Small-cap funds review

January 31, 2019

By Greg Dean

I had the chance to speak with many advisors in the closing months of 2018. One of the guiding principles at Cambridge is to be transparent and available to our clients to discuss issues, especially when results are disappointing. We also continue to have high ambitions for our team's ability to deliver superior investment results over the long term and consider our job as wealth creators for our clients to be an immense privilege and responsibility.

Table 1: Class F Returns as at December 31, 2018

As at December 31, 2018	1 Year	3 Year	5 Year	Since Inception	Inception Date
Cambridge Pure Canadian Equity Fund F	-12.0	3.0	3.8	12.2	02/15/11
Cambridge Canadian Growth Companies Fund F	-9.2	5.9	5.9	14.1	02/15/11
Cambridge Growth Companies Corporate Class F	-8.5	8.0	N/A	9.4	07/29/14

I want to spend the majority of this blog discussing some interesting ideas that reside across the funds, because with the amount of negative press out there (a change in tone from six to 12 months ago when everyone was feeling warm and fuzzy), we want to: a) remind clients that we are finding tremendous value, and b) reiterate that we buy stakes in publicly traded companies, not markets or indexes. Specifically, I want to discuss:

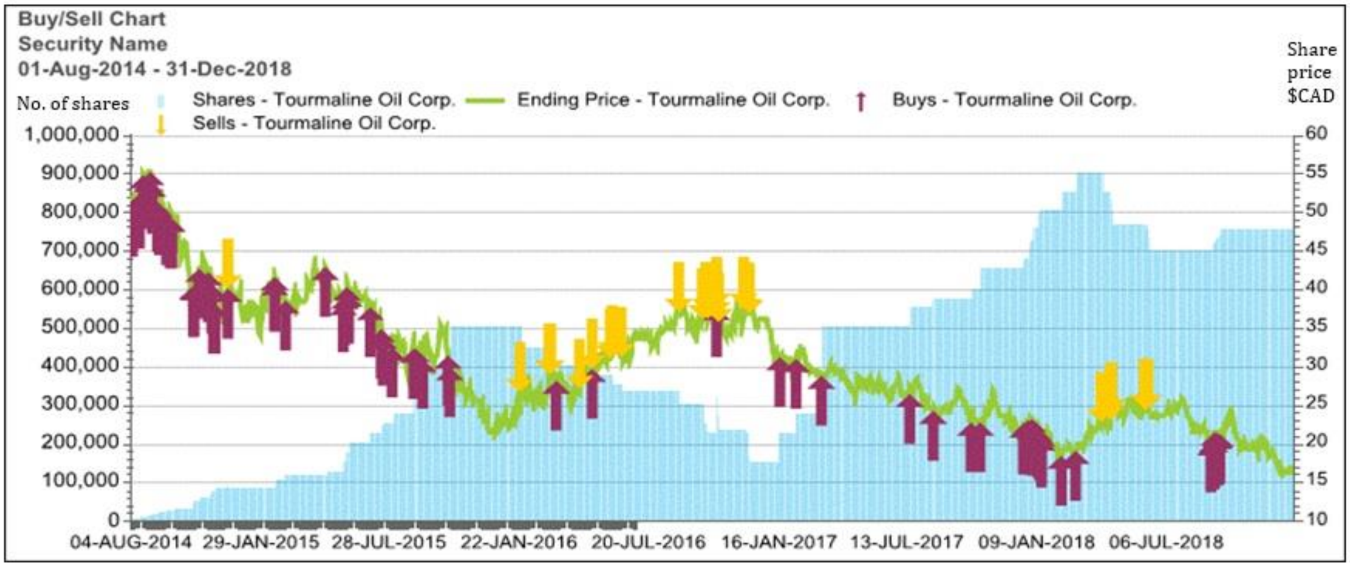
- a company we've held for many years in several funds that has been a negative contributor to results but that we continue to hold (Tourmaline Oil)
- a relatively new holding that had a challenging first 18 months in the funds and which we have continued to buy (Alfa Financial Systems), and
- a big multi-year positive contributor to the funds that we continue to hold in significant amounts because we think these are still early days in the opportunity (Burford).

