The McElvaine Investment Trust

Annual Report
2016

The McElvaine Investment Trust ("the Trust")

The McElvaine Investment Trust is a RRSP eligible fund. The Trust was formed on September 27, 1996 with the following philosophy:

1. Highly satisfactory longer-term performance can be achieved by focusing on companies selling below net asset value.
2. The purpose of an investment vehicle is to make money not to own stocks. This is an important distinction because it means the Trust will only invest when presented with an attractive situation.
3. As there are few good ideas, there are times when concentration may be helpful.

We currently offer 3 different series of the Trust. You should refer to the current offering memorandum for a detailed discussion of each Series, but very simply:

Series B:
The majority of our investors, including Tim, own these units.

Series C & Series F:
These series are modelled after the fee structure used in the Buffett Partnerships and have no management fee and only a performance fee.
Series F is only available via financial advisors.

Further information is available at our website:

www.avaluefund.com

Friendly disclaimer:

Simply put:

- *Our Annual Report contains forward looking information. I will not update this report even if my view changes.*
- *While I believe my comments and facts to be accurate, you should not rely on them without doing your own work.*
- *While I would be delighted if this report encourages you to consider investing in or adding to your investment in The McElvaine Investment Trust, the Trust is only sold via an Offering Memorandum.*

The bottom line is I may be wrong. You should do your own work.

The McElvaine Investment Trust[7]

Performance Summary as of 31Dec16

Year (Period)	Pre-fee Return (1)(2) Series B Units	Net Return (1)(3) Series B Units	Index (4)	Average Cash Balance (5)
1997	16.8%	12.8%	15.0%	59%
1998	21.3%	16.6%	-1.6%	27%
1999	38.8%	29.5%	31.6%	26%
2000	24.6%	19.2%	7.4%	9%
2001	37.2%	28.0%	-12.6%	2%
2002	5.4%	5.0%	-12.4%	5%
2003	36.5%	28.2%	26.7%	14%
2004	11.3%	8.6%	14.5%	23%
2005	22.9%	17.2%	24.1%	13%
2006	15.1%	11.9%	17.3%	11%
2007	1.0%	0.6%	9.8%	9%
2008	-47.8%	-48.8%	-33.0%	6%
2009	19.1%	18.1%	35.1%	17%
2010	2.8%	1.8%	17.6%	6%
2011	-12.3%	-13.4%	-8.7%	10%
2012	19.4%	18.3%	7.2%	18%
2013	20.2%	19.1%	13.0%	31%
2014	7.1%	6.0%	10.6%	26%
2015	-8.7%	-9.8%	-8.3%	19%
2016	5.2%	4.1%	21.1%	19%

Notes:

(1) The “Pre-fee Return” and “Net Return” information includes distributions reinvested in additional units.

(2) “Pre-fee Return” is our estimate of the increase in the asset value of the Trust during the period after the deduction of all expenses, other than the management fee and performance incentive fee, and applicable taxes. The Pre-fee Return gives you the best indication of how the Trust’s investments have performed. However, the “Net Return” is a better indicator of the returns actually earned by investors.

(3) “Net Return” is our estimate of the increase in the net asset value of the Series B units during the period. The Net Return for each series of units will differ since the fee and expense structure for each series units differs.

(4) As the Trust invests primarily in Canadian securities, we have compared its performance to that of the S&P/TSX Composite Total Return Index. This index tracks changes in the share price of the largest companies (by market capitalization) listed on the Toronto Stock Exchange (and includes the return from reinvested dividends). These companies represent a broad range of industries. The Trust may often invest in small-cap and mid-cap companies that are not included in the S&P/TSX Composite Total Return Index, and therefore, other indices may also be appropriate comparisons for the Trust.

(5) “Average Cash Balance” is our estimate of the average of the month-end cash and short-term bond balances held by the Trust. We have included this to allow you to assess how the Trust was invested in order to generate the returns shown.

(6) This Performance Table excludes the three months from 27Sep96 to 31Dec96 (start-up period). During this period, the Trust returned 3.1%

(7) It is important that you understand that performance is yesterday’s news and you should be careful about using it as a guide to tomorrow. The figures above are unaudited and in many circumstances, our estimates.

Patrick W. E. Hodgson

I originally met Pat in the 1990s when we invested in Seattle-based Todd Shipyards. Pat was Chairman of Todd and I was surprised to find out he lived in Ontario and “commuted” to Seattle. A couple of years later the Trust invested in Scott’s Hospitality and Scott’s Restaurants and our paths crossed again as Pat was on the Board of both. It led to many years of great conversations. In addition, Pat served as a member of our advisory committee. It was with great sadness I learnt of Pat’s passing over Christmas. My condolences go out to Camille and Pat’s family.

