

WHERE WORLD-CLASS INVESTORS MEET WARREN BUFFETT CEOs

“Global Value Investing” presented by Tom Russo 3rd Annual Value Investor Conference—May 8 & 9, 2006



Tom Russo, Gardner Russo & Gardner

BIOGRAPHY: Thomas A. Russo joined Gardner Russo & Gardner as a partner in 1989. Together, Thomas Russo, Eugene Gardner and Eugene Gardner, Jr., oversee almost \$4 billion in discretionary, individually managed client accounts. Each partner manages individual separate accounts and share similar investment approaches and strategies. Gardner Russo & Gardner is a registered investment adviser under the Investment Advisers Act of 1940, and is not

associated with any bank, security dealer or other third party.

Mr. Russo’s investment philosophy emphasizes return on invested capital, principally through equity investments. His approach to stock selection stresses two main points: value and price. While these would seem to be obvious key considerations in any manager’s approach, it is equally obvious that all too often they either misjudged or, perhaps more frequently, simply not viewed together.

Mr. Russo looks for companies with strong cash-flow characteristics, where large amounts of “free” cash flow are generated. Portfolio companies tend to have strong balance sheets and a history of producing high rates of return on their assets. The challenge comes in finding these obviously desirable situations at reasonable or bargain prices.

Mr. Russo’s investment approach is focused on a small number of industries in which companies have historically proven to be able to generate sustainable amounts of net free cash flow. (These industries typically have included food, beverage, tobacco and broadcasting/media.) This fairly narrow approach reflects his training and discipline at the Sequoia Fund in New York, where he worked from 1984 to 1988. Mr. Russo tries to limit risk by not paying too large a multiple of a company’s net free cash flow in light of prevailing interest rates. He attempts to broaden this otherwise narrow universe by including companies with smaller market capitalizations and companies in similar industries based abroad.

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Thomas A. Russo is General Partner of Semper Vic Partners, L.P. and Semper Vic Partners (Q.P.), L.P., limited partnerships whose investments are in excess of \$600 million, along with overseeing substantially more funds through separate accounts for individuals, trusts, and endowments. He is a graduate of Dartmouth College (B.A., 1977), and Stanford Business and Law Schools (JD/MBA, 1984). Memberships include California Bar Association and Board of Visitors for Stanford Law School. Mr. Russo is a charter member of the Advisory Board for the Heilbrunn Center for Graham & Dodd Investing at Columbia Business School.

Mr. Russo’s goal is one of an absolute return rather than a relative return, and he continues his long-term investment objective of compounding assets between 10 and 20 percent per year without great turnover, thereby realizing a minimum amount of realized taxable gains and net investment income.

BOB MILES: Welcome to the 3rd Annual Value Investor Conference held each year in Los Angeles in-between Warren Buffett’s Berkshire Hathaway [nyse: BRKa] and Charlie Munger’s Wesco Financial [amex: WSC] annual meetings.

It is my pleasure to introduce to you our opening keynote presenter and the first speaker of the morning. You may have read about him in Outstanding Investor Digest [OID], and we've included his biography in your blue registration folder.

The abbreviated version of his bio is that Tom Russo attended Stanford University and received a Masters in Business Administration [MBA] as well as a law degree. As many of you know, Charlie Munger is a big fan and admirer of Stanford finance professor Jack McDonald, so

when I mentioned to Professor McDonald that one of his prized students – Tom Russo was coming to speak to you this morning; he said that we couldn't find a finer presenter than Tom Russo.

After graduating from Jack McDonald's class in finance at Stanford, Tom worked for Bill Ruane at Sequoia Fund, which is the only mutual fund that Warren Buffett had recommended to his partners when he closed his original Buffett Partnership. After learning all about value investing from Ruane and Cunniff, Tom joined and became a partner of Gardner, Russo & Gardner, where he has built an extraordinary track record.

So it’s my pleasure to present our first speaker this morning to share his thoughts about global value investing in front of a very global crowd, an audience with representatives from all 6 continents—Tom Russo.

TOM RUSSO: Thank you and good morning. The title of my presentation today is “Global Value Investing.” Global is very timely, just coming back from Berkshire's annual meeting, where Berkshire announced a first and a quite large direct investment overseas. They've been signaling an interest for the past four or five years, and all of the non-U.S. investors in this room who have been going to Berkshire annual meetings for the last five years would have known that.

International shareholders in Berkshire Hathaway have been specially invited to separate sessions from the rest of us (US Investors) to build the Berkshire brand awareness amongst you international Berkshire shareholders, who then returned home and spread the gospel. And the gospel found a convert in Israel just this past

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month. And we now at Berkshire have a very large foreign and direct investment.

So I'm going to talk about global value equity investing...

...and I'm going to give it more than 40 percent of my best efforts. Even though global stocks -- non-U.S. denominated stocks -- represent only 40 percent of my holdings, they certainly represent a lot more of my awareness. And everything that I do has sort of a benchmark against the opportunity set for comparable investments, and that opportunity set is international.

The fact that over the years I've run portfolios that have roughly been 40 percent non-U.S. and 60 percent domestic is a byproduct of analysis, but it doesn't mean that a hundred percent couldn't happen, and it's a function of where the businesses are most attractively positioned.

Transcript compliments of:
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I was speaking to somebody in Omaha this weekend, and he suggested that I should start my remarks by saying that I urge all of you to take a very, very short-term perspective about investments, to try to cover all industries and all stocks, to trade your account furiously to make sure you never fall behind any index, and that you don't concentrate your efforts but that you stretch yourself out so you can meet the consultant's requirements of being all things at all times. He thought that if I told you this, it

would make my job easier as an investor because you would open up more opportunities for me. But I won't go down that path any farther than just to suggest that it's a possible interpretation of what investors should look for.

I thought I would cover a couple of topics. I'll start with a background as to how I became an investor with an eye towards foreign stocks, describe why someone from the middle of the United States might invest abroad, how I've invested abroad over time, and then close with some observations of the pitfalls--how I invested over the time. Then I'll share with you some observations of how one might stumble in foreign markets, and then finish with some interesting current issues about the global investment scene, and leave time for questions.

I was just speaking a moment ago with someone who actually knows where I grew up, which is a small town in the middle of Wisconsin. And you wouldn't think that would be a great start for global value equity investments, but it had some interesting characteristics. As a child, I did travel overseas a lot and became quite comfortable with early trips to Germany and other parts of the world. And already as an American, that's a subset of all Americans, because half of the Congress of the United States, for example, don't have passports and have never traveled abroad. So there is a certain ethnocentrism that prevails in the United States. And I had the good fortune as a child to travel.

My mother, for some reason, decided it would be good thing for a child growing up in Wisconsin to order newspapers from around the world. So for my tenth grade, we got newspapers from Tokyo and China and all sorts of weird spots. We'd open them up and try to decipher what they were talking about. But it had a particular resonance because I ended up spending much of

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my professional career investing in newspapers around the world.

The last thing about the town I grew up in was we had a company there named Parker Pen, which was at that time a global brand leader. Many of the people who worked there had exotic stories of travel abroad and building new businesses throughout the world. It was largely a non-U.S. company, so its fortunes fluctuated with currency because their profit streams were foreign.

Meet the founder of FlightSafety, Al Ueltschi, hear his view on the history and future of aviation, tour his flight simulators and learn how he is using aviation to cure worldwide blindness.

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Another observation I had was that as a child, though I did not have a mandatory paper route -- which seems to be required for all great investors -- I did try to invest early as a child. And the first thing I invested in was Pan American International Airlines. I lost a lot of money on that, but it started me off on the thought about international investing.

