Presentation to the Students of the Ivey Value Investing Course

Lewin Capital Management's Approach to Value Investing

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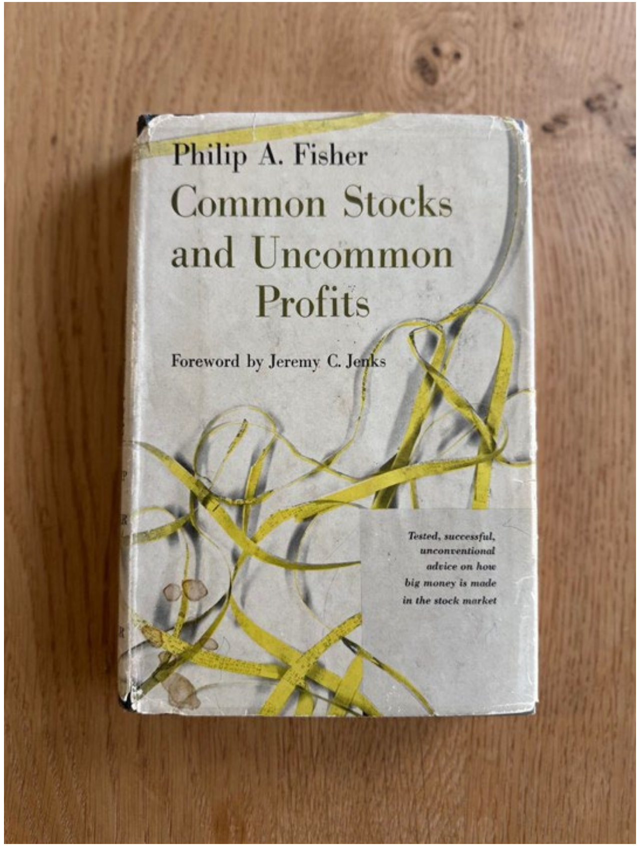
Origins of LCM's Investment Philosophy

Some key experiences that shaped LCM's investment philosophy

- ❑ Summer 1992 – All Value Fund – US Small Cap Deep Value
  - Value made sense but owning the very cheapest stocks wasn't enough
- ❑ 1994 Philip Fisher
  - Introduction to quality
- ❑ 1997-2007 PH&N Canadian Equities
  - Merits of a focused approach
- ❑ 2008 Founded LCM
  - Value investing with an emphasis on quality, using a focused approach to portfolio management

Influence of Philip Fisher



The defining features of LCM

- Value investing philosophy with an emphasis on quality
- Focused approach to portfolio management – own only best ideas
- Redefining risk – the risk we are trying to avoid is not volatility but permanent capital loss
- Long term orientation – annual performance reporting, ask clients to only allocate capital with a 5 year plus horizon
- Flexible mandate – absolute return goal, North American listed companies including ADRs, hold cash if we cannot find securities that meet our criteria
- Research focus not marketing

Fisher's perspective on the investment industry

- Quote from Philip Fisher:
  - *"The percentage of investors who own 25 or more different stocks is appalling. It is not this number of 25 or more which itself is appalling. Rather, it is that in the great majority of instances only a small percentage of such holdings is in attractive stocks about which the investor or his advisor has a high degree of knowledge. Investors have been so oversold on diversification that the fear of having too many eggs in one basket has caused them to put far too little into companies they thoroughly know and far too much in others about which they know nothing at all. It never seems to occur to them that buying a company without having sufficient knowledge of it may be even more dangerous than having inadequate diversification."* Common Stocks and Uncommon Profits, 1958

- It's gotten worse since 1958:
  - Average US Mutual Fund owns over 100 stocks
  - Average client owns between 4 and 8 Funds – 400 to 800 stocks!

What is the solution to overdiversification?

- A portfolio that owns less than 20 securities is labelled 'concentrated' by the investment industry

- I prefer the word Focused, because people think that the opposite of Concentrated is Diversified, when in fact:

  The opposite of Concentrated is **Diluted**

- A focused portfolio can still be diversified

How many stocks are needed for diversification?

What have the best investors said on this subject?

