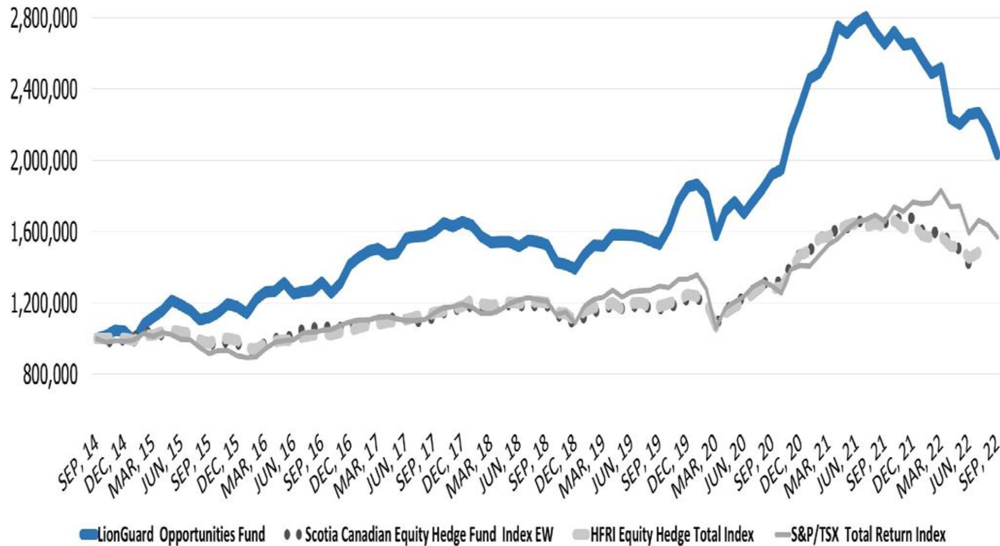
LIONGUARD
CAPITAL MANAGEMENT INC.

LionGuard Capital Management Inc.
1010 rue Sherbrooke Ouest, Suite 2350
Montréal (Québec) Canada, H3A 2R7
www.lionguardcapital.com

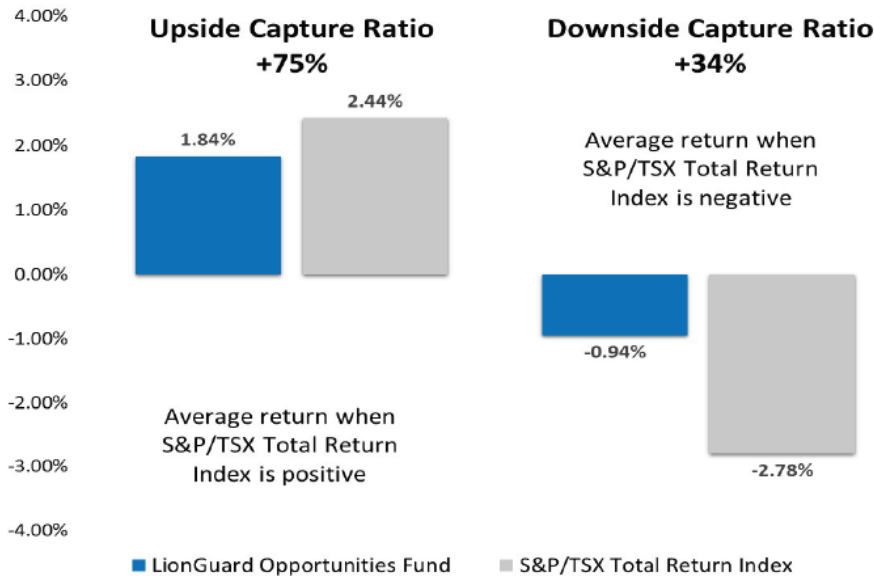
# LIONGUARD OPPORTUNITIES FUND
# QUARTERLY REPORT – SEPTEMBER 2022

Dear Investors,

During the quarter, LionGuard Opportunities Fund ("Opportunities Fund") had a net return of -9.85%. **Since the Opportunities Fund's inception, its annualized net return amounts to 9.28%.**




As compared to the broad market index (S&P/TSX Total Return Index), the Opportunities Fund's since inception upside capture amounted to 75% and its downside capture to 34%.

