

“Value Is What You Get”

Maintaining perspective as the market bounces around for non-fundamental reasons is key to the success of value investors like Greg Hartz and Mark Millsap.

Ask Mark Millsap and Greg Hartz what sets their Little Rock-based Foundation Resource Management apart from the competition and you’ll get an old-school answer: “We think the price you pay is the primary determinant of the investment outcome,” says Millsap. “You’re not going to find many out there as price sensitive as we are.”

Tight-fistedness has paid off nicely for Foundation Resource investors. The firm now manages \$1.8 billion and since 1990 its equity strategy has earned a net annualized 12.6%, vs. 10.1% for the S&P 500.

Finding deep, if not broad, pockets of value, they’re seeing unrecognized upside today in such areas as fertilizer, insurance, energy services, industrial distribution and marine transport.

INVESTOR INSIGHT



Greg Hartz, Mark Millsap, Tom Hill
Foundation Resource Management

Investment Focus: Seek out-of-favor companies with historical levels of profitability that they expect ultimately to persist despite near-term evidence to the contrary.

Foundation Resource Management

Based in Little Rock, Arkansas, FRM is employee-owned and in the sole business of managing investment portfolios for its clients. As of September 30, 2016, FRM managed approximately \$1.8 billion for more than 200 clients and has a 25+ year track record of serving insurance companies, charitable foundations, hospitals, retirement plans, and high net worth individuals.



401 W. Capitol Ave., Suite 503 • Little Rock, AR 72201
(501) 604-3190 • 1-800-431-8346 • www.frmr.com

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Investor Insight: Foundation Resource

Greg Hartz, Mark Millsap and Tom Hill of Foundation Resource Management describe the heavily cyclical bent to their current portfolio, valuable lessons learned from investing in heavily cyclical stocks, trends in financial reporting that worry them, and why they see mispriced value in Mosaic, Fairfax Financial, Seacor, Diamond Offshore and Wajax.

You often talk about your strategy as an ongoing comparison between price and value. Is it that simple?

Mark Millsap: Straightforward, maybe, but simple, no. People often talk about a company's share price reflecting what it's worth, but there can often be a vast difference between the price you pay and the value you get. A lot of work obviously goes into identifying those discrepancies between price and value. It also requires patience, discipline, a willingness to go against the grain and a long time horizon to best take advantage of them. None of that is easy, but as long as prices tend to be more volatile than intrinsic values, that's where we're going to focus.

Your portfolio today is heavy with cyclical companies, often tied in some way to natural resources and commodities. Have you found that a typical place to look for opportunity?

Greg Hartz: We don't set out just to buy cyclical stocks, but have found over the past 30 years that those stocks can often be more prone to overreaction both on the upside and the downside. In a market like today's where we're finding valuation levels generally high, we believe many cyclical stocks currently provide unique opportunity if you have the stomach for a less-than-smooth ride. As Warren Buffett says, when it comes to returns, if given the choice we'd much prefer a lumpy 15% to a smooth 10%.

MM: I started in the business in 1981, which could not have been a more different environment than we have today. Inflation and interest rates were high and stock prices overall were depressed. The rage in the stock market then was tangible assets, anything that might be an inflation hedge, and energy stocks were as sexy

then as social-media stocks are today. In that market I could buy high-quality consumer stocks like Coca-Cola and General Mills at 8-9x earnings and 5%-plus dividend yields. Today things like high-quality consumer stocks are very expensive so we're looking elsewhere. We'll take what the market gives us.

ON FINDING VALUE TODAY:

Many cyclical stocks are providing unique opportunity if you have the stomach for a less-than-smooth ride.

Stepping back a bit, differences over time in what the market will pay for a dollar's worth of earnings are really pretty remarkable – from single-digit multiples when times are hard to 25x or more when optimism and speculation are running high. We believe we're near the very high end of that spectrum today, with valuations often at levels for which there is very little justification.

In our latest quarterly letter we wrote about valuation levels in the context of "guns and butter," represented by aerospace/defense and food companies. There are any number of companies in those sectors showing little sales growth, modest earnings growth, and EPS growth mostly because of significant share buybacks. Yet valuations have exploded. Raytheon, Lockheed Martin and Northrop Grumman, for example – all of which we owned and have since sold – have seen their P/E ratios go up 80-90% in the past four or five years, during a time when revenues have actually decreased and earnings per share grew 40-55%. We see a lot of that today, resulting in prospective returns we just don't find interesting.

Let's talk about an area you are finding interesting, natural resources.

