PEMBROKE
Serving Private Clients and Institutions

July 2017

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ON THE ROAD AGAIN

Installed Building Products ("IBP") is a Columbus, Ohio-based installer of insulation systems and other building products. The Company was founded in 1977 with one location in Columbus and today generates over US$1 billion in sales from 125 locations across 48 states. IBP generates about 75% of its revenue from the residential market, 18% from the commercial market, and 7% from repairs and remodels.

Pembroke has followed IBP since its 2014 initial public offering and met management numerous times. After a small initial investment in November 2016, Pembroke portfolio managers ("PMs") scheduled interviews in April with management at IBP's Columbus headquarters. The team met with the CEO, COO, President of External Affairs, SVP Finance, and the company's mid-west regional manager during a plant tour. The visits reinforced Pembroke's view that:

1. IBP is managed by a competent and complementary team;

2. IBP is an efficient, high-quality construction business;

3. Multiple drivers have created a long runway for revenue growth and margin expansion;

4. There is compelling risk-adjusted upside potential in the shares.

Jeff Edwards, the CEO, assumed control of IBP from his father in 2004 and has taken the business to the next level. Most of the company's expansion and the assembly of the current management team occurred on Jeff's watch. Pembroke saw no weak links or visible egos on this team. Each team member conveys intelligence and credibility and appears committed to growing the business in the shareholders' best interests. That is only sensible as management owns about 30% of the equity.

Though insulation installation may present itself as an uninteresting and labor-intensive business, IBP is one of the finest construction services firms the PMs have encountered. This is due, in part, to their position in the value chain. IBP sits between a fragmented customer base (the thousands of homebuilders in the country; among whom the top five control about 10%), and four insulation manufacturers that lack pricing power. IBP is one of only two large insulation installers in the country that each control 20%-25% of the market and benefits from much cheaper insulation pricing than smaller competitors. This structural advantage and benign competitive environment is evident in their returns: 25%-30% return on equity, and 14%-15% return on invested capital. IBP turns their insulation inventory more than ten times per year.

IBP's business has many channels for growth including residential product extensions, additional M&A, commercial branch expansion and continued cyclical expansion. Single-family housing starts are still 30%-40% below historically observed levels and we expect them to continue to recover like other pillars of the American economy.

Pembroke saw first-hand how residential product extensions represent an interesting upside to growth. IBP's Columbus branch installs the full range of building products including insulation, gutters, garage doors, shower doors, mirrors and water-proofing. Learning more about the economics of rolling these products out to additional locations increases our conviction in our growth estimates.

IBP's products appear in about 60% of single family home permits in the United States. The firm believes that number can rise to over 90% over the next three to five years through mergers and acquisitions and provide another multi-year tailwind to growth. Pembroke left its meetings in Columbus with the belief that commercial sales, currently about 18% of revenue, represent another compelling organic growth opportunity. The company plans to leverage the general contractor relationships from its recent Alpha Construction acquisition and open new commercial offices in the larger residential market branches. Furthermore, there may be additional M&A in the commercial sector. The PMs are now even more confident about potential of the investment.

JUST THE FACTS

Before providing qualitative comments on the quarter, we present some quantitative information regarding our top five Canadian and U.S. holdings.

Top Five Canadian Holdings
June 30th, 2017

Company	Q2 Price Change (CAD)	Revenue Growth, Current Fiscal Year	EBITDA Growth, Current Fiscal Year	Revenue Growth, Next Fiscal Year	EBITDA Growth, Next Fiscal Year
Descartes Systems	4%	10%	15%	11%	15%
BRP	22%	5%	13%	5%	8%
DIRTT Environmental	-2%	17%	69%	16%	40%
DHX Media	3%	3%	34%	58%	49%
Gildan	11%	4%	6%	5%	7%
Average	**7%**	**8%**	**28%**	**19%**	**24%**

Top Five U.S. Holdings
June 30th, 2017

Company	Q2 Price Change (USD)	Revenue Growth, Current Fiscal Year	EBITDA Growth, Current Fiscal Year	Revenue Growth, Next Fiscal Year	EBITDA Growth, Next Fiscal Year
HMS Holdings	-9%	15%	10%	13%	15%
BofI	-9%	21%	12%	14%	16%
J2 Global	2%	32%	18%	8%	14%
National General Holdings	-11%	17%	14%	8%	24%
Gentherm	-1%	8%	11%	7%	7%
Average	**-6%**	**18%**	**13%**	**10%**	**15%**

