EWING MORRIS
INVESTMENT PARTNERS LTD.

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May 1, 2019

Dear Limited Partners,

The Broadview Dark Horse LP ended the quarter up 1.21%.[1]

In the quarter we initiated or topped-up several short positions while modestly reducing a handful of long positions. In effect, the fund is positioned roughly back to where it was prior to the large market drawdown in late 2018, where we temporarily increased our net long exposure given the decent values on offer at the time.

The most substantial investment that occurred in the quarter was the fund's investment in the convertible preferred shares of **Centric Health Corp (CTSE: CHH).** The preferred shares mirror a similar investment we made in December 2018 in **exactEarth Ltd's (TSX: XCT)** convertible debentures. The Centric preferred shares offer a 9.0% dividend and are convertible into common on a one-for-one basis. They are convertible at $0.40 per share upon maturation, have meaningful call protection and provide a nominating agreement between Ewing Morris and Centric. Ewing Morris partner, John Ewing, has joined the Centric board of directors and we are excited to have him assist Centric in executing on its strategic plan to become the leading institutional pharmacy in Canada.

On the short side, we recently re-initiated a position in a company we have successfully been short twice in the past. We know the file extremely well and see no reason for a recent recovery in the market's enthusiasm towards it. If anything, we believe there is even less margin for error given the company's more stretched balance sheet. We believe that both our track record in betting against this name, as well as that of its management teams in downplaying and obscuring the company's issues, will remain intact.

Three days after the quarter ended, we marked the fund's tenth birthday. We are proud of the track record that we have put up – achieving a 10.5% compound annual growth rate (CAGR) with a standard deviation of roughly 6% and virtually no correlation to any major North American equity index. We have been able to achieve our goal of growing and protecting your capital through varying market conditions (albeit mostly "up" conditions).

Given the fund's recent anniversary, we thought that we would take a moment to contrast the investment opportunity set that we see before us today versus what we saw in 2009. Over this ten-year span there have, quite clearly, been a number of fundamental changes in the investment landscape, as well as an evolution in how we approach and adapt to these conditions.

[1] Broadview Dark Horse LP returns are net of fees and are for the consolidated series.

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April 3, 2009 vs. April 3, 2019: End of Days vs. the End of Down Days

Let us harken back to the spring of ’09 – a much simpler time when two young-ish investment professionals set out to launch their own fund. My, how times have changed since then. Imagine trying to convince the kids of today that Donald Trump was once just a two-bit snake oil salesman pitching racist birther theories and BS university degrees, as opposed to a two-bit snake oil salesman who now happens to be the most powerful man on earth. Geez, we’re old enough to remember when you could go to jail for selling weed, rather than getting to ring the opening bell of the Toronto Stock Exchange (TSE). So much has changed in the world. Ten years feels like an eternity. We can hardly remember all those days, long ago, when Coldplay didn’t suck, and Tiger Woods did.

From a market context, the most obvious contrast between 2009 and 2019 is the overall market valuation. 2009 was a time of great uncertainty, as the financial crisis of the preceding years left investors deeply weary. This broadly-held weariness expressed itself in hugely discounted corporate values. As contrarian-minded deep-value investors, we were happy to step in and make bets on what appeared to us to be highly asymmetrical risk/reward situations. So much so, that we struck out on our own to do so.

As the consensus view changed from one of great uncertainty to one of confidence in a “normalization” process within the economy, stock prices ran aggressively and by about 2014, in our view, had largely recovered any meaningful discount that remained from the financial crisis. Since 2014, the markets have benefitted massively from a recovering global economy and central bank policy that has been accommodating, to the point of ridiculousness. Investors have therefore enjoyed a prolonged “Goldilocks” period of ultra-low interest rates and an implicit Federal Reserve “put” which has driven tremendous multiple expansion for the equity market and spread compression for the corporate credit market.

