LionGuard Capital Management
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LIONGUARD CANADIAN SMALL CAP FUND
Q2-2024 REPORT

Since Inception Performance

Since inception LionGuard Canadian Small Cap Fund ("Fund") delivered annualized return of 9.36%. This compares to S&P/TSX Small Cap Total Return Index at 5.02%.

	LionGuard Canadian Small Cap Fund	S&P/TSX Small Cap Total Return Index
2016 (Jul – Dec)	7.30 %	8.21 %
2017	11.60 %	2.75 %
2018	(15.54) %	(18.17) %
2019	28.28 %	15.84 %
2020	25.46 %	12.87 %
2021	20.39 %	20.27 %
2022	(23.96) %	(9.29) %
2023	19.47 %	4.79 %
2024 (Jan-June)	14.92 %	8.83 %
Annualized Return	**9.36 %**	**5.02 %**

On a compounded basis, the Fund delivered a return of 104.56%. This compares to S&P/TSX Small Cap Total Return Index at 48.02%.

	LionGuard Canadian Small Cap Fund	S&P/TSX Small Cap Total Return Index
2016 (Jul – Dec)	7.30 %	8.21 %
2017	19.74 %	11.18 %
2018	1.13 %	(9.01) %
2019	29.73 %	5.29 %
2020	62.75 %	18.96 %
2021	95.93 %	43.07 %
2022	49.00 %	29.79 %
2023	78.01 %	36.01 %
2024 (Jan-June)	104.56 %	48.08 %
Cumulative Return	**104.56 %**	**48.02 %**

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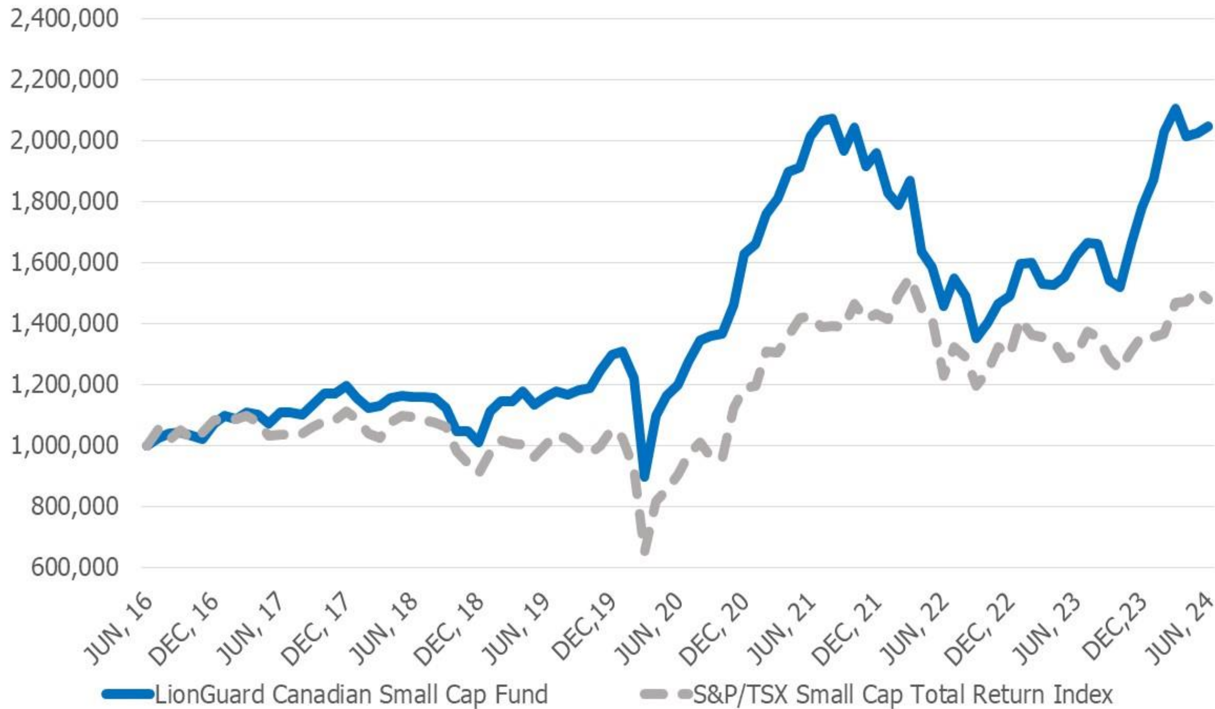
Exhibit 1: Since Inception Performance



Sources: Bloomberg, LionGuard

Market Commentary – Extreme Performance Bifurcation

The first half of 2024 is in the books, and while major equity benchmarks are widely positive, the broad participation seen in Q1 narrowed considerably in Q2. The first quarter could be described as a "rising tide lifts all boats" scenario, with all major indices finishing firmly in the green, supported by robust breadth, including new all-time highs for the S&P Midcap 400 and S&P 500 equal weight indices. Conversely, Q2 was characterized by poor market breadth and negative performance for most indices, yet a small group of large-cap growth stocks with outsized index weightings posted robust gains. Consequently, the Nasdaq-100 and S&P 500 indices had strong returns in the first half of 2024, significantly outperforming value stocks as well as mid- and small-cap benchmarks.

