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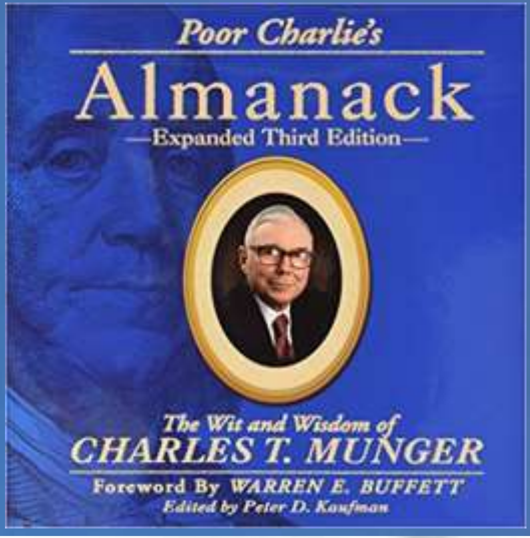
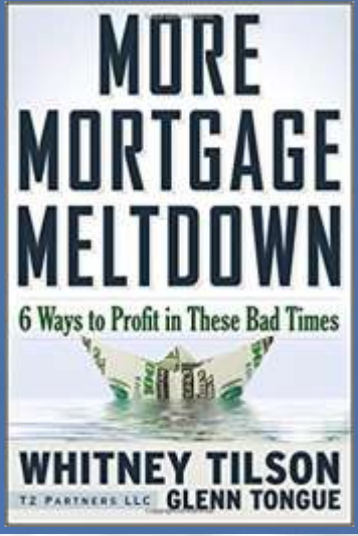
THE BEST OF VALUE AND GROWTH: MAKE MONEY INVESTING

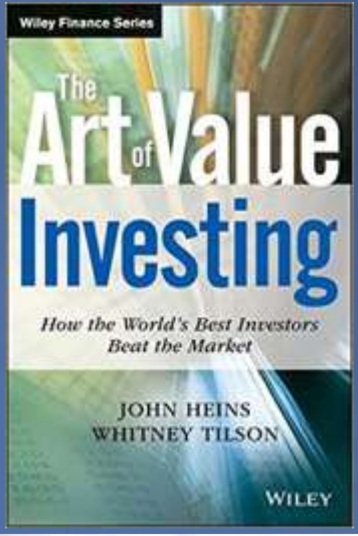
BY WHITNEY TILSON | WTILSON@KASELEARNING.COM

I WAS AN OLD-SCHOOL VALUE INVESTOR

- I pray in the church of Graham, Dodd, Buffett and Munger
- I've been to the last 21 Berkshire Hathaway annual meetings
- I've co-authored three books on value investing:







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I BOUGHT CHEAP STOCKS

- As a value investor, I mostly owned stocks that were trading at low multiples of sales, earnings and/or book value
- In most cases, the stocks were cheap because the companies were performing poorly
- I cared about businesses' quality and future growth prospects, but this was secondary to whether their stocks were cheap

THE FOUR MISTAKES OF VALUE INVESTORS

My focus on cheap stocks led me to frequently make four mistakes that are common among value investors:

1. Investing in low-quality businesses whose stocks were value traps because the businesses' fundamentals continued to decline
2. Failing to buy high-quality businesses whose stocks were fabulous long-term compounders
3. Selling the stocks of great companies way too soon because they'd risen and didn't appear as cheap
4. Failing to understand/appreciate powerful new technologies/trends

HOW A COMPANY PERFORMS OVER TIME IS MORE IMPORTANT THAN CURRENT VALUATION

- I estimate that 75% of what matters in terms of a stock's performance over time is how the company performs vs. only 25% the valuation at the time of purchase
- For my entire career, I had this backwards: I looked among cheap stocks and tried to find good businesses, when I should have looked among good businesses to find reasonably priced stocks

This was a terrible mistake that cost me and my investors dearly!

THE FOUR MISTAKES OF GROWTH INVESTORS

So the message is: "Just buy the stocks of great growth companies irrespective of valuation"? Not so fast...

Growth investors frequently make four mistakes:

1. They overestimate future growth, forgetting the powerful force of reversion to the mean, driven by technology changes, new competitors, size acting as an anchor to growth, etc. Trees don't grow to the sky
2. They pay too high a price for a stock, such that even if the business performs well, the stock doesn't
3. They fall in love with great companies and fail to sell when they should
4. They get sucked into "story stocks"

I'M NOW A MAKE MONEY INVESTOR

- I now combine the best aspects of both value and growth investing to maximize my returns as a <u>make money investor</u>
- I want to teach you how to become one as well

LESSON #1: STOCKS TEND TO FOLLOW EARNINGS

SO FOCUS PRIMARILY ON BUSINESS QUALITY AND GROWTH, BUT BEWARE OF EXTREME VALUATIONS

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HIGH VALUATIONS HAVEN'T MATTERED FOR CERTAIN STOCKS

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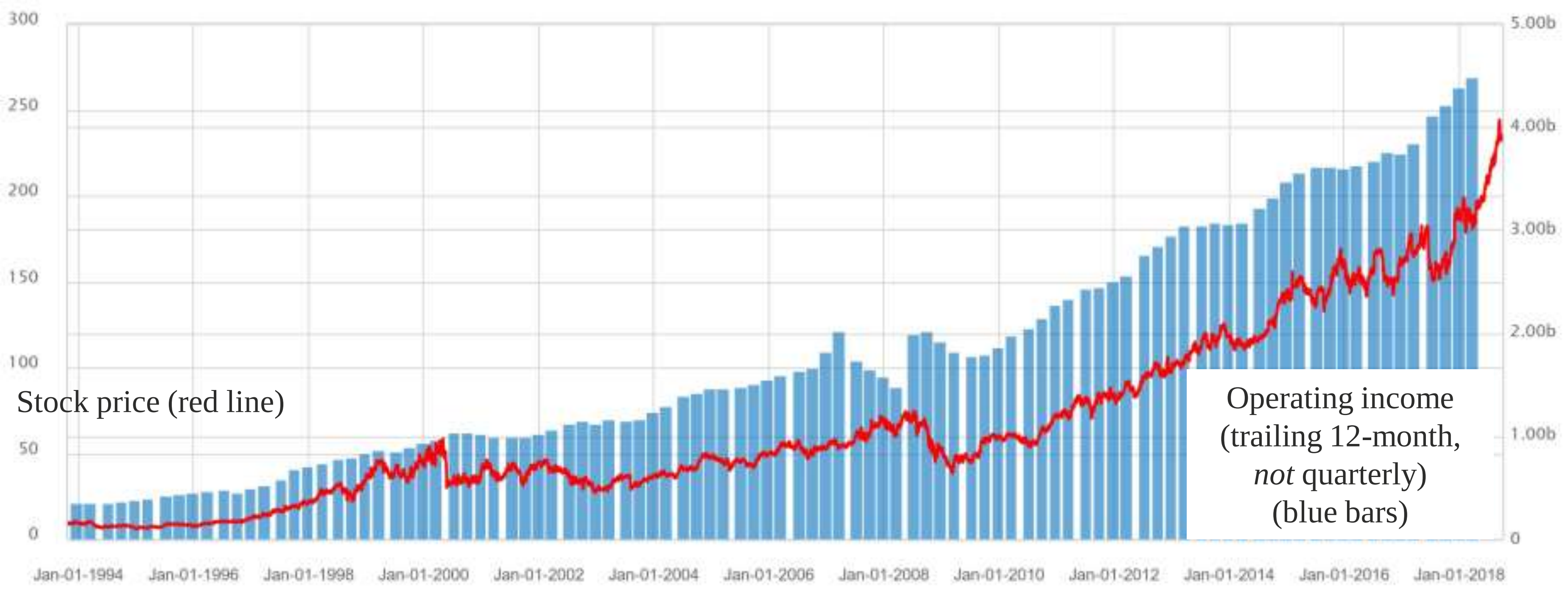
CASE STUDY: COSTCO

A 25-bagger since 1994, driven by extraordinary profit growth



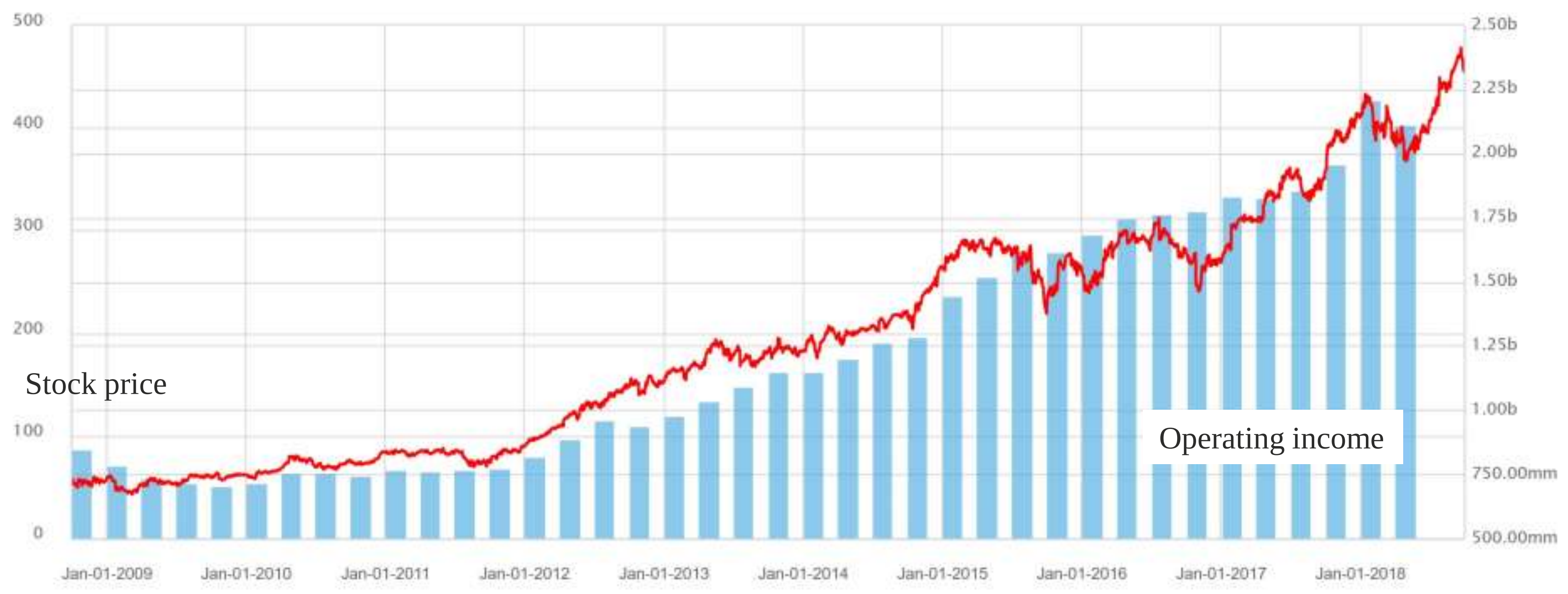
 Source for all charts in this presentation: CapitalIQ

CASE STUDY: NIKE

A 57-bagger since 1994

CASE STUDY: SHERWIN WILLIAMS

A 9-bagger over the past decade



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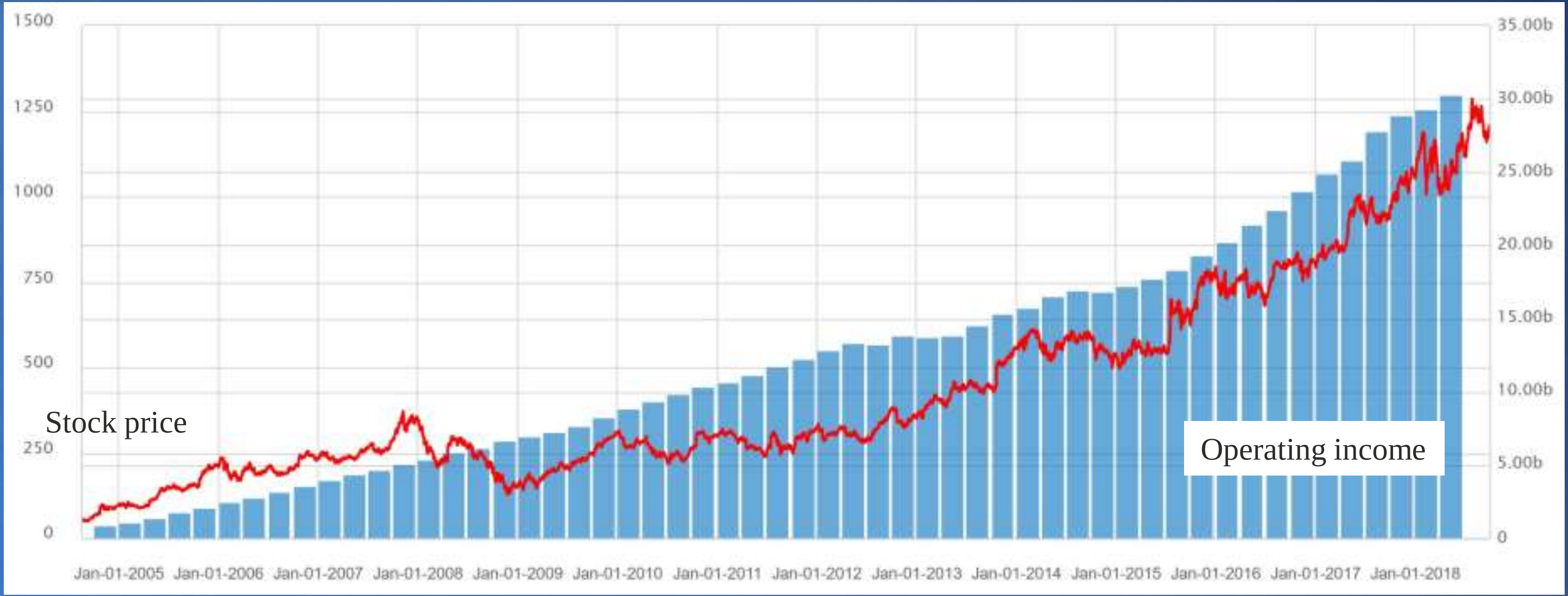
CASE STUDY: GOOGLE (ALPHABET)

A 25-bagger since its IPO 14 years ago



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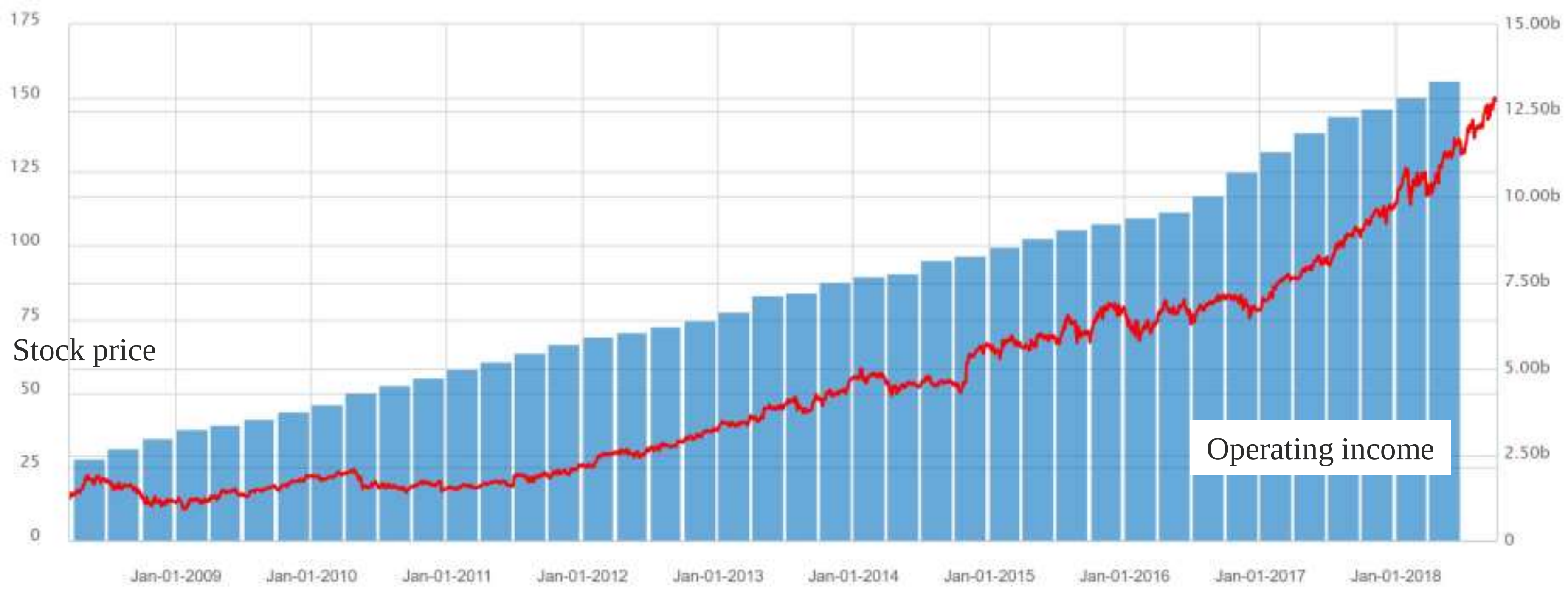
CASE STUDY: VISA

