

# **Canso Select Opportunities Corporation**

## **Annual Management's Discussion and Analysis**

**For the Period from Incorporation (February 16, 2018) to December 31, 2018**

Management's Discussion and Analysis ("MD&A") provides a review of Canso Select Opportunities Corporation's ("CSOC" or the "Corporation") audited financial results for the period ended December 31, 2018 and assesses factors that may affect future results. The financial condition and results of operations are analyzed noting the significant factors that impacted the statement of financial position, statement of comprehensive income, statement of changes in equity, and statement of cash flows of CSOC. As such, this MD&A should be read in conjunction with the audited financial statements and notes thereto. The audited financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") to provide information about CSOC.

The following MD&A is the responsibility of management and is dated April 25, 2019. The Board of Directors carries out its responsibility for the review of this disclosure through its Audit Committee, comprised of independent directors and CSOC's Chief Financial Officer. The Audit Committee has reviewed and recommended approval of the MD&A by the Board of Directors. The Board of Directors has approved this disclosure.

### **Business of the Corporation**

CSOC is an Ontario-based investment corporation. CSOC's investment objective is to provide capital gains and dividend income to its shareholders. Consistent with this objective, the Corporation evaluates potential investments in debt, public and private equity and other securities. The deployment of funds to new investments depends on both the attractiveness of new investment opportunities and the availability of capital as generated from the realization of value from existing portfolio investments.

### **Recent Developments**

On February 1, 2018, Lysander Funds Limited, the manager of Canso Select Opportunities Fund (the "Fund" or "CSOF"), announced its intention to restructure the Fund. As a result of the restructuring CSOF would be held by a publicly listed corporate structure, to be known as CSOC.

The details of the restructuring were outlined in an Arrangement Agreement ("Arrangement") contained in the Circular. Pursuant to the Arrangement, holders of Class A and Class F units of the Fund could elect to receive either CSOC Class A Multiple Voting Shares ("Class A Shares"), CSOC Class B Subordinate Voting Shares ("Class B Shares") or a combination of both based on the exchange ratio as defined in the Arrangement.

On August 31, 2018, the units of the Fund were delisted from the Toronto Stock Exchange and effective September 4, 2018, the Class A Shares and Class B Shares of CSOC were eligible to commence trading on the TSX Venture Exchange under the symbols CSOC.A representing the Class A Shares and CSOC.B representing the Class B Shares.

Effective September 4, 2018 CSOC closed the Arrangement which, pursuant to elections previously made, resulted in unitholders of the Fund receiving 1,621,460 Class A Shares and 1,156,738 Class B Shares of CSOC in exchange for units of the Fund previously held. As a result of the Arrangement, the Fund is a wholly-owned investment held by CSOC.

### *Rationale for the Conversion*

The decision to restructure CSOF and convert ownership of the Fund to a corporation included, but was not limited to, consideration of the following factors.

- **Conversion to Efficient Corporate Model.** The Arrangement provided for the pursuit of a more effective long-term investment strategy through greater financial flexibility, the reduction of overhead and administrative costs and increased access to long-term capital. It permits the assumption of larger private positions and less liquid investments including private equity and debt, loans, real estate and infrastructure.
- **Illiquidity of Investments.** The Fund invested in certain illiquid investments. The realization of value in these investments over the long term conflicted with the Fund's requirement to fund monthly and annual redemptions by unitholders of the Fund.
- **Activist Investing.** The corporate structure of CSOC enables active and direct involvement in investee companies' activities, known as activist investing, if required to ensure the realization of value from the investment.
- **Elimination of Management Fees and Performance Fees.** The Arrangement resulted in the elimination of a 1.00% per annum fee payable to the Manager as well as a performance fee payable if certain conditions were met.

## **Overall Performance**

### *General Factors*

The Corporation's ability to generate capital gains and to pay dividends depends on the performance of the holdings in its portfolio. Each company in the portfolio is unique. Portfolio companies vary from early stage start-up enterprises, to private companies in more advanced stages of development and publicly traded companies operating in mature industries. Depending on the company, there may be many paths to long term value creation including, but not limited to, additional funding rounds, initial public offering, acquisition or sale, or general improvement in financial and operating performance.

