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CENTURY MANAGEMENT
1301 CAPITAL OF TEXAS HIGHWAY
SUITE B-228
AUSTIN, TX 78746
(800) 664-4888 (512) 329-0050
(512) 329-6152 (FAX)

PERSPECTIVES AND ACTIVITIES OF THE NATION'S MOST SUCCESSFUL MONEY MANAGERS.

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ROBERTSON STEPHENS CONTRARIAN FUND'S
PAUL STEPHENS
"THE NEXT SECULAR BULL MARKET WILL BE IN
NATURAL RESOURCES & COMMODITY-BASED SECURITIES."

According to *Morningstar*, Paul Stephens has maintained 20%± of Robertson Stephens Contrarian Fund's assets in short positions and 2% or so of its portfolio in puts. And even the vast majority of his *long* positions have been in the securities of natural resource and commodity companies. So you can understand why he might not have done so well.

However, despite those seeming handicaps, Stephens somehow managed to earn a 19.8% per year return and

(continued on page 2)

MUTUAL SERIES FUNDS' MICHAEL PRICE,
RAY GAREA, LARRY SONDIKE, DAVID WINTERS ET AL.
"THE PRESS HAS GIVEN ME *MUCH* TOO MUCH CREDIT.
WE TRULY USE A TEAM APPROACH."

Mutual Shares — which is part of Mutual Series Fund — has been the model of consistent excellence under the leadership of Michael Price. For the last 21 years, the fund has earned a compound annual return of 20.2% after all fees and expenses versus 15.6% per year for the S&P 500 — with far less volatility along the way.

Part of the formula — investing in bankruptcies and special situations — has been a page straight out of the book

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BARON ASSET FUND'S RON BARON
"WORRY ABOUT THE BUSINESS,
NOT THE STOCK MARKET."

Ron Baron founded Baron Capital Management in 1983 — the year small-cap stocks began a stint in the doghouse. Despite that unfortunate timing, however, and what Baron terms "the worst year of his career" in 1990, he still managed a compound annual return of a rock-solid 18.4% vs. 12.4% for the Russell 2000 for the 13 years ending 12/31/95.

We're pleased to bring you some of his perspectives on investing generally along with some of his favorite ideas today from the Baron Funds' Fifth Annual Investment Conference.

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CENTURY MANAGEMENT'S
ARNOLD VAN DEN BERG
"THE STOCK MARKET MAY BE STRETCHING IT,
BUT THESE IDEAS CERTAINLY AREN'T."

As a 13-year-old in an East Los Angeles neighborhood, Arnold Van Den Berg was still physically underdeveloped from three years in an orphanage in Nazi-occupied Holland. To overcome his lack of strength, he took up rope climbing with such commitment that he set a record in the event — climbing 20 feet in 3.5 seconds — at his school that lasted until the event was discontinued about 15 years later.

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CENTURY MANAGEMENT'S
ARNOLD VAN DEN BERG
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While still a senior in high school, he even placed seventh in the national *collegiate* competition.

As a 31-year-old salesman for a local securities firm specializing in mutual funds, Van Den Berg became upset with how those funds had performed in 1969 and 1970. To understand why, he began to research security analysis and became an avid reader of Ben Graham and a student of security analysis.

He soon decided he wanted to manage money. But lacking the background or the credentials to enter the field, he was stymied — until someone suggested that he apply the same commitment that he'd applied to rope climbing nearly 20 years before. Then and there, he made the commitment that however long it took, he'd begin his own advisory firm. And apply that same commitment, he did — converting his small studio apartment into a virtual research office — moving everything out save his desk, his books and his bed.

One of his first discretionary clients, Robert Phillips — who joined him in mid-1974 — also loaned him the $2,500 that he used to start his firm. Incidentally, that gentleman is still a client (and, Van Den Berg adds, a good friend) today. He recounts how he was so grateful at the time that he said to him, "I'm going to make you a million dollars." — although the comment was made in jest and the idea was so farfetched at that time that they both had to laugh.

Today, having earned a compound return of 18.82% per year after all fees and expenses for 22+ years on his investment, he says he's actually now made him more than *$2* million. And, he tells us, the (audited) performance of his account is comparable to that of other equity accounts during the same period.

We'd like to credit (and thank) our late contributor and friend, Jerry Carret — son of living legend, Phil Carret — for introducing Van Den Berg to us by introducing us to Sam Hale prior to his affiliation with Century Management.

Incidentally, in preparing this feature he displayed a passion which we imagine was similar to the passion he displayed in his pursuit of excellence in rope climbing and money management. Only limitations of time and space (you probably didn't realize that we had those) kept this feature from being longer and more wide-ranging.

The following material was excerpted from a series of extended interviews between November 21st and right up to press time. We hope you find his thinking process and the ideas discussed as intriguing as we do.

BELIEVE IT OR NOT, HERE'S A CLASSIC VALUE PLAY AT A MERE 55% OF A SOLID ADJUSTED BOOK.

OID: I understand that you're actually finding some compelling bargains in this market?

Arnold Van Den Berg: *Absolutely*. For example, Moore Products [MORP/Nasdaq] is a *classic* value play today. Moore Products produces metrology equipment — that is, fairly sophisticated measurement equipment — for companies that need to measure and control the pressure, flow and/or temperature of fluids. Their customers are companies in industries as diverse as chemicals, oil and gas, medical, pharmaceuticals, textiles, food and beverage, utility, agriculture and pulp and paper — you name it.

OID: Why do you say that it's a classic value play?

Van Den Berg: Well, its stock is around $19. It has no debt. And the values are absolutely all *over* the place. It has net working capital of $10.82 per share. It has a LIFO reserve after tax of $2.50 per share. And its pension plan is overfunded by $9.50 per share after tax. So that's nearly $23 per share of liquidation value right there.

[Editor's note: Moore's 1995 annual report states that the current cost of domestic inventories exceeded the LIFO (last-in, first-out) value by $9.8 million at 12/31/95.]

