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INVESTMENT PARTNERS LTD.

EWING MORRIS & CO. 4TH ANNUAL LIMITED PARTNERS MEETING

Toronto Reference Library, October 14, 2015 – Toronto

Remarks have been edited for clarity.

Darcy:

Welcome. It is great to see a lot of familiar faces as well as some new ones. We thank everyone for taking the time to join us today. The most important asset that we have as a firm is our limited partners and we really appreciate your continued support and confidence in our organization.

This is our fourth annual investor day and some things stay the same. Every year it has been at the Toronto Reference Library and the format has been the same, a presentation and a quick Q&A. Every year I get a phone call from my Dad saying he has two questions in advance of LP day: "when is it over and what's for lunch?" So today my wife, Devin, and her brother Luke, have provided lunch from their restaurant Delica Kitchen. Any food that is not enjoyed here today will be donated to a shelter, The Sanctuary, just down the road. If you can get past that, please help yourselves to seconds.

I would also like to thank Jill Hamblin, our Office Manager at Ewing Morris, as events like this do not organize themselves. Jill makes sure the trains run on time at Ewing Morris headquarters and I think a lot of you have corresponded with her over the years, so thank you Jill.

I would also like to take this opportunity to officially welcome the newest member of the Ewing Morris team, Jenna Gillies. Jenna has joined us recently after working in the U.K. for J.P. Morgan and Blackstone, then most recently Brookfield Asset Management. Her focus is on investor communication and relationships. She has not done much to raise the median age of our operation but she has done a lot to deepen the talent pool. Jenna is a rising star and we look forward to introducing her to all of you individually.

The format for today is that I am going to give an overview of the Firm, Alex Ryzhikov is going to give a presentation on an aspect of our investment philosophy and John is going to dive into our results. Following that, we will open it up to Q&A and we will put a hard stop on the day in just over an hour.

These are our service partners and we think these guys are the best in the business. A lot of them are here today. We lean heavily on these people.

Advisory Board

Avie Bennett
Martin Connell
Linda Haynes
John MacIntyre
David Peterson
Harry Rosen
Bill Stedman
David Wilson

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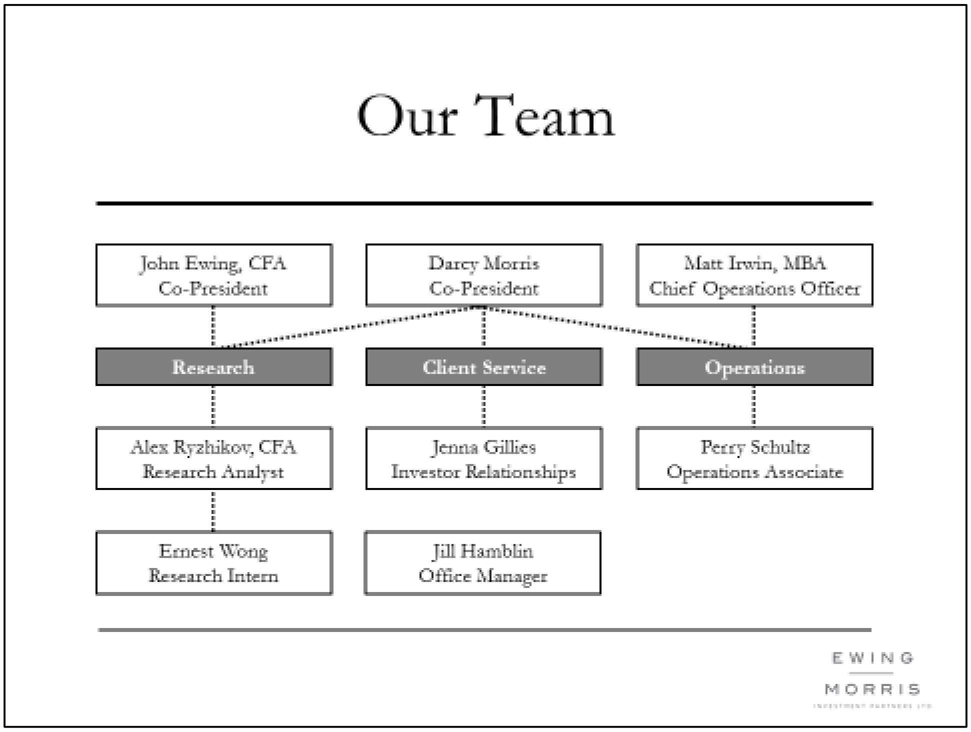
This is our Advisory Board and we are really pleased to welcome the addition of Harry Rosen this year. Not only does this group represent friends and mentors to us, but they are also meaningful investors in the Partnership. We use them as a focus group to run ideas and strategies by. All of them have vast experience in Canadian business, across a wide array of industries. Most importantly, all of them have long track records of outstanding judgement. They are imperative to our organization.



Here is what the team looks like today, you can see we have grown, but are still a small unit. I think there is strength right through the line-up.

As a reminder, the guiding principle behind Ewing Morris, from virtually the first breakfast at which John and I sat down, is to build a firm of which we would want to be clients. That means we are focused on results rather than gathering assets. We really manage money with two concepts in mind, number one is to protect capital and number two is to deliver above average results over time. We really do it in that order as the focus is always on downside protection.

There are a few other core principles that stem from that. We apply understandable investment strategies based on fundamental principles and common sense, manage a focused portfolio of well-researched businesses, we build meaningful relationships with our limited partners based primarily on candid communication, whether that be good news or bad news, and we remain committed to operational excellence – things like timely and accurate reporting when it comes to taxes and performance, regulatory compliance and partnering with first class service partners. We all have meaningful personal investments on the same terms as our limited partners and, lastly, we measure our success based on the absolute net return to our clients over time.

Partnership Overview

as of October 13, 2015

Limited Partners	**72**
Mutual Fund Trust Investors	129
Firm Assets	$91,500,000
Management Ownership	26%

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Here is what the Partnership looks like today. The most important aspect of this slide is the management ownership. Insiders account for approximately 25% ownership of partnership assets, meaning we mow our own lawn. We are also invested on exactly the same terms as all of you.

Investment Results Overview

as of October 13, 2015[1]

Year	Ewing Morris Class A[2]	S&P/TSX Index[3]	S&P 500 Index[3][4]
2011*	6.3	(2.5)	9.5
2012	11.5	7.2	15.2
2013	16.2	13.0	31.6
2014	(1.7)	10.6	12.3
2015 YTD	5.42	(3.1)	(1.6)
Total (Cumulative)	42.7	26.5	84.6
Total (Annualized)	8.9	5.8	16.2

(1) Since inception on September 11, 2011
(2) Returns Net of all Fees & Expenses
(3) Dividends included
(4) U.S. Dollars

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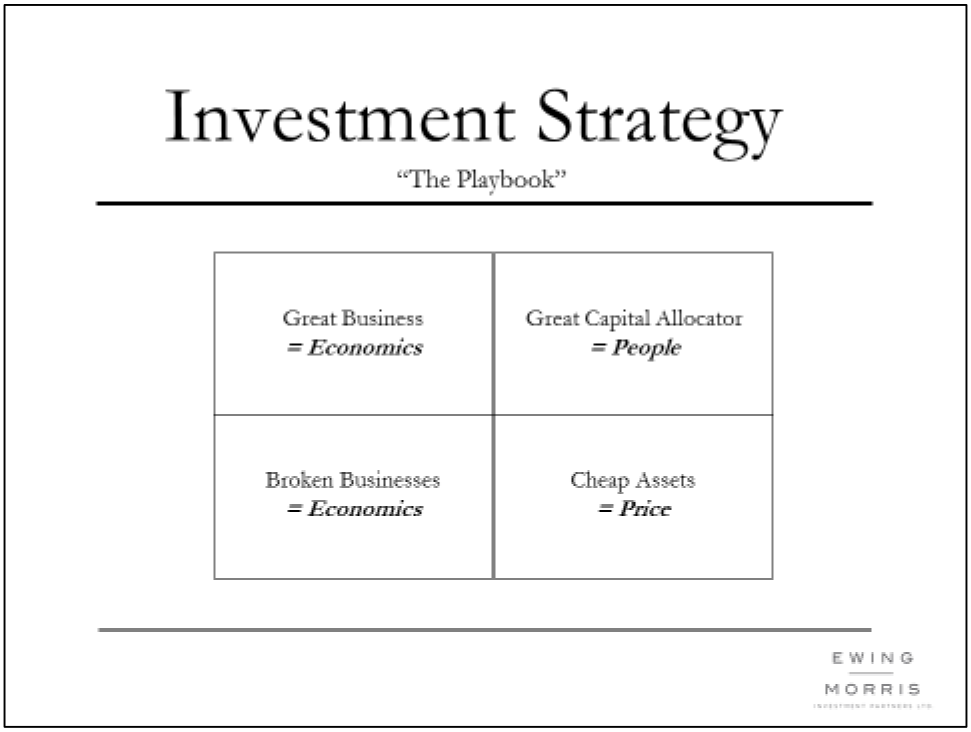
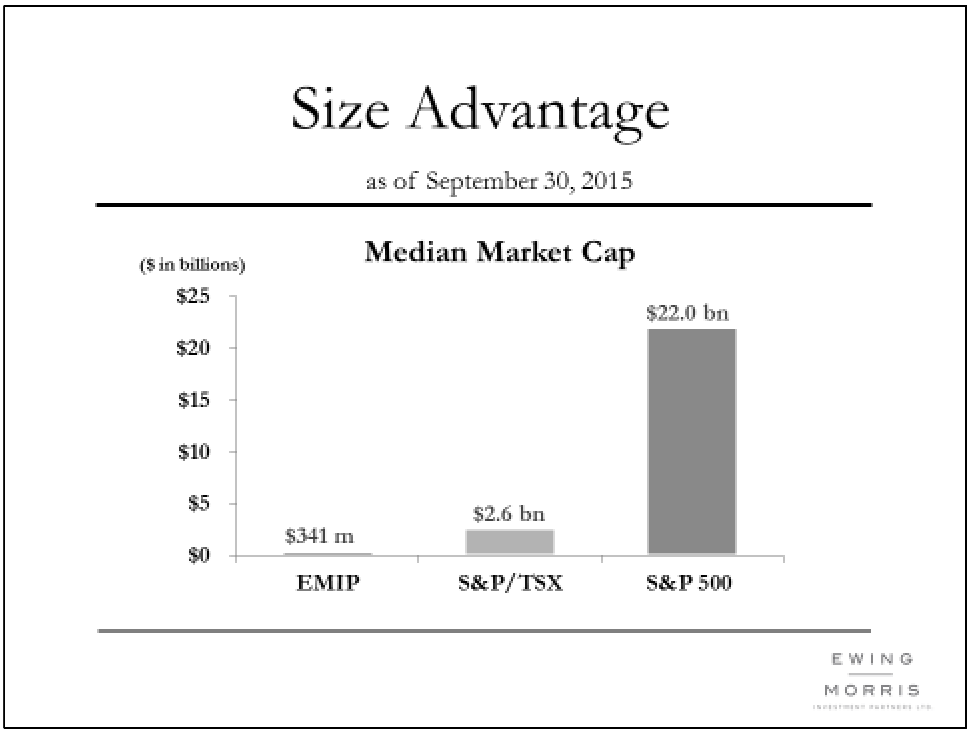
Here is how we have performed: since inception results have been solid; 2014 was challenging performance-wise, but we feel good about our ability to have protected capital for the first 9 months of this year and are excited about the future. As a reminder, we underwrite our investments to achieve a 10-15% compounded net return over time and think we have the ability to do that within the existing portfolio with the capital base that we have today.

