LionGuard Capital Management Inc.
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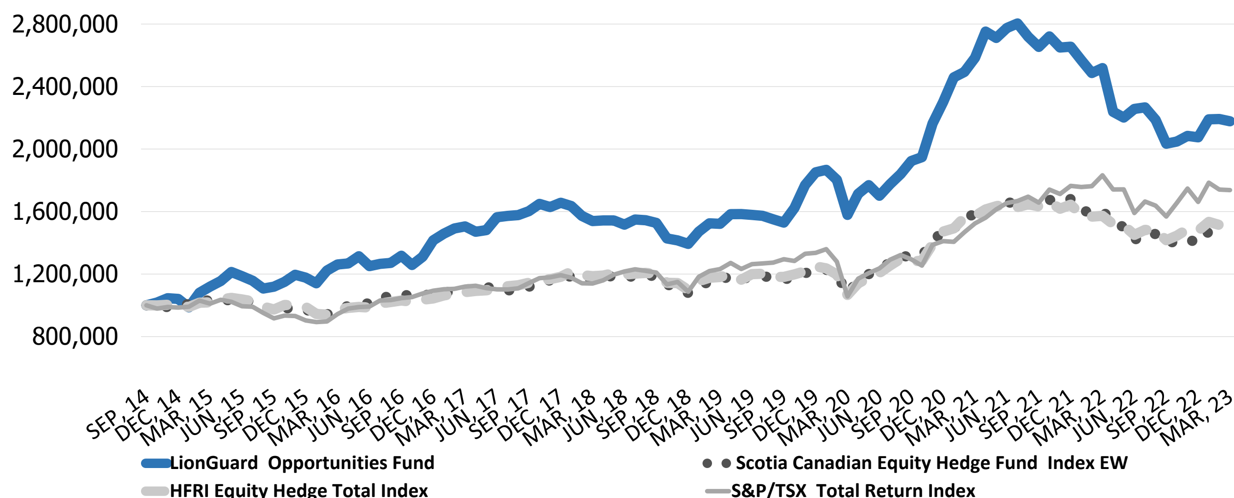
LIONGUARD OPPORTUNITIES FUND
Q1-2023 REPORT

Performance

LionGuard Opportunities Fund ("Fund") performance vs. S&P/TSX Total Return Index, Scotia Canadian Hedge Fund Index EW and HFRI Equity Hedge Total Index



During the quarter ended March 2023, LionGuard Opportunities Fund had a net return of 4.95%. Since inception, its compound annual net return amounts to 9.69% and cumulative net return to 117.82%. This compares to 6.78% and 73.74%, respectively, for S&P/TSX Total Return Index.

	LionGuard Opportunities Fund Net Return	S&P/TSX Total Return Index
2014 Since Inception (Oct-Dec)	4.11 %	(1.47) %
2015	13.07 %	(8.32) %
2016	20.30 %	21.08 %
2017	17.00 %	9.10 %
2018	(15.90) %	(8.89) %
2019	32.88 %	22.88 %
2020	24.32 %	5.60 %
2021	15.37 %	25.09 %
2022	(21.84) %	(5.84) %
2023 YTD (Jan-Mar)	4.95%	4.55 %
Cumulative Since Inception	**117.82 %**	**73.74 %**
Compound Annual Return	**9.69 %**	**6.78 %**

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Commentary

Q1-2023 Market Snapshot

During Q1 2023, global growth exceeded expectations, with a rebound in the composite PMI business surveys in the US and Europe indicating improved business sentiment, driven by lower energy prices and China's reopening. Developed market stocks performed well.

However, the geopolitical landscape remained challenging, with ongoing conflicts and renewed tensions between the US and China. Inflationary pressures persisted, with core inflation remaining stubborn, leading global central banks to tighten monetary policy.

