LionGuard Capital Management
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LIONGUARD OPPORTUNITIES FUND
Q1-2024 REPORT

Since Inception Performance

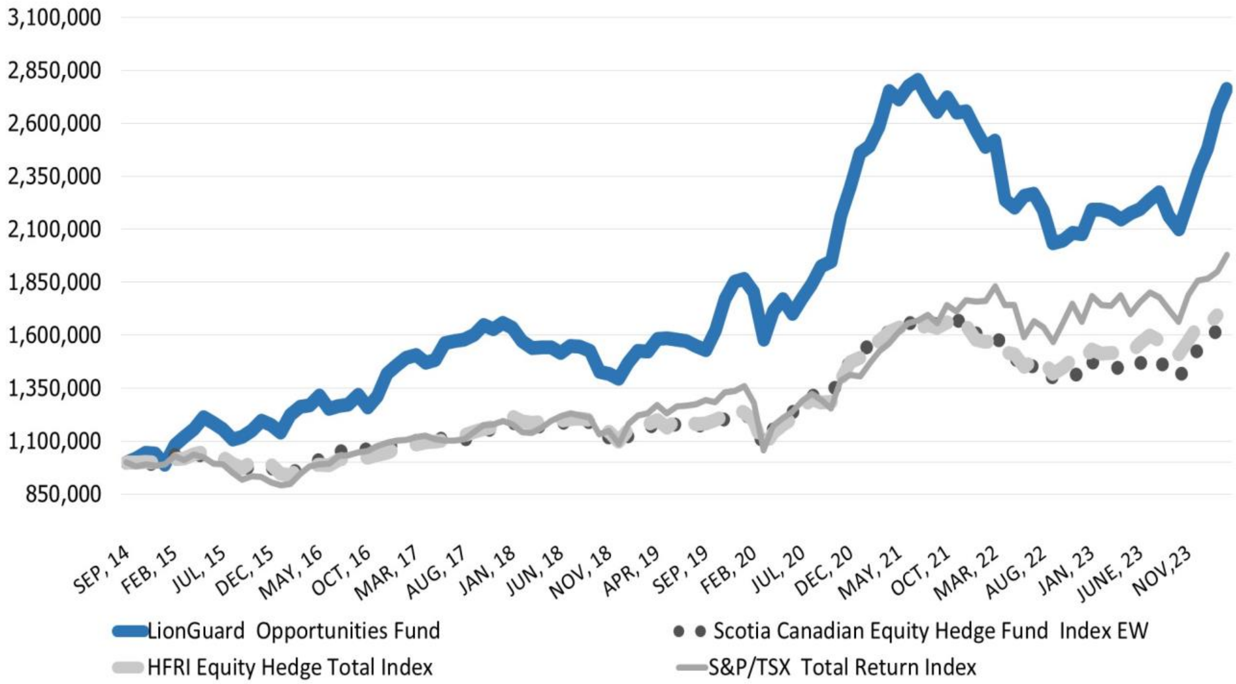
Since inception in October 2014, LionGuard Opportunities Fund ("Fund") delivered annualized net return of 11.28%. This compares to S&P/TSX Total Return Index at 7.46%.

	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 %
2024 (Jan-Mar)	16.32 %	6.62 %
Annualized Net Return	**11.28 %**	**7.46 %**

On a compounded basis, the Fund delivered a net return of 176.14%. This compares to S&P/TSX Total Return Index at 98.00%.

	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 %
2024 (Jan-Mar)	176.14 %	98.00 %
Cumulative Net Return	**176.14 %**	**98.00 %**

Exhibit 1: Since Inception Performance



Sources: Bloomberg, LionGuard

Market Commentary

In the first quarter of 2024, the U.S. stock market showcased remarkable strength, with several equity benchmarks, including the S&P 500, hitting new highs. The S&P 500 led with a total return of 10.6%, reflecting investor confidence bolstered by an improving economic outlook and expectations of Federal Reserve policy adjustments.

Despite the initial anticipation of multiple rate cuts, the market adjusted to expect just three cuts throughout 2024 amid signs of economic growth and slowing disinflation. This adjustment followed a surprising Q4 GDP growth and robust consumer spending, alongside a resilient labor market, indicating a solid economic foundation.