A 10-bagger since its IPO 12 years ago



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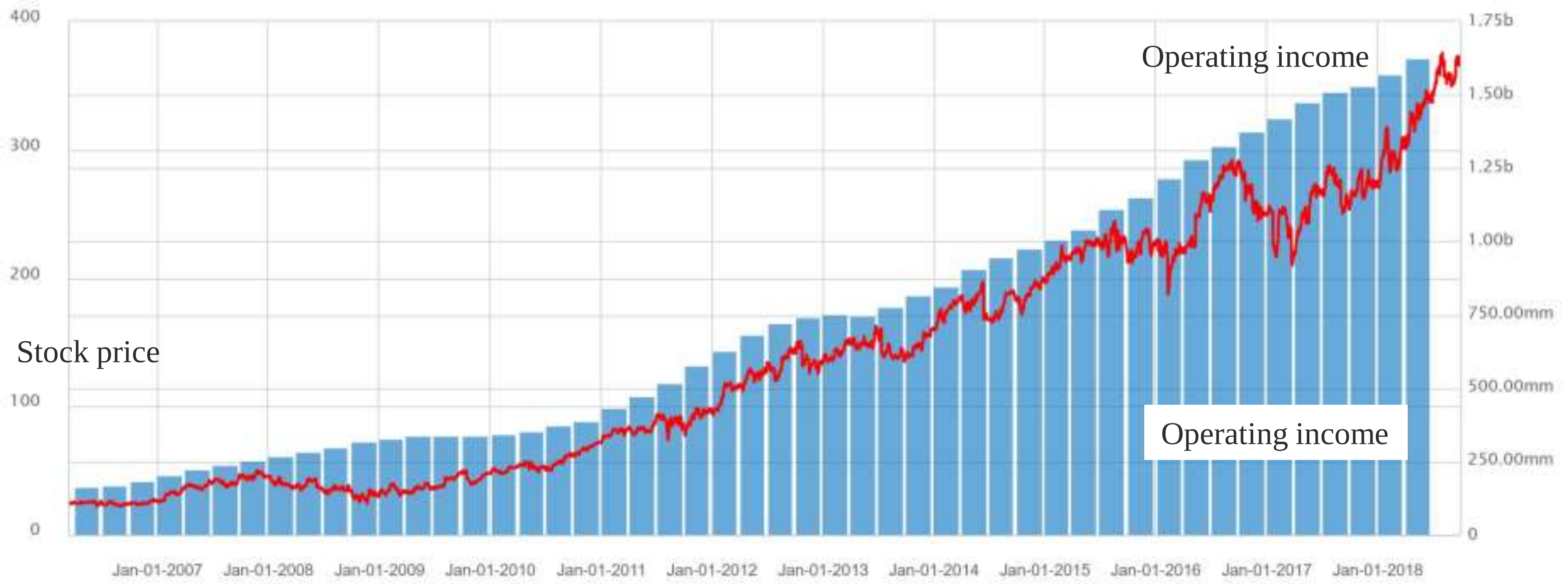
CASE STUDY: TRANSDIGM

A 15-bagger since its IPO 12 years ago



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BEST OF ALL, FIND COMPANIES WITH ACCELERATING REVENUE GROWTH

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CASE STUDY: ADOBE

The stock is up more than 5x in the last five years as the growth rate has accelerated

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CASE STUDY: NETFLIX

The stock is up nearly 50x in the last six years as the growth rate has accelerated from 12% to 36%

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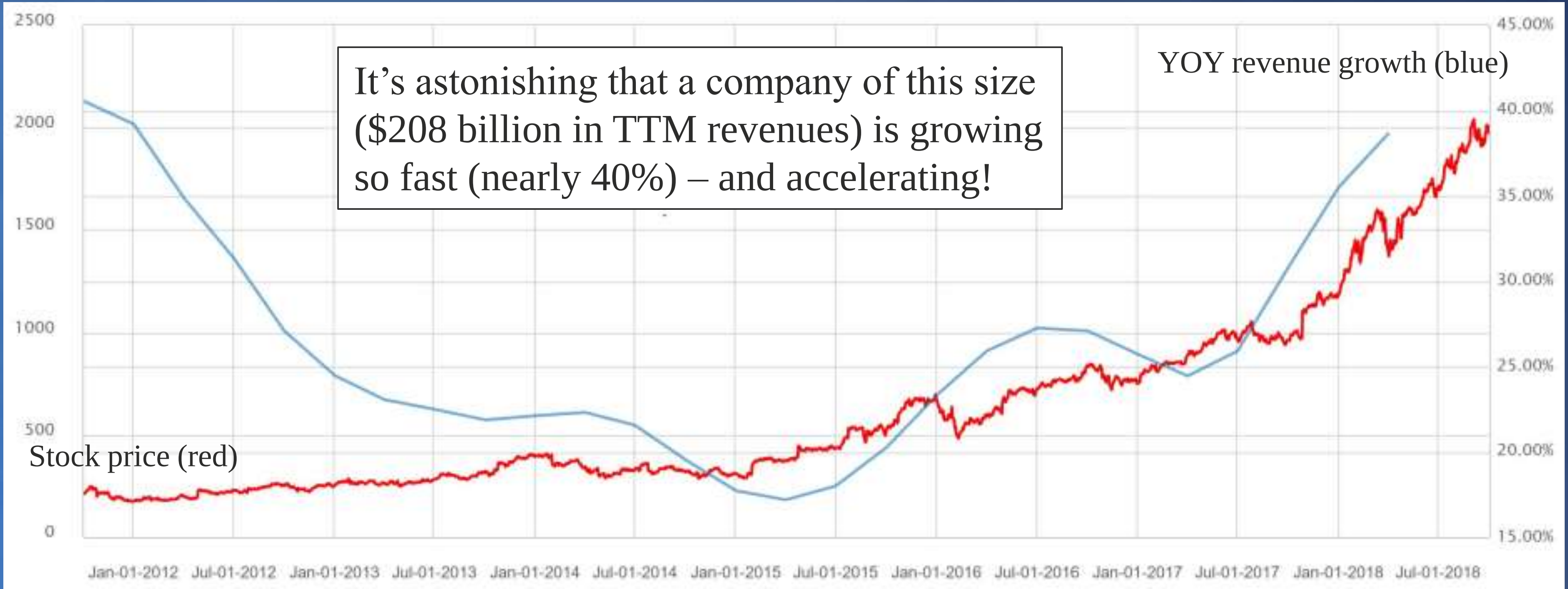
CASE STUDY: AMAZON

The stock is up 5x in the past three years



HOWEVER, EXTREME VALUATIONS CAN OFFSET EVEN ROBUST GROWTH

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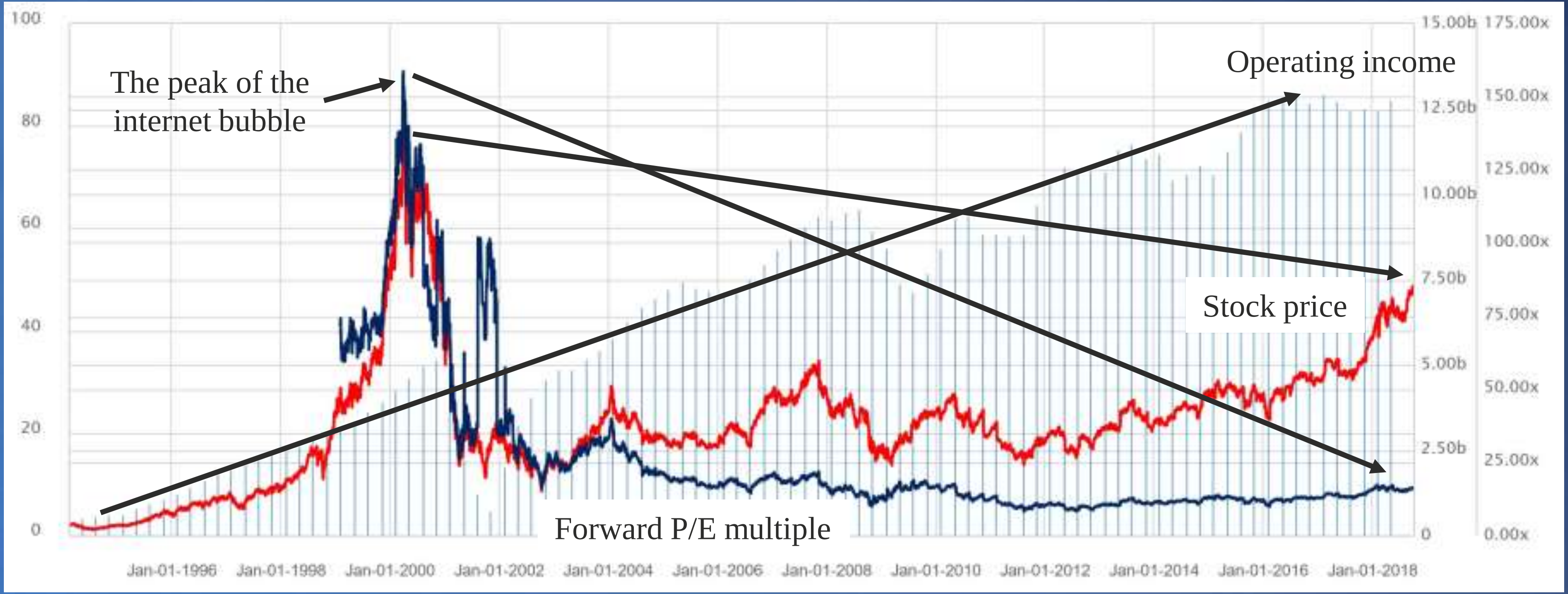
CASE STUDY: CISCO

After briefly becoming the most valuable company on the planet, the stock is still down nearly two decades later



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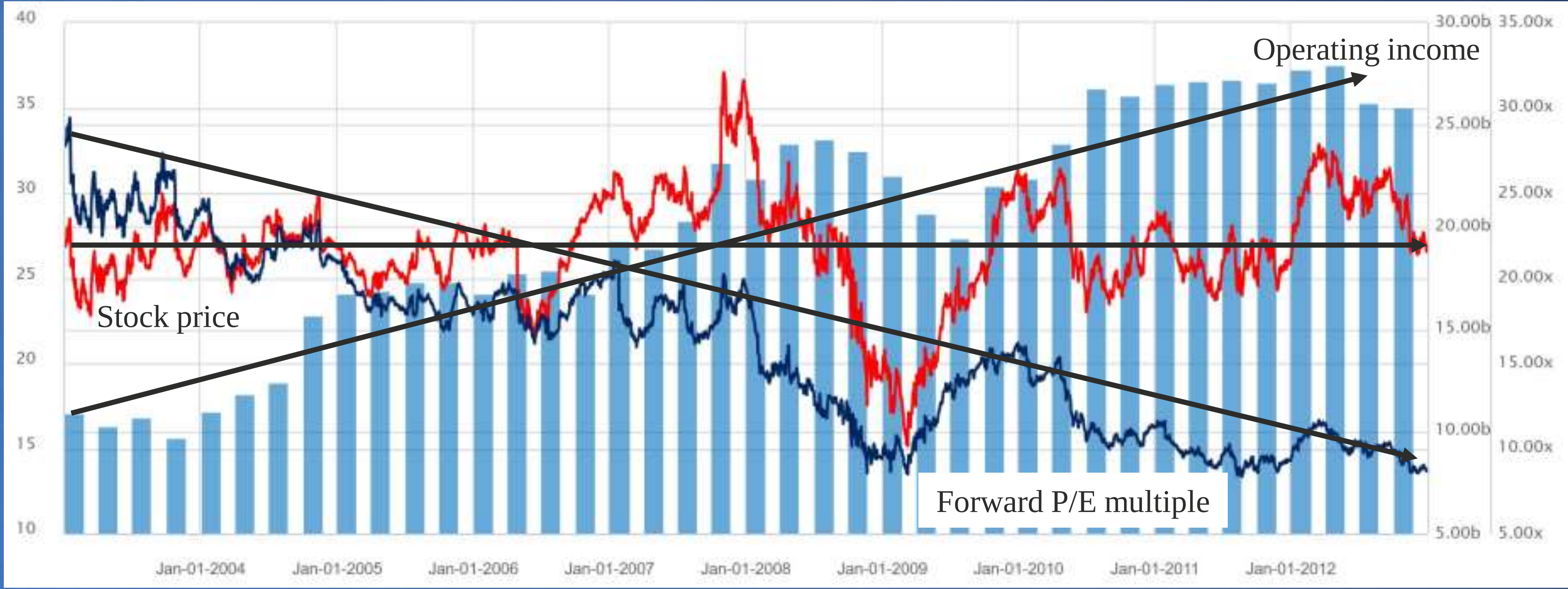
CASE STUDY: MICROSOFT

The stock price was flat for a decade (2003-2012) despite profits nearly tripling due to multiple contraction



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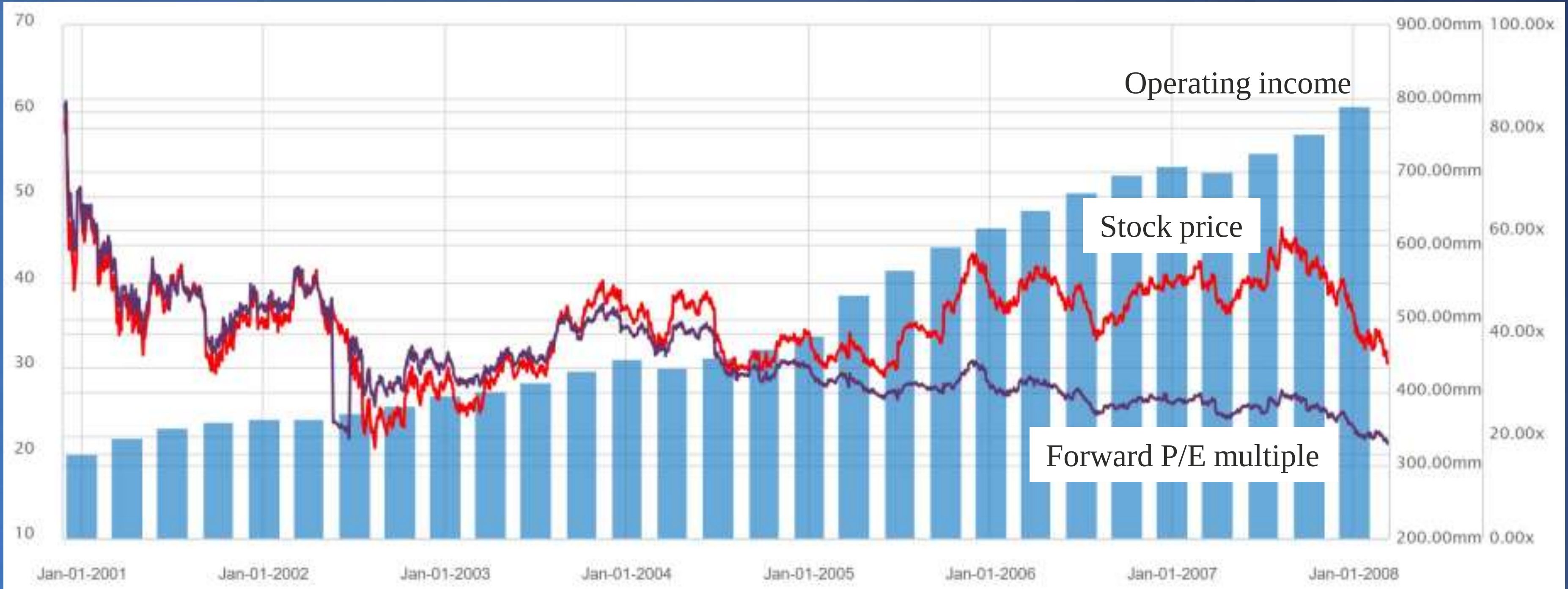
CASE STUDY: PAYCHEX

The stock was cut in half over seven years (2001-07) despite profits more than doubling because the P/E went from 80 to 20



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BEWARE OF VALUE TRAPS

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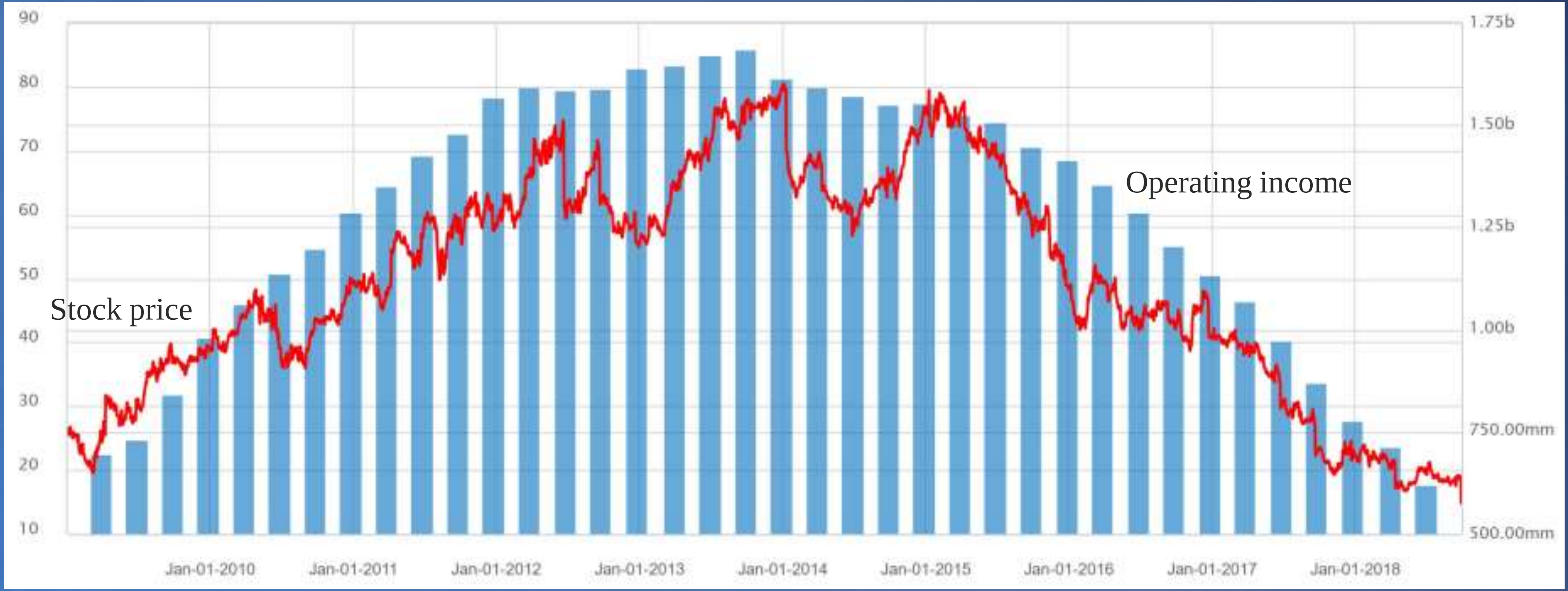
BE ESPECIALLY CAREFUL OF VALUE TRAPS:

COMPANIES WHOSE EARNINGS DECLINE AND DECLINE

- These value traps suck in value investors because they appear cheap all the way down
- Is it extremely difficult to make money on a stock, no matter how cheap it is, if the businesses' fundamentals steadily decline

