RIVEMONT

Microcap Strategy - Q3 2021

October 21st, 2021

Rivemont is the portfolio manager responsible for the investment decisions of the Rivemont MicroCap Fund.

Dear investors,

We hope you enjoyed the summer. In microcaps, summertime typically is a slower period as retail investors take vacations and spend time away from their computers, which leads to a decline in activity and trading volumes. This summer, it literally felt like nobody was around. The result was a very challenging summer for Canadian microcaps in general. Every motivated seller could make stocks decline sharply due to the lack of buyers on the other side. Our approach in this kind of market is to be patient and avoid trading for the most part unless we find some exceptional bargains to take advantage of.

Let's now look at some metrics about the fund, as at September 30th, 2021:

- $15.8 million in net assets under management.
- 90% was invested and 10% remained in net cash.
- 30 positions. The largest represented 15.6% of the portfolio.
- The top 5 positions represented 42% of the portfolio.
- Fund unit value of $9.00*, for an overall return of - 8.9%** during the quarter and - 4.7%** year-to-date.

* Series A units (MAJ720)
** **Net return after all fees**.

To compare our performance during the third quarter (July 1st to September 30th, 2021), we use the S&P/TSX Small Cap Index as our benchmark. This index reflects the small cap market performance in Canada. To get an overview of the US market performance, we refer to the LD Micro Index. Here is the performance of the two indices during the quarter:

Q3 2021 Returns	
S&P/TSX Small Cap	-2.5%
LD Micro	-9.6%
Rivemont MicroCap Fund	-8.9%

After a phenomenal first half of the year for both indices, we saw a general decline across the board in the third quarter. The lack of liquidity particularly impacted some of our positions, leading to sharp declines on low volumes. To give you an extreme example, one day during the quarter, one of our positions declined by over 40%, or an $8 million loss in market cap, on a single sell order of $5,000 at the market (it recovered since).

In some instances, we tried to act as a liquidity provider by putting large bids at low prices on some of our most illiquid positions, hoping to scoop up some bargains. This strategy worked particularly well on two stocks that strongly rebounded after we bought at or very near the bottom during the summer.

Periods of underperformance will be inevitable if we pursue a contrarian and differentiated strategy to achieve market-beating returns over the long term. Although we are certainly not pleased with the fund's year-to-date performance, the market value of our positions should eventually converge to their intrinsic value over time, which we believe will provide very attractive returns to long-term investors.

Long-term View

In a recent podcast, Howard Marks talked about a client who had been managing his portfolio for 14 years while never earning returns above the 27th percentile or below the 47th percentile, which means he was a little better than average every year but never in the best quartile. Do you know where that put him for the total 14 years period?

4th percentile. This client was literally one of the best in the world just by being a little better than average consistently for a long time.

Morgan Housel further commented on this example that "so much focus in investing is on what people can do right now, this year, maybe next year. [...] But like evolution, that's not where the magic happens. If you understand the math behind compounding you realize the most important question is not "How can I earn the highest returns?" It's, "What are the best returns I can sustain for the longest period of time?" That's not to say good returns don't matter. Of course they do. Just that they matter less than how long your returns can be earned for."
Brilliant.

Since we started the fund in January 2018, large-caps have performed exceptionally well. The S&P 500 almost doubled in the last five years and nearly quadrupled in the last ten years. Those are astonishing returns.

Meanwhile, the S&P/TSX Small Cap is up a total of 32% in the last five years and 67% over the last ten years. It's been a tough market for Canadian small-caps in the last decade. Starting today from comparatively low valuations, could Canadian small-caps be poised for a decade of overperformance over large-caps? Only time will tell.

As SmallCap Discoveries recently wrote in a blog_post about Canadian microcaps, "it's clear that since February 2021, the market has been in a long, boring, and protracted down-trend. The combination of dropping share prices and improving fundamentals is producing the perfect storm. After a year of bludgeoning, valuations in select microcap stocks have become or are becoming cheap. Not only are we finding discounts, but cheap valuations on high-growth companies – which we believe is an even greater mispricing opportunity."

We wholeheartedly agree. We have also seen some seriously mispriced opportunities in recent months. We can't predict what the future will hold, but we certainly like the market we find ourselves in.

Before we wrap up this section, let us show you how we have fared since the inception of the fund almost four years ago against this backdrop of large-cap dominance:

Compound Annual Return (2018-2021)	
S&P/TSX Small Cap	6,2%
LD Micro	9,7%
S&P 500 (dividends reinvested)	15,6%
Rivemont MicroCap Fund	17,2%

In the words of Morgan Housel again, "excellent for a few years" is not nearly as powerful as "pretty good for a long time."

And it turns out that "pretty good for a long time" is exactly what we're aiming for.

New Largest Position

Microbix Biosystems (TSX: MBX) became our largest position during the quarter after we determined the stock was extremely undervalued and decided to accumulate shares steadily. Microbix is a company that Mathieu Martin, our analyst, has been following for almost eight years. The company has struggled for many years to grow its revenues, improve its margins, and ultimately generate meaningful profits. Fortunately, this is now changing in a big way.

Following the appointment of a new CEO in 2017, the company's focus has evolved with a new emphasis on developing innovative and proprietary new product lines that could generate significant growth at higher margins – and it's working. We believe that Microbix shares can double in the coming year and could be worth much more in the longer term. The company is currently our highest-conviction investment idea.

We recently shared our complete investment thesis on the Espace MicroCaps blog to accelerate the discovery cycle and help investors understand the potential we see in Microbix.

You can read our Microbix investment thesis here: Espace MicroCaps Top Picks – Microbix Biosystems (MBX.TO)

Espace MicroCaps is a community of microcap investors dedicated to sharing educational content and investment research on select microcap companies. It supports our goals of developing a broader network and showcasing interesting investment ideas.

Outlook

At a fundamental level, most of our portfolio companies posted excellent financial results during the quarter, and we believe most of them continued to increase their long-term intrinsic value. Even though those improvements are not reflected in the short-term share price performance, we remain optimistic about the prospective returns that our portfolio could yield if we remain patient with the companies that are executing well against our expectations.

We are cautiously optimistic that the worst is behind us in terms of illiquidity and lack of buyers in the Canadian microcap market this year, as we have seen liquidity increase in recent weeks and many stocks resumed their upward trends. We hope to finish the year on a solid note.

As usual, don't hesitate to call or email us if you have any questions regarding your investments or if you wish to refer friends and family members who are looking for a profitable alternative strategy for their portfolio. The minimum initial investment in the fund is $100,000.

Thank you for your trust, and we look forward to our next communication!

Rivemont Investments

Portfolio Manager of the Rivemont MicroCap Fund

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Martin Lalonde
President
160, boul. de l'Hôpital, suite 202
Gatineau, Quebec, J8T 8J1
Tel: 819-246-8800 or 1-844-318-8800
martin.lalonde@rivemont.ca

Jean Lamontagne
Vice President, Business Development
465, rue Saint-Jean, suite 509
Montréal, Québec, H2Y 2R6
Tel: 438-387-3300
jean.lamontagne@rivemont.ca

www.rivemont.ca

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