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# LIONGUARD OPPORTUNITIES FUND
# QUARTERLY REPORT - JUNE 2017

## FUNDSERV codes: LGC100(Class A) & LGC102(Class F)

Dear Investors,

Investment Performance:

During the quarter ended June 30, 2017, LionGuard Opportunities Fund ("Fund") had a positive net (after all fees and expenses) return of 3.77%. This compares to the S&P/TSX Total Return Index ("Index"), which was down by 1.64%.

**Since Fund inception, its annualized net (after all fees and expenses) return amounts to 17.11% and cumulative net return to 54.41%.** Our quarterly and since inception results, as compared to S&P/TSX Total Return Index, are the following:

| Time period | LionGuard Opportunities Fund (net returns) | S&P/TSX Total Return Index (with dividends) | Outperformance (underperformance) |
|---|---|---|---|
| Oct 2014 – Dec 2015 | 3.99% | -1.47% | 5.46% |
| Jan 2015 – Mar 2015 | 7.50% | 2.58% | 4.92% |
| Apr 2015 – June 2015 | 5.83% | -1.63% | 7.46% |
| July 2015 –Sep 2015 | -5.81% | -7.86% | 2.05% |
| Oct 2015 – Dec 2015 | 5.07% | -1.20% | 6.27% |
| Jan 2016 – Mar 2016 | 7.09% | 4.54% | 2.55% |
| Apr 2016 – June 2016 | -0.98% | 5.07% | -6.05% |
| July 2016 – Sept 2016 | 5.06% | 5.45% | -0.39% |
| Oct 2016 – Dec 2016 | 7.44% | 4.54% | 2.90% |
| Jan 2017 – Mar 2017 | 6.17% | 2.41% | 3.76% |
| Apr 2017 – June 2017 | 3.77% | -1.64% | 5.41% |
| **ANNUALIZED RETURNS** | **17.11%** | **3.59%** | **13.52%** |
| **CUMULATIVE RETURNS** | **54.41%** | **10.19%** | **44.22%** |

As many of you know, we present Index returns for illustration purposes only, while the objective of the Fund is to generate **positive absolute returns** irrespective of the overall market direction. On this point, since Fund's inception, its upside capture ratio has amounted to 114% and downside capture ratio (the lower the better) to -33%. Thus, on average, we have delivered positive net returns in both up and down-market conditions.

Quarterly Contributors:

During the quarter, our largest contributors included **Sandvine (SVC), BrightPath (BPE) and Home Capital Group (HCG)**. On the flip side, our detractors of note included **Equitable Group (EQB), Chesswood Group (CHW) and AutoCanada (ACQ)**.

In our past reports, we discussed our views on Chesswood and AutoCanada, so this time we will focus our discussion on other companies. We do however encourage the readers to take a close look at our Q1 2017 report, available on our website, in which we discuss various dynamics currently unfolding for Chesswood.

This quarter, we have seen five (record number to-date) take-out announcements for companies in the Fund. Those companies are: **Sandvine (SVC), BrightPath (BPE), Span-America (SPAN), Canam (CAM) and Halogen (HGN)**. With overall market multiples at the high-end of historical ranges, it is not surprising that quality business with solid long-term prospects and attractive valuation multiples (the kind of companies we love to own) represent increasingly attractive M&A targets. For our take on acquisitions, refer to our Q1 2017 report.

Sandvine – Finding Mispriced Security & Navigating A Bidding War:

**Sandvine (SVC)** develops and markets Network Policy Control solutions for communications service providers. The Company's Network Policy Control solutions consists of a hardware platform and software modules bundled together to provide a system for broadband communications service providers to identify (video streams, Voice over Internet Protocol traffic, online gaming etc.), report on and act on the data traversing their networks.

We started researching Sandvine in the summer of 2014. Since then, we have written an internal research report on the Company, met with the management team and had many internal meetings and conference calls with industry experts to better understand the business. Our conclusion was that SVC has the best in class product offering and under the right leadership (already in place) is well-positioned to gain market share.

We also concluded that potential regulatory changes related to net neutrality do not represent a large threat to the Company's business, as contemplated in the marketplace. It is our belief that a sizable valuation discount between Sandvine and other technology companies was largely present because of the lack of understanding of the impact of forthcoming regulatory changes on Sandvine operations.

On May 26, 2017, Sandvine announced that it has entered into an arrangement agreement with Vector Capital (private equity company) for the sale of Sandvine at CAD$3.80/share. Cash purchase price represented 20% premium to prior day closing price and 30% premium to the volume weighted average price over the last 20 trading days. At the same time, SVC established 42-day go-shop period to actively solicit superior proposals.

