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EWING MORRIS & CO. 1ST ANNUAL LIMITED PARTNERS MEETING

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Remarks have been edited for clarity.

Matt: Everyone in this room will no doubt know the two gentlemen with their names on the door, Darcy and John. Not everyone will know who I am - my name is Matt Irwin. I run the firm's operations and I represent the "& Co." at Ewing Morris.

Although it is just the three of us that work above the Timothy's coffee shop at Yonge and St. Clair every day, we in fact have a much deeper bench. The investment management industry is supported by a large network of investment service providers. This allows us to outsource many of our non-core operational functions to very credible and capable third party providers. Jack Welch, the former GE CEO, has a very fitting quote which I think clearly illustrates why we feel this business model is an advantage to our firm. I quote, "***Back rooms** (offices) by definition will never be able to attract your best (talent). We converted ours into someone else's front room and insisted on getting their best."* And so in reality the "& Co." is much more than just myself. Many of our business partners have joined us here today and are an absolutely integral part of our firm. I'm going to quickly introduce those that were able to join us today and maybe you could just put your hand in the air when I say your name. We have Tom McNeill, our commercial banker from RBC; Gord Rafferty, one of our trading partners at GMP Securities; and Ali Zahedi from Harmony Portfolio Systems. TD Prime Brokerage is represented by Rohit Sandhu, Andrea Di Censo and Stephen Banquier. Eva Chan is here from Apex Fund Services, who does our fund administration, and Jeffrey Charles from Jones Brown, our insurance broker. We really appreciate you joining us here today.

The goal today is not for us to present but rather have a very candid conversation about the business and answer any questions that may be on your mind. So Darcy's going to say a few quick words about the firm and then we'll have a Q and A session.

Darcy: Thanks, Matt. Thanks again to everyone for making time to be here today. We appreciate it and we look forward to addressing any questions you may have or talking about whatever it is that is on your mind. But before we do that I want to talk briefly about the core principles that guide our firm.

On the desk in front of you there are two pieces of paper. The second one is a short survey that we hope you'll fill out before you leave and the top one is an overview of the Partnership. So as you can see the Partnership started operations on September 9, 2011. As of yesterday, the Partnership has returned 15% - in dollars that amounts to $2,400,000. The total number of limited partners is 45 and total firm assets are just over $30,000,000.

As many of you have heard us say before, our overarching goal is to build a firm that we would want to be investors of. Sounds like a simple proposition, and indeed it's easy enough to say, but it can be a difficult thing to do in practice. So what does building a firm that we would want to be investors of mean? Well, it means a few things:

Number one; the firm we would want to invest in is focused on investment results not asset gathering. We think we have three structural advantages that regardless of how intelligent, hard-working, or charming we may or may not be, give us a leg up against the competition. That's investment flexibility, asset size and a focused portfolio. We're happy to talk about those in more detail.

Number two; we want a firm that employs an understandable investment strategy based on sound principles. We think that fundamental business analysis should underpin investment practice. And that a common sense approach to investing in a limited number of carefully-selected and understandable businesses that are run by able management and purchased at appropriate prices, is the best way to generate sustainable long term results.

Number three; we want a firm that communicates candidly with its investor base whether it's good news or bad news. We know that the most important asset we have as a firm are the limited partners that are gathered here today and that are invested in the Partnership. Anything we might do that would compromise your trust and confidence makes anything we say or do here today pointless.

Number four; we want a firm that focuses on operational excellence and makes best-in-class service a priority. When I say operational excellence that means things like making sure our legal documents are fair and understandable; making sure that confidential information and data is protected and making sure tax and performance reporting is done in an accurate and timely manner. Making sure that operational excellence is a part of our firm's culture is the responsibility of all of us - of me, of John, of Matt, of our service providers - not the sole responsibility of one person.

Number five; we want to invest in a firm where the managing partners, or the general partners in our case, have meaningful personal investments on the same terms as the limited partners. Well, I can tell you the three of us have the bulk of our net worth invested in the fund on exactly the same terms as you, the limited partners. None of us own real estate, none of us have any desire for our investments to go back to zero - as do none of you - so we're effectively all-in.

Lastly, when we think about the firm we would want to invest in, we want a firm that measures its success based on the absolute return given to its limited partners. Many people in our business talk about prior track record, but our time is spent looking forward. Our investment goal is to double money in a reasonable timeframe, consecutively. We think a reasonable timeframe is somewhere between five to seven years which translates back to a 10%-15% return per year. Now some years will be better than others and it's doubtful that number will move in a straight-line.

