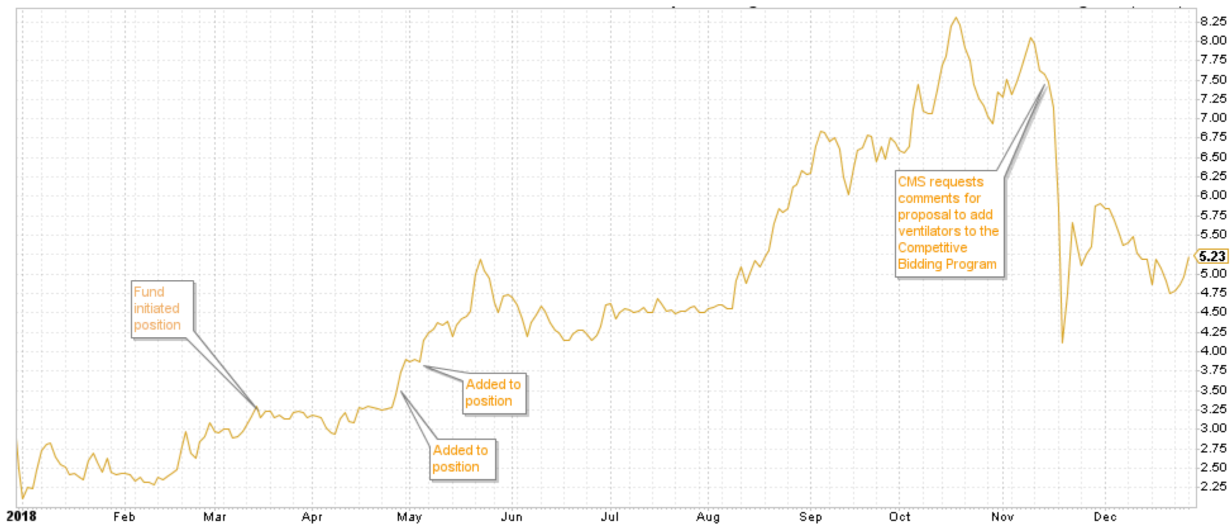
Viemed Healthcare (VMD:TO)



Position Initiation:	03/14/2018	Ptfl. Wt. (12/31/18):	25.6%
Price (at Initiation):	$3.25 CAD	Price (12/31/18):	$5.23 CAD

Gain: 60.9%

Description

Viemed is a healthcare company operating in the US market. Viemed's main focus is ventilators, particularly non-invasive ventilators that are provided in the home for late-stage COPD patients. Viemed trades on the Toronto Stock Exchange in Canadian Dollars (CAD).

Growth

Viemed has continued to grow at a rapid clip, with Active Vent Patients up 34.6% year-over-year to 5,444, as of September 30, 2018. Revenue during the first nine months of 2018, their first foray as a stand-alone public company, is up 40.1%. Net income is also up about 16% over the same time period, after adjusting for the timing of expenses in 2017. They have continued to execute well, and their steady pace of hiring new staff and entering new markets bodes well for continued growth into the future.

Stock Trajectory

Viemed's stock rose sharply in 2018, from our purchase price (in mid-March) of $3.25 CAD to a high of $8.30 CAD in mid-October. The stock drifted down for a month and then tumbled more than 40% over two days in mid-November, apparently due to a proposed rule from CMS (Center for Medicare and Medicaid Services) to add ventilators to the Competitive Bidding program. The stock recovered partially and meandered for the remainder of the year to end the year at $5.23 CAD. Although down 37% from its high, the stock has still done extremely well for the Fund, up 61% for the year (calculating from our original purchase price).

