Transcript from Front Street Capital Management

Annual Investor Meeting – April 27, 2010

Thanks a lot for coming. To start off, I would like to acknowledge my two partners, Michele Blood, who you all know, and Ginger Belker. Here we are (Slide 2). (Applause) I would also like to acknowledge one of my personal heroes who is here tonight. I really appreciate him showing up, and that is Ty Robinson. (Applause)

What I would like to do, if we can get the Q&A going early I would appreciate it. In fact, we are going to talk about a chart that we talked about last year. To tell you the truth, if we spent all night discussing that chart I would be just as happy. If I never get through my prepared remarks, again, I would be just as happy so you can start your questions at any time as we are going through this.

Here is the chart in question (Slide 3). We went through this last year and we sent it out in at least three different letters, maybe more. We will talk about it again tonight. You might be seeing this chart for the next decade or more (Laughter) and I apologize for that. (Audience: flat line?) (Laughter) We have actually, much to Ginger's chagrin, put one of those together just to put things in perspective. We think this is important to keep recent events in the proper historical perspective. When I put this together it is pretty similar to what we talked about last year and I think that is a good thing. Our thought process then and our thought process this year is almost identical. We actually think that is a good thing and we will kind of go into why that is.

(Slide 4) We have talked about this before, Ben Graham had said that there will be times when the stocks will do better than the underlying business and there are other times when the business will do better than the underlying stock. When that occurs over long periods of time, that is when opportunities arise and things become maybe a little clearer and so we will talk about that.

When the business does better than the stock or the stock does better than the business, it is really about what we talked about before – Mr. Market. I am not going to read it tonight, I have read it many years in the past and we have copies of it in the back. It is all about fluctuations and how the valuations tie into that.

(Slide 3) It is our contention that this bottom right here in 2009 sets the stage for a favorable environment for an extended period of time. In fact, the last massive bottom in the stock market was in 1974 and from the bottom of the market in 1974 to the top in 2000, the S&P 500 compounded at over 14% per year for 25 years. Let me repeat that. The S&P 500 compounded at over l4% a year for 25 years. That was a massive bottom. By the way, the companies in the S&P 500 did not compound their net worth at 14% a year for 25 years. In fact, the average has had a tendency to be that companies' return on their book value or their assets is normally somewhere between 10% - 12% per year. We basically went for about 25 years where the stocks outperformed the businesses by probably 3 or 4% and if that goes on long enough it is not sustainable. So, we took the liberty of looking at the bottom of the market in 2009 and drew a line backwards to see at the bottom how long it would have been if we put a dollar in the market in the S&P 500 and still be even at the bottom of the market in 2009. Does everybody understand what I was trying to accomplish? How long had the market gone virtually no where? In other words, how long was the bear market? How long was it a market that we had the wind in our face rather than the wind in our sails? It actually goes all the way back to 1996, or 13 years. So again remember, we have the businesses in the S&P 500 compounding their net worth by around 10-12% while the stocks have gone nowhere over an extended period of time. And you can see as the stocks go nowhere, the stocks were outperforming by 10-12% during this period. So, it really starts to create a powerful potential to set the stage for valuations to have a long lasting recovery. Any questions so far?

In addition, it is somewhat reasonable to assume that if you have 25 years of outperformance that it would take a fair amount of time to digest that. So, the idea that it took 13 years to digest 25 years of outperformance is a fairly reasonable assumption. I think the most powerful things in this whole thought process are the bottom in 2009 and the bottom in 1974. It is our contention that the question becomes after a long period of whatever you want to call it, a bear market, or the wind in your face, or a difficult environment to work in, so after a long period of time where basically people are on average unloading stocks and getting out of the market, what would the inflection point look like? What would create a paradigm shift of a significant degree? It is our contention that these moments would be defined as "a point of maximum pessimism."

I started in the business in 1977 after a very dramatic recovery off the bottom from 1974. I can tell you the only thing that I had heard during that time in the business was how awful the industry was. I know from stories that 1973-1974 were points of maximum pessimism and it spawned 25 years of fairly dramatic outperformance. Our contention is that it would almost be impossible to reach a point of maximum pessimism more than we had in 2009. The pessimism at this point in time, in my opinion, was of biblical proportions (Laughter). It is almost by definition that these kinds of periods would have to be a major low point for common stocks. Because what happens is, in here, (Slide 3 ~ 2000) people's expectations are wildly too optimistic and they are continuously disappointed. Continuously people are getting out, and getting out, and getting out, and finally you have one of these climatic events. Then anybody who ever wanted or had any inclination of being out of common stocks are out and the only ones left are devout believers or what we call in the business as the stocks would be in very strong hands. In the hands of the people that are fairly less apt to sell. The masses are gone, they are completely gone. It is our opinion that they will come back over a long, long period of time in fits and starts. It will not be a straight line but in fits and starts. Most people will not get interested again until the last leg. They might put a toe in the water but it will be a long, long period of time that people will get in very gradually and that is our strong contention.

Templeton Funds

(Slide 6) This is John Templeton of the Templeton Funds. Again, I talked about this last year but this is what is happening: "Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria." I have been saying for some time that we have barely gone from pessimism to skepticism and I do not even know if we have left the pessimistic stage yet. In this thought process, we are in the earliest stages of a recovery, in my opinion. Proof of that, is that in spite of the fact that we have had a dramatic recovery and as of probably yesterday, in most cases 100% or more fully recovered. In spite of the fact that we have had this dramatic recovery, it is absolutely fascinating to me that there has been no new money that has gone into US equity funds – negative. Literally, negative amounts of money have gone into US equity funds. It has been negative outflows all through this rally. I cut the articles out every week as to what the flows are and it has been negative throughout this entire rally. The reason is that investors are paralyzed, they are scared to death. Here are the numbers. (Slide 7) From July 31st and November 30th, investors pulled $36 billion dollars out of domestic equity funds. The article goes on to say that investors pumped in $142 billion into bond funds.

(Audience) Q: Could you give me a quick explanation of how that could be possible for the market to go up when funds are being withdrawn?

A: A lot of M&A activity of mergers and acquisitions, and in my opinion, a ton of it is short sellers covering. All of these "Hedge Funds" bet stocks are going to go down, and to cover their position, they have to be buyers. I could go through an explanation, if anybody wants, of how short selling works. All short sellers are potential buyers in the future. So, every money manager in the country, to some degree, was short, whether partially or all of it. They thought it was easy money. In our opinion, it is not only the fact that the shorts cover, but they are not going to leave the game. This was a great game and the more it goes up the more they want to short more because it cannot sustain itself. So they do not just cover. They cover and then they go and short something else. It will be years that these guys will continuously, in our opinion, get beat up until they finally throw the towel in. So we think the majority of it at this stage is corporate activity, buying other companies, and short covering. Do not underestimate the power of what percentage of the market that was creating these short positions.

(Slide 8)So in our opinion, "fear is good" because fear keeps excesses at bay. People are careful. It is when people are unafraid that one has to become afraid basically. It is dangerous when investors feel complacent and feel that there is no risk. They do that regularly in asset classes. Remember the tech stocks in 2000? There was no fear. Remember the housing market in 2005 and 2006? There was literally no fear. Even the banks felt there was no risk, no fear. Fear is a good thing because it keeps the markets in check.

As we speak, there is an asset class where the consensus is that there is no risk, no fear. There is one huge asset class right now where there is no fear, and we think it is a ticking time bomb. Anyone have any ideas? Audience: Treasuries. Reply: Thank you! It was treasuries a year ago but now it is bonds of all kinds. There was a gap last year between treasuries and other types of fixed income securities but that gap has absolutely collapsed now which would indicate that we are literally in the final stages of this thing playing out. It is incredible that people are taking unknown risks, for what? To lock in 2 or 3% for 4, 5, 6, 10, 15, 20 years. It is ludicrous, it is absolutely ludicrous. The bond interest rates have been going down for so long, they peaked in 1981 for goodness sakes. People do not understand just like all of the other asset classes, like the real estate market, it had been so long since people had lost money on a home that it had become a riskless transaction. As we talked before, there has been a net outflow of funds from US equities but the money has been pouring in by buckets and buckets into bond funds of all shapes and sizes and flavors, everything imaginable, and again to lock in 2% or 3%. I will say it again that it is ludicrous. When something gets to a ludicrous point, when the herd acts so unintelligently, the outcome, in our opinion, is very predictable.

(Audience) Q: Isn't that an expression of fear? When people are running into bonds, they are reacting to their fear. In that situation, you would say that fear is ludicrous rather than good. (Laughter)

A: They think that they are putting their money into an absolutely safe place for whatever reason, but their thought process is that there is no risk to where they are putting this money. In that case, there is no fear as to where they are putting their money.

(Audience) Q: They feel that they have addressed their fear by putting it there and therefore have no fear anymore?

A: Absolutely. They are comfortable. They are complacent.

Our contention, which is contrary to conventional wisdom, is that right now stocks have less risk than bonds.

(Audience) Q: So when the bond market crashes what happens to stocks at that time?

A: That is not the most favorable thing that could happen but interest rates took off from 1977 to 1981 in a very dramatic way (we will go through a chart in a minute). We saw what happened on that chart in 1974 to 2000. When I started the business in 1977, interest rates were somewhere around 5 or 6% and went to 21% and there was not much of a blip in that chart. We will show you actual numbers during that period. In addition, money is going to start flowing out of bonds and it is probably going to go someplace. Audience: Yes, that what I was wondering.

(Slide 9) Here is another article, same kind of thing as before: $35 billion in 2009 came out of equity funds in spite of this fabulous rally that we have had, and $421 billion went into bond funds. (Slide 3) I also took the liberty of going to the bottom of the chart in 1974 and I did the same thing I did up here. I looked backwards to see how long that gestation period was before the market took this 25 year run. How long was this bear market where the businesses outperformed the stocks? How long was that bear market and the point of maximum pessimism and the catalyst that drove 25 years? Actually, if you took the bottom of 1974, it would take you back to 1961 which, again, was exactly 13 years. If you then go one step further and you take the top at 1970-1971 and you lop off 25 years, it puts you back to 1945-46 coming out of World War II. This 25 year, 13 year pattern seems to be fairly reasonable to me.

(Audience) Q: The volume chart is almost as striking to me as the index itself. If you blow up the years around 1974 pessimism do you get a similar kind of spike with incredible selling?

A: I think 1974 was more of a drip, a drawn out period. In 73-74 it was down every day for two years straight without even taking a breath from the stories I had heard and I am not sure what the volume was during that period. These markets are going to have similar characteristics but they are going to be a little different to some degree I would assume.

Back to this period, if you look at your performance reports, which we believe is our report card. It is the most important document you get from us. If you look at our performance reports from inception during this 13 year period, for the vast majority of the accounts we made some money. It was not fun and it was quite choppy, but we actually made some money during that period. We think where we sit today is an awesome foundation for what potentially could come from here. That we have recovered in 12 months and we have survived this whole thing. I did not get out and get back in and I apologize for that. I could have gotten out here, back in here, out again, I did not do that. We got through all this. We got through a 13 year bear market. I can tell you, we are very excited to be working for the next however many years with the wind at our sails. For those of you that were with us in the 80s and 90s, know how those numbers can compound. Working in an environment that is generally favorable we can do pretty well. One thing I am emphatic about is that we are far better investors today then we were back in the 80s and 90s. We are really excited at what is potentially to come.

