Star Performers

There are some great investment minds out there.
It makes sense to stay as close to them as you can.

The Value Firm®

Think different!

Great investors outperform the investment crowd by thinking different.

Often the long-term potential of their decisions is not obvious for other investors or they do not have the nerve to follow through.

Many times we wondered "Why could anyone else not see this?" but they don't or they disagree.

When we own portions of outstanding businesses with outstanding managements, our favorite holding period is forever. – Warren Buffett.

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Our strategy

We prefer to buy when the markets are way down

Phase 1

First we bring together the very best ideas of the great value investors of our time.

Phase 2

Then we focus on the companies with a lot of growth potential.

Phase 3

And if these companies trade at a price that makes sense we buy. On margin and hedged.

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Wether we are talking about socks or stocks, I like buying quality merchandise when it is marked down. – WB.

Our investment process

Ideas

- A good amount of time is spent finding the ideas and opportunities. We find them by reading the reports of the great value investors of our time.

Understanding

- Then we try to get an understanding of the (future) business economics of the company. The business description of the 10K is a great place to start.

Risks

- Then we move on to the risk disclosure section. These are put together by management and lawyers to figure out what can go wrong with the business.

Financials

- Finally we move on to the financial statements and footnotes. We also read trade articles and other publications that are relevant to the business.

The better an investor knows a business, the better the ensuing investment decisions tend to be. Therefore, the starting point is detailed fundamental analysis. The aim should be to get to know a business better than anyone who is not an insider. There are few shortcuts and this process involves a meticulous review of all public information, such as financial reports, as well as mining other independent sources. – Lawrence Cunningham

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Companies we like

Heineken

Danone

Deere

We look for companies with the power to outperform competition for many years to come.

We will avoid companies that do not comply with good citizenship values linked to human rights, the environment, labor relations and anti-corruption. It's much more fun to look for companies that not only deliver shareholder value, but even more importantly add good value to society.

Disclaimer. *The information in this presentation, is not intended to be, nor does it constitute, investment advice and/or recommendations.*

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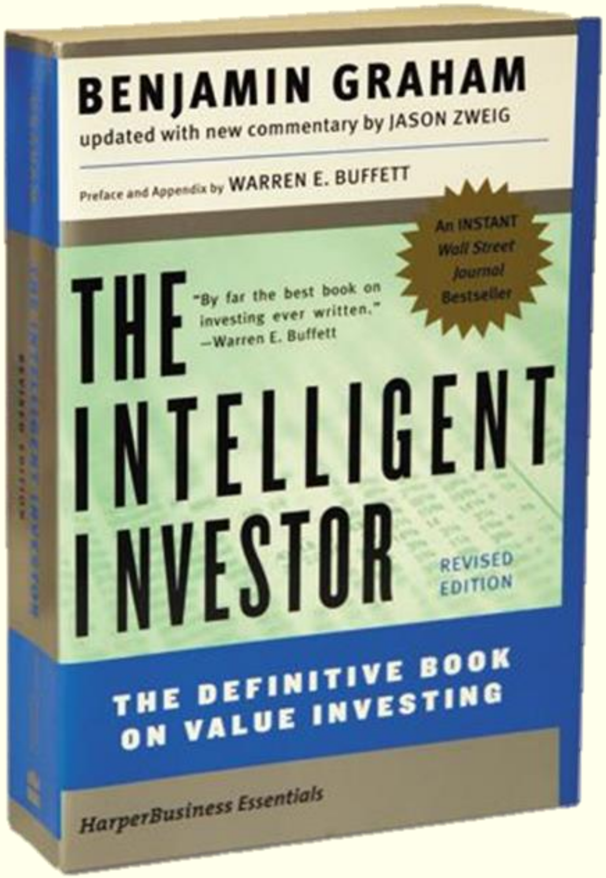
Our favorite books