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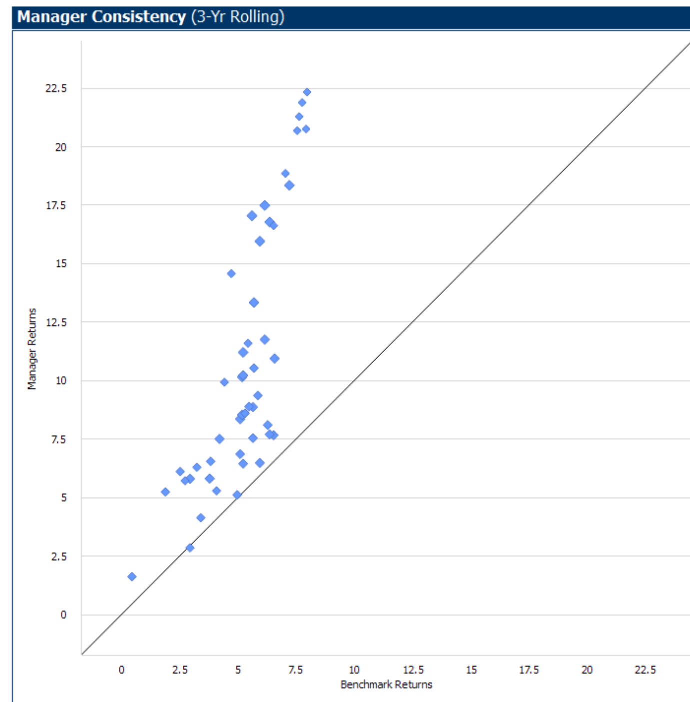
When compared to HFN Long/Short Equity Index, a well-recognized global benchmark for Long/Short equity managers, LionGuard Opportunities Fund has consistently outperformed industry peers over 3-year rolling time frames.




*Sources: eVestment, LionGuard Capital Management*

Federal Reserve Resolve:

The inflation problem is as real as it gets, and we cannot disagree with the Federal Reserve's resolve to address it head-on. However, it takes quite some time to see the effect of policy actions on the economy. Therefore, our best guess is that we will see a pause to further increases at the beginning of 2023. Federal Reserve committee members must also be cognizant of the elevated systemic risks caused by the abnormally high back-to-back interest rate increases. Having said so, we do not expect to see lower interest rates unless there is a). a confirmation of a lower core inflation trajectory and/or b). a temporary dysfunction of market operations.

BIG Re-Pricing:

While we do not have a crystal ball on where long-term interest rates will settle in the aftermath of the "Fed vs Inflation" battle, we are of the opinion that we are unlikely to see prior remarkably low interest rates for quite some time. At higher interest rates, there are now more alternatives to putting the capital to work in the stock market. To justify an investment in the stock market, there needs to be a sufficient market premium embedded in the expected long-term return. The only way to accomplish this is to have

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a lower market multiple. It is therefore perfectly logical that the overall market is under pressure as it re-sets its earnings multiple to be more competitive vis-à-vis fixed income alternatives.

In the environment of "BIG Re-Pricing", we caution investors against relying on past valuation multiples as means to value securities. Prior levels of P/E, EV/EBITDA, and other commonly used valuation multiples have nothing to do with the fair value of businesses under a different interest rate regime.

The best approach to properly value any business remains the discounted free cash flow (DCF) methodology. The good news is that DCF can easily incorporate the higher discount rate required on an investment when rates are higher. With the renewed focus on profitability, it looks like many of the prior high-flying technology companies are starting (and some we believe are already) being valued based on DCF.

The Hidden Cost of "Upgrading" & Impact on Smaller-Cap Equities:

With geopolitical tensions nowhere close to abating and abnormally high back-to-back interest rate increases causing re-pricing of assets and mounting risks of systemic shocks, it is not a surprise that equity investors are trying to desperately (and in a hurry) "upgrade" their portfolios. The hidden cost of "upgrading", however, is that it creates a false sense of security. It often leads investors to abandon the assets they know well in exchange for assets they are less familiar with.