CASE STUDY: BED BATH & BEYOND

A round trip of both earnings and the stock over the past decade



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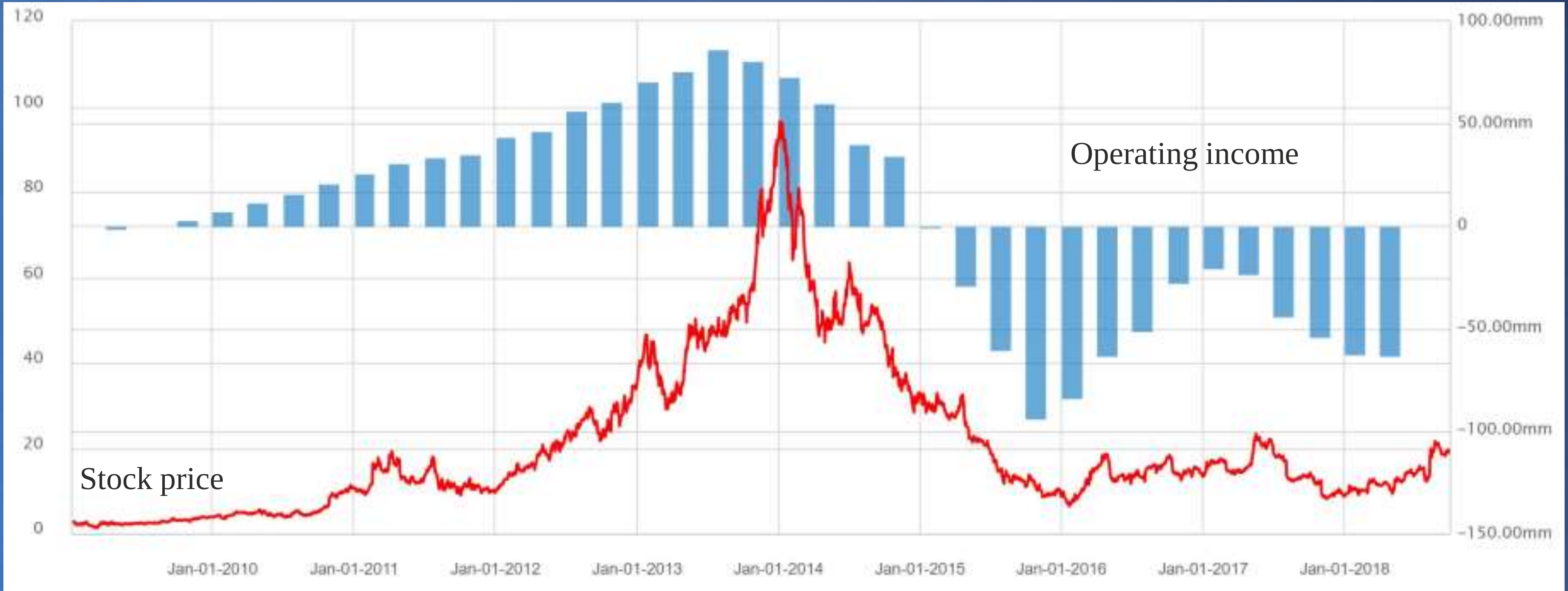
CASE STUDY: 3D SYSTEMS

In only four years, a 10-bagger followed by a 92% decline as earnings reversed and the story broke



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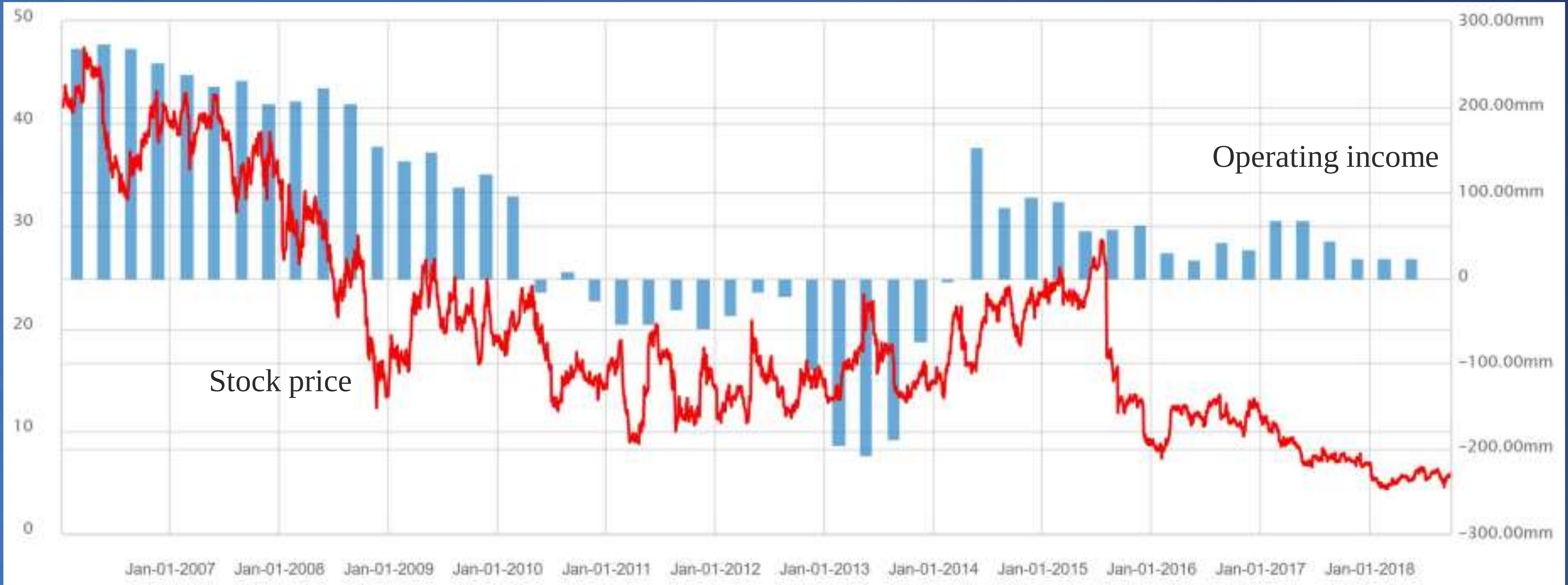
CASE STUDY: BARNES & NOBLE



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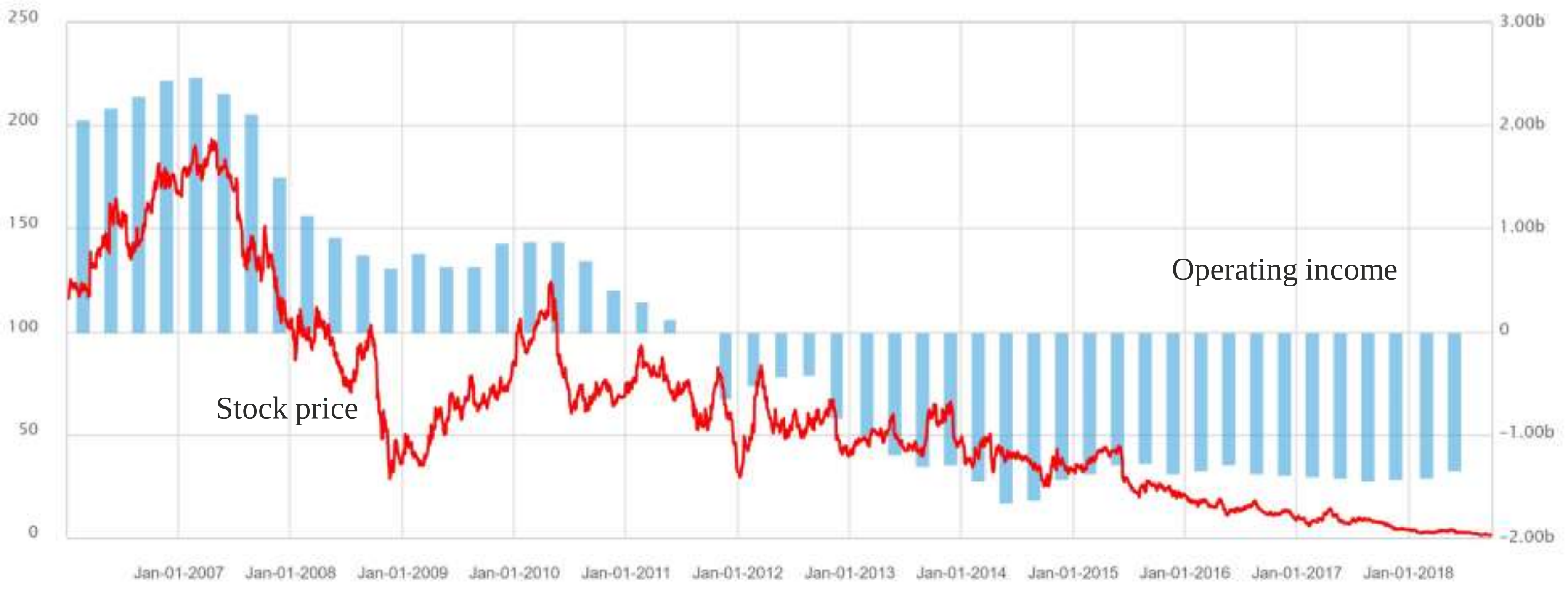
CASE STUDY: SEARS



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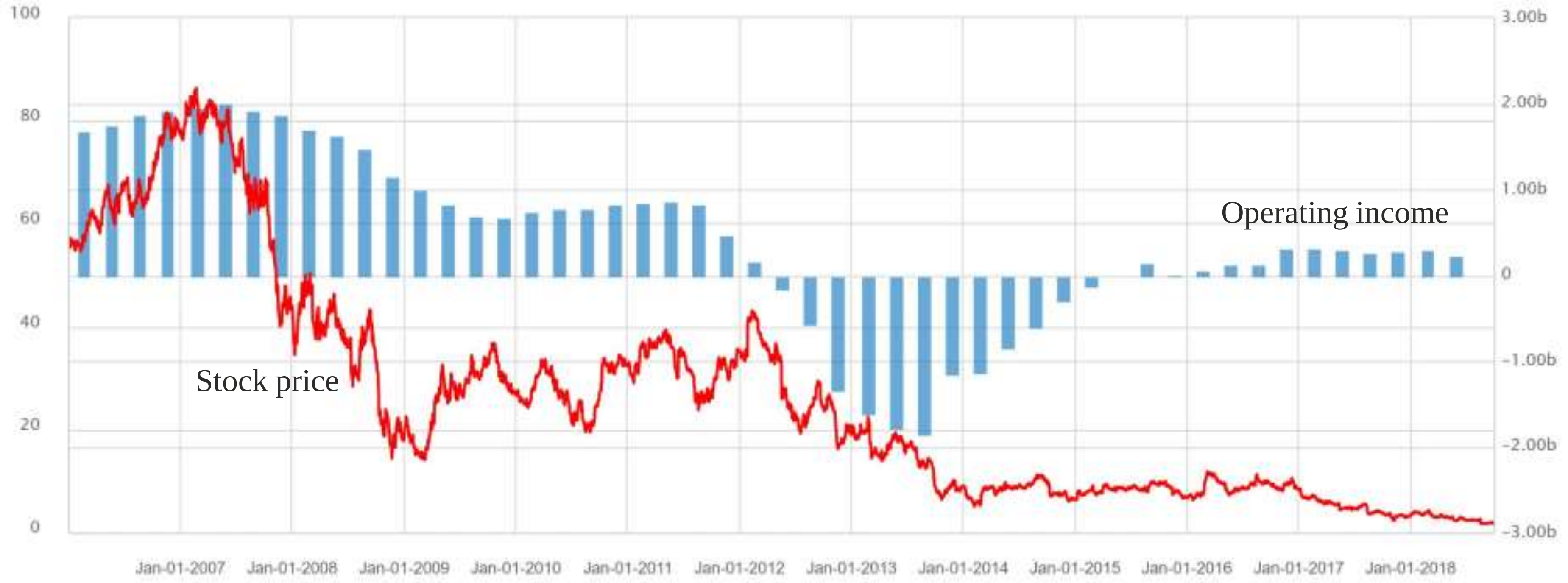
CASE STUDY: J.C. PENNEY

Operating income is positive but insufficient to service the debt



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LESSON #2:
TRY TO IDENTIFY INFLECTION POINTS

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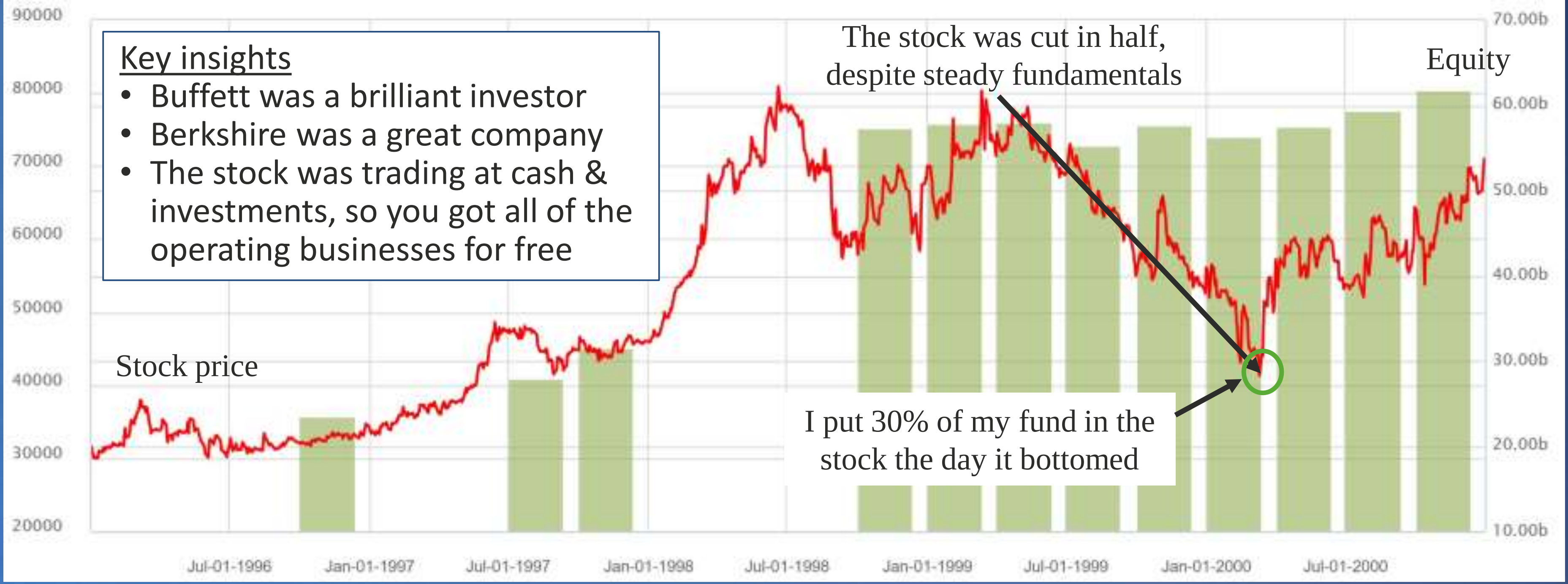
THE BEST OF BOTH WORLDS: COMBINE VALUE AND GROWTH APPROACHES

- If you correctly identify great companies that grow strongly and buy their stocks at anything but the most extreme valuation, you'll do well
- But if you *really* want to make a lot of money, buy the stocks of such companies when they're out of favor and the valuations are reasonable (if not downright cheap)
- If you catch an inflection point, there's a double tailwind for the stock: earnings grow and the multiple on those earnings expands as well
- <u>I am not talking about waiting for a market correction</u> – 90+% of the time, you should ignore the market
- I'm talking about *individual stock* corrections, which are typically driven by changes in sentiment toward the company or sector, or the company experiencing a short-term hiccup

CASE STUDY: BERKSHIRE HATHAWAY

A wonderful buying opportunity at the peak of the internet bubble in March 2000



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BERKSHIRE'S STOCK IS UP 8x SINCE THEN

CASE STUDY: MCDONALD'S

It's been a great growth stock in the past 25 years, up 8x

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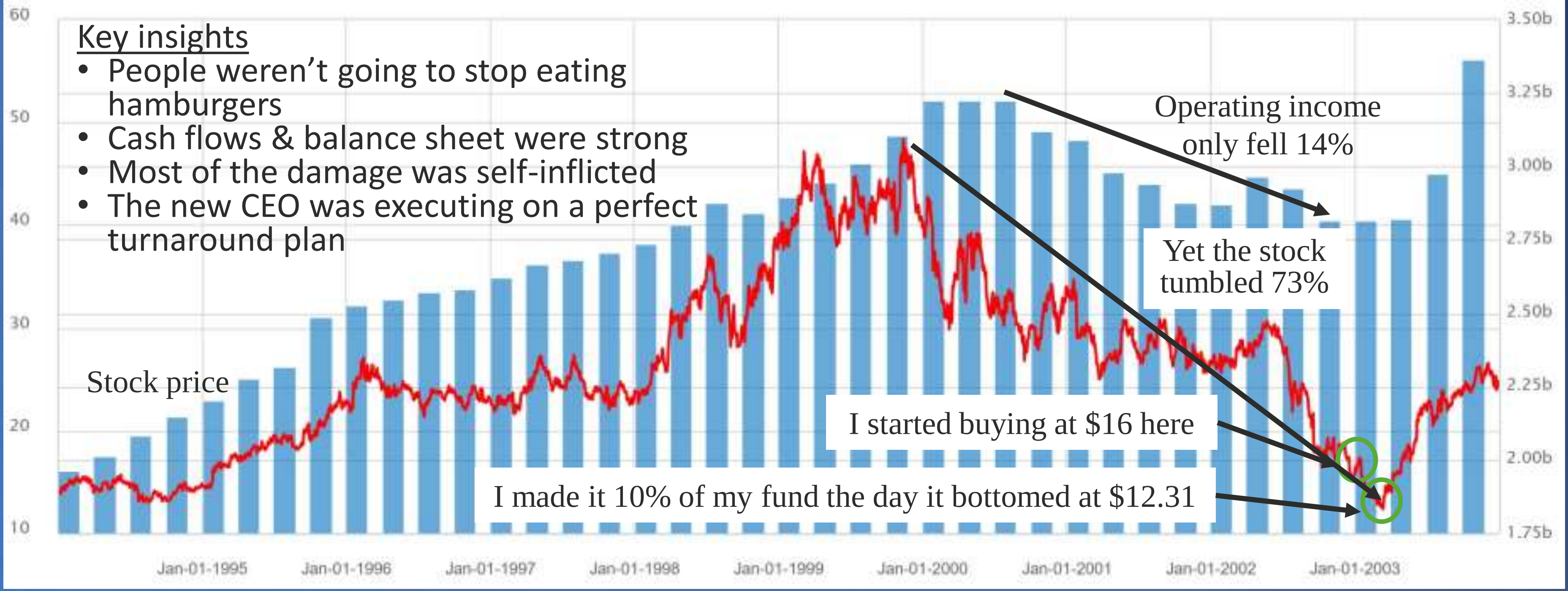
THERE WAS A GREAT BUYING OPPORTUNITY WHEN IT FELL 73% FROM 2000-2003



