McElvaine Investment Management Ltd.

Partners' conference transcript

May2016

Thanks for your interest in the transcript of our May 2016 Partners' meeting.

A couple of points first:

1. *This presentation represents our views. Not only may our views be wrong but we may have subsequently changed our opinions. Further, we may or may not continue to own the securities discussed in this presentation. Please do your own work and do not rely on our comments.*
2. *We have edited the transcript primarily for readability.*
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Agenda

Michael Ross's Presentation

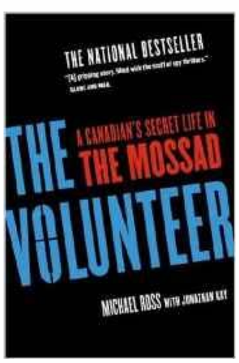
Real Estate Through a Value Investor's Lens

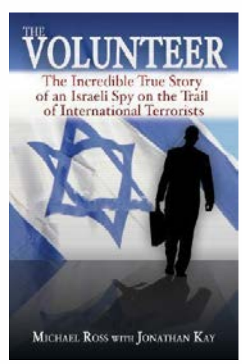
Lunch

Tim's Presentation

Bob Thompson will lead Q&A

Michael Ross





Real Estate Through a Value Investor's Lens

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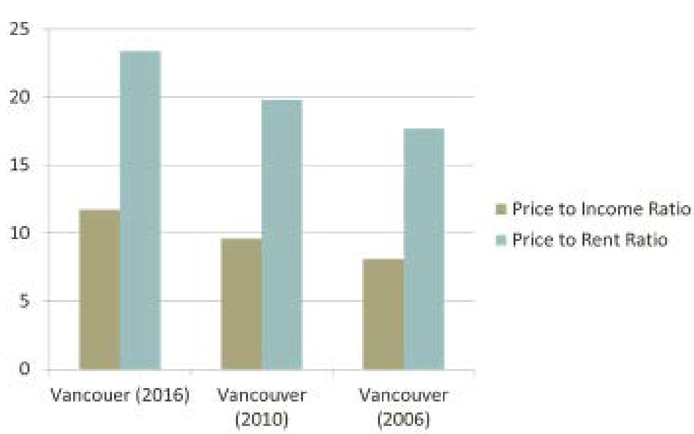
Tim McElvaine (Michael Ross' presentation had just ended, no transcript will be provided for it):

> Thank you Michael. I would like to make a couple of comments before lunch and I'll keep this really quick. Over the years, I have cautioned on valuations a couple of times: technology, income trust and then gold. In all of these cases, bullish sentiment got very enthusiastic. Now funny enough, the only time I've ever received hate mail was when I said in 2010 or whenever it was, I thought people who were buying gold were maybe a little bit overenthusiastic. It resulted in people sending me hate mail. So you don't expect that as an investment guy. Michael, maybe as a spy, but not as an investment guy.

Vancouver Real Estate History



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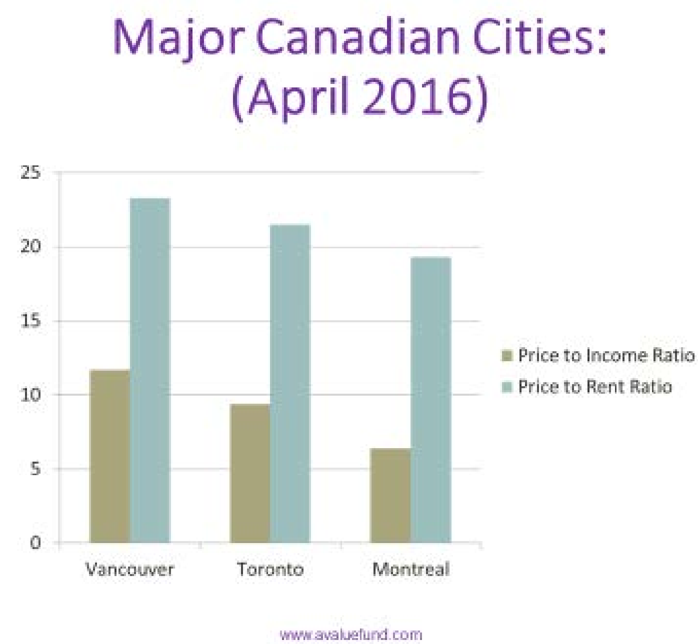
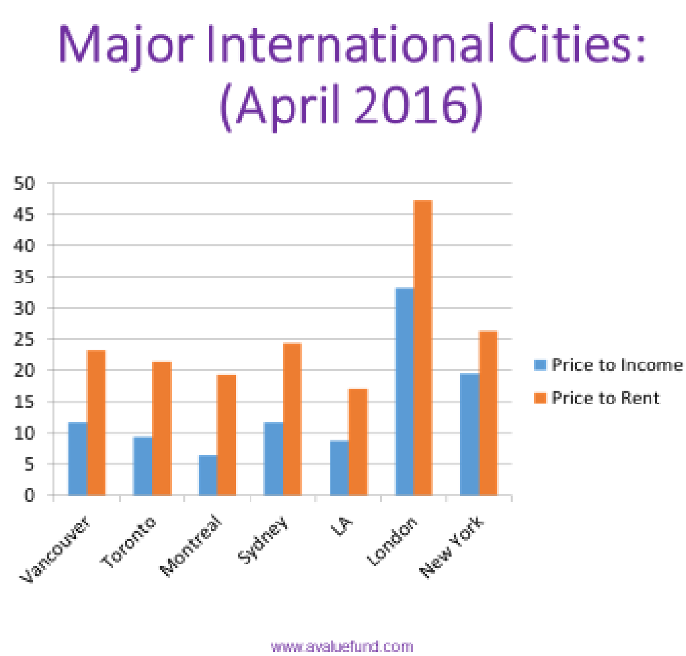
So with some trepidation I approached real estate. But nevertheless, a lot of the stuff you already know. Vancouver, over its history, has been an expensive market and only has gotten more expensive. The numbers here, it's hard to find real numbers. So this is Vancouver Central that we're using, and it's the best that we could get. So the blue is price to rent. The other one is price to income.



Comparing it against other areas, Vancouver is more expensive than Toronto and, of course, Montreal is by far the cheapest, but it has its own kind of issues.



And then if you look at it on a global basis, not surprisingly Vancouver's not significantly different from Sydney. More expensive than LA. Cheaper than London and New York. So that just gives you kind of a global context. So what does this mean to a value guy? Well, I'll talk a little bit later about our ABBA approach. Basically, two important parts of it are what's the accident meaning what's the behavioural element? And secondly, what's the bird in hand meaning valuation element?

Using our ABBA approach on real estate

- Two aspects of ABBA are:

Accident or behavioural element

Bird in hand or valuation element

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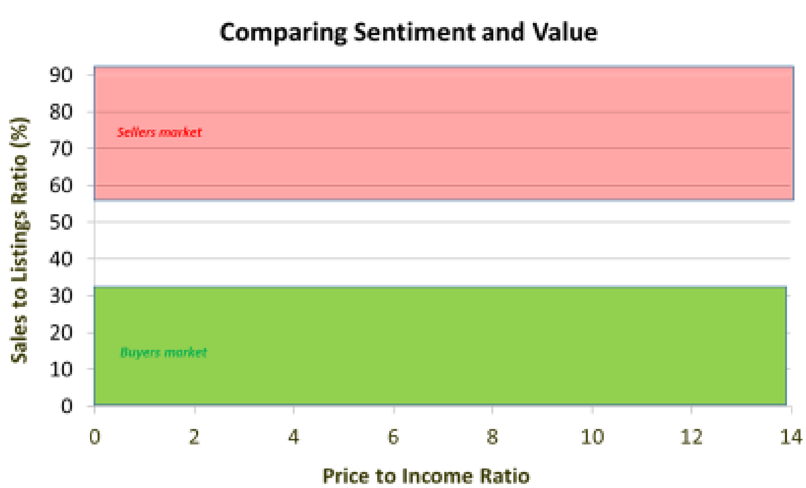
So I was trying to take that lens and put it on real estate. Not as a prediction of where it goes, but rather kind of a thermometer, a check of where we're at today. So the proxies I chose, rightly or wrongly, are on the left, sales to listing ratio.

