

# KEYSTONE'S

## Small-Cap Stock Report

JANUARY 2019

Independent Equity Advisors

Editor: Ryan Irvine, BBA (Finance)

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Focus BUY Portfolio	Sangoma Technologies Corporation
	Price: \$1.25
	Symbol: STC: TSX
	Near Term: ▲ SPEC BUY
	Long Term: ▲ SPEC BUY

### Summary

A global provider of on premise and cloud-based solutions, Sangoma's unified communication (UC) system is sold to carriers, small-medium businesses as well as original equipment manufacturers. UC describes a broad range of technologies and applications that act as a communication platform to optimize business productivity. Examples include automated answering services, VOIP, video conferencing and document collaboration to name a few. Sangoma is the primary developer and sponsor of the Asterisk project, the world's most widely used open source communications software and FreePBX, the world's most widely used open source PBX software.

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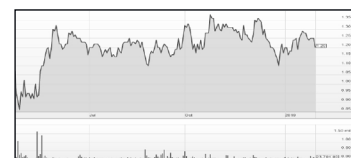
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**Sangoma Technologies Corporation****Current Price (January 31/2019): \$1.25****(STC:TSX)****RECOMMENDATION: SPEC BUY**

Shares Outstanding.....48,573,557

Fully Diluted Shares Outstanding.....56,900,909

**SELECTED ANNUAL DATA**

Income Statement	Q1 2019	Q1 2018
Revenues	\$21,439,335	\$11,845,606
Net Earnings	\$(996,732)	\$390,455
EPS	\$(0.02)	\$0.01
Fully Dilluted EPS	\$(0.02)	\$0.01
EBITDA	\$2,515,000	\$1,101,000
EBITDA/Share	\$0.05	\$0.02
<b>Balance Sheet</b>		
	30-Sep-18	30-Jun-18
Current Assets	\$28,079,327	\$31,583,752
Total Assets	\$92,649,623	\$51,561,002
Current Liabilities	\$27,970,766	\$12,458,864
Long-Term Debt	\$21,509,242	\$3,473,662
Total Liabilities	\$53,483,952	\$16,216,396
Shareholder's Equity	\$39,165,671	\$35,344,606

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Income Statement	2018	2017
Revenues	\$57,361,653	\$26,880,311
Net Earnings	\$2,453,495	\$800,195
EPS	\$0.05	\$0.02
Fully Dilluted EPS	\$0.05	\$0.02
FCF	\$5,051,464	\$2,804,931
FCF/Share	\$0.10	\$0.06
EBITDA	\$2,536,000	\$703,000
EBITDA/Share	\$0.05	\$0.01
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Total Assets	\$51,561,002	\$27,258,959
Total Liabilities	\$16,216,396	\$7,923,572
Working Capital	\$19,124,888	\$7,287,644
Long-Term Debt	\$3,473,662	\$-
Book Value	\$35,344,606	\$19,335,387
ROE	7%	4%

Industry: Unified Communications – Software/Hardware

Recommended: October 2017

Recommendation Price: \$0.72

Current Price: \$1.20

Market Cap: \$58,288,268

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**Operational**

Sangoma is a leading provider of software/hardware products and accompanying Cloud services that deliver Unified Communications capability or enhance IP communications systems, in both telecom and datacom applications. Enterprises, SMBs and carriers in more than 100 countries rely on Sangoma's technology as part of their mission-critical infrastructures. Through a worldwide network of distribution partners, Sangoma delivers high-quality products, some of which carry the industry's first lifetime warranty.

The company has been a major player in the open source telephony (OST) business for many years, is a respected contributor to open source telephony solutions, and contributes back to the OST community regularly. Sangoma provides the two most widely used open source communications software projects in the world. Asterisk is the communications engine that enables software developers to create UC applications easily. FreePBX is the most popular PBX software in the world, supporting millions of installs around the globe.

