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

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

Dear Investors,

LionGuard U.S. Small Cap Fund outperformed its benchmark, the Russell 2000 Total Return Index ("Benchmark") during the second quarter, with a return of7.16% as compared to a 4.29% return for the Benchmark.

The sectors where the Fund performed best in comparison to the Benchmark were Industrials with 408 bps of relative outperformance and Communications with 118 bps of relative outperformance. Sectors where the Fund underperformed vs the Benchmark included Consumer Discretionary with -121 bps of relative underperformance and Financials with -81 bps.

Our largest drivers of our outperformance came from positions in Issuer Direct (ISDR), DIRTT Environmental (DRTT), and Franklin Covey (FC). We also benefitted from SharpSpring (SHSP) reaching an agreement to sell itself to a private equity firm. At the same time being long SelectQuote (SLQT), Purple Innovation (PRPL), and The New York Times (NYT) detracted from our performance relative to the Index.

We take this opportunity to discuss **Issuer Direct (ISDR)**, **DIRTT Environmental (DRTT)**, **Franklin Covey (FC)**, and **Purple Innovation (PRPL)**.

Franklin Covey (FC) – is one of our top contributors YTD. We discussed the company in-depth in our Q1/2021 letter, and we take this opportunity to highlight FC's phenomenal operational performance his quarter. This leading provider of corporate training and performance improvement is in the late stage of its transformation to a subscription-based high-margin recurring revenue model, with its most recent quarter shedding light on how strong of a cash flow generative business it has become on the back of this transition.

Q2/2021 came in significantly ahead of our expectations and those of the street. Its Enterprise subscription business, All Access Pass ("AAP"), grew 17% while deferred revenue increased 26% Y/Y. The ongoing transition to recurring revenue resulted in a material beat in EBITDA ($8.5M vs consensus at $4.2M), which, coupled with improving trends in both Enterprise and Education, led to an upward revision in EBITDA guidance for the remainder of this year to $24.5-$26.5M ($20-$22M prior), with management hinting that its F22 and F23 EBITDA targets of $30 & $40M respectively will be revised upwards concurrent with its Q4/2021 earnings release in the fall. Note that the company's year-end is in August.

We expect FC's profitability to come ahead of guidance in all three periods, buoyed by accelerated growth in its Enterprise division and clear signs of pent-up demand in the Education segment. More specifically, we are extremely encouraged by its growth trajectory relative to the growing lifetime value of its logos as we believe the company has barely scratched the surface of this $80 - $100 Bn addressable market. With these incredibly high lifetime values (AAP size $43K; 50% service attachment and 85% gross margin with 90%-95% retention), we are fully supportive of management's ongoing initiatives (*including adding 30 net new client partners/year)* aimed at delivering consolidated double digit organic growth fueled by AAP's geographic expansion (Japan <1/3 subscription; China scratching the surface; North America to go to 90%+ from 80%) while not even accounting for positive trends in the Education segment.

With 40%-50% contribution margin on incremental revenue, we expect Franklin Covey to generate >$50M in EBITDA in the next few years. What would you pay for a business growing revenue and EBITDA in the teens+ while generating significant free cash flow in the interim (~7.0% FCF yield)? **Given the quality of the business and its growth trajectory, we believe that the intrinsic value of the business today is upwards of $75/share vs the current stock price of $34/share.**

We remain supportive shareholders of Franklin Covey and continue to build our position, including after just-reported quarterly results, as the **market continues to overlook a highly-recurring, highly scalable, fast-growing, well-run, and free cash flow generating business with a strong competitive moat (decades of timeless content & delivery models) and barriers to entry.**

Issuer Direct (ISDR) – is one of our top contributors for the quarter. Please refer to our previous letters for an in-depth discussion about the company.

