

Quarterly Manager Commentary

Q1 2025

The first quarter of 2025 started off positively enough. The re-election of President Trump was met with investor optimism, driven by expectations of a more favourable regulatory environment, lower taxes, increased mergers and acquisitions activity and the unleashing of 'animal spirits'. This surge in confidence led to strong market performance and even stronger price performance by our flagship fund. This euphoria was quickly replaced by growing fears from the chaotic tariff policy of the Trump administration – fear of not only the impact on businesses themselves but also of the impact on a consumer already strained by inflation. Markets began to decline and our portfolio was not immune. The negativity culminated in early April when President Trump announced the imposition of substantial tariffs against all of its trading partners on what was characterized as Liberation Day. The havoc that was unleashed on the bond and equity markets was significant and caused stocks to enter a bear market. This has been followed by a number of temporary tariff reprieves but the uncertainty continues as the market tries to discern the endgame. Suffice to say that traded price volatility has been extreme. We will have more to say on our portfolio's tariff exposure later in this commentary.

But what about the financial results of the underlying companies within our portfolio? With all of our companies now having reported first quarter results, it was a strong earnings season: all but one of our companies met or exceeded our expectations, with a few beating by a notable margin. The one exception to this strong reporting is TFI International which we will discuss in greater detail below. Another holding, Bread Financial, which fell into the camp of beating by a notable margin, ended up joining TFI as a significant detractor to our unit price performance in Q1. The price decline of Bread Financial subsequent to an in line Q4 and in advance of a significant Q1 beat is illustrative of the current confounding nature of the market.

We wrote about Bread Financial in last year's annual letter and shared how it was the largest positive contributor to our returns in 2024. Bread provides white-labeled credit cards (private label or co-branded) and 'buy now, pay later' lending as well as related loyalty program and marketing services for brand partners in North America, including AAA, the NFL, Ulta Beauty, and numerous others. We concluded our discussion of Bread as follows: "And despite its healthy move this past year, we feel it still holds the potential for significant price appreciation in the near future and it remains one of our larger holdings." Earlier in the first quarter, Bread raised US\$400 million of subordinated debt as part of their move towards an optimal capital structure and concurrently announced a \$150 million stock buyback authorization. It was a bit of a surprise to us (albeit a very pleasant one) to see them fully complete the entire authorization, re-purchasing 6.5% of the shares outstanding at \$47 per share, below tangible book value of US\$49. And we think they're just getting started. In addition, they reported Q1 earnings that beat consensus by nearly 30%. All in all, we were very pleased with their financial performance during the quarter. This, however, was at odds with the stock price which declined nearly 20% during the quarter.

While Bread's results were quite positive, TFI International's results were modestly disappointing. However, the stock price reaction was disproportionately severe, with TFI declining over 40% in the quarter. As a result, TFI, which is one of our longest tenured holdings and also one of our most profitable over the years, became the largest detractor to our returns in the first quarter.

Headquartered in Quebec, TFI is a leading North American transportation and logistics company operating across four key segments: truckload, less than truckload (LTL), logistics, and package and courier. We have owned TFI continuously, but in widely varying amounts, for over 17 years. Over that time, the company, under the long time leadership of Alain Bédard, has grown significantly, mainly through more than 125 acquisitions, and has created substantial shareholder value. For our part, we have been afforded many opportunities to improve upon the shareholder value that management has created. Our initial purchases in 2007 were at \$12 per share. During the Credit Crisis, we had the opportunity to purchase shares as low as \$3. At the end of last year, we sold shares at prices as high as \$220. Recently, we have been able to repurchase shares as low as \$105. TFI is a great example of our approach, where we identify great companies we can own for a long time, add them to the portfolio at a price where the long term expected buy and hold return will be strong, and then take advantage of market mispricing to improve upon that buy and hold return. There is sometimes a reason why the share price of a company goes up or down (although often there isn't) and in this instance with TFI there was a reason. However, our experience has been that markets tend to overreact. We believe this is one of those instances.

The transport industry in North America is experiencing one of the weakest markets since the industry was deregulated 40 years ago, and this, of course, has had an impact on the short term results of TFI. But also, in the most recent quarter, the company reported quite weak results in their U.S. LTL operations. This division became significant four years ago when TFI purchased the LTL operations of UPS – one of the most accretive acquisitions the company has ever made. In fact, the acquisition fully paid for itself in just four years. Few acquisitions deliver that kind of return.

