RIVEMONT

Microcap Strategy - 2021 Annual Letter

January 17th, 2022

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

Dear investors,

First of all, we wish you a Happy New Year. May this year be filled with health and prosperity!

We will start this letter with good news about our team at Rivemont. In December, we were pleased to announce the appointment of Mathieu Martin, who was the senior analyst for the Rivemont MicroCap Fund, as its new portfolio manager.

Mathieu is an important addition to our portfolio management team, having been an integral part of the success of the microcap strategy since its inception in 2018. Over the past eight years, he has developed his expertise and an extensive network of contacts that allow him to spot the best microcap investment opportunities in North America quickly. Mathieu brings with him an exceptional wealth of knowledge, having participated in dozens of conferences and met hundreds of company management teams over the years. He also holds the CFA designation since November 2020.

Mathieu will continue to work closely with Philippe Lapointe, the Rivemont MicroCap Fund analyst, who proved to be a key addition to the team a year ago.

Let's now take a look at some of the fund's metrics on December 31, 2021:

- $16.1 million in net assets under management.
- 95% invested and 5% in cash.
- 32 positions. The largest represented 20.1% of the portfolio.
- The top 5 positions represented 41.5% of the portfolio.
- Fund unit value of $9.17*, for a + 1.9%** return during the quarter.

- Return of - 2.9%** for 2021.

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

To compare our performance during the fourth quarter (October 1 to December 31, 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:

Q4 2021 Returns	
S&P/TSX Small Cap	3.0%
LD Micro	-8.9%
Rivemont MicroCap Fund	1.9%

We saw a substantial divergence between the Canadian and US markets during the fourth quarter. Fortunately, the Rivemont MicroCap Fund ended the year with a respectable performance by remaining closer to the Canadian index (S&P/TSX Small Cap) than the US index (LD Micro). The fund's portfolio currently has an exposure of approximately 5% to the US market.

Let's continue by looking at the year as a whole:

2021 Returns	
S&P/TSX Small Cap	20.3%
LD Micro	18.1%
Rivemont MicroCap Fund	-2.9%

Let's be honest, 2021 was a challenging year for our strategy. After seeing the fund go up more than 15% in the first few months, it slowly drifted back down for most of the last nine months. In hindsight, we could have taken more profits in February and March on certain stocks that were getting richly valued. However, it is easier to look back and identify the perfect moment to sell than to do it in real-time, with all the uncertainty that entails. All in all, we are comfortable with our decision to hold high-quality companies in the portfolio despite valuations starting to get elevated.

Another important element that led to the underperformance against the indices is sector exposure. The Rivemont MicroCap Fund is 49% exposed to the technology sector, while the Canadian and US indices have an exposure of 5% and 13%, respectively. Among the sectors present in the indices that have performed particularly well, we can think of energy and basic materials, two sectors we have little or no exposure to.

What is important to take away from this challenging year is that, unfortunately, our strategy and investment style were not in favor in 2021. That said, we have the firm conviction that the strategy is still the right one to pursue over the long term, given the results we have achieved historically.

To give you a longer-term perspective of the performance relative to the indices, here are the annualized returns since the fund's inception in January 2018:

Compound Annual Return (2018-2021)	
S&P/TSX Small Cap	6.6%
LD Micro	6.5%
Rivemont MicroCap Fund	16.6%

As we have mentioned several times in previous letters, we encourage investors to keep an eye on the long term in both good and bad years. Periods of underperformance are incredibly frustrating but necessary and inevitable in pursuing a differentiated and successful long-term strategy.

Now, how can you hold on for the long term when the primary indicator you can follow is the fund's performance, which has not been positive in 2021?

Here are, in our opinion, the three main assumptions that justify an investment in the Rivemont MicroCap Fund:

1. **The microcap market as a whole will eventually outperform large caps.**

For many years now, we have witnessed a dominance of large caps, particularly the "FAANG"[1] companies that keep propelling the US indices upwards thanks to their exceptional performance. However, remember that microcaps have consistently outperformed large caps over the very long term. The trend we are currently seeing should reverse at some point in the future and give way to microcap outperformance.

2. **The microcap market presents many opportunities for a good active manager to stand out.**

The Canadian market has more than 4,400 listed companies, of which more than 3,000 are considered microcaps (market capitalization of $300 million or less). While large financial institutions managing billions of dollars focus on the most mature 1,000 to 1,500 companies, the 3,000 microcaps are left to fend for themselves in the hands of retail investors and smaller investment funds like ours. The market is full of inefficiencies and opportunities for a team that does its research rigorously and full-time. The microcap sector is an area where the probability of beating the market is higher.