Source: Consensus and Pembroke estimates

Overview of the Quarter

Introduction

Equity markets in the United States moved higher in the second quarter of 2017 as important economic data, such as employment and official corporate spending surveys, indicate that an economic expansion is still underway. Notably, some sectors that struggled in the weeks following Trump's victory in November 2016 have posted positive results in 2017. Healthcare and technology led the Russell 2000's gains from the end of March through June, supported by a combination of strong growth and attractive valuations. In Canada, the major market index struggled to make headway as the energy and financial sectors declined modestly.

Certain healthcare stocks have been volatile in the face of the uncertainty surrounding the repeal and replacement of the Affordable Care Act. That volatility offers opportunity for long-term oriented investors; the trends in cost rationalization, increased use of data and technology in decision-making, and accountable care are not abating. Pembroke maintains a significant weight in healthcare and in the past twelve months has added new holdings to its U.S. and Canadian portfolios.

Pembroke's portfolios benefited from strong stock selection in the technology sector. The firm does not have significant weights in highly priced, extremely rapid growth companies and instead focuses on well-managed, profitable growth businesses trading at reasonable valuations (i.e., it will not buy growth "at any price"). However, the firm has an active pipeline of ideas within the technology sector that it can act upon should a market downturn provide an opportunity to buy these disruptive franchises at lower prices.

Energy stocks continue to struggle as increased supply has capped oil and natural gas prices. Pembroke maintains a cautious stance towards the sector but continues to look for well-capitalized growth companies earning a reasonable financial return even at current commodity prices.
While valuations have expanded in 2017, many investors are chasing high growth companies, leaving a slew of interesting opportunities in under-covered, less well-known businesses directed by shareholder oriented management teams. Pembroke believes that positive returns can be

generated investing in growth companies that increase their revenue and earnings on a per share basis, especially if interest rates rise modestly over the next two years and dampen cyclical growth and multiple expansion.

UNITED STATES COMMENTARY

Pembroke's U.S. equity portfolio outperformed its Russell 2000 benchmark for the quarter and remains ahead of it and S&P 500 year-to-date. Healthcare and technology contributed the most to performance. Healthcare stocks offer an attractive combination of value and growth and continue to rise after struggling following Trump's win. Holdings in the financial sector modestly detracted from performance. Fundamentals at the holding level remain strong, providing a significant source of upside should the shares in the firm's financial companies get re-rated by the broader investor community.

Pembroke's investment in **GTT Communications** ("GTT") performed well in the second quarter. GTT is an asset-light provider of telecommunication services to multi-national corporations. The company is growing organically as a result of its superior service and attractive pricing, offering customers a viable alternative to the name-brand incumbents. In addition, GTT is aggressively consolidating smaller competitors and announced two accretive transactions in the past three months. If you include the significant synergies associated with these transactions, GTT actually de-levered its balance sheet relative to its earnings power. GTT remains a large position in the firm's U.S. portfolio as it is reasonably valued given its strong free cash flow, persistent revenue stream, and large market opportunity. The management team has a successful track record of creating value for shareholders at prior companies and owns over 30% of the equity thus aligning their interests well with those of outside shareholders.

Shares in **Web.com** ("WEB") moved higher in the second quarter with reports that the company was in takeover discussions. WEB has a website domain registration business that generates significant free cash flow and also offers website design tools and services. WEB is expected to throw off approximately $130 million of free cash flow in 2017, which represents an equity free cash yield of more than 10%. The company acquired Yodle in 2016 to expand its capabilities in website design and online marketing. While many of WEB's competitors are automating the entire website design and online marketing process, WEB is differentiating itself by offering consulting services to small and medium-sized business owners who want help enhancing their online efforts. WEB is pursuing a balance between growth and profitability and uses its free cash flow to pay down debt and buy back shares. The financial dynamics at WEB make it an attractive target for faster-growth competitors looking to improve their

profitability metrics or private equity firms who see the potential to both lever WEB's balance sheet and grow the revenue base over time. Even if not acquired, Pembroke sees value in WEB's sticky customer base and, if the company can accelerate its organic growth on the back of the services offered by the acquisition of Yodle, the market will likely apply a higher multiple to the shares.