Using our ABBA approach on real estate



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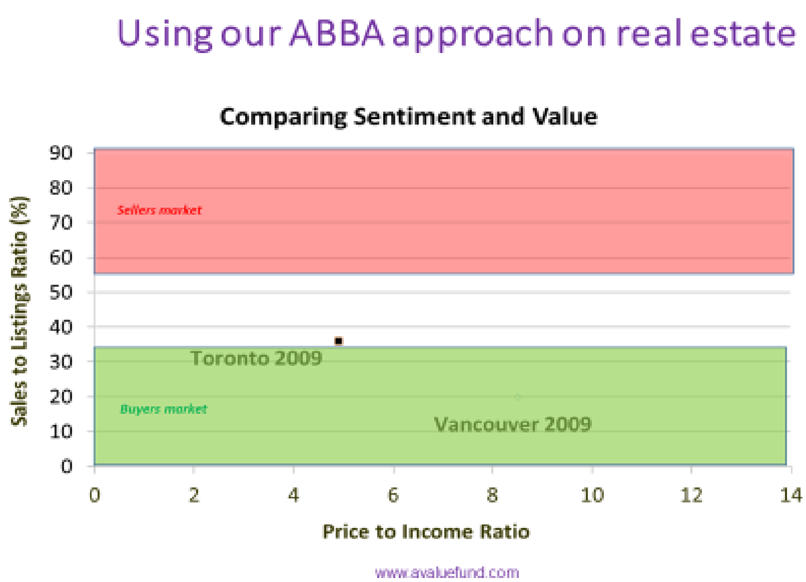
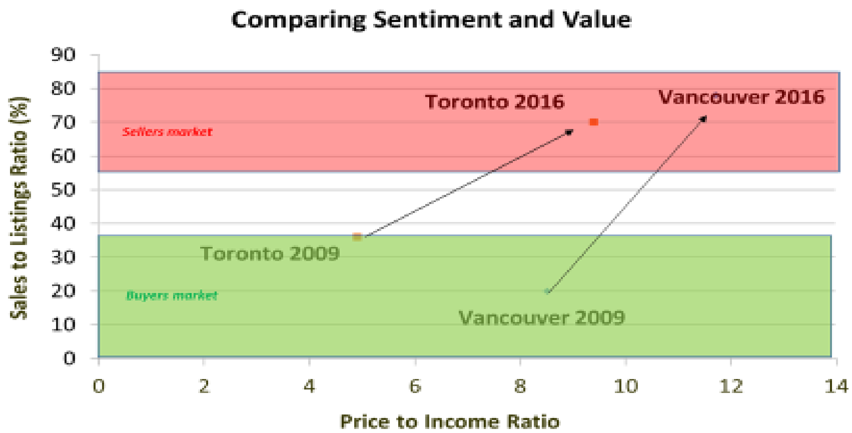
For those of you who have been hounded by a real estate broker, you'll know a sales to listing ratio of below 35 is what they term a buyer's market. So basically three and a half or less, say four or less sales for every listing is a buyer's market. And 55% or higher or roughly 6 out of every 10 sales to listings is what they call a seller's market. So if you own a house, obviously you want to be in a seller's market. If you want to buy one, you want to be in a buyer's market.



How does that work with what we have today? We put Toronto in 2009 here. A little bit difficult to get. In Vancouver in 2009 I think the dot's hidden, but it's just over the V in Vancouver. So once again, Vancouver was relatively expensive. Toronto cheaper, but was not as depressed. And this kind of makes sense as well. If you think about the number of [legs] Vancouver sits on versus Toronto, Toronto is much more diversified, a much broader economy. Vancouver is much, much narrower. So you'd expect the swings to be much greater in—for example, in Vancouver, certainly as far as sentiment goes.

Using our ABBA approach on real estate



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So where are we today? Toronto is obviously a seller's market, and Vancouver, the dots behind the O is the same thing. So we've gone from a situation where the enthusiasm has been non-existent to very high. Where does that go from here? As a value investor, it just gave me some kind of context to put the market in today. These situations rarely end well.

Nevertheless, so on that cheery note, between Michael's comments on Syria, Saudi, Iran and my comments on Vancouver real estate, we've left you in a good spot for lunch. We'll break for about half an hour. Please feel free to talk to Michael. The lunch is over there. It's kind of self-serve, and then we'll pick it up in about half an hour or so. Just before we go though I will say two things, and I think she disappeared outside. But my thanks to Shannon. Oh, there she is. My thanks to Shannon at the back for kind of lassoing you all and getting us all here today. And to Kate, my wife up here at the front.

LUNCH

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Tim McElvaine:

Thank you. Well, I hope you guys enjoyed your lunch. I've been asked a couple of times, does this mean Vancouver real estate is peaking? Look, I'm a value guy, not a real estate guy. So I'll leave that for better people. My only comment is that if there are lots of buyers and everyone's enthusiastic, this is not the base on which a bottom is built, let's put it that way. And we're trying to subdivide our property over in Victoria, if that's any indication.

McElvaine
Investment Management Ltd.

Disclaimer

I might be wrong; don't rely on my statements. Do your own work.

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So first off, my usual disclaimer. This is not because I think I'm wrong, but rather because I might be wrong.

John Kenneth Galbraith

We have two classes of forecasters:
Those who don't know

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John Kenneth Galbraith

We have two classes of forecasters:
Those who don't know
And those who don't know they don't know

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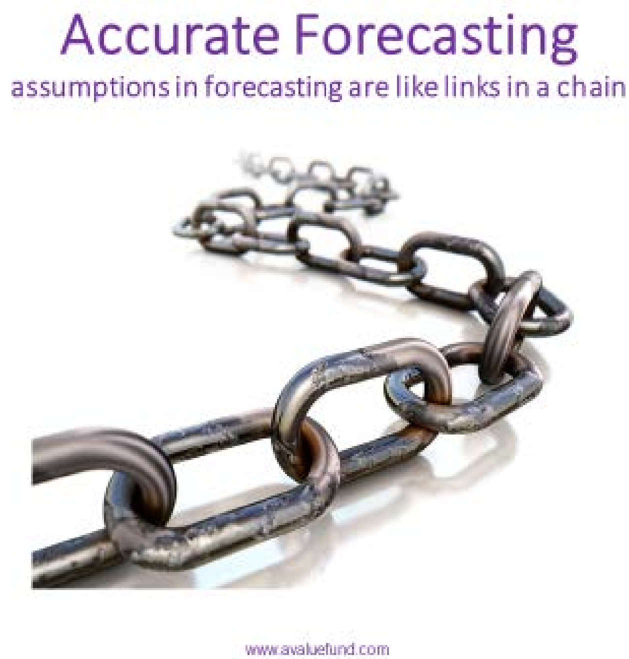
So on that note, under John Kenneth Galbraith, there are two classes of forecasters, those who don't know and those who don't know they don't know. So the first couple of minutes I'll talk about forecasting and why, in my mind, it's not the road to riches.



Accurate forecasting of course depends on a number of assumptions. The usual approach is to think about the macro economics. So what’s the world economy going to do: the first assumption. What’s the country economy then going to do: second assumption. What’s the currency going to do: third assumption. What’s the industry going to do: fourth assumption. What’s the company going to do within the industry: fifth assumption; What’s the earnings: sixth assumption. What’s the valuation: seventh assumption.

So if each one of these assumptions had a 75% chance of coming true, by the time you get to the bottom, you have about 1 in 10 or 1 in 8 chance of everything you predict actually happening. Now I know my statistical math is off a little because each of these assumptions may not be independent. I apologize for my bad statistical analysis, but you understand where I am going.

