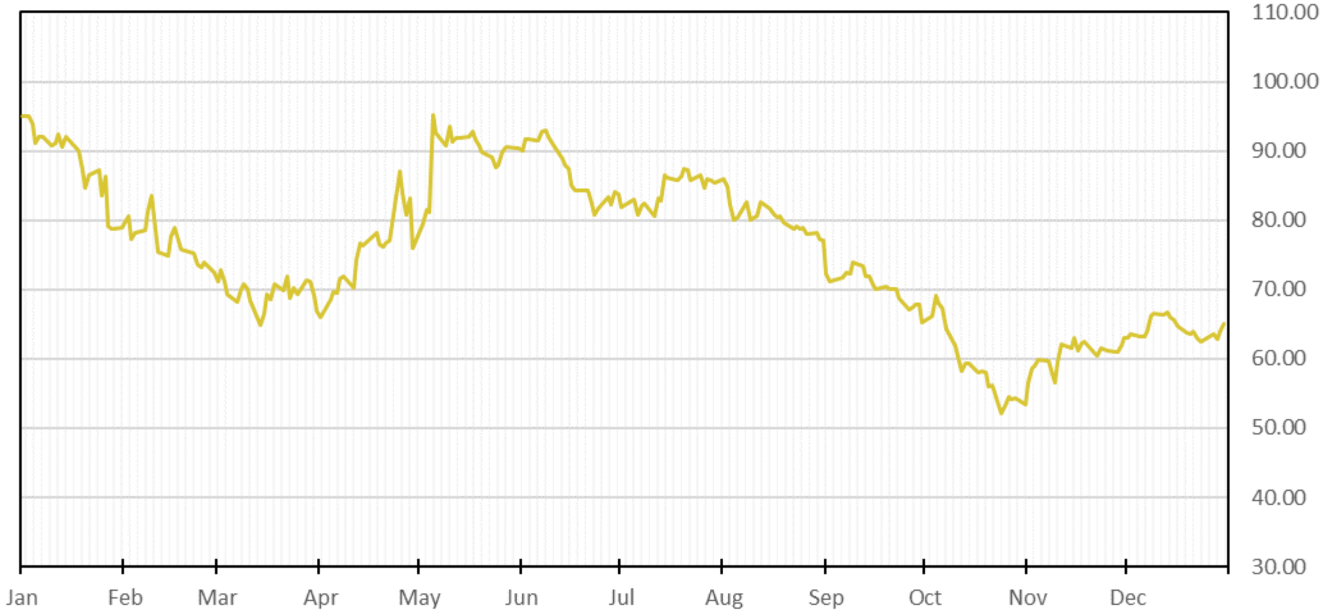
Silicon Motion (SIMO)



Price (12/31/22):	$64.99	Market Cap (12/31/22):	$2.2 billion
Stock Loss (2022):	-31.6%	Portfolio Weight:	29.2%

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, often one from Silicon Motion. SIMO is an ADR (American Depository Receipt) trading on the NASDAQ.

Massive Opportunity

We have discussed Silicon Motion a number of times this year, and we continue to believe that the market is presenting us with a massive opportunity in Silicon Motion right now. MaxLinear has contracted to purchase Silicon Motion for approximately $105 a share, about 65% above the trading price today. Although the merger may end up falling through (see below), the underlying fundamentals of the business are very strong, and we firmly believe that if the merger falls through, we should do even *better* over the long term. A true situation of heads we win, tails we win even more.

Pending Merger

MaxLinear's acquisition of Silicon Motion remains dependent on Chinese approval. Just two weeks ago, MaxLinear reiterated that they expect the merger to close in due time. (The drop-dead date for the deal is August 7th, but this deadline can be extended by mutual agreement of both parties.) Indeed, there is no legitimate reason for China to block the acquisition. Nevertheless, given the current high tensions between the US and China, especially in the area of semiconductors, many believe that China will ultimately block this acquisition of a Taiwanese company by a US company in the semiconductor space. Certainly, the trading price indicates that market participants are highly skeptical of the merger being consummated. We have no special insight into whether or not China will approve the merger, and as discussed above, we believe we will do very well with our investment in Silicon Motion either way.