Pembroke's U.S. equity portfolios benefited from the acquisition of **Xactly Corporation** ("XTLY") by Vista Equity Partners. Despite the fact that the price paid represented a 34% premium to XTLY's closing price only 30 days before the deal announcement, Pembroke's investment team was disappointed to see this takeover. XTLY helps corporations manage their sales compensation programs and offers its customers competitive benchmarking data to more effectively incentivize their sales teams. The market is only about 20% penetrated and the multi-year opportunity remains enormous. Pembroke has been able to deploy the capital from XTLY into other technology companies that also have attractive upside potential.

Shares in **Brightcove** ("BCOV") fell after the company revised down its revenue and earnings guidance for Fiscal Year 2017. The holding was relatively new without a large portfolio weighting but it was disappointing to see fundamentals take such a turn. Pembroke made its investment in 2016. BCOV, which hosts and publishes online video content, started to show signs of accelerating growth and margin expansion after two years of R&D and sales investment. That rocky period provided what Pembroke believed to be an attractive inflection point in the business. However; certain elements of BCOV's business proved susceptible to price competition leading to customer losses in the first quarter. The current valuation has attracted value buyers and potential activists; however, Pembroke sold its small weight to make room for companies with now clearer paths to growth.

Shares in Pembroke's largest position, **HMS Holdings** ("HMSY"), have struggled since the company reported first quarter results that fell below expectations. HMSY helps state governments and insurance companies reduce healthcare costs by identifying whether a third party is responsible for the cost and by reviewing the integrity of the medical services provided. HMSY has a virtual monopoly in its state government business, with 46 states signed up to long-term contracts. This business grows at a moderate pace as states take more services from HMSY and as healthcare costs rise. The company's more significant growth opportunity falls within its commercial segment, which is expected to compound at 15% or more for the next several years. Further, the commercial segment is now larger than HMSY's government division, so overall revenue growth is expected to move higher. While commercial growth fell short of investor

expectations in the first quarter, HMSY continues to add to its backlog of business by winning new customers and by further penetrating existing customers. Pembroke has confidence that HMSY's long-term growth opportunity is firmly intact. Note that management did not lower its revenue guidance for 2017 despite the slow start to the year. In the past twelve months, HMSY has deployed some of its significant free cash flow towards acquisitions, acquiring two companies that move HMSY into complementary markets, including the fast-growing population health management arena. The uncertainty around the repeal and replacement of the Affordable Care Act ("ACA") has HMSY shares trading at a compelling valuation given its strong competitive position, revenue growth, high margin structure, and significant free cash flow. Over the next several quarters we expect HMSY to rectify the operational challenges that affected first quarter results and for the overhang around changes to the ACA to lift. In Pembroke's view, HMSY shares have minimal medium-term downside but offer significant upside for patient investors.

Canadian Commentary

Pembroke's Canadian equity portfolios posted positive absolute returns this quarter, outperforming the TSX Composite Index which finished in negative territory. Canadian portfolios benefited from strong performance in materials, industrials, information technology, and real estate holdings. This was modestly offset by weaker performance in healthcare and telecommunications investments.

On an individual holding basis, some stocks posted significant declines that weighed on performance. Shares in **IMAX Corporation** ("IMAX"), a provider of motion-picture technologies and large format motion-picture systems, sold off in the second quarter as investors digested disappointing box office results. While IMAX's short-term results are indeed affected by the success and failure of major films, the longer-term opportunity to grow by increasing the number of IMAX installations worldwide remains intact. Management has taken steps to address near-term headwinds by implementing cost reduction measures and instituting a share repurchase program.

Shares in **Tamarack Valley Energy** ("TVE"), an oil and gas producer with assets in Alberta and Saskatchewan, declined in the second quarter in sympathy with weak oil prices which hampered the entire sector. Management is focused on developing projects that earn an adequate return on investment even in difficult commodity price environments. The company has opportunistically been adding to its asset base through the energy price downturn and maintains a conservatively financed balance sheet that will allow it to weather further volatility.

lumenpulse

On the positive front, two noteworthy stocks made significant contributions to second quarter returns. Shares in **Lumenpulse** ("LMP"), a provider of LED-based systems to the architectural lighting industry, rallied on news that the company will be taken private by its founders at a significant premium. The company's shares had sold off during the previous quarter as a result of weak results and reduced financial guidance. The acquisition reflects management's confidence in the longer-term viability and attractiveness of the business.

