Value Investor INSIGHT
The Leading Authority on Value Investing
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Berkshire Hathaway SPECIAL ISSUE

Real-Time Case Study

Berkshire Hathaway has become a company with no true analog. Four top value investors examine how it got there, and where it goes from here.

With $74 billion in annual revenue, arguably the greatest investor ever as its Chairman, and operations selling everything from terrorism insurance to Dilly Bars, Berkshire Hathaway Inc. is a real-time case study of American business.

That's why we assembled four leading Berkshire experts for a roundtable discussion in advance of the company's April 30th annual meeting. The participants are long-time Berkshire shareholders whose funds collectively have nearly $800 million invested in its stock.

Their far-ranging discussion of Berkshire's businesses, future and leader, Warren Buffett, proved to be as diverse and thought-provoking as the company itself – of interest to Berkshire experts and novices alike. See page 2

Berkshire Hathaway
ROUNDTABLE DISCUSSION

Participants

Bruce Berkowitz
Fairholme Capital Management

Tom Russo
Gardner, Russo & Gardner

Matthew Sauer
Oak Value Capital Management

Chris Stavrou
Stavrou Partners

Analogical Perspective

Even well-followed industries have companies that fall through the cracks. When they do, Guy Spier is often there to find them.

INVESTOR INSIGHT

Guy Spier
Aquamarine Fund LLC

Investment Focus: Seeks undiscovered companies set to benefit from what he considers compelling long-term sector or market trends. Search increasingly resulting in non-U.S. investments.

Value investors were a scarcer breed when Guy Spier founded his New York-based Aquamarine Fund investment partnership in 1995. "I thought I was walking down a relatively unbeaten path," he says. "Now with all the people claiming to be value investors, the road less traveled feels more like a six-lane expressway at rush hour."

That hasn't stopped Spier from consistently besting the market by focusing on investments that rely on what he calls "some form of reasoning by analogy." Following a central theme – say, local newspapers are a good business, for-profit education has the wind at its back or Swiss companies are often good businesses with attractively priced stocks – he scours the globe for inexpensive and often-obscure investments that will inordinately benefit if the theme holds true. See page 10

Inside this Issue

FEATURES

Investor Insight: Guy Spier

Guy Spier of New York's Aquamarine Fund discusses why he loves the education and credit-rating businesses, what distinguishes a valuable brand, where he's looking for international ideas and why he is particularly interested right now in EVCI Career Colleges, Todhunter International and Switzerland's OZ Holding.

Your portfolio is about as diverse as it gets. How do you look for ideas?

Guy Spier: One of my good friends says it's in the very nature of a good investment idea that it has an unusual originating point. So my best investment ideas can come from anywhere. I would never restrict myself to a particular kind of search, such as stock screens, or pursuing stocks making new lows, or focusing just on new, unsponsored securities from spin-offs. This is particularly true in the U.S., where most of what I look at is very picked over.

I'd say most of the ideas that have made money for the portfolio have been the result of some form of reasoning by analogy. One example: Applying well-understood U.S. investment ideas to markets outside the U.S. During the time when one-newspaper towns in the U.S. were another version of Buffett's toll booth, there were a number of European newspapers that were dominant local monopolies – like Edipresse and Neue Zurcher Zeitung in the Western and Eastern parts of Switzerland, respectively – which were still trading at attractive multiples and I was able to do very well with them.

How about Weetabix, the British cereal maker that was one of your best early investments? Was there an analogy there?

GS: One thing I focus on is brands. Whenever I start looking at a business, I try to understand what's real and unchanging in the business beyond the basic financial information that is the company's description of what's going on. Most numbers can be manipulated in one way or another. I'm looking for tangible assets that impact a company's worth.

A brand like Weetabix is just real estate in consumers' minds. That can be a tremendous asset. The no-name brand in British supermarkets is right next to Weetabix, is manufactured by the same company and is, in fact, exactly the same product. But when I went to the stores and asked people, even with modest means, why they were buying Weetabix even at a 30% premium, they'd vehemently tell me they would only give Weetabix to their family, never the no-name brand. It was almost like a test of their love for their children – "I would never give anything less than the best to my children." If she comes home with the no-name brand, in her mind she's being a less good mother. I realized that's a brand that's really got her.