I will miss Pat’s wise counsel, quick wit and humble manner. I am blessed to have known him.

The McElvaine Investment Trust

To my Partners:

Let's deal with the "elephants in the room" first.

1. Performance: We lagged the S&P/TSX Total Return Index in 2016. I'd give us a C if I was grading 2016, a passing grade (because we were positive) but definitely requiring makeup work. I measure our performance in three ways:
   a. Did we perform on an absolute basis (ie. not lose money): Yes
   b. Did we outperform the index (for better or worse I use the TSX): No
   c. Did we earn a satisfactory real return (say inflation + 5%): No

   I will discuss our 2016 performance in the following pages.

2. Active Management: Over the last couple of years a number of experienced value investors, including me, have underperformed the index. While this is not the first time this has happened, it has coincided with a significant increase in the amount of indexed money. I want to make 3 points: one, I would be careful if you invest in sector or high yield ETFs; two, more indexing will lead to more opportunities in non-index shares for value investors like us; and three, our portfolio differs significantly from any index (its active share for those of you who follow this is in the high 90s). While we will be in and out of favor, I am confident about our future returns.

3. US politics: Washington reminds me of Dr Dolittle's "pushmi-pullyu": one body, two heads and lots of manure! While there has been optimism around several of the financial policy initiatives, I always keep in mind in politics there is the action, the reaction and the outcome. What I mean is I am not sure anyone can confidently predict what legislation will ultimately be enacted. While the glass looks half full at this moment, it would not take much to drain it. In other words, as I mentioned in our December letter, increased volatility is the only assured outcome.

4. Market: It is hard to find cheap stocks at this moment so our cash has been building up. I don't get particularly fussed when this happens. A value investor can be thought of like a beachcomber. Some days there are lots of interesting things on the beach and other days there is very little. The only thing one can be confident about is tomorrow's tide will bring in something new.

In January I recorded the first of what I call "McElvaine Minutes". These will be short (and infrequent!) videos discussing some aspect of the Trust or value investing. The best way to stay in the loop is to sign up for our newsletter on our website (www.avaluefund.com) and we will notify you via email whenever a new video is posted. If you already receive emails from us, no need to sign up again.

2016 was a milestone year on a number of accounts. Firstly, we exited 2016 with a stronger portfolio than the one with which we started. I will discuss this a little more later in this report. Secondly, I have stepped down from the Rainmaker Board and our position in Rainmaker has been replaced by Wow! Unlimited Media, a financially stronger company with experienced owner operators. Thirdly, believe it or not, the Trust is now over 20 years old. In our first decade, our performance was good. In the second, certainly at the beginning, we struggled. As we enter our 3rd, I am optimistic and confident.

In fact, to underscore my confidence and following the structure Warren Buffett used in his partnerships, we have created two new series of units (Series C for direct investors and Series F for advisors) which have no management fee and only a performance fee. If you currently own Series B units, I think given we have a performance fee shortfall, you are best to stay put in Series B. If you are a new investor or adding to your investment, you may wish to consider the new series. Either way, please let us know if you would like an investor package which describes all three series.

Our 2017 Partners' conference will be on Monday June 5th at the Four Seasons in Vancouver. We will send out an invitation in a month or so. I also expect to be hosting some type of get together in the fall in Toronto. I will circulate something as we firm up the dates.

Most importantly, thank you for your friendship and confidence.

Warm regards,

Tim McElvaine
March 10, 2017

Our Return for 2016 – Series B Units

The McElvaine Investment Trust's 31Dec2016 net asset value for the Series B units was $19.98. This represents a gain for calendar 2016, net of all fees and expenses, of 4.1%. During this period, the S&P/TSX Composite Total Return Index rose by 21.1%.

Our approach is centered on four items. We invest when we have:

1. A competitive advantage when making the investment (such as a seller who does not care about the price they are getting);
2. Observable investment value that exceeds the share price at the time of purchase (no financial spreadsheet gymnastics involved);
3. A financial position ideally combined with strategic position that provides staying power; and
4. A Board and management team that is owner focused.

You may recall I have affectionately termed our approach "ABBA" representing A-Accident, B-Bird in hand, B-Brick house (as opposed to straw hut) and A-Alignment of interests.

You will note our process does not involve macro forecasting or economic predictions beyond assuming reversion to the mean at some point. Investing is a messy business and our protection is in the price we pay.