Coming out of 1973-1974, let's look at some numbers from a skilled investment manager. We are going to use our own Sequoia Fund as an example of a skilled investment manager and what their performance looked like coming out of 1973 & 1974 (Slide 10). Here are the two bad years. They were down 25% in 1973 and down 16% in 1974. I can tell you, Bill Ruane who ran Sequoia, he has passed away now, had serious doubts of whether he owned the right stocks or if he should be in the business. He actually counseled with Warren Buffett. Buffett told him he owned some really good stocks and to hang in there. The following year, 1975, he was up 61.84% and we all know that is not sustainable. In 1976, he was up 72%; this is compounding by the way. In 1977, he was up 19% and the market was down that year. We have to be running out of gas. In 1978, he was up 23%, 12% in 1979, 12% in 1980, and 21% in 1981. We have to be running out of gas here. By the way, in 1981 interest rates went to 21%, 31% in 1982, 27% in 1983, then 18%, 27%, 13%, and 7%; that by the way was the infamous stock market crash of 1987. The following years were 11% and 27.91%.

If we could superimpose…could we do that? (Laughter) That is exactly what we did here. (Slide 11). 2009 on 1974, we think we could do pretty well in this environment. We think we have great companies and we are doing great research. Are there any questions?

This said, the only thing I can really guarantee you is that whatever move we have extending beyond 2009 is not going to be a straight line (Slide 12). Repeat, it will NOT be a straight line. Is there any doubt about that? (Laughter) The market will continue to act in a way that will continue to keep the majority of the people uncomfortable. It is going to be choppy. Days like today might last a week or two. We are going to get 11% and 12% corrections. There are going to be all kinds of stuff that will keep one off balance. I would expect that we will see plenty of short-term panics which we are going to be enthusiastic to use as opportunities to accumulate more great companies at better prices. That is really our advantage. If there was no volatility we would have no advantage. Although we think we are going to have a pretty good environment to work in, we are going to try to be as disciplined as possible to buy when the valuations are right on these dips. Although I explained to you what that chart looks like, we do not look at that chart during the day. We keep our head down and we look at the quality of the companies and the valuations for our entry points.

In addition, the other thing I can absolutely guarantee is there will be no shortage of bad news during this period. During the period of 1974 to 2000, we had interest rates go to 21%, we had three recessions, we had the crash of 1987, we had Republicans and Democrats, we had gridlock and legislative reform, we had inflation and deflation, and on and on. But, the one thing that we did not have during the majority of that period was that the masses were not in the market so the reaction was of a shorter duration. The masses did not get involved until 1997, 1998, and 1999. So there is way less people to panic. Stocks are going to be in stronger hands for an extended period of time. That is our absolute contention and you will hear that from us again and again.

The other thing you will hear is each time we hit one of these potholes, the alarm is going to go off. Oh no, it is 2008 all over again. We do not believe that is possible. We believe that the majority of people that hold stocks at this point in time, the stocks are in good hands and the reactions are going to be as severe as they always are and uncomfortable but of shorter duration. Are there any questions? Should I repeat this whole thing because it is really important? (Laughter)

(Audience) Q: Where do these short sellers get the money?

A: They actually borrow the stock after putting up collateral and deliver to the buyer. They are selling today and buying later on so they borrow the stock to deliver to the buyer. And then at a later date they have to buy to cover their position. It is done on margin; they have to put up so much collateral to short so many shares. But, the problem with short selling is when you own something and you pay $10 a share and you put in $1000 and it goes to zero, you lose $1000. But, if you short something at $10 a share and it goes to $100 a share, you can keep losing multiples of what you put in. Short sellers covering can actually become almost panicked buyers. It is very powerful. Then they get margin calls because they have to come up with a certain percentage of capital to cover their position. As their position goes against them, they have to come up with more money, and if they do not have the money they are forced to go ahead and buy to cover their position. It is not insignificant.

(Audience) Q: First of all, you do not have to put up a lot of money to get into short selling. In this rising market, how is short selling a viable strategy? Who is making money at it? Day traders?

A: They made so much money for 13 years, I guess, particularly the last few years. It has become an asset class, which is almost unheard of. During the majority of my career to think that a hedge fund would become an asset class was unheard of. But when these bear markets go longer and longer for these extended periods it becomes a large part of people's activities. You are right; there will be a time when this finally gets washed out. That is probably the time that we should become a hedge fund. (Laughter) It is going to take them a long time. They were the top game. Everyone was losing money and they were making money. They are not going to turn on a dime and give all this up. It is a different thought process. Your mind becomes wired in a different way and you cannot just walk away and turn into a long-term investor. It does not happen that way. Maybe after getting your brains beat out for a decade or something but it will not happen in the first couple of years. They will continue to try to live in the glory days.

(Audience) Q: So during this recovery there was a lot of short covering?

A: In my opinion, not only short covering but as soon as they were covered, they would go out to find another short. Audience: That's gambling.

(Audience) Q: Is legislation to curb some of these excesses favorable to us or not?

A: Yes, but you know what happens; legislation passes and it is good. Things get tightened up and then people figure out how to game the system. As time goes on, it gets really loose again and some horrific event occurs and then the regulations tighten up again. It is a natural ebb and flow. Once you set the regulations, I guarantee you ten years from now there will be a lot of people that have figured out how to game the system. It is just the way it works. Then you have to come in and legislate again to tighten things up and then they will figure out some other way as time goes on. There is nothing negative or positive about the process, it is just the way it works. There has to be rules to the game and once you set the rules there are going to be a whole bunch of people trying to figure out how to get around them. It has always been that way and it always will be. There is no reason to get upset or mad. When these people get caught circumventing the rules, I am not going to get upset. They are going to fix the problem, rules will tighten up and then someone else will try to figure out how to get around them again.

(Audience) Q: Do you care why the market has gone up? Is a short covering rally just as good in your standpoint as a fundamental earnings-driven rise in the stock?

A: I can tell you, it is. We have just had earnings reports on two of our companies and they are reporting record numbers. We are probably two quarters into a recovery and they are all-time record quarters. Productivity numbers are off the charts. Companies are not hiring because they are scared so they are just running their business hotter and hotter which is bringing a lot of productivity down to the bottom line. It is inevitable that if that continues, they can only go so far and someone is going to finally hire somebody and then the employment picture will start to get better. It is going to be drawn out and I believe the longer it draws out the better I like it. The idea that it is short covering and mergers and acquisition activity means all the rest is yet to come. That is very early stage stuff.

(Audience) Q: So you do not distinguish between the whys?

A: I really don't. We have talked about this ad nauseam and I will talk about it again tonight; but, the only thing you can look at is the quality of the company and the valuation of the stock. If valuations get way excessive, then that is a different ball game. I do not care why they went up, but if the valuations get excessive then I will get concerned. But, who is buying, I do not care. Our whole philosophy is that you can only make decisions on two variables (Slide 11): the quality of the company and the valuation of the stock. Everything else is noise and something that will eventually take you out of your game plan.

(Audience) Q: What are the two companies that had the record numbers?

A: One, believe it or not, was an auto parts company, Gentex. They make rearview mirrors. (Laughter) And the other was today, which is National Instruments. I believe they are the finest company we will ever own according to our criteria. They were hiring all throughout the downturn. They are an engineering company and they were able to get outstanding talent that they would never get otherwise. We have had several companies that were expanding during the down turn and now are really reaping the benefits of it.

(Audience) Q: Did you see in the Forbes 500 how many people have gotten rich from hedge funds?

A: That is why they are not going to give it up right away. They are going to stay with it. Your mind becomes wired in a certain way. You are always looking for the negative. It is a whole different thought process. You cannot turn that on and off unless they just left the business and very few people would do that.

(Audience) Q: In the initial chart we were talking about earlier (Slide 3), having been born in 1950 and lucky enough to be looking at it today, you are talking about the maturation of the baby boomer's generation through that period in the United States. Are you incorporating emerging markets and more global thinking because that is not going to replicate itself. I think the environment and the future generations we are looking at are going to operating in a more difficult arena. In the domestic United

States, the baby boomer generation has done what it is going to do and what is to follow is not going to be as strong at driving consumption and demand.

A: So your contention is that the United States is going to be at a disadvantage going forward? I understand what you are saying, but I bet if we were standing here in 1974, there would be a bucket of reasons why that was not going to be a point in time that would launch 25 years of outperformance for US common stocks.

(Audience) Q: I think that is an important point here is that from 1974 on, the US was essentially driving the world economy and we know at this point in time that is in question. The US is not the sole and only driver of the world economy now. To the extent that US companies are able to perform on the same basis is going to at least partially be affected by the extent to which those US companies are able to take advantage of world markets. They still may be US companies trading on the New York Stock Exchange (NYSE) or a foreign company trading on the NYSE, but the companies that are going to be able to potentially do the best are those companies that are able to take advantage of the world market as a whole. Say FEDEX.

A: Possibly, but when you start becoming an economist, you are adding so many variables into the equation and we are not going there. We are not going to make decisions based upon my judgment of the world economy and where we sit in it. You do not want me to make decisions based upon those variables. (Laughter) I can guarantee you that. The problem with economics is that this is going in this direction but the problem with economics is that any time you push someplace, something else pops out. Everything gets balanced. My theory is that is how democracy and capitalism work. Things are flowing from one side to the next. Capitalism is going one way and democracy is going another and things have a tendency to work out on a fairly straight line through all the garbage. Whatever your economic contention is, I bet I could put a scenario together as to why there will be pressure someplace else to bring it back to the mean.

(Audience) Q: I think that is true, but a relevant piece of information is to what extent are the companies we are investing in able to take advantage in markets outside of the United States because often what makes a company successful is that a piece of business overseas kept them going really well while their US business was in the tank. An unrelated and similar scenario is a lot of wealthy cattle ranchers are still in business because they were in the sheep business.

A: Here is my answer to your question. I believe your question is that we need to buy high-quality companies to be able to address whatever comes at them. That is how I read your question. This is what we believe are high quality companies (Slide 14). Companies that are run with integrity; companies that have a long-term focus; companies that are lead by leaders that have a passion for their business; companies that find unique ways to break down barriers in their organization; companies that empower their employees to make decisions without fear of repercussions if they make a mistake; and companies whose management is disciplined with how they allocate their capital. We believe if I can actually find companies that do this, they will solve their problems. Whether it would be that they need to go to China to do their business, or get a manufacturer, whether they need to import or export or whatever it is that they need to do, we believe that companies that do these things will be more apt to solve those problems than any other company.

(Audience) Q: So what the other gentleman was saying, it is implicit to have long-term focus up to a point because if you do have a long-term focus you may well end up saying that for your particular company you will stay domestic and that is the best thing for this company.

A: It depends on the industry. What I do not want is some company doing something to butter up next quarter's earnings and forget about where they should be strategic planning in 4, 5, 6 or 20 years.

(Audience) Q: If the crux of your strategy is quality companies at proper valuations, how long do you continue to hold them in spite of the market not receiving it that way?

A: You have to keep in consideration that we have had a 13 year bear market.

(Audience) Q: I know, and I am not thinking that there is an easy answer, but I will give you an example, and it is the same example from last year, Cognex. You bought Cognex in my portfolio ten years ago and it is down 50%.

A: We have bought Cognex recently. They meet our criteria tightly enough that we need to continue to own it; it is essential. The problem with that particular trade is that it was a timing mistake on my part. The problem was not with the company but with my entry point. I would imagine that we have averaged down on that trade since then.

(Audience) Q: So, on the long-term, this will prevail as long as they maintain that focus.

