DM Monthly Report

October 2015

PORTFOLIO ACTIVITY

In September, we opened a new position in Cognizant Technology Solutions in the DM Foreign Equity Portfolio. No trades were executed in DM Canadian Equity.

FEATURE STOCK
Suncor Energy (SU)

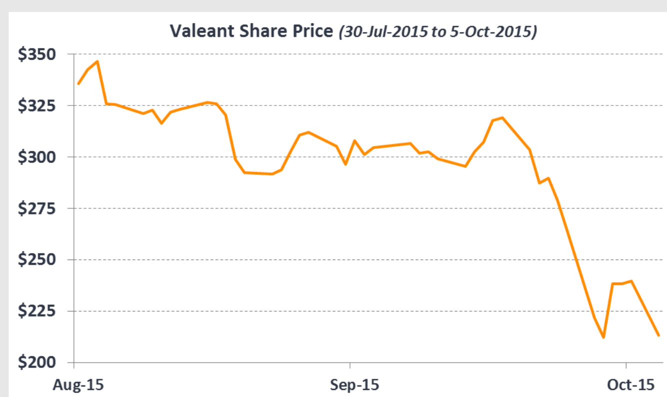
In the latter stages of Q2, SU faced an interesting predicament, one that is difficult to conceive given the state of its industry and the headlines surrounding it. Said CEO Steve Williams at a summer conference, "We have too much cash on our balance sheet; we've been generating more cash than anticipated and have put $5 billion in the bank". SU put some of this capital to work by raising its dividend in July, renewing a $500m share buyback program, and acquiring an additional 10% stake in the Fort Hills oil sands project. Its biggest move, though, came just days ago when it launched a $5bn hostile bid for Canadian Oil Sands Ltd. (COS), the largest stakeholder in the Syncrude joint venture. To defend against the takeover, COS has adopted a shareholder rights plan (or "poison pill"), meaning that a final resolution of the offer will take some time. If the deal does close, however, we believe that it would be materially positive for SU's competitive position going forward.

WELL THAT DIDN'T TAKE LONG ...

This summer, we wrote about how TSX performance has frequently become dominated by a single, mega-capitalization stock over the past 15 years. From Nortel to Potash Corp., to Research in Motion and, most recently, Valeant Pharmaceuticals, the heavy influence of these suddenly massive companies has distorted market performance on the way up and exposed index investors to unexpected risk on the way down.

A little more than a month after we sent the note out, Valeant grabbed headlines for all the wrong reasons—*and lost more than a third of its value in the process*. Problems began when the brash young CEO of a small US pharma company bought an HIV drug and promptly raised its price from $13.50 to $750 per tablet. This aggressive manoeuvre, alongside the executive's flippant demeanor in follow-up interviews, raised the ire of nearly all observers and prompted Hillary Clinton to tweet that such price gouging was "outrageous" and that she'd "lay out a plan to take it on." This seemingly obscure episode, generated by a tiny company with a tiny drug, had big implications for Valeant because a significant portion of its business model is based on the same strategy: *acquiring incumbent pharmaceutical companies and then hiking the prices of their products to boost profit*.

Though we have looked at Valeant on several occasions, we've always passed on acquiring a position because of the significant debt the company has had to assume to complete so many successive acquisitions and because its accounting treatment of this activity is extremely difficult to untangle. Of course, we didn't find the nature of its business model terribly attractive either.



Whether politicians respond to public anger and follow through with their pledges to reform industry regulations remains to be seen (already, though, there has been talk of calling Valeant's CEO to testify before US Congress). Either way, a warning shot has been fired across the company's bow and one can only assume that its breakneck pace of growth will be more difficult to maintain going forward. If Valeant's aggressive pricing model is truly in jeopardy, investors may also grow concerned about its ability to manage the roughly $30 billion in net debt now sitting on its balance sheet.

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