HOW TO TURN $10,000 INTO $10,000,000:

INVEST LIKE WARREN BUFFETT

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Who are we?

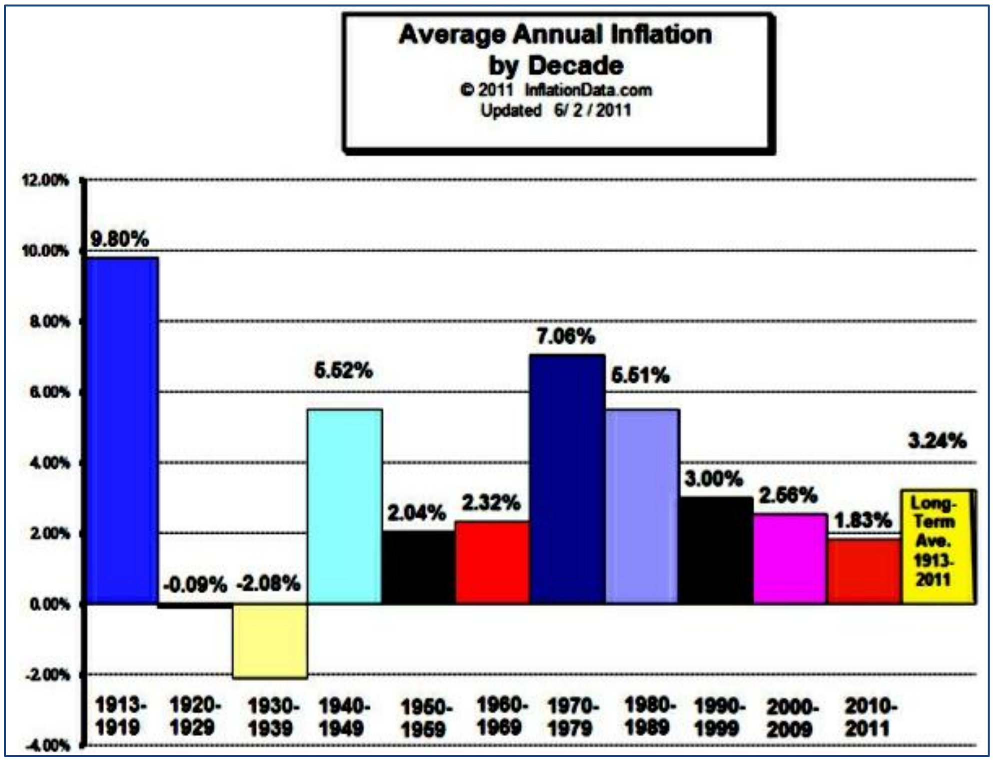
- A registered investment adviser based in New York
- We provide investment management services to all types of investors
- The foundation of our investment philosophy was inspired by Warren Buffett

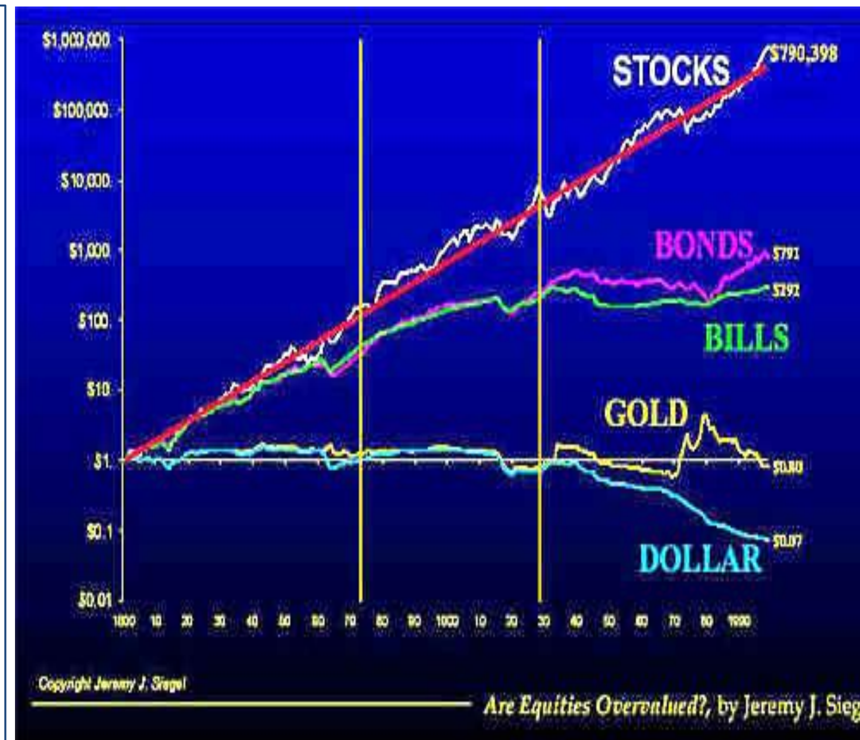
Why are we giving this presentation?

- To remove the mystery of investing in the stock market
- To show you why some money managers outperform others over the long term
- To help you better protect and grow your hard-earned assets

To protect and grow your hard-earned assets…

- Your money must keep up with inflation and taxes.
- Stocks have provided the highest return on investment over the long term.





A $10,000 Investment in Warren Buffett?

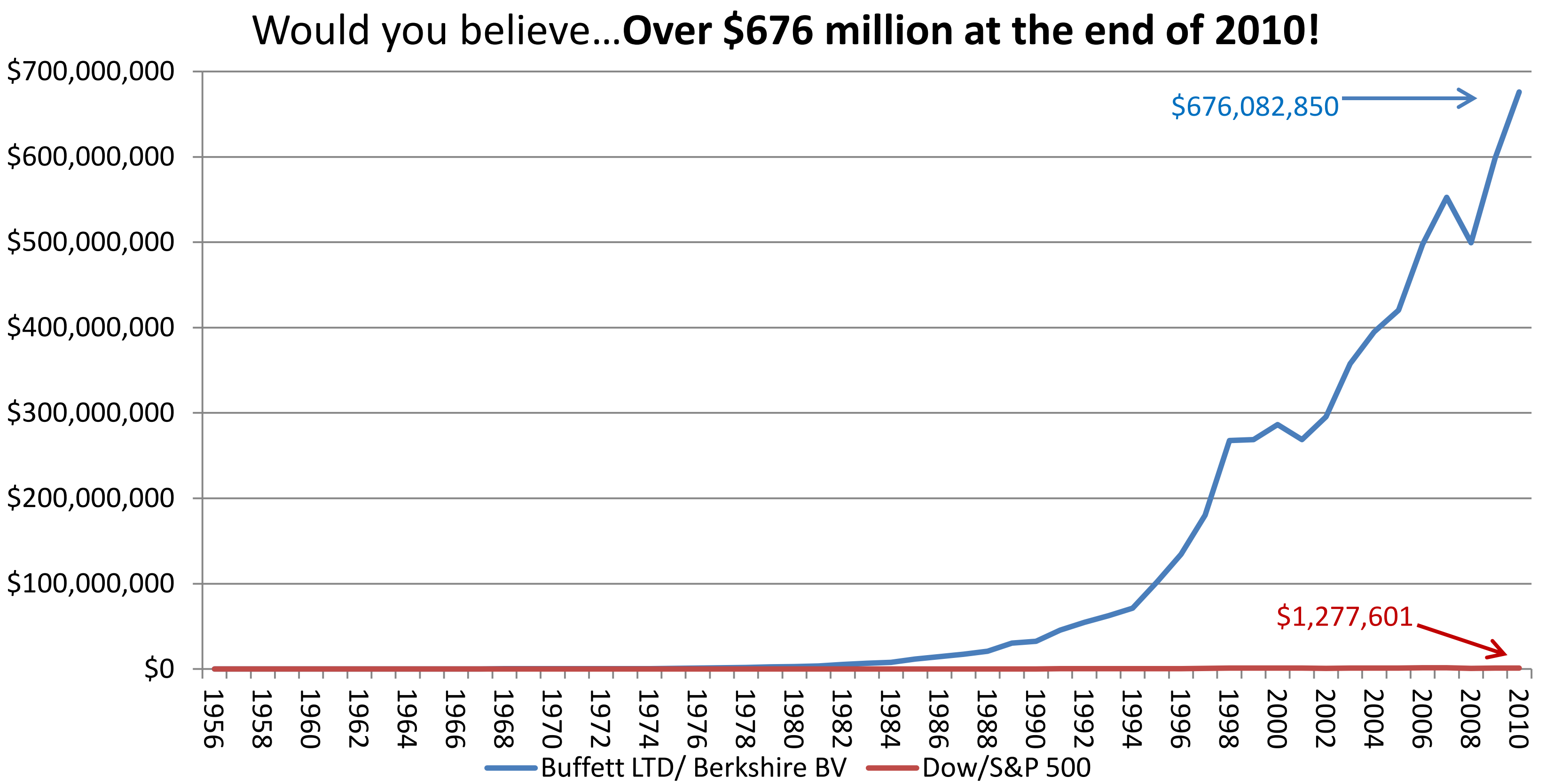
Warren Buffett: Professional Money Manager?