- The Intelligent Investor. Benjamin Graham.
- Common Stocks and Uncommon Profits. Philip A. Fisher.
- Poor Charlie's Almanack. Charles T. Munger.
- Margin of Safety. Seth Klarman.
- The Clash of Cultures. John C. Bogle.
- The Most Important Thing. Howard Marks.
- Investing between the Lines. L.J. Rittenhouse.
- Manias, Panics and Crashes. Kindleberger & Aliber.
- Financial Shenanigans. Howard Schilit.
- Irrational Exuberance. Robert J. Schiller.
- The Outsiders. William N. Thorndike.
- Good to great. Jim Collins.
- The Essays of Warren Buffett. Lawrence A. Cunningham.
- The Warren Buffett Way. Robert G. Hagstrom.
- The Warren Buffett Portfolio. Robert G. Hagstrom.
- Buffett beyond Value. Prem C. Jain.
- The Quest for Value. G. Bennett Stewart
- Valuation. Tim Koller, Marc Goedhart, David Wessels
- The John Deere Way. David Magee.
- Stress Test. Timothy F. Geithner.

To understand the investment style of Warren Buffett you can wait for Warren to write a book or you can start reading the annual reports of Berkshire Hathaway.

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Our favorite quote

"A concentrated portfolio of strong and predictable companies acquired at a price that makes sense will do the job."

Charles T. Munger

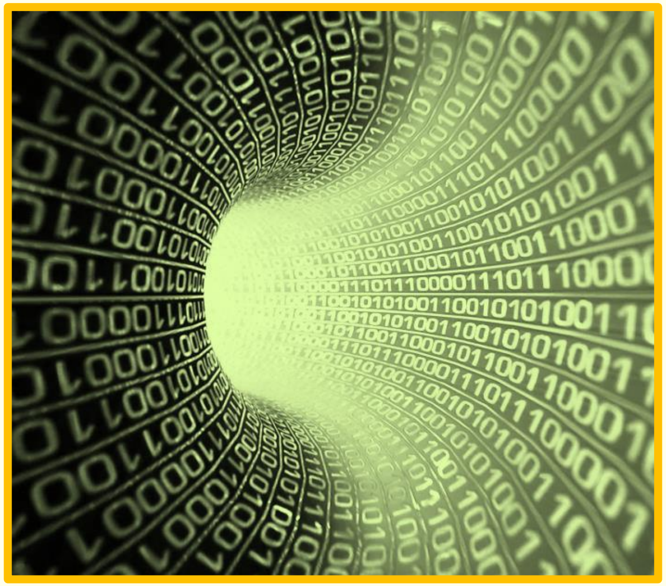
Charlie Munger on finance.
You all see what goes on in finance: the craziness, the promotions, the fuzzy accounting, the crazy trading cultures…. We have a vast gambling culture, and people have made it respectable. Just being shrewd about buying little pieces of paper…It's not a good example for other people.

It would be a good idea to listen to or read a transcript of "24 Standard Causes of Human Misjudgment", where Mr. Munger speaks about the framework for decision making and the factors contributing to misjudgements.

The Value Firm®

Our database

- If you don’t go the extra mile to study the fundamentals thoroughly and get the numbers that matter right you put yourself at undue risk.
- There are some (more or less) sophisticated stock screeners available. We developed our own tooling for fundamental research. There are some 50k+ companies available. Once a year we compile our list of 500 most preferred stocks.
- Return on Capital is a core metric at The Value Firm®. It is the one value we are unwilling to compromise on when we look to invest.
- A well designed database in combination with effective datamining tooling can be very handy in the preselection of companies. But the final investment decision takes more than “just what’s in the numbers”.



An investor should act as though there is a lifetime decision card with just 20 punches on it. – WB.

There is more to it than “just what’s in the numbers”. Much more.

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We don’t have a formula that will help you. You have to think of a lot of different things at once. There’s never going to be a formula that will make you rich just by going through some mathematical process. – Charlie Munger.

Our checklist

- ❑ What are the unique competitive advantages of the company?
- ❑ Is the company well positioned to exploit those advantages for many years to come?
- ❑ Does the company have favorable long-term prospects?
- ❑ Will the company be around 25 years from now?
- ❑ Who are the main competitors (market leaders and challengers)?
- ❑ Do we understand competition and who is going to win?
- ❑ What are the drivers for long-term growth?
- ❑ Does the company have a consistent operating history?
- ❑ Does the company have strong cashflows and high return on capital?
- ❑ Does the company have a strong and solid balance sheet (don't forget pension obligations)?
- ❑ What is the catastrophy risk of the business?
- ❑ Do we like the management of the company?
- ❑ Does management have a track record of integrity and high performance?
- ❑ Does management care about sustainability & ethical leadership?
- ❑ Is management shareholder friendly?
- ❑ Is the management rational with its capital?
- ❑ Is there a risk of shenanigans? Howard Schilit's book.
- ❑ Is there a margin of safety and does the company trade at a price that makes sense?
- ❑ Where are we in what's called "the business cycle" and how is the temperature of the stock market?
- ❑ Do we really want to "own" this business?
- ❑ What is the value of the business and can it be purchased at a significant discount to its value?

