Value Investor INSIGHT
The Leading Authority on Value Investing
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Choose Wisely, and Wait

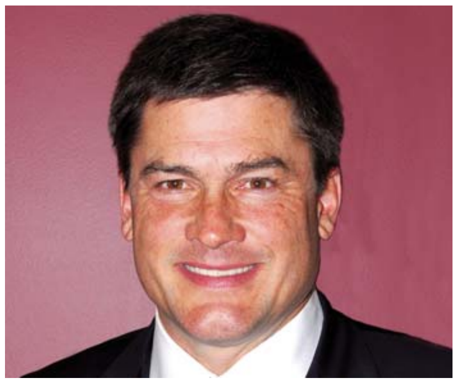
Warren Buffett counseled Tom Russo's M.B.A. class in 1984 to invest in what you know and stand by your convictions. Russo has learned those lessons well.

Track Tom Russo's daily activities and you'll see a whirl of activity – visiting management, speaking with investors, attending conferences. Track his portfolio trading and the activity level falls off a cliff. "We tend to let management do a lot of our work for us," he says.

Russo's hands-off approach has paid off handsomely for investors. A partner at Lancaster, Pennsylvania's Gardner Russo & Gardner, he manages some $4 billion and the flagship Semper Vic Partners fund he started in 1984 has earned a net annualized 14.6%, vs. 9.9% for the S&P 500.

Focused on companies with global brands and extensive reinvestment opportunities, he sees upside today in such areas as wine and spirits, beer, consumer packaged goods and banking. See page 2

INVESTOR INSIGHT



Thomas Russo
Gardner Russo & Gardner

Investment Focus: Seeks companies with global brands and a high capacity for reinvestment, run by management with a well-developed "capacity to suffer."

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Investor Insight: Thomas Russo

Thomas Russo of Gardner Russo & Gardner describes why he has no qualms about investing in multiple companies in the same industry, what management trait he values above all others, how his "never sell anything ever" profile has evolved, and why he sees unrecognized value in Pernod Ricard, Anheuser-Busch InBev, Unilever and Wells Fargo.

You've defined for yourself a rather narrow circle of competence. Describe the ideal business you typically pursue today.

Thomas Russo: My ideal business typically owns strong brands which address the needs and wants of developing-market consumers who are growing rapidly in number and in purchasing power. Those brands create the impression in consumers that there is not an adequate substitute, which makes them aspirational and affords their owners valuable pricing power.

I'm a value investor, which says I want to buy 50-cent dollars, but given my firm's predilection for serving the needs of taxable investors, I also want that dollar to tax-efficiently compound in value over long periods of time. That means the businesses must have great capacity to reinvest, which is not all that common. I own Nestle [NESN:VX] rather than Kraft, for example, because Nestle historically planted seeds for its brands in hundreds of countries that now can absorb immense amounts of capital spending to build infrastructure and to invest in marketing to activate those brands. Kraft, with its much more U.S.-centric past, does not have the same capacity for reinvestment. I want our money to work for us – in essence, I am passing through to our portfolio-company management much of my obligation to reinvest.

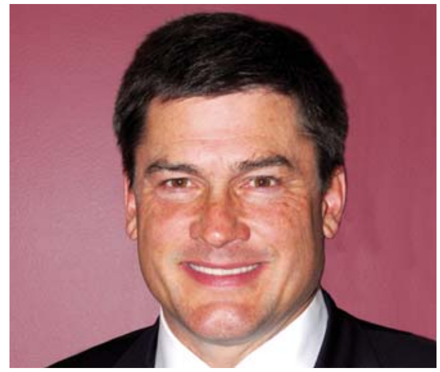
In addition to the capacity to invest behind growth, it's equally vital that corporate leadership has the will to do so even when such investments burden current reported profits. Jean-Marie Eveillard used to talk about the importance for investors to have the "capacity to suffer," and I'd argue that same capacity to accept short-term pain for long-term gain is critical in management. The market often doesn't like any burden on reported profits, so adequate levels of investment often invite scorn and ridicule that leaders have to be able and willing to endure.

Do you find that willingness in short supply today?

TR: It has never been particularly abundant. I often find it in family-controlled companies, where management is far more likely to think generationally rather than focus on how to deliver results within some finite period to maximize the value of their stock options. It doesn't require family ownership to find managers who care about their company's future beyond them, but it is even more rare without it.

I think about the efforts of spirits company Pernod Ricard [RI:FP] in China. In the early 2000s competitors were pulling back in the country because the economy was going through a rough patch and the markets for premium imported whiskey and cognac were painfully slow to develop. Patrick Ricard saw it as an opportunity to invest in developing both the marketing profile and distribution of the company's Chivas Regal and Martell brands, a path that proved very unprofitable in the early years. Today China is Pernod's third-largest market, accounting for some 15% of profits and growing 18-20% per year. There was nothing pre-ordained about this success – the company made investments necessary to build a category that tapped into an increasing sensibility among Chinese with rising disposable incomes to show standing and status through the brands they consumed. If Pernod had not been there early, and endured the pain of being early, they would not have the position they have today.