3. **Rivemont is an active manager that can beat the market.**

This assumption is undoubtedly the most crucial one. As there are few certainties in this world, we once again insist on the performance history of the past four years as a demonstration of our ability to beat the market.

It is also essential for you to be comfortable with the portfolio management team and our investment philosophy, namely, to hold a concentrated portfolio of high-quality, high-growth companies. In this regard, the following section aims to explain our research process and some of our investment criteria.

Research and analysis process

In its simplest form, our investment strategy is to discover high-quality companies as early as possible in their development. For us, a high-quality company meets the majority of the following criteria:

- Strong revenue growth (over 30% per year)
- Profitable or demonstrating a clear trajectory towards achieving profitability
- Enjoys strong competitive advantages that will continue to improve
- Is predictable and easy to understand
- Is managed by an excellent management team and an experienced board of directors

When you think of the microcap market, you might imagine very small companies that don't have a proven business model, don't generate a lot of revenues or profits, have poor competitive advantages, and that are run by questionable management teams.

Well, you would be right because that is precisely what reality looks like.

We consider that less than 5% of companies listed on the Canadian market meet or could one day meet our investment criteria. Therefore, it is essential to be extremely selective and strict in our standards and our research process to avoid pitfalls.

For each company that we analyze, we first try to identify if it meets the criteria we previously listed. If so, we will investigate further by looking at the company's history, developing a financial model, speaking with the management team, testing the product or service, and contacting other investors or industry experts to ensure we fully understand the opportunities and risks.

Our financial model always comes with what we call a "conviction level," a list of sixteen criteria to which we award between one and four points each, for a total score of thirty points. This exhaustive analysis leads us to scrutinize the experience and history of the management team, the composition of the board of directors, the company's competitive advantages, its financial health, and much more.

We add a score of -5 to 5 points for the company's potential return according to our current estimate of its intrinsic value. A score of -5 represents a wildly overvalued company and penalizes its total score, while a score of +5 means a very undervalued company with high return potential.

Each company's score is centralized into a dashboard that allows us to rank and compare the various available opportunities, both in our portfolio and on our watch list. The objective is always to allocate our capital where the prospects are the most favorable.

At the risk management level, we also perform a forty-five-point risk analysis for each company to ensure we understand what could go wrong and determine our comfort level with those risks. Our list of risks covers financial health and capital structure, operations, industry, financial modeling, environment, social, and governance.

These tools were developed over the past few years and guide our decision-making process without necessarily creating formal rules to follow. Fundamental investing, especially in microcaps, is often more art than science. By combining a rigorous analysis process with the flair and know-how of our team, we can recognize good investment opportunities more easily.

In general, we aim to invest around 75% of the fund's capital in fifteen high-quality companies that have passed through all the filters listed above. We also target keeping about 10% in cash to remain nimble and act quickly when an opportunity arises. Finally, the last 15% is invested in 15 to 20 earlier-stage companies carrying more risk but presenting a higher return potential if successful. In some instances, we might want to buy a position early if we believe that the risk/reward profile is favorable. These positions add to the volatility but also the potential returns of the fund.

Outlook

As Rivemont grows, our team and our resources also increase. One of our goals for 2022 is to increase the frequency of communications with our clients to keep you informed about your investments. The quarterly letter will continue to exist in its current form, but we will also start producing monthly video capsules in February. These capsules will allow us to comment on monthly performance, share important news about our portfolio companies, talk about the trends we see in the market, and provide insights into our investment philosophy.

We believe that interesting opportunities abound right now in the current microcap market, given the challenging year we have just experienced. Most of the companies we own or follow made fundamental progress in 2021, but their stock prices fell. Compared to the start of 2021, we can now buy stronger companies for lower prices.

Does an array of bargains mean the market will go up next month? Not at all. However, does this position us favorably for solid long-term performance? In our opinion, certainly.

In closing, 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.

We hope to continue growing your portfolios alongside ours for many years to come, and we look forward to our next communication!

Rivemont Investments

Portfolio Manager of the Rivemont MicroCap Fund

[1] “FAANG” is an acronym that refers to the stocks of five prominent American technology companies: Meta (FB) (formerly known as Facebook), Amazon (AMZN), Apple (AAPL), Netflix (NFLX); and Alphabet (GOOG) (formerly known as Google). Source: Investopedia

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