A: Absolutely, that is our belief. By the way, the company you have talked about the last several years is not on our list this year, it is gone. We finally made a decision to pull the plug on ADC because they had too much business that went into copper wiring and we thought they had enough fiber optic business to override that and we have better situations so we just moved on. The one thing about this decline that we have had here is that we have had the opportunity to buy any company that we have ever wanted to own at any price that we have ever chosen to own them, so we have had more activity in the last couple of years than we have had in a while because it was an amazing opportunity to upgrade the portfolio.

(Audience) Q: There are probably others. I remember either last year or the year before the company that you felt that was poised to take advantage of what was happening in fiber optics, which was Bookham, and I noticed they are not in the portfolio now. Did they lose their focus?

A: No. They merged with a company called Avanex and they turned into Oclaro and we are right in the curl of the wave with Olaro. That fiber optic scenario that we have talked about for the last several years is occurring as we speak and Oclaro is right smack dab in the curl of that wave. It could not be in a better position. Also, in answer to your question, I have made all kinds of mistakes in your portfolio, many of them are timing mistakes, and I publicly apologize for each one of those as I stand here today. But the most important thing to judge your portfolio on is the Quarterly Performance Report. In spite of the fact that we bought Cognex a couple of times at an inopportune time, hopefully those quarterly numbers since inception are at a respectable nature given what we have been through the last several years.

This is really good. Are there any other questions on the chart? This is the beginning and the middle and the end for us.

(Audience) Q: I am a real estate broker and I know that is not your specialty. What do you foresee? Are we at the bottom? (Laughter)

A: In my opinion, there is probably no doubt that the vast majority of the damage is done. Each market has its own individual characteristics. Missoula is going to be different than Kalispell and Coeur d' Alene. The question becomes when does the recovery occur and I have no clue.

(Audience) Q: The stimulus package is not doing it.

A: No, the stimulus package will not do it. There has to be enough inventory turnover and there has to be enough of a decline in new home starts to suck up all this inventory and I have no idea when that is going to occur. I have been interested in acquiring some recreational properties and we think this is an opportune time not only because prices are down but there are properties coming up for sale here that probably should never come on the market. A family acquired a gem, a piece of property, which should never leave someone's hands. Those kinds of things are going to come up. My theory is (I am not sure if we are going to do that) if we start to accumulate them and if this thing stays down for 7, 8, or 9 years, we will have a bunch of properties. If it turns around next year, we have might have one or none. The idea would be to go in having no idea.

(Audience) Q: Are you talking about yourself?

A: Yes, I am talking about myself. (Laughter)

(Audience) Q: A lot of buyers out there are figuring if they wait two or three more months, they will save more than the $8,000 stimulus by waiting; that prices will decline that much.

A: We believe the short to intermediate term in any market is not predictable. Again, if I were to buy real estate I would look at two variables: the quality of the property and what the price is. I would not try to predict the stimulus or what President Obama is or is not going to do or try to predict people's emotions. I would not look at any of that. I would look at two variables and two variables only. If I can stand on the property and get weak in the knees and it is at a price that is attractive, that is all I would need to know.

(Audience) Q: The other variable is financing. These banks are just being idiots. (Laughter) They were idiots ten years ago, now it is in reverse.

A: As the prices recover there will be more lending available. It is a natural part of the cycle. It would be natural given what we just went through that banks would tighten up their lending practices. That is what everyone wants them to do. The reason we got into trouble is that the lending process got sloppy. Now it tightens up, it gets too tight and over twenty years from now it is going to be too sloppy again. Our opinion on this kind of stuff is not to get frustrated with it, just recognize it and deal with it. Whether it is something the Government does or something the bank does, it is all part of this pendulum swing in our opinion.

BREAK

Part II

So maybe we will try to fast forward through some of the stuff on the mutual funds but, again, ask questions. We'll take this anywhere it goes tonight. The first part took longer than I anticipated but I think that is great because I was hoping that would be the case. Let's try to run through this and we will see how far we get tonight.

As we always do, we will try to go through the numbers on our account, the Front Street account, and see what the funds have done and a little background on them. (Slide 15) The Fairholme Fund has been an important fund that we have used in the mutual fund accounts. They have been recognized by Morning Star as the Manager of the Year in 2009 and also the Manager of the Decade for the entire ten year period. This is out of twenty or thirty thousand some odd mutual funds. (Slide 16) Their numbers were up 38% in 2009 and 12% so far in the first quarter of 2010. They have managed through this; you would not have even known that we have been in a bear market the way that Fairholme has managed through this process. It has been fairly remarkable. Someone suggested to me, "Why don't we just put it all in Fairholme?" Unfortunately, this just is not that easy. We have talked before that the larger the size of the pool of money, the more difficult it is to achieve in the future as to what you did in the past. In Fairholme's case, $134 million was in the firm when we started with them. Today, it is $14 billion. In my opinion, the real part of Bruce Berkowitz' genius is not only the numbers that he has been able to put up but the ability to do it with a larger and larger pool of money. We think that what he has done is absolutely extraordinary but at some point in time we do believe that it could be an anchor. This is why we do not put all of the money into Fairholme and why we are always on the lookout for the next Fairholme. We identified Fairholme in its embryonic stages and we think that we can do it again. The one thing about putting all of our money into Fairholme, and my apologies to Gentex (our rear view mirror company), is that it is essential we make all of our decisions looking through the windshield and not in the rear view mirror. Past history is important but it is not everything.

Next is Sequoia (Slide 17). As you may have noticed, we have been buying a lot of Sequoia and readjusting the mutual fund portfolios to increase our exposure to the Sequoia fund. Their numbers were up 15% in 2009 and up 8% so far in 2010. Here is why we own Sequoia and why we are proud to do so. Warren Buffett had a partnership in the late 1950's and 1960's. He broke that partnership up somewhere between 1969 and 1971. We talked before about the hedge fund manager just walking away because the environment was different. Very few people would ever do that but Warren Buffett did. When prices got to the point where he could not find valuations that he could work under, he looked at the markets and said, "I don't understand this anymore. I am going to send all of the money back to the investors." That is such a rarity. I guarantee you the mass majority of hedge fund managers will not do that. They will continue to try to beat their head against the wall until they finally have to give up. When he gave the money back to the investors, they did not know what to do with it or where to put it. Buffett told them if they insisted on staying in the market, they should give the money to Bill Ruane (a classmate of his at Columbia taking courses from the famous Ben Graham). That was the genesis of the Sequoia fund.

(Slide 18) Their long-term track record is 14.14% per year; that is pretty good. But, what makes this different is that it is a **forty year track record**. We talked about Fairholme's success over the last 13-15 years or so and the firm went from $130 million to $14 billion. Imagine what the size of Sequoia should have been with a forty year track record of 14%. It would certainly have mushroomed to a level that they could never achieve in the future as to what they did in the past. But Sequoia is different. The people that run Sequoia are more interested in out-sized performance than they are in lining their own pocket so they closed to new investors in 1982 and did not reopen until 2008, which is **26 years**. In spite of one of the most legendary track records and one of the finest managed funds that I am aware of, the size of the fund is about $2.5 billion. So when they reopened, we rushed to reallocate funds to Sequoia.

One thing that has occurred with Sequoia is the grim reaper has sort of cut into their client base. Since they have been closed for so long, there has been generational turnover and a lot of redemptions. They had to sell things to match the redemptions. One of the reasons why they wanted new money was so they did not have to continue selling things that they did not want to sell. It may not be for a while that they would close to new investors. But most of the time, when funds close, they stay grandfathered to people who are already in them.

The next fund we own is Longleaf (Slide 19). They had a big year last year. They did not do quite as well in 2008, but they are off to a fairly decent start in 2010. Longleaf is very focused on the two variables that we are interested in: quality of the company and valuation of the stock. They do a fabulous job. All of these funds have some negative or another, unfortunately. The negative on Longleaf is the fact that they have three funds that they manage, which is not much except for the fact that our preference is that the entire organization is focused on one pool of money. This pool of money is where our capital is so that all of the energy on everybody in the organization is focused on one thing and that is our pool of money. It is a slight negative that Longleaf has three different funds. If you look at a lot of your accounts, it is probably a smaller position than some of the other funds that we have.

I have kind of a long story on Aegis and Pinnacle. This is the tale of two Ben Graham style managers. We talked about this a little bit last year but it is a pretty fascinating situation, I think anyway. A quick review of how we see the world again: we think that you can only make decisions on two variables (the quality of the company and the valuation of the stock) and we think there are two polar opposite ways to view that (Slide 20). These are two seminole investors, legendary thinkers in the investment field. One is Ben Graham who had the idea of buying reasonable companies at ridiculously low valuations. The other one was Phil Fisher who had this idea of buying great companies at reasonable prices. The theory has always been that the Ben Graham style of investing would actually do a little better in down markets and not maybe quite as well in up markets. I know, from personal experience, that the Phil Fisher style of investing has a tendency to do better in up markets and not as well in down markets. We have always felt that by combining these two, we would have a natural hedge. The Ben Graham method of investing has had a much lower degree of volatility, at least for the last thirty years. That was really the case in the 2001-2002 decline. The Ben Graham style managers that we used (Bill Dunn, Tweedy Browne at the time, and Aegis, which we did not own at the time) were actually up during those three down years. The theory does work. However, there are times when circumstances converge. What normally would be the case kind of goes out the window in some short period of time. We have seen that again and again. Long-term capital had this thing, even with very smart guys, where they had everything down to the last nickel of what their risk factor was and all of the sudden all of these things converged and the thing blew up and almost took the economy down with them about seven or eight years ago. There are not always times where things converge that are very unusual and probably will not happen again here for a very long time. That is exactly what happened to the Ben Graham style managers in 2008. Normally stocks with low stock valuations have less to go down in a down market because all of the premium, or the fluff, is already beaten out of those stocks. So when the market goes down, there is a tendency for those stocks not to go down as much as other markets. However, 2008 was an anomaly in and of the fact that the panic hit such a degree that any stock that was not considered to be an AA rated company was thought to be on the verge of bankruptcy and they were priced as if they were going to go bankrupt. So what started at already low valuations went to absurdly low valuations. For this one little period of time, the Ben Graham style manager really took it on the chin, which is normally not the case in down markets. They usually significantly outperform. This caught a lot of folks in this camp; it shocked them.

We have two Ben Graham style managers and they are Aegis and Pinnacle. Both of these managers found themselves in sort of a different position. Both managers raised a lot of cash in 2007 because they were having a hard time finding bargain stocks. Aegis got to about 25% cash in the portfolio and Pinnacle got almost 50%. Prices continued to weaken and by the early part of the first quarter of 2008 rolled around, Aegis could not stand it anymore. He got fully invested; the bargains were just too juicy and he basically spent all of the money on what he thought were terrific valuations. Pinnacle, on the other hand, was a very careful guy. He would buy something and every time he bought something, it basically disintegrated the next day. He just pulled back and he quit buying and he started just holding the cash. I am sure his process started to feel like a bottomless pit. Again, instead of buying into it, he just pulled back and sat on the cash. By the way, this strategy started to bother me sometime in 2008 because I understood that the valuations at that point in time were extraordinary. If you were only looking at two things, the quality of the company and the valuation of the stock, there would be no reason why you would hold cash. The only reason why you would hold cash is if you were looking at some other variable (like the U.S. deciding not to be competitive) that is not part of our thought process emphatically. I took the liberty and started to move some of the money away from Pinnacle and started to allocate it to other funds that were more fully invested. It was a disaster. It was frightening. I made the decision that, God bless him, he has all of this cash so I am going to let him decide when to allocate the money because I do not know when to do it; I have just proven that. I do not know where the bottom is. I am going to give him every opportunity to go ahead. He has created an opportunity of a lifetime by holding that amount of cash with valuations as low as where they had gotten. I was starting to get really excited as to what his opportunity was. Pinnacle ended 2008 only down 17% when the market was down 38%. (Slide 21) The accolades came rolling in; 5 star rating for a fund that small is almost remarkable. It was top 1% of its peer group and was the fund manager of the year. I think there was only one other fund that did better than Pinnacle in 2008 out of all the thirty thousand mutual funds. Again, a part of me was so excited that it was set up for literally the opportunity of a lifetime. However, there was another part of me that was feeling a little apprehensive. I was thinking, if this guy pulls this off, it destroys the entire foundation for everything that I do. If he actually did pull it off, the worst part of it all, the pressure on me to do what everybody wants me to do is going to be almost unbearable.

