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# LIONGUARD CAPITAL MANAGEMENT INC.

# LIONGUARD CANADIAN SMALL CAP EQUITIES FUND

# QUARTERLY REPORT – JUNE 2019

## Since Inception Returns:

LionGuard Canadian Small Cap Equities Fund ("Small Cap Fund") gross returns, as of June 30, 2019, can be summarized as follows (note that period longer than a year are annualized):

| Time period | LionGuard Canadian Small Cap Equities Fund (gross returns) | S&P/TSX Small Cap Index | Outperformance (underperformance) |
|---|---|---|---|
| YTD | 14.76% | 8.96% | 5.80% |
| 1 year | -0.08% | -10.51% | 10.43% |
| 2 years | 2.45% | -3.97% | 6.42% |
| 3 years | 5.18% | -2.26% | 7.44% |
| 4 years | 3.08% | -0.08% | 3.17% |
| Since Inception | 3.32% | -1.00% | 4.31% |

We are pleased that the Small Cap Fund is delivering on its promises and much appreciate strong interest for this product from consultants, institutional investors and family offices. As a reminder, Small Cap Fund's objective is to outperform its Benchmark by at least 200 bps per annum over a rolling time frame of four years.

## Q2-2019 Investment Performance:

LionGuard Canadian Small Cap Equities Fund more than delivered on its mandate and significantly outperformed its benchmark, S&P/TSX Small Cap Index ("Benchmark") during the Q2-2019. During this period, Fund returned 1.37% as compared to Benchmark at -0.96%.

The sectors where the Fund performed best in comparison to the Benchmark were the Energy sector with +208 bps of relative performance and Real Estate with +110 bps of relative performance. The sectors where the Fund underperformed vs the Benchmark included Materials with -178 bps of relative performance and Consumer Discretionary with -106 bps.

Our largest relative contributors in Q1 were Altus Group (AIF), BSM Technologies (GPS) and Heroux-Devtek (HRX). At the same time, being overweight in Tucows (TC), Exco Technologies (XTC) and Total Energy Services (TOT) has cost us relative to the Benchmark. Please see comments below on some of our contributors.

**Altus Group (AIF)** is a leading provider of software, data solutions and advisory services to the real estate industry. The company's main business lines are Property Tax, Commercial Real Estate Consulting, Geomatics, and Altus Analytics.

AIF has been a core holding of ours. We believe that the company's flagship product, Altus Analytics, is well on its way to displace other competing products and to become a de-facto standard within the real estate industry. In a way, Altus Analytics positioning within the real estate sector can already be compared to that of Bloomberg in the financial services industry.

Altus reported disappointing Q3-2018 results, which led to a decline in the stock price. In our view, quarterly miss was nothing more than a delay in revenue recognition, due to regulatory changes in AIF's property tax business. Despite this being communicated by management, investors nevertheless reacted negatively to the Q3 numbers.

Our decision to maintain exposure through the temporary sell-off led to AIF contributing positively to our fund's return this quarter.

As discussed in prior quarterly reports, we expect to see a very active merger and acquisitions (M&A) activity in the Canadian (and U.S.) small and medium-capitalization space for the foreseeable future. For details, refer to prior reports which are posted on our website.

At the beginning of April 2019, one of our holdings, **BSM Technologies (GPS)** announced that it has entered into a definitive arrangement to be acquired by Geotab for $1.40 per share. The all-cash offer represented a 41% premium to the closing price prior to the announcement. With GPS added to the list, we now have four take-outs (Gluskin Sheff, Solium Capital, ZCL Composites & BSM Technologies) in our funds since the beginning of the year.

BSM Technologies is a provider of IoT enabled telematics and asset management solutions. They provide services to a good number of government agencies and are a dominant telematics solution provider to the tier-1 railroad operators. At the time of its takeout, BSM was generating solid levels of free cash flow and our projections lead us to believe that investors should expect materially higher levels of profitability on a per-share basis going forward. Company's operations were improving under the leadership of a new CEO, who was focused on top-line growth and on addressing numerous low hanging fruits on the cost structure front.

