

## QV Investors



## Performance

The total return of the BMO Small Cap Index (unweighted) for the quarter was 7.7% compared to 4.4% for the S&P/TSX Composite Index. The QV Canadian Small Cap Fund gained 11.6%. Fund performance in the quarter benefited from increased merger and acquisition activity (M&A). A US competitor acquired Fund holding Gennum Corporation and BCE Inc. announced the proposed acquisition of Fund holding Astral Media.

Excluding these transactions, performance was similar to the benchmark but the path to generating returns was quite different. Due to the Fund's more defensive positioning, the portfolio did not rally as strongly in January when the index generated the bulk of its returns. The Fund continued to generate gains in February and March whereas the benchmark ended the quarter below its January highs. Benchmark weakness late in the quarter was primarily driven by a pullback in the resource sectors in which the index is heavily concentrated.

## Portfolio Commentary

We introduced Secure Energy Services (SES) and added to existing holdings Canadian Western Bank (CWB) and Stella Jones (SJ) over the most recent quarter. We began building a position in SES during Q4 of last year and the weight is now sufficient in size that we can provide comment on this purchase. SES provides Western Canadian energy producers with processing, recycling, disposal and drilling fluid supply services. Insiders at Secure are aligned with outside investors with approximately 20.0% ownership. The services that the company provides are cyclical in nature but appear to have attractive long-term growth prospects due to the growing trend towards deeper wells with long horizontal legs. This trend is resulting in growing amounts of completion fluids and drilling waste. We have been impressed by the company's ability to grow cash flow on a per share basis each year since its founding in late 2007 while maintaining a strong balance sheet.

The Fund's position in Canadian Western Bank (CWB) was increased to a top five holding over the past three months. We believe we are taking advantage of recent share price weakness by increasing exposure to a fundamentally strong bank that improves most of the Fund's valuation and growth characteristics. CWB possesses industry-leading growth, buttressed by disciplined lending standards.

Stella Jones is one of North America's largest railway tie and utility pole producers. The valuation appears attractive with a P/E ratio of less than 11.0x, complimented by a return on equity that has been in the double digits for each of the past ten years.

We exited our position in GLV Inc. during the quarter and reduced positions in Argonaut Gold and Uni-Select Inc. The sale of Gennum also closed before quarter end. The Fund continues to focus the majority of investments in stable business models that exhibit strong competitive positioning. Most valuation and growth metrics appear attractive when compared to the BMO Small Cap Index. For example, the P/E ratio for the Fund is currently 13.3x compared to 16.9x for the benchmark and 13.7x for the Fund's long term average. The recent increase in the Fund's cash position is due to proceeds received from recent M&A activity. We will be patient and opportunistic in investing the Fund's cash balance.

## Outlook

Excess liquidity, improving corporate profits and reasonable equity valuations, especially when compared to bonds, are all sound reasons for the current equity bull market to remain intact. However, the volatility that has characterized much of the past several years is likely to continue as persistently high debt burdens for much of the developed world continue to amplify investment risks. The Fund continues to focus the majority of investments in stable business models that exhibit strong competitive positions. Although this defensive positioning can help in difficult markets, it will not eliminate the Fund's exposure to a broad based sell off in equities if another financial crisis unfolds.