Now for our investment philosophy or world view. We describe it as applying a private equity mindset to public markets so what that means is that we analyse businesses from the perspective of whether we would want to own 100% of that business, with the existing management, at the current price, and whether we would be content to hold that business for several years. The advantage that we have by executing in the public markets is that we have the opportunity to buy fractional ownership of these businesses at prices that no rational owner would part with the entire company. Stemming from that world view is our strategy. We use the analogy of a sports playbook to describe it.

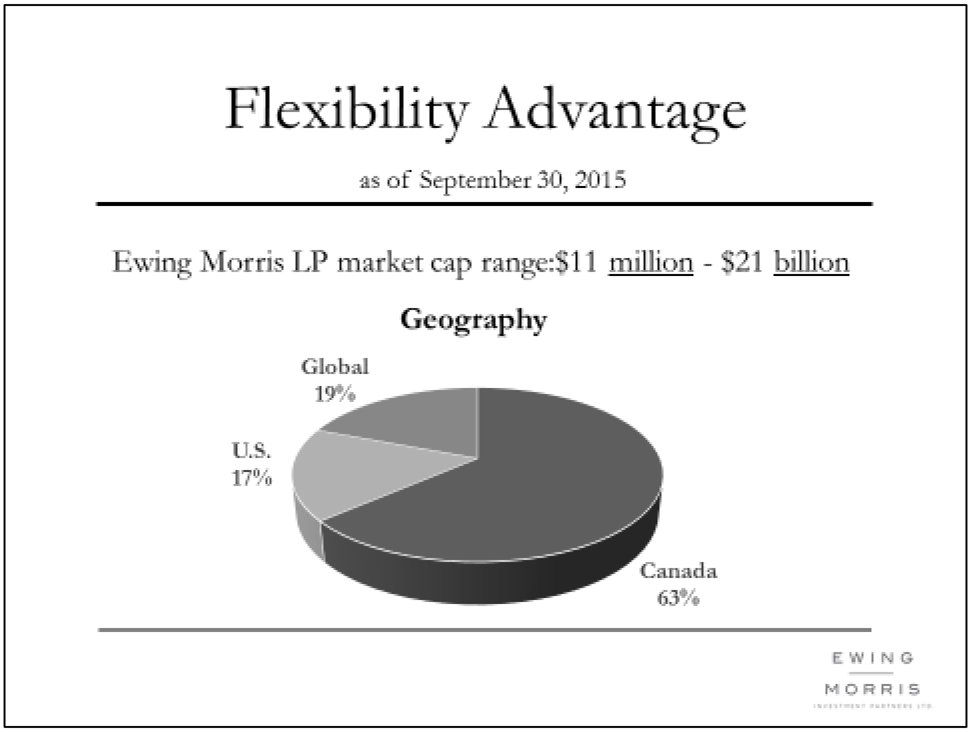


The idea is that a championship sports team will have perfected and practiced a number of different plays so that in a game situation, there is always a strategy to score. The first play is the Great Business. In the Great Business, economics are the primary driver in the investment decision. We are looking for companies with high returns on invested capital, sustainable competitive advantages, and one or two compelling growth opportunities. The problem is that the market is mainly efficient and usually these businesses are not available at attractive prices, which is why you need other outlets. The second play, that we call the Great Capital Allocator, is investing in businesses where there is a great investor at the helm. So these are individuals or management teams that have demonstrated a track record of creating shareholder value over time through a series of corporate actions and they do so with a process and discipline that we deem to be repeatable into the future. The people are the primary driver of this investment decision. The third play is what we describe as Cheap Assets, and those are investment situations where there is disconnect between the operations of the businesses, or the income statement, and what the assets of that business are worth on the balance sheet. You can think of these scenarios as buying companies at below replacement value or below auction value. Price is the primary driver here. The fourth play is Broken Businesses and those are situations where we will short businesses we believe to be in fundamental economic decline which has not been reflected in the market price yet. Every investment we make is filtered through one of these four plays.

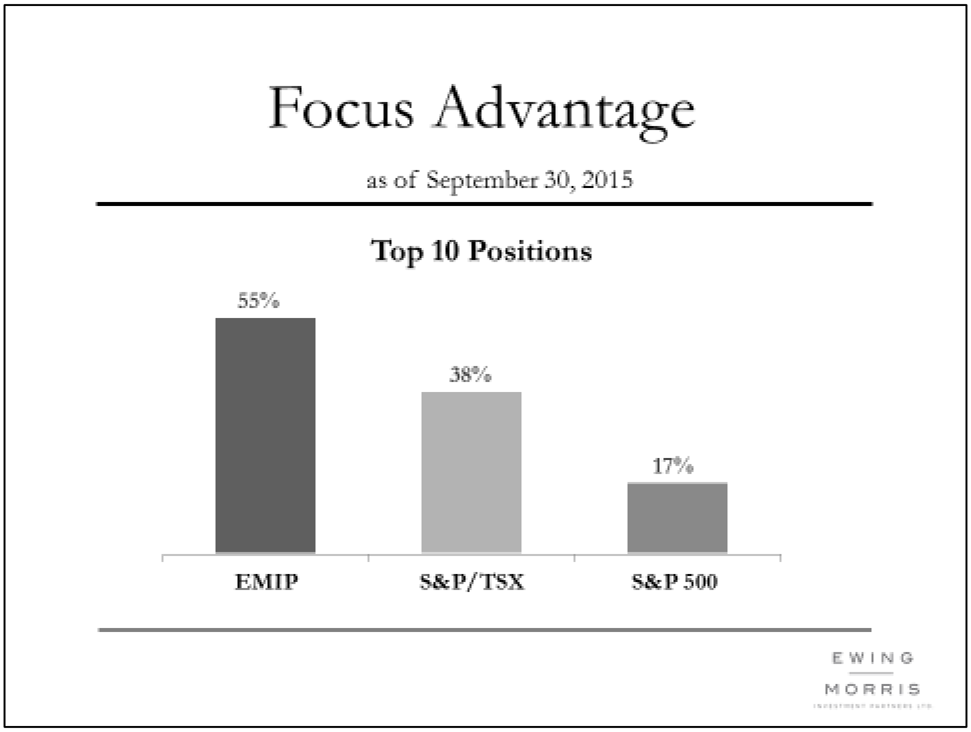
Now, I think our competitive advantage is our people, our reputation and our framework, but we also have three structural advantages that give us a further leg up. Those are size, flexibility and focus.



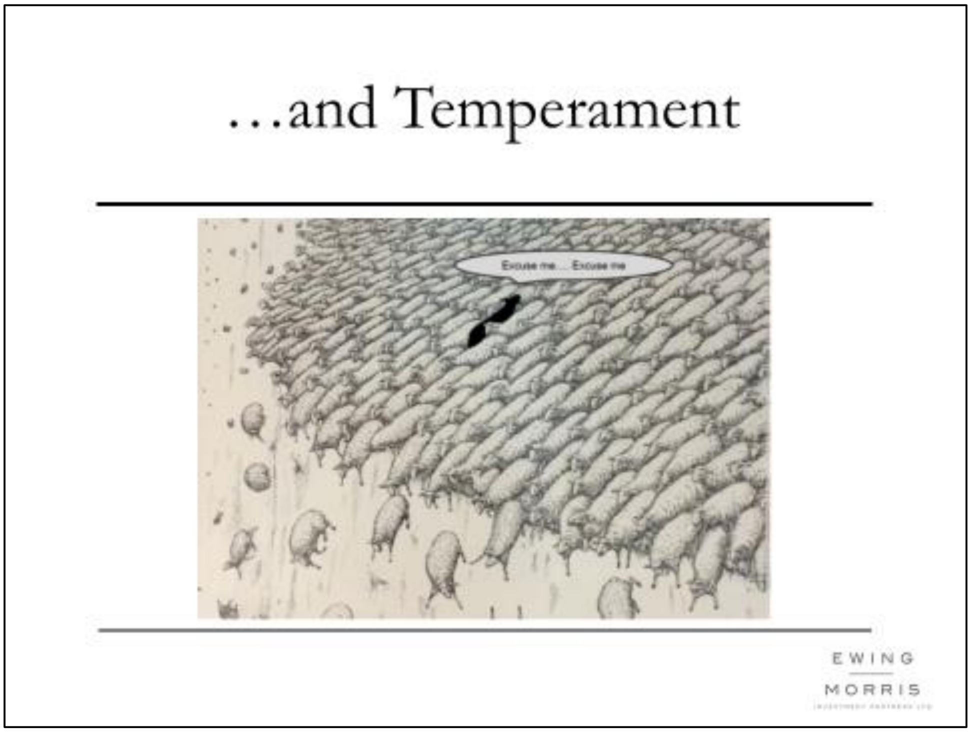
Today, we run about $90 million dollars; in the capital markets that is micro scale. Therefore, we focus on small cap investments. Today, the median market cap of companies in our portfolio is about $340 million and you can see how that compares to the S&P/TSX and S&P 500.



In terms of flexibility, flexibility is the advantage to seek opportunity wherever we might find it. That applies to market cap, geography and it even applies to capital structure. How are we executing on that today? Well today we own 20% of an $11 million dollar company, but we also own shares in a $21 billion dollar company. In terms of geography, about 20% of the portfolio is invested outside of North America today.



The third advantage is focus and that is the idea that great investments are scarce. We have no interest in watering the wine with our 100th greatest investment idea. We take concentrated positions where it is merited and today over half of the Partnership assets are invested in our top 10 holdings. You can see how that compares to the TSX today.