We wish, as I'm sure all of you do as well, that the stocks in our portfolio would tick up just a little bit higher each and every day. But we all know that the world doesn't work that way. Investment results cannot be guaranteed. What we guarantee for our limited partners is that these are the core principles that will guide our firm. And that if we ever stray from them we hope and expect to be held accountable.

Okay. Without further ado let's get into Q and A. John, are there any ground rules before we start.

John: Right. We're happy to answer questions on any and all topics whether that is specific investments in the Partnership, broader picture questions or even when we think the NHL lockout might end. We understand a few people might have to leave before 1 o'clock when we're expected to wrap-up. Feel free to do so, just make sure you leave while Darcy's talking. And with that, why don't we kick it off with questions.

Question: So you mention that the asset size of the firm is a key component to your strength. What asset size do you see as being optimal? Is there a limit to where you'll stop collecting new assets? How are you going to manage that?

Matt: John?

John: I think the point about size being the enemy of returns is a really core principle and someone managing a small amount of money can take advantage of situations that larger firms can't. We always want to make sure we preserve that advantage. The fact that we're rewarded primarily based on the returns of the fund and not the size of the fund is a key check to make sure that we'll keep it that way for a long time. I think for context it's worth noting that the fund that I was responsible for in my previous firm managed about $350 million and only invested in small Canadian companies. We've got a much broader universe to seek opportunity. In terms of orders of magnitude, we're still a long way away from where the ceiling might be. Anything to add, Darcy?

Darcy: We say if you run a good split time in the first mile of a marathon you don't stop and celebrate. And so from our perspective we're still just out of the gates here and I think there's a long way until we bump up against an asset size that hinders our performance. The other important thing is that being investors in the fund ourselves, and being compensated primarily for investment results, that acts as a safeguard in that it's in our own best interest that the fund stays an optimal size for investment results.

Question: You're a new fund, new people, new money, new ideas, how do we investors take comfort from the fact that there are mechanisms in place that protects our capital as investors in the event that something happened to Ewing Morris & Co.?

Matt: Right, I think it's important to highlight some of the controls that we have in place. First of all we don't custody the assets at Ewing Morris HQ; they're at our prime broker at TD Securities which is a AAA-rated Canadian bank. And our prime broker is backed by TD bank itself so the assets are guaranteed in a segregated account.

We also have a number of controls that we put in place to make sure that no one has sole discretion on transfer of those assets. As every limited partner knows, we require documentation to receive or redeem funds into the Partnership. Then, in order for funds to be transferred between our escrow bank account and TD Prime Broker we require a signature from Ewing Morris as well as from our fund administrator Apex and then a final approval by TD. Another check is that on an annual basis our auditors, PWC, audit every transfer that occurs throughout the year. So those are the three ways we provide you with a sense of security about your assets.

Question: If you guys were the Cabinet sitting in Ottawa what would you tell the Prime Minister to do with the proposed Chinese takeover of Nexen Energy?

John: I think if you've got a country where you never allow foreigners to invest, that's going to be bad for that country over time. And not only is the country going to starve for investment it's probably going to be reciprocated and strong Canadian companies are going to struggle to have access to expand internationally. And so I think having a blanket "no" to situations like this is almost certainly a bad idea.

However, the idea of letting foreign governments that may not have Canadians' best interest at heart own key assets obviously has its risks. This is a lot different than whether we allow foreigners to own a hardware store. But on the whole I think the Canadian energy industry is a really capital intense business and Canada's not a huge source of capital in the world. So for Canada as a whole to develop its resources it's probably not a good idea to have the door shut to outside capital. So generally speaking I think it's probably a good idea and should be approved.

Darcy: One of our core principles is investment flexibility and that accounts to geography as well. If we want to invest outside of our domestic borders we would hope that we'd be allowed to do so and that there wouldn't be government interference. I think for the most part that applies to our philosophy for allowing foreign investment into Canada.

Question: In terms of your flexibility, what other markets are you looking at? Are there any emerging markets that you're doing research on or looking at investing in?

John: Flexibility, as we've said, is a core principle. To date the vast majority of investments take place in Canada and our attention has focused primarily on North America. When we think about international investments and where the next steps might be, if you take an industry like the automotive industry where if you thought you had the expertise and the resources to understand a company like Ford which is a global business that happens to be headquartered in North America then you've got the requisite expertise and resources to understand a business like Toyota that is located in Asia or Volkswagen located in Europe. And so, if you were to arbitrarily limit yourself to North American companies in a situation like that maybe it would turn out Toyota was the best of those three investments and now you've just forced yourself into making a second rate decision by imposing arbitrary rules. We do have investments in some international businesses that happen to be headquartered in North America but I wouldn't be surprised if at some point in the future we made investments in international businesses that happen to be headquartered in other countries. Darcy, anything to add?