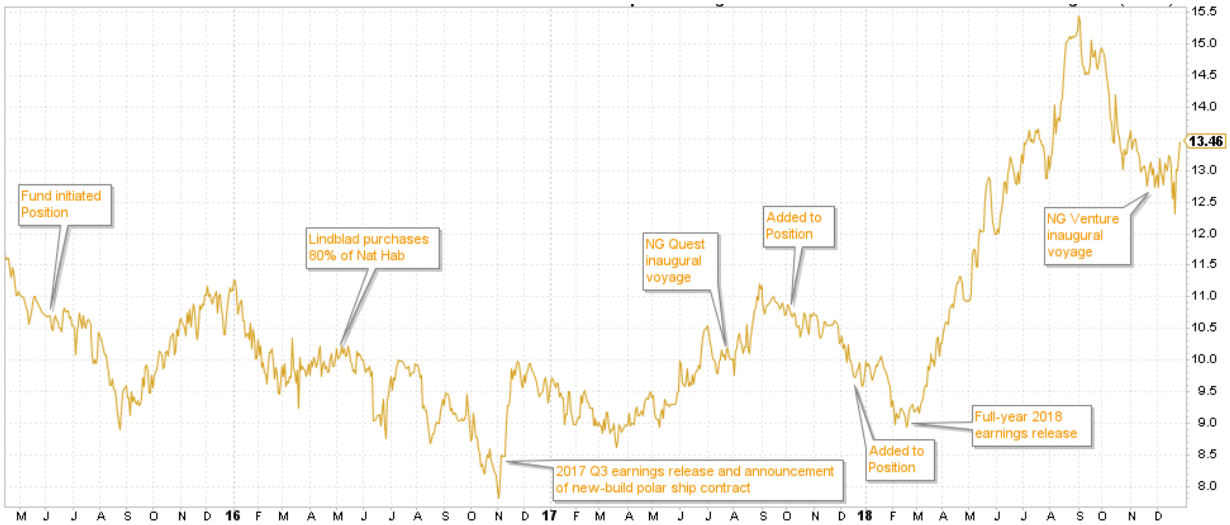
Competitive Bidding

As previously mentioned, CMS (Center for Medicare and Medicaid Services) has proposed to add ventilators to the Competitive Bidding program, which triggered a tumble in the stock price in mid-November. Although definitely a negative for Viemed, we believe the market is overreacting to this announcement. We would like to highlight three points about the potential addition of ventilators to the competitive bidding program. One, this will not occur until 2021 at the earliest, because CMS has put the next round of competitive bidding on pause as they revamp the program. Two, the changes the CMS is implementing in the program are in favor of the providers and are likely to greatly improve the final reimbursement rates generated by the program. In particular, the changes include using clearing bid pricing vs. median bid pricing, binding bids vs. non-binding bids, and the ability for prices to adjust upwards as well as downwards. Three, Viemed is no stranger to reimbursement cuts. In 2016, CMS cut reimbursements for ventilators by 35%, and Viemed recovered its previous revenue and profitability in 12-18 months. We believe that Viemed would recover even faster from any reimbursement cut that would potentially occur from competitive bidding.

Valuation

Despite its high growth rates and large and growing potential market, Viemed trades at a P/E of just 16.0. We continue to see Viemed as being deeply undervalued, and we are excited about its future.

Lindblad Expeditions (LIND and LINDW)



LIND

Position Initiation:	10/20/2017	Ptfl. Wt. (12/31/18):	20.4%
Price (at Initiation):	$10.66	Price (12/31/18):	$13.46

Gain: 26.3%

LINDW

Position Initiation:	06/05/2015	Ptfl. Wt. (12/31/18):	7.3%
Price (at Initiation):	$2.50	Price (12/31/18):	$3.21

Gain: 28.4%

Description

Lindblad is a small-ship cruise company focused on the expedition market. Lindblad offers primarily nature-oriented cruises to exotic locales such as Antarctica, the Arctic, the Galápagos Islands, and similar spots. These cruises are more expensive and profitable than the standard fare offered by mainline cruise companies. LIND is the common stock and LINDW represents warrants to buy the common stock at $11.50, expiring on July 8, 2020.

Growth

Lindblad has been steadily executing their game plan, building new ships to grow their capacity and revenues. Over the first nine months of 2018, revenue and net income have both grown significantly, with revenue up 18%, and net income even more. And despite the increased inventory from new ships, occupancy has actually *increased* from 87.8% in 2017 to 90.7% in 2018, and bookings for 2019 and beyond remain strong.