Accurate Forecasting

the more links, the more chance of a

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The bottom line is, if there are a whole bunch of links to your chain, the more links or assumptions, the more chance of a weak link.

John Kenneth Galbraith

The only function of economic forecasting is to make astrology look good

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Another John Kenneth Galbraith quote and this is my last—for those of you who are forecasters. The only function of economic forecasting is to make astrology look good. Pardon to Nancy Reagan.

If Forecasting is Not Accurate

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So if forecasting is not accurate and you're out in the fog, what do you do? Well, thankfully there's always value investing.

Value Investing

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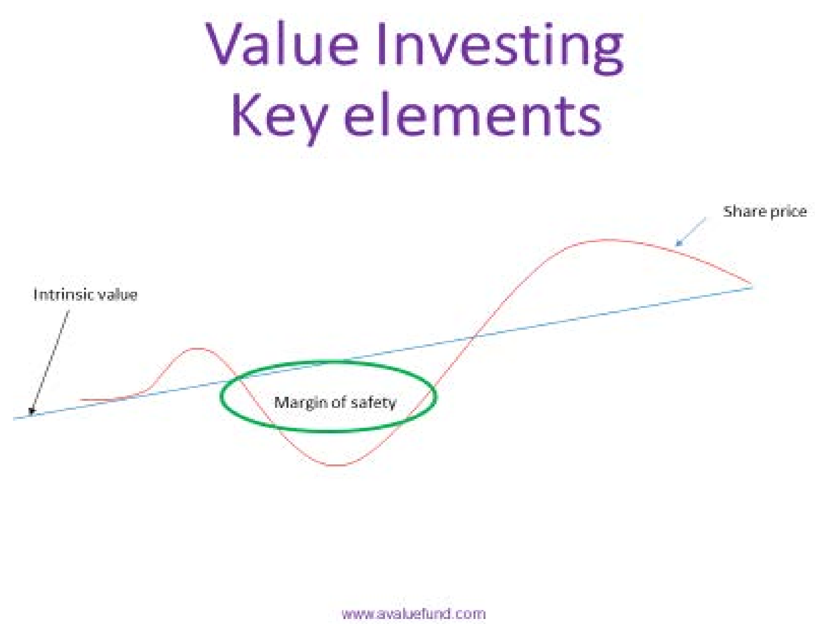
That is what I'll spend the next couple of minutes on.

We ran this video a couple of minutes ago. It’s on our website (www.avaluefund.com) under the tab *Our Investing Approach*. You can watch it there. It’s about four minutes long, and it goes through the things we look at. I won’t bother running it again.

I boiled it down to what are the key parts or the key elements to value investing. And I know Bob and I will talk about this a little bit later. But one of them is emotion. I think Charlie Munger was asked, what role does behavioural finance play in the stock market? And he said something to the effect of, is there anything else?

And at the end of the day, that’s it. People are human. Investments are human. Even a mechanical system like ETF is based on human fund flows. So you can’t separate the emotion from the market. This means, as a value investor, as I did with the real estate slide, one of the things I'm trying to always understand is the level of enthusiasm in a stock's price. Is it high, low or is it neutral. When I find some pessimism or lack of enthusiasm, then within that, where is the margin of safety? What do you have today that's worth more than you're paying?

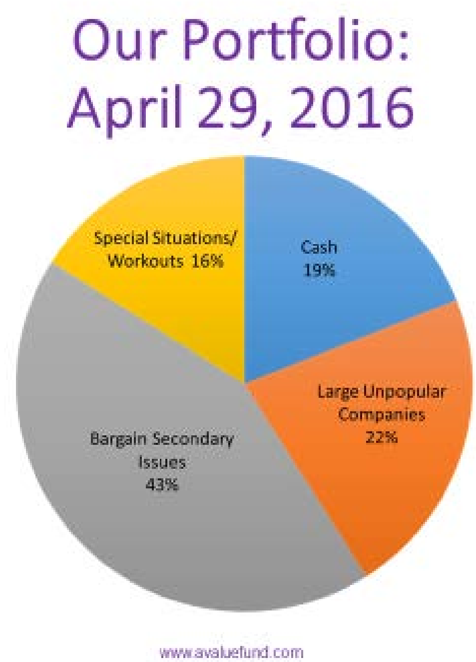


Looking at the slide, over the course of a company's life the stock price is the red wavy line. There will be some times when it's selling significantly below intrinsic value or what it's worth. This is what we call the margin of safety.

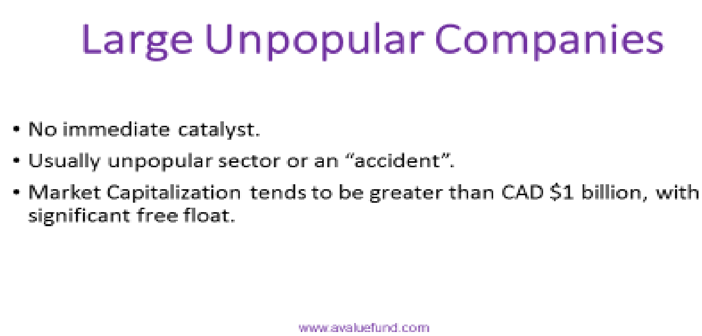
Now the "father of value investing" was a guy named Benjamin Graham. For those of you who came to Cundill conferences before, would have heard us talk about Ben Graham.

Warren Buffett and many others worked for him. His book, *The Intelligent Investor*, talked about these two concepts. Mr. Market, the idea that you have a manic depressive kind of partner who some days wants to buy your business at a high price and other days wants to sell it to you cheaply. That's Chapter 8. And Chapter 20 is how valuation fits into that.

That's the two things I was talking about, emotion and valuation. Within that, Ben Graham talked about portfolio construction, and he had really four components. This is how I think about our portfolio, but I never really present it in that fashion. So I'll lay it out this way and give a little bit of structure to what we do. I'll talk about a couple of ideas within each category, and then we'll move to the Q and A.



This is our portfolio at the end of April. As you can see, by far the largest component is what I call bargain secondary issues, which I'll talk to in a second.



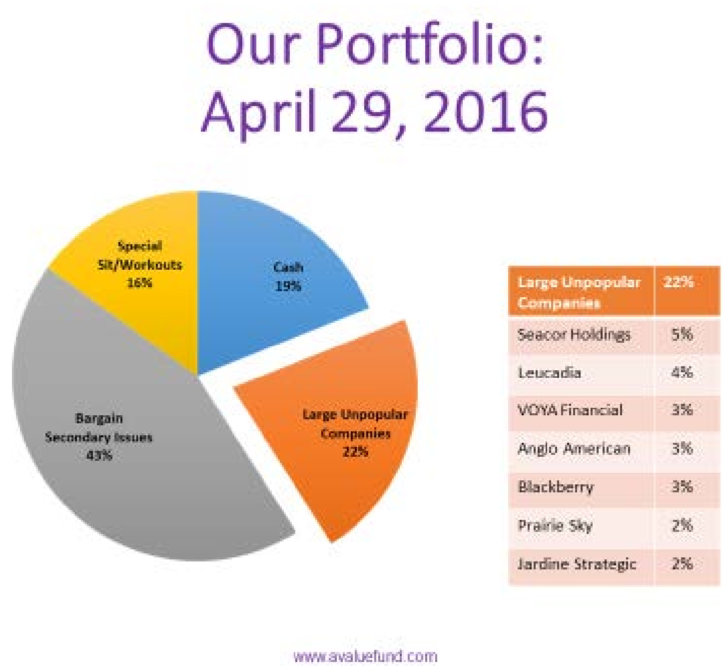
Large Unpopular Companies for us, it has been like hitting singles, doing the yardage. It has always been a reasonably profitable area for us, as with special situations. The bargain security issues have tended to be the long bombs. They've either worked out really well or stumbled.

I look at how our portfolio might change going forward. Definitely there will be less in bargain security issues and more in large unpopular companies, depending on the market, and cash as a consequence of that.