Darcy: If you look closely at the statement of investments in the annual financial statements we send out you'll notice the bulk of our investments are in Canada. That's really a function of opportunity. We think that there's a structural advantage for investors like us investing locally or domestically and the reason is most investment talent in this country is focused on the natural resource sector. It makes sense because that's what our country's known for internationally. A lot of the international talent that comes to Canada to hunt for investment opportunities tends to focus on natural resources as well. So if you're a fund like us where we're looking at primarily real businesses, for lack of a better phrase, it's quite an inefficient market. There are not many people that come from abroad to look for software companies in Canada, for example. So going forward we'll certainly seek opportunity wherever we see it, but we think there's plenty in our backyard for the moment.

Question: For the foreign companies that you buy you're taking currency risk, or at least your investors are. What's your attitude towards hedging that risk and how do you gauge the risk of investment in a foreign currency?

Matt: I'll field that one. We hedge out our currency exposure on a weekly basis. We're only exposed to U.S. companies at the moment in terms of foreign currency. So what we do is we simply take our stock exposure vs. our cash exposure and we buy or sell U.S. dollars depending on whether we're long or short. We net it out on a weekly basis.

Question: So your exposure is zero?

John: Yes. And the reason is that all of our limited partners are Canadians who live and spend most of their money in Canadian dollars. We're agnostic to currency values since it's not our expertise in predicting them. So it makes sense to us to just hedge out foreign currency and focus on analyzing businesses which we think we can do pretty well.

Question: John, maybe you can explain how that short portfolio is managed and what your objectives are with it and how it factors into the balance sheet of the business?

John: Sure. This is probably a good time to just touch briefly on the playbook framework that we invest with. Just to quickly remind you, there's four plays in our investment playbook. And, stepping back even, the playbook is really this idea that a championship team needs to have a few plays that they perfected in practice so that when you get into a game regardless of what the defence does you still have a way to score.

And so our preferred play is investing in what we would call Great Businesses and that's a business with wonderful economics, a sustainable competitive advantage and a terrific growth opportunity. The problem is that lots of other people are looking for those too and you don't get a chance to buy them at good prices very often so you need to have other plays.

The second play would be what we call a Cheap Asset and that's buying a business that may not be a wonderful business necessarily but it's something where we feel very confident in our assessment of what its worth and the stock is trading at a meaningful discount to the asset value.

The third play would be what we call the Great Capital Allocator and so that's a business run by a terrific investor who's got a great track record of successful investment, still has a good runway to continue producing solid investment returns and they've got incentives aligned to continue to do that. So that's more betting on the jockey than the horse.

And the fourth one, getting back to your question, is what we'd call shorting Broken Businesses. So this is not looking for the next Sino-Forest or Enron. It's looking for a house with a crack in the foundation where the house is coming down sooner or later no matter how good the management team running the business might be. The shorts are there to stand on their own two feet and to make money regardless of what the market does. And obviously in a time when the market declines the short should do a little bit better than they otherwise would and in an extreme bull market maybe the shorts wouldn't do quite as well but over time we expect to make money on the shorts regardless of what the market does. I don't know if there is anything that you would add?

Darcy: The way the fund is structured today is 83% long and 20% short. And you can think of it as two different portfolios. So on the traditional long-only portfolio, that we'd all be familiar with, you have 83% long investments which leaves 17% in cash. And then when we short businesses we sell them first and receive cash at that time. And so when I say we're 20% short, that means we also have 20% in cash proceeds from those short sales. That cash is then set aside to cover those shorts.

Question: So you don't use it to leverage the portfolio?

John: We don't use it to leverage the portfolio. So if you added those two cash positions together the cash in the fund would be about 40% today with about 60% net invested in securities.

Question: When you look at your returns in your first mile and put them against the playbook - which plays have given you the lead against the market in your first mile?

John: The two biggest return investments to date were both Great Capital Allocators - a company called Constellation Software and another company called MainStreet Equity. They were both large positions in the fund - if you find someone like that they're rare and you want to have a meaningful amount of money behind that investment when you find them. So those are both, each individually is about 10% of the portfolio. Collectively the Great Capital Allocators represent about 40%. And both of those were up about 50% in the first year. So they were large percentage returns on large investments. And so those were the two biggest contributors. I think if you go through a cycle I would expect in times when the market is fully valued I'd expect our portfolio to be more heavily weighted towards Great Capital Allocators and Broken Businesses; and if you're at a period of depressed market valuations that's when we're more likely to get opportunities to buy Great Business and Cheap Assets. So the results from the four different plays, will look different in different market environments. But overall with every investment we make we're looking for investment we think we can make 15% a year. Anything to add?