New Ships

In December 2018, Lindblad's second new-build ship, the NG Venture, embarked on its inaugural voyage to Baja California. This is a slight delay from the original plan to launch the NG Venture in June 2018. Similarly, the NG Endurance, their new-build polar expedition ship, is now on track to launch in January 2020, instead of the originally planned November 2019. In the larger scheme, a few-month delay in the launch of new ships which have a multi-decade lifespan will not affect the long-term prospects of Lindblad. In addition to the NG Endurance, Lindblad has announced plans to build another new polar expedition ship for delivery in 2021 and retains the option to order another such for delivery in 2022.

NG Endurance

Part of the reason for the delay in the NG Endurance's delivery date was the decision to upgrade the ice-level to Polar Class 5 (the lower the number, the better). This is a better ice-level than that of Lindblad's present polar ships (the NG Explorer and NG Orion), which are rated Ice-1A, roughly equivalent to Polar Class 7. In fact, at present, Polar Class 5 is the best ice-level of any ship purpose-built for cruises. This is significant because the NG Endurance will be able to visit Antarctica and the Arctic in the spring (instead of only their respective summers), lengthening these lucrative seasons as well as offering unique voyages at times and to places that they would not be able to take advantage of otherwise.

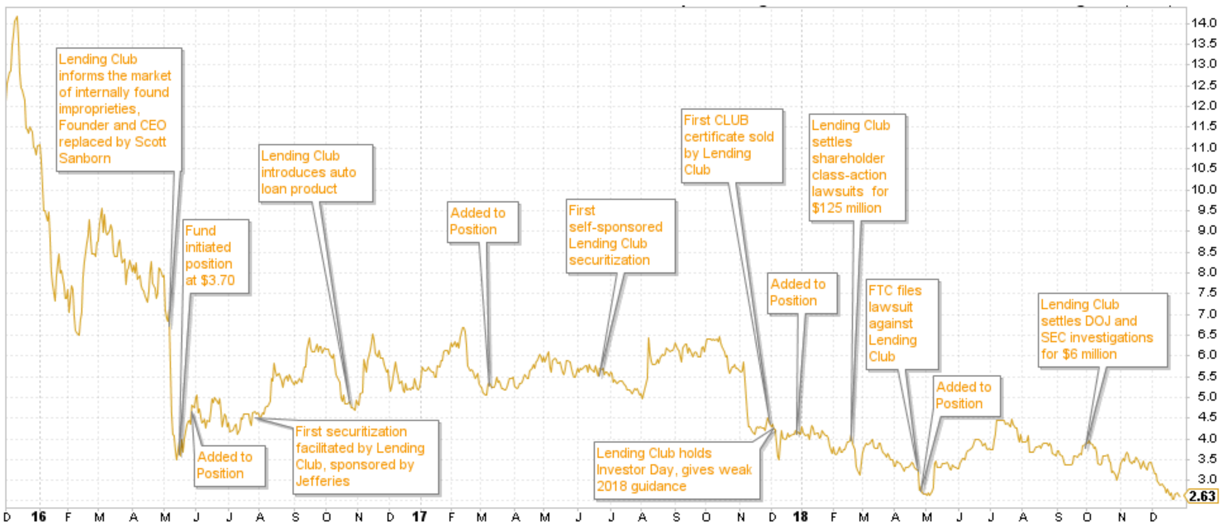
Nat Hab

Lindblad's 2016 acquisition of Nat Hab, their subsidiary focused on land-based expeditions, has proven successful. Nat Hab has seen strong growth in 2018, with revenue for the first nine months of 2018 up 26% and operating income for the Nat Hab segment up 141%. One of the key synergies they had anticipated from the acquisition was cross-selling to their respective customer bases, and indeed, cross-selling has done very well. As one data point, in the first quarter of 2018, the number of Lindblad cruise customers traveling with Nat Hab was up 40% vs. the first quarter in 2017. At the same time, Lindblad revealed that Nat Hab customer bookings with Lindblad for the full year 2018 were at that time already up 50% vs. 2017.