Given a wave of consolidation in the telematics space, the take-out announcement of BSM was not a big surprise to us. The Company was trading at a large discount to multiples at which some its peers have recently been acquired, while at the same time having a highly desirable customer base.

**Heroux-Devtek (HRX)** is the world's third-largest manufacturer of landing gear for aircraft and helicopters. The company's area of expertise falls in the landing gear vertical of the commercial aircraft industry benefitting from positive end-market demand with air traffic forecasted to increase at a 5.0% CAGR for the next two decades. This provides for high barriers to entry, predictable growth business, enabling HRX to run a defensive operation characterized, to a large extent, by (a) revenue visibility, as suppliers in the industry, are awarded exclusive contracts for the lifespan of a given program; and to a lesser extent by (b) recurring revenue through its aftermarket business, as landing gear requires refurbishment every 8 years.

Under the leadership of Chairman Gilles Labbé who recently stepped down from his role as CEO following a near two-decade tenure, HRX has effectively transitioned from a Tier 2 supplier to a Direct OEM supplier. Actions taken by management over time resulted in solidifying HRX's positioning in the space to ultimately compete for and win direct OEM contracts.

In essence, we had identified and invested in a defensive, growing business, with solid management execution and insider ownership (Mr. Labbé owns 10% of the company) ensuring alignment of interest with shareholders.

Our interest in HRX spiked over time as the company announced its plans to make two acquisitions to further boost its competitive standing in the industry. One acquisition of interest was Compañia Española de Sistemas Aeronauticos, S.A ("CESA"). CESA significantly expanded HRX's reach in Europe enhanced its proprietary products and paved the way for customer diversification as it brought in Airbus (joint owner of CESA) to the ranks of HRX's direct customers. As a result, HRX now serves the two largest aircraft manufacturers: Boeing via a 2013 contract, and Airbus. Equally important, the transaction gives HRX a foray into the Actuation market, a sector that is less capital intensive than the landing gear business.

As Heroux-Devtek capitalizes on a period of good revenue and margin expansion, we are confident that new CEO Martin Brassard will do a great job in navigating the company going forward.

We also take this opportunity to introduce **Sangoma Technologies (STC)**, which is one of our recent additions to the Fund. Sangoma is a comprehensive Unified Communication (UC) solution provider with presence in numerous countries. Its key customers are small-to-medium size businesses, telecommunication equipment OEMs, and telephony service providers.

Several years ago, STC was a one-product company, yet through smart acquisitions and internal R&D initiatives, the company has transformed itself into a complete Unified Communication solution provider under the leadership of its CEO, William Wignall.

What Mr. Wignall has accomplished over the past several years is nothing short of remarkable. Since becoming the CEO, William has dramatically improved the organic growth rate of the business (from nil to over 10%) and improved the profitability (from a negligible amount to a current run-rate of more than $12mn in Ebitda). William has demonstrated both an operational expertise and a capital allocation discipline. All acquisitions concluded to-date have proven to be accretive and aligned with the long-term vision of the company. With a strong and disciplined leader at the top, we feel that STC is well-positioned to capture the massive opportunity in the shift from on-premise to cloud-based Unified Communication.

According to Global Market Insights, the UC market is forecasted to reach US$96 billion by 2023. At the same time, the current adoption rate of cloud-based UC is still under 10%. Therefore, we believe that there is a big business opportunity for companies that are focused on this space.

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At this time, U.S. investors have recognized major opportunities in the cloud-based UC space and awarded large players (such as Ring Central and 8x8) with lofty valuations. In contrast, STC still trades at a huge discount versus its larger peers. One of the reasons for the discount is the relative size of the company, while another reason is the ongoing shift at STC from hardware business towards a recurring SaaS business. With both trending in the right direction, we believe that it is just a question of time until STC gets the credit that is deserves. STC's recurring UC SaaS revenue is growing at over 10 % versus hardware at mid-single digits. As transition to software continues at a quick pace, investors should also expect to see a meaningful margin expansion.