To protect its future, Sangoma recognized the critical need to evolve the company beyond its reliance on

**RATINGS****VALUE (TRAILING)**

EPS	\$0.02
P/E	62.50
PEG Ratio	-0.21
P/S	0.91
P/EBITDA	15.4
EV/EBITDA	20.4
BV/Share	0.81

**GROWTH**

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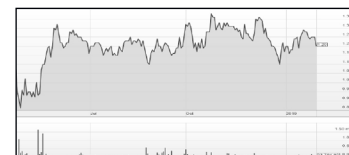
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PSTN-based products. This started with an operational rebuild, the acquisition of VegaStream, an internal build out of the product portfolio to compete in new market and customer segments such as SBCs, the addition of a core PBX product and introduction of cloud services with SIPStation, VoIP and cloud PBX offerings together with a range of IP phones.

Sangoma is now a stronger competitor in the larger, more typical telecom software/services/equipment market, which is not generally OST based. With its PSTN interface boards, Vega gateway products, SBCs, Free PBX, IP phones, Switchvox, and various Services (primarily Cloud-based and maintenance), Sangoma now sells to carriers, service providers, enterprises, SMBs, and OEM customers with several third-party application providers using Sangoma products.

In the first quarter of fiscal 2019, Sangoma Technologies US Inc., a wholly owned subsidiary of Sangoma Technologies Inc., acquired Digium Inc., a U.S. based company to expand and broaden the suite of service offerings, add key customers and employees, and help to grow the business.

**Innovation**

Sangoma continues to invest in Research and Development (R&D) to develop new products and to improve existing offerings. New additions to the product portfolio over the last few years include:

- T3 Mux Appliance
- Version 4 of NetBorder SS7 Media Gateway
- Vega 50, 400 and 5000 series Gateways
- NetBorder Express Microsoft Lync Certification
- NetBorder SS7 VoIP Gateway Appliance
- W400 GSM Board
- Vega 100 and 200 Gateways
- NetBorder Transcoding Gateway
- NetBorder Lync Express Appliance
- Vega 400 Session Border Controller
- A116 16-Span Digital Telephony Interface Board
- B500 BRI Board
- STM1 Mux Appliance
- Call Progress Analysis for Asterisk Systems
- NetBorder SS7 Gateway Release 5.0
- Full line of Session Border Controllers
- T116 16-Span Tapping Board

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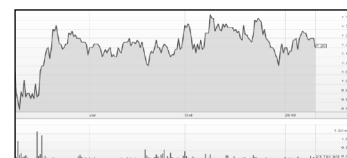
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- NetBorder VOIP Gateway
- Lync Express 2.0
- SBC 2.0
- Video Multipoint Control Unit (MCU)
- FreePBX
- SIP trunks for FreePBX users through SIPStation
- FoIP service
- Sangoma's commercial IP-PBX range called PBX-act
- IP-phones with instant connect to FreePBX and PBXact
- PBXact UCC Cloud PBX Service
- Zulu softphone client
- Digium lines of cards and gateways
- Switchvox
- D-series phones
- DCS

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**Sales and Marketing**

Over the last several years Sangoma has steadily increased its investment in, and focus on, sales. Sangoma has professional sales teams across all key geographic regions to identify and engage local distributors and resellers to address opportunities with larger customers such as carriers and OEMs. Sangoma continues to use a dual sales path to customers: direct sales to large customers (typically OEMs and carriers) and distribution to others.

Carriers are typically telcos, ISPs, ITSPs, wireless/mobile operators, and service providers who resell services using either their own networks or those of others. All of these organizations are potential customers for Sangoma.

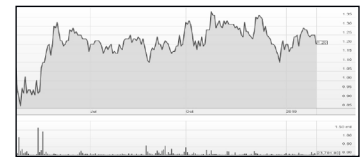
OEM partners are companies that "design in" Sangoma products as a component of their solutions. OEM customers tend to be committed participants in their given markets, and have longer-term focus. It is important to reach these potential customers in the early days of any project to secure design wins and to have sales and marketing programs that will ensure close collaboration during product and sales development cycles that may last as long as three years.

In other cases, Sangoma utilizes an indirect distribution model to reach the full breadth of customers in

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markets where such partners have established relationships. For enterprise and SMBs, the company has built a network of distributors and resellers. Distributors typically sell to resellers. These resellers then sell, install, and support end users. Using regional distributors and resellers supported by Sangoma's sales and marketing efforts has proven very successful. The impact of lower margins from a two-tier distribution model is offset by the net new growth of sales that distributors bring to Sangoma, as well as the cost reduction of handling relatively small orders. Distribution channels require frequent attention to keep Sangoma as the premier supplier in a crowded product marketplace. Sangoma has implemented several incentive programs with its resellers and distributors and has developed a comprehensive set of channel promotion programs to incent and reward its channel partners for performance and behaviours that Sangoma believes will grow its revenues.

