

Turtle Creek

2017 Letter to Unitholders

Fellow Investors,

2017 was an eventful year at Turtle Creek. At the end of January, we closed our main fund to net new capital. In April, we launched a new fund focused exclusively on U.S. companies. In the middle of the year one of our larger holdings successfully battled through a liquidity crisis (which tested and validated our long standing principles and investment approach). Lastly, over the course of the year, we increased the U.S. company weighting for the main fund from 23% to 40% at year-end. In this year's annual letter we will discuss each of these developments, as well as address a number of other topics, such as our short and long term results and some differences we have observed between Canadian and U.S. stock markets.

The vast majority of our assets under management are in our two long-time, virtually identical funds: Turtle Creek Investment Fund ("TCIF") and Turtle Creek Equity Fund ("TCEF"). In previous annual letters, we have simply referred to these funds as Turtle Creek. However, now that we have two additional funds, going forward we will refer to the combined TCIF and TCEF portfolios as the Founders Fund.

For the year, the Founders Fund increased 5%¹, trailing the Toronto Stock Exchange and the S&P MidCap 400 indices, which both returned 9%². Rather than focusing on the calendar year in isolation, we stress the longer term. As we have always noted, even in years of significant outperformance, much more important than any one year are five-year, ten-year and fifteen-year compound annual returns. For the Founders Fund these are 18.5%, 16.7% and 15.6%, respectively³. Since starting Turtle Creek 19 years ago, we have grown our investors' money at a compound annual rate of 23.5%. In perhaps more understandable terms, \$1 invested in 1998 is now worth \$57.

How We Measure Ourselves in the Short Term

As the largest investors in Turtle Creek, we are no different than you: we want to gauge our performance as investment managers at the end of the year. However, we think using the change in unit price over just 12 months is a terrible way to make that assessment – evaluating a long term investment strategy using short term price movements makes no sense.

Since founding Turtle Creek, we have preferred to use the change in Cash Flow Value (which we previously called Intrinsic Value) as the appropriate metric for evaluating our shorter term results. Cash Flow Value is the present value of the net free cash flows we expect our portfolio companies to generate in the future, using a consistent discount rate.

1. Turtle Creek Equity Fund Class I Series 1.0 Units.
2. S&P/TSX Composite and S&P MidCap 400 are total return indices expressed in Canadian dollars.
3. See Performance Disclosure on Page 11.

2017 was an eventful year. We closed the Founders Fund, we launched a U.S. fund, one of our larger holdings successfully dealt with a liquidity crisis and the U.S. content of the Founders Fund increased substantially.



Turtle Creek

2017 Letter to Unitholders

The table below shows the change in the Cash Flow Value of the Founders Fund for the past five years.

Year end	Change in Founders Fund
2013	+12%
2014	+17%
2015	+20%
2016	+2%
2017	+5%

The annual increase in Cash Flow Value has averaged 11% over the past five years. In our view, when evaluating investment success, five years can still be considered relatively short term, and only beyond such length of time does one move into the long term.

You will note that the increase in the past couple of years has been more muted. Over the last two years, we believe the quality of the portfolio has improved markedly, which means that the risk-adjusted return profile of the portfolio has improved. We haven't tried to capture this lower risk/higher quality value by lowering the discount rate. As a consequence, we have essentially experienced a one-time 'headwind' with respect to the change in Cash Flow Value. We know financial theory would argue for using lower discount rates, but we've never altered our discount rate, despite significantly different interest rates and stock market valuations over the past 19 years. For us, the *absolute* valuations are not overly relevant – it is the *relative* valuations among our companies that matter the most. And, to be clear, we do have a means of weighting toward lower risk/higher quality cash flows elsewhere in our portfolio construction process – it just isn't done through lowering the discount rate and so doesn't show up in the calculation of our portfolio's Cash Flow Value.

How We Measure Ourselves in the Long Term

It is all well and good to talk about growing intrinsic value - or in our case Cash Flow Value - but if the positive performance does not materialize sooner or later in the unit price then the talk is going to start to sound pretty hollow. In the long run, the only proper way to measure an investment manager is to assess actual net investment returns to investors. One can debate when 'long term' begins, but we think beyond five years is a decent starting point.

Shown below are our five, ten and fifteen year compound annual returns, compared with the market.