Special situations just flow in and out depending on what's going on. And I'll talk a little bit more about each one of these. Starting with large unpopular companies.

<u>Large unpopular companies:</u> Usually there's no immediate catalyst. It's as I said, obviously unpopular, or it might be an accident, which is an earnings miss or something like that. It might be a country, for example.

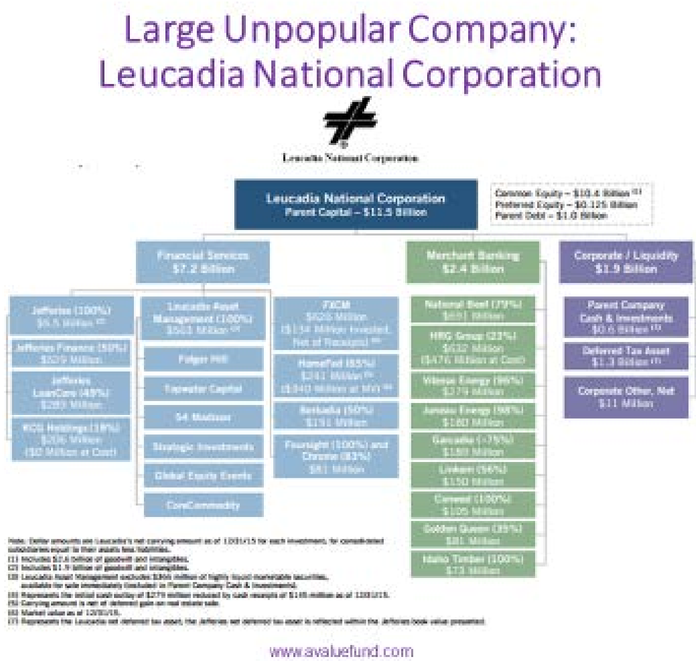
If you recall many years ago we had a large position in Japan. And to show you how unpopular it was, if you guys were at the conference, if you weren't, it'll show you what a lousy marketer I am. So I presented why I like Japan and the companies we own. Then I asked a friend of mine to come up and talk about Japan, and he basically gave the biggest song and dance on why Japan was destined to go off the edge of the cliff into never-never land. And this was in, what, 2010, something like that? So of course those of you who chose to believe me left somewhat shaken in my investment acumen. But of course in spite of what my "Japan expert said" the market then went straight up and we made money. The moral is when stocks are unpopular they are usually unpopular for a reason and our job is to balance that "unpopularity" against the valuation.



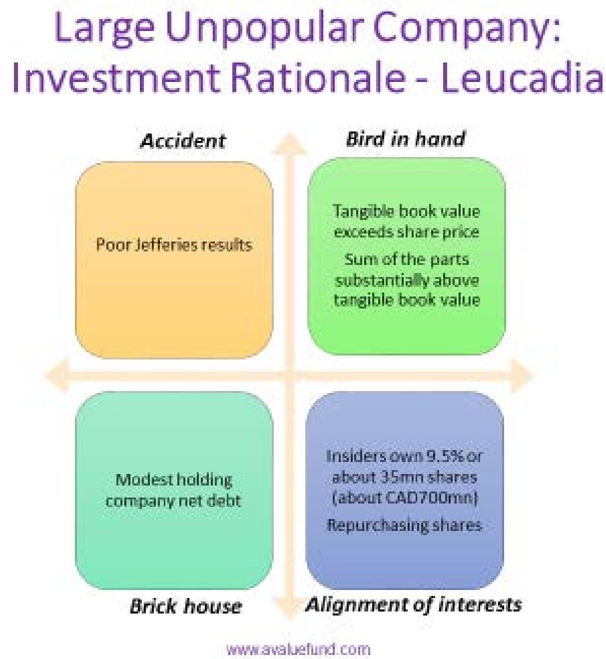
Large Unpopular Companies	22%
Seacor Holdings	5%
Leucadia	4%
VOYA Financial	3%
Anglo American	3%
Blackberry	3%
Prairie Sky	2%
Jardine Strategic	2%

If you cut out what our large unpopular company segment looks like, we have six companies within that group. They tend to be more than a billion in market cap. I really look at it from a liquidity point of view. Things such as Voya Financial, we talked about a couple of years ago, was really a distress sale by ING. I won't get into it today. BlackBerry, well, that fits the definition of unpopular. Prairie Sky we purchased in February, I guess it was, probably about $18 and change. It's not very unpopular at the moment, but it was at the time. Jardine Strategic we purchased in the earlier part of this year as well. And the other two I want to talk about, SEACOR and Leucadia.

I'm going to move through this really, really quickly because I want to keep it short. I could give an hour presentation on each one of these and everyone including Kate, my wife, who is my biggest supporter, would leave the room by the time I was finished. So I'm going to whip through these ideas very, very quickly. I'm happy to talk with you at nauseam about them next week, but for the purposes here, I apologize if I'm not going into enough detail for some of you who are value fanatics.



Leucadia National has a long history run by two value investors, one of which was a Canadian. And as all of us will be, they reached 70 years old. One of them decided to go off and basically run a winery. And they engineered a change of leadership, essentially by buying Jefferies. Jefferies, a global investment bank, is by far the largest component of the assets. They also have a whole bunch of other stuff. People have called it a mini Berkshire Hathaway. It's not. Warren Buffett buys wonderful companies at fair prices. Leucadia doesn't. Let me put it that way. They deal in more difficult situations.



So putting it into this ABBA framework, and you've heard me talk about it before, there are four parts, the accident, the A. That was poor Jefferies results and at National Beef combined with a negative view of the outlook for high yield debt. The bird in hand, that's our term for the margin of safety: tangible book value exceeds the share price and the sum of the parts, meaning what I think the different businesses are worth exceeds the tangible book value. The brick house or what's the financial standing and its ability to weather the storm: it has modest holding company debt. And then alignment of interests, meaning, does the board care about you: well, the three guys, including Joe Steinberg who's still involved, have some $700 million invested in it, which would kind of keep my attention if I was involved. They've been repurchasing shares as well.

You can see this—you'll see me go into this each time. There's a problem which drives the sentiment. There's a margin of safety or what I call the bird in hand. There's a view of its staying power or its brick house I call it. You know, the idea someone goes into a house and it looks terrible. The shutters are falling off, the door's falling off, and the realtor says, "Well, it has good bones." That's the idea. That's what we look for in a company. It may look really ugly, but it has good bones. So that's the brick house. And then the alignment of interests. Why are the people, on the board particularly, thinking about you as an external shareholder?

SEACOR Holding Inc., once again a very complicated company. They are in the business of owning and operating equipment for offshore marine, which is basically supplying oil drilling rigs. That’s one of the reasons it’s unpopular. Other divisions include Inland which owns and operates barges moving things like fertilizer, grain, steel. Their shipping division has some Jones Act tankers and tugboats plus a couple of smaller divisions.

But putting it within my framework again, unpopular sector, weak results. Tangible book value exceeds the share price. Our estimated sum of the parts, what each of these businesses are worth, once again, is higher than tangible book. Minimal holding company debt and insiders, particularly the CEO Charles Fabrikant, own about $160 million worth of stock.

The interesting thing here, many years ago when they were doing well, Barron’s magazine called their CEO the “Buffett of Barges”. Rather than simply an operator, Charles Fabrikant is more of a capital allocator. If you take, for example, their offshore marine business, well, a couple of years ago when things were doing well, he spun off the helicopter division to shareholders. More recently he has worked with a private equity firm and sold them a convertible debenture on the marine business, which means that he can spin it off as well. And the result has given him the cash to be an acquirer in a market such as this one. He writes a wonderful annual report for those of you who are value investors. It’s www.secorholdings.com, and I definitely recommend it to you.

Once again, all of that stuff aside, we paid between $40 and $50 for a company with a tangible book of about $70 and a Sum of the parts north of $70. Over the last 20 years he’s run it, it has tended to have a 12% return on capital. Insurance value, replacement cost of his vessels, much higher than tangible book. So we got all of this at a discount. That’s the type of things that I’m very interested in doing.

