

Written by Tye Bousada

Apple Orchard

ATS Automation Tooling Systems Inc. (ATS) is one of the top holdings in your Portfolio. The bulk of ATS's profitability is derived from their systems group, which is engaged in planning, designing, building, and servicing automated manufacturing and assembly systems. For example, when a healthcare company needs to design an automated handling solution for its fragile test tubes containing biohazardous material, it contacts ATS.

After following ATS for many years, we saw an opportunity in early 2009 to start building a position in the business. At the time, investors were very concerned that companies would no longer build new production lines and therefore, would no longer need ATS's services. This fear translated into what we believed was a very low share price for ATS relative to its long-term potential. As a result, we started buying shares in the company. Since the first quarter of 2009, the fears around ATS's business have subsided somewhat, and the share price has appreciated as a result. Specifically, it has increased from our average cost of approximately \$6 to over \$7 today - an appreciation in excess of 16%.

Looking forward, the medium-to-long term outlook for ATS is very strong. In our judgment, ATS can more than triple its profitability from its current run rate over the next five years due to increased demand for its products and services as well as due to an expanding level of profitability across its business lines. Additionally, ATS has a very strong balance sheet with over \$130 million in cash and only \$40 million in debt. Finally, and most importantly, we do not believe this growth in profitability nor ATS's strong balance sheet is currently reflected in the stock price. Based on our analysis, ATS is trading for less than 7.5 times its future earnings. Stated another way, if we owned 100% of this business, our cash return would rise to above 13% per year.

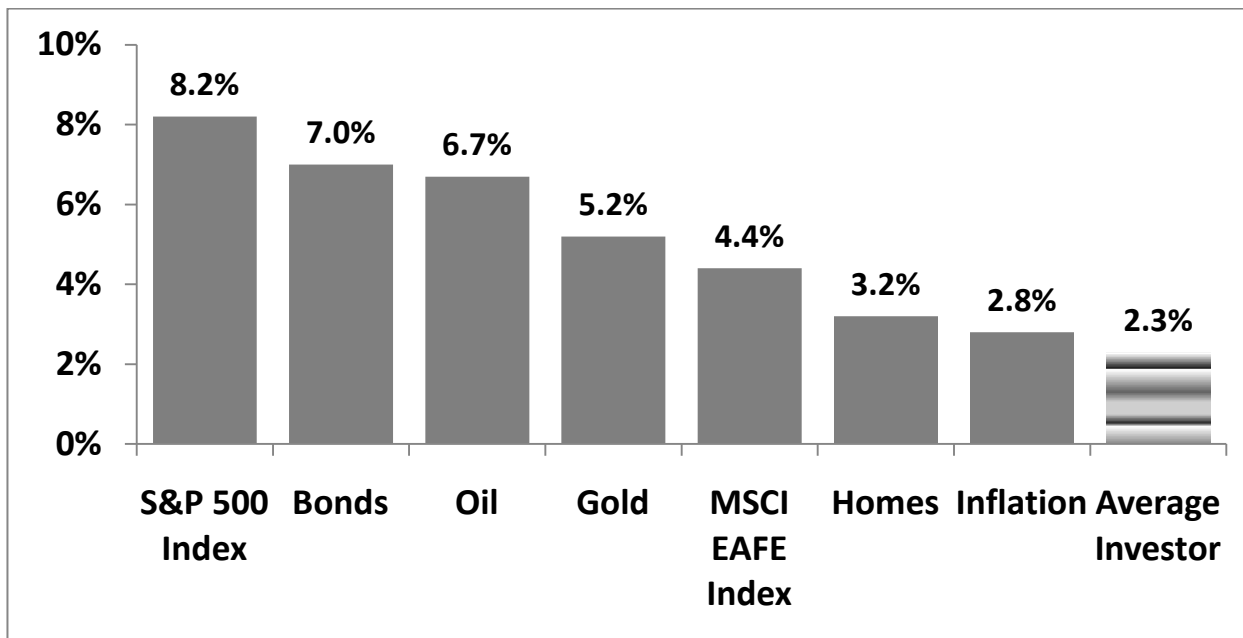
The appreciation of ATS's share price has not been a straight line up over the last year and half. In fact, the short-term volatility in the share price has been quite substantial. As best we can tell, this volatility has been driven by macro-economic news. Negative macro-economic news creates fear and causes people to sell the shares while positive news reduces pessimism resulting in higher stock prices. This can be best exemplified by ATS's share price movement over the last four months. Specifically, its share price at the beginning of June was \$7.10 and it ended the quarter (September 30th) at a price of \$7.07. You might be asking yourself where the volatility is. Well, within this period, ATS fell by over 23% and then appreciated by 29%.

Did the value of the underlying business actually decline by 23% and then subsequently increase by 29% in four short months? We don't believe so. What created the volatility, in our opinion, was the simple fact that the price of ATS is quoted on a daily basis and people were reacting to short-term global news, most of which had absolutely nothing to do with the fundamentals of ATS's business. This short-term news caused a material disconnect between the price of ATS and the longer-term value of the company.

