VENATOR
CAPITAL MANAGEMENT LTD.

FIRST HALF REVIEW

Instrument (Inception)*	June 2017 Return	Year-to-Date Return	Compound Growth
Venator Founders Fund (March 2006)	**0.7%**	**-4.5%**	**11.3%**
Venator Investment Trust (September 2007)	**0.6%**	**-4.6%**	**7.7%**
Venator Income Fund (August 2008)	**0.8%**	**4.1%**	**12.0%**
Venator Select Fund (September 2013)	**-0.3%**	**-8.6%**	**12.1%**
S&P/TSX Total Return (March 2006)	-0.8%	0.7%	5.3%
Russell 2000 (March 2006)	3.5%	5.0%	7.5%
S&P Toronto Small Cap (March 2006)	0.5%	-4.1%	2.0%
S&P 500 (March 2006)	0.6%	9.3%	8.1%
Merrill Lynch High Yield Index (August 2008)	0.1%	4.9%	9.1%

Canadian Markets

Canadian markets were weak in the first half of the year, due in large part to the composition of our non-diverse market. The energy complex remains under pressure due to the oversupply/overproduction of both oil and gas. Gold may be firm, but it has lost its volatility, and gold stocks need volatility to fuel speculation. Financials have been held back by the Home Capital saga, along with concerns over the housing market in general. Outside of these core Canadian sectors, there really is not much diversity in terms of large cap market value.

Recent IPO activity is trying to rectify this situation, but too much money chasing too few diversification options has led to what we believe are excessive valuations in the Canadian diversified industries space. We run our screens North America wide and, in almost all cases, we are finding cheaper and superior investment options south of the border, especially in the technology realm. By way of example, TSX listed Kinaxis Inc. (KXS) is inexplicably the fourth highest valued enterprise software company in North America on a price-to-sales basis; it's a good company, but with a mid-20% growth rate it should probably not be on such a high perch relative to other comparables. Another example would be Canadian self-storage leader StorageVault (SVI), which is trading at a 70% premium to its net asset value, while its peers trade at roughly 10% premiums, suggesting potential downside for the stock simply to come in line with its peer group. While the company deserves credit for growing operating income from $5 million to a projected $60 million, we would note that this growth has not come cheap with debt exploding from $25 million to a projected $500 million, and shares outstanding increasing from 40 million to a projected 360 million. We believe that the market is not fully accounting for the dilutive impact of previous acquisitions.

A couple of sectors that we find intriguing due to lower relative valuation are REITs and energy services. In the case of domestic REITs, they seemingly trade at healthy yields and discounts to their US counterparts, but we need to be conscious of the potential for rising interest rates and the negative impact they can have on the sector. In the case of energy services, some companies appear to be near the valuation trough witnessed earlier last year, which is in stark contrast to their US counterparts who currently carry higher valuations due to rising drilling activity. The main problem we have with this opportunity revolves around our bearish view on oil; our preference would be to buy back into the sector if oil were to drop into the mid-$30's.

Due to our current aversion to resources and what we view as high valuations in the Canadian diversified industries space, our exposure to Canadian stocks continues to be lower than our historical average.

US Markets

South of the border, the bull market has continued, largely on the back of the largest five technology stocks now being renamed FAAMG (Facebook, Amazon, Apple, Microsoft and Google). Outside of these stocks, the market has been a bit of a mixed bag. Retail has given up its gains from last year, housing appears strong, automotive has slid on fears of having reached a cyclical peak, financials have recently begun to heat up, healthcare is bouncing up and down based on projected political speculation, while industrials are trading in a narrow band. Overall, we find the US market to offer a far more interesting pool of diverse opportunities that we plan to focus on for the balance of the year.

We remain excited by prospects within the technology and home ownership markets. Technology, in one form or another, is always the future and is always in style. Of course, having gone through the tech meltdown, we know that growth is not enough to ensure profits when you overpay (see our recent retrospective on Cisco Systems); in other words, good companies do not always end up being good stocks. That being said, where there is growth, there will always be opportunity.

