LEWIN CAPITAL MANAGEMENT LTD.

January 30, 2017

Dear clients and friends,

Re: LCM Annual Letter December 31, 2016

In LCM's ninth annual letter I will provide a brief overview of key events in the markets in 2016, review our results and discuss our disciplined approach.

Year in Review

There was a lot of optimism in the markets this year – stock prices rose despite high levels of uncertainty. The UK vote to leave the EU surprised many and weakened the pound, but the UK stock market marched on to new highs. Similarly, uncertainty caused by Trump's election win did nothing to dampen investor enthusiasm – stock prices in the US and Canada have continued to rise since November 8th. Even the Federal Reserve raising interest rates was greeted as good news by investors. Optimism was not limited to stocks, as commodities and junk bonds also rose. It was a year characterized by shifting politics across the globe and a willingness to accept risk by many investors.

In Canada, for most of the year, the market breadth was narrow and the rise in stock prices was enjoyed by only a few. The top 10 best performers were all resource companies and of these, 8 had leveraged balance sheets. These companies started the year under pressure from their lenders, but once it appeared the global economy might skate them onside, the risk of insolvency faded and the stocks rose dramatically. Gains broadened out in both Canada and the US following the Trump win. For a long-term investor, party politics typically do not significantly impact investment decisions because a party that veers far right is often replaced by one that veers left, and over the long run the impacts tend to cancel each other out. The Trump situation could be different. It appears he may use his position to single out and influence industries and companies directly, making politics more important, and the identification of winners and losers much harder to determine. Although lower taxes should benefit business, US trade policy is tremendously impactful to the global economy and is the wild card on every investor's radar as Trump comes to power.

In terms of research and portfolio activity, in 2016 I interviewed the senior management of 25 companies, conducted 2 plant tours, and travelled to Calgary, Toronto and Omaha in search of new ideas. We sold one business, made opportunistic purchases of an existing holding, and found one new idea. Our new investment is a well-managed company, with dominant brands and the best balance sheet in its industry. We purchased an initial position with room to buy more as this industry looks like it may take some time to bottom. These transactions reduced our cash position to 41% at year end, down from 47% one year ago. We will continue to deploy our capital with the same patience and discipline we have had since inception and we are confident that the market will offer up more opportunities.

Results[i]

This year we earned a return of 4.6%. This return is below our long-term goal to earn in excess of 7% per year and lagged market averages. Our disciplined approach to investing

caused us to take a cautious approach to the resource sector, which is what contributed to the bulk of the returns in the Canadian market. Canadian stocks were up 21.1% and the U.S. stock market rose 8.5% in Canadian dollars (up 12.0% in local currency). In terms of attribution, this year we had 2 strong performers and 2 weak performers. Both strong performers were helped by earnings growing ahead of expectations and a modest increase in valuation multiples. As for the weak performers, we sold 70% of one in 2015, and in hindsight should have sold it all. We sold the other poor performer during the year (for about what we paid for it in 2010), as it became apparent that it may begin to face some secular decline. Outside of these 4 positions, while the business fundamentals continued to advance for the rest of our portfolio, the stock prices did not move much. This can happen in any given year which is why it is important to evaluate an investment strategy over a longer period of time.

Over the last 5 years LCM has earned a return of 17.7% per year, which beat a simple average of the Canadian and US stock markets by 3.0% per year. The 17.7% return was earned with 31% of the portfolio in cash on average thus the invested portion of the portfolio earned roughly 26% per year over this period.

Since it was founded in 2008, LCM has earned a cumulative total return of 218.7%, or 14.6% per year on an annualized basis. Said differently, $100 invested at LCM when we opened our doors before the financial crisis in mid-2008 is worth roughly triple that amount today. We have accomplished our long-term goal to earn in excess of 7% annually, and LCM has beaten the market by 6.4% per year relative to a simple average of the Canadian and US stock markets since inception. We are pleased with these results and view them as a product of our patient and disciplined approach.

LCM's Disciplined Approach

In past letters I've written that our "narrow and deep" approach inevitably means that we will not always own what is "hot" and indeed, sometimes it may appear that the action is passing us by. 2016 felt like one of those years. We did not benefit from the few big winners in Canada because many of these businesses were levered resource companies and this type of business typically does not meet LCM's quality threshold due to the real potential for permanent capital loss. In addition, a rosy outlook for China is an important prerequisite for sustainable gains in most resources, as China currently accounts for up to half of global resource demand. In our opinion emerging signs of a debt bubble in China warrant a cautious approach to this sector.