Imagine for a minute that you started a small apple orchard when you were 20 years old. Over the years, you have grown that business into a profitable enterprise with lots of opportunities for future growth. As an

owner of that business, your primary goal is likely to ensure that you are wisely managing the risks in your business in order to protect what you have built. Your second goal is likely to capitalize on the growth opportunities ahead of you. You have no plans to sell the business immediately as you don't need the money today so your orchard is a long-term investment. Now ask yourself the question: would receiving a price quote on your apple orchard every quarter, month, week, day, hour, or second help you make better or worse decisions about your business? For the vast majority of people, the answer is: much worse. Here is the proof:

20-year Annualized Returns by Asset Class (1990 – 2009)



Source: JP Morgan, Bloomberg

Bonds: Barclays Capital US Aggregate Bond Index; Oil: Bloomberg WTI Cushing Crude; Homes: S&P/Case Schiller US Home Price Index; Inflation: US Consumer Price Index; Investor returns: Calculated using Dalbar fund flow information; Annualized returns in USD

Focusing on short-term price fluctuations can cause the following:

1. The desire to chase whatever is hot - buying it after the price has already moved up, just in time for it to move down
2. A narrow focus on short-term performance, causing a person to forget why the original investment was purchased in the first place
3. An emotionally-driven investment decision

Our focus at EdgePoint is to deliver investment results that are at or near the top of our peer group over a ten year-time frame. In order to achieve this, we follow our time-tested investment approach.

Specifically, we are long-term investors in businesses. We view a stock as an ownership interest in a high-quality business and we endeavour to acquire this ownership stake at a price below our assessment of its true worth.

We believe that the best way to buy a business at an attractive price is to have an idea about the business that is not widely shared by others - what we refer to as a proprietary insight.

We strive to develop proprietary insights around businesses we understand. We focus on companies that have strong competitive positions and defensible barriers to entry, strong long-term growth prospects, and are run by trustworthy and competent management teams. These holdings generally reflect our views looking out more than three years. We firmly believe that focusing on longer time periods enables us to develop proprietary views that are not reflected in the current stock price.

Our approach is deceptively simple. We buy good, undervalued businesses and hold them until the market fully recognizes their potential. Following this approach requires an ability to think independently, a natural curiosity necessary to search out new ideas, and a commitment to embrace the thorough research that is required to uncover opportunities the market doesn't fully appreciate. It also requires us to shut out the noise and emotion that short-term price fluctuations can cause.

Fixed Income Comments

The macro-economic uncertainty that has contributed to the equity volatility has created interesting opportunities in corporate bonds this quarter. Corporate bond spreads widened this quarter pushing Canadian corporate bond spreads wider by 5 to 20 basis points (one basis point is equivalent to 0.01%) across the yield curve this year.

This uncertainty has enabled us to find several attractively-priced convertible bond issues that not only provide attractive yields but offer the opportunity to participate in any upward movement in stock prices. In the meantime, we are comfortable owners of the bond, while receiving a coupon (interest) payment.

Kinetic Concept's convertible bond, which matures in 2015 was purchased with a yield of 4.24%, or 300 basis points over U.S. government bonds with a similar maturity. Kinetic Concepts is the leading provider of wound care therapy and there is a great opportunity for the company to expand the application of their technology as well as increase international sales. We like the fundamentals of Kinetic Concept's medical technology business and believe it could grow significantly over the next five years. This bond issue allows us to participate in the success of the business while still paying us a coupon.

The size of the Canadian dollar high-yield bond market in Canada has grown throughout 2010, with approximately one new issue each month. We have selectively participated in a number of new bond issues whose underlying business fundamentals we feel are strong and the company is able to generate substantial free cash flow.

Corus Entertainment Inc. issued 7-year debt in February of this year with a coupon of 7.25% and a spread of 445 basis points over Government of Canada bonds. Corus is a leading Canadian media and entertainment company that has a strong presence in specialty TV channels, radio and content development. The company owns powerful brands and is run by a conservative management team that has generated solid returns and is committed to having a clean balance sheet free of high levels of debt. We purchased Corus bonds through the new issue process and increased our initial position by purchasing additional bonds in the secondary market. While the bonds have risen in price from their initial price of \$100 to \$106 at the end of September, we continue to own these bonds which pay a relatively high coupon.

Corporate bonds continue to represent 100% of the bond component of the portfolio.

In summary, we are pleased with the collection of businesses in your portfolio and excited about their long-term individual prospects. We continue to approach investing in these markets with a sense of measured confidence. We thank you for your confidence in us, and look forward to having the opportunity to build wealth for you over the long term.

Sincerely,

Tye

Commentary as at September 30, 2010. The above companies are selected for illustrative purposes and are not intended to provide investment advice. EdgePoint Investment Group Inc. may be buying or selling positions in the above securities.

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