After that, I went to Dartmouth where I studied abroad, Stanford Law School and Business School, as Bob said, with Jack McDonald, and then Sequoia Fund where the value investment--active lessons about value investing--took place. For me, that probably starts the story about investing abroad.

Sequoia Fund was different than any other investment firm that I've come across on Wall Street because they specialize on their own

research. There's no contact, even though the firm may serve many billions of dollars, there is no research, there's no sell side contact. It's based in New York, but really could be based anywhere. They focus on just a handful of industries. They specialize largely in consumer-branded companies, and those consumer-branded companies often have a global reach. Their selected businesses -- food, beverage, tobacco and media industries -- tend to generate substantial amounts of cash flow.

I started there in 1984, just after the 13-year bear market was beginning to churn and equity had begun to interest investors once again. But within short order in the mid-1980s, what developed was the decade of the leveraged buyout. As leveraged buyouts started to increasingly influence the valuation of companies in the food, beverage, tobacco -- remember, RJR sort of typified that -- and the media arena, the domestic valuations of those companies became over-heated.



At the same time as that occurred in the mid-1980s, the leveraged buyout balloon, the ability to obtain information about foreign companies was increasing, and the competitive landscape for the businesses that I focus on (for example global food companies and global beverage companies) was broadening to include foreign and global competitors. So in the mid-1980s, the leveraged buyout of RJR meant that one of the great possible investments in the U.S. was taken away. But in an effort to understand RJR as an investor, it had become important to look at British American Tobacco, Gallaher, and Rothmans of Canada.

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To understand businesses in the areas that I concentrate on (the circle of competence I draw is around food, beverage, tobacco, and media) I had to understand the foreign companies, because they're increasingly the competitive set. Once the domestic valuations for those businesses accelerated because of threatened leveraged buyouts, it was natural to then compare the valuations of their foreign counterparts. They were cheaper, and they remained cheap for quite a long time. And that's what led me into committing substantial amounts of money abroad.

So the question is then--why would an American invest abroad?

It's not a trivial question, because for the first twenty years of Berkshire Hathaway's annual meeting, when asked why Warren didn't choose to invest abroad, his comment was historically, "The U.S. is a very big market." He said, "We have sizable capital, but nothing to exhaust the possibilities by just looking throughout the United States."

His early comments also were that he didn't have the ability to know the people. It's an important comment. Because if you grow up in the United States and you meet somebody who has a background, you pretty well understand the important indices that that background describes to you about character. But if you meet with an English company and the man who runs it says that he went to Marlborough or he went to Eton, in America, those references may mean very little, though in fact they may spell out everything.

Warren's early comments were that he wouldn't be able to make the distinctions as it relates to the most important question that one asks as an investor: Who will manage the business on your

behalf, and how will they think of you when they go to reinvest that abundant cash flow that consumer products businesses could generate? You just missed the signals because you were unfamiliar with the benchmarks. And then combine that with the adequacy of the U.S. market to absorb capital. It's really a setting that confronted most American investors when I started out in the mid-1980s.

**The answer to: “Why invest abroad?”
is that it’s 95 percent of the world.
And, in fact, the growth in world
economies even then, but increasingly
so, has largely occurred abroad and
will probably continue to do so.**

But going back to Jack McDonald's class--he actually encouraged us in the early 1980s to look abroad. His simple observation was that 95 percent of the world lives abroad. It's a bit presumptuous to think that 100 percent of the interesting opportunities would be domestic when 95 percent of the people live away. That is fairly compelling math.

He made an early fortune investing in Japan, more specifically, in Japanese insurance companies during the 1960s. He also made a substantial investment in a business that he wrote up as a case study called Veuve Clicquot. Veuve Clicquot was a French champagne company, and the business was branded "Champagne of the State." But the interesting aspect of the case was that it was really a balance sheet story, not an income statement story. The balance sheet involved the enormous amount of reserves that were held in their cellar, as well as the real estate that they owned in the champagne region. And the public market value was substantially undervalued (the real estate assets) because they were pretty much focused on earnings per share,

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and it just showed that.

I was intrigued by that example, and especially so in hindsight because a very large concentration of my investment activity over time has been in spirits companies. It certainly was an early observation.

Investing globally can be very difficult.

The perspective of trying to invest abroad in the early 1980s was an interesting one because it was quite difficult to do. Information was scarce.

The perspective of trying to invest abroad in the early 1980s though was an interesting one because it was quite difficult to do. Information was scarce. Currencies were often fixed and difficult to convert. The classes of securities in which one could invest were restricted.

So a good example would be that in the mid-1980s, I chose to invest in Nestlé. And Nestlé was a difficult company to invest in as an American because you couldn't buy the registered shares, you couldn't buy the bearer shares, which are not registered, so instead you had to buy something called participating certificates in bearer shares. You had to be willing to participate in an instrument that really was a second-class-citizen type investment. That was the world in Switzerland at the time.

Value Investing in India

Fast forward to today. People ask me what about investments in India. And in India, though I'm not really very up to speed on the particular nuances of the Indian market, I do know that a person returned from India excited about a local

bank, but the local bank shares trading in India traded for a substantial -- maybe as much as 30 percent -- discount to the price of those same shares as you could purchase them in the U.S.

There's a specific facility that's been created for the U.S. In order to invest as a U.S. citizen in those Indian shares, you have to participate in that facility and pay an enormous premium for that. This concept of classes of shares being restricted even continues to this day, even though it's far less burdensome than it was in the mid-1980s.

At the same time, there was a large amount of friction or extra costs. And that had to do with high fixed commissions and stamp taxes and duties, and the financial process of investing abroad was difficult. There were a few global sub-custodians in the mid-1980s. As you can imagine settling trades abroad was a hair-raising feat.

Different accounting methods and standards can be a challenge for investors when investing globally.

Generally speaking in the U.S., there was still a significant trace of arrogance related to accounting standards. This was before Enron showed that we had little to be arrogant about.

But when you'd invest in Europe in the early 1980s, people would ask, "But can you trust the accounts? Can you trust the accounting? And how can you make the adjustments for the accounting so that you know what you're buying is like American stocks that you invest in?" The concern over accounting was something that has over time diminished because we've shown our own abuse.

The early investment universe was also highly

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restricted because of trust departments in the U.S. If you happened to be serving the needs of a trust investor, most of the time they insisted on having only American Depositary Receipts or ADRs because they required domestic settlement of trades that you could effectively do through an ADR. So the concept of actually owning a foreign stock settled abroad was outside most trust departments accepted terms.

Those are the sort of issues that one confronted. As a result of that, global capital flows just didn't happen, and Americans were not invested abroad. As a result of that, the markets were in many instances a lot cheaper.

At the same time, even in the mid-1980s, Berkshire's chairman was out on the annual meeting circuit talking about the quality, the high quality, of certain businesses versus traditional economics of most businesses. In the early period, Europeans didn't really make that distinction as clearly. So if you had a newspaper company, the shares went down because there was a cyclical drop in advertising. The share price might go down even farther than the earnings decline because people didn't attribute a high standard or a high benchmark for newspapers because they were superior franchises. They traded them as though they were steel companies in terms of the market's fickle nature of embracing those businesses.

As Berkshire shareholders, we would have long learned from Warren's comments that then monopoly newspapers were like a drawbridge; they were a franchise to claim money. If in the marketplace, the newspaper shares were declining, because of economic miracles in a way that U.S. shares just didn't do any longer because people recognized the franchise, it provided an opportunity for an American to go in

and purchase what are globally equally good business newspapers at bargain basement prices.