Another important difference between 2009 and 2019 is the rise of index investing and the impact it has had on active investing strategies. It is certainly no secret that index products offer a less expensive way for investors to access market beta than through the mutual funds that dominated retail fund flows throughout the 1990s and early 2000s. Truth be told, they are a demonstrably better option for investors when compared to many high-fee, long-only, plain vanilla mutual funds.

Exchange-traded funds (ETF) market share in North America has risen appreciably and, perhaps as importantly, the competitive response of mutual fund companies and other “active” managers has been to consolidate themselves and decrease the number of traditional funds on offer. The result of both the ETF boom and the active managers’ response to the ETF boom has been a tremendous concentration of capital chasing investment opportunities in large, liquid securities. More importantly for the Dark Horse and its limited partners, this dynamic has conversely led to a dearth of capital chasing smaller, less liquid opportunities.[2]

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[2] Source: Ernst &Young Global ETF Survey 2017. BMO ETF Outlook report as at January 31, 2019 estimates ETF assets under management to increase to US$10tn by 2024 from 2018 assets under management of US$3.3tn.

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The bookshelves around our office are filled with books on value investing strategies written as far back as Benjamin Graham and David Dodd's Security Analysis in 1934. The overarching process in value investing is to arbitrage human psychological biases by buying out-of-favour (aka "cheap") securities and selling them when sentiment has changed to being more optimistic. There was a clear "mean reversion" effect in place and the strategy earned most capable practitioners above-average rates of returns over the many decades between 1934 and, perhaps, 2014.

Capital markets, being giant arbitrage mechanisms, lead to efficiency in prices over time as participants seek to maximize risk-adjusted returns. As such, it is perhaps not a surprise that the traditional value investing approach has lost its edge over time. However, the degree to which the relationship has broken down, especially in Canada, has been striking.

My view, and that of our firm as a whole, is that the massive swelling of ETF assets under management, which charge minimal fees and therefore require substantial assets in order to make economic sense, combined with the response from many active managers to scale in order to compete on fees with the ETFs, has simply obliterated the amount of capital willing to come in and arbitrage "value" securities. Thus, in spite of the broad market being materially higher than it was 10 years ago, it is still very possible to find value-laden small-cap securities. The issue, of course, is that in 2019, it is not at all clear that identifying undervalued securities is, in and of itself, all that helpful without a mechanism to get them un-undervalued. As such, a passive small-cap value investor in Canada with a basket of statistically dirt-cheap securities is, in our view, likely to still be holding a basket of dirt-cheap securities in 1/3/5/10 years' time.

We've recognized the existence of this conundrum and adapted our process over the past few years. Generally speaking, nothing makes it into the Dark Horse portfolio today without a view on what we call "multiple ways to win". By this we mean that we cannot rely on being "bailed out" of our investment through the mean reversion process, and that each investment needs to be able to generate a suitable internal rate of return (IRR), even in a situation where the mean reversion process does not function.

Luckily, the public securities markets are not the only markets in which corporate assets can be transacted. To paraphrase value investing legend Martin Whitman, there are multiple markets. These include: the market for Leverage Buyouts (LBOs), the market for recapitalizations and the market for strategic buyers and sellers (collectively the private market). When the delta between valuation in the public markets and private markets diverges there is an arbitrage opportunity. It is this arbitrage opportunity that has benefited us hugely, as sophisticated private market buyers have acquired portfolio holdings of ours at substantial premiums over their recent public market valuations.

In the past few years we have experienced this with several portfolio companies. Just a few of these examples are the acquisition of **Enercare Inc**. **(TSX: ECI)** by Brookfield Infrastructure (53% premium), the acquisition of **Onvia Inc. (NASDAQ: ONVI)** by Deltec (100% premium) and the acquisition of the majority of **Forestar Group Inc. (NYSE: FOR)** by D.R. Horton (37% premium).