OID: Which doesn't sound all bad for a $19 stock.

Van Den Berg: And it gets even *better*. They also own about 130 acres of excess real estate. And we've talked to real estate people in Spring House, Pennsylvania, who tell us that land is selling for $100,000 per acre right down the street. But rather than use that $100,000 per acre figure — which would imply a value of *$13* million — let's just say it's worth *$10* million.

OID: We must not have explained the ground rules. You round up...

Van Den Berg: And that $10 million divided by Moore's 2.6-odd million shares outstanding would add another $2.50 per share after tax. That would bring their adjusted liquidating value to more than *$25*. Meanwhile, their stock's at $19. So you can buy Moore today at a discount of about 25% from its *liquidation* value.

OID: It sounds like the values are all over the place, all right.

Van Den Berg: And if you add their $9.50 of overfunded pension after tax, their $2.50 of LIFO reserve after tax and their $2.50 of real estate after tax to their current book value of approximately $20.70, you can see that their adjusted book value is north of *$35*.

So today's price is over 45% off adjusted book. And Moore doesn't have any intangibles on their balance sheet. So that $35 adjusted book is *solid*.

OID: That sounds like a classic value play, all right.

BASED ON OUR ESTIMATE OF PRIVATE MARKET VALUE, TODAY'S STOCK PRICE IS 40¢ ON THE $1 OR LESS.

OID: I don't mean to look a gift horse in the mouth. But what does it look like on a non-liquidating basis?

Van Den Berg: On a going concern basis, given the cash flow and the earnings potential, we believe Moore has a private market value of at least $45 to $50 per share.

OID: So that it's selling at 40¢ on the dollar or less business-wise — according to your estimates?!

Van Den Berg: That's right.

(continued on next page)

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CENTURY MANAGEMENT'S
ARNOLD VAN DEN BERG
(cont'd from preceding page)

OID: May we ask how you arrived at your estimate — and, of course, why you say "at least"?

Van Den Berg: Actually, we always do our valuations several different ways. But, in a nutshell, Moore is on track to have sales this year in excess of $140 million — which is more than $50 per share.

OID: Closer to $54, but who's counting...

Van Den Berg: So their market cap plus their debt — which is easy to calculate since they don't *have* any debt — is only about 35% of sales.

And we've done a lot of studies of price-to-sales and price-and-debt-to-sales. When you get down below 45%, you're getting down near bear market multiples.

OID: Depending on the type of business, of course.

Van Den Berg: That's exactly right. And I am making a generalization. However, for this kind of company, 35% of sales is *cheap*.

OID: If they were earning decent returns, maybe so. But it looks like they lost money in 1993 and 1994, only made 9¢ in 1995 and only earned about 24¢ in the first three quarters of this year.

Van Den Berg: I knew you'd be asking that question.

OID: How long have they been earning subpar returns? And what makes you think they'll get better?

Van Den Berg: Their subpar results go back three or four years. But a lot of it, I think, is due to their R&D. During those years, they had the highest expenditures on R&D that they've *ever* had. To give you some idea, here are Moore's R&D outlays per share the last five years: $4.32 in 1991, $4.65 in 1992, $4.54 in 1993, $3.96 in 1994 and $3.77 in 1995.

But now they've finished their new line of products. Plus, they've increased their shares outstanding from about 2.1 million to closer to 2.6 million by selling 500,000 new shares to their pension fund. So we believe that they can probably normalize their R&D going forward at about $3 per share.

OID: That's very interesting, although it doesn't explain why Moore lost $2.20 per share in '93 and didn't earn more than it did in '95 when their R&D was only $8.1 million — although management points to depressed sales as the culprit in 1993.

Van Den Berg: That's right. Another reason why their margins are depressed is competitive pressures worldwide. However, their sales are picking up enough that we believe that they'll be able to raise their margins as well.

(continued in next column)

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OID: In fact, I see their sales have been increasing at a 20% annual rate for the last half a dozen quarters.

Van Den Berg: That sounds about right. They've been showing a *very* nice increase in their sales. Likewise, they've announced that their *bookings* are up 20%. That's a mighty good sign that the higher R&D was well spent.

OID: And that eventually translates into earnings?

Van Den Berg: We think so. In fact, we believe that Moore will get its net profit margin back up to about 5%.

OID: That's what they've earned historically?

Van Den Berg: They have. We're not expecting them to do that next year, mind you. But they *certainly* have the capability to do it in the next three or four years. And 5% margins would give them close to $2.70 of earnings power on '96 sales — and, therefore, something north of $3 on the sales they're likely to achieve in '97.

OID: In which case the current price would represent slightly over 6 times normalized earnings.

Van Den Berg: You've got it. So the only leap we're making is that higher sales eventually lead to something near historical margins. And we're *very* comfortable there.

ACTUALLY, MY $45-50 VALUATION MAY BE LOW.
IT COULD VERY WELL BE $60 OR MORE.

Van Den Berg: And based on the multiples of the closest acquisitions that we can find, we'd be talking about a private market value of 20-25 times.

OID: They sold at 20-25 times earnings?!

Van Den Berg: They sure did. And, in fact, that's not so surprising. Our studies suggest that the average P/E paid for acquisitions tends to peak at 22-24 times earnings in markets similar to today's. That's approximately what they tended to be, incidentally, in 1968, 1972 and 1987 and what they've averaged since 1994.

OID: And we thought double-digit P/Es were unholy...

Van Den Berg: Still, absent an actual acquisition, stock prices very rarely exceed 80% of acquisition prices and, therefore, tend to peak at more like 20 times earnings.

But getting back to Moore, the closest acquisitions that we can come up with suggest a P/E of 22-24. And so there's our private market value estimate of $45-50.

OID: Actually, using your figures, we come up with $60 to $75...

Van Den Berg: We don't use peak multiples in our valuations. During the 1970s, the average P/E multiple on acquisitions got as low as 13 and probably averaged 16-17. And that's what we're using. We try to be conservative....

OID: Please get that out of your system right now.