There was just a lack of an awareness of the differences between certain types of businesses that open up opportunities abroad. That's the context that an investor faced then. Some of the issues remain today, but many do not.

Global Value Investment -Weetabix

I'll just give an interesting example. In the early 1980s, I started to invest in a British company, which manufactured a favorite product of my wife, who is British. It's a cereal company based in England. And I started to invest in the shares. I was dealing with a local British broker, Neuberger Berman, which was my prime broker and chief custodian. Neuberger thought we were settling trades, and we went on for years like this. One day, they thought they'd do an audit just to see what number of certificates we had in-house and sort out what we thought we had.

We were so far off that there was a team in Neuberger that spent the next two or three months trying to chase down certificates that we had assumed were delivered and never were. And they were owed us, but the delivery system that was casually set up then for a reasonably small company just weren't global and they weren't perfecting the trades. We thought we owned them. Neuberger thought they had them.

Finally, we went into sort of a red battle alert and spent weeks and weeks trying to chase down these certificates. We finally got it right, but that just gives you a sense of sort of the primitive environment that one faced.

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My own perspective as to why it is important to own some funds abroad is that I feel over time Americans will devalue their currency.

My own perspective as to why I thought it was important to have a portion of my investors' funds abroad was, on one level, quite specific. Having studied at law school and having sort of recognized the way politics work, I just feel -- then did and still do -- that over time, Americans will devalue their currency. The process of democracy being permitted to promise more to their voters to get votes than they can deliver is a dangerous system. And we see it most forcefully today.

We have promises to make the world safe from all terrorists, and so we spend \$90 billion on a war effort, while also promising investors to cut their taxes and the taxes of middle income Americans. With that type of promise, though it seems like we can maintain that construct in the U.S., over time just doesn't last.

As an investor, recognizing the nature of our political process, I felt really early on that it would be a wise thing to have a portion of our funds denominated in foreign currencies. That's one of the kind of macro moments -- one of the very few macro moments I've had over my career--but that's one of them.

I fled the overpriced U.S. market through and by leveraged buyouts, and in the process of doing that felt that the global counterparts were all in better position. So I could look at Hershey in the U.S., but in doing the research would come away with the feeling that Nestlé had a better business, it was more global.

U.S. companies are very often focused (operationally and certainly professionally, the people who work there) on this large and rewarding domestic market. The domestic market is big, it's 250 to 300 million consumers, and it's the richest market.

At one point, Hershey's said, "That's it. Let's go home."

If you were at Hershey, you actually at one point at the end of World War II had a global business. Your products traveled around the world with the GIs. At the end of the occupation period in Japan, there was enormous demand for Hershey chocolate in the communities around the bases because it was the product the winners ate, and so the locals loved it. At one point, Hershey's said, "That's it. Let's go home." And they gave up what could have been a global franchise in a Coca-Cola-like fashion, as it would have followed the troops around the world. "That's it. Let's go home." And it was perfectly fine because the U.S. market was abundant.

But they didn't develop the people, and they certainly didn't distribute the brand in a way that was global. Think by contrast of Nestlé where they had about one-and-a-half percent of their employees living in Switzerland and something like less than one percent of the revenues are Swiss-generated. Their whole existence, their very essence, is built around non-domestic activities.

So that just makes them much more acutely aware about the market and how to conduct themselves in global markets. At the same time, the people who run the businesses are, by virtue of where the activities occur, far more international than what you have historically found in U.S. companies. If you're looking for businesses that will have the highest probability

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developing emerging markets or taking advantage of traditional markets abroad, my feeling is just by comparison, that I prefer to find those global leaders abroad.

Another thing that's interesting about American companies, at least during the '80s and early '90s, is that we as a country have never really been particularly good at handling issues relating to currency.

I remember with Parker Pen particularly early as a kid and then just watching other businesses evolve over time, American businesses have had sort of a love/hate affair with foreign activities because of the impact of currency on the results. Often during times when the foreign currencies were quite weak, they would pull back from operations because they weren't producing the kind of results that they showed for those same operations during periods when the foreign currencies were quite strong.

You had businesses that had an on again/off again involvement with foreign markets. I think the foreign companies with which I've invested have been far steadier in terms of exploiting global opportunities, even despite the swings that currency effects. And that may be in large part because of the fact that they weren't driven by as short-term a compensation package as option-based U.S. managers were. They had an ability to take a longer view.

It's sort of a split decision as to whether it's better to invest with American icons abroad or with non-American icons abroad.

Those were my own perspectives as to why to invest abroad. I preferred some currency exposure and I preferred the more international staff that you can get with foreign companies. I

think the foreign companies were more patient than what I was seeing in America. And then there is a value around the world in many instances (and this is sort of a split decision) as to whether it's better to invest with American icons abroad or with non-American icons abroad.

For most of my career, America has been very cherished. From the mid-80s through 9/11, you would have had a period of time when if you could have offered Coca-Cola or Nike or any number of American icons around the world, you were really selling something that the rest of the world without exception preferred. But, you know, at some point, those preferences shifted as the loyalties of the world's consumers regard America in different ways.

So to have Nestlé or Heineken or Cadbury Schweppes out in the marketplace means that if there is a sense that American products are less interesting to consumers for reasons that might be political, we have a fairly meaningful portfolio of offerings that go to market without any American sort of stamp whatsoever.

Now, I said it's a split decision because there are a certain number of products that are just absolutely coveted for no other reason than because of the American association. So we have both. But it is an issue that you can be aware of.

My first investment in a foreign company came out of the spirits industry.

Veuve Clicquot from Jack McDonald proved to be of interest -- and that investment was in a company called James Burrows PLC, and it was a small English company whose main product was Beefeater's Gin. It's very symptomatic of how the world works in terms of the research process leading to an investment.

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During the mid-80s, Brown Forman shares collapsed because they had made an ill-fated investment in California Coolers. Shares plunged far beyond the cost of that poor investment. I became interested in the spirits industry by looking at Jack Daniels.

It soon became obvious that the spirits industry in the U.S. was consolidating mightily, and that the people who were in the spirits business wanted to concentrate their brands by sole distributors in any given market. What had previously been scattered affiliations throughout many distributors were now allowed to concentrate with one distributor.

The conflict comes from having market share. The James Burrows family-controlled, single product company stood to lose out in that consolidation because they had nothing else to offer. They would lose out competitively. Consequently I was wary of the company.

Then I looked at the valuation, and it was extremely reasonably priced at something like six times earnings without real estate from their restaurant business that they had. It was family-controlled and had been a family-run company for well over a century, and a public family company for over a century.

As an investor in businesses, which generate enormous cash flows, my single most important issue to get right is what management will do with cash flow through reinvestment.

Because it was family-controlled, the British market discounted its value because they feared the company's propensity to self-deal. And I've often found that to be the case. It's an interesting conundrum. As an investor in businesses, which generate enormous cash flows, my single most

important issue to get right is what management will do with cash flow through reinvestment. Do they care about the owner, or do they care about themselves? That's the number one thing.

It's called agency cost and what's the likelihood that my agent, my hired hand who runs the business that I own as a shareholder (if you think about shareholders collectively), that they're going to think of their own interest instead of our interest? The answer is very high.

Most American companies, especially with options being the source of compensation, the odds are really high that they're going to think about themselves more than us.