MM: As a point of perspective, over the last 90 years resource stocks have represented, on average, approximately 13% of the S&P 500 Index weighting. That number today is approximately 6%, which as described in a GMO whitepaper from September is very near the all-time low weighting over the entire 90 years.

What we've seen since 2011 in many commodity markets, and since mid-2014 specifically for oil and gas, are markets going through painful and sometimes drawn-out clearing processes. Production gets way ahead of demand, prices come down substantially, production is cut back, capital spending falls, and supply and demand moves toward a better balance. In oil and gas, for example, you're seeing demand rise as miles driven goes up and overall fuel efficiency goes down because of the types of vehicles being purchased, while production levels have declined for two going on three years. The market is being allowed to naturally clear and we expect that to continue.

It's also encouraging to us as investors that across resource companies you're seeing managements – often newly installed – focus on cost cutting, cash generation, debt reduction and overall financial discipline, which was lacking under old regimes preceding the 2011 cycle peak. Management teams tend to make hard decisions when they have no choice, which has been the case in many resource areas over the last five years.

GH: Exxon Mobil [XOM] is an example of a company we had never owned in our careers until earlier this year. It obviously operates in a cyclical industry, but we consider it one of the highest-quality companies in the world. It's the largest integrated oil company in the U.S., with

a level of diversification and a disciplined capital-allocation approach focused on creating shareholder value that make it resilient through the commodity price cycle. The balance sheet is so strong that it is one of only three U.S. companies rated Aaa by Moody's (Johnson & Johnson and Microsoft are the other two), and they've increased annual dividends 10% per year over the last 10 years. It took oil prices going from \$107 to \$27 for the stock in January to get to a level where we were comfortable buying it, trading at 10.5x ten-year-average earnings per share.

You've been active in precious-metals miners, whose stocks have had a strong run until recently. Is your thesis still intact?

MM: We have large positions in gold miners like Goldcorp [GG] – which trades at a particularly low price relative to our calculation of intrinsic value – Newmont Mining [NEM] and Barrick Gold [ABX], other mining companies like Teck Resources [TCK], and also equipment suppliers to miners like Wajax [WJX:CN].

I mentioned this earlier, but these companies have gone through a five-year adjustment in virtually every part of their business, starting with management. New managements have injected discipline in capital allocation and cost control, focusing on lowering all-in sustaining costs and generating cash. Particularly with respect to gold, the easy reserves have been found, so reserve replacement has been coming down for that reason as well and production will decline in 2016 for the first time in a long while. Again, an example of a market naturally clearing. At the same time, even though share prices have moved a bit, they're still trading relative to the price of gold at about half the 15-year average. That measure in 2008 was four times what it is today.

We're not hearing any mention of guarding against rising inflation or interest rates.

MM: I would say that's there as well, given debt levels around the world and the monetary-policy experiments underway.

We've focused more on the business and industry dynamics, but that these types of stocks can hedge against some negative macro risks is certainly not a bad thing.

We're guessing if we asked about mistakes that some of the biggest would be around misreading a cycle in a natural-resource stock. True?

MM: I guess that would come with the territory in investing in these types of ar-

ON HUMILITY:

As the saying goes in the investment-advisory industry: If you're not humble, you're about to be humbled.

— thank you for asking! One area we missed from a research standpoint was in thermal coal, where we had a position in Arch Coal that we initiated after the stock had dropped 87% in 2012. Here the past was not necessarily prologue and the market didn't clear as we expected. We saw coal prices plummeting and the heavy switching to natural gas as an alternative power source, but we badly underestimated the sustainability of low natural-gas prices and the regulatory challenges facing coal. To make matters worse, we thought in analyzing Arch's balance sheet and its legacy costs that we had plenty of time to ride out the cycle. That was not the case. [Note: It's now public again, but Arch Coal filed for bankruptcy in January, wiping out the equity of shareholders at the time.]

GH: These are the types of mistakes you need to guard against in any highly cyclical industry. Going a few years further back we had another unfortunate experience in seaborne oil transportation, with what is now called Overseas Shipholding Group [OSG]. The industry was struggling in 2010-2011, but we thought the situation looked much like it had in 1999,

with levels of utilization and scrapping rates that indicated we were much closer to the bottom than the top of the cycle. But the primary thing we missed this time was the number of small, mom-and-pop operators financed by European banks that had cropped up, often with three or five or seven boats. That cumulative extra capacity killed the industry when the economy slowed down. And, as with Arch Coal, we underestimated how quickly OSG's balance sheet would come under pressure. That was another lesson on the importance of truly understanding the structure and timing around the debt, not just the nominal amount of it.