	5 Year	10 Year	15 Year
Founders Fund	18.5%	16.7%	15.6%
S&P/TSX Composite	8.6%	4.6%	9.0%

As a side note, if the recent increase in U.S. company content in the Founders Fund is sustained or increases, we will have to look at a more appropriate benchmark to compare our results going forward, most probably a blend of the Toronto Stock Exchange and the S&P MidCap 400 index. But we don't have to turn our minds to this yet as the returns for these two indices were identical in 2017.

The increase in Cash Flow Value has averaged 11% per year over the past five years.

Our five, ten and fifteen year returns are significantly ahead of the market.



Turtle Creek

2017 Letter to Unitholders

Identifying 'Outsider' Companies

A couple of years ago we read an excellent book titled *The Outsiders: Eight Unconventional CEOs and Their Radically Rational Blueprint for Success*, written by William N. Thorndike, Jr. If you haven't read it, we recommend you do. The book grew out of a study the author had made of the CEO of Teledyne, a rather uncelebrated company leader who had generated remarkable long term results for shareholders. Thorndike wondered if there were other CEOs of U.S. companies that had generated comparable long term returns for their shareholders – returns that substantially outperformed the overall stock market as well as their peers. In the end, Thorndike identified eight such companies which he profiles in *The Outsiders*.

Thorndike was struck by the commonalities that existed among the various companies. Some of the common features were a focus on operational excellence, which included a decentralized management style, minimizing cash taxes, prudent balance sheet management and a constant awareness of the importance of capital allocation (including a willingness to buy back their own shares, where appropriate).

Will Thorndike co-founded and runs a private equity firm in Boston. We came to meet Will through a mutual friend who, after reading *The Outsiders*, wondered if the kinds of companies that Turtle Creek seeks to own shared similarities with those profiled in *The Outsiders*. On a subsequent trip to Boston in 2016, we made a point of reaching out to Will, getting together to have a wide ranging discussion on investing and the nature of 'Outsider' companies. Later that year, Will was kind enough to join us for dinner in Toronto. In the afternoon before the dinner, we thought we would take a quick look at our portfolio through Will's lens. So, we looked at our ten largest positions in the portfolio and the total return to shareholders over each CEO's tenure. At the time, the ten largest holdings in the Founders Fund were all Canadian companies, which meant they were not part of Thorndike's universe as he looked exclusively at U.S. companies. It was a quick exercise meant to stimulate dinner discussion.

With four of our ten largest holdings, the CEOs were relatively new, averaging about four years in charge of their respective companies. In three of these four cases, the CEOs had replaced retiring predecessors and in the fourth case the change was due to a proxy contest which resulted in the replacement of both the board and management. Four years is a short period of time and much too early to assess those incumbent CEOs with respect to long term shareholder returns.

With the other six holdings, CEO tenure averaged over 20 years – definitely enough time to apply the 'Outsider' test. In all instances, the annualized shareholder return during the CEO's tenure was 20% or more, with an average return of 23%. These are remarkable returns over such long periods of time and are in the same neighbourhood as the U.S. companies profiled by Thorndike.

It is not surprising that these six companies were in the Founders Fund in the middle of 2016. We attempt to identify 'highly intelligent' public companies among the thousands that exist and the track record of these six companies for certain was a factor in our deliberations. However, what we do find surprising is that among the many companies in our coverage universe, these six were all top ten holdings; that is, we thought they were cheap. You would think that with such remarkable long term track records (averaging 20% or better compound annual returns for shareholders) they would be more fully valued by the public market. Indeed, this often happens. Take, for example, Alimentation Couche-Tard, which is also in our coverage universe and has delivered compound returns for its shareholders of 24% per annum over a remarkable 30 years. In this case, the public market was according the company a much fuller valuation and, while we owned shares, it was a smaller holding because it was trading at a smaller discount to Cash Flow Value relative to our other holdings.

Outsider companies share a focus on operational excellence and a constant awareness of the importance of capital allocation.

A number of our larger Canadian holdings stack up respectfully as 'Outsider' companies.



Turtle Creek

2017 Letter to Unitholders

One might ask why we thought that the six outstanding companies were cheap and whether this is a repeatable part of our investment process. We believe that our long term focus is at least part of the explanation – it has often allowed us to recognize more value than the market when assessing outstanding companies. For example, a long term focus is often required to look past what may be short term challenges that are over-emphasized by the market. Even when there is not a short term challenge, we are sometimes more willing than the market to consider what management can achieve over the long term in terms of growth. While projecting long term organic growth and future acquisitions is not easy or precise, we force ourselves to quantify our best estimate of a company's future cash flows. When we do this for a 'highly intelligent' company run by a management team with a talent for allocating capital, it often allows us to uncover value.