The performance of these portfolio companies depends on a variety of factors, which include but are not limited to, economic conditions, interest rate levels and investor confidence as indicated by equity market performance.

Financial markets experienced a significant correction in the fourth quarter of 2018. The US Federal Reserve raised overnight rates for the 4<sup>th</sup> time in 2018 and the 9<sup>th</sup> time since the current tightening cycle began in 2015. Signs of a US economic slowdown appeared as GDP growth moderated to 2.6%. Slower economic growth, ongoing trade tensions between the US and China and concerns about the impact of higher interest rates propelled equity markets lower, credit spreads wider and bond yields lower.

Despite the negative headlines in the fourth quarter, the U.S. economy continues to expand at reasonable levels, with growth in the U.S. expected between 2 and 3% in 2019. The Canadian economy is expected to expand 2% in 2019. Inflation in both the U.S. and Canada is near targeted 2% level. Finally, both the Federal Reserve and the Bank of Canada adopted a wait and see stance to further rate increases. The Fed revised its target for balance sheet reduction.

We remain concerned about consumer debt levels and inflated house prices in Canada. Housing market activity has slowed considerably since the government introduced measures to stress test borrowers. The uncertainty caused by various trade disputes between the U.S. and various trade partners along with declining oil prices has negatively affected overall economic activity. The Bank of Canada has guided to higher interest rates toward a 'neutral' level over the coming quarters. Canadian households are vulnerable to a sharp rise in interest rates and an increase in unemployment.

### *Specific Factors*

For the period ended December 31, 2018 CSOC reported a net loss of \$1,816,593 or (\$0.65) per Class A Shares and Class B Shares. This is the result of \$1,952,467 in unrealized mark to market losses primarily on public equity holdings of Second Cup Ltd., Yellow Pages Limited, and M-Split.

### **Summary of Investment Portfolio**

As at December 31, 2018, CSOC's investment portfolio held through CSOF consisted of equity and debt securities in eleven different portfolio companies. The below table sets out the investments by market value in the portfolio.

| Description   | Average Cost \$   | Fair Value \$     | % of Portfolio |
|---|-------------------|-------------------|----------------|
| <b>Cash &amp; Cash Equivalents</b>                      | <b>494,153</b>    | <b>494,153</b>    | <b>3.74%</b>   |
| <b>Equities Held Long</b>                               | <b>15,200,165</b> | <b>12,533,915</b> | <b>94.98%</b>  |
| Hubba, Inc.   | 3,401,863         | 5,489,712         | 41.60%         |
| Second Cup Ltd.   | 3,400,936         | 1,690,345         | 12.81%         |
| Xplornet Communications                                 | 141,651           | 1,557,392         | 11.80%         |
| Yellow Pages Limited                                    | 2,095,719         | 1,081,115         | 8.19%          |
| BZ Holdings Inc.(Formerly Purch Group Inc.)             | 918,783           | 1,027,237         | 7.78%          |
| ClearStream Energy Services Inc. -Preferred             | 729,400           | 729,000           | 5.52%          |
| M-Split   | 838,474           | 439,233           | 3.33%          |
| Torstar Corporation                                     | 1,392,200         | 204,875           | 1.55%          |
| Canadian Life Companies Split                           | 78,572            | 83,916            | 0.64%          |
| ClearStream Energy Services Inc.                        | 2,012,939         | 65,905            | 0.50%          |
| Genworth MI Canada Inc. Jan 20 P38                      | 79,786            | 65,620            | 0.50%          |
| Genworth MI Canada Inc. Jan 21 P36                      | 43,360            | 44,550            | 0.34%          |
| Genworth MI Canada Inc. Jan 20 P40                      | 19,380            | 17,250            | 0.13%          |
| Genworth MI Canada Inc. Jan 21 P38                      | 18,120            | 15,800            | 0.12%          |
| Genworth MI Canada Inc. Jan 20 P42                      | 17,820            | 14,050            | 0.11%          |
| Genworth MI Canada Inc. Jan 20 P28                      | 10,480            | 7,400             | 0.06%          |
| Genworth MI Canada Inc. Jan 20 P32                      | 682               | 515               | 0.00%          |
| Telepath Networks, Inc.                                 | -                 | -                 | 0.00%          |
| <b>Equities Held Short</b>                              | <b>(382,772)</b>  | <b>(460,290)</b>  | <b>(3.48%)</b> |
| Genworth MI Canada Inc.                                 | (382,772)         | (460,290)         | (3.48%)        |
| <b>Fixed Income</b>                                     | <b>1,340,700</b>  | <b>628,268</b>    | <b>4.76%</b>   |
| Telepath Networks, Inc.                                 | 1,340,700         | 628,268           | 4.76%          |
| <b>Grand Total</b>                                      | <b>16,652,246</b> | <b>13,196,046</b> | <b>100.00%</b> |
| <b>Other Assets, Net of Liabilities</b>                 |                   | <b>(38,042)</b>   |                |
| <b>Investments at Fair Value through Profit or Loss</b> |                   | <b>13,158,004</b> |                |