The collapse of Silicon Valley Bank (SVB) in March, marking the second largest banking failure in US history, triggered a significant sell-off in the US and European financial sectors. Despite a strong January rally for equities and positive reactions in fixed income markets to declining inflation and prospects of easier monetary policy, February saw a downturn as strong economic data and sticky core inflation prompted investors to reassess their interest rate expectations and anticipate higher-for-longer interest rates.

Runs on the Banks

The recent banking events have been severe, with the collapse of Silicon Valley Bank (SVB) and Signature Bank, and First Republic experiencing a drastic 89% drop in March. The impact of these events is likely to stay with the regional banks and investors for years, as they grapple with the aftermath and regulators consider new regulatory measures. The images of runs on the banks and the complete wiping out of USD 17 billion of bonds at Credit Suisse have sent shockwaves through the financial industry.

The issues leading to these banking failures appear to be diverse. SVB's collapse appears to be a result of traditional risk and maturity management failures, compounded by regulatory shortcomings. Signature Bank's collapse seems to be linked to portfolio issues, while Credit Suisse has been grappling with problems for years, with talks of a potential merger with UBS in the past. The current situation has led to a forced "wedding" for Credit Suisse, and Deutsche Bank is also reportedly in motion.

While these banking issues may not be systemic at this point in time, the possibility of withdrawals leading to further failures looms large. The severity of the situation and the ripple effects on the regional banks and investors cannot be understated, and the need for robust regulatory measures and risk management practices in the banking sector has come to the forefront of discussions. The recent events have highlighted the vulnerability of the financial industry to unforeseen crises and the need for continuous vigilance to safeguard against future risks. Overall, the recent banking events have created a sense of urgency for the industry to address the underlying issues and restore confidence in the stability and resilience of the banking system.

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Investment Philosophy

With more and more investors joining in as partners, we thought it was important to further communicate our investment philosophy and process, so that everyone is always 100% on the same page.

We focus our investments on companies that exhibit three key characteristics:

Firstly, we seek high-quality businesses with stable and predictable business models, evidenced by a strong free cash flow return on invested capital (FCF-ROIC). These businesses can reinvest their free cash flow at high rates of return for an extended period and generate sustainable free cash flow (FCF). We also prioritize companies with capable and shareholder-aligned management teams and boards of directors.

Secondly, we invest within our circle of competence, which includes businesses and industries that we have extensively studied and analyzed. This allows us to make informed assessments on how these businesses are likely to evolve over time, based on our expertise and understanding.

Lastly, we target companies with highly attractive valuations, trading at a significant discount to their intrinsic value as determined by discounted cash flow (DCF) valuations using our internal models. This focus on valuation allows us to identify opportunities where the market price does not fully reflect the true worth of the underlying business, providing potential for favorable returns.

In summary, our investment strategy is rooted in a meticulous selection process that prioritizes high-quality businesses, aligns with our Circle of Competence, and seeks investments at attractive valuations. This approach enables us to compound our investors' capital over time by capitalizing on structural inefficiencies and unique opportunities especially pronounced among smaller-capitalization equities.

As astute investors, however, we try to go beyond just acquiring high-quality businesses at discounted valuations. Our keen interest lies in identifying mispriced companies that possess positive near-term catalysts, which necessitates a comprehensive analysis of multifaceted factors. These include strategic shifts, such as the transition from hardware to software, or from perpetual to cloud-based business models, which demand astute evaluation.

Additionally, we conduct assessments of financial metrics that may be temporarily obfuscated by recent acquisitions or divestitures, as well as governance practices and potential modifications to the board of directors that could significantly impact the company's performance. Our scrutiny extends to identifying forthcoming opportunities, such as accretive deployments of excess capital, monetizations of non-core assets or lines of business, and refinancings that have the potential to augment free cash flow per share.

Furthermore, we conscientiously evaluate the efficacy of improved reporting transparency and shareholder awareness practices, and duly consider the potential impact of new institutional capital flows. Our approach enables us to diligently identify companies that are mispriced in the market yet hold promising prospects for positive catalysts.

