PEMBROKE

October 2018

Pembroke at 50

2018 marks the celebration of an important anniversary for Pembroke. The company was founded in 1968, making this our 50th anniversary.

For 50 years, we have invested in entrepreneurial growth companies and served the investment needs of our clients. More than the simple passage of time, 2018 is an opportunity to reaffirm and celebrate our core values, our consistent investment philosophy and, most importantly, what we have achieved for our clients.

As a firm, we value integrity, excellence, humility, accountability and alignment and we believe that our focus on innovation, insight, and growth has been key to our success.

We have witnessed tremendous change over the past half century and we have invested in many wonderful companies that have created significant wealth for their shareholders. We have also learned some tough lessons along the way. The wisdom gained every year has helped us focus on what matters; creating wealth for our clients over the long-term.

We thank all our clients for having confidence in Pembroke, and we all look forward to celebrating our 50th anniversary with you as we continue the journey.

On the Road Again

For those of us who travel frequently, airline loyalty programs are often of particular interest.

Points International ("Points" or "PTS") is a Toronto-based technology company that serves the loyalty program industry. In other words, PTS helps large airlines, hotel chains, and other hospitality companies manage their points programs. Points has been a holding in the Canadian portfolios since 2012. While the share price has struggled to make headway, the company has made excellent fundamental progress.

The loyalty industry is a large and growing industry. Each year, over $50 billion of value in points is issued and sold by North American loyalty programs. Loyalty programs are key retention tools in the airline and hospitality industries. For many consumers, the collection of loyalty points is a pursuit - for some it is even an obsession! The industry is not well understood by many observers, but it is a known fact that the issuance of points is a very profitable venture for the issuing entities. In fact, over 60% of miles issued are now being purchased by third parties as part of an affinity program. One well-known example would be the CIBC Aerogold card. In this instance, the credit card issuer buys the points from Aeroplan for use on Air Canada flights as the consumer spends money on the card.

Points operates a "Loyalty Commerce Network" with over 60 loyalty program partners using some feature of the network. Points has a direct integration into these "points banks" around the world. The loyalty program operators are trying to stimulate activities in their programs as the reward redemptions lead to customer engagement and satisfaction. Points has three main activities:

1. Loyalty Currency Retailing:
   Points operates the Buy/Gift/Transfer programs for many of its clients. This program enables loyalty customers to "top up" their accounts via the purchase of miles so that they can meet a reward

threshold to get a “free” ticket. The loyalty companies have outsourced these functions because Points effectively leverages data to engage the customer base.

2. Points Travel:
   This service helps the loyalty program achieve a deeper engagement with its customers. If the loyalty customer books a hotel room through the program site, the customer can earn more miles. Points has assembled room inventory that is price competitive with major travel sites. This position creates a win/win situation for the loyalty program and the consumer.

3. Platform Partnerships:
   Points provides access to its network, and tools to third parties such as Marathon Oil or Groupon who don’t have their own loyalty programs but instead use other established loyalty programs to stimulate their customer base.

Points has had great success retaining its clients. The only significant client losses have come via mergers of loyalty programs. Through cross-selling of complementary services, new client wins, and the development of new revenue sources, Points has absorbed those client departures and proved its long-term growth opportunity. Co-founders Rob Maclean and Chris Barnard are still leading the company and have successfully steered it through a multi-year investment phase. Like many smaller Canadian companies, Points has limited sell-side research coverage and thus trades at a very modest valuation.

Just the Facts

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

Top Five Canadian Holdings

September 30th, 2018

Company	Q3 Price Change (CAD)	Revenue Growth, Current Fiscal Year	EBITDA Growth, Current Fiscal Year	Revenue Growth, Next Fiscal Year	EBITDA Growth, Next Fiscal Year
Solium Capital	-2%	27%	11%	19%	113%
Badger Daylighting	-6%	17%	19%	11%	18%
Kinaxis	10%	20%	46%	22%	31%
Canadian Western Bank	-1%	11%	18%	10%	9%
Westaim Corporation	0%	NM*	NM*	NM*	NM*
Average	**0%**	**21%**	**28%**	**15%**	**43%**

Top Five US Holdings

September 30th, 2018

Company	Q3 Price Change (USD)	Revenue Growth, Current Fiscal Year	EBITDA Growth, Current Fiscal Year	Revenue Growth, Next Fiscal Year	EBITDA Growth, Next Fiscal Year
Boingo Wireless	54%	22%	74%	19%	16%
Carbonite	2%	28%	648%	12%	18%
HMS Holdings	52%	12%	54%	7%	7%
Euronet Worldwide	20%	13%	34%	13%	20%
Pure Storage	9%	34%	- to +**	27%	57%
Average	**27%**	**22%**	**200%**	**15%**	**23%**