MM: As the saying goes in the investment-advisory industry: If you're not humble, you're about to be humbled. Hopefully we learn a thing or two along the way.

You from time to time devote space in your investor letters to accounting issues. What are some top-of-mind ones today?

GH: One is our caution relative to intangible assets like goodwill. Until 2001, when a company made an acquisition at a price above the book value of the assets purchased, the intangible asset created was amortized ratably over a long period. Current accounting treatment doesn't require that, so goodwill is treated like a permanent asset until changes in the related business or industry warrant a valuation adjustment that is expensed. These types of intangibles are not insignificant, accounting for about 63% of the S&P 500's collective book value per share. To give you a sense of the potential risk attached, that percentage fell to the low 50s in the financial crisis as companies took writedowns on assets for which they badly overpaid.

As a practical matter, we tend not to ascribe considerable value to intangible assets and instead favor companies that have higher levels of tangible assets. Our most recent calculation on our equity composite shows a weighted average of intangibles as a percentage of book value of around 30%, half that of the S&P

500. Much of these intangibles come from large, long-term pharmaceutical positions, for which we believe goodwill is a smaller risk because it is offset by significant spending on research and development, which while immediately expensed often provides substantial value for years to come. Excluding pharma positions, intangibles were only 16-17% of our holdings' total book value.

I wouldn't argue our caution relative to goodwill valuations has been rewarded of late. But our history, training and discipline tell us that it one day will be.

At the risk of putting non-accountants to sleep, another risk we've highlighted is the increased prevalence of companies' emphasizing earnings on an adjusted rather than GAAP [Generally Accepted Accounting Principles] basis. Typically, non-GAAP earnings don't include such fairly common things as asset writedowns, closing out business units or acquisition-related adjustments. In the fourth quarter of last year, for example, GAAP earnings were nearly 25% lower than the adjusted earnings reported for the S&P 500. Historically, that gap has been around 13%. It may not be circumstantial that the last time we saw a comparable gap in those numbers was in 2008 immediately prior to the financial crisis.

We will make adjustments when appropriate, but we tend to focus in our analysis of long-term profitability on GAAP earnings and free cash flow. If you're trying to assess a business and management, we don't think it's a good idea to wipe away a number of actual mistakes.

Describe your buy discipline.

MM: We have an active universe of around 600 stocks on which we've done fairly recent research, focused on assessing the companies' normalized levels of profitability and returns. For example, we'll look over at least one or two cycles at the return on equity actually earned and then assess whether the business, management and balance sheet will allow the company to continue to earn at that level over time in the future. If our answer is yes, in most

cases we'll take the normalized historical ROE and divide it by the current price-to-book-value ratio, yielding what we might expect to earn on our investment in that security. If the normalized ROE is 10% and we pay half of book value, we can argue for a 20% expected rate of return. If that same stock is selling at 2x book, we'd expect a 5% rate of return.

We look at other valuation measures as well, based on the history of the company and of its peers, but this ROE-based

ON "SILVER BULLETS":

We combat groupthink by allowing people to stand up for something about which they have great conviction.

approach makes particular sense with cyclical businesses that go through extreme profitability swings, where we shouldn't extrapolate a recent past that might be excellent or terrible. Our hurdle rate to buy is generally a 15% expected annualized rate of return, although we'll take somewhat less for a company, like Exxon Mobil, that we consider of the highest quality. We're sellers when that rate gets into the mid-single digits.

Explain the "silver-bullet" process you have in place for certain buys.

MM: A few years ago after reading Christopher Risso-Gill's *There is Always Something to Do*, a book about the famed Canadian value investor Peter Cundill, we borrowed the concept of giving every member of the investment team a "silver bullet" that they could use once a year to override the group and call for a buy when the current price was above the group's collective buy price. Greg and I have final say only on the size of the position. The idea is to combat groupthink and allow people to stand up for something about which they have great conviction. I'm happy to report that while there have only

been a handful of such selections so far, they've been almost uniformly successful.

What's a recent example?

Tom Hill: Seacor [CKH] is a stock for which I recently used my silver bullet. It's a holding company heavily focused on marine transportation – to offshore energy installations and in inland-river waterways – that is run by one of the most-accomplished players in that industry, Charles Fabrikant. The company's book value plus dividends since 1992 has compounded at better than 12% per year, and Fabrikant has demonstrated a clear ability to take advantage of down markets to make Seacor a stronger competitor when the market turns.

