

October 2nd, 2017

You read that right, it's October. As such, this letter will be pumpkin spiced. We're not sure what that means either.

The third quarter was another positive one for the Dark Horse, bringing us to three for three for 2017. As we all know, having a strong start through three quarters doesn't mean you'll come out ahead in the end (insert obligatory Buffalo Bills reference here), but it certainly sets the fund and its investors up for a solid year.

While Q2's gains were driven primarily by one stock – **Forestar Group (FOR:NYSE)**, with the rest of the portfolio netting out to flat, Q3 had a much broader group of contributors. While **Par Technology Corporation (PAR:NYSE)** was our largest single contributor, it was not alone. Par's share price recently crossed the \$11.00 mark which saw us trim the position. It is no longer our largest holding but remains a core position. Other notable contributors were our shorts in a Florida-based insurer and **DHX Media Ltd. (DHX-B:TSX)**, as well as long positions in **VersaBank (VB:TSX)**, **Clarke Inc. (CKI:TSX)** and **Genesis Land Development Corp. (GDC:TSX)**.

Clarke and Genesis both announced special dividends in the quarter. We are big fans of special dividends, far more than regular dividends, particularly for the opportunities they present in their aftermath. Imagine a stock trading at \$10 that we believe is worth \$13. If the company pays out a \$2 special dividend, the stock will then fall \$2 and become an \$8 stock worth \$11.

If you take out your calculators you'll realize the return potential is much improved post special than before. Throw in the possibility for a bit of sloppy trading post-divvy and we often find opportunities to redeploy capital with even better return profile than our simple example would indicate. We call this our Special Dividend Re-investment Plan (or SDRIP).

In terms of detractors, there were no material blow-ups or disasters during the quarter. The biggest single factor weighing on results was our USD exposure. Having shrunk our U.S. book over the past 18 months or so, we were less impacted than we could have been by the sharp and surprising loonie rally/greenback sell-off. With the market, particularly the Canadian market, not doing much one way or the other this year we have not had to pay much of a premium for our "Oh Shit"¹ insurance.

Feasting on Scraps: Some Surprising Additions to the Portfolio

Back when we launched the Dark Horse in 2009 we were presented with a smorgasbord of tantalizing opportunities. We had our pick of the finest delicacies the market could offer – a

¹ This is the technical term for our Canadian index hedges, so named for the expression everyone will make when, and if, the market actually sells off.

veritable bounty that we could casually peruse looking for exactly what we wanted. Nothing but the finest cuts and freshest produce – all being offered to us at tremendous values.

Today, the opportunities that come our way are much more reminiscent of a *Chopped*² basket...and not one of those BS easy baskets they hand out on *Chopped Junior*. We're talking the equivalent of watermelon radish, gummy bears, tripe and sloe gin.

Not only are the pickings slim, but the clock is moving even faster than it used to. We aren't afforded the luxury of time that we were just a few years ago when opportunities would languish for months. Any opportunities that arise these days are often gone before we can even build a spreadsheet. It's as if Alton Brown showed up unannounced and took away our radishes while we were still looking for the mandolin.

One advantage we have over the overwhelmed *Chopped* contestant is that if we *really* don't like the basket we can just say, "ah, screw it" and effectively pass on that round. That being said, a true *Chopped* champion finds a way to make something out of the seemingly strange and mismatched ingredients. Most anything can be turned into a terrine, risotto or bread pudding.

Of late, we have had much more success finding opportunities amongst the leftovers and sub-prime cuts on offer. This may sound a bit surprising given the continued march higher in valuations and our oft-mentioned reticence to overpay for stocks. What we are seeing, however, is a far more bifurcated market, particularly in our home market of Canada. The relative serenity of a flat market is obscuring some material dislocations beneath the calm. It is these dislocations that have created opportunities on the long side for the Dark Horse.

We considered pairing off each of our recent additions to the portfolio with more commonly used *Chopped* basket ingredients to further drag on this narrative. Part way through a comparison of an unloved, small cap oil services stock to dandelion greens we realized that would be a bit of a challenge and more than a little tedious. Besides, the next person we meet with an in-depth understanding of the vagaries of the oil service industry *and* the know-how to properly prepare the bitter greens would likely be the first.

Instead we will stick to the more general message from the metaphor and discuss two recent additions we have pulled from the basket. They are **Trilogy International Partners Inc. (TRL:TSX)** and **Strad Energy Services Ltd. (SDY:TSX)**.

Trilogy is a former SPAC³. SPACs, for those unfamiliar with the instrument, are essentially great vehicles for investment bankers, lawyers, promoters and management teams while also being moderately interesting to hedge funds. For everyone else, they have typically been tremendous value destroyers. The inherent flaws of the structure are numerous and would require a much longer (and far more boring) discussion. For the purposes of this letter, let's just summarize by saying that

² *Chopped* is a popular cooking show where contestants are offered a basket of random ingredients and asked to make three dishes with them. The worst dish in each round is "chopped" thus eliminating that chef. It's entertaining and you should watch it.

³ SPAC stands for "Special Purpose Acquisition Company".

SPACs are something that upon first glance we would want very little to do with – not unlike popular *Chopped* ingredient geoduck.



Above: This is a geoduck (pronounced “Goopy Duck”). It is unclear if it is also pumpkin spiced.

The thing about Trilogy now is that it is an **ex-SPAC**, having gone through a successful acquisition vote. The legacy (and baggage) from the company’s genesis has weighed heavily on the stock bringing the price down from its \$10 issue price to the \$6.00 range. The underlying businesses, being wireless networks in New Zealand and Bolivia⁴, have more or less met expectations indicating that the substantial decline in value is almost exclusively due to the baggage of being a SPAC. While some of this decline is justified given the dilution from the promoter shares (a hallmark of SPACs) and the full multiple paid for the business, it is our belief that “guilt by association” has created a compelling opportunity for us to initiate a position.