Shares in **BRP Inc.** ("DOO"), a manufacturer of vehicles and propulsion systems for the powersports industry, performed well in this quarter on the back of robust quarterly earnings and clear evidence of strong business momentum. BRP's lineup of products is resonating well with consumers and the company is out-executing its competition. Moreover, positive financial performance has led BRP management to initiate a dividend and launch a significant share buyback program.

Balanced Fund Commentary

Pembroke's balanced portfolio, the **GBC Growth and Income Fund**, has performed well year-to-date. Positive returns were a three-fold function of 1), a few names that had significant returns, 2), a large portion of the remaining holdings that experienced positive returns, and 3) a lack of notable laggards. Performance was well ahead of the S&P / TSX Composite Index as well as the S&P / TSX Dividend Aristocrats Index – which declined during the first two quarters.

The asset mix remained relatively unchanged during the period with approximately 29% of the portfolio invested in fixed income. This component is primarily invested in securities rated "A+" that, on average, have a collective yield to maturity of 2.3% and an adjusted portfolio duration of 4.6 years.

Income is generated from dividends and interest. The yield is currently an annualized 3.3%. The growth component of the portfolio stems primarily from the 44 dividend paying companies that are expected to appreciate in value over time. Seventeen of these holdings, representing 40% of the equity exposure, are also held in Pembroke's standard Canadian growth mandate. The holdings unique to this portfolio generally have business models that are less volatile, pay meaningful dividends, and are expected to grow their earnings at a more moderate rate. Companies are selected based on having an attractive, well-funded, sustainable dividends as well as reasonable growth opportunities. Management quality and aligned interests with shareholders are also key investment considerations. The

equity holdings in the GBC Growth and Income Fund mirror those held in the **Pembroke Dividend Growth Fund**.

The **Pembroke Dividend Growth Fund** presented positive returns year-to-date; meaningfully ahead of its benchmark. The Fund's overall goal is to provide a higher level of capital protection than our traditional growth funds while still securing a modest level of growth and current income. Although the strategy to achieve this goal is to invest in business models that generally have a higher degree of visibility compared with investments in Pembroke's core growth funds, this mandate has a large exposure to equities that can, and likely will, experience volatility. As equity prices are a function of investor sentiment, the valuations and multiples that investors associate with public companies can vary widely, even if the underlying business does not experience such swings in their profitability and cash flows. The longer-term performance of this Fund has been encouraging but it has not been linear.

SleepCountry

At the top of the contributions by stock were **TECSYS (**"TCS") and **Sleep Country Canada** ("ZZZ"). TECSYS is a software company providing distribution management solutions for the supply chain needs of hospitals in the United States. The company showed promising signs of profitability improvements during their most recent quarterly results. There is also an increased level of optimism that the company will be able to win more new hospital clients and increase the sales penetration amongst existing users. The market capitalization of the company is starting to reach levels such that more institutional investors are considering it.

Sleep Country Canada is a mattress retailer operating across Canada. The company has, for the most part, generated consistent and impressive results since their initial public offering two years ago. The strong same-store-sales growth has come, in part, as a result of effective advertising. Their relative position in the market has only strengthened as other competitors have struggled and the most prominent of them recently filed for creditor protection with the expectation that a number of locations will be closed as part of the restructuring process. Growth is expected to continue as the company deploys cash flow into further store openings and existing store renovations.

MEDIAGRIF

The two largest detractors from performance were **Peyto Exploration & Development (PEY)** and **Mediagrif Interactive Technologies ("MDF").** Peyto is an energy company with most of their production coming from gas. They are focused on operating a few different regions within the Alberta Deep Basin. During the past six months, Peyto experienced some production delays due to lack of availability of services and weather-related issues including a longer down time during spring break-up. Management has guided production volumes to return to higher levels in

the second half of 2017. Adding to some company-specific issues, energy as a sector is out of favour with investors as debates regarding supply and demand levels weigh on commodity prices.

