FAM Value Fund

Semi-Annual Shareholder Letter 2020

June 30, 2020

Dear Fellow Value Fund Shareholder,

Whenever we meet with shareholders, either one-on-one or at our annual shareholder meeting, we are asked questions about the future, "When will the market stop going down? When is the next recession? Should I sell now and try to get back in when things are clearer?"

We usually address these questions with a consistent answer, "We don't know and in fact no one knows when a recession is coming or when the market will recover." We think the events of 2020 prove this idea without a doubt. No one knows. Below is a partial list of unprecedented events that have occurred in the past six months.

When the coronavirus appeared in Italy and investors figured out that the virus would not be contained to just Asia, the market had one of its fastest and sharpest declines in history. As measured by the equal-weighted S&P 500 Index, the stock market declined by 40% in 23 days marking the fastest decline of that magnitude in decades.[1]

After hitting bottom on March 23, stock prices have climbed 42% as of June 30, 2020. The second quarter of the year was the best quarter for stock returns in two decades.[2] The rally is even more incredible because it occurred in what will certainly be the worst quarter for the American economy since the Great Depression. The worst quarter in history, outside of the Great Depression, was the first quarter of 1958 with a GDP decline of 10%. Ironically, this decline was the result of the Asian Flu hitting the United Sates in late 1957.[3] The second quarter of 2020 will certainly decline at a greater than 10% rate.

While the world was distracted with the coronavirus, China moved aggressively to take control of Hong Kong.

Meanwhile, the price of a barrel of oil traded at a negative price meaning if you were willing to take possession of one barrel of oil you could get the barrel and $25 in cash.

A final point on making predictions. Here is the last sentence from the introduction of our 2019 Annual Letter which we wrote in January 2020:

"With low interest rates and a seeming resolution to the trade war we see more of the same for the economy; modest GDP growth, job creation, and higher corporate profits."

No one knows.

Portfolio Activity

[1] Bloomberg, as of 6/30/2020

[2] Bloomberg, as of 6/30/2020

[3] FactSet, as of 6/30/2020

Before we get into actual trading decisions, it might be helpful to know how we approached the first six months of the year. During January and February, we were cautious buying one stock, **Monro (MNRO)**, and selling the majority of our shares in two industrial stocks – **Donaldson (DCI)** and **Snap-on (SNA)**. In early March, we switched from sellers to thinking about the companies we would like to own. Since we did not know the magnitude or duration of the market decline (see above), we decided to buy, slowly. We focused on buying the highest quality businesses – both new stocks and adding to existing holdings. From the day the market went down 10% from the peak, February 27, to the first week of April, we purchased 17 stocks for a total of $73 million. These purchases were primarily funded by reducing our cash position from more than $80 million to less than $40 million and assorted sales including **Monro** and **FLIR Systems (FLIR)**.

Sales

We sold all our **Snap-on** shares and most of our shares in **Donaldson** during the first two months of the year into a market of rising prices.

Snap-on is a manufacturer of high-end tools used by professionals in the automotive and industrial markets. The company is probably best known by its trucks that call on automobile repair shops. We spoke to mechanics that liked the Snap-on brand name and aspired to own their top-of-the-line tools and diagnostics. We liked the financial profile of high margins (which had doubled in the last eight years), low debt, and 20% return on equity. In addition, Snap-on generated more than $600 million a year of operating cash and needed only $200 million to invest in the business to support growth. Unfortunately, that growth never materialized. From our original purchase in October 2017 through the end of fiscal year 2019, sales grew by a total of 2% over two years. We determined that they faced numerous headwinds to grow and sold our position in February.

Donaldson was a longtime Fenimore holding that we purchased in the Value Fund during the first quarter of 2016. We acquired the stock for less than $28 a share and watched the price rise into the $50s this year. Donaldson makes air filters for commercial and industrial equipment like long-haul trucks, mining equipment, and natural gas turbines. We liked the fact that filters wear out and must be replaced. This generates some amount of repeat sales and can make for a steady business. The financial profile is favorable with a good balance sheet, cash profits, and mid-20s return on equity. Three years into our investment, the company had grown EBITDA (earnings before interest, taxes, depreciation, and amortization) more than 30% and the stock had nearly doubled from our original purchase. However, after that period growth began to slow and profits began to decline. We felt the stock was fairly valued given the slowdown in growth and sold the majority of our shares in the first quarter.

FLIR Systems manufacturers infrared camaras used in a variety of commercial, personnel, and government markets. The firm received some publicity when the Boston Police Department used one of its cameras to capture the Boston Marathon bomber hiding in a boat.