Source: Consensus and Pembroke estimates

**Not meaningful*

***Not measurable*

Overview of the quarter

Introduction

After a strong second quarter in 2018, US equity markets continued to outperform their international counterparts in the third quarter of the year. Canadian equities struggled again, held back by the poor performance of natural resource stocks. A strong economic backdrop in the United States is supportive of that country's equity market strength. However, many market pundits are warning that interest rate increases will slow the economy, leading stocks in cyclical industries such as housing or autos to struggle. As in the first half of the year, growth stocks out-performed value stocks in the third quarter as investors sought the relative "safety" of secular growth companies to avoid the risks associated with a cyclical downturn. Within the small to mid cap universe, stocks in the communications services, healthcare and information technology sectors stood out from the pack. In Canada, healthcare, industrials and real estate stocks outperformed, as did financial services companies despite fighting a flattening yield curve. Natural resource stocks and energy stocks were driven lower with worries of an impending economic slowdown.

Many of Pembroke's investments performed well in this environment. In the US especially, the firm's largest holdings posted strong second quarter results, leading to significant outperformance of the portfolios versus the major market benchmarks. In Canada, the firm's positions in the information technology sectors and financials helped offset weakness from energy and natural resource holdings and a disappointing final chapter from one of the firm's long-standing positions. The firm's dividend growth portfolios performed well during the quarter and outperformed their benchmark.

Pembroke's investment team is satisfied with the fundamental results being reported by its holdings. Further, the team continues to identify new investments that meet its parameters for growth, balance sheet strength, and valuation. In certain cases, our holdings' stock prices have surpassed their near-term potential, and Pembroke's portfolio managers have sold them entirely or reduced them in size to protect against valuation compression. Across all portfolios, we believe there is upside potential from further earnings growth - both in the long-term and in the short term. The firm's largest positions remain reasonably valued and well-positioned to continue taking advantage of their strong competitive positions to create shareholder value.

CANADIAN COMMENTARY

Pembroke's Canadian equity portfolios posted slightly negative returns in the third quarter of 2018, essentially in-line with the S&P/TSX Composite Index. The resource sectors were the most significant detractors to performance for both the broader Canadian markets and Pembroke's portfolios. Energy stocks retraced earlier gains due to uncertainty following a court ruling halting construction of the Trans Mountain pipeline as well as negative regional realized pricing trends. Meanwhile, materials stocks were pressured by weakening precious and base metals prices. The Fund's technology, financial, and industrial holdings posted modest gains during the period.

Two stocks posted significant declines that weighed on performance.

Shares in **DHX Media** ("DHX"), a leading owner and producer of children's media content, underperformed during the quarter. The company reported disappointing quarterly results and concluded a strategic review process that ultimately did not yield sufficient value to shareholders. Given the company's execution record and Pembroke's opportunities to deploy capital in other investments, we have divested our position in DHX.

Shares in **Transcontinental** ("TCL.A"), a manufacturer of flexible packaging products and a provider of commercial printing services, declined in the third quarter following interim results that missed market expectations. The quarterly report was the first to include contribution from the acquisition of Coveris, a sizable player in the North American flexible packaging industry. While margins at Coveris were weak due to delayed pass-through of higher raw material and freight costs to customers, we remain excited by the strategic and financial potential of the business.

Two stocks made significant additive contributions to returns in the third quarter.

Shares in **Enerflex** ("EFX"), a designer, manufacturer, and supplier of natural gas compression systems, rallied in the period following quarterly results that showed strong bookings and backlog figures driven by increased demand for natural gas infrastructure. Enerflex has built a diversified international presence, such that it is not dependent on activity levels in any given gas-producing region. The company is well positioned to play a part in solving egress issues faced by natural gas producers and should also benefit from Shell's recently announced approval of the LNG Canada project.

Shares in **IMAX** ("IMAX"), an entertainment technology company specializing in motion picture technologies and presentations worldwide, rallied in the third quarter. Interim results showed operating leverage that was well received by investors, and summer box-office trends proved to be better than anticipated by the market. Moreover, the 2019 box-office slate looks favourable to IMAX, and headwinds in international markets that had weighed on results for several years appear to be abating. The company is well financed with a net cash position, generates free cash flow, and remains reasonably valued relative to its growth prospects.

