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FIRST QUARTER 2021 - NEWSLETTER

Dear Partner,

Here is our portfolio review and commentary for the first quarter of 2021.

Performance Review

During the first quarter of 2021, the TONUS PARTNERS FUND gross return was **10.75%**. Over the past twelve months, the Fund achieved a gross return of **64.64%**.

Since the inception of the Tonus Composite[1] in October 2007, it has achieved a compound gross rate of return of **10.18%**, compared with **7.92%** for the benchmark[2].

Portfolio Review

The Fund got off to a strong start in 2021 with a first-quarter return of +10% as the robust rally in late 2020 by our smaller-capitalized investments continued into the New Year. Over the past twelve months, since the initial COVID outbreak in March 2020, the Fund has performed marvellously well and its value is up **+65%**. Last year was our busiest time ever at Tonus. As our structure enables us to react quickly and nimbly to market volatility, a host of transactions were made to lower risk and boost our expected return. Risk reduction is mentioned first because it remains our top priority. We believe that we were able to achieve this strong performance without taking undue risk or deviating from our value approach or pursuing speculative trends.

Many of you have expressed concern over the market's overall hefty valuation of late. There is no denying that some industries have rallied without their fundamentals improving sufficiently to justify current prices. However, many companies are poised to benefit, potentially to a far greater extent than currently expected, from all the money that has been pumped into the system. In the next year and beyond, governments will be spending, consumers will release pent-up demand for everything after amassing huge savings, and businesses will invest to meet that demand.

From this standpoint, the economy should record solid growth, fueling sales and earnings. As we have explained in the past, stock prices are driven by earnings and multiples (e.g. P/E

[1] Please see page 4 for a description of the Composite.

[2] As explained in the 4Q20 letter, starting in 2021, we are presenting a benchmark which consists of 25% S&P/TSX TR + 25% S&P/TSX SmallCap Index + 25% S&P500 TR ($CAD) + 25% Russell 2000 TR ($CAD). Please see page 4 for a full description of the benchmark along with its historical returns

multiples). Generally speaking, though there may be no upside left in the market's overall earnings multiple, profits for specific companies can still grow substantially in the quarters to come. That is what we focus on and it fits well with our bottom-up, research-intensive process. Our portfolio is currently trading at 17.6x 2021 expected earnings, which is hardly expensive by this metric. Moreover, some of our in-house models point to earnings substantially above current expectations. In the long-run, the risk-adjusted expected returns for these companies look much brighter to our eyes.

Pitfall of Speculation

Specific pockets of the market are being propelled to questionable levels by reckless investment behaviour. True to our principles, we continue to shy away from such speculative investment decisions fraught with risks. While it may be less spectacular over the short term, ours is a more sustainable approach to investing over the long run.

If you remember, back in our letter of Q4 2017, we compared the Bluebirds, i.e. two companies with similar names, but contrasting business models. We wondered which BlueBird, the school bus manufacturer, **BlueBird Corporation (BLBD - $25.03)**, or the transformative gene therapy developer, **bluebird bio (BLUE - $30.15)**, would fly higher in the years to come. In the early going, the biotech darling soared above its 90-year-old industrial namesake. From 2017 to early 2018, it was up 250%, rising from $68 to $231, while the bus manufacturer that we owned climbed from $16 to $22. BLUE (biotech) then had its wings clipped by the unforgiving reality that biotech investments often afford binary outcomes. Today, its stock price is down 82% while our investment is up 40%. Spurred by investor enthusiasm for electric buses, BLBD's stock price spiked earlier this year given the company's exposure, albeit small, to electric vehicles. Sticking to our game plan, when the shares recently reached our target price of $22, we sold and placed the company back on our wish list.

Double Dipping

This same wish list came in handy in the quarter as we reinvested in **Shawcor Ltd (SCL - $5.31)**, a stock we had sold in July 2018 at $26. Since then, we continued to track its movements from the sidelines given its levered balance sheet. As downside protection remains a core element of our investment philosophy, we were ill at ease with putting a floor price on the business given the large amount of debt it carried.

This all changed last December when the company announced a deal to sell one of its divisions for $105 million, thus significantly reducing its debt. While uncertainty remains regarding demand for its pipe products and services, we were able to buy shares back at $3.50, which valued the company at $470 million.

According to our valuation, their automobile and industrial segment and their underground composite storage tank business are worth, respectively, $300 million and $250 million. Consequently, we saw very little downside risk at our purchase price. Its FlexPipe business, a market leader in composite pipes, once generated $60 million in EBITDA and still has value. Bredero Shaw, its pipe coating and protection services business, will see strong demand in the years ahead. Indeed, many offshore projects are presently being completed as the world turns to natural gas to lower carbon emissions. Today, the stock is up 50% from our purchase price and our sum-of-the-parts analysis points to more strong gains to come.