Recently, the U.S. LTL division has lagged the company's expectations. TFI knew when they purchased the division from UPS that it would be a lot of work and it would take time to change the culture and get the business onto TFI's operating model. It turns out that it is going to take longer than expected to accomplish this. The most recent results, combined with conversations with management, have caused us to reduce the Business Value of the company by approximately 10%.¹ We never like it when we have to reduce the forecast for one of our companies. However, as we strive to have a balanced view with our forecast for each company, it is inevitable that this will sometimes happen. As we pointed out in last year's annual letter, of the 26 companies the flagship fund continuously owned during the year, we increased our intrinsic value on 23 and took our value down on 3.

With our view of value down by 10% and the share price down by more than 40% during the quarter, we did what you would expect: we more than doubled the number of shares we own. We are confident this is yet another example of taking advantage of short term market fluctuations and would note that the shares have already recovered to the point where we are modestly trimming the position.

The largest positive contributor to the returns for the flagship fund in the quarter was Middleby Corporation. Middleby is a U.S.-based global leader in the design, manufacture, and marketing of commercial foodservice, food processing and residential kitchen equipment. The largest division is commercial foodservice, which offers a comprehensive range of equipment including ovens, fryers, refrigeration units, beverage dispensers, and smart kitchen solutions. Middleby serves many of the largest foodservice chains in the world, with clients such as McDonald's, Starbucks, and Chipotle. The next largest division is food processing which provides industrial-scale solutions for processing proteins and baked goods, including ovens, mixers, slicers, and packaging systems. The smallest division is the residential equipment group which sells premium appliances under brands like Viking and La Cornue, offering products such as ranges, refrigerators, and outdoor cooking equipment.

And, by the way, on the subject of tariffs, Middleby is a much more U.S. centric manufacturer compared to any of their competitors. They view tariffs as an opportunity and are excited about the competitive position it places them in.

While we haven't owned Middleby nearly as long as TFI, we have been a shareholder for more than seven years and it definitely meets the criteria of the kind of company we are looking for. It is a highly intelligent company with a strong management team and board that have built, through acquisitions, the leading commercial foodservice company in the world.

In January, the Wall Street Journal reported that an activist investor had purchased 5% of the company and was seeking board representation. We often worry about 'activist' investors as sometimes they take a short term approach to achieving a higher share price rather than creating long term shareholder value. With that concern in mind, we had a long conversation with the new shareholder. As it turns out, this particular activist is from the long term value creation camp. His name is Ed Garden. You probably don't recognize the name but you might

residential divisions, particularly with regards to technology and innovation. From the outside looking in, we are not sure about the answer but are confident that the board will come to the correct view.

The day after Garden's investment was disclosed, the Middleby board issued a press release explaining that they have been running a strategic review process for many months. This ongoing review has already produced three initiatives. First, the company disclosed its plan to spin off the food processing division as a separate publicly traded company. This is expected to occur in early 2026. Middleby's food processing operation is an excellent business but there are no synergistic benefits to it being part of the larger Middleby group. Second, they announced a tripling of the share buyback authorization with an intention to repurchase 6% to 8% of the company each year. We had been encouraging the company to maintain an appropriately capitalized balance sheet and to be more 'opportunistic' in their share buybacks whereas they were thinking they should be more 'programmatic'. We are strongly in the opportunistic camp (we want our companies to do what we do) and, it is nice to see the company shift in this direction. Third, the company announced that, while they will continue to be acquisitive, there will be a tighter 'strategic focus' with acquisitions. We don't view this as a significant shift as management had indicated to us last year that they believed their residential portfolio was essentially complete.

Circling back to tariffs: while things will undoubtedly keep changing, as it stands today the direct impact on our portfolio is quite modest. That having been said, we are also focused on the secondary impact of tariffs on the broader economy. In that regard, we are already seeing lower consumer sentiment and a notable drop in President' Trump's approval ratings. Without a doubt, this has played a part in how much he has backtracked since Liberation Day.

The direct impact of tariffs would have been more significant were it not that USMCA (United States-Mexico-Canada Agreement) compliant goods are exempt from tariffs. The USMCA is a trade agreement that replaced the North American Free Trade Agreement (NAFTA). It was negotiated during the first Trump administration and, among other things, introduced more stringent rules of origin, requiring a higher percentage of content to be sourced from North America to qualify for tariff-free trade. All of our companies are USMCA compliant.

While trade data suggests that only approximately 40% of cross-border goods between Canada and the United States are USMCA compliant, this substantially understates the true level. Analysis done by the economics teams of several Canadian banks indicates that approximately 90% of trade is compliant – it is simply the case that many smaller companies hadn't done the paperwork since there was no economic incentive to do so. They will certainly do the paperwork now.