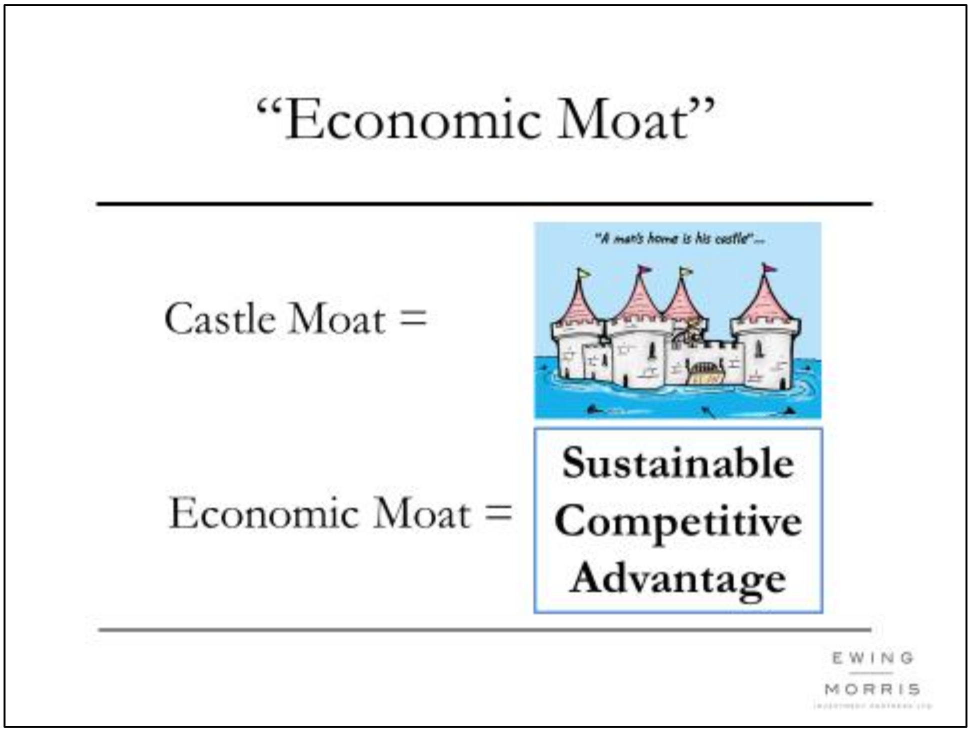
Now, this framework and these structural advantages are what give us the confidence that we can achieve returns that match your expectations over time. And they are essential, but so is temperament. As we all know, stocks in our portfolio do not tick up each and every day. As nice as that would be, the world just does not work that way. The world is cyclical and areas and styles that are out of favour today will come back. At the same time, some world event will create a market dislocation in other areas. It is the temperament to be opportunistic, contrarian and independent thinking, that will also contribute to long-term above average results.

In conclusion, I like to boil what we do down to three things; number one, we maintain a disciplined investment strategy, number two we execute creatively, every day, within that strategy and, number three, we surround ourselves with good people, which I think today is a testament to. And with that, I would like to introduce my colleague, Alex Ryzhikov, who is going to give a presentation. Alex has been with us for just under two years, but we have known him for longer than that. He is a research analyst on the Partnership and he also runs a small fund internally. Alex is a great investor and his most recent claim to fame is that he was, according to the Omaha World Herald, the very first person in line for the Berkshire Hathaway 50th annual meeting.

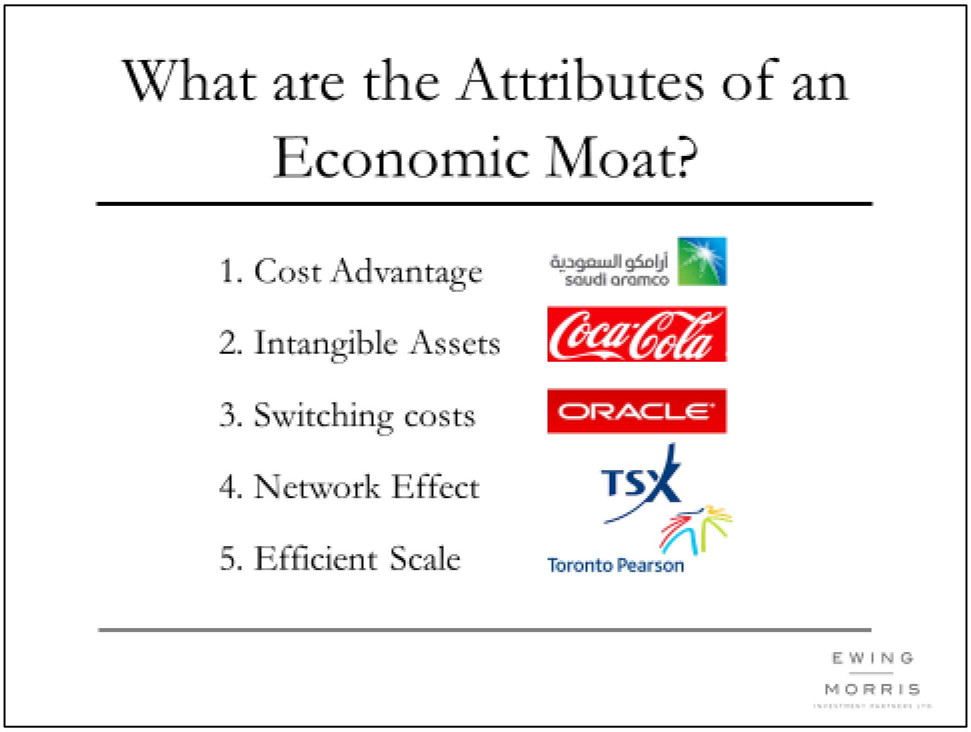
Alex:

Thank you Darcy. I would just like to point out that this slide was a very last minute addition, so if my performance today is not very good, I blame it on this embarrassing slide.

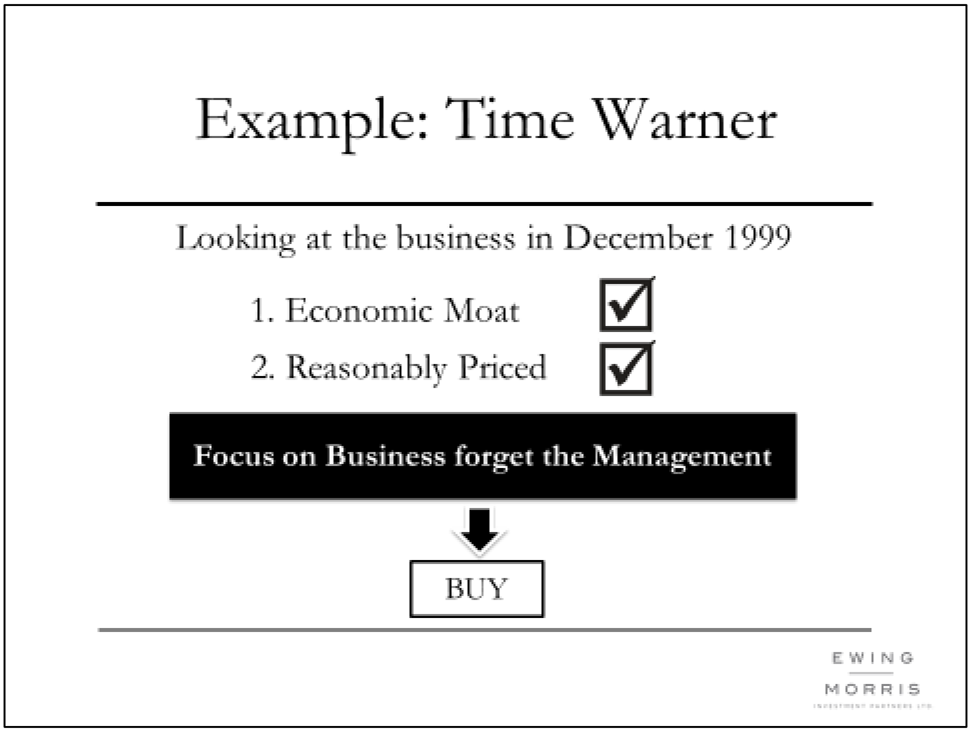
One of the questions we are asked quite often is how do we approach selecting Great Capital Allocators. I think the approach we use is one that would have been very similar if we were in your shoes looking for a great asset manager. Specifically, we believe it is more important to understand the investment process employed by the manger as opposed to what current holdings the manger has in his or her portfolio. So with that in mind, I am hoping that my presentation will provide you with some additional insight into how we invest at Ewing Morris.



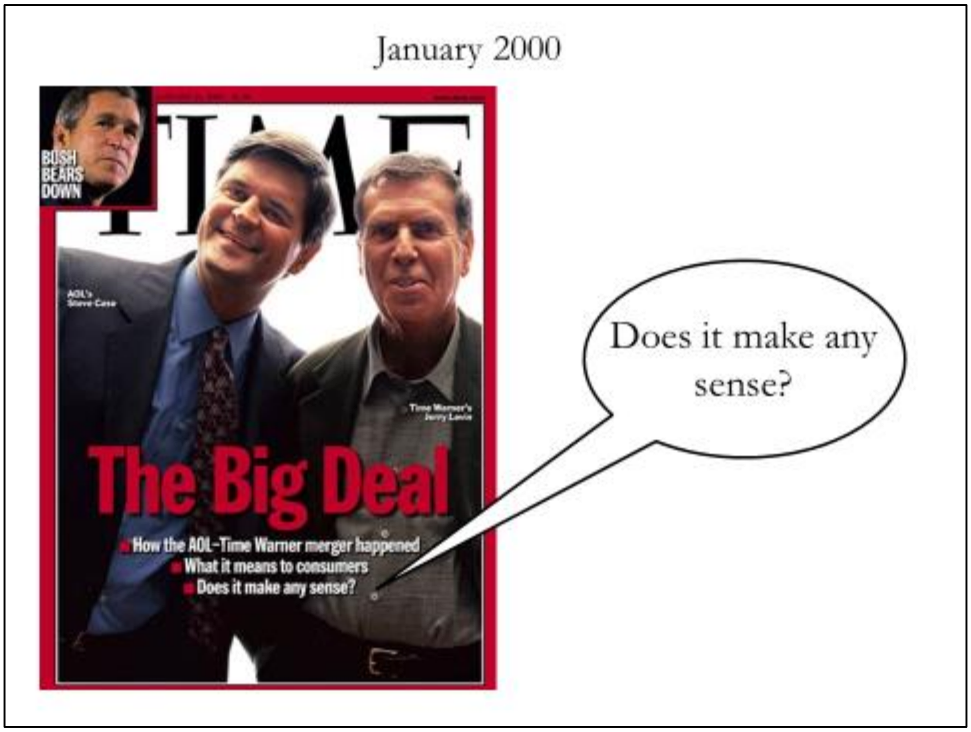
I would like to start with a quote: "Buy a business that an idiot can run, because sooner or later, one will." This is a famous Peter Lynch quote that, for some, has come to mean: "focus on the business and forget the management". Today, I want to examine this approach. First of all, what does it mean to focus on the business? Usually it means determining if the business has an economic moat.



