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LIONGUARD U.S. SMALL CAP FUND
QUARTERLY REPORT - SEPTEMBER 2021

Dear Investors,

LionGuard U.S. Small Cap Fund slightly underperformed its benchmark, the Russell 2000 Total Return Index ("Benchmark") during the third quarter, with a return of -4.99% as compared to a -4.36% return for the Benchmark.

The sectors where the Fund performed best in comparison to the Benchmark were Energy with 47 bps of relative outperformance, Real Estate with 26 bps of outperformance, and Industrials with 9 bps of relative outperformance. Sectors where the Fund underperformed vs the Benchmark included Financials with –186 bps of relative underperformance and Technology with -175 bps of relative underperformance.

Our largest drivers of our outperformance came from positions in Franklin Covey (FC) and The New York Times (NYT). At the same time being long SelectQuote (SLQT) and Purple Innovation (PRPL) detracted from our performance relative to the Index.

We take this opportunity to discuss **Franklin Covey (FC)** and introduce **Ryman Hospitality Properties (RHP)**.

Franklin Covey (FC) – is one of our top contributors for the quarter. Please refer to our Q1 and Q2 letters for a detailed discussion of this business. As discussed in our most recent letter, FC's operational execution during the last-reported quarter was nothing short of phenomenal. The company generated over 17% growth in AAP and 26% growth in deferred revenue coupled with a sizeable beat on the profitability line.

We continue to expect the company's growth and profitability metrics to exceed guidance and street projections, buoyed by accelerating growth in the Enterprise division (>80% of sales) as well as clear evidence of pent-up demand in the Education division (balance of sales). Typically ignored for being a small percentage of the business and not the key thesis driver (justifiably so as the Enterprise TAM >$ 90 Bn), the Education market is likely to experience material growth over the next few years when contrasted with historical trends. As per our research on the Education space, we believe that, after having prioritized spending and resources into digitization initiatives over last the 2-3 years (accelerated by Covid-19), school districts are now well-positioned to re-allocate budgets, including a portion of the significant Education Stimulus dollars into supplemental initiatives aimed at improving the learning experience and creating well-rounded students. We expect Franklin Covey, over the next few years, to benefit materially which will complement the strong double-digit growth we anticipate from its AAP segment.

While Franklin Covey is up a lot year-to-date, the company remains extremely undervalued relative to its potential, market size, and margin expansion opportunity. In Franklin Covey, we have bought into a non-cyclical high-quality business underpinned by (a) evident competitive moat (decades of timeless IP), (b) high teens organic growth in recurring revenue (>95% retention), (c) a largely underpenetrated customer base and (d) 40% - 50% incremental EBITDA margin flowthrough in what is a $90 billion TAM for a $220 million revenue base. Despite these dynamics and a compelling setup for years to come, Franklin Covey continues to trade for ~6.5% FCF yield, or 3.5x implied EV/AAP sales vs precedents in the 7x – 8x range.

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As they continue to execute on their growth strategy, we remain supportive shareholders of this business and its top-tier management team.

Ryman Hospitality Properties (RHP) – was a positive contributor to our performance in Q3. Ryman is a REIT which owns 5 of the largest hotel and convention centers in the U.S. They operate under the Gaylord banner and are generally irreplaceable assets, all being destination centers for vacations and group conferences alike with each location being able to accommodate thousands of guests. We initially bought shares in the company in January and continued to build our position throughout the quarter.

Our general working thesis is that after working from home for 20+ months, employers and employees alike are looking to reconnect and meet in person. Corporate cultures must be rebuilt, and whether that means large gatherings in 2022 or 2023 we expect them to begin to take place. Many of the group bookings that were lost during the pandemic were merely pushed out, with Ryman having rebooked the bulk of them into 2022 and beyond. In the meantime, the pent-up demand for vacation travel has picked up the slack. While Ryman generally books 70% of their room nights to group travel and 30% to leisure, that relationship has flipped over the past 6 months. During the summer we tracked available room nights at the 5 hotels and saw pricing moving up and availability moving down. On the back of this strong leisure travel demand, the company saw their first positive month of cash flow since the pandemic began in June and should see continuous improvement from here on out.

The company did not sit idle during that last 20 months, having used the time to complete their expansion of the Gaylord Palms (located right outside the front gate of Disney World) and refurbished the Gaylord National located right outside Washington D.C. We expect 2022 results to match the record pre-covid results of 2019 and 2023 to be a record year for Ryman. Our opinion of this was only strengthened when on the first of October, Merck announced phenomenal results for their new anti-viral drug to treat Covid at the onset of symptoms. A recent study showed 37% of Americans are still unwilling to eat inside a restaurant (and presumably to go to a large hotel as well). We believe as the world develops more and more effective treatments, these fears will abate over time and our thesis will be proven correct.

Our Take on Inflation:

With high inflation likely here to stay (careful with buying into Fed's transitory inflation), many investors are wondering what to do in an environment when the purchasing power of their currency is eroded year after year. Historically, the stock market has proven to be a good place to invest to counter the harmful effects of inflation. Numerous businesses can, after all, over time, pass on price increases to their customers.

The best businesses to consider during times of high inflation are those with strong pricing power and low requirements for additional capital investments. Pricing power is often linked to the perceived brand value, as well as the structure of the industry in which said business operates. Real estate tends to perform well because of the higher replacement cost unless sizeable additional capital is required to maintain the property. Software-centric technology companies, that can scale up easily, are certainly very well-positioned relative to unscalable and capex-heavy alternatives. This is the case during most environments but is especially so when inflation is in high gear. Capital-light businesses can accelerate the growth of their revenues and potentially further expand their margins despite higher labor costs.

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The worst businesses to invest in during a high inflationary environment are those that operate in commoditized industries and thus command no pricing power. One should certainly stay away companies that have long duration commitments at fixed prices. Most long-term commercial contracts do include inflation adjustments, yet it is often the case that their realized margins often end up lower during the fulfillment cycle.

We strongly discourage investors from holding high cash levels and from allocating capital to long duration fixed income securities. Handpicked high-quality businesses, acquired at sensible prices, should materially outperform such alternatives, especially during the environment of high inflation. Overall, high inflation should not be of too much concern to investors who can identify businesses that are able to not only protect their current businesses but can further deepen their moats vis-à-vis weaker rivals.

Our portfolios are positioned to reflect this view, including the LionGuard U.S. Small Cap Fund.

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)

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