That is to time the market like a perfectly timed clock. If he actually pulled this off, the pressure on me to try and do that in the future is going to be almost insurmountable. Low and behold, March 2009 rolls around and John Deysher becomes 80% invested. He buys aggressively in March right at the bottom. What ensued was one of the most powerful rallies I have ever seen. By the middle to the end of April, he had already taken profits and was back to 50% in cash, which is where he still sits today.

(Audience) Q: So in early March he was 80% invested, and he is down to 50% today?

Answer: He took profits and was waiting for another pull back, and as we speak, he still waits. He did not do so well in 2009 compared to the market but since then he has actually outperformed the S&P very consistently since then in spite of the fact that he is 50% invested. So his work is extraordinary, we would just like him to do a little more of it. (Slide 22)

Meanwhile, back in the other camp, the Aegis fund had a horrible 2008 as many of you know. But I give him an enormous amount of credit; he stuck to his principles and stayed fully invested. (Slide 23) The result of that brought the fund up 91% in 2009 and is up another 12% so far in the first quarter. Again, now the accolades come the way of Scott Barbie. (Slide 24) Actually, in 2009 there was one fund that outperformed the Aegis Value Fund. Again, out of all thirty thousand funds, one fund outperformed the Aegis Value Fund. It was sort of a weird fund with weird and bizarre options and things in the fund. We are very proud of Scott. He is a very young man, in his early forties. We think he is going to be a great partner for the next twenty years for us. We are really proud of him sticking to his guns. Here is Aegis' performance (Slide 25).

In May and June, we started to move money away from Pinnacle and into particularly Sequoia because we did not have access to it previously. We have been moving a lot of money out of Pinnacle and into primarily Sequoia but also some of the other funds. We talked a little last year about what we have been trying to do: get a little more of a balance between the five funds in our accounts. We think we have kind of accomplished that. We still own Pinnacle; it is now maybe 20% or less of the portfolio. One thing you should know about the fund manager is that almost all of his net worth is in the fund. He does not take a salary. Whatever fees he gets from the fund are reinvested and his ownership increases. Literally, all of his income and all of his net worth is in this fund. So whatever he is doing for us, he is certainly doing for his own money. We think that eventually he is going to work his way through this situation. He does terrific work; however, if he continues to get off track or stray from what we think is the philosophy and looking at other variables, we will start to move other money at some later date down the road.

(Audience) Q: What is the size of the fund?
Answer: The size of the fund is one of the huge advantages to the firm. It is about $60 million; just tiny for a guy of his qualifications. He was a fund manager at the Royce Value Funds for about thirteen or fourteen years, which is a great mutual fund company and Ben Graham style company but they run $25 billion so the idea of having that quality of managers managing a small pool was what was really attractive to us.

(Audience Q: Is Pinnacle closed?
Answer: Oh God, no! He will take anything you'll send him. (LAUGHTER)

Tweedy Browne

We still own some Tweedy Browne (Slide 264). The American fund was up 27% and up 4% for the first quarter. The Global fund was up 37% and 4% for the first quarter. We talked about them; they were a pure Ben Graham shop and the size of the fund kept getting larger and larger and their performance was good. So they got to about $11-12 billion, which was bothering us. We have talked about this year after year. As the fund got larger and larger, their style started to morph from the Graham style more to the Fisher style to buy better companies, which was really something they had to do. You could not run that much money with the Ben Graham style of investing. It was something that was very necessary they do. They actually did it. They had a two hour conference call the other day. I listened to it all and when I hung up the phone, it was apparent to me that the transition was complete from being a Ben Graham manager to buying better companies and willing to pay a little higher prices. It is not a bad thing in and of itself except for the fact that they are not as good at it as, say, Sequoia. We have Aegis who has proven themselves with enormous amounts of courage to be a Ben Graham manager that is going to stay exactly where he needs to be. We have Tweedy that is sort of halfway in and halfway out. We think we can improve upon Tweedy by reallocating it into our five other funds. We have started that process. A lot of the funds are not held at TD Ameritrade. We held them off the books because we could not buy Tweedy when we were at Piper Jaffray so I have to call everyone and get paperwork signed. It is a process that is going to take quite a while, but we are getting more aggressive about doing that. (Slide 27 & Slide 28)

I know we need to get to the companies but I have a couple of housekeeping things that I need to get through here. We have done this the last three years, but I am going to do it again and I will probably do it every year that we do this meeting. That is the mutual fund cost basis. On your TD Ameritrade statements, the cost basis for your mutual funds is incorrect. It is not the amount of money you put in the fund. Let me repeat that. The cost basis on your TD Ameritrade statement is not the amount of money that you put in the fund. What happens with a mutual fund is every time a fund makes a distribution and you reinvest that distribution, your cost basis goes up by the amount of that distribution. If the accounting did not work that way, then you would pay taxes twice, which you do not want to do.

So the cost basis on your statement does not represent how much you put into the fund and how much it is worth. An example is the Aegis Value Fund, which has had more distributions than the other funds. Here is a statement that we just pulled off (Slide 29). The original amount of money that was put in the fund was $148,000. The market value today is $183,000 and so there is a $35,000 profit for this particular account. They put in $148,000 and they had distributions of $82,000 so their cost basis went up to $231,000 on the statement. It looks like on the TD Ameritrade statement that you put in $231,000 and it is only worth $183,000 so you lost $47,000 when in reality you are up $35,000.

So I will reiterate that the most important document that we sent out for you to judge us is the quarterly performance report that we send to you. We send them for both the mutual funds and for the equity accounts. This is our report card. It gives the since inception numbers and the last quarter in each year. You must know that all mutual fund accounts that started before 6/12/2007, have a starting date of 6/12/2007 for those accounts. The reason for that is when we moved to TD Ameritrade and our own Front Street Capital; we thought it was important to download all of the historical numbers for the equity accounts first. By the time we did all of that, there was a gap between the last historical number and the new starting date, which was, by the way, 6/12/2007 that we could not reconcile. So instead of trying to fudge something in there, we just started every account at the date 6/12/2007, which to our chagrin turned out to be just about the top of the market. Many of these accounts have longer histories and many of them go all the way back to Bill Dunn, but we do not have those numbers logged. If you ever have any questions on the performance reports, please call. It is the only way that you need to evaluate us. These reports are after all fees, they take into consideration all cash in and out, they have the recent quarter, and they have the since inception in each year compared to the S&P 500. That is our report card. That is how we want to be judged.

(Slide 30) In 2009 the Front Street Equity Accounts were up 38% plus or minus 6%. As you know, all the accounts are not identical; we talked about this in the past. The first quarter we were up

11.5% plus or minus 1.5%. Again, the way we like to be judged is on these performance reports that you get quarterly. There is a tendency to look down the statement and look at what stocks are up or down from what we bought it at and make some sort of judgment on that. I am sorry but it does not mean anything because it does not take into consideration things that we have sold at a profit or a loss in the past. So it is a snap shot of what we own but it tells nothing about the history and does not compare it against anything. These performance reports are really what are important (Slides 31 – 34). Just a couple more things and then we will get to the companies. By the way, if anybody needs to go, you can feel free to get up and leave; that is no problem. I know we are kind of extending on your time here.

This is really important. Conventional wisdom is that volatility and risk are the same thing. We do not really believe that. Here is what we think risk is (Slide 35). We think risk is not following sound principles. We think risk is not doing your homework. We think risk is believing you can forecast things that cannot be broken down into simple terms. We think risk is not operating with an adequate margin of safety. We think risk is being seduced by the crowd. We think risk is believing you can forecast short to intermediate term moves in the stock market. We think volatility is stuff goes up and down.

We have now actually weathered two of the most dramatic market declines in the last 75 years: the decline of 2000-2002 and 2008-2009. Both times, within 12 months, we made 100% recovery. So we believe that we have done a pretty good job of controlling risk. We also believe that we really cannot control volatility very well and we accept it as part of being in any publicly traded security. By the way, that includes bonds. Volatility is adherent in any publicly traded security including fixed income securities. This is our fee schedule (Slide 36). We charge 1% for equity accounts, 3/8ths of a percent for mutual fund accounts, and 0.1% for income accounts.

You have two relationships, by the way. One with TD Ameritrade and one with us and there is a firewall between us. We do not have access to your accounts. We can only buy and sell on your behalf and charge the fees that you have signed off on quarterly. There has been some confusion about Madoff and these kinds of things. That situation is impossible with the structure that we have today with a firewall between us and your securities. TD Ameritrade, by the way, charges $31 for a mutual fund trade. We have very few mutual fund trades. It is $9.95 for an equity trade. We probably have the lowest turnover of almost any manager imaginable. Our fees are very low; if you shop the street, we are probably the lowest on the street, by almost half in some cases. I will not go through all of this, but we have all kinds of fees out there and they are all less than our schedule because we were not very disciplined when we set things up. We do not think it is fair for some people to be paying something and others to be paying something else. We may try to actually standardize the fees at this level. That will be a conversation that I will begrudgingly have at some point in time.

<u>Questions? (Slide 37)</u>

Audience Q: I see we are back into Corning.

Answer: We exited really begrudgingly because back when the tech bubble burst, their balance sheet required them to sell some stock and it diluted our interest a little bit. That bothered me so we left it at one point of time. But I have followed it very closely since then. According to our criteria, they are a very innovative company. They fit our criteria very tightly. Probably 80% of their sales today are with their new products in the last 10 years. Extraordinary. They are an innovation machine. We had an opportunity long after the bottom when we had Financial Federal get purchased giving us the opportunity to have some cash available. Way off the bottom, we had an opportunity to reallocate some of that money in Corning at ten times earnings which is unbelievable for the company. We talked about the quality of the company and the valuation of the stock: I was pinching myself that we had that opportunity.

(Audience) Q: In my portfolio, when will I see equities from China, India, and Greece? You do not buy any of those do you? (Laughter)
Answer: I like to get annual reports that I can actually read in English. I like it when I get on the conference calls and they speak English. We had Toyota for a while and those conference calls were translated. I could not get any inflection in their voice and it took twice as long as it should have. I did not like it. We will buy domestic equities. There is plenty of opportunity in domestic equities with companies that we can understand and know. The only exposure we are going to get to foreign markets is when they have businesses that operate in other markets.

(Audience) Q: Of these companies, which ones have overseas companies? Does Whole Foods do it?
Answer: I would think that almost all of them to some degree or another. Whole Foods is still in its fairly early stages. I am not sure about Mexico or Canada but I would guess at some point in time they would. I do not know off the top of my head if they are currently (they actually have stores in Mexico, Canada and the UK). It is really not something we actively seek out. We look at the quality of the company and the valuation of the stock and if this energized organization thinks the best thing to do is to go overseas, they will do it. If they do not, then we are okay with that too.