It is fun to collect inanities (investing "mistakes") because there's never a shortage. The lessons learned from these inanities are a crucial part of a well designed check list. You need a different checklist and different mental models for different companies and industries.

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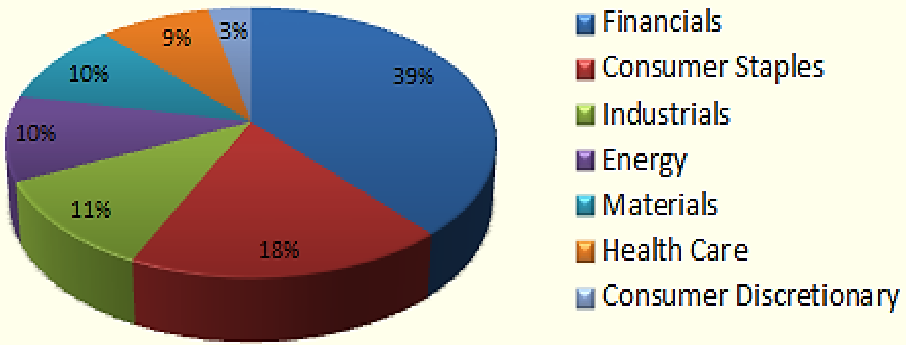
Our performance



Average annual return since 9 september 2011	
31 March '16	**28,4 %**

Remarks:

- These are auditable results, before taxes.
- These are not actual fund performance or investors returns, but returns based upon the companies own invested capital.
- Is it skill? Is it luck? Well, probably both. "*Luck is a dividend of sweat. The more you sweat, the luckier you get*." Ray Kroc.
- Next update: 30 June 2016.

Top Holdings *(31 December 2013)*	Weight (%)
Wells Fargo	8,5
Bank of New York Mellon	6,2
Berkshire Hathaway	6,1
Waste Management	5,7
Nestlé	5,0
% Assets in Top 5 Holdings	31,5

Since 31 December 2013 we made substantial changes to the portfolio. We prefer not to share them, because good investment ideas are rare, valuable and subject to competitive appropriation just as good product or business acquisition ideas are.

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Disclaimer. *The performance data quoted herein represents past performance and is not a guarantee of future results.*

It's not easy

- If you invested 10.000 USD in Amazon.Com in 1999 ten years later it would be worth 1 million USD. Ever heard of Balchem? Since the end of 1985 it has gained an average of 26,2% annually. That's called "good fortune".
- If you invested in Kodak, Polaroid or Xerox, once all great and successful companies, they either went bankrupt or needed to rise from the ashes. That's "bad luck". And what about Enron, Worldcom and Lehman Brothers!
- It can be very hard to really grasp the long term potential of a business. Ray Kroc, the founder of McDonalds, once asked a group of MBA students to tell him what business they thought he was in. The hamburger business of course, they told him. No, he replied. "My business is real estate."
- There is a tremendous amount of information on the markets, value investing, what do do and what not to do. But it is not easy to "translate" that information into a few solid investment decisions.

"You don't need the IQ in the investment business. What you have to be is aversive to standard stupidities. If you keep these out, you don't have to be too smart". Charles Munger.

Note from the author: You need both.

It can be very hard to really grasp the long term potential of a business.

The memos of Howard Marks are great reads. One of his memos is entitled "It's not easy". It elaborates on second level thinking. Google it and read it.

How to beat the market

Thomas J. O'Halloran, photographer

86% of the investment managers failed to beat the market in 2014. Professional investors have a long history of failing to beat the market after accounting for their fees. It's our estimate than less than 1% will outperform the index consistently with more than 3%. We believe the average investor (whether individual or institutional) is much better off by periodically investing in a low cost index fund.

We try to beat the market by doing three things different.

