COHO CAPITAL

Coho Capital Management, LLC

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Dear Partners,

Coho Capital increased 6.3% in 2016 compared to a rise of 12% in the S&P 500. Our portfolio did not participate in the post-election rally, which was led by heavily leveraged, commodity and industrial companies. It is always nice to beat the markets, but we consider annual results short-term in nature and focus our efforts on compounding capital over the long-term. Over the last five years, Coho Capital has increased at 20.2% per year compared to 14.7% for the S&P 500. We utilize the S&P 500 Index as a comparison because it is the most difficult index to beat over time. We realize our investors have alternatives for their money and want them to compare the performance of Coho against their best option, an S&P 500 Index fund.

Given our global mandate to seek value, we could utilize the MSCI ACWI Index as another way to assess performance. Relative to the MSCI, Coho Capital has returned an extra 10.6% per year, resulting in aggregate outperformance of 92.5% over the past five years.

In our note about Amazon, we wrote about investing in businesses that are inevitable. Part of what makes a business inevitable is a self-reinforcing business model. Google is a great example. The company processes three billion searches per day. Every individual search refines future search results, further optimizing the accuracy of Google's search algorithm. This feedback loop continually strengthens the efficacy of Google's search product while simultaneously widening its competitive moat. Compare the virtuous circle of Google's business with the vicious cycle of a mining business: A mining company mines surface level ore first, but upon depletion must drill further into the earth incurring greater costs the longer it is in business. Thus, the business becomes structurally weaker over time.

There are not many self-reinforcing business models in the world, but of those available we feel there is a greater representation within the technology sector than any other segment of the economy. Value investors are often quick to dismiss investments in technology companies for fear that competitive moats are ephemeral. The evidence is strong in this regard, with technology's inexorable march vaporizing former sure things. But what if we have entered a new paradigm? The phrase "new paradigm" may set off alarm bells, but it is our contention that software focused business models possess more durable moats than when hardware ruled the roost. Venture Capitalist Marc Andreessen advanced this notion in his seminal essay "Software is Eating the World."

Many value investors view technology through a hardware-centric lens, a view premised upon the manufacturing of non-essential gadgets with ever shrinking margins. After a brief window to make

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money, bankruptcy is all but assured once someone invents a better mousetrap - essentially, grist for the creative destruction at the heart of capitalism. The shift from a hardware-centric to a software-centric world, however, has turned this notion on its head. Software-centric business models are some of the most compelling in all of business; light capital expenditures, infinitely scalable, high switching costs, and naturally conducive toward network effects. In short, many of the qualities one sees in a self-reinforcing business. We want to own these types of business and the Market is offering them to us at attractive prices because too many market participants remain focused on a hardware-centric notion of technology.

We scooped up several self-reinforcing business models at attractive prices during the second half of the year. They are profiled below:

Alibaba

We have studied Alibaba for a long time beginning with our investment in Yahoo, which represented a backdoor way to acquire Alibaba, not publicly traded at the time. In our year-end 2013 letter, we wrote the following on Alibaba:

“Founded by former English teacher Jack Ma, Alibaba is a phenomenon. The company dominates the world’s largest e-commerce market with a 49% share, compared to Amazon’s 20% share of the US online retail market. Approximately 73% of all online retail transactions in China utilize Alibaba’s online payment platform, Alipay. Alibaba possesses profit margins of 44% compared to 0.5% for Amazon.

It would not surprise us if in a few years’ time, Alibaba is amongst the world’s most highly valued companies. “

We visited the company again in our 2014 mid-year letter, as we outlined our rationale for purchasing Softbank:

“In short, we continue to believe that Alibaba represents one of the most compelling growth stories in global markets. With a nearly unassailable position within its business segments, enviable economics, and a long runway for growth, we believe Alibaba has a shot at becoming one of the most valuable companies in the world.”

It is fair to say our thesis on Alibaba has not changed. The company has a lot of things we desire in a business: network effects, switching costs, scalability, and latent pricing power.

Alibaba is a collection of business units, but is most well-known for its e-commerce segment consisting of Alibaba (business-to-business), Taobao (consumer-to-consumer and business-to-consumer) and Tmall (online shopping mall for branded goods). The group grew sales 54% year-

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over-year during the most recent quarter and counts 493 million monthly active users across its three platforms.