Question: Just on that do you have a targeted return where you'd sell stock?

John: When we think about, again using that playbook framework, the Great Capital Allocators and Great Businesses are scarce and that means you want to have a meaningful amount of money behind them when you find them. In my experience they also tend to surprise you; a Great Business comes up with a great new product that you weren't anticipating or Great Capital Allocator finds an opportunity that you were never anticipating. And so I think you want to be a reluctant seller of Great Businesses and Great Capital Allocators because they tend to, they tend to surprise you and they can really snowball over time. And so I think you just want to let them keep rolling down the hill. With Cheap Assets and Broken Businesses these are ones where you're more likely to take what people would call a round trip. Where you might buy it cheap, it moves up and then something bad happens and it goes back to where you started. And so you want to be more aggressive sellers of Cheap Assets and Broken Businesses and not wait for the last piece of meat that's on the bone. And so those ones before we make the investment we've really got an idea of here's what we think would be fully valued but we're not, we're not usually waiting for that last penny on those investments.

Darcy: Maybe to add a little context: an example of a Great Business that we've used in the past is something like the 407 toll highway that's north of the city. That's a business where the asset is a long swatch of concrete located in an area of quickly growing population density. So if we're going to do an analysis on that business we can confidently say it's likely this highway is going to still be here 50 years from now. And that over the next 50 years we can predict that there will be some on-going maintenance costs but there will also be some on-going ability to continuously raise toll rates and so therefore we can confidently model out the investment over the next 50 years. So the 407 highway would qualify as a Great Business at the appropriate price and theoretically our holding period would be 50 years as long as someone didn't offer us a ridiculous price to take it off our hands.

An example of a Great Capital Allocator is Warren Buffett and Berkshire Hathaway. Here's an investment where three times in Berkshire Hathaway's history the stock has been down 50% but you would have been a net loser if you had sold it at any time. So when you find the right Capital Allocator that has a long runway to keep adding value we see no desire to sell.

Cheap assets, to John's point, are companies that don't qualify in those two plays so you *don't* want to be a reluctant seller. And on the shorts we stay very disciplined on position size and covering because there is inherent leverage. Each short position accounts for no more than 2% of the portfolio where the Great Business or Great Capital Allocators will have an average weight would be 10%. And the Cheap Assets are 5% weights on average.

Question: Do you have an example of a play that hasn't worked or isn't working from which you've learned and may help you in future investments?

Matt: That's a great question. John?

John: I'd say in the first year there's been two mistakes that are worth talking about. One is the short we had on Indigo Books and Music, the store that most of you would be familiar with. So the reason that we shorted as a Broken Business is because we thought the transition from physical books to e-books was likely to have a bigger impact on profitability than most people were anticipating. And as we look back from today that has proven to be correct. Where we got wrong was their Kobo, their e-book business that they were able to sell to a Japanese company for a price well in excess of what we thought conservatively it was worth. And the price surprised not just us but a lot of industry people that were familiar with the business itself. And so when we factored in the proceeds from the sale of Kobo the short position no longer made sense and we exited at a moderate loss. Overall it cost about half of one percent of the portfolio's assets. And so the lesson from that I think was to really think even more carefully than we did about the value of the sort of secondary assets that might be in a business that we're shorting. Valuing a money-losing but rapidly growing business is not right in our wheelhouse but we got it wrong and that hurt.

The other mistake that I think's worth talking about is not one that's probably obvious to anyone who might read the financial statements and that was a long investment we had in a company called Canada Bread which is one of two large fresh bread manufacturers in Canada. They make bread most recognizably under the Dempster's brand. So we actually made a little bit of money on this investment in the last year. We didn't deserve to and we got lucky I would say. I think my, the most important part of my job is assessing risks before we make investments and really creatively answering the question "what could go wrong?" and making sure the true answer is "virtually nothing". And so in the case of Canada Bread the risk that materialized that was knowable before we made the investment but I had overlooked was the impact that gluten sensitivity might have on volumes of fresh bread that sold. This is particularly important because the profits of the business are highly sensitive to production volumes. There are starting to be signs that people's increasing awareness around gluten is impacting volumes and if that turns out to be true we would not have wanted to own the stock and our assessment would have been wrong. We didn't want to wait around to find out and so once we realized there was this risk that we had missed entirely we decided to sell and exit. So like I said we made a small, a small gain but my, as I said before, my most important job is to identify risk and I missed a big one. And if we make a habit of missing risks, we're going to lose money and that's not what we're here for. So Canada Bread I think is perhaps the bigger mistake even though we actually made a little bit of money.