- 1956 — 1969: Buffett Partnerships (an early hedge fund)
- 1965 — Today: Chairman & CEO of Berkshire Hathaway

Question:

If you had invested $10,000 in the Buffett Partnership in 1956 and rolled it over into Berkshire Hathaway stock in 1969, how much would you have had at the end of 2010?

A $10,000 Investment in Warren Buffett?



*Buffett LTD/Berkshire BV represents partnership returns from 1957-1968 plus book value growth in Berkshire Hathaway from 1969-2010.
**Dow/S&P 500 represents the total return in the Dow Jones Industrial Average from 1957-1968 and S&P 500 Index from 1969-2010.

Compounded Annual Returns ➡ Buffett: 22.9%; Dow/S&P 500: 9.4%

A $10,000 Investment in Warren Buffett?

How did he do it? By…

- investing in high-tech, high-growth stocks? → No.
- investing in newly created public companies? → No.
- day-trading? → No.
- trading on inside information? → No.
- predicting the future better than others? → No.

Warren Buffett Tenets

Only invest in high-quality businesses that:

1) Are simple to understand
2) Have favorable long-term economic characteristics
3) Are managed by honest and able managers
4) Can be purchased at a significant discount to intrinsic value

An Example:

Buffett's Most Recent Investment:

An Example: IBM

I. Simple to understand?

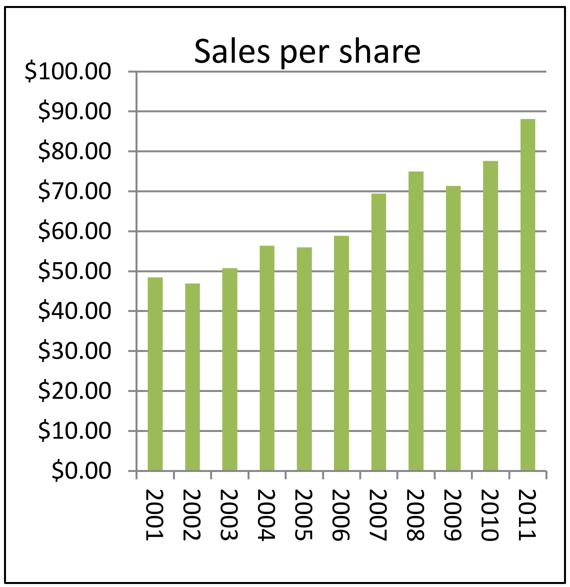
- They provide IT support services for corporations
- Over 100 years old
- Significant global presence, operating in more than 170 countries
- Nearly 60% of its operating income is annuity-like/recurring.
- 5 operating segments:

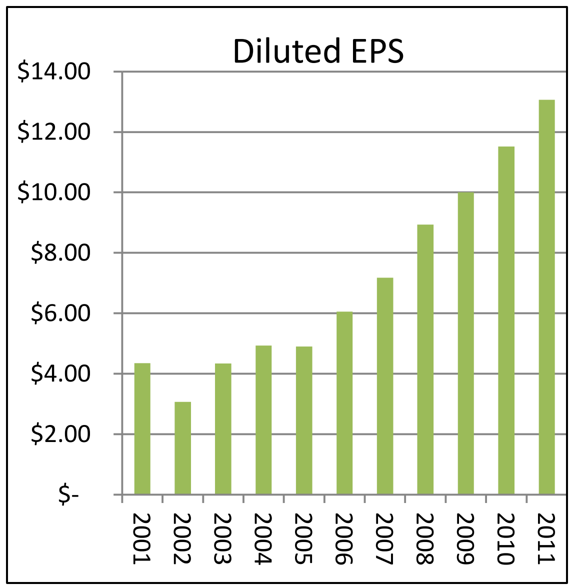
Segments:	Main Products/Services:	% of Income	Margins
Software	Middleware and operating systems software	44%	35%
Global Technology Services	IT outsourcing services	27%	15%
Global Business Services	Analytics, Strategy, Consulting	13%	15%
Global Financing	Client financing	9%	48%
Systems and Technology	Enterprise server and storage systems	7%	8%

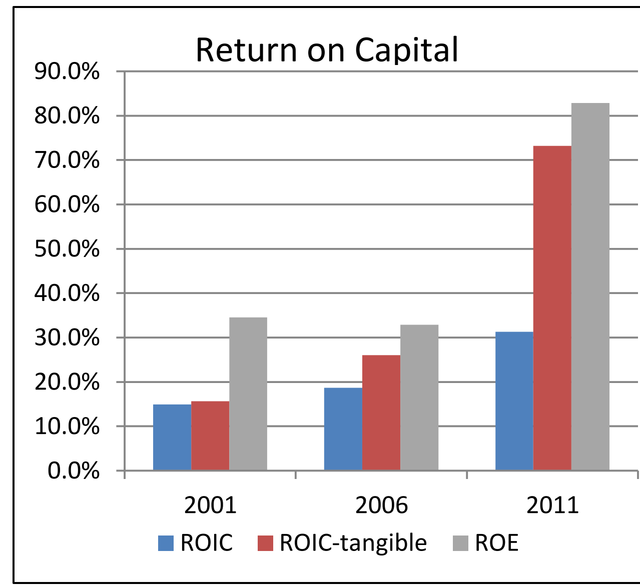
An Example: IBM

II. Consistent operating history/favorable long-term prospects?

- Buffett: "It is a big deal for a large company to change auditors, law firms or IT support."
- Strengths in R&D: IBM has been awarded more U.S. patents every year than any other company for 18 consecutive years (5,896 in 2010 alone)
- 5 year CAGR: Sales/share = 8.4%, EPS = 16.6%
- Free cash flow margins = 15%
- 5-yr avg. return on invested capital = 27%; ROE = 70%



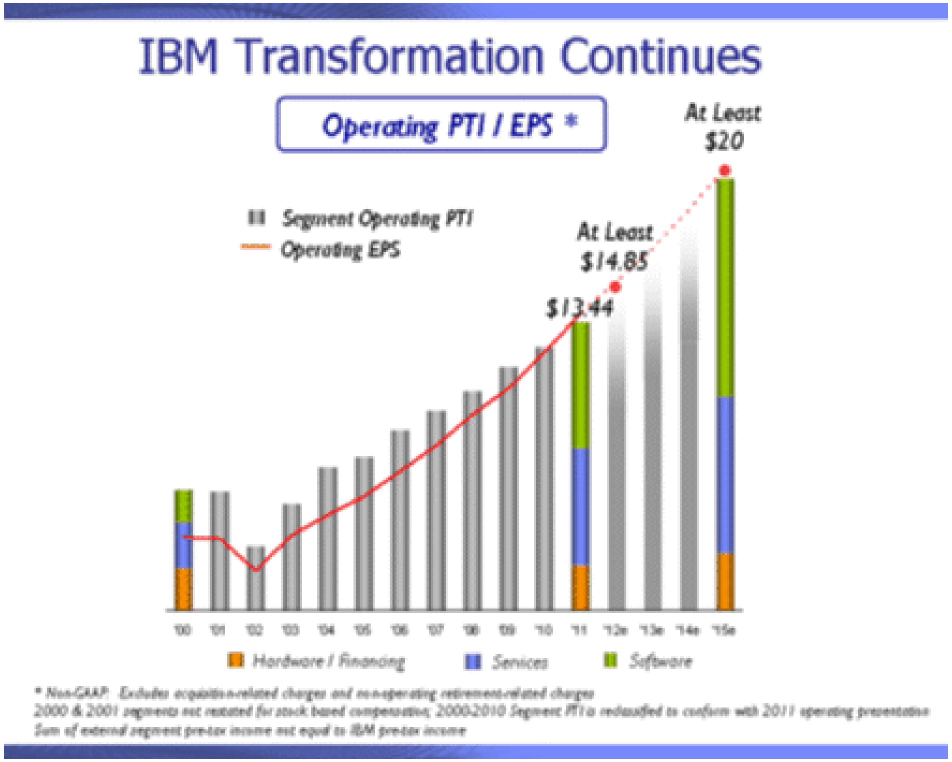




An Example:

III. Managed by honest and able managers?

- Setting long-term goals and achieving them?