The supplanting of brick and mortar retail by e-commerce is happening more quickly in China than in the States due to less robust physical retail infrastructure. Chinese E-commerce sales grew 36% last year to approximately $900 billion and now represent roughly 18% of aggregate retail sales, compared to 12% in the US. With an 80% share of Chinese e-commerce, it is fair to think of Alibaba as a toll on online Chinese consumption. Chinese consumption trends should remain favorable with Boston Consulting Group predicting 20% annual growth in online spending over the next four years. According to eMarketer, a market research company, China's online spending will be greater than the rest of the world's e-commerce combined, providing ample runway for Alibaba's ecommerce business.

Like Amazon, Alibaba's multiple business units reinforce each other, creating a business ecosystem that grows more valuable with each additional user and transaction – a self-reinforcing business model. With one out of every three Chinese using Alibaba's ecommerce options, the company possesses tremendous network effects. This provides Alibaba a platform for onboarding new services, such as Alipay (online payment), YunOS (second largest mobile operating system in China), Autonavi (China's leading map service supplier), Tmall Supermarket (online grocer), Juhuasuan (group shopping) AliCloud (cloud computing) Youku Tudou (online video hosting and streaming) and others.

Alicloud and Ant Financial in particular are poised to emerge as lucrative growth drivers over ensuing years.

Alicloud is the leading cloud company in China with a 70% share. Like Amazon, Alicloud has aggressively lowered prices to rapidly scale, having dropped prices sixteen times last year. Increased economies of scale create a virtuous cycle with reduced prices attracting new customers, enabling greater scale and widening Alicloud's competitive moat. In addition, Alibaba's significant in-house demand for cloud computing services provides a natural platform to scale offerings and incubate new technologies, providing the company a substantial advantage over competitors.

AliCloud already has a $1 billion run rate and is expected to grow by a 100% compound annual growth rate over the next two years. However, because Alicloud is still in investment mode and sustaining operating losses, the market ascribes it minimal value. Amazon's cloud business achieved operating margins of 22% once it reached $3B in sales, suggesting Alicloud could demonstrate profitability as early as next year. Once Alicloud demonstrates a profitability inflection we think the market will confer a rich multiple on its earnings stream. Ultimately, we believe Alicloud can be the Amazon AWS of China, but at its nascent stage of growth, the market does not yet recognize the

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potential. We saw a similar scenario play out with our holdings in Amazon and expect a favorable outcome with Alibaba as well.

While the market may not rerate Alibaba's cloud business for a couple of years, a more immediate opportunity for monetization lies in Alibaba's 33% stake in Ant Financial, a leading Chinese fintech company established by Alibaba in 2004. Ant Financial's anchor product, Alipay, was launched by Alibaba to solve the core bottleneck to Chinese e-commerce, how to transact without widespread adoption of credit cards. With 450 million users, Alipay is now China's most popular online payment method with a 68% share of the mobile payment market.

In addition to Alipay, Ant Financial offers a broad range of financial services and products including insurance, money market funds, wealth management, and credit scoring. Similar to its cloud business, Ant Financial's scale provides the company an almost unassailable advantage. For example, Ant Financial's wealth management unit, Yu'e Bao has 152 million active annual users compared to 9.9 million for Charles Schwab or 7 million for Chinese competitor Citic Securities. The company's credit scoring service, Sesame Credit, is like FICO in the US and has scored 130 million credit profiles.

Established payment processors are typically difficult for new entrants to dislodge. New providers must navigate a trust gap with new users, which is difficult to do without scale. We are comforted by the fact that Alipay understands trust is its core product and key to its longevity – "No matter what kind of technology you're using, trust is the most fundamental thing when it comes to financial services. Yes, you can use different ways of consumer marketing to get many users in a short period of time, but if you want to sustain a business, it has to be based upon trust." – Eric Jing, Ant Financial CEO speaking at Davos earlier this year.