Question: When you short stocks, how sensitive are you to the cost of borrow?

John: So when you short a stock the, this is sort of turning the whole maxim of buy low sell high on its head. So you sell high first with the idea of buying low later. And so in order to sell first we need to borrow stock from someone else in order to sell it to a third person and then at the end we'll buy it hopefully at a cheaper price and give it back to the person who lent it to us in the first place. That's how the mechanics of shorting work. And so, when you borrow anything there's usually an interest rate attached and that interest rate depends on a number of factors but primarily the availability of that stock. So, if you took a large company that was widely held it's usually quite cheap to borrow. If you took a smaller company that might have a few large shareholders who aren't interested in lending the stock the borrowed cost might be quite expensive. And so the, the cost of borrow definitely factors into the analysis - if you short something that your borrowed cost is 10% and it goes down 10% we actually made no money. So it has to go down more than enough to compensate for the borrow cost. And so the cost to borrow is always a factor. When we're looking to short things when we think about that goal of doubling money in a reasonable time period and that hurdle we're looking on our shorts to make, for the stocks to be down about 50% in a three-year period, that's translates back into about 15% a year. So we're looking, we're not looking to short things that are slightly overvalued or might go down a little bit. We're looking for big moves. And so if we're right about the big move then paying a little bit extra for the borrow shouldn't in theory be a barrier to making that short. But the, it's certainly, the higher the borrow the less attractive the short idea. One final point, a high borrow cost sometimes indicates that the borrow might not be available that much longer and that's a situation that you want to avoid. So there's information content in the borrow rate as well.

Question: What is your strategy for not doubling down on your mistakes? What's your strategy for saving yourself from doing that?

John: I think it's really important to always not only ask how could the business fail but how could we be wrong. I think if the stock price is down a meaningful amount that's a good trigger point to go back and review the work that we did and check, and really challenge ourselves. And this is where Darcy contributes in a really important way to the portfolio as kind of an official devil's advocate on our investment ideas to really say I'm not so sure about this, John. But I think this idea of if your facts are right and your judgement is sound even if others may differ act on your research and your judgement. And so if a stock that we had invested in had gone down significantly we'd challenge our initial work to make sure we still thought that it was right. But if we did then we'd happily buy more.

Darcy: Agreed. The way we look at the market is that the market is there to serve us rather than to dictate terms to us. And so I can testify that John rarely has the stocks in the Partnership up on his computer screen. What's open instead is company documents, annual reports, financial statements, word and excel documents. So how we approach an investment is that we'll make a thesis on a business independently of where the stock is trading. We'll put an intrinsic value on what we think an entire business is worth using conservative assumptions. Only then when we think we have a handle on the business' value will we go "to market" by turning on our Bloomberg machine, or Capital IQ in our case, to see where the business is valued in the market. If the stock is trading at a significant discount to what we confidently think it's worth that's when we will step in and buy aggressively. Generally speaking, when the market is down those are days when we're deploying more capital. But to John's earlier point about Indigo, we won't always be right so we need to be vigilant about checking the assumptions we have inherent in our investments.

Question: What impact does market conditions and macroeconomic conditions have on your investing activities?

Matt: Darcy do you want to tackle that?

Darcy: Sure. That's a question that gets posed to us a lot. I think it's evident that we're living through a financially difficult time in history but the answer to "what's going to happen in Europe?", for example, is that we don't know. We read the same newspapers as everyone else does. And it's not that we don't think it's an important question it's just that we think the answer is unknowable. I don't want to sound cute, but we spend our time focused on building arks rather than predicting rain. When we analyse a business we just assume that there will be a recession at some point within the next five years. So whether that recession or crisis comes tomorrow or whether it comes three years from now or five years from now we can invest confidently because we have accounted for it.

I think if we were to go back to the office after lunch or if we all woke up tomorrow morning and let's say the stock market was down 30%. And this is plausible considering Athens has been on fire for two years, we would subscribe to what Rothschild said: buy when there is blood on the street …even if it's your own blood." And so in a situation when the markets decline dramatically it is unlikely that the 13 stocks in our portfolio would be the only ones that happened to be up. But that would be the time where we, again, would probably want to invest more capital than we ever have.

Question: What's your plan for being fully invested?

