GAVIN

GAVIN EQUITY POOL: TALE OF THE TAPE

Edition 1, Volume 1, June 2020

SHORT-TERM RESULTS	1-Month	3-Month
GAVIN EQUITIES	(2.27%)	11.91%
S&P/TSX COMPOSITE	2.45%	16.91%
BENCHMARK INDEX*	1.61%	15.98%

*50% SP/TSX Composite and 50% S&P 500 (CAD)

Despite the modest movement, June was another volatile month for equities. What began as a rotation into more cyclical value stocks quickly turned into a dash for defensive and growth orientated securities as coronavirus cases in the United States accelerated. Our picks trailed the benchmark for a second straight month, finishing the quarter over 400 basis points behind the benchmark. The general risk-on sentiment combined with a lower US dollar meant that momentum names reigned while select commodity and emerging markets advanced.

For the month, top contributors were Fairfax India (+11.9%), Canfor Corporation (+16.0%) and Grocery Outlet (+9.2%). Fairfax, which trades at a 50% discount to book value, followed India's equity market higher in June. A pick-up in new home purchases combined with higher lumber prices lifted Canfor's share price from low valuation levels in June. We continue to believe shares are undervalued despite the 85%+ increase from our purchase price as have taken partial profits. Grocery Outlet is a fast-growing discount grocery chain of independent operators in the United States. Shares appeared to advance on news of the company's addition to the S&P Mid-Cap Index which should secure solid fund flow support.

On the other side of the ledger, the primary detractors for the month included Scorpio Tankers & Diamond S Shipping (each down roughly 28%), Cimpress Plc (-16.5%), and Winpak (-9.8%). Despite improving fundamentals and earning nearly 8% of their value in a single quarter, shippers continue to face downward share pressure. While debt levels and slowing global trade are not lost on us, we believe the market is mis-pricing future earnings power of these names. We trimmed Cimpress at the beginning of June following a strong start to the quarter and a technical breakdown in the shares. We believe shares are now underpriced but acknowledge the short-term hurdles the company faces. Finally, Winpak continue to trade within a tight range. Any weakness in the shares will provide an opportunity for us to increase our allocation to this high-quality consumer packaging company.

2Q 2020 Contributors

Cimpress Plc (+37.2%) – The company recently completed a large investment program and integrating strategic acquisitions. This aided the firm in posting an all-time high in trailing twelve-month free cash flow in its most recent quarter of $340 million (19% of its current market capitalization). Management's willingness to invest capital back in its core business, at a time when returning capital to shareholders was being rewarded with higher valuation multiples, will likely contribute to it's competitive advantage going forward. We believe over the long-term shares are worth roughly $140 per share, approximately 100% higher from today's levels. However, these investments came at a cost to the balance sheet. When combined with the impacts of COVID-19 on manufacturing and the company's reliance on small businesses for revenue, shares are likely to remain pressured in the near-term. This has led us to reduce our weighting in the portfolio, taking profits on surges higher. Our confidence in the management team remains un-waivered as the CEO has become further aligned with investors. Robert Keane is forgoing his cash salary and electing to receive performance share units which are worthless unless the 3-year moving average of the share rice compounds at an annual rate of 11% on a 6-10 year look back period.

Polaris Inc (+85.0%) – Shares of Polaris rebounded quickly following a sell-off in the first quarter that saw the prices hit levels last experienced in 2012. We took advantage of this weakness, adding to our position. This move has been well rewarded with shares doubling off their 52-week lows. Since 2012, Polaris has expanded its book value and free cash flow by 60% and 50%, respectively. Returns on capital have deteriorated following acquisitions of TAP and Boat Holdings but this should improve as integrations progress. The company is dealing with the global pandemic by reducing operating expenses, mainly on the human capital side, by 25%. With shares approaching our intrinsic value we have been reducing the weight of the position, although it remains at a healthy level of 4%.

Agnico Eagle Mines (+55.2%) – We have held Agnico Eagle shares since mid-2015. The opportunity to purchase a solid gold producer which has mines in favorable geopolitical jurisdictions came from a four-year slump in gold prices and production issues at a mine caused by wildlife (oil prices, a major expense also peaked in 2014). Since this time, gold prices have returned to near record levels while oil prices have been cut in half. Meanwhile, AEM shares have tripled with the company now priced as a premium operator. With the gold market setup for a good run, given low real interest rates and loose monetary policy, we do not expect to lower our exposure to miners. However, we will continue to seek out an opportunity to rotate in a better value name while maintaining the key attributes of AEM.