Increasing U.S. Content in the Founders Fund

At the end of the year, the mix of Canadian and U.S. company exposure in the Founders Fund was 60% and 40%, respectively. This compares with American content of 23% at the beginning of the year and only 6% at the beginning of 2016. We describe below the multi-year process that has resulted in increased U.S. content in the portfolio. But first, it is worth commenting on Turtle Creek's history with regard to Canadian and U.S. holdings. Until a couple of years ago, the Founders Fund would quite properly have been described as a Canadian equity fund since, over the life of Turtle Creek, through the end of 2015, 97% of the portfolio (on average) has consisted of Canadian companies listed on the Toronto Stock Exchange.

The gradually growing U.S. company content over the last two to three years is the result of work we began over five years ago. By that time, we had pretty much worked our way through all of the (non-resource) Canadian mid-cap companies and turned our attention to the United States. Of course, we will always evaluate new Canadian opportunities – mainly as a result of initial public offerings or significant management changes with existing companies – but the new companies we find are more likely than not to be located outside of Canada.

Over the past five years, we have identified a meaningful number of U.S. companies that meet our qualitative criteria, but it has taken some time for any of these companies to be sufficiently 'cheap' to earn a position in the Founders Fund, let alone command a larger weighting. For example, by the end of 2014 there were four U.S. companies in the portfolio, but in aggregate they only accounted for 4% of the Founders Fund. In other words, some U.S. companies we followed were cheap enough to merit an investment but none were particularly cheap compared to many of our Canadian holdings.

We always knew we would find high quality, mid-cap (typically \$2 billion to \$25 billion) companies in the United States. However, we didn't know if any would be as attractively priced in the market as some of the Canadian companies we owned. Indeed, there has been a familiar pattern to our process – we would identify a terrific U.S. company, but then our valuation work would conclude that the market was according it a full price and we would therefore not add it to the portfolio. Of course, we would continue to do work on these companies, closely following and monitoring them. Over time, some have become cheap enough to be included as meaningful holdings in the portfolio.

A good example of this process is BorgWarner, a 100+ year old U.S. headquartered global automotive components and parts supplier. In early 2015, the stock was trading at around \$60 – a prime example of a great company trading at a full price. Fortunately for us, in the second half of 2015, its stock declined to the low \$40s. As we did more work on the company, our view of value climbed while the share price continued

U.S. content in the Founders Fund increased from 23% at the beginning of the year to 40% at the end.



Turtle Creek

2017 Letter to Unitholders

to decline. We added it to the portfolio in January 2016, purchasing our first shares at \$30. Through the early part of 2016, the share price continued to fall, hitting a low of \$28. Now it was a great company trading far below a full price. By late 2016, with the share price still below \$30, we had built BorgWarner into our largest U.S. holding with a 4% weighting in the portfolio.

This pattern has played itself out many times in the past few years: i) we would identify a terrific, 'highly intelligent' U.S. company, but decide not to invest in it after concluding the company was more fully valued than our existing holdings; ii) we would wait until some later point when, in some cases, the company suffered a sharp decline in its share price; and then, iii) we would buy in size. As we have built up a larger group of U.S. companies to follow closely, an increasing number are competing for positions in our portfolio from a valuation standpoint.

To be clear, we are not trying to increase the U.S. content in the Founders Fund – we are simply trying to construct the best portfolio from the companies we follow closely. We wouldn't care if the portfolio were 100% Canadian or 100% American (although neither is likely going forward). The exciting news for us in the past year is that, with patience and persistence, we have found some well-run U.S. companies that offer value similar to some of our larger Canadian holdings. As we do more work on an increasing number of U.S. companies, it will not surprise us if the U.S. weighting in the Founders Fund continues to grow.