Bargain Secondary Issues

- No immediate catalyst.
- May be “accident” or simply neglected.
- Market capitalization tends to be smaller than CAD $1 billion, or has limited free float.

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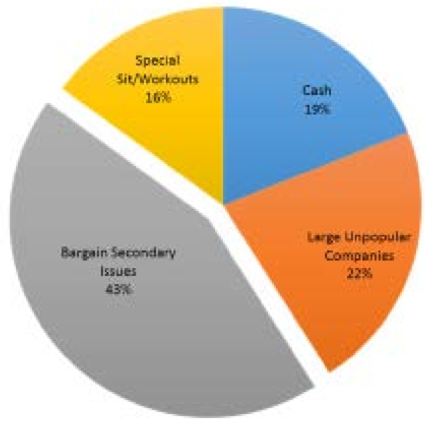
<u>Bargain secondary issues</u> tend to be somewhat smaller in market capitalization and are either an accident or just neglected. I’ll talk about a couple of ideas here.

Our Portfolio: April 29, 2016

Bargain Secondary Issues	43%
Glacier Media	9%
Carmanah Technologies	7%
Dundee Corp	4%
The Caldwell Partners	4%
Noranda Income Fund	3%
Symphony International	3%
7 other holdings	13%



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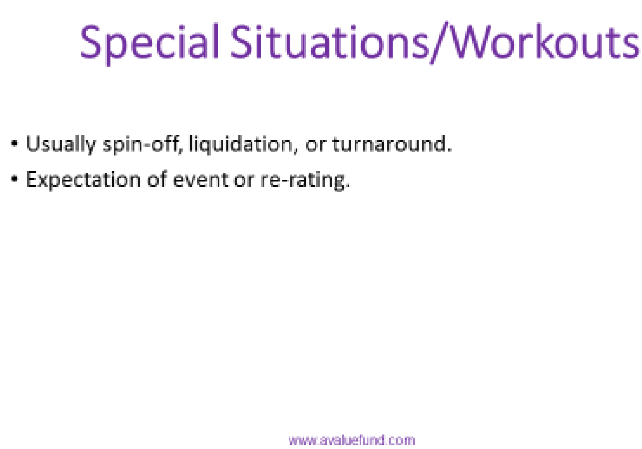
The largest position is Glacier Media of which I'm on the board. It's been a long time holding. It's had its challenges. I'm happy to talk about that later. Carmanah Technologies we talked a little bit about last year. We basically bought this as a special situation. It was a rights issue, backstopped by insiders. We paid about a buck or so. The stock is maybe $4 and some now. So most of the gain there has been unrealized. But it's still a cheap stock.

I want to talk about Symphony International. Once again it came across my path as a rights issue. That's what got my interest. We didn't buy it on the rights issue, but we bought it a little while after. It trades in the UK. It has a number of investments including a hospitality business, which manages about 18,000 hotel beds throughout Asia and Australia. It runs about 2000 restaurant outlets, all different brands. It has about 300 retail store outlets. About 50% of their business is in Thailand. So you're not talking about a small company.

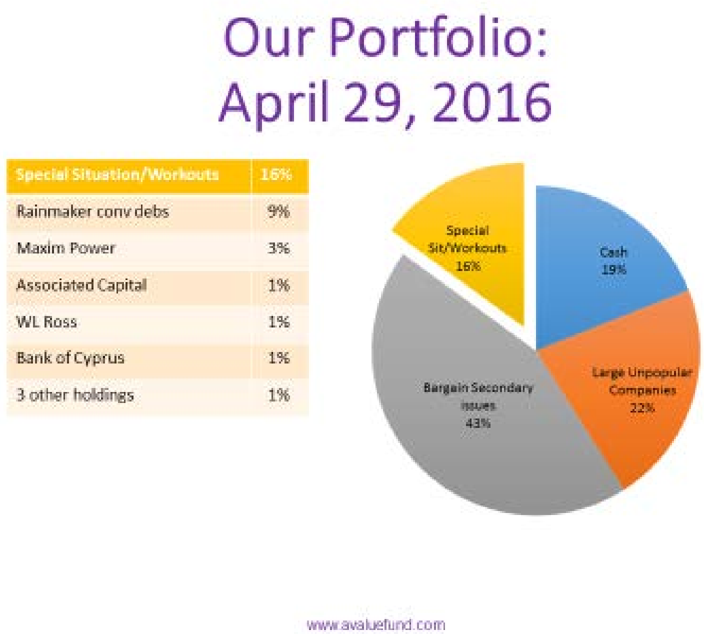
Under healthcare they own part of an Indian hospital company. They own three hospitals in Singapore. They have a REIT which owns 49 other hospitals. And then they have a real estate component.

All of this tends to be emerging market related. When the emerging markets came down, the price of Symphony of course suffered. Symphony has a complicated structure which leads to inefficiency and hence a bargain secondary issue. More specifically, they're priced in US dollars. They trade on the London Stock Exchange, and all their businesses are in Asia. So there's no natural buyer who's going to gravitate to this type of structure. Net asset value is probably about $1.30 right now and the stock price is $0.71. They have net cash, as you saw on the earlier slide at the holding company level. It's best viewed as a private equity business with insiders, primarily one individual owning about 20% of the assets—or 20% of the shares. Symphony paid—as I said, it trades about $0.70 and they paid almost a .07 cent dividend this March. Insiders are purchasing shares and have performance incentives, etc. So once again, it fits into this ABBA model.



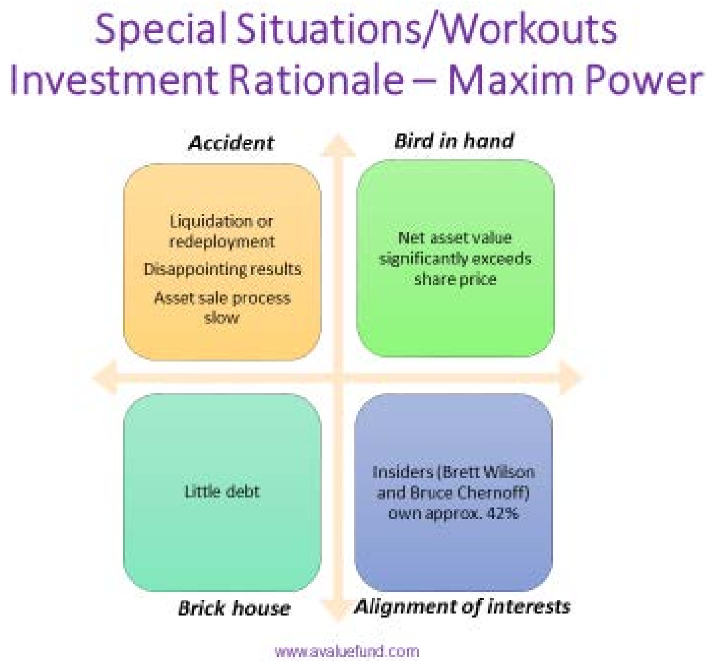
Special situations, spin-off liquidation, recapitalizations:

Rainmaker, which we can touch on as well, has been—I put it under a workout situation. As of today, and this differs from the end of the year, we only own convertible debentures in Rainmaker. They pay 8% interest, higher up on the capital structure obviously than equity.



I'll talk about Maxim and Associated Capital and then I'll wind this up.

Maxim Power is a Canadian company once again, with various components. I think it's a quasi-liquidation/redeployment of capital. The main parts to it are their Albertan power operations, US operations, their French operation, the latter two they've said are for sale.



The stock price really hasn't done anything as people wait to see what happens in the sale process. Their Canadian generating assets are located in Alberta, which isn't the most robust market for hydro. These poor results have overshadowed their other operations. The stock trades about $3. I think the US business could be worth more than $3 alone. Then you have the French business, and whatever will happen with the Canadian businesses plus other assets. There's little debt and two guys, Brett Wilson, the Dragon Den show guy and Bruce Chernoff own 42% of this. I trust and like Bruce Chernoff.

