Lionridge
CAPITAL MANAGEMENT INC.

Portfolio Manager Commentary

Fall, 2011

STAYING SAFE AND PROFITING FROM THE DELUSIONS OF THE MASSES

Using the above title, I recently gave a series of talks on the topic of investor psychology and how emotions often override facts and influence financial markets. As I have studied this phenomenon for many years, I chose it as a discussion topic as I believe individuals can avoid unnecessary risk in their investment portfolios if they become more aware of the psychological factors in investing. Due to human emotions, the markets have a tendency to get overexcited about positive news and overly pessimistic about negative news. Focusing on short term factors, markets create dangers that can be avoided and opportunities that can be exploited by keeping a rational, long term perspective on things.

The recent drop in market values is probably justified generally on the basis of fundamentals – I've long felt that market prognosticators and participants were becoming overly confident and optimistic during the rebound from the 2009 meltdown. However, skittish investors continue to throw out some babies with the bathwater and provide us with specific opportunities to buy some great businesses at irrationally low prices, one of which is discussed below.

We launched our new Lionridge Total Equity Portfolio as of March 30 of this year, and are pleased to report that our results reflect the importance of taking a disciplined approach and how this provides protection of your capital. During the six month period ending September 30, 2011, our Total Equity Portfolio Composite had returns of -3.0%, which compares very favourably with our global benchmark which was down -12.6%. These results also show advantages to geographic diversification, as during this period the TSX was down -16.6%.

Our long standing U.S. Equity mandate, the Lionridge US Equity Portfolio, has also done very well during this volatile period, relative to its benchmark comparison, the S&P 500. As at the end of the third quarter, the Lionridge US Equity Portfolio Composite was down -0.9% on a year to date basis, comparing well to the S&P 500 which was down -4.9% during that period (both returns measured in Canadian dollars).

We strive to achieve dual objectives for you, better returns with lower risk than the overall market, and I'm pleased to report that we've been doing this for you. We likely have choppy waters ahead of us, but you can go about your daily lives with the confidence that we are out to avoid the dangers and exploit the opportunities provided by market irrationalities.

At your service,
Hardev Bains
President
Lionridge Capital Management Inc.

Investment Highlight: Medtronic Inc.

Medtronic is the world's leading manufacturer of implantable medical devices (examples include pacemakers and stents). Throughout most of the last decade, this company was a "glamour" stock. Its strong growth and profitability resulted in a stock price for several years that we would consider expensive. That party ended with the market meltdown in 2008, and although Medtronic's share price has somewhat rebounded from its 2009 lows it's still well below levels seen previously. In fact, it is well below levels seen 10 years ago.

Despite continued growth in revenues, cash flows and maintenance of strong profitability, the markets are shunning this stock whose price seems to be dead in the water, and whose growth has slowed from more rapid levels seen last decade. This former glamour stock has become a value stock. This provides us with the perfect opportunity to buy a piece of a great company at a great price. Positives include the following;

- A market leader with strong geographic diversification, U.S.-based Medtronic does business in over 100 countries. Over 40% of the company's revenues are from outside the U.S. and it is well positioned in important emerging markets.
- It enjoys a stable and positive long term outlook for its core end-markets in the cardiac, spinal, neurological and other health care categories.
- Medtronic demonstrates strong profitability and financial performance in the areas of profit margins, free cash flow generation and returns on capital. This company creates tremendous value for its shareholders.
- Prudent and effective capital management is a hallmark of this company's management. Along with a strong balance sheet, Medtronic is using part of its strong cash flows for share buy-backs, which at these price levels add considerable value to remaining shareholders like us.

By purchasing a company with these attributes at a great price, we see significant upside potential with minimal downside risk. In other words, it's a great investment for pursuing our dual objectives for you; growing and protecting your capital.

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