MAXAM

CAPITAL MANAGEMENT

Maxam Diversified Strategies Fund – Q4 2016 Commentary

The Maxam Diversified Strategies Fund[1] gained +2.2% in the month of December and finished the 2016 calendar year with a +14.4% gain.

What a year.

2016 was an eventful year to say the least. Investors were kept busy with numerous market moving developments: oil hit a low of ~$25 in January and ended the year above $50; negative interest rates in some countries confused academics and bond 'investors' alike, while the U.S Federal Reserve once again waited until the year's final FOMC meeting to raise the Fed Funds rate; but perhaps most notable was the shift in geopolitics demonstrating that populism is on the rise – as evidenced by BREXIT and Trump's presidential victory.

After a sharp sell-off in January it was no looking back for Canada's natural resources and financials heavy stock market – the TSX moved steadily higher throughout the year despite the tumultuous list of news and events highlighted above. We've often said that equity markets need a wall of worry to climb – well the markets didn't just climb the wall in 2016, they hurdled *worries* with ease and sprinted to the finish. Well, ok, perhaps it wasn't that dramatic, but we were surprised by the markets' resiliency nonetheless.

Suffice it to say, if you owned the Canadian index in 2016, you did quite well. If you happened to own gold, oil and marijuana stocks in 2016, then you absolutely crushed it! Despite having negligible to no exposure to any of those themes, we still managed to generate a solid return.

What worked | What didn't.

We had a diverse group of names drive our results in 2016.

Polaris Infrastructure was a strong performer for the fund in 2016. Polaris, a renewable energy company focused on the sale of electricity generated from geothermal power, was a relatively unknown turnaround story to start the year. Management delivered both strong operational and development results throughout 2016, and initiated a dividend. We continue to have a favourable outlook for the company – its valuation is still attractive, and we believe management have a clear path to future growth and further dividend increases.

Drivers kept getting in fender benders and Boyd Group kept delivering strong results. As one of North America's largest owner/operators of autobody and autoglass repair facilities, we continue to like this stable and recession-resistant business model led by a strong management team. The auto-collision repair market is highly fragmented and remains ripe for continued consolidation by Boyd.

When investors see a news release from a company that announces a surprise dividend cut and restructuring of operations, they tend to sell first and ask questions later. Wi-Lan Inc., an intellectual property licensing firm, delivered news along those lines in late 2015. While already familiar with the company, we immediately began our due diligence which included an initial conference call with management, and then a subsequent meeting. As investors aggressively sold the stock it created a compelling opportunity for us. Our thesis was that Wi-Lan's share price would re-rate higher as short-term selling pressure subsided – and investors took note of the extremely cheap valuation and gained a better understanding of the company's new strategy. Our investment in Wi-Lan worked out quite well as we exited the name with about a double in six months. This was a great example of our opportunistic and *value with a catalyst* strategy at work.

TIO Networks, a technology company specializing in processing bill payments, was also a good performer for the fund in 2016. TIO completed the acquisition of Softgate Systems this past year – a financially accretive and strategic acquisition that gave them even greater scale in the U.S. TIO has developed a solid track record of both organic and acquisitive growth over the past few years and we expect they'll continue to deliver in 2017.

Everything didn't come up roses for us in 2016. Sandvine, a provider of data and traffic management technology to cable and telecommunications companies, disappointed investors with weaker than expected results on more than one occasion. Some have commented that the risk/reward profile for Sandvine is less attractive now given the recent disappointments – however, consider the following: Sandvine has no debt, cash represents almost 50% of their market cap[2], they are free cash flow positive, pay a 3% dividend yield, and they trade a little over 5x EV/EBITDA on 2017 estimates. While we must allow for the possibility that Sandvine is a value-trap, we continue to see potential catalysts that could unlock/drive value.

Our short position in home renovation retailer RONA Inc. moved materially against us in February 2016. Our fundamental short thesis on RONA, in brief, was that their results would weaken due to a stretched Canadian consumer and stiff competition from superior players Home Depot and Lowe's. Well, *we were right, until we were wrong*. RONA shares had declined by about -20% from when we first shorted them, and then American giant Lowe's announced that they had reached an agreement to acquire RONA for $24.00 per share. In 2012, the Quebec government and some significant Quebec-based shareholders had blocked Lowe's from acquiring RONA, and our belief that the playing field remained unchanged ended up being incorrect.

While the loss on our short position in RONA's common shares wasn't pleasant, our familiarity with the RONA/Lowe's transaction led to us recognizing an opportunity in RONA's preferred shares. Lowe's offered a meaningful premium to RONA's common equity shareholders, however they only offered $20 per share to RONA's *preferred* shareholders, instead of par value of $25.

We acquired a position in RONA's preferred shares at $20 per share with the expectation that our downside was limited to owning a security that paid us a solid yield and was backed by a high-quality U.S. mega cap corporation. The upside scenario was that Lowe's would eventually sweeten its offer to redeem the preferred shares rather than maintain a tiny nuisance listing in Canada. In November Lowe's delivered on our upside scenario by acquiring the preferred shares for $24 per share.

"ABP"

Markets have already moved a lot in anticipation of what may come from a Trump presidency – and now we wait to see what policies will actually be put in place. We're about to get into the "show me" stage.

We believe that the investing environment in 2017 has the potential to be much more volatile than 2016. The impact of Trump policies and rhetoric, the direction of oil, Canadian real estate prices, interest rates and currency fluctuations all have the potential to impact investor sentiment and move markets. Overall stock market valuations are not cheap by historical measures, and numerous sentiment indicators we follow imply that the bulls greatly outnumber the bears today – something that gives us pause.

Our strategy aims to embrace volatility, endeavouring to use it to our advantage. When the prices of securities react to market moving news and events, there are often compelling opportunities to take advantage of – one way to do that is to *always be prepared*. We have our list of favourite companies, both names we currently own and those we'd like to own at the right price, that way we're ready to act when opportunity arises.

While the market averages may be expensive, we remind investors that a portfolio of securities is not necessarily analogous to the market. We believe there are always specific compelling investment opportunities available, one just needs to find them.

With our active, opportunistic, and flexible approach to investing we believe that we are well positioned to embrace the opportunities that volatility presents us with. Our focus will remain on investing in companies where we have identified fundamental or hidden value, plus a catalyst or event that we believe will unlock that value.

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 Master Units, and are net of fees and expenses.
[2]Sandvine share price was $2.68 at time of writing.

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