2Q 2020 Detractors

Recro Pharma (-46.8%) – Recro had two setbacks that impacted quarterly results. The first was that one of REPH's key customers, TEVA, had reduced orders on Verapamil, a generic blood pressure drug that REPH manufactures. Mylan, TEVA's key competitor in the space, came back into the market much quicker than anticipated to re-take its 50% market position, where they were expected to be around 30%. This caused TEVA to scale back manufacturing. In addition, business development and new product partners had previously been a strength going into 2020 and expected to accelerate. The onset of Covid has impacted REPH's ability to grow and backfill any weakness out of TEVA due to their inability to meet with potential partners and arrange facility tours. At this point, based on the low-end of revenue guidance, we pin REPH at 5.9x 2020 EBITDA, well below peers in the CDMO business. Most have gone private or have been purchased, but Catalent, Inc., is currently trading at 28x 2020 EBITDA after a 40% increase year to date.

Scorpio Tankers & Diamond S Shipping (-35%) – Perhaps our single most frustrating position has been our shippers. Despite being among a very select group of companies with improving earnings through the coronavirus impacts and earning 16% of their market capitalization in the trailing twelve months, the stocks have continued to sell-off. Looking back on our pre-COVID thesis, the supply situation continues to be constructive on the global fleet, with 21% of ships being older than 15 years and an order book making up 8% of the overall fleet, a historical low. However, questions around how demand picks up for product with the floating storage story falling off, and increased trade war rhetoric between China and the US is likely raising concerns about ton miles shipped.

Societe BIC (-11.8%) - For Societe BIC, market challenges within all three categories have been made worse by the Coronavirus. The company has maintained, and mostly extended, its market share lead among its core groups (lighters, shavers, and stationary) while shoring up its financial position. The company remains one of the premier names in the portfolio, with regards to profitability, management team and balance sheet strength. The manufacturer generates 11.7% return on invested capital, holds a net cash position and management has significant skin in the game with a controlling interest over 52%. Shares are now trading at 13.1x price to forward earnings versus a historical average of 16.x and U.S. market multiple that is over 20x. However, some secular declining products are now meeting a cyclical slowdown. With few catalysts on the horizon to boost growth or improve the fundamentals, we are beginning to question if this is in fact a name that we mis-timed or mis-priced.

2Q 2020 Additions / Subtractions

Hingham Institution for Savings (HIFS-NASDAQ) was added to the portfolio in early April. The company is a premier lender within the commercial and residential real-estate in Massachusetts and Washington. HIFS has been a public company under current management since 1993, and since that time, prudent risk management and thoughtful growth and expense management has led to a 10.8% annualized growth in book value, and perhaps even more impressively, without any year experiencing a drop in book value over that time (2008/2009 saw BV increase 9.1% annually, with ROE over 11% in both years).

Canfor Corporation (CFP-TSX) was reintroduced to the portfolio in April. CFP is an integrated forest products company based in Vancouver. The company has production facilities in BC, Alberta, North and South Carolina, Alabama, Georgia, Mississippi, and Arkansas. We had previously owned the company through most of 2017 as shares rose from $11 to over $30 per share at which point, we exited. After a failed take-over bid by a tightfisted investor at $16 per share we were able to repurchase the stock for under $7 per share.

We added a 3% position in Grocery Outlet (GO-NASDAQ) during the quarter. GO is a fast-growing, small- box (15,000 to 20,000 sqft) grocer offering deep discounts on name brand consumables and fresh products. The company currently has a store base across six states with the majority in California, Washington and Oregon. The stores offer a large, ever changing assortment of products with savings of 40%+ compared to conventional grocers and 20% to discounters. GO offers a unique perspective within the portfolio, with growth attributes at a reasonable price as well as durability during recessionary periods.

Exiting the portfolio was Anheuser-Busch (BUD-NYSE). Management's quest for growth through acquisitions, funded in large part by debt came at an inopportune time with COVID-19. As a large percentage of the company's sales is linked to restaurants and bars as well as sporting events, it is likely to be a long road for the firm to right size its debt in the current environment. Furthermore, one of the key components to pay down debt was through divestitures. With spending cuts and bankruptcies likely to accelerate this was another red flag that suggested we should move to the sidelines on the name. With improving fundamentals, it is a name we will likely revisit in the future. BUD reigns supreme among distribution models and brand names on a global level which drives high profitability.

We also made an effort to shore up the quality within the portfolio. As we made room for Hingham and Canfor, KAR Auction (KAR-NYSE) and Ag Growth (AFN-TSX) were sold. Overall, we view this as a balance sheet upgrade and against a better economic backdrop would consider returning to these names.