- Warren Buffett - six stocks are enough for adequate diversification
- Philip Fisher - 5 large companies is enough if there is not much overlap in their business, or 10 smaller business depending on the nature of the company.
- Seth Klarman in Margin of Safety: 'ten to fifteen different holdings usually suffice... diversification for its own sake is not sensible“
- Stock selection is paramount in a focused approach – a higher bar must be used

LCM's focused approach

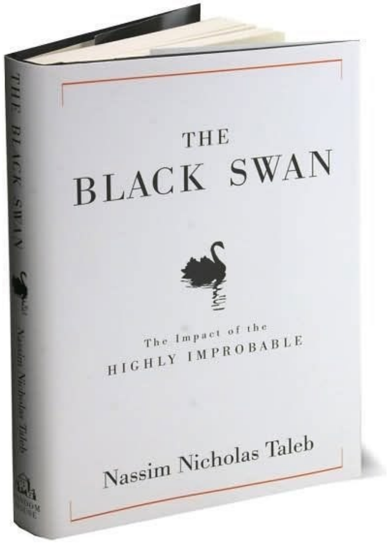
- Experience shows that good ideas are rare, portfolio should be structured accordingly
- Potential for more reward, less risk by owning more of one's 1st, 2nd or 3rd best ideas and not bothering with the 30th, 40th or 50th best idea
- Focused should still mean diversified
- Stock selection is paramount
- **Patience** and **discipline** are key ingredients for success
- Overdiversification does not reduce the risk of loss in bad markets, it reduces the volatility of returns versus the index

Why volatility is a poor measure of risk

- Investment returns are not normally distributed. Central thesis of Black Swan – think of how many '100 year floods' have occurred in financial markets since 1987

- 'Beta' for individual securities changes through time i.e. Manulife

- Many logical qualitative measures of risk such as inferiority and opacity of business model and inherent leverage are not captured in past standard deviation of price



Risk is permanent loss of capital

Risk is an absolute not relative concept

"Central to our approach is the conservative view that the key risk to be concerned with in investing is not volatility but the potential for a permanent loss of capital." – quote from LCM website.

How to minimize the risk of permanent capital loss:

- Value investing with an emphasis on quality
- Focus on balance sheet / business model
- Rigorous due diligence
- Holding cash if you don't have ideas that satisfy your criteria
- No shorting or leverage
- PATIENCE and DISCIPLINE

LCM has a long term mindset

"The owner of equity stocks should regard them first and foremost as conferring part ownership of a business."

\- Benjamin Graham -

- It takes time in business to make money
- Five year minimum suggested client horizon
- Annual letter with performance calculations every January
- Custodian holds all securities – monthly statements
- LCM uses no leverage – lenders can shorten horizon at an inopportune time

Patience and **discipline** are key ingredients for success

How to make money in the stock market?

There are 2 skills required to make money in the stock market:

1. The ability to value a business

2. The ability to identify quality

The ability to value a business

- Goal is to find investments at a sufficient discount to an estimate of intrinsic value that you obtain a margin of safety
- Make sure you first start with a worthwhile business
    - Chapter 3 Fisher – The fifteen points to look for in a common stock
- The role of economic forecasting is often misunderstood
- Assess earnings power or free cash flow 3 to 5 years out
    - Far enough out in time to look beyond the market and sell side
- Minimal prospect for permanent capital loss at the time of purchase is often the hardest constraint to satisfy
- Portfolio management is not just the maximization of returns
    - Joel Greenblatt's idea - largest positions are the ones with the least downside