Mediagrif is a technology company that owns several web and mobile platforms that provide customer solutions to managing business-to-business relationships. This stock was part of last quarter's commentary as they reported results in the first part of the year which disappointed investors from the standpoint of growth. This prompted questions about the company's underlying growth potential. Despite this, free cash flow is healthy and management has used part of this to fund two acquisitions of properties they describe as growth assets. The market is taking a wait-and-see approach; unwilling to give the company credit for these assets until evidence of such growth is reported.

Pembroke is encouraged by year-to-date performance. While the majority of return was founded on solid fundamental execution amongst holdings, the return was ahead of what was expected for this mandate on an annualized basis. The firm does not anticipate giving back these returns; however, some of the individual stock contributions that aided performance through the first half cannot be expected in every period going forward. Pembroke is slowly increasing the number of holdings in the portfolio as the managers come across new ideas and continues to analyze names across a broad range of sectors on an ongoing basis.

International Equity Commentary

The **GBC International Growth Fund** delivered positive returns the first half-year; outpacing its benchmark, the Morgan Stanley Capital International (MSCI) All Country World ex USA Small Cap index.

Growth-oriented market leadership was a broad tailwind to performance. Stock selection was positive across most sectors led by Healthcare and Consumer Discretionary. Notable contributors in Healthcare included European pharmaceuticals holdings **Ipsen** and **Recordati**, while **China Lodging Group** bolstered relative performance in the Discretionary sector. Overall sector positioning was positive during the six-month period driven by overweight positions in Financials and Industrials. These favorable effects were partially moderated by weak stock selection in the Information Technology and Materials sectors. Within Information Technology, the Fund's internet and semiconductor holdings did not keep pace with the primary Index contributors, while Materials stock selection was hampered by share price weakness in mining holdings **Granges** and **Dowa**.

Stock selection was strong across most geographic regions led by Emerging Asia and Japan. Within Emerging Asia, Chinese consumer and Indian financial holdings were the primary contributors, while outperformance in Japan was driven by industrials, real estate and financials. These gains were partially offset by the underweighting to Emerging Asia and Europe ex-United Kingdom stock selection.

Notable changes during the six-month period included an increase in Discretionary to an overweight position as June 30th, supported by new positions in Emerging Markets, Europe and Japanese consumer companies. The Fund's Energy, Materials, Information Technology and Industrials exposures were moderated; the latter two reductions precipitated by increased valuation risk following strong gains. From a geographic perspective, Fund positioning was mostly steady. The allocation to Developed Asia ex-Japan was reduced through liquidations in select Australian holdings, driven by weaker company fundamentals. Exposure to the Europe Middle East and Africa region was also reduced via the liquidation of Turkish bank and oil refining holdings. Concomitantly, there were modest increases to Europe, United Kingdom and Latin America.

Fixed Income Commentary

The **GBC Canadian Bond Fund** posted a positive return on a year-to-date basis but slightly trailed its benchmark FTSE TMX Canada Universe Bond Index. The **Pembroke Corporate Bond Fund** posted a positive return on a year-to-date basis but slightly trailed its benchmark FTSE TMX Canada Corporate Index.

The Bank of Canada appeared to reverse course in the second quarter of 2017. The Bank seemed to be in no hurry to alter course after making “emergency” rate cuts in January 2015 and again later that year. In June the bank’s tone abruptly changed citing improved growth prospects that will eliminate economic “slack”, improved business confidence, and a sharply reduced drag from lower oil prices. This stance was broadly consistent with central bank comments in the United Kingdom, Europe, and the United States.

As a result of this action, the Canadian yield curve flattened as short and mid-term yields rose and long yields declined. Falling yields made long dated bonds the strongest performer in the quarter.

Long duration Provincial bonds continued to outperform in the government sector, returning 2.1% for the quarter, as Provincial yield levels remained flat and spreads tightened versus Government of Canada bonds. The Canada Index returned 0.4% in the quarter. In the corporate

sector credit spreads actually declined in most cases so that corporate bonds outperformed the broad market in the short, mid, and long term. However, the overall corporate index slightly underperformed the overall market as it has a lower weight in long term bonds. The Corporate Index return of 1.0% for the quarter was driven by a rebound in the long Infrastructure sector and the longer duration A rated index returning 3.5% and 1.8% respectively.

Year to date the Corporate Index returned 2.9%, outperforming the Overall Index of 2.4% by 50 basis points. This is well ahead of the Canada Index of 1.0%; however, it lagged the Provincial and Municipal Index returns of 3.5% and 3.6% respectively.