John: Good ideas are rare and the window of opportunity when they come along doesn't often stay open for very long. So I think it makes sense to always keep a moderate amount of cash in the Fund so that if, when you see a window open you can jump through it, you're not in a position where you need to sell something else in order to buy this new idea. So I would expect us to hold about 10% cash in the Fund at all times. And if it was less it would be because we had just jumped through a window of opportunity and then we would start to look to take the cash back to ten. Any cash beyond that and the way the fund is today it's about 17% total of free cash, so an extra seven is currently available. That's really a function of opportunities. We've got a couple things that we're looking at today that we might be able to put that extra 7% to work. But it's really there as just a by-product of opportunities. We can't find anything to do then the cash will build and if we've got lots of investment ideas then the cash position will shrink. But it also has the by-product of serving as a bit of cushion for the fund if you're in a period where the market's declined.

Darcy: I think the ability to hold cash is another big advantage that we have against other investors. A lot of other fund companies, especially pensions and endowments, are mandated to be fully invested at all times regardless of investment opportunity. That's a concern that we don't have.

Question: If you were go through the holdings in your portfolio and ask yourself what opportunities you're most excited about in the next few months can you give us a couple of examples?

John: The biggest position today which should by definition then be the one we're most excited about is a company called Canadian Natural Resources. Most people probably think of us as primarily investing in smaller companies and that's where you're most likely to find mispriced companies. Canadian Natural is a $35 billion company, it's a large company, large oil and gas company, primarily oil with operations primarily in Canada. It's a company run by a guy named Murray Edwards, a Canadian billionaire and a whole team really of terrific investment-minded oil and gas people. So this is a company we own as a Great Capital Allocator. They've got a track record over the last decade plus of compounding value at well in excess of 15% a year. The oil and gas is an interesting business for capital allocators because it's a business that demands a lot of capital. They've got billion dollar projects, they can put a lot of money to work. And so the runway to continue to deploy capital at high rates of return continues to be there. And the people who deliver that track record in the past are still in the fold and are highly incented and motivated through their stock ownership to continue to do it. So it fits the characteristics of a Great Capital Allocator. And it also for some more nuanced features of its portfolio relative to some other large oil companies trades relatively cheaply today, I think. And so I think on capital allocation alone it would qualify as about a 10% investment for the fund. But the fact that it's actually quite cheap today as well is enough to justify making the position a little bit bigger than that. So that's the one that we're most excited about.

Question: It's unique for such a large company to be so cheap.

John: It really is unusual for a large company like that to be, to be mispriced. And I think that maybe just speaks to the value of the flexible mandate that we have. We're usually going to look at smaller companies because that's where you're most likely to find mispriced businesses. But there's very few funds that you'll ever see that will hold a $10 million market cap company which we have and a $35 billion market cap company in the same fund. Most investment firms have different departments that handle those two different things. And the idea of having one fund with all our best ideas and no filler I think is to Darcy's first point at the beginning of the day a key advantage. Not many firms are structurally set up to allow any one investment manager to hold both kinds of companies like that in the same fund. I think it's a huge, huge advantage that we have with our structure.

Darcy: To John's point about being able to find Great Capital Allocators that take advantage of their industry, energy is really unique in this case. If you consider EnCana, a Canadian energy company we're all familiar with, it has a $15 billion market cap and a capex budget every year of about $5 billion. Effectively they're a new company every three years in terms of capital invested. Therefore it's critical that you evaluate management's capital allocation ability if you were to invest in Encana stock.

Energy is also unique in the sense that it's a very cyclical industry. If you have the ability to allocate capital well, energy is a spot where you can divest businesses at high multiples through the top of a cycle or buy back stock at five times earnings at the bottom of the cycle - that's a characteristic that a lot of other industries don't have. If you look at a company like Diageo, which owns Guinness and Johnnie Walker, there's relatively stable demand for a product like that and you would unlikely experience dramatic swings in its valuation. So even if you had a Great Capital Allocator at the helm of that business they can't take advantage the same way they could in energy as in the case of Canadian Natural Resources.

Question: But taking Canadian Natural Resources as an example, is there not an implicit bet on the commodity price?

John: When we think about the reason to own Canadian Natural it would be for the great capital allocation. I think we can make in excess of 15% a year based on the capital allocation if oil prices were unchanged. And so that means that if oil prices rose over time the return would be higher. And if oil prices fell over time the return will be lower. But to your point there is an implicit exposure to oil prices. We don't have opinion on the direction of oil prices and so you may have noticed in the financial statements that there is a large short position that is a hedge on the price of oil which is the idea of taking that inherent oil exposure that comes along with an investment in Canadian Natural, neutralize it and just allow the investment income to be determined by the capital allocation results of the company.

Question: Are there sectors you don't like or don't understand and avoid?