So the one device that I've used to try to control against that risk has been to try to line up with family-controlled companies. Because at least in that case, the family can sit at the board meetings and parade over the managers who might want to take our money because there would be some taking of the family's money as well. You have some asleep-at-the-switch, corrupt or just dull-witted families, and it doesn't give you the protection that you'd like. But in some cases you can find that.

Most investors, however, fear family-controlled companies because the stories of corrupt ones or inept ones command attention. The discount is often wide in the family-run businesses. In the case of James Burrows, that was particularly so because it is still completely run by the family.

The family will shepherd your interest.

My feeling is that the family will shepherd your interest if they're honest, and then when it comes time to sell, they won't fight, because if it's right to sell, it's in their interest to sell. Whereas in public companies, they'll fight, because they will

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lose their position, the only thing that they have in life is their role as managers of the public company, and all the largesse that spins from that.

And sure enough, Whitbread acquired James Burrows. If you consider my Semper Vic 1984 – 2006 annual returns, the end results of this partnership, (which I've run since 1984, my last year at Stanford Business School), in 1987 was a year of unusual out performance. If you remember, it was the year that we had the great crash of October. But one of the reasons why my annual return was up 37 percent in 1987 was that we had made an investment around that time. Remember, I said that Brown Forman fell apart in 1986, so I began to do the research on the spirits industry, and by 1987, had made an investment.

In '87, Whitbread acquired James Burrows, and I thought I'd reinvented the laws of gravity because my partnership annual investment went up so much.

1987, one of my best years of outperforming the Dow Jones Industrial and the S&P 500, was a terrific confirmation that research that starts off of with a domestic company -- in this case, Brown Forman – that embraces the global landscape for their competitors, can uncover a company in a foreign market that actually is an international company based in a foreign market that might be quite under-priced, which is a more adequate investment than the domestic company with which you started the investigation in the first place. So I think that sort of set my antenna up.

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A global investor and a value investor

At the same time in the early 1980s, I had asked a very simple question about a product that my wife used to eat, which is a breakfast cereal called Weetabix. And I said, "I wonder if it's a public company." Of course, it was hard then to find out anything about anything foreign, but I did figure out that it was public, it was very mis-priced, and we can take a look at that. So I think it gives a very good example of what it means to be both a global investor and what it means to be just a value investor.

EBITDA = Earnings Before Interest Taxes Depreciation and Amortization

In 1989 (I started investigating foreign companies in '87) this is where it starts. Weetabix's EBITDA was 19 million pounds and it had 7 million pounds of cash. I determined the business was worth 8 times EBITDA plus cash, less debt, and I came up with an intrinsic value of 13 pounds. With 11.87 million shares outstanding it was trading at 5.95 pounds per share. Then each pound was worth US\$1.61

So that's the beginning of the story. Now, I would mention that I used the word EBITDA, which Buffett this weekend suggested was false signs and all sorts of horrors would ensue if you even mentioned those six letters in rough approximation to each other. But for me at least, EBITDA is useful because it helps me cross countries because of different depreciation schedules and amortization schedules.

It's one thing to say in a U.S. context that you've looked at pre-tax earnings rather than EBITDA. But when you start to look at Heineken versus Cadbury Schweppes versus Budweiser, and if you don't adjust for those non-cash charges -- and one way to do it is using EBITDA -- you

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have a more difficult time comparing across the market. I have used EBITDA, and I confess it in front of you.

Moving on, this is a breakfast cereal company in 1989. Intrinsic value, 13, trading at 5.95, very, very undervalued. There wasn't a single broker in London who knew anything about the company. I had a chance to start buying the shares. What appealed to me was they were probably the first company in England, one of the first three companies in England, to use television advertising.

When the question comes up about how does one do due diligence about a company that's based abroad, I say that anytime I meet an English family in Disney World or someplace and they have a little child, I'd go up and say, "Do you eat Weetabix?" and ask questions. And the thing that I was always struck by was they'd come back and say, "Yeah. And, boy, do they have a great advertising campaign."

I remember meeting one ten-year-old, and he said, "When I was nine, they had this campaign. When I was eight, they had that campaign." He could go all the way back from his earliest years and say what the campaign was as it evolved. It was really substantially a part of their corporate culture and their product set.

I'd like to own what you see when you open up someone's kitchen cupboard, and you see all the brands that are lined up...

... And they're there for a reason, but they may not even be able to explain to you. But my goal would be an investment in all of those that show up regularly.

Weetabix shows up in every British household. And it's based on the advertising.

Even grown adults, when asked, "Do you have Weetabix?" will answer (because one of the messages is that it has something good for you, it somehow fortifies you for the day's events) "No, I'm getting busy, so I tend to eat on the run. But if I have an important meeting, I'll have my Weetabix." And just that kind of legacy that endures is what you really want to find in the investment.

QUESTION: I love Weetabix as a customer because it's available here and it's in Europe, you can have it wet, you can have it dry. But how would you buy shares today?

TOM RUSSO: Well, you can't. Let me give you the final story. As a money manager who's American, I have to fight cultural preferences. I do manage some but not much institutional money. Most of my clients are families. But, you're at a committee meeting with an institutional client and they have a smart advisor and you start to talk about Weetabix. I remember one guy said it's the worst tasting product, tastes like sawdust and the whole litany of complaints. He actually suggested that it might be used for soaking up oil spills in the North Sea because it has the ability to absorb infinite amounts of liquid.

But you had this issue--many investors would say, "Why on earth would you own that stock? Because the product tastes so bad, who would eat it?" My only comment is that the British have to eat it and they have to stay loyal to it and stay with it as a brand. If that's the case, then you have a pretty steady business.

Now, this company was able to innovate, they were able to make some acquisitions of adjacent companies, and they were able to price and grow brand share over the ensuing eight years. By 1997, the EBITDA had grown to 52 -- we'll pick

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up in '98, it had grown to 63 million pounds. The cash had grown to 65 million pounds. They still said the business was worth eight times EBITDA, and their intrinsic value had grown to 47 and the share price had gone to 37.

The interesting issue about being a value investor is I bought it with a comfortable discount from intrinsic value. The discount remained, it wasn't quite so deep, but it was certainly, from my perspective, deep enough to continue to hold the shares.

During this period of time, the compound annual return from this was about 27 percent. It was far higher than anything I would imagine and certainly above any kind of average that I've enjoyed over any period of time. But it was driven by the growth in EBITDA and buildup of cash.

My belief for my investors is that I should be able to compound money at double digits.

I didn't sell many shares. Then the Internet came along, and people started to worry more about computers than breakfast cereal. Wal-Mart entered the English market, so they started to put pressure on brands, and they started to pressure Weetabix. So to respond, Weetabix had to increase their advertising, which took some of their EBITDA away. They had to increase their spending on product innovation to defend against copycat knockoffs of their old brand.

In the process of fighting the potential threat as a Wal-Mart subsidiary, they flattened out their EBITDA for the next five years. In the meantime, the shares dropped all the way down to 19 pounds. As a value investor, you have to live through periods of under performance if

you're going to out perform in the long period. But it's particularly hard when, in this case, for example, your U.S.-based investors, as they saw their shares decline from 37 to 19, were empowered in their criticism of your investment because the product was so foul tasting. It was very easy for them to say, "Well, not only are you losing money, but it's a stupid idea because the product stinks."

My feeling at the time was they were investing in their business to try to support it going forward. They were consuming some of their up-front profits in the process. The business continued to have viability, and their cash continued to grow, it was up to 80 million pounds at that time. All of the checks that I had suggested the business had viability, though the shares had in the meantime proceeded to drop by 50 percent. At the low, which was just between these two periods, it hit 19 down from 37.