Investment Returns versus Your Returns

For discussion purposes, I have estimated the components of our 2016 returns as a percentage of our 2016 opening Series B net asset value per unit. I should caution you these figures are my estimates and are unaudited:

Returns from investments	5.5%
Operating expenses and related taxes	-0.3%
Return pre-management and pre-incentive fee	5.2%
Management fee	-1.0%
Incentive fee	0%
Taxes on fees	-0.1%
Net return to you	4.1%

I don't really think about the portfolio in terms of geography but more by the nature of the investments. The “bible” of value investing is the book “The Intelligent Investor” written in the 1930s by Benjamin Graham. Taking a little bit of liberty with Ben Graham’s ideas, I have broken our investing into 3 categories. I define the categories as follows:

1. Large unpopular companies – Generally speaking, for a larger company to come across our path, it must be unpopular. Unpopular may mean it is located in a country or region which investors dislike or is suffering from a negative event or news. Examples from our history include the opportunity in Mattel shares which took place when Mattel ran into difficulties with its business or more recently in 2011 when we had a large investment in Japanese stocks. Over our history, we have had reasonable returns in this area but patience (and tolerance) were definitely required.

2. Bargain secondary issues – While a larger company may be a bargain, it is usually due to unpopularity. A secondary company may become cheap for a number of reasons including unpopularity but also because of neglect or a constraint or dislocation such as a spinoff. For simplicity, I have defined a secondary issue as a company with a market value below $1bn although some of our investments have been much smaller companies.

3. Special situations and workouts - I would include in this area everything from liquidations to distressed debt. This category will be unlikely to contain equity investments unless they have a limited life. (eg. Liquidations, risk arbitrage etc…)

Following this format, I estimate the contribution of each segment to 2016 returns as follows:

Large unpopular companies	7.3%
Bargain secondary companies	-0.5%
Special situations and workouts	-1.3%
Forwards, hedging and everything else	0%
Return from investments	5.5%

The Year in Retrospect

Large unpopular companies:

The vast majority of our returns in this category came from three stocks: Anglo American, Seacor Holdings and Leucadia National. All three's price suffered in the early part of 2016 but recovered strongly by December 31st. By early 2017, we had trimmed our positions in 2 of the 3.

Bargain Secondary companies:

This category represented over half of the Trust's assets for most of the year. Performance by security was a mixed bag; Noranda Income Fund and Village Farms contributed to performance while Carmanah Technologies and Caldwell Partners detracted from our returns. (Both Carmanah and Caldwell had been strong performers in prior years) Lack of a reasonable return on this segment of the portfolio was a big drag on our overall performance.

Special Situations and workouts:

While this category may contain anything from a workout to a liquidation, our returns (or lack of them) were due to our position in Rainmaker convertible debentures. As mentioned, these debentures were redeemed for cash and new shares in Wow! Unlimited in mid-December.

Forwards, hedging and everything else:

The Forward and hedging line represents the net contribution of our currency forwards and put option positions. Coincidently this ended up netting to zero in 2016 as gains in our currency hedges were offset by losses in our put options.

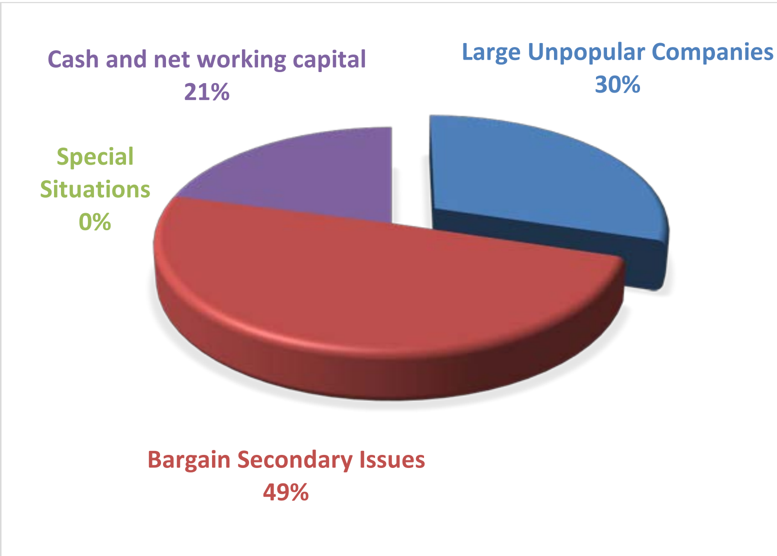
Other items:

The Trust ended the year with taxable income as the Trust's interest and dividend income exceeded its expenses. This amounted to approx. $0.08 per unit which was allocated to all investors. It will appear on your statements as a distribution and reinvestment in units.