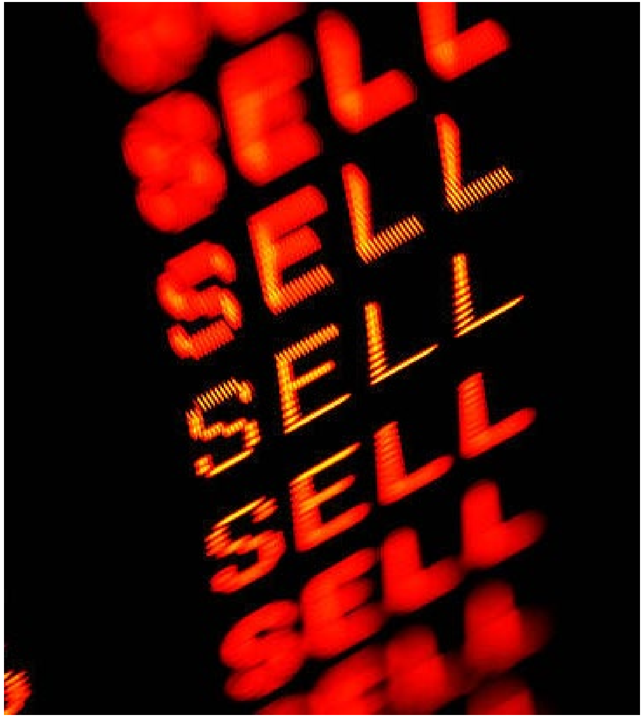
The ability to identify quality

- Only focusing on value can leave a lot of returns on the table
- Quality is what determines long run returns
- How to assess quality? Classic business analysis
  - Rhupal Bhansali's book Non-Consensus Investing Chapter 7: Ten myths and truths about quality
- Prospective ROIC is a good metric to summarize quality
- Sustainable Growth Model
  - G = ROE x (1 – dividend payout ratio)
- Pristine quality is not required – sometimes relative quality is easier to demonstrate, double digit prospective ROIC should suffice
- Final test – does the business have strategic value?

The sell decision

Five reasons to sell:

1. Investment thesis is incorrect
2. Change in business model or management
3. Deterioration in fundamental outlook
4. Valuation is excessive
5. Portfolio management considerations



LCM results*

Performance to December 31, 2023

	4 years (Annualized)	15.5 years Since Inception June 30, 2008 (Annualized)	15.5 years Since Inception June 30, 2008 (Cumulative)
LCM Portfolio	17.0%	13.6%	620.1%
Canadian Stock Market TSX TRI	8.6%	5.6%	131.3%
US Stock Market (US $) S&P 500 TRI	12.0%	11.1%	408.4%
US Stock Market (CDN $) S&P 500 TRI	12.6%	12.9%	558.9%
Average of Canadian & US Stock Markets	10.6%	9.3%	294.0%
LCM Outperformance	+ 6.4%	+ 4.3%	+ 326.1%

- Long term goal is to earn in excess of 7% per year on average. A secondary benchmark we have used since inception is an Index portfolio with 50% invested in the Canadian Stock market, and 50% in the US Stock Market. Since inception cumulative return of 620.1% corresponds to a return of 13.6% per year over the past fifteen and a half years.
- Over the past fifteen and a half years, more than thirty percent of the portfolio on average was in cash so the invested portion of the portfolio earned a much higher return, to generate a total portfolio return of 13.6%
- To the end of June 30, 2023 (LCM's 15th anniversary) over both the past 5 and 15 years LCM has outperformed 95% of Canadian Equity Funds and 75% of US Equity Funds according to both RBC and Mercer institutional pooled fund surveys.

* See bottom of page 28 for full description of performance reporting.

