I officially started at Investors Management Corporation (IMC) on January 1, 2016 after working alongside Quinton Maynard at Morehead Capital Management for the prior five years. At Morehead Capital I worked on several endeavors, including public market investing, private equity investing, and a period working inside of one of our portfolio companies. While these experiences were valuable, my passion lies with public market investing. I feel very fortunate that Quinton has given me a chance to contribute to IMC within this domain as Public Securities Manager.

My job is to manage a portfolio of public market investments for IMC with the goal of producing high absolute returns on your capital. While my business does not sell goods or services, it should be held to similar standards as the other subsidiaries of IMC. My goal is to operate in a way that gives IMC a competitive advantage in the public markets, and hopefully one that is simple to understand and sustainable over the long-term. Over time markets will change, unexpected world events will occur, and the portfolio five years from now may have entirely different securities than today. However, the underlying philosophy and core tenets should remain the same. In this initial annual letter, I will outline the foundation of my approach to investing your capital and why I think it should give us a high likelihood of success over time.

I – Core Tenets:

Public & Private

Core to my approach is to connect the private acquisition efforts of IMC to my daily activities investing in the public markets. On the surface the two endeavors may seem entirely different. While many who operate in the public markets view stocks merely as pieces of paper and quotes bouncing around on a Bloomberg screen, at IMC we literally view a stock as a fractional ownership interest in a business. IMC is a conglomerate, with the principal model of using the cash generated from existing subsidiaries to fund the acquisition of additional privately held businesses. As an extension of that effort, ***I view my portfolio as a "conglomerate" of minority interests in exceptional subsidiaries that happen to be publicly listed***.

The medium in which I buy the stakes is different, but the underlying process and philosophy are linked. I make investments based on bottom-up company research, not macroeconomic forecasts or attempts at timing the market. I focus on the underlying economics of a business and the long-term trajectory of earnings, not the recent fluctuations in the share price. However, when I decide to buy or sell a stake in a company I punch in numbers on a computer screen rather than contracting over months' worth of documents.

On any given day if you are walking around the IMC office and we haven't met before, don't attempt to track me down by looking for the guy surrounded by monitors with CNBC blaring. I've got my head down doing the same fundamental company and industry analysis as everyone else at IMC, likely buried in annual reports, trade journals, and newspapers.

Concentration

For the public portfolio I believe a collection of five to ten core holdings strikes a good balance of sensible diversification while still allowing the subsidiaries to produce results that can move the needle. While this level of concentration is unconventional amongst most public market investors, I believe it is reasonable when compared to IMC's private investing efforts. Historically IMC has owned between three and six private businesses at any point in time. For a privately held corporation with controlling ownership in each subsidiary, three to six subsidiaries that operate in different industries and in different geographies feels prudently diversified. For many years IMC was 99%+ concentrated in just one business (Golden Corral), so it is nice to have a broader portfolio.

As a thought experiment, imagine a regulation was passed that required IMC to immediately own a minimum of 100 different private businesses. This requirement would be a tremendous detriment towards our efforts to compound capital. First, in order to hit the quota we would have to buy companies we don't understand very well with minimal time studying each acquisition. Second, we have very specific criteria for the types of businesses and people we like to work with, and finding 100 that fit the profile is highly unlikely. Finally, even if 10 or 20 of the businesses produced incredible results, each would be such a small contributor that collectively IMC would only be capable of producing results slightly better than your average enterprise.

While that scenario sounds impractical when applied to private businesses, it is exactly how most public market funds operate. The average mutual fund owns 145 stocks, and many investment funds own 200 – 300 positions. This extreme diversification essentially guarantees mediocre performance. At IMC we have zero interest in average results.

We invest in this concentrated manner only because I am fanatical about investing and have built my entire lifestyle around the goal of producing excess results. We currently own seven businesses in the portfolio because each one requires hundreds of hours of research, which I do personally using primary information and without input from other analysts. We aren't "trading stocks", we are acquiring stakes in businesses and bring the same level of analytical rigor to the public markets that we do in diligencing our private acquisitions.

