February 27, 2015

Value Investor CONFIDENTIAL

Inside this Issue

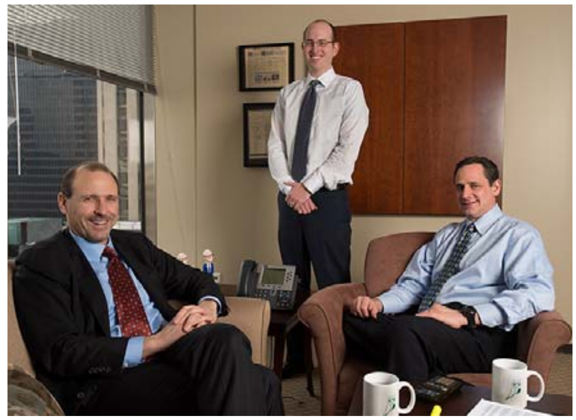
FEATURES

Long-Term Perspective Wins

Mitch Kovitz, Jonathan Shapiro, and Joel Hirsh prove that an intense focus on high quality businesses trading at discounts to intrinsic value will win the day over the long-term.

Since its founding in 2003, Mitch Kovitz and Jonathan Shapiro have built an incredible team at Kovitz Investment Group. The addition of Joel Hirsh in 2006, makes the team all the more vigorous in their search for high quality businesses that offer out-sized return potential with a low probability of permanent capital loss.

INVESTOR CONFIDENTIAL



Kovitz Investment Group (KIG)

Kovitz.com

Philosophy: Focused on high quality businesses selling at a significant discount to their conservative estimate of underlying private market value.

They will be the first to tell you that their approach is a little "old school" and unconventional to others in the industry, but they wouldn't change their approach for anything in the world.

It's hard to argue with their results. In fact, their returns have been downright stellar. Since inception, KIG has returned 11.17% vs. 7.81% for the S&P 500.*

Currently, the team is finding value in high quality businesses that they believe are mispriced by the general marketplace. They are finding value in such industries as airplane manufacturing, media, construction services, and retail.

**As of December 31, 2014*

Investor Confidential: Kovitz Investment Group

Kovitz Investment Group explains why they focus intently on identifying the moat of a business, how their days are structured for their success, how they were influenced by Warren Buffett as a person and investor, and why they see upside in Boeing, Jacob's Engineering, CBS, and Bed, Bath, & Beyond.

How did you get started in the investing world? And how has your view of investing evolved (if at all?)

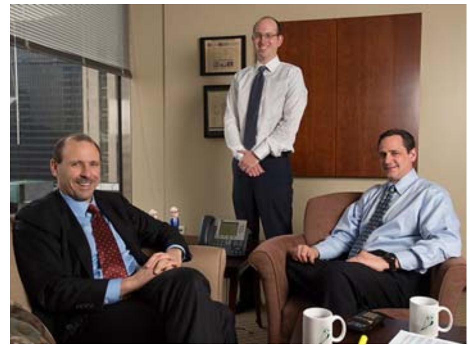
Mitch Kovitz: It began in the late 80s when I left the world of accounting. Once I began my career in the investment advisory and asset management business, I started looking for investors who were beating the markets, and doing well versus their competition. Mainly because most of the track records I had seen were not doing any better than Index funds, which were just coming into vogue.

Index funds had been around since the 70s. But people started to realize that passive investing had done very well. So in making sure that I was still adding value to my clients, I stumbled upon Peter Lynch. I read all his books, and in his books he talked about Warren Buffett being the 'best investor of all-time.' It's hard to believe, but at the time I didn't know much about Warren Buffett. Back then there weren't a lot of people in the investment business that followed the value stripe. And if you didn't follow value investing, there was a chance you would not have known of his investment philosophy.

I started to read about him. I read all of his investment letters and quickly discovered that I was very compatible with how he thought about investing. There was a system and process (a roadmap) I thought I could use to generate market beating returns and actually execute it over the long-term. So it all started in the mid-90s when I was actually executing the system. Nowadays I am focused more on a growing asset that is undervalued. Meaning, I focus on great businesses rather than just asset prices. You never know when the discount between current price and intrinsic value will close. For instance, if the asset itself doesn't grow in value for the next 5 years, more than likely your rate of return won't be so great. However, if we invest in great businesses where the intrinsic value keeps growing, we give ourselves a better opportunity for compounded returns. I am also much more paranoid of a disappearing moat than I used to be. Changes seem to occur much quicker these days compared to when I first started in this business in the late 80s. Whether it's increased amounts of capital chasing great ideas or the advent of the internet, competitive moats seem to be constantly under attack.

What does your typical day look like from beginning to end?

MK: For us it's all about gathering information, and then giving ourselves time to think. This means reading newspapers (New York Times, Financial Times, Wall Street Journal) and circulating all kinds of intelligent information amongst the three of us. What's probably most telling about us is what we <u>don't</u> do compared to other companies in our business. We don't have any organized regular investment meetings. We don't believe it's a good idea to have a situation where you feel forced to come up with great investment ideas every week. Most of the time you get the best results in investing by doing absolutely nothing. When there is a



Kovitz Investment Group

Focused on Quality

When Mitch Kovitz left the accounting world in the 80s, he was in search of something better. He went into the investment advisory and asset management business, and quickly noticed that many of the big advisories were not doing any better than regular index funds. Thus began his search for investors that were beating the markets. In his search he stumbled upon one of Peter Lynch's books, and in that book he discussed a fellow named Warren Buffett. Lynch even went as far as to call him the "best investor of all-time."

"It's hard to believe, but I didn't know much about Warren Buffett…I started to read about him. I read all of his investment letters and quickly discovered that I was very compatible with how he thought about investing. There was a system and process (a roadmap) I thought I could use to generate market beating returns. And actually execute it over the long-term."