Beyond China, Alipay is making impressive gains abroad with 40 million overseas users transacting in eighteen currencies. Alipay is accepted by over 100,000 foreign merchants and has partnered with leading banks and payment vendors, such as Barclays, First Data and VeriFone. Perhaps most significant for Alipay's opportunities abroad has been the company's partnership with Uber, which accepts Alipay in 68 different countries. We expect Alipay's overseas opportunities to expand considerably with the Chinese diaspora, as well as Chinese tourists, creating network effects to aid its adoption.

Ant Financial was valued at $60 billion during its last round of financing in April of 2016. Given its role as China's de facto online currency, we expect a larger valuation upon IPO, rumored to be later this year. We expect Ant Financial's IPO to be an important catalyst in highlighting Alibaba's 33% stake in the company.

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"Information is the oil of the 21st century, and analytics is the combustion engine." – Peter Sondergaard, Gartner, Global Head of Research

Alibaba's massive platform of users opens multiple pathways to monetize user data. Aggregation of data across media, e-commerce and entertainment channels provides a rich data set with myriad opportunities to cross-sell additional products and services to its large and growing base of customers. We expect Alibaba to monetize its data through the provisioning of merchant service and optimization tools. For example, Ant Financial utilizes Alibaba's data to target personal loans and wealth savings vehicles to its customers.

Despite its dominant position and compelling growth opportunities, Alibaba does not have a demanding valuation. We think Alibaba's core business should trade at least 25x forward earnings given its inherent operating leverage and projected annual sales growth of over 28% over the next few years. This results in a stock price of $114. If we add $15 per share for Alibaba's investments and stake in Ant Financial, we arrive at a stock price of $129, 27% higher than today's quotation. We expect emergent businesses such as Alicloud and digital entertainment to be material contributors to future economic returns providing downside support.

After Amazon, Alibaba is our second largest position.

Software Feedback Loops Enable Winner Take All Markets

"In normal markets you can have Pepsi and Coke. In technology markets in the long run you tend to only have one…. The big companies, though, in technology tend to have 90 percent market share. So we think that generally these are winner-take-all markets. Generally, number one is going to get like 90 percent of the profits. Number two is going to get like 10 percent of the profits, and numbers three through 10 are going to get nothing." – Venture Capitalist Marc Andreesen

The dominance of Facebook and Google is astonishing. Together, the two companies have a 64% share of the digital ad market with Facebook at 33% and Google at 31%. Despite their dominance, both companies are growing their reach with Google capturing 60% of all digital advertising growth and Facebook the remainder at 40%. All other digital online marketers and ad tech platforms are losing share. Such dominance could be reason for caution if the digital ad market were mature. However, we expect growth to remain explosive as advertising share of old media remains well above its proportion in digital media.

Google and Facebook's stranglehold on the digital economy extends to apps as well with the two companies combining for eight of the top ten mobile apps.

