FAM Value Fund

Annual Shareholder Letter 2018

December 31, 2018

Dear Fellow Value Fund Shareholder,

In 2018, most investments declined with U.S. stocks, international stocks, real estate, and some bonds providing a negative return for the year. It was the opposite of 2017 when these asset classes produced positive returns overall.[1] In this difficult environment, the FAM Value Fund declined -6.18% for the year. This was a little better than the Fund's primary benchmark, the Russell Midcap Index, which declined -9.06%.[2] As 2018 was the FAM Value Fund's 32nd year, we have experience in many different market environments. During this time, the Fund has declined nine of those years, a little less than one-third of the time. The table below shows the calendar years and the amount of the annual decline.

Year	Annual Return	Year	Annual Return	Year	Annual Return
1987	-17.2%	2002	-5.3%	2011	-0.4%
1990	-5.4%	2007	-0.8%	2015	-1.7%
1999	-4.8%	2008	-28.7%	2018	-6.2%

Of course, every decline is a little different and the bear market of 2018 came on suddenly after stock prices hit a number of all-time highs during the year. It may be hard to remember that the Dow Jones Industrial Average closed at more than 25,000 for the first time in January.[3] Given the speed of the decline, we are being asked the question, "What's happening in the market?" Our thought is that the combination of slowing worldwide economic growth and high stock valuations has contributed to a fall in prices. The point about high valuations is important. We have been concerned about valuations for a couple years. The sentences below were written two years ago in the 2016 FAM Value Fund Annual Letter:

"The net result of these trends could be a record year for corporate earnings. We should point out that the stock market has already anticipated this good news. The price to earnings ratio on the S&P 500 Index is the highest in more than a decade and many individual stocks that we look at are trading at, or above, our estimate of fair value."

When we wrote these words, the U.S. stock market, defined as the S&P 500 Index, was trading at 18.8 times trailing earnings compared to a long-term average of 17.7 times. By the end of calendar year 2017, the multiple of earnings was even higher at 20 times.[4] In short, investors were willing to pay a high multiple for corporate earnings due to low interest rates and expectations of strong future growth. Using the weather as an analogy, many investors were expecting blue skies forever. Now, with some storm clouds brewing, they are likely re-evaluating their outlook. These clouds include slower economic growth in China and Europe, political uncertainty around the world, and concerns about the future level of interest rates in the United States. If there is a silver lining in these clouds, it is the fact that stocks are a much better value today and we are finding more investment opportunities.

To illustrate this point, in the first nine months of the year we made only one significant investment, a purchase in **Henry Schein (HSIC)**. In addition, we made small purchases in three existing holdings. During this time, the portfolio's cash balance drifted up to nearly 10% of the Fund's assets. Since September 30, we have invested more than $85 million in two new stocks and several existing holdings (please see the Portfolio Activity section for details).

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[1] Bloomberg, 12/31/18
[2] Bloomberg, 12/31/18
[3] Bloomberg, 12/31/18
[4] Bloomberg, 12/31/18

When we tell people that our investment team has been fairly active in the market the immediate question is usually, "Well what are you buying?" The answer to that question is consistent over time. While the company names change in any particular year, we continue to execute our investment philosophy and process. Our philosophy can be summed up in the idea of intrinsic value. We believe that every asset – be it a bond, a piece of real estate, or a company – has a value that is "intrinsic" to that asset. A share of stock represents a fractional ownership in a business. The value of that business comes from the amount of cash it produces and the rate of growth in that cash flow into the future. If you know those two variables, it is fairly easy to figure out what a firm is worth. Of course, making accurate projections about the future is difficult. As a result, we build some guardrails into our investment process to protect us if our forecasts are wrong.

Our process revolves around four core criteria that we seek:

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
3. An excellent management team that exhibits both honesty and the ability to allocate capital
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 the management team 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.

Portfolio Activity

Purchases

During the first nine months of the year, we purchased one new position and added a small amount to three existing holdings: **Air Products & Chemicals (APD)**, **Dollar General Corp. (DG)**, and **Mohawk Industries (MHK)**.

