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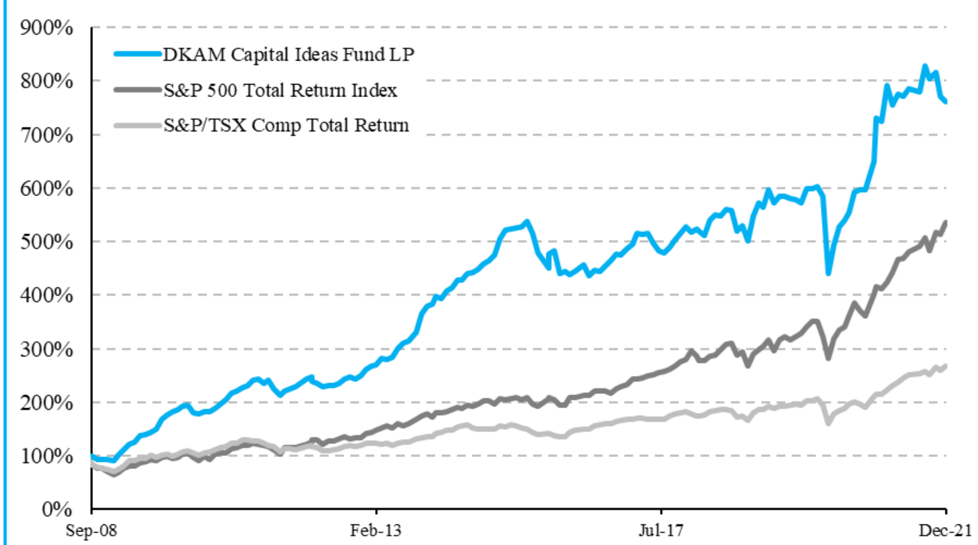
INVESTMENT ISSUES • STRATEGIES • INSIGHTS FROM DONVILLE KENT

Moment in Time

DKAM Capital Ideas Fund LP vs. Benchmarks
Inception (October 2008) - present



Over the years we've been picking stocks and there are moments in time when unexpected opportunities present themselves. Some small and some big. In this edition of the ROE Reporter, we will discuss how we currently find ourselves in a historic opportunity. The current market correction has been better for some stocks and dramatically worse for others. It has certainly been a warranted correction for some stocks and a guilty-by-association sell-off for others. For a selected group of stocks, we are seeing earnings multiples at extremely low levels not seen since 2008/2009, or even all the way back to 1995 for certain stocks. How can this be the case with the S&P 500 only off ~10% from the highs? We'll do our best to illustrate and justify in this edition of the newsletter.

Hot topic

While the investment community continues to fret about inflation, we feel inflation will surprise to the downside. As discussed in recent monthly commentaries, inflation becomes worrisome when it becomes "runaway inflation." We are indeed observing inflation infiltrating the economy right now. However, it's being pushed by price shocks, many of which are coming back down, particularly in commodity prices. We have covered this extensively over

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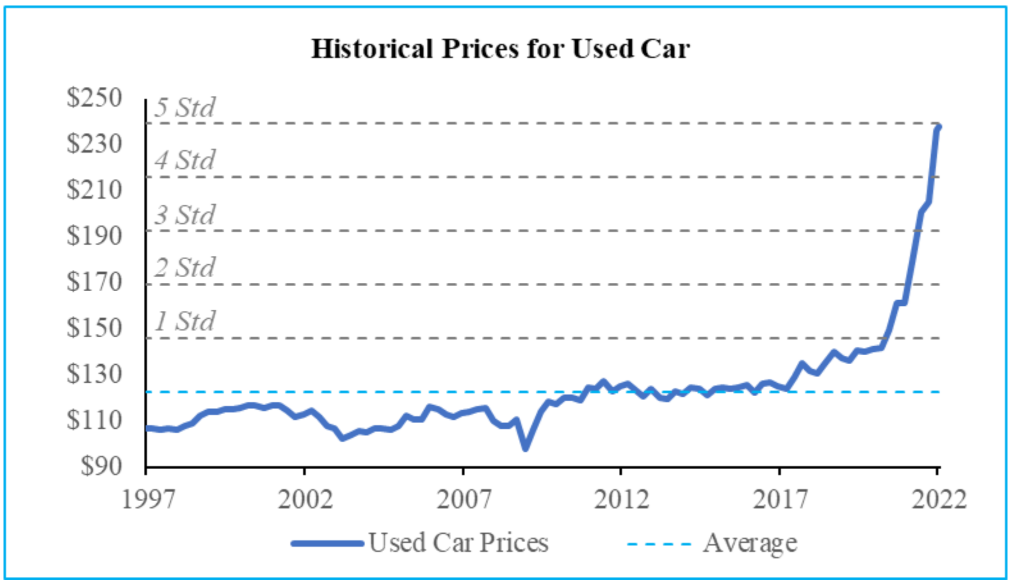
the past year so we will keep it brief. We should see a reversion to the mean in commodity prices, and likely even lower for a brief period due to increased capacity.