The second stock from our wish list purchased in the quarter came in the wake of the extreme speculation observed in so-called meme stocks[3] in early 2021, with GameStop being the poster child of this phenomenon. In January, this struggling videogame retailer's stock price skyrocketed from $19 to $450 as short sellers were squeezed by speculators who pumped up the price out of spite. When we looked into who were the top shareholders of GameStop out of idle curiosity, a familiar name emerged: Senvest Management. This New York hedge fund is owned by **Senvest Capital (SEC - $308.00)**, a publicly traded company headquartered in Montreal. By buying the stock, investors acquire ownership in the management company and, more importantly, a significant number of units in their hedge fund (held at the publicly traded entity level).

Investors can then estimate Senvest's book value by analyzing public disclosures on its holdings. Tonus bought shares of SEC back in 2010 after seeing that they had made a large investment in preferred shares of U.S. banks during the financial crisis. With such shares rising significantly, the gains to be recognized by its hedge fund were easy to predict.

This time around, noting that their largest position (GameStop) was hitting stratospheric levels in January, we were again confident that the value of their assets would go up significantly while, by our calculation, the stock was still trading at 60% of our estimated year-end book value (compared to 70% historically). With this large gain to be recognized only in 2021 (subsequently disclosed as more than $850 million), the upside was attractive. We currently expect their book value to be $530 per share, making the current share price very attractive. At its historical valuation of 70% of book value, the stock could fetch north of $370. The company seems to agree: it is buying back as much of its own shares as it can, based on monthly regulatory filings that we are monitoring.

Corporate Development

Great news at Tonus! We were recently awarded an institutional mandate to launch a new fund focused specifically on U.S. small-cap stocks. After a thorough review of our operations, governance, and investment philosophy, the Q.E.M.P. advisory board, which includes members from Caisse de Dépôt, FTQ, National Bank, and Mercer, selected Tonus Capital to manage some of its assets. In addition to streamlining our procedures to best-in-class levels, in concurrence with the mandate, we are delighted to report that we have hired another analyst, Jonathan Cadet, who joins our team to research U.S. small-cap stocks. This changes nothing for you, our partners in the Fund. Our focus remains finding the best risk-adjusted investment opportunities available, be they Canadian or American, small or large cap. As these new U.S. shares are sought out and analyzed, those that pass muster will be added to both Funds concurrently.

If you have any questions regarding this corporate development, please feel free to contact us.

Sincerely,

Philippe Hyn

Philippe Hynes, CFA
April 10, 2021

[3] A meme stock is a stock that has seen an increase in volume not because of the company's performance, but rather because of hype on social media and online forums like Reddit

For reference, find below the historical gross returns of our North American equity strategy:

Tonus Composite Performance – As of 03/31/2021

	Tonus Composite (Gross Returns)	*Index*
3 months	10.75%	8.47%
6 months	34.37%	25.81%
1 year	64.64%	62.35%
3 years	8.59%	12.35%
5 years	8.31%	12.86%
10 years	11.78%	9.92%
Since Inception	**10.18%**	**7.92%**

Source: FactSet Research Systems, Inc.
Returns are gross of fees and are calculated using a time-weighted rate of return. Past performance is not indicative of future results. Returns greater than 1 year are annualized. Benchmark consists of 25% S&P/TSX TR Performance + 25% S&P/TSX SmallCap Index performance + 25% S&P500 TR Performance ($CAD) + 25% Russell 2000 TR Performance ($CAD). S&P500 TR ($CAD) and Russell 2000 TR ($CAD) are adjusted for US dividend withholding taxes

Please note that Tonus Capital serves as the investment manager for the Tonus Partners Fund. Historical returns shown are for the Tonus Partners Fund. Prior to January 2016, the returns are from the Tonus Select Fund from October 2007 to October 2011 and from the weighted average of all managed accounts (including those accounts no longer with the firm), using the same strategy implemented in the actual Tonus Partners Fund, from November 2011 to December 2015. Although the structure and the name of the investment product changed, it had for the entire period the same investment mandate, objectives, strategy and benchmark. Past returns are not necessarily indicative of future performance. At any moment, the portfolio composition may vary widely from a the benchmark. The benchmark was changed to the current format starting in 2021. Prior to 2021, the benchmark presented was calculated by taking 50% of the performance of the S&P/TSX and 50% of the performance of the S&P500 in Canadian dollars. Would you like to see the historical benchmark returns, please follow this link. Returns are gross of fees and in Canadian dollars. Any investment in the Fund is speculative and involves substantial risk, including the risk of losing all or substantially all of such investment. This document is not to be construed as a public offering of securities in any jurisdiction in Canada and is for informational purposes only. While the information and material in this document are believed to be accurate at the time they are prepared, Tonus Capital Inc. cannot give any assurance that they are accurate, complete or current at all times. The Tonus Composite was created October 31st, 2007 and the Tonus Partners' Funds was created January 4th 2016.