On a different note, during the depths of the 2008 crisis, one of the most extraordinary conference calls I heard



Thomas Russo

Who Says?

As an undergraduate history major at Dartmouth in the 1970s Tom Russo remembers being particularly interested in historiography, which he describes as the study of how historians interpret history. "It's the study of 'Who says?' – how different people interpret actual events based on their knowledge, preferences and biases," he says. "Sensitivity to that has been very valuable to me as an investor."

Russo's own history sheds considerable light on the development of his investing strategy. His grandfather's travails investing in energy stocks helped form an ongoing aversion to commodity-related bets. His first job as a bond analyst as interest rates rose in the mid-1970s made him highly wary of inflation's corrosive effects. A Warren Buffett talk to his Stanford business-school Investments class in 1984 drove home the importance of focusing on what you know and stretching your investing horizon to allow for companies to compound value. Those lessons were reinforced after graduate school during four years as an analyst at the Sequoia Fund, where deep-dive primary research was all that mattered. Says Russo today: "You don't have to rediscover lessons that have been well made by others before you."

was that of Johann Rupert, the longtime chairman and large shareholder of another of my holdings, Swiss luxury-goods company Richemont [CFR:VX]. He started talking directly to company operating managers who were on the call, reassuring them that the reason the company held billions of euros in cash was to allow it to survive difficult periods and continue to build its brand franchises through them. He went on to describe where the company was planning to invest heavily, such as China and Russia, as well as where it would stop investing, primarily Japan. The tenor of the conversation was much different than what you typically heard at the time. I found it all to be a dramatic statement of how to prudently shepard assets.

When we last spoke [*VII*, June 30, 2006], you were almost exclusively focused on four businesses: food, beverages, tobacco and ad-supported media. Has that changed?

TR: Until I get more thoughtful about companies such as Google or Apple – the replacements for the media businesses that once had such a lock on consumer communications – you can lop off that last leg.

One of the lessons I took from Warren Buffett years ago was to define the areas you're comfortable with and stick to them. Branded consumer businesses are those for which I have a natural affinity and that I think I understand. While I would have a hard time on the weekend observing what DRAM chip is in the cell phone of the person walking next to me, I pay a lot of attention to – and think I learn a lot from – what people are wearing, or eating, or smoking or drinking. Of course these are also all businesses that lend themselves to the types of global growth opportunities I most value.

The share of your portfolio in U.S. companies continues to decline. Why?

TR: We probably held 35-40% in non-U.S. stocks five years ago and that number today – counting Philip Morris International [PM] as non-U.S. because all of its operations are overseas – is closer to 70%. One practical reason is that my foreign investments have worked better than those in the U.S., but I have also actively swapped out of U.S. companies that didn't have adequate global reinvestment opportunities and into European holdings that did. Most of that is a result of company-by-company assessment, but I will admit to casting an eye toward history and wondering if today's U.S.-centric investor isn't like the similarly positioned British investor in the early 1900s who would have left a lot of money unearned as a result of his nation losing economic relevance due to progress elsewhere while he or she stayed invested only domestically.

ON EUROPE:

It has been masked by broader economic woes, but Europe is becoming a more amenable place to do business.

Isn't that sentiment a bit inconsistent with your finding opportunity in old-world Europe instead?

TR: The opportunity is less about Europe and more about European companies, that as a result of historical accident or conscious effort have established profound footholds in the fastest-growing parts of the world for their celebrated and long-nurtured brands. Unilever [UN], for example, has been imbedded in India through its Hindustan Lever subsidiary since long before India's economy became more open and hundreds of millions of people started to enjoy incomes above a subsistence level. The aspirational appeal of so many European brands – think Cartier watches, Chivas Regal scotch, even Heineken beer – has been cemented in consumers' minds and is a powerful driver of demand as rising incomes in many parts of the world take those brands from unattainable to affordable.

As a value investor, companies in Europe hold even greater appeal today. We have never really had to wrestle with excessive valuations there because it has always been deemed a slow-moving region, but investors are now actively frightened away. In addition, I think another unrecognized result of the economic crisis has been that European companies are increasingly able to operate their businesses as dictated by competition rather than regulatory fiat. Just one example: Nestle struggled for years after buying Perrier because the French government wouldn't let it rationalize local production, which was orders of magnitude less efficient than in Nestle's comparable San Pellegrino operation. That changed two years ago and Nestle has done what it needed to do to make Perrier more competitive, while freeing up capital to invest in growth. As a result, the Perrier business has grown 30% over the past two years. In general, while it has been masked by broader economic woes, Europe is becoming a more amenable place to do business.

You mentioned swapping out of certain U.S. companies. Describe your thought process behind an example or two.