Some value investors have trouble with brands and how to value them.

GS: Clearly, not all brands are alike, some produce much better long-term profits than others. I generally think that the more personal the consumer's choice, the more potentially valuable the brand can be. When it comes to things like what cream you put on your face, what pills you put inside you, what chewing gum you chew, people become a lot more specific about what they're looking for. The brands that are perceived to deliver it have more value.

Whenever you're at somebody's home, open the cupboard and ask the person why they bought the specific brands in there. When I've asked people in the past about laundry detergent, for example, they'd say they liked the red packet, or it was a good price, or it was what their mother bought. They weren't very motivated. You want to own the brand that gets people when they are price insensitive. If you can get into the mind of the consumer, you start noticing there are real distinctions to make.

The Internet, by the way, is destroying the pricing power of many brands. It's not clear that news brands, for example, are what they were. It was much more true in the past than now that people had a preferred source of news that they were loyal to – their newspaper, their television

Guy Spier

Man of the World

As international resumes go, Guy Spier's is a standout. With an Israeli father and South African mother, he grew up in South Africa, Israel, Iran and the U.K. He has degrees from Oxford as well as Harvard Business School.

His background's affect on his investing? "One benefit is I'm probably more inclined and willing to look at opportunities outside the United States," he says. And more capable to do so, given his ability to communicate – and read local source documents – in German, French and Spanish, in addition to English. "But I need to be careful about why I'm looking for international ideas – if it's just to stay connected to other places, using investing as the vehicle is probably not the right thing to do. To be a better investor you always have to ask what your true motives are. It's not a given the reasons are always good ones."

show. There are just so many choices now that maintaining a strong brand is difficult.

Another fascinating thing: the majority of global brands today were created in the U.S. and Western Europe. That is probably not the case going forward. If you really want to understand brands over the next 100 years, you probably have to look much more in Asia.

You've also said you try to identify industries with the wind at their backs, and then look for investment bargains in those industries. Can you give a few examples of that?

GS: One is the credit-rating business, where I own Moody's and some comparable businesses overseas. Rich Pzena [of Pzena Investment Management] makes a very compelling argument that you should buy underperforming companies because of the powerful statistical evidence of reversion to the mean. In the ratings-agency business I'm actually going against that concept. In this business, for reasons I think I can understand, I don't believe it will revert to the mean for an awfully long time – 30 or 40 years or more. Given that, I think many of these stocks still have real upside even though they seem richly priced.

What's so attractive about the ratings business?

GS: Charlie Munger has talked about how when you have combinations of things happening, you get the best investment results. In the credit-ratings business there are three or four things happening which I think combine to make it so attractive.

The ratings agencies reduce the cost of borrowing in spades for a debt-issuing corporation. With a rating, issuers reduce borrowing costs by at least 10 to 20 basis points, sometimes a lot more. So against the interest savings, the cost of the rating is a bargain.

At the same time they save money for issuers, the operating leverage of the providers is very high. There's almost no capital investment, you just have to hire people and put them into offices. There's no inventory. The fees are paid prior to delivery of the product. And the companies don't really have to promote themselves. When I pick up the *Financial Times* and read the headline emblazoned on the page "Moody's lowers Mexico's debt rating," that is the most incredible free advertising. And, with entrenched brands and strict licensing and regulatory requirements, the barriers to entry are high.

Also, the growth in disintermediation, the growth in securitized financial assets – from auto-finance companies, credit-card lenders, mortgage lenders – has created a secularly growing market for the ratings agencies. That's a trend that I think is unlikely to stop.

ON FOR-PROFIT EDUCATION:

Even if you're average, you'll be getting students through your doors. If you're great, demand will be that much better.

You're also very optimistic about the education business, why?

