IBV CAPITAL

Q1 2021 Partnership Letter

Dear Partners,

In normal times, finding attractive investment opportunities presents its challenges. Now, more than ever, a combination of our rigid internal investment requirements and external factors is making it unusually difficult.

Fortunately, we have encountered similar struggles in the past. Just as we overcame those, we are likewise encouraged that present conditions won't last forever. They never do. And we will once again return to finding attractive investments with more frequency.

Our investment sourcing and selection framework plays a critical role in our process and the ultimate success we strive to attain. The framework we have developed has resulted in frequent triumphs – we have made a profit on 85% of our investments – and limited failures.[1]

This level of achievement can be attributed to a sourcing and selection framework that is centered on eliminating risk. Since risk is of paramount importance, we have developed a definition that guides us. To us, risk is the probability of a permanent loss of capital.

Our conviction to avoid risk proves to be an influential constraint. Despite the offsetting freedom we gain from our ability to 'go anywhere' in terms of industry, geography, and asset class. The limitation we confront is entirely due to the fact that few opportunities will present the conditions whereby losing capital is truly a low-probability outcome.

Historically, the most desirable opportunities identified by our framework have shared a common feature. Predictable drivers of intrinsic value. Once we uncover this attribute, we focus on ensuring these drivers of value are skewed towards producing positive outcomes as opposed to unfavorable ones.

We are acutely aware of the differences between an intrinsic value driver's cause and effect. For instance, revenues should not be deemed stable just because they are increasing. Only revenues driven by recurring volumes – naturally or contractually – along with a high degree of pricing stability will exhibit lasting consistency and predictability. We apply this causal thought process to other elements of a business too.

Our assessment of a business's cost structure focuses on its operating leverage and ability to adapt to input cost pressures. We much prefer companies that are able to improve their margins by selling more of their products as opposed to stagnant margins regardless of volumes sold. We also favor a company that has the status or ability to quickly pass input cost increases on to their customers or avoid them altogether.

We appreciate the importance of the relationship between a company's operating margins and capital intensity too. For instance, businesses with higher capital requirements should command higher margins. An electric utility combines these features. Whereas a business with low capital requirements can be successful with low margins – this is reflective of automotive retailers. When a capital-intensive business has low margins, the velocity of the company's sales becomes a primary driver of success.

While this doesn't represent our exhaustive list of desirable factors, it does reflect the characteristics that our framework is designed to surface. It also highlights that our rigid set of conditions will dramatically narrow our field of investible opportunities and explains our historical omission of many industries and even geographies.

For instance, investing in commodity producers or early-stage pharmaceutical companies can generate wonderful returns, but accurately predicting this positive outcome in advance is incredibly difficult. The same can be said for most opportunities in countries that do not respect the rule of law.

This brings us to our rationale for expanding our investment universe to include various industries, geographies, and asset classes. Without expanding our versatility, finding the opportunities that we deem acceptable to invest in would become unnecessarily challenging. Instead, we designed a framework that supports us in managing against our definition of risk.

We can then blend it with our conservative views on the price we are willing to pay for the value we would like to receive. We take comfort in paying such a low price for a security that we remain well positioned to make money on - or at least allow us to walk away financially unharmed – even if all the company's key intrinsic value drivers produce unfavorable outcomes. This approach offers the delicate balance that's necessary to achieve a simultaneous objective – protecting our capital while earning attractive rates of return.

Unrelenting Appreciation

The market value of our IBV Capital Global Value Fund increased by 7.1% (net of fees) in the first quarter of 2021. While the intrinsic value of our portfolio decreased by 3.4% during the quarter. For comparative purposes, during the first quarter of 2021, the MSCI World Index increased by 4.9%.[2]

While our investment performance continues to share an alignment with the market, its root cause could not be further from the widespread and unrelenting lift to global asset valuations. Instead, our returns have been catalyst driven and include securities across asset classes – including debt, preferred shares, and equities.