III. Managed by honest and able managers? (cont.)

- Returning value to shareholders?

Historical Cash Flows			
(in millions)			
Cumulative Cash Flows: 2007-2011		Total	Line
	Cash flows from operations	$96,621	1
-	Capital expenditures	20,291	2
=	**Free cash flow (FCF)**	**76,330**	3
-	Acquisitions and additions to assets	19,039	4
+	Disposal of fixed assets	2,837	5
=	**FCF before financing activities**	**60,128**	6
+	Net Issuance of debt	7,251	7
=	**FCF available for div. & repurchases**	**67,379**	8
	Cash dividends paid	**14,242**	9
+	Stock repurchases	**52,533**	10
=	**Total Returned to Shareholders**	**66,775**	11

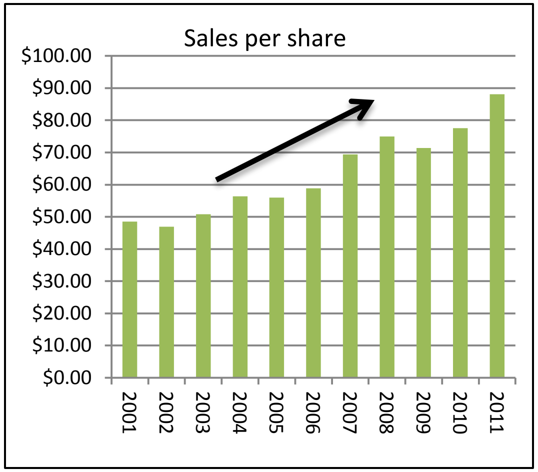
*If you had invested in IBM at the beginning of 2007, within 5 years you would have received over half of your investment back through dividends and stock repurchases.

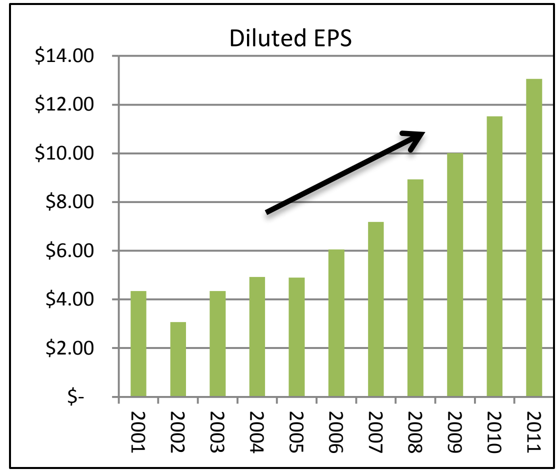
Meanwhile, the stock doubled over that time.

An Example: IBM

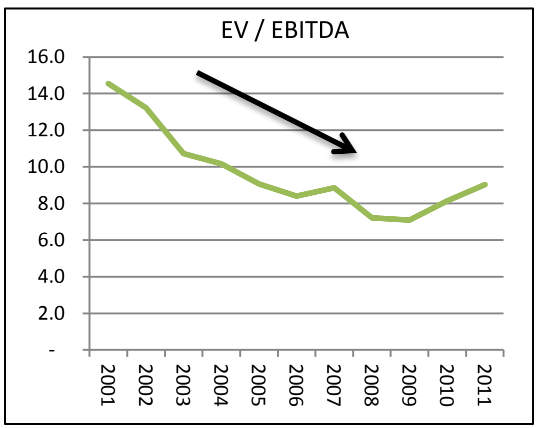
IV. Trading at a significant discount to intrinsic value?

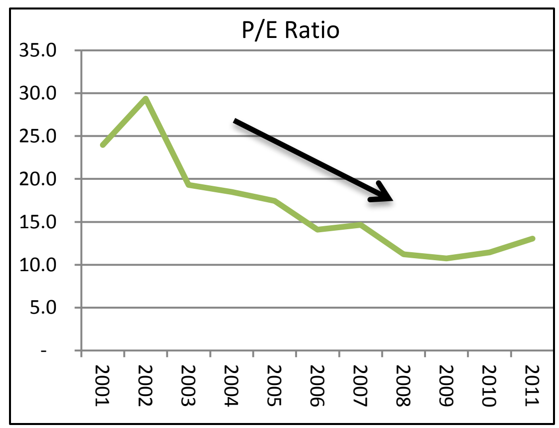
- Buffett looks for companies whose business economics…





- …have performed better than their stock prices.





An Example: IBM

IV. Trading at a significant discount to intrinsic value? (cont.)

- Traditional measures of value suggest…

Traditional Valuation *(in millions, except per share)*	As of 3/31/2011*
Stock price	$163.00
x Shares outstanding	1,287
= Market value of equity	$209,846
+ Total debt	$28,624
- Cash	$11,651
= Enterprise value (EV)	$226,819
Income Statement:	
FY2010 EPS	$11.52
FY2010 EBITDA	$22,981
FY2010 SALES	$99,870
Valuation Multiples:	
P/E	**14.2x**
EV/SALES	**2.3x**
EV/EBITDA	**9.9x**

**Buffett started buying in early 2011.*

"The stock market is filled with individuals who know the price of everything, but the value of nothing."
-Philip Fisher

But…What is the VALUE of IBM?

IV. Trading at a significant discount to intrinsic value? (cont.)

- Value comes from three main sources: Assets, Earnings Power and Growth.
- Separate the good information from the bad information.

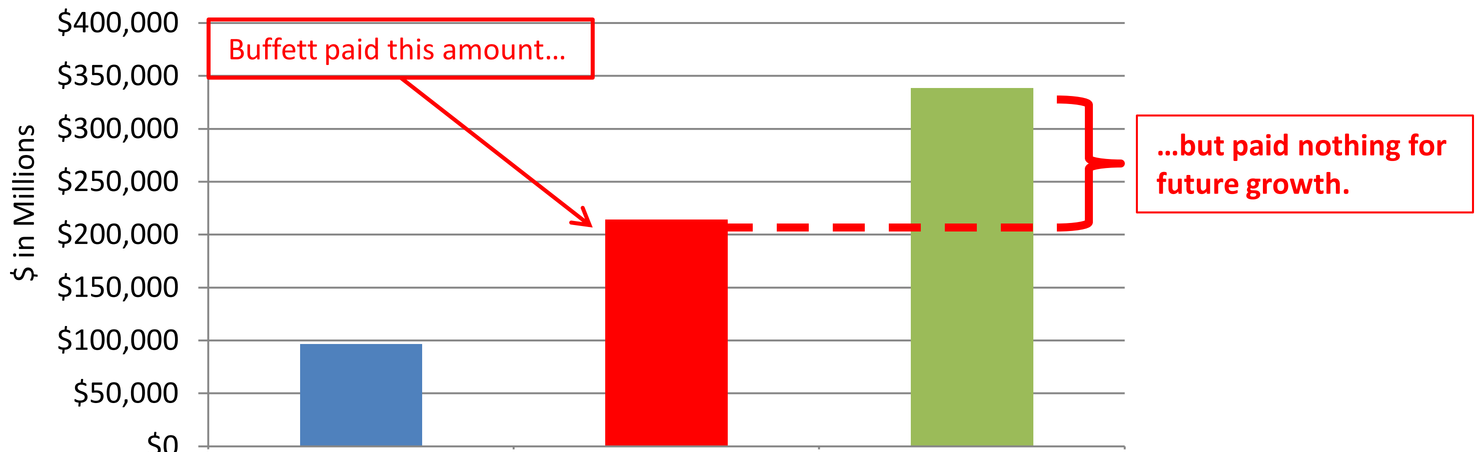
Reliability Dimension:	Asset Value (Reproduction Value)	Earnings Power Value (EPV)	Growth Value (EPV with Growth)
	✓Tangible	✓Current Earnings	✓Includes Growth
	✓Balance Sheet	✓Extrapolation	✓Extrapolation
	✓No Extrapolation	✓No Forecast	✓Forecast
	MOST RELIABLE	**LESS RELIABLE**	**LEAST RELIABLE**

Adapted from Bruce Greenwald's Value Investing Program at Columbia Business School.

