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THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

A Historical Approach to Investing in Misunderstood Businesses

J. JEFFREY AUXIER is the President and CEO of Auxier Asset Management LLC. He founded the Auxier Focus Fund in 1999. Mr. Auxier began his career at Foster Marshall-American Express (now Morgan Stanley Smith Barney). He serves as a Director of eBags, Inc. He served as a member of the Smith Barney Portfolio Management Advisory Board, member of the Chairman's Council from 1990 to 1996. In 1993, Mr. Auxier was awarded the Consulting Group Bob Dwyer Award, which honors the Portfolio Manager whose integrity, knowledge and commitment to the discipline of investment management exemplifies the highest standards. Money magazine named Mr. Auxier their All-Star Broker, two years in a row (1997/1998). Mr. Auxier graduated with honors from the University of Oregon in 1981. He studied at the University of Oregon with an emphasis in accounting, and he holds a Bachelor of Science degree in Finance.

SECTOR — GENERAL INVESTING

TWST: Tell us about Auxier and why you founded the firm.

Mr. Auxier: I entered the investment business back in 1982 with the Seattle-based firm Foster and Marshall. My passion was in research and being a business analyst. I really enjoyed studying outstanding capital allocators and great business enterprises. So after 14 years of managing separate accounts for some very talented and demanding clients, we set up the firm in 1998. We had strong performance numbers through the 1980s and 1990s, which led to the establishment of the Auxier Focus Fund in 1999. The Fund has outperformed the Standard and Poor's 500 by over 100 percentage points since inception through year-end 2012.

TWST: What is your overall investment philosophy?

Mr. Auxier: Our overall investment philosophy is rooted in price and value. Ideally, we are bargain shoppers for outstanding businesses. We look at the individual enterprises and capital structure of each company, to assess risk and predictability in the operations. As a risk manager, the key is a daily rigorous, dedicated research effort seeking facts, fundamentals and determining intrinsic value. Price is a critical part of the process. What you pay for an investment will largely determine what you are going to return over the long haul. We strive to be patient, rational long-term investors seeking out opportunities that combine undervaluation together with growing cash flows and intrinsic value. The ultimate aim is the double or triple play — expanding valuation with increasing business value.

TWST: Tell us a little bit more about the research you do. Where do you focus?

Mr. Auxier: There are certain types of businesses we are most comfortable with, so we concentrate on those types of businesses where we can quantify the risk. Although we do manually peruse 1,000 or 2,000 companies a year, it comes down to companies where we can quantify the downside if we are wrong. As a portfolio manager, you're also a risk manager. In our view, the power of compounding is the most underappreciated concept, and so we really have to quantify risk. You need the humility to keep checking and grinding on the fundamental operating reality every day. According to Google Chairman Eric Schmidt, currently more data is being generated in two days than all of the data that was generated from the dawn of civilization through 2003. A persistent fact finding effort is vital. We need to know why a stock is down. Is that down permanently or temporarily? Is it a digital-induced decline as in the case of newspapers or **Eastman Kodak** (EKDKQ), or is it a temporary, fixable problem? We like the large but surmountable problems.

TWST: As you said, there is so much information out there, how do you wade through it all?

Mr. Auxier: I think this is where experience is important. Because I have been studying individual businesses going back to 1982, I have a database to filter out the noise. When you have done over 45,000 hours of research on businesses, you narrow the list where you can quantify the risk/reward. With the Auxier Focus Fund, the big advantage is cumulative research, knowledge that comes from owning businesses for a long period of time, studying managements, determining which managements underpromise and overdeliver. Also, it helps to know accounting and to understand the history of bubbles and bubble pricing.

There is a benefit to having managed for tough clients through the 1983 PC bubble, the 1987 crash, the 1990s thrift crisis, the 2000 technology stock meltdown, the 2006 housing crisis and the following credit bust in 2008. You develop a respect for markets and realize humility is necessary to survive. It's not so much looking at quotes on a screen; it's about understanding the business and the cyclicality of investing. Like Warren Buffett says, you can count on three things in the market: fear, greed and folly. If you are rational and you study history, there are always opportunities to make above-average, risk-adjusted returns. We thank God for human nature. People tend to repeat the same mistakes over and over. Being a business analyst is exciting when you look at something like **Costco** (COST). We originally bought it back in 1984-1985, and that stock was probably $0.15 to $0.20. A $2,000 investment is now worth over $800,000 today. People don't realize the top 25 U.S. stocks over the past 25 years have returned between 19,000% and 63,000%. You can still do very well with mundane, quality businesses over the long term.

TWST: When you say "quality business," how do you define that? How do you identify a quality business?

Mr. Auxier: Quality starts with a mission to provide a superior product or service. Where there is a passion for execution and a desire to keep building for the longer term. A management that is disciplined in capital allocation and strives to build intrinsic value every day. We like businesses that have low mandatory capital expenditures and are able to see their profits in cash. Conversely, high fixed assets, constant retooling of plants and capital intensity can lead to a greater balance sheet risk. We prefer companies that sell necessities, especially in periods of high debt, as lower-ticket disposable items tend to be more predictable and less cyclical than big-ticket items. An example of an industry with heavy capital requirements and retooling is the airline industry. There are enormous variables, capital investment and financing involved in that industry, so we are less likely to be comfortable there than, say, a beverage company. We like businesses that are their own bankers, that generate far more cash than the business needs, especially in a period where printing by central banks is rampant.