Sangoma continues to increase its focus on, and investment in, marketing. The company has assembled corporate marketing programs to promote its brand and products more aggressively and to convey the message about Sangoma's full solutions of connectivity products, PBX's, Phones, and SIP trunks. Sangoma is now using various marketing techniques typical of technology firms to generate greater awareness of the company and its new products. This includes participation in tradeshow, speaking at selected industry events, attending specialized seminars run by Sangoma's distribution channel and other partners, investing in electronic marketing strategies (e.g. web presence, social media and blogging, online advertising, search engine campaigns, etc.), conducting lead generation campaigns, and creating thought leadership pieces.

VoIP Supply LLC adds new unique marketing and sales strength to Sangoma, including an efficient eCommerce transaction business, backed by a professional inside sales organization, and tailored marketing programs to attract and drive traffic to the website.

**Q1 Fiscal 2019**

Q1 2019 revenue jumped 81% to \$21.44 million from \$11.85 million in the first quarter of fiscal 2018 ended September 30, 2017. The increase in sales was driven

**RATINGS****VALUE (TRAILING)**

EPS	\$0.02
P/E	62.50
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P/S	0.91
P/EBITDA	15.4
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**GROWTH**

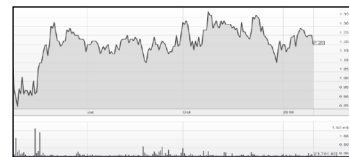
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by organic growth in both products and services and by the acquisitions of the CCD business from Dialogic in January of 2018 and Digium Inc. in September 2018. This quarter's results therefore include one month of Digium results.

The cost of sales for the quarter ended September 30, 2018, was \$9.00 million compared to \$5.73 million for the quarter ended September 30, 2017. Gross profit for the first fiscal quarter of 2019 was \$12.44 million, double the \$6.12 million realized in the first quarter of fiscal 2018. Gross margin for the first quarter was 58% of revenue, up from both last quarter and the same quarter a year ago. This increase is mostly due to the impact of the two acquisitions and gross margin is expected to increase slightly in future quarters when the Digium results will be included for the entire quarter.

General and administration expenses were \$4.02 million for the quarter ended September 30, 2018, an increase of 80% over the same period ended September 30, 2017 (\$2.24 million). The increased spend is from both acquisitions, CCD and Digium, and the amortization of intangibles from those acquisitions. For this quarter, the intangible asset value and associated amortization is an estimate pending the completion and audit of the valuation expected to be complete for the second quarter results and as a result the quarterly amortization could change in future quarters. Operating expense for the first quarter of fiscal 2019 was \$10.64 million, a 98% increase over the same period last year (\$5.37 million), reflecting the additional costs resulting from the incorporation of the CCD and Digium teams.

Q1 2019 operating profit (before interest, tax and one-time acquisition expense) for the quarter ended September 30, 2018, was \$1.81 million, more than double the operating income of \$0.75 million in the first fiscal quarter of 2018. In the first quarter of fiscal 2019, Sangoma recorded \$2.10 million of costs directly associated with the legal, financing and closing of the acquisition of Digium Inc. on September 5, 2018. The net loss for the quarter was \$1.00 million (-\$0.019 per share fully diluted) compared to a net income of \$0.39 million (\$0.011 per share fully diluted) for the equivalent quarter ended September 30, 2017. This temporary swing is driven almost entirely by the one-time

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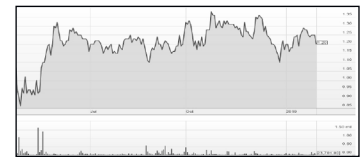
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costs described immediately above.

The table below shows the reconciliation of net income and total comprehensive income to EBITDA, which is a metric used by Sangoma and the industry to monitor its performance.