Special Situations/Workouts:

ASSOCIATED
CAPITAL GROUP

Cash	$205.8	
Investments in Securities/funds/partnerships	$417.2	
GAMCO A shares (4,393,055 shares)	$136.4	
Other items net	$ -8	
Book Value	$751	*$29.53/share*
GAMCO note (due Nov/ 2020, 4%)	$250	
Adj book value	$1,000	*$39.37/share*
Shares o/s	25.4	
Other		

- Alternative Asset Manager with $1bn in assets.
- Research business with $8 mn in revenue.

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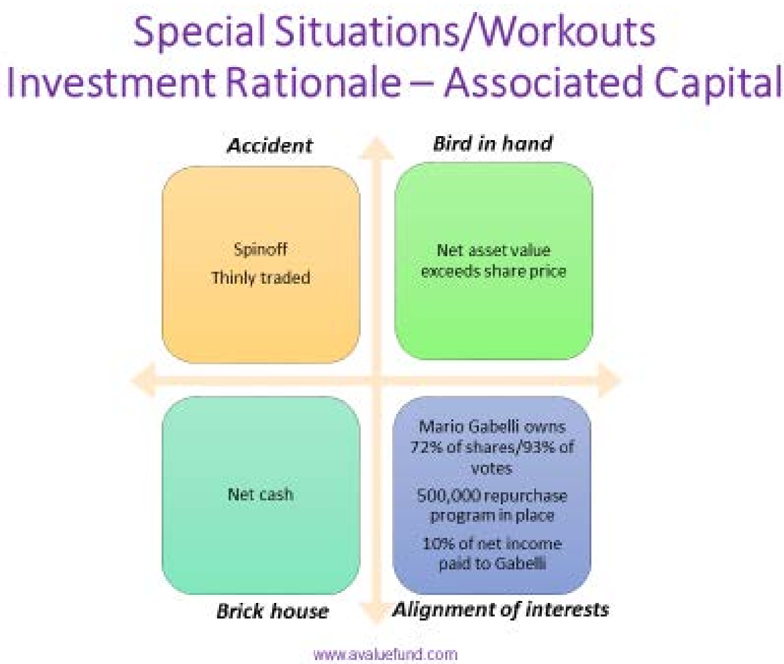
The final one I'll talk about, Associated Capital, was a spin-off. I could talk about different components, but it's a little bit complex. The numbers on the surface, book value is about $30 a share, consisting primarily of cash and securities. Mostly investments in mutual funds, because the main owner of this structure is Mario Gabelli, the US fund manager. He spun this out of GAMCO, basically to take all the non-GAMCO assets, all the non-mutual fund management assets out, as the valuation of GAMCO was not giving any credit to these assets.

Now one of the peculiarities of accounting, and I'm a CA so I say this with no malice is some of the accounting rules are basically rubbish. One of the neat things about this company is they were owed $250 million. $250 million out of a billion dollar company is monies owing from GAMCO. Because they were somewhat related to GAMCO, this is not shown as an asset, rather it's shown as a reduction in shareholder's equity. Basically, if you lent $250 million to your grown up child but you don't view that as an asset (assuming your child is trustworthy!). That's basically the accounting they did here. If you add back the $250 million, it's owed in components of $50 million a year for the next 5 years, and it pays interest etc., the adjusted book value is a little bit less than $40 a share.



So once again, spin-off, thinly traded, net asset value exceeds the share price, and has net cash. Mario Gabelli has 72% of the shares or 90 odd percent of the vote. They have a large repurchase plan. Basically they're shrinking the capitalization, in effect, privatizing it. And the only twist in it is Mario Gabelli gets a good chunk of the income off the top. But it's not really an income play. It's more of an asset value play, to my mind.

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I'll wind up quickly. And I'm the world's worst salesman, so I won't put you through the embarrassment to me of trying to do an elevator pitch. But I'll highlight a couple of things.

In the fund management industry, as this picture shows, people manage a lot of different funds, right. You see one guy in the paper and he'll be talking about one fund. Then he manages another one, and maybe they have private clients and maybe they have institutional clients. And finally, he has his own private trading account. So at the end of the day, are you actually in a fund that matters to that person?

So which fund do they care about? Which fund do they have their money in? In many cases they actually don't have their money in the fund. They also have a private personal trading account. So as a client, what are you supposed to think about that?

I manage one basket (one fund) and all our eggs are in it!

Well, from my point of view, all of our eggs are in one basket. I have one thing I do and that's manage The McElvaine Investment Trust. That's it. Well, other than the stuff I do around the house, I guess Kate. But I don't manage multiple accounts. We don't have special fund A for the people we really like and special fund B for everyone else. All our eggs are in the one basket.

The McElvaine Investment Trust
How To Invest

- Series B
  - *1% plus performance fee;*
  - *Only available directly from us*

- Series F
  - *0% mgmt fee, only performance fee (Buffett Model)*
  - *Only available through an advisor (on Fundserv)*

We have Series B, 1% plus performance fee. Series F, which is only available through advisors and FundSERV. Has zero management fee and basically follows the Buffett model.

The McElvaine Investment Trust

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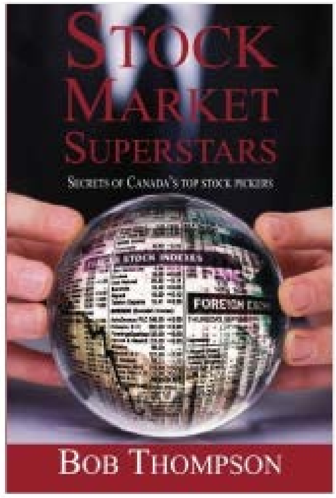
In summation, I talked about why we do value investing, and I'm passionate about that. I talked a little bit about how we invest and there's the video on our website. And finally, gave you some idea of what type of stuff we do. Why everything fits into an accident, margin of safety or bird in hand, brick house or financial stability and alignment of interests. I now want to quickly move to the Q and A, and then we'll hopefully wrap up in about 20 minutes. Our format's changed a little bit this year. I'll be very interested in your feedback on it. As I introduce Bob, I'll introduce him quickly—I don't know why I need my notes though Bob, because I've known you a long time.



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Bob Thompson works at Canaccord Genuity where he is a Portfolio Manager and Alternative Investment Strategist.

Bob wrote a book. He was kind enough to feature me and a number of other people in it, talking about the different ways of investing. You'll see him on BNN and in Maclean's and The Globe and Mail and things like that. He's the guy to ask about where Vancouver real estate's going because he's coming out with an article in Maclean's in a couple of weeks on that.

Please welcome Bob up here and we'll quickly move through some Q and A and then wrap everything up. [applause]

Tim McElvaine: I'm really interested in your feedback on this because last year I rambled forever. I thought it was an interesting presentation, but that was me, right. So we are trying to change it. Bob kindly came to me and said "Why don't you do it a little bit differently next year?" So this is a little bit different. There are feedback forms. Let us know what you think.

Bob: Tim's such an amazing guy to just sit down and chat with, and that's why I was glad we could do this because we need the fire right here and then be all set. But you know when I did the book I tried to look at the qualitative things that people have that you can't quite put your finger on, about a money manager, right. Why—during his heyday, why was Tiger Woods the best golfer in the world? What did he actually do better? Did he practice more than everybody else? No. Was his body type better than everybody else? No. There was something that he had that you couldn't put your finger on that made him the best golfer in the world.

That's what I tried to do in the book, and I think these sorts of discussions bring it out too, maybe a little bit into the inner workings of Tim and why he's done a great job over time. So I'll just mention your value investor's take on real estate was fantastic. I thought that was great because it's really hard to get the emotion out of it. And what I've kind of looked at is the anatomy of a euphoria. And it's the same I think in the stock market, the real estate market or tulips in the 1650s. If you can identify that euphoria and stay away from it, then you're going to do a good job.