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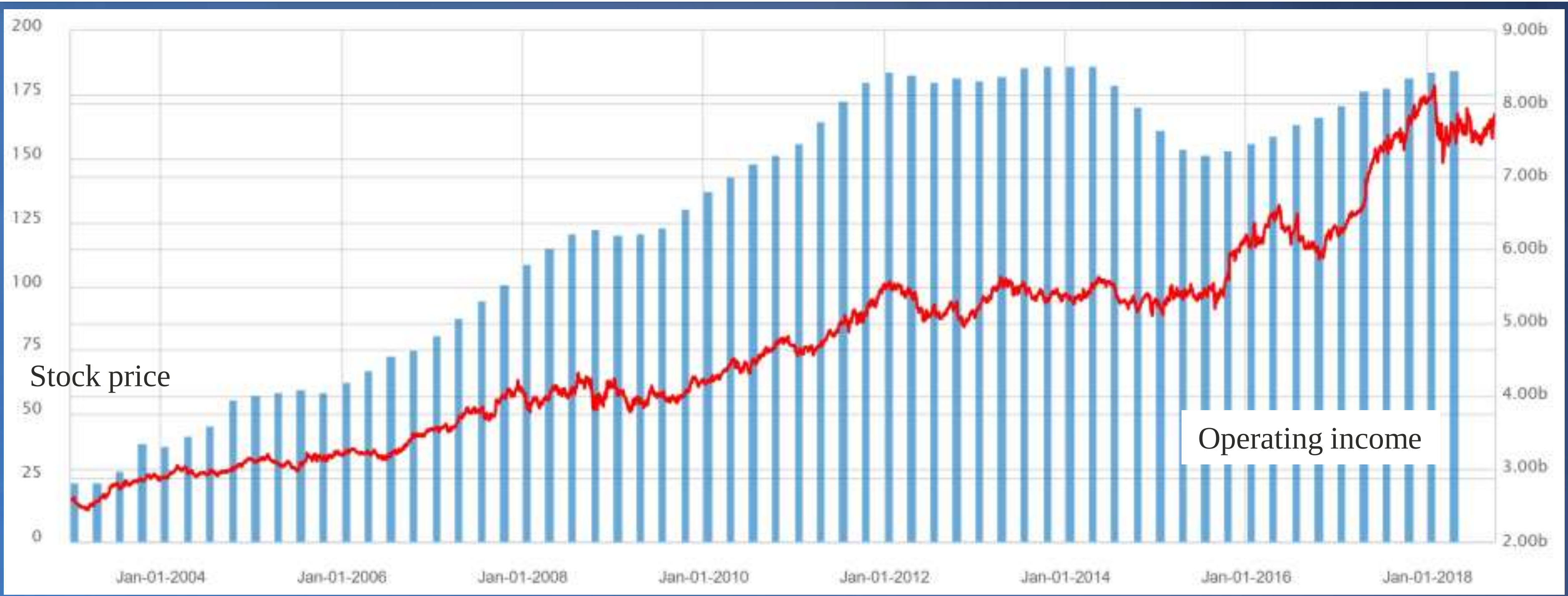
MCDONALD'S STOCK IS UP 13x SINCE 2003



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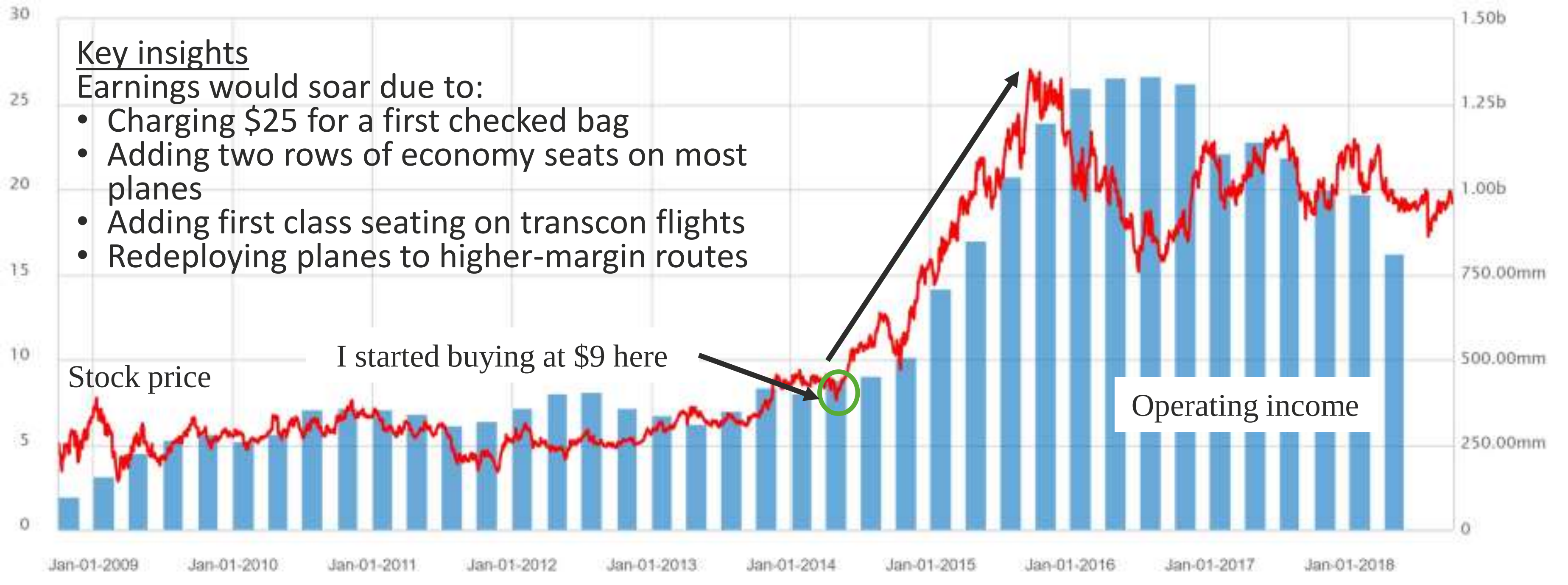
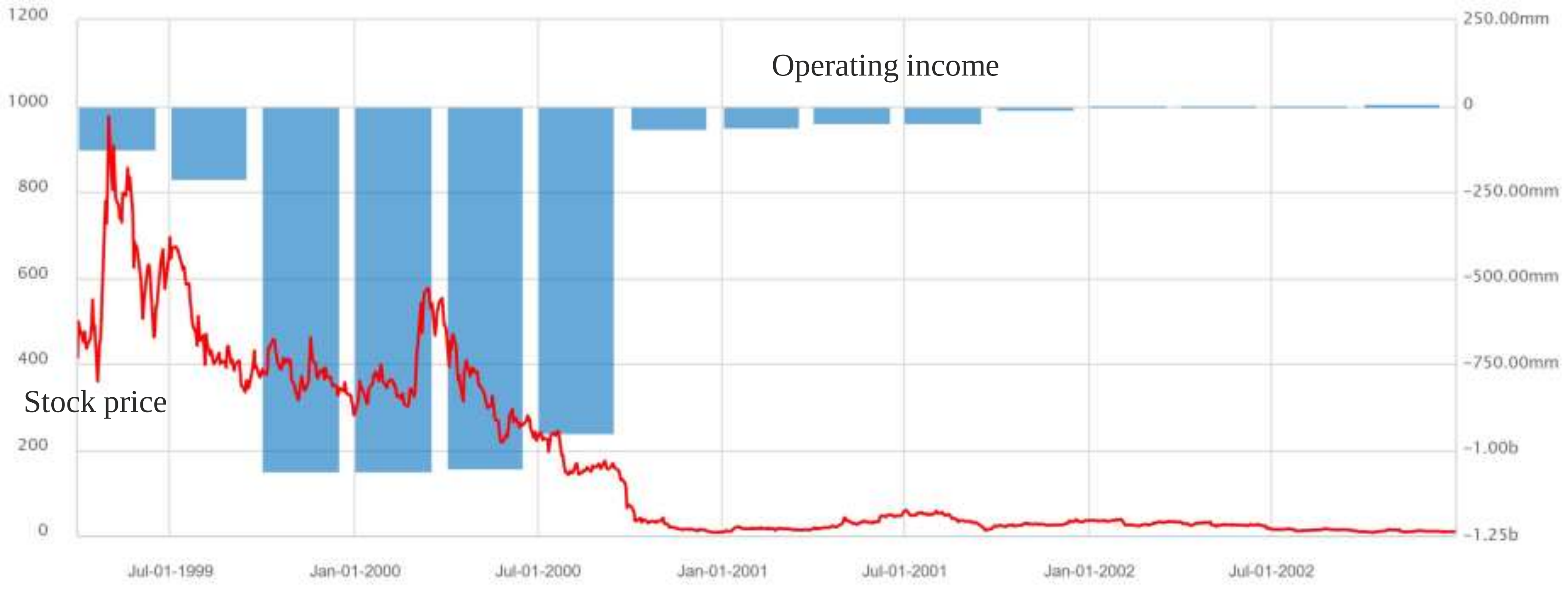
CASE STUDY: JETBLUE

Both earnings and the stock tripled in 18 months from 2014-15



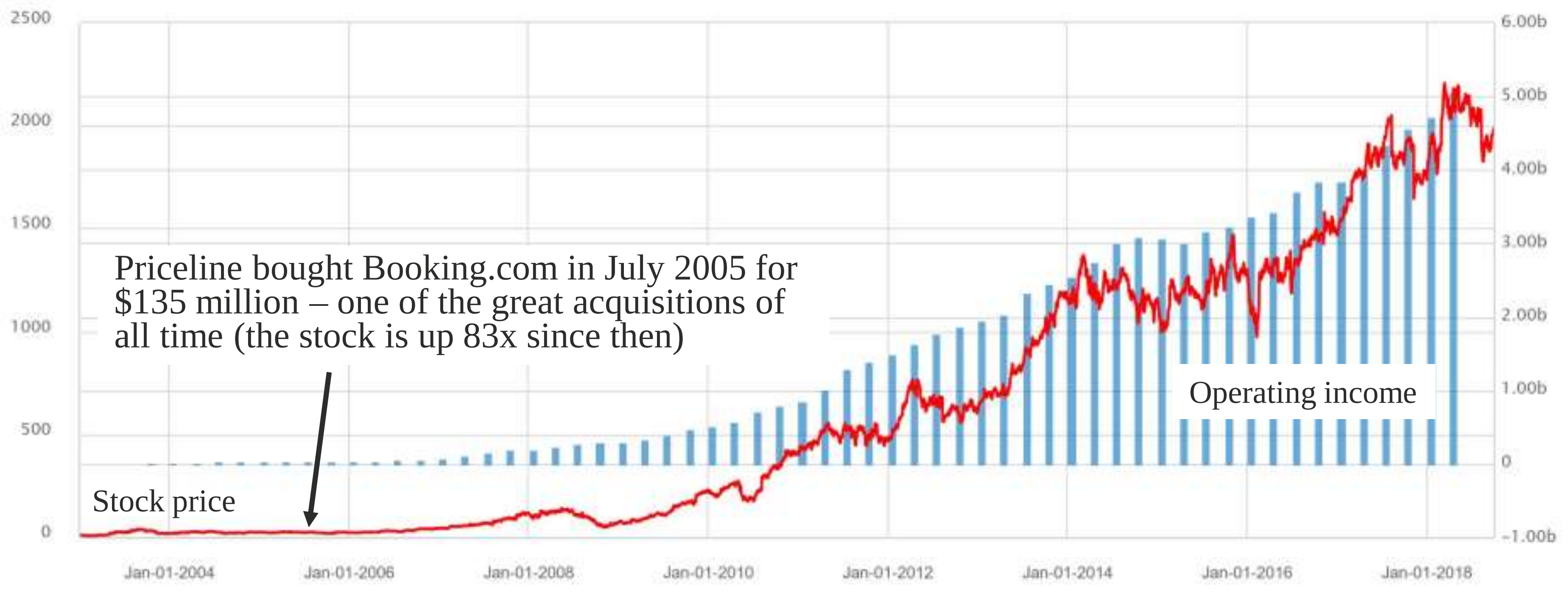
CASE STUDY: BOOKING HOLDINGS

The stock went down by 99% (!) from 1999-2000 and stayed depressed for two years



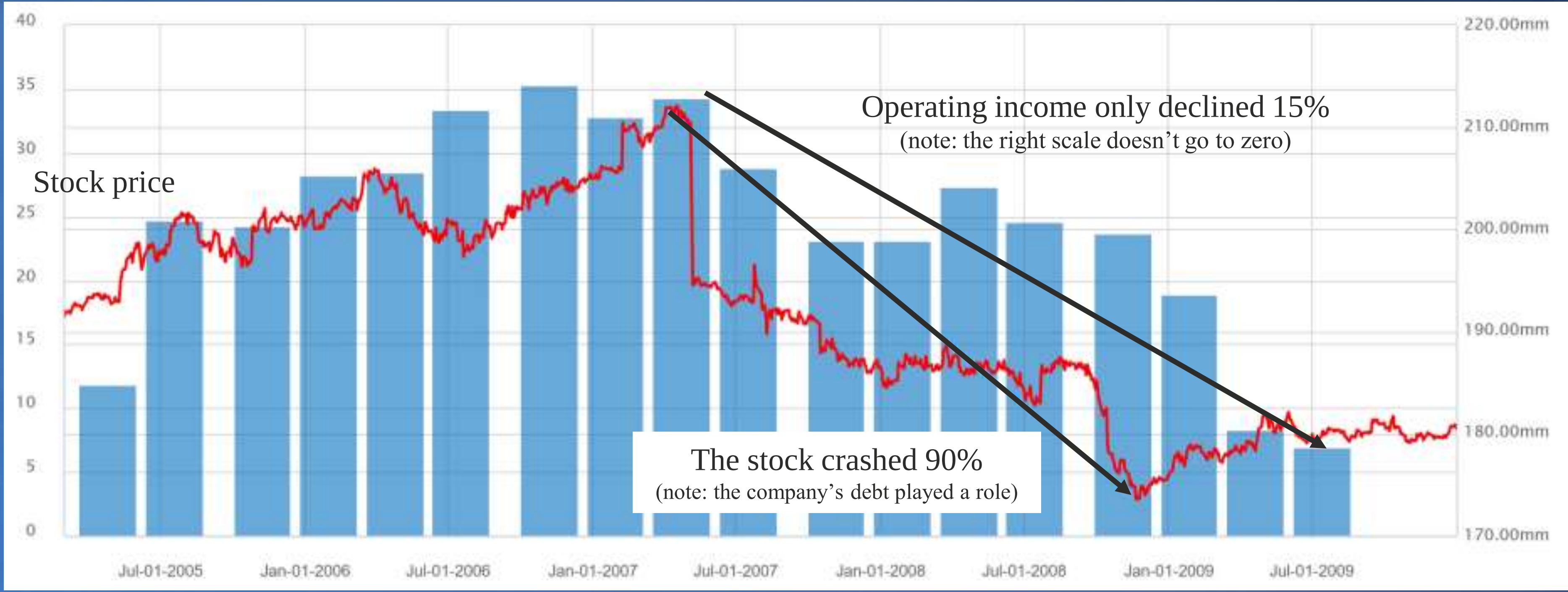
 (Formerly Priceline.com)

THE STOCK IS UP 220x SINCE 2003



 (Formerly Priceline.com)

CASE STUDY: DOMINO'S PIZZA



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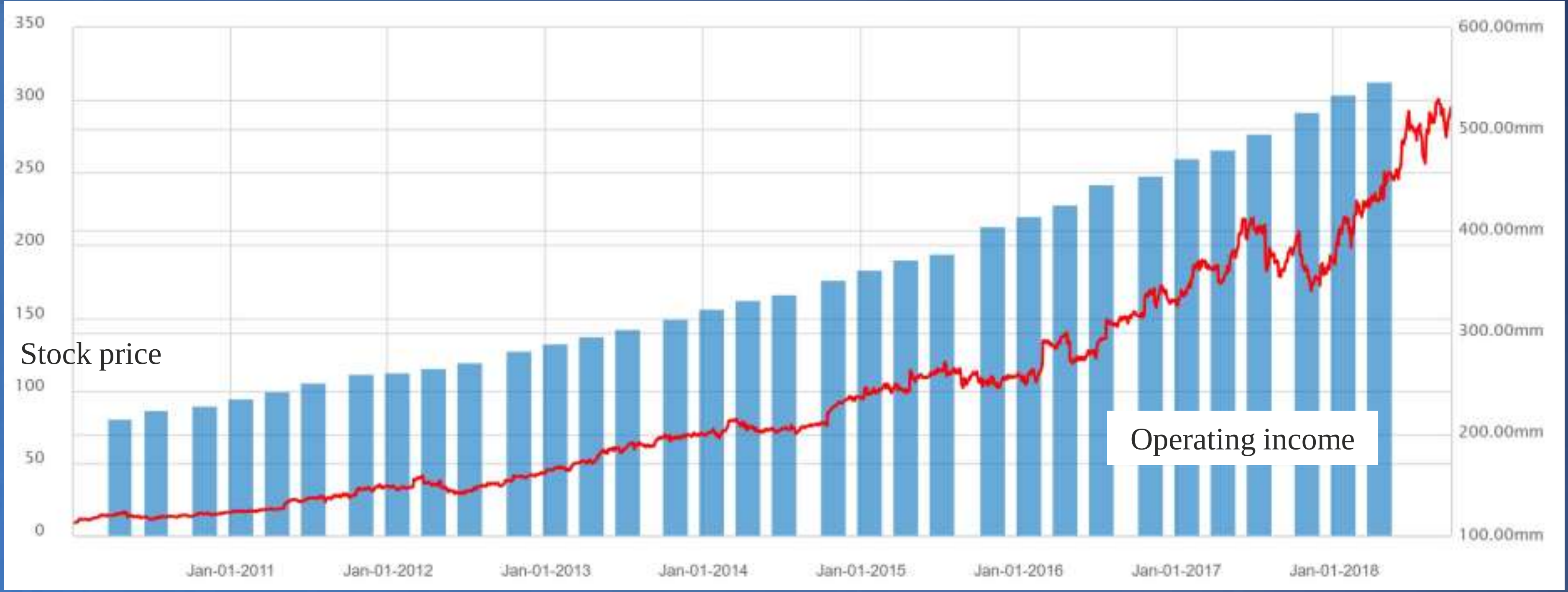
DOMINO'S PIZZA'S STOCK IS UP 75x SINCE ITS 2009 LOWS