These days their environment is structured in such a manner to execute on that system and philosophy. This means a lot of research, reading, and updating their multidisciplinary mental models for when they may need it most. In direct contrast to the popular show on CNBC, *Fast Money*, Shapiro joking refers to their style as "slow money".

call to do something and constantly produce investment ideas with regularly organized meetings, it can cause harmful action. In order for a discussion to occur one of us has to send an email or walk in the other person's office and say, "it's time for us to buy this" or "it's time to sell that" or "it's time to pare down here." We let that process dictate the discussion, not an organized regular meeting.

Jonathan Shapiro: It's not overly unique, but I typically start the day digesting the news flow of the day on companies we own or are looking at. Essentially trying to get the "lay of the land." We also look at other companies' news that may influence an industry. We are always on the look-out for how it could come back to impact the businesses we own. Other than that, we are just reading. Typically, if we're in the middle of looking at a company for potential purchase, I spend the time reading and getting as much information as I can. And other days when there's nothing urgent or time sensitive, I'm just trying to increase my knowledge base. It's been really important for us for the last several years. For example, we didn't know a great deal about the energy or media industry 3-4 years ago. But over the last couple of years, we've really begun to understand the nuances of these industries. It really helps us gain conviction in our decisions of specific companies.

Joel Hirsh: There aren't many professional investors that "really" look out several years. Everyone says they look out several years, but very few actually execute on this philosophy. What really differentiates our day compared to the rest of the industry, is that we spend most of our day reading and thinking. Sometimes I will even read books on subjects of interest during the workday. I don't know how many professional investors take the time to read books. Charlie Munger and Warren Buffett talk about this topic regularly. You want to expand your knowledge base to gain the confidence to make only a couple of decisions a year that you'll have to live with for years. I think it's critical to our success. That's what our day is set-up to accomplish: learn. Energy is a great example. We did a lot of reading in 2009/2010 on the oil and gas sector, that didn't really matter for years. But it became enormously valuable to us recently.

ON MENTAL MODELS:
You want to expand your knowledge base to gain the confidence to make only a couple of decisions a year that you'll have to live with for years.

What's a little known secret about KIG that few people know about?

MK: We have a fairly significant long/short complex. Lots of people don't know about it, but we manage about $500 million just in that area. And we've been managing that long/short portfolio since 1998. Since that time the long/short portfolio has generated net returns just north of 14%.

Who are the people that inspire you the most? And why?

MK: Two people had an enormous impact in my life, and it's amazing how similar they are as far as their character. One is my father, and the other would be Warren Buffett. My father got me started in the business, and he showed me how to operate as a human being and professional. He has an unbelievably strong moral compass, and as a result, it helped me to operate with integrity throughout my life. He would say, "Professionals should always do what's best for their customers. Clients don't come to you simply to execute their ideas for them. You do customers a great disservice if you succumb to their own desires at the expense of their financial well-being." It takes tremendous will-power at times because of "career risk." Doing what's best for the client can sometimes go against their own biases, as well as underlying market trends. If the grain starts to go against you for a long time, people start asking you, "Hey, what are you doing?" But this philosophy has kept us out of very bad situations such as, not buying internet stocks leading up to the crash in 2000 and not buying commodity stocks in 2007. There can be tremendous career risk when you underperform for a period of time. But in the end you have to sleep at night, and act with integrity and doing what you say you were going to do without deviating. In this way, my father certainly had a major impact in how I operate as a professional.

Warren Buffett is another person that inspired me because of what he stood for as a person. It's very similar to my father. Buffett of course laid out a system to generate market beating returns, and instead of keeping to himself, he willingly gave away the recipe (the secret sauce). He did this without asking for anything in return, just as Benjamin Graham did for him. He wouldn't have gotten to where he was without someone being kind to him, so he extended that generosity 100-fold. And it amazes me that still to this day that not many professional investors follow the system. It's just remarkable to me. Buffett's character cannot be overstated enough. I remember reading a quote from Buffett a couple of years ago where he said, the last 40 years of his life, he has derived unbelievable benefit from how he acted in the first 40 years of his life. He's capitalizing now on all the good things he did the first 40 years. And it shows. People want to be around him. Just think about all the businesses that sell to him below market prices because they want to be part of his empire.

Think of the people that call him when they need a partner or an investor. Whether it's Goldman Sachs (GS) or General Electric (GE). They do this because they know he's going to operate in good faith and do what he says. It just made so much sense to me as an individual. That's how we want our clients to see us.

JS: To use a recent example, I was just talking with my kids about the Brian Williams situation at NBC. As Buffett says, "it takes 20 years to build a reputation and five minutes to ruin it." If you think about that, you'll do things differently. Everything you do and say will have positive or negative ramifications in the future. You want to be thinking in terms of how this will affect my credibility. Ultimately that's all you have in life. Doing something to jeopardize that is the last thing you can afford to do as a person.

JH: In my particular case, I came from a computer science background. If Mitch hadn't given me Xeroxed copies of every letter that Buffett had written during our first lunch together, I would've probably structured derivatives for a living. Those letters were very impactful, and it's obvious as soon as you read them. To tell you the truth, I've always wondered why it's not obvious to many others. I would say I have learned the most from Warren Buffett, Joel Greenblatt, as well as these two guys (Mitch and Jon).

What are the top 3 books that you would recommend to an investor?

JS: It almost embarrasses me to say, but it was only 5-6 years ago that I first read *Atlas Shrugged*. And it's probably better that I waited because I don't think I would've gleaned as much from it if I read it at a younger age. It helped to reinforce the concepts of capitalism, and the way honorable (and dishonorable) people go about their everyday lives. I also thought Howard Marks' book *The Most Important Thing* was great as it reinforced many similar processes and thoughts in how we operate. He probably has 20 most important things, but every one of them is truly the most important thing. He encapsulated and wrote about each of those things in such an incredible manner. He covers all kinds of different topics such as how to treat clients and how to think about risk.

