QV Update

June 7th, 2013

Steven Kim, MBA
Ian Cooke, CFA

Trust During Uncertain Times

The Latin word for credit is *credo*, which is to believe or trust. An investment in any security requires at least a little credo with an exchange of payment for a right to an asset and/or the future cash flows of an asset. In the case of a bond investor, credit risk is focused on capacity and willingness to pay. Over the past month there has been increased anxiety for bond holders as yields have had an abrupt move higher. This has exposed the risks to bond asset values and leveraged companies. It is no coincidence that highly indebted REITs have begun to underperform the broader market indices as of late.

Evaluation of credit risk is a key to investing in fixed income securities and crucial to preserving capital. However, the concept of credit is not isolated to the fixed income realm. Credit risk, or lack of trust in its root sense, is inherent in equities as well. Investors must believe in the context of an uncertain market that management will make decisions which benefit shareholders and that a business will generate future cash flows. To us sceptics, this is a difficult notion to blindly accept.

A few factors that we consider to help earn our trust include levels of insider ownership, management's actions over longer periods, and accountability. Specifically, we assess whether management has followed through on their commitments. These are some key considerations when deciding to initiate a new investment, continue investing or even sell. Recently a number of holdings have reported quarterly results, and a few have re-iterated why we continue to believe in the future prospects of the investment.

Uncertain Outlook: Constellation Software

QV holding, Constellation Software provides software and services to the private and public sectors. Management's growth strategy has focused on adding niche businesses with strong profitability to their existing portfolio while increasing efficiencies in existing businesses.

As a result, the company's share price has experienced significant gains, trading from around $20 in 2006 to over $140 in 2013. Constellation's success has led to questions about the future sustainability of the performance. In his most recent letter to shareholders, CEO Mark Leonard indicated his belief that the company has the management and financial capacity to double the business in size and profitability in the next 5 to 10 years. We believe that this is an achievable goal.

CEO Mark Leonard owns approximately 6.7% of the company, reflecting his personal stake at risk, alongside other shareholders.

Further consideration is given to the exemplary track record in the past 10 years:

	Revenue Per Share	Cash Flow Per Share
2002	$3.22	$0.43
2012	$42.05	$6.83
CAGR	29%	32%

Source: Company documents & S&P Capital IQ

Equally impressive, is that the growth has been largely funded by internally generated funds and not at the expense of excessive equity issuance or dilution. Given the track record of generating returns on capital and management's ownership levels, we believe that Constellation continues to offer an attractive investment opportunity for its shareholders. Provided that management can continue executing their business plan, which has been proven to date.

Uncertain Environment: Major Drilling

QV holding, Major Drilling's CFO was in the office recently and emphasized the entire organization's ability to reduce costs during difficult periods. Levers such as employee's willingness to accept reduced hours and potential wage reductions were cited as examples. An emphasis on balance sheet strength to withstand difficult end markets was further expressed.

Major Drilling offers specialized drilling services, predominantly to precious and base metals miners. The current environment of deferred capital expenditure programs by many miners has not been easy. These headwinds were evident in this past quarter as revenue fell off about 43% from the previous year. Absolute profitability declined as well but profitability as a percentage of revenue held in fairly well. In our opinion, this demonstrates management's ability to reduce costs and increase efficiencies in tough times.

Despite the environment, Major has generated enough cash to fund capital expenditure, reduce debt and pay their dividend for the quarter. Major's balance sheet is in the best shape it has been in historically, with a net cash position of $38 million. In comparison, many of Major's competitors are significantly more leveraged and likely less prepared for more difficult times.

Although end markets can get even tougher the competitive positioning, commitment by management to maintain a strong balance sheet and flexible cost structure continue to be key reasons for continued investment.

Uncertainty and a lack of trust will always persist. Succumbing to the current levels of distrust in the markets will have consequences with far longer tenure than today's worries. While never advocating blind trust, if looking carefully there continues to be investment opportunities. We believe our process of giving credit to companies that are managed by invested teams, have sustainable business models and supported by strong balance sheets will be rewarded in the long run.