Valuation

Back in 2015, when the Fund first invested in Lindblad (through the warrants, LINDW), their growth was in the somewhat distant future. At the time, Lindblad was operating at capacity and there was a necessary time lag until new capacity could be ordered and built. As the growth has moved from the distant future to the near-future and present, the stock has started rising, as the market starts to see their potential. At the same time, Lindblad has been growing into their rising valuation, as their revenue and net income have both grown significantly. At present, LIND has a P/E of approximately 30. Although elevated, we believe their clear and steady growth more than makes up for this, and we believe this company has a bright future ahead of it.

Lending Club (LC)



Position Initiation: 05/16/2016	Ptfl. Wt. (12/31/18): 18.0%
Price (at Initiation): $3.70	Price (12/31/18): $2.63

Gain: -28.9%

Description

Lending Club connects people seeking to borrow money with investors seeking to lend money. Lending Club qualifies the borrower, sets the interest rate, and funds and services the loan, which is then sold to various investors, in whole or split into pieces. Lending Club's main focus at present is unsecured personal consumer debt, and they are the leader in this space.

Aftermath from 2016 events

Lending Club underwent a major upheaval in May 2016, when they announced that improprieties were discovered internally in a small number of loans. In the ensuing investigation, the Board sought and received the immediate resignation of Renaud Laplanche, the founder and CEO, and dismissed three other senior executives. For further details into the scandal, see our original Position Paper dated July 22, 2016.

There were a number of immediate effects in the aftermath. Firstly and most importantly, many loan investors, especially banks and other institutional-level investors, immediately paused their loan purchases. In response, Lending Club put all their efforts into winning back the trust of these investors, and going through all the due diligence procedures necessary to bring the different groups of investors back to the marketplace. Loan volume fell 40% in the immediate weeks after, but then recovered to stabilize at about 30% down over the next few quarters (at first with the financial incentives offered by Lending Club tied to volume, and then later even without), before returning once again to consistent growth.

Second, the entire management team at Lending Club was switched out over the next few months, with Scott Sanborn, the then-COO, becoming CEO, and the rest of the management team being filled out over the next year or so. Needless to say, the whole episode was a headache and distraction for the company, but the present management team has done an admirable job of returning the company to the path of growth and overcoming the difficulties.

Thirdly, predictably, the DOJ, SEC, and FTC all opened investigations into Lending Club, and there were federal and state-level class action shareholder lawsuits as well.

Lingering effects

In addition to the immediate aftermath, there were various lingering effects as well. There were (and are) significant ongoing costs from these legacy issues, including litigation, regulatory, audit, and other costs, as well as investor incentives, severance and retention pay, and non-cash goodwill impairment. Through the third quarter of 2018, the scandal has directly cost Lending Club $172 million in one-time legacy costs, $131 million in settlements, and $73 million in goodwill impairment. Some of these costs (about $100 million) were covered by insurance, but most were not. At this point, most of their issues are behind them, but it will probably be about another year before these legacy costs are entirely finished.

As we just stated, most of the legacy issues have been wrapped up. The class action shareholder lawsuits were settled in February 2018 to the tune of $125 million. The DOJ and SEC investigations were both settled in September 2018 with relatively minor fines amounting to $6 million, covering actions from 2009-2010 and late 2015-early 2016, respectively. These were relatively minor issues self-reported by Lending Club when they were uncovered in their internal investigation. The major legacy issue remaining to be resolved is the FTC lawsuit filed in 2018, which is covered in more detail below.

In addition to the temporary costs to deal with the legacy issues, the overall cost profile of the company has risen as they beefed up their compliance and instituted new layers of control to satisfy all due diligence and regulatory requirements. Although in 2016 they had just broken into GAAP-profitability and were set to show increasing operating leverage, the company took a major step back. The cost profile has now been permanently raised, and although revenues have risen to record levels, the company has still not returned to GAAP-profitability.