An Example: IBM

Equity Valuation of IBM at the end of 2010:

- Asset Value = $98.9 billion
- Earnings power value = $215 billion. Growth does add value!
- Total intrinsic value likely between $320 billion — $360 billion.



Reliability Dimension:	Asset Value (Reproduction Value)	Earnings Power Value (EPV)	Growth Value (EPV with Growth)
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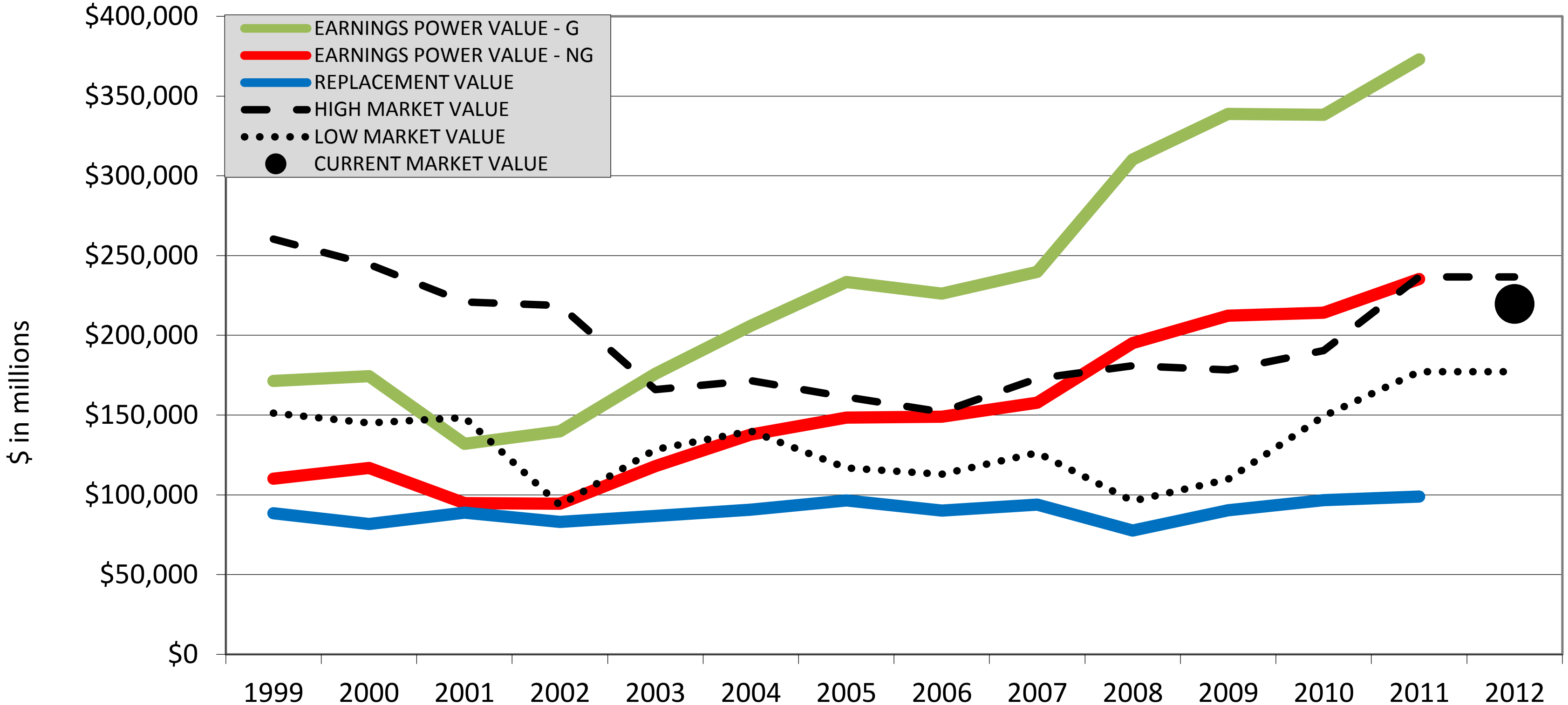
	MOST RELIABLE	**LESS RELIABLE**	**LEAST RELIABLE**

Adapted from Bruce Greenwald's Value Investing Program at Columbia Business School.

An Example: IBM

IV. Trading at a significant discount to intrinsic value? (cont.)

- From 1999 through 2002, the stock was overvalued.
- In 2008-2009, the stock was trading close to reproduction value.
- Today (January 31, 2012), IBM's stock remains undervalued (paying nothing for future growth).



An Example: IBM

IV. Trading at a significant discount to intrinsic value? (cont.)

- Another way to look at it: Free Cash Flow implied rate of return...

	Expected Forward Rate of Return	2011
	Free cash flow	$ 16,604
/	Avg. market value of equity	$ 162,630
=	**Free cash yield**	**10.2%**
+	Volume growth	2.0%
+	Inflation	2.0%
=	**Free cash flow implied forward rate of return**	**14.2%**
vs.	10-year Treasury bond yield	3.5%

An Example: IBM

Does IBM pass all of Warren Buffett's tenets?

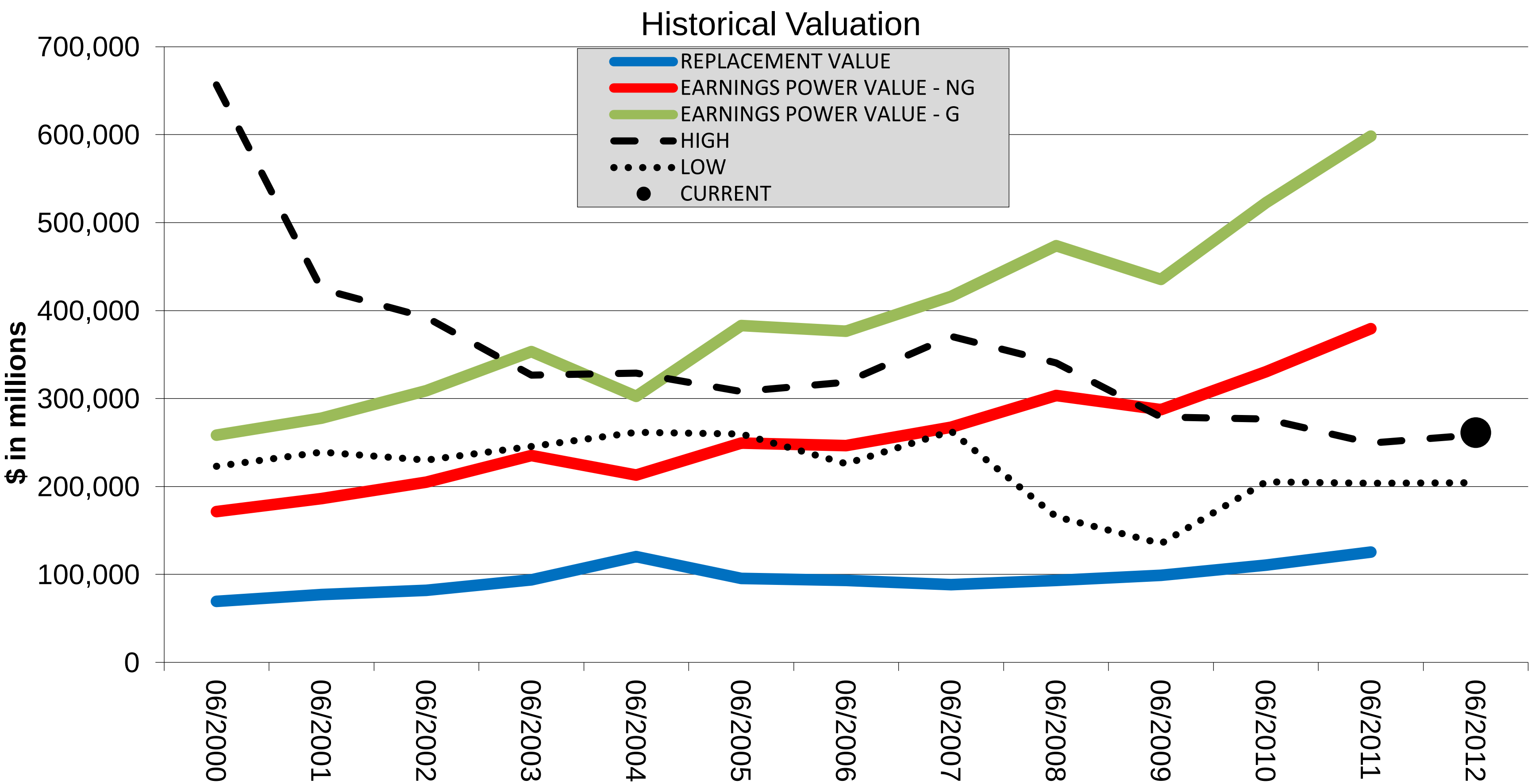
- ✓ Simple to understand?
- ✓ Have favorable long-term economic characteristics?
- ✓ Managed by honest and able managers?
- ✓ Can it be purchased at a significant discount to intrinsic value?