A prime example is used car prices, as illustrated in the chart below.[i] Cars comprise a significant portion of consumer spending, and as such, a big part of inflation. Used car prices are now sitting 5 standard deviations higher than their average. In many instances the price of a used car is higher than its brand-new equivalent. Obviously, this dynamic isn't sustainable. Over the last two years used car prices are up over 70%, having an outsized impact on the overall Consumer Price Index (CPI). The point being that if an unsustainable dynamic mean reverts, there would be an equally large deflationary impact on the reported CPI number. Take into account the recent declines in steel, lumber, iron ore, DRAMs, etc, and the year-over-year comparisons for inflation become quite small fairly quickly.

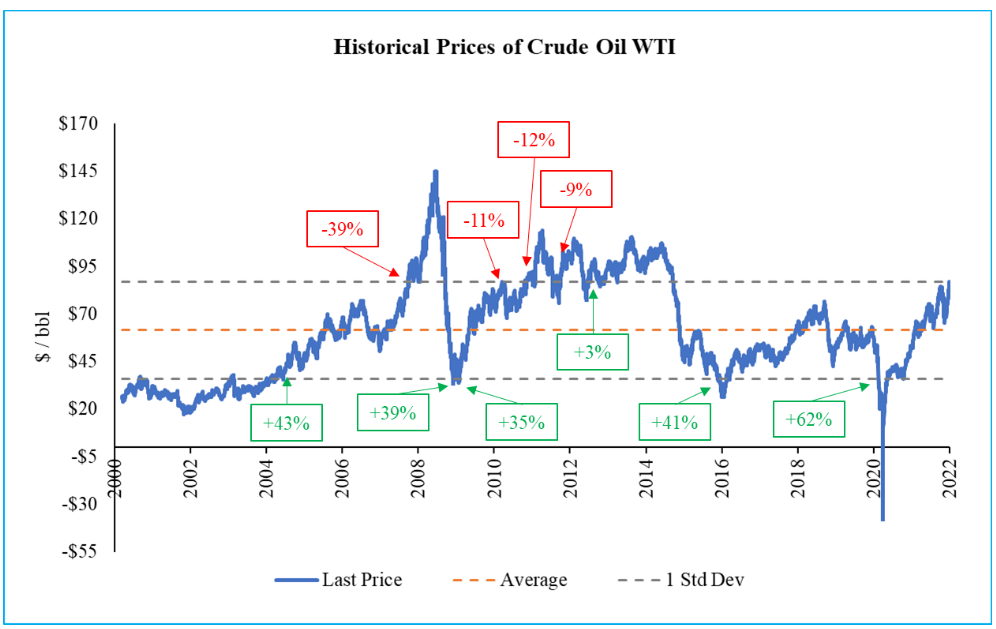


Cornerstone Macro published the inflation forecast below which projects headline inflation falling from 6.6% in Q4 2021 to 6.1% in Q1 2022. The forecast further predicts that inflation will decrease to 3.9% in Q2 2022, 2.9% in Q3 2022, and ultimately dropping to 1.4% in by the end of the year. This is independent of the Fed raising interest rates and many of the year-over-year deflation numbers already in play (ex. lumber, steel, iron ore, and DRAM prices). All this to say, we believe that interest rate hikes are more than priced into the market. The slowdown in inflation will surprise the market, which should be a positive for growth stocks.