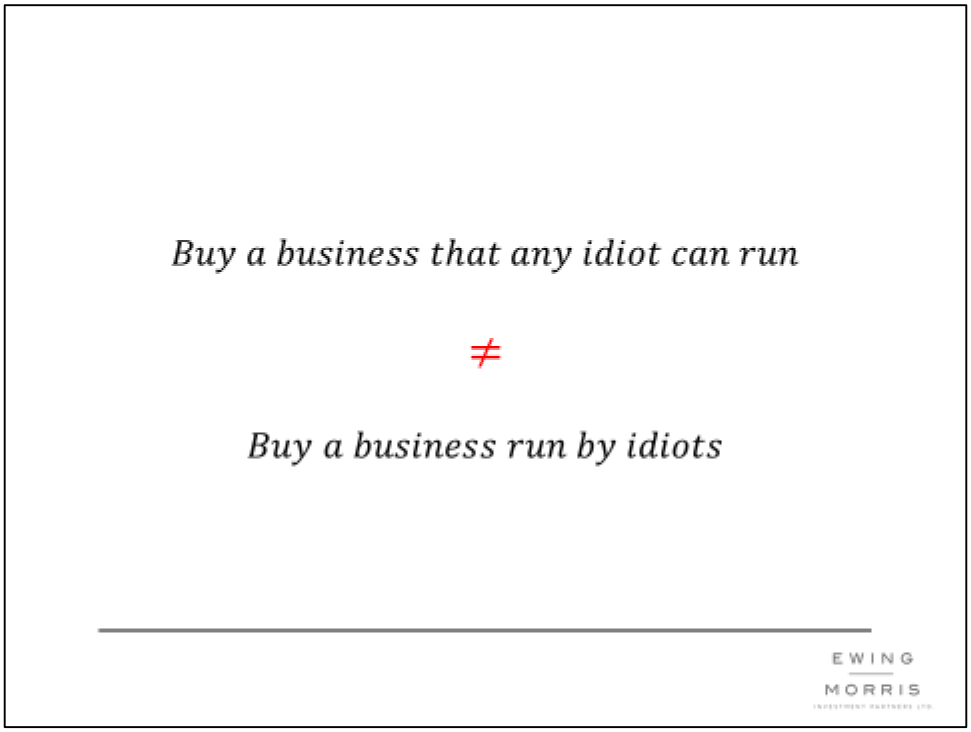
An economic moat is simply another word for a sustainable competitive advantage and, although there is no right definition to what constitutes an economic moat, the following five business attributes have often been associated with an existence of an economic moat: Cost advantage like Saudi Aramco; intangible assets such as patents and brands, with Coca-Cola being a good example; switching costs, Oracle ERP software comes to mind here; network effect, people often use exchanges like the TSX, and efficient scale and, in this case, Pearson Airport would be a good example.



Imagine you are an analyst looking at Time Warner in December of 1999; you would have been justified in concluding that the business appeared to have an economic moat. The cable operations benefited from minimum efficient scale that limited the number of potential competitors in a given geographic market, giving it some measure of pricing power, while the company's media assets such as HBO, CNN, Sports Illustrated had strong brands that people were willing to pay a premium for. If you decide that the business is reasonably priced, you have to conclude that Time Warner's common stock represents an attractive investment opportunity. However, only two months later, Time Warner's management announced their intention to merge with AOL, a transaction that, in essence, gave away a 55% ownership stake in Time Warner's assets in exchange for a 45% stake in a business with substantially lower earnings power and, at the very least, a questionable moat. For those who cannot clearly see the last question on this Time cover it asks: "Does it make any sense?"



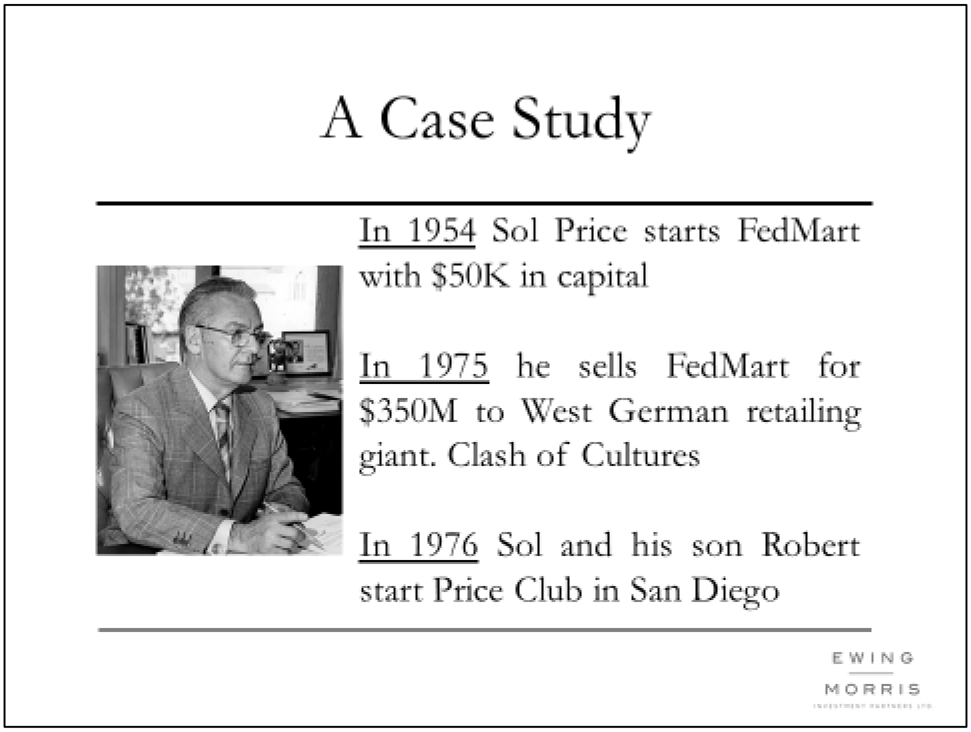
And the short answer to that question is: No! Only two years later, the company reported a $100 billion loss, including a $45.5 billion goodwill write-down. Today, you can imagine a management team arguing that the goodwill write-down is a non-cash item and should be excluded from the evaluation of management's performance. The following quote from Ted Turner, the company's Vice-Chairman and largest shareholder at the time, highlights the fact that goodwill write-downs all too often represent a true economic loss: "The Time Warner-AOL merger should pass into history like the Vietnam War and the Iraq and Afghanistan wars. It is one of the biggest disasters that has occurred to our country. I lost 80 percent of my worth and subsequently lost my job. We looked it up to see if I was the biggest loser of all time because I lost about $8 billion." Now, I think Mr. Turner is exaggerating the impact that this transaction had on the United States, but then again, I have never lost $8 billion. That is not to say that every great business also needs to have a great capital allocator at the helm for it to be a successful investment.



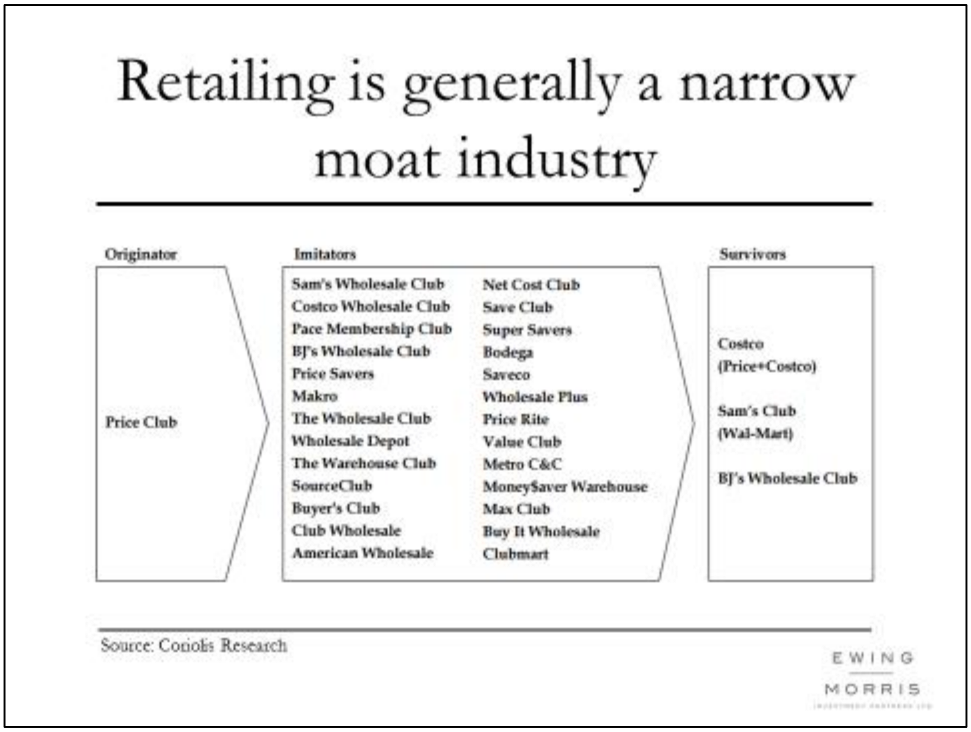
But we do believe that, almost irrespective of what competitive advantages or the economic moat that the operating business has, investors in public companies should pay close attention to the management team at the helm of the business to reduce the probability that their actions will lead to a permanent loss of investors' capital. If you ignore management, all too often you will end-up owning companies run by idiots and that is not the advice that Peter Lynch was giving.

So far, we have seen how management can destroy what otherwise looks like a wide moat, but there is another important reason why focusing on management can be very lucrative. You are all probably familiar with ABInBev, the world's largest brewer that owns some of the most recognizable brands. It is not hard to argue that this business has many attributes of a wide economic moat: well-known brands that people are willing to pay a premium for, economies of scale, an elaborate distribution network that would be difficult to replicate and so on. So, if management wanted to widen its moat, certainly these elements are all that the senior management should talk about?

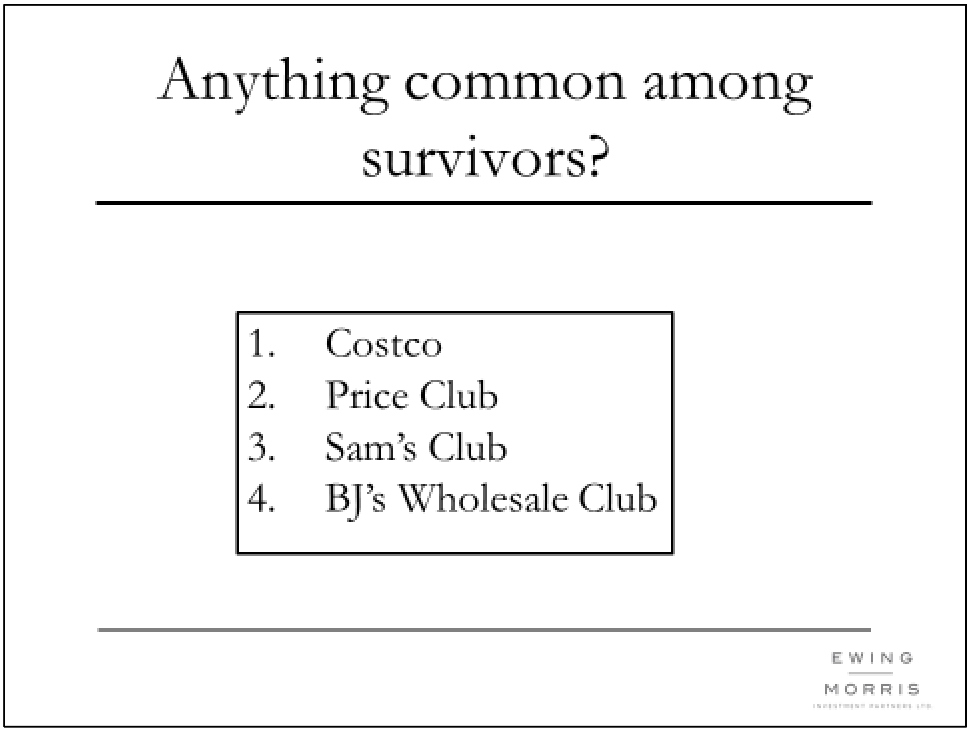
Well, not quite. If you have ever heard the company's CEO, Carlos Brito, present, you know that all he talks about is "Dream, People and Culture". And this is a quote from him on the nature of ABInBev's economic moat: "The only sustainable competitive advantage we have as a company is the people we attract. Everything else can be copied". So what Carlos Brito appears to be saying is that People and Culture can in themselves be a source of an economic moat. We should remember that economic moats, just like castle moats, are built and maintained by people and, if you find exceptional engineers and builders, wide moats often follow.