- We look for strong companies with an attractive balance between future earnings power and the price of the stock. Opportunities are often found where the flock doesn't fly.
- We use a dynamic hedging approach that aims to make it possible to use a sensible amount of leverage without too much risk.
- We believe a well-diversified portfolio of 25 to 30 stocks will yield the most cost-effective level of risk reduction.

Professional investors have a long history of failing to beat the market after accounting for their fees. By periodically investing in an index fund you can actually out-perform most investment professionals.

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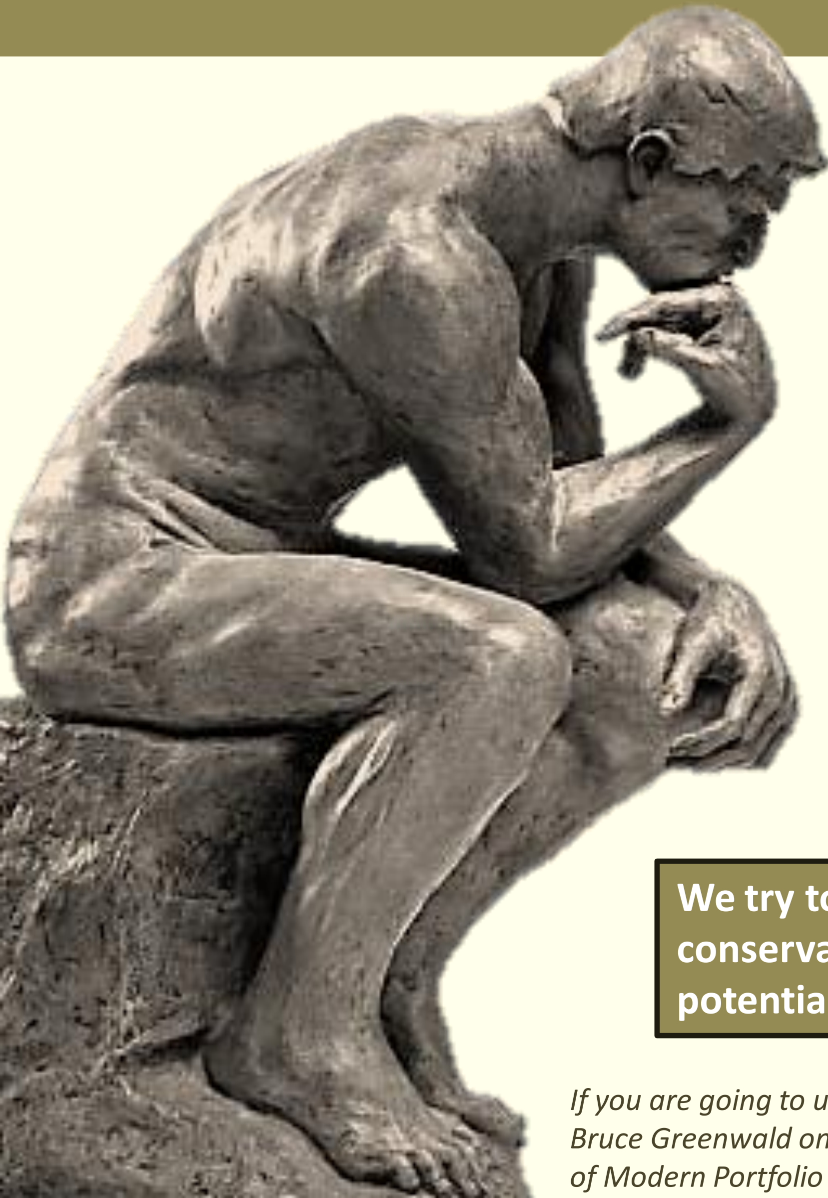
How to value a company



- We try to make a conservative estimate of the long-term business potential of the company. If the company is too difficult to understand, and most of them are, we skip the company and move on to the next.
- There is no formula or "simple method" that will be of any assistance. The two main ingredients we prefer to use are "owner earnings" (cashflow minus maintenance capex) and long term growth rate.
- And finally we try to put a reasonable price tag on the business potential of the company. And that's much more a matter of experience (industry specific ratios) than the result of complex discounted cashflow calculations.
- It is better to be approximately right on your valuation (interest rates do matter) than precisely wrong on the future of the company's cashflows.