Business Fundamentals

After a monster 2021, Silicon Motion has continued growing in 2022, with revenue for the first three quarters of the year up 15% and operating income up 13%. In the absence of stock buybacks and dividends due to the pending merger, cash continues to pile up on the balance sheet. We expect continued growth in 2023 and beyond, both from market share gains in a growing market and from entry into adjacent spaces, such as enterprise SSD, which is currently slated to begin ramping up by the end of this year.

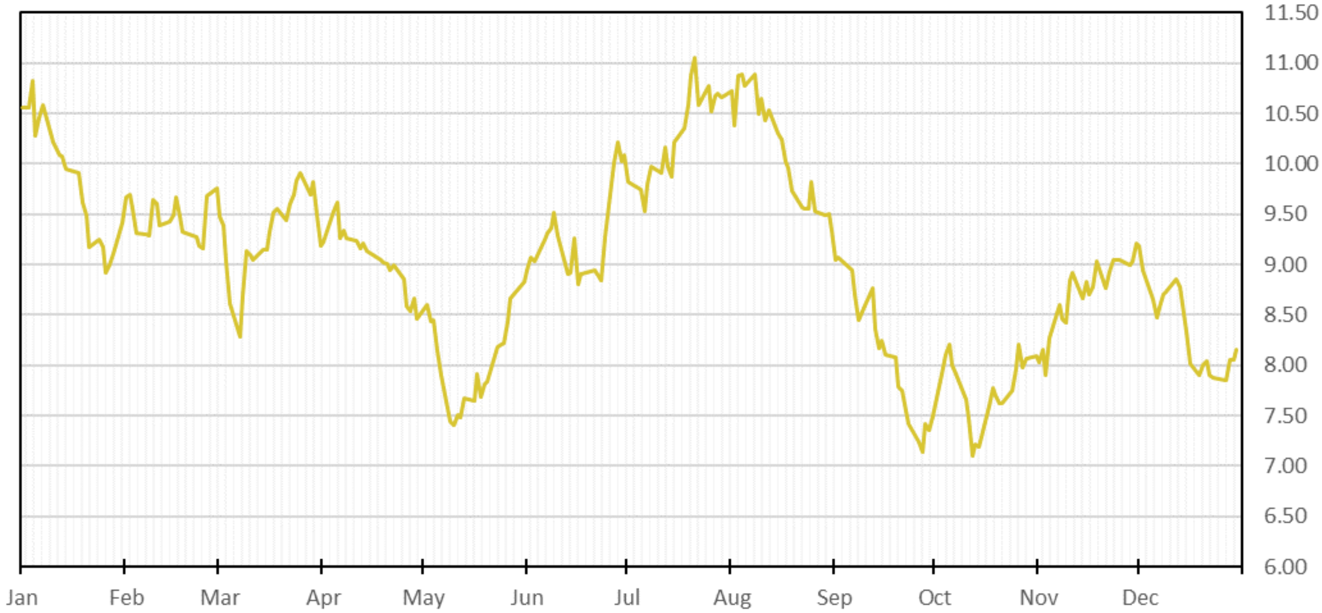
Presentation

In case you missed it, in November we gave a short presentation on Silicon Motion at an investor conference, followed by an interview in December by Andrew Walker of Yet Another Value Blog. Both are available on our website (focuscapitaladvisers.com), under the Research tab. We believe you will find the presentation and interview informative.

Conclusion

Last year, we wrote that we rarely see such an incredible investing opportunity as we were seeing then in Silicon Motion. Yet the stock is down significantly for the year, despite continued strong execution and a merger deal on the table. We are running out of superlatives to describe the strength of the investment opportunity available, and we have added to our position at these lower prices, making Silicon Motion the Fund's largest position. We see Silicon Motion as the perfect quadfecta – high profitability, high growth, reduced risk, and ultra-cheap valuation. Regardless of what happens with the merger, with a P/E of 11 and an ex-cash P/E a little over 8, we expect great things from Silicon Motion and are excited for its future.