Differences Between Canada and the United States - Companies and Capital Markets

Many of our investors have asked whether we have found any differences between Canadian and U.S. companies, and whether we can conduct due diligence on U.S. companies that is comparable to what we do with our Canadian names. We have found no differences in the nature of the companies themselves, particularly in terms of our ability to spend time with executive management and the quality of the dialogue. Concerning the second part of the question – can we do the same work – in many respects our process of getting to know U.S. companies is easier and more efficient than with Canadian companies. Generally speaking, U.S. companies provide more extensive public disclosure and they tend to apply more effort to investor relations than their Canadian counterparts. As an example, many of the U.S. mid-cap companies we follow hold annual investor days and supplement these with special events for shareholders. It is rare to find a Canadian mid-cap company that offers anything similar.

While the companies themselves don't exhibit any differences, there are certainly some interesting differences between Canadian and U.S. stock markets that are relevant to the way we invest. For example, we find that U.S. stock markets react more ferociously to any new information about a company, such as quarterly earnings results and changes to analyst recommendations, compared to the Canadian market. We don't necessarily observe a larger range of prices over longer periods of time – i.e. 52-week and 104-week high-low ranges are similar between the Canadian and U.S. companies that we follow and own. However, the speed and magnitude of reaction in the short term is more pronounced with U.S. companies. We will leave it to others to speculate why this is the case. Perhaps there is more short-term momentum investing in the United States, or maybe there are cultural differences between the two stock markets. Whatever the reasons, we are encouraged by this difference. Those of you who understand the Continuous Portfolio Optimization aspect of our investment process will appreciate how much better it works in the face of greater share price volatility.

A second key difference is the flexibility U.S. companies have to repurchase and cancel their common shares. In both jurisdictions, a company is allowed to purchase, on a daily basis, up to 25% of the traded volume of their shares. However, there are additional significant constraints for Canadian companies –

We have found some well-run U.S. companies that offer value similar to some of our larger Canadian holdings.

The U.S. stock market reacts more sharply to specific company events; in both directions.



Turtle Creek

2017 Letter to Unitholders

they are only allowed to repurchase 5% of their outstanding shares (or 10% of the float) in a 12-month period and are further constrained to buying no more than 2% of outstanding shares in a single month. If a company wishes to repurchase more shares in the market, they must pursue a substantial issuer bid in which they need to file an information circular, wait 30 days, and then buy and cancel common shares through a tender process. In the United States, none of these additional rules apply. While U.S. companies generally disclose to the market the maximum potential size and duration of a repurchase plan, they otherwise buy back any amount of shares they wish to and then only have to disclose the actual number of shares purchased in subsequent quarterly filings.

This difference can have a profound impact on a company's shares outstanding over time. A striking example from earlier in the year is Restoration Hardware (a company we do not own and are not closely following) which repurchased *half* of its outstanding shares in less than five months through two repurchase programs. Compare this with one of our long time Canadian companies, TFI International (formerly TransForce). Early in 2016, when TFI's share price had declined to \$20, the company decided the best use of capital was to repurchase about 11% of the company's outstanding stock. Because the amount contemplated was in excess of the 'normal course' rules in Canada, TFI undertook a 'substantial issuer bid' process, filing a circular, waiting 30 days and then trying to buy shares in a range of \$19 to \$22. In the end, the company was only able to repurchase a quarter of the shares it was trying to buy, all at the upper band of \$22 per share. Had TFI instead been subject to U.S. rules, it would have simply been in the market, day after day, buying shares. In all likelihood, TFI would have been able to repurchase *all* of the shares it was seeking and in all probability, they would have been repurchased at a *cheaper* price. And the market would not have known whether or not the company was successful until TFI reported its quarterly results. We like companies that include opportunistic share repurchases (i.e. at low prices) in their toolbox for creating shareholder value. The greater flexibility that U.S. companies have in this regard can have a meaningfully positive impact, over time, on the Cash Flow Value per share of the company.

The Funding Crisis at Home Capital

Home Capital is a regulated trust company and bank that has grown from very humble beginnings in the mid-1980s to become Canada's largest alternative mortgage lender. It has a history of careful underwriting with a focus on the value of the collateral underlying its loans. Over the last decade, its loan losses have averaged less than 0.1% per annum – a rate indicative of the prudence of its underwriting. However, in 2017, the company had more than its share of difficulties.

We have followed Home's success for well over a decade but only added it to the Founders Fund about six years ago. Prior to that point the company had consistently traded at a premium valuation, but by 2012, concerns that Canada's housing market was about to implode at any moment (in a repeat performance of the U.S. subprime debacle) had depressed the company's valuation such that it merited a position in the portfolio. Since then, consistent with our investment approach, we have held it in varying amounts.