JH: I always tell people to read Joel Greenblatt's book, *The Little Book That Beats the Market*, if they're new to the market. As far as for more sophisticated investors, I recommend *You Can Be a Stock Market Genius*. I also believe *Fooled by Randomness* is a book everyone should read. And I think the *Wal-Mart Effect* is a great book in terms of really understanding a moat, sustainable competitive advantage. I think it's very interesting to read it now and see what's happened in Omni-channel retailing.

> ON INTEGRITY:
> Doing what's best for your investors can sometimes go against the grain of the underlying market trends. But in the end you have to sleep at night and have the integrity to do what's best for your investors.

What is your philosophy and process to investing?

JH: We try to estimate a fair value price that the company would be worth if it was sold in its entirety to a reasonably knowledgeable buyer. We do so using a long-term outlook of at least 3-5 years. And the actual method we use to determine our fair market price can deviate by the type of company. But essentially we are looking for high quality businesses with a readily identifiable moat that we believe to be sustainable. We also need to articulate why it's sustainable, and then we want it to trade at a significant discount to our fair value estimate to build in a margin of safety.

JS: Generally, we don't do a great deal of screening. But what we have done is put together what we consider our universe of investable stocks. And that's based on the quality of the business, competitive advantages, and businesses that don't change too rapidly. We've put together this list over the years, and every so often we add in or take companies out. Right now it's about 450, and we just focus on those companies. Those are the businesses we want to own but only if they're selling at the right price (possess a margin of safety). Essentially we are taking the universe of 10,000 publically traded stocks, and we are distilling it down into 400-500 businesses that we focus on intently. At any point in time, usually 300 or more of those businesses are trading at nowhere near a price that we would be interested in owning it.

JH: I would say we operate somewhat separately and as a group. We're all doing our own reading. We all do our own research, and then we are updating each other if a stock gets to a point where one of us is interested. At that point it would cue the other two to take a look and see if it has the potential for investment. We really go out of our way not to influence each other. And I think that has served us very well.

JS: Within our own individual frameworks, we all have a good understanding of what a good business looks and smells like. So we have a like mindset on the kind of companies we would be interested in buying. At that point it's all about ascertaining what the individual company is worth and then buying it at a significant discount to that price. Whenever we all think a stock is getting near those levels, then we all get involved.

You mention recently that "FOMO" or, fear of missing out, is not an emotion that you possess. How important is that especially in today's market environment?

JS: One of the most difficult time periods for us was 1999/2000 when all of our clients thought we were loopy for not buying into the internet craze. We knew in our hearts that the valuations didn't make sense and the underlying businesses didn't have much staying power. And it really looked like we were missing out. We didn't know when it would end, but we knew it would at some point. This is another example of doing things for the right reasons and having integrity for our clients and ourselves. We never want to do things because other people are benefiting from situations we deem to be unsustainable. So we may look stupid for a period of time but fortunately those periods of time haven't extended too far. Mitch mentioned commodity stocks in 2007/2008, that was another example of something we knew we shouldn't be buying, even though everyone else was. We just have to stick to our discipline, and look silly at times.

How important is it for you to have a client base that shares your focus on the long-term?

JH: It's critical. Having an asset base that is permanent or semi-permanent is a huge advantage. It's a much less competitive arena when you can use that more permanent asset base to press your time horizon out a couple of years. There just aren't that many investors conducting this kind of work and truly thinking out 3-5 years. The vast majority of our holdings over time can more or less be boiled down to; an industry leader (#1 or #2), the business being sustainable because of its moat, temporarily selling at 11-13 times free cash flow, and we have to be willing to wait 3-5 years. We just can't be sure on the timing. We like that because the risk we take is on the timing, as opposed to increased odds of permanent loss of capital. This puts the odds squarely in your favor. Most professional investors are under significant short-term pressure. So having an asset base that is aligned with your philosophy or is permanent in nature is critical to investing long-term. The dot-com days are a good example, as well as 2007 when commodities were trading well above marginal cost of production and everyone was loving them. Nowadays, no one likes them even though oil is very likely trading at or below the marginal cost of production.

> ON INVESTING GENERALIST:
> We don't think it's a coincidence that the best track records that we are trying to emulate tend to be investment teams (or persons) that are generalists.

Do you have interest or expertise in a particular industry that you would call your "circle of competence"?

MK: We are more generalists. We all have our favorites that we like or feel more comfortable in, but we are very much generalists by nature. We think you are a better investor if you're a generalist because you can more easily scan what's available and decide what's cheap. Keep in mind that what's cheap in one industry, may not be cheap in another. So looking at one business in one particular industry can limit the potential for opportunity. And sometimes it's even great not to be in an industry all together, because the other industry provides companies with better moats or cheaper prices.

JS: Over the years, we've talked about this as an investment team: should each of us focus on 2 or 3 sectors? And we always come back to the same answer: no. We always arrive at the same conclusion that we should all be looking at whatever we think meets our strict criteria for a high quality business regardless of which industry it's in. We have a good understanding of what a great business looks like, so it really doesn't matter necessarily which industry that business is in. We want to be able to look across a lot of different industries. We view our job as allocating our clients capital to its best possible use. And if we just focused on just one or a few industries we may be saying, "well, I like Kohl's better than Wal-Mart at these levels." But you might be overlooking the industrial company out there that's cheaper than both Kohl's and Wal-Mart on an absolute basis. If each of us were focused on just a few industries then we really wouldn't be allocating capital to where it would perform best.

JH: I don't think it's a coincidence that the best track records that we are trying to emulate tend to be investment teams (or persons) that are generalists.

Describe your value discipline once you have arrived at an understanding of the Intrinsic Value of the business?