We originally purchased the stock during calendar year 2013 below $30 a share. During the first few years of ownership, the company struggled and announced a large acquisition in a non-core business. Results were weak and the Board of Directors began to feel pressure from shareholders, including us. We held personal meetings with the CEO and interacted with the lead director via letters and phone conversations. In June of 2017, FLIR announced a new CEO, Jim Cannon from Stanley Black & Decker. Jim communicated a solid plan and hired a strong CFO to help implement that plan. His vision included selling some of the lackluster divisions and a significant increase in profit margins. The stock reacted favorably and by late 2018 was above $60. At that point, we had a double in our investment in five years, a 15% rate of return.

Unfortunately, FLIR has not sold any divisions and borrowed money to buy two businesses with exciting technologies (drones), but little in the way of current sales and profits. Last year, the company announced they would be scrapping their original turnaround plan. Needless to say, the stock reacted poorly to this news. After two CEOs in seven years and uneven results, we decided to sell the stock. Our timing was not ideal. While we made a profit on the holding, it was well below what it should have been.

In late April, we made the difficult decision to sell all our shares in **Marriott International (MAR)**. We say it was difficult because we admire Marriott CEO Arnie Sorenson and the company's "asset lite" business model. While everyone has probably stayed at a Marriott hotel, you may not realize that Marriott actually owns very few hotels. Most of their hotels are owned by third parties that have invested their own capital to own the building. These third parties pay Marriott a fee to manage the property, make reservations, and allow the hotel property to participate in the very successful Marriott loyalty program. This arrangement allows Marriott to grow without putting up any money to build new hotels.

We sold the stock due to a combination of two reasons. As the largest owner of hotels around the world, Marriott is very exposed to the decline in international travel and the elimination of large conventions and group meetings. Most Marriott hotels are not drive-to locations – but require a resumption of airline traffic. In addition, Marriott customarily carried more debt than our typical holding given the steadiness of its business model. Of course, in a pandemic that steadiness is gone and we expect a significant decline in profitability this year. This combination of debt and declining profits led us to err on the side of caution and sell the stock.

A Buy and Quick Sell

During the year, we bought and sold a position in **Monro**. The company operates more than 1,200 automotive repair and tire stores around the country. We don't usually sell a stock after just a few months of ownership. However, given the decline in the market and the opportunities that presented us, we sold our position in Monro to purchase what we believe are higher quality businesses.

Purchases

As we mentioned above, we purchased 18 stocks during the first six months of the year. The vast majority, 16 of the 18 purchases, occurred between February 27 and April 3. Rather than give a description of all 18 stocks, we think it is helpful to understand what we were looking for in the businesses that we were buying stock in and why we believe they can add to future returns.

First, some definitions. What do we mean by a high-quality business? We think about business quality as a combination of the amount of cash profits the business can send to its owners and the amount of capital, or investment, that is needed to run the business. It is logical that a business that can return a lot of cash to its owners with a small investment is better than the opposite situation – a low return on a large investment!

Let's look at a hypothetical example by comparing a company that drills for oil with an insurance agency. Both businesses generate cash profits on the capital invested in the business.

	Oil Company	Insurance Agency
Capital invested in business	$1,000	$1,000
Cash profit before reinvestment	$250	$380
Reinvestment needed to grow	$(500)	$(38)
Cash to the owners	$(250)	$342

There are two important points from the table. First, the insurance agency generates 50% more cash profit per dollar invested in the business. Second, to grow an oil company, you have to constantly drill new wells. Oil in the ground is a declining resource. If you drill one well and let it produce for 20 years, the oil production will decline every year into the future. Additionally, this means the cash profits from the business cannot go to the owners but must be reinvested back into the business. The typical oil company invests more than one year's cash profits and must raise more money every year.

On the other hand, the insurance agency has very few reinvestment needs, maybe a few new computers! Virtually all the cash the business generates can be returned to the owners. Which business would you rather own?

So, what did we buy in the first six months of the year? The table below shows a number of the new holdings and how they compare to the average public company in the key items of return on invested capital and capital intensity.