TWST: You mentioned crashes create opportunities. Does that mean the market volatility we have seen over the last couple of years is a good thing?

Mr. Auxier: Yes, the average New York Stock Exchange stock will fluctuate 50% a year, so that's a normal part of the auction market. You get better bargains in the auction markets than in negotiated transactions. Emotional behavior can lead to material misappraisals.

TWST: Do you invest internationally as well?

Mr. Auxier: Yes, we invest both domestically and internationally. When I started back in the early 1980s, I was studying Warren Buffett and Carlos Slim. In the 1980s, we bought tracker positions in many of Carlos Slim's companies. On the international side, we will often own a stock for years before really committing in a meaningful way. There are certain businesses that are not subject to accounting gimmickry, so we'll tend to be in an international beverage or food position more so than an international bank.

As an example, we bought **Cifra**, a low-cost provider of groceries in Mexico, which is now **Wal-Mart de Mexico** (WALMEXV.MX) in the 1980s. In 1993, crisis hit when the Mexican peso suffered a devastating devaluation. Having owned the company for years, we were ready to act. That investment is now up over 15-fold since 1993. More recently, another low-cost provider of groceries, **Tesco plc** (TSCO.L), out of the U.K., is another example. We had a small position in the company, and we continued to track it. It is of comparable quality to a **Wal-Mart** (WMT) and one of the leading international supermarket businesses. They historically have been great operators. Aggressive overexpansion caught up with **Tesco**. They took their eye off the customer, suffering a huge miss in earnings. The stock crashed to a bargain price just above net real estate value. We had watched the stock for six or seven years and were ready to pounce.

We want to take advantage of the market when it's offering compelling bargains. We typically come alive when the market is pessimistic. Most people are worried during a recession, but we turn it upside down and say, "time to shop." Right now, we're finding value in multinationals domiciled in the U.K. due to the gloom. Since 1947 the U.S. has been in recession less than 5% of the time. In the 1990s, in the aftermath of the U.S. savings and loan crisis, our small banks outperformed the market for the following six years. You want to look at those price points that recessions provide. People are going to miss this entire European downturn. They will look back and wonder why they weren't buying. The positions we bought after the 1987 crash led to a tremendous year in 1989. That was because of our post-crash activity. The buys we made in the teeth of the savings and loan crisis led to big years in 1995, 1996, 1997; again, the result of buying when others were selling. We would rather take a time risk than a price risk. It may take longer and we have to be patient, but we would rather

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Highlights

J. Jeffrey Auxier of Auxier Asset Management discusses his firm's investing strategies. As a risk manager, he is looking for stocks that are undervalued with strong cash flows and intrinsic value. Auxier defines quality companies and how Auxier looks for international ideas, as well as naming some key examples of the portfolio holdings.

Companies include: Costco Wholesale (COST); Wal-Mart de Mexico SAB De CV (WALMEXV.MX); Tesco plc (TSCO.L); Wal-Mart Stores (WMT); The Bank of New York Mellon (BK); Molson Coors Brewing Company (TAP); Abbott Laboratories (ABT); Hospira (HSP) and Allergan (AGN).

do that than chase a hot momentum stock for a quick gain. We would rather get in early for the double or triple play.

TWST: Would you give us a couple of examples?

Mr. Auxier: I mentioned **Tesco**, and that was purchased over the last year when it was under a relentless selling pressure. We'll buy businesses like **Bank of New York** (BK) — it's a processor bank, very low-risk type of bank, it's not a spread lender — but the stock dropped down to a historically low eight times to nine times earnings. Typically, it

1-Year Daily Chart of Tesco plc

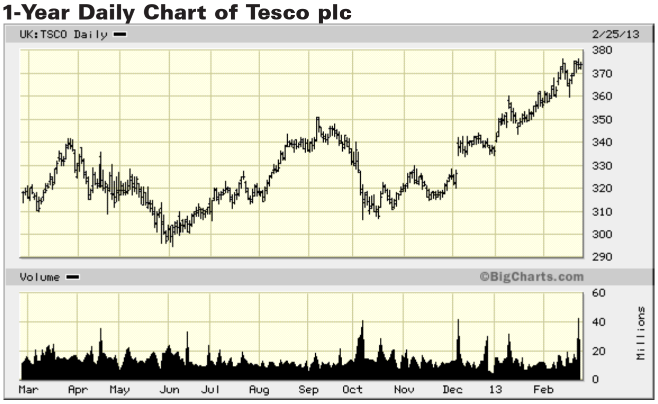

Chart provided by www.BigCharts.com

would be a high-teens-multiple-type business. We are trying to look for misunderstood situations. **Molson Coors** (TAP) is another example. Here's the oldest brewery in North America, since the late 1700s. More recently they've been expanding internationally and in the craft segment. The stock recently traded down to 10 times to 11 times 2013 earnings in the fourth quarter of 2012. This is a leading beverage company. Right now, many of their markets are suffering from recession. Their customers are out of work, there was a difficult National Hockey League strike. But five years from now, if the business can achieve just a 15 times multiple, this seemingly dull company could provide exciting returns.