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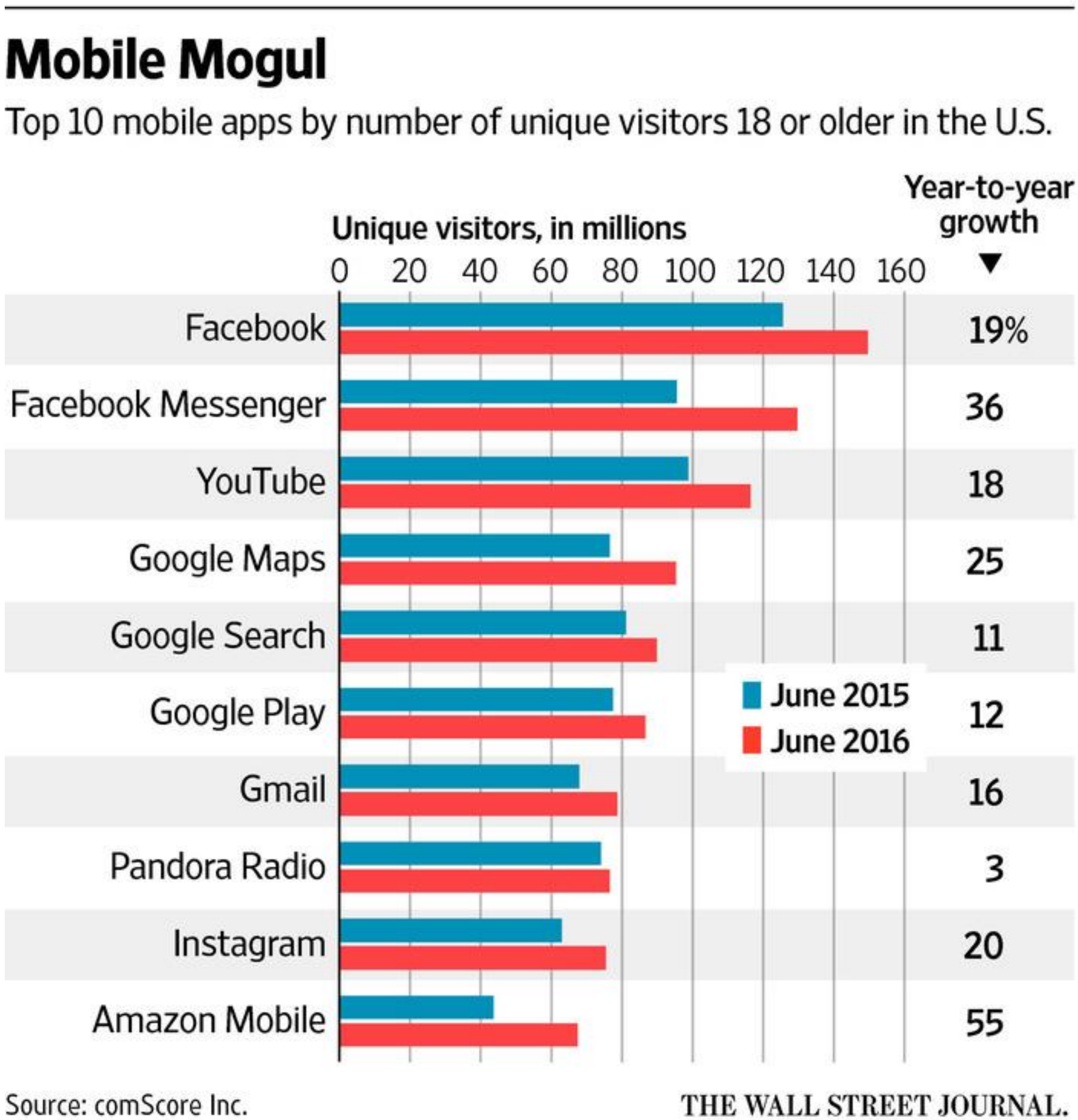

We think both companies possess durable moats and are underpriced.

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Facebook

"Man is by nature a social animal." – Aristotle

The world has never seen a company with the reach of Facebook. The company's social network has 1.8 billion users with 1.2 billion of those users, or a sixth of humanity, using the service daily. Over a billion people use its messaging platform WhatsApp, which is the second most popular app in the world, after Facebook at number one. Facebook's other messaging platform, Facebook Messenger, also surpassed one billion users last year. For those counting, that is three apps with over a billion users each. Facebook's fourth platform, Instagram, may become the fourth, having grown to 600 million users last year and still experiencing rapid growth.

With incremental margins of 70% and revenue of over $3 million per employee, Facebook possesses a monopoly-like profit engine. We think Facebook is still early in its monetization opportunity with inherent operating leverage and multiple pathways to drive profits through software enhancements and enhanced data utilization.

Facebook is akin to a multi-level marketing company, yet it does not have to peddle product. There is nothing untoward about what Facebook does, but like a multi-level marketing company it leverages its users' social networks. Instead of product, however, Facebook sells advertising and media feeds. Users freely turn over their data every time they use the site, creating a rich stream of data to mine for profits. It is no wonder Facebook enjoys such lush margins, considering the company is the world's largest media distribution platform—and does not pay for any of its content.

Despite the company's global reach, its monetization efforts are nascent. In a worldwide advertising market of $700 billion, Facebook has less than a 4% share. We expect to see a dramatic acceleration in advertising market share as Facebook gets more adept utilizing data. Recent market data confirm our thesis with social network ads accounting for 3.6% of Internet traffic to retailer sites over the holidays, approximately 10 times the 0.25% share they garnered last year.

