THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Investing in the Best of the Best

CHRISTOPHER TSAI is President and Chief Investment Officer of Tsai Capital Corporation, a global equity manager headquartered in New York City. He founded the company in 1997 and serves as Chairperson of the firm's Advisory Committee. Tsai Capital is an SEC-registered investment adviser. Mr. Tsai seeks long-term investments in businesses Tsai Capital believes are high-quality, growth companies that offer significant upside potential and a margin of safety at the time of purchase. His research-intensive, fundamental and long-term approach to investing has created significant wealth for his investors. Through Tsai Ventures, the seed and early stage venture capital arm of Tsai Capital Corporation, Mr. Tsai invests in private companies and helps to build relationships for entrepreneurs. Mr. Tsai was retained by Paul Hastings LLP, a leading international law firm, to provide expert assistance with the analysis of equity securities. Mr. Tsai has been profiled in numerous financial publications including Barron's, Bloomberg Brief, Financial Planning, Investment Advisor Magazine, Private Asset Management and The Wall Street Transcript. He has been interviewed on Bloomberg Radio, China Money Network, Fox Business Network and The Street.com TV. Mr. Tsai has contributed to Investment & Pensions Europe about investing in art as an alternative asset class. He is also the author of "Back Door to China", a Worth Magazine article about investing in contemporary Chinese art and a Fundweb article about the importance of maintaining portfolio exposure to Asia's growing middle class. Prior to forming Tsai Capital, Mr. Tsai was an equity research analyst at Bear, Stearns & Co. Inc., John A. Levin & Co., Inc., and Gabelli Asset Management. He began his career in finance at a young age, working for his father, distinguished financier, fund manager and philanthropist Gerald Tsai, Jr., analyzing investment opportunities for the Tsai family and family foundation. Mr. Tsai has been a benefactor of numerous nonprofit organizations, both nationally and internationally, including the Hirshhorn Museum and Sculpture Garden, The Metropolitan Museum of Art, the Serpentine Gallery Pavilion, the Solomon R. Guggenheim Museum and the World Monuments Fund. Mr. Tsai received a Bachelor of Arts degree in philosophy and international politics from Middlebury College, where he is a member of the Middlebury College Arts Council and previously served as a Young Alumni Advisor.

SECTOR — GENERAL INVESTING

TWST: It's been a couple of years since you spoke to us. Please give us an introduction to Tsai Capital, including an overview of your client base.

Mr. Tsai: Tsai Capital Corporation is a registered investment adviser that I founded in 1997. The company is based in New York City. We're long-term thinkers, and our focus is on identifying companies that we believe have significant upside potential and a margin of safety at the time of purchase. In other words, we look for growth companies that we can buy at value prices. We prefer companies that produce consistent results and that have been around for many years, but that's not to say we don't invest in younger firms as well. Our client base is a mix. We manage money primarily for high net worth individuals but also for corporations and other entities.

TWST: You talked a little bit about the types of companies that you're looking for. Tell us a bit more about your investment philosophy. And what are some of the aspects that you think make it unique?

Mr. Tsai: Our view is that there are very few companies in the world that can actually sustain a competitive advantage over a long time horizon. Consequently, few businesses can earn a high rate of return on equity and invested capital over a long period of time and maintain above-average earnings growth for many years. It's about compounding. The durability of growth is more important to us than the rate of growth, though we love it when we can get high growth over a long period of time. We look for businesses that are high quality and have an economic moat, some form of durable competitive advantage. There are not a lot of companies that meet all the fundamental criteria that we look for.

Highlights

Christopher Tsai discusses Tsai Capital Corporation. Mr. Tsai looks to buy growth companies at a value. According to Mr. Tsai, what makes the firm unique is that it is focused on the best of the best. When selecting investments, he focuses on high-quality companies with a competitive advantage. The durability of a company's growth is also important. In addition, he looks at the culture and leaders of an organization, and especially likes management teams who invest alongside shareholders. Ultimately, Mr. Tsai aims to concentrate his investments in his best ideas and does not allocate according to an index.

Companies discussed: Colfax Corp. (NYSE:CFX); Danaher Corporation (NYSE:DHR); Roper Technologies (NYSE:ROP); Robbins & Myers (NYSE:RBN); Mead Johnson Nutrition Co. (NYSE:MJN); Nestle SA (OTCMKTS:NSRGY); Danone SA (OTCMKTS:DANOY); McKesson Corporation (NYSE:MCK) and United Technologies Corporation (NYSE:UTX).

In addition, we're trying to find businesses that have certain qualitative aspects that are attractive. For example, we like management teams that have skin in the game. We don't like to see managers who receive lots of stock options and don't invest their own capital alongside shareholders. It's important to us that management is aligned with shareholders, so that's something we look at carefully. We look at culture and the leaders of an enterprise. What motivates them? After all, at the end of the day, it's all about people.

We also look at whether or not the allocation of capital by management is efficient. So we look at, for example, for every $1 of earnings that has been retained, what has that done to the share price? Has it created value, or has it destroyed value? We like transparency in accounting, and we prefer companies that have conservative accounting. So a high correlation between GAAP and marketed earnings, as we call it, is important, though there can be a justifiable mismatch for certain types of businesses.