Tourmaline Oil

Tourmaline is a Canadian natural gas producer. The company is about 10 years old and the senior management team, led by CEO Mike Rose, has largely worked together for over two decades. Their focus on low operating costs, large resources in place, low leverage and owned infrastructure has allowed them to become the second-largest gas producer in Western Canada. We have owned shares of this business since 2011 (when existing management took over) within Cambridge Pure Canadian Equity Fund and

Cambridge Canadian Growth Companies Fund, and since the inception of Cambridge Growth Companies Corporate Class in August 2014 (see Chart 2 below).

Chart 2: Tourmaline Oil



Source: FactSet.

Table 3: Tourmaline and oil market data

Year	2014 - average	As at Jan. 15, 2019
Stock price	$49.45	$18
Canadian light oil price (per barrel)	CAD$94	CAD$62
AECO gas price (per thousand cubic feet (mcf)	CAD$4.50	CAD$1.80
Tourmaline daily production (barrel of oil equivalent per day (BOE/d)	112,929	300,000
Operating netback (profit per barrel)	$22.49	$11.76
Cash flow per share	$4.57	$4.74
Price to cash flow	11x	4x

Source: Bloomberg L.P. and Cambridge Global Asset Management.

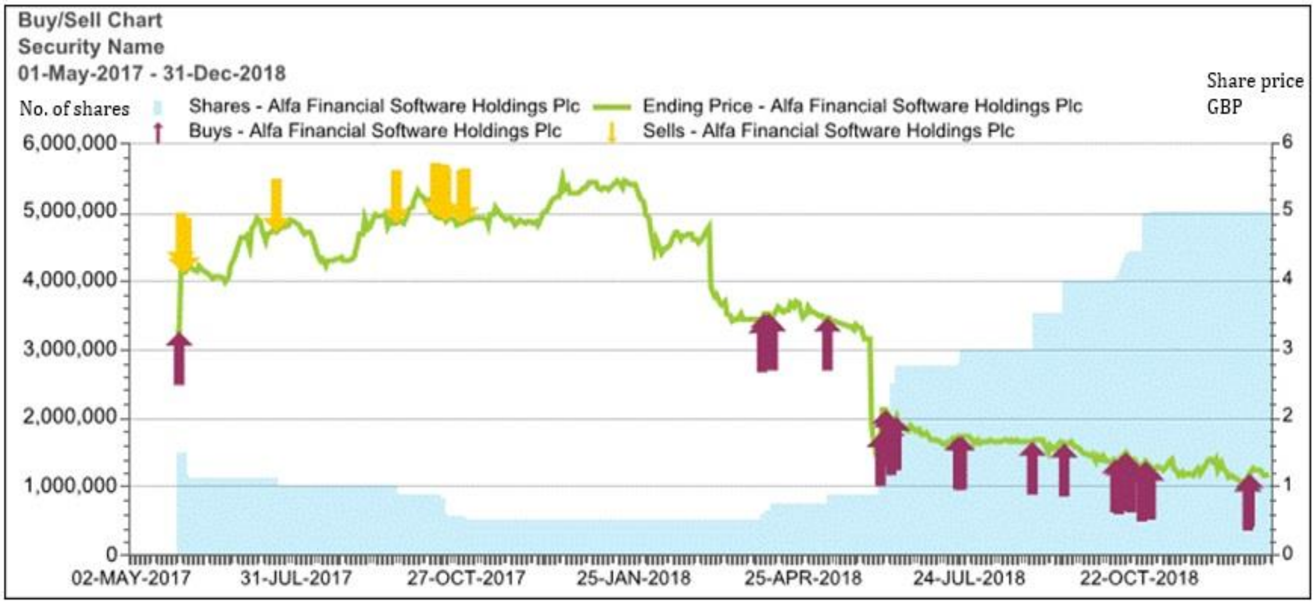
You can see from Chart 2 and Table 3 above that Tourmaline's stock price is down by 60% and cash flow per share is flat at December 31, 2018 versus the 2014 average. Having said that, Tourmaline now produces 2.4x more oil and gas, but it earns about 50% less (compared with the 2014 average) profit per barrel of oil equivalent (BOE) of gas – highlighting that even the best-run producers don't have pricing power. I consider this remarkable and a testament to Tourmaline's operating capability: despite commodity prices falling over 50%, the company has managed to keep cash flow *per share* flat. In hindsight, we paid 11x cash flow for a business that was benefitting from close-to-peak commodity prices and underappreciated the amount of downside in Tourmaline's valuation multiple as commodity prices fell.

