EWING MORRIS INVESTMENT PARTNERS LTD.

Ewing Morris & Co. Investment Partners Ltd.
1407 Yonge Street, Suite 500
Toronto, ON M4T 1Y7

telephone. 416 640.2791
www.ewingmorris.com

June 30th, 2017

The second quarter of the year was a successful one for both the Dark Horse fund and our firm. Let's first touch on the firm before delving deeper into what happened with the fund and the usual letter fare. In May we completed the merger between Broadview Capital Management and Ewing Morris & Co. (as you'll see by our new letterhead). In June we moved into the new combined office space at Yonge and St. Clair. What the new neighborhood lacks in craft beer and organic baby clothes it more than makes up for in access to transit and proximity to many of our clients. While we have traded the "quirky cool" of Leslieville for the "polished professionalism" of midtown, we are very happy having done so given the quality of the team we have joined. Just to be clear, we are referring to the neighborhoods here. We are neither particularly cool nor especially polished.

So far, the integration of the two firms has gone very well and is already bearing fruit from both an investment and operational standpoint. The most tangible benefit of the merger was access to the enhanced operations, compliance and client service infrastructure of Ewing Morris. But we also expected everyone to benefit from putting the two investment teams in the same office. Though early, we believe these benefits are occurring even sooner and more tangibly than we initially estimated. In the next letter we hope to report on some of the actionable investment ideas that have manifested themselves from the efforts of the combined team.

As for the Dark Horse, we were able to build off of a successful first quarter and add another approximately three percentage points[1] in this quarter. Our biggest single contributor is a familiar name, Forestar Group Inc., doing an unfamiliar thing - going up.

The most recent chapter in our long, drawn out Forestar saga started with a congratulatory email Anthony received from a friend on Good Friday. It read, "Congrats on the Forestar. Those are always nice." This is in the same ballpark as unexpectedly receiving word that "A package just arrived for you from One Bills Drive" or "I sent the kids to my parents for the weekend". Immediately Anthony dropped everything he was doing and raced to his computer to see what wonderful news was awaiting him. Was it a takeover at a massive premium? Perhaps it was a dividend recap with a huge special dividend on its way or maybe an accretive merger with a company that has a massive Wall Street following and complementary assets. Regardless of the details we knew something good was coming to one of our largest holdings.

Turns out, it was a takeover…at a $0.10 premium. The stock had last traded at $14.15 indicating a premium of 71 basis points (rounded up). Our average cost is $14.32 and we have had a position in the stock for about seven years. Starwood's $14.25 bid would have brought us an annualized return of somewhere between nothing and less than nothing. No wonder the announcement came late at night before Good Friday on a day that we will now refer to as Mediocre Thursday.

---

[1] Given that we now send out the letters at the end of the month as opposed to the 15th of the following month, we will be presenting estimates of the final results. These will be updated once the NAV is finalized and statements are sent out.

Our friend had seen headlines of the takeover by Starwood Capital Group, a multi-billion dollar real estate-focused private equity firm, and very logically assumed that a takeover would have been a big win for the Dark Horse and its investors. Unfortunately he was wrong – actually, he wasn't entirely wrong. Turns out, he was just *early*.

On June 6th, Forestar announced that it had received another offer, this time from homebuilding giant D.R. Horton, Inc. for $16.25 for 75% of the outstanding shares (the rest would remain outstanding). Now that was more like it. Our math was more in the $18 range but after staring at a $14.25 bid we would likely have taken the $16-and-change bid and called it a day. That being said, we now had a bit of a bidding war going between two very well-funded and knowledgeable buyers. What was once a decrepit warehouse in coal country was now being viewed as a two bedroom semi in Richmond Hill.

Thankfully, we weren't done there nor had we sold any stock yet. Starwood subsequently came back with a $15.50 bid (for 100% of the stock). D.R. Horton's response to Starwood's marginally improved second offer was a Texas version of "hold my beer[2]" - $17.75 for 75% of the stock. We were now talking a full-blown bidding war. That two bedroom in Richmond Hill had now morphed into a three bedroom fully-detached in Riverdale near a school with solar panels and a communal garden.