### ***Hubba, Inc.***

Hubba accounted for 41.6% of the Fund's assets at December 31, 2018.

Hubba is a private company operating a business to business (B2B) product network connecting producers of branded products with retailers and other key influencers. The company facilitates commercial relationships between active members of the Hubba community driving growth in their respective businesses.

CSOF held 249,000 Hubba, Inc. Class A, Series 4 Preferred Shares purchased on September 2, 2015.

### ***Second Cup Ltd.***

Second Cup accounted for 12.8% of the Fund's assets at December 31, 2018.

Second Cup (TSX: SCU) is a Canadian specialty coffee retailer with 262 cafés operating under the trade name Second Cup™ in Canada, of which 25 are company owned with the balance operated by franchisees.

CSOF held 913,700 Second Cup Common Shares with an initial purchase of shares made on January 7, 2015.

### ***Xplornet Communications***

Xplornet accounted for 11.8% of the Fund's assets at December 31, 2018.

Xplornet, a private company, is a Canadian rural-focused broadband service provider of facilities based broadband Internet access service and related subscription services to subscribers located in rural areas across Canada that typically do not have access to cable or fibre broadband infrastructure.

CSOF held 3,300 Series C Warrants detached from originally issued bonds.

### ***Yellow Pages Limited***

Yellow Pages accounted for 8.2% of the Fund's assets at December 31, 2018.

Yellow Pages (TSX: Y), is a digital media and marketing solutions provider in Canada, offering targeted tools to local businesses, national brands and consumers allowing them to interact and transact within today's digital economy.

CSOF held 177,523 common shares with an initial purchase in January 5, 2015.

### ***BZ Holdings Inc.***

BZ accounted for 7.8% of the Fund's assets at December 31, 2018.

BZ is a private company. On September 4<sup>th</sup> Purch, the predecessor to BZ, closed the sale of its B2C business which included Top Ten Reviews and Space.com to Future plc. Proceeds from the sale approximated US\$130 million, a portion of which were used to retire debt and preferred shares. As a result, CSOF's holdings were reduced by US\$911,805 on December 21, 2018.

Following the sale of the B2C business, the remaining B2B business was rebranded as Business.com, an interactive marketplace platform that provides millions of small and medium business owners with the tools, services, and expert advice they need to help them grow their business. The Business.com brand includes: Business.com, BuyerZone and Business News Daily.

CSOF held 166,723 Series C Preferred Shares purchased at USD\$4.51 on May 22, 2015.

### ***Clearstream Energy Services Inc.***

Clearstream accounted for 6.0% of the Fund's assets at December 31, 2018.