And just as an aside, if you want to write this down, I think the best book I ever read John Kenneth Galbraith, again, since you brought him up, it was called A Short History of Financial Euphoria. He wrote it in 1993. Why I think it was a great book is because it was less than 100 pages in big print. So you could do it in about two hours. But it really looked at the anatomy of lots of euphoria over time. It fits right into what value investors look at.

I guess the first thing we'll get into is, I've always thought that the best natural investors are sociopaths because emotion doesn't come into play, right. So how do you as a normal human being, who is hard wired to be a bad investor, which human beings are hard wired over thousands of years, to run from danger, etcetera, how do you combat that fear as a deep value investor?

Tim McElvaine: Well, I think the most important thing is to make sure that you have a margin of safety or this idea of a bird in hand. So it's one thing to get unnerved by headlines, and like everyone else, I read stuff too, and you go, well, that doesn't look very good. But I frame that against, well, what does that mean today as far as a price goes? So price is the great equalizer in that situation I think.

Bob: Do you ever watch CNBC?

Tim McElvaine: No, not usually. I have lots of kids and I get enough noise at other times. I don't need it on the television too.

Bob: How about technical analysis? You ever been swayed?

Tim McElvaine: No, I'm not swayed by technical analysis.

Bob: You know, another rule that I kind of go by when selecting managers is to sell hubris and to buy humiliation. It's usually a great investment strategy. Now the growth guys are all starting to groan right now. Their definition of good stocks is not performing stocks, and all the lousy stocks are starting to perform. The market should be more rational and make their growth companies perform. So we've had the worst period of value investing over the last three years—or the market has been rewarding value investing worse than the 1998 to '99-time frame. And you start to see some things come back and the market starts to reward, I guess, the cyclical companies, the companies that are turning around. Do you see that now? Do you see the market starting to look at different things than it was looking at in the last three years?

Tim McElvaine: Well, being humble and being a technology investor, haven't been two things you'd use in the same sentence for a while. I don't wish them any ill will, but so be it. Let them play their own game. Is value coming back? Yeah, I think so. Am I happy to take a tailwind? For sure. Is it here or not? I think so, but it doesn't change what I do. But it sure as heck makes life a little bit easier.

Bob: Well, I think the reason value investing has been the best over long periods of time is you get that double whammy. When the turnaround happens, you get the earnings growth of the company and then you get the P/E expansion too. You get the double whammy. Whereas a growth investor's looking at one thing--you're not necessarily going to get that big expansion like you're going to get.

So maybe a good question here, a real life example, what's a stock from the past that you bought that worked out but made you absolutely sick as a human being to have to buy it. You say to yourself, I got to do this, but it just feels bad that I'm having to buy this company. Or is that every stock?

Tim McElvaine: No, I don't—how shall I say, it's kind of a terrified enthusiasm you feel when you're buying as a value investor. So Japan certainly fell into that category, especially after hearing that guy's presentation at my conference. But at the end of the day, when I go back to my office and I think, do I have price on my side? Are the board and managers thinking about shareholders? And is the capital structure reasonable—then it calms me down, let me put it that way.

Bob: We'll get into the kind of balance sheets in a minute. Probably the most hated asset class in the world right now, and I start to see the names pop up on your list, is the materials mining class. So you talked about some of the names, but let's talk about Anglo American, who laid off I think half their workforce or something recently. What drew you to that? In the mining industry, they don't necessarily ever have the best balance sheets or cash flow or things that normal value managers look like. And a lot of value managers just kind of gloss over that mining industry completely because they don't know how to analyze the stocks. So what did you see with Anglo?

Tim McElvaine: Well, you may recall, many years ago we owned Howard Hughes Corp, they owned property, real estate in Las Vegas and a number of areas.

But any rate, what it had and what I tend to find usually works out is when you have very long life assets, spanning sometimes multi-decade. They're valued in the stock market at spot. So at the time people were valuing its multi-decade land bank of real estate in Las Vegas based on the last trade of a house in Vegas. Well, of course that's going to change sometime in the next 30 years. Same thing with Anglo American. So if you took De Beers, if you took their three core businesses, which are De Beers, platinum, copper, their reserve life is maybe 20 to 70 plus years. Long, long, long time, valued off spot. So your question then becomes, all right, they have assets that at some point in time will be valued for more than they're carried at today. The question gets into, first, do they have the financial capacity to be there for the next 70 years?

Anglo had a little bit too much debt, but it was reasonably well structured and pushed off as far as its repayments go. Now just a couple of weeks ago they sold one of their businesses in Brazil for about $1.5 billion - more than people thought. That will further enhance their financial position. So long life assets, staying power, and then the final component is shareholder focus. That's the one where if I gave an A on life of assets, I gave a B on financial structure. I gave a C on capital allocation--it was the one that I was worried the most about. Clearly you rarely get things where every box is an A plus.

So you're dealing—you know when that book 50 Shades of Gray came out, I thought, oh, great, another value investing book. Little did I realize. But that's kind of what I deal in, right, 50 Shades of Gray. Everything you deal in, in value investing, has a pro and a con to it.

Bob: Well, that's interesting because a big criticism of Japan, probably when you were investing in Japan, was that companies were not shareholder focused. They didn't really care about that. How did you overcome that in your—

Tim McElvaine: Well, it depended. I have been in Japan a long time, it's tough to paint a whole country with the same brush, right. Within that there were things to do. Sometimes you traded off a little bit of shareholder focus for maybe institutional things, like the move to repurchase shares which may not be driven by a specific management view, but rather more a kind of government view. So it was always a trade-off. Some of them we had were very shareholder focused. Other ones were just very cheap.

Bob: Howard Marks said, for those of you who haven't heard of Howard Marks, it's the one person that Warren Buffett said he learned something from every time Howard Marks speaks. He said that sometimes the difference between being wrong and being early is indistinguishable in investing. So as a value investor, what's your average holding period, and why is your holding period longer than average?

Tim McElvaine: Oh, because our stocks don't go up quickly. That's why it's longer than average. I'd like it to be shorter than average.

Bob: Because it takes them so long to go up, okay. [laughs]

Tim McElvaine: Sorry about that guys. Usually the first thing that has to happen--and usually we buy and then the stock price goes down some more. So you have to be ready to average down and buy again. It takes some time for things to change. It can take time for, say in the case of Japan, for a crisis to be hit that caused them to do something that changes the environment. In the case of Anglo America, for things just to get so painful, that capacity was coming out, that it just forced a change. So I don't know, did I answer your question?

Bob: Kind of. That brings up something else that I was thinking about which is, as a value manager, you want to buy obviously at the exact point of maximum pessimism, which you can't determine. So that's why you average down. How many times do you average down do you say? Is this the point of maximum pessimism, or is this what they call a value trap and this company is going to be a big problem going forward?

Tim McElvaine: Yeah, well, you'll never find that out until about a year and a half after you bought the damn thing unfortunately. But I think you have to be prepared to average down. And one of the things I think I've done somewhat poorly in the past, but I am much more focused on now, is putting some risk controls over portfolio balance, for example. That gets into a little bit of what you're saying because there's some point in time where you have to say, I have enough in this stock. I think I'm right, but I just need to stop. One of the things I put in place was an advisory board with three guys I like and respect. They have had successful careers in the finance business. They're good friends of mine and unit holders of the fund. I meet with them about every – I was going to say every quarter, but it's usually every six months, and go over our portfolio review. They've helped me stay focused on risk containment. So that's a second part of it.

Bob: Value investing is really a bit of a time arbitrage, right. You're look out three or four years. Like you said with Anglo American, maybe 20 years. Whereas the market's looking at what's going on in the next few months. Do you ever pay attention to brokerage firms' outside research in that way? Because usually it's very short-term looking.

Tim McElvaine: Well, the—

Bob: Or just do the opposite of what they say?