All but one of the major U.S. equity benchmarks (Russell Microcap Index) were in positive territory for the first half of 2024, led by the Nasdaq Composite (+18.6%) and the S&P 500 (+15.3%) indices. From there, index performance dropped off sharply. The small-cap Russell 2000 fluctuated around the breakeven level throughout most of the year before and delivered a modest of 1.3% for the first six months of the year.

Among the majors, only the Nasdaq Composite (+8.5%) and the S&P 500 (+4.3%) finished in the green in Q2. The Nasdaq-100 equal weight declined 0.2% in Q2, underperforming its cap-weighted benchmark by 8.2 percentage points, while the S&P 500 equal weight declined 2.6%, underperforming its cap-weighted benchmark by 6.9 percentage points. This 6.9 percentage point spread between the S&P 500 and its equal weight index is the third widest since the inception of the equal weight index in 1989.

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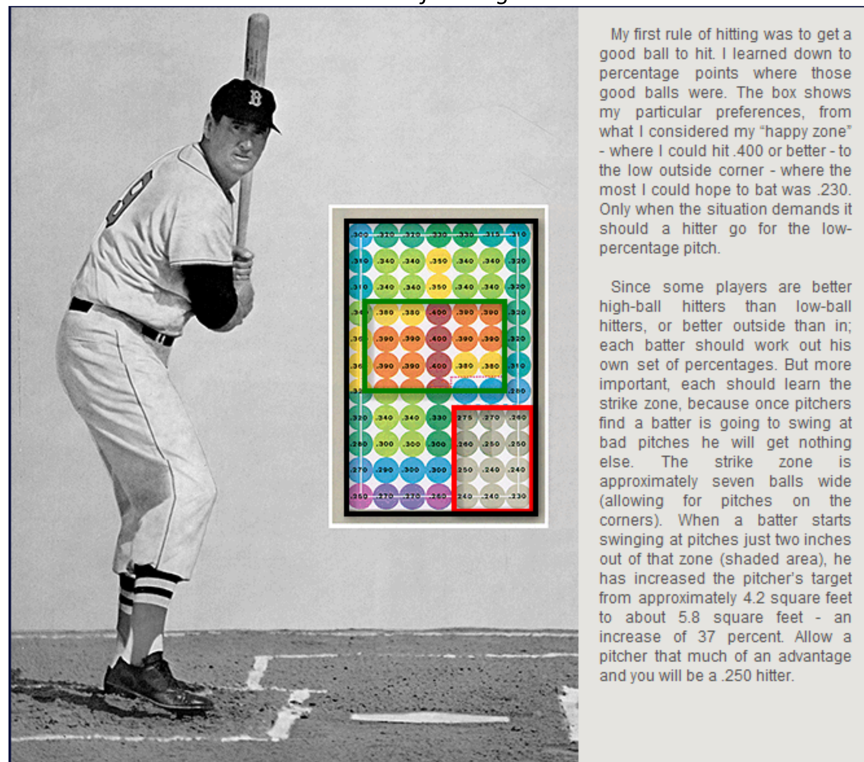
Extreme performance bifurcation highlights the robust gains by a few select mega-cap stocks, which have the largest weightings in their respective indices, with three companies alone comprising more than 20% of the S&P 500. This trend has created a significant gap between large-cap and small-cap performance, with the top ten S&P 500 members now holding a combined index weighting of approximately 35%.

”LionGuard’s Magic Quadrum” Situations for Best Risk-Adjusted Returns

“LionGuard’s Magic Quadrum” approach prioritizes investing in situations where risk-adjusted returns are the highest. One such situation is when a high-quality company, led by an exceptional management team, in an expanding industry, temporarily trades at a large discount relative to its intrinsic value. The underlying growth of the industry acts as a powerful tailwind, akin to rowing with the current rather than against it, which when applied to right securities limits downside risk while providing significant upside potential. By aligning our investments with the said parameters, we have been able to deliver some of the best risk-adjusted returns, per basis points of allocated capital. Conversely, investing in stagnant industries can be highly misleading. While such businesses may appear very attractively priced of the surface, the absence of industry growth can introduce unforeseen challenges, potentially turning seemingly safe “deep value” investments into disappointments.

We would encourage all investment professionals to clearly determine situations that constitute their Magic Quadrant. To further illustrate the importance of this, here is an excerpt and a picture from Ted William’s “*The Science of Hitting*”. This picture is framed on the desk of yours truly as a constant reminder to focus on situations where the odds of success are the highest. This framework can be applied to almost all industries and professions, with the varying degrees of success, depending on the evolution of the landscape and flexibility with application.

Exhibit 2: Ted William’s “The Science of Hitting”



Source: Internet

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Example Of A Growing Industry: Surge In Power Generation Demand

The surge in US power generation demand presents a high-conviction growth industry, driven by the electrification of various sectors, advancements in renewable technologies, and the burgeoning demand for data centers powered by artificial intelligence (AI) and machine learning (ML). Central to this theme is the urgent need to modernize and enhance the US electric grid, which is currently ill-equipped to handle the anticipated growth in demand.