**EBITDA (Earnings before Interest, Depreciation, Amortization and One Time Items)**

SC Thousands	Three months ended	
	Sep 30, 2018	Sep 30, 2017
Net Income	(994)	390
Tax	522	213
Interest	(4)	(1)
Interest on Operating Line	187	42
Stock Based Compensation	32	34
Amortization of Property, Plant and Equipment	84	35
Amortization of Intangibles	588	288
One time acquisition related expense	2,100	100
	-	-
EBITDA	2,515	1,101
Percent of revenue	14.3%	6.3%

**Revenues, Net Income & EBITDA by Quarter**

CS thousands	Second quarter 2016-2017	Third quarter 2016-2017	Fourth quarter 2016-2017	First quarter 2017-2018	Second quarter 2017-2018	Third quarter 2017-2018	Fourth quarter 2017-2018	First quarter 2018-2019
Sales	\$ 6,570	\$ 6,812	\$ 7,678	\$ 11,846	\$ 11,736	\$ 16,244	\$ 17,536	\$ 21,439
Gross Margin	\$ 4,350	\$ 4,478	\$ 4,933	\$ 6,120	\$ 5,991	\$ 8,970	\$ 9,827	\$ 12,444
Operating Expense	\$ 3,859	\$ 4,025	\$ 4,519	\$ 5,374	\$ 5,083	\$ 7,558	\$ 8,226	\$ 10,635
Operating Income (Loss)	\$ 492	\$ 453	\$ 414	\$ 746	\$ 908	\$ 1,412	\$ 1,601	\$ 1,809
Net Income (Loss)	\$ 290	\$ 281	\$ 166	\$ 390	\$ 614	\$ 750	\$ 699	\$ (997)
Net Earnings per Share								
Non-diluted basis	\$0.009	\$0.009	\$0.005	\$ 0.012	\$ 0.018	\$ 0.016	\$ 0.019	\$ (0.021)
Fully diluted basis	\$0.009	\$0.008	\$0.005	\$ 0.011	\$ 0.017	\$ 0.015	\$ 0.017	\$ (0.019)
EBITDA	\$ 758	\$ 729	\$ 702	\$ 1,102	\$ 1,274	\$ 1,895	\$ 2,536	\$ 2,515

**Outlook for Fiscal Year 2019**

Sangoma expects revenue for fiscal 2019 to be approximately \$100 million. Further the company anticipates generating adjusted EBITDA (excluding one-time costs associated with the Digium acquisition) of \$10 million this year, with adjusted EBITDA margins expanding to over 13% by fiscal 2020.

Sangoma finished the quarter with a cash balance of \$5.00 million and total debt of \$24.91 million following the completion of the Digium transaction.

**RATINGS****VALUE (TRAILING)**

EPS	\$0.02
P/E	62.50
PEG Ratio	-0.21
P/S	0.91
P/EBITDA	15.4
EV/EBITDA	20.4
BV/Share	0.81

**GROWTH**

Revenues	81%
FCF	-150%
EPS	-300%

**RISK/LIQUIDITY**

D/E	0.55
Current Ratio	1.00

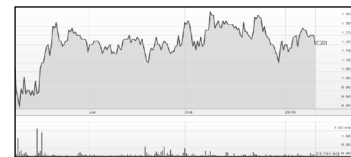
**SELECTED ANNUAL DATA**

Income Statement	2018	2017
Revenues	\$57,361,653	\$26,880,311
Net Earnings	\$2,453,495	\$800,195
EPS	\$0.05	\$0.02
Fully Dilluted EPS	\$0.05	\$0.02
FCF	\$5,051,464	\$2,804,931
FCF/Share	\$0.10	\$0.06
EBITDA	\$2,536,000	\$703,000
EBITDA/Share	\$0.05	\$0.01

Balance Sheet	2018	2017
Total Assets	\$51,561,002	\$27,258,959
Total Liabilities	\$16,216,396	\$7,923,572
Working Capital	\$19,124,888	\$7,287,644
Long-Term Debt	\$ 3,473,662	\$-
Book Value	\$35,344,606	\$19,335,387
ROE	7%	4%

**Sangoma Technologies Corporation****Current Price (January 31/2019): \$1.25****(STC:TSX)****RECOMMENDATION: SPEC BUY**

Shares Outstanding.....48,573,557  
 Fully Diluted Shares Outstanding.....56,900,909