(Audience) Q: How often do you re-evaluate these guys?
Answer: The snide answer would be every day. We gather information on companies every day. It might be a conference call one day on Whole Foods or it might be an article the next day on Valspar. I do not know when the flow of information comes but we are evaluating them every single day to some degree. The decision to sell something is sort of the straw that breaks the camel's back. It is not something that is going to occur overnight. I can tell you which ones I worry about more and then all of the sudden they get better and then I worry about something else a little more. They go through these stages.

(Audience) Q: Level 3 seems to have not caught a wave that the others have. Is that because of their debt burden or is there some other explanation to this?
Answer: We are talking about Level 3, which owns a telecommunications fiber optic infrastructure coast to coast and also overseas. We have talked about this industry before. The amount of traffic going over the network is growing at an insatiable rate exponentially. That has not ceased, it has just actually compounded. Video is now getting it to explode again. High definition takes it probably a 1000 times even more than video. The whole scenario is playing out as we have talked about the last several years. As you most notably have noticed, Oclaro is really right now right in the curl of the wave of the activity and the stock has been participating commensurately. The ones that have not participated commensurately right now are the people that own the networks. The reason for that is crystal clear. I kind of categorize it as the beaten dog syndrome. This industry has been beaten and drubbed for so long that their mentality is that they are used to succumbing to whatever their customers want. The two controlling factors in this industry are Verizon and AT&T; they are almost a duopoly. If you have noticed, in spite of the fact that the demand for their product has gone up astronomically, they are lowering their prices. It is unbelievable! In our opinion, it is kind of like the beaten dog syndrome. They are so used to saying "You want us to lower our prices? Ok." We believe that they

are going to wake up one day and say, "Oh my God, we have pricing power." Apple is kind of controlling. They are getting all of these margins right now because they are coming out with all of these innovative new products. They are all exciting products but if you think about it, what consumer electronic device has ever not gotten the margins beat out of them and not gotten commoditized? Cell phones: within a few years, Motorola went bankrupt just about because the margins got blasted out of them. The PC had become commoditized. Eventually these consumer electronic devices will become commoditized. People are going to wake up and see that the power in all of this is in owning the network because you can duplicate an iPhone or an iPad. Somebody can come out with another one next year that is going to look the same but nobody is going to rebuild the network. They are not going to dig the streets up again. It will never happen again. And these folks are going to have pricing power and when they do, our opinion is it is going to be "Katy bar the door" because the money is going to flow. It is going to flow to the equipment suppliers like Oclaro, it is going to flow to AT&T, and it is going to flow to Verizon. Verizon and AT&T's stocks are paying almost a 7% dividend because people are thinking that it is a bad business model. It is not a bad business model. They just have not figured out yet that they are going to be able to raise their prices. Are you going to give up your cell phone or your hand-held device because they raised their prices $20 a month? It is not going to happen. We believe the power is in the network. When you talk about the debt, if it lasts too long, Level 3 is not going to work for us because they have a debt load. And we talked before about what companies bother me a little bit: Level 3. But on the flip side, if at some point in time we start to get some pricing power in this network, this thing could be a wonderful thing to own for the next 25 years because they are not going to dig the streets up again.

(Audience) Q: What happened to JDS Uniphase?
Answer: We still own it. This whole fiber optic area had been beaten into the ground. We stayed with it and kept up with it. We think we have a little edge in that area. We really pulled Oclaro out of the weeds almost. You will probably see a few more odd names pop up like JDS Uniphase, we bought a little Ciena recently, Finisar we are following pretty close, and there is a company called Oplink. You will see a couple other fiber type names get feathered in once in a while. Five or six years from now, we will probably be done with this space but there will be some odd names. Usually the odd names will be associated with this space.

(Audience)Q: Timberland Company is not doing very well. What is their problem?
Answer: Their stock actually, has done quite well recently. Audience comment: "Not on my statement." (Laughter) On your last statement the stock was $16 maybe. It is $23 today. We have gone through the story. They kind of got adopted by the hip-hop folks with their Timberland boots and that went away so they have had to rebuild the brand to some degree. We think they have done a pretty good job of it. We sent an email out recently, by the way. Did you see that? When it comes to the passion piece, this guy is off the charts. Almost from that alone, we feel obligated to really stick this thing out through the end because it is rare you will find a CEO of a public company that has that much intensity and passion for their business. It is a family business. He and his family own 40% of the stock. They have half the number of shares out that they did eight years ago. They made one brilliant acquisition and that was Smart Wool. The CEO of Smart Wool is now running the entire Timberland operation. We still think it has legs. We have no intention of throwing the towel in on that one as we speak.

(Audience) Q: Are you buying Nucor again?

Answer: Not yet, but we will. We think that the commodities have actually sort of levitated in here. We did not think that they should come off the bottom the way they did. We talk about China, there is some talk that the real growth in China right now is in the high rise office and apartment buildings and the prices that they are getting for these things is in no way comparable to what rents could possibly be. It is a bubble that could be emerging and if that thing bursts, that is where we think a lot of the steel is levitating to. We think we are going to get a shot at this thing at a really nice valuation before this is all over. This is a horribly cyclical industry that should have been brutalized during this down turn and we think that the commodities were levitating a bit. Some catalyst will occur that we think we will get a new shot at Nucor. We actually purposely have it on the list because it meets all of our criteria. It is a horribly cyclical business and we got out close to the top of the last cycle. We have every intention of getting back in again.

(Audience) Q: Why Herman Miller?
Answer: Again, our criteria is culturally oriented. I do not think there is a company that fits our culture better than Herman Miller. One of their founders was a fellow named Max Depree. He wrote several books on management. That management style lives and breathes in Herman Miller. In addition to that, they are one of the finest design companies on the planet. The one piece they always lacked was that they were not very good manufacturers. When I first went back there maybe ten or twelve years ago, they were working with Toyota to learn world class manufacturing techniques. They have come all the way up the scale. The combination of the world class design with the world class manufacturing we think is a match made in heaven. The problem with Herman Miller is it is a very cyclical business, it is still office furniture, and it is late cycle, meaning that office furniture really does not start to pick up until later stages in the recovery. We think they did a fine job of managing through the down turn.

(Audience)Q: Can you talk a bit about the reverse stock split for Oclaro?
Answer: A regular stock split is if you have 100 shares and split two for one, you would get 200 shares at half the price. It is all cosmetic; it does not really mean anything. This whole industry, again, as we talked before, got completely decimated. These stocks became "penny stocks", less than a dollar. Oclaro is selling for about $2.50 as we speak today, actually up from .20 cents. We actually bought stock for some accounts at .30 or .40 cents. It is $2.65. They are going to do a reverse stock split so instead of the stock being $2, it is going to be one for five so it will be $12 or something. A lot of mutual funds and money managers are not allowed to buy stocks under $5 so they have been getting a lot of pressure from investors to do a reverse stock split so these people can own the stock. To me, it is purely cosmetic. It does not matter to me one way or the other.

(Audience) Q: A couple of months ago you mentioned that you thought Berkshire Hathaway was in a good buy position price.
Answer: That was when it was in the low 60s. It ran up to about $85. It was a pretty good move for Berkshire Hathaway. It is not a stock that would normally have too dramatic of fluctuations. The one thing that I would like to warn everybody about is as far as our criteria, this is the company that meets the criteria in every way, shape, or form. It is literally the world's perfect company for what we do. There could not be an organization that would be better for what we look for than Berkshire Hathaway. With that said, up to very recently, I have never sold a share. That was blasphemy. However, our strategy is that when something happens to Warren Buffett, we would like to have our position in about 5% of the account or less. He is 79 years old, pushing 80 years old. For that reason, you may see some sales because I want to be in a position that when something does happen to him we are not

stuck with too big of an ownership stake. We know the stock is going to get pelted for some period of time. I do not know for how long but I would like to be in a position where we can buy it and not be stuck with too big of an ownership stake. So that is the strategy going forward. We have felt that way for a long time. When he is getting close to 80, I am thinking, if I am going to do it, what am I waiting for? For him to be 95 years old? (Laughter)

Any more questions? We should adjourn then. Thank you so much!

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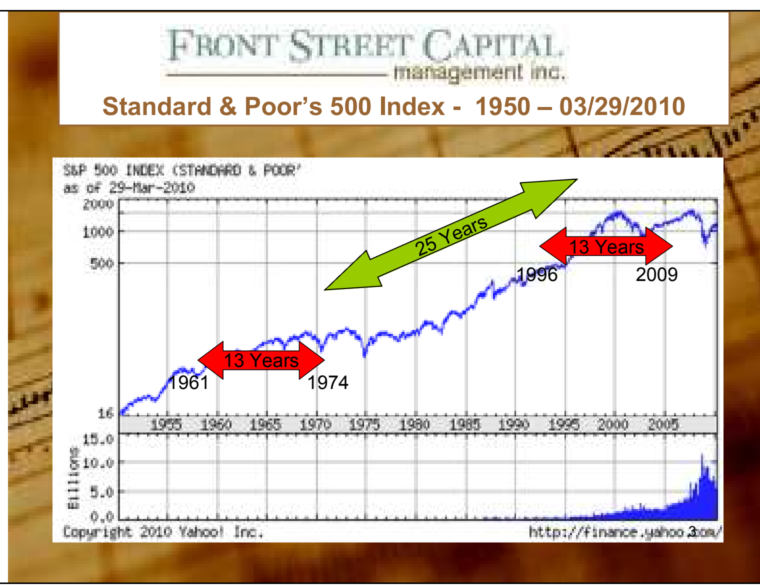

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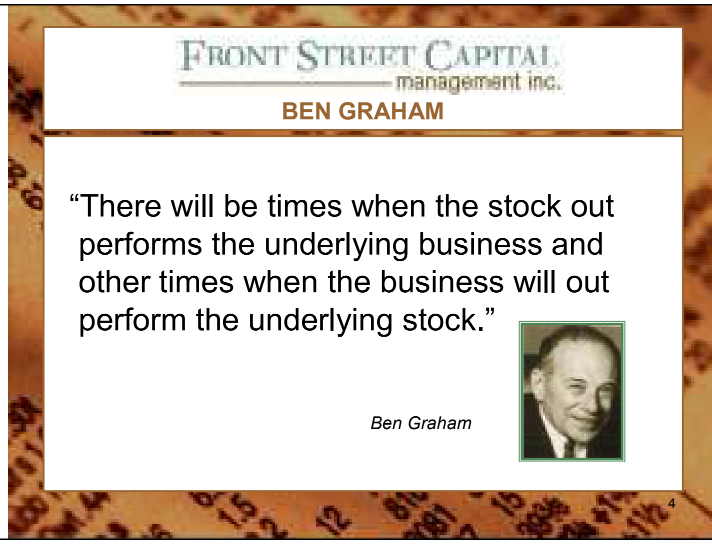

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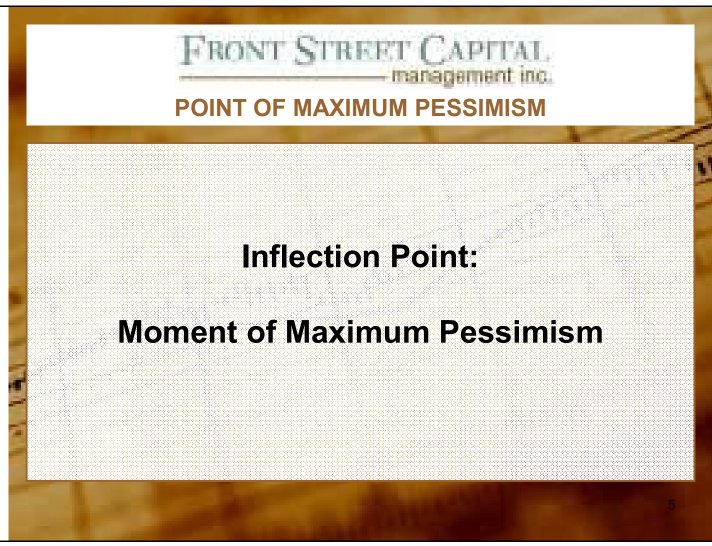