One opportunity that bull markets tend to expose is quality laggards. These are great companies that were ahead of themselves valuation-wise, but managed to keep growing without a similar move in the stock prices. In other words, a previously expensive stock which has grown into its valuation and now appears relatively inexpensive. Salesforce.com is a good case in point: while the company's expected two-year gross profit per share growth is 40%, the stock price is only up 6%. At six times revenue, the company, widely considered to be the premier cloud application company, is in the bottom half of valuations among software companies with over 20% internal growth.

The other macro view we are optimistic about is the mid-to-long term outlook for housing in the United States. There are several factors that are intersecting to create a longer-term opportunity in this space. Millennials are finally getting married and buying single-family homes. The delay of roughly 5-7 years between my generation getting married in their mid-20's vs millennials getting married in their early-30's created a gap in the housing market, which is now expected to create a growth trajectory in the coming years. That said, the biggest impediment to home buying is a lack of homes for sale, which is starting to have a profound effect on housing prices which, in turn, is spurring demand for renovations. Basically, we like everything about housing, and we are continuing to expand the breadth of our positions in the space, with a preference for companies more dependent on volume than price (for example, retail over lumber).

Income Fund Review

Venator Income Fund continues to generate consistent monthly gains, often exceeding its underlying yield. We continue to take a cautious approach given expectations that rates can only go higher from here. We have also observed a lack of reward for going further out on the risk curve thanks to a general compression in credit spreads. To this end, we have been buying higher quality bonds and using a modest amount of leverage (roughly 30%). The current underlying yield of the Fund is approximately 6%, which is being weighed down by a sizable position in lower yielding convertible bonds that offer alternative avenues of investment upside, with a low risk of default, in our view.

The strategy continues to be something of a 'have your cake and eat it too' vehicle, combining lower leverage and volatility with solid returns, even while we wait for better opportunities to present themselves in the credit markets. We remain optimistic with regards to our ability to continue to exceed the underlying yield of the Fund in the coming months.

Equity Strategies Review

As has been the case for the last two years, our equity strategies have started slowly in 2017. On the bright side, our short book has been profitable this year, and we have had more meaningful gainers than losers in the long book. However, the

portfolio has suffered larger losses in two of our top three positions, both of which combine to account for roughly all the current year losses. Over the past few months we have added several new positions to the portfolio, in businesses where we believe that the respective stock prices have not kept up with accelerating fundamentals. As previously mentioned, at times you can find a good business that doesn't deserve its laggard status after a market run. The simple fact is that some stocks run too much, while some don't move enough. At this point in the market cycle, a laggard has the potential to offer a higher probability catch-up trade, provided the underlying business is of considerable quality. Finding companies whose improving fundamentals have outpaced their stock performance in a bull market (in other words, the companies that have experienced substantial valuation compression) isn't very difficult. The trick, however, is to identify businesses that were too expensive to begin with, or those that are of dubious quality; after all, some of these laggards are in the penalty box for good reason.

In summary, the projected upside of our equity strategies remains high in our opinion and, as a result, we remain optimistic. While many articles have been written lately about the death of value investing, we don't believe this to be true. Excessive trading is, in our opinion, random. On the other hand, our track record over the past decade illustrates that the ownership of solid businesses, with strong underlying fundamentals, purchased at attractive prices, is the road to long-term success. Tropicana Resorts, a no growth, tier 2, local casino operator that was trading below book value when initially purchased – is a great example of the type of business we invest into and seek to profit from. Fast forward to today and this company, as far from FAAMG as you can possibly get, has nearly tripled in price over the last 18 months, and is currently in the process of effectively being taken private.

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

Brandon Osten, CFA
CEO, Venator Capital Management Ltd.

This commentary is intended for informational purposes only and should not be construed as a solicitation for investment in any of the Venator Funds. The Funds may only be purchased by accredited investors with a medium-to-high risk tolerance seeking long-term capital gains. Read the Offering Memoranda in full before making any investment decisions. Prospective investors should inform themselves as to the legal requirements for the purchase of shares. All stated Venator returns are net of fees. It is important to note that past performance should not be taken as an indicator of future performance.