**SELECTED ANNUAL DATA**

Income Statement	Q1 2019	Q1 2018
Revenues	\$21,439,335	\$11,845,606
Net Earnings	\$(996,732)	\$390,455
EPS	\$(0.02)	\$0.01
Fully Dilluted EPS	\$(0.02)	\$0.01
EBITDA	\$2,515,000	\$1,101,000
EBITDA/Share	\$0.05	\$0.02

Balance Sheet	30-Sep-18	30-Jun-18
Current Assets	\$28,079,327	\$31,583,752
Total Assets	\$92,649,623	\$51,561,002
Current Liabilities	\$27,970,766	\$12,458,864
Long-Term Debt	\$21,509,242	\$3,473,662
Total Liabilities	\$53,483,952	\$16,216,396
Shareholder's Equity	\$39,165,671	\$35,344,606

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**VALUATION AND FAIR VALUE ASSESSMENT**

By growing organically and smartly through accretive acquisitions, Sangoma is now forecasting fiscal 2019 revenue of \$100 million. The company has been looking to move the EBITDA margin consistently through the 10% rate and appears to have achieved this with the 14.3% posted in Q1 2019. 14.3% is not sustainable near term, but the higher trend is in place. We look for 2019 EBITDA margins to be in the 10-11% range. Adjusted EBITDA margins should expand to over 13% by fiscal 2020. The company is generating about \$2.5 million per quarter in EBITDA and cloud revenue is growing at over 30% per year. Sangoma is well positioned to produce \$2 million in EBITDA on a quarterly basis. As per management's guidance, we expect adjusted EBITDA for 2019 in the \$10 million or \$0.20 range. Sangoma holds an attractive price-to-2019 EBITDAe of 6.35. The company also holds relatively significant debt, so an Enterprise Value to EBITDA multiple is more appropriate. With an Enterprise Value (market cap + net debt) in the range of \$80.6 million and expected adjusted EBITDA for 2019 of \$10 million the company trades with an EV/EBITDA multiple based on 2019e of 8.06. Given the company is expecting to improve EBITDA margins in 2020 to 13%, which would produce 30% EBITDA growth even with no revenue growth (we expect significant growth), we suggest near-term fair value would be 10-12 times 2019 expected EBITDA. At 10.5 times, our fair value is \$1.75 or 40% higher than the current price.

**CONCLUSION**

Sangoma's Fiscal Q1 2019 results were very strong. Q1 marked the first time in the company's history in which quarterly revenues have exceeded \$20 million. Digium contributed to the top line immediately. Management has stated the integration work unfolded pretty much as planned during the quarter and the management teams are jointly working through expected savings during the second quarter, all of which is proceeding well. Adjusted EBITDA more than doubled from last year and at \$2.5 million, the first quarter is a great start that puts Sangoma well on track to achieve the company's \$10 million EBITDA guidance for the year. Following the Digium acquisition, the company is confident in the team's ability to deliver a \$100 million

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business in 2019.

Sangoma has completed seven acquisitions in the past seven years which appears now to be providing the company with the product breadth and scale to compete in the rapidly evolving UC industry. Sangoma has a solid management team which has successfully diversified from a one product offering to a multi-solution company in a relatively short-time frame. In August of this past year, Sangoma made a potentially game changing acquisition in Digium (US\$28 million or ~1x sales), a top player and competitor in the open sourced communications market. The market met the acquisition with near-term trepidation, likely due to the fact that Digium was only marginally profitable at acquisition – essentially operating EBITDA flat. There is a significant opportunity for Sangoma to drive significant revenue and cost synergies all the while removing a competitor from the market. The team has done this in the past and if they execute well with the Digium acquisition they should be able to unlock solid shareholder value.

With an Enterprise Value (market cap + net debt) in the range of \$80.6 million and expected adjusted EBITDA for 2019 of \$10 million the company trades with an EV/EBITDA multiple based on 2019e of 8.06. Given the company is expecting to improve EBITDA margins in 2020 to 13%, which would produce 30% EBITDA growth even with no revenue growth (we expect significant growth), we suggest near-term fair value would be 10-12 times 2019 expected EBITDA. At 10.5 times, our fair value is \$1.75 or 40% higher than the current price.