Van Den Berg: The best comparable sale that we can find for Moore Products is Elsag Bailey's acquisition of Fischer & Porter. They paid $29.90 per share — or approximately $157 million. Their earnings and cash flow were as depressed as Moore's. So we used normalized figures to calculate their multiples.

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CENTURY MANAGEMENT'S
ARNOLD VAN DEN BERG
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And using our normalized figures, we estimate that Fischer & Porter sold for .77 times price-and-debt-to-sales, .69 times price-to-sales, 13.6 times cash flow, 8 times EBITDA, 2 times book and 22 times earnings.

If we apply those same multiples to Moore's normalized figures, we come up with $38.93, $37.10, $53.18, $49.38, $41.40 and $55.00. Averaging those figures, we come up with $46.67. And that figure doesn't include their overfunded pension, their LIFO reserve or their excess real estate — which would add about $14.50.

So we believe our estimate is very conservative. Someone could *very* easily make the case that Moore's private market value is higher.

OID: Actually, I thought you just did...

Van Den Berg: We do look for a bigger discount here, too, because this company only has 2.6 million shares outstanding. It's a small cap stock. It's highly illiquid. And it isn't exactly the kind of company many institutions are going to look at.

But we operate in this area. So we're not concerned about what institutions do.

OID: Marty Whitman says the same thing — that he's not into studying abnormal psychology...

Van Den Berg: We don't care if Wall Street follows it. We do our own research. And given everything we see, we're convinced that not only is it selling *well* below liquidation value, but that it's selling at a *tremendous* discount to private market value.

Between their increase in sales, the slowing down of outlays on R&D and the fact that their capital expenditures are more or less equal to their depreciation, their earnings are going to be true *free* cash flow.

OID: In other words, available to their shareholders, not to their suppliers.

Van Den Berg: We can calculate free cash flow another way by starting with their gross cash flow and deducting capital expenditures. However, I expect their free cash flow to very closely parallel their earnings anyway. And when it does, their stock's going to trade more in line with the kind of valuation it's gotten in the past.

OID: Which is?

Van Den Berg: Well, its price-to-book multiple got as high as 1.7, 1.6 and 1.63 in 1983, 1986 and 1987. And its price-and-debt-to-sales ratio got as high as 1.32, .93 and .97 in 1983, 1986 and 1987. So if they get a price-and-debt-to-sales ratio of 1.00 — and again, they'll have $54± per share in sales this year — well, you can do the math as well as I can.

OID: Your confidence in my ability to multiply by one is much appreciated. But I imagine your point is that, again, it supports your valuation of $45-50 or more.

Van Den Berg: Exactly.

PRICE TO REVENUE CUTS THROUGH THE FLUFF
FOR MOORE AND THE S&P 400. AND IT AIN'T PRETTY.

OID: But is 1 times revenue really reasonable?

Van Den Berg: I think so. The S&P 400 is selling for 1.10 times sales and 1.27 times price-and-debt-to-sales. Once again, by contrast, Moore is currently selling at 35% of price-and-debt-to-sales.

And we could argue back and forth about whether Moore *should* be worth as much as an S&P company. However, it's certainly not worth *70%* less.

OID: Although one can also argue about whether the S&P is worth more than 1 times sales.

Van Den Berg: Absolutely. Again, the S&P 400 is trading at over 1.10 times sales as we speak. And the highest price-to-sales multiple at which the S&P 400 has ever traded in this interest rate environment is 1.16 times sales in 1968-69.

OID: So that the S&P 400 has been more expensive in other interest rate environments.

Van Den Berg: Yes. In 1961, it hit 1.29 times sales. But that was with a AAA rate of 4.3%.

OID: Which still puts today's prices too close to the record highs by that measure for comfort.

Van Den Berg: And in 1968-69, that 1.16 multiple was with AAA rates at 6.2% — which is lower than where we are today. After all, AAA rates are around 7%. But it's close enough.

OID: It works for me.

Van Den Berg: So, by that measure, we're within 5% of the all-time record highs. By comparison, the S&P 400 has traded 38-40% of sales at bear market bottoms.

Incidentally, relative to cash flow and earnings, the story's quite similar. In 1968-69, the S&P 400 sold for 19.15 times earnings and 11 times cash flow at its peak. And those are about the same valuation levels we're at today — 19.5 times earnings and 11 times cash flow.

OID: If you think you can scare me, you're right...
And I gather that one of the implications is that either interest rates decline or valuations do.

Van Den Berg: That's right. Valuations are unlikely to go much higher absent a lower interest rate/lower inflation environment. And we'd need higher growth — because the economy was growing a little bit better than it is today.

But getting back to Moore Products, the only thing I'm pointing out is that sometimes you can cut through the fog by looking at valuations relative to sales — because it gets around questions about margins and accounting gimmickry and all the other things you can do internally.

MANAGEMENT ISN'T 100% SHAREHOLDER-ORIENTED,
BUT THEY ARE ENGINEERS THROUGH AND THROUGH.

OID: What can you tell us about their management?

Van Den Berg: They're honest, hard working and competent. But they're not the focused kind of management that's totally shareholder-oriented. If they were, they could

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CENTURY MANAGEMENT'S
ARNOLD VAN DEN BERG
(cont'd from preceding page)

probably realize the $45-50 value that I've mentioned.

They're extremely conservative though. For example, when we ask them about the real estate — why they don't sell it and redeploy the capital into the business — they say, "Well. Yeah. It's good real estate. But why sell it and have to pay taxes? And the excess pension? Yeah. That's true. But we used the pension when we needed money to fund our R&D and our sales growth."

So they're not really driven to move their stock.

OID: What are they driven by?

Van Den Berg: This management is engineers through and through. And what they're driven by are engineering-related considerations — in other words, by their desire to do research and produce quality products.

OID: Still, how much of Moore's subpar margins have been a result of subpar management or other factors?

Van Den Berg: As I mentioned, they just completed a tremendous surge in their spending on R&D.

