A View From Here - May 2018

In last month's A View From Here, we ended our note with the following quote by Charles Ellis:

"Be patient and persistent. Good things come in spurts - usually when least expected - and fidgety investors fare badly."

In the spirit of actions speaking louder than words, on April 16th, our investment in Aveda Transport received a takeover offer over 80% higher than the previous day's close helping to propel account values to one of the best monthly gains in the past few years.

Climbing A Wall of Worry

There is a lot of investor angst in the air that seems to be borne out of a controversial U.S. and geo political situation and what appears to be general discontent that is high up on the 'Richter Scale'. This has led to worldwide stock market volatility in recent months after the exponential gains in the U.S., which had been achieved over the past year. The striking success of speculative investments in Blockchain and Marijuana created investor envy that led to the public's participation only to see these investments sell off significantly since February. The seemingly 'easy' riches of owning large U.S. technology companies have become far more challenging and the Canadian benchmark TSX index remains at about the same levels of 10 years ago.

Further, fear of higher interest rates created more strain for investors as a new round of pressure found its way into some of the very investment names that had carried the index in recent years (all things dividend paying and utility based). These circumstances have gone a long way to create a negative view of the future of investments in Canada and much has been written in the media about avoiding the Canadian stock market.

All these concerns seem to have most of the necessary ingredients for the well-known axiom that 'Markets Climb a Wall of Worry', so we shouldn't be surprised if they go higher from here.

We Are Performing Well

Our investment accounts have achieved steady growth since the fall of 2017 (despite a set-back last month) with a particularly strong April that saw record earnings released from some of our core holdings, more than offsetting any disappointment. We had been increasing our investment in Aveda Transport during this period and the takeover offer helped create a strong performance in April. Despite being our smallest investment position, it is another company we have owned to receive a buyout offer for at a significant premium.

Takeovers Vindicate Our Value-Based Strategy

When I look back over the past 20 years, there have been over a dozen of our investment holdings that received takeover offers. This includes; *Sherritt*, *Cara Foods*, *Viceroy Homes*, *Cominco*, *Rio Algolm*, *Nova*, *Pet Valu*, *Genesis Land Development*, *Flint Energy*, *Softchoice*, *Glentel*, *Journal Media* and now *Aveda* . What makes a takeover so exciting is that they tend to occur at a significant premium and gives us the finality of value maximization. In any other circumstance, closing out an investment leaves something to chance but a buyout takes out most of the thinking and creates the liquidity in the company's shares to sell a large position at stable prices.   We are usually aggressive to crystallize and move on because few things are worse than holding out for the last 10% only to see a deal disintegrate.

It should not surprise us that an offer was made for the company, as most of the investments we pursue are cheap relative to the prevailing market view as well as their peers. As this circumstance persists, someone notices - whether it's an industry player or a private equity firm. Maybe there will be more to come in some of our current holdings.

With that, let's dissect the investment that was Aveda.

The Aveda Investment Comes to an End

Aveda is North America's largest transport of drilling rigs for the oil and gas industry and we originated a small investment in 2014 at much higher prices. Consistent with many of our holdings, the company's insiders held a large position in the company (insiders are the officers and directors of the company), and had been showing consistent growth despite being inexpensive by most metrics that we employ. However, by year's end, the price of oil had collapsed and brought down all things tied to the industry. My view at that time was that the company was in a good position to make acquisitions at attractive prices and sellers became so anxious that in one case, they sold the business for almost nothing. This occurred throughout 2015 and 2016 as Aveda took on additional debt that was secured by the equipment acquired. We were looking for an increase in revenue and a positive turn in cash flow as a sign to make further commitment which materialized during the second quarter of 2016, when revenue and cash flow began to exponentially increase.

In January of 2017, management announced that they had renegotiated their credit facility and planned to raise equity by selling additional shares to strengthen their balance sheet. We had to accept that given their growth, some dilution was necessary, as they had purchased businesses without raising any money. Management opted to issue an additional 38 million shares, which I was not particularly happy with. This meant that a lot of the possible upside I saw for us had just been reduced significantly due to the fact that all profits would now be shared by almost three times the amount of shares that would now be outstanding. Throughout 2017 and early 2018, the share price remained subdued despite a steady stream of strong revenue and cash flow achievements. The challenge Aveda faced was that even with a strong pipeline, they had to hire subcontractors to fulfill the work, which challenged cash flow growth. This circumstance was a good problem to have, as the company worked hard to secure additional equipment and employees to meet increased demand. From fall of 2017 onwards, we became more aggressive in building Aveda into a larger component of our accounts and ultimately held almost 6% of the company.

While on one hand, I was disappointed management decided to sell the business at a time where things could ramp up over the next couple of years, the return is immediate and helps propel the performance of our accounts while providing another step in the vindication of our deep-value proposition.

From what I see out there, things are difficult in the investment landscape, but our accounts have remained resilient, and are either at, or within a stone's toss of all-time highs. I am proud of that achievement and contend that our long-term performance continues to exceed almost any benchmark you can throw at it.

Thanks for taking a look, and as always,

All Good Things

Adam Hennick
Mackie Research Capital
Tel: 416 860-6848   Toll Free: 1-877 860-6848
www.adamhennick.com