In this case I don't think my perception of the company was much different than the group's, but I thought we could be more opportunistic as the industry downturn entered its more extreme stages and that we should move forward more quickly than others would maybe argue. That has yet to pay off, but to me the thesis is still fully intact.

How many positions do you typically hold at a time?

MM: We usually have 30 to 40 stocks, so the average position size is around 3%, but our largest holding today is about 9% of the portfolio. We think this provides enough diversification, but it also allows us to benefit from our skills and not have to look anything like the market. In a market environment like today's, which we consider broadly overvalued but with some pockets that are very undervalued, that's extremely important.

On the subject of cyclical stocks, describe your investment rationale for fertilizer-company Mosaic [MOS].

GH: Mosaic is a phosphate and potash fertilizer company that was formed in 2004 through the merger of Cargill's crop-nutrient business and IMC Global. Potash and phosphate are two of the three, along with

nitrogen, primary fertilizer ingredients. The company owns mines in the U.S. and Canada, as well as a blending and distribution operation in Brazil, a distribution business in Asia, and a phosphate-mining joint venture in Saudi Arabia.

As you say, this is a cyclical industry, and margins are currently depressed as distributors have been liquidating inventories in the face of less-than-robust demand, which is a function of cyclically low global crop prices. We don't try to call the bottom of any cycle, but the company believes the inventory liquidation has run its course and channel demand is poised

to pick up. Longer-term, we're assuming the combination of increasing global crop consumption and decreasing arable land per capita will drive growth in global fertilizer demand as producers need it to increase crop yields.

One thing that makes demand somewhat more variable is the fact that crop nutrients, particularly potassium and phosphate, don't have to be added to soil every year, making demand even more driven by crop prices. Application can't be put off forever, though, so a longer lull in consumption – such as the one we're currently in – leads to pent-up demand.

On the supply side, about 12% of global potash mining capacity, mostly from China, has been closed down in the last two years. There is some capacity being added in North America and in Russia, but those additions are being offset by mine closures.

Where does Mosaic fall on the industry cost curve?

GH: Once the expansion of one of its Saskatchewan mines is complete next year, Mosaic's cash-cost profile will be roughly on par with Potash Corp. [POT] and Agrium [AGU], and slightly above the state producers in Russia and Belarus. Remaining higher-cost producers in China, Saudi Arabia and South America represent roughly one-third of industry capacity.

How are you valuing Mosaic's shares, now trading at around \$27?

GH: The market tends to value stocks based on the last 12 months and the next 12 months, but for this type of cyclical business we think it's essential to look over a much longer time period. Over a full cycle, the last ten years, we calculate Mosaic's average return on equity at 16.2%. Divide that by the 0.85x multiple of book value at which the stock was trading when we purchased it around \$24 a month ago, and our expected annualized return was about 19%.

That expected return includes the company's dividend yield, now just over 4%, which makes it easier for us to wait for the fundamentals to turn. We think the dividend is safe because it is just about covered by the current level of free cash flow, even in a depressed part of the cycle.

Is the balance sheet built to last?

GH: Net debt to EBITDA is 3.2x, but only about 20% of total debt is due in the next five years. We believe the company has more than enough liquidity, including \$650 million of cash and \$2 billion available on a credit line that runs through December 2021. We're relying on the bal-

INVESTMENT SNAPSHOT

Mosaic
(NYSE: MOS)

Business: Integrated global producer and marketer of concentrated phosphate and potash crop nutrients and animal-feed ingredients for the global agriculture industry.

Share Information (@11/29/16):

Price	27.06
52-Week Range	22.02 – 32.26
Dividend Yield	4.1%
Market Cap	\$9.48 billion

Financials (TTM):

Revenue	\$7.46 billion
Operating Profit Margin	6.6%
Net Profit Margin	5.9%

Valuation Metrics

(@11/29/16):