We try to put a reasonable price tag on a conservative estimate of the future potential of the company.

If you are going to use "growth" in your valuations please watch Bruce Greenwald on YouTube: "Value Investing and the Mis-measures of Modern Portfolio Theory".

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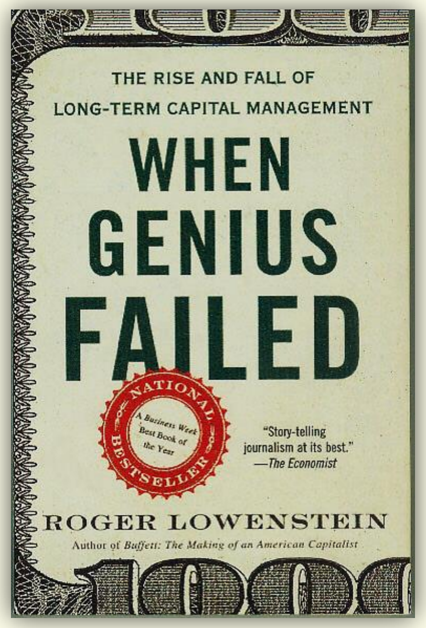
Leverage

- Warren Buffett once said that leverage is addictive. Once having profited from its wonders, very few people retreat to more conservative practices. We try to be one of them.
- We are aware of Buffett's comments about the implosion of Long-Term Capital Management: "Whenever a really bright person who has a lot of money goes broke, it's because of leverage. It's almost impossible to go broke without borrowed money being in the equation."
- We leverage up a little bit now and then and use three types of hedging. Individual stock hedging, portfolio hedging and currency hedging.



Initially successful with annualized return of over 21% (after fees) in its first year, 43% in the second year and 41% in the third year, in 1998 it lost $4.6 billion in less than four months following the 1997 Asian financial crisis and 1998 Russian financial crisis requiring financial intervention by the Federal Reserve, with the fund liquidating and dissolving in early 2000.

And of course we have the hardly noticed bankruptcy of this 600B USD AUM company of The Leverage Brothers. Or was it Lehman Brothers? Anyhow.

We leverage up a little bit now and then and use options to mitigate the risks. We do not promote using leverage. On the contrary.

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Remarks on Value Investing

The financial markets are inherently unstable

- More manias, panics and crashes will plague us and more financial crisis will occur.
- The financial markets will continue to overreact, which offers opportunity to the disciplined and patient investor.
- History showed sudden declines of 50 % and more. If you can not accept this brutal reality you better stay out.

A value investor buys when stocks are out-of-favor

- A stock is not just a ticker symbol. It is an ownership in an actual business. Investing is most intelligent when it is most businesslike.
- A shrewd value investor buys in a bear market, when everybody else is selling.
- Be very patient and "never underestimate the value of doing nothing" (Winnie the Pooh).

The historical stock market return is 6 to 8 %

- The value of an investment is a function of its present price. The higher the price you pay, the lower your return will be.
- If you buy stocks when the markets are overvalued you will most certainly underperform.
- Opportunities are usually found where the flock doesn't fly. If you want to pick stocks that outperform, it typically requires departing from the herd.

Read 500 pages every day. That's how knowledge works. It builds up like compound interest.

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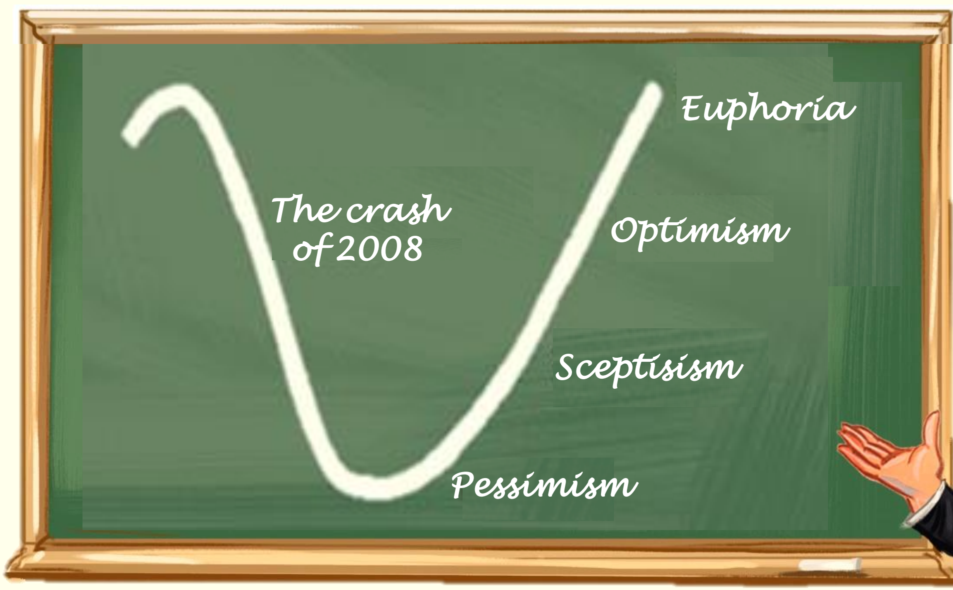
30 pages a day would count up to 10.000 pages a year. That's a good start.