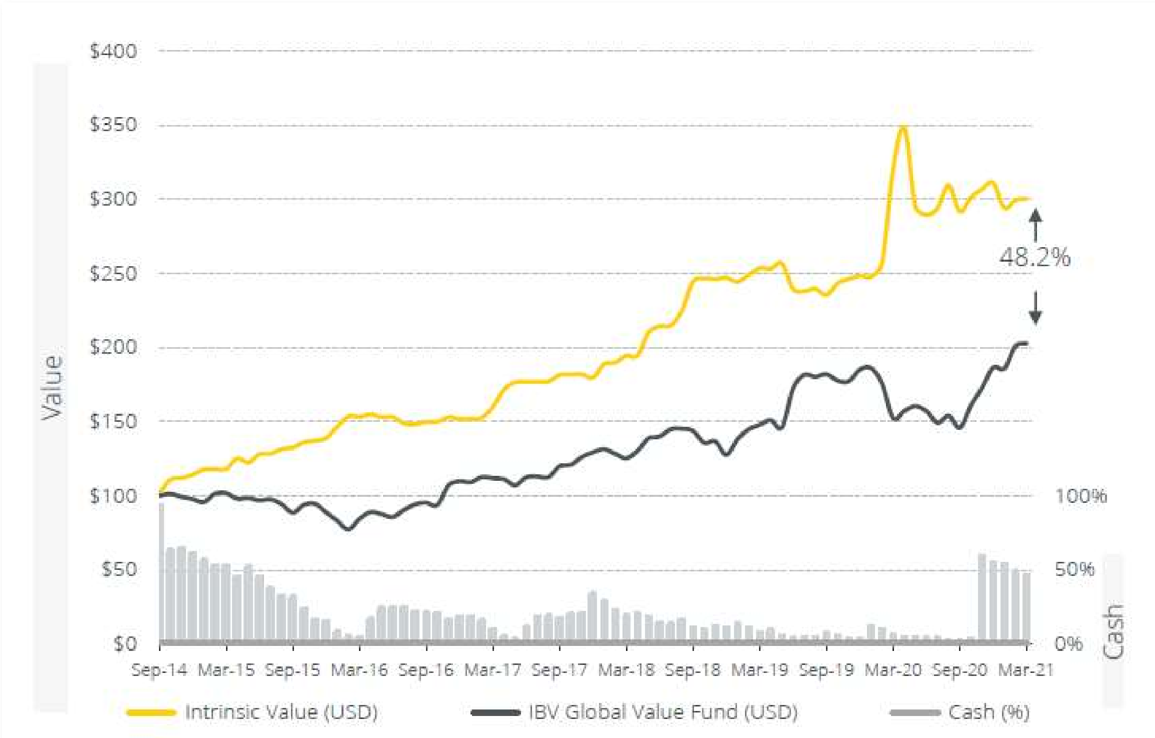
For instance, during the quarter, our investment in the 11.5% senior secured notes of HC2 came to a successful conclusion. On February 21, 2021, the company redeemed the remainder of these notes to secure refinancing on more attractive terms.

The redemption prompted the early achievement of our expected intrinsic value because it was in advance of the scheduled maturity date of December 2021. We are very pleased with the 20% annualized return this debt investment has generated.

Similarly, we have exited our two-and-a-half-year investment in Element Fleet Management (EFN) preferred shares. While EFN was a troubled company a few years ago, at the time, we determined that its underlying assets and long-term prospects were very attractive. This gave us a lot of comfort in making an investment and we're thrilled to report that we incurred a modest level of risk for the level of return we earned.

The return we have generated from our investment in FirstGroup Plc (FGP) has been outsized to date. After developing a well-considered investment thesis in 2018 we had purchased shares of FGP. Our extensive due diligence and patience positioned us well to act quickly when COVID-19 began impacting global markets. When markets tumbled, we dramatically increased our investment in FGP. This has already proved to be highly beneficial, and we continue to see the potential for more value to be created.

When combined, these activities have all contributed to increasing our portfolio's market value. While new investments were added to the portfolio in the quarter, they were not yet meaningful enough to offset this market value impact. Consequently, it narrowed the gap between the intrinsic value of our portfolio – what we think our portfolio is worth – and the market value of our portfolio to 48.2%.



We have developed a long history of making investments that result in profits. This investment sourcing and selection success has been amplified by our investment weighting strategy. We have repeatedly shown an ability to disproportionately focus our portfolio on investment triumphs as opposed to the few mistakes we have made. This has translated into realizing $20 in profits for every $1 in realized losses.[1] While we're thrilled with the outcome thus far, we're constantly working towards enhancing our process and these profitability metrics.

Navigating the Capital Structure

To emphasize the benefits of our investment sourcing and selection framework, we will focus on three timely investments within our portfolio that traverse the capital structure. While each exhibited vastly different investment considerations, the outcomes are consistent with initial expectations. They exhibited a high probability of success and ultimately produced strong returns relative to the risk we undertook.

We will begin with our recently closed investment in the senior secured notes of HC2. Prior to COVID-19, we identified that the senior secured notes of HC2 were trading below par – despite offering an attractive 11.5% coupon – for reasons that were not entirely justified.

Specifically, the assets of the company – the subsea cable installer, insurer, and steel fabrication businesses – had a combined value that provided ample coverage for the debt the company had incurred.

At the outset, we were pleased with the management team's commitment to de-levering the company through targeted asset sales. It provided us comfort that we would receive full payment for lending them funds.

True to form, shortly after we purchased the notes, the company began selling their operating businesses and using the proceeds to redeem the debt we owned – often at a premium to par. This went on until the end of 2020 when a newly instituted management team – the old team was removed following a contentious boardroom battle – raised equity in a buoyant market to opportunistically refinance the company on attractive terms.

The final redemption of the notes took place at par value – we received above par for 27.5% of our position – marking the end of our investment. Over two years, we realized a 20% IRR on our investment. This resulted in a meaningful positive contribution to our portfolio return profile, particularly within the context of the responsible level of risk that accompanied the investment.