While large-cap stocks, particularly in the S&P 500 and Nasdaq, dominated the headlines, small-cap stocks also demonstrated notable performance, albeit with a more modest increase compared to their larger counterparts. The Russell 2000, representing small-cap stocks, rose by 5.2%, trailing the large-cap indices but still showing resilience and growth potential. This performance suggests a diversifying market where not just the largest companies are contributing to the upward momentum.

The sector-wise performance in large caps was broad, with ten out of eleven sectors advancing. The communications, energy, and technology sectors led the charge, reflecting ongoing trends and sectorspecific drivers. Despite the general market optimism, the real estate sector slightly declined, highlighting the nuanced and varied sectoral dynamics within the broader market rally.

The Federal Reserve's updated projections indicated a more supportive stance despite the hawkish adjustments to monetary policy, acknowledging the need to safeguard against growth risks to achieve a soft landing. This dovish tilt in policy expectations, amid an improving economic landscape, supported positive investor sentiment during the quarter.

Introducing "LionGuard's N-FCF/IC"

Despite the risk of delving into complexities, we believe it would be helpful for our investors to understand how we approach and adjust conventional Return on Equity (ROE) and Return on Investment Capital (ROIC) measures to better assess returns on deployed capital. As part of this objective, we're glad to share with our dedicated readers an internal metric which we call "LionGuard's N-FCF/IC."

Its methodology goes beyond traditional ROE and ROIC calculations, which do not account for the nuances of business cycles, the impact of significant growth investments (in our case at almost always very high rates of return), and other considerations. By adopting a more sophisticated approach, we aim to provide a much more meaningful analysis of the underlying quality of securities in question.

LionGuard's N-FCF/IC calls for computation of normalized free cash flow (N-FCF), adjusting for elements like stock-based compensation, working capital fluctuations, maintenance capex requirements, etc. These and other adjustments to standard free cash flow offer a more insightful perspective on a company's operational efficiency and profitability. Furthermore, it steers clear of the large distortions presented by conventional earnings-based metrics employed within ROE and ROIC.

Moreover, this approach allows us to differentiate between businesses merely showing good numbers today and those poised for potentially tremendous value creation over time because of high incremental N-FCF/IC growth capex initiatives. Such an analysis must be performed on top of nevertheless backwards-looking calculations that provide a snapshot of business performance to date.

Investment Operations

During the quarter, some of our largest contributors included **Trisura (TSU), Topicus (TOI)** and **Softchoice (SFTC)**. On the opposite side, our detractors included 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. In addition, we are very pleased to introduce our new position, **Knight Therapeutics (GUD)**, a company we have been following closely over the years.

- **Trisura Group (TSU)** – Trisura is Canadian-based specialty insurance company with operations in Canada and U.S. It was one of our top detractors during last 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

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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 favourable 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.

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.

- **Topicus (TOI CN)** – Topicus employs a playbook reminiscent of Constellation Software (CSU), one of the world's premier compounders, focusing on the European vertical market software (VMS) sector. This strategy involves acquiring companies and providing them with tools to apply industry's best practices, while nevertheless allowing them to operate independently. We believe this approach facilitates the preservation of each company's unique strengths, while materially improving their free cash generation capabilities.

  We estimate that the returns on new capital deployments are extremely robust and potentially exceed 25%. Such high returns underscore Topicus's acumen in M&A, which is not surprising given their strict adherence to CSU's proven playbook.

  We believe that huge addressable market in Europe provides a fertile ground for Topicus's continued expansion for many years to come. The company's disciplined capital deployment coupled with a large addressable market, position it well as a likely multi-year compounder.

- **Softchoice (SFTC CN)** – Softchoice Corporation (SFTC) exemplifies excellence in the IT sector with its outstanding management team and proven ability to generate strong free cash flow (FCF). This financial prowess is further highlighted by the company's strategic decision to issue a C$4.00 special dividend, a move that not only rewards shareholders but also showcases Softchoice's disciplined capital allocation and commitment to shareholder value. The company's consistent FCF generation underpins its financial stability and provides the flexibility to pursue growth opportunities while rewarding investors.

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In its recent results, Softchoice demonstrated resilience and adaptability. The firm's robust performance, particularly in high-growth areas like software and cloud services, reflects its strategic positioning and operational efficiency. This performance, coupled with a sound investment in shareholder returns, underscores the company's solid foundation and its proactive stance in navigating the IT landscape. Softchoice's management has adeptly balanced growth initiatives with financial prudence, reinforcing the company's reputation as a reliable and forward-thinking enterprise.