	Year/Year % Change							
	1Q21A	2Q21A	3Q21A	4Q21	1Q22	2Q22	3Q22	4Q22
Headline CPI	**1.9%**	**4.8%**	**5.3%**	**6.6%**	**6.1%**	**3.9%**	**2.9%**	**1.4%**
Gasoline (3%)	5.0%	48.8%	41.6%	51.7%	23.9%	8.4%	0.3%	-10.7%
Utilities (3%)	3.1%	6.0%	8.2%	9.6%	7.0%	5.9%	4.1%	0.4%
Food and Energy (21%)	3.8%	9.8%	10.2%	13.2%	9.0%	6.7%	4.2%	-0.2%
Core CPI (79%)	**1.4%**	**3.7%**	**4.1%**	**4.9%**	**5.4%**	**3.2%**	**2.6%**	**1.8%**
Goods Less Food & Energy (21%)	**1.6%**	**6.5%**	**7.8%**	**9.3%**	**10.2%**	**2.8%**	**-1.4%**	**-4.5%**
Core Goods ex Autos	1.3%	5.4%	6.5%	7.8%	7.6%	3.3%	-0.1%	-2.8%
New Vehicles	1.4%	3.5%	7.6%	10.7%	12.0%	6.7%	-1.3%	-6.1%
Used Vehicles	9.6%	32.0%	32.7%	30.6%	37.4%	5.8%	-7.8%	-10.9%
Services Less Energy Services (58%)	**1.4%**	**2.8%**	**2.8%**	**3.4%**	**3.7%**	**3.4%**	**4.1%**	**4.1%**
Shelter (33%)	1.6%	2.3%	2.9%	3.8%	4.2%	4.1%	5.0%	5.1%
Healthcare Services (7%)	2.9%	1.6%	0.9%	2.2%	3.0%	4.1%	5.0%	5.3%
Transportation Services (5%)	-3.4%	9.1%	5.0%	4.9%	6.8%	2.2%	3.2%	2.3%

Trading versus investing

Our investment approach is focused on investing in companies that are growing their profits and diligently reinvesting profits in their businesses. We expect these companies to compound and to be worth significantly more in two, five, and 10 years from now. This is vastly different from trading commodities where an investor needs to correctly guess when to get in and when to get out because the long-term returns in these industries are abysmal. The following chart illustrates how the oil trade is played out with figures noted in the boxes reflecting the 12-month return on the iShares S&P/TSX Capped Energy ETF during the following 12 months.[ii]



