Maxam Diversified Strategies Fund – Q3 2017 Commentary

The Maxam Diversified Strategies Fund[1] gained +2.6% in the month of September, +1.7% for the third quarter and is up +6.9% through the first nine months of 2017.

Equity markets put in a solid showing during Q3 with Canadian, U.S. and most international markets posting gains. The heavyweight Energy and Financial sectors led the way for Canada during the quarter, buoyed by the price of a barrel of oil rising through the $50 level, and two interest rate hikes from the Bank of Canada.

Do Loons soar?

The Canadian dollar was one of the big stories in the third quarter. After hitting lows for 2017 near $0.72 CAD/USD in May, hawkish commentary and two interest rate hikes from the Bank of Canada sent the Loonie soaring to almost $0.83 in September. The move was partly exacerbated due to massive short covering from speculators, whom had amassed the largest bet against our currency in over a decade. With this positioning now basically flipped – speculators are betting on continued gains for the Loonie – we're inclined to fade the consensus and believe the more probable near-term outcome could be a weaker Canadian Dollar. One thing is for sure, Canadian household debt is as elevated as ever, and last time we checked higher interest rates don't help ease debt burdens, nor consumer budgets.

A weaker Canadian dollar relative to the U.S. greenback should potentially act as a tailwind to some of our holdings that generate the majority of their revenues in U.S. Dollars.

Q3 Performers

Notable strong performers for the fund during the quarter included Bird Construction and Centric Health, as well as several merger arbitrage positions that successfully closed.

We've discussed our positive view on Bird Construction in previous commentaries. We're fans of the company's rock-solid balance sheet, attractive valuation and it's improving project backlog with potential upside from the federal government's promised infrastructure spending. In August the company reported Q2 results that were nothing to write home about, however the share price reacted favourably due to management's incrementally positive outlook and progress surrounding P3 bidding activities. Fly Bird, fly.

Centric Health is one of our newer holdings in the fund and it moved in the right direction for us during the quarter. The company is a healthcare services provider with two key operating segments, specialty pharmacy and surgical/medical centers. Centric's specialty pharmacy business provides pharmaceutical dispensing and clinical consulting services to long term care homes and retirement communities. The company's surgical and medical centers provide a range of procedures to individual, corporate and government clients. Demand for Centric's services are bolstered by demographic trends and a healthcare system that is challenged by rising costs and increasing wait times. We like the growth opportunity in front of Centric and believe there are some approaching catalysts that will reward investors.

Meh?

In October long-time Maxam holding Medicure announced that they had reached an agreement to sell their interest in Apicore for US$105 million (that's over 130 million loonies!). Recall that one of the key reasons we owned Medicure was to capitalize on the value we believed we saw in their fixed-price option to acquire Apicore.

One of the challenges (and opportunities) with an investment thesis on Medicure was that the company never disclosed what the strike price on its fixed-price option was. Medicure consummated the acquisition of Apicore in a multi-step process over the last few quarters and disclosed that they had paid approximately US$59

Maxam Capital Management Ltd.
902 – 510 Burrard Street Vancouver, BC, Canada V6C 3A8 T 604 685 0201 F 604 685 9970

million. The significant gain realized from the Apicore divestiture has been met by the market with a big… "*meh*".

Post the closing of the Apicore sale, Medicure, which trades at a little more than $8 per share, should have more than $4 per share in cash and no debt. Long-time followers of ours will know we love large net cash balances in the hands of good capital allocators. Medicure today enjoys solid sales of its existing drugs in to U.S. hospitals and has several additional drugs in the pipeline that we believe will drive shareholder value. Oh, and that cash!

Some base hits

The third quarter was quite active for our merger arbitrage positions. The fund enjoyed the successful closure of several transactions, including: Norsat International / Hyterra Communications, Sandvine / Francisco Partners, Innova Gaming / Pollard Banknote and Tio Networks / Pay Pal. As a quick refresher, merger arbitrage is a *market neutral* strategy – meaning the strategy can and should perform regardless of the direction of the overall stock market. Merger arbitrage can be a solid source of decent returns, and sometimes even provides optionality for better returns (i.e. more than a base hit) if a higher bid for the target materializes due to shareholder pressure or another acquirer entering the process.

#staynimble

The successful closure of these merger arb positions resulted in the fund's cash balances increasing by approximately 10%. This leaves us being in the enviable position of having fresh capital to deploy. Our narrative through our commentaries, and in our actions, has been consistent over recent quarters: we have been actively positioning the fund to both prepare for a potential increase in market volatility and, most importantly, to take advantage of it.

We continue to opportunistically add to both long and short positions, as well as additional merger arbitrage situations. With respect to shorting securities, while we do have a number of ideas in the *on deck* position, we are mindful that the market environment over the last few years has been a difficult one for short sellers. With an increasing portion of fund flows continuing to move into passive investment products, which largely disregard company fundamentals, we are cognizant of the influence on security prices – both up and down. We have recently been exercising additional patience towards adding incremental short exposure, preferring to wait for the technical picture to become more supportive of such positioning.

Investor complacency continues to be a consistent characteristic of the current market environment – an element we are mindful of. While we have continued to see decent economic growth and solid corporate financial results in the U.S. and Canada, we still believe some market participants may not be appropriately pricing risk.

We believe that our active, opportunistic and flexible investment philosophy is particularly well-suited to this market environment. We are intensely focused on the reward-to-risk ratio of our investments and we are excited about how we have positioned the fund to be able to take advantage of opportunities as they arise.

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.