The business cycle



Sir John Templeton

The cycle of manias and panics results from the pro-cyclical changes in the supply of credit.

Bull-markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria.

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Crisis? What crisis? 1622, 1637, 1720, 1772, 1791, 1796, 1819, 1825, 1837, 1847, 1857, 1866, 1873, 1882, 1893, 1901, 1907, 1929, 1962, 1970, 1987, 1991, 1997, 2000, 2008...

Lessons learned

- ✓ Nobody can tell you when a panic will occur. But it surely helps to have an idea where we are in what's called "the business cycle".
- ✓ Everybody, and that includes Warren Buffett, Seth Klarman and Leon Cooperman, will make mistakes now and then.
- ✓ Most people have a herd mentality. What will set you apart is the ability to valuate a business unaffected what other people think. Always do your own research!
- ✓ If smart people learn from their own mistakes while wise people learn from the mistakes of others, the goal is to be both smart and wise. – Lawrence Cunningham.
- ✓ The single-most important decision in evaluating a business is pricing power.
- ✓ Better spend one night with a company's financial statements than two days with it's management.
- ✓ It's tempting to use leverage, but it is a very risky proposition. You have to have downside protection to prevent yourself from bankruptcy when adversity takes over.
- ✓ And that means not only hedging against stock market volatility, but also against currency fluctuations. You're safer & better off without leverage.
- ✓ For smaller portfolio's a NCAV/NNWC strategy might be much more profitable, but we prefer a portfolio of strong & predictable companies anyhow.
- ✓ We do not trade commodities (like gold, sugar or beans), don't buy stocks of turnarounds and we also do not short individual stocks.
- ✓ We carefully try to avoid the Capital Asset Pricing Model (CAPM), Beta and EBITDA-multiples.
- ✓ We don't use complex discounted cashflow analysis either. DCF is like the hubble telescope. Move it an inch and you will end up studying a different galaxy.
- ✓ It makes sense to study EVA®, MVA, SVA & CVA. Return on capital is an important measure of business performance. But when it comes to weighted average cost of capital. We don't do that.
- ✓ By far the best strategy, we think, is to buy a well diversified portfolio of strong and predictable companies at a price that makes sense and hold on to these stocks as long as the company remains a good company.
- ✓ It takes many, many years to learn that there is still a lot to learn. If you think you understand Buffett & Munger, think again.

A thorough understanding of accountancy, the language of the business, surely helps. There are some great lectures on the web, e.g. by Aswath Damodaran.

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Contact us

- We look for companies with the power to outperform for many years (decades). And if such a company trades at an attractive price we buy.
- A good understanding of the long term economic conditions of an industry and it's competitive dynamics surely helps.
- We use a dynamic hedging approach that aims to make it possible to use a sensible amount of leverage without too much risk.

Thank you. And do not hesitate to contact me.
Email: peter@thevaluefirm.com.

How to value a dot.com company?
Take their loss for the year. Multiply the result by negative 1 to make it positive. Multiply that number by at least 100. If the stock price is less than the result BUY! If not, buy anyway.

The Value Firm B.V.
Mr. Peter Coenen
Pastelstraat 127
1339 JH Almere
The Netherlands
T: +31 6 230 44 767
E: info@thevaluefirm.com

If you don't believe in Value Investing, what do you believe in? - WB -

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