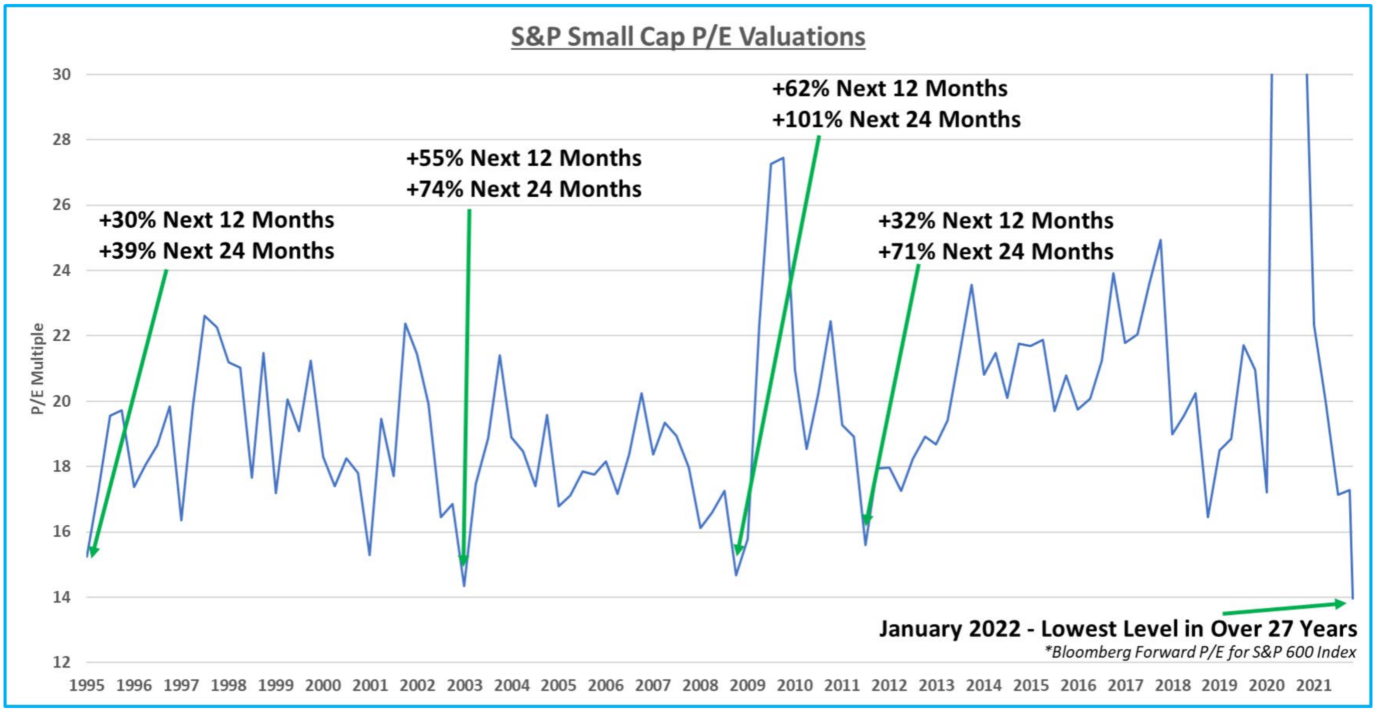
As the above chart illustrates in 2009, 2016, and 2020, theoretically the best time to get into an energy trade is when the price of oil drops significantly. During these periods, it was an opportune time to place a bet on energy companies. However, with oil currently trading near $90/bbl (equivalent to one standard deviation above average historical oil prices), it appears that the easy money has already been made. This is a critical point to emphasize as the energy trade in Canada is important and has a large impact on all other Canadian stocks. The capital required to make bets on energy has to come from somewhere, usually abandoning one sector only to return in force later once the energy trade has played out.

Small caps trading at historical discount to large caps

The dynamic described above is similar to what we are currently observing with large caps versus small caps. Large caps have performed extremely well and have outpaced small caps considerably, leading to a truly historic buying opportunity in the small cap market. Figures noted in the boxes below reflect the 12-month return of the S&P Small Cap 600 Index for the following 12 months. The chart below has corrected even further since the Financial Times printed this chart in 2021 and the valuation discount between large caps and small caps has plummeted to levels not seen since 1995.

Small caps trading at historically cheap valuation

The most important chart that supports our opening claims is the chart of small cap price to earnings multiples. The chart above was small cap relative to large, versus the chart below is simply the valuation of small cap stocks using Bloomberg's forward estimates (quarterly data). After taking a look at this graph it becomes quite apparent why we're referencing this as a historic moment in time. Bloomberg's data for this index goes back to 1995 and as of January 2022 *we're currently seeing the cheapest small cap valuations in that 27 year span*. The next necessary step is to see how small cap stocks perform once hitting these low valuations. As the graph shows, the returns over the next 12 and especially 24 months from the lows in valuations are notably strong. Now sitting at the cheapest valuation, it would make sense to expect similar if not greater returns.



Value versus growth

With all of this in mind, it's natural to ponder, "Are all stocks near historically low valuations?" The short answer is "No, not even close." This correction has been overwhelmingly punitive for small caps, particularly small cap growth stocks. Many large cap stocks, especially large cap value stocks, have corrected just slightly (or not at all).

A significant amount of capital has flowed into value stocks, most likely as a safety trade, pushing them to trade at high multiples despite low levels of forecasted growth. In contrast, the sell-off in growth stocks has led to low multiples despite high levels of forecasted growth and profitability. The following are just a few examples illustrating this dynamic.[iii]

	Coca-Cola	CLOROX	DOLLARAMA	GILDAN
Valuation	19x EBITDA	16x EBITDA	16x EBITDA	11x EBITDA
Growth	6%	3%	9%	7%

*DKAM estimates for 2022 Revenue Growth and EBITDA

	vitalhub Care Evolved	goeasy	PROPEL HOLDINGS	givex	Colliers
Valuation	14x EBITDA	6x EBITDA	8x EBITDA	9x EBITDA	9x EBITDA
Growth	78%	20%	100%	19%	15%

*DKAM estimates for 2022 Revenue Growth and EBITDA

Stock rankings

The current market environment is giving us real déjà vu circa March 2020 and December 2018. During these periods (as well as today), we saw several overvalued, overhyped companies and now we're seeing a lot of opportunity in the high-quality names that have been injured from the shrapnel of unprofitable company blow-ups.