So, while the stock of Tourmaline detracted significantly from results in 2014, I can't think of many opportunities presently where we can benefit from an aligned and competent management team who have a proven ability to create value, where the key drivers of the business are at/near troughs and the valuation is 4x cash flow with little leverage.

Alfa Financial

Alfa Financial Systems is a U.K.-based software company focused on the asset finance industry encompassing numerous sectors, including vehicle manufacturers, heavy capital equipment manufacturers, lessors and banks. Alfa is by far the largest vendor of this type of complex software, and while it has been operating for over 25 years, it only went public in mid-2017. Chart 4 below illustrates our investment decisions going back to the company's initial public offering (IPO).

Chart 4: Alfa Financial Software



Source: FactSet.

After conducting our due diligence, we decided the business was poised to grow substantially over the next three to five years and the stock was attractively priced at 325 pence on June 2, 2017; but given the limited access to management, we made it a small weight. It subsequently performed well and no longer represented a top 30-40 idea globally. Consequently, we decided to trim the weight, selling half our position over the next six months.

Since then the company revealed that several customers have deferred software purchasing decisions or paused implementation plans, resulting in revenue growth materially below our expectations at the time of the IPO. Through additional research into the situation, we feel comfortable that the business model is sound. It appears this is more of an order timing issue and 2019 orders will improve. The current price of the stock reflects market expectations of continuing headwinds, giving us an attractive margin of safety as we look to the future.

We now own[1] 10% of the float of Alfa Financial at an adjusted cost base of 175 pence, roughly 10x what we obtained at the IPO. We are confident in the outlook based on its balance sheet and existing profitability, and believe there is some upside and not a lot of downside from today's prices.

Burford Capital

Burford Capital is a U.S.-based finance and investment management firm specializing in providing legal and litigation finance, among other services, to global law firms and fortune 500 companies. Listed on the London Stock Exchange, Burford manages GBP4 billion in assets and is a global leader within this industry. It became a public company in 2009 and Cambridge became a shareholder in 2016. Chart 5 below provides a timeline of Cambridge's investment decision making in this company.

Chart 5: Burford Capital

Source: FactSet.

Across the funds I manage[2], Cambridge owns approximately 1.2 million shares of Burford at an average cost of GBP10.50 each and the stock has already rewarded us handsomely in those two or so years with a 60% unrealized gain. Why are we still holding onto it, you might ask? Well, over that two-year timeframe, Burford's book value per share has doubled and the return on equity has averaged 30% per year, so the multiple of book value has remained flat and all the value creation has been through intrinsic value growth.

Today Burford manages about GBP4 billion in assets, and Cambridge believes it is still early days in the use of litigation finance with Burford poised to maintain its leading market share – it raised about 4x more

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[1] Securities of Alfa Financial are held in Cambridge Canadian Growth Companies Fund; Cambridge Growth Companies Corporate Class, and certain other funds managed by CI Investments Inc.