TR: I did a substantial amount of selling in 2008 and redeployed capital into stocks I already owned, such as Pernod Ricard, Richemont and SABMiller [SAB:LN], that were down 50-60% because the global economy was so stressed and companies connected to emerging markets were particularly hard hit. Shares in Dr Pepper Snapple, a domestic soft drink company with little historical ability to grow outside our shores, were sold. Kraft Foods, domestic focus, sold. International Speedway, the parent company of NASCAR which had run out of rope in expanding in the U.S. but was still attempting to do so, sold. H&R Block was cheap and trying to work through serious diversification errors, but its lack of reinvestment opportunities kept it from making the cut.

What about newspaper company McClatchy, one of your last, painful media holdouts?

TR: With every company I own there is always the question of sustainability, that a transformation in its industry will leave it behind. Five years from now you may ask me the same question about the tobacco companies I own and why I continued to hold them in the face of changing user preferences, regulatory hurdles and litigation risks. You may ask me the same question about Nestle and why I didn't see the extent of its vulnerability to competition from private-label brands. McClatchy was losing to the disruptive forces of technology in its industry and my mistake was in believing its franchise would hold up better and longer than it did. It's that simple.

This process in 2008 was really quite profound for me as an investor. It increased my resolve to hold only companies I deeply believe in because you never quite know when forces outside of your control set off a tidal wave across markets that shakes everything to its foundation. During a crisis, the less conviction you have about something, the more likely you are to handle it poorly and the more likely the company in question is vulnerable. After 2008, I am more concentrated even than usual, with nearly 75% of the portfolio in my top ten holdings.

Having sold as much as I did also put forever to rest my longstanding profile of never selling anything ever. I am over that. One outcome of this exercise has been to more pointedly question the enduring nature of the status quo and to not hesitate in reducing portfolio holdings when the uncertainty is too high.

You mentioned tobacco stocks, of which you own Philip Morris, Altria [MO] and British American Tobacco [BTI]. What's behind your conviction about their future?

TR: The world knows all of the vices of tobacco and the risks inherent in investing in tobacco stocks, all of which is incorporated in their share prices. But we also know the business has a high degree of brand loyalty, is still growing in the developing world, is enormously cash-generative and is increasingly controlled by fewer large competitors who are likely to be sensible about the significant pricing power their brands command.

So using Altria as an example, they pay out 80% of cash flow in dividends [providing a 6% yield at current prices] and still have plenty to invest in maintaining their brands' strength and in making selective acquisitions. They bought UST, the leading smokeless tobacco company, which also owned a domestic wine business. They also acquired the John Middleton cigar company. Also important to me is that as a result of the sale of Miller Brewing many years ago, the company now owns $15 billion worth of SABMiller shares, a global beer company we find attractive and hold on its own.

ON SELLING:

After 2008 . . . I put forever to rest my longstanding profile of never selling anything ever. I am over that.

How many new ideas do you add to your portfolio in any given year?

TR: We've added two new portfolio companies over the past year, Anheuser-Busch InBev [BUD] and MasterCard [MA]. We wait for breaks in prices in companies we would like to own, and both of these came under pressure for U.S.-specific reasons at a time when their appeal to me is almost entirely due to their businesses outside the U.S.

MasterCard had intrigued me since it came public in 2006, but it quickly became a darling of the investment world and I missed the opportunity. It came back to earth last year when increasing fears that post-crisis regulation in the U.S. would limit debit-card fees and profitability sent the shares below $200. At the time it looked like the company would earn in 2012 something like $24 per share, so we were able to pay 8x that earnings number for a company that had really seen no change in its long-term opportunity set and whose new CEO, Ajay Banga, was to my mind one of the most impressive international finance executives in the world.

While it's not a food, beverage or tobacco company, MasterCard fits all my criteria: a heavily branded consumer product that has extraordinary potential globally due to the substitution of commerce for subsistence, and the migration within commerce toward payment systems other than cash. This is also a case where I believe the business is enhanced rather than threatened by technology, resulting in innovative ways to pay by credit that will hasten the shift away from paying by cash. [*Note*: MA shares recently closed at $359.]

I will talk later about A-B Inbev, but there the break in the share price had more to do with a quarterly shortfall in domestic shipments of core U.S. brands like Budweiser. In addition to being overdone, the market's reaction was doubly ill-considered because the shortfall in large part was due to a strategic decision to raise prices on lower-end products, to lessen people's incentive to trade down in price. Steps to improve long-term brand equity over time caused short-term problems – just the type of capacity to suffer I like to see.

How do you think about valuation?

TR: I wouldn't say I'm overly precise when it comes to valuation. Most of the companies we're speaking about today trade at around 13x earnings and I am comfortable holding the right companies with P/E multiples up to the mid-teens. Nestle, for example, trades at maybe 15x estimated earnings, but less than that if you back out the burden of $2.5 billion in investment spending on emerging markets this year, up from $1 billion last year. Those transformative types of investments impact earnings because you're developing capacity that does not yet have full scale advantages. But the company will likely earn at least 20% on that committed capital, adding on the order of $500 million in annual operating income five years out. Overall, I believe it can grow earnings at least 7-10% annually over the next five to ten years, which with dividends should result in a double-digit annual return on my shareholding, which is my general aspiration for the portfolio.

