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THIRD QUARTER 2024 - NEWSLETTER

Dear Partner,

We are pleased to share with you our portfolio review and commentary for the third quarter.

Performance Review

During the third quarter of 2024, the TONUS PARTNERS FUND obtained a gross return of **6.5%**. Year-to-date, the Fund achieved a gross return of **26.5%**.

Since the inception of the Tonus Composite[1] in October 2007, it has achieved a compound gross rate of return of **11.4%**, compared with **8.1%** for the benchmark[2].

Portfolio Review

Continuing its recent trend, our Fund registered another good quarter with a return of +6.5%. It is up +26.5% so far in 2024, bringing its five-year compounded rate of return to +19% per annum. We are delighted by this performance given we have yet to see a meaningful relative outperformance of small cap stocks. While July was a great month for the category, on a year-to-date basis, small caps' return of 9% are merely half large caps' 18%. We may sound like a broken record by telling you that we don't know exactly when small caps will take off, but it should eventually serve as a nice tailwind for our returns.

Prudence and Discipline

We are entering the final quarter of the year with a higher-than-average cash level due to two factors. One, we have recently liquidated some investments that performed very well and reached their full value, namely **PlayAGS (AGS – $11.39)**, **Napco Security Technologies (NSSC - $40.46)**, and **Powell Industries (POWL - $221.99)**. We also trimmed our position in **Dollarama (DOL - $138.54)** and **CECO Environmental Corp (CECO - $28.20)** as we deemed their respective upside potential to downside risk less favourable. A lower weight was warranted.

Two, with markets generally going up this year, many companies on our radar saw their valuation move to a point where we consider the risk of buying too high. When stock prices move up, so do expectations. The S&P 500 index is currently trading at 21.5x its anticipated 2025 profits (relative to an historical average of 19x). What's more? These earnings are expected to increase by 15% over 2024 levels. In the context of increasing unemployment, low consumer confidence, and a contraction in the manufacturing sector, achieving such an increase in profits next year is not impossible, but it would be astounding. Investors are banking that short-term Fed (and Bank of

[1] Please see page 3 for a description of the Composite.
[2] Please see page 3 for a full description of the benchmark along with its historical returns.

Canada) rate reductions will be sufficient to spur economic growth and produce the exceptionally rare, but highly anticipated, economic soft landing.

As you know, we do not attempt to forecast the short-term direction of markets, nor do we make specific macro predictions. We do observe data and we do draw broad economic conclusions from our discussions with various management teams. But at its core, our focus remains on finding stocks that offer great long-term prospects that trade at a price which limits our downside. The higher the price/valuation, the higher the expectations and, in general, the higher the risk we bear. Higher market valuations combined with strong returns in our Fund led us to be net sellers of late. Our cash position has increased, and we are entering the fourth quarter with a more defensive approach. This is not to say that we will restrict ourselves from initiating new positions, especially if the markets are volatile, but we will only do so if the anticipated payoff is large enough relative to the risk we are taking.

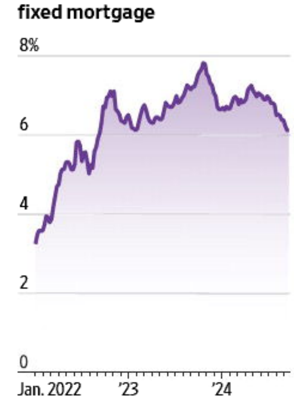
A REAL example

Real Matters (REAL - $9.15) is a company we acquired in the last quarter that exhibits such attributes. Over the past 20 years, REAL has developed a platform that connects financial institutions to real estate appraisers and title agents. Before funding a mortgage, lenders require both an independent appraisal and a title search on the property. REAL acts as the middleman by dispatching the jobs to thousands of appraisers and notaries competing for the business. For large financial institutions, this network helps them speed up the process of mortgage underwriting and standardizes data collection. REAL is the clear leader in the space with all the top Canadian and U.-S. banks using their network.

