LIONGUARD
CAPITAL MANAGEMENT INC.

LionGuard Capital Management
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LIONGUARD OPPORTUNITIES FUND
YEAR 2023 REPORT

Since Inception Performance

Since inception in October 2014, LionGuard Opportunities Fund ("Fund") delivered annualized net return of 9.80%. This compares to S&P/TSX Total Return Index at 6.92%.

	LionGuard Opportunities Fund	S&P/TSX Total Return Index
2014 (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	14.38 %	11.75 %
Annualized Net Return	**9.80 %**	**6.92 %**

On a compounded basis, the Fund delivered a net return of 137.39%. This compares to S&P/TSX Total Return Index at 85.69%.

	LionGuard Opportunities Fund	S&P/TSX Total Return Index
2014 (Oct-Dec)	4.11 %	(1.47) %
2015	17.71 %	(9.67) %
2016	41.60 %	9.37 %
2017	65.67 %	19.33 %
2018	39.33 %	8.72 %
2019	85.14 %	33.59 %
2020	130.17 %	41.08 %
2021	165.56 %	76.47 %
2022	107.55 %	66.17 %
2023	137.39 %	85.69 %
Cumulative Net Return	**137.39 %**	**85.69 %**

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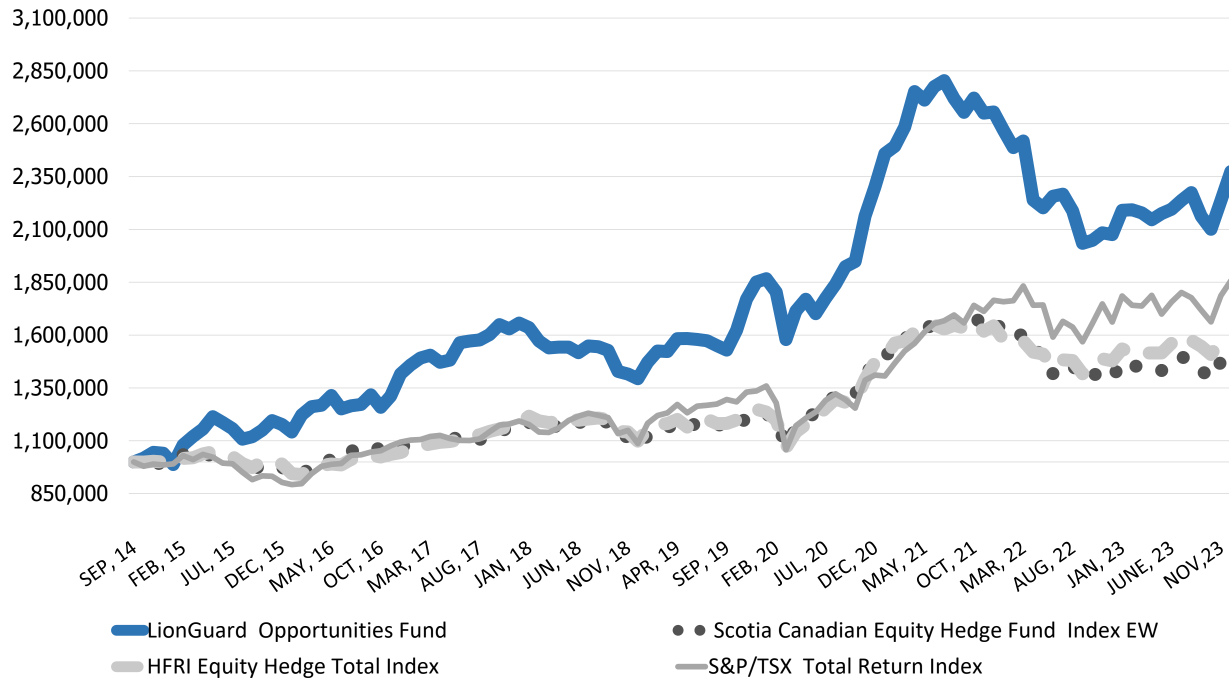
Exhibit 1: Since Inception Performance



Sources: Bloomberg, LionGuard

Stock Market in 2023

The year 2023 in the financial markets was an extraordinary period of resilience and surprises, marked by a series of dramatic turns that defied conventional wisdom and expectations. Early in the year, the consensus was braced for an economic downturn, with widespread predictions of a looming recession. Contrary to these forecasts, however, large cap U.S. indices not only averted a decline but soared to new highs. This bullish trend was underpinned by a robust labor market and sustained consumer spending, challenging the narrative of an impending economic crisis. The resilience of the U.S. economy coupled with a meteoric performance of “Magnificent 7” (see below) were key factors in this largely unexpected market performance, as it continued to chug along despite rising interest rates and inflationary pressures.