Sales, on the other hand, didn't go up that much during those years. So part of their subpar returns have been a result of heavier expenditures on R&D — which we believe, and which *they* believe, will be trending down once their new line is funded.

But if you look at their margins, you can also see a deterioration in their pretax margin *outside* of the difference in R&D spending. And that's just because SG&A expenses increased relative to sales.

So part of the lower margins and returns may be due to management not being quite as cost conscious as they might be. In other words, if a shareholder-oriented fanatic were running Moore, he'd probably be able to fine tune their operation and make it achieve the kind of margins that it's earned historically.

A RECENTLY ARRIVED CATALYST AT MOORE: THE PRESIDENT OF THEIR #1 COMPETITOR.

Van Den Berg: So, you may wonder, "What's going to unlock the value?"

OID: I appreciate you letting us sit in on this interview.

Van Den Berg: Well, it would be wonderful if some major company were to buy them and take over their R&D and their marketing. They'd have $54 per share of sales. And much of their R&D and marketing would probably turn out to be unnecessary duplication.

OID: Begging doesn't help. Believe me, I've tried...

Van Den Berg: There's also a recently arrived catalyst. That catalyst is their new chairman of the board as of June — Edward T. Hurd — the first chairman from outside of the Moore family.

OID: What can you tell us about him?

Van Den Berg: According to a Moore press release, he has 35 years of experience in the global process control area. And prior to joining Moore, he served as president of Honeywell's industrial service division from 1990 to 1995. And that division is one of Moore's primary competitors — probably their prime competitor.

OID: Interesting.

Van Den Berg: So, in effect, they brought in someone who really knows the business and who knows how to compete against them.

Obviously, since he was heading up their major competitor, they were especially happy to get him. Clearly, he had experience within the industry with a major, well-run company. And from everything we can tell, he did a great job at Honeywell.

But the most important thing that he's bringing to the company is a fresh approach and a systematic way of focusing their product line. He's looking at every item in their product line and asking, "Do we want to keep it? Is it material to our operation? Do we want to focus on it more? Or should we eliminate it?"

And, more important still, when a family-run business goes out and brings in someone from outside, I think that it signals something very significant.

OID: That the kids have unrelated interests or that the acorns fell too far from the tree?

Van Den Berg: They're saying, "We're engineers. And we do a good job in that area. And we've done a good job running this company in the past. But it's not as profitable as it should be today. So maybe we should bring somebody in whose primary focus is to run the business."

I think they realized that there may have been too much emphasis on engineering and not enough on marketing and other facets of the business. But they wanted someone who really understood their business, knew their products, knew their competitors, etc.

OID: And, what the heck — if it happened to handicap one of their prime competitors, all the better.

Van Den Berg: I think it came about partially based on the recognition that their margins aren't as good as they should be and partially because they're getting more conscious of their stock.

OID: Sounds familiar...

Van Den Berg: And one of the things that brought it to light is that they needed to fund their recent sales growth and R&D. So they sold some stock to their pension plan, which is mostly them anyway. So I guess that didn't bother 'em.

OID: I imagine not.

Van Den Berg: But I think that they're realizing that, "Geez, if the stock price were up a little higher, maybe we'd sell some to the public and get a *real* price instead of $16." — which in my opinion is a *giveaway*.

[Editor's note: The price at which 500,000 shares were sold to their pension fund.]

OID: And they made him chairman?

Van Den Berg: Yes.

OID: That sounds serious.

Van Den Berg: I believe it's *very* serious. And I think

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CENTURY MANAGEMENT'S
ARNOLD VAN DEN BERG
(cont'd from preceding page)

you've put your finger on a key item: They brought him in as chairman of the board and have given him free rein. He presides over many Moores. The fact that they were willing to bring him in as chairman speaks volumes.

And we believe Hurd is going to start stirring the pot.

OID: What makes you say that?

Van Den Berg: As we talk to this management more and more with the first outsider taking over the reins and starting to look at the way they do business, it's becoming increasingly clear to us that they're starting to think about ways of unlocking their shareholder value, too.

Prior to Hurd's arrival, we got the impression that the chief financial officer agreed with us, but that these things just weren't a very high priority. Now they're doing strategic planning and are open to reviewing all options — which may be the very reason that they brought Hurd into the company.

BUT EARNINGS AND CASH FLOW WILL IMPROVE
WHETHER THEY REFOCUS OR NOT.

Van Den Berg: It's not that they're *anti*-shareholder today — because they do own 38% of Moore *themselves*.

OID: So they're only hostile to the shareholders who own the other 62%.

Van Den Berg: Not at all. They're the kind of people who are focused on doing the job, on the engineering, etc. I feel *very* good about this management. I feel very good about their character and dedication and about the product that they put out. There's never been any problem with it.

I think the only thing missing is someone thinking, "What can we do to raise the consciousness of the Street about our stock, raise our value and get our stock price up from the $18-19 that it trades at today closer to the $30-35 where it *should* be trading?"

OID: I thought you said $45-50 or more?

Van Den Berg: I said $45-50 private market value. Usually, unless a company is acquired, it rarely sells above 80% or so of its private market value.

That said, our feeling is that enough is happening that their earnings and cash flow are going to improve even if they stay right on the track they're on and *don't* focus directly on shareholder value — because their new products are starting to hit and, again, their sales are up.

You can talk about R&D being well spent all you want. But the proof's in the marketplace. When the R&D produces sales, you can have a lot more confidence that it was actually well spent. So, again, we believe that it's simply a matter of time until their earnings follow.

HOW DOES MOORE STACK UP COMPETITIVELY?
THAT'S EASY. JUST LOOK AT THEIR SALES.

OID: What can you tell us about how Moore Products stacks up competitively?

Van Den Berg: It's interesting that you ask that — and maybe that accounts for some of the pressure that they've experienced on their margins.

But International Paper — a major player in one of their fields — selected Moore as its supplier just last year. They entered into what they call an alliance agreement.

OID: Meaning?