The interesting thing is that by the time it reached its low, the compound from start to finish had declined to 10 percent.

That's what I look to do. And the reason why, even with that big sharp decline we were still at 10 percent, is that the EBITDA grew at roughly 10 percent over that same period of time. So the link that exists between stock price performance and growth and value was what supported the performance even with that sharp decline. But at this time, the business was trading at two-and-a-half times EBITDA.

Along came Hicks Muse, a leveraged buyout firm, and figured out that at 54 pounds or roughly 8 times EBITDA plus all that cash on the balance sheet, they could probably acquire the business. And they did, so that was the end of the public market investment in Weetabix. Now, this is a family-controlled company. And

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one of the pitfalls you face in investing in any family-controlled company is that they may not look at the capital structure with as much thought as you might. So in this case, even when they had a hundred million pounds of cash, I couldn't encourage them to buy back stock. So they had 11.8 million shares outstanding at the beginning and all the way through to the end. The good news was they weren't diluting our investment by offering 2 or 3 percent of the stock to management through options every year. But the bad news is that they didn't take advantage of what would have been a home run by taking out of the market shares at a price that reflected the market's focus on more sexy Internet company shares and its paranoia over Weetabix poor short term results.

Had they started buying back shares at 20 pounds a share, they would have retired 5 million shares, which would have taken the final number down to 6 million something. And the price would have remained the same, eight times operating cash flow of roughly 63 million would have still been 500 million pounds, but it would have been on the basis of far fewer shares, and instead of paying us 54 pounds, it would have been something closer to 75 or 80.

It just would have been the mathematics of having taken shares off the market. It's sort of a hypothetical, because they couldn't have picked up as much stock as that, because I owned 17 percent of the company, so those shares were out and the family-owned stock. They wouldn't have been able to find a full 5 million shares to reclaim all their money, but they could have found some, and it would have made our investment, I think, pay off more forcefully at the time had they been able to do that.

QUESTION: Do you find any difference in the American subsidiaries of foreign companies

taking suggestions from activist shareholders?

TOM RUSSO: I'd have to say yes, but I would find that I'm equally unable to persuade American companies to do that, as I am foreign companies.

But I would just jump forward to some of the observations what we'll end with by saying one of the things that's changing in international investing is the growth in renegade pools of activist capital. So I'm a believer in the management-friendly style of investing.

My goal, when I invest in a business that I like because of the management, is that I'll probably want to own it forever.

So with that as my mantra, I tend not to be a very effective activist. When the business is well run and when they're at least neutral with cash, we're not in trouble. Because in this case what they didn't do is something smart with the cash, but what they most importantly didn't do is blow the money.

Let me share with you another global value stock pick, the Dutch newspaper De Telegraaf.

There's another company I like to talk about, de Telegraaf, which is a Dutch newspaper -- which I've owned over the same period of time -- which started life with a lot of cash and a relatively low EBITDA.

Semper Vic Partners' 22-year average annual return is 17.5%

At the time I started investing in them, they had a lot of cash on their balance sheet. It's a bit

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difficult to consider newspaper cash their own cash because they did have subscriptions prepaid that fall into this line called cash.

They were very liquid, in any case, and trading at a relatively low multiple of its EBITDA. They had 52 million shares outstanding to begin with, and fortunately still today they have 52 million shares outstanding. At some point with their cash and growth, it was two hundred and some million shares outstanding. I just couldn't pound on their heads enough to get them to take some of that cash and buy back stock. But instead, they made all sorts of bone-headed acquisitions because they thought that their mission was to build the business.

They started out with magazines in Sweden, then they bought another newspaper in Holland, and they spent a lot of money on a new plant. They effectively managed to squander the cash that they had generated through their core business, which was an attractive business.

They didn't buy back stock, and more detrimentally to the investor is that they wasted the money. Fortunately the business franchise has survived. I stayed with the investment. It was relatively lackluster, because during this period they were squandering our money.

It's only been just recently that the changed environment has come to impact our interests favorably. It was from two forces. The first force is the growth and leveraged buyout pools affecting European companies.

As I started all the way back in the mid-80s -- and I went to Europe in part because the U.S. market was consumed by leveraged buyouts, and the valuations in Europe were less full because

the businesses like newspapers, capable of setting cash flows, were under recognized by the market (absent Buffett's lessons) and capital pools didn't flow and they didn't like leveraged buyouts.

Now you've got leveraged buyout pools throughout the world and Kohlberg Kravis Roberts & Co (commonly referred to as KKR) acquired a European television broadcaster recently called Scandinavian Broadcast Systems. And in the Dutch market, Telegraaf had a 27 percent stake in that business, so they now have converted their stake to a share of KKR's private mortgage company.

That was the start of a good thing, because rather than owning just a piece of a stumbling Dutch broadcaster, we now have a share of an European-wide entity that has a proper capital structure, more leverage, that's run by the talented folks that KKR had brought in.

I think we'll make a lot more money being a participant in a leveraged equity than we would have if I stayed as a minority holder in a Dutch only TV station. We received those shares, and that's a good development.

More importantly, in Holland, you had CSM and you had VNU and you had three other companies, which all had historically controlled boards and often had controlled family share holdings suffer at the foot of activist shareholders.

And the management finally went back to the control family and said, "If you don't wake up, you're going to be awakened by an activist pool which will come in, and they'll simply strip this business and take all the value of the stock that's massively under priced. You can do it or they'll come and do it for you."

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So this family recently decided that they'd sell a non-strategic asset, a newspaper. Then another leveraged buyout pool of money came from England run by a former English newspaper leader named Montgomery, and they paid twelve and a half times EBITDA to buy a newspaper in Holland, and two hundred and some million euros in cash flowed into the company. It was at the time when we [Telegraaf] had a market capitalization of 900 million.

For one small paper, they were paid 200 million. And the family then agreed for the first time ever to deploy some of that cash to buy back stock. This was a dud. And it was a dud not because they issued a lot of stock through options, because they just -- they kept that flat, not because they couldn't generate cash, but because historically they just didn't think about share buy back as a use for cash, and they felt it sort of imperative to spend the money, and they spent it unwisely.

The future is better because I think they're under a much shorter leash, not because I police them through my entreaties (because they were deaf to my recommendations over all of those years) but because the market has finally gotten new factors for leveraged buyout of pools to purchase those businesses and the activist pools to frighten those managers.

Company Specific Investments

That really leaps me forward. I would say how I invested abroad -- I'll just race through a couple more points, and then I'll open it up for questions. Brown Forman led to James Burrows. James Burrows is in one group of investments as an American you might make, and those are what I call company specific investments.

I'd say Telegraaf is company specific. Weetabix was in a sense company specific. One way you find out about those is do exactly what Berkshire's chairman said that he did when he invested in Korea. You get a country guide, which in a very simplified fashion describes what the companies are that are public in the market, and you just thumb through it and look at the numbers on a standardized format. You'll see interesting businesses that exist in just local markets.

I knew about Weetabix from my wife's tastes. But in France, there's a company called Talc de Luzinac which I owned at one point which was the largest talcum powder producer in the world, very specific, very local, public, and cheap at the time.

In Argentina, there is a brewery called Killman's. It was sort of a loose affiliate of Heineken and a family of great standing. Something I discovered just by thumbing through country guides.

Country Specific Investments

So anytime someone says to me, for example, “The Norwegian market collapse” I'll give a very brief look at this investment. These are country-specific investments.