You mentioned selling in 2008, but what have you sold more recently and why?

TR: In 2010 we started the year with Richemont at about 7.5% of the portfolio. The stock went up 75% and it ended the year at about 7.5% of the portfolio because we sold shares as it became less undervalued and the weighting became higher than I considered appropriate. That is just part of the ongoing process to adjust position sizes based on price movements, but I'm always mindful of Warren Buffett's caveat not to cut flowers and water weeds. Some of the proceeds from selling Richemont went to buy more Wells Fargo [WFC], to rebuild a position size after the stock had fallen in price. There is always the risk in such cases that Wells could be a value trap, while Richemont's great leap forward only presaged a great next few years' of earnings growth. I am mindful of that, but I would not have been comfortable with Richemont at 13% of the portfolio.

You appear to have materially cut your Comcast [CMCSA] stake recently. Why?

TR: My concern is over the impact of technology on its core business. The company says that if everyone starts using Apple TV or Google TV, what they have to pay extra as a result to Comcast for Internet access and using so much more bandwidth will compensate for whatever they no longer pay on the cable side. That may turn out to be true, but the outcome is very uncertain. The government may limit price increases. Consumers may balk at increases coming from monopoly providers. I am not comfortable that cable providers have done enough in managing their governmental and consumer relationships for the best outcomes to occur.

Describe your more detailed investment case for Pernod Ricard.

TR: Pernod over the past 20 years has taken its business from the sale of pastis, a declining liquor sold primarily in France, to marshaling a broad portfolio of iconic global spirits brands such as Chivas Regal scotch, Martell cognac, Beefeater gin and Absolut vodka. The business model has been to add brands through acquisition and integrate them into direct local distribution systems that have been built carefully over many years at great expense. As more brands are directed through that dedicated distribution, revenue synergies are realized, cost efficiency goes up and the system itself provides even greater competitive advantage.

The financial model has been to leverage up to make the acquisitions, run the businesses better and then extract cash from them to pay down debt rather quickly. That got derailed a bit by the poorly timed purchase that brought them Absolut in 2008, which ended up requiring some asset sales and a rights offering to restore the balance sheet. To the company's credit, financing issues didn't keep it from investing in the Absolut brand, an 11-million-case-per-year brand when they bought it that they believe can sell 20 million cases annually. That will come from selling it more forcefully in 25 markets where Absolut was already the leading premium vodka, but where the category

INVESTMENT SNAPSHOT

Pernod Ricard
(Paris: RI:FP)

Business: Global marketer of spirits, wine and champagne, under brand names including Absolut, Chivas Regal, Jameson, Beefeater, Martell and Perrier-Jouet.

Share Information
(@11/28/11, Exchange Rate: $1 = €0.751):

Price	**€ 67.97**
52-Week Range	€ 56.09 – € 72.78
Dividend Yield	2.1%
Market Cap	€ 18.00 billion

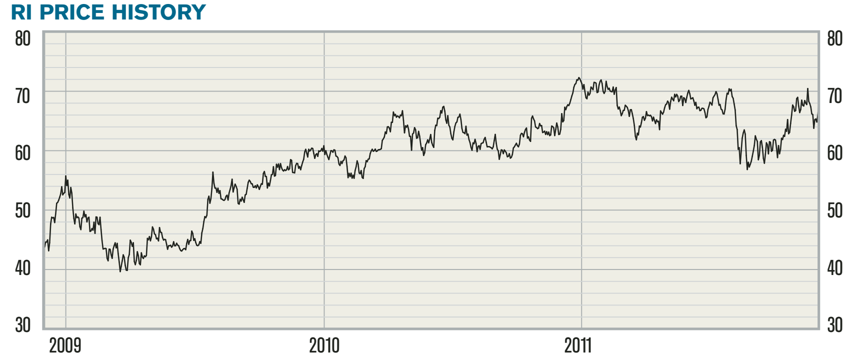
Financials (FY2011):

Revenue	€ 7.64 billion
Operating Margin	25.0%
Net Profit Margin	13.7%

Valuation Metrics
(Current Price vs. TTM):

	RI	S&P 500
P/E	17.1	13.4

RI PRICE HISTORY



THE BOTTOM LINE

Having long invested in local distribution, the company is well positioned to capitalize on developing-market consumers' increased appetite for its status-confirming brands, says Tom Russo. With further multiple compression unlikely, he believes share returns should at least match his expectation for low-double-digit annual net income growth.

Sources: Company reports, other publicly available information

was not fully developed because the agents representing the brand did not own it. That shows the power of the dedicated global system Pernod has.

Is Pernod's success in China typical of the upside you see for the company in emerging markets?

TR: The scale obviously differs by country, but another example would be India. Over the past decade Pernod has sown the seeds of success by establishing a profitable niche for premium scotch whiskey in the country, which commands a tiny share of the market today. As that share grows along with disposable incomes, the growth potential for the company is dramatic. To give you a sense of the scale, current worldwide annual demand for premium scotch whiskey is 70 million cases. The overall market for "scotch whiskey" made in India – most of it today from low-quality brands – is 125 million cases per year.