Stocks Ranked by EBITDA Margin

Company	Ticker	EBITDA Margin
Dye & Durham*	DND CN EQUITY	53%
VerticalScope	FORA CN EQUITY	41%
GoEasy	GSY CN EQUITY	40%
Nuvei	NVEI CN EQUITY	39%
Playmaker	PMKR CN EQUITY	38%
Topicus	TOI CN EQUITY	36%
Pubmatic	PUBM US EQUITY	35%
Enghouse	ENGH CN EQUITY	35%
WeCommerce	WE CN EQUITY	31%
Constellation	CSU CN EQUITY	30%
RediShred	KUT CN EQUITY	30%
AppLovin	APP US EQUITY	27%
Pluribus	PLRB CN EQUITY	26%
DoubleVerify	DV US EQUITY	24%
NeoGames*	NGMS US EQUITY	24%
Propel	PRL CN EQUITY	22%
Sangoma	STC CN EQUITY	20%
VitalHub	VHI CN EQUITY	17%
GiveX	GIVX CN EQUITY	16%
Magnet	MAGT CN EQUITY	16%
Colliers	CIGI CN EQUITY	15%
NowVertical*	NOW CN EQUITY	15%
Wishpond	WISH CN EQUITY	10%
Voxtur	VXTR CN EQUITY	10%
Digital Turbine	APPS US EQUITY	10%
East Side Games	EAGR CN EQUITY	10%
Adcore	ADCO CN EQUITY	9%
Converge	CTS CN EQUITY	6%

**Projections based on announced but not closed acquisitions*

***Based on 2022 DKAM EBITDA estimates*

A recent report from National Bank examined IPOs to determine the single greatest driver of stock performance and ultimately concluded that EBITDA margin has the highest correlation to positive performance. We thought this would be an interesting place to start. We've sorted some of the companies we follow most closely by EBITDA margin.[iv]

Profitability is important for many reasons. For one, it reduces the risk of needing to rely on the capital markets to fund operations. Companies with high margins are self-funding and can re-invest profits back into their business. Additionally, being highly profitable greatly improves optionality. A company can pay a dividend, buy back stock, acquire businesses, pay down debt, etc. This is where long-term compounders are found.

Stocks Ranked by Revenue Growth

Company	Ticker	2022 Sales Growth
NowVertical*	NOW CN EQUITY	440%
NeoGames*	NGMS US EQUITY	156%
Voxtur	VXTR CN EQUITY	136%
Pluribus	PLRB CN EQUITY	130%
Propel	PRL CN EQUITY	100%
Pubmatic	PUBM US EQUITY	84%
VitalHub	VHI CN EQUITY	78%
Dye & Durham*	DND CN EQUITY	72%
East Side Games	EAGR CN EQUITY	68%
WeCommerce	WE CN EQUITY	56%
Playmaker	PMKR CN EQUITY	48%
Converge	CTS CN EQUITY	45%
Sangoma	STC CN EQUITY	43%
Wishpond	WISH CN EQUITY	40%
VerticalScope	FORA CN EQUITY	39%
AppLovin	APP US EQUITY	35%
DoubleVerify	DV US EQUITY	32%
Digital Turbine	APPS US EQUITY	32%
Nuvei	NVEI CN EQUITY	30%
Adcore	ADCO CN EQUITY	30%
Magnet	MAGT CN EQUITY	30%
RediShred	KUT CN EQUITY	28%
GiveX	GIVX CN EQUITY	27%
GoEasy	GSY CN EQUITY	20%
Constellation	CSU CN EQUITY	20%
Topicus	TOI CN EQUITY	20%
Colliers	CIGI CN EQUITY	15%
Enghouse	ENGH CN EQUITY	12%

**Projections based on announced but not closed acquisitions*

***Based on 2022 DKAM Revenue estimates*

The next important step is to factor in growth. A company can have high margins but if they can't effectively re-deploy those profits back into their business you end up owning a value trap. Long-term compounders are found at the intersection of growth and profitability.

