Executive Summary

The Mackenzie Cundill Team focuses on unrecognized, misunderstood or undervalued stocks anywhere in the world. Portfolios are concentrated with high-conviction investment positions across a range of value drivers to provide meaningful upside and to limit correlated behavior among positions. Such portfolio construction methods are important to properly balance risks and upside return potential.

Below, you will find where the Cundill team has identified great value stocks from around the world and their rationale for investing in the equities of three companies on behalf of Mackenzie Cundill funds and for selling three other positions.

The team seeks out companies that have catalysts that can close the valuation gap over a 3 to 5 year period and they carefully monitor milestones for each investment to ensure that the buy thesis is intact otherwise they consider eliminating the position.

The Buys

Hitachi

Hitachi is a Japanese conglomerate that, historically, had a bloated cost structure and was too focused on hardware products. New management came in after the international financial crisis and started cutting costs and exiting non-core businesses.

Opportunity to buy: On Feb 3, 2016, Hitachi announced Q3/2016 results and cut its fiscal year (FY) operating profit guidance. This was a shock to the market which, just six months prior, was anticipating FY operating profit to be even higher than guidance. As a result, the stock was punished by losing over 25% in value over the next week or so, providing us a very compelling entry point.

Investment drivers: Hitachi is now more focused on Information Technology services, mobility and the Internet of Things. The old product-focused mentality is being reshaped to deliver more service-oriented revenue and to be more aligned with industry vertical segments of their customers. Management has demonstrated success in lifting margins on earnings before interest and taxes (EBIT) from 3% to about 5.5%. Their goal is to get to 8% and we believe that is credible. Despite the improved profitability and better capital allocation, the shares still trade at a significant discount to our estimated value based on a variety of widely used valuation metrics. The balance sheet is strong with little net debt (total debt less cash). We believe this stock is undervalued and we see meaningful upside from here.

Novartis

Novartis is a Swiss global healthcare leader in branded pharmaceuticals, eye care and generics. Its quality and productive Research & Development capabilities and the turnaround potential in its eye care business (Alcon division) offer substantial upside potential.

Opportunity to buy: The team initiated a position in 2016 after the stock had a dramatic fall in price due to market concerns regarding patent expiries and an underperforming eye care division.

Investment drivers: We believe Novartis’ strong pipeline of new drugs will more than offset the upcoming patent expiry of its cancer drug, Gleevec. The company, historically, has delivered one of the most productive product pipelines in the industry, and the eye care division, Alcon, is being restructured to become more focused, while sharing costs with other divisions. Such a restructuring or an outright sale would sharply increase shareholder value.
Novartis had already divested lower-margin animal health and vaccines units and started implementing a firm-wide cost cutting plan. As shareholders, we also like its strong balance sheet, tremendous free cash flow generation (cash available to pay down debt, make acquisitions or raise dividends) and 3.5% dividend yield.

**A.C. Nielsen Company**

Nielsen is the global leader and industry standard in information, measurement and analytics to the consumer packaged goods, media and retail industries.

**Opportunity to buy:** An earnings miss provided the team with a rare opportunity to buy a high-quality “compounder” with monopolistic attributes, at a bargain price. A compounder is a company that can increase its intrinsic value organically over time.

**Investment drivers:** We believe Nielsen’s strong brand and dominant market position, along with its high percentage of recurring subscription-based revenues (approximately 70%), will continue to generate strong free cash flow for shareholders. Catalysts include financial deleveraging and share buyback activity, strategic acquisitions as well as consistent revenue growth and margin expansion (therefore driving multiple expansion). Our valuation work indicates there is substantial upside potential from our initial purchase price and over time as our thesis plays out, the nice thing is that the intrinsic value of the company can increase while catalysts are surfacing value.

**The Exits**

**GameStop**

In our opinion, GameStop is a catalyst-void, brick-and-mortar retailer facing significant secular headwinds. Its shares were divested to fund higher conviction ideas and because we felt that GameStop could eventually go the way of Radioshack or Blockbuster.

**Helmerich & Payne**

This is a high-quality energy service company that was eliminated because it was no longer trading at an appropriate discount to intrinsic value. We had earned a substantive profit on it and were overweight commodities. Proceeds were used to fund higher conviction ideas with diversification in mind.

**Sankyo**

This company operates in the Japanese pachinko market. Pachinko is a type of gaming machine that caters only to Japanese consumers. The company is in a declining industry with little to no international opportunities. We exited this position and re-deployed capital in more compelling ideas.

"There is always something to do. You just need to look harder, be creative and a little flexible.” – Peter Cundill

**Summary**

We believe that the market is in the early stages of a multi-year recovery for the value style and that history has shown that styles can lead for five to seven years. We are convinced that investors should do well by owning some Mackenzie Cundill funds as part of a well-diversified portfolio.

The Cundill Team is unwavering in its adherence to the principles of the father of value investing, Ben Graham, and the beliefs of Peter Cundill, Canada’s value investing legend. We have the entire world to find cheap stocks with catalysts to bring value to the surface. Some stocks are leaders in cyclical industries, and we try to buy them near their cyclical trough. Some have hidden value where their sum-of-the-parts is greater than the whole. Other opportunities are compounders in the midst of a business transformation or a restructuring. The great thing about value investing is that, as Peter Cundill used to say, “There is always something to do. You just need to look harder, be creative and a little flexible.” We agree.

For more information about the Mackenzie Cundill Funds, please contact your financial advisor.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

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