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Client Letter – June 30, 2012

You may notice the new logo at the top of this page. In order to avoid confusion with Yacktman Asset Management Co. (the company founded by my father which manages The Yacktman Funds), we have decided to officially change our company name from Yacktman Capital Group, LLC to YCG, LLC. Despite the name change, the management team remains the same and we look forward to implementing the same proven strategy that has produced favorable results.

This past quarter was one where it would be more heartening to view stock charts upside down as most of the equity market slumped. The S&P 500 index declined 2.75%, and results across our strategies were similar. Despite this down quarter, a more long-term view, which is how we believe results should be measured, shows the Concentrated Composite with Option Enhancement returning 11.55% annually since its inception four years ago, significantly outperforming the S&P 500's annualized return of 3.86%.

Recent dominant headlines included the sovereign and bank debt crisis in Europe, as well as the looming "fiscal cliff" at home. The "fiscal cliff" refers to the end of this year when the combination of automatic spending cuts and expiring tax breaks could siphon over $500 billion out of the economy next year. The over indebtedness of the US and Europe is real, and the "fiscal cliff" is unfortunately only one of many austerity decisions that these governments will be forced to make as they try to arrest the growth of their respective countries' debt to GDP. Prior fiscal and monetary policies have bought governments time, but each additional round of stimulus seems to have diminishing returns, suggesting that time is perhaps running out. In the end, though, we do not claim any clairvoyance over how the European Union or our own debt situation might look years from now, and so we spend our time constructing a portfolio of mostly high quality businesses at cheap prices that can provide an attractive rate of return no matter what the future holds.

Vivendi: Value in Complexity

With all the chaos in the European region, one might wonder why we have taken an interest in Vivendi, a large media and telecom conglomerate domiciled in France. For one, where a company is domiciled does not necessarily indicate from where a company's revenue stream is derived. Thus, the chaos can create buying opportunities for businesses that may be more insulated from Europe's woes. Also, in our experience, complexity, which Vivendi's byzantine corporate structure provides in spades, plus a rapidly falling stock price, equals a great place to search for value. So, we rolled up our sleeves, attempting to first understand the six core companies that make up the conglomerate: SFR, Maroc Telecom Group, Activision Blizzard, Canal+ Group, Universal Music Group (UMG), and GVT. Here's what we found:

SFR is the largest division by percentage of operating profit and is wholly owned by Vivendi. It is the second largest telecommunications operator in France with over 21 million subscribers and roughly a third of the mobile phone market. Recently, SFR has been plagued with negative news based on the arrival of new competitor, Iliad, which quickly garnered over 2.2 million customers and penetrated the market using a low-price strategy. This new competition has forced SFR to cut prices and is the main culprit behind the aforementioned reduced profit expectations. Fortunately for Vivendi, our research suggests that concerns regarding Iliad's power play for market share may have been overdone. Iliad's pricing strategy, while successful in gaining customers, has squeezed their margins so much that they are probably not earning their cost of capital, making it unlikely that they can sustain their lower prices over the long term. In addition, Iliad has recently had troubles with their service, dropping up to 50% of all calls during peak calling times last April. These issues, coupled with a look at how similar fourth player entrant scenarios have played out in other foreign markets, suggest that Iliad will not materially erode SFR's market share.

The second largest contributor to operating profit is Maroc Telecom Group. The company is the leading telecommunications operator in Morocco with a virtually 100% market share in fixed line and Internet (ADSL) services and a market-leading nearly 50% share of mobile phone services. As a result, Maroc Telecom currently enjoys massive monopolistic margins. While margins may be negatively impacted as fixed line usage declines in favor of a more competitive mobile broadband market, Maroc's strong share in mobile and broadband should enable it to keep cash flows relatively stable over time. Vivendi owns 53% of the company.

Next in line is a 60% stake in Activision Blizzard, the American gaming company known for its best-selling PC game, Starcraft. Currently, the company produces the ever-addictive hit PC game World of Warcraft as well as the Call of Duty video game series, which contains the best-selling game of all time. The company continues to release hit games that are not just for the video game enthusiast, but also part of a global phenomenon where large video game competitions are held. One such example is Starcraft in South Korea, where video game matches are televised and watched by millions in the country. Overall, Activision Blizzard is a stable cash cow with a strong, cash-filled balance sheet.

The fourth division is the wholly owned Canal+ Group, which has stakes in various businesses that produce and distribute premium and themed channel content in French-speaking Africa and throughout much of Europe, including the leading pay-TV service in France. In addition, Canal+ Group is looking to build its newly released CanalPlay Infinity into a dominant video streaming service, hopefully heading off any plans by Netflix to enter its market. While we're unsure about the ultimate success of this endeavor, we view it as free call option and are happy to see that Canal+ Group is actively pursuing ways to protect and monetize its valuable content.

Universal Music Group (UMG), Vivendi's fifth division and wholly owned, is the largest of the "Big Four" record companies with a leading market share. In the past, there has been much controversy due to widespread Internet piracy where only one in every ten songs downloaded was actually purchased. However, with the growth of legitimate music platforms like iTunes, it seems UMG and other record companies may start to see more growth in digital media downloads. Additionally, UMG has recently announced an agreement to purchase EMI, the fourth largest record company of the "Big Four," which should help to further rationalize cost structures and pricing in the industry. As further evidence that these companies have brighter futures than their recent past would suggest, even Napster founder Sean Parker has stated that he believes the music companies to be undervalued.

Vivendi's sixth and last core division is wholly owned Brazilian telecommunications company, GVT. As a new entrant to the Brazilian market, GVT is profitably taking market share at a fast rate. Only 18% of households have pay TV, so GVT has plenty of room to both steal market share and continue to penetrate the market space.

As for the recession concerns in Europe, not only does Vivendi derive revenues from all over the globe, but when looking at Vivendi's basket of services in Europe, it is good to note that Internet, media, and mobile services are quickly becoming non-discretionary goods in today's world. In other words, yesterday's luxuries are becoming today's necessities. Such a change in the elasticity of the goods should help to insulate revenues during a recession.

Overall, our study of Vivendi uncovered a company whose business lines of telecom, media, and games are all high market share, relatively acyclical services that produce a stream of stable and probably growing cash flows. In addition, our research suggests that the troubled SFR division's problems are likely temporary. Finally, as is so often the case, we believe that the recent precipitous drop in the stock price could serve as a catalyst to split up the company, which would greatly simplify the story and likely lead to a higher valuation for the stock. Regardless, at the time of purchase, with a bargain basement price of approximately 6x forward earnings and less than 4x earnings excluding the publicly traded Activision and Maroc Telecom stakes, and with 8% cash and 12% total dividend yields, we're getting paid handsomely to wait. So, while we certainly agree with the old saying that there's beauty in simplicity, we hope that Vivendi can help sow the seeds of a new aphorism: there's profit in complexity.

<u>Concluding Remarks</u>

As always, we are invested right alongside you. We encourage you to remain focused on a long investment horizon. Despite the global challenges, we sleep well at night owning a portfolio of what we believe to be predominantly high quality businesses trading at discounted prices. We will continue to diligently seek out the best risk-adjusted expected returns.

We thank you for your continued trust and loyalty.

Sincerely,

Brian A. Yacktman

Manager

William D. Kruger

Manager

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