FTC lawsuit

On April 25, 2018, the FTC sued Lending Club in federal court on four counts. Firstly, the FTC alleges that Lending Club advertises repeatedly that they have “no hidden fees”, but then fails to disclose the origination fee (of 1-6%) except in one or two obscure spots in the loan application that are easily missed.

Secondly, the FTC alleges that Lending Club sent emails to prospective borrowers that their loan has been approved even though Lending Club had not yet finished their final credit review and many such borrowers were in the end not approved.

Thirdly, the FTC alleges that Lending Club has in “numerous instances” withdrew payments from borrower accounts twice in one month, after the loan has already been paid off, or after the borrower instructed Lending Club that they wish to pay from a different account or via check. In many such instances, the borrower suffered overdraft fees.

Fourthly, the FTC alleges that Lending Club failed to provide customers with a clear and conspicuous Privacy Notice, as required by law.

Lending Club has responded publicly to the FTC complaint, and frankly, after reading both the FTC complaint and Lending Club’s response, the FTC seems to be unreasonably aggressive in its attack on Lending Club. Taking the points one by one, Lending Club points out that the origination fee is disclosed in numerous places on the website, that such fee is factored into the disclosed APR, and that *Lending Club uses the standard Truth in Lending form provided by the government specifically to clearly inform borrowers about their fees and interest rates.* No borrower is able to complete their application without viewing and checking a box that they reviewed and agreed to the Truth in Lending form, despite the ambiguous language used by the FTC complaint to make it appear to the contrary.

As for the second count, Lending Club freely admits that there was an error in their system sending out such emails *for a grand total of 88 days in 2015* until they discovered the issue by themselves and fixed it.

As for the third count, Lending Club denies in full that such improper double payments occur in "numerous instances", and they describe the checks and balances they have in place to prevent it, including manually checking any duplicate same-day withdrawals. Some errors occur when the consumer errs and sends a check when an ACH withdrawal has already been scheduled. Lending Club states that from 2015 to 2017, they received fewer than 300 complaints relating to double payments. When there is an error, they refund the customer, and typically reimburse him for any overdraft fees he had to pay as well.

As for the fourth count, Lending Club used to suffice with the customer acknowledging having read their Terms of Service, which included a link to their Privacy Notice. In 2016 they changed their practice, on their own initiative, to explicitly reference the Privacy Notice as well.

In summary, the first and third counts, which on the face are the most serious, appear to hold little water, and the second and fourth counts appear to be blown out of proportion by the FTC, in addition to no longer occurring. Indeed, in a court hearing in September, the presiding judge expressed surprise at the FTC for pursuing this case so aggressively and strongly suggested to the FTC that they should seek a settlement.

Growth

As mentioned above, investors at first fled the Lending Club marketplace and then slowly returned. The first to return were retail investors and hedge funds, who were responsive to financial incentives to invest at volume. Next to return were asset managers and other institutions, and the slowest were banks, whose regulatory and due diligence requirements took the longest time. Over time, however, all the different parts of Lending Club's marketplace returned, and a year later loan originations were growing again. Indeed, by the third quarter of 2017, revenue had surpassed the previous high, but it was not until the second quarter of 2018, two years after the scandal, that loan originations hit an all-time record of $2.8 billion. ('Loan originations' is the total sum of money borrowed through the Lending Club platform. 'Revenues' is Lending Club's cut from origination fees, servicing fees, and other revenues derived in the process of making and selling the loans.)

Lending Club has also started a number of new initiatives to expand the reach of the company. One new area they are breaking into is refinancing auto loans, a product they launched in California in October 2016, and have been expanding nationally since. This is still a small business for them, but has large potential, as there is more than $1 trillion outstanding of auto loans in the U.S., much of which can be refinanced at a lower rate. Lending Club also believes this will give them the potential down the road to offer personal loan customers the chance for a lower rate if they secure the loan with their auto title.