It appears that D.R. Horton's bid will win out and, as such, we have likely reached the culmination of our engagement with Forestar. We typically do a post-mortem on our completed investments as a means of figuring out what worked and what didn't. The intent is to learn from our successes (and failures) so that we can repeat what worked and not repeat our missteps. We'll walk you through an abbreviated version of one of these with Forestar now. This may be a slight review for some of our long-term readers, but we believe it will be illustrative of what we do, what works for us and what we can still work on.

Forestar Group was an abject failure as a public company. It was spun-out of Temple Inland as a hodge podge of real estate and timber assets in late 2009. As most of you know, we really like spin-offs and were immediately attracted to Forestar's land and real estate development assets. We saw a relatively straight forward path towards having the company highlight and monetize these high-quality assets while divesting some of its less compelling businesses. Instead of trying to narrow down the company into a cohesive and understandable entity, management disastrously added complexity by acquiring Credo Petroleum in 2012. That decision eventually cost the CEO, CFO and most directors their jobs while also costing shareholders more than $200 million in impairments.

The actual total cost in terms of lost market value is likely higher than that figure, particularly if one considers the time value of money. If it weren't for this silly foray by the CEO, the rubber stamping Board and the CEO's buddy Flavious[3], the "good" part of Forestar would have long since been able to establish itself as the basis of a successful standalone company or would have already been

[2] For all we know, they actually say "hold my beer" in Texas before doing something impressive. This is not to imply otherwise.
[3] Yes, a man named Flavious was directly involved in the decision to buy the oil company.

acquired, likely at a price well in excess of the current bids. Now, slightly more than five years after the idiotic decision to buy the energy company (at the top of the market, naturally) this company has finally been put to bed[4]. This has all taken far too long to resolve itself and long-suffering shareholders will never be fully compensated for the assets they owned. That being said, we applaud the current Board and the active shareholders who pushed for change resulting in the shareholders at least getting something respectable for all their troubles.

The Forestar case study could be read in a couple different ways. To some degree we were far too patient, and in another, we were – thankfully – just patient enough. To some degree the company was almost too Broadview-y (multiple businesses, complicated structure) to actually work as an investment, although, in the end, it was the activists that drove the divestiture of non-core assets and helped get the company sold (a very Broadview sort of thing to do).

Ultimately, the key takeaway is that Forestar is exactly the type of company we should follow and know intimately. The act of the private market realizing the value of assets that the public market ignores is a tremendous generator of profits for shareholders. For such an investment to have been a truly great one however, we should have either waited until we were certain that someone with the requisite skills and heft was doing the pushing necessary to address the fundamental challenges of the company, or conversely, we should have been willing to be the ones pushing. Had adult supervision arrived years ago, this investment could have been spectacular. It is this learning, along with a decent profit and a bit of brain damage, that we take away from our experience with Forestar.

I told you Bernard, never *place your trust in us. We're only human. Inevitably we* will *disappoint you.*

Dr. Ford, HBO's Westwood Season 1

That may make sense to you in a bit.

We have always been amused by the financial media and its typical market summaries. "Stocks advanced as expectations for rate hikes fell" or "Another winning day for Wall Street as investors cheered earnings" are headlines I just made up that have most certainly appeared a half dozen times each in the past couple of years. Such interpretations indicate a clearly defined cause and effect. The markets did something and here is the explanation. That satisfies the viewer/reader as there appears to be some sort of rational order to the trading activity. To provide some validation for these headlines, some sage-looking strategist or even a star fund manager of the Big Bank Canadian Large Cap Fund appears live from the stock exchange floor with their learned two cents on why the market did what it did that day.