GS: Again, there is a combination of things. Educational systems – one of the most important determinants of a country's growth and prosperity – are generally geared to educate the elite, not the masses. But the industrial economies of the past, where you just needed a few highly educated people while the vast majority of people were working on production lines or delivering stuff, are being turned on their heads. Now nearly the entire population needs training and education that goes past age 18.

So there's no question the sheer number of students is going to increase dramatically, and somebody has to house them. Even if you're just average, you'll be getting students through your doors. If you're very good, and eventually people recognize that, that's only going to make the demand for your educational services that much better.

How do the economics of the business work?

GS: What's most compelling about the economics is that the amount of money for-profit colleges take from students in fees is a fraction of the students' increase in earnings power. For DeVry, which we own, the average person coming in for a two-year IT degree is earning an average of $30,000. Two years later, having spent about $20,000 on a degree, the average salary is closer to $50,000. The ROI for the student is an absolute no-brainer.

For the companies, while there's some capital investment in real estate and fixed assets, the breakeven on those investments in terms of student capacity are low, 20% to 30%. For-profit companies do a much better job of fully using their facilities, throughout the day and throughout the year. The business has great operating leverage, and gets better as more courses go online.

Your DeVry (DV) investment has been a rollercoaster. Have they been tainted by any of the scandals in the sector around phony enrollment numbers and excessive loan defaults?

GS: After I purchased DeVry it doubled, and it has come all the way back to just a bit above my purchase price. There has been no question that DeVry was fudging any of their numbers. What happened is that they got out of touch with the market. Management had high and noble ideas bred during the Internet boom of what an education should be, and thought the DeVry brand could take them there. But they were delivering something that was above what the market really wanted.

I still believe all the basic elements are in place for DeVry. Buffett likes situations where he has a good sense of what is going to happen, but doesn't mind if he doesn't know when it's going to happen. I firmly believe DeVry's classrooms are going to be filled going forward, it just won't happen as soon as I expected.

Should you have recognized DeVry's missteps sooner?

GS: I've thought a lot about that. I think I was much more inclined to believe management's sense that the business was turning the corner a year ago than I should have been. In a sense, it's not so much the opinions of people who are different from us that we should leery of, but rather the opinions of people who are similar and we like. That's not because they're dishonest or more likely to be wrong, but because they're likely to have the same biases and to ignore the same evidence.

Tell us about your investment in EVCI Career Colleges (EVCI)?

GS: I loved the education business but couldn't stand that all the companies in it seemed to be trading at 40 or 50 times earnings. I found EVCI literally by going on Bloomberg and doing a search by SIC code for education.

EVCI was originally a darling of the Internet era because of an electronic videoconferencing business they had that had since collapsed. What was left, though, was Interboro Institute, a two-year for-profit school serving the New York City area.

Interboro is unique because they target people who can't afford an education themselves, who score the worst on credit-ratings reports and who can't get education loans. They design the curriculum to meet accreditation requirements at a cost lower than the grant money from combined state Tuition Assistance Program grants and federal Pell grants, which pay about $4,200 per semester. They price at $3,900, and their cost per student is probably around $3,400. It's the only college in the country I know of that does that, and it's a very interesting niche. Companies that consider themselves to have higher-end brands are not eager to be educating that kind of student – no one really wants to get into it.

In a way, this is a company doing well by doing good?

GS: No question. Who would believe two years at Interboro changes your job prospects so much, but it does. Most of these students would be unemployable.

How scalable is a business like this?

GS: Revenues were up more than 60% last year, to $33 million, as two new campuses came on line. Net income was up even more, 85%, so it was profitable growth.

Somewhere between 50,000 to 60,000 students each year fail to graduate from New York City high schools. Interboro only has around 3,000 students, so they've really only scratched the surface of the existing market in New York City, let alone additions to the market every

INVESTMENT SNAPHOT

EVCI Career Colleges
(Nasdaq: EVCI)

Business: Operates Interboro Institute, a for-profit two-year college serving metropolitan New York City, focusing on serving economically disadvantaged students and those with challenged academic histories.