Conclusion:

1. Buffett bought IBM for roughly 60% of its true underlying value!
2. Free cash flow-based implied forward rate of return = 14%!!

More Examples…

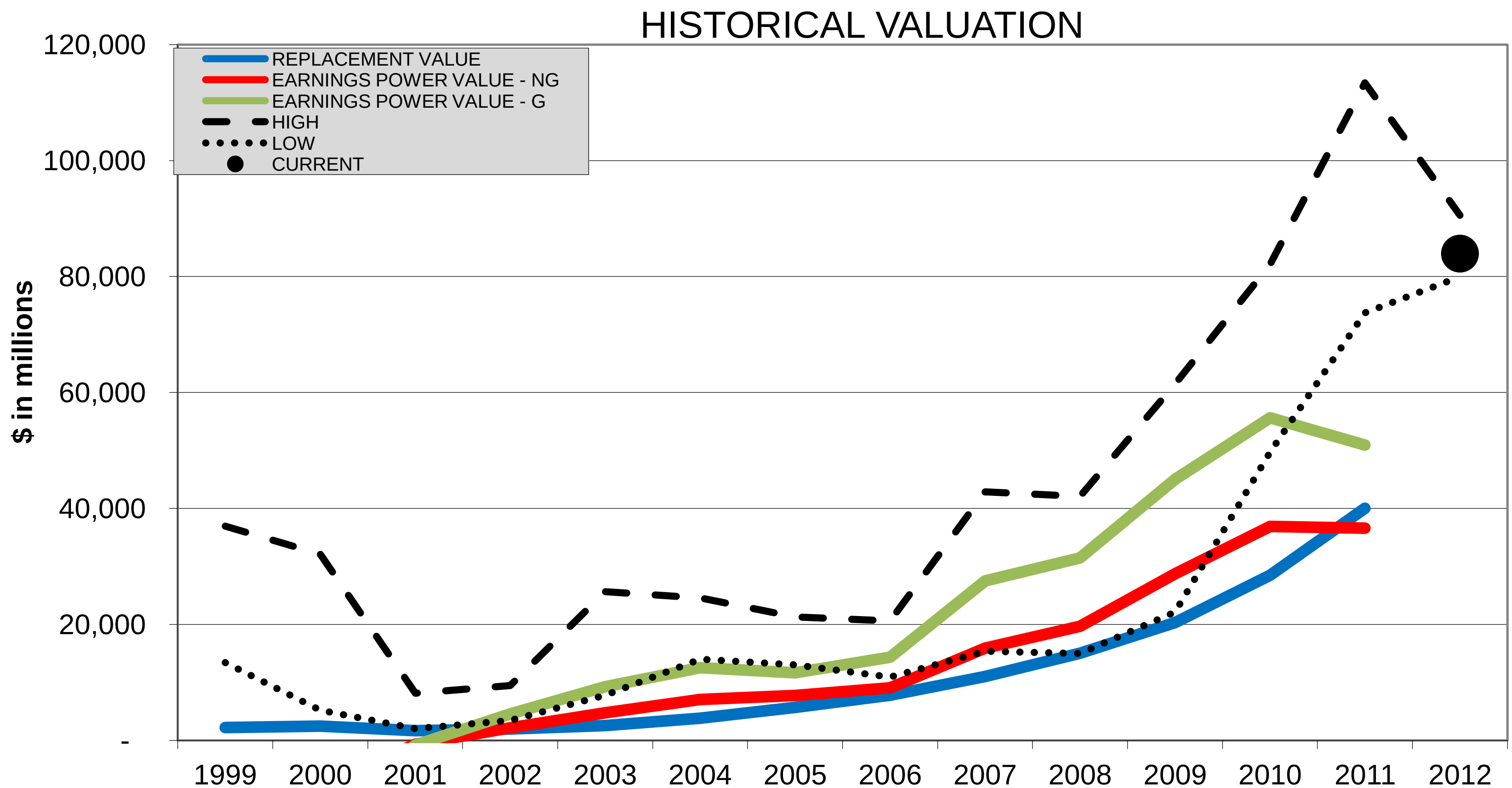
Another Example: Microsoft



Conclusion:

1. Microsoft is likely worth 2x its current market value!
2. Free cash flow-based implied forward rate of return = 16%+

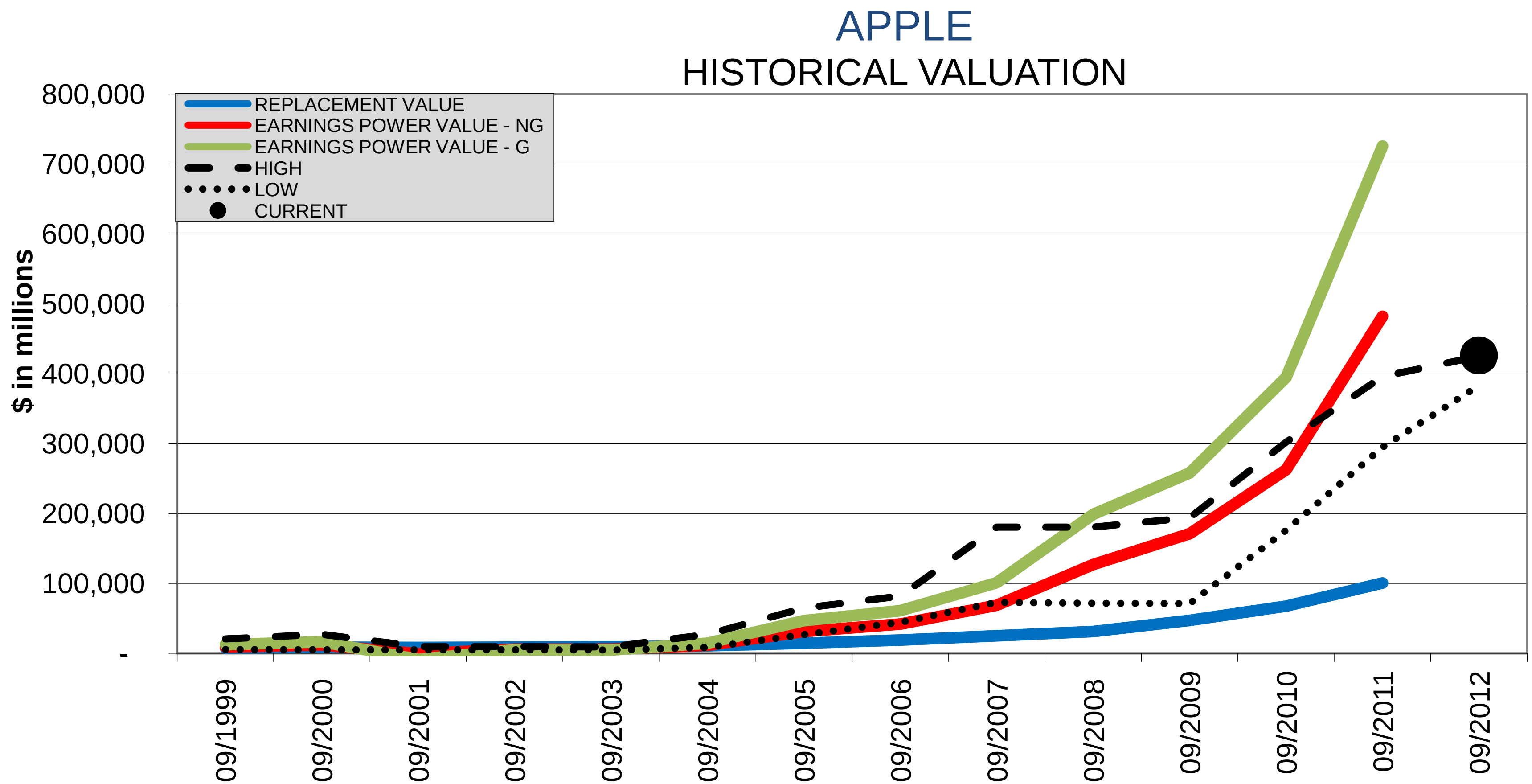
Another Example: amazon.com



Conclusion:

1. Amazon looks too risky for our clients (valuation is too high).

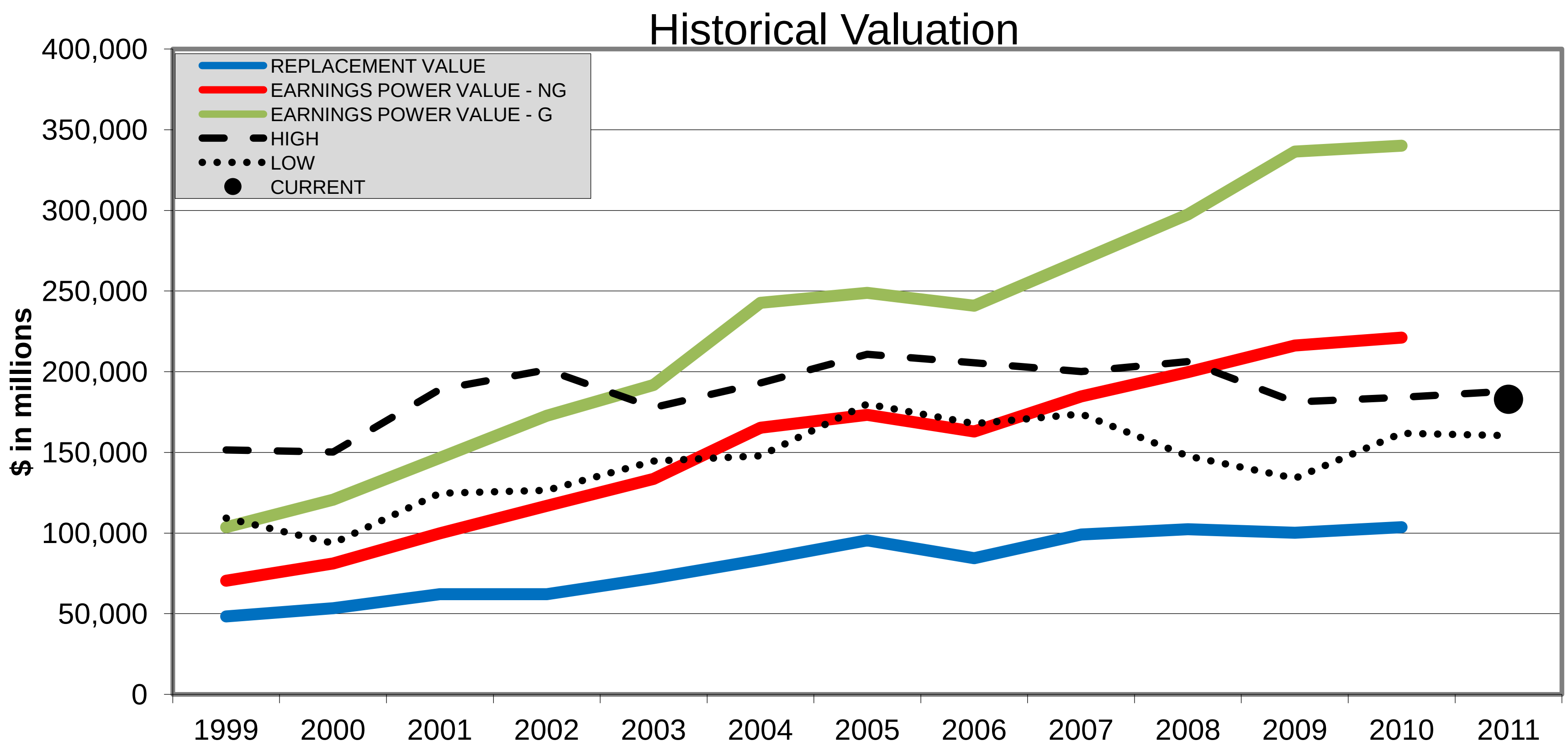
Another Example:



Conclusion:

1. You can buy Apple Inc. today for roughly 60% of its intrinsic value!
2. Free cash flow-based implied forward rate of return = 13%+

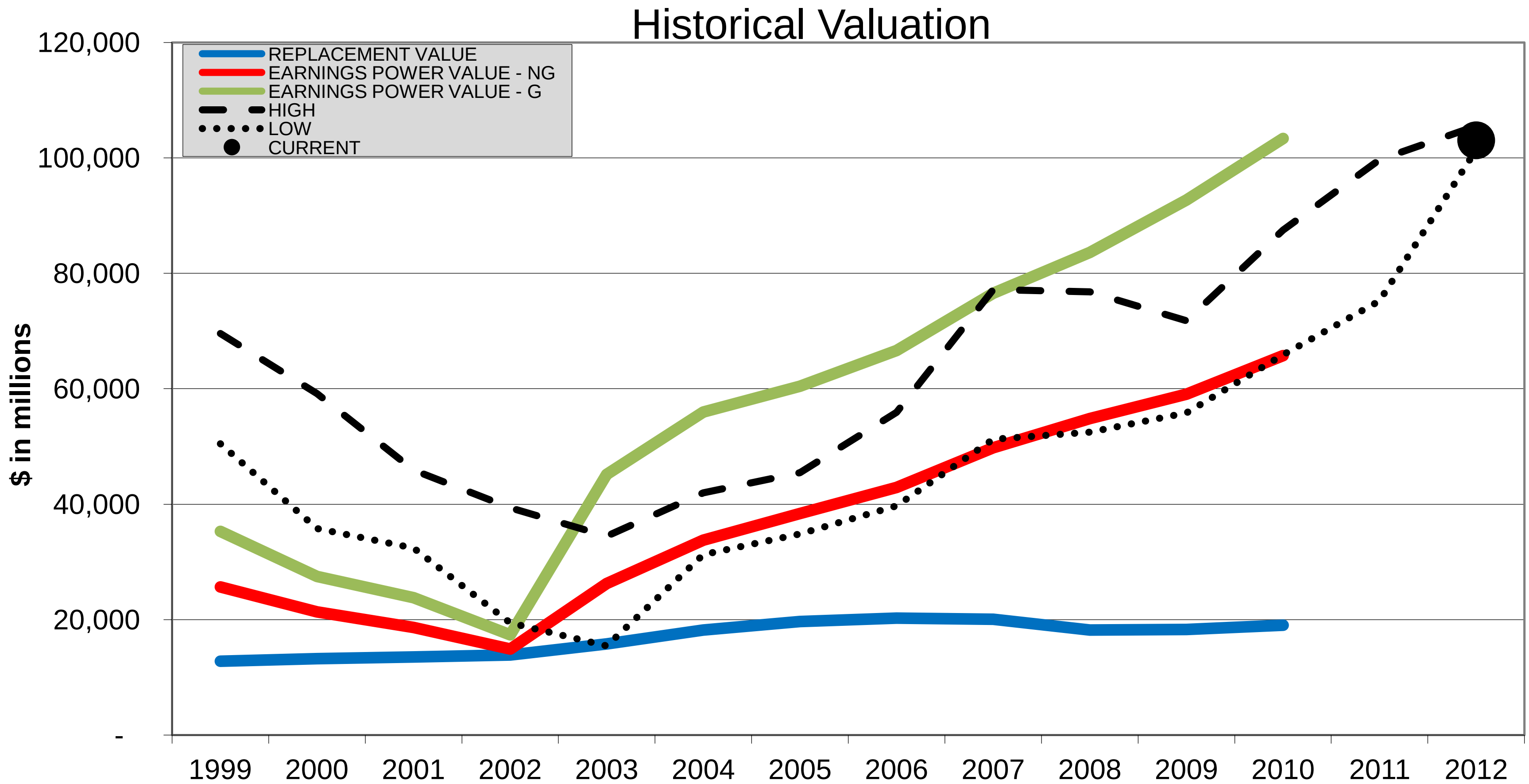
Another Example: Johnson & Johnson



Conclusion:

1. JNJ is trading at half of its underlying value!
2. Free cash flow-based implied forward rate of return = 14%+

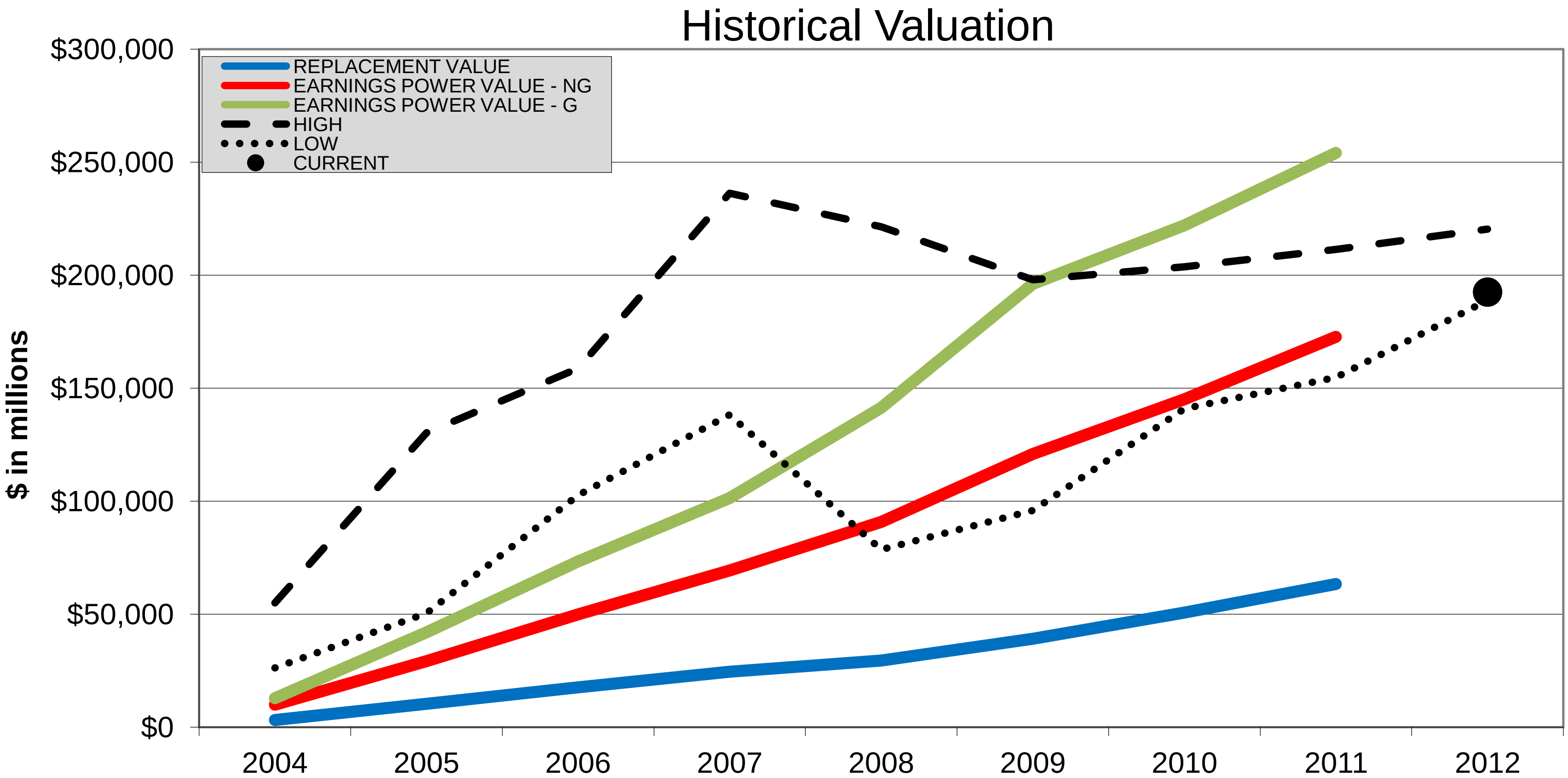
Another Example:



Conclusion:

1. McDonald's current stock price looks a little pricey.

Another Example: Google



Conclusion:

1. You can buy Google today and get all of the growth for FREE!
2. Free cash flow-based implied forward rate of return = 13%+

Professional Money Managers

You should be asking me…

If Buffett's investment philosophy is so simple, why don't more professional money managers invest the same way he does?

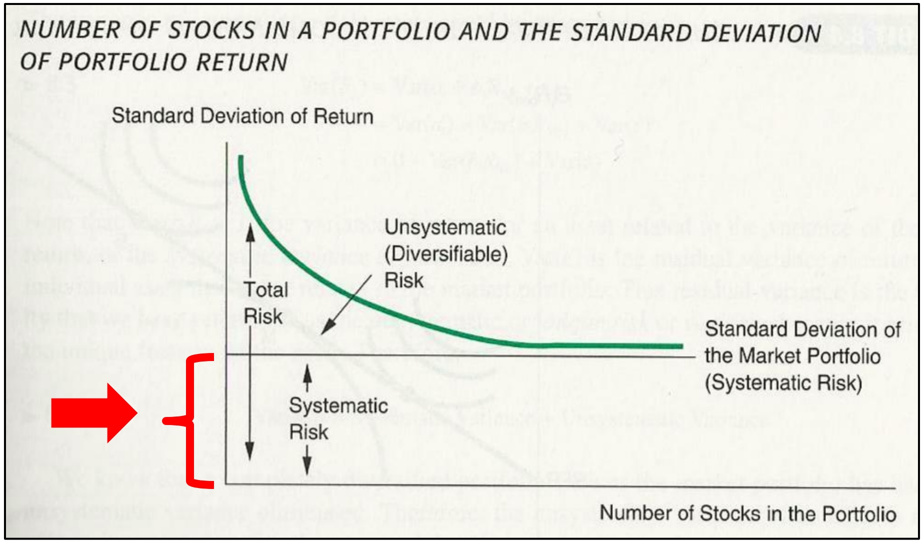
Answer?

- Why do people still smoke cigarettes?
- Why do so many people live beyond their means?
- Why do millions of people play the lottery?

***When we have an emotional connection to something (i.e. money), we do not always make the best decisions.**

Systematic Risk?

