INTRINSIC VALUE MANAGMENT

INVESTMENT RESEARCH AND MANAGEMENT FRAMEWORK WHITE PAPER

INVESTMENT METHODOLOGY - The Investment Research and Management Framework

Publicly Traded Companies

We use a disciplined and rigorous fundamental analysis and valuation process to select companies for inclusion in our portfolios. Preservation of capital is always of paramount importance. The flowchart (please see the discussion of the *Cassandra Stock Selection Model*™ in the Investments section of this website) and discussion below summarize our highly disciplined investment approach.

- **Large Equity Universe -** We start with a universe of around 9,500 publicly traded companies. This is a large universe and encompasses stocks that are traded on the NYSE, AMEX, NASDAQ National Market and NASDAQ SmallCap Market. Companies representing all market capitalizations are included in the database - from the very smallest micro-cap companies to large, multinational conglomerates.

- **Computer Screening -** We use our computers to screen through the large equity universe and identify companies with three desirable attributes:

    1. **Excellent Businesses -** Excellent businesses, by our definition, are businesses that are well-run, have superior business economics and have the potential for an increasing intrinsic value. Various measures of a company's financial health and strength are examined here as well.

    2. **Low Historic Valuation -** Our computers screen for businesses that are undervalued on an historical basis. We use well-known historical valuation measures such as price-to-earnings ratios (P/E), price-to-book ratios (P/B), and price-to-sales ratios (P/S), as well as various proprietary measures.

    3. **Low Prospective Valuation -** Our computers screen for businesses that are undervalued on a prospective, or forward-looking, basis. We use consensus estimates for earnings and growth rates; and such prospective valuation measures as the price-to-earnings-to-growth ratios (PEG). We also use various proprietary measures.

    This first pass at identifying excellent businesses that are selling for reasonable prices usually yields between 200 and 400 candidates out of the large equity universe of around 9,500 companies.

- **Computer Ranking -** We next use a proprietary computer ranking model that ranks companies on the basis of historical valuations; prospective (forward-looking) valuations; financial strength; operating performance; sales and earnings momentum; price momentum; the probability of an increasing intrinsic value; and the likelihood of the existence of a catalyst that will spark recognition of the company and lead to an increase in the company's stock price.

  The *computer ranking* step is our second pass at identifying excellent businesses that are selling for reasonable prices. This step allows us to view, on a relative attractiveness basis, the 200 to 400 candidates selected in the *computer screening* step. We go through the ordered list of 200 to 400 candidates, one-by-one, to select the stocks that we take to the next step - which is rigorous, *value driver* and *fundamental analysis*.

- **Value Driver and Fundamental Analysis -** In this, perhaps the most important step, we undertake rigorous, fundamental and value driver analysis to select the companies that will be added to our portfolios. The business of the company is examined carefully. We thoroughly review each company's filings with the Securities and Exchange Commission (SEC). This includes the company's annual reports (10-K); quarterly reports (10-Q); proxy statements; and other filings. We also review the company's press releases and other public sources of information on the company. Many of the traditional approaches to fundamental analysis are applied in this step. Value driver theory and analysis is also applied in this step.

  As part of the fundamental analysis of each company, we conduct extensive due diligence on the company. This due diligence might include such things as talking with the company's management, talking with competitors, and visiting trade shows in the company's industry. We also consult third party sources of research on the company.

  Understanding how a company fits into the broader *industry* of which it is a part, and the overall economy, is vital to assessing the company's financial and competitive strengths and weaknesses. Accordingly, we analyze each company's industry as a part of our fundamental analysis of the company.

  Monitoring and assessing the general *economic environment* is an ongoing part of our investment research and management process. We believe this enables us to better understand the companies and industries in which we invest.

  It is important also to realize that each company is a part of the overall market for publicly traded equity securities (i.e., the stock market). Accordingly, it is useful to understand if the stock market is overvalued, undervalued or fairly valued. We use a proprietary *market valuation model* to estimate the valuation of various segments of the overall stock market as represented by several different market indexes.

- **Valuation -** Our final step, after all of the fundamental, value driver, industry, and economic analysis has been completed, is to estimate the *intrinsic value* of the company. We compare our estimate of the intrinsic value to the current market price for the company's stock to see if there is sufficient potential for an increase in the price of the stock. This is the stage where we determine if the company is, in our estimation, selling for a *reasonable price*.