Facebook is the perfect example of network effects in action. The greater the number of users on Facebook, the greater its utility for all users. Like Google, there is a virtuous aspect to its operations. The more we use Facebook, the more data we provide its software algorithms, which in turn become smarter in tailoring news and advertising toward us. This data creates a rich vein for Facebook to mine for optional services.

With many of its users engaged across its multiple platforms, Facebook becomes in effect a mobile operating system (OS), offering a menu of choices to remove friction from users' lives. Why open separate apps, when you can order an Uber, play games, exchange photos, stream videos, and make payments all through the same software interface? China's most popular messaging platform, WeChat, has executed on messaging as a mobile OS brilliantly. Recent updates to Facebook

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Messenger capabilities, along with the hiring of WeChat executives, suggests Facebook seeks to execute the WeChat playbook on a global scale.

Facebook properties dominate the mobile economy. It's scale and user base extends across geographies and nearly every conceivable demographic. We think the company is just scratching the surface on utilizing its treasure trove of data to grow profits. With the Street focused on slowing ad loads, as well as bungled advertising metrics, this wonderful business can be purchased for less than 20 times next year's earnings.

Alphabet (Google)

"Google has a huge new moat. In fact, I've probably never seen such a wide moat." – Charlie Munger

It should be clear from our discussion of Facebook and Alibaba that technology is a platform driven world. Those with the most used platform win due to exponentially lower costs as platform users scale. This is again a core differentiation between a hardware-centric technology marketplace and a software-centric technology marketplace. While there are hardware standards, there are rarely hardware platforms. A platform requires scalability and a transaction nexus for users, something much more difficult to pull off via hardware.

Google is one of the most relied upon utilities in the world, with over three billion searches a day. According to NetMarketShare.com, Google has a 78% share of global desktop search and over 90% share in mobile search. Every search refines Google's search results, improving search optimization. Perhaps this is why competitors have not been able to make a dent in Google's market share. After years of effort and billions of dollars spent by Microsoft, Amazon and others, there remains no acceptable substitute for Google. Further, Google has sealed off potential breaches to its moat by establishing dominance in browsers (Chrome has over 50% share in desktop browsers) and mobile operating systems (Android has a 78% share of the mobile phone market operating system).

As with Facebook and Alibaba, Google aggregates data across its ecosystem of services to serve up more precise advertising and create additional opportunities for monetization. If data is the oil of the 21st century, then Google is John. D. Rockefeller. Apart from search, Google has six separate products with over a billion users including YouTube, Gmail, Google Maps, Google Play Store, Android and Chrome. Google's ability to mine data across its properties, as well as to quantify results, makes it the most effective advertising channel in the world. Emarketer, a market research company, expects digital advertising to grow at a 40% annual clip over the next five years, suggesting Google can continue to grow earnings at a heady clip.

Google has been competitively entrenched for so long that the company acquired a high-class problem – it was making so much money that financial discipline was an afterthought.

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Businessweek detailed the company's efforts to instill more financial discipline under new CFO Ruth Porat in a recent cover story.

"Adwords meant advertisers only paid for ads that worked. The result revolutionized media and advertising, and gave Google a revenue stream that almost seemed limitless. Googlers have a name for its ad business: the 'cash machine.'" – Businessweek, Budgeting Google's Moonshot Factory

Google's Other Bets, or non-alpha bets (there can be only one ALPHAbet and it is search) lost $3.6 billion last year. Ms. Porat has been culling speculative bets and insisting upon a realistic path to profitability, while removing redundancies. We think a bit more financial supervision was needed and should provide a nice tailwind to earnings.

As for Google's core search business, it recently completed its 20th straight quarter of 20% growth. Put another way, Google has doubled its search business in less than a year, for five straight years!

Apart from its search business, Google has attractive future monetization opportunities in its cloud business, maps and YouTube.

Google CEO Sundar Pichai has called YouTube the "primetime of the mobile era." He is right. The site is an advertisers' dream reaching ten times more 18-49-year-olds during primetime than the top ten shows combined. More than a billion people watch YouTube videos each month with 80% of those users outside the U.S.