Despite the strong fundamentals and positive financial indicators, based on our internal assumptions, Softchoice appears significantly undervalued when analysed through a discounted cash flow (DCF) lens and when compared with industry peers. The recent large special dividend, which we fully support, is a testament to Softchoice's confidence in its financial health and its strategy of balancing reinvestment with rewarding shareholders.

- **Knight Therapeutics (GUD)** stands out as a true hidden gem, not only for its excellent free cash flow generation, huge net cash position, and solid growth rate but also for the strategic acumen of its leadership poised to grow per share intrinsic value of the company for years to come.

  Jonathan Ross Goodman, the Chairman, renowned for building and selling Paladin Labs (PLB CN) at 16x EBITDA and 5.2x sales, is at the helm of Knight, steering the company with a vision reminiscent of his success at Paladin. To put it in perspective, Paladin launched an IPO at $1.50/share in 1995 and was sold to Endo Pharmaceuticals at $151/share in 2011. Complemented by top management team including President & CEO, Samira Sakhia, savviness, and experience of senior leadership is superb for the company of this size.

  Knight's growth strategy, focusing on licensing new drug therapies, showcases a methodical approach that has significantly enhanced its revenues and adjusted operating income. Despite these achievements that tremendously increased its intrinsic value, the company's stock price has not participated over the years, showcasing just how irrational market dynamics can be.

  To-date, Knight has become a leading player in licensing therapeutics across Latin America, demonstrating strategic foresight and adept management, especially highlighted by its strategic acquisition of Biotoscana in Brazil. Despite challenges, including an activist battle and the impacts of COVID-19 which initially slowed the integration process, Knight has shown resilience and is delivering on expectations.

  As of the end of last quarter, Knight had $162M of cash and marketable securities and $62M of debt on its balance sheet. With net cash position of $100M (18% of its market capitalization), coupled with high FCF generation, Knight has been very active on enhancing shareholder value through substantial stock repurchases in the open market. To put in perspective, in 2023 they bought back $53M worth of stock and since inception of NCIB program the amount is close to $240M.

  An additional layer of downside protection for investors are Knight's "hidden" assets in the form of limited partnership (LP) investments, which we believe are worth anywhere between $120M and $160M. As those investment monetize over the next few years, an additional approximately $140M (26% of current market capitalization) of liquidity will become available. Combined with today's net cash, a case can be made that 44% of today's market capitalization is in liquid cash or soon-to-be liquid cash position.

On that basis, Knight's today's enterprise value (EV) is around $300M and its normalized free cash flow (N-FCF) yield on EV for fiscal 2024 and 2025 are 15%+ and 20%+.

Furthermore, going forward we see a lot of room for margin expansion, which coupled with high FCF conversion rate and solid growth rate, set the stage for much higher FCF per share, not even accounting for buy-backs or any Substantial Issuer Bids (SIBs).

It is key to highlight that insiders own more than 23% of outstanding shares, creating a clear alignment of interests with minority shareholders of the company. Insiders, coupled with long-term minded large shareholders provide a good protection against predatory bids for high-quality yet greatly mispriced business. In this case, especially given the company's long-term prospects, we see it as a major positive. If history is an indication of the future, any forthcoming monetization should only take place at fair valuation levels.

With a proven track record of strategic acquisitions, robust and fast-growing FCF generation, high levels of net cash on balance sheet, and aggressive buyback program, Knight Therapeutics is well-positioned for sustained growth and an increase in per-share intrinsic value, mirroring Jonathan Goodman's remarkable tenure at Paladin Labs.

Conclusion

We sincerely thank our esteemed partners for placing their trust in our ability to compound their capital. Our commitment remains steadfast: to seize the distinct opportunities presented by the irrationalities of the stock market and its various dynamics, aiming to acquire stakes in superior businesses at exceptionally favorable prices. This approach has consistently proven its merit, allowing us to grow your investments (and ours) with considerably lower risk compared to broader market participation.

Moving forward, we are eager to capitalize on the structural inefficiencies found within the small and mid-cap equity markets. These areas offer pronounced prospects for alpha generation, especially for a highly specialized firm like ours. Furthermore, our expanding expertise across a wide array of industries positions us well to identify and exploit a diverse and unique set of investment opportunities.

We are excited about what the future holds and look forward to sharing our ongoing progress with you.

Sincerely,

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