JH: Generally speaking we are looking for 1/3 discount from intrinsic value. Although we can adjust it based on the quality of the business or how concerned we are about the business. Once everyone has reached an independent decision, we will get together and have a meeting. We'll go around in a circle and we'll cast a vote on whether or not to buy and if not, what price. This process is purposely non-consensus in that 2 against 1 means it's in the portfolio, and anyone can veto. But by definition we've already established the business as a high quality business because it's in our universe. At this point we are trying to determine the intrinsic value and making sure we are buying at a significant enough discount to that value, thus giving us a sufficient margin of safety.

How do you think about managing risk?

JH: Typically when we establish a position, we buy half of what we want to own. We don't believe we are capable of picking the bottom. And we just assume the stock will fall 20% from where we first establish a position. Generally, if the stock price falls and nothing else has changed, we will purchase the remainder of the position. Full positions are typically 3-5%, and can sometimes be higher. I think one of the interesting things when I look at the portfolio is that the largest holdings are generally not the holdings with the absolute highest amount of upside. But they do tend to be the ones with the largest margin of safety.

MK: We're no better than anyone else is at trying to catch a falling knife. We look at the value of the business and the discount from intrinsic value. Really, there are only two reasons why we are buying stock: 1) the stock is falling while the intrinsic value of the business is stable or suffering only a minor impairment, or 2) the stock price is stagnant while the intrinsic value of the business is increasing because free cash flow is growing. So those are the two reasons why we would be buying thinking a stock is at a discount. I would venture to guess that 90% of the time it's because the stock is dropping. Very rarely are stocks not moving up on really good news. When it does happen, it is usually during an environment of rising interest rates. But most of the time we are buying things that are going down in price. History tells us that we will be early when we make our first purchases, so we want to make sure we have plenty of dry powder to increase our position.

JS: We don't think anyone can precisely quantify risk. There's no statistical measure out there that really means anything to us, so it's mainly common sense and staying true to our process about buying companies that have significant moats around them. The experience over the years of seeing how stocks have traded, lets us know that we won't be able to pick a bottom. As much as we like to think we are buying a really cheap stock, we know that further decreases in stock prices from our initial purchase is a likely scenario. In that moment, we need to be prepared to go against the grain and buy it even as it's falling further.

ON RISK:
Risk is a balance sheet with a significant amount of debt with which we're not comfortable. A stock price moving around a lot doesn't mean much to us.

JH: One of my favorite anecdotes is why standard deviation became a very popular measure for risk: it's because it was the closest proxy in a regression model. It was a number that they could observe. But the probability of permanent loss? There was no way that was observable because it couldn't be regressed. And then over time it just became the "tail wagging the dog."

JS: A balance sheet with a significant amount of debt that we're not comfortable with is an example of risk. A stock price moving around a lot doesn't mean much to us.

Does management play a big role in your investing?

JH: We very rarely meet with management. Generally, management is trying to sell you something. We believe that actions over time in how they have allocated capital is a better barometer. *The Outsiders* is a great book on this topic.

JS: By meeting with management in person, their level of influence can send mixed signals in your decision making process. In our history, it's never been a positive. When you meet with management, everything sounds great. You end up walking out of their office wanting to go buy the stock right away based on just their exuberance. And it rarely works out well in that scenario. So we think we are much better served by reading as much as we can about the companies, analyzing the filings, and focusing on how management has allocated capital in the past. This will give you a good understanding of how they will allocate in the future.

JH: The irony is — the management teams that we've really come to admire, you can tell in the transcripts how much they don't want to talk to analysts. They want to run the business with a long-term time horizon and they want to manage their capital.

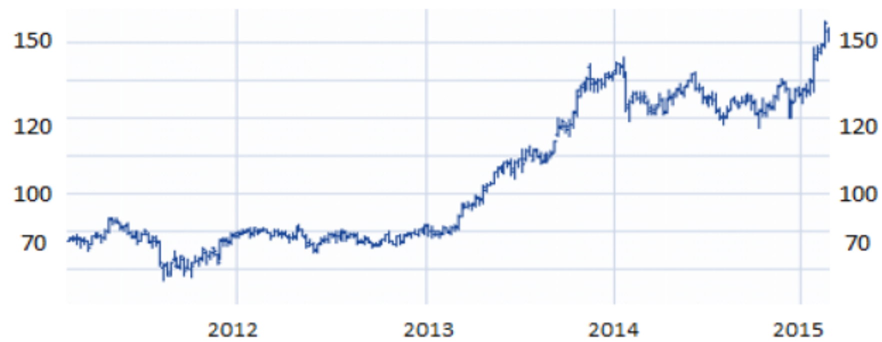
It seems you recently added to your position in Boeing (BA). Can you describe your broader investment thesis?

MK: We've owned Boeing a long time. And we've bought it at varying times as well. Our most recent purchase was in the $125 area, and we believe the business is worth somewhere in the $170-$180 range based on a multiple of free cash flow a couple of years out. Boeing has been around for a long time. We believe there is a significant moat around this business from decades of manufacturing planes, engineering know-how, and supplier relationships. The airline industry cares about the kinds of planes they buy and Boeing just so happens to be one of the best. We believe their competitive position is excellent. There is really only one other major competitor. The business in our opinion is undervalued.

INVESTMENT SPOTLIGHT

Boeing		**Price**	**$151.31**
(NYSE:BA)		52-Week Range	$116.32—158.83
Description: Engaged in the design, development, manufacture, sale and support of commercial aircrafts.		Dividend Yield	2.05%
		Market Cap	$106.80B
Basic Valuation:		**Largest Owners:**	**% Owned**
P/OCF:	12.51	Capital World	8.66%
P/FCF:	16.67	Evercore Trust	6.67%
Trailing P/E:	20.40	T. Rowe Price	5.54%

BA STOCK PRICE HISTORY



INVESTMENT SUMMARY

Mitch Kovitz says there is a range of reasonableness in ascertaining the earnings power of Boeing. He thinks the company can earn somewhere in the range of $12-16 per share in free cash flow. At a 14-15 multiple, it puts intrinsic value in a range of $168—240 per share.