The Trust's expenses consisted primarily of custodial, legal, audit and other operating expenses which amounted to a little over 0.30% of net assets. Our management fee was 1% of net assets bringing the total MER with taxes to something around 1.48%. There was no performance fee paid on the B units. There continues to be a performance fee shortfall for the B units which will have to be made up prior to any performance fees being paid.

Where We Are Now

Below are some details on our portfolio at 31Dec16. Audited financial statements, including a statement of Investment Portfolio, have been included separately from this Annual Report. Following the Ben Graham categories referred to above, our portfolio looked roughly as follows:



Large Unpopular Companies	29.8%
Seacor	6.4%
Leucadia	6.3%
Voya Financial	5.3%
Anglo American plc	3.2%
Four other holdings	8.6%

Large unpopular companies:

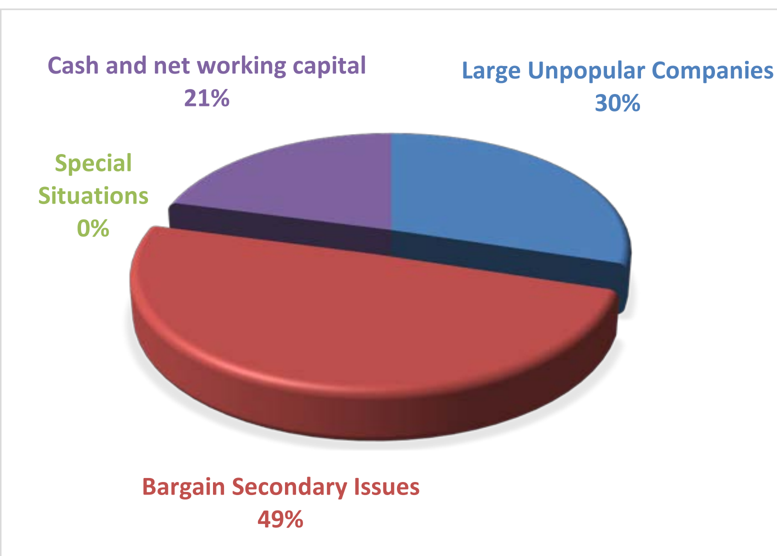
While I did not breakout geography, the majority of these investments are US listed. In early 2016, we started buying shares of Seacor Holdings which is an operator of marine vessels primarily related to the oil & gas industry (although it does have a large barge operation). We acquired our position at a significant discount to tangible book value hence the bird in hand. Its balance sheet on an unconsolidated basis has significant financial flexibility (brick house). Chairman and CEO Charles Fabrikant has a good reputation as a capital allocator and owns approximately 7.5% of Seacor or well over $100mn of stock. Shares of Seacor appreciated somewhat in the latter part of the year on renewed optimism for the price of oil and gulf drilling activity as well as news Seacor may proceed with a spin-off of its Off Shore Marine Services unit.

Leucadia National similarly suffered in the early part of 2016 due to its exposure to parts of the bond market via its wholly owned Jefferies LLC, a US based securities firm. In addition, another large subsidiary, National Beef, had poor results. The bird in hand in our Leucadia investment rational was Leucadia's conservative tangible book value which exceeded by a large margin the price we were paying, a reasonably strong capital structure and large insider ownership. We acquired our first shares in Leucadia in late 2015 and added significantly to our position in early 2016. By December, Leucadia had appreciated on improved results in both its securities and beef businesses.

I have discussed VOYA Financial in the past. We have owned shares for several years and had in fact trimmed our position in early 2015. By mid-2016, the share price had fallen as the market had grown concerned over the pace of operational improvements at VOYA and with their exposure to oil & gas high yield debt. We took advantage of this pessimism and added to our position. We once again trimmed our position in early 2017 as the stock had rebounded strongly from mid-2016 prices.

Anglo American, the South African mining group with interests in diamonds (DeBeers), platinum, coal, copper and other metals has certainly has been a roller coaster. Concerns over their commodity market exposure and balance sheet led to a significant fall in the price of the shares. Our initial investment occurred in mid-2015 and we continued to buy as the share price fell. By late 2016, the view of the market towards Anglo had changed. Not only has Anglo's balance sheet improved due to asset sales and improved cash flows but the outlook had also improved on optimism on commodities prices and on the potential of a separation of Anglo's South African operations. We trimmed our position in Anglo in late 2016.

Bargain Secondary Issues:



Bargain Secondary Issues	49.4%
Glacier Media	9.3%
Wow! Unlimited Media	8.9%
Carmanah Technology	6.6%
Maxim Power	4.0%
Symphony International	3.7%
Eight other holdings	16.9%

Nearly all of our current bargain secondary issues are Canadian listed although several have significant non-Canadian operations. The largest holding in this segment is Glacier Media which has been a long standing investment of ours and one I suspect many of you are tired of hearing about. Keeping this short but sweet, over the last 2 years Glacier has significantly improved its balance sheet and operations. While challenges remain, I do expect good things in the future.