Burford Capital (BUR, BUR:LN)



Price (12/31/22):	$8.15 USD	Market Cap (12/31/22):	$1.8 billion USD
Stock Loss (2022):	-22.8%	Portfolio Weight:	19.7%

Description

Burford is a global litigation finance company, which in essence means that they fund and otherwise monetize commercial lawsuits in exchange for a portion of the proceeds received. Burford trades both on AIM (the junior London stock exchange) in Great British Pounds (GBP) and on the New York Stock Exchange in US Dollars (USD).

2022 – More Business as Usual

Business continues to be conducted as usual, with continued record-high levels of commitments and deployments and continued IRRs of approximately 30%. We estimate Burford's adjusted NAV to be worth about the present market cap and compounding at approximately 20-25% for years into the future (using conservative assumptions and net of expenses and debt payments). It is rare to be able to buy a compounding machine like Burford without having to pay any premium, and we are thrilled to be able to do so.

And this calculation is for Burford's litigation portfolio alone. It is not assigning any value for Burford's third-party fund business, which is expected to bring in $400 million+ over the next few years. And it is not assigning any value for the YPF litigation (see below), which just by itself has potential to return in excess of Burford's market cap. We are buying a profitable compounding machine at an excellent price and getting all the rest for free.

YPF Litigation – Awaiting the Judge's Ruling

It has taken years to get to this point, with some additional delay from COVID, but the YPF litigation is finally nearing its conclusion. Note that I say nearing, as we still have some way to go. During 2022, both sides filed their motions for summary judgement, responses, and replies, with the final briefing filed in June.

As the filings are a matter of public record, this has finally opened a window for outside observers to see each side's legal strategy and arguments. They make for very interesting reading (well, if you're into this type of thing), and we believe the briefings bolster the strength of Burford's case. We believe that Burford is more likely than not to prevail and that US judges will not simply allow Argentina to break a contractual obligation they accepted when offering an IPO in New York. Nevertheless, we do not say this with massive confidence, as all litigation is inherently unpredictable. (Argentina's best argument is probably their claim that even if they must pay, the obligation should be denominated in pesos. Due to the massive devaluation in the intervening time, payment in pesos would amount to almost nothing. Burford and Petersen dispute Argentina's interpretation of the law on this matter.)

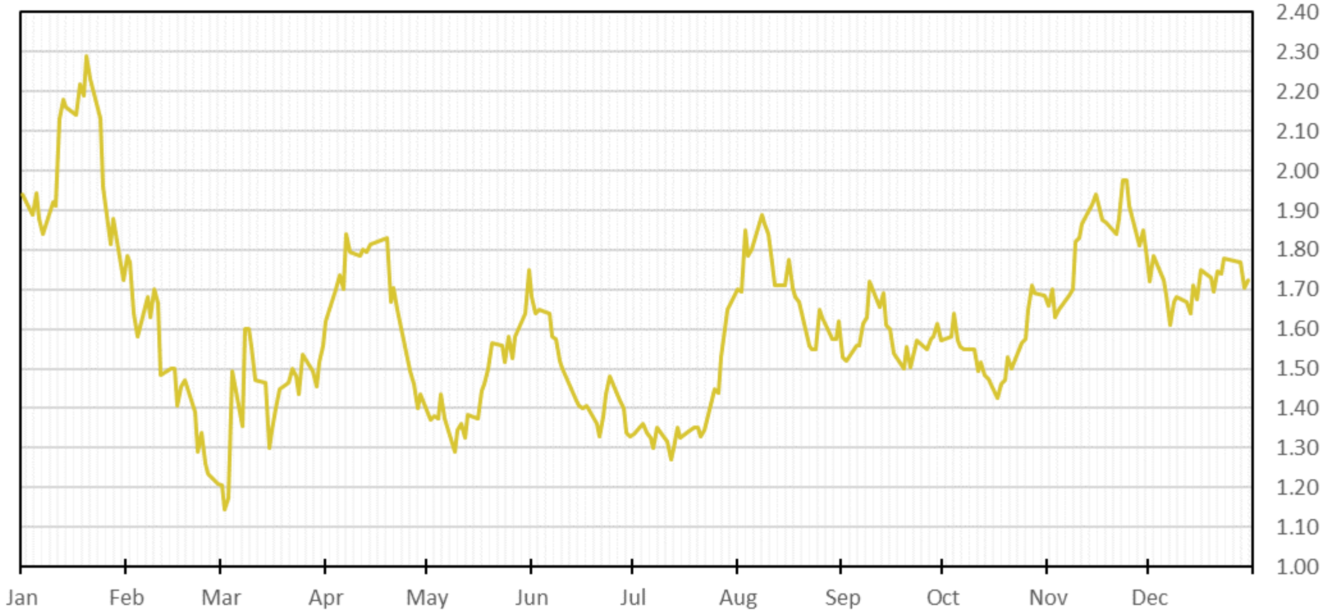
If Burford prevails in the YPF litigation, they will likely be awarded between 1x-2x the present market cap (plus interest, which should more than double the above figure). Clearly, the market is not pricing in expectations of Burford prevailing, so we would expect a large pop if Burford wins. However, if Burford loses the case, the stock may very well experience a sentiment-based drop, despite the present price not seeming to include much value for the YPF case to begin with. We would view any such drop as a buying opportunity.