Yet again, this under-the-radar small cap provider of Communication (and now, to a lesser extent, compliance) modules, reported strong fundamentals in its April Q1/2021 earnings release. The company saw explosive growth in its customer count as it now serves 3,500 clients, bringing it a step closer to its 5,000 customers goal in the next 18 months. This resulted in 32% increase in high margin Communication revenue (**organically!**) with ACCESSWIRE's 38% growth partially offset by 12% growth in compliance revenue for blended organic growth of 24%. With Communications now accounting for ~70% of revenue, gross margin expanded another 3% to 72% which resulted in 59% increase in EBITDA Y/Y despite incremental S&M investments aimed at expanding ACCESSWIRE's market share to 3%-5% over time (vs <1.5% today).

And yet again, despite commendable execution and exceeding expectations, the market continues to underappreciate ISDR's true potential. We believe this business, run by a highly disciplined and aligned CEO (owns 16% of outstanding shares) **is worth multiples of times its current valuation** as we see a sustainable path to generate double digit organic growth with 20%+ EBITDA margins (~7.0% FCF yield). We expect continued organic execution, ongoing buybacks (the company lifted the price ceiling and bought back $452,000 worth of stock at ~$23.00/share), and potential cash deployment in M&A (will expand total addressable market by 2-3x) to shed the light on the company and act as the catalysts needed to bridge the gap between the market value and intrinsic value.

DIRTT Environmental (DRTT) – Due to the lingering impacts of COVID-19, DRT Q2 results failed to meet street expectations. However, as we look past these transitory results, we focus on three key developments in the quarter:

> **Based on current quoting and bidding activities, management is calling the trough, and anticipates activity will rebound significantly in the second half of this year**. Based on channel checks and discussions with the management, despite the US economy reopening and workers going back to the office, office reconfiguration has yet to become a significant part of the current pipeline. Having said that, and according to a recent article authored by Mr. Michael Ford, who sits on the board of DRT and is the head of Microsoft multi-billion real estate portfolio, the office

configuration of the post pandemic era would favor modular construction over conventional because of the inherent advantages of modular (*flexibility to reconfigure office space at will*). We expect this major wave of office reconfiguration to be a significant growth driver for years to come and DRT is well positioned to capture market share when the floodgate of office reconfiguration is unleashed.

- **DRT published its first ever ESG report, we believe this is a major milestone for two reasons:** 1) ESG focused ETFs and funds will start paying more attention to DRT and could one day become a holding of those investment vehicles (*positive from a capital flow perspective*); 2) Announcing publicly the company's commitment to sustainable construction could attract partners and clients who share the same commitment; hence, expanding the company reach to markets that were previously not available.

- **One of the major modular construction companies, Modulaire Group, was acquired by a group of shrewd investors**. Although the business of Modulaire Group is not directly comparable to DRT, the transaction clearly highlights the opportunities within the space, and validates the credibility of modular construction. We believe the acquisition of Modulaire Group sets the stage for industry consolidation with DIRTT having all the characteristics in place as a fantastic target for many strategic and financial buyers.

Purple Innovation (PRPL) – During the quarter, there was a clear Covid reopening movement, where many companies who had suffered during Covid reversed and traded sharply higher on expectations of pent up demand and a return to normal. Likewise, many of the companies who had been deemed Covid winners reversed and traded lower. This gave us the opportunity to accumulate shares at an attractive price in Purple Innovation. Purple is a mattress company that is often mistaken for the new Bed In A Box category, but is in fact a novel, new mattress technology company that is winning substantial share in the luxury mattress category. We have followed and admired for Purple for a number of years, but at the time of our fund launch we deemed the shares too expensive and decided to wait for a more attractive entry point. This market trend of selling shares in Covid winners provided such an entry point and we ended the quarter with Purple as a top ten holding.