Sources: Company reports (10Ks, 10Qs), other public information

Previous to the 787 fiasco, then after getting the issues fixed, the stock remained very attractive. These issues happen from time to time in this business. But Boeing has done a good job of fixing the problems, and we don't see anything in the horizon that's going to stop them outside of their own control. The question is, "can they operate and build these planes effectively to glean the profits they were expecting when they initially started building the plane?"

In our opinion, the problem is within their power. The earnings success will be in the number of planes they are building and the success of 3-4 different platforms recently that should allow them to reach our estimates. The market is missing this part of the story, and is a little too short-term in their thinking. As a result, a few years from now we see much higher free cash flow and a much higher stock price as a result. The defense side of the business doesn't bother us. And even more recently, there is more talk of more money being spent nationally on the defensive budget. Even if you were negative on defense in the U.S., 1/3 of Boeing's defense revenue is from other countries. So that's not going to be a major factor for them. The major driver for Boeing going forward will be the commercial airplane business which should generate a significant amount of free cash flow over the coming years.

JS: Just recently when we purchased in the mid $120s, there was concern over the price of oil. The stock had fallen from the mid $130s, and all of a sudden there were news headlines talking about how Boeing's backlog is going to get cut because with the price of oil so low, airlines won't need their new fuel efficient planes anymore. Not only did we think oil prices weren't going to stay low forever, but when airlines make decisions on planes they're not looking at the current price of oil. They're looking at the likelihood of where oil will be in the next 20-30 years. The time frame that their customers are thinking about when they purchase a plane gave us confidence that we didn't need to buy into the speculation that Boeing would suddenly see massive cancellations.

MK: Management at Delta's most recent earnings call was asked if they had cancelled any plane orders, and the CFO responded, "not one."

How are you looking at valuation at today's share price at all-time highs?

MK: There's going to be a range of reasonableness, so based on a range of planes being built, and other inputs, we are thinking a range of $12-16 per share in free cash flow. And we think a 14-15 multiple on that is very reasonable considering you know they are returning cash to shareholders through share buybacks or increases in the dividend. That'll give you a range of $168-240 for a reasonable range of intrinsic value. And, over time, it should get reasonably close to that full value. What sidetracks Boeing not hitting their numbers are the costs. And I don't think there's going to be a lot of planes being canceled. It's going to be costs that we need to keep an eye on in the future.

JS: The free cash flow should be growing at a rate much greater than earnings over the next few years just due to accounting for GAAP purposes. They capitalized a lot of the spending on the 787 specifically, the depreciation of that will be hitting their earnings statement but they won't need to put in a ton of fresh capital. For that reason, cash flow is in excess of GAAP earnings right now, and we believe it's likely for this to continue with growth into the future. If we believed these cash flows were at a peak currently then we would probably start to worry, however we see another several years of significant increases in cash flow.

JH: When you look at the history of airplanes, building a new one with all new material is an incredibly difficult engineering feat. And the fact that it takes an extra year or two, or that it doesn't go quite as smoothly, isn't very meaningful in the time frame of the product that is going to be used and counted in decades. So for us it become not if, but when the cash flow comes, which is why we are using a wide range. Interestingly, this is also part of its attractiveness. It doesn't fit neatly into a short-term time frame and it's difficult to put in a very precise model.

What, if any catalysts do you see at these levels?

MK: The catalyst for us is the cash flow that will be coming into Boeing. I don't think there is anything out there other than that which we really care about. We don't normally search for catalysts. In fact, most of the time price is the catalyst. And if there's a catalyst out there that everyone knows about, that will push the price upward long before its realization.

It appears you just established a position in Jacob's Engineering (JEC). Can you tell us about it?

INVESTMENT SPOTLIGHT

Jacob's Engineering
(NYSE: JEC)
Description: Provide a range of technical, and construction services to industrial, commercial & Gov't.

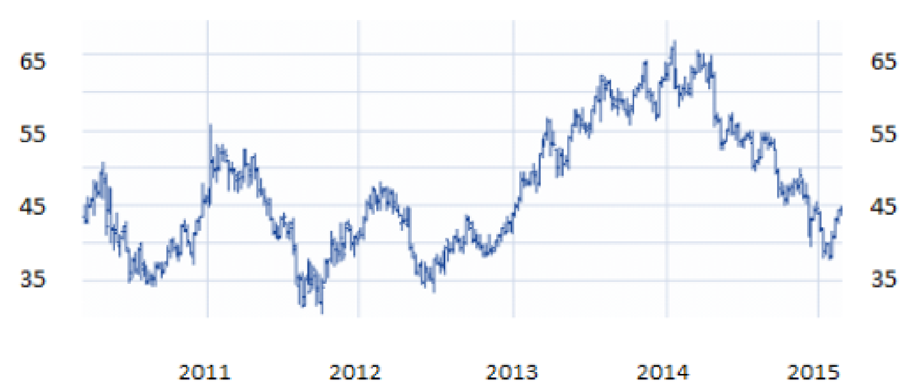
Basic Valuation:

P/TBV:	5.95
P/FCF:	14.41
Trailing P/E:	17.50

Price	**$44.35**
52-Week Range	$37.87 — 65.58
Dividend Yield	N/A
Market Cap	$5.71B

Largest Owners:	**% Owned**
Vanguard Group	7.44%
Fidelity Management	6.20%
Artisan Partners	5.60%

JEC STOCK PRICE HISTORY



INVESTMENT SUMMARY

At current prices, Joel Hirsh thinks that $3 per share is likely trough earnings with normalized earnings somewhere in the $4-5 range. With a 14 multiple he sees intrinsic value in the range of $56-70.