As you can see, there are a lot of high growth projections for 2022.[v] Some of these rates are more reliable than others and some are more consistent than others. This has to be taken into account before making a final investment decision.

Valuation, the price an investor pays for future earnings, needs to be considered in conjunction with margins and growth. Many stocks are cheap for a reason and many stocks are expensive for a reason. In our experience, it makes sense to pay up for high quality compounders versus trying to find value in the bottom of the bargain bin. However, returns can be dramatic if one can grab high quality compounders at a discount. This correction in small cap stocks has led to some indiscriminate selling, allowing us to find high quality stocks that are on sale. The following table illustrates the cheap valuations we are seeing.[vi] We have not seen valuations this low for quality growth businesses since 2008/2009.

Stocks Ranked by Valuation

Company	Ticker	EBITDA Multiple
Dye & Durham*	DND CN EQUITY	4.6
RediShred	KUT CN EQUITY	4.9
GoEasy	GSY CN EQUITY	5.8
GiveX	GIVX CN EQUITY	6.3
Pluribus	PLRB CN EQUITY	6.4
Propel	PRL CN EQUITY	6.8
Adcore	ADCO CN EQUITY	7.7
NeoGames*	NGMS US EQUITY	9.2
Sangoma	STC CN EQUITY	9.4
Colliers	CIGI CN EQUITY	9.5
NowVertical*	NOW CN EQUITY	10.6
Pubmatic	PUBM US EQUITY	10.9
Enghouse	ENGH CN EQUITY	13.9
VerticalScope	FORA CN EQUITY	14.3
Playmaker	PMKR CN EQUITY	14.9
VitalHub	VHI CN EQUITY	15.0
Converge	CTS CN EQUITY	15.1
AppLovin	APP US EQUITY	16.8
Constellation	CSU CN EQUITY	18.8
East Side Games	EAGR CN EQUITY	20.5
Nuvei	NVEI CN EQUITY	22.1
Digital Turbine	APPS US EQUITY	24.2
WeCommerce	WE CN EQUITY	26.1
Voxtur	VXTR CN EQUITY	27.4
Topicus	TOI CN EQUITY	28.9
Wishpond	WISH CN EQUITY	31.6
DoubleVerify	DV US EQUITY	36.1
Magnet	MAGT CN EQUITY	76.1

**Projections based on announced but not closed acquisitions*

***Based on 2022 DKAM EBITDA estimates*

Finally, we combine EBITDA margins, revenue growth, and valuation to calculate a single score for each stock. The higher the combination score, the more attractive a stock is. This ranking is just a starting point. It's a way to narrow one's attention in order to more efficiently allocate further analysis.

Stocks Ranked by Combining Margin, Growth & Valuation

Company	Ticker	Market Cap ($M)	Sales Growth	EBITDA Margin	Price to EBITDA	Combination
NowVertical*	NOW CN EQUITY	51	440%	15%	10.6	42.9
Dye & Durham*	DND CN EQUITY	2,341	72%	53%	4.6	27.1
Pluribus	PLRB CN EQUITY	71	130%	26%	6.4	24.5
NeoGames*	NGMS US EQUITY	760	156%	24%	9.2	19.5
Propel	PRL CN EQUITY	361	100%	22%	6.8	17.9
RediShred	KUT CN EQUITY	66	28%	30%	4.9	11.7
Pubmatic	PUBM US EQUITY	1,114	84%	35%	10.9	10.9
GoEasy	GSY CN EQUITY	2,319	20%	40%	5.8	10.3
GiveX	GIVX CN EQUITY	74	27%	16%	6.3	6.9
Sangoma	STC CN EQUITY	581	43%	20%	9.4	6.7
VitalHub	VHI CN EQUITY	112	78%	17%	15.0	6.3
Playmaker	PMKR CN EQUITY	146	48%	38%	14.9	5.8
VerticalScope	FORA CN EQUITY	504	39%	41%	14.3	5.6
Voxtur	VXTR CN EQUITY	504	136%	10%	27.4	5.3
Adcore	ADCO CN EQUITY	39	30%	9%	7.7	5.1
East Side Games	EAGR CN EQUITY	303	68%	10%	20.5	3.8
AppLovin	APP US EQUITY	17,961	35%	27%	16.8	3.7
Converge	CTS CN EQUITY	1,991	45%	6%	15.1	3.4
Enghouse	ENGH CN EQUITY	2,597	12%	35%	13.9	3.4
WeCommerce	WE CN EQUITY	481	56%	31%	26.1	3.3
Colliers	CIGI CN EQUITY	8,045	15%	15%	9.5	3.2
Nuvei	NVEI CN EQUITY	10,525	30%	39%	22.1	3.1
Constellation	CSU CN EQUITY	44,257	20%	30%	18.8	2.7
Topicus	TOI CN EQUITY	15,436	20%	36%	28.9	1.9
Digital Turbine	APPS US EQUITY	3,868	32%	10%	24.2	1.7
Wishpond	WISH CN EQUITY	66	40%	10%	31.6	1.6
DoubleVerify	DV US EQUITY	3,864	32%	24%	36.1	1.6
Magnet	MAGT CN EQUITY	1,035	30%	16%	76.1	0.6