US Commentary

Pembroke's US equity portfolios posted strong absolute and relative performance in the third quarter of 2018, building on robust performance in the first half of the year. Strong stock selection, in combination with significant exposure to industry sectors benefiting from secular tailwinds, contributed to performance. The financial results announced by many holdings were impressive, driving the underlying stocks to new all-time highs. Pembroke's investment team believes these companies' future earnings power remains under-appreciated, leaving room for further stock price gains, especially over the medium to long term.

The firm's investments in the healthcare industry contributed more than any other sector to third quarter portfolio performance. Heading into the quarter, one of the firm's largest positions was **HMS Holdings** ("HMSY"). This company, which helps state governments to recover improperly paid medical bills and insurance companies audit hospitals for reasonable care and billing practices, delivered another strong quarter and raised revenue and earnings guidance meaningfully for the remainder of 2018. For the past two years, management has been investing in new growth initiatives and streamlining its operations; those efforts are now being rewarded with profit margin expansion. With its largest competitor recently acquired by a private equity firm, HMSY is also in a strong position to gain market share. Finally, acquisitions completed over the past three years have been fully consolidated, and HMSY has launched new product offerings.

During the third quarter, the shares of **Boingo Wireless** ("WIFI") surged to a new all-time high after reporting second quarter financial results. The company helps wireless telecom carriers provide a better consumer experience to their subscribers by alleviating network congestion. Powerful trends including video consumption, higher-quality media files, and the proliferation of streaming services are driving increased demand for data and bandwidth. Network congestion is becoming acute in crowded areas, such as sports arenas. WIFI addresses this increased demand and appeals to both owners of venues and telecom carriers by improving consumers' experience with their mobile phones. The second quarter results highlighted the profit margin potential in WIFI's business. The roll-out of 5G networks, starting in 2019, may spur further demand for the company's offering. Additionally, a recent acquisition broadens the company's addressable market and extends WIFI's growth profile.

Shares in **Installed Building Products** ("IBP"), which installs insulation in new homes, retreated over the past three months as concerns about housing affordability in the US gripped the markets. Specifically, with two announced interest rates increases in 2018, and another expected before year end, some market participants are worried that higher financing costs will crimp demand for new homes. Pembroke has a different perspective on the long-term opportunity in front of IBP. First, while housing demand is certainly affected by mortgage rates, affordability indices remain favorable when examined in the context of the past 25 years. In addition, demographic trends and consumer health metrics remain

supportive. Second, the company is acquiring small competitors at attractive prices to consolidate its market position. IBP continues to leverage its raw material buying power to lower costs and drive profit margins higher. Third, while the company was caught off guard by rapidly rising insulation costs in the first half of 2018, management may be able to offset this inflation and continue to expand margins. Pembroke has used the recent share price weakness to build on its position in this well-positioned installer.

Shares in **Axos Financial** ("AX", formerly known as **BOFI Holdings**) gave back some of their first-half gains as financial stocks struggled in the face of a flattening yield curve. The company delivered another strong quarter of results but is absorbing elevated costs in the short-term to (1) support the launch of a new digital banking platform, (2) prepare for additional regulatory requirements as they near the $10 billion asset threshold, and (3) bring on new clients from a recent acquisition. The management of Axos has provided excellent stewardship of the bank since Pembroke first acquired shares in 2013. The company has successfully diversified both its lending practices and its funding sources, all while maintaining strong credit standards and an efficient, asset-light cost structure. The recent acquisition of $3 billion in deposits from Nationwide Bank will not only lower AX's funding costs but could also lead to cross-selling opportunities into the Nationwide customer base. After having reduced the position's weight at higher prices, Pembroke has added back to its holding in AX given the company's attractive growth profile and valuation.

Balanced Fund Commentary

Pembroke's balanced portfolio, the **GBC Growth and Income Fund**, generated modestly positive returns in the third quarter of 2018. The fixed-income portion of the fund, represented by the **GBC Canadian Bond Fund**, posted slightly negative returns during the period in a challenging environment for fixed income investors. Meanwhile, the equity portion of the portfolio, delivered positive absolute returns that rebounded from weakness earlier in the year.

Two stocks were significant contributors to performance in the third quarter of 2018.

Shares in **Enercare**, ("ECI"), a leading North American provider of residential and commercial services and energy solutions, performed very well in the quarter as the company announced that it will be acquired by Brookfield Infrastructure Partners at a 53% premium to market prices. Brookfield recognized Enercare's stable cash flow generation and broad customer base and saw opportunities to leverage its existing operations on Enercare's platform. The transaction highlights the significant valuation gaps that can exist between public and private market valuations.

Shares in **Cineplex** ("CGX"), an entertainment company operating movie theaters and other entertainment assets, rebounded in the period following an encouraging quarterly report. Financial results were buoyed by improved box office performance, which has been a headwind for the company in the past year. Moreover, investments in new entertainment formats are beginning to bear fruit and are poised to contribute to overall corporate growth rates. The company continues to generate sufficient free cash flow to fund both growth initiatives and dividend payments.

