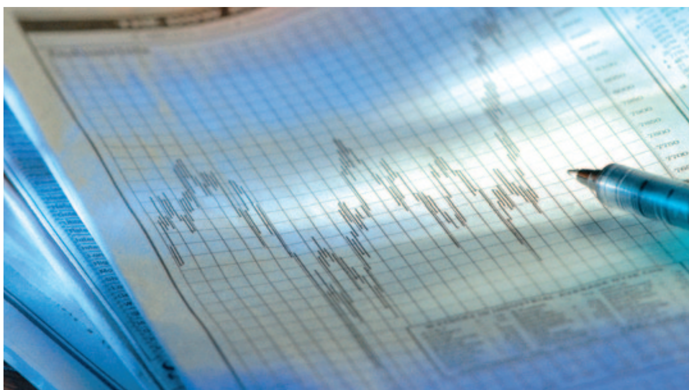
GFI Investment Counsel Ltd.
Preserving and growing family capital™

GoodQuarter Q2'17



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"We are paying 100 times earnings for something whose earnings aren't going up … now that is a terrible, terrible investment,"

— Warren Buffett, CNBC interview with Becky Quick weekend of May 5th, 2017, with regards to holding cash.

Dear Valued Client,

The first half of 2017 was a period marked by strong returns for GFI's clients. Equities held in client accounts have increased roughly 12% over the past six months, while fixed income securities increased by approximately 3.5%. The annualized rate of return achieved by our equities over the past six years of approximately 18% is likely not sustainable over the long term. The type of high-quality, publicly traded businesses that GFI selects for client accounts generally return 8% to 12% annually and, while we are very pleased with the returns our holdings have generated, we know that an inevitable period of lower returns will occur at some point in the future.

As we have discussed many times in the past, investors must make hay while the sun shines. Periods of strong returns more than compensate for inevitable periods of volatility that occur from time to time. In aggregate, as long as investors have the fortitude to withstand some ups and downs, attractive long-term rates of return are achieved through holding quality businesses over long periods of time.

On July 1st, GFI celebrated 10 years as a licensed investment manager. As in any business, days are filled with challenges to overcome and moments to celebrate. We have been privileged to meet and work with incredible people and we are humbled by the support and encouragement we receive from our clients. Thank you again for your continued support and we continue to ask that you reach out to us to discuss anything at all. We are always available to talk.

Daniel Goodman, CFA
President and
Chief Executive Officer

Effie Wolle, CFA, MBA
Chief Investment Officer

P&G

Revisiting a sale from the summer of 2015

In the spring of 2015, GFI sold all client shares of Procter & Gamble Co. ("P&G"). In our newsletter after the sale, we wrote:

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The Buy Side

GFI recently sold Procter and Gamble Company ("P&G") shares for client accounts and purchased shares of Precision Castparts Corp. ("PCP"). We have been focused on the long-term trends at Procter and Gamble, and were not confident about the direction of this company. To use the last quarter as an example, four out of five of P&G's key segments had volume decreases. The Beauty, Hair and Personal Care segment, represented by such brands as Head & Shoulders, Old Spice and Cover Girl, had a volume decrease of 5%, with the company's performance in developed countries the weakest. The company's Health segment, which includes Crest and NyQuil, also saw negative volume growth. Lastly, even the company's Baby and Feminine product lines saw volumes decrease 2%. We believe these trends, which are most acute in the developed world, point to increased competition and a consumer that is slowly becoming more comfortable with generic brand alternatives. We ultimately decided that we would prefer to use the capital we had invested in P&G to put into a business with greater potential for earnings growth.

As mentioned, P&G was replaced with Precision Castparts Corp. PCP manufactures investment castings and forged components for the aerospace, industrial turbine and defense industries. Put simply, PCP provides components for jet engines and other critical aircraft components that have extreme performance requirements. Given the stringent requirements for the parts and Federal Aviation Administration regulations, aircraft manufacturers and aircraft operators often choose from one of two qualified manufacturers for these highly engineered components and, thus, the business has limited competition and high barriers to entry. A significant portion of PCP's revenues come from long-term contracts and although prices fluctuate based on the pass-through costs of metals and alloys, the company's margins have been remarkably consistent over long periods.

The Chief Executive Officer of PCP worked for many years on the plant floor and understands the business extraordinarily well. He consistently finds ways to cut operational costs, has credibility with his staff and an excellent track record. We look forward to being shareholders of PCP for years to come.