The last filing in regards to summary judgement was made on June 23rd, and we now await the judge's ruling (or, possibly, her decision to hold a full or partial trial). It has been seven months already, so we do expect to see a ruling any day (week? month?) now. There is nothing to do now but wait.

Conclusion

Burford continues to win cases and bring in very solid returns. They are by far the largest player in the litigation finance space, able to take on bigger investments and make bigger bets while still being conservatively diversified. The possibility of a major windfall from the YPF litigation is a very sweet cherry on the top, but whatever happens with the YPF litigation, we expect continued growth and solid returns from Burford's diversified portfolio, both that owned by Burford and that managed for third parties.

Kingsgate (KCN:AX)



Price (12/31/22):	$1.725 AUD	Market Cap (12/31/22):	$258 million USD
Stock Loss (2022):	−11.1%	Portfolio Weight:	16.9%

Description

Kingsgate (Sydney: KCN) is an Australian gold mining company with one major asset, the Chatree gold mine in Thailand. Although closed for a number of years due to governmental action, Chatree is imminently restarting operations and will begin to generate substantial cash flow. Despite the change in fortune that is already underway, Kingsgate continues to trade at a significant discount to the underlying value of its Chatree mine. Kingsgate trades in Australia in AUD (Australian dollars), but its business is mostly sensitive to USD (US Dollars). All numbers in this Position Paper are in USD, except for share price, which is in AUD.

2022 Updates

In our April letter of this year, we introduced Kingsgate, a new investment for the Fund that we entered at the end of 2021. The situation remains much the same as then, except that substantial progress has been made on the refurbishment of Plant 2, and we are now fast approaching its imminent restart. We expect the first gold pour to take place in the first quarter of this year, followed by the refurbishment of Plant 1 and the resumption of mining, which are being financed from the processing of stockpile in Plant 2. By mid-2024 at the latest, the mine should be fully operational and operating at capacity.

Over the course of 2022, Kingsgate management has accomplished a great deal to get the mine back up and running. They arranged financing at decent terms, without needing to dilute shareholders with a capital raise or a large warrant award. (In fact, six years after the mine totally closed, Kingsgate actually has slightly fewer shares outstanding now than they did then. This is a testament both to management's ability to manage costs and fight for the company's legal rights over a prolonged period and to management's desire to do right by the shareholders. Such qualities are far from given in many companies in similar situations.) They upgraded the mine's gold reserves by 46% based on higher gold prices since the mine closure (using a gold price of $1,700 an ounce; gold now is above $1,900 an ounce, so this upgrade actually understates the case). They have drawn a new LOM (Life-of-Mine) plan and planned and executed on the first stage of refurbishing the mine, both on time and within budget. And they have restarted exploration activities in the newly awarded SPLs (Special Prospecting Licenses), with a focus on the most promising areas, including high grade areas nearby Chatree that can serve as feed ore for the present processing plants.