Over the past few years Purple has established itself as the fastest growing mattress brand in the luxury category witnessing growth of 51% per year for the 2019-2020 period. It did this while expanding EBITDA margins from -5% in 2018 to +13% in 2020 and becoming highly cash flow generative. It is currently about 4% of total North American luxury mattress sales with goals to grow that figure to the 10-15% range over the medium term. It can accomplish this with internally generated cash flow and a realistic plan to expand margins. Despite these traits the stock has pulled back over the past quarter as the market worries about current mattress sales levels being unsustainable.

While it is true that overall mattress sales have increased due to Covid, with people confined to their homes and putting a premium on at home comfort, we believe Purple can grow through that industry reversal. While Purple did experience a 51% increase in sales in 2020, this is simply in line with its pre-pandemic growth rate of 50% in 2019. As only 4% of the luxury mattress category it is easy to envision Purple continuing to grow, albeit at a slower pace, while the rest of the industry contracts back to historical levels. Our forecast has Purple growing sales at a compound rate of 19% over the coming 5 years, a large deceleration from the prior 5 years (large of laws numbers comes into play) but one we feel is reasonable to underwrite into our analysis. Given the upcoming rollout of new, higher priced mattress lines as well as the expansion of Purple's own showrooms in the coming years, we are comfortable with our analysis.

This revenue growth should allow Purple to leverage its fixed costs and marketing spend, with margins expected to continue to scale in 2022 and beyond. While Purple is not cheap today, firmly fitting into the growth at a reasonable price camp, we note the 400% growth in EPS from 2020 to the end of our forecast horizon of 2026. From today's levels we expect to compound our investment at a rate of 19% annually over those coming 5 years. Purple has all the attributes of being a true compounder, and with the market selling off Covid winners we were finally able to accumulate shares at a price that fits with our return requirements.

Market Commentary:

At the point of this writing, the global economy is undergoing a strong comeback. In addition to massive fiscal and monetary stimulus, several countries started lowering Covid-19 prompted restrictions, which has a direct positive impact on the economic activity. We are also seeing strong pent-up demand, following many months of restrained traveling and socializing. Those dynamics, coupled with much healthier consumer balance sheets vs pre-pandemic levels, are a perfect recipe for a booming economy.

Global stock markets have caught up to these dynamics and most of the broad-based indices are close to or at all-time highs. While some of the overall market dynamics make sense to us, we highlight an increasing amount of fast money attracted to speculative activities and the fact that Covid-19 is not yet fully behind us. We are cognizant of the fact that accommodative policies have their expiration date and there is a price to pay at the end. We also want to take this opportunity to recognize that the economic disparity between various social groups and between in many cases large and small businesses has increased over the last 12-18 months.

Our analysis of the prior post-pandemic periods leads us to believe that many people currently, on average, are increasingly willing to take risks. With three additional forces at work - (1) higher risk tolerance, (2) larger wallet sizes, (3) accelerating massive inter-generational wealth transfer to younger recipients who want to put this capital to work in the market & other much more speculative endeavors - one must wonder whether recent irrational speculative frenzies are just getting started. Thus, risk management especially when it comes to shorting securities and participating in markets prone to "tightness" is as important as it has ever been. Parabolic movements to the upside, above and beyond fundamentals, must be incorporated as part of everyday risk assessment.

With colossal changes taking place simultaneously across numerous industries, the current environment continues to provide ample opportunities for alpha generation based on fundamental research and analysis. Although the overall stock market has done very well, bottom-up stock pickers have done much better in 2020 and so far in 2021. We fully expect such a dynamic to persist for quite some time.
Below are examples of some of the dynamics that our team is following:

- Evolving work-from-home culture & emergence of flexible modular offices:

It is obvious that numerous companies are moving to the so-called "hybrid model", which provides much greater flexibility to employees to work from home while nonetheless effectively participating during group meetings and discussions. Most of the management teams we speak with are in the process of evaluating how their new physical and virtual office environments will function, how much physical square footage can be rationalized, what software solution(s) to use, how to change physical offices towards flexible and modular design, etc.