As opposed to a piece of sushi-grade tuna or a perfectly ripe summer tomato, we probably can’t just present Trilogy “as is” and wait for the judges (in this case, other investors) to show their appreciation. There is work to be done to create a dish that will appeal to the market. While we think the underlying assets (particularly 2degrees⁵) are attractive, the entity clearly suffers from an overly complicated corporate structure and a conglomerate discount.

As a publicly-traded security, Trilogy would greatly benefit from the elimination of the minority interests or the divestiture of the Bolivian business. Ideally, it would pursue both strategies. Trilogy only owns 73% of 2degrees and 71% of the Bolivian business, Viva. The presence of such substantial minority interests brings with it much more complicated financial reporting, as well as additional operational complexity. Cleaning those up would go a distance towards reducing the gap between the current share price and the intrinsic value of the assets. We conservatively peg that value at between \$7.50 and \$9.00.

⁴ Yes, *that* Bolivia. Don’t worry we use an extremely low multiple on this business. The New Zealand assets derive the majority of the value in our analysis.

⁵ 2degrees is Trilogy’s New Zealand wireless carrier not the name of John and Darcy’s boy band from high school as we originally thought.

While Bolivia is enjoying a period of nearly unprecedented economic stability, that does not negate the fact that it is still Bolivia. There will be a far broader audience for a company that is the sole owner of a growing New Zealand-based wireless operator than a company that owns partial stakes in carriers located in two completely unrelated jurisdictions. Like so many failed dishes on *Chopped*, Trilogy currently lacks cohesion with assets that “just don’t go together” in an appealing fashion.

We are encouraged that the management team behind Trilogy has shown an ability and willingness to monetize businesses in the past. In addition, the Board of Directors – many of which are connected to Alignvest, the firm that sponsored the SPAC – will be incented to make something out of this dog’s breakfast. This is particularly true given the fact that Alignvest has now launched a second SPAC and will need to show some sort of positive track record if they’re to launch a third. If neither the management team or the Board acts prudently to surface value, we could see a scenario in which an activist – or SPACtivist⁶ – would appear on the scene to force the matter.

Strad is one of the first tangible examples of the Ewing Morris and Broadview investment teams working together on an actionable idea. While Strad has been a small holding in the Opportunities Fund it was not on the Dark Horse’s radar until the two firms merged. Since merging, we have collaboratively dug deeper into the file. The existing Ewing Morris team provided an understanding of the oil services industry while the Dark Horse guys brought a fresh set of eyes and a more “activist” mindset. In working together, both portfolio management teams believed it was prudent to accumulate stock – initiating a position in the Dark Horse and adding to the position in the Opportunities mandate.

We foresee two techniques that would allow Strad to once again become a popular dish with Bay Street patrons. The first is simply to wait to become fashionable again (i.e. ride out the energy cycle). For any of you who are unwilling to believe that small cap energy service stocks will ever catch a bid we would point you to the sudden rise in popularity of Poke. If kitschy 70’s Hawaiian food can become the “it” food, anything can make a comeback.

Strad now has a very clean balance sheet which, if nothing else, should allow it to survive without a major restructuring or significant asset disposals. This balance sheet strength would permit the company to live to see better days in the oil patch, assuming they ever come. To be clear, we are not betting for or against such a recovery in the energy services industry just making the point that it could happen. Strad, if nothing else, is a very cheap call option on this potential recovery.

The second path, and the one that we would certainly hope management works toward, would include a more aggressive financial engineering strategy. Such a move would not eliminate any upside from a recovery in demand for the company’s equipment rentals and matting assets. In fact, if the company were to monetize its U.S. assets at a reasonable (and we believe achievable) price of around 75-80% of book and retire stock in the context of the current price, the company would be left with even more leverage to any rebound in the operations.

⁶ Trademarks pending on both SPACtivist and SDRIP.

From a more intangible point of view, the prudent use of excess cash to retire shares as opposed to pursuing more acquisitions would alleviate the market's fear that management are poor allocators of capital. The last acquisition the company completed (and more specifically, the dilutive equity raise to fund it) left a very bitter taste in the mouth of many investors.

Just to be emphatically clear, we have not developed any more of an appetite for *the market*. We have found a select few opportunities from amongst the thousands of securities available to us. At the same time, we have trimmed some of our long standing positions as they have appreciated while maintaining our index and individual shorts. Broad market valuations continue to be supported by mindless buying indicating to us that the supposed weighing machine is "out of order". Throwing caution to the wind and materially increasing net exposure is not something we would endorse at this time. Doing so would likely leave investors highly exposed to having the value of their portfolio*wait for it*...chopped.

Anthony Hammill

Lee Matheson

Please note that Series returns will be distributed in monthly statements. If you have not accessed your statement yet, please email Matt Irwin – mattirwin@ewingmorris.com

Broadview Capital Management was formed in late 2008 by Anthony Hammill and Lee Matheson and combined entities with Ewing Morris & Co in May 2017. Ewing Morris & Co. Investment Partners Ltd. is a value driven Canadian investment firm established in September 2011 by John Ewing and Darcy Morris.

The Dark Horse is a North American long-short fund focused on small cap companies. This strategy is capital structure agnostic and seeks "equity like" returns. The investment approach is to look for structural, nuanced or temporal inefficiencies, conduct deep research and pursue company involvement as a back-up plan. Investment opportunities are reviewed through a private market value lens.

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