	MOS	S&P 500
P/E (TTM)	21.6	24.3
Forward P/E (Est.)	30.4	18.4

Largest Institutional Owners

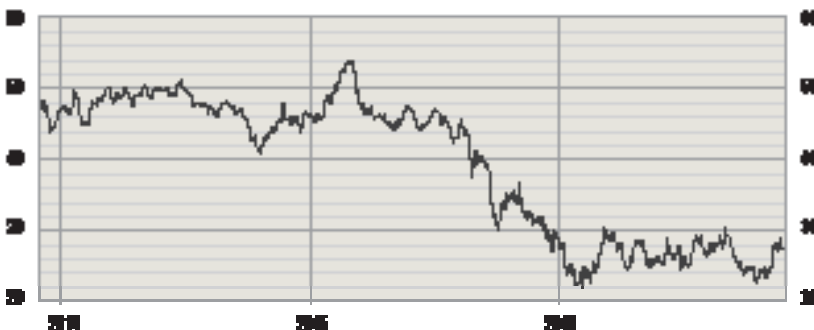
(@9/30/16):

Company	% Owned
Vanguard Group	9.5%
Franklin Templeton	5.4%
BlackRock	4.5%
State Street	4.2%
FIL Investment Adv	3.5%

Short Interest (as of 11/15/16):

Shares Short/Float	11.4%
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MOS PRICE HISTORY



THE BOTTOM LINE

As its end markets go through a clearing process that brings supply and demand into better balance, the company is well positioned and well fortified to capitalize on long-term demand growth for its products, says Greg Hartz. At the \$24 price he paid for the shares recently, he pegged his expected annualized return on the stock at around 19%.

Sources: Company reports, other publicly available information

ance sheet to allow a return to adjusted normalized earnings.

Do you need an even stronger stomach to own contract-driller Diamond Offshore Drilling [DO]?

MM: We don't believe industry conditions have ever been worse than they are currently for Diamond Offshore, and while we can't say the fundamentals won't deteriorate further, we can say they're likely to eventually show vast improvement from current levels. That can make a company like Diamond, with a history of creating tremendous value during down cycles, quite interesting.

The balance sheet is obviously important, and we consider Diamond's the strongest in the industry. Net debt to EBITDA is 3.2x, but only 23% of total debt is due in the next five years, and nearly 60% of debt is not due for more than 20 years. Moody's rates their debt two notches above the next-best competitor.

The company will conclude a fleet upgrade this quarter, which will free up capital going forward. Total capital spending for 2016 is expected to be \$625 million, down about 40% from a year ago. Free cash flow is expected to be positive this year, a remarkable accomplishment given the industry dynamics.

How do you assess the risk that abundant, low-cost shale oil depresses for several years the demand for the higher cost, deep-water exploration that Diamond Offshore supports?

MM: The industry is currently prioritizing quicker-payoff projects, which benefits shale, which has lower upfront costs. But we don't expect that to last. Because deep-water wells are more prolific and the decline rates are lower, aggregate cash flows over the life of a deep-water project can actually be superior to those of shale. With ongoing advances in technology, it is difficult to say which will be most economical in years to come.

Something else to consider is the probability that the incoming administration in the U.S. will ease some of the regulations

put on the offshore-drilling industry following the Macondo oil spill. Any relief on that front would improve the competitive position of offshore drillers, to the benefit of best-in-class service providers like Diamond.

What assumptions are you making about oil prices?

MM: We believe oil prices will rise to a level that will allow state producers in the Middle East to fund their national budgets and avoid civil unrest. At current prices, Saudi Arabia burned about 20% of its

sovereign wealth fund annually in 2014 and 2015. I don't have a point estimate for the oil price necessary, but we believe it is likely to be 30-50% higher than current levels.

People forget that oil-price swoons are normal. Since 1985 oil has declined at least 29% on nine separate occasions. The average rebound one year following the trough was just over 60%, and typically the bigger the fall, the more pronounced the rebound.

How cheap do you consider Diamond Offshore shares at today's \$15.70?

INVESTMENT SNAPSHOT

Diamond Offshore Drilling (NYSE: DO)		Valuation Metrics (@11/29/16):	
Business: Provider of contract-drilling services to the energy industry worldwide with a fleet of 28 offshore rigs; company is majority owned by holding company Loews Corp.		DO	S&P 500
Share Information (@11/29/16):		P/E (TTM)	24.3
Price	15.71	Forward P/E (Est.)	18.4
52-Week Range	14.17 - 26.72	Largest Institutional Owners (@9/30/16):	
Dividend Yield	0.0%	Company	% Owned
Market Cap	\$2.15 billion	Loews Corp	53.3%
Financials (TTM):		Vanguard Group	5.6%
Revenue	\$1.68 billion	BlackRock	4.4%
Operating Profit Margin	22.1%	Dimensional Fund Adv	4.2%
Net Profit Margin	(-43.6%)	AQR Capital	2.7%
		Short Interest (as of 11/15/16):	
		Shares Short/Float	16.1%

DO PRICE HISTORY

THE BOTTOM LINE

While conditions in the company's industry are woeful, says Mark Millsap, its track record, financial strength and shareholder-focused management support the argument that it will prosper as the market cycle improves. Dividing its long-term average ROE by the current price/book value, he expects an annualized return from today's price of some 35%.