**Projections based on announced but not closed acquisitions & DKAM 2022 estimates for revenue & EBITDA*

We have covered many of these companies in past write-ups and included more quantitative and qualitative details like scalability, track-record, quality of management & pricing power. Our top picks at the moment are **GoEasy, VitalHub, Propel, GiveX, Sangoma & NeoGames**. Below we'll highlight a couple that are new to the public markets.

NeoGames (NGMS) provides a comprehensive technology platform for state-regulated lotteries that provides everything they need in order to run their iLotteries (online games). Services include games, regulation & compliance, payment processing, risk management and player management. NeoGames has a highly profitable partnership with Pollard Banknote (NeoPollard) that complicates their reported financials. The economics of the partnership get reported as "Share in profits of joint venture" and their interest in the revenues doesn't get reported as revenue on the financial statements. Combine these factors while taking into consideration the highly accretive acquisition of Aspire Global announced recently, which we feel will close imminently, and NeoGames is one of the highest growth and cheapest stocks in the market. We have been adding to this position during this correction.

GiveX (GIVX) went public in December 2021 and is even more under-the-radar than NeoGames. The company operates a cloud-based fintech platform with PoS, engagement, payments, and analytics. We like this stock for many reasons, including the fact that it has been operating profitably for the last 20 years and has funded its growth from its own cash flows. In contrast, many of its competitors, such as LightSpeed, lose money every year and have to issue additional equity in order to fund operations. The small market cap can be misleading as GiveX represents some of the world's largest brands, such as Wendy's, 7-Eleven, Major League Baseball, Fairmont, and the LCBO for a total of more than 93,000 locations. We expect 5% organic growth on the legacy business, 15% growth from the PoS business, and an additional 10-15% per year from tuck-in acquisitions, all while operating with ~15% EBITDA margins. We participated in the IPO and have been increasing our position during this correction.

Final thoughts

The simple reality is that corrections do happen. Recent occurrences include in December 2018 when the Fed was deliberating over a potential rate hike as well as in March 2020 when the pandemic first imploded. In both scenarios, investor panic propelled a major sell-off, only to be followed by a swift recovery. For more evidence, refer to our Fund, which soared by 79% over the 11 months following March 2020.

We view the current correction as setting the stage for great things to come. Given the stellar Q3 2021 earnings announced by our portfolio companies, the historically low small cap valuations, and the irrational punishment of growth stocks, we are definitely bullish on the outlook for our small cap growth stocks. This correction has established the foundation for the next big move.

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All estimates, projections, and calculations have been generated by DKAM. This does not constitute advice for personal investments but rather a breakdown of how Donville Kent approaches stock analysis.

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[i] Source: Bloomberg.

[ii] Source: Bloomberg.

[iii] Based on DKAM analysis.

[iv] Based on DKAM analysis. Projections for companies with fiscal year ends other than December 31 have been adjusted to provide an equal comparison.

[v] Based on DKAM analysis. Projections for companies with fiscal year ends other than December 31 have been adjusted to provide an equal comparison.

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