Another engine fueling this type of business is that wealthy Chinese and Indians and Brazilians are increasingly traveling the world, developing a taste for the stature-confirming brands they find there. One company we are close to owns the billboard concession in the Shanghai airport. They contracted for the business when it had 23 million passengers three years ago, but this year it will handle 70 million passengers, the vast majority of which are Chinese traveling the world and potentially developing Western preferences. That's a powerful force behind the Pernod Ricard story.

How much of a problem will exposure to Europe and North America be?

TR: Developing and emerging markets account for maybe 40% of the business, with Western Europe roughly one-third and North America around 25%. I don't spend a lot of time trying to handicap how the debt crisis plays out and its near-term effect on the economy, but I do believe Europeans and Americans will continue to indulge in small luxuries with relatively small price points like those Pernod sells. The risk is if retailers panic as they did in 2008 and pull sharply back on inventories. Barring that, any developed-market sluggishness should be more than offset by emerging-market growth.

With the shares trading at a recent €68, how are you looking at valuation?

TR: The stock trades at about 14x next year's estimated earnings, for a company I believe can grow net income at low double-digit rates for several years. Given the overhang from concerns about Europe, I would argue that any further multiple compression is unlikely and believe the multiple should actually expand if growth comes in as I expect and as potential in places like India is better recognized. Even if the share price just rises with earnings growth, we expect to be perfectly happy.

ON THE DOLLAR:

Over time the dollar has been declining in value – I am happy to maintain our natural exposure to other currencies.

Do you hedge currency exposure here?

TR: No, which is true as a general rule. I looked back at the impact currency has had on my returns since 1991 and found it has added an incremental 0.5% per annum. It has followed a volatile path, but over time the dollar has been declining in value, a dynamic I would expect to continue given seismic movements in global economic power. Given that, I am happy to maintain our natural exposure to currencies other than the dollar.

Moving along the adult-beverage spectrum, describe the upside you see in Anheuser-Busch InBev.

TR: I have been a long-time investor in the global beer market for many of the same reasons I like the spirits business. Brands when properly handled convey stature and standing, making them aspirational. This creates vast opportunity when aspirational consumers are increasingly able to afford the product.

But I had never been a big fan of either Anheuser-Busch or the company that bought it in 2008, InBev. With A-B, I wasn't convinced management was sufficiently focused on building long-term brand and shareholder value. With InBev, my concern was that its famous penchant for cost cutting risked hollowing out the institution and its brands over time.

I took a closer look as the integration of the two businesses got underway. This is a scale business, in which high market shares translate into marketing advantages, distribution advantages and operating-cost savings. The merged company was ideally suited to capitalize on its scale, as it now controlled 20%-plus of a global market that has become far more consolidated.

I have since gained an appreciation for management as much more than mere cost cutters. I saw it first in the way it creatively re-positioned Stella Artois from a bargain-basement brand to one celebrating more of a high-end, fashion-setting image and competing head on worldwide with other European brands such as Heineken and Peroni. I heard it in how they talked about Anheuser-Busch's legacy marketing focusing too much on the clever and cute and not enough on actually building long-term brand loyalty. Their execution of large-scale and high-cost marketing partnerships with soccer's World Cup and the National Football League has illustrated both global marketing brawn and local marketing sophistication.

Which is not to say they don't know how to run a tight ship. For example, in North America since the acquisition management has taken out costs across the board, been more strategic with advertising and marketing spending, and raised prices on low-end brands. Operating margins for the North American Anheuser-Busch business have gone from the mid-20s to now pushing 40%.

What are they doing to revitalize the faded Budweiser brand?

TR: As much as we may have enjoyed the "What's up?" commercials or those with chirping frogs, the reality was that those types of campaigns had much more talk value than Budweiser brand value. That led over time to the hollowing out of the brand and a big decline in market share, a void that luckily for the company was more than filled by the rise of Bud Light.

Management does not believe Budweiser should be allowed to languish further, so has relaunched the brand to early success in the U.S. by celebrating its American heritage and the notion that it is a beer that rewards hard work. They've also done something I would not have thought possible, which is turn Budweiser into a premium growth brand outside the U.S. By playing up its iconic association with American values, Bud is expanding rapidly in places like China, Brazil and Russia, where the premium ends of the market are small but growing rapidly.

In China, for example, Budweiser already has 35% of the premium import market, which accounts for maybe 4% of the 550 million barrels of beer sold each year. Management believes over the next decade the overall Chinese market will hit one billion barrels per year and that the premium piece will go to 15%, comparable to most developed markets. Back-of-the-envelope math would indicate that if Bud can maintain its share of premium beer sales in China, its operating profit in the market could go over the decade from around $200 million to $3 billion. That is just one brand in one admittedly giant market, but shows the kind of global opportunity the company has.

How cheap are the shares, now at $58.20?