Share Information
(@4/26/05):

Price	**6.11**
52-Week Range	5.55 – 12.64
Dividend Yield (TTM)	0.0%
Market Cap	$75.95 million

Short Interest:
(As of 4/8/05)

Shares Short/Float	2.6%

Financials
(TTM)

Revenue	$33.07 million
Operating Profit Margin	14.0%
Net Profit Margin	18.9%

Valuation Metrics:
(Current Price vs. TTM)

	EVCI	S&P 500
P/E	12.2	19.8
P/CF	10.4	12.4

Largest Institutional Owners:
(@12/31/04):

Company	% Owned
Wellington Mgmt	3.4%
First Investors Mgmt	3.3%
Kennedy Capital	3.1%
Mellon Financial	3.0%
Eaton Vance	2.7%

EVCI PRICE HISTORY

THE BOTTOM LINE

EVCI's unique, defensible business model serving economically disadvantaged students has tremendous upside potential, says Guy Spier. He believes the company can potentially grow 45-50% per year over the next five to seven years, while maintaining profit margins. If it does, market value would be 8 to 9 times its current value.

Sources: Company reports, other publicly available information year. They're trying to temper growth expectations, but I think they have tremendous growth potential over the next five to seven years.

There's no reason they can't also expand beyond New York. They recently bought a small college in Pennsylvania, just to get the license. I expect them to do something interesting with that.

So why is the stock, at around $6, less than half its 52-week high?

GS: No question they've been hurt by things going on elsewhere in the industry. But what makes it such a compelling investment now is that there's also no question for me that the issues raised at other for-profit colleges do not apply to Interboro. They just went through a detailed audit to verify their student count, which gives me confidence it is accurate. As for some of the loan scandals elsewhere, that's not possible at Interboro because the students aren't applying for any loans.

I don't think the fundamentals of the business at EVCI have changed: Fixed operating costs. High operating leverage. A defensible niche in which they're fulfilling a small percentage of the demand, and demand that is growing.

How are you thinking about EVCI's current valuation?

GS: This isn't how people tend to teach looking at valuation, but I ask that if this company has $33 million in revenues, is it possible they can reach $330 million in five to seven years? Absolutely. Is it possible they'll be earning 15% net income margins on that higher revenue? Yes, that's quite likely. So if they're earning $50 million, even with no change in multiple, it can be a $650 million market cap company [versus $76 million today]. Having done this extent of analysis, I try to be patient and not look at the stock price too much.

Did the recent announcement of new outsized compensation plans for top management concern you?

GS: It was disappointing, particularly the level of cash compensation in the new packages. You don't want to take cash out of the company, so I would have preferred a higher equity component to align interests more with shareholders. I can sympathize with board. I've seen private-equity deals where they're doing roll-ups of schools and the kind of management EVCI has would be very attractive to those types of companies. But how they handled it was not ideal.

Switching gears completely, tell us about another obscure American investment you own, Todhunter International (THT).

GS: Todhunter has four different lines of business. The cash cow is a bulk alcohol business in which they ferment citrus alcohol out of squeezed oranges. There are actually lower taxes on spirits that use citrus alcohol than alcohol distilled from potatoes, so this is a neat, defensible, little business. They also have a vinegar

INVESTMENT SNAPHOT

Todhunter International
(AMEX: THT)

Business: Producer, supplier and bottler of rum, brandy, wine, spirits and other alcohol-related products. Sells to others on a contract basis, as well as marketing its own Cruzan-brand premium rums.

Share Information
(@4/26/05)

Price	**13.00**
52-Week Range	11.70 – 14.40
Dividend Yield (TTM)	0.0%
Market Cap	$82.41 million

Short Interest:
(As of 4/8/05)

Shares Short/Float	0.4%

Financials
(TTM)

Revenue	$98.17 million
Operating Profit Margin	(-4.8%)
Net Profit Margin	(-1.6%)

Valuation Metrics:
(Current Price vs. TTM)

	THT	S&P 500
P/E	neg.	19.8
P/CF	neg.	12.4

Largest Institutional Owners:
(@12/31/04):

Company	% Owned
Dimensional Fund Adv	4.8%
Vanguard Group	1.2%
Axa	0.8%
Northern Trust	0.3%
Calpers	0.2%

THT PRICE HISTORY

THE BOTTOM LINE

Poor reported profits reflect investment in the fast-growing Cruzan rum brand. If the Cruzan business continues to grow as it has, Guy Spier believes the brand itself could be worth hundreds of millions of dollars in a few years. Downside is limited: Without the marketing investment, he says, the stock trades at only 10-11x "normal" earnings.

