

QV UPDATE

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All Aboard?

We are in the middle of the North American quarterly reporting season. From companies that have reported so far, we get the sense that numerous businesses are now growing top line at attractive organic growth rates. Take our investment in **Canadian National Railway** as an example. The company reported record shipping volumes, revenue, and earnings per share earlier this week. Revenue increased 17% with double-digit increases in grain, fertilizers, metals & minerals, intermodal and automotive. Although they are outperforming competitors, demand across the railway industry has been brisk. Rail car volumes for the six largest Class 1 railroads in North America are up 8% quarter-to-date and 5% year-to-date. Industry volume records have been set. When we look at CN Rail's recent revenue growth, we have to go back nearly 10 years to uncover a growth rate as strong as the first half of 2014, despite facing dismal weather during the first part of this year. As the economic veins of North America, monitoring rail activity can provide reasonably good coincidental economic indicators. Current activity suggests that the North American economy continues to move in the right direction.

Railways are not the only businesses out there demonstrating significant top line growth. QV's Small cap strategy holding **Winpak Ltd.** is a consumer packaging company based out of Winnipeg. The business reported second quarter results Thursday night, with their fifth consecutive quarter of record revenues, growing 12.6% year over year. Volume growth was widespread across many of the company's product groups, including rigid container, lidding products, yogurt, condiment, and specialty beverage containers.

Outside our strategies, a number of companies are also demonstrating attractive top line growth. For example, **Amazon.com** announced quarterly results Thursday night and saw net sales increase to \$19.34 billion, 22% higher than a year ago. This is truly astonishing growth when we assess it over the long term. By the end of this year, Amazon will likely have grown their business by over 5,000 times in less than two decades. Only 19 years ago, Amazon's CEO, Jeff Bezos, was delivering

packages to the post office every evening in the back of his Chevy Blazer!

With trains chugging along, packaging lines humming, and electronic books flying off the shelves, it can be tempting to throw caution to the wind and get all aboard equities as they continue to reach new all-time highs.

It appears now that caution is indeed flailing in the wind. Margin debt in the US as a percentage of GDP is moving toward new highs. Increasingly, market players are participating with more borrowed money in a more highly valued market place. We are not reaching for greater exposure to the recent market melt-up. Instead, our focus is on ensuring that our businesses possess steadfast leadership and quality features that will help themselves grow out of increasingly expensive short-term valuation measures.

A few important considerations for investing in businesses today include:

What does this business look like in a more difficult period?

If a business does not have a good balance sheet in today's environment, when will it ever have a good balance sheet?

Does this business have long-term competitive barriers and a product or service that will be in long-term demand?

The last question is the most difficult to answer. Would a bookstore operator twenty years ago really have thought seriously of Jeff Bezos in his Chevy Blazer as their biggest competitive threat? Because we are not going to get the last question right all the time, we hold a diverse portfolio of 25-40 businesses.

Winpak and CN Rail are performing well in today's environment. They have also operated well in more challenging periods and have maintained strong balance sheets throughout. No business should be owned at any price, so we will continue to monitor valuations in the context of this market rally. We will reduce our exposure to high quality businesses if valued excessively. Investing is not all about being on the train. It's about travelling with purpose and safety. Enjoy the ride.