The “Magnificent 7” - a group of dominant tech companies including Alphabet, Amazon, Apple, Meta, Microsoft, Netflix, Tesla, and Nvidia - played a pivotal role in 2023's market dynamics. Beginning the year with a significant weight in the S&P 500, they grew to represent an extraordinary 28% of the index by year-end. Their staggering performance not only illustrated the huge concentration in the market but also underscored their immense influence on overall market returns. While the broader market faced real challenges, these tech giants drove the majority of the S&P 500's gains.

2023 wasn't without its moments of crisis. The collapse of Silicon Valley Bank in March, followed by other significant banking failures, sent shockwaves through the financial world. These events, occurring amidst tightening monetary policy and an inverted yield curve, had real potential to trigger global contagion.

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Having experienced the Global Financial Crysis in 2008, we knew that the risks of a broad-based panic were real. Thankfully, Federal Reserve officials, having learned from the past, have taken decisive and timely actions to avert much bigger issues. Nevertheless, this experience has once again highlighted the fragility of the financial system and the rapidity with which confidence can be shaken.

In the latter part of the year, the market narrative took another turn. Growing optimism that inflation was easing and that the Federal Reserve might begin reducing interest rates in 2024 sparked a big rally in the final quarter of 2023. This shift in sentiment was bolstered by the belief that the Fed could achieve a "soft landing" for the economy - slowing it just enough to curb inflation without causing a recession. The prospect of significantly lower borrowing costs and continued economic support led to a resurgence in market confidence even extending the rally beyond the “Magnificent 7”.

The nature of inflation in 2023 also played a critical role in shaping market outcomes. Unlike previous inflationary cycles, this year's inflation showed signs of moderating without the anticipated severe economic repercussions. This highly unusual behavior suggested a unique inflationary environment leading many to believe that it was exacerbated to the upside by transitory post-Covid dynamics. It further reinforced the market's belief in a potential 'soft landing,' contributing to year-end optimism.

The year 2023 marked a watershed moment in both the investment world and broader society, heralding the onset of what can aptly be described as the AI (Artificial Intelligence) technological revolution. This era is characterized by groundbreaking advancements in AI, poised to induce substantial transformations across a multitude of industries. These developments are not only opening new channels for revenue generation and altering traditional margin profiles but are also accelerating the pace of change at an unprecedented rate. Consequently, this is leading to a more pronounced segmentation between industry frontrunners and those lagging behind, thus intensifying the competitive landscape.

Much like previous technological revolutions, the rise of AI is expected to be profoundly transformative. It holds the potential to give birth to new, yet-undiscovered businesses and necessitates an open-minded approach to navigating this evolving terrain. Particularly in the early stages of AI implementation, paying close attention to incremental changes and monitoring value-creating Key Performance Indicators (KPIs) will be vital. This vigilance is crucial for identifying businesses that are effectively harnessing new technology and differentiating them from those that are falling behind. The journey through this AI-driven era is anticipated to be dynamic and replete with developments.

In the realm of our investments, we are already observing significant developments as numerous companies are increasingly adopting new technology to redefine their businesses. One of the trends among data rich companies is the monetization of data, which we view as a hidden asset that is often undervalued by the market. Additionally, many companies are transforming their processes and delivery mechanisms in ways that were previously inconceivable, in some cases leading to record increases in employee productivity and even the emergence of novel, greenfield opportunities.

Our commitment is to remain engaged with the developments in AI, their practical applications, and the implications they hold for various businesses. Our mandate to protect and to compound your capital necessitates staying abreast of these rapid advancements, given their profound ability to affect the intrinsic value of a diverse array of businesses.

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Investment Operations in 2023

The year 2023 proved once again that the pursuit of broad market predictions often proves to be a futile endeavor. It further reinforced our pragmatic approach focused on investing in highly mispriced yet high-quality businesses with strong pricing power and properly incentivized management team, rather than attempting to predict broad market movements. High-quality businesses typically possess robust business models, strong market positions, and the ability to generate consistent earnings.

In retrospect, we believe that our 2023 performance is anchored not in broad market movements, but largely in our stock selection process. We engaged with securities within our circle of competence on our terms, investing only when fundamental analysis presented unique opportunities, and we were judicious in our choices, opting to wait patiently on sidelines until highly compelling entry points presented themselves.

During the year, some of our largest contributors included **goeasy (GSY CN), Burford Capital (BUR US), Lumine Group (LMN CN)** and **EQB (EQB CN)**. On the opposite side, our detractors included **Trisura Group (TSU CN)** and various short positions. Comments on our contributors should shed light on the type of businesses we choose to engage with, and the level of conviction required for such engagements.