In my five years working for IMC and Morehead Capital, there have been three years with zero private acquisitions and five purchases completed in the other two years. This is an unusual cadence for many, but it fits with our belief that great investments are rare and when we find one the best move is to allocate a decent chunk of capital behind it. My expectation is that investments in new public companies will follow a similar uneven pattern because great opportunities are infrequent and unpredictable.

Intrinsic Value

I view the daily price fluctuations of publicly-listed businesses as a benefit to the long-term oriented investor. Each business day I receive a price quote on the companies I own and follow, and often this quote fluctuates dramatically. However, I do not look to these price quotes to determine how much the company is worth. Instead I focus on the intrinsic value of the business, which is equal to the present value of cash the company can produce over time. Occasionally the price quote diverges significantly from the underlying intrinsic value, enabling the opportunistic purchase of an excellent business.

To illustrate this concept, imagine your family and three other families decide to partner up and acquire a dream beach house for $1 million. Each family will contribute $250,000 towards the purchase price, owning 25% of the property and entitled to 13 weeks of use. Over your twenty years of joint ownership the surrounding area appreciates nicely at a 3% annual rate, and the property is now worth approximately $1.8 million with each quarter stake valued at $450,000. This is a pattern that many privately held companies also follow, where a business with attractive characteristics in a growing industry steadily increases intrinsic value over time.

But, what if the partnership agreement contained an unusual provision where each of the partners had to list the price at which they would buy another family's 25% interest or sell their 25% stake ***each and every day?*** The day-to-day price quotes will likely vary dramatically, and often they will have no connection to how much the house is actually worth.

For example, during a perfect summer vacation when the economy is roaring and you are building life-long memories with your family, you may have zero desire to relinquish your share of the property. However, to comply with the agreement you must submit a price, even if you hope no other family accepts it. Accordingly, you write in a sell price at $1 million for your stake, implying the house is "worth" $4 million on that particular day. Conversely, on a cold winter day when finances are tight and your kids are approaching college, the notion of selling your stake may sound quite appealing. Practically begging that another family accepts your offer, you submit a quote of $150,000, implying that the house is now only "worth" $600,000. While the actual value of the house was on a steady march towards $1.8 million over decades, this example shows that the day-to-day quotes can vary dramatically for a host of reasons.

This beach house example may seem extreme, and would certainly add a layer of unnecessary stress to a vacation property, but it is very similar to the dynamics of the public markets. The underlying businesses typically trend in a fairly stable direction, especially businesses with the competitive position, economics, and attributes that we look for. However, the prices quoted to buy and sell a stake each day can be all over the map. ***This is my favorite aspect of public investing, because if I am patient and think independently, occasionally I can swoop in and pick off an interest in a dream beach house when the owner is desperate to sell for one reason or another***. Our goal is not then to immediately flip the stake, but instead to own the asset and participate in the underlying appreciation over the long-term.

Daily price fluctuations can be a gift or a curse depending on how an investment operation is set up. If I was glued to a monitor watching prices fluctuate all day, I would begin to forget that I'm acquiring actual businesses. I may drift into trading too frequently, or attempting to predict where the quote is trending rather than focusing on the underlying business. As Ben Graham and Warren Buffett have pointed out numerous times, the best part of these daily quotes is that they can be easily ignored. If you are happy with the business, and have no interest in adding to your stake or selling a piece at the offered prices, you can simply defer and check back in another time.

Variant Perception

Great investments require both the initial filtering of business characteristics along with a "*variant perception*" where our insights diverge from the crowd somehow. My starting place is to assemble a list of companies that have attractive economics, favorable growth prospects, and first-class management teams. This narrows the vast investment universe down to a more manageable group of companies to study with depth. Is my investment strategy simply to invest in that curated list? Not quite.

If I am buying a piece of a business at a price I think is attractive, on the other end someone is exiting the business because they find the sell quote appealing. To be in a differentiated and advantaged position in this exchange takes independent thought, extensive work, and strong conviction. I must understand the prevailing sentiment, but tactically arrive at a different conclusion.