Other Investments

The intrinsic value of any business or investment, including the special situations discussed below, is the present value of the future cash flows of that business or investment. Accordingly, the basic process that we discussed above in the section entitled "Publicly Traded Companies" is used in the selection and evaluation of special situations (which are often publicly traded companies, too) and other investments. Modifications are made to the above process, where necessary, to accommodate the uniqueness of each investment that we review.

Special Situations

We define a *special situation* as a business or investment that falls outside the scope of finding and investing in *excellent* businesses and investments and paying a *reasonable price* for those businesses and investments. Special situations can take many forms. As one example, a special situation could involve a strong company that acquires a weaker target company with the expectation of creating value in the weaker company by improving its operations. Another example might be a company that is a spin-off of a larger company that has a strong management team and a product with significant profit potential. And yet another example might be the initial public offering (IPO) of a promising, high growth company. These are but three of many possible examples of special situations. As with other investments, we calculate our estimate of the special situation's intrinsic value. In special situation investing, more risk is usually taken on with the possibility of attaining higher investment returns.

PORTFOLIO MANAGEMENT

We use a *portfolio approach* in the management of our investments. Accordingly, publicly traded companies and other investments selected in the steps described above are combined to create a portfolio of investments. The following discussion briefly summarizes our portfolio approach.

Diversification

The maximum benefits of diversification occur when investments in a portfolio are negatively correlated or have low correlation with one another. Accordingly, investments are selected, to the extent possible, such that the investments have low or negative correlation with one another.

We diversify by investing in different segments of the U.S. Equity markets (i.e., large-cap, mid-cap and small-cap); in different economic sectors; in various industries; and in various individual companies and investments. Additionally, we may use index funds on both a temporary and permanent basis to achieve the objective of diversification. While not expected to be used on an extensive basis, if at all, we may also use futures, options, other derivatives, short selling, and other financial instruments and strategies, as we deem appropriate, in order to achieve our investment objectives.

Monitoring

The portfolio and its investments are continuously monitored.

The individual businesses and investments are monitored to ensure that they continue to be the excellent businesses that we believed them to be when they were initially selected. Additionally, we monitor the special situations to ensure that, in our judgment, they remain suitable special situations. We also monitor the intrinsic value of the business or investment. Businesses and investments are considered for possible sale as described below under the section entitled *Sell Discipline*.

The portfolio is monitored to ensure that it remains diversified, as we deem appropriate. Portfolio management is a very complex investment activity that relies heavily upon the experience and skills of the investment manager. There are many factors to consider in managing a portfolio, the number of which are too numerous to mention in this brief summary. Such factors and considerations might include, however, an assessment of and the outlook for the general economy, the major market segments, the different economic sectors and the various industries; a valuation of the market segments; the changing relationships between the businesses and investments in the portfolio; and the changes taking place in the major economic, demographic and technological arenas of our society and the world.

Sell Discipline

Knowing when to sell is as important as knowing when to buy. We use the same principles and methodology in the *sell decision* as we use in the *buy decision*. Our basic rules for selling are to consider a business or investment for sale when: (1) it has become fairly valued or overvalued, as measured by its intrinsic value; and/or, (2) the fundamentals have deteriorated to the point that it is no longer an excellent business or investment; or, a suitable special situation. While simple in form, this model actually takes into account most of the scenarios for which an investor would consider selling an investment. The investment manager does consider other unique situations for possible sale should they arise.

This disciplined process for deciding when to sell a business or investment takes the emotion out of the selling decision. It allows us to focus on the fundamentals and not be swayed by unrealistic hopes and expectations for an investment as do many investors, professional and amateur alike.

Rebalance

Portfolio management is a continuous and dynamic process. The various factors discussed above are constantly impacting the portfolio in a myriad of ways. The end result is that the portfolio needs to be rebalanced on a periodic basis.

The investment manager continuously monitors the individual investments and the portfolio and makes the changes that it deems appropriate. With each change, consideration is given to maintaining an appropriate balance in the portfolio.

CONCLUSION

The investment research and management framework we have described here in the management of our portfolios can be thought of as a process that is circular in nature. A diagram, or flow chart, of this framework is shown in the section of this website discussing the Cassandra Stock Selection Model™. The start of the circular process is the computer screening of the large equity universe of around 9,500 companies. The circular process ends with the rebalancing step. But, as is the nature of circles, the process doesn't really stop there. The rebalancing step necessitates that new investments are selected to replace investments that are sold. And so the circle continues in a never ending fashion.

We believe that our disciplined approach to finding and investing in *excellent* businesses and investments, as well as special situations, and paying a *reasonable price* for those businesses and investments – together with the *portfolio approach* that we use - offers our portfolios the potential for higher returns with lower risk over time.