John: I don't want to use blanket statements because you never know when you might find something that's unique or unusual in a sector that does actually fit into our realm of understanding. But generally speaking biotech or pharmaceutical type businesses are not within our area of expertise. I'd say generally speaking mining companies are not within our area of expertise. And large balance sheet financials like big banks or insurance companies have a lot of inherent risk. There are always skeletons in closets of wings of the house that you didn't even know were there. And so those are the three areas that we're unlikely to spend much time on. The common denominator is that they're all really complicated with lots of unexpected things that can go wrong and investing in businesses with those characteristics is not a good way to compound value.

Question: Do you have any qualms about buying stocks that you don't approve of the business such as a tobacco stock or casino stock or something like that?

John: When we define risk we really think about what we'd call permanent loss of capital and that's where a stock price goes down and it's never coming back. The three main sources of that are valuation when you just pay too much for a company, the balance sheet, the company has too much debt, it might go bankrupt and then you never get to enjoy the rebound. And the third one would be a big structural change in the industry. Often that's technology like Netflix coming along to Blockbuster. But often that big change in an industry is regulatory in nature. And so businesses that we might have qualms about are generally speaking going to be businesses where other people do too. And so if you take something like alcohol, Prohibition might come along again. Or gambling; all forms of gambling including lotteries were banned in the U.S. for almost 70 years from the late 1890s to the 1960s. And so the businesses like that just from a pure risk perspective let alone our own ethical leanings are inherently unattractive because there's just these big unknowable risks that might come along with them.

Darcy: It is something we think about and discuss, but it's hard for us to put ourselves into a box on what some limited partners might consider an ethical investment and what some other partners might not think is ethical. And so we govern ourselves by this idea that we wouldn't want to do business with anyone that we wouldn't want to take home for dinner with our families. And so that extends to the type of people that manage the companies that we invest in as well.

Question: Have you guys explored real estate in any capacity and can you talk about your thoughts on real estate?

John: Real estate's a business where there're a lot of really smart people in the business that spend all their time focused on real estate. And so I think any real estate investment we might make we need to come with the idea that, we don't spend all of our time looking at real estate and so we're unlikely to be the smartest guy in the room on that. So we should be cautious if we're going to make investments in real estate. You've also got this kind of underlying idea that interest rates are as low as they've been in a really long time. And that means that real estate values generally speaking are as high as they've been in a really long time. And so again we should be, we should be cautious in that environment.

We do have an investment in a real estate company, the company's called Mainstreet Equity, I mentioned it as one of the Great Capital Allocators. Mainstreet owns a portfolio of mid-market apartment buildings mostly in western Canada. It was started by a guy named Bob Dhillon in the late '90s who owned a handful of, a half a dozen apartment buildings that we were worth about $17 million that he put into a public company. And fast forward to today the shares outstanding number is essentially unchanged and yet the portfolio which was worth $17 million in 1998 is now worth more than a billion. He's compounded value over 35% a year. He's got virtually all of his own net worth in the company, he's still a relatively young guy in his 40s. And so his incentives are lined up to continue to do what he's doing. The sub category of properties that he's interested in is generally too small to be of interest to larger real estate investors like the pension funds. And so his ability to continue to buy similar buildings remains intact. And he might not be able to compound value at 35% a year for the next decade but to think that he can compound value at 15% or better even if interest rates go up and I think is quite high and so we feel quite comfortable with that investment. Anything to add Darcy?

Darcy: One investment trend that we see right now is people stretching for yield in this low interest rate environment. In the public market, real estate is primarily structured through REITs that pay out all its earnings in the form of the distribution. And so these are usually high dividend paying stocks and, in our opinion, some REITs look to have been bid up above their underlying value by people searching for yield. And so another area that real estate has come across our desk is on the short side.

Question: There's a lot of cash built up on balance sheets in North America because of a lack of demand and you've talked a lot about looking at past records and all that but do you see any companies that might have an opportunity to put that capital to work and position themselves in the most advantageous manner and how do you gauge that and what's your strategy in purchasing those?

John: Evaluating cash on the balance sheet of a company is kind of a tricky thing. There's a lot of companies in Japan where half of the market value of the company is cash on the balance sheet. And a friend of mine used to say that if you give me a dollar and I promise to never give it back to you how much is that worth to you and the answer is nothing.

And so assessing what someone's going to do with the cash on their balance sheet is really, really important because that dollar in the hands of a great capital allocator is worth a lot more than a dollar. That dollar in the hands of an average Japanese CEO is worth close to zero. And so really thinking about what someone might do with that cash is really important I think. And that's just a subset of how we think about looking for Great Capital Allocators, really looking for people that the dollar in their hands is worth a lot more than a dollar.

Darcy: When we've talked to CEOs in our portfolio companies that have a lot of cash on the balance sheet our tendency has been, for the most part, to vote in favour of share buybacks as a way to utilize excess cash.