Sources: Company reports, other publicly available information

MM: In a very volatile period, over the past ten years Diamond Offshore generated average returns on equity of 22%, posted aggregate earnings of \$55 per share, invested an aggregate of \$65 per share on capex, and paid aggregate dividends of \$38 per share. The shares peaked at \$150 in 2008 and today trade at just 63% of book value. By dividing the average ROE by the book-value multiple, we estimate an expected annualized return of nearly 35% from the current share price.

To add to what I said earlier about value creation, it's a big positive to us that Diamond is guided by such great capital allocators. Loews Corp. [L], which is run by the Tisch family, owns 53% of the company and is well represented on the board. Seacor's Charles Fabrikant, who Tom mentioned earlier, is also on the board. These are people who know a thing or two about navigating through cycles.

From drilling to insurance, describe your interest in a name known well to value investors, Fairfax Financial [FFH:CN].

TH: Prem Watsa built Fairfax more or less from scratch over the past 32 years, and its insurance operations now have 140 profit centers across various property, casualty, reinsurance and specialty lines. All of the company's major insurance operations have combined ratios below 100% – meaning money received in premiums exceeds claims and administrative expenses – and that ratio overall this year is running around 93%. That underwriting record gives us confidence that they know how to manage the insurance cycle.

What particularly distinguishes Fairfax, of course, is its investment activities, which have driven annualized growth in book value from 1986 to 2015 of just over 20%. But while the long-term record is great, the last five years have been terrible, largely because of aggressive hedges Watsa put on in anticipation of what he has called a "50-to-100-year financial storm." We think that's a key reason the shares are cheap, as investors have "withdrawn" capital during a period of

underperformance. We take the opposite position, that the best time to invest with successful value investors is when they are underperforming, not when they're beating the market.

Haven't there been some pretty big moves in the portfolio of late?

TH: Two big things have happened. One, between the end of the third quarter and prior to the U.S. election, Fairfax sold 90% of its long-dated Treasury securities due to Watsa's belief that a significant increase in deficit spending will drive interest rates higher. Two, following the election Fairfax reduced hedges – that primarily short

the Russell 2000 Index – from 112% of equity exposure to 50%. While that's certainly a large reduction, the remaining hedge on the equity portfolio is still a sizeable insurance position against a market downturn. The portfolio now stands with around \$10 billion in cash and short-term investments, roughly 35% of the total. These moves haven't changed our investment case for the stock, but we're closely monitoring how the investment portfolio is changing.

The shares at a recent C\$637 are off around 18% from their 52-week-high in February. How are you looking at upside from here?

INVESTMENT SNAPSHOT

Fairfax Financial
(Toronto: FFH:CN)

Business: Canada-based property/casualty insurer and reinsurer that differentiates itself through CEO Prem Watsa's active, value-based investment of its insurance "float."

Share Information

(@11/29/16, Exchange Rate: \$1 = C\$1.343):

Price	C\$637.0
52-Week Range	C\$587.51 – C\$780.13
Dividend Yield	2.3%
Market Cap	C\$15.25 billion

Financials (TTM):

Revenue	\$9.97 billion
Operating Profit Margin	7.2%
Net Profit Margin	2.9%

Valuation Metrics

(@11/29/16):

	FFH:CN	S&P 500
P/E (TTM)	59.7	24.3
Forward P/E (Est.)	18.5	18.4

FFH:CN PRICE HISTORY



THE BOTTOM LINE

While over time the company has distinguished itself through its investment activities, the record on that front in the rising market over the past five years has been "terrible," says Tom Hill. He argues that is the best time to invest with successful value investors, and estimates an expected annualized return for the shares from today's level of around 16.5%.

Sources: Company reports, other publicly available information

TH: The shares trade at just 1.1x book value, and the ten-year average return on equity is around 18%. That gives us an expected return of 16.5%, which is especially attractive given who is at the helm and invested alongside us. Prem Watsa still owns 8% of the company, with a voting interest above 40%.

You mentioned earlier Wajax, a smaller-cap company that distributes industrial equipment in Canada. Why do you consider its shares attractive?