This "flight to *supposed* quality" exacerbates movements across asset classes and even more so among individual securities. As a result, the disconnect between fundamental values and market quotations can reach historical proportions. Making said changes to managed funds is a safe short-term bet for many managers who are afraid of career risk during periods of market turbulence.

As it relates to smaller capitalization equities, desperate "upgrading" of managed funds leads to no real marginal buyers and quite a few sellers of many smaller capitalization stocks. Overall, small-cap equities as a group currently trade at one of the cheapest valuation levels relative to larger-cap alternatives. Within that group, some high-quality businesses trade at levels that are greatly disconnected from fundamentals.

Seizing Assets on The Cheap:

During the broad-based selloffs, like we are currently experiencing, with some companies' market quotations falling greatly below their fair values, those willing to "steal" companies on the cheap are certain to show up. Strategic buyers, management buy-outs, and private equity players can often "pull the trigger" at the right price. For private equity participants, even with higher prevailing interest rates, the math can still make sense depending on how cheap the asset has become.

Most boards of directors recognize the disconnect between market quotations and the true value of the businesses they oversee, yet often fail to take action to lower the probability of a take-out on the cheap. Best boards, however, are never asleep at the wheel and take proactive actions to take advantage of the environment. If the company is operating with an excessive cash level (or even an under-levered balance sheet relative to the quality of the business adjusted for the business environment), usage of cash must become a strategic priority. Typical alternatives include Dutch Auctions, Normal Course Issuer Bids, and

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acquisitions of other businesses on the cheap. Many of the businesses we invest in today are doing a fantastic job of using their excess cash to take advantage of this environment. Several of the companies we invested in have been acquired this year and some are in the process of a strategic review at this time (see below for details). Clearly, highly mispriced assets cannot stay cheap forever.

Q3-2022 Contributors:

During the quarter, some of our largest contributors included **Franklin Covey (FC US), TFI International (TFII CN)** and **Iteris (ITI US)**. On the opposite side, our detractors of note included **Sangoma Technologies (STC CN), Issuer Direct (ISDR US)** and **Burford Capital (BUR US)**. We discussed several of these companies in the past, so please see our prior quarterly reports for more details. Our opinion of these businesses has not changed, while their market prices continue to fluctuate.

In addition, we invite you to read our commentary on takeout offers for **ChannelAdvisor (ECOM US)** and **KnowBe4 (KNBE US)**. As discussed earlier, very cheap high-quality assets present highly attractive acquisition targets in any market environment. We fully expect M&A activity for such assets to heat up over the next several quarters as acquirers proceed with their due diligence and adapt to the new market environment.

**ChannelAdvisor (ECOM US)** received an offer to be acquired for $23.10/share, or 50% premium to the pre-announcement closing price. ChannelAdvisor is a leading global e-commerce channel management software provider founded in 2001. Their cloud-based ecommerce platform is sold to Retailers and Brands looking to significantly expand their operational reach while reducing the complexity that comes with it. By unifying hundreds of marketplaces into one end-to-end platform, businesses can take control of their ecommerce strategy by standardizing their SKUs pricing while tracking and managing inventory across most marketplaces including Amazon, eBay, Walmart, and 300+ others globally.

We first came across ECOM in 2020 when it was trading for ~$12/share and were impressed with the work management had done to significantly enhance its profitability profile from negative margins to ~22% margins today, all while sustaining double-digit growth in revenue. With terrific operational metrics (>80% recurring revenue; >100% Brands net revenue retention; expanding margins), a solid management team, and proven governance (bought back $25M or 6% of the company YTD as of the end of June), we viewed our downside as minimal and our upside as material with the company generating >8.0% FCF yield on EV pre-takeout with over 18% net cash position. We view the strategic combination with CommerceHub as a positive for ECOM as it will enable the combined entity to enhance its innovation capabilities while significantly growing its network by targeting new brands and channels.

