MAXAM
CAPITAL MANAGEMENT

Maxam Diversified Strategies Fund – Q2 2018 Commentary

Nine years in…

The Maxam Diversified Strategies Fund turned nine years old on June 30, 2018. Since its inception the fund[1] has generated a total return of +165.7% net of all fees and expenses – equating to an annualized return +11.5%.

We are proud to have delivered strong absolute and relative returns to our investors and, importantly, that these strong returns were delivered with excellent risk-adjusted statistics. The Maxam Diversified Strategies Fund was recognized for these strong results with two awards at the 2017 Canadian Hedge Fund Awards[2].

	Performance			Sharpe Ratio[3]	
As at June 30, 2018	5 Years Annualized	Since Inception Annualized	Since Inception Cumulative	5 Years	Since Inception
Maxam Diversified Strategies Fund[1]	13.1%	11.5%	165.7%	1.8	1.2
S&P/TSX Composite TRI	9.2%	8.2%	103.8%	1.1	0.8
S&P/TSX Small Cap TRI	6.5%	7.6%	93.8%	0.5	0.5
Scotiabank Canadian Hedge Fund Index[4]	5.7%	4.5%	48.2%	1.1	0.7

We are very grateful for the privilege of managing capital for our investors. It has been an eventful first nine years and we expect the next few years will be no different! We look forward to taking advantage of opportunities as we continue the pursuit of growing and protecting our investors' capital.

Q2 Review.

The second quarter of 2018 was a frustrating quarter from a return perspective for the fund. While many of our positions performed just fine, some of our largest positions did not do the heavy lifting for the fund. In fact, a few of our larger holdings were drags on performance in the quarter.

We remind ourselves, and our investors, that price does not always equate to value – especially in the short-term where headlines and emotions rule. This is our opportunity as active investors.

Here's how a few things played out during the quarter.

Our long position in ZCL Composites moved against us in Q2. This manufacturer of liquid storage solutions for above and below-ground applications announced in early May that it had completed a comprehensive review of value maximizing strategies that did not bring forward anything of substance. As my daughter would say: ☹

We, and the market in general, read this news as meaning there were no buyers for the company – at least not at a value at or above where the market was then valuing ZCL. A corporate sale of ZCL was a significant catalyst we were targeting, and we exited our position when this catalyst did not materialize.

A core tenet of our fund strategy is to invest in situations where we believe we have identified fundamental, or hidden value, plus a catalyst or event that will unlock that value.

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With the material catalyst we were targeting for ZCL not coming to fruition as we had hoped, we don't consider this investment a success, but we also hesitate to call it a complete loser[5]. After accounting for regular and special dividends received from ZCL, and our final sale price, we did end up realizing a positive total return from the name despite our thesis not playing out as expected. We believe this is a good example of why getting the *value* side of our [value + catalyst] equation right is as important, if not more so, as getting the *catalyst* side right - especially from a risk management perspective.

Bird Construction's stock performance thus far in 2018 has been, to put it nicely, uninspiring. The first half of the year saw some uncharacteristic challenges for this well-run contractor, including a strike at a client's mine (no fault to Bird), and an accounting regulatory change that contributed to a noisy quarterly earnings release. The confusion over the accounting rule change was compounded by a dispute with a government client over the handover of a P3 project and the associated extra costs incurred. Bird is now trying to remedy this issue through negotiation, and it may end up going to arbitration. While the stock appears to have priced in a worst-case scenario outcome, we believe Bird has a decent chance of achieving a favourable resolution.

Our core thesis on Bird remains unchanged. Their balance sheet is rock solid, and we're collecting a >5% dividend yield while look forward to the company's depressed backlog and trough margins to begin trending higher.

In the near-term, we also see the potential for a material catalyst before the end of the year. The LNG Canada consortium, led by Royal Dutch Shell, is expected to announce its final investment decision on its LNG export terminal in Kitimat, BC. Should this project proceed, Bird and its partner Civeo will immediately get to work on building a 4,500-person workforce accommodation centre. We estimate that Bird's share of this project is a >$300 million revenue opportunity over 18-24 months. Insiders have recently been buying stock, and so have we.