MM: The company is the largest multi-line distributor of industrial equipment, power systems and industrial components in Canada. It sells, rents and services

things like heavy trucks, cranes, forest-harvesting equipment, pumps and power generators, primarily to the mining, energy and forestry industries. It's been in business for 158 years and has a network of some 125 branches across the country that handle well-known brands including Hitachi, Hyster, Yale, Tigercat and JCB.

Given the weakness in its end markets, the company's earnings have fallen sharply from their peak in 2012, but management has done an excellent job of streamlining the cost base and benefitting from strong service and after-market-parts businesses. In the latest quarter free cash flow was both positive and flat with the prior year, an accomplishment given the more challenging economic environment.

So the story here is really quite similar to what we've already talked about. End markets are bad, but won't be permanently, which seems to be what the market is pricing in. If in such a situation we're comfortable with the quality of management and the balance sheet, that can provide opportunity.

What flexibility does the balance sheet provide?

MM: The company issued stock last year to reduce leverage, and they have continued to pay down debt. Net debt to capital is 35% and net debt to EBITDA is 2.7x. Total debt today is about \$150 million, maturing in August 2020.

Management says it has capacity to spend up to \$100 million for potential acquisitions and is targeting engineering, repair and services businesses. The prices paid obviously matter, but we like the strategy and believe the balance sheet can support it, especially with the overall business generating free cash flow.

What kind of return are you expecting from today's C\$24.20 share price?

MM: The stock trades at about 1.7x book value, with a 4.2% dividend yield. The dividend is currently fully covered by earnings and we expect it to be maintained. Dividing the price-to-book multiple by the ten-year average ROE of 26.4% provides an expected annualized return on the stock of about 15%.

One challenging aspect of any consistently applied investing approach like that of value investors is that there can be relatively long periods where you look out of touch. Even over rolling five-year periods, a great long-term investor might underperform 40% of the time. How do you think about that?

MM: The last five years in particular we've had a hard time keeping up with the market, in no small part because our cash – now around 20% of the portfolio – has been a deterrent to outperformance, as it

INVESTMENT SNAPSHOT

Wajax

(Toronto: WJX:CN)

Business: Sells, rents and services equipment, power systems and components to natural resources, industrial, construction and manufacturing customers in Canada.

Share Information

(@11/29/16, Exchange Rate: \$1 = C\$1.343):

Price	C\$24.22
52-Week Range	C\$13.34 – C\$24.90
Dividend Yield	4.2%
Market Cap	C\$484.2 million

Financials (TTM):

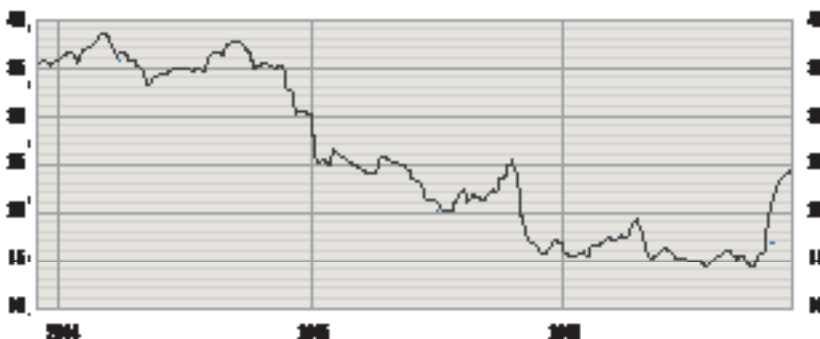
Revenue	C\$1.23 billion
Operating Profit Margin	2.6%
Net Profit Margin	(-2.5%)

Valuation Metrics

(@11/29/16):

	WJX:CN	S&P 500
P/E (TTM)	n/a	24.3
Forward P/E (Est.)	23.3	18.4

WJX:CN PRICE HISTORY



THE BOTTOM LINE

Its customers have been suffering cyclical downturns, but the company has been in business for 158 years, generates free cash flow and has the financial flexibility to reinforce its market positions through acquisition, says Mark Millsap. Assuming a return to normalized profitability, he pegs the expected annualized return on the stock at about 15%.

Sources: Company reports, other publicly available information

is for any active manager in a bull market. None of this shakes our conviction in what we're doing.

We know there will be times when we appear smarter than we are, and there will be times when hopefully we're smarter than we appear. But over time with a consistently applied approach we have compounded the portfolio at above-average rates of return and believe that if we stay disciplined we can continue to compound that way in the future. That mindset is of great benefit to us through the ebbs and flows of what works and what doesn't.