Let's take a look here. A colleague of mine went to Williams College with a Norwegian from a prominent family. In 1991 the Norwegian market collapsed. It collapsed because of the conflict in the Middle East. The Suez Canal was closed off for shipping; the petroleum shipping that took place there ceased.

The Norwegian economy is extremely leveraged to oil, mainly because of shipping. And all of the ships were owned by families privately through leveraged pools they call some kind of

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KF funds or something, and extraordinary leverage to generate tax deductions to sheltered income from the very high tax rates that the people in Norway face.

The moment one of these ships goes dry, it goes into dock and comes off service, they go bankrupt. Because they're so leveraged that if they're not engaged, they immediately go bankrupt. Note that in Norway, there's no personal bankruptcy. So once the ships started to fail to provide commerce, the clock immediately starts ticking because you had to fund those investments out of other holdings. That process led to a collapse of the Norwegian stock market and was directly related to the Gulf War.

So you said, "Norway's collapsed. What should we do?" My answer is, "Let's buy the newspaper." So I went over, and this one here was the Wall Street Journal of Norway, and a complete free fall. And this is 1991--\$21 a share.

With global value investing you need to decide if you are going to hedge currency.

A very interesting observation about this particular investment: One of the things that you either decide to do or not is hedge currency. And since I said at the start that I was sort of interested in providing some currency exposure through investing abroad, I'm clearly not presenting myself as fully hedged. Some people do. Some people have a practice that the only thing they are interested in is businesses abroad. They say, "We don't care about currency, we hedge every single investment."

In this case, you couldn't have made that investment because the market was in such a free fall in Norway that there was no foreign market for hedging the currency. The interest

rate differential was just so great that it wasn't practical to hedge.

Going into the investment that we made in Norway at that time, we knew that, and we knew we'd lose a lot of money to the currency because the market was not clearing, the pressures were that the crown would collapse; you couldn't hedge it.

But the investment was priced accordingly, because the same factors that led to the inability to hedge the currency were extremely high interest rates, but they also led to extremely low equity valuations.

We bought the shares and immediately suffered substantial currency declines. But over time, the discount in the valuation of the business, this regular business of the local Norwegian Wall Street Journal was sufficient to offset the currency, in fact. The result was sort of a seven-bagger over approximately fifteen years. It's probably a modest, not outrageous compound, but it was an example of yet again the first class of investments which are country specific.

You can't imagine anybody thinking about an investment that's less interesting than a Norwegian newspaper with 3.7 million potential readers in the world and no prospects for global growth. But that said, you can find very attractive businesses by thumbing through country guides and looking at just the specific investments within a given country.

Another area that I've used as an area of focus would be what I call the global brand leaders.

And those are pretty obvious. That's Nestlé, Heineken, Unilever, Cadbury Schweppes. If

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you're looking to get brands that are entrenched, that are legacy, there's really no better way to do it than someone like Heineken which has been in emerging markets for 35 years, or Nestlé that have had plants around the world for a hundred years.

Even Unilever and Cadbury have followed the British Empire around the world. They have terrific legacy brand value, and I own all of those with the idea that those branded positions enjoy sort of consumers in reserve. Because all the people who are aware of those brands during the periods of time when it had very little income, very little spendable money, discretionary spending, coveted those brands but couldn't afford them.

As the economies in India, China and the rest the world begin to prosper and discretionary spending goes up, some of the earliest luxuries that a consumer can afford are those brands that they couldn't afford before.

Global brand leaders are pretty apparent.

The third area that has been very helpful for me has been subsidiaries of global brand leaders.

I look down the list of some of my investments over time, Allied Domecq, which was originally called Allied Lions, had an Irish tea company called Lion's Irish Tea, and they had a British -- I'm sorry -- a Canadian liquor company called Corby Distillers.

Now, both of those businesses were public in their home markets. Even though they were controlled by Allied Lions, they were public in their home markets because of something called the Foreign Investment Requirement Acts that exist in so many countries.

If you want to participate in a country as a foreign company, you were often required to leave a public stake outstanding in that market so that the locals wouldn't feel like they were being colonized. Those shares are issued under something like the Foreign Investment Requirement Act, maintaining a local presence. But there's no requirement that those shares have to be owned by local investors.

So I have again and again and again participated in markets in businesses that I like, cash-generated businesses that are run by the global leaders with western tax treatments, western managers, and western style accounting. That way I'm able to participate in a market like -- well, neither Ireland or Canada concerned me -- but in other markets such as the Czech Republic, which I visited in the early '90s.

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Now, while I came away with an investment in Philip Morris' Czech subsidiary, I couldn't in good conscience invest in almost all the other businesses I saw there because of the fear over the market, the rule of law of corporate governance. The former Communists who ran all the businesses, they just didn't impress me as the type of people I'd like to give my wallet to and ask them to give it back sometime later with more money in it. It just didn't impress me as such.

But I chose to participate in a market that I was sure would grow, which was the Czech market, because they have such a history of success in business, through a company such as Philip

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Morris Czech Republic. Now, this investment hasn't had the same appreciation over the years as has Philip Morris, its parent company. It's worth noting that one of the drawbacks of investing in the single market subsidiary of a global enterprise is that things happen. Indeed, the Czech market has increased disposable spending, and so the share of the Czech market of local products that Philip Morris still produces has gone down as their international brands have gone up and had higher prices and higher margins. So that has played out. But other things have conspired to dim the returns offered by this investment.

One of them is that as a part of the Altria universe, when Altria [parent company of Philip Morris] wants to list company's dividends and this company is not allowed to reinvest their Czech market cash flows into Uzbekistan or into the markets that are growing outside of Czechoslovakia in the same region. Even though we have knowledge of the markets, Altria retains the ability to invest directly in those markets. The Czech subsidiaries are Czech only.

As a result, when they develop abundant cash flow, in order to get at that money, the parent has to dividend it out. And they get an 85 percent tax exclusion on that dividend, but we'd have to take the dividend. So over the years, this business has paid out dividend incomes that have averaged over 13 percent.

Global value investing, in general, is an interesting way to invest, but it does come with some pitfalls.

At the moment, the dividend is still 9 percent. I'd much rather as an investor not have taxable income, and I would much rather they took every dollar of free cash and bought back the

shares or done something to increase the compound. We had an extraordinary dividend deal from that investment all along, but we hadn't been able to re-employ the capital into growing into other markets that were adjacent, and we paid a lot of taxes unnecessarily. So that's one of the pitfalls.

The other thing that's interesting about the third area that I have participated in, which is this global leaders local market subsidiaries, is you can become a pawn in a couple of factors. One factor is that Altria originally used the facilities in the Czech Republic to produce for the Russian market. They would ship across the border to Russia.

At some point, they proved up the market and the Russian market built a facility that they then needed to shift the production to. We lost absorption. Russia developed its own product and therefore the Czech market suffered.

That's one aspect, the other is the global battlefield can sell on you for reasons that are non-Czech. So for example, if Altria goes into Italy in a way that upsets its competitor British American Tobacco [BAT], BAT may respond in a disruptive way to the Czech market that our company has to respond to at the expense of earnings that are specific to this market.

Over the years I've invested in several global markets. One of them was in the Irish market, and it was called Readymix PLC, which was a construction equipment and crushed stone company. And it worked fine.

I've owned Readymix since the early '90s. It paid a little dividend, it's grown well, and yet it's just exactly what I was referring to before, it couldn't grow with other markets and it's

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very controlled because the parent of Redi-Mix Corp controlled the rest of the market that they otherwise might have coveted because of adjacencies.