Different ways to make money in stocks

Some case studies from my past

1. Having insight into a business model

2. Identifying a cyclical decline mistaken for secular

3. Valuing a business and ignoring the headlines

4. Dealing with losers

First Case Study: Making money from insight

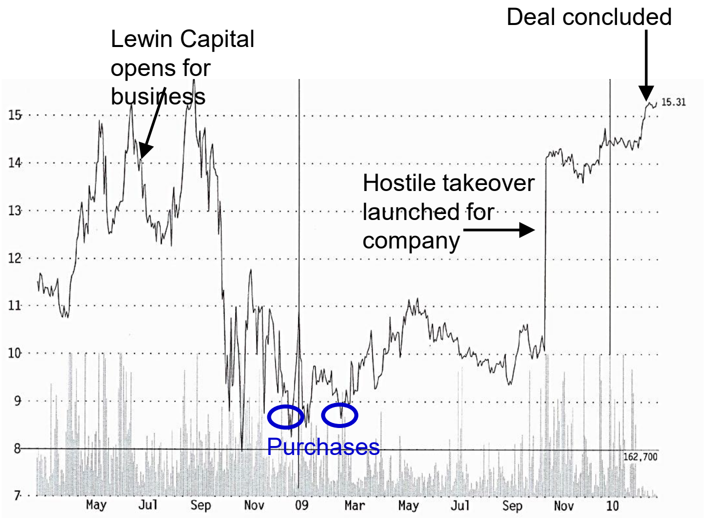
Enerflex Unit Trust

- Canadian and international gas compression
- Studied company and industry for fifteen years
- Over past decade have met with the founder/chairman, the president and toured facility in Calgary
- Understanding the business model was our edge
- Insight: highly variable cost structure and talented management = small losses at cycle troughs
- Financial details: strong balance sheet and ten year average ROE of 12%
- Trust structure not well understood

Making money from insight

Enerflex, cont'd

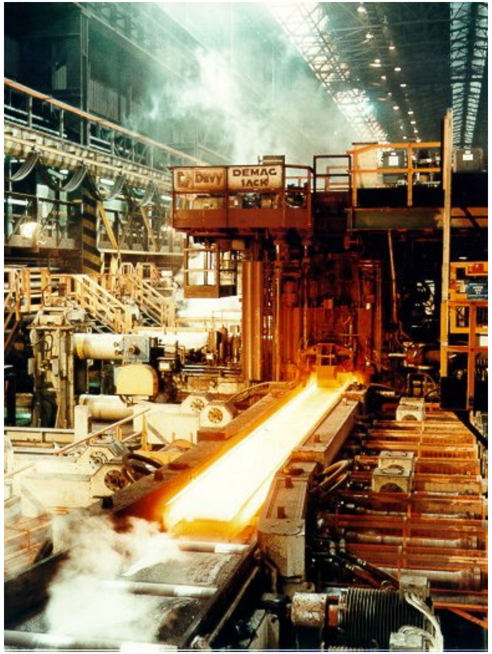
Enerflex (EFX.un-T) to February 26, 2010



- Target: 20 to 26% annual total return over three years at time of purchase
- Risk: limited downside due to valuation, quality of business model, balance sheet. 19% forecast downside
- Action: Purchased a 6% position in two transactions in Dec/08 and Feb/09 at average cost of $8.95
- Conclusion: Received $14.65 cash and shares upon takeover from competitor plus earned $1.20 in distributions over holding period
- Total return: 77% in approximately one year

A cyclical decline mistaken for a secular decline

IPSCO Common Shares in 2003 (example from previous firm)

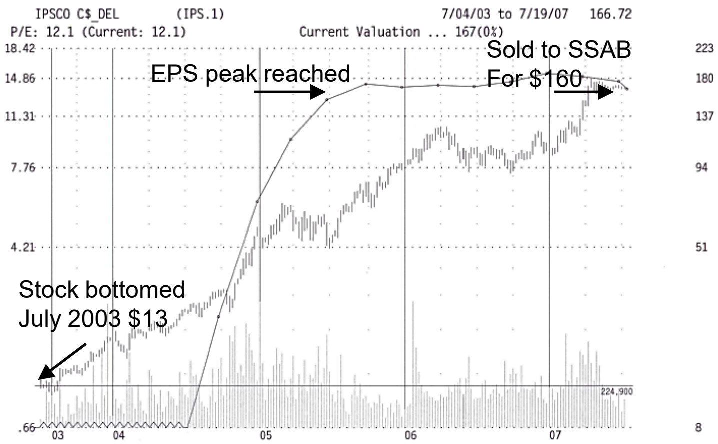


- Steel sector at inflection point:
  - Hot-rolled steel price at 20 year lows
  - Imports peaked in 2002, failure of high cost producers
  - Steel industry viewed as capital intensive dinosaur by investors
- A cyclical decline that is presumed to be secular can create an exceptionally compelling opportunity
- IPSCO decent relative quality: low capital cost, high value customers
- Company had tripled capacity with 2 new U.S. mills that were not contributing
- Financial details: decent balance sheet, new low cost capacity, stock trading at 0.5X book value
- Purchased all we could – owned 9% of the company or $40 million at the lows ~$13