TR: The valuation today is quite modest at just over 13x 2012 consensus earnings estimates. The market seems to be concerned in the near term about rising input costs and doesn't yet grasp the potential in developing markets. We believe there is a clear path through reinvestment and continued cost synergies from the A-B acquisition for the company's bottom line to grow at a low- to mid-teens annual rate for some time – with the stock price at least following suit. The market seems leery of management's ability to execute, a concern I find completely unfounded.

What's behind your interest in consumer-products giant Unilever [UN]?

TR: The basic premise here is that the company has the highest relative exposure to fast-growing developing markets, while at the same time has been the least well-run of the large global consumer-goods companies. As it hits its full stride, the upside potential is quite high.

Unilever's heritage has been a mixed blessing. It was early in building out its global footprint, so that a relatively high 55% of revenues today come from developing and emerging markets. It has long-established and thriving businesses in places like India and Brazil, giving it a leg up in the parts of the world that should grow the fastest.

On the other hand, an overly complex and duplicative organizational structure left it with excessive fixed costs, a lack of decentralized accountability for results, inconsistent brand-building efforts, inadequate information systems and a muted

INVESTMENT SNAPSHOT

Anheuser-Busch InBev
(NYSE: BUD)

Business: Largest global brewer with 14 of its brands – including Stella Artois, Beck's, Budweiser and Michelob – generating annual sales in excess of $1 billion.

Share Information
(@11/28/11):

Price	**58.22**
52-Week Range	49.05 – 64.53
Dividend Yield	1.7%
Market Cap	$92.82 billion

Financials (TTM):

Revenue	$38.64 billion
Operating Profit Margin	30.9%
Net Profit Margin	12.9%

Valuation Metrics
(@11/28/11):

	BUD	S&P 500
Trailing P/E	18.9	13.4
Forward P/E Est.	13.7	11.7

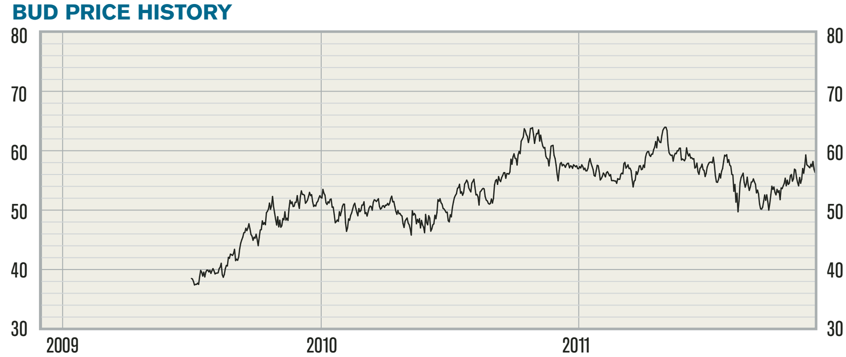
Largest Institutional Owners
(@9/30/11):

Company	% Owned
Clearbridge Adv	0.3%
KeyBank	0.3%
Gardner Russo & Gardner	0.2%
Wellington Mgmt	0.2%
Brown Brothers Harriman	0.2%

Short Interest (as of 10/31/11):

Shares Short/Float	n/a

BUD PRICE HISTORY



THE BOTTOM LINE

With unmatched global scale in a scale business and management that appears as adept at brand building as it is at cost cutting, Tom Russo believes the company's earnings can growth at a low- to mid-teens annual rate for some time – with the stock price, now trading at a "modest" 13x forward earnings, at least following suit.

Sources: Company reports, other publicly available information

sense of urgency. Up against companies like Procter & Gamble, Nestle, Colgate-Palmolive and Reckitt Benckiser, that put them at a competitive disadvantage that has been a challenge to overcome.

Much of our bet is that Paul Polman, who took over as CEO in 2009 from Nestle, will successfully complete the cultural transformation started under previous CEO Patrick Cescau. It's a monumental task, but he is rooting out organizational inefficiency and inefficient manufacturing utilization. He is investing in management information systems like those he championed at Nestle, which promote localized decision-making supported by company-wide best practices and information. He is more consistently nourishing brands with the proper amount of advertising and marketing support. All told, he still has 200 to 300 operating-margin basis points to go to get to the minimum mid-teens level a business like this should have.

One concern I have is that the company may have moved too quickly on the acquisition front, buying the personal-care business of Sara Lee in 2009 and then Alberto Culver about a year ago. Those businesses have been slow to integrate, complicating the broader transformation and slowing it down.

INVESTMENT SNAPSHOT

Unilever
(NYSE: UN)

Business: Manufactures, markets and sells consumer packaged goods in more than 180 countries; brands include Knorr, Lipton, Dove, Vaseline, Axe and Brylcreem.