Van Den Berg: Meaning that International Paper was so enthused about it that they took it beyond just the normal relationship. They entered into a long-term corporate alliance agreement in which International Paper will use Moore Products as the primary supplier of distributed control systems. The agreement covers all International Paper production and R&D facilities worldwide, all subsidiary companies in which International Paper holds a controlling interest, and all engineering contractors used by International Paper.

OID: Do you know Moore's current market share?

Van Den Berg: I think they're a leader in most of the niches they're in. And they're in some pretty good niches. My sense is that they're so specialized — like this deal they put together with International Paper — that it's almost like they're the only ones doing it. A lot of their products and services are more or less tailored to the individual customer. They're selling the hardware, the software and the consulting in one package.

However, we've asked Moore the same question. And they tell us that even *they* don't know. Apparently, this is an extremely fragmented, highly specialized market. So it's been very difficult to nail down market shares.

OID: But isn't Moore competing with companies that are far larger — with distribution capabilities and R&D budgets to match?

Van Den Berg: Moore's competitors include Siebe and ABB Asea Brown Boveri, Inc., although we believe the Industrial Automation and Control Division of Honeywell is the one they meet in the marketplace more often than anyone else.

So how do they compete against larger competitors? Well, again, these guys are engineers first and foremost. This is their area. They're totally committed to it and have been for many years — since the company was founded in 1940. And that commitment and focus translate into developing excellent products.

Also, in the scientific world, anything having to do with measurement and process control is a very necessary and valuable service — in part because it relates to plant safety.

OID: Interesting.

Van Den Berg: Second, they're a niche player. They operate in niches that are too small for bigger companies. For example, Moore has developed proprietary software to run some of its measurement products. Well, you know that Microsoft isn't going to get into a field like that where potential sales are so limited. There's just no way for them to *justify* it.

OID: And you don't expect IBM to set up a division to compete with Moore, either.

Van Den Berg: Exactly. And there are many, many

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CENTURY MANAGEMENT'S
ARNOLD VAN DEN BERG
(cont'd from preceding page)

different niches available for them to serve — although the main industries they serve are probably oil and gas, paper, textiles and chemicals. They serve pharmaceuticals. They even have some services and devices specifically designed for the *metal* business. So they're able to serve quite a few industries and, therefore, also not be dependent on any *single* industry.

Wherever you need measurement — which is in almost *every* technical industry — they sell their products. Some they sell right off the shelf and others they design for that particular industry. They're a $120+ million company.

OID: Actually, it's closer to $140 million in 1996.

Van Den Berg: So they do have substantial sales. And 22-25% of their sales are foreign. So it looks like they have global potential, as well.

OID: And I believe I read somewhere that they have offices in Brazil, the U.K. and Hong Kong, among others.

Van Den Berg: I think that's right. And they're very well thought of from a service/product quality perspective in their industry and among their customers. But the Street doesn't know about 'em — and the few that do aren't too fond of 'em because of their stock price and because of the way they manage the company, etc.

OID: Plus, it's hard to imagine anyone making a living trading this company's shares.

Van Den Berg: That's right. I don't think anybody follows this company. With only 2.6 million shares outstanding, nobody at a major brokerage firm would bother writing about this thing — even if they thought it was a good idea.

OID: That's a great sign.

Van Den Berg: Yes. It's not followed at all. If you talk to management, you'd see another reason why not: This management doesn't really want to bother with it. They're obviously not in there trying to promote their stock. They're just running their business. They just say, "If you like the stock, buy it. And if you don't, don't."

On the other hand, I really believe that if you were to take Moore Products to 10 value players, I don't think too many of them would disagree with the basic premise that this thing is worth twice what it's selling for.

[Editor's note: In fact, Moore Products' latest proxy shows Peter Cundill & Associates and Quest Advisory owning 7.6% and 6.3%, respectively.]

OID: And, certainly, the arrival of the president of their leading competitor is an encouraging sign. Apparently, he thinks Moore has what it takes.

Van Den Berg: That's certainly true. However, again, they have some very strong market positions that you can count on — where they're pretty firmly entrenched.

But, frankly, their sales are growing 20% a year. What *more* do you need to know?

OID: Good point — for now, at least.

Van Den Berg: So I think they're *very* competitive. Also, they're not necessarily in markets that are experiencing explosive growth. For example, we've seen some perk up in oil and gas, but it isn't exactly like that business is booming. And I don't think the chemicals, textiles, utilities and agriculture areas are doing anything that would suggest that Moore should be in any kind of boom period or anything of the sort.

So the fact that they're increasing their sales at a time when the industries they serve are kind of in neutral indicates to me that their products are competitive and that they're finding some good opportunities.

OID: Although, in their latest annual report, management points to "strong economic conditions" in their "traditional process control markets".

Van Den Berg: Certainly, their business has picked up. But my point is simply that business is not exactly booming for their major customers — and yet Moore's sales are growing very nicely.

OID: Also, for whatever it might be worth, although total sales were up 20% in '95, it looks like their domestic sales were only up slightly over 15%, whereas their international side was up over 40%.

Van Den Berg: They're trying to build their business in the Asia Pacific region and Europe and Latin America. So that's fine with me. It just suggests they're *succeeding*.

MOORE HAS HIGHER RETURNS THAN IT APPEARS.
ONLY THEY'RE HIDDEN BY EXCESS CAPITAL.

OID: Given that this company seems to be cyclical and in a state of flux, this is probably an unfair question. However, based on your knowledge of this company, do you have a sense of its normalized ROE?

Van Den Berg: I don't know if I necessarily agree with your premise that Moore is *cyclical*. There's nothing in its history other than the last few years that suggest it is.

OID: Really?

Van Den Berg: Really. And, even if it *is* cyclical, then it's not cyclical in the classic sense — where it goes from making money to losing money, etc. Its earnings may peak out and plateau for awhile before they move on to a higher plateau. But I think this company is capable of having better margins than they've had historically.