With all this going on, negotiations continue to hammer out the final details of the settlement between Kingsgate and Thailand, with recent high-level meetings in Sydney including the Deputy Prime Minister. Talks are confidential, but there are numerous signs that Kingsgate will be receiving more concessions in conjunction with a final settlement. At the very least, we expect Kingsgate to be awarded BoI (Board of Investment) tax incentives to waive taxes for 8+ years, a move that would substantially raise profitability. Another possibility, although less likely, is for Thailand to adjust the royalty schedule for gold, which at present is very much an outlier compared to world standards. Currently, Thailand charges gold royalties using a sliding scale which tops out at 20%; at present gold prices, the royalty amounts to a blended rate of about 10%. If Thailand were to adjust the gold royalty to 3% (the top end of the general range worldwide), this would be very significant for Kingsgate.

We stress that Kingsgate stands to be very profitable even if there are no further concessions at all. Kingsgate was very profitable back when the mine was operating in 2016 at gold prices of $1,200 an ounce. With the increase in gold prices to above $1,900 today, Kingsgate stands to be even more profitable. Any concessions from Thailand are just icing on the cake, so to speak. And in the meantime, we still have the $750 million (plus interest) TAFTA award in the background, both as leverage to encourage a final settlement that is fair and compensatory to Kingsgate and as a backstop in case the settlement somehow falls apart at the last minute, an event we consider very remote at this point.

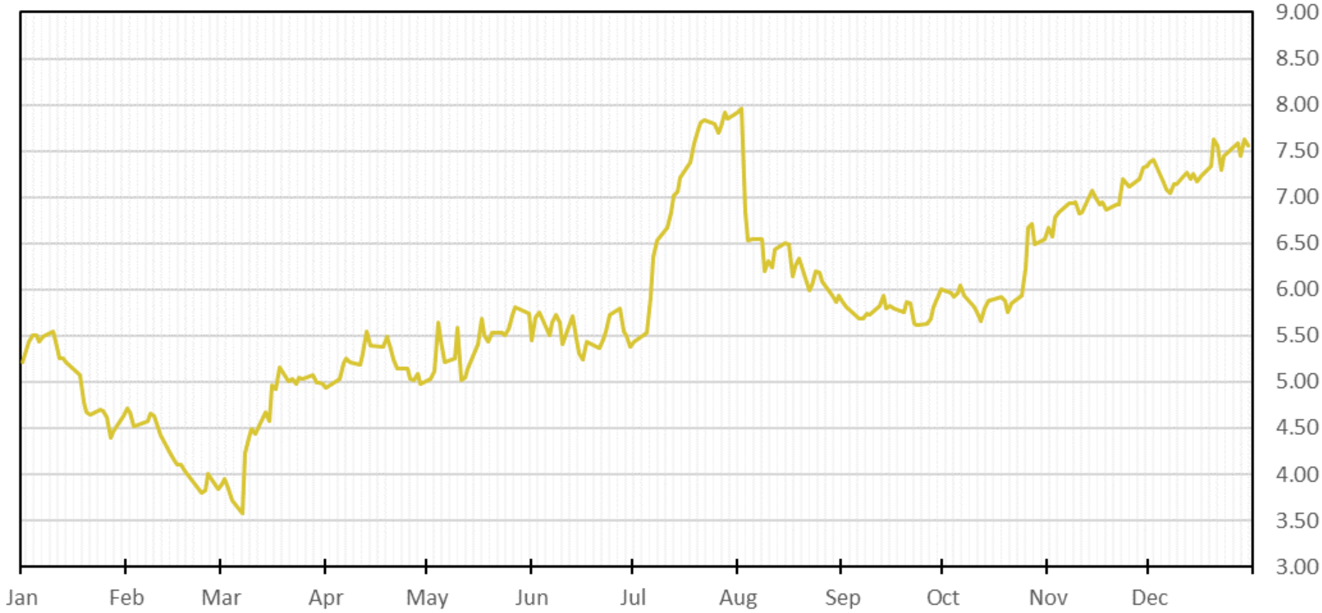
Presentation

We recently presented on Kingsgate at the MOI Global Best Ideas conference, which took place last week. The presentation is available on our website (focuscapitaladvisers.com), under the Research tab. We believe you will find the presentation informative.