Sources: Company reports (10Ks, 10Qs), other public information

JH: Jacob's Engineering (JEC) is a new position for us. We bought it in mid-December, and we've added some since in the low 40's. This is part of a number of stocks that we've recently found attractive that are somehow related to oil. We've done a lot of work on oil and commodities. Generally speaking, if the commodity is trading above its marginal cost of production you're making a prediction on what's going to happen, which makes it a very difficult task. As a result, when commodities are trading well above the marginal cost of production, we tend not to have looked very long in any of those businesses. Although, there can be some really good businesses most sell with little margin of safety. We invested in Nucor when steel prices were below the average cost of production back in '09/'10. Now with the case of oil, we believe this recent drop has put oil beneath the marginal cost of production.

Where do you see the marginal cost of production for oil?

JH: We think that the way it's talked about most often in the press is not as precise as everyone would lead you to believe. If you read reports and articles 6 months ago, most pegged it around $80. That's what they said was the marginal cost of production. So if it fell below that, they said it would be a disaster. But the marginal cost of production is a moving number. As the underlying commodity goes up, all the service providers raise their prices and cost of production goes up. And as the price goes down, everyone gets their prices cut. Ultimately, this will cause the marginal cost of production to go down. And there's a difference between the marginal cost of production for say, undertaking new wells versus those where you've already sunk the costs. You want to know what the cash costs are of continuing to run the well. So in the case of trying to find out where the marginal cost of production is, the only way is to basically have an experiment which is, more or less, what Saudi Arabia is doing – you push prices down and you see where supply comes off.

In our view, supply has been turned off quicker than expected with rigs coming down faster than 2009. And that would suggest that the marginal cost of production ranges between $50-60 per barrel. Cash costs of current rigs for some particular properties can be as low as $20. But clearly it's not sufficient at $50. Generally speaking, Capex budgets are being cut by 20-30% for the drilling of new wells. And again, the rigs are rapidly coming down. So, the actual action of the rigs coming down leads you to say that the marginal cost of production is roughly in the $50-60 range.

So with that as the backdrop, you can look at the equity prices and see what's priced into the stock (assuming the oil trades in some range above the current range). We generally think $60-80 over the intermediate to long-term. But we don't really have an opinion other than at these prices, businesses are challenged in trying to spur positive net present value. Over time supply is a function of that, and prices will be a function of that supply and future demand.

In the short-term, oil seems to trade like a stock based on reports of production or rigs being stacked. Over an 18-36 month period, it will be about supply and demand levels. Right now the glut that is being reported is only 2-3% over consumption. So we would not be shocked to see a reversal from these levels.

ON COST OF PRODUCTION (oil):
With the amount of supply coming off the market, as well as the actual action of the rigs coming down, it leads you to say that the marginal cost of production is roughly in the $50-60 range.

With shares trading around 13 times FCF, how are you looking at valuation in today's share price as it continues to make 52-Week lows?

JH: It's gotten really cheap because it's been lumped into the entire oil & gas category, even though upstream is only 7% of their business. It's being priced right now as if their upstream oil & gas business is a much larger portion of the business. At current prices, we're thinking that somewhere around $3 per share is likely trough earnings with normalized earnings in the $4-5 range. We don't think it's a coincidence that the company is fairly-aggressively buying shares for the first time since 2002. Noel Watson is the Chairman, and he seems to set the cultural tone. Also, he owns a very significant amount of shares. So he is clearly aligned with shareholders. We like companies that don't regularly buy back stock, but then when its price appears attractive on a normalized basis all of a sudden they are.

Historically, this is a high multiple business. And we are talking about an industry leader, with very little risk of technological disruption. It's really a relationship based business. They aren't going after the blockbuster type projects. They're going after mid-cap type projects that are recurring in nature so they can develop a relationship with the company or municipality. They essentially seek to become an extension of their customers so they can secure repeat business. This has led to higher returns on capital compared to its industry peers. And we don't think that's a coincidence either. They are highly diversified by industry and geography. And really the stock has been cheap on fears of oil.

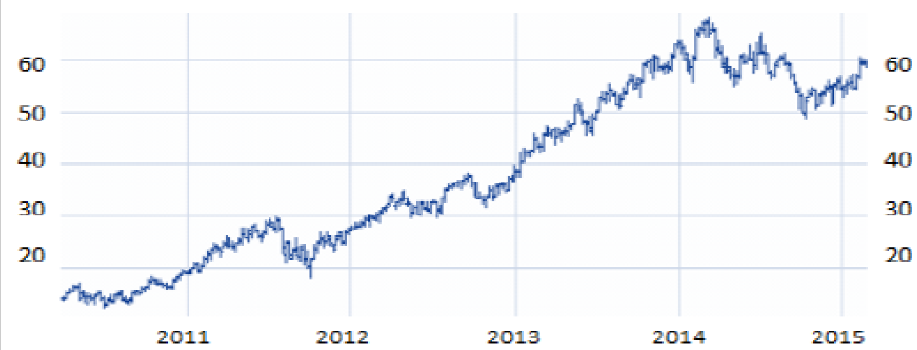
The market thinks the earnings could decline this year, but they may not. And their backlog continues to get pushed out to the right. So they continue to grow their backlog, but they haven't been able to get things going from the planning phase to the construction phase. And we think over time, as diversified as they are, that the infrastructure needs of the country aren't going away, and the earnings will eventually be pulled forward. So what we have is a very high quality business that's trading for just under 14x what we believe to be a trough number (not quite trough on trough but close).