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A recent *Wall Street Journal* article highlighted that Gillette, a unit of P&G, saw its share of the men's razor industry fall from 70% to 54% between 2010 to 2016. In response, Gillette has lowered prices on many of its products, an ominous sign in the consumer packaged goods industry.

The impact online retailing is having on the purchasing habits of consumers is astonishing. In addition to shoppers ordering more products online, brand affinity is eroded as websites market their own products, while newer and cheaper brands that don't have the overhead associated with old business models impact traditional products and distribution channels.

Historically, P&G created or purchased brands that grew annually through slight price increases and volume gains. This centuries-old model is shifting, and investors who are not paying attention are overpaying for companies whose prospects aren't what they once were. One of P&G's main competitors, Unilever NV, bought Dollar Shave Club, Inc., a relative newcomer to the razor industry with a direct-to-consumer business model and lower prices. While the price Unilever paid seemed expensive at the time, we believe this purchase will make strategic sense for the company over the long term.

"Diworsification"

Stay focused

GFI maintains an ongoing watch list of high-quality companies that we do not own but continue to study and learn about regularly. To be prepared for future opportunities, we follow these companies' financial performance and developments closely, in case we find an opportunity to become shareholders.

We were recently reviewing three companies on our watch list: Gartner, Inc., Stericycle, Inc. and Verisk Analytics, Inc. If you would have asked us a few months ago, we would have spoken admirably of these three companies. Given recent acquisitions by these companies, however, we were disappointed to find that our desire to invest in Gartner, Stericycle and Verisk Analytics has decreased significantly.

Stericycle, a medical waste management firm, purchased document destruction firm Shred-It International Inc. Gartner, an information technology and software research company, bought a human resource solutions company called CEB Inc. Verisk Analytics, a provider of critical data to insurance companies, purchased Wood Mackenzie Limited, an information and consulting company focused on the oil/petro-chemicals industry.

Both Stericycle and Verisk, which made their acquisitions in late 2015, have suffered from the underwhelming performance of their acquired businesses. Verisk acquired Wood Mackenzie just as oil prices were crashing. Stericycle's acquisition of Shred-It, a business already in decline, has been destroying shareholder value practically from the date of purchase. Gartner, an extremely profitable and fast-growing company, purchased a significantly lower-quality business in an unrelated field. In fact, the three acquisitions made by these companies were all largely unrelated to their core competencies.

These acquisitions have all been disappointing. Rather than shareholders being able to own a singular business ranked amongst the best in the world, shareholders must now tolerate a significant dilution of quality if they want to own these companies today.

Businesses that generate strong returns in one industry often find it hard to resist the seduction of expanding the empire lorded over by management. Peter Lynch called this process "diworsification," and it captures perfectly what's happened over the past few years at these once-fine businesses.

Our portfolio contains many businesses that are very acquisitive. That in itself is not a problem, as our portfolio companies restrict their acquisitions to the same narrow industries in which they have expertise and can attain strong synergies. The one exception to this is Berkshire Hathaway Inc., a large conglomerate run by Warren Buffett that owns everything from railroads to utilities, from GEICO General Insurance Company to candy shops. Given its decentralized structure, Berkshire Hathaway has been an exception to the rule that diversified conglomerates tend not to perform very well.

The businesses we own or have owned, such as Canadian National Railway Co. and Whistler Blackcomb Holdings Inc., have provided such attractive rates of return specifically because they hold wonderful assets and stay focused on their core business. We will continue to differentiate businesses by their capital allocation and ensure that they build, rather than destroy, shareholder capital for our clients.

GFI Investment Counsel

GFI Investment Counsel ("GFI") provides tailored investment portfolios to families, foundations, trusts and corporations. We work closely with our clients to customize investment accounts that coincide with our clients' unique requirements. GFI focuses on preserving and growing client capital through intense due diligence, focus, and discipline.

In January 2008, GFI launched Good Opportunities Fund ("the Fund"), an alternative investment fund available to accredited investors. The Fund focuses on a select group of investment opportunities that provide an attractive risk/reward dynamic regardless of asset class or market capitalization. The Fund is managed with a focus on understanding the businesses, their capital structure, and risks and opportunities.

For more information about GFI Investment Counsel or the Good Opportunities Fund,
please call **416.488.8825** or **email info@gfiic.com**.

GFI Investment Counsel Ltd.

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