VENATOR
CAPITAL MANAGEMENT LTD.

KNOW THYSELF

Instrument (Inception)*	January 2016 Return	Year-to-Date Return	Compound Growth
Venator Founders Fund (March 2006)	**-7.9%**	**-7.9%**	**12.7%**
Venator Partners Fund (July 2014)	**-8.2%**	**-8.2%**	**-3.2%**
Venator Investment Trust (September 2007)	**-8.0%**	**-8.0%**	**8.8%**
Venator Income Fund (August 2008)	**-2.2%**	**-2.2%**	**11.6%**
Venator Select Fund (September 2013)	**-11.2%**	**-11.2%**	**15.2%**
S&P/TSX Total Return (March 2006)	-1.2%	-1.2%	3.9%
Russell 2000 (March 2006)	-8.8%	-8.8%	5.0%
S&P Toronto Small Cap (March 2006)	-4.1%	-4.1%	-0.9%
S&P 500 (March 2006)	-5.0%	-5.0%	6.5%
Merrill Lynch High Yield Index (August 2008)	-1.6%	-1.6%	7.6%

Yeah, that was a tough month. It was tough for the markets in general, but our fund holdings, long and short, just didn't perform well relative to our hedge models which resulted in some rather unhedged-like performance. In our hedge strategy, our longs underperformed the market dropping approximately 9%, while our shorts only added 1% to our numbers (our two largest shorts, Exxon and Walmart, were both up on the month despite some decidedly negative news flow, and this was a material contributor to the poor performance of the short portfolio).

I think most people are aware that markets in general have been pretty weak in North America over the past twelve months. This could have been masked somewhat by currencies (if you invest in the US with your currency exposure unhedged) or sector bets, but generally it's been tough. Drawdowns from highs have been significant and our hedge funds have managed to stay roughly in-line or better than their benchmarks to the downside; the Income Fund has slightly underperformed the Merrill Lynch benchmark but our fund is carrying such a strong yield (13%) currently that we don't see this situation persisting for long. The following chart indicates how far some benchmark indices have dropped from their all-time highs vs our funds:

MARKET DRAWDOWNS		
Investment	Date of High	Drawdown
TSX	Sep-14	-18.3%
Russell 2000	Jun-15	-20.2%
TSX Small Cap	Jul-14	-35.0%
Equal Weight S&P	May-15	-12.8%
Average		*-21.6%*
Merrill Lynch High Yield	Aug-14	-9.6%
Venator Founders Fund	Mar-15	-11.4%
Venator Partners Fund	Mar-15	-14.2%
Venator Income Fund	Feb-15	-11.3%
Venator Select Fund	Dec-14	-12.6%

One problem that many shareholders can have with a company's stock is a form of myopia in that investors fail to see both sides of a story. Sell-side analyst reports often carry only boilerplate risk factors and often disregard company specific ones or unique accounting ones (i.e. oil and gas models never run sensitivity down to $20 oil, but often regard $60 oil as a likely scenario). In its simplest form the most obvious trade-off is that between perceived quality and valuation. Amazon is a great company, but you have to pay 60x 2017 earnings to own it. Conversely, everyone knows that terrestrial radio is a growth challenged industry, which is why you can buy Entercom at less than 7x free cash flow. Valuation vs fundamentals and trying to match them up is only the easiest point-counterpoint in the stock market. The key here is to know both sides of the fundamental story, the bull and bear cases if you will, and pick a side.

When we speak to companies, or analysts, or even other fund managers, one of the first questions we ask is "how do you blow up" or "how do you go to zero" or "where might you be dead wrong"? This is because if you don't know what will blow you up, then you don't know your own business/strategy well enough. During an initial session with management we always ask: what could mess up all of your grand plans? But that is only one part of the devil's advocate portion of the interview. Others include: why are people short selling your stock? Or, why do you think half of your analysts have "hold" or "sell" recommendations? If you don't know both sides of the story (and it's very possible that an analyst might not be telling you exactly why they don't like your stock for political reasons), and what conditions are needed for a homerun vs a strikeout, then you aren't fully informed.

To help illustrate this critical 'devil's advocate' thinking, the following is the counterpoint to some of our favorite positions:

Entercom Communications (Long): *Counterpoint:* It's radio. Radio is perceived as a long-term secularly declining market. While $500MM in debt vs over $100MM in EBITDA isn't a huge number, a good chunk of that debt carries an interest rate north of 10%, and the company missed the mid-2015 window to refinance it at a lower rate with longer terms. The company is effectively controlled by insiders preventing any shareholders from getting active. The regulatory environment also makes it difficult to take it over even with a friendly buyer. Overall, the company doesn't look that cheap with an EV/EBITDA of nearly 8x, which is how analysts look at the valuation. *Point:* We believe the radio business is more stable than people want to think, and that advertisers are underspending on the medium which could result in revenue/earnings growth without user growth. Furthermore, the company is cheaper than it looks at 6.5x free cash flow. The reason why a higher EV/EBITDA can result in downright cheap multiple of free cash flow is that *not all EBITDA is created equal*. In Entercom's case, it has enough tax shields to keep its cash tax rate extremely low for over a decade, and it has very little in the way of capital expenditures. Coupled with our opinion that the Company is run by some of the best operators in the industry, we think that the bear points are more misconceptions than actual facts, and that these misconceptions have offered us the opportunity to buy a solid business at a very low price.