Tim McElvaine: Interestingly enough, we have a number of analysts who are actually investors in the fund. I think usually the analysts have a reasonable understanding of the business and of the people and what's going on. I think they're forced to try and translate that into the next quarter. If you take Carmanah, for example. A great company. They're going through a product transition/upgrade this year. So no one knows what their revenue's going to be quarter to quarter. I met one of the analysts and he's throwing up his arms. He says, "I'm putting it to sell or hold because I don't know what to model it for the next quarter." He said, "Three years out it's going to be a great stock, but I just don't know how to do the next four quarters to get there." That type of approach plays right into what we do of course.

Bob: That sort of makes it tough, I guess, valuing a business that's publicly traded because the market's swaying the price of that. But—

Tim McElvaine: Well, that's good, right?

Bob: Have you ever invested in private companies then?

Tim McElvaine: Yeah, we have and it's not something that we'll do unless we get backed into it, meaning it was part of a recapitalization of a company or something like that. There are lots of people who do private stuff. That's not what I do. Someone once said that the stock market is an expensive place to figure out who you are, or something to that effect. Well, I'm fairly confident in the stuff that I'm doing, and we're going to stick to our knitting that way. There are a lot of, I don't want to say value guys who say: "Yeah, I started out as that type of investor. But I matured over time and became this type of investor." Great for you. I haven't matured. So—and I'm quite happy with that.

Bob: Let's talk just a little bit more about the margin of safety, which you mentioned. During a normal business cycle, you always notice that at the top the debt is always massive and companies lever up at the top, Barrick Gold or Teck twice in the last eight years here in Vancouver. Then obviously there's a downturn and there's a problem and the company maybe goes bankrupt or doesn't, or comes out of it. Explain that margin of safety. What would you look at in those sort of circumstances? Because a lot of times companies like Teck or Anglo American or these sorts of businesses have a lot of debt on their balance sheet at the bottom and they're on the verge of maybe not being able to make it.

Tim McElvaine: Yeah, if you compare Teck to Anglo, for example, Teck's--the majority—and I apologize for any of you guys who are Teck fans, because I'm not saying it's good or bad, but the majority of Teck's value was in coal, period. For me as an external, passive investor, I'm going to have to have a really strong view on the competitiveness of their coal and the future of coal. Anglo had a whole bunch of different components, of which coal was part, but so was copper, so was diamonds, platinum, phosphates, etc. They had many different components. That makes it much easier when you're investing in a distressed sector. Then you can say, all right, there are various levers they can use to solve this. It's not completely dependent on one thing.

Bob: Now this is maybe a macro question for a guy that doesn't like macro, but looking at the balance sheets, which is what you do, would you invest in—if it was a corporation, a Western government? Or what do you think is going to happen to those balance sheets? Looking at them, I mean, countries are bankrupt. They can only print money for so long.

Tim McElvaine: Well, I'll probably avoid this with the exception of saying, the thing that caused financial calamities is when you borrow short and you're dependent on someone else's good will. I'm going to get myself in trouble here. For example, if you compare China to Europe, China, their external debt is relatively small. Even though their debt is very high, I think the external portion is something like 15% of GDP. They're going to have problems for sure. They have an opaque financial system which never ends well. But most of their debt is internal. Europe, most of their debt is external, dependent more on the happiness of foreigners. That makes a much, much more difficult situation. So that's as much as I'm going to say on that.

Bob: I think Japan's debt is huge, but a lot of it's internal again, right?

Tim McElvaine: Yeah, and it's allowed them to keep going far longer than anyone thought they could.

Bob: Of course you heard what Trump said the other day. He said, "We want to run up the debt and then we'll just restructure down the road if we can't pay it and we'll buy it back at 80 cents on the dollar." That might not work so good for a country.

Tim McElvaine: I think if you polled ten economists—now I should preface this by saying, one shouldn't be a contrarian just to be contrary. That leads to lots of divorces and no friends. But if you surveyed ten economists today, I'm pretty sure the standard thing would be rates will be lower longer. And maybe they're right, maybe they're not. But—don't know where I'm going with this other than to say, you never know what the tipping point is.

Bob: There's just a couple of questions came in from your unit holders, and one of them was—first would be a little interested in hearing a little bit more about Glacier Media. And you talked about that, but maybe a little more detail about how's their tax owing issue? Are they going to reinstate their dividend? Such things.

Tim McElvaine: Yeah, Sounds like from Francois, oh yeah, right there. I have to be a bit careful as I am on the Board and Glacier is in a quiet period. Glacier, as you know, has a number of businesses. Community newspapers, some database businesses, Fundata, a number of things. I joined the board maybe two years ago, just after they got hit with a tax reassessment for effectively just under $50 million, of which they had to post half of it, or just over 20.

Glacier has difficulties on the operational side, but they're not—you get into secular stuff with newspapers, they're not the end of the world, right. They're a very cash generative business. These are good guys. They can manage this. Glacier's main issue was on its capital structure. It sold—I think since I joined the board, some $50 million worth of assets to clean up the capital structure. Then they have a business that has its positives and negatives, but it's not the end of the world. So I don't really lose a lot of sleep over Glacier to be quite honest, especially at the current price.

The tax stuff, we won't know for five years. If you talk to the Glacier guys, they're adamant that all the facts are in their favour. I'm sure if you talked to CRA they would be adamant none of the facts are in Glacier's favour. I don't know. From our point of view, we've posted half of the money. The rest, if any or maybe even a refund, won't be known for a number of years. You asked about excess real estate values. Through the last year and a half, we've sold most of the surplus real estate. There are a couple of pieces left, including a building in Victoria, the Times Colonist building that could be worth a lot of money. So excess real estate is not completely done, and the numbers still could be reasonably large from that. But most of the real estate is gone. Sum of the parts basis, even if you put a low multiple on the newspaper, I'm quite comfortable it's more than where the stock price is trading.

Bob: Maybe we should open it up for some questions, because we've been about 20, 25 minutes. Are there any questions from the audience? And I'll repeat the question so everybody can hear. Do we have to keep talking?

Tim McElvaine: One more and then we can stop.

Bob: Any other questions? Individual companies or—

Tim McElvaine: Yeah, Gina.

Female: [Indiscernible] but what kind of succession plan do you have in place for the fund and also for your [indiscernible]?

Bob: So what if Tim gets hit by a bus tomorrow?

Tim McElvaine: Yeah. You and Stuart (another investor present) worry about that. You guys sell insurance on the side or something? I think you do. The good thing about having the advisory structure is, those guys are all investors. So if something happened to me, they could oversee a vote of the unit holders and a liquidation of the fund or whatever people felt was best to do. I think that was important—especially as a kind of small company, it's important to have that type of structure. The guys who are on the advisory committee have been chairmen of publicly listed companies. This isn't something that would be complicated for them to do. We use—Jason had to leave, but we use BLG here as our lawyers.

I'm not really worried about what would happen to the fund if I wasn't around. I think it would have an orderly transition. Plus, the fact that it's open ended. We're not taking any prisoners, right. If something happened and they decided to go through a liquidation cycle, people can get their money out. I don't know if that answers it Gina, but I'm not intending on going anywhere anytime soon. I have too many kids and too high a cost base to do that.

Bob: Do you think you would ever really retire? In other words, I mean, it's your passion, the investing and you're always going to be interested in looking at companies and buying things. A lot of people in this industry never really retire. They just—they continue to do it, whether it's their own money or whatever the case is.

Tim McElvaine: Well, it’s an interesting business. The business is a little bit like problem solving. You’re constantly given interesting situations. So well, I’m what, 52, 53 now, retirement isn’t coming anytime soon.

Tim McElvaine: Thank you very much Bob and—[applause]

Bob: Good. You’re welcome.

Tim McElvaine: I enjoyed this format. Please give us feedback —there are some feedback forms there. It’s important that you give us an idea of how you’d like future meetings to go.

As I said a little bit earlier, we talked about three things. Why I approach things the way we do and why I can continue to approach things the way we do. How we do it, with that video, and then what type of things we’re invested in. I really appreciate everyone coming out today. I’m a phone call away if you want to chat, and thanks very much. Take care of yourselves. [applause]


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