Sources: Company reports, other publicly available information and cooking wine business that makes some money, and a drink bottling business that loses money.

What's exciting about Todhunter – and where the investment bet is – is their premium rum business under the Cruzan brand. The rum market has long been dominated by Bacardi. Ten years ago an executive from Bacardi, Jay Maltby, came in to run Todhunter and set out to build a premium rum brand to compete with Bacardi.

The model was what happened in the vodka market, where the dominant Absolut brand was successfully taken on by Grey Goose. Grey Goose created this great premium brand by playing on what has been done similarly in chocolates: You're standing at the bar with your girlfriend or the person you want to impress and she asks for vodka. Are you going to take the low price? No, you're going to look cheap if you do that, so you ask for Grey Goose, which has this beautiful bottle and this high price and that all makes you feel good. Grey Goose was a huge success and was eventually bought for $2 billion by Bacardi.

In a land of giant competitors, this is much easier said than done, no?

GS: Jay Maltby is a very smart guy, a seasoned industry veteran who has done this before. He put a lot of emphasis on establishing a position with wholesalers, benefiting from a realignment that took place in that business a few years back when Diageo bought part of Seagram's liquor business. That was an opportunity for Maltby, with established relationships, to come in and say "This brand is going to mean something to you" to wholesalers.

On the product side they took the Cruzan price per case from $1.75 to $7 to $8, comparable to Bacardi. They gave the bottle a misted, cool look, and created a bunch of flavorings like Absolut did with vodka.

They've also been quite creative and clever on the retail-marketing side. The brand is produced in the British Virgin Islands, and they've got a broad marketing deal with a very popular country-western singer named Kenny Chesney, who lives in the British Virgin Islands. Sales have been particularly strong in the southeast U.S.

It takes time to build a liquor brand like this. But the bottom-line is that they're starting to get real traction with Cruzan – case volume in the last three years is growing 30% a year.

ON TAKING ON GIANTS:

Grey Goose proved in vodka there are things small, nimble companies can do much better than large ones.

So Todhunter's poor financial performance – operating losses, from decent margins two years ago – is a result of pouring all their money into building the Cruzan brand?

GS: Yes. I think it's a good example of what you want a good management to do. If management can't find a good use of cash, they should dividend it out to shareholders or otherwise return it. In this case they're using the cash to develop a very interesting brand, and there's the potential that brand will eventually realize tremendous value in the hundreds of millions of dollars.

You could say they're spending desperately to grow at all costs. But I look at it the other way around, that management is very confident about the money they're spending. Grey Goose proved that there are some things that small and nimble companies can do much better than large ones.

So there's an option value here of the company hitting a homerun. What's the downside if it doesn't work?

GS: The stock is trading around $13, with a market value of around $80 million, plus $30 million of debt. At an annual revenue run rate of around $100 million, I think they would make $7 to $8 million in net income and $10 to $12 million in operating income if they stopped spending on Cruzan. So the stock is only trading at a 10 or 11 multiple on normalized net earnings. The downside is very low, against an upside that is very high.

You just returned from India, Singapore and China. Are you finding more values overseas?

GS: Oddly, for someone who didn't grow up in the U.S., early on I still had this kind of imperious attitude that if it wasn't listed in the U.S., I didn't want to know about it, based on the assumption that the standards of corporate conduct relative to shareholders weren't at an appropriate level [elsewhere]. But that's changing.

The key standard I apply when investing outside the U.S. is whether I can read a company's source materials and whether I can communicate with management directly. Otherwise, I am outside my circle of competence and I'm going to have to take a pass.