The fact remains, however, that boards of directors and management teams of publicly-traded companies, in many circumstances, do not have meaningful incentives to close the valuation gap between public and private markets. For virtually all directors and for many managers, such a transaction results in the cessation of an income stream with only modest compensation for foregone future income. This brings us to the most potent arrow in the Dark Horse quiver which is engagement with investee companies on ways to enhance value. People used to refer to this type of action as "activism," but we feel that it should be a regular activity of any engaged equity owner.

We have engaged with many investee companies over the past few years with a high rate of success. We have encouraged and assisted several portfolio companies that were looking to access additional capital to grow organically or inorganically, including **Medworxx Solutions Inc**. **(TSE: MWX), exactEarth Ltd**. **(TSX: XCT)** and **Centric Health Corp. (TSX: CHH)**. We have also engaged with several portfolio companies where we felt that intrinsic value would be maximized through a sale of the business. Examples include the sale of **AlarmForce Industries Inc**. **(TSE:AF)** to BCE (71% premium), the sale of the assets of **WesternOne Inc. (TSE: WEQ)** to United Rentals (~45% premium), and sale of **RDM Corp. (TSE:RC)** to Deluxe Corp (20% premium).

Another way in which we have shifted our strategy to achieve desired IRRs, despite a generally expensive market, is to find situations where we are at least "paid to wait" for a catalytic event to come along. This is reflected in recent transactions such as our convertible preferred share investment in **Centric Health Corp. (TSX: CHH)** and our convertible debenture position in **exactEarth Ltd (TSX: XCT)**.

In both cases we are senior on the capital structure to the common shares, and therefore do not participate in the upside from "dollar one" but are compensated through dividends or interest payments while retaining exposure to equity upside through the conversion features of the securities. These opportunities would not have been available to the 2009 version of the Dark Horse, or its LPs, as we lacked the capital, connections and specific know-how to execute on them. The ability to take advantage of the gaps in efficiencies in securities that rank above common shares in a company's capital structure has allowed Dark Horse to expand its investable universe, which should benefit returns over the longer-term.

The long book today includes roughly 25% in credit instruments or preferred shares and another 15% where the expected IRR of the investment is derived meaningfully from running yield. The fund continues to hold securities such as the preferred shares of **Atlantic Power Preferred Equity Ltd. (TSX: AZP.PR.A)** and the preferred shares of **GMP Capital Inc. (GMP.PR.B) (TSE: GMP)** which offer tremendous asymmetrical risk/reward given the potential upside in the event there is a change of control transaction. In either case, the running yields represent roughly 8% while one waits for a catalytic event to occur which could provide significant upside for these securities.

There will doubtlessly be changes to market dynamics in the next decade and we will keep our eyes and ears open and adjust accordingly. While we will never deviate from the view that the best risk-adjusted way to earn returns is to acquire deeply discounted securities, the way that we implement that view needs to reflect the ever-changing nature of the public securities markets, as well as our own learnings and evolution.

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To all our limited partners, and especially to those who have been with us since the fund's inception, we greatly appreciate the support and the trust that you have placed in us to protect and grow your hard-earned capital. There has been sizable growth in the fund, as well as our own understanding of the markets and of ourselves, (strengths, weaknesses, biases etc.), as professional investors. We come to you ten years after launching the fund with this knowledge in hand, leaving us even better-suited to take advantage of the unique opportunities – long and short, equity and otherwise – that the coming decades present us.

Until next time,

Lee Matheson

About Ewing Morris:

Ewing Morris & Co. Investment Partners Ltd. is a value driven Canadian investment firm established in September 2011 by John Ewing and Darcy Morris. Our aim is to achieve preservation and growth of capital for our Limited Partners by focusing on inefficient markets. We do this by relying on fundamental analysis, high conviction and the use of flexible capital. We manage strategies with a focus on small and mid-cap companies. We manage investments for individuals as well as charitable organizations, institutions and corporations.

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