On the investor side, Lending Club has launched securitizations backed by portfolios of their unsecured personal consumer debt. At first, Lending Club worked through Jefferies and other investment banks, with their first securitization coming to market in July 2016. But starting in June 2017, Lending Club started self-sponsoring its securitizations under the CLUB (Consumer Loan Underlying Bond) structure. Since then, Lending Club has put out $1.8 billion worth of securitizations. And beginning in December 2017, Lending Club introduced CLUB certificates, which are basically whole loans packaged in a security with a CUSIP. This makes it look and act in the secondary market like a regular bond, opening the asset class to a wider group of institutional investors who wanted to purchase whole loans but could not do so directly, unless wrapped in a security wrapper. (Unlike regular securitizations, which involve tranching and overcollateralization, the CLUB certificates are simply groups of whole loans of similar credit grade and term wrapped in a security wrapper.) In under a year from introducing CLUB certificates, Lending Club already sold more than $1 billion through this new format.

These new methods of selling and funding the loans benefit Lending Club in two major ways. Firstly, Lending Club benefits from high-margin revenue directly associated with the securitization process. Secondly, both the regular securitizations and the CLUB certificates open up the marketplace to a wider group of investors, simultaneously diversifying, legitimatizing, and increasing their investor base, allowing them to make even more loans than before.

Profitability

The scandal and resultant increased cost profile (which in retrospect was necessary) has delayed Lending Club's return to GAAP-profitability. Nevertheless, Lending Club has shown significant operating leverage, with revenue growth outpacing that of fixed expenses significantly, and a clear path to profitability. On a cash-flow basis, they are already quite profitable. As an illustration of this, despite the $204 million of cash costs (net of insurance) associated with legacy issues that they have had to bear over the past 2+ years (in addition to their other operating costs which are GAAP-negative even without the legacy costs), their cash and securities has only declined from $868 million before the scandal to $787 million as of September 30, 2018. We expect that with the winding down of the legacy issues, increased operating leverage with increased loan originations, and steady cost control, the underlying profitability will become evident. We further expect Lending Club to reach GAAP-profitability by late 2019 or early 2020.

Valuation

With a market cap of ~$1.25 billion, net cash and securities of ~$780 million, and a pristine balance sheet, the market is valuing Lending Club's business at~$470 million. We consider this to be an extremely low figure, especially considering the resilience that the company has demonstrated in weathering this storm while keeping its balance sheet in good condition and returning to growth. We expect 2019 and 2020 to bring Lending Club back to GAAP-profitability, and we do not consider it a stretch at all for the company to reach a run-rate profitability of $100 million a year. Long-term, they have even greater potential than that, and we see the downside as limited. We are happy to be invested in Lending Club at this level and are excited for its future.

Silicon Motion (SIMO)

Position Initiation: 01/17/2014 — Ptfl. Wt. (12/31/18): 13.2%

Price (at Initiation): $14.15 — Price (12/31/18): $34.50

Gain: 171.7%

Description

Silicon Motion designs and sells controllers which manage the NAND flash memory ubiquitous in modern computing. Wherever there is NAND flash, there must be a controller, and often one from Silicon Motion. SIMO is an ADR (American Depository Receipt) trading on the NASDAQ.

SK Hynix

As you may recall from our original Position Paper about Silicon Motion, one of the risks we highlighted at the time was the possibility of SK Hynix insourcing their controller needs for the smartphone market as they transition from eMMC to UFS. Indeed, this has come to pass, and SK Hynix is slowly reducing their reliance on Silicon Motion for controllers. Nevertheless, the effect on Silicon Motion's business is much milder than feared. The transition from eMMC to UFS is a slow and prolonged process, and substantially all of SK Hynix's needs for eMMC controllers are still provided by Silicon Motion. And on the UFS side of the equation, although SK Hynix will produce their own UFS controllers for the foreseeable future, Silicon Motion is making up ground by providing UFS controllers to other flash manufacturers, particularly Micron. The overall effect is that the smartphone controller market is flat to slightly declining for Silicon Motion.