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CASE STUDY: MICROSOFT

The stock is up 4x since 2013 thanks mostly to multiple expansion

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CASE STUDY: PAYCHEX

The stock is up 3x since 2009 thanks to both earnings growth and multiple expansion

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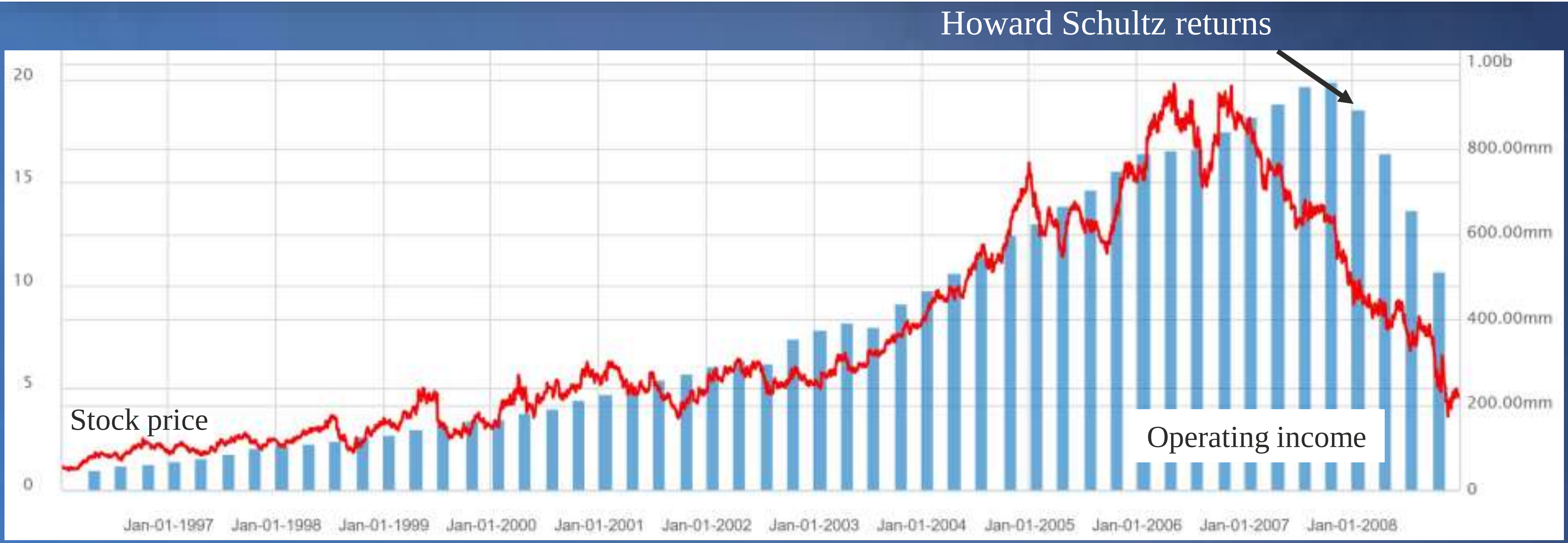
CASE STUDY: STARBUCKS

The stock rose 20x from 1996-07, then it fell 80% due to the bear market and profit getting cut in half



THE STOCK ROSE 15x FROM 2009-15 AS EARNINGS GREW 7x AND THE MULTIPLE DOUBLED

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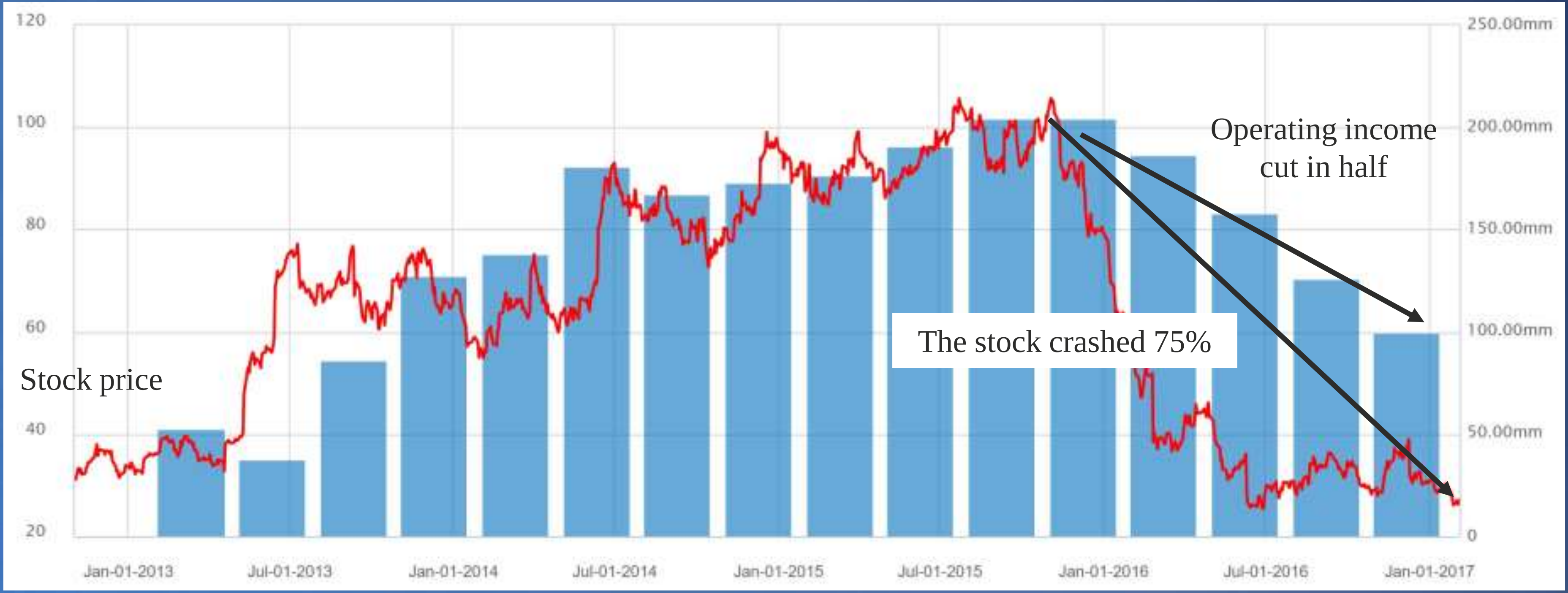
CASE STUDY: RESTORATION HARDWARE

Profits quadrupled and the stock tripled in the first three years – and then both fell sharply



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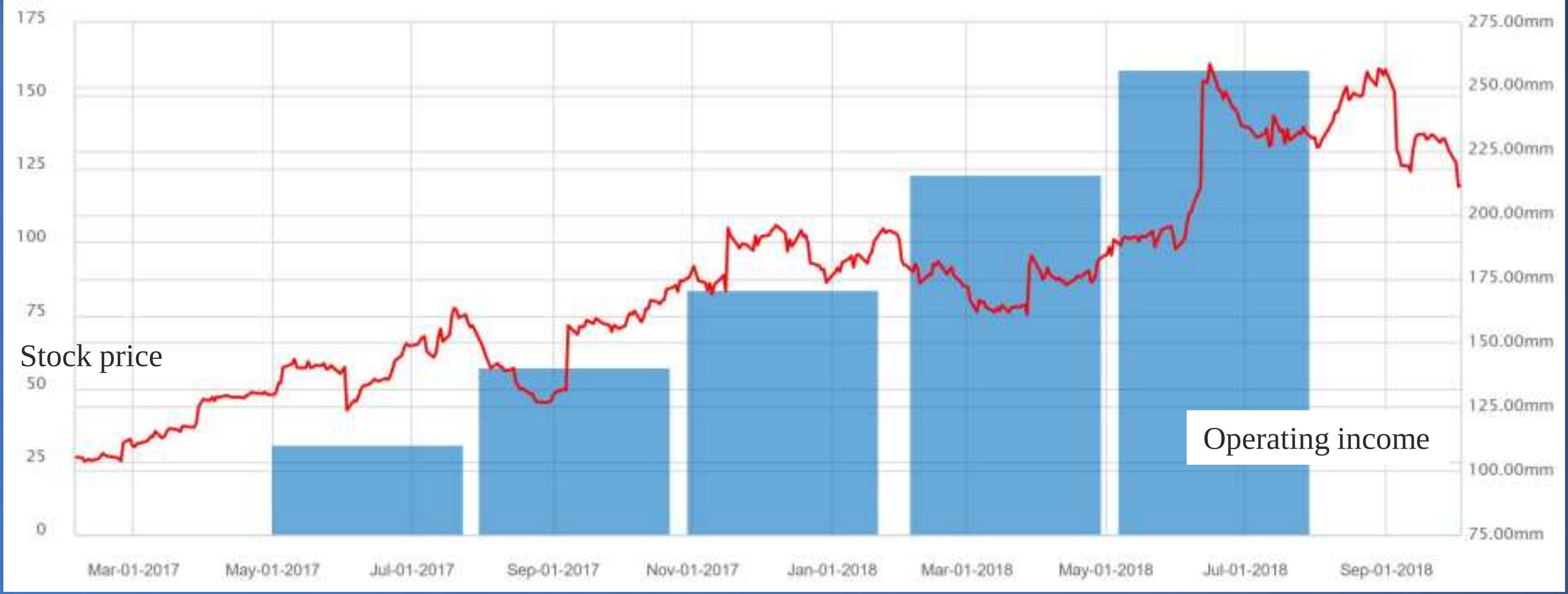
THE STOCK IS UP 5x IN ONLY 18 MONTHS AS PROFITS HAVE HIT NEW HIGHS



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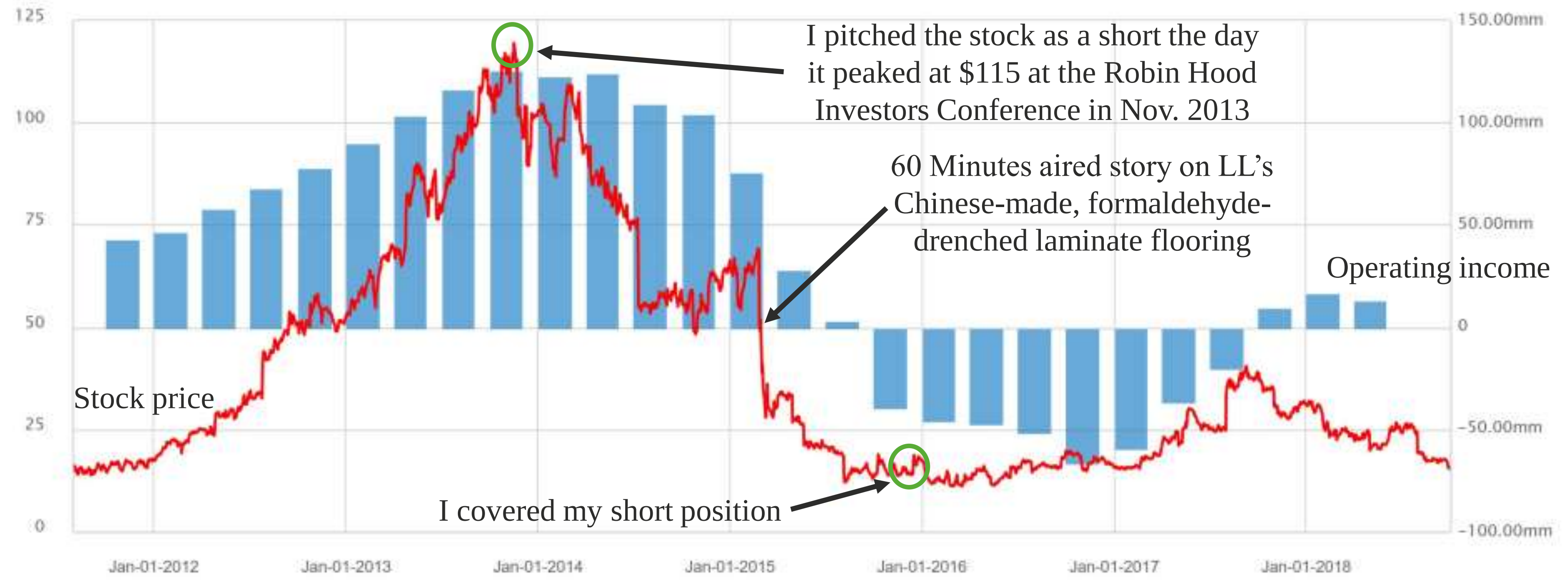
CASE STUDY (SHORT): LUMBER LIQUIDATORS



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HOW TO IDENTIFY INFLECTION POINTS

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INFLECTION POINT = VARIANT PERCEPTION

- An inflection point in a stock occurs when the consensus view is that the company will continue to stagnate/decline, but instead it grows
- They are very difficult to identify – but you don't have to be exactly right
  - "It's better to be roughly right than precisely wrong"
- If you believe a company/stock is at an inflection point, then you have a variant perception – a belief that a company will perform much better (or worse, if you're shorting) than most investors expect
- But having a variant perception is easy – you must also **be right**!

HOW TO HAVE A CORRECT VARIANT PERCEPTION

- To have a correct variant perception, you must have a unique piece of data, insight or analysis
- This is much more likely to happen if you're in your sweet spot – a country, market or industry in which you have deep knowledge, experience and relationships
- This typically requires a lot of hard, focused work, often over years, even decades
- It's very easy to be the sucker at the poker table – avoid this at all costs!

EXAMPLES OF HOW I DEVELOPED INSIGHTS THAT LED TO CORRECT VARIANT PERCEPTIONS

- Netflix: I met twice privately with Reed Hastings, for more than an hour each time, and gained an understanding of him and the company
- Berkshire Hathaway: I've studied Buffett, Munger and the company deeply for more than two decades, including attending the last 21 annual meetings
- Lumber Liquidators: I had a source who told me that Chinese suppliers were sending the company toxic, formaldehyde-drenched laminate flooring
- McDonalds: I spoke with a franchisee who told me about the tremendous turnaround that was underway
- CKE Restaurants: I called dozens of Hardee's restaurants to determine that the new Thickburger was a home run
- JetBlue: I spoke with numerous people in the company and industry as I wrote five articles about it

CASE STUDY: NETFLIX

This was the situation when I pitched it in October 2012

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KEY ELEMENTS OF MY INVESTMENT THESIS

This slide (and the next three) are what I presented on 10/1/12, the day the stock bottomed

- Market leader (more than 10x the size of its nearest competitor) in a rapidly growing global business (estimated 30-40% annual growth in streaming video)
- Lots of talk about competition, but very little is currently detectable
- Difficult to value the company because it has chosen to forego current profitability to drive growth by investing in: a) more, better streaming content and b) international expansion
- Enormous optionality on the upside and very cheap on an EV/revenues (0.80) and EV/paid subscriber ($99/sub) basis
  – In April, Disney and News Corp. bought the 10% of Hulu owned by Providence Equity Partners for $200 million in cash, valuing the business at $2 billion – and each of Hulu's two million paid subscribers at $1,000
- Downside protection due to Netflix's attractiveness as an acquisition candidate
  – Netflix would be a bite-size acquisition for any number of companies
  – I can think of nearly a dozen companies that would want to own Netflix's 28+ million paid subscribers for $100/sub
  – If someone put Netflix into play, the mother of all bidding wars would erupt

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I COMPARED NETFLIX TO AMAZON, WHICH HAD RISEN 20x IN THE PREVIOUS DECADE

- Both use technology and the internet to deliver an old product in a new way
- Visionary, entrepreneurial CEOs
- A great, convenient service at a very low price
  - Netflix offers a compelling value proposition: it costs 26 cents/day and the average streaming viewer watches 1¼ hours/day = 21 cents/hour of entertainment (pay-per-view is ~10x more expensive)
- Customers can leave at any time without penalty, so both companies must continuously improve to deliver a better customer experience
- Extremely large, global growth opportunities
- Willing to sacrifice short-term profits for long-term growth
- Perceived to have no moat – but actually have substantial competitive advantages
- Both have large, deep-pocketed competitors – that are bureaucratic and slow-moving
- Stocks (Netflix today and Amazon in 2001) are widely hated and shorted

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I SAID NETFLIX WAS A BETTER BUSINESS

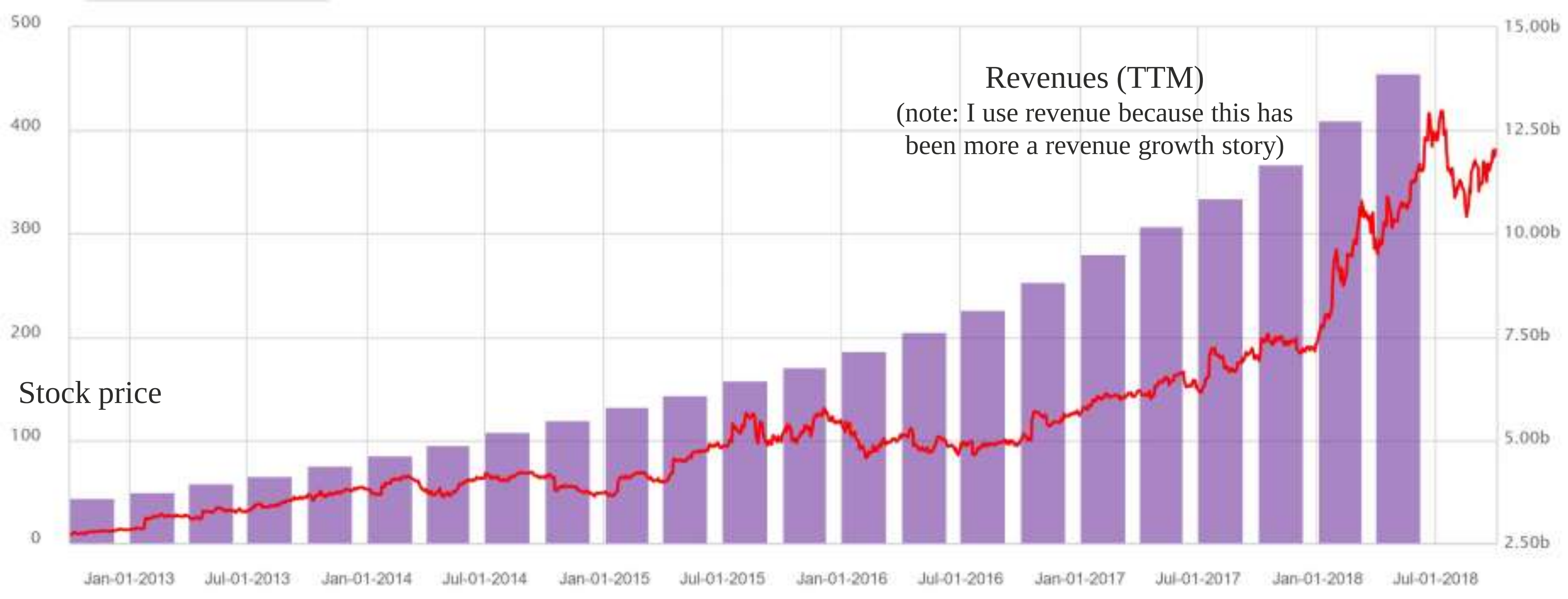
- A "lighter" business model that can scale much more quickly and at lower cost
  - Netflix delivers its product electronically, so it has virtually no fulfillment costs, doesn't have to build warehouses, etc.
- Higher margins, profits, and free cash flow
- Both companies have large international opportunities, but I'd argue that Netflix's are greater
  - Netflix is just starting to expand overseas; last quarter, international was 7% of sales vs. 43% at Amazon
- Both companies have scale advantages, but I'd argue that Netflix's are greater
  - More paid subscribers allows Netflix to pay for more, higher-quality content, which in turn attracts more subscribers, etc.