With a **tsunami of work coming to change traditional offices layouts to highly flexible modular environments,** our investors should not be surprised to see DIRTT Environmental Solutions (DRT-TSX; DRTT-NSDQ) as one of our holdings. We have been following this company closely since 2014 and are exceedingly excited about its immediate and long-term prospects. DIRTT is the world's leader in environmentally friendly modular construction solutions for mainly corporate offices and hospitals. In addition to being a great long-term business poised to disproportionately benefit from the trends described above, **the company's stock price has all the pieces in place to gain from ESG-led allocations**. For more details on DIRTT, see company-specific write-ups below. We also encourage the readers to access DIRTT's 56-page ESG report at:
https://www.dirtt.com/assets/attachments/DIRTT-ESG-Report-2020.pdf

- Booming services economy & people's thirst for in-person experiences:

While we have seen a boom in the "goods economy" throughout the Covid-19 crisis, the "services economy" is extremely well-positioned for a comeback likely significantly overshooting the pre-Covid 2019 run-rate. All our channel checks point to the same conclusion - people desperately want to travel, take cruises, go to restaurants, attend concerts, watch live sporting events, join in-person sports classes, join social clubs, throw parties, etc. Drawing parallels with the past post-pandemic periods, such behavior is likely to persist for years to come. With a lot of capacity removed from various "services industries" during the lockdown, **one should expect to see major shortages from the supply side of the equation coupled with often disproportionately advantageous economics to those who remained in business**.

- The future of select Covid beneficiaries:

Numerous prior trends have greatly accelerated because of Covid-19. Examples include implementation of e-commerce solutions by retailers, usage of supply chain optimization solutions, adoption of digital health offering(s) as part of the employee's insurance packages, etc.

In our opinion, faster top-line growth rates experienced by most businesses have brought forward the adoption of said technologies/processes, rather than have stolen from the future periods. In other words, in many cases, the benefits are real and sustainable unless solely driven by the transactional component which is expected to abate post restrictions.

Specifically, for examples illustrated above, we have full confidence that:

- retailers will continue to invest in their e-commerce presence for years to come.

- C-suite executives will spare no expense to ensure that their businesses use supply chains solutions to better navigate future disruptions.
- businesses will increasingly offer e-health option(s) to their employees to improve productivity and to respond to the increasing demand by their employees.

- Recognition of the importance of ESG practices by all stakeholders:

  As early advocates of socially responsible investing, we much welcome the increased awareness by the investment community of the importance of ESG. With the record amount of capital flowing into the ESG-focused ETF's, we fully expect qualified companies' stock prices to benefit accordingly.

  Furthermore, fund managers of all sizes are more and more sensitive to the underlying companies' ESG practices and increasingly reflect those in their allocations. With such trends poised to accelerate further, a strong case can be made to favor businesses that score well on their ESG practices. In our opinion, it is only a matter of time until the ESG-driven scoring methodology, at the individual company level, is well-developed and actively applied by investment professionals. Gone are the days of ESG by-standers who expect to manage institutional capital and be well-ranked by consultants.

  Increasing pressure from the investment community coupled with consumer's increased awareness of the fragility of the environment, as well as other social injustices, has finally reached corporate C-suites and Boards of Directors. For the first time, we are seeing real tangible changes at the companies themselves. As capital allocation decisions are increasingly made through ESG-mandated processes, businesses that demonstrate a lower environmental footprint are poised to gain significant market share.

Corporate Updates:

Our team remains focused on identifying numerous mispricing opportunities present among North American small- and medium-capitalization equities. The current market environment bodes well for fundamental stock picking despite higher overall market levels. Rather than making a call on the direction of the markets, we much prefer managing the capital in a prudent manner by investing in unique situations with highly attractive upside-to-downside profiles.

We take this opportunity to welcome Sahib Singh, CPA, as a Controller to our team. Sahib brings extensive accounting and audit experience to LionGuard Capital Management where he will oversee our internal accounting processes.

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)