portfolio approach with their own goods and service offerings. To be clear, we do not own any GoPro shares in any of our funds. We have assessed the challenges with the business to learn how we can avoid similar problems in our own portfolio.

Financial Record

One of our core seven tests when analyzing a business is a review of the company's financial record. We look for

evidence of how the company has performed over time, compared to peers and in different economic environments. We place significant emphasis on how a business performed during previous recessions or when a particular sector was facing headwinds. AutoZone, an auto-parts retailer and global equity strategy holding, has a strong financial track record and has performed well in previous challenging economic environments. In 2009, AutoZone's operating profits increased 5% due to ongoing storefront expansion and stable demand for failure and maintenance-related auto parts, which represent the bulk of sales. We don't believe every recession or downturn will be the same, but data like this can help us assess how valuable a company's goods and services are to its customers at different times. GoPro's limited financial track record and lack of history would have failed to pass this test.

Franchise & Outlook

Another core test at QV is assessing the value of a franchise and determining its outlook. Typically, this means we look for evidence that a company has been able to meet customer needs, to adapt and innovate over time. Assessing the company's value proposition and the stability of its market share can also be useful indicators. Intel, a micro-processor manufacturer and global equity strategy holding, has a strong franchise which has translated into high and stable market share. In the personal computing market, the company has held greater than 90% market share for an extended period of time. The company has one of the strongest research and development teams in the industry and one of the sector's largest portfolios of intellectual property. The company's leading design capabilities and manufacturing know-how are aspects that peers have struggled to replicate for many years. Attributes of a quality franchise are much more evident in Intel's business than in GoPro's.

While the strategy may appeal to thrill seekers (like those who rely on GoPro cameras), QV does not chase the latest investing fads or trends. Our seven tests and risk management process not only guide us towards areas of healthier risk and reward, but also allow us to avoid many unattractive investments.