SPROTT CANADIAN EQUITY FUND

June 2017 Commentary

The Sprott Canadian Equity Fund, Series A returned 0.7% in June and was down by 8.4% in 2017. The S&P/TSX Total Return Index returned -0.8% for the month and 0.7% in 2017.

As we wrote about in our May letter, the divergence between the U.S. and Canadian equity markets this year continued in June. We can measure this divergence by both the year-to-date return of the S&P 500 and the S&P/TSX and by the valuation multiple of both markets. Through June 30th the S&P 500 and S&P/TSX have returned 9.3% and 0.73% (including dividends reinvested), while the 12-month forward price-to-earnings (P/E) ratio for both indices was 17.6x and 15.6x respectively. The spreads for both the total return and P/E ratio for both markets is the result of many things but namely the better economic data in the U.S. – especially the robust employment data and expectations of 'market friendly' policy changes (tax reform and infrastructure spending). Although Canadian economic data has improved, our capital markets are still coping with a volatile resource market, specifically: oil and gas, a weak Canadian dollar, and broad based regulatory changes in real estate/housing markets in Ontario and British Columbia.

Given the underperformance of the Canadian markets in 2017 and the 2-point P/E multiple discount, we continue to be overweight Canadian stocks. Our greatest area of focus in recent months has been in the energy sector (both in Canada and the U.S.), as sentiment has deteriorated to unprecedented levels. Valuations of most energy stocks that we track are now at levels at or below where they were in early 2016 when WTI prices were below $30 per barrel. Aside from the marginal supply growth among U.S. shale producers (which is a very small % of total global supply), international supply growth remains fairly stagnant given OPEC production cuts, while demand continues to improve with global economic growth. We continue to believe that a widening gap between the reality of the crude markets and perception/sentiment is presenting a great investment opportunity. We remain invested in mostly large, liquid cash flowing energy stocks with balance sheets supportive of the current oil price environment.

There are a number of solid investments in our portfolio that look undervalued (to us at least!). Certain investments have executed their business plans for the very reasons we invested, yet have not been rewarded by a higher equity value (yet). If these businesses are not recognized by public market investors, we are certain their value will be surfaced either through private capital or strategic investors. This is starting to take place most notably in the proposed acquisition of Dominion Diamond (DDC) and, more recently, the likely acquisition of Innova Gaming (IGG). Both have been positions in the fund.

Innova is a Canadian land-based lottery equipment vendor with long-term contracts with Ontario Lottery & Gaming (OLG), the State of Michigan, Missouri and others. Pollard Banknote (PBL) announced its intention to acquire IGG in all cash deal at a significant premium to its prior trading value back in March. As expected, PBL raised its offer for IGG in June positively impacting the portfolio.

IGG manufactures and sells a technologically superior video lottery terminal to States and local merchants, bingo and veteran halls, and has maintained a profitable and steady growth business for a number of years. The company has an established recurring revenue business model and a high and expanding EBITDA margin of ~30%. While trading at an extremely depressed valuation it was only a matter of time before a private or strategic buyer made a 'play' for the business. PBL was the most likely acquirer of IGG and should be able to scale the business and reallocate certain SG&A costs making the purchase highly accretive to PBL and its shareholders.

One of the greatest risks in the portfolio at present is the risk of having investments acquired before their value has surfaced in the market. The fund holds many quality businesses like DDC and IGG that have failed to perform in the market as expected. However, many of our investments' core businesses and operations have performed well, growing top and bottom lines while managing balance sheets and cash flows responsibly. The longer these investments continue to do well operationally and trade at low valuations, the greater the risk that they can be acquired at far lower intrinsic values than we forecast.

Thank you for your continued support and confidence in the Fund.

Jon Wiesblatt,
Portfolio Manager

James Bowen,
Portfolio Manager

COMPOUNDED RETURNS (%) AS AT JUNE 30, 2017[1]

	1 MTH	YTD	3 MTH	6 MTH	1 YR	3 YR	5 YR	10 YR	15 YR	ANNUALIZED INCEPTION (09/26/97)
SPROTT CANADIAN EQUITY FUND, SERIES A	0.7	-8.4	-4.2	-8.4	-7.4	-14.5	-13.3	-9.8	0.7	7.4
S&P/TSX COMPOSITE TRI	-0.8	0.7	-1.6	0.7	11.0	3.1	8.7	3.9	8.0	6.5

SPROTT ASSET MANAGEMENT

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[1] All returns and fund details are a) based on Series A units; b) net of fees; c) annualized if period is greater than one year; d) as at June 30, 2017; e) 1997 annual returns are from 09/26/97 to 12/31/97. The index is 100% S&P/TSX Composite TRI and is computed by Sprott Asset Management LP based on publicly available index information.

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