Let us look at a case study. In 1954, a 37-year-old San Diego lawyer started a membership discount chain called FedMart with a $50 thousand investment. Over the ensuing 21 years, he grew the company to 40 stores and sold it for $350M to a West German retailing giant. Unfortunately, after the sale, Sol had a fall out with the new owners and was fired at the second board meeting. A year after departing FedMart, Sol with his son opened a new wholesale store called Price Club that became quite successful over the ensuing four years.



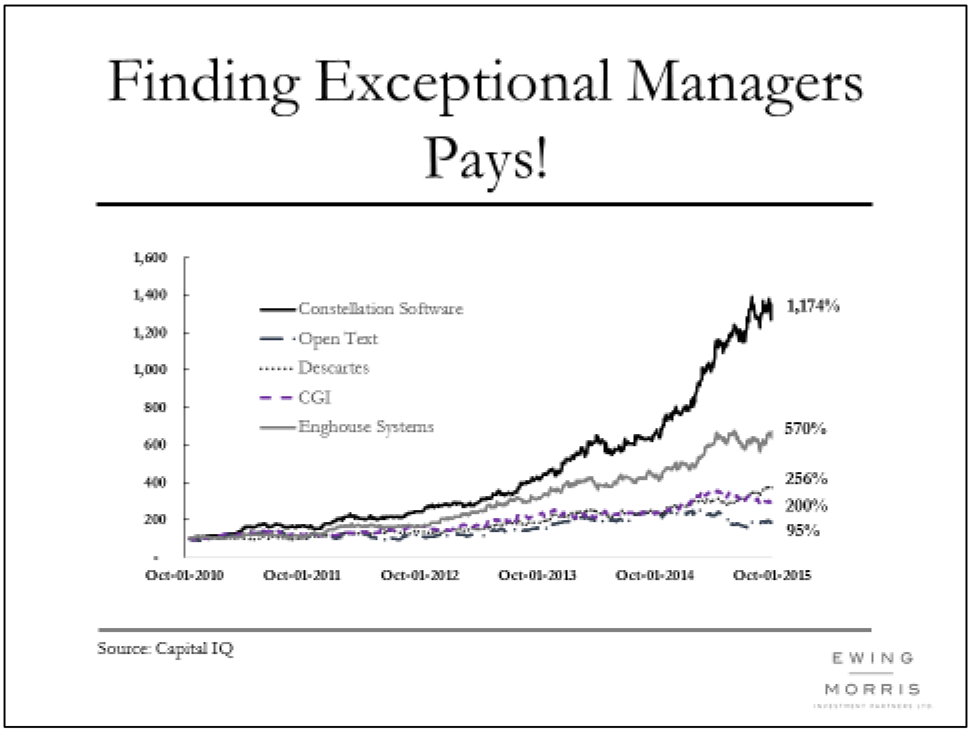
As you probably know, retailing is a very competitive or, in other words, a narrow moat industry and it is not surprising that, after Price Club went public in 1980, it attracted a lot of competitors looking to replicate its success as illustrated by the accompanying table. Now, you might be asking yourself what happened to FedMart? Well, after Sol departed FedMart, it almost immediately started to lose money and closed its doors in 1982.



But, let's go back to the previous slide. I think there is something remarkable about the list of winners. Costco, was started by Jim Sinegal and Jeffrey Brotman in 1983. Prior to starting Costco, Jim Sinegal worked under Sol Price for 24 years and was able to lure a lot of Price Club employees to Costco. So Costco and Price Club were basically built by the same people. I believe everyone is familiar with Sam Walton and his track record as a retailing executive. Three out of four winners appear to have managers with strong track records of success. Imagine you were looking at this list of imitators in the mid-1980s. You knew that if you could pick the eventual winners, you stood to make a lot of money. But how do you go about selecting the winners? You could have looked for evidence of an economic moat and likely concluded that none existed and therefore abandoned the idea. Or, alternatively, you could have bet on the track record of people involved and it looks like this second approach would have made you very wealthy.

Today, Costco is an extremely successful enterprise with a market capitalization of $63 billion. Most people would argue it has a very wide economic moat, but I think this next quote from the company's co-founder, Jeffrey Brotman, is quite telling to what he believes Costco owes its success.

"We're identical to the Price Club primarily because so many of our management personnel come from that operation. Everyone has gone to San Diego and copied the Price Club. <u>But it is one thing to copy it physically and another to copy it mentally.</u>" This is only a portion of the quote as he goes on to explain what he means, but in essence it looks to me like at least he believes that Costco owes much of its success to the right People and the right Culture.

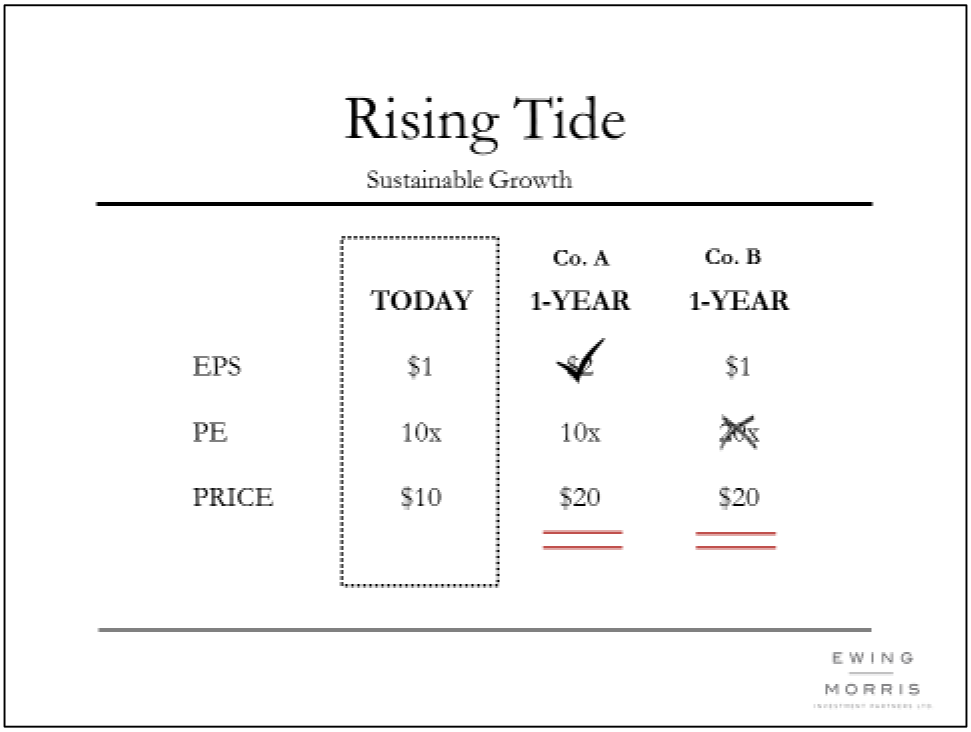


An example in our portfolio is Constellation Software, where Constellation and its peers have taken similar approaches to value creation, but where different people have produced markedly different results for investors.

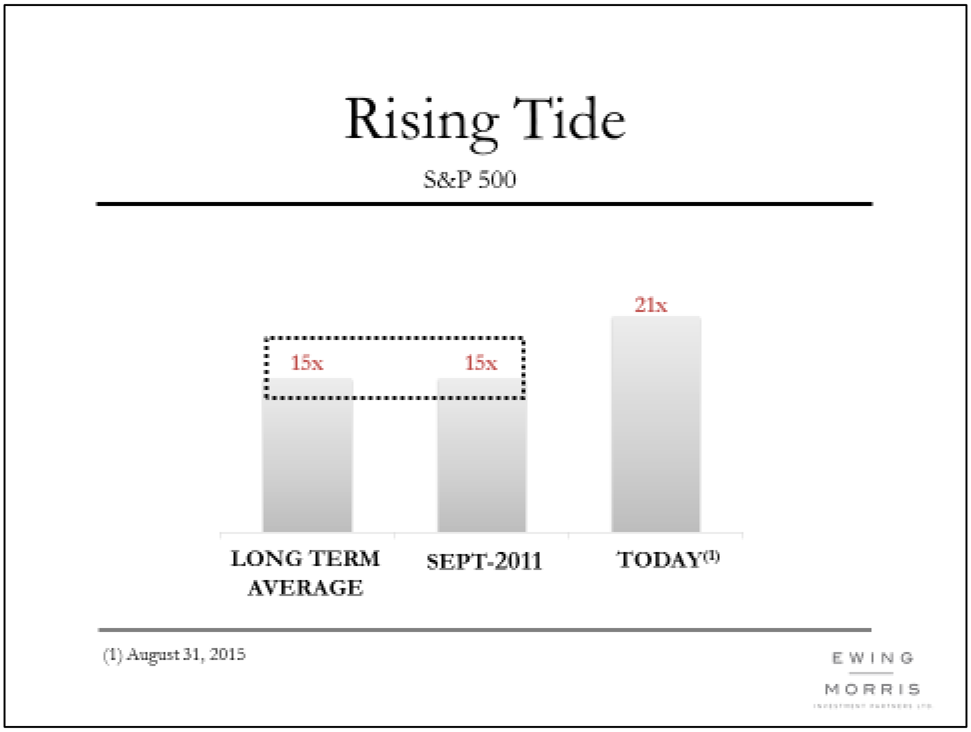
Now, as Darcy mentioned when it comes to Great Businesses and Cheap Assets, management do not form the core of our investment thesis. Having said that, we think that the CEOs listed here will not only preserve our capital, but in themselves represent a very valuable option that could translate into better than expected returns from these investments.

In conclusion, today I wanted to share with you our belief that, when it comes to public companies, management analysis should be closely tied into business analysis and separately, when looking for wide moats, it often pays to find exceptional engineers. With that, I will pass the mic to John.