One of the confounding things about the optimism prevailing in markets over the past few years has been the difficulty in finding decent quality companies to buy at reasonable prices. In 2015 I interviewed the senior management of 9 high quality companies in the energy industry in search of value. These companies were all low-cost producers with reasonable balance sheets and because oil and gas prices were down and the street was pessimistic, it seemed like a good place to look for opportunity. Despite some aggressive assumptions about the future, and faith in management, I was unable to find a margin of safety in the equity of any of these companies.[ii] Using the most attractive of the nine companies as an example, despite being significantly off its high, the stock was still trading at about a 40% premium

above my estimate of fair value. The CEO of this company had seen many cycles and was (in my opinion) an excellent allocator of capital. When I interviewed the CEO, he explained that he believed buying back his own stock with his cashflow didn't make any sense at current prices, and neither did buying any of the competitors. This was congruent with my own calculations. Instead of buybacks or acquisitions, all of the cash gets reinvested (i.e. goes back into the ground to develop new resources), which is what is assumed in the calculation of fair value. Ten years earlier, this same CEO was able to buy competitors for one quarter to one third of an estimate of fair value, using a similar valuation framework. This sounds about right given the attributes of this business. What this example demonstrates is that sometimes valuations remain out of whack for a while, and discipline is required to wait until values are attractive.

While having a disciplined approach may seem to hold you back from time to time (particularly in hot markets), it is a key component to avoiding permanent capital loss. This approach means ensuring that each new investment is attractively valued and meets a minimum standard for quality. Discipline is what limits the downside when the environment changes unfavorably, or when you make a mistake. Because the gains from one year compound on the gains from the next, avoiding large losses is critical in a successful long-term investment philosophy.[iii] LCM's long-term track record is a function of this process.

With all that said, thankfully we were able to find some pockets of value to put more capital to work in 2016. We took advantage of the opportunity to purchase more of an existing holding for about half of our estimate of fair value and this is now our largest position. Also as mentioned, we identified one new idea in an industry we first started studying in 2014. After a few avenues of research didn't bear any fruit, we shifted our focus within the sector and ultimately were able to identify and purchase an initial position in April of 2016. This company has dominant brands and the best balance sheet in its industry. Given the quality of this business, and a track record of excellent capital allocation, we hope to be able to own this business for many years. We expect that we will get more chances to increase this position in coming quarters. It may take several years to realize, but these investments should help us accomplish our long-term return goals, and because they were identified in the context of our disciplined framework, the downside of both investments is limited.

What can clients expect going forward?

In every letter we caution that losses on an annual basis are unavoidable from time to time. Despite conservatism, rigorous due diligence, greater selectivity and the ability to hold cash, investing in the stock market entails enduring some bleak periods along with the good ones. Given that owning shares in a company is analogous to being a part owner of a business, just as no business owner can expect to increase their net worth in a straight upward line, neither can an investor in stocks. Despite this fact, investing remains one of the best ways to protect and grow one's capital. Being emotionally prepared in advance for the inevitable setbacks that will occur, and considering one's investment results over the long term, are useful ways to stay the course and reap the rewards that the market can offer. Although we expect our performance to be different from the market from year to year, we continue to anticipate generating returns in excess of 7% annually over the long term.

I wish you all the best for 2017. If you have any questions please call me at 604-558-0070.

Sincerely,

Daniel Lewin CFA
President

P.S. We are grateful for referrals to friends where our approach might resonate. Due to our segregated model we have minimum of $5 million in investable capital for new clients.

[i.] All stated returns are gross of fees. We take pride in ensuring that our fees are fair and reasonable for the service LCM provides. If you would like a copy of LCM's Investment Management Agreement that outlines our fees and services in more detail please contact us. Returns for LCM are from a representative account as all client assets are held on a segregated basis. Small differences will occur between accounts due to rounding and the timing of cash flows. The S&P TSX Composite Total Return Index is used to represent the Canadian stock market returns, and has returned 3.7% per year over the eight and a half years ended December 31, 2016. The S&P 500 Total Return Index translated into Canadian dollars is used to represent the U.S. stock market returns, and this index has earned 12.8% per year in Canadian dollar terms over this same period. Thus LCM's total portfolio return of 14.6% per year has beaten the Canadian and U.S. Stock Markets by 10.9% per year and 1.8% per year respectively since inception. "Since inception" refers to the eight and a half year period from June 30, 2008 to December 31, 2016.

[ii] The term "margin of safety" first appeared in Benjamin Graham and David Dodd's book, Security Analysis (1934) and was later discussed in greater detail in Graham's often cited book, The Intelligent Investor (1949). The basic idea is that when making an investment, there should be an excess of calculated intrinsic value over the price paid. This is to limit the potential for a permanent loss of capital. According to Graham, "the function of a margin of safety is, in essence, that of rendering unnecessary an accurate estimate of the future." A margin of safety is what distinguishes an investment from a speculation.

[iii] A great investor friend of mine gives the following quiz to his clients: Two managers performed as following over four years Manager A: +30%, +30%, +30%, (-40%), versus Manager B: +8%, +8%, +8%, +8%. Who is better off? The answer is manager B, by avoiding the large losses. The order of the returns doesn't matter as investment returns over time are geometrically linked rather than arithmetically. Here is the calculation of the value of $100 invested with Manager A: $100x1.30x1.30x1.30x0.60 = $131.82. Manager B: $100x1.08x1.08x1.08x1.08 = $136.05.