Share Information
(@11/28/11):

Price	**32.40**
52-Week Range	28.20 – 35.17
Dividend Yield	3.3%
Market Cap	$92.21 billion

Financials (TTM):

Revenue	$59.74 billion
Operating Profit Margin	13.3%
Net Profit Margin	9.8%

Valuation Metrics
(@11/28/11):

	UN	S&P 500
Trailing P/E	16.0	13.4
Forward P/E Est.	14.0	11.7

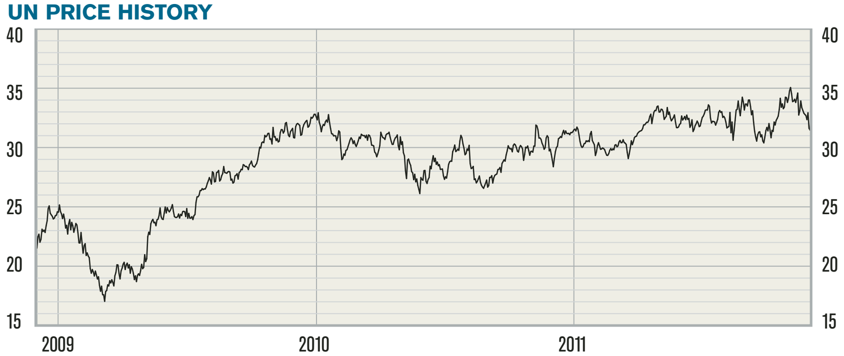
Largest Institutional Owners
(@9/30/11):

Company	% Owned
Wellington Mgmt	1.5%
Invesco	1.1%
Fisher Inv	0.9%
Capital World Inv	0.8%
BlackRock	0.6%

Short Interest (as of 10/31/11):

Shares Short/Float	n/a

UN PRICE HISTORY



THE BOTTOM LINE

The company's operational and cultural transformation under CEO Paul Polman is a "monumental task," says Tom Russo, but he believes the resulting margin gains coupled with strong developing-market growth will fuel 10%-plus bottom line growth. Multiple expansion on top of that, he says, would make "the payoff well worth the wait."

Sources: Company reports, other publicly available information

What upside do you see in the U.S. ADR, now at $32.40?

TR: At a 14x forward multiple, the shares trade at a discount to peers. The company owns publicly traded subsidiaries in India and Indonesia, which trade at much higher multiples and if backed out make the rest of the business that much cheaper. I could do clever things like short out the subsidiary exposures to isolate the core business, but I'm content to win from them delivering on relatively modest expectations from an unchallenging valuation.

You have 55% of the business in markets that are typically growing at an annual rate of 10-15%. With operating leverage and the margin improvements coming through, that should sustain bottom-line growth in excess of 10% per year. If that happens and we get some multiple expansion on top of that, we'll do well.

This is still a show-me idea. But the model of P&G under A.J Lafley and Reckitt Benckiser under Bart Becht – when those firms delivered enormous shareholder value during similar periods of transformation – leads me to believe the payoff here could be well worth the wait.

Your position in Wells Fargo would appear to be a strategic departure. Is it?

TR: Wells is a company whose shares I have owned for almost 20 years. While not a perfect match with the rest of my portfolio, it has a long and successful history in nurturing and taking advantage of its first-class consumer brand. It has evidenced significant capacity to reinvest, and management has shown the willingness time and again to focus on building long-term value at the expense of short-term criticism.

I consider the stock today a 50-cent dollar, in large part because of the market's profound concern about the banking sector in general. Just a few weeks ago the stock fell 5-6% after an analyst report highlighted how American banks were exposed to trouble in Europe. The reality is that Wells is not that exposed to

Europe's problems, but its stock goes along for the bumpy ride with the rest of the industry.

What sets Wells apart in your mind?

TR: It starts with a clear focus on retail banking and a culture oriented toward driving customer involvement with a broad range of products. They recognize that just by staying close to home they can leverage the returns that accrue from increasing the number of products and services – from checking, to credit cards, to wealth management – sold per household. That's how employees in the branch are incented. This focus has kept Wells from having to rely on wholesale money, derivatives and sophisticated financial instruments to generate profits. They do things the old-fashioned way, lending money and offering financial services.

The ongoing opportunity – and challenge – for Wells today is to successfully transmit its culture to the Wachovia business it purchased at the height of the financial crisis. Wachovia had essentially the same footprint as Wells in terms of branches and total assets, but it sold far fewer products per customer, relied much less on core retail deposits, was more involved in reckless mortgage lending and had gone further afield in investment and corporate banking. That cost it its independence and allowed Wells to buy it – in a splendid capacity-to-reinvest moment – at roughly 10% of what Wells was worth at the time.

The process of making acquired Wachovia more Wells-like has burdened the income statement since the merger, as have crisis-related expenses that will not last forever. Duplicate integration expenses have run at well over $1 billion per year since the acquisition. There are also significant costs attached to managing through troubled real estate loan portfolios and in dealing with unprecedented refinancing activity. As these costs continue to go away and the Wachovia business starts to operate according to new metrics more consistent with those of Wells, you should see a dramatic increase in the company's earnings power.

On top of that is the earnings benefit that will come from the eventual return of a more normal yield curve. I cannot tell you when the world becomes safe enough for capital that we will once again have a yield curve that makes sense, but I am quite confident it will happen, and it will relieve some of the massive pressure on net interest margin that comes from investing non-loaned money at rates painfully close to what's being paid for core deposits.