JS: Joel mentioned that 7% number – it's important to note that many of the analysts will mention how 40-50% of Jacob's business is exposed to energy. And that number may be roughly correct, but most of it is in the mid-stream and downstream areas of oil production; areas that are not going to have the same kind of declines as the up-stream operations. So we look at that as a great opportunity where the stock price is down 30% or so, and it's been a company in our universe as something that we wanted to own. And this gave us the opportunity to buy it at what we believe is an attractive price.

INVESTMENT SPOTLIGHT

CBS Corp		**Price**	**$59.10**
(NYSE:CBS)		52-Week Range	$48.83—68.10
Description: Operates multiple businesses ranging from media to entertainment.		Dividend Yield	1.02%
		Market Cap	$29.42B
Basic Valuation:		**Largest Owners:**	**% Owned**
P/OCF:	26.08	Capital World	4.87%
P/FCF:	31.20	Vanguard Group	4.89%
Trailing P/E:	11.30	State Street	4.00%

CBS PRICE HISTORY



INVESTMENT SUMMARY

Joel Hirsh expects earnings to grow at a 12-15% rate. With that kind of growth, it's not hard to get into the $4.20-5.00 range. At a 16-18 multiple, it gets you into the $80-90 range for the intrinsic value of the business.

Sources: Company reports (10Ks, 10Qs), other public information

It appears you also recently established a position in CBS (CBS). Can you describe your broader investment thesis there? Do you believe there was undue selling pressure on the stock after the spin-off of its outdoor advertising unit (CBS Outdoors)?

JS: We opened a position in CBS in the fall of last year. Whether it was the spin-off causing weakness or just a general indifference to the media industry is anyone's guess. It's not too relevant to us because when the stock was trading in the low $50s we thought that was a very attractive price given how we feel about the position that CBS currently possesses in the media industry. A weak advertising market has been a concern for the last 6 months or so. But the greatest perceived threat to the media industry is mainly concerns from a technological disruption due to companies like Netflix (NFLX) and Hulu. Are people going to abandon cable and satellite TV in favor of all these over the top options? There is also a fear of whether or not the current ecosystem of the bundled programing will survive. We believe that even in that type of scenario, the companies that create content are clearly still going to be in a very good position. Providers will have to get content from somewhere.

JH: This fear is discussed in every transcript, and it's interesting because we're talking about an oligopoly of four companies essentially that control the space. And it is not the music industry. The music industry is sort of the ghost that everyone is still running away from. The music industry was destroyed by Napster where content became free. The media content industry is really controlled by Disney, Time Warner, Fox and CBS. And the management teams running these businesses understand that they have an ecosystem of fees paid by the cable companies to the media companies of somewhere in the ballpark of $50 billion. And then they're generating another $40 billion in national/local advertising. And it's an income stream where you make an agreement, the agreement lasts for years, and there's inflation adjustments that go on throughout. It's a very high multiple cash flow stream. When you look at what they're saying, they believe offering CBS or HBO over the top is additive to their current subscriber base via cable/satellite providers. People in their young 20s who don't mind having a patch work of Netflix or Hulu, and maybe one or two other services. If you start piecing together all the different channels it would take to take care of just my household, for instance, you begin to see how the bundle becomes quite intriguing. So they think its additive. We have a difficult time believing that they will purposefully tear down a $90 billion per year revenue stream but will experiment a bit in going for growth on top of it. I think the commentary out of the various CEOs is they believe its additive, and they're not in a rush to destroy what they've got. And we'll have to see how that plays out. But we're essentially betting that if they start it to harm their own ecosystem, they'll act in their best interests not to. We're just not sure that the popular story of, "technology will come in and disintermediate it," is a fair statement because it's not a technology problem – it's a content ownership problem. I'd argue that the reason Netflix is so heavily investing in its own shows is because they saw the writing on the wall. Most of the content they negotiated the first time around was probably mispriced, and the next round of content negotiations may be a little tougher.

With shares trading around $56 per share, how are you looking at valuation at today's share price?

JH: Because CBS has historically been a broadcast company, they've had a larger percentage of their revenues tied to advertising. And they've done a really nice job the last several years of renegotiating the retransmission agreements with the cable companies as well as reverse retransmission fees with their affiliates. And as a result, I think this is the first time they have gone to 50/50 in advertising versus fee income. And it's likely that advertising will continue to shrink below 50%. But we feel there is still a very high probability that the growth in the fee segment will more than offset any reduction in ad revenue. CBS's fees are still below what cable companies are paying cable channels with lower ratings, so there is room for expansion there. And CBS has some of the best content programming in the industry. It's very close, if not on par with, the other three media companies we mentioned before. Their suite of live action sports (NFL/NCAA), and extremely popular shows like the NCIS properties, Big Bang Theory, and newer offerings such as Scorpion. It's very rare for a company to have a suite of content offerings like this bringing in 15+ million viewers each episode. They are in a very good position content-wise.

As their fees begin to increase because of their content, we think the multiple will close the gap somewhat with Disney, Time Warner, and Fox. We also expect there to be substantial buybacks. They have $2.6 billion remaining in their current repurchase plan that they are looking to deploy over the next 12-24 months. You could see earnings per share growing at a 12-15% rate, so it's not hard to get into the $4.20-5.00 range. And with a 16-18 multiple, it gets you into the $80-90 range.

You mentioned, "BBBY current valuation represents one of the largest asymmetries in our portfolio." Can you describe your broader investment thesis there?

> ON THE MEDIA INDUSTRY:
> ...the popular story of, "technology will come in and disintermediate the media industry," isn't a fair statement because it's not a technology problem – it's a content ownership problem.