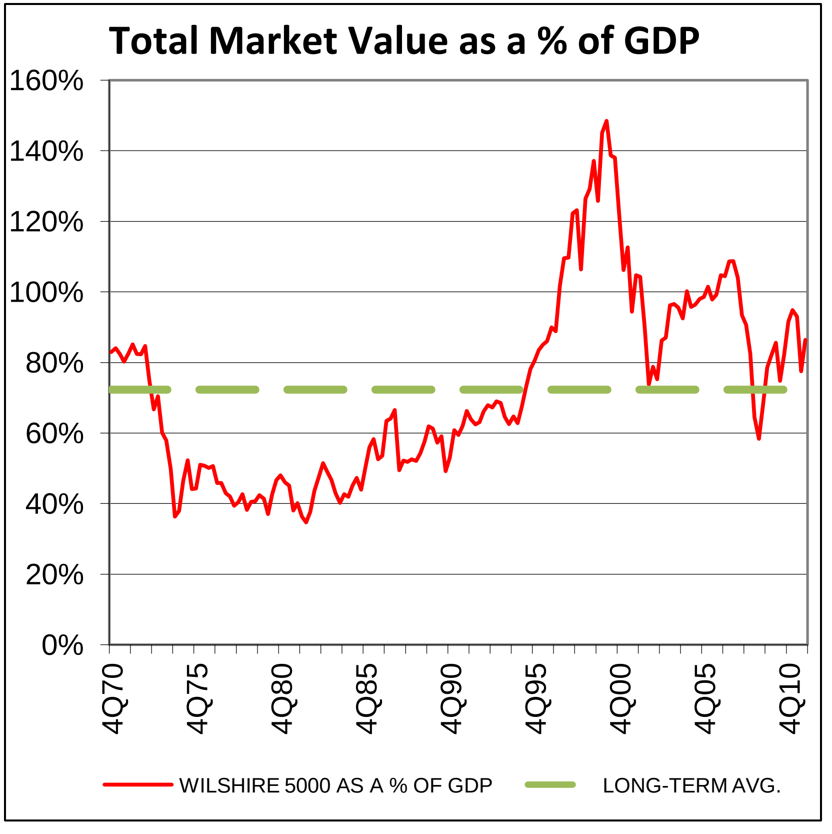
How do you know if the overall stock market is overvalued or undervalued?

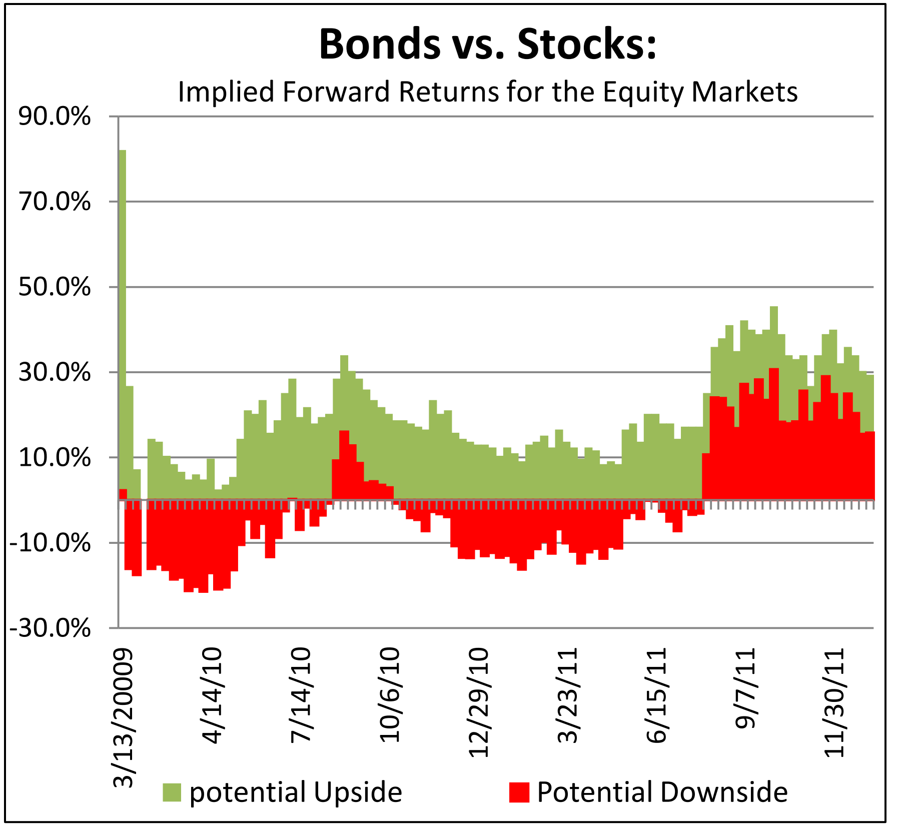


Expected Returns – The Equity Markets

Are equity markets overvalued or undervalued?

- Slightly overvalued when measured against GDP
- Significantly undervalued when measured against bonds.





Expected Returns – The S&P 500 Index

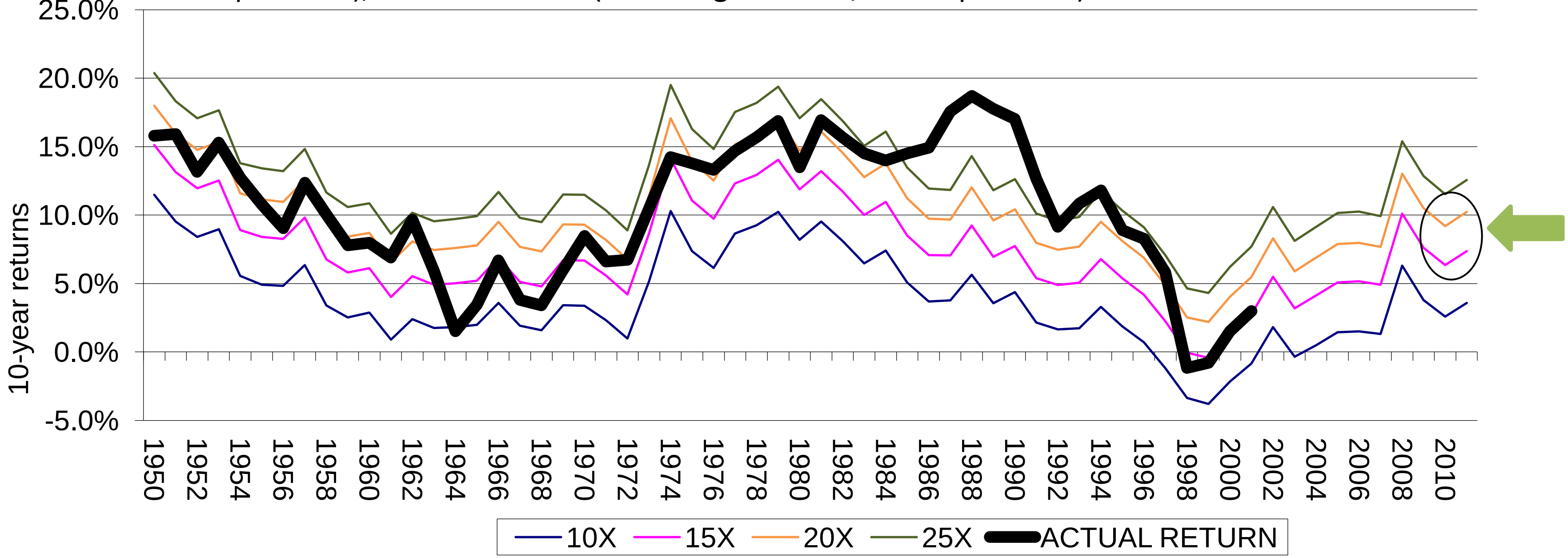
Long-term returns for the general market will likely be 7%-10% from here.

Assumptions:

- 5% earnings growth for the S&P 500 Index.
- A range (10x-25x) of price/earnings multiples for the S&P 500 ten years out (smaller colored lines).

Results:

- The thick black line is the actual 10-year rolling average forward return for the S&P 500.
- In 1999, the average forward 10-year return for the market was negative.
- Looking forward from 2011, average annual returns could be as high as 13% (assuming an end P/E multiple of 25), or as low as 3% (assuming an end P/E multiple of 10).



Systematic Risk?

Is the overall stock market overvalued or undervalued?

- Slightly overvalued relative to GDP.
- Undervalued vs. bonds.
- Expected 10-year forward rate of return = 7% — 10% per year.

How to Turn $10,000 into $10,000,000 ?

A 13.7% rate of return is what you need to turn $10,000 into $10,000,000.

Starting Value = **$10,000**

Length of Time		Rates of Return			Buffett
		5%	**10%**	**13.7%**	**22.87%**
10	years	$16,289	$25,937	$35,950	**$78,426**
20	years	$26,533	$67,275	$129,238	**$615,060**
30	years	$43,219	$174,494	$464,604	**$4,823,650**
40	years	$70,400	$452,593	$1,670,235	**$37,829,825**
54	years	$139,387	$1,718,719	$10,017,279	**$676,201,838**

> Your goal as an investor should simply be to purchase, at a rational price, a part interest in an easily understandable business whose earnings are virtually certain to be materially higher five, ten and twenty years from now."
>
> — Warren Buffett

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