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High Rate of Monetizations

Our Opportunities Fund has a track record of experiencing 3-5 take-outs per year on average. This is due to our focus on high-quality companies that trade at highly attractive levels, often with a high net cash position and high free cash flow yield. These characteristics make our portfolio companies highly attractive targets for various value unlocking events.

These events may include take-outs by private equity firms, strategic players, or buy-outs by management teams. Additionally, other possibilities such as Dutch auctions, substantial issue bids, special dividends, or carve-outs of segments can also contribute to the monetization of our investments.

Q1-2023 Contributors

During the first quarter, some of our largest contributors included Iteris (ITI US) and Burford (BUR US). Please review prior letters for a detailed write-up on Iteris (ITI US). On the opposite side, our detractors included various long positions and one of our key holdings, Franklin Covey (FC US).

- **Burford (BUR US)** – On March 31, 2023, a ruling was issued in the Petersen and Eton Park cases against the Republic of Argentina and YPF, involving Burford (BUR US). The Court ruled in favor of Petersen and Eton Park against Argentina, but the damages could not be quantified as the reference date for calculation remained unresolved. BUR estimates the total possible claim value to be between $5.0 billion and $8.4 billion, before interest, with their entitlement being approximately 40% of the total potential gross proceeds, implying a range of $2.0 billion to $3.4 billion, before interest. To put it in perspective, BUR's market capitalization prior to the ruling was about $1.5 billion.

  BUR has indicated that the plaintiffs have two options: they can negotiate a resolution with Argentina, which may result in a substantial discount to the judgment amount in exchange for agreed payment, or they can enforce the award in a potentially lengthy campaign. The exact outcome and timeline of the resolution remain uncertain, but BUR's statement suggests that there are possibilities for negotiation and potential discounts in the final judgment amount.

  In addition to outstanding news outlined above, Burford, the world's leader in litigation finance, remains at the forefront of the industry by effectively deploying its on-sheet and third-party capital at impressive rates of return exceeding 30%. As a gold standard in a fast-growing and recession-proof industry, Burford continues to deliver exceptional results. Despite some investors' lack of understanding and hesitation towards this industry, Burford remains resilient and continues to thrive. Please refer to our prior quarterly reports for further insights into the company.

- **Franklin Covey (FC US)** – Franklin Covey remains one of our highest conviction investments with its intrinsic value pointing to an upside of around 100% from current levels. We wrote extensively about FC in past reports, which clearly explain why we believe it to be a multi-year compounder.

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While FC's Q2 report was in-line with expectations, the stock is down 14% on a 2% change in revenue guidance owing to a tougher macro environment. A two percent change. We view the reaction as overly-punitive taking into account (1) just how minor the revision was , (2) the fact that more customers are renewing and expanding vs Q2 of last year, and (3) the 8.5% net cash position on the balance which will continue to increase as we expect FC to generate >$30 million in operating cash flow in the back half of the year. With a significant cash build-up on the balance sheet and the Board's decision to announce a $50 million repurchase program, we expect FC to become more aggressive in buying back stock which will continue to support downside protection. Thanks to the hasty sell-off, this double-digit earnings compounder is now available at 10x EBITDA.

Focused on Performance

We are excited about our ongoing commitment to grow our investors' capital through strategic investments in small and medium-capitalization equities, capitalizing on inherent inefficiencies in the market. While last year's mark-to-market impact was higher than anticipated, the volatility of the stock market, particularly the forced selling of smaller-capitalization equities, has presented us with distinctive opportunities to acquire outstanding businesses at highly favorable prices. This tried-and-tested approach has consistently yielded higher returns for our investors while maintaining a prudent level of risk, outperforming broader market investments. We remain dedicated to this winning formula for long-term wealth creation.

Sincerely,

Andrey Omelchak, CFA
President & Chief Investment Officer
LionGuard Capital Management

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