MY CONCLUSION

- I don’t think it’s likely that Netflix is going to be a 20-bagger (like Amazon) in the next decade
- But if there’s a 10% chance of a 10-bagger, the expected value of this one scenario justifies the entire price today
- I like investments in which I think my downside is limited and there are numerous multi-bagger upside scenarios
- But there is a wide range of expected outcomes, including ones with a substantial, permanent loss of capital, so this should be sized conservatively (3-4% of my portfolio)

NETFLIX IS UP *50x* IN THE PAST SIX YEARS

Driven by revenues up nearly 4x and P/S multiple up from 0.8x to 12.2x



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CASE STUDY: SODASTREAM

- SodaStream manufactures home beverage carbonation systems, which enable consumers to easily transform ordinary tap water instantly into carbonated soft drinks and sparkling water

Soda makers: + **Carbonating bottles:** + **CO2 cylinders:** + **Flavors:**

Soda makers:
- Large variety of designs, price points
- Durable, easy to use

Carbonating bottles:
- Reusable
- Hermetically-sealing cap
- BPA-free
- Glass or plastic

CO2 cylinders:
- 60 or 130 liters
- Consumers exchange empty cylinders for full ones at retail locations or home delivery via internet/phone

Flavors:
- Full range of regular, diet, "All-Natural," mixers, energy
- 2/3 less sugar and carbs than leading brands; no high-fructose corn syrup

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A VALUE TRAP OR INFLECTION POINT?

The stock and earnings continued to fall after I bought it and publicly pitched it twice

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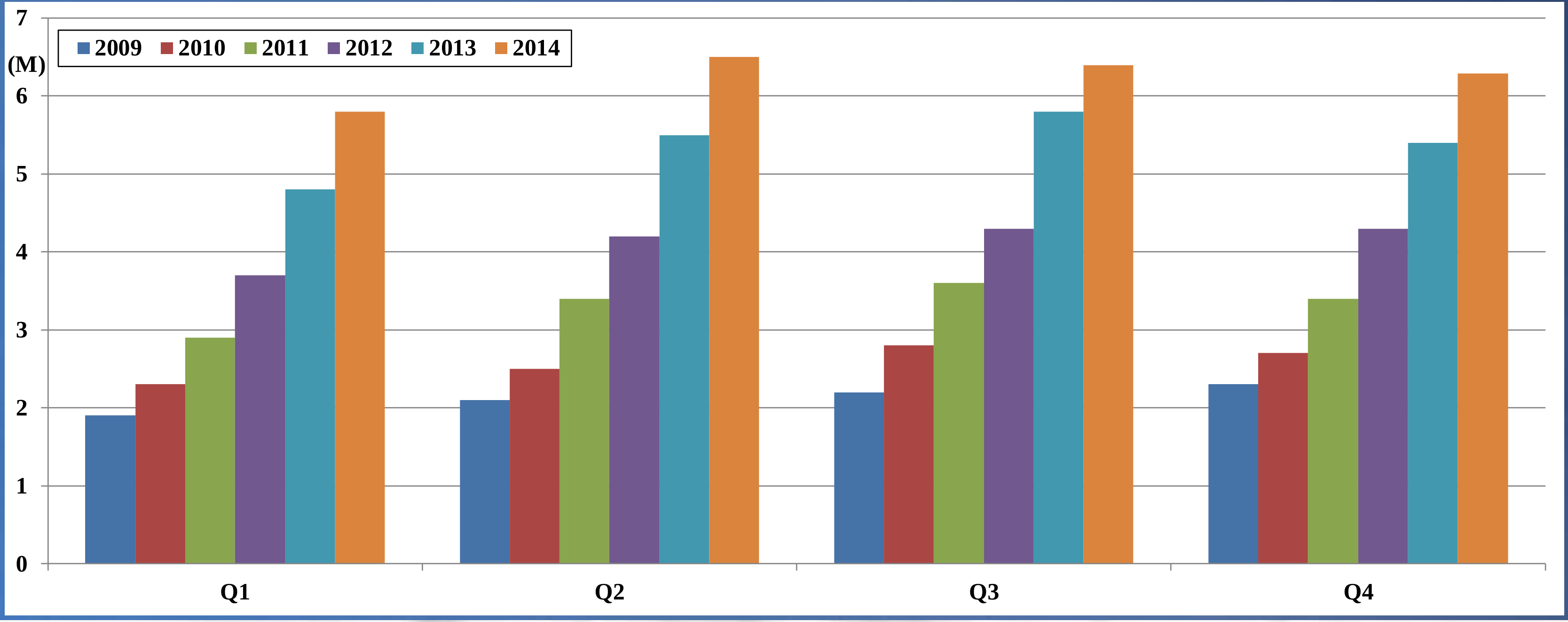
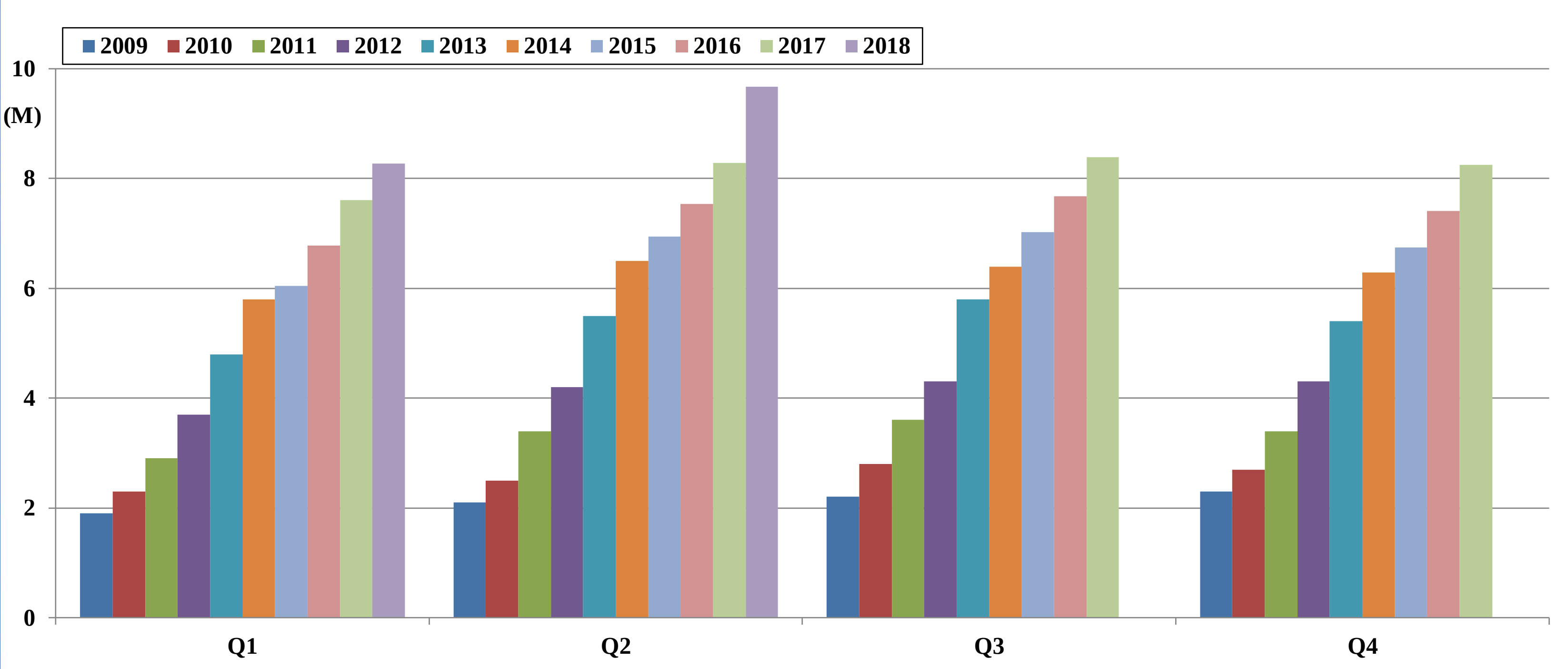
I FOCUSED ON THE FUNDAMENTAL DRIVER OF SODASTREAM'S VALUE, CO2 REFILLS

- The strength and consistency gave me conviction that the company was healthy



OVER THE LAST FOUR YEARS, CO2 REFILLS HAVE CONTINUED TO GROW STRONGLY



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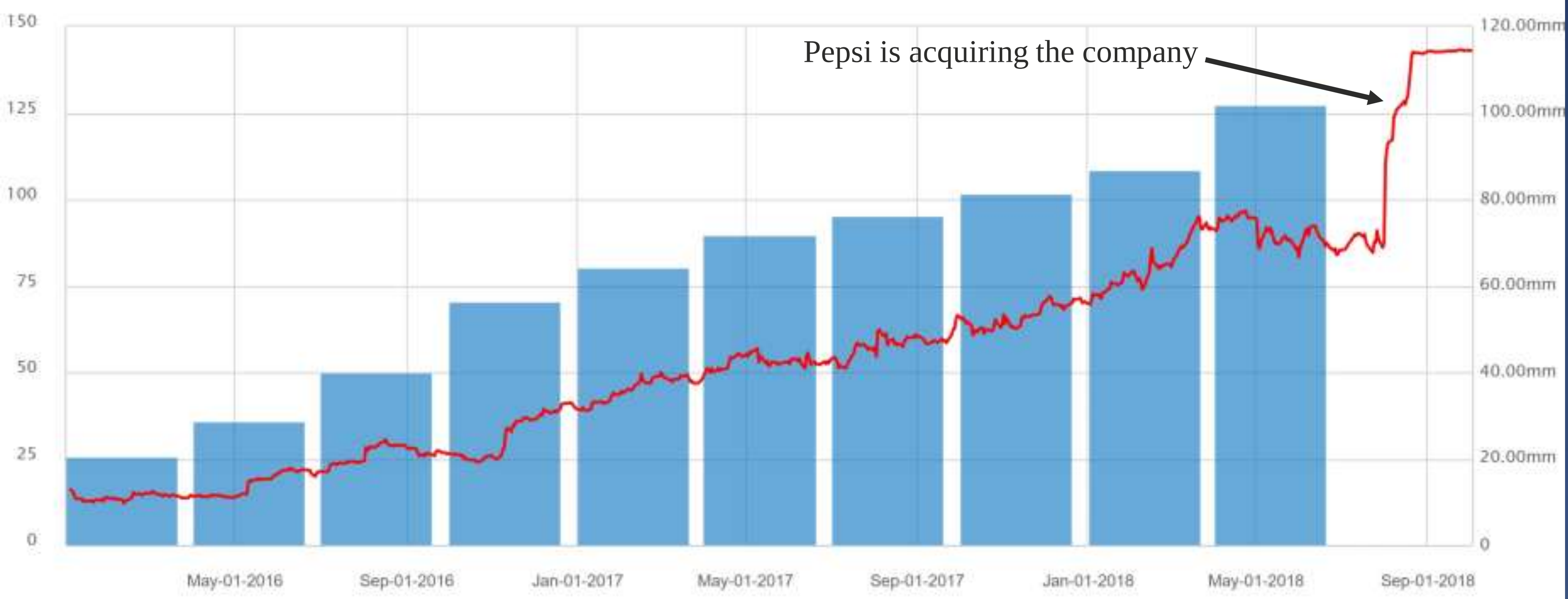
EARNINGS ARE UP 5x AND THE STOCK IS UP 12x



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WHAT TO DO WHEN A POSITION IS RUNNING AGAINST YOU?

- This is so hard!
- No wonder mismanaging this has blown up some of the world's smartest investors
- It's especially hard for value investors, for whom it is ingrained that a lower price means "buy more!" (or a higher price means "short more!")
- Classic value investors are going to screen a lot of value traps as attractive
  - We will probably buy some of them
  - Performance will be enhanced by recognizing mistakes on value traps and getting out quickly instead of digging in stubbornly

WHAT TO DO WHEN A POSITION IS RUNNING AGAINST YOU? (2)

- When a stock is running against you, emotions are almost always swirling, especially if you've publicly pitched the stock
  - Your value investing instincts are that if you liked it at the price you bought it, you should like it more now that it's cheaper
  - But emotionally you want to sell, end the pain and never think about this terrible stock again
  - There's also a powerful feeling of wanting to wait until it gets back to the price you bought it before selling
- Start with the assumption that you've missed something in your analysis (i.e., the market is right and you're wrong)
- Figure out what you've missed and actively seek out disconfirming information

WHAT TO DO WHEN A POSITION IS RUNNING AGAINST YOU? (3)

- You must ask – and honestly and correctly answer – a series of key questions:
  - Have I made a research error? Have I done full 360-degree research diligence on this (not only talked to company, but customers, suppliers, competitors, other industry participants, etc.)? Am I possibly missing anything? Have I talked to or read a piece by someone I respect who has the opposite position on?
  - Has the stock moved with the market or the sector or is it stock-specific?
  - Is there new information that led to a big one day move (earnings, M&A, litigation, management changes) and, if so, how does it impact my original thesis? Do I have thesis drift?
  - What position limits and risk overlay should I apply?
  - How many basis points of total portfolio performance have I lost? If I double down and it goes another 20% against me, how much would that be, and am I ok with that? How many basis points of the total portfolio performance am I willing to lose on a single position?
- Consider stop losses, particularly on the short side

WHAT TO DO WHEN A POSITION IS RUNNING AGAINST YOU? (4)

- Tune out the noise and think clearly and rationally
- Focus on the fundamentals: if earnings rebound, the stock will as well
- Resist the temptation to double down again and again
  - Remember: You don’t have to make it back the same way you lost it
- Doing nothing may be the best option, but you also must have the courage to admit a mistake and get out…or know that you haven’t made a mistake and buy more

<u>LESSON #3: LET YOUR WINNERS RUN</u>

ONCE YOU BUY A GREAT STOCK, HOLD ON

AS LONG AS THE STORY REMAINS INTACT

(IT'S OK TO TRIM TO MANAGE RISK/POSITION SIZE)

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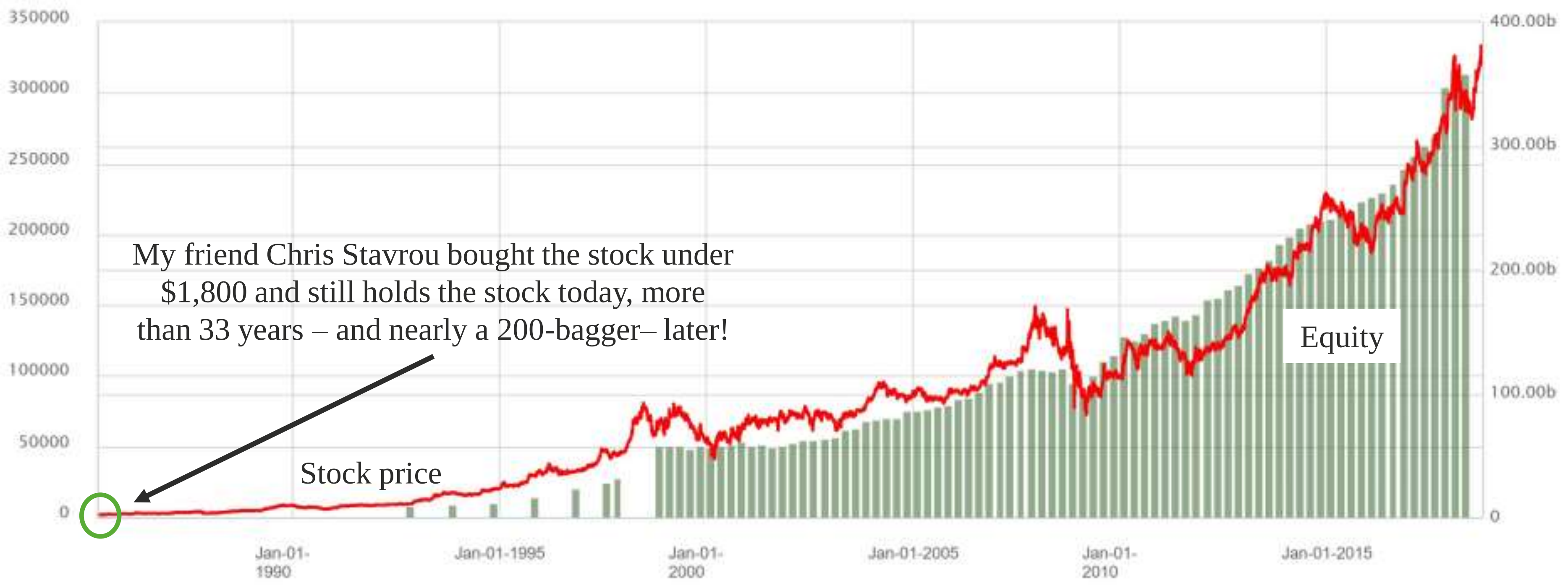
CASE STUDY: BERKSHIRE HATHAWAY



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CASE STUDY: BROWN-FORMAN

Maker of Jack Daniels and other spirits

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I SOLD FOUR OF THE GREATEST GROWTH STOCKS OF ALL TIME

- I not only owned but publicly pitched four of the greatest growth stocks of all time – Apple, Ross Stores, Home Depot and Netflix – and then sold them *far* too early

CASE STUDY: APPLE

I wrote this article in October 2000, when the stock was at $1.58

Cisco, Apple, and Probabilities

Motley Fool Staff (the_motley_fool)
Oct 16, 2000 at 12:00AM
www.fool.com/archive/boringport/2000/10/16/cisco-apple-and-probabilities.aspx

Boy! My column last week sure struck a nerve! Some people didn't take too kindly to being warned -- OK, maybe "Be very, very afraid" was a little dramatic -- about owning hugely valued technology stocks, especially when (in my opinion anyway) this sector is experiencing a speculative bubble bursting, Friday's rebound notwithstanding.