Although this is not part of our investment thesis, a highly discounted well-run operation with a growing recurring revenue component is a prime takeout candidate by the bigger operators.

<u>Fund Positioning Going Into Q3-2019:</u>

We continue to be conservatively positioned, as many small capitalization companies have rallied to higher valuation levels. Having said so, we still see a lot of pockets of market irrationality and do not exclude the possibility of higher market valuation levels on the back of lower expectations for interest rates for the foreseeable future. We remain underweight in Energy and Materials sectors, as we still find little compelling risk-adjusted investment opportunities among those sectors.

<u>Corporate Updates:</u>

On May 1, 2019, LionGuard Capital Management (LionGuard), in combination with Walter Global Asset Management (Walter), issued a press release announcing that Walter became a minority shareholder in LionGuard.

This is a major positive news for LionGuard, all our current and prospective clients and all the stakeholders. Long-term strategic partnership with Walter enables us to materially accelerate the growth of LionGuard including by expanding our teams across research, operations, and client-servicing functions. Walter's commitment includes direct allocations towards LionGuard-managed funds via parent company Walter Financial.

We appreciate the confidence that Walter has shown in our organization, team members and institutional quality fundamental research capabilities. We are thrilled to work closely with Sylvain Brosseau and believe that Walter is the best strategic partner we could ask for. As part of the transaction, Mr. Sylvain Brosseau has joined our Board of Directors.

*Mr. Brosseau has over 25 years of experience in the investment management industry, including his tenure as Global President and Chief Operating Officer of Fiera Capital from 2003 to 2017. Under his leadership, the company grew its assets under management from $5 billion to $120 billion and its market capitalization from $20 million to over $1 billion. He also spearheaded the firm's international expansion, overseeing more than 15 acquisitions across Canada, the United States and Europe and the opening of new offices throughout North America and Europe.*

*Before joining Fiera Capital, Mr. Brosseau served as Executive Vice-President, Institutional Markets at TAL Global Asset Management Inc. and as Executive Vice-President at TAL International, where he oversaw* *worldwide distribution and operations. His experience also includes terms as Vice-President of Marketing and Vice-President of Technology and Operations at Talvest Mutual Funds.*

*Mr. Brosseau is a current member of the board of directors for several organizations, including the Caisse de dépôt et placement du Québec, Equisoft Inc. and LionGuard Capital Management Inc. He has also sat on the board for numerous other organizations in the past, such as Fiera Capital, Centria Commerce, Fiera Properties, Bel Air Investment Advisors, Charlemagne Capital, Fiera-Axium Infrastructure and Fundserv.*

In other news, we are glad to welcome Mr. Karim Meneeim to our team. Karim joins us as a Senior Investment Analyst & Risk Manager. We wish Karim great success at LionGuard.

*Prior to LionGuard, Karim worked as an Investment Analyst covering global equities with a focus on public real estate securities at $2.0 billion fund where he conducted bottom-up analysis and due diligence on several listed securities in different countries. Prior to his tenure at that firm, Karim worked in sell-side equity research as an Associate, where he covered Canadian small-to-mid cap equities in the Special Situations space comprised of Consumers and Industrials names.*

Conclusion:

We remain both vigilant and open to investment opportunities. At the same time, we do find a good number of quality companies that currently trade at notable discounts to our calculation of their intrinsic values. We fully expect to see more takeout announcements, especially in the small and medium-capitalization universe, over the next several quarters.

On the corporate front, we are excited to welcome the best partners we can think of, who are committed to helping us to deliver on our long-term vision for the Company. You can also expect more announcements from us as we expand our organization and add passionate and experienced personnel to our team.

May you have any questions, please contact us at any time.

Yours sincerely,

Andrey Omelchak, CFA
President, CEO & Chief Investment Officer
(on behalf of LionGuard Capital team)