There is a great advantage in investing in a country like India in comparison to say, South Korea, Russia, Japan or China. First, the language of business is English. But in my view the people in India have also been much faster than elsewhere to learn the subtleties that are required to make capitalism work.

You've also been a fan of Swiss companies. Tell us about OZ Holding (OZI).

GS: OZ started as a small Swiss bank, founded with capital from Martin Ebner, who was at one point hailed in Switzerland as the Swiss Warren Buffett. They started with a call-writing business, in which they approach pension funds with small and mid-cap stocks in their portfolios and offer to write calls options that they'll sell in the marketplace. They then share some of the margin on the calls with the pension funds.

They've since also developed two

other businesses. A corporate advisory business for small- and mid-size companies in the areas of stock-option plans and capital structure. They also are building an institutional asset-management business, with about Sfr 1.2 billion under management.

How did OZ get your attention?

GS: What was interesting was that this was one of the first Swiss companies to repurchase its shares. They basically take a significant portion of the money they make each year and repurchase shares. Over the time they've been in existence, they've probably reduced their share count by 50%. The more I looked into it, the more I've come to believe this is a company that is completely focused on the right way to run a company, control overhead, allocate capital, incentivize management and, in the process, create shareholder value.

What's the investment thesis?

GS: One reason I think the stock is a bargain is because people don't like that there's no visibility on future earnings. Over the last seven years, OZ has earned Sfr 574 million – in some years it earned net income over Sfr 100 million and in a couple years it even lost modest amounts.

The stock currently trades at Sfr 79, for a market value of around Sfr 318 million. As they develop less market-dependent businesses, I judge their core earnings power to be at least Sfr 20 million per year, which results in a 16x multiple, about the market multiple in Switzerland.

But their average earnings over the last seven years were Sfr 80 million. Sooner or later the market is going to turn around, and when it does OZ is going to make a lot more money than it's making now, and you're only paying a market multiple now for that upside.

On top of that, they will continue to return money to shareholders. Of that Sfr 574 million in net income over the past seven years, 473 million has been returned to shareholders through dividends or share repurchases.

In the end, I have great confidence in management to do the right thing, the upside is very high, and the stock is priced to limit the downside. It's a great case of my having a pretty good idea of what's going to happen – I just don't know exactly when.

We have to ask: Is everything in your portfolio so obscure?

GS: Actually, with valuations where they are, I'm tending to hide more and more in safe assets. We have relatively high cash balances and hold a fair share of what I call superior businesses, 80-cent dollars growing at 10%.

Such as?

GS: In that category we own Berkshire Hathaway, Aflac, Nestle, Moody's and Heineken. I know these companies well, and by owning them I think I'm a more discerning investor. If you only look at lousy businesses, you'll start to believe, on some level, that that is all that exists. But if you try to own only effective compounding machines, you're more likely to replace them with more effective compounding machines. VII

INVESTMENT SNAPHOT

OZ Holding
(EBS: OZI)

Business: Switzerland-based financial services company with primary operations in brokerage, corporate advisory and asset management.

Share Information
(@4/26/05, Exchange Rate: $1 = Sfr 1.1919)

Price	**Sfr 78.80 ($66.11)**
52-Week Range	Sfr 60.00 – Sfr 88.50
Dividend Yield (TTM)	3.2%
Market Cap	Sfr 318 million ($267 million)

Financials
(Full-year 2004)

Revenue	Sfr 35.2 million ($29.5 million)
Operating Profit Margin	66.0%
Net Profit Margin	57.0%

Valuation Metrics:
(Current Price vs. TTM)

	OZI	EBS
P/E	13.6	16.4

OZI PRICE HISTORY

THE BOTTOM LINE

Earnings have varied widely depending on Swiss equity-market performance, which has been poor. But OZ's development of less market-dependent revenue, its smart management and a history of shareholder-friendly behavior gives Guy Spier confidence that shares will rise dramatically on the eventual improvement in Swiss markets.

Sources: Company reports, Aquamarine LLC, other publicly available information