[2] Cambridge Growth Companies Corporate Class and Cambridge Canadian Growth Companies Fund.

capital than its private or public equity peers. Burford can benefit its clients by addressing the misalignment of incentives when traditional litigation work conducted by law firms employs the billable-hour model. This model places corporations needing legal advice and lawyers providing advice on opposite sides of the incentive table. Capital is entering the industry looking to realign incentives around outcomes in terms of time and materials.

Cambridge doesn’t believe Burford will be the only winner and we are very aware that its success will draw others into looking more seriously at offering this service. We do think Burford has a first-mover advantage and a very robust operating model where they have sourced large sums of capital in very diverse and creative ways and demonstrated an ability to deploy that capital at very attractive IRRs for their clients (20%+) with durations that will make this type of uncorrelated return very attractive as it becomes more common.

There are many more nuances to Burford’s widening moat. However, for the purposes of this letter, I hope I have given you insight into the deep industry work we carry out to understand strategy and business models and determine the intrinsic value of a business, which is distinct from the daily market price. We believe that, at 3x book value with further asset growth ahead of Burford, this is an attractive time to own the position we have accumulated, and it remains a meaningful weight in Cambridge Growth Companies Corporate Class and Cambridge Canadian Growth Companies Fund.

I hope these illustrations shed light on how Cambridge makes decisions and how we seek to take advantage of mispricings in the stock market. Below is a broad overview of attribution across the three small-cap Cambridge funds that I manage for 2018, which was among the more challenging years in terms of absolute performance, but among the most influential in setting the table for strong forward-looking results, in our team’s view.

Kind regards,

Greg Dean

Cambridge Growth Companies Corporate Class

Contributors	**Detractors**
Wix.com	Alfa Financial
HubSpot	Byggmax
Burford	Middleby Corp
Auto Trader	RaySearch Labs
Atlassian	Maisons du Monde

The fund benefitted from its technology holdings over the year, with four of the five top contributors coming from the sector (Wix.com, Hubspot, Auto Trader and Atlassian). Exposure to retailers such as Sweden-based home improvement retailer and France-based Maisons du Monde were among the largest detractors. Long-term holding Middleby, a global leader in the foodservice equipment industry, had a challenging year, but we remain confident that better days are ahead. The portfolio's significant underweight allocation to the U.S. was a headwind relative to the benchmark, MSCI World Small Cap Total Return Index[3], although this was somewhat offset by strong security selection.

Cambridge Canadian Growth Companies Fund

Contributors	Detractors
Wix.com	Sleep Country
Auto Trader	Teekay Offshore
HubSpot	B&M Retail
Burford	Premium Brands
Great Canadian	Middleby

There was a similar theme within Cambridge Canadian Growth Companies Fund, as the three top contributors to performance were technology holdings. As we mentioned, Burford performed well, while Great Canadian Gaming also contributed nicely as it demonstrated impressive contributions from its newly acquired gaming bundles in the Greater Toronto Area. Retailers were again among the top detractors as Canada-based Sleep Country and U.K.-based B&M Retail saw their shares slump.

Cambridge Pure Canadian Equity Fund

Contributors	Detractors
Great Canadian	Sleep Country
Wix.com	Premium Brands
TFI International	Prairie Sky
Auto Trader	Keyera
Boyd Group	Tourmaline

Within the Cambridge Pure Canadian Equity Fund, the top contributors to performance included some familiar companies -- Great Canadian Gaming, Wix.com and Auto Trader. Trucking and logistics operator TFI International performed well as it was supported by the backdrop of a tight freight market and strong economy. Energy-exposed companies were a drag on the fund over the year and were among the main detractors.

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[3] MSCI World Small Cap Total Return Index (CAD) standard performance: 1 year -5.69%; 3 year 5.88%; 5 year 9.71%; ; Since inception (1/1/2001) 7.85%. Source: Morningstar.

IMPORTANT INFORMATION

Greg Dean is a Portfolio Manager to some of the Cambridge funds. He has no material interest in the securities discussed herein; however, he is an investor in certain Cambridge funds that hold these securities.

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