Wow! Unlimited Media as I have previously discussed is a combination of Rainmaker and Frederator Networks, a New York City based animation multi-channel network using video platforms such as YouTube. We first got involved in Rainmaker many years ago when it was the leading post production studio in Vancouver. Needless to say, times and technology changed and its post production business became less profitable. To offset this, the Board at the time acquired a number of assets including an animation studio. By 2006, we had a very large unrealized gain in our holding. If only I had sold our shares then! Simply put, things turned ugly and I joined the Board. Thankfully several years later I was joined by Craig Graham who with Michael Hefferon led the turnaround of Rainmaker.

As mentioned in my December letter, in late 2016 the Trust exchanged its Rainmaker debentures for cash and shares in a reshaped firm which will be called Wow! Unlimited Media. In addition, I stepped off the Rainmaker board. The new entity will be led by Michael Hirsh who was a co-founder of Nelvana as well as the leader of the consortium which acquired CINAR in 2004. You may recall we owned CINAR and the sale netted a good profit for the Trust. I like Michael and where he will be going with the new firm. I would like to take this opportunity to extend my thanks for all his hard work to Craig Graham who was Chairman and CEO of Rainmaker.

We have owned Carmanah Technology, a designer and distributor of infrastructure related LED lighting (including solar) since late 2013 originally investing via a rights issue. While it detracted significantly from our performance in 2016, we continue to have a large unrealized gain in the shares. I continue to have a lot of confidence in its CEO John Simmons. In addition, Carmanah has a strong balance sheet with cash net of long term debt in excess of $12mn. Over the last couple of quarters, both the company and several of its directors have been purchasers of Carmanah shares.

Maxim Power is a relatively recent investment of the Trust. While its stock price roughly ended the year where it started, there was a significant change in the underlying businesses of Maxim. Maxim started 2016 having significant French and US based power generation assets in addition to its Alberta power related assets. Over the course of the year, Maxim sold all of its foreign operations which on closing I estimate will result in Maxim having over $100 million in cash. I have a lot of confidence in its two largest shareholders who collectively own over 42% of the shares. I expect 2017 will similarly be an important year for Maxim as the Board considers its next steps. We added to our position in early 2017.

I discussed Symphony International in last year's report. A condition of its 2012 rights issue was if its discount to NAV in September 2017 was greater than 35%, it would effectively liquidate a large portion of its investments and return the capital to shareholders. Not surprisingly, in late 2016, the Board instituted a share repurchase plan which has reduced its discount to under 30%. We trimmed our position in early 2017.

<u>Special Situations and net cash:</u>

As we no longer hold convertible debentures of Rainmaker, our special situation category has significantly decreased in size. While we continue to have a couple of liquidation stubs (Deans Knight, NBNK), our activities in this area have been muted. Cash rose somewhat in 2016, and into 2017, as we sold more than we bought.

<u>Outlook:</u>

While one never knows how a stock may perform, I will make a couple of comments:

1. In aggregate, the balance sheets of our holdings improved through 2016. In fact, I am pleased with the financial strength of the businesses we own.
2. While there was substantial appreciation in a number of our "large unpopular" holdings, our "bargain secondary" holdings didn't do much stock price-wise in 2016. This means going into 2017, I view them in aggregate as cheap.
3. The vast majority of our holdings have large insider ownership. It gives me a lot of comfort knowing we are dealing with owners rather than hired guns.

As mentioned in the beginning, there is a lot of potential for volatility in 2017. I think we are well positioned, both with our history and with our cash, to take advantage of any opportunities.

Why Invest with Us?

Our approach is focused and our interests are aligned. Many firms and ETFs invest automatically with little regard for value. Other firms have multiple funds and their fund managers look after several funds. Are these firms interested in asset growth or your investment returns? Do the portfolio managers have their money in the same place as you? When they manage several funds, how do you know you are in the right one?

With The McElvaine Investment Trust:

- *We are experienced value investors;*
- *We get paid when we perform;*
- *We invest our money alongside yours;*
- *We care how our investees make their money;*
- *We do one thing: value investing; and manage one fund:*
  The McElvaine Investment Trust.

McElvaine Investment Management Ltd.
Suite 219
2187 Oak Bay Avenue
Victoria, British Columbia V8R 1G1
Canada

Telephone: (250) 708-8345
Fax: (250) 708-8346

Website: www.avaluefund.com