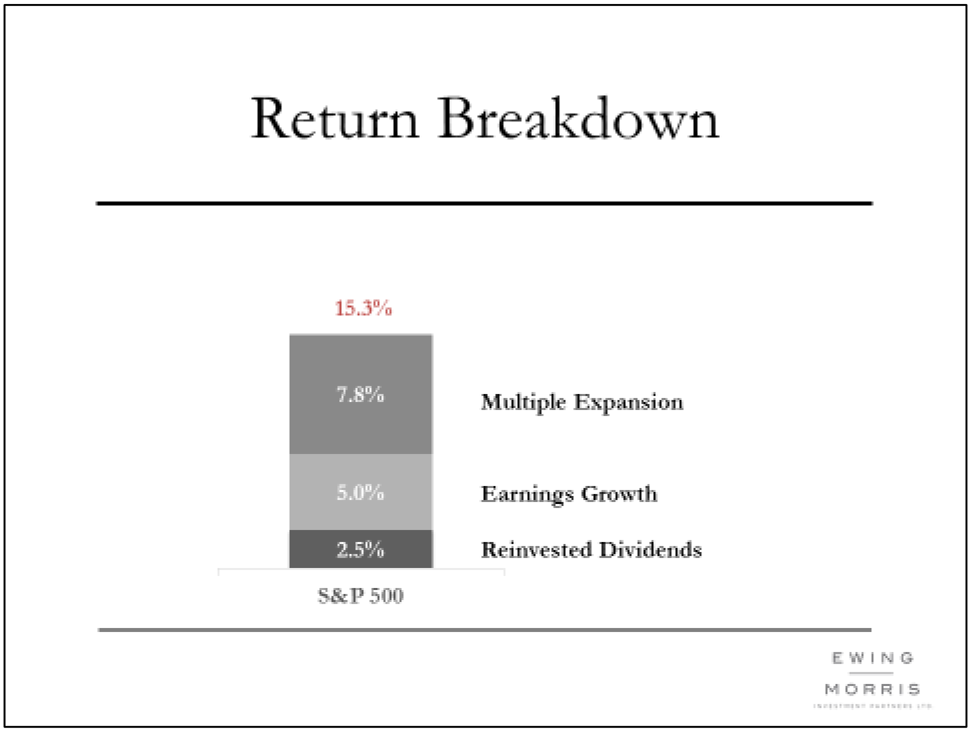
John:



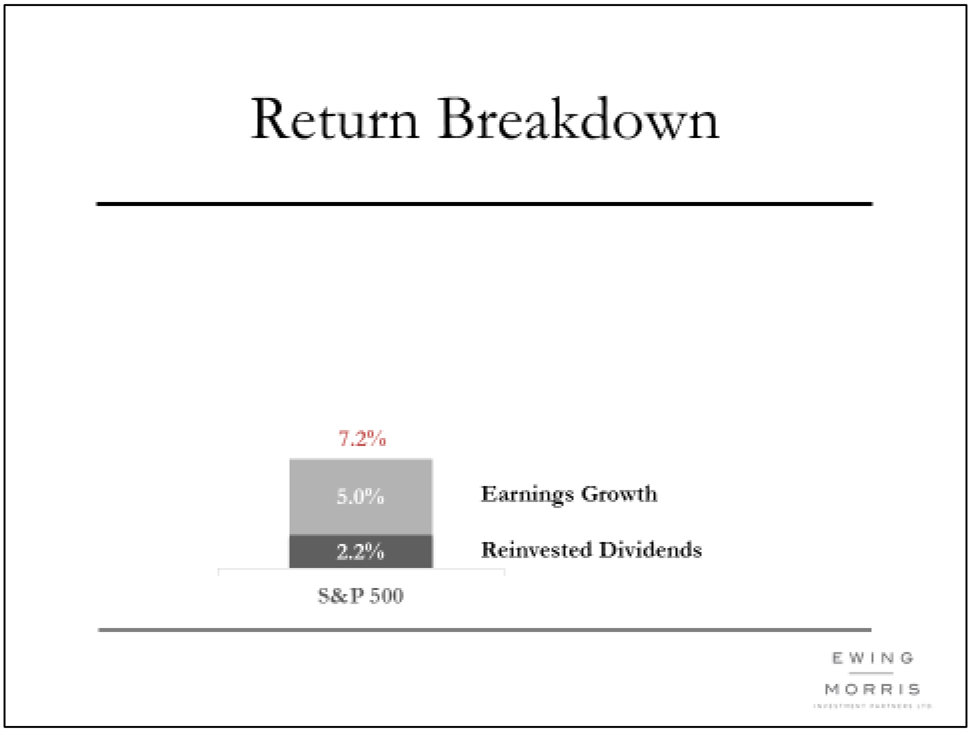
I want to start by explaining a simple, but important concept which is really about how stock prices increase. Let us say you have a company that earns $1 per share and trades at 10x earnings; the stock price will be $10. There are two ways that it will turn into a $20 stock. The first way would be for the earnings to double to $2, while the stock price still trades at 10x earnings, so now you have a $20 stock price. The second scenario for the same company would be where the earnings stay the same at $1 per share, but the multiple doubles to 20x earnings. The stock price will also double to $20 per share. Financially, you would be indifferent between the two, but it is unrealistic to expect the earnings multiple to continuously increase over time, so if you can find a business which can grow its earnings power over time, that is a much more repeatable approach to making money.



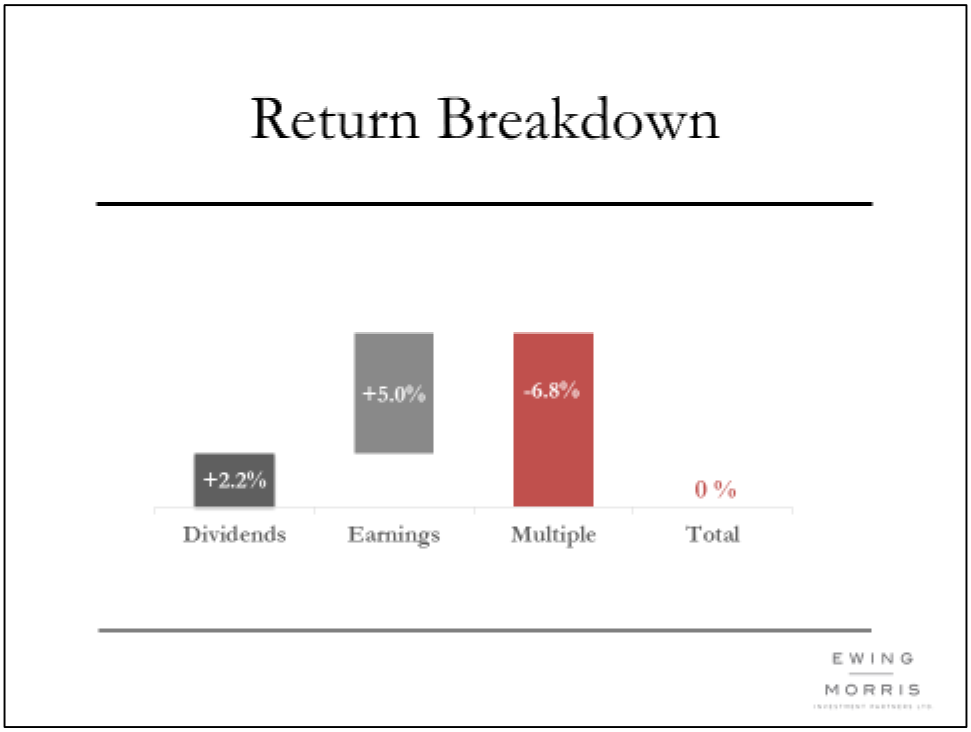
I think that is particularly important when you put 20x earnings in historical context. The long-term average earnings multiple for the S&P 500 is 15x, and when we started in September 2011, stocks coincidentally were trading around 15x earnings. That is in contrast to today where the earnings multiple on the S&P 500 is closer to 21x, well above the long-term average. This has important implications to explaining the recent returns in the stock markets.



During the last four years, the S&P 500 compounded at about 15% annually. This consisted of a little over 2% from reinvested dividends, about 5% from earnings growth with the balance coming from multiple expansion as earnings went from 15x to 21x.



You can use the same framework to forecast returns from stocks going forward. The dividend yield on the S&P 500 today is a little over 2%. If you were to assume the same 5% earnings growth, (which by the way is probably an aggressive assumption since we have not had a recession since 2009 and it is unrealistic to assume you would have a 9-year period without any recessionary impact), that would get you to 7%. It is unrealistic to count on multiple expansion again with stocks already trading at 21x, well above the long-term average. So without that multiple expansion bump, you are probably looking at mid-to-high single digit returns on stocks going forward.



That assumes that stocks will trade at 21x earnings at the end of the period. If the multiple were to revert back to its long-term average of 15x, that would wipe out returns entirely and you would be looking at a 5-year return of zero. I think that is a really important concept to be aware of, especially if you have been investing with managers who have been buying large companies at 13x earnings with the expectation that they would trade at 16x. That can work when multiples go from 15x to 21x; I am not sure that can work going forward for the next 5 years.

So instead, if you want to make money in the next 5 years, we think investors need to be able to do at least one of two things really well:

1) Identify businesses that can grow earnings power at high rates over time; or
2) Identify really cheap stocks

When we make an investment in a Great Business or Great Capital Allocator, we are really looking for companies that we think can grow intrinsic value at double digit rates for a long time. Since we started, we have invested in 18 companies that we consider to be either Great Businesses or Great Capital Allocators. 11 of these have been held for at least 12 months. We estimate intrinsic value and how it changes over time, and by our estimates, the average annual growth in intrinsic value has been 17% per year on average.

GB & GCA Scorecard

as of September 30, 2015

Ewing Morris Playbook	Investments >1 year	Return > $0	Batting Average (%)*
Great Business & Great Capital Allocator	11	9	82%