Coronavirus Bear Market 2020 - Quality Opportunities
FAM Funds example - two metrics on business quality:

- Column One = Capital Intensity - lower is better
- Column Two = ROIC (measure of Return on Invested Capital) - higher is better

FAM VALUE FUND		
HOLDINGS THAT WERE ADDED TO IN Q1	**CAPEX/CFO (3-YRS.)**	**ROIC LTM**
COMPANY A	13%	91%
COMPANY B	25%	76%
COMPANY C	18%	54%
COMPANY D	26%	36%
COMPANY E	30%	31%
COMPANY F	6%	36%
COMPANY G	37%	37%
Company H	53%	22%
Company I	8%	65%
Company J	9%	57%
AVERAGE	23%	50%
MEDIAN	21%	45%
AVERAGE (1,000 COMPANIES)	52%	26%
MEDIAN (1,000 COMPANIES)	36%	22%

Securities Purchased in the Value Fund Between Feb 27 and April 3, 2020	
Analog Devices	Genpact
Berkshire Hathaway	Landstar System
Black Knight	Steris PLC
Broadridge Financial Solutions	Stryker Corp.
CarMax	The Hanover Group
Fastenal Co.	Vulcan Materials
Fidelity National Info Services	Xilinx
Fortune Brands Home & Security	Zebra Technologies

Closing Thoughts

As we write this letter, we are observing both the good news of a second strong jobs report and the troubling news of a doubling in the virus infection rate in the United States from 4% of tests to 8% in just 19 days (June 12 to July 1).[4] While economic activity has improved from March/April levels, we are now confronted with a potential pullback as governments order some businesses to close temporarily to "stop the spread."

Given the highly uncertain outlook, we are focusing on buying shares of stock in what we deem to be the best companies at good prices, increasing the quality of our holdings, and reducing our exposure to balance sheets with debt. Two of our sales, Marriott International and Monro, were some of our highest debt businesses. We know that this strategy will likely underperform the initial snapback in stock prices during a recovery, but believe it's the best long-term (2+ years) strategy for protecting capital in a potential decline and achieving long-term returns.

Our Investment Philosophy and Process

Finally, especially during these extraordinary days, we feel it is important to reiterate our investment approach as we did in our 2019 letters.

Our philosophy can be summed up in the idea of intrinsic value. We believe that every asset, be it a bond, piece of real estate, or company has a value that is "intrinsic" to that asset. The value of an asset comes from the amount of cash it produces and the rate of growth of that cash flow into the future. If you know the future outcomes of these two variables, it is fairly easy to figure out what an asset is worth.

This is how we think about valuing companies and therefore the value of their stock. A share of stock represents a fractional ownership in that business; therefore, the price of the stock should track the value of that business over time. Of course, making accurate projections about the future is difficult. So, we build guardrails into our investment process to mitigate risk if our forecasts are wrong.

Our process focuses on four criteria:

1. A good business that is growing and protected by some competitive advantage
2. A strong financial position with low debt, high profit margins, cash profits, and high returns on capital

[4] The COVID Tracking Project, covidtracking.com, as of 7/1/2020

3. An excellent management team that exhibits both honesty and the ability to allocate capital for the benefit of the shareholders
4. A purchase price that is below what we think the stock is worth

Once we purchase a stock, we follow it closely and try to meet with management face-to-face at least once a year. We also monitor the price-to-value relationship over time. As long as the stock does not become significantly overvalued, we tend to hold onto our stocks for many years.

This long-term view is reflected in the Fund's low turnover ratio which is significantly lower than the mutual fund industry average. One benefit of a long holding period is that when we do sell a stock and realize a capital gain, it is usually a long-term gain which is taxed at a lower rate than a short-term gain.

FAM Funds will continue to follow our business-first approach as we conduct in-depth, firsthand research at the company level. Our steadfast focus is to invest in a collection of high-quality businesses that we think are getting more valuable over time – regardless of the short-term political or economic environment.

Thank you for investing with us in the FAM Value Fund.

Best & Worst Performers for 12/31/19 to 6/30/20*

Top 5 Contributors	Average Weight (%)	Contribution (%)	Top 5 Detractors	Average Weight (%)	Detraction (%)
Fastenal Co.	2.74%	0.42%	Markel Corp.	4.60%	-1.10%
Dollar General	2.28%	0.41%	CDW Corp.	5.31%	-1.22%
Black Knight	3.02%	0.37%	South State Corp.	1.52%	-1.24%
Analog Devices	1.33%	0.37%	EOG Resources	1.96%	-1.28%
Xilinx	1.16%	0.26%	Ross Stores	5.66%	-2.07%

This reflects the FAM Value Fund's best and worst performers, in descending order, based on individual stock performance and portfolio weighting. Past performance does not indicate future results.