Long-time holding Medicure Inc. didn't do much for us in Q2 but we're looking forward to good things through the balance of 2018 and beyond. This Canadian specialty pharmaceutical company is off-the-radar screen for most investors – but we think this will change.

Medicure just launched a new drug in May and has a product pipeline that puts it on a path to becoming a five-drug company by mid-2020. The company's balance sheet is in excellent shape with net cash amounting to ~75% of its market cap. This substantial cash balance not only provides the company with flexibility to make accretive acquisitions, but also establishes great downside protection for investors. We think Medicure's current share price represents a compelling *value-with-catalyst* opportunity today.

The Westaim Corporation is another fund holding that we believe is trading at an attractive valuation with potential catalysts on the horizon. Westaim is a Canadian investment company with significant investments in two businesses, HIIG and Arena. HIIG is a specialty property and casualty insurance business, and Arena is an alternative investment management and specialty finance company.

Westaim currently trades at an attractive valuation of approximately 1.0x book value, and both HIIG and Arena are performing well. Following several unsolicited enquiries, Westaim management issued a press release in April stating that it may consider opportunities to enhance the growth and value of HIIG. Recent acquisitions of P&C businesses have been in the 1.3-1.7x book value range, implying nice upside for Westaim's HIIG investment.

Arena's assets under management have shown nice growth and the firm recently added a high profile individual to lead business development. We've seen a number of acquisitions in the money management sector over the last several months, and we believe a take-out could be a medium to long-term potential catalyst that would benefit Westaim shareholders.

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Great!

We've been here before.

The current drawdown for the fund over the past few months reminds us of a couple other periods we've been through before. While each time is admittedly different, these periods have ended and the fund has moved on to new highs.

What is consistent with previous periods is the inherent value we see in our current positions. As we move into the second half of 2018 and towards 2019, we are optimistic about several meaningful catalysts that we see for some of our largest positions. Accordingly, we believe these catalysts should act as significant drivers of future performance.

Looking forward.

Geopolitical and macroeconomic uncertainty combined with an aging bull market and valuations that, on average[6], are not cheap suggests to us that the path ahead for broad market returns will continue to be volatile.

While market volatility is often not pleasant to go through, we view it as something we can take advantage of with our active, opportunistic, and flexible investment style. We have been using some of the recent market volatility to opportunistically invest some of our cash position. We also have been increasing the fund's short exposure in a measured fashion and have added some new merger arbitrage positions.

I expect our results will continue to have a lower correlation to the broader markets than traditional funds. Being different than the *average* has historically been how, and why, we have added value throughout market cycles and since fund inception.

Aligned.

Myself and my partners are putting our own money where our mouths are. We have meaningfully added to our own personal investments in the fund over the past few months and are excited about the opportunities in front of us.

Thank you for your investment and your continued trust.

Sincerely,

Travis Dowle, CFA
President & Fund Manager
Maxam Capital Management Ltd.

[1]Returns are for Series A Units and are net of fees and expenses.
[2]2017 Canadian Hedge Fund Awards List of Winners: http://alternativeiq.com/wp-content/uploads/2014/06/Winners-2017-pdf.pdf
[3]Sharpe ratio is the average return earned in excess of the risk-free rate per unit of volatility or total risk (*Investopedia.com)*. It is a measure of return per unit of risk taken *(higher is better).* Risk-free rate used is the Bank of Canada Overnight Lending Rate.
[4]Scotiabank Canadian Hedge Fund Index Equal Weighted: http://www.scmonline.com/analytics/cgi-bin/hedgefund/entry_screen.cgi
[5]Please note that some of our losers will just be losers. We plan and expect to hit the ball each time we step up to bat. Sometimes we'll hit a single, sometimes a double or even a home run – and sometimes we'll hit the ball all the way to the warning track before it's caught by a leaping outfielder.
[6]A reminder that averages are just averages. Benchmarks and indices, and more importantly our fund, are comprised of companies with valuations above and below the average. We don't consider our holdings to be *average*!

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