As things stand today in our flagship fund, only four of 30 companies (making up 10% of the portfolio) are directly impacted by tariffs in any notable way. The most impacted is Spin Master, which is a global children's entertainment company. While their divisions that produce television and film content and digital play are not impacted, their toy division is directly caught by the tariffs as the vast majority of toys are manufactured in China and other Asian countries. While Spin Master is not at a competitive disadvantage versus other toy companies, such as Mattel and Hasbro, since everyone sources their toy product from Asia,

sales for everyone will undoubtedly be impacted by higher prices. Toys were exempted from tariffs in Trump's first administration, so we will see what happens this time.

While USMCA-compliant goods are tariff exempt, passenger vehicles may be an exception. The Trump administration is focused on the level of vehicle assembly that occurs within the United States and, despite being USMCA compliant, passenger vehicles could be subject to tariffs. We own two global tier-one automotive suppliers – BorgWarner and Magna – whose diversified international operations give them more flexibility than many of their peers to mitigate any tariffs.

The fourth and final company with notable direct exposure to tariffs is Floor and Decor, the leading hard surface flooring retailer in the United States. At the beginning of Trump's first administration in 2017, Floor and Decor sourced as much as 50% of its products from China. Today, the amount is below 10% with the company sourcing from 250 vendors in 27 countries around the world. Their business model is to go direct to the vendors, cutting out brokers and middlemen. The company recently noted that the implementation of tariffs at various levels with different countries would be a competitive advantage because they can handle the complexity of such changes and quickly pivot their sourcing compared with their competitors who rely on brokers and middlemen.

Tariffs, or even the threat of tariffs, may cause the economy to weaken even further. But we are confident that our companies are well positioned to navigate these challenges. Almost all of our companies are the leaders in their respective industries and have proven to be nimble during past challenges, such as the pandemic period and the concomitant supply chain challenges. None of our companies are competitively disadvantaged by tariffs and many are actually in a stronger competitive position. Just two examples are mentioned in this commentary: Floor and Decor with its global direct sourcing model and Middleby with its substantial U.S. manufacturing base versus its competitors.

Quarterly Results

Unit Price Results

During the quarter, the net asset value of the **Turtle Creek Equity Fund** decreased by 10.3%.² This was behind the S&P MidCap 400 index which decreased 6.2% and the S&P/TSX Completion index which increased 0.5% (both in Canadian dollars).³ We made no additions or removals, to end the quarter with 30 holdings.⁴ 66% of the portfolio was invested in U.S. companies and 34% in Canadian companies.

Turtle Creek Synthetic PE Fund ("TC SPEF") declined 17.1% during the quarter.² We removed one company from the portfolio, to end the quarter with 26 holdings. ⁴ 65% of the portfolio was invested in U.S. companies and 35% in Canadian companies.

Turtle Creek United States Equity Fund ("TCUS") declined 11.8% during the quarter, behind the S&P MidCap 400 index which declined 6.1%, both in U.S. dollars.^{2,3} We made no additions or removals, to end the quarter with 28 holdings.⁴

Turtle Creek Canadian Equity Fund ("TCCF") declined 13.8% during the quarter, behind the

S&P/TSX Completion index which increased 0.5%.^{2,3} We made no additions or removals to the portfolio, to end the quarter with 22 holdings.⁴

Business Value Results

Changes in Portfolio Business Values during the quarter are shown below.

	TCEF	TC SPEF		TCCF
Quarterly change in Portfolio Business Value	▲ 3%	▼ 6%	▼ 3%	▲ 2%

Disclosures

Information Sources: Turtle Creek Asset Management Inc. ("TCAM" or "the Manager"), Bloomberg.

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Endnotes

1. A company's intrinsic value or Business Value represents our best estimate of the present value of such company's future cash flows and is necessarily comprised of many assumptions, the use of which includes a number of risks and uncertainties that may cause actual values to differ from our estimate. A Fund's Business Value is calculated using our estimate of Business Value for each company, weighted based on the portfolio's holdings.
2. Based on the change in net asset value of the Fund's Class I Series 1.0 Units.
3. The S&P/TSX Completion and S&P MidCap 400 are total return indices. The S&P/TSX Completion (formerly called the S&P/TSX MidCap) is a Canadian index that is comprised of the constituents of the S&P/TSX Composite Index that are not in the S&P/TSX 60. The S&P/TSX 60 is a Canadian index that is comprised of the largest companies within the S&P/TSX Composite index. Comparisons to certain indices and benchmarks are provided for illustrative purposes only and are intended to indicate broad market performance and characteristics. Comparisons to indices and benchmarks are limited in part because indices and benchmarks are not managed and do not charge fees or expenses. The Fund may underperform or outperform an index or benchmark for many reasons.
4. Holdings that constitute less than 0.25% of the Net Assets of TCEF are not included in the number of holdings. Similarly, holdings that constitute less than 0.1% of the Net Assets of TC SPEF, TCCF and TCUS are not included in the number of holdings.