We started looking at REAL in 2020 when interest rates dropping to historical lows drove a spike in volumes and earnings. While impressive, we were worried these results could be unsustainable. Shortly thereafter, mortgage initiation hit a wall when a) many buyers could not afford the elevated home prices and b) refinancing transactions, which are economical (in the United States predominantly) when mortgage rates are falling, came to a halt as rates could not fall more than their rock-bottom levels. Industry volumes went from 13 million at their peak to a low of 4 million last year which led to a significant reduction in REAL's revenues.

We decided to revisit the story and met with the company's senior executives twice during 3Q24. We believe that the worst is behind them; REAL should start enjoying higher volumes, revenues, and profits as mortgage rates decrease from their peak levels of a year ago. What's more, during the downturn, REAL continued to invest to upgrade its platform while others struggled to remain in business. In fact, two of its largest competitors have shut down, leaving REAL poised to increase its market share right when the macro environment is improving. To make money with our investment, mortgage volumes do not need to go back to their historical peak levels of 2021. In fact, they don't even need to go back to their annual average of 9 million. From 2024's 4 million transactions, mortgage volumes should increase to 6 million annually, a level at which we believe REAL would earn more than $50M USD. This would likely drive the stock to double from our purchase price of $7.

Average rate on a 30-year fixed mortgage



Source: Freddie Mac

Addition to the Team

We will continue to seek great investment ideas on both sides of the border. We see a favourable environment where relatively few portfolio managers take the time to properly research small/mid size companies. While some would perceive the ensuing price volatility as a measure of risk, we see it as opportunity. To maximize our odds of finding the next gem, we constantly strive to upgrade and lengthen our focus list. To that end, we are pleased to share a positive development at Tonus Capital. In September, we were delighted to welcome a new full-time research analyst, Faiçal Al Alawi. Faiçal was a bright student this past Spring in Philippe's investment class at Concordia University and his addition will enable us to research more stocks. By "checking under more rocks", we increase our odds of finding new investment ideas.

Sincerely,

Philippe Hynes, CFA
Partner
October 8, 2024

Aaron Warnongbri
Partner

For reference, find below the historical gross returns of our North American equity strategy:

Tonus Composite Performance – As of 09/30/2024

	Tonus Composite *(Gross Returns)*	*Index*
3 months	6.5%	8.0%
YTD	26.5%	18.5%
1 year	37.9%	28.7%
3 years	17.1%	8.4%
5 years	19.3%	12.1%
10 years	10.4%	10.1%
15 years	12.8%	10.7%
Since Inception	**11.4%**	**8.1%**

Source: FactSet Research Systems, Inc.
Returns are gross of fees and calculated using a time-weighted rate of return. Past performance is not indicative of future results. Returns greater than 1 year are annualized. Benchmark consists of 25% Canadian Large Cap TR + 25% Canadian Small Cap TR + 25% U.S. Large Cap TR ($CAD) + 25% U.S. Small Cap TR ($CAD).
U.S. performance adjusted for US dividend withholding taxes

Please note that Tonus Capital serves as the investment manager for the Tonus Partners Fund. Historical returns shown are for the Tonus Partners Fund. Prior to January 2016, the returns are from the Tonus Select Fund from October 2007 to October 2011 and from the weighted average of all managed accounts (including those accounts no longer with the firm), using the same strategy implemented in the actual Tonus Partners Fund, from November 2011 to December 2015. Although the structure and the name of the investment product changed, it had for the entire period the same investment mandate, objectives, strategy, and benchmark. Past returns are not necessarily indicative of future performance. At any moment, the portfolio composition may vary widely from the benchmark. Returns are gross of fees and in Canadian dollars. Any investment in the Fund is speculative and involves substantial risk, including the risk of losing all or substantially all of such investment. This document is not to be construed as a public offering of securities in any jurisdiction in Canada and is for informational purposes only. While the information and material in this document are believed to be accurate at the time they are prepared, Tonus Capital Inc. cannot give any assurance that they are accurate, complete, or current at all times. The Tonus Composite was created October 31st, 2007 and the Tonus Partners' Funds was created January 4th 2016.