2018: A Breather Year

2018 was somewhat of a breather year for Silicon Motion. Revenue and income were up slightly in 2018, back to 2016 levels, as NAND pricing has returned to 2016 levels. We see 2017 and 2018 as a sort of plateauing before the next leg of growth, which we expect in 2019 and 2020. We expect this growth to come from consumer SSDs, where they are gaining market share, from enterprise SSDs, a new and likely lucrative area of investment for them, and perhaps somewhat speculatively from their Shannon subsidiary.

NAND Pricing

Silicon Motion is highly sensitive to NAND flash pricing trends. As NAND flash comes into oversupply and prices drop, Silicon Motion *benefits* from the increased demand sparked by lower prices. Cheaper prices means more NAND flash sold, and more NAND flash sold means more controllers needed. NAND flash pricing rose sharply in 2016 and 2017, and this held back adoption rates, particularly of SSDs in the computer market. Pricing dropped back down in 2018, to levels comparable to early 2016 and lower. Pricing is expected to drop further in 2019 due to buildup of capacity among manufacturers and a weak smartphone market. This should help Silicon Motion's lucrative SSD controller business, as SSD adoption is expected to increase as prices drop.

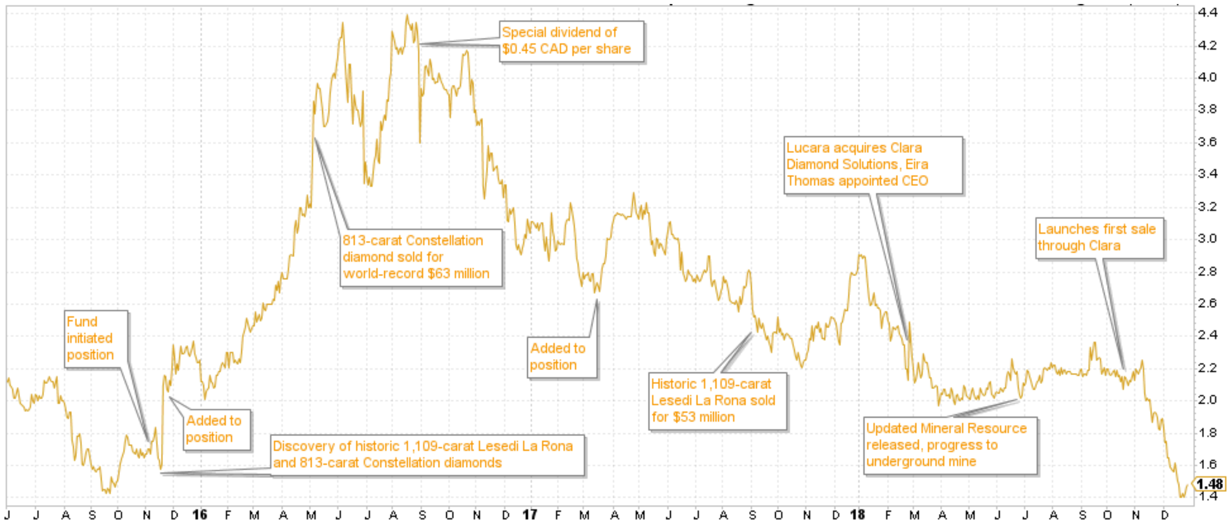
Shannon

Shannon is Silicon Motion's Chinese subsidiary focused on providing bespoke SSD solutions for hyperscale data centers. They have two main customers they are working with at present, one of which is the well-known Chinese internet giant Alibaba. 2018 proved to be a disappointing year for the Shannon business. Although at the start of the year, they guided both consumer SSD and SSD Solutions (consisting mainly of Shannon) to be up 20% for the year, as the year progressed the guidance changed a number of times. Guidance for consumer SSD was raised by the Q2 and again by the Q3 conference calls to end the year with expected growth of ~35%. SSD Solutions, on the other hand, had its guidance lowered. At first, they only anticipated a one-quarter delay of revenue from Q3 to Q4. But at the Q3 conference call, they disclosed that the procurement plans at their two Shannon customers have changed, and in place of a significant ramp in 2018, they instead intend to start small with live data center testing and a significant ramping delayed to the latter half of 2019. This is disappointing, and we wait to see if, in time, Shannon can become a fourth major leg of the business.