We prefer to own companies that don't need to access the capital markets to pursue their business strategy – so that no matter what may happen to a company's share price in the short term, there is no impact on the underlying long term business value. In the case of Home Capital, while the company did not need to access the public market for equity, it did rely on the confidence of depositors to lend it money. If that confidence were ever to be shaken, then the business of Home Capital could be harmed. Despite our assessment that the probability of that occurring was small, this is precisely what happened.

U.S. companies have much greater flexibility with respect to repurchasing shares.

We like companies that will pursue opportunistic share repurchases.

Turtle Creek

2017 Letter to Unitholders

As a regulated trust company and bank, Home Capital offers CDIC insured (government guaranteed) deposit accounts and issues CDIC insured term GICs to investors. Furthermore, it had done a good job of matching the term of its assets with its liabilities – in other words, it funded shorter maturity mortgages with longer maturity GICs. But its funding activity also included approximately \$2 billion (about 10% of its deposit base) in High Interest Savings Accounts (HISAs) – effectively demand deposits. On April 26, 2017, Home Capital surprised the market by announcing that their HISA balances had declined by \$600 million since the start of the month and that they expected further declines to occur – in fact, over the ensuing days, the balances declined an additional \$1.2 billion. All told, within the span of a few weeks, Home Capital's \$2 billion of HISAs had shrunk to just \$200 million. Home Capital had just suffered a classic 'run on the bank' for that portion of their deposit base. In response to the 'run' on the HISAs, the company also announced on April 26 that it had secured an expensive \$2 billion bridge facility from HOOPP (a large Canadian pension plan). The facility dealt with the immediate liquidity issues, but given the 'off market' cost of the facility, it exacerbated the confidence problem. Despite being government guaranteed, sales of GICs plummeted, forcing Home to take further steps to stabilize the business.

What surprised most market participants, including us, was the speed and severity of the loss of confidence in the company. The fact that it happened in the face of an exceptionally strong credit environment made it all the more unusual. In particular, there had been: no collapse in house prices; no hikes in interest rates; no jumps in unemployment; no increases in mortgage arrears; and, no deterioration in the overall profitability of the company.

In other words, the run on the bank was not triggered by credit issues at Home Capital. Rather, the public lost faith in the company as a deposit taking institution because of a feeling that there was something wrong. Accusations, confusion and rumours swirled around the company and the belief that this regulated financial institution was a financially strong organization was very quickly replaced with the belief that the company was near collapse. Home Capital certainly made some mistakes that contributed to the loss in confidence (for example, removing its CEO earlier in the year without a replacement lined up), but it ultimately was a combination of many outside forces and factors which destroyed confidence.

Our approach at Turtle Creek was to continue as we always have: to absorb the new information and logically and rigorously reassess the situation. We recognized that there was a small risk that Home Capital's equity value could be wiped out if drastic actions were taken by regulators in order to have the company 'dealt with'. But we thought what was far more likely was that if constructive changes could be made in terms of management and the board, confidence would slowly restore, and while earnings in the near term would be sub-optimized, Home Capital's very strong balance sheet would allow it to survive this crisis. After all, Home Capital's book value was multiples above where its share price was trading at the peak of the crisis.

As it turns out, we were correct in our assessment. Within a week of the HOOPP financing, Home's board underwent substantial changes with the addition of a number of very experienced financial industry executives. This new board took a series of steps to stabilize the business and restore confidence. First, the company entered into an arrangement to, if necessary, sell-on up to \$2 billion of new residential mortgage originations to allow Home Capital to continue to fulfil its existing new mortgage commitments and to renew existing mortgages. In fact, very little was done under this arrangement and with Home Capital's deposit base stabilized, the company had no further use for it. Second, the company announced the sale of \$1.2 billion of commercial mortgages at, essentially, par value, providing not only liquidity but evidence as to the quality of Home Capital's book. Third, and more significantly, the company issued treasury shares to Berkshire Hathaway such that Berkshire is now a 20% shareholder of Home Capital

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Turtle Creek

2017 Letter to Unitholders

(dropping Turtle Creek down to being the second largest shareholder). As a result of these steps, sentiment toward Home improved substantially. Purchases of Home Capital GICs quickly rebounded to pre-crisis levels and the company's deposit base began to grow again. Lastly, an experienced industry executive, Yousry Bissada, was appointed Chief Executive Officer. In short order he has recruited an experienced Chief Financial Officer and made additional senior management changes. We believe Mr. Bissada has the experience and confidence of the industry to return the company to pre-crisis levels of market share and profitability.