Our investment in Element Fleet Management's (EFN) Series E preferred shares have also come to a successful conclusion. We first purchased the preferred shares in September 2018. At the time, EFN was not the strong financial and operational company it is today. To the contrary, it was in operational disarray following a failed trucking company acquisition and there were signs of clientele attrition in the leasing business.

We correctly identified that the company was undercapitalized and would need to build its cash position immediately. Instead of incurring the potential dilution risk of an equity raise or market risk associated with another steep dividend cut – they eventually chose to raise equity in a bought deal – we sidestepped the risk by purchasing the preferred shares.

However, we remained exposed to the Bank of Canada (BoC) 5-year Treasury Rate as these preferred shares were subject to a rate reset using the BoC rate as their benchmark. Unfortunately, immediately after we purchased the preferred shares, the BoC rate began to fall, offsetting the positive impact of the equity cushion EFN's management put in place. This would prevent us from quickly benefiting from our accurate assessment of the situation. Though it would be a few years of holding the position, we collected a healthy dividend yield of 7.4% on our adjusted cost base while we waited.

This dividend yield would contribute to us earning an IRR of 12.7%. Considering the incredibly modest level of risk we incurred – particularly following the company's balance sheet renovation and stabilization of its operations – it's worthwhile placing this return into perspective. During our holding period, the average BoC rate was 1.2%. This implies that we earned a 11.5% premium to a longer-term risk-free rate and emphasizes the excellent asymmetrical return to risk trade off we underwrote.

In the fall of 2020, FirstGroup Plc (FGP) recommenced the sale process for its North American businesses – First Student and First Transit. This process was delayed at the onset of COVID-19 and despite being restarted has been longer than anticipated.

As North America's vaccine programs have rolled out with increasing pace, the visibility on a permanent re-opening of schools and businesses is coming into focus. This reality should lift any simmering reservations that qualified buyers may have about the financial performance of these businesses in the near to medium term. With these headline risks being removed daily, the underlying fundamentals of these businesses will come to the surface so their true value can be revealed.

Coincidentally, shortly after the quarter had ended, we learned that FGP had completed the sale process and proposed a use of proceeds. To maintain our long-standing tradition of only discussing what transpired during the quarter in our letters, we will wait until our next communication before providing our full commentary on this transaction.

Since the new year began, we have introduced a few investments from around the world into the portfolio. These businesses participate in specialized textile manufacturing, childcare, and aerospace manufacturing.

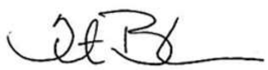
A common thread between each business is the predictability of their intrinsic value drivers as a result of their dominant market positions in their respective areas of intense specialization. Identifying investment opportunities that exhibit these qualities is exactly what our investment sourcing and selection framework is designed to achieve. We're looking forward to reporting on these investments in more detail in the future.

A New Look

To commemorate a defining moment in history – when the world went fully virtual – the team at IBV Capital embarked on an ambitious mission to rejuvenate our website. The new site was carefully designed to visually align with our orientation materials as well as our Toronto office. This was done to perfection – it's a beautiful website.

We are particularly proud of its enhanced functionality. Now, Investment Partners can effortlessly access our firm's history, fund details, partnership letters, media appearances, and thought pieces. And subscribing to our thoughtful communications has never been easier! We encourage you to visit www.ibvcapital.com to explore our new look.

Sincerely,



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[1] The disclosed performance metrics are based on a total of 54 investments managed by Talbot Babineau since December 2010 on behalf of IBV Capital's Managed Accounts ("Managed Accounts") that were fully or partially realized as of March 31, 2021. The calculation excludes investments in derivatives (i.e., currency futures and options) as well as cash and cash equivalents. Total proceeds (including realized gains, dividend income, and interest income) were above $0 on 85% or 46 of the 54 investments included in the calculation. Furthermore, the Managed Accounts earned total proceeds of $65 million and incurred total losses of $3.4 million on the 54 investments. The Managed Accounts are a composite of five discretionary accounts that Talbot Babineau has managed since December 2010. Between December 2010 and December 2013, Talbot Babineau managed the Managed Accounts while employed at KF Matheson Holdings Corp. as the vice-president of investments. During this period, Talbot Babineau was not a registrant. On September 9, 2013, IBV Capital Ltd. became registered with the OSC as a portfolio manager and an exempt market dealer and on December 12, 2013, it registered as an investment fund manager. From this point onwards, the Managed Accounts continued to be managed by Talbot Babineau but at IBV Capital Ltd. and in his capacity as a registrant. Past performance is not indicative of future results and there can be no guarantee that the Managed Accounts or IBV Capital Global Value Fund will achieve comparable results or be able to avoid losses.

[2] "IBV Capital Global Value Fund" consists of USD$ IBV Capital Global Value Fund LP Class A master series unit returns, net of fees. Inception date of this series is September 1, 2014. "Intrinsic Value" represents IBV Capital's internally calculated value for the cumulative securities within IBV Capital Global Value Fund. "MSCI World Index" is based on the USD$ returns MSCI World Free NR Index.