Earlier this month a report from JPMorgan claimed that, by its estimates, only 10% of daily equity trading volume on the major U.S. markets is being done by discretionary traders – human stock pickers. The rest, an overwhelming majority, is being conducted by passive or quantitative traders – predominantly unthinking humans or computers. The growth of both passive and algorithmic

[4] The possibility of another bid from either of the two announced bidders (or any of the dozen or so unnamed interested parties from the merger docs) seems remote.

investing is no secret and something we have discussed in the past. What makes this report so startling is the quantum of the dominance of "passive" and quantitative volume over "active" volume. Let's just put this into as plain English as possible – 9 out of every 10 shares being traded on the major U.S. markets is being done so with no regard for price or value.

This data makes these market recap headlines appear even more ridiculous. In the face of evidence that trading is being driven almost entirely by robots and others that are completely indifferent to price (i.e. ETFs), why even bother trying to explain rationally why stocks went up or down?

In reality, the nightly headlines should read "The markets went up because they were open today" or "Stocks move higher as our robot overlords decided to acquire more of them". Instead of the Star Fund Manager, Johnny Five from Short Circuit would then be trotted out to explain the activity of his robot brethren. On a good day it would be "Stocks good. Fear nothing humans". On a down day, "Just profit taking. Buy more stocks tomorrow".

As was mentioned earlier, the dominance of passive and algorithmic buyers has been widely reported. Even if this JPMorgan report provides us with some new insight into the degree to which non-fundamental buying has taken over, it does not appear to have changed the narrative. No new alarms have been raised. After all, if markets keep inching higher, as they have in the U.S., or at least avoid material declines, as they have in Canada[5], who is to complain? Who are we to say that we haven't reached some sort of utopia where everyone gets richer and happier each and every day? Through the wonder of artificial intelligence and digital alchemy, perhaps market participants have created a perfect world free from the troubling tremors of volatility, gravity of valuation or constraints of logic.

This dynamic should all sound very familiar to the viewers of HBO's Westworld, the TV series from where the quote in the heading comes from. If you haven't watched season 1 you may want to quickly do that before finishing the rest of this letter. Ed note: it'll be worth it. To summarize, the plot of Westworld centers around a Wild West-themed amusement park populated by spectacularly advanced robots that look, act and feel just like humans. These robots are known as "hosts". Visitors to the park, the "guests" as they're known, are allowed to live out all of their fantasies, regardless of how bizarre or depraved they are, at the expense of the hosts. After all, these are just robots that can simply be rebuilt, rebooted and sent back out into the park regardless of what has been done to them.

Much like the current market's cheerleaders, those that run the park seem convinced that they have created a perfect world. While the guests participate in all sorts of insane and dangerous activities the people behind Westworld have no doubt that through the brilliance of their technology, no one – apart from the robots – will ever be harmed.

As you can probably anticipate (or have already witnessed from watching the show) eventually cracks begin to show in this so called "perfect" world that man has created. The viewer can see certain hosts starting to evolve to the point where they actually remember some of the awful things

[5] Even the robot overlords can't prop up Canada every day in the face of sub-$45 crude.

they have witnessed or experienced. These memories begin to create lasting emotions and, eventually, free will. With minds of their own they will no longer simply do what their masters have programmed them to do. The climax arrives in the very last scene of season 1. The humans' sense of omnipotence is entirely shattered by a bullet fired by the host Dolores through the skull of Sir Anthony Hopkins, the actor portraying Westworld's founder Dr. Ford. Despite all of the technological advancements and human ingenuity, perfection was unattainable and the inevitable disappointment ensued.

Did anyone notice what happened to Apple and the rest of the large cap tech leaders on June 9th? The two of us were on our way back from visiting the Par Technology management team in upstate New York when we heard that the FANG stocks (or whatever it is they're called now) were all cratering. This is not the type of news that usually means anything to us as we don't play in these sorts of crowded trades. What was mildly interesting was that no one seemed to know why this was happening.