JS: Bed, Bath & Beyond was clearly late to the party in investing in an omni-channel offering. It's also something that management clearly took to heart, and now they are spending furiously. We think that spending to get to the level of where the other retailers are is an acceptable and necessary use of capital. As a result current earnings are being somewhat depressed. But long-term we don't believe that all business is going to the internet and that Amazon will continually take market share. But even if more sales go online, Bed, Bath will have a much better presence on the internet. Just look at their website two years ago compared to today, and you can see they have a better understanding of how to sell online and compete in an omni-channel world.

JH: A lot of the concern with Bed, Bath is that everyone is obsessed with their margins because their margins constantly go down. For retail in general, if you choose to be competent in omni-channel, your margins will likely go down. Yet, the free cash flow for the whole enterprise still grows over time. They were clearly late to the game, but now they are catching up. We saw opportunity right around the $60 area. At that price, it was priced for no growth of free cash flows, in our opinion. And we think the odds are they will grow. Certainly on a per share basis.

JS: They actually just initiated an accelerated repurchase plan where they took on debt for the first time. We believe this was the right thing to do given the valuation and where interest rates are. They've been buying back stock for years, but this is the first time they did it in a meaningful chunk. Up until this time they've never needed to take on debt. Their free cash flow was such, that they could finance the expansion of their store base through organic cash flows. Things have certainly gotten tougher on the retail front, but we think an established player like Bed, Bath will do well over the long run. It's hard to change people's habits. And it really is a pleasant place to shop- the customer service is good, and the selection is great. Hopefully, Bed, Bath will be able to win back some share of the online market now that they're up and running.

You mention a "once in a generation change" to retail in the form of omni-channel retailing. What kinds of moats do you see in a company like Bed, Bath and Beyond to give you the confidence they will be able to thrive?

JH: It's really their brand and their couponing. Couponing's been very important for them. It's almost like their membership rewards program. We think they've hinted that it will get better over time when they have more data from their omni-channel offering. Thinking back to 2006, this was one of the first stocks I struggled with. When you walk through the actual stores, they just execute differently, and the competition just couldn't seem to copy Bed, Bath's model. And obviously right now, you could argue from 2009 to 2013, maybe their margins reached a level that's above normal. Mainly because there wasn't much competition at the time. And now maybe the margins reset lower.

You've seen significant gains in many of your financial holdings, such as Bank of America, Bank of New York Mellon, Wells Fargo, and Goldman Sachs. Even insurer American International Group. Do you foresee yourself trimming positions if this sector continues to see the kind of run we've seen the last few years? As a group where do you see the valuation?

JH: We've done a smattering of trimming in financials. And we continue to update our price targets. Obviously the stocks are not as cheap as they were three years ago. At that time they were despised but to us it was just a matter of time of letting all the provisioning run through the balance sheet. They're still fairly cheap, but they could be very cheap with normalized interest rates.

MK: Financials are obviously worth more as interest rates go up, but everything else is worth less. Rates may stay here or reset higher, so this certainly puts the financial industry in an interesting situation.

INVESTMENT SPOTLIGHT

Bed, Bath & Beyond (NASDAQ:BBBY)

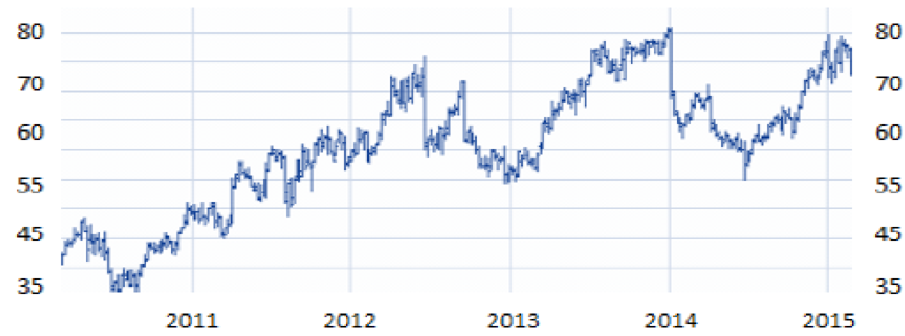
Description: Sells an assortment of domestic merchandise and home furnishings.

Price	**$74.71**
52-Week Range	$54.96—79.64
Dividend Yield	N/A
Market Cap	$13.71B

Basic Valuation:	
P/TBV:	5.07
P/FCF:	15.69
Trailing P/E:	15.00

Largest Owners:	**% Owned**
Brown Brothers	5.66%
Fidelity Management	5.26%
Vanguard Group	5.18%

BBBY PRICE HISTORY



INVESTMENT SUMMARY

Although shares sit near 52-weeks highs, Bed, Bath & Beyond shares are still pricing in little-to-no expectations for the future of the company considering it's classification as a high quality business. The stock currently trades around 12x the estimated earnings power of the business of $6.25 per share.

Sources: Company reports (10Ks, 10Qs), other public information

What was the worst investment you've ever made?

KIG: Our worst investment decisions usually stem from the investment we didn't make. Along the lines of stocks we missed would be American Express at $10-11 per share. That was a bad mistake because we really understood that business. Starbucks is another one when it got into the single digits during the financial crisis. Sometimes we are too stubborn like with Nike when we didn't pull the trigger a while back at 15 times earnings, because we wanted it at 13 times earnings. Nokia would be an example of a company where we just completely mis-assessed the moat and we were lucky to get out before it crumbled. We actually made money on Nokia, but we consider it a horrible mistake because we were so wrong on the moat aspect of the business.

Things will happen and you will lose money. And you'd like to say you'll avoid it next time. If you look at the track records of the best investors, they all have mistakes. That's just part of investing.

What are The 3 Things an investor should focus on the most to increase their chance of investment success over the long-term?

1) *Never feel obligated to act*
(never let cash burn a hole in your pocket)

2) *Take time to think*
(reading w/o thinking is pointless)

3) Only a few drivers really matter to any investment
(identification of moat, oligopolies, valuation, margin of safety). VIC