QV UPDATE
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QV Investors Inc.

Opportunities in a Frothy Market

"Nasdaq breaks record-high set during dotcom boom"
– Reuters, June 18, 2015

"Fitbit IPO hits the ground running. Shares of the company jumped as much as 60% in their debut"
– Time, June 18, 2015

"Using proceeds from debt sales to send cash to stockholders has never been more popular"
– Bloomberg, June 19, 2015

Value investors live by the popular creed made famous by Warren Buffett in 2008; "be fearful when others are greedy and greedy when others are fearful". With headline after headline of record market highs, hot initial public offerings and the use of cheap debt to leverage returns in equity markets, the market is clearly in risk-on mode. However, applying generalizations to an entire market is a lazy investor's exercise. It creates ignorance, complacency and luckily, opportunity. In today's letter, we would like to highlight a few attractively valued companies in what is an increasingly expensive market.

The West is on Sale

Weak energy prices and uncertainty related to Alberta's change in government has created negative investor sentiment in this region. Valuation multiples have compressed on high quality companies to levels rarely seen. Take ATCO as an example. ATCO is a large electricity transmission and gas distributor provider in the province of Alberta. The company also has a power generation and structures and logistics business. It is one of the few public companies in Canada with a history of generating returns on equity above 10% in every single year over the past fifteen. ATCO is also one of very few Canadian equities that have increased dividends every year over the past two decades. The company's structures and logistics business, which manufactures remote accommodations, faces numerous end market headwinds today. ATCO's power generation business is generating lower profits due to the weak Alberta power price. However, the company's utility division, which represents the bulk of earnings, is still growing at an attractive pace. Even in the midst of the current end market malaise, ATCO grew book value per share by nearly 10% over the past 12 months. Despite this, shares have contracted by close to 25%. Right now, the company is trading at an attractive discount to its long-term median price/book value and book value has plenty of room to grow over the medium term.

Iron Ore Bear Market

In the resource space, it is very difficult to find high quality assets with strong balance sheets. Numerous marginal projects came into production during the heyday of the resource boom. As a result, a number of balance sheets are stretched and numerous projects are uneconomic in a weaker commodity price environment. We think we have found an exception in Labrador Iron Ore. Iron ore prices peaked in 2011 at approximately $190 a tonne. Today, ore is transacting at closer to $60 a tonne. Shares in Labrador Iron Ore (LIF) have followed the price of the commodity down, declining from over $30 a year ago to as low as $11 this quarter. LIF is a high quality business tied to a healthy asset. It has no debt, no capital requirements and a 7% gross overriding royalty on all revenue generated from the largest iron ore mine in Canada. This asset has operated for over 50 years and has a resource base that can generate high quality iron ore pellets for at least another half century. Despite the malaise in iron ore, the royalty is generating approximately $1.00 in dividends per annum (greater than a 7.5% yield on our average cost) and mine operations generate enough cash flow to cover annual maintenance. We also receive a 15% equity interest in the underlying assets which include the mine, railway and port infrastructure.

So yes, we are generally fearful when it comes to the broad market. Greed is rampant in many ways. However, select opportunities still exist, and we will happily deploy capital when appropriate.