As mentioned above, the new holding from early 2018 is **Henry Schein (HSIC)**. Schein is a distributor of dental, medical, and veterinary products to office-based practices. The main product categories are consumables, equipment, and software. It is a global enterprise with one-third of their sales outside of the United States. We have long admired Schein and their management. The corporation has a long track record of success with a 10-year sales growth rate of almost 8% per year and eight consecutive years of earnings per share growth.[5] This strong performance has been reflected in the valuation of Schein's stock. Over the last 10 years, the stock has had an average price-earnings ratio of nearly 19 times earnings and has regularly traded above 20 times earnings.[6] Given uncertainty in the distribution industry, we were able to purchase the stock in the first quarter at less than 17 times earnings.

Since our purchase, the company has reported solid earnings with positive organic sales growth in all six of their segments. In addition, management is taking steps to unlock shareholder value through the creation of a software joint venture and the spin out of their veterinary business into a separate firm. While there are questions about the role of distributors in the dental industry going forward, we believe Schein's lead over the other players and the proactive moves by management could result in a higher stock price.

In the fourth quarter, we were very active adding to 13 existing holdings and purchasing one significant new position, **Avery Dennison Corp. (AVY)**. The existing buys covered a number of industries including banking, energy, and industrials. In each case we believe the stock was selling at a price that was below the true intrinsic value of the company. With several purchases in the last quarter, the Fund's cash is down to 5.49% of assets. We believe the future returns on these purchases should be much higher than the returns on cash over the long term.

Based on sales and market share, Avery Dennison is the leader in manufacturing pressure-sensitive labels. These labels are used on thousands of products from bottles to automotive tires. Avery's size and 40% market share give them an advantage over their competitors in product pricing and delivery.[7] Management has done an excellent

[5] Henry Schein 2017 Annual Report
[6] Bloomberg, 12/31/18
[7] Avery Dennison 2017 Annual Report

job in growing the operation and profit margins over time. We estimate that the return on invested capital is above 15% and that Avery generates significantly more cash than is needed to grow the business. We purchased the stock after it declined more than 25% from its high price.

Sales

There were three significant sales during the year.

When the market was roaring in January, we sold our entire position in **Loews Corp. (L)** after a 40% increase in the stock price over the last two years. Loews is a holding company in New York City managed by the Tisch family. The enterprise has five primary assets and a liquid investment portfolio, so it is fairly simple to add up the value of the pieces and determine a per share value. The challenge has been that the public stock price has typically traded at a significant discount to the sum of the parts. We believed this was due to management's poor capital allocation decisions. After observing management's choices over a few years, we determined the value of the business was growing at only a modest rate and that it was unlikely that the discount to fair value would close.

Our longtime real estate investment, **Forest City Realty Trust (FCE.A)**, was acquired by another one of our holdings for $25.35 in cash. We valued Forest City at $25 a share and made a substantial purchase in 2016 at below $19 a share. Our value was confirmed this summer when one of our holdings, Brookfield Asset Management, offered $25.35 to acquire it. The acquisition closed in December and we were able to redeploy the cash proceeds into other investments.

Finally, we sold the majority of our shares in the advertising agency **Interpublic Group of Companies (IPG)**. We originally purchased the stock in April of 2012 when IPG was the operating laggard among the four, global advertising holding companies. These firms are in the flow of most advertising dollars spent around the world helping organizations with creative ideas, purchasing advertising time, and developing campaigns. Historically, these were great businesses as agencies earned a commission on every dollar spent by advertisers to promote their products. IPG was the laggard, but we thought the problems were solvable by a new management team. We were right. The new team fixed the balance sheet and increased profit margins over the last six years. The stock price doubled over this time. In the last few years, we have been questioning the ad agency business model given the amount of new competition and disruption in the industry. The emergence of new competitors such as Google and Facebook may have changed the game for the traditional advertising model. In addition to our concerns about competition, IPG made a large acquisition funded in part by increased debt. This added to our concern and we sold almost all of our shares.