Clearstream (TSX: CSM) is a fully integrated provider of midstream production services, which includes maintenance and turnarounds, pipeline wear technology, facilities construction, welding and fabrication, and transportation, with current locations across Western Canada.

CSOF held 5,272,434 common shares and 729 preferred shares of Clearstream.

## Selected Annual Information

The following table shows selected annual information about CSOC for the most recently completed fiscal year of the Corporation:

|   | 2018 (CAD \$) |
|---|---------------|
| <b>Total revenue (loss)</b>                     | (\$1,986,235) |
| <b>Profit (loss) from continuing operations</b> |               |
| <b>Total</b>                                    | (\$1,816,593) |
| <b>Per share</b>                                | (\$0.65)      |
| <b>Diluted per share</b>                        | (\$0.65)      |
| <b>Total assets</b>                             | \$13,708,509  |
| <b>Total non-current financial liabilities</b>  | -             |

Revenue and profit (loss) level during the period February 16, 2018 to December 31, 2018 was determined primarily by unrealized losses on the Corporation's investment portfolio. The financial data has been prepared in accordance with IFRS and the Canadian Dollar is the presentation and functional currency.

## Discussion of Operations

For the period ended December 31, 2018 the Corporation reported a net loss of \$1,816,593. The loss was primarily the result of unrealized losses on public equity holdings of Second Cup Ltd., Yellow Pages Limited, and M-Split.

The net assets of the Corporation were \$13,617,007 at December 31, 2018 or \$4.90 per CSOC Class A Share and Class B Share.

## Effect of Fund Redemptions prior to the Arrangement

Unitholders of the Fund were permitted to redeem their units at the net asset value ("NAV") per unit on an annual basis every March. Since the Fund anticipated further redemptions in March 2018, it began selling less liquid assets for more liquid ones so as to be able to meet 2018 redemption requests. In March 2018, unitholders redeemed approximately \$23.4 million of units following a \$30.3 million redemption of units in March of 2017. These redemptions resulted in the Fund selling assets to raise cash to fund the redeemed units. As a result of these redemptions the proportion of less liquid, private placements in the portfolio increased.

## CSOC Tax Status

The Fund has a pool of tax loss carry forwards that can be utilized to shelter gains of the Fund so long as the trust continues to be maintained and certain other conditions are met. If the Fund were to be wound-up into CSOC at a time when it had losses, such losses would expire unutilized. Consequently, the current intention is to maintain the continued existence of the

Fund until such time as all or substantially all of the losses of the Fund are utilized, or so long as the benefits associated with maintaining and utilizing such losses (e.g. current and potential cash tax savings) outweighs the cost of maintaining the Fund. As the holding period for many of these investments of the Fund is measured in years, and the Fund has tax losses, the “transitional period” could be several months to a year or more. Any new investments will be made directly by CSOC.

## **Liquidity**

Prior to the Arrangement the Fund was a closed-end investment fund which was created to hold a portfolio of securities comprised of global debt and equity securities. Redemptions only occurred monthly, at a discount to NAV, or annually at NAV.

Through its holding in the Fund, CSOC maintains a similar portfolio of investments as did the Fund immediately prior to the Arrangement. Over time the portfolio composition may change significantly in terms of specific company holdings as well as concentration of holdings.

The deployment of funds to new investments depends on both the attractiveness of new investment opportunities and the availability of capital as generated from the realization of value from existing portfolio investments. The availability of funds for dividends depends on the generation of income or capital from existing portfolio investments and the meeting of certain statutory financial requirements permitting the payment of dividends.

Liquidity risk is managed by maintaining a portion of the Corporation’s assets in investments traded in an active market that can be readily sold. All liabilities of the Corporation are due within one year.

The securities of the Corporation are listed on the TSX Venture Exchange under the ticker CSOC.A and CSOC.B and have daily liquidity.