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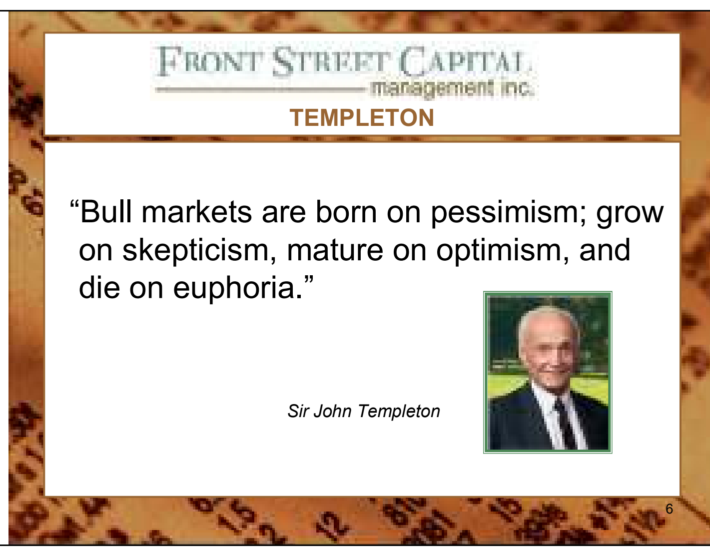

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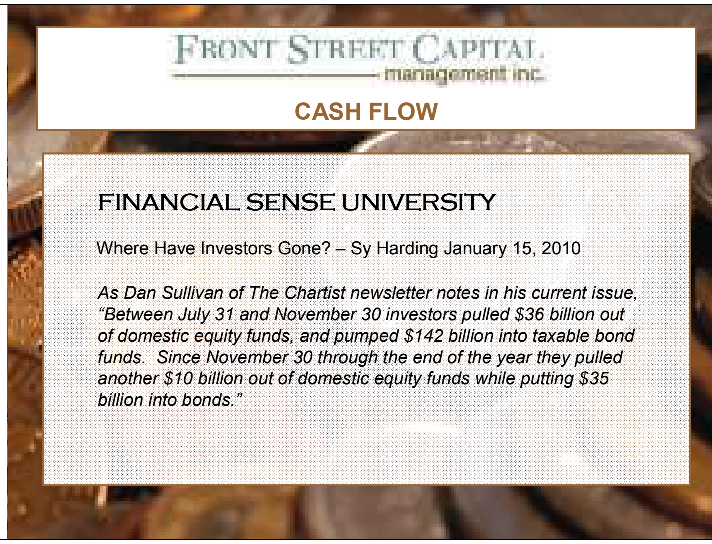

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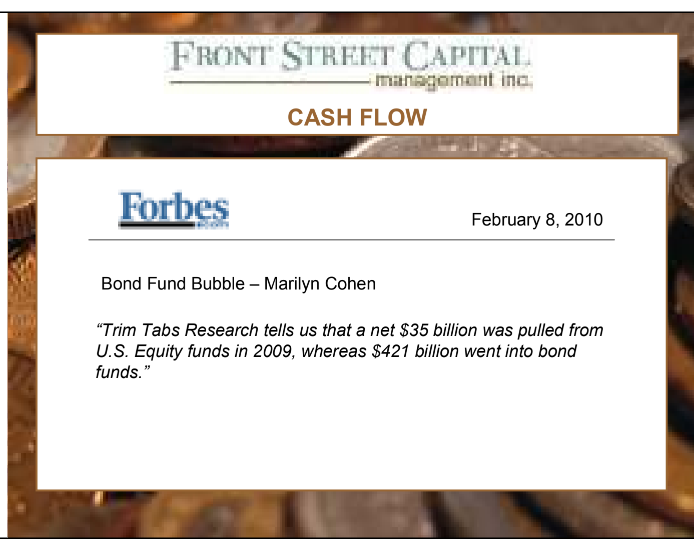

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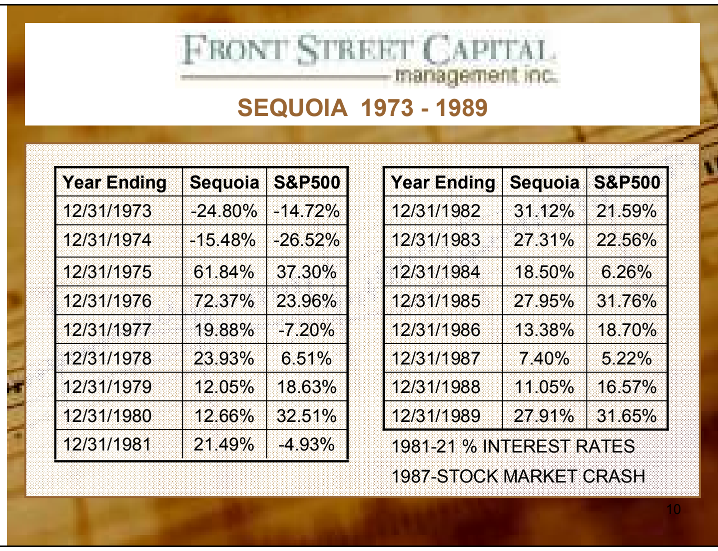

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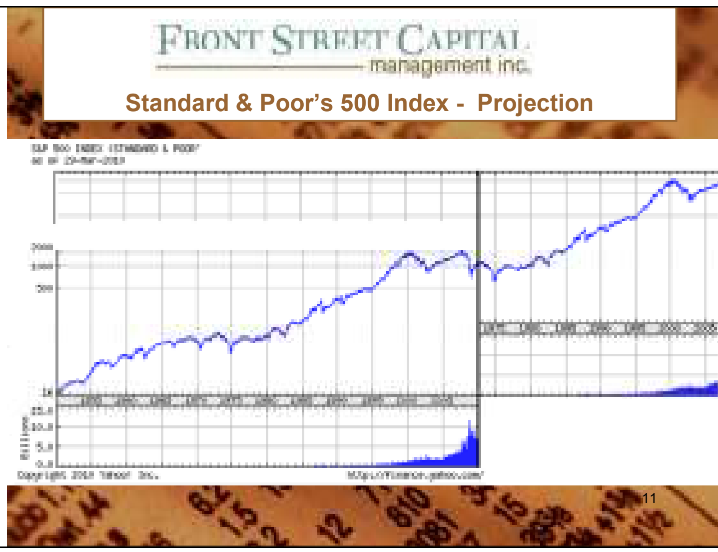

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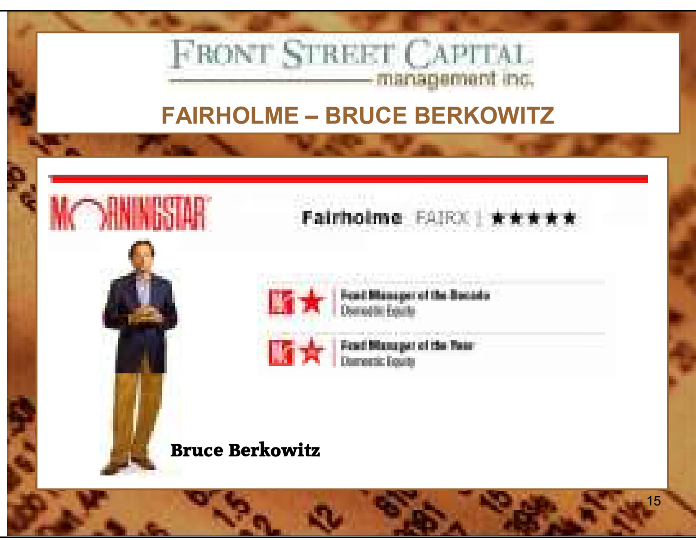

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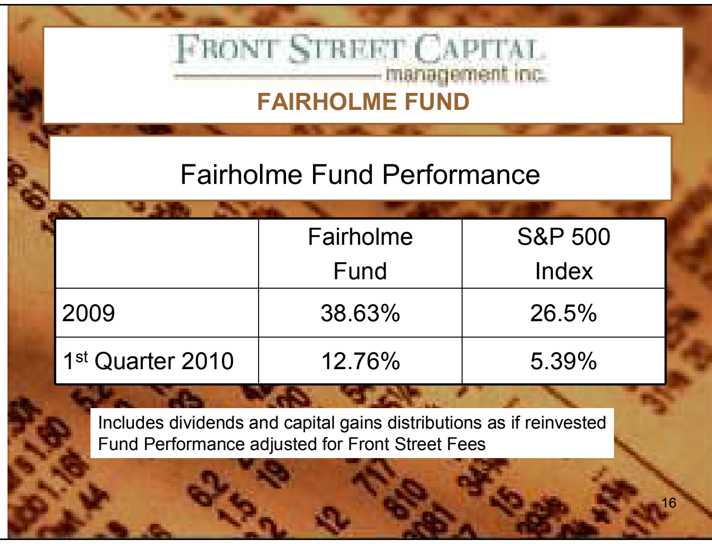

	Fairholme Fund	S&P 500 Index
2009	38.63%	26.5%
1st Quarter 2010	12.76%	5.39%

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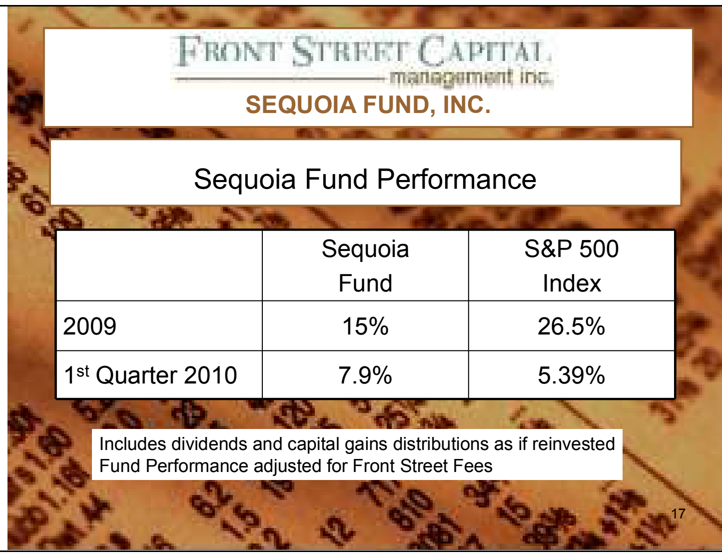