I visited with Readymix in the early 1990s. It was very, very cheap, but it was controlled by a foreign company. I was comfortable that it wouldn't have local market issues. But its counterpart, CRH, the international building materials group, has been an absolute growth engine, and it's grown well beyond the Irish market, because it's Irish based, and they looked upon the rest of the world as their oyster.

I'd have been far better off in that particular instance buying CRH at a roughly equivalent value but the allowing the compound of that reinvestment to move us farther along as they built a global empire.

Readymix has just sort of stagnated in its local market. It was statistically cheaper than CRH, but it hasn't had the same growth because dividends were paid out and its marketing opportunities were constrained by the local market.

Then you can try to be a little too clever.

For all of these years, I tried to find local subsidiary ways to play the great global leaders. Every time I met with Coca-Cola in the early 1980s, I'd say, "Well, tell me about the markets. You have local subsidiaries, tell me about the markets." And, of course, Coke just soared during this period. I was in search of the perfect small market play on Coke. I'd have been far better off at that point just buying the global leaders.

The last point I'd state is that if you want to be a global investor, there's absolutely no reason why you'd ignore American companies whose greatest prospects are foreign.

So in this portfolio, I would include among them Brown Forman [nyse:BFB]. I initially invested in Brown Forman, a wine and spirits company, back in 1986 time frame when it collapsed and led me to James Burrows, and I invested then.

In 1986, Brown Forman may have done 4 million cases a year of Jack Daniel's, 3.5 million of which were U.S. They're now up over 7 million, and the additional three and a half million cases have all come from foreign markets. It's all come at much higher margins than the U.S. markets.

Throughout this period of time, Brown Forman has been willing to sacrifice near-term earnings to invest in the startup of those international markets. So investing in Brown Forman in the U.S. with U.S. law, and I know the people, I know where they went to school, I know what their values are, I'm still able to capture enormous global growth.

So I would say it certainly is the case with Brown Forman. And in their case, one of the reasons the investment has performed as well as it has is even though it's family controlled, they understand what it means to buy back stock.

Over this period of time, there have been three periods when they bought back 15 percent of the shares when they were mispriced by the market. As a result, the remaining shares enjoyed a leveraged return, the last time about three years ago with interest rates at three and a half percent, to buy back several hundred million dollars worth of stock.

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They used these very cheap borrowed funds to buy back an under-priced share. And so that fiscal or corporate finance sophistication helped us in the investment where we never really had similar help from our foreign holdings.

Only now, just as an aside, have the European companies begun to consider share buy back as a promising possibility.

Another pitfall that I'll refer to is a fairly arcane and specific one but it's an intriguing one. I own shares of Heineken's holding company. Heineken's holding company is specifically tied to Heineken NV.

Heineken NV is an index listed and fairly liquid member of the Dutch index. At some point, the holding company shares – which have a one-for-one relationship, which means for every holding company share, you have one share of NV -- the holding company shares have always traded at a modest discount because they're less liquid, they're controlled by the family, people worry that the family will steal from you somehow.

About four years ago, following the creation of the European Union [EU], the pension assets in Holland were permitted for the first time ever to invest EU wide. What it meant was that the EU exposure that the Dutch pension funds wished to gain would come from indexing the largest German companies, the largest Spanish companies, and the largest Italian companies.

For a time before then, the Dutch pooled their own Dutch stocks because they were required to own Dutch stocks in the pension funds. If they were stockholders, they had to be Dutch stockholders. So a portion of that money finally spilled down to Heineken Holding, which is less liquid and not part of the index.

Once released and the capital re-allocated, there was selling in the Dutch market of Heineken Holdings to free up that capital to go into the German index, the Spanish index and the Italian index. Therefore the Italians, Germans and Spanish came in and bought the Dutch index, which led the share price of those members of the Dutch index higher, while at the same time Dutch selling drove the share price of the holding company in Heineken lower. For a period of several years, the spread that had historically been 10 or 15 percent widened to as much as 40 percent.

Now, I'm a shareholder in Heineken Holdings. I look at that as opportunity to buy more Heineken Holding shares. But the pressure was for factors that relate to the macro world.

And you'll see time and again as you invest abroad that there will be macro factors.

A couple of those over the time that have helped boost my investment returns. Another was the world health scare of SARS and the Asian based avian flu and their impact on China and Asia-related investments.

As Asian stocks declined because of the fear that China would become insular and set back, we were able, based on substantial investments in Richemont – the Swiss based luxury goods company, whose business suffered during the avian flu and SARS epidemic -- and we took

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advantage of what was a crisis at the time.

At the same time, Altria, my largest holding, sent the chairman over to China at the time when most of the world sort of avoided China. He came over and said, "We're with you through thick and thin."

The Chinese government appreciated that expression of support, and some years later gave Altria the only contract, legal contract, to develop a manufacturing presence in China and to develop a relationship with the Chinese monopoly to sell Chinese brands abroad. The opportunity to strike during a period of crisis definitely exists, and that was an example.

Let me share with you some of the pitfalls of global value investing.

One major pitfall is language and culture. Very close colleagues of mine took me to Korea after the '98 currency crises. The Asian markets suffered from too much capital flows, over building and then the collapse of their currencies.

In the midst of that, we went to Korea. And, you know, I was extraordinarily frustrated because I was literally at the mercy of the interpreters, which is yet another pitfall. I very much tried my best to understand the specific factors of which I made an investment and went to the Lotte Confectionery Company, which is just what I wanted, it's a confection company in a decent market.

We sat with the vice chairman and spoke for almost 45 minutes. I asked a question about the following year's cash flow. The interpreter and the vice chairman spoke for about 45 minutes, at which point the interpreter said to me, "Better." I sort of threw up my hands. Because all of that dialogue, I didn't know if they were talking about

their golf game or what they were doing. But if in talking they were talking about the ingredients that supported the conclusion "better," what I heard back was "better," and that wasn't enough. As a result, I was somewhat dismayed by the culture and the language.

I remember at the time, there was also a great bankruptcy that occurred with a company called Hinix, and there was a photograph of the chairman being led off in chains, and he had a terrific suit on, he had a heavy, blue, full-length cashmere winter coat, and then sort of below his knees he had this pair of high-top Reeboks with, you know, all of these vibrant stripes and everything else.

Looking at that photo I realized that I just don't understand a country and a culture where they can be all dressed above their knees and then down below, you know, in public in a professional setting wear high-top Reeboks.

I couldn't quite get my arms around a culture that would have such contrasts apparent. But those things led me astray, because the market is up probably twelve-fold since '98 when I passed for cultural reasons. So I just think you have to be awfully careful when investing outside your own country, language and culture.

Let me take a few moments to share my thoughts on some interesting current issues – one being corporate governance standards.

Americans are trying to hoist the Europeans with our corporate governance sort of trends. I own a large position in Nestlé, and Nestlé's CEO was nominated by its board to replace the chairman a year and a half ago, for reasons that are quite specific. The board had a recent expansion with many, many young and recent tenured board members, and the board felt that with

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lacking experience, they wanted to have the CEO who was a board member appointed as chair to see them through the period of time.

At the same time in the executive committee, there were also a whole series of changes. That meant as a CEO, he felt uncomfortable relinquishing the title. There were enormous amounts of business integration, global management change, and he felt uncomfortable giving up those responsibilities at a time when his executive committee at that particular time was a very young tenure. Rather begrudgingly he accepted the joint position with the condition that it would be temporary.