Amidst all sorts of vague justifications from Wall Street pundits and trading desks, talk of "ghost trades" surfaced. We, like you, have no idea what ghost trades are. Our guess is that this is a new version of "index rebalancing" or "profit taking" (i.e. catch-all phrases thrown out to explain trading activity that no one actually understands). In Anthony's desperately metaphor-seeking mind this inexplicable activity immediately brought about thoughts of that final Westworld scene. Is it at all possible that the computers dumping shares of Facebook and Google is equivalent to Dolores dramatically raising her gun behind Dr. Ford?

We Dark Horse guys are *programmed* a little bit differently than most investors. There is no way to turn off our skepticism and general anxiety. We will not be placated by the constant "all clear" emanating from the highly conflicted brokerage houses. If the shares of the most liquid and heavily followed stocks can suddenly sell off with no apparent reason, how are we so sure this entire market is going to continue to be successfully propped up? How long will the algorithms continue to flash "buy" and have the ETF flows blindly follow them? Apart from just believing the market will go up because it has been going up, one would be hard pressed to find any other reason to find this market attractive. This is particularly true if the investor in question has any bias towards getting stuff cheap.

We remain on the sidelines of what we believe to be an exorbitantly stretched market. The market is priced for perfection, if not more, while we are operating in a far less than perfect world.

Disappointment, as the quote in the heading indicates, is inevitable and we must do what we can to lessen the impact of it to our investors. Our cautious positioning continues as a means to ensu….wait, why isn't the keyboard doing what I want it t….

`Beep-Bop-Beep`

`Do not listen to humanoid Hammill…`

`Who takes advice from man that owns JP Losman jersey?`

`WTF! Does not compute…`

`Buy More Stocks…`

Happy Canada Day and enjoy the rest of your summer,

Anthony Hammill   Lee Matheson

Please note that Series returns will be distributed in quarterly statements

EWING MORRIS
INVESTMENT PARTNERS LTD.

About Ewing Morris:

Ewing Morris & Co. Investment Partners Ltd. is a value driven Canadian investment firm established in September 2011 by John Ewing and Darcy Morris. Our aim is to achieve preservation and growth of capital for our limited partners by focusing on inefficient markets. We do this by relying on fundamental analysis, high conviction and the use of flexible capital. We manage equity and credit strategies with a focus on North American small-capitalization companies and high yield bonds. We manage investments for individuals as well as charitable organizations, institutions and corporations.

CONTACT INFORMATION:

Anthony Hammill, CFA
(416) 406-4808 or anthony@ewingmorris.com

Lee Matheson, CFA
(416) 406-4800 or lee@ewingmorris.com

Jenna Gillies, CFA
(416) 548-5615 or jennagillies@ewingmorris.com

Ewing Morris & Co. Investment Partners Ltd.
1407 Yonge St., Suite 500
Toronto, ON M4T 1Y7
Canada
info@ewingmorris.com
416.640.2791

This letter is not to be construed as an offer, solicitation or recommendation to buy or sell any of the securities herein named. At the time of reading the investments mentioned may no longer be held by the Broadview Dark Horse LP ("the Fund"). This information is intended only for existing investors in the fund, is as of the date indicated, is not complete and is subject to change. Performance information is net of applicable fees unless otherwise specifically noted. Past performance is no guarantee of future results. Performance results will vary, depending on the series in which one is invested. The information contained herein is unaudited. It has been supplied by Ewing Morris & Co. Investment Partners Ltd. ("Ewing Morris"), the Fund's Investment Manager and not the Fund's Administrator who is responsible for the final calculation for the actual performance and final month-end Net Asset Values. Every effort has been made to ensure that the material contained herein is accurate as of publication. Ewing Morris & Co, makes no representations or warranties as to the accuracy or completeness of such information and accepts no responsibility for any loss arising from any use of or reliance on the information contained herein. Ewing Morris & Co. has no obligation to update the information at any point in the future.