If you look across the universe of companies in America — and companies overseas because we are global investors — there are really not a lot of businesses that meet our standards, particularly at the right price. I guess to answer your question: We're unique because we're so focused on the best. Diversification is important, but only to a point.

TWST: Let's talk about what some of those names are. What are some of the companies that meet your criteria, and what attracts you to each?

Mr. Tsai: You mentioned that the last time I spoke with *The Wall Street Transcript* was about a couple of years ago. So I thought I would mention one name that I had previously mentioned and add two new names to the mix. I previously mentioned a company called **Colfax** (NYSE:CFX). **Colfax** is a business that was started by Mitch and Steve Rales, two highly successful businessmen and efficient allocators of capital.

Colfax was founded in 1995. It's based in Maryland. So what is **Colfax**? **Colfax** is in three areas. They're in nonsexy businesses: metal fabrication, fluid handling and gas handling. We prefer, generally, businesses that are easy to understand, and **Colfax** certainly fits within that category. So in terms of those three areas, if you think about metal fabrication, those would be, for example, pipes that have to be laid underneath water, underneath oceans to transport natural gas. Fluid handling, for example, pumps that are used on oil rigs to remove wastewater from those rigs. And gas handling, one could think about the large centrifugal fans that are used to ventilate mine shafts. So very important products, but often operating behind the scenes and certainly non-sexy products.

So **Colfax** has actually had some difficulty over the past couple of years since I did recommend the company to *The Wall Street Transcript*, mainly its end markets have weakened. Weak oil and gas prices have negatively impacted the company's customers, which in turn has depressed business for **Colfax** since capital spending has generally slowed. But they have really weathered this storm quite well. Their margins have held up, and they continue to convert about 100% of net income to free cash flow. They have really managed their cost structure well.

The stock is currently about $28 a share; that's a $3.4 billion market cap on 123 million shares outstanding. It's trading at about 18 times our estimate of a $1.55 in earnings per share for the next 12 months, so about 18 times forward earnings, which is a discount to its historical average of about 21 times. We think that the end markets have bottomed.

They just appointed a new CFO. His name is Christopher Hix. And it's important that I mention Christopher Hix because I previously followed his career over at **Roper Technologies** (NYSE:ROP). So Hix held a number of leadership roles from 2001 to 2005 at **Roper Technologies**. And during his tenure over there, the share price of **Roper Technologies** increased by many fold. Following **Roper Technologies**, he became CFO at **Robbins & Myers** (NYSE:RBN) in 2006. The firm at that point was a rather unknown

1-Year Daily Chart of Colfax Corp.

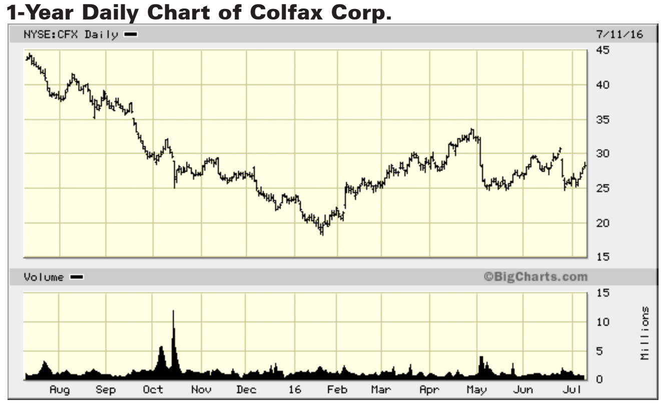

Chart provided by www.BigCharts.com

industrial manufacturer, and Hix was responsible for restructuring the company, divested businesses, acquired businesses, repurchased stock. It wound up to be a winning combination that helped drive the share price up many times there as well.

Mitch Rales and Steve Rales are still very much the architects of **Colfax**, but now you have Chris Hix as CFO and Matt Trerotola who worked previously with the Rales' brothers over at **Danaher** as CEO. So they have a fabulous management team. They're great allocators of capital. They've gone through a difficult period in terms of weakening end markets, but we think those end markets are now bottoming, and we see the company becoming even more efficient in the way it operates and getting back to a growth mode. The business is still cyclical, but over time, we expect management to reduce the cyclicality.

TWST: What is another example?

Mr. Tsai: Mead Johnson (NYSE:MJN). **Mead Johnson** is the premier pure-play pediatric nutrition company. And it's a company with a market cap of about $16 billion. It's based in Glenview, Illinois, and it's headed by Peter Jacobson, who's done a really great job of fortifying the company's brands, expanding distribution in various areas, such as the Chinese digital channel, and allocating shareholder capital. **Mead Johnson** has a 40% to 45% U.S. market share and a low-double-digit share in China. China is very important to the company. We figure it accounts for about 30% of sales. But **Mead Johnson** is not just exposed to China but to other Asian markets as well. That's a huge plus because it's benefiting from the growth of the middle-class population in Asia, which continues to be a major theme that we focus on.