Since the start of the crisis in April, we have had conversations about Home Capital with a large number of our investors. The most common question has been to ask what we have learned from this experience.

Rather than walking away with a number of new insights, instead, this experience has served to confirm some of our long held beliefs. For instance, while we have always made note of the boards that govern our companies, we recognize it is very difficult to assess their quality: how well they function, how hard working the directors are, the boardroom chemistry, just to name a few considerations. We have served on many public and private company boards in the past, and recognize that looking at the backgrounds of each director doesn't help much in determining board effectiveness. It is difficult to know in advance just how well a board will behave in a crisis.

Home Capital's crisis of confidence also provides a great example of how few investors are truly reflective and independent in their thinking – with most overreacting to every new rumour or innuendo. Coincidentally, during the crisis period, we were reading a book called *The Knowledge Illusion*, authored by two cognitive scientists, Steven Sloman and Philip Fernbach. They point out that while as a group, humans have done amazing things, we are error prone and sometimes irrational. The fundamentally communal nature of intelligence and knowledge explains why we often assume we know more than we really do and why false beliefs are so hard to change. We were reminded of this fact almost daily as the Home Capital drama played out. If you have the time to read the book, we highly recommend it.

To be fair, we did gain one insight: we have a remarkable investor base. A year ago, we announced that we would soon be closing our Founders Fund to additional capital. In the months that followed we received substantial new capital from both existing and new investors and capped the fund early in the year. A few months later, Home Capital was the lead news story across the financial press and we weren't sure how our new investors would react. To the best of our abilities, we always try to give new investors a sound understanding of our investment approach. A key element of that understanding includes the reality that unit price volatility, at times, is inherent in managing a focused portfolio of mid-cap public companies. While we try our best to manage expectations regarding this volatility, it is our experience that, until an investor experiences a drop themselves, you don't know how they will react. In fact, virtually all of our new investors have been strongly supportive.

We have always believed in Benjamin Graham's observation that in the short run the market is a voting machine but in the long run, it is a weighing machine. However, a company must ensure it can withstand the negative short term 'voting' in order for the long term 'weighing' effect to take over. It seems only fitting then, that the most famous student of Ben Graham has become the largest shareholder of Home Capital – giving the company the time to prove the naysayers wrong.

Berkshire Hathaway's investment gives Home Capital the time to prove the naysayers wrong.

Turtle Creek

2017 Letter to Unitholders

Historically Low Market Volatility in 2017

The S&P 500 declined 1% or more on only four days during all of 2017, while the broader global index (MSCI ACWI) declined 1% or more on only two days. This compares with the previous five years which averaged 22 days per year for the S&P 500 and 17 days per year for global markets. Over the previous ten years the averages are 36 days and 31 days, respectively. Indeed, one has to go back to the mid-1990s to find a market period that even approaches the low volatility of 2017. By the middle of January 2018, a new all time record was set in terms of the number of trading days without a 5% decline.

From our perspective, low overall market volatility limits the extent to which we are able to implement the Continuous Portfolio Optimization aspect of our investment process since this process obviously works better in a market environment that has more ups and downs. We take advantage of swings in share prices to rebalance our portfolio and so dislocated markets are actually a pretty good environment for us.

Ironically, recent low volatility combined with rising share prices has caused Sharpe ratios for global stocks to surge to extraordinary levels. The Sharpe ratio is an attempt to assess 'riskiness' (technically, risk-adjusted returns) by looking at investment returns adjusted for short term price volatility. Our long time investors know that we have always rejected such attempts to use price volatility as a proxy for riskiness. It is absurd to argue that equity markets, which are hitting all-time highs and are now well into the ninth year of an historic bull market, are at their lowest level of risk in history, and yet this is what the backward-looking Sharpe ratio implies.

In our fourth quarter commentary released a few weeks ago, we (prophetically perhaps?) stated:

"The longer we go with such muted volatility in the market, and the more capital that flows into passive funds, which reinforces low volatility, the more investors will become lulled into a false sense of security. This could be a classic case where stability is breeding instability - in terms of traded share prices, that is."

And just a few weeks later, we find ourselves in the midst of a rip roaring market correction, having witnessed a greater than 10% drop in the major indices within a period of only nine days. In fact, we have now had four days of declines greater than 1%, equivalent to all of 2017.