Valuation

Silicon Motion is still quite undervalued. With its strong balance sheet and highly profitable margins, Silicon Motion has an attractive business model. And with a P/E of just 13.4, the market is discounting its many future avenues of growth. We are happy to own Silicon Motion at these levels, and we expect the Fund to benefit significantly from its ownership of Silicon Motion in the coming years.

Lucara Diamond Corp. (LUC:TO)



Position Initiation: 11/04/2015 Ptfl. Wt. (12/31/18): 4.5%

Price (at Initiation): $1.69 CAD Price (12/31/18): $1.48 CAD

Gain: 18.9%

Description

Lucara is a Canadian company which owns and operates the Karowe diamond mine in Botswana. The Karowe mine has a coarse diamond distribution, with a high percentage of specials (diamonds > 10.8 carats) and very large stones. Lucara trades on the Toronto Stock Exchange in Canadian Dollars (CAD).

Execution

2017 and 2018 saw some missteps in execution, as Lucara had problems with both their mining and processing contractors. Fleet maintenance was an issue, fleet utilization was low, and the mine was forced to process low-grade stockpile. In addition, waste mining was behind schedule and plant utilization was below capacity. Lucara switched contractors twice (!) and the issues finally appear to have ended in the latter half of 2018. Execution misses are execution misses, and we are not happy about them, but the underlying resource's core value remains undiminished.

Resource Update and Underground Mine

In June 2018, Lucara released their long-awaited updated Mineral Resource to upgrade the Inferred Resources between 400-600 meters below surface to Indicated Resource status. The remaining Indicated Resources are mostly in the South Lobe, which yields larger, high-value stones. In addition, the geological model update reveals that a much greater portion of the South Lobe (51% vs. previous estimate of 12%) is from the geological unit EM/PK(S), which yielded the historic 1,109-carat Lesedi La Rona and 813-carat Constellation as well as other very large stones. All this bodes well for the continued fortune of the mine. With the contractor problems now behind them, Lucara intends to move ahead with a Feasibility-level study for an underground mine.

Clara

On February 25, 2018, Lucara announced the purchase of Clara Diamond Solutions for a 3.7%-7.5% dilution (depending on milestones). At the same time, they replaced the CEO with Eira Thomas from Clara, Eira being one of the three co-founders of Lucara as well. Clara intends to introduce an innovative new process to sell diamonds from mines to diamond cutters and manufacturers. In place of pushing diamond boxes (assortments of diamonds which the diamond buyers must buy in a lot, whether they want all of them or not), the sales through Clara will be pull-based instead. The potential buyers upload their requirements for what type of polished diamond they are seeking and at what price, the mines upload their inventory and what they would accept for them, and Clara sits in the middle, analyzing the rough and matching the correct rough to the highest offer.

This offers a number of benefits over the way the process is done at present. One, this can be done on an ongoing basis instead of at fixed sales, reducing the holding of inventory for the mines. Two, the reduced inefficiencies can raise the price paid to the mines while still benefitting the manufacturers, who would not have to trade away or manufacture unwanted rough at a loss. Lucara estimates that this would unlock greater than 20% of value throughout the diamond pipeline, some of which would accrue to Clara/Lucara as their commission. (Clara keeps the spread between the offer and the ask, and a transaction only takes place at a large enough spread.)

Clara has begun trial runs and commercialization (with their own Karowe mine and eventually others as well) in the end of 2018 and continuing into 2019. Although we are skeptical of acquisitions as a rule, and this was a related-party transaction to boot, we remain in a wait-and-see stance vis-à-vis Clara. If they can attract significant inventory from junior diamond mines and reach their full potential as a platform, this can be highly accretive to Lucara as a whole.

Valuation & Dividend

The stock has steadily declined since the end of 2016, and we believe the execution issues and associated poor performance have masked the underlying value. We continue to see Lucara as undervalued, and in the meantime we are being paid dividends of 6.8% annually to hold the stock.