What does "normal" look like here and how do you see it impacting the share price, now at $24.15?

TR: I have a high degree of comfort that profits should approach $4-plus per share by 2014. If that happens, I don't know what the multiple will be, but it will likely be significantly higher than today's 6x that normal earnings level. In the meantime I am comforted by a balance sheet that isn't pledged with instruments I can't understand and by a retail franchise that is secure and offers enormous value to consumers who use it.

What could go wrong?

TR: The world remains troubled from a capital standpoint, so it's likely that Wells

INVESTMENT SNAPSHOT

Wells Fargo
(NYSE: WFC)

Business: With $1.3 trillion in total assets, provides banking, insurance, investments and mortgage products and services through 9,000 offices primarily in the U.S.

Share Information
(@11/28/11):

Price	**24.15**
52-Week Range	22.58 – 34.25
Dividend Yield	2.0%
Market Cap	$127.36 billion

Financials (TTM):

Revenue	$72.87 billion
Operating Profit Margin	35.6%
Net Profit Margin	20.8%

Valuation Metrics
(@11/28/11):

	WFC	S&P 500
Trailing P/E	8.9	13.4
Forward P/E Est.	7.4	11.7

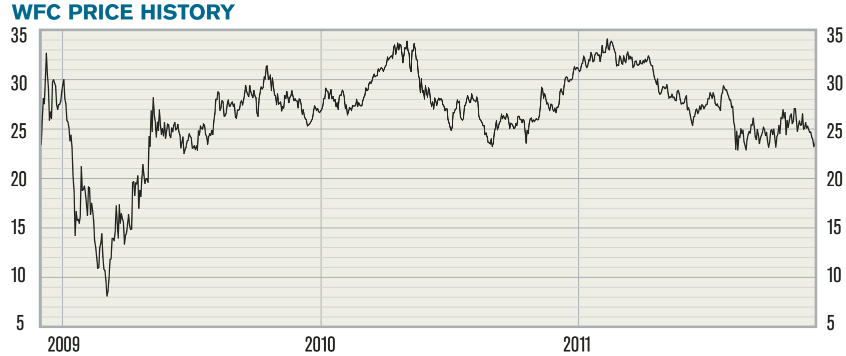
Largest Institutional Owners
(@9/30/11):

Company	% Owned
Berkshire Hathaway	6.8%
Fidelity Mgmt & Research	3.8%
Vanguard Group	3.7%
State Street	3.6%
Capital World Inv	2.9%

Short Interest (as of 10/31/11):

Shares Short/Float	1.0%

WFC PRICE HISTORY



THE BOTTOM LINE

As integration expenses from its acquisition of Wachovia go away and the acquired business achieves metrics more consistent with its own, the company's earnings power should increase sharply, says Tom Russo. That, he says, would warrant a "significantly higher" multiple than the current 6x his $4-plus estimate of normal per-share earnings.

Sources: Company reports, other publicly available information

will be required to tie up more capital than it needs. That may limit its flexibility in buying back shares, which at today's prices would likely be highly accretive to shareholder value.

There is also always a risk that the company is no longer content with being the best retail bank and deploys capital elsewhere, say into the investment-bank and brokerage businesses acquired from Wachovia that can have a way of siphoning off investment. I do not believe that will happen, but it's worth watching.

While Wells is your only bank, you obviously have no hesitation owning multiple companies in the same industry. Why?

TR: There are not that many great businesses in the world, so to the extent I can have multiple exposures in them, I am lucky. Pernod is one of three spirits companies I currently own, the others being Brown-Forman [BF-B] and Diageo [DEO]. In addition to AB-InBev in beer, I have owned Heineken [HEIO:NA] since 1989 and SABMiller since 2008. We also spoke about tobacco. In general, it seems artificial to me to force myself to buy the best steel mill, for example, because I have already filled my one allotment for a global spirits company. Where it gets a bit awkward is when I'm expecting companies in the same industry to expand share in the same key countries, but given the overall growth potential in those countries and the admiration I have for the companies' franchises and management, I don't consider that an overly risky position to take.

ON SECTOR INVESTING:

It seems artificial to force myself to buy a steel mill because I have filled my allotment for spirits companies.

You seem more or less unperturbed by the market turbulence we've experienced in recent years. Any secret to that?

TR: I've been lucky enough to have trained at the Sequoia Fund and to have invested in Berkshire Hathaway for the past 28 years, so I've tried to learn from those who take a patient posture and have had such robust success.

Recent commentary around Bill Miller's retirement suggested that investing today is a new game requiring a new set of tools. I believe pronouncements of a new era will prove to be as misplaced going forward as they have been in the past. The work Bill did over his career – identifying great businesses trading at fair prices and lengthening out the time horizon to investors' profit – should remain a rewarding game going forward. That is the game I attempt to play as well. VII

Thomas A. Russo

Partner, Gardner Russo & Gardner
General Partner, Semper Vic Partners QP & LP

223 East Chestnut Street
Lancaster, PA 17602
717-299-1385