**KnowBe4 (KNBE US)** is one of the leading security awareness platform companies enabling customers to assess, monitor, and minimize the ongoing cybersecurity threat of social engineering attacks.

KNBE received an offer to be acquired by Vista Equity Partners for $24/share, or 39% premium to the pre-announcement closing price. We believe the offered price significantly undervalues the business and would rather see the company stay public than be acquired at a discount to intrinsic value. The board has since formed a special committee comprised of independent directors to engage with Vista and take other actions that it deems appropriate. For a business growing its revenues by over 25% a year organically with

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a significant margin expansion opportunity and a massive addressable market, we believe that this high-quality subscription platform deserves a significant premium over the proposed offer price.

**Burford Capital (BUR US)** is the industry leader in a fast-growing investment field referred to as Litigation Finance. Litigation Finance is simply funding others' litigation in exchange for some or all of the proceeds should the case be ruled in the plaintiff's favour. Corporates or individuals are often sitting on valuable claims. However, claim holders often do not have the means to fund the case themselves, do not want to take the risk of an all-or-nothing verdict, or do not want to wait years until resolution. In these instances, clients or their lawyers will call Burford to fund these cases.

Burford is the largest litigation finance firm in the world, and the most well-known. These afford it advantages from a reputational, size, confidence, and talent attraction standpoint. Burford operates a mix of 3rd party funds where it charges fees under a 2 and 20 model, as well as funding cases directly on its own balance sheet with shareholder equity. The IRRs since inception on completed cases are a remarkable 30%. With returns like that it's no wonder Burford has continued to raise new funds and redeploy retained earnings back into cases.

Burford's financials have been negatively impacted during Covid, but this cloud should soon pass. Due to the slowdown in the courts over the past 2 years, case progressions (and thus realizations) slowed. With courts now fully open, judges are determined to clear the backlog. This should lead to a catchup of delayed GAAP earnings.

With much of the world worried about recession, Burford should be a safe harbour. Through good times and bad, lawsuits will continue, and one could make the argument that finances get more strained during recessions and there is a stronger need than ever for Burford's financing. As the most well-known name in litigation finance, Burford will be the first call for those looking for funding.

Based on our estimates, Burford trades for only 7x 2023 cash earnings. Given its high organic growth rate, industry-leading position, very high ROE, and counter-cyclical characteristics, we think BUR deserves to trade at a much larger multiple closer to its long-term DCF upside of more than 150% from these depressed levels.

**Sangoma Technologies (STC CN)** now trades at a 21% free cash flow yield. Adjusted for the reclassification of a revenue line item, STC's guidance for fiscal 2023 calls for an organic revenue growth rate of 6%. This is after a record year for hardware sales, which benefitted from excellent supply chain management in 2022. With management expecting more normal level of sales for hardware, an overall 6% organic growth rate guidance bodes very well for the growth rate of recurring software operations. There is no fundamental rationale for the stock to trade at these levels other than short-term fund flow dynamics exacerbated by the current state of the overall market.

**Issuer Direct (ISDR US)** now trades at a 29% net cash position while generating a 7% free cash flow yield. Management is very actively buying back shares in the open market, while continuing to invest in the growth of the business.

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8 Years of Performance:

Following Q3/2022, we completed 8 years of investment operations for LionGuard Opportunities Fund. Our annualized since inception net returns amount to 9.28%. The recent pullback in markets had quite an impact as the Fund's since inception net returns at the end of 2021 stood at 14.42%.

Since inception, we outperformed all major North American equity market indices with the only exception of S&P500 Total Return Index. We also outperformed all major equity-focused hedge fund indices. Finally, we always had positive 36-month rolling returns.

Closing Comment:

We look forward to continuing to compound our investor's capital by taking advantage of structural inefficiencies available within small and medium-capitalization equities. Despite a higher than we would like to see mark-to-market impact so far this year, stock market volatility (and especially indiscriminate often forced selling activity for smaller-capitalization equities) provides us with opportunities to buy great businesses at highly attractive prices. Time and time again, this has proven to be a winning recipe to compound our investors' capital at higher rates of return and with a lower level of risk-taking than investing in the overall market.

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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