Our internal research at that time established that Sandvine's intrinsic value, as a stand-alone entity, is around $4.25/share. We were also of the opinion that there is a sizable probability of another bidder stepping up to the table. Thus, instead of taking our profits at around $3.86/share (where the stock was trading post Vector Capital offer), we increased our position. At that time, in our opinion, the downside was limited to $0.06/share ($3.86 less $3.80), while highest likely upside was around $0.64/share (as high as $4.50, in the case of a bidding war, less $3.86).

On June 27th, Sandvine announced "that it has received a binding offer from an affiliate of Francisco Partners (the "New Offeror"), pursuant to which the New Offeror, has offered to acquire all of the issued and outstanding common shares of the Company by way of plan of arrangement for cash consideration of CAD$4.15 per share."

To make a long story short, we waited for sufficient confirmation that bidding war between Vector and Francisco established close to the maximum possible market price for SVC. We, therefore, proceeded with taking most profits at $4.47/share.

<u>Home Capital Group – Warren Buffett Endorsement:</u>

For those who have yet to read our past comments on Home Capital Group (HCG), we urge you to refer to our earlier quarterly reports, which are available on our website. HCG's path towards eventual Warren Buffett's endorsement is nothing short of extraordinary.

Despite our affinity to Home Capital, on the back of their long-term track record of value creation, at the beginning of 2017 we have become increasingly concerned with potential "run-on-the-bank" (ROTB) scenario. With a never-ending wall of negative developments, it was not inconceivable that HCG's funding may not only come at an increasingly high cost (negatively impacting net interest margins), but also that panic-like behavior may emerge leading to ROTB. With most of their funding coming from brokers deposits, latter scenario could not have been ruled out.

As the funding became a major issue, at the end of April 2017, stock price spiraled to below $7/share. At that point, there were several likely scenarios for how the situation may unfold. Copy-pasting our internal notes from May 2017, those scenarios were the following:

1. *HCG is sold to another company since the financial company that has issues accessing funding cannot continue as a going concern*

2. *HCG monetizes part of its book and secures guaranteed funding for the balance of the book, so will continue as a going concern on a smaller scale*

3. *HCG finds third party(ies) to provide temporary funding support while their book goes into orderly wind-down*

4. *Regulator forces the sale of the company at distressed prices*

*Scenario 1: HCG's tangle book value is around $22/share. After subtracting maximum potential payoffs related to OSC charges and class action lawsuit, for combined value of about $3-4/share, adjusted tangible book value is equal to at least $18.50/share. Given high distress situation, HCG should transact at a discount to book. At 20-30% discount to adjusted tangible book, we obtain close to $14/share. Using this very basic math, if it gets sold, I think that shareholders should be able to realize between $13 and $18/share. It is a fair assumption that Canadian regulators would support such a transaction. Separation of the company is also possible with one buyer taking on Alt-A book and another prime book. HCG already announced that they engaged RBC and BMO to review strategic alternatives.*

*Option 2: Given recently announced transactions for the sale of up to $1.5bn of mortgages and another one for sale of around $2.0bn of mortgages, it looks like HCG is moving in this direction for the time being. No terms have been disclosed, but it is fair to assume that by doing so they are protecting their book value, which is much higher than where the stock is trading today. Given the caliber of new BOD additions, we should not be surprised to see more similar transactions, if that is the route they decide to take.*

*Option 3: Orderly wind-down over 3-year horizon should lead to the approximate value of $18/share. This assumes no net new earnings in interim, as liquidation costs and much higher interim funding costs would lead to no profitability. It also assumes about the same credit experience as they have had to-date, which I think is fair given a healthy loan to values.*

*Option 4: At this point, chances of the last option are smaller, as HCG has already secured some short-term funding and has improved their governance by getting new strong additions to BOD. Having said so, short-term mark to market remains highly unpredictable.*

All risks and opportunities considered, a small position in HCG was warranted at below $8/share, which is how we decided to proceed. Subsequently, on June 21, 2017, Home Capital Group announced that it has reached an agreement for investment in common equity and provision of credit facility by Warren Buffett's Berkshire Hathaway.

Conclusion:

We remain both vigilant and open to investment opportunities. We believe that overall market volatility is likely to increase, especially from levels we have seen year-to-date, which should benefit long-term investment operations of the Fund. 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.

May you have any questions and/or want to obtain more details on how to invest with LionGuard, feel free to contact us at any time.

Yours sincerely,

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