Moore just serves so many industries — at least eight to ten different industries. And they're all *big* industries. So while someone might make the case that this industry is cyclical by definition, Moore is so small that once they get their products and their marketing right and their costs under control, I don't think they *need* to be cyclical. Their market is big enough that once they start growing, they could *keep* growing very smartly for quite awhile.

OID: What Rob Friedman of Mutual Series Fund calls a cyclical growth stock.

Van Den Berg: You can do pretty much anything that you want with their numbers.

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CENTURY MANAGEMENT'S
ARNOLD VAN DEN BERG
(cont'd from preceding page)

OID: So you are familiar with our publication...

Van Den Berg: But we figure that they can earn a 15% return on equity and a 5% net profit margin. And both are roughly equivalent in their earnings implications. Either way, that's $3.00 of earnings per share.

OID: And I gather that they've earned those kinds of margins and returns in the past?

Van Den Berg: That's right. For example, between '83 and '87, their net profit margin ranged between 4.5% and 5.9%. And I think they're in a much better position to generate those margins today.

OID: Having spent the R&D.

Van Den Berg: That's right — and having developed their markets. Again, I happen to feel that if this company is well managed — which it may be soon with Hurd — Moore's margins could in fact be even *higher*. But, given the current stock price, you don't *need* higher.

And $3 on their current $20.70 book would give them a ROE of about 14% on beginning of year equity.

OID: Roughly what Buffett says is around the historical average for American industry.

Van Den Berg: But don't forget that they have all of these excess assets: all of their excess real estate, all of their excess pension assets, etc.

So if they were to sell some of these excess assets and buy back stock with the proceeds above the current book, they'd raise their return on equity considerably.

OID: In other words, they don't need those assets. And, therefore, they dilute shareholder returns.

Van Den Berg: That's right. So this doesn't look like a very high return business. But, as you can see, appearances can be deceiving.

OID: As can assumptions, of course.

Van Den Berg: That's always possible. But I'm very comfortable with the assumptions we're using here.

And I know we're going to call them earnings. But, as you know, $3.00 of earnings can be *$1* in free cash flow or *no* free cash flow. But, *whatever* Moore's earnings are,

(continued in next column)

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they're also going to be *all* free cash flow — because their depreciation and their capital expenditures are roughly the same. So this company has the potential to generate $3.00 of free cash flow.

OID: That sounds good.

Van Den Berg: And in these figures, we haven't even factored in anything for share repurchases. Again, they have excess assets in a number of categories. But even if you just take the most obvious ones and the ones that are most easy to verify...

For example, $38 million of excess pension funding is equivalent to $24 million after tax. And, again, there's the $10 million of excess real estate. That winds up being about $6.5 million after tax. And that's not including anything for their LIFO reserve of $6.4 million after tax. But when I add up those two numbers, I come up with about $30 million.

OID: In after-tax proceeds available for share repurchases.

Van Den Berg: And let's say that you pay $30 a share — a 57% premium over its current stock price. That would lower their shares outstanding from its current 2.6 million to 1.6 million and boost their normalized earnings — with only a 4% margin — to nearly $3.50 per share. And if they could get back to a 5% net profit margin, we'd be talking about nearly $4.40 of earnings per share — which wouldn't be too shabby on an $18-19 stock.

OID: And even if they paid $50 per share, we estimate that they could have earnings of $2.75 to $3.50.

Van Den Berg: I'm not suggesting they *need* to pay that much or even that they *should*. In fact, I think that they could buy back a very significant number of shares at $25 to $30 by way of a Dutch auction. But those figures illustrate the impact that share repurchases could have.

However, the mindset of the company — up until recently, at least — has been that of typical engineers...

OID: They wear pocket protectors?

Van Den Berg: They do. In fact, they even wear pocket protectors on their *financial statements*. They're absolutely bulletproof. They don't need *remotely* as much in the way of assets as they have.

They haven't thought in terms of buying back shares historically. But I don't think the implications are lost on their chief financial officer or Edward Hurd.

BETWEEN THE PEOPLE, THE ASSETS AND THE PRICE,
IT'S HARD TO SEE HOW MOORE BECOMES A DISASTER.

OID: What could turn Moore into a mistake — fraudulent accounting?

Van Den Berg: No. I worry about almost everything. However, this is one company where I *don't* worry about fraudulent accounting. You very rarely find engineering companies involved in cases of fraudulent accounting. You generally find that sort of thing in marketing companies and fad companies where people with the nature to do that type of thing tend to be located.

OID: So all you worry about is bad engineering?

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CENTURY MANAGEMENT'S
ARNOLD VAN DEN BERG
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Van Den Berg: No. First of all, I don't really think there *is* much risk simply because of all their assets. They'd have to be blind to turn this into a disaster.

And even with their high R&D and everything else, they're *still* going to earn 40¢ this year and have $1.75 of cash flow. And that's spending $3 to $4 of R&D.

OID: I see what you mean.

Van Den Berg: So let's assume they run into trouble. Short term, they could cut their R&D in half and have *$3* per share of cash flow — with no debt. Plus, these people all have their whole life's work tied up in the company.

Therefore, it's hard for me to see how anyone could lose a lot of money in this company.

OID: You're obviously not very familiar with the Emerson Pittance...

Van Den Berg: And if it ever *did* start to bleed, I think that there are enough assets that you could get out of this thing without too much trouble. I'm not saying you would get out without a loss, but it wouldn't be a disaster.

This is the kind of company I feel very comfortable just sitting on. And I say that for a number of reasons: First, its assets are increasing. Second, its sales are growing. Third, people are addressing its deficiencies. And, fourth, they've got a good name.

So if they ever *did* start to get into trouble, any number of companies would view them as a very desirable acquisition candidate.

OID: Although companies in trouble very frequently don't command a premium price.

Van Den Berg: No. But from *today's* stock price, shareholders might *still* make out fine.

OID: What, then, do you worry about?

Van Den Berg: Not much. Frankly, our only problem with this company has been not being able to buy *enough* of it. It's very thinly traded. And we want to buy it right. So we don't chase it.