## Summary of Quarterly Results

The tables below show the key operating results of the Corporation since the Arrangement for each of the two most recently completed quarters:

| Description                         | September 30, 2018<br>(CAD \$) | December 31, 2018<br>(CAD \$) |
|-------------------------------------|--------------------------------|-------------------------------|
| Total revenue per share             | (\$0.13)                       | (\$0.58)                      |
| Realized gains (losses) per share   | \$0.00                         | (\$0.01)                      |
| Unrealized gains (losses) per share | (\$0.13)                       | (\$0.57)                      |
| Total Shareholders' Equity          | \$15,141,485                   | \$13,617,007                  |
| Equity per Class A Share            | \$5.45                         | \$4.90                        |
| Equity per Class B Share            | \$5.45                         | \$4.90                        |

The variations shown in the table above relate to the timing of investment decisions and do not reflect any general trends or seasonality. For each quarterly period, the financial data has been prepared in accordance with IFRS and the Canadian Dollar has been the presentation and functional currency.

### Subsequent Events

On March 29, 2019, Brenda Burns resigned from her positions as a Vice-President of CSOC and a member of the CSOC Investment Committee. Brenda continues as a Director of CSOC.

On January 28, 2019 CSOC purchased £60,000 10% January 22, 2021 PIK Convertible Notes of Brill Power Limited. Brill Power is a privately held company focused on power electronics, battery degradation, and battery modelling.

On January 2, 2019 CSOC purchased 200,000 Class A Common Shares of Reformulary Group Inc. @\$1.00. Reformulary Group is a privately held company focused on healthcare in Canada.

### Capital Resources

CSOC has no commitments for any capital expenditures as of December 31, 2018.

### Off-Balance Sheet Arrangements

CSOC does not have any off-balance sheet arrangements.

### Changes in Accounting Policies Including Initial Adoption

There were no changes during the period ending December 31, 2018 to the Corporation's accounting policies. The Corporation's accounting policies for its financial instruments are disclosed in detail in Note 2 of the Annual Audited Financial Statements.



## **Financial Instruments and Other Instruments**

For the period ended December 31, 2018, CSOC held derivatives and short positions in an investment portfolio in accordance with its investment mandate. The list of all associated risks disclosed in detail in Notes 3 and Note 11 of the Annual Audited Financial Statements.

## **Transactions between Related Parties**

Effective August 1, 2018, CSOC entered into an operational services agreement with Canso Investment Counsel Ltd. ("Canso"). The operational services agreement sets out that Canso will provide day-to-day operational services to carry out the business and affairs of the Corporation.

CSOC does not pay any management or performance fees to Canso.

## **Disclosure of Outstanding Share Data**

As at December 31, 2018 and the date hereof, there were 1,621,460 Class A Shares and 1,156,738 Class B Shares of the Corporation outstanding.

## **Other MD&A Requirements**

Additional information relating to the Corporation is available on SEDAR at [www.sedar.com](http://www.sedar.com).

### **FORWARD-LOOKING STATEMENTS**

*This report may contain forward-looking statements and information within the meaning of applicable securities legislation. Forward-looking statements can be identified by the words "seeks", "expects", "believes", "estimates", "will", "target" and similar expressions. The forward-looking statements reflect the current expectations of CSOC regarding future results or events and are based on information currently available to it. Certain material factors and reasonable assumptions were applied in providing these forward-looking statements. All forward looking statements in this press release are qualified by these cautionary statements. CSOC believes that the expectations reflected in forward-looking statements are based upon reasonable assumptions; however, CSOC can give no assurances that the actual results or developments will be realized. These forward-looking statements are subject to several risks and uncertainties that could cause actual results or events to differ materially from current expectations, including the matters discussed under "Risk Factors" in the management information circular dated as of March 16, 2018 (the "Circular"). Readers, therefore, should not place undue reliance on any such forward-looking statements. Further, a forward-looking statement speaks only as of the date on which such statement is made. CSOC undertakes no obligation to publicly update any such statement or to reflect new information or the occurrence of future events or circumstances except as required by securities laws. These forward-looking statements are made as of the date of this report.*

*Additional information about CSOC is available under its SEDAR profile at [www.sedar.com](http://www.sedar.com).*