**We upgrade Sangoma to our Focus BUY Portfolio at SPEC BUY in light of the opportunity presented from the Digium acquisition and the strong recurring revenue growth and business growth overall. Shares are relatively illiquid - place limit orders in the \$1.20-\$1.35 range and be patient.**

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**2008a; 2009e**

The term (a) refers to the actually results that a company has posted on its financial statements. The term (e) refers to analyst estimates of future results.

**Book value (BV)**

The total value of a company's assets, on its Balance Sheet, less any liabilities. Also referred to as Shareholder Equity. (The value of a company's assets, on its Balance Sheet, does not necessarily reflect the true value of assets).

**Cash Flow from Operations (CFO; Operating Cash Flow)**

The cash inflow that a company receives during a period, resulting from operating activities (does not include Cash Flow from Investing or Financing).

**Current ratio**

One of many ratios designed to evaluate short-term liquidity of a company. Calculated as current assets divided by current liabilities, this ratio gauges the level of cash resources relative to current liabilities as a measure of cash obligations (the ratio should be greater than 1).

**D/E: Debt-to-equity ratio**

A measure of a company's financial leverage calculated by dividing long term debt by shareholders equity. It indicates what proportion of equity and debt the company is using to finance its assets (a lower ratio indicates lower relative debt ratios).

**EBITDA**

Earnings before interest, taxes, depreciation, and amortization. EBITDA is calculated as revenue minus expenses (excluding tax, interest, depreciation, and amortization).

**EPS: Earnings per share**

A company's earnings available to common shareholders, also known as net income or net profit, divided by the number of shares outstanding.

**Fair Value**

The price at which an analyst believes a company's stock should be priced. Although this value is based on intelligent analysis, it in no way is a representation of what the company's share price will be trading at given any period of time. The analysis used to determine Fair Value is based on numerous assumptions and uncertainties. Fair Value should be used only as a general guide to investing and should not be depended upon.

**FCFE: Free cash flow to equity**

Cash flow from operations less working capital requirements, sustaining capital expenditures and scheduled debt repayments. FCFE consists of cash inflows that are available to the shareholders of the company.

**Net working capital surplus (deficiency)**

A measure of the company's ability to carry on its normal business comfortably and without financial stringency, to expand its operations without the need of new financing, and to meet emergencies and losses. Calculated by deducting current liabilities from the current assets (as positive figure is a surplus, whereas a negative figure is a deficiency).

**P/B: Price-to-book ratio**

Calculated as a stock's market value (current closing price) divided by its latest quarter's book value. While a lower P/B ratio could mean that the stock is undervalued, it could also serve as a sign of weak fundamentals, and as with most ratios, this varies a fair amount by industry.

**P/CF: Price-to-cash flow ratio**

Calculated as a company's current share price divided by its cash flow per share (i.e., free cash flow divided by the number of company's shares outstanding) over the last four quarters (called "TTM," or "trailing 12 months" calculation). It is a measure of the market's expectations regarding a firm's future financial health.

**P/S: Price-to-sales ratio**

It is calculated as a stock's current market price divided by its sales (revenue) per share. When calculating this ratio, we use the company's revenue from its latest four quarters, or on a TTM basis.

**ROE: Return on equity**

A measure of a corporation's profitability, calculated as net income divided by shareholder's equity. ROE is often useful in comparing the profitability of a company to other firms in the same industry.

**Tangible Book Value (TBV)**

The total value of a company's assets, on its Balance Sheet, less any liabilities and intangible assets such as goodwill. Also referred to as Shareholder Equity. (Also true asset values likely differ from Balance Sheet Values, Tangible Book Value is generally considered a more accurate representation of value).

**Times Interest Earned**

The multiple of Net Income (before interest and taxes) to interest payments during the period. This assesses a company's ability and margin of safety, with respect to meeting its interest obligations (a higher number is more attractive).

**Yield**

The investment return resulting from income distributions. Calculated as the annual or annualized interest or dividend distribution, divided by the cost of the original investment.

Disclosure					
Stock Holding				Other	
Companies	KeyStone	KeyStone Employees	Related Companies	Investment Banking Client	Related Company Business Relationship
Sangoma Technologies	NO	NO	NO	NO	NO

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