OID: Then we're especially grateful for you sharing it with us. However, to activate the Emerson Curse, all you had to do was buy a few shares in my name — although, for the full effect, may I suggest margin...

Van Den Berg: I don't want to *mislead* you. We have a very good position in Moore Products today — and, obviously, we're very happy to own it.

OID: I definitely got that impression.

Van Den Berg: You mentioned accounting fraud. And after having been in this business for 25 years, very little surprises me. But, frankly, that *would*.

As we follow this company and learn more about them, we find lots of evidence that they are solid, conservative people. You can see that in everything from their annual reports, financial statements, their salaries and in the contact that our analyst, Jim Brilliant, has on a regular basis with their management.

OID: As I recall, this year's proxy showed no one making more than $160,000±.

Van Den Berg: That's right. None of the Moores need the money. And they're very straight-up people. I think very highly of them. And none of the fingerprints in their proxies or their annual reports indicate any kind of self-dealing whatsoever.

I wouldn't give 'em an "A" for managing the company. But I wouldn't say anything negative either — because their main concern hasn't been to get the stock price up. They're trying to build a company with a great deal of pride in their products and a reputation to match. And, unfortunately, sometimes when someone focuses too much on *one* thing, they can slip up elsewhere.

But, again, to their credit, I believe they're correcting that imbalance with their new chairman.

AS LONG AS WE DON'T *LOSE*, THEN WE *WIN*.
AND IT'S HARD TO SEE HOW WE LOSE HERE.

OID: So, given all of that, why is this thing so cheap?

Van Den Berg: That's easy. In this kind of a market, what people are looking for is earnings momentum and earnings growth. These people would be a little too stodgy for your average hot money manager.

OID: That's what we keep hearing — that the market today is almost entirely momentum driven.

Van Den Berg: I can see it by looking at the stocks that are moving. This company's really cheap. But people probably won't look at it until there's a bear market and they want a place to hide and they know that there's some downside protection here.

OID: After the wounds have been inflicted.

Van Den Berg: I would think so. One of the things that impressed me about the value approach is that the portfolios of the Schlosses and the Tweedy, Brownes of the world — the diehard value guys — held up amazingly well in the 1973-74 bear market.

On an absolute basis, obviously the performance wasn't great — when you compare it to a Treasury Bill or something like that. But when you go through a market that declines 14% and 26% in successive years and show very little in the way of losses, I think that pretty much says it all.

OID: Or as Bill Ruane likes to say, "To win the race, you first have to finish it." — just the reverse of the newsletter credo of "Live fast and die ~~poor~~ young."

Van Den Berg: My answer to this has always been that if you don't lose, you win. If we buy 20-25 companies like this one, some of them will continue to disappoint and lag and so forth. But there'll be enough winners in there to make up for the losers as long as we don't lose a lot.

And it's very difficult for me to see how you can lose a lot in a company that is potentially a very desirable acquisition, that has all of these assets — including excess assets that aren't needed — that has high R&D that can be cut and on and on and on...

So I tell my clients to look long term. If we don't lose money on any of these and we have the winners that are invariably some percentage of this group, then we'll be fine.

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CENTURY MANAGEMENT'S
ARNOLD VAN DEN BERG
(cont'd from preceding page)

In other words, as long as we don't *lose*, we *win*.

OID: Or, as Buffett says, there are only two rules.
Rule #1: Don't lose money.
Rule #2: See rule #1.

Van Den Berg: Exactly. And as long as we do that, when I look out 20 years, I don't know if we'll earn 15%, which would be 16 times our money, or 18%, which would be 27 times our money, or 20%, which would be 38 times our money. However, who would be unhappy in any case?

OID: You obviously married well...

Van Den Berg: I understand that demand for Ben Graham's books is inversely correlated to the stock market: The worse the market gets, the more demand goes up — because people start thinking about the *down*side. Well, that's *always* our approach — not just after a market decline.

OID: And I assume this relates to Moore Products...

Van Den Berg: When we discuss private market value, price-to-sales multiples, etc., we're talking about the *upside*. But the most important thing always is not to *lose*. The assets I just mentioned are your *downside* protection. I'm very comfortable buying it well below liquidation value. And if the company does better than it has historically, then that's fine, too. We're just not *counting* on it.

OID: I somehow gathered...

Van Den Berg: A true value investor might just say, "This one's selling at only two-thirds of liquidating value. What more do you *need*?"

OID: You're not a true value investor?

Van Den Berg: That isn't the only thing we look at — because even liquidating value can be deceiving. You can have inventory and plants that aren't worth what they're being carried for on the books. And even if they are *today*, they can evaporate pretty quickly.

In this case, however, we think this is a pretty solid liquidating value. The excess pension is there. And so is the LIFO reserve and the real estate. All are solid assets that we'd be happy to own at the prices I've mentioned.

So even if Moore Products' private market value is "only" $45, I think you can buy it pretty safely at $19.

OID: And you have?

Van Den Berg: As I recall, we've paid as little as $15± and as much as $19±.

I'VE SEEN THIS KIND OF SITUATION BEFORE. AND TWICE THEY BECAME OUR BIG WINNERS.

Van Den Berg: But I've seen this situation before — you know, where a company clearly has great products, but doesn't quite have it all together — and then they bring in a guy who can put the ribbon on the package and make it a very attractive gift. I think this guy from Honeywell has the potential to do just that.

The same thing happened at the other two companies that became our big winners...

OID: Only one war story per customer, if you please — or, at least, one winner...

Van Den Berg: Exactly the same thing happened at both companies we thought were just boring value plays. We bought Galileo at an average cost of $5. And it's selling for between $23 and $25 today. And we've sold a lot of our shares at that price. And another one was Maxwell Labs. There, our average cost was $8. And today it's at *$42*.

But if you'd told me that those two were going to be our big winners, I wouldn't have believed you — because they were just two boring companies that were selling below book value with good products, good technology and good things going on generally that weren't being reflected in their stock price.

But, in both cases, all of a sudden...