Two stocks were significant detractors to performance in the third quarter of 2018.

Shares in **Transcontinental** ("TCL.A"), a manufacturer of flexible packaging products and a provider of commercial printing services, declined in the quarter following financial results that failed to meet market expectations. The quarterly report was the first to include a contribution from the acquisition of Coveris, a sizable player in the North American flexible packaging industry. While margins at Coveris were weak due to delayed pass-through of higher raw material and freight costs to customers, we remain excited by the strategic and financial potential of the business.

Shares in **Sleep Country Canada Holdings** ("ZZZ"), a mattress retailer operating over 185 stores across Canada, were weak in the third quarter as investors digested same-store sales growth that was negatively impacted by inclement spring weather. Moreover, potential macroeconomic headwinds such as a slowing housing market and moderating consumer confidence weighed on investor sentiment. Nonetheless, we feel that Sleep Country continues to show attractive growth prospects with the opportunity for new store openings, additional sales of sleep accessories, and the potential contribution from e-commerce initiatives. In addition to its attractive growth profile, the company is conservatively financed, earns high returns on capital, and pays a well-financed dividend to shareholders.

Income in the balanced fund is generated from a combination of dividends and interest. The equity portion of the fund has a current annualized gross yield of 3.4%, while the fixed income segment of the fund is primarily invested in securities rated "A+" that, on average, have a collective yield to maturity of 3.1% and an adjusted portfolio duration of 4.7 years. The asset mix of Pembroke's balanced mandates did not change materially through the year, with approximately 30% of the portfolio invested in fixed income securities at September 30, 2018.

International Equity Commentary

The **GBC International Growth Fund** trailed the MSCI ACWI ex-US Small Cap Index during the quarter ended September 30. Stock selection in the emerging Asia region was the primary detractor from relative performance on a geographic basis, offsetting the positive effects of stock selection in the UK and Japan.

Within emerging Asia, stock selection in China and Taiwan was the primary source of underperformance. Chinese biotech company **3Sbio** ("1530 HK") was a notable detractor, hampered by weaker than expected sales growth in its key biosimilar arthritis drug. Chinese software company **Kingsoft** ("3888 HK") also detracted from performance, as the company experienced decelerating growth in its gaming business amid competition and weak game releases. This weakness was offset, however, by continued strong growth in its cloud and office software businesses. Within Taiwan, semiconductor company **Globalwafers** ("6488 TT") was negatively impacted by the broad pull-back in semiconductor-related stocks during the period. Despite weakening industry sentiment, underlying company fundamentals remained strong, as Globalwafers posted revenue and operating margins that were ahead of consensus estimates. Continued tight capacity in the wafer market was also supportive of the company's pricing outlook.

Offsetting these adverse effects was UK litigation finance company **Burford Capital** ("BUR LN"), which was bolstered by solid first-half 2018 earnings results. Burford is the largest investment manager in the sector and has continued to build scale. Litigation finance is a growing and increasingly important area of the business of law—moving into the mainstream of the legal industry. Within Japan, medical device manufacturer **Asahi Intecc** ("7747 JP") contributed positively, supported by continued strong overseas sales growth. The company's future focus will be on US sales of its highly profitable guidewires.

From a sector perspective, the fund's allocations to information technology, energy and real estate were increased during the six-month period, offset by reductions to materials, financials and healthcare. From a geographic perspective, the UK and Latin America exposures were increased, while the emerging Asia weighting was reduced.

As we head into the final quarter of 2018, surveys suggest that global growth is likely to decelerate modestly into the remainder of the year. Contrary to our expectations of near-term stabilization in the summer, we continue to see signs of deceleration in growth momentum. Specifically, purchasing manager surveys continue to point to deceleration in the pace of industrial order growth and subsequent industrial production growth. Given substantial and relatively abrupt changes in US trade policy, we now expect near-term economic activity to slow somewhat as firms work out the new rules and adjust to the impact on their supply chains.

At the same time, we expect the growing divergence between the US and other economies to begin to normalize. Specifically, in Q2 2018 the US economy expanded at an annual rate of 4.2% — a rate of growth which may well mark the cyclical high. Consistent with this high economy-wide growth rate, corporate earnings growth accelerated to 22% year-over-year, a decade high (excluding the post Great Financial Crisis bounce). Barring additional policy support, it is difficult to see US corporates maintaining this rate of profit growth. The 10% tariffs that went into effect on a broad range of consumer goods in late September are likely to support price increases for the affected products toward the end of this year, acting as a headwind to consumption growth or a hit to corporate profitability. If the rest of the world continues to grow at the current pace, while the US economy slows marginally, the growth gap, and by extension the substantial outperformance of US markets vis-à-vis the rest of the world, may moderate from here.