Let's talk about that for a second. The middle-class population in Asia is booming, and that trend is expected to continue for many years. About six years ago, Homi Kharas of the Organization for Economic Cooperation and Development released an important study. And the study showed that the middle-class population in Asia would increase from 525 million people in 2009 to 3.3 billion by the year 2030. That's a sixfold increase. And along with that growth in population comes growth in consumer spending. The OECD projected that spending would go from $5 trillion to $33 trillion over that basically two-decade period.

That growth curve is very much in place, and I mention it because **Mead Johnson** is positioned to capture the increase in spending by the middle-class population in Asia. It's important to note that local brands are often not trusted. Parents want the best for their children everywhere in the world. **Mead Johnson** has a trusted brand, and it's manufactured with the highest science and quality behind it. So **Mead Johnson** benefits from the fact that it provides a trustworthy product to a growing population base. Also, we think that **Mead Johnson** will be a primary beneficiary of the relaxation in China's one-child policy.

I like the fact that when infants are put on a particular formula, change is not a good thing — think tummy trouble. So a lot of effort by the company is put into the initial stages in terms of marketing and getting doctors to recommend the brand and getting parents to start their loved ones on the brand. But once that's done, it provides a certain level of stability to the company's revenues because parents don't necessarily — they're not likely to switch brands.

The stock is currently at about $83. We figure that the company will earn $3.60 a share over the next 12 months. So it's selling for about 23 times forward earnings. They have a long runway of growth ahead of them due to the factors that I mentioned with respect to population growth and the relaxation of China's one-child policy.

We think that the company will eventually get acquired, which is an added benefit. We think the stock is worth about $100 a share in a takeout, so the stock is selling at a 17% discount to its private market value. It's a consolidating industry. **Nestle** (OTCMKTS:NSRGY) is hungry. **Danone** (OTCMKTS:DANOY) is hungry. But in the meantime, whether or not the company gets taken over, intrinsic value is growing at about 10% a year, the company pays a 2% dividend, so it's a nice combination.

TWST: And what is the third stock you'd like to discuss?

Mr. Tsai: It's **McKesson** (NYSE:MCK). **McKesson** is based in San Francisco. It's been headed by John Hammergren since 2001. **McKesson** is the largest wholesaler of prescription drugs by revenue. The company is also the second-largest specialty pharmaceutical distributor in the United States. It's about a $41 billion market cap. The stock sells for about $178 a share, and it's down from a high of about $240. So that's interesting to us.

So why is it down? It's down largely because the market is concerned that payers will continue to curb the growth of drug spending, and there will be less of a tailwind from the generic side. But we think that the company's enormous scale provides significant bargaining power and that these concerns are already reflected in the stock price. The stock is selling for about 12.7 times forward earnings. And this multiple is about 7% below its historical average for a business that continues to grow very well.

"The company is also the second-largest specialty pharmaceutical distributor in the United States. It's about a $41 billion market cap. The stock sells for about $178 a share, and it's down from a high of about $240. So that's interesting to us."

McKesson certainly has the kind of competitive advantage that we look for. It should continue to grow EPS at a low-double-digit rate and continue to produce high rates of return on equity and capital. And also, I'd like to note that **McKesson** produces strong free cash flow, which can be used for a larger share repurchase program or for acquisitions, both of which we have not included in our assumptions and in our EPS estimates, which call for about $14 in earnings per share over the next 12 months. And lastly, we think that management may unlock some value by spinning off its Technology Solutions business, which we figure has a value of about $5.5 billion to $6.5 billion, excluding debt.

TWST: You talked about the growing middle class in China being a big theme that you pay attention to. What other important macro trends are on your radar and influencing your approach to investing at this point?

Mr. Tsai: It's interesting you mention that because this theme about the growth of the middle-class population, not just in China but in Asia as a whole and populations in general, has a powerful spillover effect into other areas. You can think about the need for clean air, the need for clean water; much of the world lacks clean water and clean air. And that is just becoming more and more of a problem for the world because populations are growing very quickly not just within the middle class but in general. So we have exposure to businesses we think are playing within those themes: how to solve the water problem, how to bring clean water to the world's growing population, how to provide clean air.

And more and more people are moving to cities. The urbanization of the world is just beginning. So we think about, "Well, how can our investors benefit from that?" You can't necessarily build horizontally and expand horizontally, but you can build and expand upward. So businesses like **Otis**, which is part of **United Technologies** (NYSE:UTX), which is the world's largest manufacturer of vertical transportation systems — think elevators, escalators and moving walkways. It has fantastic margins.

TWST: Is there anything else that you think is important to note?

Mr. Tsai: You asked me earlier about how we're different. We're different because we are really focused on choosing the best of the best. We place a lot of emphasis on people and culture. And we don't allocate capital based on any index. We take a fundamental, bottom-up approach and concentrate assets in our best ideas. We like diversification, but only to a point. We certainly don't want to look like an index. At the end of the day, it all comes down to making the best decision for our clients. Too many investment managers just look and act alike. That's not what we're about.

TWST: Thank you. (MES)

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