Lionridge
CAPITAL MANAGEMENT INC.

DISCIPLINE, DILIGENCE, EXCELLENCE

Portfolio Manager Commentary — Summer, 2011

Since my last commentary, I made my annual trip to Omaha to attend the Berkshire Hathaway meeting. While it's always an informative treat to listen to Warren Buffet and Charlie Munger answer questions, the other benefit I derive is the opportunity to chat face to face with like minded money managers. Being a disciplined value investor is usually a lonely pursuit, as one does not have much in common with the vast majority of professional money managers.

My mission this year was to discuss some logical explanations as to why there are some terrific companies trading at cheap prices. After identifying a company as a creator of shareholder value that is also available at a cheap price, I'm often left with a nagging feeling as to why such an obvious bargain can exist. The same information I have is available to everyone and there are a lot of smart people out there examining it. Although I've been a professional investor for over a dozen years, I had the opportunity in Omaha to discuss this conundrum with some professionals who've been at it a lot longer. The unanimous explanation proffered was simple; the causes of these anomalies are investor psychology and the short term time frame of most institutional money managers.

Most investors have a tendency to look at the more recent performance of a stock and extrapolate forward. Therefore, if the price movement has not been positive for a stretch of time the reaction of major market participants can perpetuate this trend (although not indefinitely), creating the type of opportunities we seek.

This is what has happened with a number of solid companies that we own. At the turn of this century they were very expensive, trading at prices that were unjustifiably high compared to their likely intrinsic value. Since that time these companies have continued to do what they do well, gradually growing their intrinsic value. At the same time, the prices of their stocks have not moved as much and as a result they have gradually transitioned into value stocks. How long this trend continues we don't know, but we're happy to hold them knowing that they continue to grow the value of their businesses and accordingly our wealth, regardless of what the prices of their stocks do in the short term. Eventually the market recognizes their value, patience and discipline are the keys to building our wealth.

The deluge of economic news of late has resulted in some strong market reactions. The budget issues in the US, the fiscal crisis in Europe and the cracks in China's growth story show that we're not in for smooth sailing in the near future. There's a bit of smugness in Canada over our solid currency and our resource-based economy. We shouldn't be too complacent, however, because when the U.S. and China sneeze, we catch a nasty cold.

I do not mean to cause you alarm or despair. I simply choose to open my eyes to realities that many choose to gloss over, and respond accordingly. There are dangers, there are also opportunities. Protection of your capital is the central concept in my process of building your wealth. I invest your capital on a company by company basis, seeking out the strong companies that are well positioned to get through rough times and only buying them if the price is right.

At your service,

Hardev Bains

Investment Highlight: Shoppers Drug Mart Corporation

Shoppers Drug Mart Corporation ("Shoppers") is Canada's leading pharmacy chain, with almost 1,200 stores across the country. As everyone has undoubtedly noticed, they have done a terrific job of establishing their market dominance over the last number of years by building out high profile store locations and pursuing astute merchandising and marketing programs.

This is a company with the wind at its back. With an aging population, demand for its core pharmacy service is expected to increase and result in more store traffic during the upcoming years. Walking from the entrance to the pharmacy counters located in the back of stores, customers become well acquainted with the selection of personal care, cosmetic, household goods and food merchandise in the stores. Shoppers has done a great job in increasing sales of the so-called "front of store" categories with effective selection and promotion (including its successful loyalty program). Profitability of this business has been further enhanced with an effective introduction of private label products in several categories, which typically earn a higher margin.

Shoppers earns a good return on its capital, providing evidence that it is creating value for its shareholders (i.e. it is building wealth for you). Just as importantly, Shoppers has a terrific balance sheet with low debt, allowing it to weather economic downturns well.

Finally, the company's shares have been trading at a price which offers a great investment opportunity. This was partly caused by a regulatory decision last year which curtailed certain rebates that pharmacies were receiving from generic drug suppliers. We believe the current price represents a discount to what this company is worth, providing us with the ever important margin of safety.

With a combination of a margin of safety price, strong business fundamentals and a great balance sheet, our investment in Shoppers is expected to achieve our dual criteria of growing your wealth and protecting your capital.

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