QV Investors

QV Update

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Bamboo Investing

When I was a kid, my best friend's dad was a successful realtor in Edmonton. There are two things I remember from his home office. The first was when he made calls he reversed his name. As an example, I would call and say, "This is Dansereau Darren speaking", which I think helped people remember his name. The second thing I remember is the rows of Zig Ziglar motivational cassette tapes. When I read this excellent quote in a piece written by John Hussman, I realized the wisdom in those tapes.

"The seed of a bamboo tree is planted, fertilized and watered. Nothing happens for the first year. There's no sign of growth. Not even a hint. The same thing happens – or doesn't happen – the second year. And then the third year. The tree is carefully watered and fertilized each year, but nothing shows. No growth. No anything. For eight years it can continue. Eight years! Then – after eight years of fertilizing and watering have passed, with nothing to show for it – the bamboo tree suddenly sprouts and grows thirty feet in three months!"

– Zig Ziglar (Motivational speaker, author, & salesman)

For a salesman, this would point to the tireless pursuit of opportunities until they bear fruit. As an investor, I take this to mean that patience and conviction is paramount. A new investment idea may not play out in the next quarter or two. But if the original thesis for the company is still intact, and with a good dose of patience, the investment could be very successful. (Ideally it does not take eight years, but we are patient.)

Shoppers Drug Mart (SC) is an example of our "bamboo investing." We had been watching Shoppers for a number of years, but it was too expensive. This changed in January 2011 when we purchased Shoppers in our balanced and large cap equity accounts.

Shoppers' share price declined during the financial crisis and then stabilized until new Ontario legislation was introduced in late 2009. The new rules lowered the professional allowances that drug companies paid to pharmacies and reduced the prices of generic drugs. Prior to these regulatory changes, Shoppers was intending to increase its square footage by 8-9% in 2010. This was quickly abandoned with the introduction of these new regulations. We reviewed the stock in January 2010 and determined that the regime change would significantly hamper the earnings power of the company. We had also seen debt levels increase. We decided to wait. The stock then dropped to the low $30s in mid-2010 as new provinces entertained the idea of implementing similar legislation and the CEO of Shoppers took a confrontational approach with the Ontario government.

In January of 2011, Shoppers CEO Jurgen Schreiber stepped down from his position. The departure was untimely since Shoppers was in the midst of managing revenue declines stemming from the new regulations. We had seen that the effects of the regulations were not as bad as originally feared. The stock declined upon Schreiber's departure and we took the opportunity to initiate a position in the company. We seeded and watered the ground.

The investment thesis was based on a strong franchise in its store base, continued growth from an aging population, and one of the top consumer loyalty programs in the country.

After our purchase, the regulatory environment continued to affect the business, but Shoppers continued to execute its strategy on pace. In late 2011, Dominic Pilla, a 30 year veteran in the health care and retailing sectors, was chosen as the next CEO. We continued to water. The prospects for their business seemed to strengthen over 2012 and into 2013. We continued to increase our weight as the valuation remained attractive while other areas of the market moved to higher multiples.

In July of 2013, Loblaws announced a deal to buy Shoppers Drug Mart using cash and stock that worked out to a price of $61.50 per share. A 30% premium to its last close. On their investor call, Loblaws management admitted their attraction to the exposure that Shoppers had to a demographic that Loblaws was more reliant on. A strength we had originally invested in and we patiently waited on as the company executed. The Bamboo had shot up thirty feet, but it took two and a half years rather than eight!

Recently, we sold our position in Shoppers as no other bidders materialized. The stock we were to receive as part of the deal left us exposed to Loblaws in a difficult grocery environment. We have found better alternatives.

Inside the Fund

Domtar Corporation, a pulp and paper company in our large cap and balanced funds, announced another acquisition in its personal care division. Domtar has set a course to diversify its exposure away from pure commodity areas like pulp and paper and into areas like disposable adult incontinence products and baby diapers. When we are watching a portfolio holding change their business mix, we want to ensure the balance sheet is in check and the plan is achieved by paying reasonable multiples in acquisitions. The management team has been successful in acquiring four personal hygiene companies in the US and Europe at reasonable prices. This week, Domtar announced another acquisition and will be acquiring a Spanish personal care company that will raise Domtar's personal care segment EBITDA to between $150 and $200 million. This division was non-existent three years ago. We have also seen the balance sheet remain in good shape during this process. We look forward to Domtar's success in transforming its business.