The emerging markets (EMs) fared poorly in Q3 2018. This performance was largely idiosyncratic and self-inflicted: The South African government's decision to reopen the possibility of farm repossession, for example, and the upcoming presidential election in Brazil where the top two contenders are from the far-right and the far-left. Increasingly reckless economic policies in Turkey and the exposed fragility of the Indian financial system also compounded EM underperformance. At the same time, rising US yields and increasing fiscal deficits in EMs have reduced US dollar liquidity. More recently, higher oil prices in the wake of the US re-imposing economic sanctions on Iran contribute to a more challenging macroeconomic environment for the EMs, as many remain large energy importers.

From a portfolio strategy perspective, positioning within the fund has reflected our more cautious outlook, with a reduced EM weighting in favor of increased developed market exposure. Within EM, we have maintained overweight positions in India, Mexico and South Africa. Within China, our positioning continues to emphasize domestically-oriented consumer and technology companies that we believe are well positioned to benefit from the economy's ongoing transition to a consumption and services-driven growth model.

Fixed Income Commentary

Interest rates continued to creep higher in the third quarter although the drama over the NAFTA negotiations moderated the increase. Meanwhile, the US Federal Reserve is very open about their desire to push rates back to "normal" levels and it is acting decisively to do so. This policy approach makes perfect sense, given that the US economy is booming from tax cuts, government spending, and the fact that interest rates are still low versus inflation.

The Canadian government seemed immensely relieved to have a tentative deal on the new NAFTA, now called USMCA. This agreement was reached right at the US-imposed deadline. More certainty on the terms of trade with the US will make it easier for the Bank of Canada to also push interest rates higher.

For the quarter, the **GBC Canadian Bond Fund** generated a negative return but outperformed its benchmark, the FTSE TMX Canada Universe Bond Index. The fund's outperformance can be attributed to the following factors. First, a shorter-than-benchmark duration contributed as benchmark yields rose by 20-25 basis points. Second, floating-rate notes outperformed short-term fixed rate issues. Some of the stronger performing floating-rate issues held in the fund were TD Bank, BMO, RBC, GE Capital and Lloyds Bank PLC.

At the end of quarter, the portfolio yield-to-maturity stood at 3.1%. With 25% of the fund invested in floating-rate notes, the **GBC Canadian Bond Fund** continues to be well positioned should rates continue to rise in the final quarter of 2018. Canso Investment Counsel continues to believe this stance is prudent, as investors are not adequately compensated for duration risk with long Canada bond yields at 2.5%.

In the Community

Maggie Pagonis, Director of Finance, co-chaired the Hellenic Ladies Benevolent Society's annual Ilios Gala, held at the Windsor Ballrooms in Montreal on June 1st, 2018. The event, which supports their Summer Camp Program and Educational Assistance Program, raised $80,000, ensuring a positive and successful year for many children in need within the Hellenic community of Montreal.

Committee members at the 2018 HLBS Ilios Gala

Nicolas Chevalier, Partner & Portfolio Manager, was President of the organizing committee of the Fondation Jeunes en Tête's 27th Annual Golf Tournament. The tournament was held on June 11th, 2018 at Elmridge Golf

Committee members at the 2018 Fondation Jeunes en Tête's Golf Tournament

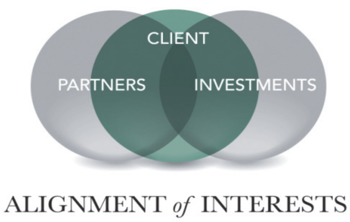
Club and raised $762,000. The mission of the foundation is to help prevent psychological distress among youth aged 11 to 18 in Quebec.

As part of our 50th anniversary celebration, **Pembroke** is the presenting sponsor of the Alexander Calder Radical Inventor exhibition at the Montreal Museum of Fine Arts. The exhibit runs until February 24th, 2019.

The winning team from Lambton College

The students from Lambton College in Sarnia, Ontario travelled to the Enactus World Cup in San José, where they competed successfully against national champion teams from 34 other countries and emerged victorious. Their project One Seed has had a dramatic impact in rural Zambia and the experiential Enactus program is allowing students in Canada and around the globe to apply entrepreneurial principles to build a better more sustainable world. **Ian Aitken** is the Founder and Chairman of Enactus Canada, an organization that Pembroke is pleased to support.

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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