

Pathfinder Investment Outlook

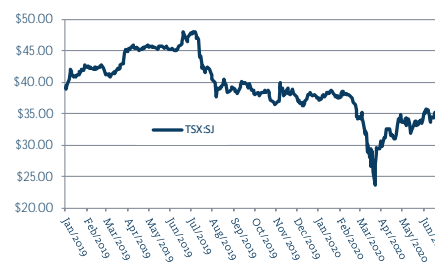
For the week ending July 10th, 2020

Pathfinder North American Equity: Stella Jones Inc.

This week, we complete our series focused on companies in our mandates that have created an “edge” for us during the pandemic. Recently, given all of the geopolitical issues, there has been a significant focus on writing about “macro”. While the macro situation impacts all companies, it is investments in individual businesses (i.e. the micro) that actually make up the portfolios at Pathfinder. Macro is stubbornly difficult to predict on a consistent basis but focusing on a specific micro situation (i.e. a company that we can invest in) can provide an opportunity for us to get an edge either through better information or adopting an investment thesis that other investors do not value in the same way. For example, there are companies whose business model have made them effectively recession proof and others who have actually seen accelerated demand for their products as a result of the pandemic, Stella-Jones is one of those companies.

- Stella-Jones Inc. (SJ:TSX)**, which specializes in producing and marketing **pressure treated wood** products, has been growing both internally (organic) and externally (acquisition) through consolidating the fragmented rail tie and utility pole markets. It has subsequently become the dominant operator in the North America.
- Over 90% of the rail ties SJ supplies to **railroad** companies are used for repair and maintenance due to **safety** and **regulatory** measures. **Utility** poles, on the other hand, run on a **replacement cycle** and a majority of the existing stock are approaching the end of their lifecycle. The nature of those two businesses means they are **less impacted by the business cycle**.
- The remaining business is **residential lumber**, which is plywood and dimensional wood used for outdoor activities. During the COVID-19 pandemic, this business has been doing well as **households are staying home** working on renovation projects (including backyards and decks), rather than spending on travel. This was a bit of a surprise to us at the time that we learned of by participating in 2 virtual management conference calls in March.
- The other item that we learned was that the business was deemed an **essential service** so production operations could continue and therefore, both sales and delivery of produced product were not materially impacted.
- The combination of all of this resulted in **limited revenue impact** for the company. At the same time, the stock market discounted a significant impact to SJ’s business and the **price of the stock fell** significantly.

Figure 1: Stella-Jones Inc. July 10, 2020



Source: Bloomberg Markets LP, Pathfinder Asset Management Limited

“**This means that**” because we understood the business model and viewed the market reaction as somewhat irrational, we were able to add to our position for existing clients and establish a position for new clients. In this case, our edge came from having a well-researched opinion that other investors did not value in the same way.

Michael Rudd, CFA | President, CEO & Portfolio Manager



Pathfinder Asset Management Ltd. | Equally Invested

1320-885 W. Georgia Street, Vancouver, BC V6C 3E8

E info@paml.ca | T 604 682 7312 | www.paml.ca

Sources: Bloomberg, Pathfinder Asset Management Limited

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*All returns are time weighted and net of investment management fees. Returns from the Pathfinder Partners' Fund and Pathfinder Real Fund are presented based on the masters series of each fund. The Pathfinder North American Equity Portfolio and The Pathfinder North American Income Portfolio are live accounts. These are actual accounts owned by the Pathfinder Chairman (Equity) and client (High Income) which contain no legacy positions, cash flows or other Pathfinder investment mandates or products. Monthly inception dates for each fund and portfolio are as follows: Pathfinder North American Equity Portfolio (January 2011), Pathfinder North American High-Income Portfolio (October 2012) Pathfinder Partners' Fund (April 2011), Pathfinder Real Fund (April, 2013), and Pathfinder International Fund (November 2014).

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