OID: "All of a sudden" is right: The gains in Galileo look like they all came in a one-year period. And the gains in Maxwell appear to have all come since April.

Van Den Berg: That's right. Maxwell brought in a new guy. And within six to nine months, he had their product line repackaged, one of their product lines just caught on, their sales went up and their earnings followed. So now we're *realizing* their value. And the same thing happened with Galileo.

However, they weren't bought as growth stocks, although they're being bought as growth stocks *today*. They were being bought as value stocks — just like Moore.

OID: You sound like FPA Paramount's Bill Sams.

Van Den Berg: In fact, when we started buying Galileo, it had a book value of $8. And our average cost basis is $5. When we started buying Maxwell Labs, it had a book value of $15. And we were buying it at $8.

OID: But aren't you paying more for Moore?

Van Den Berg: Only using *stated* book. Again, the adjusted book here is much higher for all of the reasons that I've already mentioned.

And one more parallel: One thing that we used to always hear people say about Maxwell Labs was that they had more PhDs per square foot than M.I.T. But they brought in a guy who did some marketing, some refocusing and so forth.

If Hurd turns out to be like this guy from Maxwell, then we could have a lot to look forward to in Moore, too.

OID: And the odds of that?

Van Den Berg: In all candor, I'm not suggesting that Moore Products will be a great winner or anything of the sort — because Galileo and Maxwell Labs were the two big winners out of 15 or 16 companies.

But they both had the same kind of factors present: Things weren't going well. They were a little bit sloppy, but they were good people. They produced good products. And they wanted to do a good job. They just needed somebody to refocus 'em.

And based on everything I can see, that seems to be exactly what's going on at Moore. There seems to be a slow, evolutionary process going on — partially from within

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CENTURY MANAGEMENT'S
ARNOLD VAN DEN BERG
(cont'd from preceding page)

the company and partially from Hurd — to bring the company into focus and to increase shareholder value. And, as that occurs, that increased shareholder value will eventually be recognized in their stock price.

OID: Interesting.

Van Den Berg: So we're beginning to get a hint of this new, more shareholder value-oriented thinking. And as they continue to evolve that way, I think the Street will recognize it, too.

OID: With a higher stock price.

Van Den Berg: Exactly. You wanted something selling at 50¢ on the $1. There's no question in my mind that this one fits the bill there. It's just a classic value.

OID: It sure sounds like it.

Van Den Berg: If you take their excess pension of $9.50 and their excess real estate of $2.50 per share and their LIFO reserve of $2.50, you have $14.50. And the stock's at $19. So for $4.50 per share, you can buy a company with $54 per share in sales, $3 per share in normalized earning power and a $20+ book.

OID: Thanks for the offer. But we're too busy to get involved in any LBO until we finish this edition.

But do you know where we could borrow $4.50?

Van Den Berg: I'm afraid not. And that's too bad because somebody could get themselves a real bargain — although, again, it won't happen on an unfriendly basis. But I think something's going to happen on *their* side.

OID: If you get an investment banking commission, do you think we could get a deferred advertising fee...

Van Den Berg: So there's a lot of things going on. But I don't need *any* of these other things to convince me that this is a great buy.

INVESTORS AND ANALYSTS ARE DISGUSTED, BUT MANAGEMENT IS BUYING BACK SHARES.

OID: Do you have any other bargains for us today?

Van Den Berg: I've got another one for you that's just as cheap as Moore Products, but that has *other* things going for it, too.

OID: You're kidding.

Van Den Berg: No. It's just as cheap. However, it's also further along to proving that it's on the right course. It's also selling at a 50% discount to private market value. It's got a great balance sheet and a great product line. And Eastman Kodak just bought a stake in one of its divisions.

OID: And you haven't told us about it yet?

Van Den Berg: The company's name is CPI [CPY/NYSE].

OID: A couple of our contributors have mentioned CPI. But given how it's done since, we would appreciate it if you'd keep that strictly between us...

Van Den Berg: I can keep a secret if you can.

[Editor's note: *Portfolio Reports* estimates CPI was one of the top purchases of Baupost Group & FPA Capital Fund and a new position for each in the quarter ended 9/30/96.]

Van Den Berg: But, of course, that's one reason why CPI is so *depressed*.

OID: I beg your pardon...

Van Den Berg: When we get on the conference call with this company, you ought to hear the analysts. In fact, only a few analysts even *follow* it. And they don't sound too happy.

Of course, it's easy to understand why. In 1991, CPI was selling at $34 per share — which was 1.1 times sales.

OID: You'll no doubt understand if we have to edit that last comment out because of space constraints...

Van Den Berg: We haven't been making money in this one since October 28, 1993. That's when we bought our first shares. So we're not a hero in this one either.

But it doesn't bother me a bit. I have great faith. Actually, we're buying more shares every chance we get. Below $17.50, we think CPI is just a *great* purchase. And it's at $17 today.

OID: That certainly qualifies as a contrary opinion.

Van Den Berg: The next time CPI has a conference call, you really ought to listen in. It's fascinating. This is a company that at one time had the eye of Wall Street. And you'd think more than a few guys would be following it. After all, this isn't some unheard of company. But that's what produces values.

OID: In other words, disgust.

Van Den Berg: That's *exactly* what it is. And let me tell you something: If I'd been in CPI at $34 five years ago, I probably wouldn't feel much different — in fact, I *know* I wouldn't. There's a kind of psychological drip there that gets to you when you're holding a stock.

OID: As one of our contributors says, the stock may not know where it's been, but you do.

Van Den Berg: We had one stock that was a loser for seven or e... ...o buy it. And I'm g... ...wisdom on Wall S... ...g down. The only ... ...y's value has mate...

OID: And ... ...I.

Van ... ...stock been such ... ...is market, stocks of ... ...nings are taken out...

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OID: You noticed that, too?

Van Den Berg: One of the problems with the Street is that they sometimes focus exclusively on earnings and ignore free cash flow, depreciation, R&D or anything else.

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