With over 25% of the Fund invested in floating rate notes at the end of the quarter, the **GBC Canadian Bond Fund** is well positioned in the event that rates rise further. The position in floating rate notes were a benefit to the Fund as short term yields rose, as were several of the long positions in G.T.A.A, Highway 407 and TransCanada Pipelines as long yields declined. The Fund returned 0.59% for the quarter and 1.66% year to date both underperforming the FTSE TMX Universe Index by 0.4% and 1.1% respectively. The Canadian FTSE TMX Universe index rose 1.11% for the quarter and 2.36% year to date. The difference is attributable to the Fund's underweight position in the long maturities as long yields declined in the quarter and year to date. Canso Investment Counsel, the sub-advisor to this Fund, continues to believe that investors are not adequately compensated for the risks of owning longer term bonds.

The **GBC Canadian Bond Fund** is invested in a diversified portfolio of high quality bonds. The portfolio yield to maturity is 2.3% which compares favorably to the market and this is achieved with significantly less interest rate risk. The portfolio continues to be positioned defensively in the event of a further increase in interest rates with a duration of 4.6 years compared to the index duration of 7.6 years.

The **Pembroke Corporate Bond Fund**'s underperformance year to date is attributable to the portfolio's underweight in long term issues in a period where long bond yields declined. The underperformance was partially offset when Xplornet redeemed their 2020 bonds at the end of May at a price of $103.25. In addition, the Pembroke portfolio continues to benefit both quarter and year to date from spreads narrowing in positions such as Navient and Sobeys Inc. In addition, the portfolio has a healthy weight in floating rate issues which also benefited the portfolio as short term yields rose. The portfolio continues to accumulate floating rate positions as Canso Investment Counsel, the sub-advisor to this Fund, believes that investors are not adequately compensated for the risks of owning longer term bonds. Relative to the FTSE TMX Corporate Bond Index duration of 6.4 years, the shorter portfolio duration of 2.1 years positions the portfolio

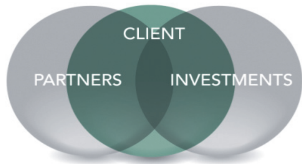
defensively in the event that interest rates rise further, while maintaining a healthy yield to maturity of 2.0%.

Outlook & Conclusion

Pembroke believes its portfolios are sufficiently diversified across holdings and industries, with well-managed, well-financed and reasonably valued growth companies. The team continues to travel to industry conferences and company headquarters to monitor holdings and build a pipeline of new investment opportunities. Pembroke is also investing in its people and processes in ways that further our objective to deliver superior risk-adjusted returns to our clients. Pembroke never expects a linearly rising market and would actually welcome a correction to allow it to establish new positions or raise existing weights in some expensive but high quality businesses. The firm remains optimistic that over the medium and long term the portfolios are positioned to show positive returns.

Business Update

Effective July 1st we will be reducing the management fees on certain funds, please contact your Pembroke Representative to find out how these changes will impact your account.



THE FIRM

Pembroke Management Ltd. was founded in 1968 and is based in Montreal. Pembroke's business and investment philosophy is rooted in the concept of ownership. Owners do what is in the long-term interests of their customers and stakeholders to maximize their own wealth. For this reason, Pembroke will more often than not back management teams that either own significant stakes in the companies they manage or whatever they own represents a significant part of their personal wealth. Furthermore, Pembroke tries to not take unnecessary risks in its investment portfolios because the Pembroke partners are large shareholders in the firm's funds. The result is a powerful alignment of interests.

Pembroke is registered as an Investment Advisor in Quebec, Ontario, British Columbia, Alberta, Manitoba, the United States, Denmark and Ireland. The firm manages segregated portfolios for institutional and high net worth clients. Pembroke Private Wealth Management is a subsidiary of Pembroke Management and is a mutual fund Manager and Dealer for the GBC family of mutual funds and the Pembroke family of pooled funds.

PEMBROKE PRIVATE WEALTH CONTACT

For additional information regarding Pembroke Private Wealth Management please call us in Montreal at 514-848-0716 or 800-667-0716 or in Toronto at 416-366-2550 or 800-668-7383, or refer to our website **www.pml.ca**.

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