Maybe the excellent company is being penalized for investing in the future, and as long-term owners we embrace the drop in near-term profitability others cannot tolerate. Or, thorough financial and market research leads to an opinion that great underlying economics of the company are not yet appearing in the reported financial statements. Whatever the case may be***, the analysis must be accompanied by a clearly articulated rationale for why I am able to acquire the stake on such good terms***. This variant perception does not have to be complex to be effective. Like many other aspects of investing, simpler is almost always better.

Punch Card

"I always tell students in business school they'd be better off when they got out of business school to have a punch card with 20 punches on it. And every time they made an investment decision they used up one of those punches, because they aren't going to get 20 great ideas in their lifetime. They're going to get five, or three, or seven, and you can get rich off five, or three, or seven." – **Warren Buffett**

In my public investing efforts at IMC the Punch Card test is the final and most important question for every investment - the ultimate filter. The framework of 20 punches is excellent because it places such a high value on each move. With a finite quantity, each Punch is likely to be thoroughly researched, in a company with excellent long-term prospects, and one in which you intend to own for a number of years. As renowned investor Philip Fisher once said, "I don't want a lot of good investments, I want a few outstanding ones".

Many investors agree with the framework of the Punch Card metaphor, but find it impossible to implement within a typical investment fund. ***With long-term oriented, permanent capital, IMC possesses a distinct structural advantage that enables and suits the Punch Card approach***. This mentality should result in a higher threshold for acceptable investments than nearly all other public market investors. IMC is a perfect testament to the efficacy of this approach, with the bulk of IMC's returns coming from a handful of outstanding companies owned over long stretches.

II – Investment Types:

I segment appropriate investments into two buckets which I define as ***"Core Holdings"*** and ***"Intermediate Holdings"***. My preference is to allocate capital towards Core Holdings; ideally the portfolio would consist of five to ten of these investments. To fill out the remainder of the portfolio, I will also allocate capital towards Intermediate Holdings when compelling opportunities present themselves. Both investment types align with the principles outlined in the first part of this letter, however they vary slightly because they involve different types of companies and time horizons:

Core Holdings

Core Holdings are investments in companies where intrinsic value per share is increasing at high rates (15%+) over long stretches and we make money as business owners by participating in the underlying increase in value over time. ***I treat a stake in a Core Holding as essentially a permanent holding with no target price or intention to sell***. These companies are the "crown jewel" subsidiaries within my conglomerate, and I would only sell if the circumstances around the company changed or if I received a ridiculously high offer for my shares. I would not accept a fair offer for my stake, because then I would have to pay taxes on the sale and reallocate the capital into a new company that likely has inferior characteristics.

Finding these companies is exceptionally difficult; they require a wide moat, high returns on capital, and a long runway for growth. Because the hurdles for qualification as a Core Holding are so exacting, if I find one I will typically allocate 10% - 20% of the portfolio towards the investment. I also tend to be more flexible on the initial valuation because the majority of the returns will be tied to the economics and runway of the company rather than a perfect entry price:

"If the business earns 6% on capital over 40 years and you hold it for that 40 years, you're not going to make much different than a 6% return—even if you originally buy it at a huge discount. Conversely, if a business earns 18% on capital over 20 or 30 years, even if you pay an expensive looking price, you'll end up with a fine result." – ***Charlie Munger***

Intermediate Holdings

Intermediate holdings are opportunistic investments in mature businesses with stable growth when the market quote is meaningfully below intrinsic value. These established companies have the qualitative traits I am looking for, but may only be growing at single-digit rates. With structurally lower growth, an investor cannot earn high returns simply from owning these businesses permanently. However, ***the combination of a bargain purchase price, solid growth in intrinsic value, and a three to five year holding period can result in excellent returns.*** The example below shows how a favorable entry price, 7% earnings growth, and modest share repurchases can combine into an Intermediate Holding that merits one of the 20 punches:

	Year 1	Year 2	Year 3	Year 4	Year 5
Annual Earnings	**$100**	**$107**	**$114**	**$123**	**$131**
Earnings Growth		*7.0%*	*7.0%*	*7.0%*	*7.0%*
Earnings Multiple	10.0x	12.0x	13.0x	14.0x	15.0x
Valuation	**$1,000**	**$1,284**	**$1,488**	**$1,715**	**$1,966**
Growth		*28.4%*	*15.9%*	*15.2%*	*14.6%*
Shares Outstanding	50.0	49.0	48.0	47.1	46.1
Increase/(Decrease)		*-2.0%*	*-2.0%*	*-2.0%*	*-2.0%*
Share Price	**$20.00**	**$26.20**	**$30.99**	**$36.44**	**$42.63**
Increase/(Decrease)		*31.0%*	*18.3%*	*17.6%*	*17.0%*
Overall IRR					**20.8%**

While Intermediate Holdings are contemplated on a much longer time horizon than nearly all other public market investors, they are finite in nature and will have higher turnover compared to the Core Holdings. I will be in no rush to sell the position, however along the way I will be monitoring the price looking for an opportune time to exit.

III – Company Types:

I am a "one man show" handling the portfolio, so time management is essential. The ability to quickly pass on companies that do not match my criteria frees up time for in-depth study on companies that do align with my investing style. As part of that process, when I'm first evaluating a business I try to determine which of the five categories the company fits into:

Low/No Moat
The vast majority of businesses fall into this group, such as your average convenience store or insurance agency. These are perfectly fine businesses and likely provide a solid product or service to customers. However, without a sustainable competitive edge it is unlikely the business can generate high returns on capital over long stretches. Therefore, the only way to generate attractive returns as an owner of such businesses is to correctly time the entry and exit over a short period of time, which I believe is difficult to do with consistency. As long-term owners we prefer to stick with businesses that are steadily increasing in value over time, and consequently ***I avoid investing in Low/No Moat businesses***.

Legacy Moat – Returning Capital
These businesses have an entrenched position within current markets that enable strong and consistent profitability ***relative to the prior invested capital***. However, there are few opportunities to deploy incremental capital at similarly high rates, so the management team elects to distribute the majority of earnings back to the owners at the end of each year. Well known examples include Coca-Cola and Hershey's. Both companies have protected and predictable earnings, but without compelling investment options they justifiably distribute over 80% of earnings to investors through dividends. These are wonderful companies, but with limited growth opportunities they are not a good fit as a Core Holding. However, if ***I can acquire a Legacy Moat – Returning Capital at a clear discount to intrinsic value the company can work very well as an Intermediate Holding***.

Legacy Moat – "Outsider" Management
This group of businesses has all of the characteristics of a Legacy Moat, but the management team decides to ***retain all of the capital and deploy it into new businesses through a focused Mergers & Acquisitions program***. The home office effectively serves as an internal private equity fund, using the permanent capital supplied by the operating companies to fund a disciplined acquisition effort. William Thorndike's book "*The Outsiders*" does an excellent job of detailing these unique management teams with a talent for capital allocation. When the right businesses are paired with an exceptional capital allocator, the result can be remarkable compounding of shareholder capital such as Berkshire Hathaway (Buffett), Tele-Communications Inc. (Malone), and Constellation Software (Leonard). ***If I find a Legacy Moat – "Outsider" Management run by a world-class capital allocator, and with a long runway for acquisitions, the company is a candidate for a Core Holding***.

Reinvestment Moat
This is the rare company that has all of the benefits of a Legacy Moat along with ample opportunities to ***deploy incremental capital at high rates within the current business***. At the end of each year the profits are simply plowed right back into growing the existing business, simplifying the task of capital allocation. Reinvestment Moats tend to have self-reinforcing business models, such as scale advantages or network effects, which widens the company's competitive advantage over time. The best example is Wal-Mart in the early 1970's, when there were only 51 locations and the company was aggressively growing. Today the company has 11,000 locations, and both sales and net income are up over 5,000x from 1972 levels. ***An emerging Reinvestment Moat, with a proven model and a long runway for expansion, has the potential to be an exceptional Core Holding***.

