

FINDING THE BOYD GROUP OF THE 2020's

HEDGE FUNDS (Inception)	JANUARY 2020	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund** (March 2006)	-1.1%	-1.1%	10.3%
Venator Select Fund (September 2013)	2.0%	2.0%	14.5%
S&P/TSX Total Return (March 2006)	1.7%	1.7%	5.9%
Russell 2000 (March 2006)	-3.2%	-3.2%	7.3%
S&P Toronto Small Cap (March 2006)	-2.9%	-2.9%	1.6%
S&P 500 (March 2006)	0.0%	0.0%	9.1%
Merrill Lynch High Yield Index (August 2008)	0.0%	0.0%	8.0%

ALTERNATIVE MUTUAL FUNDS (Inception)	Jan 2020	YTD	1-YR	3-YR	5-YR	10-YR
Venator Alternative Income Fund*** (January 2020)	0.9%	0.9%	7.1%	5.5%	4.7%	9.2%

*As of January 31, 2020

**Venator Investment Trust is also available as an extension of the Founders Fund strategy; its monthly performance mirrors the Founders Fund, and it is eligible to be held in both registered & non-registered accounts

***Performance data prior to January 24, 2020 relates to Class F Units of Venator Income Fund, which was distributed to investors on a prospectus-exempt basis in accordance with National Instrument 45-106

The 2020's got off to an interesting start with a display of what may lie ahead for the coming decade. While the Coronavirus has taken all the headlines, this is more than likely a temporary phenomenon that will create short-term buying opportunities, as opposed to any real long-lasting economic disruption. The real story, in our opinion, was weakening economic numbers; not weak enough to trigger fears of a recession, but more than enough to indicate a slowing economy. What remains interesting is the continuing outperformance of large caps over small caps which were down 3% on the month, on both sides of the border. Admittedly, I am not sure what can break this cycle.

Last decade, the 2nd best stock in Canada was Boyd Group Services Inc. (TSX:BYD), which saw its share price move from \$5 to \$200, a 40X return. Fortunately for Venator Capital and our clients, we enjoyed a front row seat to Boyd Group, buying initial shares back in 2009 at around the \$3.50 level, and subsequently selling our last shares near the end of 2017 around the \$100 level (such is the fate of the value investor, who often sells 'too early' to the momentum buyer). There were a number of illustrative factors that made Boyd Group a great investment over the past decade that can help one identify the next 20-bagger, and indeed we have several holdings that appear to be in the early or middle innings of Boyd-like run. These characteristics include:

- **A great CEO/capital allocator:** Without a doubt, you need good management to achieve what Boyd Group has done; namely, increase earnings by 20x over 10 years through both organic and acquisitive growth. That said, a major factor behind Boyd's success related to a disciplined multi-year acquisition spree that only doubled the number of shares outstanding while increasing adjusted net income by 20x. This approach resulted in a 10-fold EPS increase, as our original 2010 EPS estimate was \$0.60 per share and 2020 normalized EPS is expected to be close to \$6.00.
- **A not-so-cyclical business:** Nothing interrupts a great run in a cyclical company like a downturn in a cycle. This explains why people pay a premium for less cyclical businesses, like technology and distributors, than for highly cyclical businesses, where downturns hurt both revenue growth and profit margins. While auto collision cycles ebb and flow, it's a muted cycle where top line downturns are sub-5% (and can be expanded through) and where profit margins don't move in dramatic fashion.
- **A growth opportunity:** To be clear, you don't need a great growth tailwind, but you do need some growth. You can get 10-baggers from turnarounds and cyclicals, but for 20+ baggers you can't have a secular anchor or cyclical time bomb getting in the way. Auto collision repair is a 3% grower at best, which Boyd supplemented with an 8%-12% organic/acquisition growth expansion model.

- **A super low valuation (preferably obvious rather than speculative):** When we originally bought Boyd, it traded at 5x earnings; today, it trades at 35x earnings. In other words, 75% of the share gains can be attributed to multiple expansion. Admittedly, there aren't a lot of 5x earnings situations out there today that don't have secular or balance sheet challenges, but it does illustrate the benefits of getting in early when companies are still undiscovered small caps.

We actually have a number of similar low-cyclical, healthy growers with incremental acquisition opportunities in the Funds today. While today's market doesn't offer up a lot of 5x earnings opportunities, more neglected pockets of the market are offering valuations for great companies in the 10x-15x earnings range which still have substantial multi-year upside potential. Despite markets at record highs, we see our share of potential multi-year home runs out there and look forward to capitalizing on them.

One final note, as existing investors of Venator Income Fund are already aware, we recently filed a prospectus for Venator Income Fund and renamed it to reflect its new 'liquid alternative' status – Venator Alternative Income Fund. The mandate and underlying strategy remain identical to the previous OM Fund, and the fees associated with Class A & F units are unchanged. However, as a prospectus offering, Venator Alternative Income Fund is now available to a much broader investor base and will strive to build on its impressive 11-year track record.

As always, we reserve the right to change our mind!



Brandon Osten, CFA
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This commentary is intended for informational purposes only and should not be construed as a solicitation for investment in any of the Venator Funds.

The Venator Hedge Funds may only be purchased by accredited investors with a medium-to-high risk tolerance seeking long-term capital gains. Please read the Offering Memorandum for each Hedge Fund in full before making any investment decisions. Prospective investors should inform themselves as to the legal requirements for the purchase of securities. All stated Venator Hedge Fund returns are net of fees. It is important to note that past performance should not be taken as an indicator of future performance.

Commissions, trailing commissions, management fees and other expenses all may be associated with investing in any of the Venator Alternative Mutual Funds. Please read the prospectus and Fund Facts relating to each Alternative Mutual Fund before investing. The indicated rates of return of the Venator Alternative Mutual Funds are the historical annual compounded total returns, including changes in share or unit value and the reinvestment of all dividends or distributions, and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently, and past performance may not be repeated.