Developments at Turtle Creek

We have always promised our investors that we would stop accepting net new capital in the Founders Fund at the point where raising additional funds could potentially have a depressing impact on our long term investment returns. Much has been written by others about the impact of fund size on investment returns. Since we started Turtle Creek, we have been cognizant of ensuring that we do not fall prey to the temptation to grow assets under management ("AUM") to the point where investment returns are negatively affected. At the end of January, after positive monthly performance plus net new subscriptions increased AUM above \$2 billion, we stopped taking new capital into the Founders Fund (our [2016 Annual Letter](#), available at www.turtlecreek.ca, provides a more fulsome discussion).

During the year, the market exhibited historically low volatility. This ended abruptly in February 2018, just as this letter was released.

We closed the Founders Fund to net new capital.



Turtle Creek

2017 Letter to Unitholders

We now have nine full-time professionals on the investment team. Earlier in our letter we described how we have been expanding the number of companies we are closely following. This is only possible because of our larger investment team. We intend to continue to grow the investment team in a measured pace so that we can increase the number of companies we follow. Just as we, many years ago, looked south of the border, once we felt we had ‘sorted’ the Canadian mid-cap companies, at some point we will look beyond North America. But that day is some time off – we still have plenty of work to do in the U.S. market.

Our work to identify more ‘highly intelligent’ U.S. companies continues in earnest. We are convinced that expanding the number of companies that we closely follow will improve our portfolio construction process and therefore improve overall returns. In investing (but not necessarily in other facets of life), having more choice is a good thing. Balancing an increased roster without sacrificing context and a close understanding of one’s existing investments is certainly a challenge, but one that we feel we have met and will continue to meet. We do not know how large we can make this roster without losing that context and understanding but we know we have room to expand.

A couple of years ago, in anticipation that the non-Canadian content in the Founders Fund would increase over time, we formed Turtle Creek Canadian Equity Fund (“TCCF”). We wanted to provide a vehicle that comprised only our Canadian companies for investors who wished to have that exposure. And then this year we formed Turtle Creek United States Equity Fund (“TCUS”) as we believed that we could, for the first time, construct a compelling portfolio of strictly U.S. public equities.

In the same way that we closed the Founders Fund to net new capital, we will do the same for TCCF and TCUS at the appropriate times. We will always size our funds to fit their investment strategy and opportunity set.

Conclusion

As we begin our 20th year, we are pleased that our founding principles and investment approach continue to demonstrate their validity and resiliency. We have long rejected making market prognostications or engaging in punditry and that will not change. Instead, we remain focused on evaluating opportunities to improve the long term risk/return profile of our portfolios. We will continue our process of identifying ‘highly intelligent’ companies and in doing so we fully expect to find additional ‘Outsider’ companies and to profit from their focus on increasing shareholder value. Indeed, we believe we have identified many such companies over the past few years.

We thank you for your continued support.

Your Partners at Turtle Creek

The investment team increased to nine professionals during the year.

We are committed to right sizing each of our funds to the investment strategy and opportunity set.



Turtle Creek

2017 Letter to Unitholders

Performance Disclosure

The Founders Fund performance, from November 1, 1998 until November 1, 2008, reflects the performance of Turtle Creek Investment Fund (created in September 2000) Class A Series I Units and the performance of its predecessor entities (collectively "TCIF"), and Turtle Creek Equity Fund ("TCEF" or the "Fund") Class I Series 1.0 Units thereafter. Since TCEF and TCIF maintain almost identical portfolios (with the exception of the TCIF's private company investments), historical performance for TCIF has been combined with that of TCEF. There were no private investments in TCIF before 2003 and, in aggregate, the private investments had a negligible impact on TCIF's returns to November 1, 2008. TCIF's fee and carried interest structure did not apply prior to September 1, 2003 and, thereafter is not the same as the structure used for TCEF (details are available upon request).

Performance data is in a common currency (Canadian dollars unless otherwise specified). The S&P/TSX Composite and the S&P MidCap 400 are total return indices. Comparisons to certain indices are provided for illustrative purposes only, and are intended to indicate broad market performance. Comparisons to indices are limited because indices are not managed and do not charge fees or expenses. The Fund may underperform or outperform the indices for many reasons. Past performance must never be construed as investment advice or a prediction of future performance.