- **goeasy (GSY CN)** – goeasy Ltd. (GSY CN) has established itself as a long-term compounder in the financial services sector, demonstrating a remarkable growth trajectory backed by a robust business model and high reinvestment rate. This approach has enabled the company to achieve consistent returns and steady expansion over time.

  In the first half of 2023, concerns about the potential impact of the Canadian government's decision to lower maximum permissible rates on goeasy's profitability initially caused investor apprehension. However, the company's strong performance and positive outlook have largely alleviated these worries, suggesting that the rate cuts were not as detrimental as initially feared based on the stock price reaction. Our analysis led to the conclusion that the overall impact of a potential rate cap will not be significant to the company’s bottom line and can in fact lead to more beneficial competitive dynamics over time.

  This period of excessive concern (starting in May 2023; refer to Exhibit 1) provided an even better (GSY was already trading much below its intrinsic value) buying opportunity to invest in a multi-year compounder at a phenomenal price, which we have gladly taken advantage of. Although within our circle of competence we frequently find high-quality businesses trading below their intrinsic values, it makes a huge difference to be able to buy them with confidence at levels that are strikingly irrational.

  The latest quarterly results highlighted that credit has tightened, benefiting goeasy, as they now approve only 15% of applicants, a decrease from 17% last year, and with better credit quality. This is particularly evident in their auto loan segment, where 80% of originations come from the top two tiers, compared to 50% two years ago. The net charge-off guidance for 2024, based on a 7% unemployment assumption, appears quite conservative, suggesting room for positive revision.

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Massive improvement in the efficiency ratio by 400 basis points to 28.6% indicates the company is reaping the peak benefits of operating leverage at this stage in its business life cycle. This improvement is a remarkable achievement. When coupled with a strong loan growth profile, it looks like more positive surprises (to conservative street estimates) are in store on this front.

Exhibit 2: GSY CN Chart

Sources: Bloomberg, LionGuard

The potential rate cap changes, expected in the latter half of 2024, are unlikely to significantly impact the company, possibly pushing the yield to a higher range of guidance. Additionally, goeasy is exploring additional ancillary products to offset the rate cap, which, given the quality of the management team, should be taken seriously. In the meantime, we also believe that GSY's three-year guidance is conservative and there is a high likelihood of upward revision to the current numbers.

- **Burford Capital (BUR US)** – BUR's massive victory in the Petersen and Eton Park cases is a pivotal development in the company's journey. This win against the Republic of Argentina and YPF is a reflection of BUR's adeptness in legal proceedings, affirming its capability to turn intricate legal cases into great financial gains.

  The court's final judgment on the Petersen and Eton Park cases represents a total liability of approximately US$16 billion payable by Argentina to the plaintiffs. BUR's estimated entitlement from this judgment is around US$6.3 billion. To put it in perspective, this is compared to BUR's current market capitalization of US$3.3 billion. Although it is very hard to estimate the present

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value of this asset, it is fair to say that it is worth anywhere between 30% and 100%+ of the current market capitalization.

Subsequently, in December 2023, newly elected Argentinian president, Javier Milei, suggested that Argentina is considering issuing a bond to pay for US$16 billion YPF lawsuit. Despite Argentina's poor finances, should they use this case as an example of a good behavior, to improve their odds of getting additional loans from IMF and other creditors, this would bode extremely well for BUR shareholders. The odds of that happening have increased a lot following the president's comments.

Exhibit 3: BUR US Chart

Sources: Bloomberg, LionGuard

In addition to a massive win above (and increasing odds of a payout following December developments), the company's ongoing performance signals a strong operational stride. In our opinion, even if we give zero credit to a legal win against the Republic of Argentina, the company continues to trade at levels not reflecting its excellent track record of returns on capital deployed and very strong growth trajectory for new capital deployments.

- **EQB (EQB CN)** – EQB's outstanding performance showcases a bank that is on a very solid footing, thanks in large part to its top management's effectiveness and strategic execution. Furthermore, EQB is a testament to sound risk management practices. The bank's resilience in credit metrics, even amidst market uncertainties, signifies a financial institution that is rooted in strategic operational efficiency. These are not transient achievements but are reflective of a management team that is strategically aligned, operationally adept, and focused on delivering consistent, tangible value to its long-term shareholders.

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Back in September of 2022, our estimate of EQB's intrinsic value was around $95/share. We also established a minimum justified stock price level, a level to which the stock price is likely to revert in short order (excessive irrationalities for this company rarely last), at $72/share. At that time the business was trading at $51/share, which was a mere 0.7x P/B and 5.1x FY23 P/E.

Backed by over 15 years of analyzing the company and its industry, investing in EQB at those prices was straightforward. Contributing to this decision were several factors: the company's diversifying funding sources, our confidence in its lending practices, the company's increasing scale (which in this case is a plus) and high return on equity (ROE) profile. Note that our ROE projections remain higher than management's new guidance.