Question: You talked John about a small market cap company, what do you think about the lack of liquidity of those types of investments in microcap companies.

John: If I take that $10 million market cap company that we are invested in and we have a large stake in the company we view that essentially as a private investment. It technically trades on the TSX but we're probably going to hold that until something happens to that company, hopefully a good thing. So the liquidity is definitely a challenge with smaller companies. And I think the way we handled that is to really think through the portfolio approach and we would want a heck of a lot less than 100% of the portfolio invested in companies like that. But the ability to, when you've got smart, long term oriented investors in the limited partnership that allows us to make investments in companies like that where someone who doesn't have the same stable client base might not be able to invest in. And so it can be a real source of opportunity. And we'd just make sure that we monitor and limit the portion of the portfolio that's invested in things like that. The one other thing on liquidity for small companies is, so let's say the trading volume of a small company is such that it would take us three months to get the position size that we're looking for. If we had a really short term horizon on investments of six months that means it would take us three months to get in and we'd have to start selling the second that we finished buying to get out in the six months. That stock would effectively be unavailable for purchase. But if you've got a five-year horizon, then three months to come in isn't such a handicap anymore. And so having that long horizon with illiquid stocks actually let's you take advantage of and invest in small companies that people with shorter term horizons would have to overlook that company entirely, even if they saw the same investment opportunity in that company that we did. We don't have to be any smarter but just by having a longer horizon you get a chance to buy things that are too illiquid for other people.

Darcy: An irony with investing in small caps is that if we're right about the business then liquidity will take care of itself as they grow into mid cap and hopefully large cap businesses.

One thing I should emphasize is that we realize this is a liquid investment vehicle for our limited partners and that there is the ability to contribute or redeem on a monthly basis to our fund. I'm not sure it's the best way to maximize long-term investment results, but Partnership liquidity is definitely something that we are aware of and able to handle if and when people want to take their money back - or put more money in.

Question: I think part of the answer to my question may tie into the longer term growth of the assets but any comments towards expanding the brain trust in the sense of different perspectives on different industries, different checks and balances in terms of poking holes or punching holes in investment decisions?

Darcy: Sure. I think we have a lot of capacity with the three of us and the support team that we have in place. Adding people doesn't necessarily make us better investors and in some cases can detract from our ability by increasing distractions. We're also vigilant about corporate overhead and we really want to be careful as we increase that. Certainly additional salaries is one way to quickly bump that up.

On the other hand, just like great investment ideas we think great investment talent is scarce. We make an effort to constantly meet with students, new investors, old investors and if the right person shows up at our door we'll gladly invite them to take a seat at the table. So we're always looking to add talent. Do you have anything to add?

John: One thing we've also done is really tried to nurture relationships with a handful of investors that we think really highly of. And so you don't necessarily need people to be on staff to pose as devil's advocates. And so there're a handful of people that we try and meet with and speak with regularly to help provide that brain power.

Question: You talked a little bit about hedging some of the oil price risks and you also mentioned real estate prices being high, interest rates being incredibly low. Have you guys looked at doing anything to sort of negate that potential inflation, rising interest rate risk?

John: The exposure in the fund to energy, the indirect exposure in the fund in energy with investments like Canadian Natural which we own as a Great Capital Allocator and other investments we have in other plays is quite a bit higher than the exposure to interest rates. So it's not, it's not of the same urgency to make sure that we neutralize interest rates. We don't have anything like that today. It's something we'd definitely consider and we'd think harder about it if we thought that exposure to higher interest rates was larger in the first place.

Darcy: We're certainly monitoring risks like interest rates and inflation. We just have to be careful not to trick ourselves into thinking that judging macro risks is a science. For example, Mainstreet has outstanding mortgages on their balance sheet but those are locked-in at fixed rates that we think are manageable. As far as inflation we think the best way to guard against inflation is by having businesses that have pricing power that they can pass onto their customers or businesses where you can allow for large volume increases with minimal capital requirements.

John: We promised that we'd finish by one o'clock and so we really want to thank you for taking time to join us and hear what we had to say today. I want to thank Leni and Devin for providing the wonderful lunch and Doug for his help at the door. And most importantly I want to thank everyone for the trust and confidence that you've placed in us when you asked us to manage some of your money. I think managing money on behalf of others is one the largest responsibilities someone could take on and we take that responsibility really seriously and we're going to continue to work very hard to deserve the trust and confidence you've placed in us. That wraps up the formal part of our day. We're happy to stay behind and answer any other questions that remain unanswered but we hope that you have a wonderful day and thanks for joining us.

(applause)

[**End of recorded material**]