* Percentage of investments with return > $0

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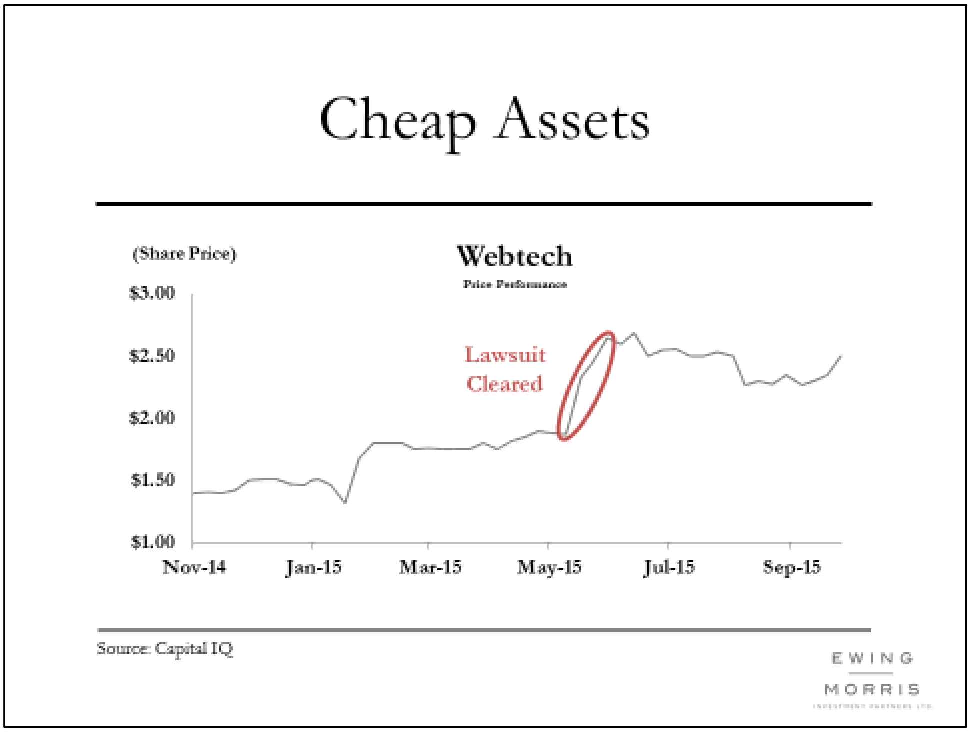
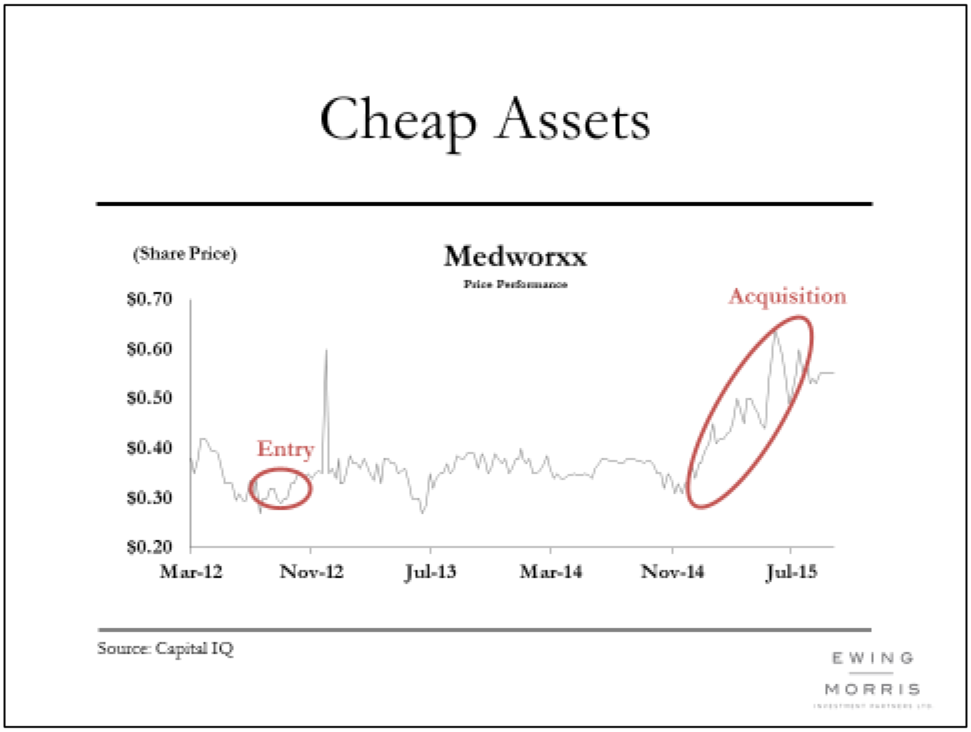
We think we have been identifying the right companies and it has generally resulted in positive returns to the fund. Of those 11 companies, we have made money on 9 of them since we started, which is an 82% success rate.

The other approach that I think will work going forward is to be able to identify really cheap stocks, and that is where the Cheap Asset play comes in to effect. As Darcy explained, when we invest in a Cheap Asset, we are looking to buy a dollar for fifty cents. Our success will usually be determined, not by the direction of the general market, but by one of two ways.



The first thing that can happen is a problem disappears. We use an example of an investment in a company called Webtech Wireless. Webtech is a Vancouver-based software company. At the time of our investment, it had a $25 million enterprise value and was subject to a lawsuit by one of its former customers that was seeking $50 million in damages, or double the market value of the company. So if size alone was not enough to scare people off, the lawsuit probably was. Based on our assessment of the situation, the lawsuit was without merit and we thought it would work out over time, but the time horizon was difficult to forecast. In May of this year, the lawsuit was cleared and the stock price of the firm went up 40% in one day. It does not matter what economic data came out of China that day or what speech Janet Yellen might have given, if the lawsuit clears, then the stock will go up on that day. So that is what we mean when we say a problem disappears.



The other way that a Cheap Asset investment will work would be an acquisition. We will use another example from the portfolio, a company called Medworxx. Medworxx is a Toronto based software company which we invested in 3 years ago. It had a dominant position in a niche software product for Canadian hospitals. They thought they had an opportunity to replicate that position internationally, but needed to raise capital to finance their sales and marketing efforts. If you fast forward 3 years later, they successfully landed clients in the U.K., Australia, France and the United States. The business had really performed as expected. At that point, ourselves and another large shareholder suggested to the Board that they consider strategic alternatives which resulted in the recent sale of the company and a positive result for the Fund.

Cheap Asset Scorecard

as of September 30, 2015

Ewing Morris Playbook	Investments >1 year	Return > $0	Batting Average (%)*
Cheap Assets	20	17	85%

* Percentage of investments with return > $0

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In aggregate, we have completed 20 Cheap Asset investments and have made money on 17 of them, representing an 85% success rate. Again, that gives you a flavour for the Cheap Asset approach.

To conclude, in a bull market, almost any strategy will deliver results and often having no strategy at all will work the best. I think our approach can deliver results in almost any market condition and the results of 2015 are good evidence of that. That concludes our prepared remarks, we are happy to take your questions now.

Jenna:
Why don`t we begin with a question that has been top of mind for many; this year has been a tough year economically specifically with a downturn in the energy sector. John, can you speak to the how the portfolio has been affected by energy prices and how you expect to protect capital going forward.

John:

The decisions we have made around energy collectively represent by far our biggest mistakes since we started and certainly a large reason for the loss in calendar year 2014. It was really two sub-mistakes: firstly, we had too much energy exposure in what I describe as a normal oil price environment and the second mistake was that we had too narrow a range of possible outcomes in our minds as to where oil prices might go. We did have a meaningfully sized oil hedge that was in place north of $100 oil, the math of the short is that it shrinks as oil price comes down so the hedge had become smaller as the oil price declined. When oil was at $70, we removed the remainder of the hedge which looked like an obvious mistake in short order. If you look broadly around the world, Darcy mentioned the importance of temperament and contrarian thinking as a key ingredient of investment success, and energy is one of the few areas that is clearly out of favour today. It is something that we have familiarity with, specifically with some terrific people who are operating in the energy businesses. I think it makes sense for energy to still be a meaningful part of the portfolio, it represents about 16% on a gross basis and net of a couple hedges about 8% of the total portfolio. So it is far from a massive bet, but still a meaningful part of the portfolio and I think it makes sense given the current sentiment around energy. There will be a point when oil prices eventually rebound where energy will represent 0% of the portfolio.

Darcy:

The best investments are made countercyclical, as John said. It is an area that is out of favour so it probably does not make sense to step away now.

Question:

Do you think the energy business going forward will be anything like what it was in the past or do you think it is gravitating towards the Broken Business, Cheap Asset category?

John:

I think it is hard to say blanket statement that it is all or none. I think long-term oil should trade around marginal cost which is probably somewhere between $70 - $90 a barrel today. That probably makes any new oil sands projects borderline economic, perhaps forever. So I think that has permanent implications for a place like Fort McMurray which could impact energy related companies or companies that have oil sands properties, or could be a public company that has a hotel or casino in Fort McMurray, so there are definitely parts of the energy sector that will never be the way that they were. I think the companies that can be economic at $70 oil or below may go back to the way they were.

Darcy:

In the energy sector, there will be a big labor cost restructure. I was sitting next to a guy on the plane on the way to Calgary and he was talking about how he lived in a 4,000 square foot house outside of Banff, describing his cars and the great life that he lived. He mentioned he worked for a big oil company as a pumper. I replied that he must be a rig supervisor or in a senior position there and he said "nope, they tell me to go fill the trucks and I go fill the trucks". So that is the type of thing that will change. You also see people dropping out of high school in the Maritimes and Alberta and going out to the oil patch. I think that is something that will reset. However, you cannot forget that there is not a lot of excess supply in the oil business. The world cannot live without oil so, currently, you could easily see a supply shock to the upside.

Question:

You mentioned Cheap Assets from an acquisition stand point, have you seen any energy related companies being takeover candidates?

John:

There are a couple of Cheap Asset energy investments, I would not count on any of them being takeover candidates per se. We have generally tried to focus, even if they are in the Cheap Asset category, on people that we think are above average managers with strong balance sheets and they are probably more likely to be acquirers than targets. The best takeover targets in energy probably have the most downside risk because the reason they are targets is that the balance sheet is stretched. So you are walking a tight rope; it could be a takeout target or could just go broke beforehand. There are three or four non-energy related Cheap Asset investments that we hold today that are high probability takeout candidates in the next six months in addition to two that have recently exited the portfolio.

Question:

You have an investment in Canadian Natural Resources, which is a Great Capital Allocator. Is there a size limit that you would consider in terms of investing on the basis of the Great Capital Allocator strategy and do you think that Canadian Natural Resources is more of an oil or energy proxy rather than a Great Capital Allocator?

John:

Canadian Natural Resources is one of the larger Canadian oil and gas companies. If you were to look at Canadian Natural's results over time, and plot out some of its peers, the peers generally track alongside oil price whereas Canadian Natural has performed substantially above that. So it is more than just a proxy for oil. When we make a Great Capital Allocator investment, the track record is a big part of the assessment, as are the people, but an equally important part is what we call the runway going forward, so how repeatable is that track record. A good example is a Canadian company, people are likely to know the brand but may not know the company itself, which is called MTY Food Group. They are a dominant owner of food court franchises, about 20 brands altogether, including Mrs. Vanelli's Pizza, Thai Express, Mr. Sub, Country Style and, my personal favorite, Manchu Wok.. They have had an unbelievable track record of capital allocation success, but are at a point where they own virtually everything in that category there is to own in Canada. So for them to keep allocating capital going forward, they either need to make acquisitions in other geographies, the U.S. being the most obvious one, or in a slightly adjacent category, and they have moved into casual dining table cloth restaurants versus fast food. Now, they are probably more likely than average to be successful doing that, but it is harder to anticipate the success of that company as they pivot into a different asset class. It would be similar to identifying an investment manager with a visible track record in Canadian small caps which has now chosen to invest in Japanese large caps. Maybe they will figure it out, but there is a lot of uncertainty as to whether the skills will be transferrable or not. Energy is such a capital intensive business where the projects are so big that size becomes a barrier much later than it does in any other industry. For example, MTY has a $600 million market cap it and its runway is done whereas Canadian Natural Resources has a $20 billion market cap and still has a lot of room.

Question:
Is there a particular investment size limit that you consider and more broadly what is the Fund size capacity?

John:
People ask a lot about the capacity of the Fund and at what point we might close it. I think it is one of the most important questions someone can ask, particularly because we think size is the enemy of returns. It is a difficult question to answer precisely so I will give you our framework. The output of which would suggest, at least today, probably somewhere between $300 - $500 million would make sense. At least at this point, it is largely academic managing around $90 million today. When we talk about the idea of focus that means putting the majority of your capital into your best ideas. Let us say we want to be able to put 10% of the Fund into an investment, and we do not want to own more than 10% of a company, if you took our median market cap in the Fund today, that would suggest that the Fund could support between $300 - $500 million of capital. If you were to get slightly more granular and look at each play, the median market cap of the Cheap Asset play has been about $100 million, which is the one where you would bump into the ceiling first. Although there are situations where having a large stake in a company makes it a better investment because you have more influence over management - you can help influence a sale or solve a problem, whereas if you just own a token amount of a company, you simply have to wait. Therefore it is not clear that Cheap Assets would work less well with more capital. The median market cap of Great Businesses has been about $700 million, so that would give us plenty of room within that $300 - $500 million capacity range, and the median market cap of Great Capital Allocators has been north of $1 billion so that is unlikely to be the bottleneck. That is how we approach thinking about capacity.