	Sequoia Fund	S&P 500 Index
2009	15%	26.5%
1st Quarter 2010	7.9%	5.39%

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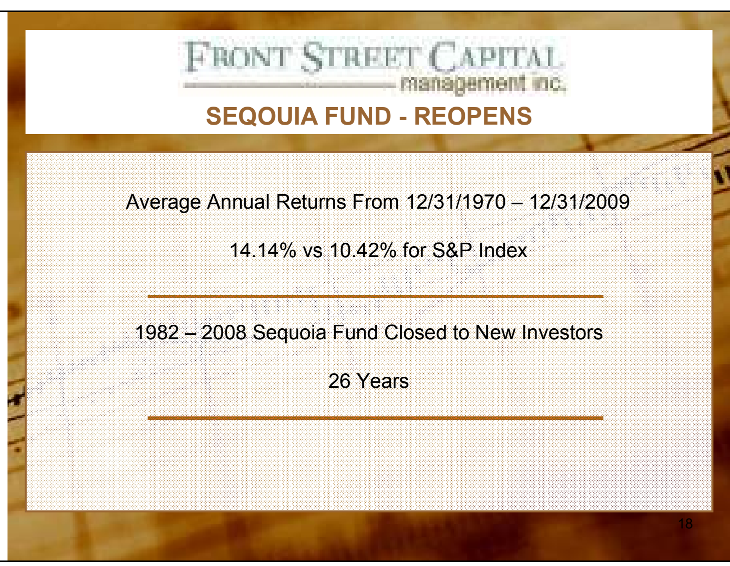

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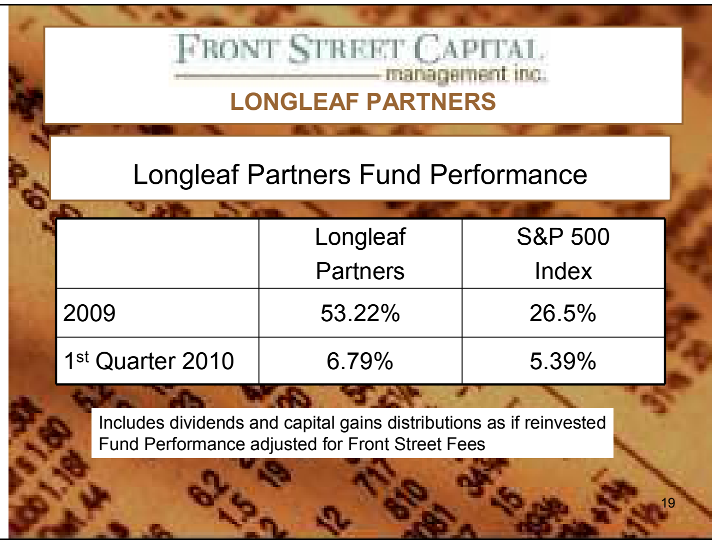

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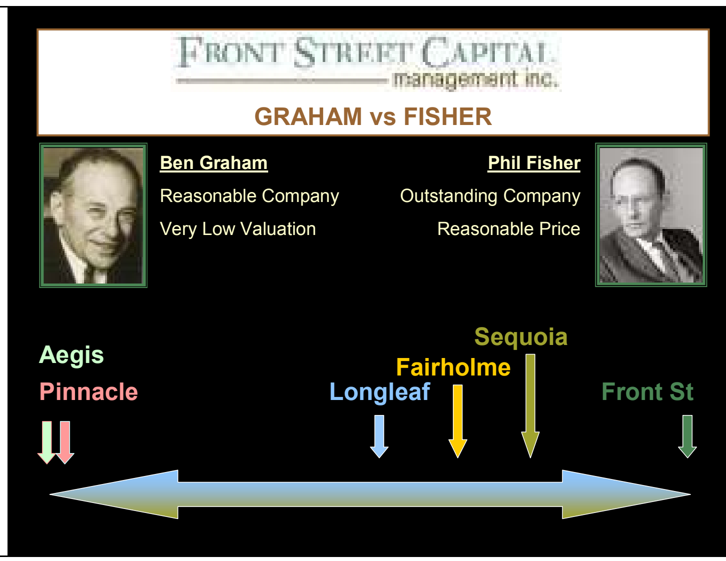

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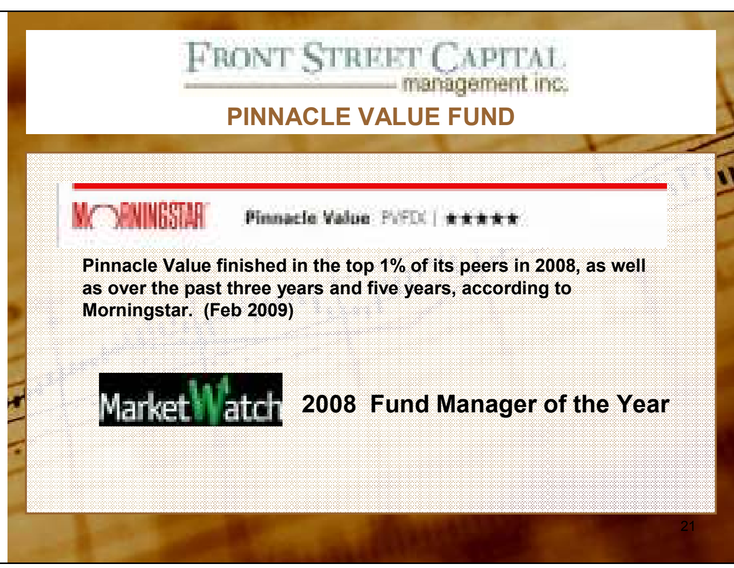

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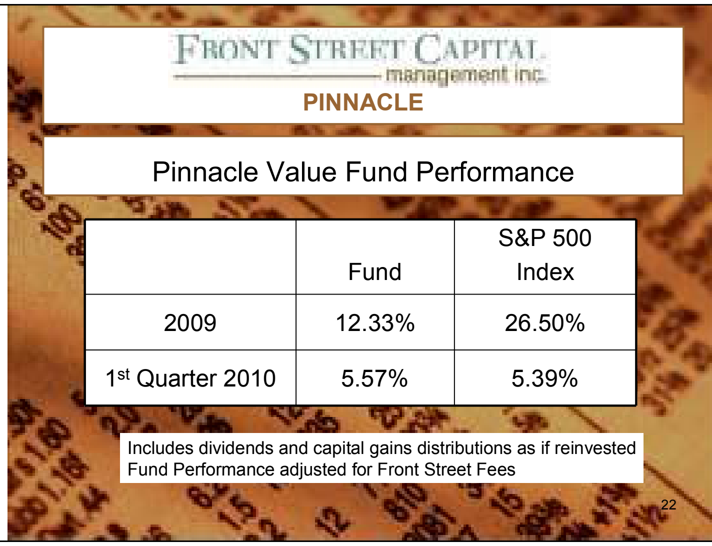

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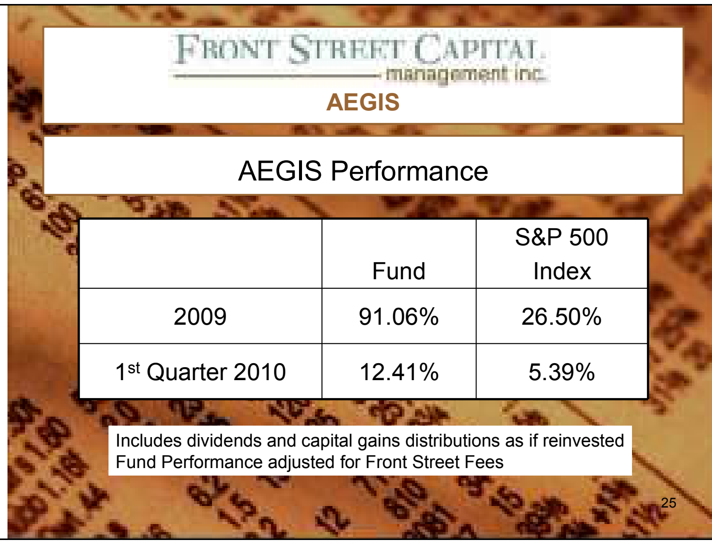

	Fund	S&P 500 Index
2009	91.06%	26.50%
1st Quarter 2010	12.41%	5.39%

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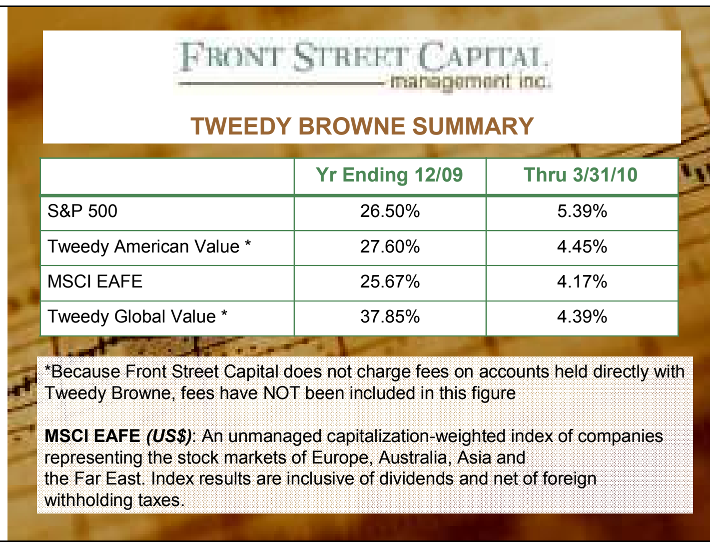

	Yr Ending 12/09	Thru 3/31/10
S&P 500	26.50%	5.39%
Tweedy American Value *	27.60%	4.45%
MSCI EAFE	25.67%	4.17%
Tweedy Global Value *	37.85%	4.39%

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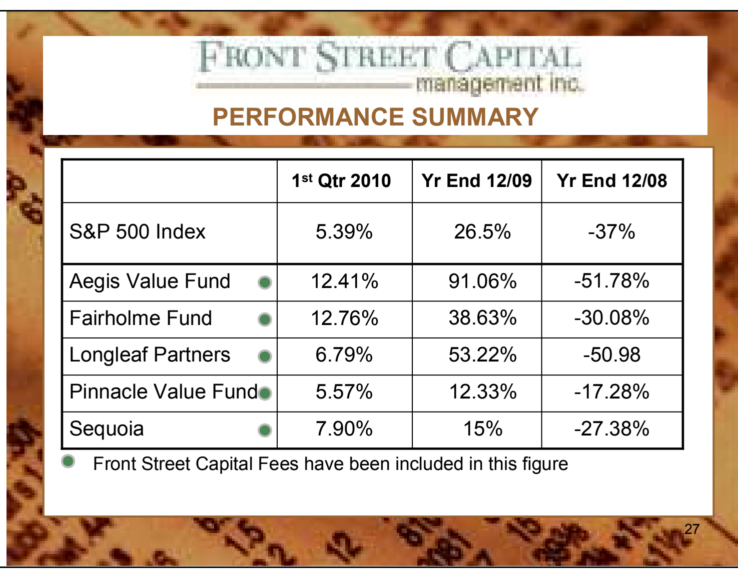

	1st Qtr 2010	Yr End 12/09	Yr End 12/08
S&P 500 Index	5.39%	26.5%	-37%
Aegis Value Fund ●	12.41%	91.06%	-51.78%
Fairholme Fund ●	12.76%	38.63%	-30.08%
Longleaf Partners ●	6.79%	53.22%	-50.98
Pinnacle Value Fund ●	5.57%	12.33%	-17.28%
Sequoia ●	7.90%	15%	-27.38%