As a bit of an aside, we had let cash build to a similar level to today prior to the 2008 crisis, to a somewhat uncomfortable extent for some clients who understandably were concerned that we were leaving money on the table by not being

fully invested. We held firm and were glad to have the cash when we saw bargains like we'd never seen before in the fourth quarter of 2008. At that time we sent a

ON THE ELECTION:

We're not counting on it yet, but we're hopeful better economic growth provides a tailwind we've been missing.

note to our investors suggesting they send us more cash, and I think three of our 140 or so clients did. It's hard to make those calls, but we think it's something our clients pay us for. While our cash level hasn't

made us look smart lately, in this market we're glad to have it.

We can't not ask about the election. From a portfolio-manager's perspective, how are you processing the results?

GH: We'd argue it's too early to draw any actionable conclusions. But no matter what type of stock investor you are, economic growth is a wind at your back and helps cover up mistakes. The growth rates we've had since the financial crisis haven't provided that favorable backdrop. We're not at all counting on it yet, but we're hopeful better economic growth provides some of that tailwind going forward that we've been missing for some time. VII

Foundation Resource Management

Disclosure

Definition of the Firm: Foundation Resource Management (FRM) is an independent investment adviser registered under the Investment Advisers Act of 1940, founded in 1992, headquartered in Little Rock, Arkansas, and manages equity, fixed-income, and balanced portfolios.

Policies: Additional information regarding these results, fees and compensation, policies for valuing portfolios, and calculating performance are available upon request. Please email info@frmlr.com or call 501.604.3190x3.

FRM Value Equity Strategy Description: An investor in this offering should have a long-term investment horizon. FRM's Equity Composite is an all-capitalization, value-focused, long-only stock offering. It invests predominately in mid- and large- capitalization companies, yet it has no restrictions on what size company in which it can invest. The portfolio managers use bottom-up fundamental analysis based on value investing principles to identify potential investments trading below the portfolio managers' view of the stock's intrinsic value. The offering focuses on capital appreciation while seeking to minimize the permanent loss of capital. Because of the size and value-driven characteristics of the portfolio's holdings, performance can vary from the broader stock market.

FRM Equity Composite Description: The FRM Equity Composite represents those accounts following the FRM Value Equity strategy. The composite was created on September 30, 1990. The Equity Composite performance is comprised of all equity portfolios managed by Greg Hartz from 9/30/1990 to 12/31/2001. From 1/01/2002 to present, the composite performance includes all equity clients managed by Foundation Resource Management. The performance referenced in this article is from September 30, 1990 through September 30, 2016. This performance is net-of-management fees. For additional fee disclosure information, please refer to the Fees Section provided below in this disclosure.

Performance Measurement: The composite's valuation and performance is computed using a time-weighted calculation of quarterly performance. Clients do not participate in an automatic dividend reinvestment program; however dividends and other earnings are reflected in Composite performance. Valuations are computed and performance is reported in U.S. dollars. Past performance is not an indicator of future results.

Benchmarks: The Standard and Poor's 500 index is a capitalization weighted index of 500 stocks, and it is designed to measure performance of the broad economy through changes in the aggregate market value of stocks representing all major industries. The S&P 500's returns are based on monthly value and performance taken from public sources. The returns for the index do not include any trading costs, management fees, or other costs. It is fully invested and includes the reinvestment of income. The index is not investable.

Fees: Gross-of-fee returns are presented before investment advisory fees but after all brokerage commissions. The client's actual return will be reduced by the advisory fees and any other expenses

Foundation Resource Management

Disclosure (continued)

incurred in the management of the account. Net-of-fee returns are presented net of model fees and are derived by deducting the highest applicable investment advisory fee rate in effect for the respective time period from the gross returns each quarter.

Fee Schedule: FRM's investment advisory fees are described in Part 2A of Registrant's Form ADV. The following is a representative example that shows the effect an investment advisory fee could have on the value of a client's portfolio:

For a \$1,000,000 initial equity investment, the total investment management fees for an account that experiences a 6% annual compound return are: One Year: \$10,320 Five Years: \$53,400

For a \$1,000,000 initial fixed income investment, the total investment management fees for an account that experiences a 6% annual compound return are: One Year: \$3,610 Five Years: \$18,690

Closing Comments: It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities discussed in the article. Economic and market conditions may have changed and FRM's views regarding the prospects of any particular investment may have changed. FRM does not assume any duty to update any information in this article and no representation is made with respect to its accuracy on any future date.