The shift from traditional energy sources to electricity in heating, transportation, and other sectors necessitates a modernized grid capable of managing increased and intermittent power loads. This "electrification of everything" megatrend is a significant driver of future electricity demand. Renewable energy technologies are becoming more cost-effective, spurred by government initiatives like the Inflation Reduction Act (IRA).

These renewable sources require significant upgrades to the grid to handle intermittent supply and increased distribution needs. The rise of AI and ML has led to an explosion in data center construction, significantly increasing electricity demand. To put it in perspective, AI queries can use 30 times more energy than traditional searches, massively escalating power demand. Thus, data centers, already major electricity consumers, are expected to see their demand grow exponentially, necessitating enhanced grid capacity.

The existing US electric grid is outdated and not designed for the anticipated load growth. Investments in smart grid technologies are crucial to enable real-time supply-and-demand management, improving grid resilience and efficiency. Upgrading the grid to accommodate both renewable energy and increased consumption from data centers and electrified transportation is essential. Improving the efficiency of primary energy delivery to end customers is a practical and time-effective approach to addressing increased load demand. Furthermore, significant energy losses occur during transmission and distribution, presenting opportunities for efficiency improvements.

The transition to renewable energy has increased the demand for transformers, essential for adjusting voltage levels to match grid requirements. Shortages and price hikes, driven by increased demand for raw materials, still present pandemic-related supply chain disruptions, and geopolitical tensions, have limited utilities' ability to integrate renewable energy.

Investment Operations

During the quarter, some of our largest contributors included **Goeasy (GSY)** and **Lumine (LMN)**. On the opposite side, our detractors included **Badger (BDGI)**.

- **Goeasy (GSY) -** In previous quarterly reports, we have shared our perspectives on Goeasy. Since then, GSY has delivered outstanding results and is well-positioned, in our view, to continue expanding its loan portfolio at a robust pace while maintaining profitable underwriting standards. Although the recent announcement of the planned departure of CEO Jason Mullins is unwelcome

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news, we believe that the efficient operations of Goeasy will persist under new leadership. We sincerely thank Jason Mullins for his remarkable tenure at Goeasy, appreciate his commitment to remain on the Board, and wish him great success in his future endeavors.

- **Lumine (LMN)** - We have also extensively discussed our views on Lumine, one of Canada's most exciting compounders and a spin-off from Constellation Software. We continue to believe that Lumine's vast addressable market, their capability to deploy capital at returns exceeding 25%, and the highly favorable capital deployment environment (with significant accretive capital deployments anticipated in the second half of 2024) are not fully reflected in the stock price. Companies with exceptional long-term capital deployment prospects should not be valued based on next year's multiples.

- **Badger Infrastructure (BDGI)** – Badger Infrastructure Solutions is North America's largest provider of non-destructive excavating services, started 2024 on a strong note with Q1 revenue of $161.6 million closely matching estimates and adjusted EBITDA of $29.2 million surpassing forecasts. The company's U.S. operations showed robust performance, with revenue per truck (RPT) in the U.S. increasing by 3% year-over-year, highlighting the positive impact of its sales strategy. Despite a slowdown in Canada due to project delays, Badger's adjusted EBITDA margin improved to 18.1%, the strongest Q1 result since 2019. Fleet growth expectations remain steady, with plans for 190-220 new builds and capital spending between $90-$130 million for the year.

  Badger's outlook is bolstered by significant industry tailwinds in the U.S., including increased infrastructure spending and anticipated heightened activity following the November presidential elections. The U.S. division, which accounts for approximately 80% of Badger's business, demonstrated very impressive results with a 19% year-over-year revenue increase and a substantial improvement in EBITDA margin to 19.7%. These positive trends underscore the effectiveness of Badger's data-driven sales approach and suggest continued room for growth as new initiatives are rolled out. In contrast, Canadian operations (which account for less than 20% of the business) faced challenges with an 18% decline in revenue due to the delay of several large projects. However, the company expects sequential growth in Canada as these projects commence later in the year and into 2025.

  Although Badger has not yet proven to be a long-term compounder, under the current leadership and with strong and growing industry tailwinds, it is likely to grow its earnings per share at a faster pace going forward. Given the level of mispricing, vis-à-vis its intrinsic value, in our option Badger is a prime takeout candidate at these levels, potentially attracting interest from strategic buyers including Clean Harbors (which tried to buy the company in the past and which coincidentally just increased their Canadian subsidiaries' credit facilities) and numerous other industry players. The company's strong execution in the U.S., positive industry tailwinds, strategic growth initiatives and room for higher margins, positions Badger favorably for earnings growth for years to come. Whether the company remains public entity for long is a bigger question, in our opinion, than its earnings trajectory.

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Focus on Compounding

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 proven its merit, as illustrated by our risk-adjusted returns.

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

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