I want to be clear that I was not forecasting a general stock market decline, or even a blow-up of the entire technology sector. In fact, I think much of the market -- and even large swaths of the tech sector -- are reasonably valued. But simple math makes it virtually certain that the great majority of stocks -- tech or not -- trading at multiples of hundreds of times earnings (in some cases, hundreds of times *sales*) will severely disappoint. When and how quickly this will happen, I have no idea.

If I were to summarize my earlier column in one (long) sentence, it would be: I believe that the probabilities are very low that over time the six companies I cited (and many more), however fine, will be able to grow quickly enough, given their sizes, for their extremely richly valued stocks to compound at much of a rate at all -- and if they so much as hiccup, there's a *long* way to fall (see **Intel** (Nasdaq: INTC), **Nokia** (NYSE: NOK), **Home Depot** (NYSE: HD), and many more). I guess it's a sign of the times that this is viewed as controversial or offensive.

Some of the more eloquent emails I received were: "Loser" and "You are an idiot. Thanks a lot you jerk." Or "You are an idiot. Don't try and drive down the prices with your 'foolish' scare tactics. Nobody is listening to you." But those were the exception. Most people who took the time to email appreciated a reasoned argument -- whether they agreed with it or not -- that made them think. And that's all I'm trying to do: Get people to think sensibly about stocks.

- One must "distinguish between a stock and a company. Many of the people who emailed me argued that I just didn't understand what a great business Cisco (Nasdaq: CSCO) is -- or EMC (NYSE: EMC) or Oracle (Nasdaq: ORCL) -- and what a fool I am for buying a dog like Apple (Nasdaq: AAPL). Well, as I pointed out more than once, I don't quibble that Cisco is a fabulous business -- certainly superior to Apple -- but price matters!"
- "Apple's enterprise value is $3.3 billion [and the stock] is now trading at a mere 4.6 times trailing free cash flow."

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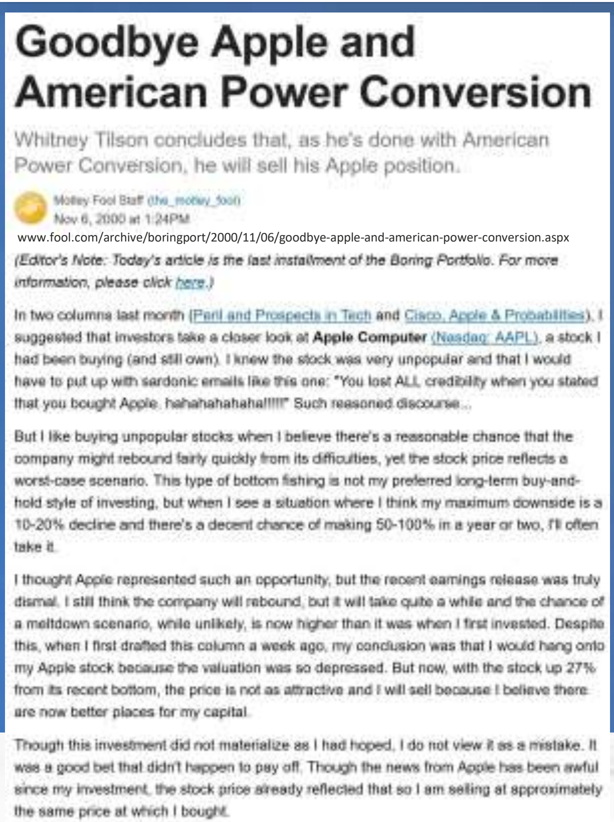
I SOLD THREE WEEKS LATER



Goodbye Apple and American Power Conversion

Whitney Tilson concludes that, as he's done with American Power Conversion, he will sell his Apple position.

Motley Fool Staff (the_motley_fool)
Nov 6, 2000 at 1:24PM

www.fool.com/archive/boringport/2000/11/06/goodbye-apple-and-american-power-conversion.aspx

(Editor's Note: Today's article is the last installment of the Boring Portfolio. For more information, please click here.)

In two columns last month (Peril and Prospects in Tech and Cisco, Apple & Probabilities), I suggested that investors take a closer look at **Apple Computer** (Nasdaq: AAPL), a stock I had been buying (and still own). I knew the stock was very unpopular and that I would have to put up with sardonic emails like this one: "You lost ALL credibility when you stated that you bought Apple. hahahahahahaha!!!!!" Such reasoned discourse...

But I like buying unpopular stocks when I believe there's a reasonable chance that the company might rebound fairly quickly from its difficulties, yet the stock price reflects a worst-case scenario. This type of bottom fishing is not my preferred long-term buy-and-hold style of investing, but when I see a situation where I think my maximum downside is a 10-20% decline and there's a decent chance of making 50-100% in a year or two, I'll often take it.

I thought Apple represented such an opportunity, but the recent earnings release was truly dismal. I still think the company will rebound, but it will take quite a while and the chance of a meltdown scenario, while unlikely, is now higher than it was when I first invested. Despite this, when I first drafted this column a week ago, my conclusion was that I would hang onto my Apple stock because the valuation was so depressed. But now, with the stock up 27% from its recent bottom, the price is not as attractive and I will sell because I believe there are now better places for my capital.

Though this investment did not materialize as I had hoped, I do not view it as a mistake. It was a good bet that didn't happen to pay off. Though the news from Apple has been awful since my investment, the stock price already reflected that so I am selling at approximately the same price at which I bought.

- "I like buying unpopular stocks when I believe there's a reasonable chance that the company might rebound fairly quickly from its difficulties, yet the stock price reflects a worst-case scenario."
- "I thought Apple represented such an opportunity, but the recent earnings release was truly dismal. I still think the company will rebound, but it will take quite a while and the chance of a meltdown scenario, while unlikely, is now higher than it was when I first invested."
- "Now, with the stock up 27% from its recent bottom, the price is not as attractive and I will sell because I believe there are now better places for my capital."

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IT DIDN'T LOOK LIKE A BAD SALE FOR THREE YEARS

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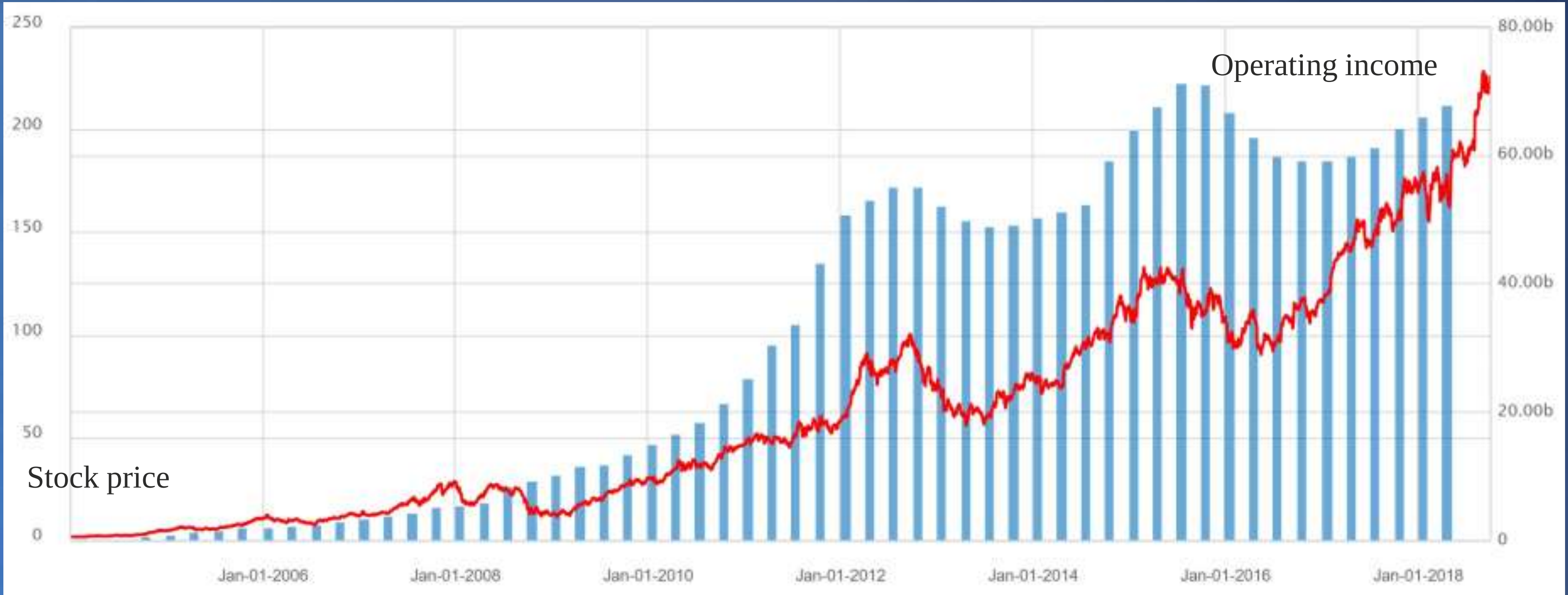
THEN I MISSED A 150-BAGGER OVER THE LAST 15 YEARS



I COULD HAVE BOUGHT ANYTIME IN THE TWO YEARS AFTER THE iPHONE LAUNCHED AND STILL MADE 10x

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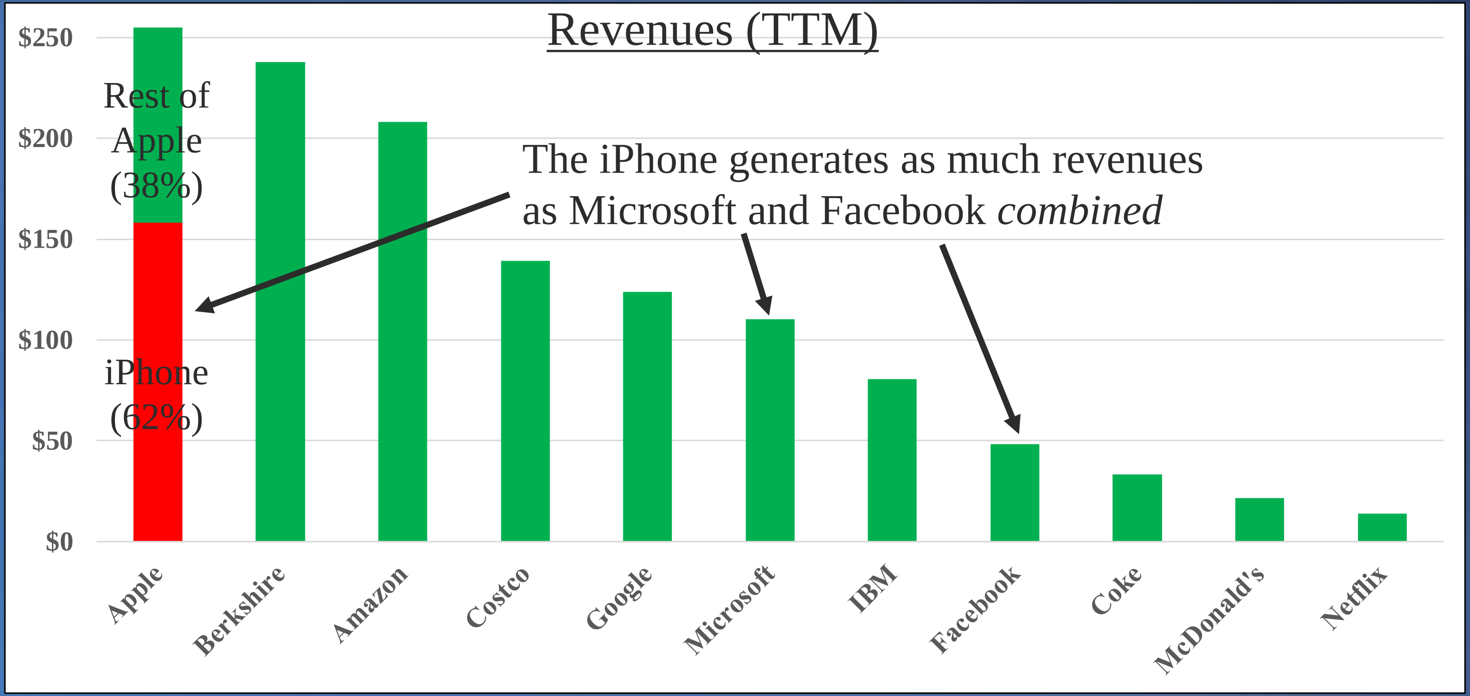
THE iPHONE IS ONE OF THE MOST SUCCESSFUL PRODUCTS OF ALL TIME



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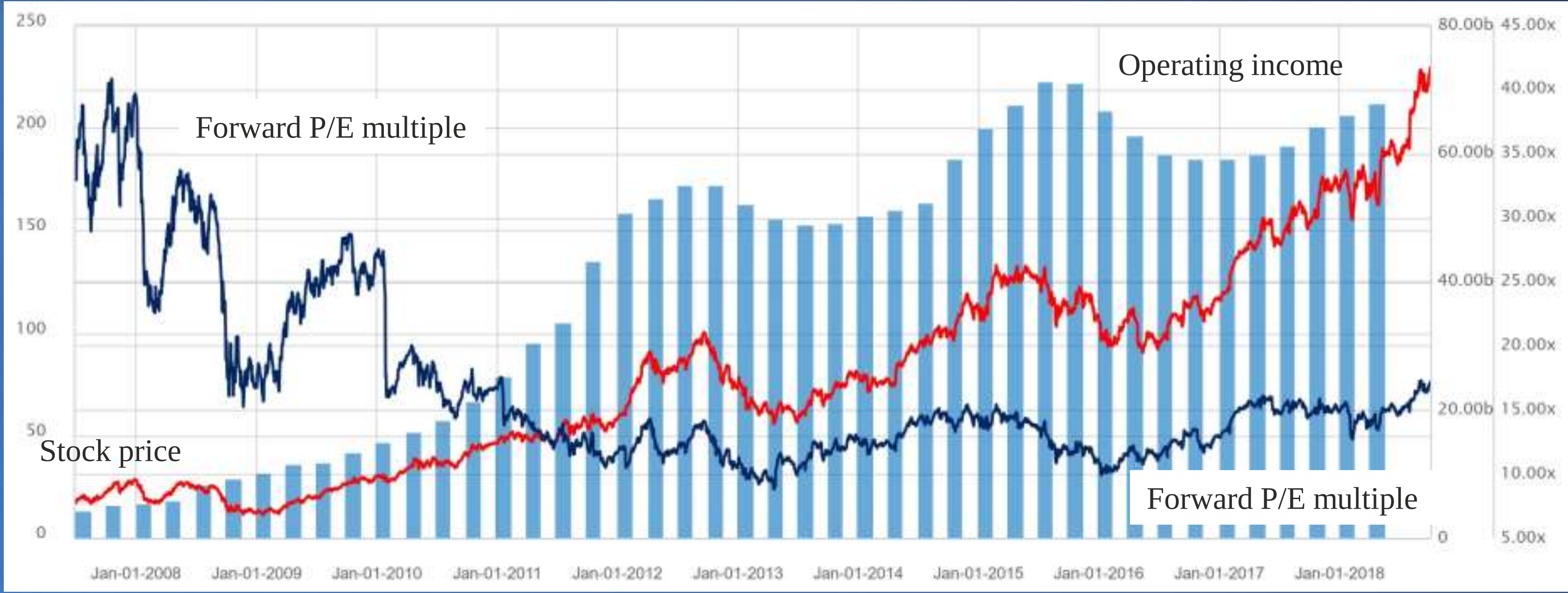
APPLE'S STOCK WASN'T EVEN EXPENSIVE

It's traded below 20x forward P/E for most of the past decade – and below 10x on a few occasions



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CASE STUDY: ROSS STORES

I wrote this article in June 2000, when the stock was at $1.94

Ross Stores: The Rodney Dangerfield of Stocks

Discount apparel retailing is an out-of-favor sector. Whitney Tilson goes shopping for some bona fide bargains.

Motley Fool Staff (the_motley_fool)
Jun 19, 2000 at 12:00AM

www.fool.com/archive/boringport/2000/06/19/ross-stores-the-rodney-dangerfield-of-stocks.aspx

I like to invest in businesses with powerful, enduring competitive advantages. But so does everyone else, which means that the stocks of such companies are rarely undervalued. Thus, I'm willing to consider good but not great businesses if the price is right.

In this category, my favorite kind of investment is buying a solid company whose stock has been crushed because it's in an out-of-favor sector. **Ross Stores** (Nasdaq: ROST) -- commonly known as Ross Dress for Less -- fits the bill perfectly. I discovered the company in January and accumulated a substantial position that I've been adding to in the past week as the stock has gotten whacked again.

While discount apparel retailing is a tough industry, and it's hard to argue that Ross has much of a moat around its business, the company's management has been executing superbly for many years and is very shareholder-oriented, the business has surprisingly good economic characteristics, and the stock is dirt cheap.

Background
Ross is the country's second-largest off-price apparel retailer after **TJX Cos.** (NYSE: TJX), which owns Marshalls and T.J. Maxx. Ross has 385 stores in 17 states, with 70% in California (162 stores), Texas (55), and Florida (52). Ross is the dominant off-price apparel retailer in 12 of the 17 states in which it operates. Ross targets middle- to upper-middle-income women ages 25 to 54, and offers, according to its annual report, "first-quality, in-season, name-brand apparel, accessories and footwear for the entire family at everyday savings of 20% to 60% off department and specialty store regular prices."

- "My favorite kind of investment is buying a solid company whose stock has been crushed because it's in an out-of-favor sector. Ross Stores (Nasdaq: ROST) -- commonly known as Ross Dress for Less -- fits the bill perfectly."
- "Given what a difficult industry Ross operates in, its economic characteristics are very impressive."
- Ross is trading at "7.6x consensus analyst estimates of $2.04 for this year. Any way you cut it, that's cheap, especially in today's richly valued market."
- "Putting all this together yields a good chance of 20-25% annual returns for the next five years. I'll take that any day."

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I SOLD THREE MONTHS LATER

Ross Stores Disappoints

Since Ross Stores reported second-quarter earnings last month, further bad news has emerged. Is it still a value?