Exhibit 4: EQB CN Chart

Sources: Bloomberg, LionGuard

Since November 2022, based on our internal estimates, EQB's intrinsic value has risen by at least 17%, placing it at over $110/share. Accordingly, our minimum justified stock price level now stands at approximately $84/share, which is where the company trades today.

- **Lumine (LMN CN)** – Lumine Group, spun out from Constellation Software (CSU) in March of 2023, operates as a global VMS consolidator with a primary focus on the Communications and Media industry. Since its inaugural acquisition in 2014, Lumine has completed over 11 acquisitions, achieving a Compound Annual Growth Rate (CAGR) of 65% in both revenue and EBITDA, and boasting a robust 29% Return on Invested Capital (ROIC) in FY 2022. Investors may question CSU's rationale for spinning off this asset. The management has cited two primary reasons:

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- Introduction of more effective incentive structures for LMN employees.
- Enabling Lumine to leverage its own balance sheet for more ambitious acquisitions.

Drawing from the established playbook of CSU, characterized by the acquire-and-optimize strategy, Lumine's competitive advantage over other VMS acquirers in the space is underscored by its ability to leverage the extensive financial performance data of acquired entities, a strong network that facilitates deal sourcing, and application of proprietary best practices learnt at CSU.

This approach enables Lumine to adeptly sidestep common pitfalls associated with a roll-up strategy. In addition to having access to this substantial database and expertise at the head office, what sets Lumine apart from CSU and potentially other CSU spin-offs is its focus on large-scale carve-out acquisitions. Carve-out acquisitions have the potential to generate higher ROIC when entrusted to capable hands. Some of the unique attributes of corporate carve-outs can include:

- Less competitive bidding for assets, where price is not always the critical factor.
- Historically underfunded by parent and burdened with excessive corporate overhead.
- Opportunity for ongoing deals if the seller is satisfied with the process.

Our investment in Lumine has been reinforced by recent performance, where margins and capital deployment continue to exceed expectations. We foresee substantial growth potential for LMN for years to come, while maintaining high ROIC levels, which is a solid recipe for long-term shareholder value creation.

- **Trisura Group (TSU CN)** – Trisura is Canadian-based specialty insurance company with operations in Canada and U.S. It was one of our top detractors during the year, due to a write-down in their U.S. operations. We are of the view that the write-down is an isolated event. This perspective is strengthened by Trisura's limited exposure to industry-specific risks such as wind, hurricane, and wildfire property catastrophe risks. The renewal of reinsurance coverage for all remaining property programs further solidifies this stance, showcasing the company's proactive risk management. Furthermore, in our opinion, the explanations provided by the management team have been fair, frank and more than reasonable.

  Trisura's Canadian operations are characterized by high profitability and a robust market position in key lines. Coupled with established distribution relationships, the Canadian unit has consistently exhibited excellent performance, with combined ratios averaging around 80% in recent quarters. The favorable property and casualty (P&C) market conditions and pricing dynamics are expected to sustain healthy premium growth trends into foreseeable future.

  The commitment of Trisura to its U.S. fronting platform infrastructure is noteworthy. The strategic hiring of a Chief Risk Officer (CRO) and the establishment of dedicated risk management teams and collateral collection groups demonstrate Trisura's dedication to strengthening its operational foundation in the U.S. market. These investments signal a strong belief in the potential of the U.S. fronting platform, a position with which we agree. This platform is expected to be a significant driver of premium growth for years to come.

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In our opinion, Trisura is an excellent small cap compounder. We are of the high opinion of TSU's market position and its management team. Although recent ROE's around 20% might not be sustainable, we believe high-teens long-term ROE's are achievable. Thus, we stand unabated by the recent stock price correction and see it as a major buying opportunity into a high-quality operation at highly attractive prices.

Conclusion

We extend our gratitude to our valued partners for their trust in our abilities to compound their capital. Our focus is unwavering: to capitalize on the unique opportunities that arise from frequent stock market irrationality and other market-driven dynamics, by acquiring pieces of high-quality businesses at highly attractive valuations. Over time, this strategy has proven effective in compounding your (and ours) capital while taking much lower risk than investing in the market at large.

Looking ahead, we are excited to continue leveraging the structural inefficiencies prevalent in small and mid-cap equities. These segments of the market present clear opportunities for alpha generation, particularly for specialists like us. In addition, our ever-growing expertise spans a broad spectrum of businesses, enabling us to capture a diverse and idiosyncratic range of opportunities.

Our team is highly enthusiastic about the opportunities ahead and looks forward to updating you on our continued progress.

Sincerely,

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

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