Conclusion

Kingsgate is on the cusp of restarting a highly profitable gold mine and is valued at only 3-4x the yearly expected cashflow. We believe that this is a highly undervalued business which will experience a substantial resetting of market valuation as the mine comes back online. We are literally getting a $1 billion+ mine for under $300 million.

Viemed Healthcare (VMD, VMD:TO)



Price (12/31/22):	$7.56 USD	Market Cap (12/31/22):	$287 million USD
Stock Gain (2022):	+44.8%	Portfolio Weight:	7.3%

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 both on the Toronto Stock Exchange in Canadian Dollars (CAD) and on the NASDAQ in US Dollars (USD).

Post-Pandemic, Core Vent Business Returns to Growth

With the pandemic behind us and hospitals again open to vendors and outsiders, Viemed's core vent rentals have returned to growth, although at a slower and more uneven rate than before the pandemic. Over 2022, they have grown their crucial vent patient count about 12%, mostly in the latter part of the year, but this is still a far cry from their prior growth rates which were regularly north of 30%. At this point, one can definitely start questioning why growth remains muted, and one wonders whether all the new initiatives that management has been entering recently are distracting them from growing the core business further.

Viemed Vindicated in Appeal of OIG Review

In May of 2021, the Office of Inspector General (OIG) of Health and Human Services released an audit of Viemed's 2016 and 2017 Medicare NIV (Non-Invasive Ventilator) claims, in which the OIG found that 98% (!) of audited claims were ineligible for Medicare coverage because they were "medically unnecessary". In line with this report, CMS initiated procedures to reclaim $9 million worth of payments previously made to Viemed.

As we made clear in last year's Portfolio Update, the OIG position was patently absurd on its face, and a cursory reading of the OIG report and Viemed's response quickly revealed the bias and contradictions within OIG's position. Without repeating all the specific details that we provided then, we repeat that we have seen this movie before, and we expect Viemed to ultimately prevail as they have done in each of their previous audits.

Indeed, our prediction has already begun to be realized. In May of this year, Viemed announced that the Reconsideration process (the first layer of appeals, still within the CMS system) reversed the vast majority of the disputed claims in Viemed's favor, reducing the remaining disputed amount to just $1.1 million. Viemed continues to appeal the remaining disputed claims through the multiple remaining layers of the appeals process, starting with an appeal to an Administrative Law Judge. Although the appeals process can take a number of years to reach its conclusion, we expect Viemed to eventually prevail on virtually all of the disputed claims.

Concerns

In our previous Portfolio Updates, we highlighted a few areas of concern that we wish to draw attention to again. First, the excessive stock-based compensation and phantom share programs remain a serious issue with Viemed, and indeed, have gotten worse. These two programs combine to almost 60% (!) of adjusted net income (net income with the above programs added back in), an unconscionable percentage by any measure and heading in the wrong direction. This issue is extremely important to us as we only want to be invested in companies where we can be confident that management will do right by the shareholders.

Second, we continue to be concerned that management may be losing their laser focus on the core of the business, non-invasive ventilation, as they chase other short- and long-term opportunities. They continue to dabble in various related and unrelated sources of revenue, including social workers, remote patient monitoring, and a staffing agency. We believe these various efforts which are far afield from their core competencies are reducing focus and management attention from their main bread-and-butter NIV business, as evidenced by the slowing growth in their main line of business despite the general return to normal.

Third, management has also indicated that they are actively considering acquisitions, and we are nervous that management will overspend or spend unwisely to acquire competitors or tangentially related businesses.

Conclusion

We remain cautiously optimistic about Viemed's long-term growth potential and hope to see their rapid growth begin to resume. Nevertheless, the concerns are mounting up, and we have begun to significantly lighten our position. Over the course of 2021, we sold about 25% of our position, and we recently sold another 50%. By this time next year, barring new developments that address our above concerns, it is likely that we will have exited the name entirely.