Darcy:

People forget that when you get an investment right, liquidity takes care of itself. The median market cap today is $341 million, if we are sitting here 5 years from now with the same portfolio and the median market cap is still $341 million, we have probably done something wrong. If you get the investment right, liquidity will take care of itself, and there have been examples in our career where we have seen this take place. A company we have known for a long time is Computer Modelling Group. John and I first saw Computer Modelling Group at a $50 million market cap, last year it touched $1 billion. We first saw Constellation Software at $250 million and the company today is an $11 billion company, so hopefully we can get a couple of those things right. The other thing when it comes to size is that you cannot forget our incentives which, in general, guide a lot of behaviour. Today, about 25% of the Fund is management assets and we are compensated primarily for investment results. So the focus is really on results and everything is in line to encourage that. If the Fund reached a size that it would impair our ability to invest, then it would be in our best interests to close it.

Question:
You have had some success with these software technology companies, there are several new companies popping up in Southern Ontario. Are you looking into any of these start-ups and if so, what are you doing to angle yourselves to invest in them?

John:
Start-ups are a really difficult area to invest in because when you do not have any business track record, it is entirely about the people. A start-up by a young person with no track record is likely un-investible, a start-up by someone who has built the same sort of business once or twice in the past is maybe a bit different if you can judge prior track record. It is difficult to invest in a company if you do not have the business history to evaluate it.

Question:
What would your view on the Shopify IPO be?

John:

This is not a company I know well, they have clearly had success with their partnership with Amazon, which looks like a huge win for the company. When you think about IPOs in general, it is helpful to go back to the private equity mindset to public companies where we are looking for companies we would love to own, but in public markets sometimes we have the opportunity to own fractions of a business at a price that no one would sell you the entire business for in an auction. With an IPO, typically, the sellers have decided to sell the whole company or part of it and have chosen the timing of the auction, probably for their own benefit. It is unlikely that buying an IPO is a good time to be buying because you have a more informed person on the other side of the table who just chose the time and price. Whereas if you are buying a stock that is already in the market, it is a lot more likely that it is trading at a price less than the whole company might be worth.

Darcy:

Our emphasis on software technology is really around enterprise software that has mission criticality and high switching costs which relates back to pricing power. It does not have to be sexy consumer facing software. It can be accounting software or transit software, businesses where there is a lot of data history and switching suppliers would create a lot of business risk. To your point about something like Shopify or Twitter, the latest and greatest businesses that you read about, we will study a lot of these businesses. They seem to be world-changing, but for instance, the last time we looked at Shopify, it was trading at 15x revenue. It might be a Great Business, but in our world, where we have to filter through a lot of ideas and turn over rocks, 15x revenue is just too hard for us to handicap and it gets passed on. There are two investments in the portfolio today that I think represent really innovative technology; one, we own a business that manufactures wireless hardware used in emerging markets, namely Africa, the Middle East and parts of Russia that allows people to create wireless internet infrastructure at a fraction of the cost to lay fibre and traditional satellite. That is a business that has been growing at 50% per year for a number of years that has lately been out of favour so we have had the opportunity to purchase at a price which we think is attractive. Another is a consumer facing software business based out of California that helps consumers buy cars. That is a business again which has been growing at 50% per year and is facing some short term issues. It has traded historically at double digit revenue multiples and is now trading at 1.5x revenue. We are on the lookout for these types of investments.

Question:

How do you get comfortable with management teams, and what kind of criteria do you use to evaluate them, particularly if they do not have a long track record?

John:

It will be difficult to judge, and you probably put it in the too hard pile if they do not have a track record, but it would be largely similar to how you might choose the investment manager. You would look at the track record of results which would be a key part of it, you would look at the investment process and if it is repeatable, whether the track record had more to do with luck or skill and, finally, that you have someone with high integrity. Some of the ways you would do that would be spending time with people, reading interviews, watching interviews that the CEOs have given over time which can help you uncover that. Specific parts of the track record that have to do with when they made acquisitions, how they paid for them, if they worked out well, when they bought back stock; was it in 2008-09 during the downturn or was it during a peak and then not at all during the downturn. An example of that would be Mainstreet Equity in the portfolio. The share price went from $20 per share to $5 in 2008, they bought back a third of the shares outstanding at $6 per share and the stock is north of $30 today. Both in magnitude and timing, that is the best share buyback I have ever seen a company do and that is not a one-off, it is illustrative of the CEO's investment decision-making over time. Incentive is another part of it, the Great Capital Allocators usually have a lot of their own money at stake on the same terms as shareholders. Again, Mainstreet's CEO owns a third of the company.

Darcy:

Evaluating management is important and it is an art. Amongst the other traits that John mentioned, consistency of action over time develops trust. There is a famous investor that we have studied called Phil Fisher who used an experiment. He said "imagine I granted you the right to buy 10% of anyone in this room's lifetime future earnings, who would you pick?" You would not pick the person with the highest IQ or the most money, you would pick the person that has demonstrated consistency of action, does the things they say they are going to do, delivers when they say they are going to deliver, etc. And the same applies to the short side, he said "imagine I granted you the ability to short any individual in this room, well what would you look for?" Again, you would look for people who have cut corners, people who cheat and things like that. Those are elements that we keep in mind and spend a lot of time thinking about.

John:

An anecdote of this is going to visit Canadian Natural Resources; management visits are an important part of the investment process, regardless of the play. Darcy and I were there meeting the company president 2-3 years ago. We were walking to this very small, unassuming meeting room and we passed the printing room which had a big sign on the door saying print black and white only, no colour, which I thought was interesting. We get to the room and we asked how they keep this cost conscious, results oriented culture in such a large organization, and he offered an example: as a large company they had never acquired any art, however, when they made acquisitions they would often come with some art, so they would auction what they could. Whatever they did not sell, they would keep on the wall and at that point the CEO turned and pointed to an unimpressive water colour and exclaimed "like this piece of cr*p". You cannot get that from conference calls or investor days, it is really going to meet people when the culture comes through which is why it is important to actually go on the road and meet with people on their turf, not just meet with management when they come to Toronto.

Question:

Can you speak a little bit about your exit strategy for investments? With Webtech, an event happened and the company was taken out, however with the Great Capital Allocators and Great Businesses that plug along, do you trim when they become expensive?

John:

The framework is slightly different by play, so a Great Business or Great Capital Allocator is one where we want to be reluctant sellers, as in our experience they have a tendency to keep surprising on the upside. That does not mean that a Great Business is a great investment at any price, but you want to be a reluctant seller. Whereas with the Cheap Assets or Broken Businesses there is typically a finite amount of return available. If you are buying something that you think is worth $1 and you buy it at $0.50, your return potential is 100%. When it has increased to $0.75, now you have something where the return potential has gone from 100% down to 33% and there is a decent chance that the price will go back to $0.50 on you again. You want to be an aggressive seller of cheap assets, you do not necessarily want to wait for the final event because as the stock moves up, it is becoming a worse investment along the way. You might want to recycle that money into another $0.50 dollar that you have somewhere else. In terms of the position sizing over time, not being agnostic to valuation, the story of our investment in Boyd Group is illustrative of this. They are one of the four large owners of auto collision repair chains in North America. We were not all the way done our work, but close enough that it was looking like it was worth starting the investment. We made a 2% investment at the time. A key consideration was there was a co-founder dynamic CEO/right-hand man that had been in place for a long time. The original CEO had a health issue, left the business and sold all his stock about a year prior to our investment. It was really difficult just looking at the track record to disaggregate the contributions of the CEO who was no longer there. A long-time right-hand man was now CEO, and it was a company that was going to be making a lot of acquisitions going forward, so you needed to have confidence in this new CEO's judgment for the investment to work out. I went out to Winnipeg to meet with them with the expectation going in was that I would come home and there would either be a 0% weight or a 5% weight. I spent the day with them and visited some shops and spoke with some of the other executives and returned with confidence about this guy. I came back with a 5% weight with the idea that, as more water passed under the bridge and we had more history, it would probably grow to a 10% weight within the next twelve months. Either fortunately or unfortunately, the stock price started to move pretty quickly from there and got to an 8% weight on its own. The CEO, as history has now shown, is an outstanding operator, but the price was now less attractive and so we trimmed from 8% to 6% and then to 4% and then it dropped to 2%. The stock price came back a little bit and it went back to 5% and is back to 3% today. So it is one where we are reluctant sellers of the business as it is a business with great economics and a great runway with an outstanding person, but was not a great investment at any price. We are reluctant to exit entirely, but the size of the weight can change over time.

Darcy:

At the end of the day, our decisions are based on opportunity cost. We look at the portfolio as a playoff bracket; does our next investment provide a better return than our least favourite investment. If there is an opportunity where return expectations are the same, but one provides less risk, we make that switch. In a situation where a new investment offers a higher return for similar risk, we will make that switch also.

Question:

Is there a certain amount of cash you like to have on hand?

John:

Yes, the framework for that has been, especially dealing with smaller cap companies, we do not want to be in a position where we have found something we want to buy but have to sell something else first to act on it, as the window may not stay open long enough. I typically like to have one investment position size of cash at all times, call it between 5% and 10% cash on hand, so any cash beyond that is just a bi-product of ideas and opportunity costs. If we cannot find investments that meet the 15% hurdle then cash will be larger and if we can, it will be smaller, but likely not less than 5 or 10%. Today, it is around 5% and it was 10% until fairly recently. We found an investment that we are aggressively adding to that will be a 10% weight when it is full. We are a little more than half way there so that shrunk the cash a little from 10 to 5%. We also have a few other things that are ideas that have done well but valuations are not super compelling and will take some money off the table.

Question:

You mentioned that the portfolio is invested 20% internationally, do you hedge currency at all?

John:

All of our clients live and spend in Canadian dollars so we think about the Fund in Canadian dollar returns, therefore the default should be towards hedging currencies for international investments. We have done that with U.S. investments since the very beginning and then, starting about two years ago when we started looking further afield to the U.K., Australia and New Zealand, we had to make a decision about hedging those currencies. The default again should be to hedge and that is what we do with the pound for the U.K. investments. Looking at Australia and New Zealand, these are economies that are actually quite similar to Canada. They are commodity driven export economies and their currencies tend to move almost in lock-step with the Canadian dollar. It is quite expensive to hedge those currencies and I do not think you are getting very much insurance for the big premium you are paying to do that so we have not hedged the Australian dollar and the New Zealand dollar. Both of those currencies have come down a fair amount in the last year but have had a very similar change to the Canadian dollar so our theory has proven true.

This concludes our presentation, which we hope you have enjoyed, and we thank you for attending today.