Motley Fool Staff (the_motley_fool)
Sep 11, 2000 at 12:00AM

www.fool.com/archive/boringport/2000/09/11/ross-stores-disappoints.aspx

In June, I wrote a bullish column on **Ross Stores** (Nasdaq: ROST) based on my belief that the stock was substantially undervalued despite recent difficulties. Even weak Q2 earnings didn't change my opinion materially. But, subsequent news has been quite disappointing, leading me to conclude that the stock, while still attractively priced, is not as undervalued as I once believed.

Q2 Results

Ross reported Q2 earnings in mid-August that matched reduced analysts' estimates of $0.43 per share. Due to "a softening in consumer spending and a more promotional climate," net income declined 7.0% year-over-year, despite a 6.9% increase in sales. Earnings per share, however, rose 2.4% due to a 9.9% decline in the number of shares outstanding.

These results were what I expected and didn't especially concern me -- and I really liked the big share repurchases. What does concern me, however, are declining cash flows, rising debt, diminishing share repurchases, and continued weak sales in August.

- "…the stock, while still attractively priced, is not as undervalued as I once believed."
- I'm concerned about "declining cash flows, rising debt, diminishing share repurchases, and continued weak sales in August."
- "With Ross trading at approximately 9x this year's recently lowered expected earnings, I believe that the concerns I've cited above are priced into the stock, and any positive news whatsoever could send the stock soaring, so I'm content to hold a modest position. This remains a solid, well-managed company with many attractive characteristics that I highlighted in my earlier column."

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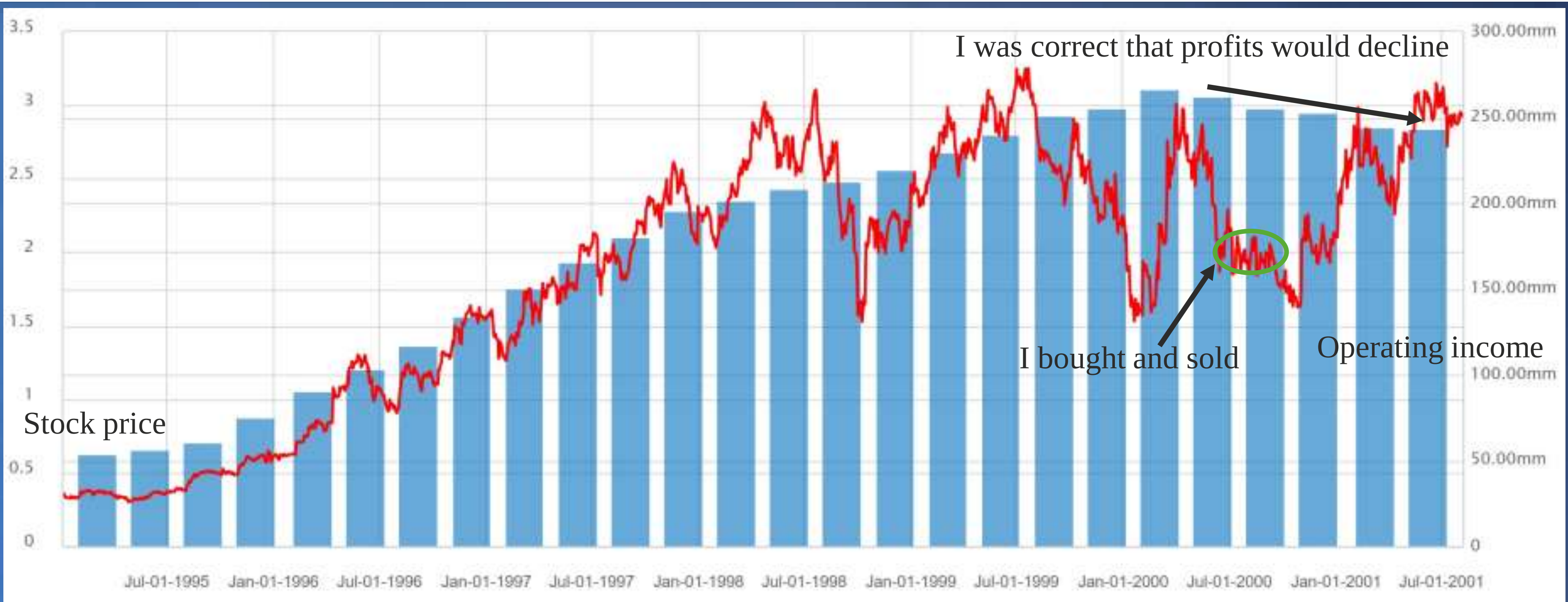
I WAS CORRECT THAT PROFITS WOULD DECLINE



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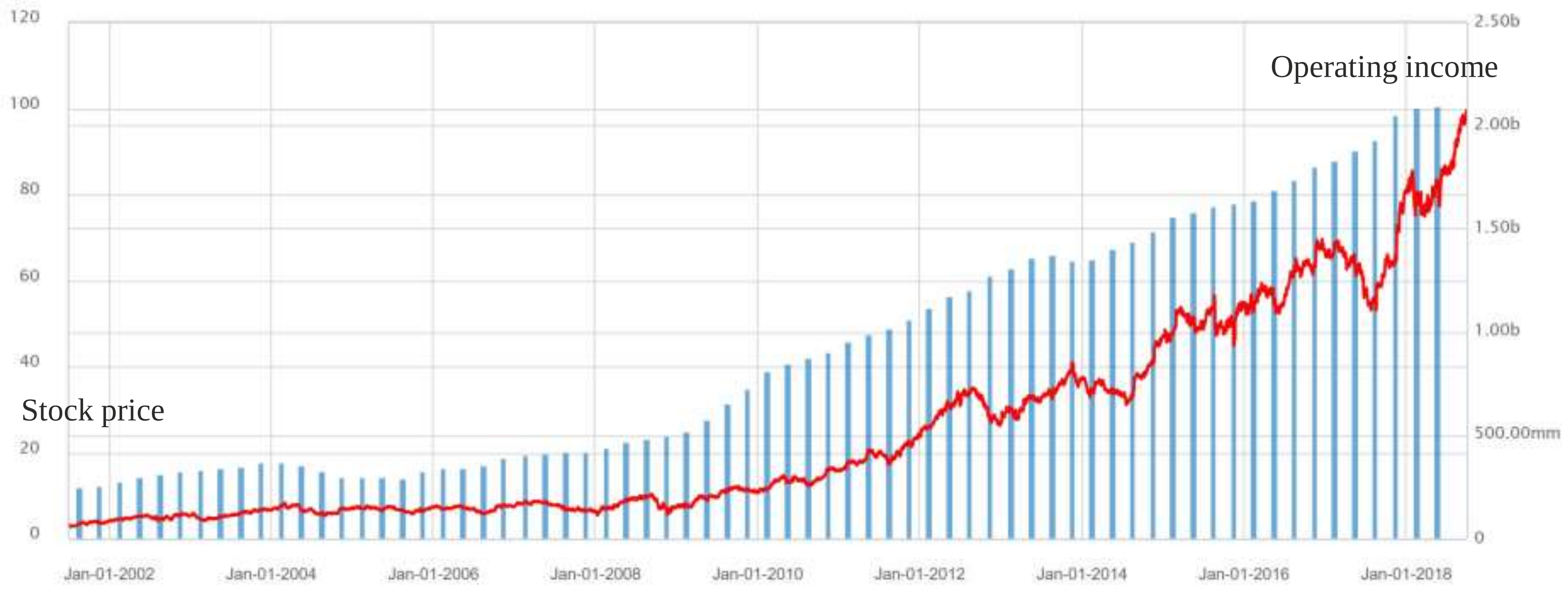
I MISSED A 50-BAGGER OVER THE LAST 17 YEARS



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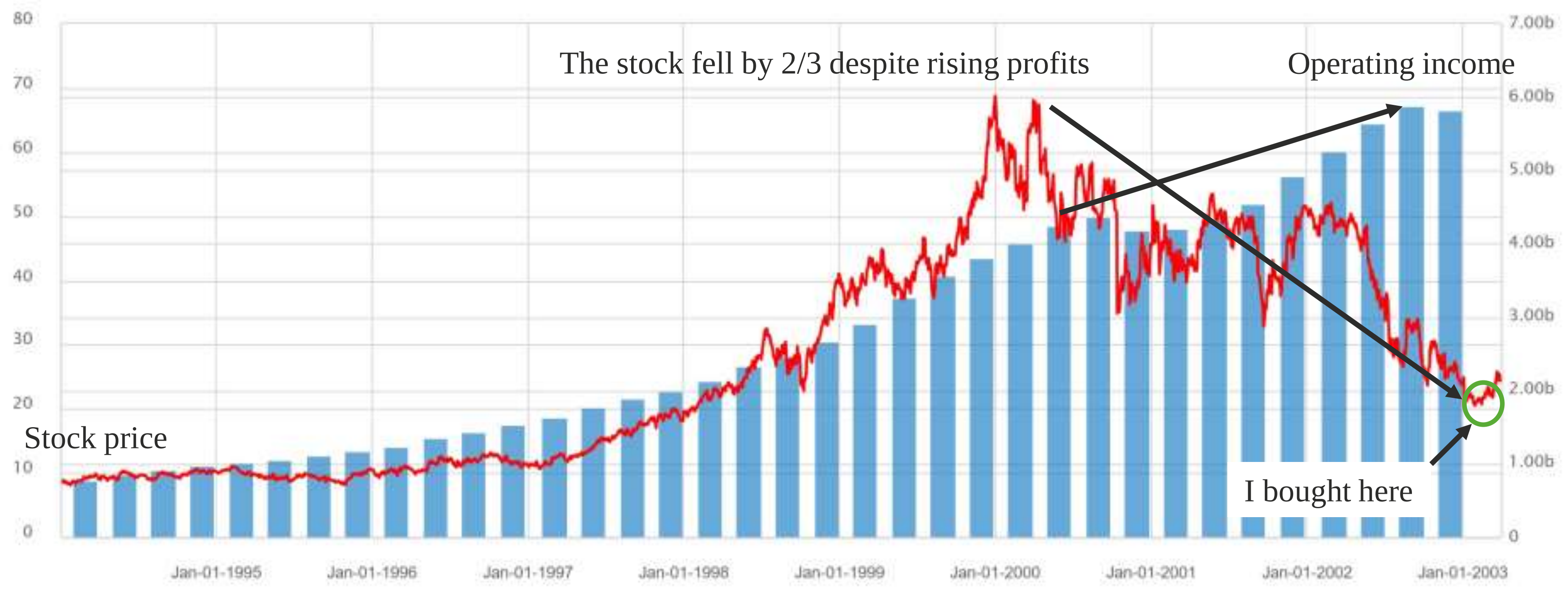
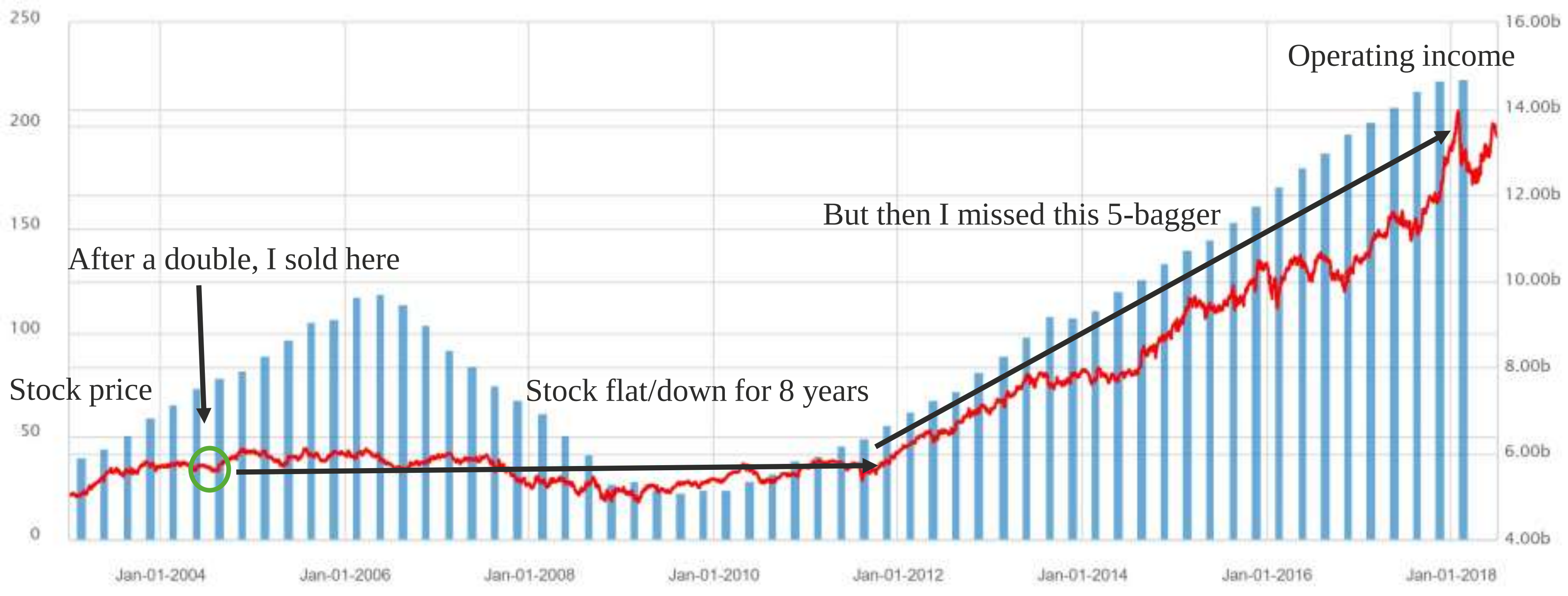
CASE STUDY: HOME DEPOT

A wonderful growth stock until 2000, when the Nifty 50 bubble burst



THE STOCK WAS FLAT EIGHTS YEARS LATER – AND THEN ROSE 5x



NETFLIX: MY ALL-TIME BEST BUY – AND WORST SALE

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THE THREE MOST DANGEROUS WORDS IN INVESTING

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THE THREE MOST DANGEROUS WORDS IN INVESTING: I MISSED IT

- The four most dangerous words in investing are: "This time is different"
- The three most dangerous words are: "I missed it"
- The many case studies in this presentation highlight a critically important point: just because a stock has moved up – even doubled or more – doesn't mean it's expensive and shouldn't be bought
- Value investors like to buy stocks trading at or near 52-week (if not multi-year) lows – it makes us feel like we're getting a bargain
- I've lost count of how many times I've looked at the stock of a great company and failed to buy it because it's moved higher and I said to yourself, "I missed it. Maybe I'll buy it if it pulls back" – but it rarely does
- Lesson: ignore where a stock has been and focus exclusively on where it's likely to go

YOU MUST SELL IF THE GROWTH STORY FALLS APART

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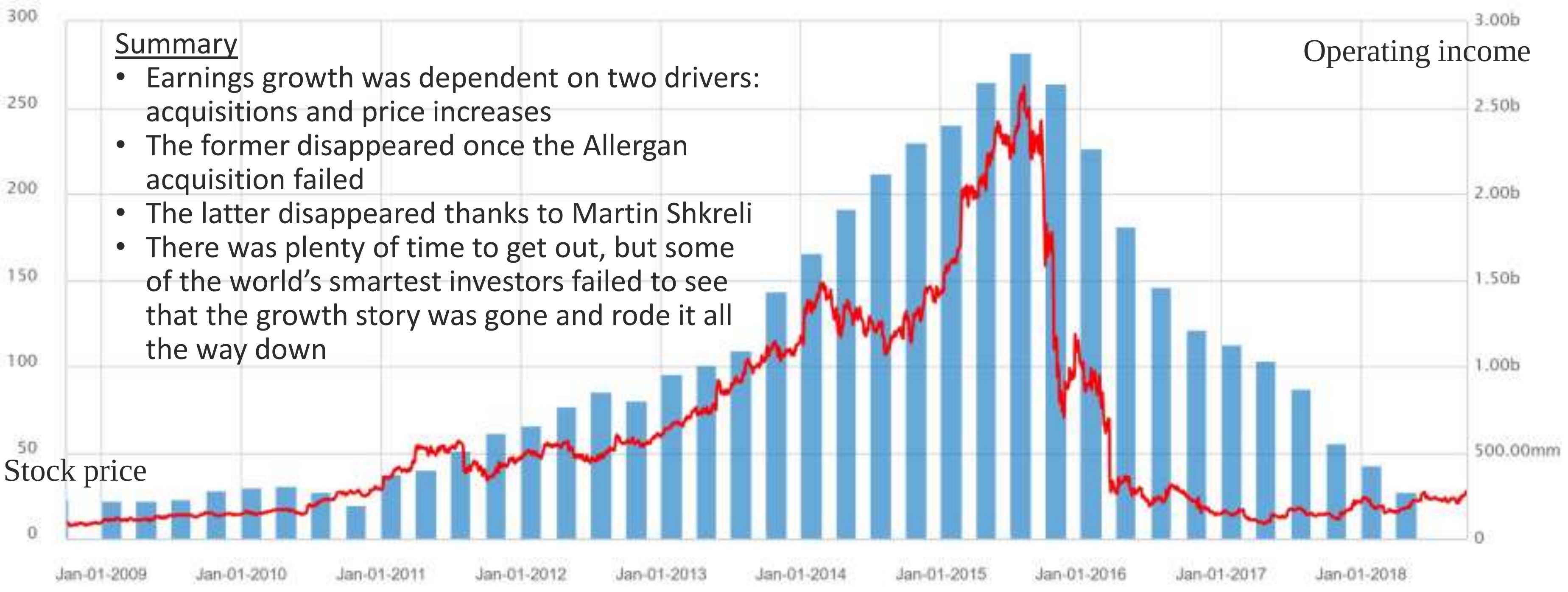
CASE STUDY: VALEANT

Earnings rose 11x, driving the stock up 20x – before it fell by 97%

<u>Summary</u>

- Earnings growth was dependent on two drivers: acquisitions and price increases
- The former disappeared once the Allergan acquisition failed
- The latter disappeared thanks to Martin Shkreli
- There was plenty of time to get out, but some of the world's smartest investors failed to see that the growth story was gone and rode it all the way down



(Valeant has been renamed Bausch Health Companies – BHC)

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CASE STUDY: NEW YORK TIMES

The stock is half its peak reached nearly two decades ago

<u>Summary</u>

- Newspapers used to be a great business, but the rise of the internet destroyed the advertising business and permanently impaired profitability