The future is mobile and YouTube is tailor-made for mobile with more than half of its video clips watched on mobile devices. It reaches more Millennials than any cable network. Generation Z, those born during 1995 or after, consume 2-4 hours of YouTube a day, compared to less than an hour of traditional television. Eight hundred twenty million people use YouTube for music streaming, seven times more than its next largest competitor, Spotify. As advertising dollars continue to shift from linear television to digital, YouTube should be a prime beneficiary.

Google's cloud business (Google Cloud Platform or GCP) is currently a distant third to Amazon and Microsoft. Nonetheless, the company has a few arrows in its quiver to capture market share. Most importantly, technology infrastructure is not an impediment with Google controlling 30% of the world's web traffic. The company's global collection of data centers with homegrown servers, extensive fiber network, and world-class security ensures the company can deploy its infrastructure in an economically sensible manner despite its late start.

Google has spent two decades organizing massive amounts of data and knows better than anyone how to utilize data to unearth insights. We expect Google's data analytics expertise will enable the company to make competitive inroads in cloud computing. As the world moves toward unlimited computing power and storage, it is hard to think of a company better positioned than Google.

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Recent GCP product introductions suggest such a road map, with Google's expertise in data analytics and machine learning being applied to language translation, image sorting and text contextualization.

After netting out cash, Google currently trades for 17x 2017 earnings, below the S&P 500 multiple of 18x. This is well below other dominant companies with durable franchises and cheap relative to Google's 20% growth. However, if one considers that YouTube, GCP and Other Bets are still in investment mode, the valuation metrics become even more favorable. If YouTube were valued like a cable network, it would be worth $300 a share. GCP could be worth as much as $100 per share right now. Adjusting for the value of YouTube and GCP brings Google's multiple to less than 11x earnings. The multiple moves to 8x if we adjust for net cash. How much would you pay for all this? Don't answer, because if you act now, you will also get Google's investments in drones, internet balloons, smart contact lenses, Nest thermostats, voice technology, autonomous cars, robots, broadband, Google Maps and Waze for free!

Visa

Apart from Google, Visa is the best business model we have ever seen. It is essentially a royalty on global spending. Visa is the ultimate network effects business, with retailers dependent upon the vendor with the most users (billions of Visa cards issued) and users wedded to the vendor with the most points of purchase (over 44 million merchants). This has resulted in deep integration within the payments ecosystem. Visa accounts for nearly half of all credit card transactions.

Despite its dominance, we expect Visa to experience sustained double digit earnings growth. The secular shift away from cash and checks is in early innings with 85% of global transactions still conducted by cash and check. The migration to plastic/electronics payments should accelerate in coming years with consumers eager to adopt the convenience and security that electronic payments provide, as well as the perks. Enhanced competition among credit card issuers has resulted in a dramatic rise in credit card rewards with the six largest issuers offering over $100 billion worth of rewards over the past six years.

The proliferation of digital payment options, such as Apple Pay and Google Wallet, as well as an increasing share of wallet for e-commerce, should drive increased volumes for years to come. Paradoxically, the growth of mobile payments has weighed on Visa's valuation as many market participants view payment by mobile phone as a threat to Visa's business model. Most mobile payment networks, however, utilize Visa's and MasterCard's networks. It is easier for Apple to partner with Visa, and its relationship with 17,000+ financial institutions and 44 million merchants, than it is to traverse the regulatory quagmire of establishing a financial network on its own.

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There is also the issue of trust, the largest barrier to widespread adoption of a new payment network. Apart from being the global standard of electronic payment – "It's everywhere you want to be," Visa has spent billions over decades building its brand. According to Interbrand, Visa is considered the 61st most valuable brand in the world, just ahead of Starbucks. Customers know their finances are secure when using Visa and that the card will be accepted almost anywhere.

As a software based business, Visa can grow with only minimal increased capital investment. As a result, incremental margins inflect higher due to tremendous operating leverage. Increased volumes should bring other benefits as well with Visa poised to reap new ancillary revenue streams through the packaging of data analytics for financial and merchant clients.