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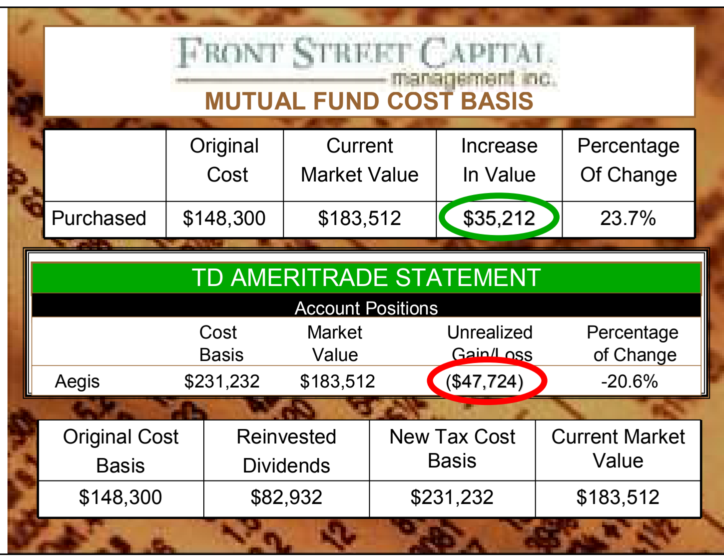
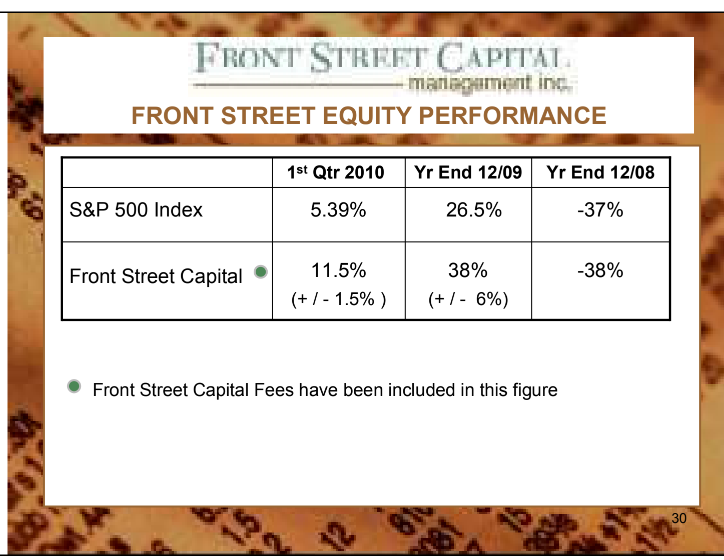
Slide 29	
Slide 30	

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FRONT STREET CAPITAL management inc.

MUTUAL FUND DISCLAIMER

Aegis Value Fund	www.aegis.com
Fairholme Fund	www.fairholmefunds.com
Longleaf Partners	www.longleafpartners.com
Pinnacle Value Fund	www.pinnaclevaluefund.com
Tweedy Browne	www.tweedy.com
Sequoia Fund, Inc.	www.sequoiafund.com

Past Performance is no guarantee of future results. An investor should read the prospectus carefully before investing or sending money. Current performance and Prospectus can be found at each fund's website. Information gathered from sources deemed reliable.

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FRONT STREET CAPITAL management inc.

MUTUAL FUND COST BASIS

	Original Cost	Current Market Value	Increase In Value	Percentage Of Change
Purchased	$148,300	$183,512	$35,212	23.7%

TD AMERITRADE STATEMENT

Account Positions

	Cost Basis	Market Value	Unrealized Gain/Loss	Percentage of Change
Aegis	$231,232	$183,512	($47,724)	-20.6%

Original Cost Basis	Reinvested Dividends	New Tax Cost Basis	Current Market Value
$148,300	$82,932	$231,232	$183,512

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FRONT STREET CAPITAL management inc.

FRONT STREET EQUITY PERFORMANCE

	1st Qtr 2010	Yr End 12/09	Yr End 12/08
S&P 500 Index	5.39%	26.5%	-37%
Front Street Capital •	11.5% (+ / - 1.5%)	38% (+ / - 6%)	-38%

• Front Street Capital Fees have been included in this figure

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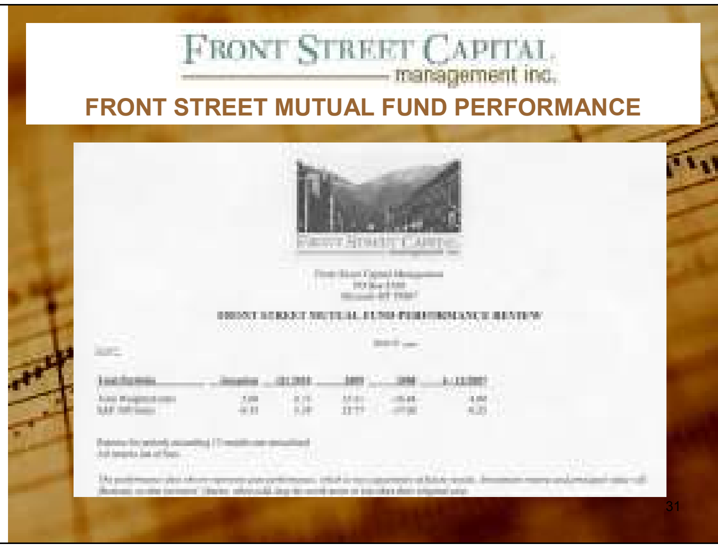
<tr><td>Slide 31</td><td>
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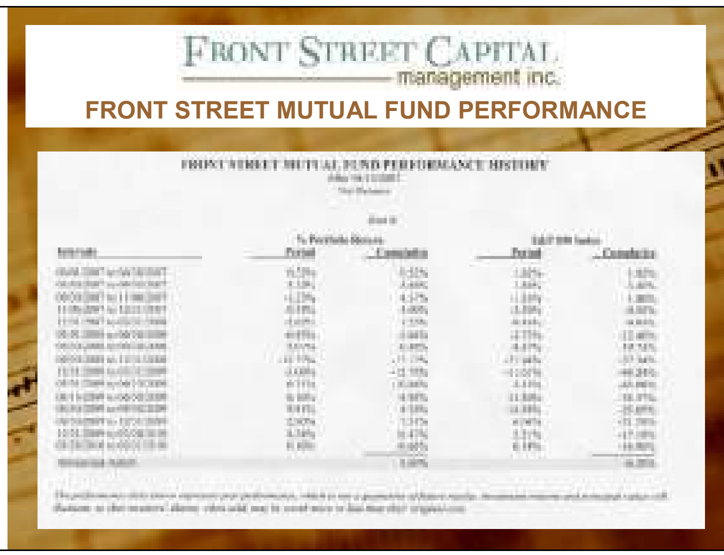
<tr><td>Slide 32</td><td>
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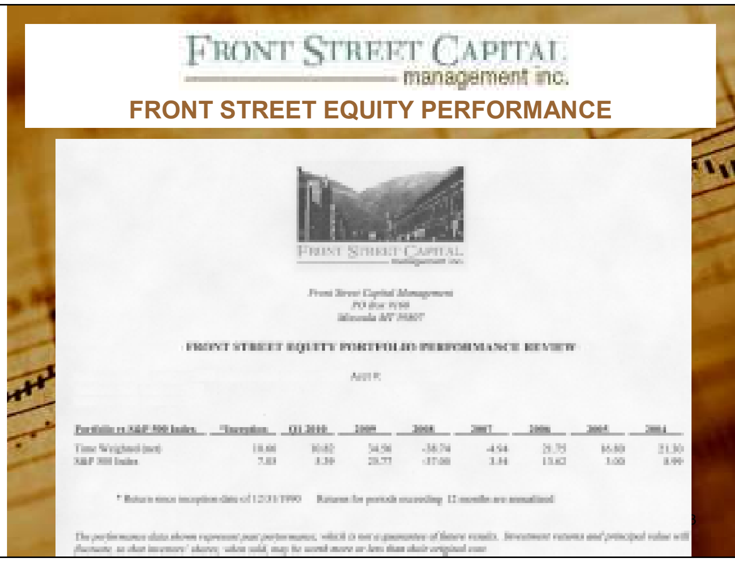

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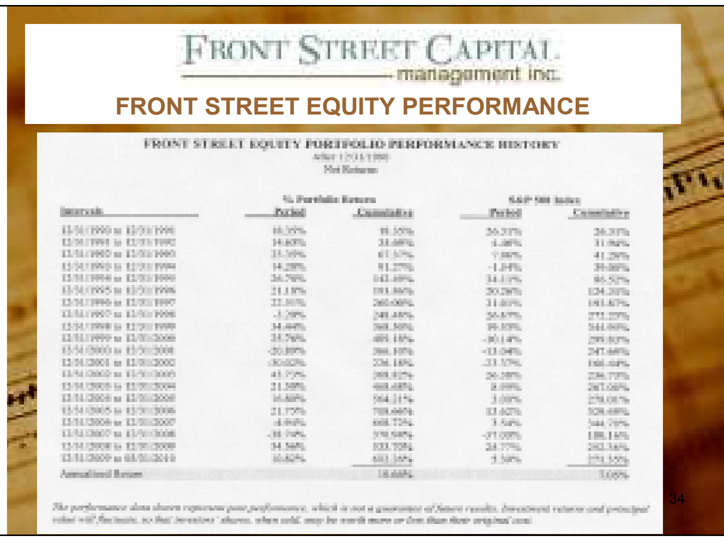

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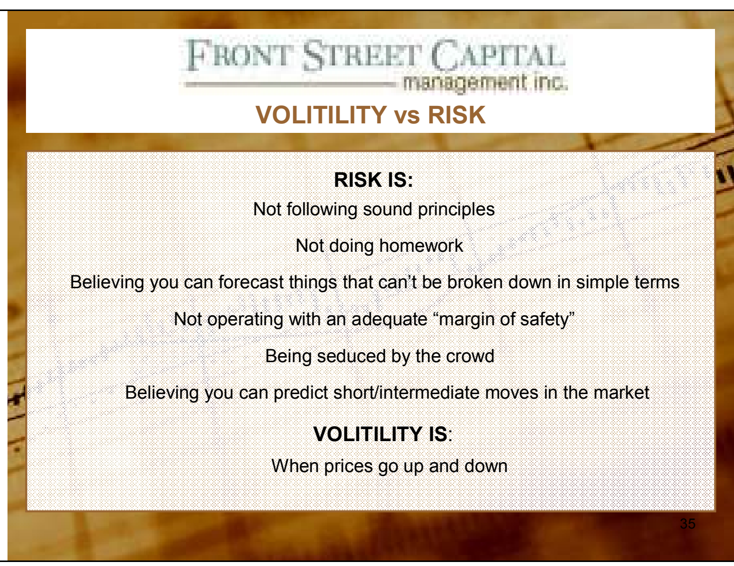

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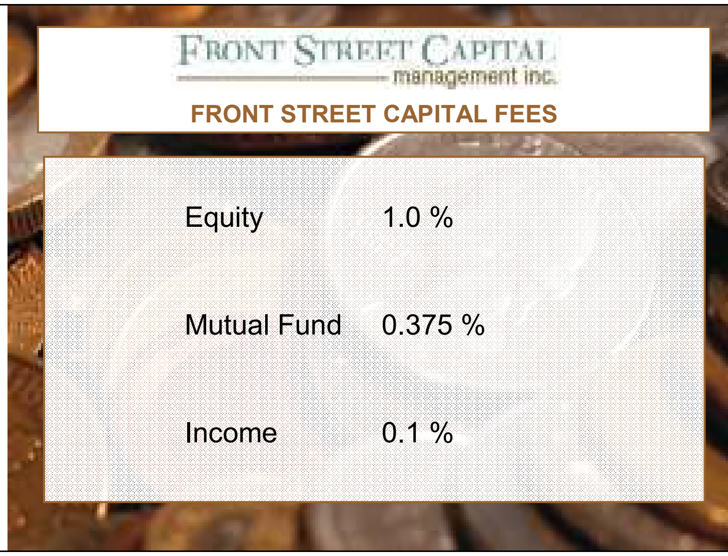

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