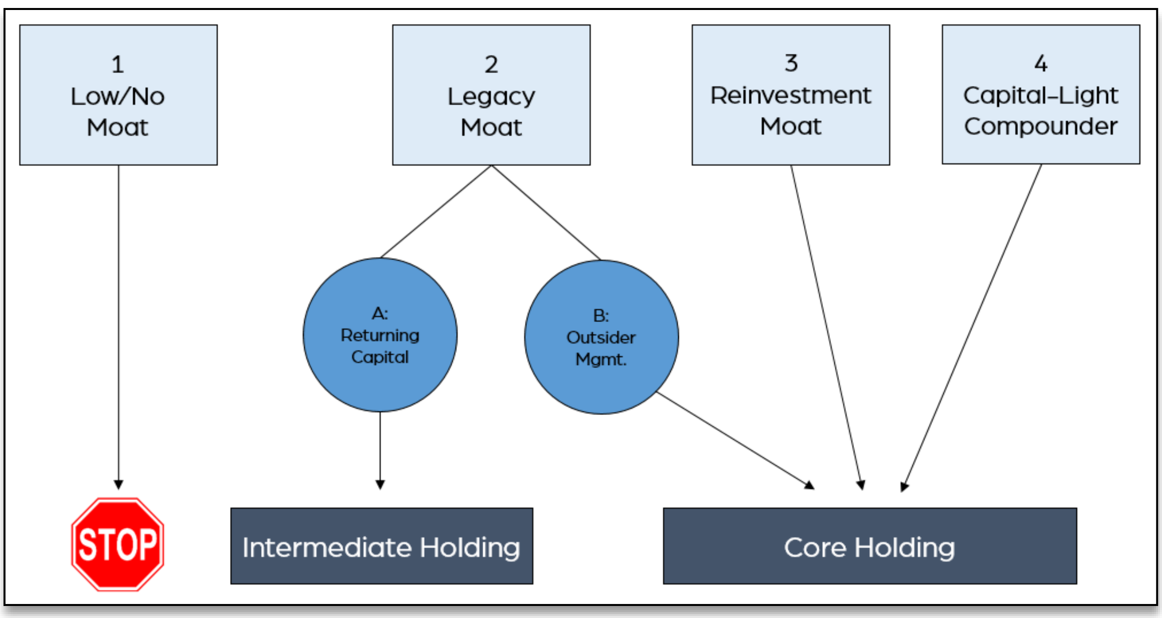
Capital-Light Compounder
These businesses have the ability to increase revenues and earnings over a long period of time while

requiring minimal or zero incremental capital investment. Typically, the competitive advantage for these businesses is rooted in intangible assets, so future growth is not contingent on large capital expenditures. As these businesses grow, they are also able to distribute a very large amount of cash to the owners - a dream combination. Prominent examples include See's Candies, Visa, and Moody's. ***If I can acquire a Capital-Light Compounder, with industry tailwinds and shareholder-friendly management, it could be an ideal Core Holding.***

For a more detailed explanation of the specific companies I seek to invest in, please refer to two write-ups I completed in 2016:

Reinvestment vs. Legacy Moats
Capital-Light Compounders

The Investment Types and Company Types work together as seen in this diagram:



IMC is an extremely unique platform for public market investing which enables the application of the principles outlined in this letter. My directive from Quinton is fairly simple; invest IMC's capital as if it was my own money. There is no prescribed formula, style box to fit in, or tracking error to balance. Free from the constraints of many institutional investors, all we care about is maximizing after-tax cash flows. For anyone who is driven by the goal of producing high returns, this is a dream scenario.

While I cannot guarantee investment results, there are a few things that are 100% in my control that I can promise to you as shareholders. First, you will never find anybody who loves investing and who wants to produce great results for IMC more than me. I'm obsessed with the endeavor and consider myself incredibly fortunate to do my dream job in an incredible environment each day. Secondly, in investing, knowledge compounds and accumulates over time, so I promise to be a vastly improved investor each year I write to you. Finally, all of my liquid net worth will be invested in the exact same manner as the IMC portfolio, so my interests will always be aligned with your own.

I am extremely appreciative of the opportunity that IMC and Quinton have given me. I want nothing more than to put together a stretch of incredible results that benefit IMC shareholders and prove that Quinton made a wise decision. If you would like to talk further about my public market investing efforts please don't hesitate to reach out; I'm always open to discussing a topic I enjoy so thoroughly.

Best,

Connor Leonard

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