Apart from attractive long-term trends there are two medium-term trends, which we think will bolster Visa shares: Visa Europe and increased uptake in India. Visa acquired Visa Europe last year and is early in its integration efforts. Analyst models only expect modest accretion from the deal, but we believe results will surprise on the upside and offer a multi-year earnings catalyst. Credit card penetration in Europe is low at 40% relative to 55% in the U.S. In addition, Europe offers low-hanging fruit for margin optimization. Visa's fee structure in Europe is well below the Visa network average at $0.055 per transaction compared to $0.21 in the rest of the world.

As for India, Prime Minister Narendra Modi's decision to remove high value currency notes from circulation should accelerate development of electronic payments in the country. Mr. Modi's decision was made to curb tax evasion and root out corruption. Nonetheless, the long-term implications of demonetization are profound. India's war on cash has effectively taken out 86% of the total cash in circulation in an economy that is 90% cash reliant. We don't expect credit card usage to surge overnight with existing electronic payment infrastructure nascent. However, with limited ability to transact in cash, migration to electronic payment is inevitable. A massive catalyst to jumpstart credit card usage in one of the most populous, fastest growing economies in the world, positions Visa well for sustained double digit growth.

Visa is currently priced at 22x earnings, in line with its historical average. We think analysts are not properly modeling the opportunity for pricing power in Europe, but that aside, Visa is emblematic of what we want from all our holdings, a company that does the compounding for you. This is far preferable than recycling our holdings every couple of years.

Visa is also an example of studying our mistakes. The company is one of our all-time great errors of omission. We did a fair amount of research on the company prior to its IPO but decided to pass due to concerns over valuation. We watched the shares rise by nearly 5x over ensuing years.

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S&P Global (SPGI)

S&P is best known for its credit ratings business. Credit ratings denote a company's financial strength through assessing its ability to meet its debt commitments. Together with Moody's, S&P is a government sanctioned duopoly with each company controlling 40% of the market for credit ratings. The credit ratings business is attractive with strong pricing power, recurring revenues, and high margins. Pricing power comes not just from a lack of competition, but from the favorable economics created by credit affirmation. Companies with credit ratings can raise capital more cheaply than those without. Further, regulations governing deposit and capital requirements for financial institutions often feature restrictions on the credit worthiness of investment holdings. Similarly, many investment funds are structured to only invest in certain categories of debt. Thus, not only is it more economical to obtain a credit rating, it is pragmatic as well.

There are a number of earnings drivers for the credit ratings business over the next five years, providing a favorable environment for growth. Debt maturity schedules indicate that over $2 trillion a year in debt will need to be refinanced on an annual basis over the next five years. Second, increased capital requirements on behalf of European banks has attenuated bank loan issuance. As a result, European corporate issuers of debt have been increasingly utilizing public debt markets, increasing demand for debt ratings. With low interest rates and increased regulation, we expect the disintermediation of European banks to continue. Third, emerging markets continue to represent a compelling opportunity for increased debt issuance on the part of domestic corporations as well as government borrowing. Last, public finance and infrastructure spending represent an attractive opportunity for growth. According to McKinsey, adequate global infrastructure would require $57 trillion in spending to keep up with GDP growth through 2030.

Outside of the ratings business, S&P possesses a collection of excellent businesses including a dominant index franchise (S&P 500, Dow Jones), market data subscription services (Capital IQ), market intelligence (Platts), and commodity pricing (SNL Financial). Like its ratings business, S&P's non-ratings businesses are asset-light, highly scalable, feature recurring revenues and exhibit strong pricing power.

Like many of the businesses we are attracted to, S&P Global has significant future earnings growth in subsidiaries that are underappreciated by the market. Perhaps most promising is the company's 68% share of India's leading credit rating agency, CRISIL. Credit issuance in India is only in early innings leaving a multi-decade runway for growth. One of the ways we think of these types of businesses is as publicly traded "Unicorns," which have not yet been discovered and are only in series A funding rounds.

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The companies that make up Coho Capital's portfolio represent the highest quality collection of businesses that we have ever owned. Market quotations for these companies remain attractive, making now an ideal time to consider investing additional funds in Coho Capital. Since inception, Coho Capital has outperformed the S&P 500 by over 35%. If you know of someone who may be interested in our long-term business ownership approach, please consider making a referral.

Respectfully yours,

Jake Rosser
Managing Partner
Coho Capital Management