A cyclical decline mistaken for a secular decline

IPSCO cont'd

IPSCO IPS-T July 2003 to July 2007



- Thesis: required rebound in steel demand to normal levels, timing uncertain but stock cheap at 3.5X estimated cycle average earnings
- Outcome: U.S. emerged from recession, Chinese growth unexpected bonus
- Earnings per IPS share went from (\$0.01) in 2003 to \$15.04 in 2007
- Good ideas are rare. This was a small position in a very large portfolio – when you hire a smaller manager you benefit more from your manager's best ideas
- LCM identified similar opportunities in different industries in 2009 and 2019.

Valuing a business and ignoring the headlines

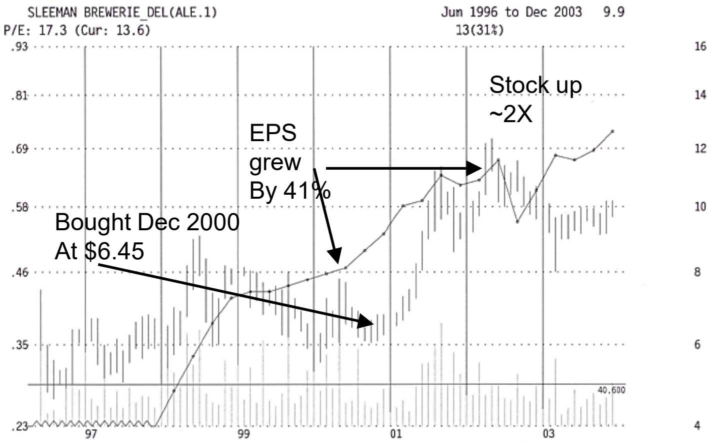
Sleeman Breweries in December 2000 (example from previous firm)

- Investors were obsessed with hyper-growth in the lead up to the tech bubble, neglecting slower growing and low-tech businesses
- “Old economy” such as brewing was viewed as irrelevant
- One key skill required for making money in investing is not macro forecasting but:
  - The ability to value a business
- Brewing a predictable business – easier to value
- Repeat nature of consumption gives management opportunity to optimize production process
- Brands matter but can go in and out of fashion in the stock market

Valuing a business and ignoring the headlines

Sleeman Breweries cont'd

Sleeman ALE-T June 1996 to December 2003



- Thesis was "low tech growth": 8-10% top line growth (1/2 volume, 1/2 price) translating into 20%+ annual EPS growth over 2 to 3 years
- Low risk given quality of business and valuation at 10X current, 8X prospective free cash flow
- Outcome: investment doubled over 18 months as EPS grew and technology faltered
- In 2009 LCM identified a global business with more dominant brands at 12.5% free cash flow yield. This investment was compelling in both deflation or inflation scenario

Sell discipline – how to deal with losers

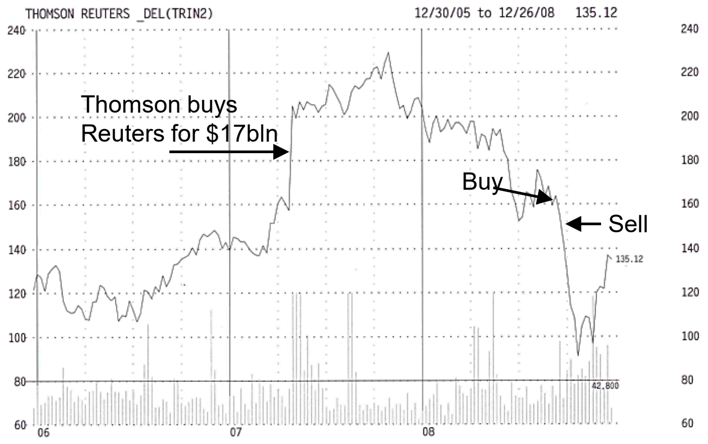
Thomson Reuters American Depositary Shares TRIN on NYSE