Concordia Healthcare (Long): *Counterpoint:* It's no secret that the whole sector is under tremendous pressure due to a fear of government scrutiny regarding pricing. Furthermore, its recent acquisition of AMCo resulted in a sizable debt burden amounting to about 10x free cash flow (more important to us than EBITDA when assessing leverage) that will likely result in no more material acquisitions (a primary source of growth) for at least the next two years. So no growth + lots of debt + questionable regulatory headwind = stay away. *Point:* This one has been both one of our biggest winners on its way from $6.00 to $100.00, and one of our biggest losers on its way back to $40.00 (we have traded around the position but never totally sold out of it). At $40.00, or about 4x free cash flow, the stock is clearly reflecting some bad news. On the other hand, its collapse has pretty much matched its comparable companies and indices, so while that big a drop would normally appear company specific, it appears that the big downward move was mostly attributable to sector weakness. Fundamentally, the company operates in a non-cyclical space that is always growing in volume. No one would dispute that. From a price perspective generic drugs are always lower than the previously patented branded drugs, so the healthcare system always benefits from generic pricing to some degree. And it's a very free and competitive market so I personally don't think there is any price collusion among participants (nor has the sector been accused of this). Furthermore, a common misconception is that people actually pay the extortionist list prices on medical products and services, and this is patently untrue. The company could probably drop its list prices by 50% and experience very little financial impact because no one actually pays them! Furthermore, it is the rare instance that Concordia is the highest price generic in its category so other competitors are going to have to take some serious pain before Concordia is going to have to renegotiate with its customers. Finally, its recent acquisition moves nearly 40% of its business outside the United States where the political environment isn't nearly as charged. Currently, at 4x free cash flow it seems to us that the bear factors are fully priced into the stock and the company can add material annual free cash flow just by paying down debt and lowering interest expense annually. (Of note, this position is an interesting illustration of hindsight. Concordia reached its high on the back of is acquisition of AMCo which occurred a few weeks before the negative headlines started hitting the sector. Had the company completed its acquisition financing as expected, that $110 high amounted to 11x-12x free cash flow which is hardly expensive for what was a market darling. So this was not a situation where investors got "too greedy" after a stellar rise).

Callidus Software (Long): *Counterpoint:* Cloud software adoption is maturing and profitability goals are under scrutiny. More importantly, market leader and Callidus partner Salesforce.com recently acquired a smaller competitor in the Configure-Price-Quote (CPQ) market and may be reluctant to continue actively partnering with Callidus as a result, especially if it expands this division into Callidus' core commission management product. *Point:* Callidus is the market leader in its core commission management market; they practically invented the end to end commission-price-sell-pay market. The company has more of a heavyweight product offering that sells primarily into more complex industries (think insurance) and therefore Salesforce.com's newly acquired lightweight offering has some catching up to do. But more importantly CPQ isn't a huge component of Callidus'

revenue and we don’t think that Salesforce.com is as active a partner as the company has seemed to imply (it’s a bit of a double edged sword when you try to market yourself as a preferred partner of a market leader but then they go out and buy a competitor; there was a time when Microsoft Solution Provider used to mean something, now it doesn’t). With that in mind, Callidus is doing something really unique: they are experiencing an accelerating growth rate and they are doing it profitably. So while 4x revenues isn’t exceedingly cheap for the software sector in general, it is comparatively cheap given its leadership position, growth and profitability.

Energizer Holdings (Short): *Counterpoint:* Given that we are short here, the counterpoint is the bull case. Energizer was spun out of Energizer (that's not a typo, the former parent changed its name to Edgewell) as a mostly pure play on the battery operations. While batteries are a secularly challenged market, Warren Buffett’s recent acquisition of the Duracell division of Proctor and Gamble has led to some positivity around the space. The bull case revolves around expected margin improvement and improved focus now that it's a pure play. The bull case is actually that simple. *Point:* We have some history in this space due to our long time holding in competitor Spectrum Brands. Historically, Spectrum could never sustain a multiple much beyond 10x free cash flow because the street didn't like that more than 50% of revenues came from their battery business; they have since diversified through acquisition such that batteries are now less than 20% of their profits. They have also never achieved the margins which Energizer is now boasting that they are capable of (and they are skeptical of Energizers goals). Of course, no one, including Energizer management, have ever seen what Energizer can achieve as a standalone company. That being said, if Energizer’s unproven goals are currently priced into expectations and it has been given a higher multiple (15x) relative to these goals being achieved, our belief is that downside will occur should the stock fall short of its margin goals or if the market were to re-recognize the secular challenges facing Energizer (similar to those that previously penalized Spectrum Brands).

Precision Drilling Bonds (Long): *Counterpoint:* I thought it would be a good idea to throw a bond in here just to illustrate the difference in thinking when you are looking at a bond versus a stock. We are talking about the embattled oil and gas sector so the sentiment is going to work against them. The stock has been pressured with the sector largely due to deteriorating EBITDA which is bringing covenant coverage into question. This could be exasperated if the company is forced to cut its dividend, which is widely expected. A weaker stock price will create less of a buffer for the bonds. *Point:* This one is all about the asset quality backing the bonds. At face value the bonds are worth, by our estimate, around 30% of the value of their tier one rigs, cash, and a discounted value of its completion operations. But with the bonds currently trading at 70 cents on the dollar, they are currently worth closer to 20% of our estimated value of their assets. With a 15% yield to a less than 5-year maturity that is a pretty high reward for, in our opinion, not a lot of risk. If the cycle does turn in the next four years, which would represent an abnormally long trough for oil and gas, we could get a quicker realization of these gains.

In closing, we aren't saying that all our ideas will work out in our favour - only that it’s important to know what could beat you, so you can assess the probability of those adverse events occurring. It's also important to hold firm, or even add to positions, in the event that they start working against you (i) as long as you understand why it’s happening, and (ii) provided that your initial thesis has not changed. Mike Tyson once famously said “everyone has a plan until they get hit”, and this is true. In the investment business you are going to get hit, but it's much easier to absorb the punch when you can see it coming.

As always, we reserve the right to change our mind!

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