

QV UPDATE

Weekly Commentary | September 27, 2019

Ian Cooke, CFA



Beavering Away

Over several evenings this past week, my family has enjoyed watching a group of beavers prepare for winter on a river near our house. They come out just before sunset, move branches across the water and place them near their lodge. They will spend the entire winter inside this den, snacking on the strategically placed twigs. It is magnificent to witness their thoughtful planning and hard work.

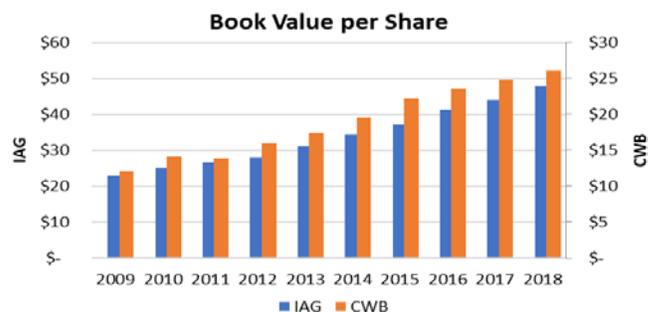
Here at QV, we are also beavering away. September has been full of opportunities to review existing and prospective investments. At the Scotiabank Financials Summit earlier this month, our small cap team received notable updates from two of our financial sector investments, discussed below. At nearly 25% of the portfolio, financials comprise the largest sector exposure within our small cap strategy. It should be noted that 25% is our maximum single sector weight, mandated to help ensure QV portfolios provide sector diversification. For some time, we have been heavily invested in several small cap Canadian financials. The basis for our interest in the space has been steady operations generating attractive returns on equity and extensive opportunities for growth.

Canadian Western Bank (CWB) represents over 5% of the small cap strategy, making it one of our top 3 positions. With the shares off approximately 5% over the past year, one might quickly conclude things are not going well for this bank. However, operational results paint a very different picture. Over the past year, revenue and earnings have grown by 8%, book value per share has increased by more than 10% and the dividend, which now yields 3.1%, was increased at the end of August. Importantly, the bank is on track with its transition to an advanced system that will allow it to optimize capital management and be on equal footing with the large Canadian banks. Management believes this will make their business less capital intensive, allowing it to increase growth without requiring additional capital. We often hear that CWB is a proxy for oil and the Alberta economy. The shares have certainly been correlated to oil prices in the past, but this connection is likely to break down over time. Not only has the company navigated well through past Alberta

economic downturns, lending has steadily grown beyond this province. In 2009, Alberta represented 52% of loans for the bank, compared to 32% today. Canadian Western Bank is even opening its first Ontario-based branch in Mississauga shortly.

iA Financial Corp. (IAG) is owned in all of QV's Canadian mandates and, like CWB, it is also a top 3 investment in the small cap strategy. Operationally, this Quebec-based insurer is executing to plan. Over the past year, premium and annuity revenue has increased 7%, earnings are up 11%, book value per share has increased 6% and the dividend has grown to a record level. Shares have appreciated by approximately 13% over the past year but the valuation for this business remains subdued, trading at less than 10.0x earnings. This discount appears to be attributed to fears that company prospects will diminish in a lower interest rate environment. Declining interest rates are not a new challenge for IAG. The company has persistently faced lower bond yields since going public nearly twenty years ago. During this period, IAG has demonstrated an ability to navigate profitably, with earnings recently reaching all-time highs. Management reiterated this at the summit, highlighting that they have acted to reduce interest rate exposure and do not see any short-term risks associated with interest rates. The company is well positioned to address longer-term risks through shifts in its product offering and by maintaining a strong balance sheet (it's the strongest it's been in nearly a decade).

Just like the busy beavers, Canadian Western Bank and iA Financial Corp. have worked hard to prepare themselves for the inevitable changing of the seasons. Their long track records of building equity for owners over time appear intact.



Source: S&P CapitalIQ & QV Investors