In the USA, Institutional Shareholder Services [ISS], providers of proxy voting and corporate governance services to institutional investors, and others in North America mounted a charge against Nestlé because that was going towards the American model that they resist and away from the European model of non-exec chair.

The American investors of Nestlé began to speak, uniformly agreed with Nestlé that they were comfortable with the reasons that the chairman and CEO would rest temporarily in this one person, in particular because this person happens to be extraordinary. Nestlé's history over 80 years is that they only had a joint position like this I think less than 12 years out of 85 or something. It's quoted on the history and the pattern of conduct.

The American shareholders, who all agreed with Nestlé at the same time, then said that they would vote against it, because as long as the proxy consultants in North America said it was against corporate governance best practices, they felt as money managers unwilling to go against that, because it shows in order to

take a stand contrary to an ISS or someone like ISS's perspective, you have to have such paperwork to comply to meet the standards of disagreeing. It's a hurdle that no one was willing to take, even though in conversations with management, they concurred with the wisdom of that way.

That shows you there's a growing reach of corporate governance that not necessarily will lead to better outcomes.

Heineken had the same thing happen. I've talked about the Heineken Holding Company versus the Heineken NV. The holding company, family controlled, controls the NV, and has given the NV the patience to invest for the long haul, the patience to take investments that don't pay off soon but will pay off not short-term rich but long-term rich, and Heineken has succeeded over the years by having that stable capital structure.

A western shareholder tried to dislodge that by insisting that they collapse that structure. I believe it's added value not detracted value. But the world of corporate governance is converging around the international holdings.

The good news on share re-purchase is that it's become much more frequently used abroad.

For example, Nestlé announced a \$5 billion share re-purchase in the last year, having never had one before, and it reflects their view that the opportunity is compelling in light of the market's undervaluation.

On another front, the stock option successes in the U.S haven't surfaced internationally. As I said at the start, I felt that they've been more patient as executives in looking out. But the

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stock option abuse could lead to more short-term conduct. It really hasn't kicked in.

The rising pools of activist capital have helped me in Telegraaf, and the appearance of the leverage buyer capital helped Weetabix. It hasn't helped; it took away Weetabix, to be specific. But the valuation level in general goes up because there are pools of capital willing to commit to privatize businesses when they're out of favor.

Many of my investments sell consumer products, and as a result they are increasingly selling through ever larger global retailers. So as a phenomenon, I worry about pricing pressure and the inability for my manufacturers to appeal to their consumers through an increasingly consolidated retailers environment, which increasingly has power to threaten to delist their products from their shelves if they don't agree to tougher terms. So that's a world that I inhabit and another pitfall.

One last thing I'd say before your questions, is, the threat of counterfeit.

Since I invest in the world of intellectual property, brands, trademarks, is something that's very timely. It's a critical issue as time goes forward. And, as I described at the start, global investing is 40 percent of my day. So I've given you a sense of how I spend 40 percent of my time and what I care about and how I've gotten there.

That concludes my prepared remarks about Global Value Investing, now I will be happy to answer any of your questions.

QUESTION: Coming back to your Weetabix example, how high will you go with one stock as a percentage of your portfolio?

When the price rose and your percentage of ownership increased and your margin of safety reduced, were you tempted to sell or reduce?

TOM RUSSO: I'm comfortable with positions as large as 10 percent. I won't typically go much beyond 10 percent, which reflects my lawyerly ways.

I believe that I can know what's important operationally for most companies, but I can't ever really know about the thing that is most important, which is litigation risk. So I stop around 10 percent.

Weetabix never got near 10 percent at market value. It ended up being 10 percent on take out, but it was never really that large of a position that I had to re-weight it. It was because at the start -- when you think about it, it was only 11 million shares times 5 pounds, it was a 60 million market cap when it started, got to something like 500 million at one point.

The good news at the start is I had very little money demands, and so I could take advantage of it. At the end, every share I bought could find a home without worrying about weighting.

So as far as the movement towards intrinsic value, I always felt that 8 times was too low, because most food company acquisitions have come at something north of 10. So 8 was conservative because I just never knew what the family might do. You know, the risk is that they can also disabuse your interest when they sell the business.

When this company was sold the chairman and the CEO stayed on to work with the leveraged buyout firm. My risk at that point was that I had no idea of the term structure of the compensation deal that Hicks Muse entered into

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with the family member who sold out his family, colleagues, as well as the public shareholders. So the risk of that occurring kept the multiple below what a public company typically sold for.

So it never (at 8 times earnings) got close enough for me to feel the pressure. It was still trading at a 25 percent discount to intrinsic value.

That's when I ended up with 16 or 17 percent of the shares outstanding and I just kept buying. It was hard because the clients, as I said, hated the products, and they didn't like to see the collapse that happened to occur at the same time when so much easy money was being made with Internet stocks.

It was one of those great moments where Weetabix would go down weekly and Cisco would quadruple daily. It doesn't get much worse than that.

QUESTION: What is your opinion of Budweiser [BUD]?

TOM RUSSO: It's more expensive than the companies that I have invested in the beer business, which is Heineken, and we own SAB Miller through Altria. I don't know what it is; it's \$7 billion in SAB Miller through Altria.

With Budweiser, I've been really impressed with their ability to create demand for their product abroad. Particularly in China, the BUD brand itself is developing a following, the Chinese like it. The market doesn't have enough margin yet to make any difference because the pricing is so low.

But the brand is there, and I think it's going to be a good factor going forward. I think you can -- if you just adopt a very long horizon, you probably

would do well with Budweiser. But it just seems expensive in terms of the valuation.

The other thing is a bit surprising - it's not a family-controlled company. The Busch family, though in secure control of the business, really only own about one percent of the company.

BUD is a bit quirky, and there's just some weird stuff. There's some weird family dynamics at Budweiser right now, Pat Stokes versus the young August. There's weird stuff, and that fight hasn't been fully fought.

QUESTION: What are your thoughts on the valuation of Berkshire Hathaway?

TOM RUSSO: Well, I think this week was an encouraging visit with management. I think what they've done is a couple of things. Warren Buffett and the Berkshire board of directors have wrestled with succession. And one way of getting that done is that they've communicated with the managers who run the subsidiaries personally through visits to the board, what it means to be part of Berkshire.

Berkshire's culture comes back in a simple message, maintain and extend your competitive advantage or moat. We have more money than you'll need ever. But everything you want to do, come tell us, and if it's good, you'll do it because we want you to deepen and broaden your moat.

Most importantly, at Berkshire the message is never do anything with our reputation, period, full stop.

Berkshire's message of its culture has become far more prominently delivered. It certainly was so at the annual meeting.

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Shareholders’ concern then about succession, how would the firm succeed more and succeed after Warren I think is answered by the fact that the culture is now more front and center discussed and probably sustainable.

It has to be so if, for instance, recently acquired, Iscar Manufacturing was willing to keep 20 percent of their business with the partner at Berkshire. If they felt that Berkshire was going to change course in midstream, they just committed corporate suicide if it were in fact that the business was going to be run differently with different values going forward.

The Iscar acquisition sent a big message that the values will remain. And so the fear over succession, I think, has been addressed, and I think that's been a weight on the stock price.

Also the fear over what they can do with the capital has been addressed because they've just committed about \$18 billion in acquisitions over the last 24 months.

Well I see that my time is up and I will be happy to stay after the break to meet each of you and answer any other questions that you may have. Thank you.

Bill Child on the
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“What a fantastic group of value minded investors gathered together in one place. Thanks for inviting me to share my business story, company culture and personal values.”

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