- Historically a decent company but always too expensive
- Thomson overpaid for Reuters in 2007
- Merger integration made it difficult to discern underlying profitability
- Stock down and ADS trading at 20% discount to North American common shares
- Six months due diligence
- Thesis predicated on no growth in end markets, time needed to realize synergies post integration ~9X prospective free cash flow
- Purchased 4% position on Sept. 5, 2008

Sell discipline: how to deal with losers

TRIN Cont'd

Thomson Reuters ADR Dec 2005 to Dec 2008



- One week after purchase Lehman Brothers declares bankruptcy, AIG bailout, Merrill Lynch sold – warranted review of thesis
- With its customers under pressure initial "no growth" case optimistic. No room for "hope" in an investment thesis
- Sold for small loss (0.2% of portfolio) on Sept 19,2008
- Peter Lynch advocated selling losers and letting winners run yet most investors do the opposite due to loss aversion and anchoring "pulling out the flowers and watering the weeds"
- Dealing with losers a key factor in how LCM made a profit in 2008

Some useful books

Books

- ***Common Stocks and Uncommon Profits*** by Philip A Fisher
- ***Paths to Wealth Through Common Stocks*** by Philip A Fisher
- ***The Intelligent Investor***: *The Definitive Book on Value Investing* by Benjamin Graham
- ***One Up On Wall Street***: *How To Use What You Already Know To Make Money In The Market* by Peter Lynch with John Rothchild
- ***Fortune's Formula***: *The Untold Story of the Scientific Betting System That Beat the Casinos and Wall Street* by William Poundstone
- ***Poor Charlie's Almanack*** by Charlie Munger, compiled by Peter D Kaufman
- ***A Few Lessons For Investors and Managers from Warren Buffett*** by Warren Buffett compiled by Peter Bevelin
- ***Non-Consensus Investing***: *Being Right When Everyone Else Is Wrong* by Rupal J Bhansali
- ***The Dhandho Investor***: *The Low - Risk Value Method to High Returns* by Mohnish Pabrai
- ***The Outsiders***: *Eight Unconventional CEOs and Their Radically Rational Blueprint for Success* by William N Thorndike
- ***The Black Swan***: *The Impact of the Highly Improbable* by Nassim Nicholas Taleb
- ***The Caesars Palace Coup***: *How a Billionaire Brawl Over the Famous Casino Exposed the Corruption of the Private Equity Industry* by Sujeet Indap and Max Frumes
- ***American Steel*** by Richard Preston
- ***Energy Myths and Realities***: *Bringing Science to the Energy Policy Debate* by Vaclav Smil
- ***The Lords of Easy Money***: *How the Federal Reserve Broke the American Economy* by Christopher Leonard
- ***When Money Dies***: *The Nightmare of Deficit Spending, Devaluation, and Hyperinflation in Weimar Germany* by Adam Fergusson
- ***The Great Depression***: *A Diary* by Benjamin Roth, James Ledbetter, et al.
- ***Drive***:*The Surprising Truth About What Motivates Us* by Daniel H. Pink
- ***The Almanack of Naval Ravikant***: *A Guide to Wealth and Happiness* by Naval Ravikant compiled by Eric Jorgenson

Thank you for your interest

More information is available at www.lewincapital.com

*All stated returns are gross of fees. We take pride in ensuring that our fees are fair and reasonable for the service LCM provides. If you would like a copy of LCM's Investment Management Agreement that outlines our fees and services in more detail please contact us. LCM Portfolio is the actual performance of a representative account as all client assets are held on a segregated basis, and all LCM clients share the same investment mandate and portfolio strategy. Small differences will occur between accounts due to rounding and the timing of cash flows. The Average of Canadian and US Stock Markets is calculated as an average of the S&P TSX Composite Total Return Index and the S&P 500 Total Return Index translated into Canadian dollars. The S&P TSX Composite Total Return Index has returned 5.6% per year over the 15.5 years ended December 31, 2023. The S&P 500 Total Return Index has earned 12.9% per year in Canadian dollar terms over this same period. Thus LCM's total portfolio return of 13.6% per year has beaten an average of the Canadian Stock Market and the US Stock Market by 4.3% per year since inception. "Since inception" refers to the fifteen and a half year period from June 30, 2008 to December 31, 2023.