Closing Thoughts

After a very quiet 2017, stock prices swung wildly in 2018's fourth quarter. Given the recent twists and turns in stock prices, it seems more perilous than usual to make a prediction about 2019. With all the normal caveats about predicting the future, this is what we are seeing today. Corporate news and economic data released the first week of January indicate that the global economy is slowing and expectations about earnings for 2019 may be too high. We should learn much more in the third week of January when companies begin to report their financial results.

In the meantime, the Fund's holdings are generating considerable cash profits that can be used for investment, acquisitions, dividends, or stock buybacks. We think we have invested in management teams that can use these cash profits wisely and create value per share. The recent decline in stock prices has created more opportunities to purchase shares in well-run operations at a discount to what we think they are worth. After a few years of writing about fair to high valuations and limited opportunities, we see good opportunities to invest in what we believe to be great businesses at attractive prices.

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

Best & Worst Performers for 2018

Best Performers		Worst Performers	
CDW Corp.	0.95%	Mohawk Industries	-2.13%
AutoZone	0.67%	Illinois Tool Works	-0.85%
Interpublic Group of Companies	0.46%	MEDNAX	-0.69%
Brown & Brown	0.36%	South State Corp.	-0.64%
Henry Schein	0.30%	EOG Resources	-0.63%

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 12/31/18)

	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception 1/2/1987
FAM Value Fund Investor Shares	-6.18%	-6.18%	8.26%	7.18%	11.55%	10.08%
Russell Midcap Index	-9.06%	-9.06%	7.04%	6.26%	14.03%	11.04%
S&P 500 Index	-4.38%	-4.38%	9.26%	8.49%	13.12%	10.02%

Past performance does not indicate future results.

John D. Fox, CFA
Co-Manager

Thomas O. Putnam
Co-Manager

Drew P. Wilson, CFA
Co-Manager

FAM VALUE FUND TOP 10 HOLDINGS

As of 12/31/18

Name	% of Total Net Assets
CDW Corp.	6.1%
Ross Stores	5.9%
IDEX Corp.	5.3%
Markel Corp.	5.1%
Brown & Brown	4.7%
Berkshire Hathaway, Inc. - Class A	4.4%
Brookfield Asset Management Inc. - Class A	3.7%
CarMax, Inc.	3.4%
AutoZone	3.4%
Illinois Tool Works, Inc.	3.2%
TOTAL NET ASSETS	$1,132,404,096

AVERAGE ANNUAL TOTAL RETURNS AS OF DECEMBER 31, 2018
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)*	10.08%	11.55%	7.18%	8.26%	-6.18%	1.20%*
Institutional Class (1/2/17)	4.96%	N/A	N/A	N/A	-6.00%	1.01%*

**Disclosure: The total annual operating expense ratio as stated in the fee table of the Fund's most recent prospectus is 1.20% 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 1.01% after fee waivers of (0.18)% for the Institutional Class. The total annual operating expense as reported in the Fund's audited financial statements is 1.18% as of 12/31/2017 after a fee waiver of (0.01%) for the Investor Class. The Advisor has contractually agreed, untl May 1, 2019, 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%.*

Past performance is not indicative of future results, current performance may be lower or higher than the performance date quoted. Investment returns may fluctuate; the value of your investment upon redemption may be more or less than the initial amount invested.

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 the FAM Value Fund and should be read carefully before you invest or send money. The principal risks of investing in the Funds are: stock market risk (stocks fluctuate in response to the activities of individual companies and to general stock market and economic conditions), stock selection risk (Fenimore utilizes a value approach to stock selection and there is risk that the stocks selected may not realize their intrinsic value, or their price may go down over time), and small-cap risk (prices of small-cap companies can fluctuate more than the stocks of larger companies and may not correspond to changes in the stock market in general).

To obtain a prospectus or summary prospectus and performance data that is current to the most recent month-end for each fund as well as other information on the FAM Value Fund, please go to famfunds.com or call (800) 932-3271.

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