Tidefall Capital LP
Q2 2022
July 18, 2022

	Q2 2022	Year To Date	Since Inception (Jan 21, 2020)
TIDEFALL *(after fees)*	-14.0%	-15.1%	121.2%
S&P *(total return)*	-16.1%	-20.0%	18.2%
TSX ***(total return)***	-13.2%	-9.8%	15.4%

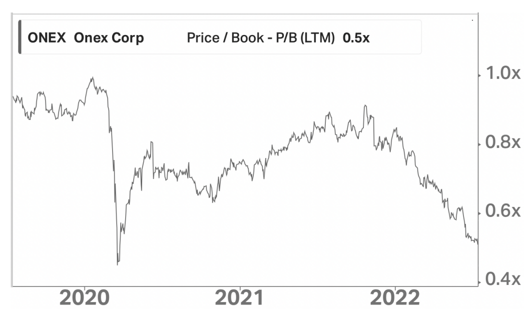
We used the weakness in equity markets to re-enter Onex, a Canadian investment and asset management firm trading near its pandemic level discount to its investing capital per share *(book value)*. At CDN$64 per share today, we believe the market is pricing the stock with extreme pessimism.

Since its inception in 1984, Onex has completed 790 acquisitions with an impressive gross internal rate of return of 27%. More recently, the founder, Gerry Schwartz has been stepping back from the business and after an initial mistake of splitting leadership among multiple executives, wisely made Bobby Le Blanc *(who joined Onex in 1999 from Berkshire Hathaway)*, President in August of 2020.

Change under Le Blanc has been swift; acquisition decisions were brought back closer to Onex leadership with a renewed focus on its historical strengths of industrials, business services/software, healthcare and financial services. Operational expertise was also improved with key hires from top tier firms like Danaher, and finally investor communications were clarified with more transparent KPIs. Le Blanc is highly motivated to succeed, with common stock ownership 10x his total annual compensation and 1.1 million in stock options, the majority of which have an exercise price near the current stock level and expire in just 15 months.

The easiest way to value Onex is to break it up into its two main components: Investments and third party asset management which comprises the base management fee and the incentive fee *(often referred to as 'the carry')*. As of Q1, Onex investing capital was CDN$121 per share however, given the difficult equity markets and based on historic correlations, we estimate this figure may have fallen to ~CDN$95. Yet, even with this decline it means that Onex is likely trading at a 33% discount to <u>just</u> its investment capital.

At such a large discount, and with the vast majority of Onex's investments being valued by the company itself, it's reasonable to ask how realistic are the valuations? However, it's fairly easy to get comfortable that Onex is in fact being conservative with its numbers *(a statement that we would be unwilling to make about many in the private equity industry)*. In fact, over the past decade, Onex Partners' sale of its investments were realized at an average 7% <u>premium</u> to the prior quarter value and a 16% <u>premium</u> to the prior 2 quarters.



Onex shares trading at a 33% discount to its investing capital per share is particularly interesting when you compare it to its past where it has historically traded at, *(or even above)* its investing capital per share. Indeed, the discount has widened to the extremes not seen since the pandemic lows in early 2020. However, this discount is even wider than it appears, since it ignores the value of the third party asset management business *(which is also significantly larger now than its pre-pandemic level)*.

Although this segment manages $33b in third party capital and brings in $274m in base fee revenue, it is only breakeven profitable *(unlike its more mature peers which routinely have significantly higher margins)*. Recent key hires from Blackstone and Carlyle are undoubtedly expensive but likely to pay off as it will help attract outside investors, leveraging Onex's fixed cost base.

Onex is targeting $65b in AUM by 2026 which is inline with its previous 5 year fundraising growth and would result in $555m of base fee revenue and $120m in recurring earnings. Using a 15x earnings multiple and discounted back at 10%, this fee related earning stream would be worth an additional CDN$17 per share. Additionally, there is the incentive fee *('the carry')* that depends on Onex's performance and is therefore highly variable but if targets are met, would result in $155m per year, and when valued at 5x earnings, would be an additional CDN$7 per share.

Adding the investing capital per share to the value of the asset management business leads to a total value of CDN$119 per share, <u>for a discount to its intrinsic value of 47%</u>. Although the value of the asset manager is difficult to determine precisely, it's important to remember that given the stock's massive discount to just its investing capital, <u>investors are getting the asset manager upside for free</u>.

Onex is well aware of the large valuation disparity and has bought back 12% of the company since the pandemic, continuing its long standing buyback which has seen total shares outstanding decline by 55% since inception. We feel it is likely that part of their large $1.4b in cash, <u>which represents 1/3rd of its market cap,</u> will either go to a well timed purchase of another asset manager to gain scale or if the shares remain deeply discounted, once again be used to max out their buyback.

Trevor Scott