Performance (as of 6/30/20)

	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception 1/2/1987
FAM Value Fund Investor Shares	-11.72%	-4.49%	6.22%	7.27%	10.92%	10.07%
Russell Midcap Index	-9.13%	-2.24%	5.79%	6.76%	12.35%	11.09%
S&P 500 Index	-3.08%	7.51%	10.73%	10.73%	13.99%	10.35%

Past performance does not indicate future results.

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**Reflects top contributors and top detractors to the fund's performance based on each holding's contribution to the overall fund's return for the period shown. The information provided does not reflect all positions purchased, sold or recommended for advisory clients during the period shown. It should not be assumed that future investments will be profitable or will equal the performance of the security examples discussed. Past performance is no guarantee, nor is it indicative, of future results. For more detailed information on the calculation and methodology as well as a complete list of every holding's contribution to the overall fund's performance during the time period shown, please call (800) 932-3271 or visit the fund's website at famfunds.com. Portfolio composition will change due to ongoing management of the fund. References to individual securities are for informational purposes only and should not be construed as an offer or a recommendation, by the fund, the portfolio managers, or the fund's distributor, to purchase or sell any security or other financial instrument. The summary is not advice, a recommendation or an offer to enter into any transaction with Fenimore or any of its affiliated funds. The portfolio holdings as of the most recent quarter most recent quarter.*

FAM VALUE FUND TOP 10 HOLDINGS

As of 6/30/20

Name	% of Total Net Assets
Brown & Brown, Inc.	6.41%
IDEX Corp.	6.18%
Ross Stores, Inc.	5.66%
CDW Corporation	5.32%
CarMax, Inc.	4.66%
Markel Corporation	4.60%
Brookfield Asset Management Inc. - Class A	4.46%
Illinois Tool Works, Inc.	4.16%
Berkshire Hathaway	3.62%
Air Products & Chemicals	3.47%
TOTAL NET ASSETS	$1,220,033,599

AVERAGE ANNUAL TOTAL RETURNS AS OF JUNE 30, 2020

The performance data quoted represents past performance.

	SINCE INCEPTION	10 YEAR	5 YEAR	3 YEAR	1 YEAR	TOTAL FUND OPERATING EXPENSES*
FAM VALUE FUND *Investor Class (1/2/87)*	10.07%	10.92%	7.27%	6.22%	-4.49%	1.20%*
Institutional Class (1/2/17)	10.09%	N/A	N/A	6.42%	-4.30%	1.12%*

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Please consider a fund's investment objectives, risks, charges and expenses carefully before investing. The FAM Funds prospectus or summary prospectus contains this and other important information about each Fund and should be read carefully before you invest or send money. To obtain a prospectus or summary prospectus for each fund as well as other information on the FAM Funds, please go to fenimoreasset.com or call (800) 932-3271.

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**FAM Value Fund Disclosure: The Fund's total annual operating expense ratio as stated in the fee table of the Fund's most recent prospectus is 1.26% after fee waivers of (0.01)% for the Investor Class. The Fund's total annual operating expense ratio as stated in the fee table of the Fund's most recent prospectus is 1.00% after fee waivers of (0.12)% for the Institutional Class. When excluding Acquired Funds Fees and Expenses, which are not direct costs paid by the Fund's shareholders, and fee waivers, the total annual operating expense as reported in the FAM Value Fund's audited financial statements for the Investor Class is 1.18% after a fee waiver of (0.01%) and the Institutional Class is 0.99% after a fee waiver of (0.12%) as of 12/31/19. The Advisor has contractually agreed, 5/1/2021, to waive fees and/or reimburse the Fund certain expenses (excluding interest, taxes, brokerage costs, Acquired Fund Fees and Expenses, dividend expense and extraordinary expenses) to the extent necessary to maintain Net Fund Operating Expenses for Investor Shares at 1.18% and Institutional Shares at 0.99%.*

Institutional Class shares became available for sale on January 1, 2017. For performance prior to that date, this table includes the actual performance of the Fund's Investor Class (and uses the Fund's Investor Class' actual expenses), without adjustment. The performance results shown on this and the next page for the periods prior to January 1, 2017, the date of commencement of operations for Institutional Shares, are for the Investor Shares, which are subject to higher fees due to differences in the shareholder administrative services fees and certain other fees paid by each class. Institutional Shares and Investor Shares would have substantially similar performance results because the shares of each class are invested in the same portfolio securities of the Fund. Because of the difference in the level of fees paid by Investor Shares, the returns for the Investor Shares may be lower than the returns of the Institutional Shares.