Another company we like is **Hospira** (HSP). They're the leader in generic injectable drugs. Spun off from **Abbott** (ABT), they encountered a setback with an FDA problem leading to a closure with one of their primary manufacturing facilities. The stock has been crushed into the high $20s. But again, that's s fixable problem. They've got a strong, experienced operator in CEO Michael Ball who came from **Allergan** (AGN) in 2011. We think the odds are high that the problems will be solved and the recovery highs will be well worth the wait. In today's world, a somewhat invisible but lethal risk is the loss of purchasing power. Again, it is imperative to work harder to aim for the double or triple play on all our investments, and we need to get adequately compensated for the risk.

TWST: You mentioned risk a couple of times. How do you manage risk?

Mr. Auxier: To start, you've got to be committed to that rigorous research effort and an enduring approach. My goal is to research eight hours to nine hours a day. Next, temperament. Ego and emotion can lead to overpaying and overborrowing. These are sins that can lead to permanent capital loss. Humility is important together with rationality to further mitigate risk. John D. Rockefeller preached running the business off the ledger. That takes the emotion out of investing. The invested portion, both stocks and bonds, in the Auxier Focus Fund since 1999 are actually both up over 200%, but we haven't been fully invested. We understand that clients have very low tolerance for downside volatility, so we try to beat the indexes with far less risk.

We hold many market-agnostic positions — cash, special situation debt or workouts. These are not correlated with the market and provide a needed source of cash during times of panic. Our aim is to keep the shareholders' assets compounding and that outperformance is far more important in down markets. The math in compounding: if you are up 50% in year one, up 50% in year two and you're down 50% in year three, you lose to a steady 8% over that three-year period. We are continually working to eliminate the portfolio torpedoes that interrupt the compounding process.

TWST: Are we going to see continued volatility for the next year or so?

Mr. Auxier: Hopefully. The problem is that the bond market normally is nearly as volatile as the stock market. The Federal Reserve has repressed that volatility through the QE program, purchasing $85

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1-Year Daily Chart of Molson Coors Brewing Company

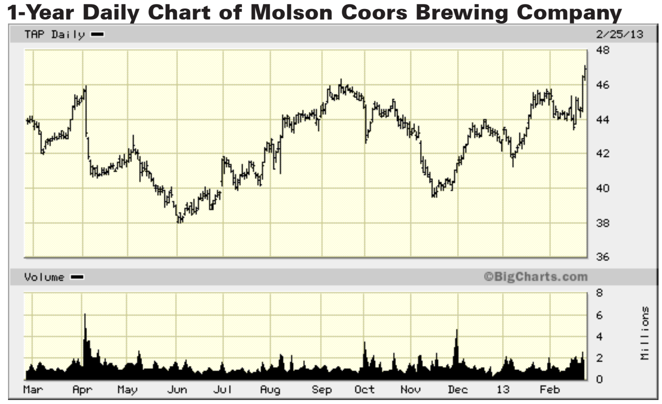

Chart provided by www.BigCharts.com

billion of bonds a month. So your free market is not functioning; it's being interrupted by the Fed. The government intervention is distorting reality, so you have to be on high alert. We've been on high alert since 1999, the beginning of easy-money Fed policy. You have to be very much aware that these interest rates are not the norm. We've had two 40% market declines in the last 12 years. We've only had five 40% declines since 1900. The root cause: extremely easy money led to gross misallocations in capital and bubbles formed. We have experienced booms in technology, housing and commodities, which all lasted over 113 months. Each boom was followed by a painful correction.

TWST: What is your best advice for investors?

Mr. Auxier: The best advice is to study great investors and study the craft of investing. Investing is the craft of the specific. You need to understand what you own and the underlying risk. If you go back in time, whether it's John D. Rockefeller, J. Paul Getty, Carlos Slim — their approach to investing in the markets is remarkably similar. Price, value and margin of safety are recurring themes. Superior, disciplined capital allocation is so powerfully positive. Good businesses, when purchased right, are the best choice — especially in today's investment environment. Looking across the investment spectrum, it is hard to beat a well-nurtured business with strong leadership and a relentless drive to improve the underlying product or service, purchased at a bargain price. The investing public tends to miss out on attractive risk-adjusted investment opportunities by focusing too much on the short term, on what they can't control and by letting emotions, rather than fundamentals, dictate their allocations. You have to do your homework; there are no shortcuts. Like Peter Lynch used to say, "Investing without research is like playing stud poker and never looking at the cards."

TWST: Thank you. (LMR)

J. JEFFREY AUXIER
President & CEO
Auxier Asset Management LLC
5285 Meadows Rd.
Suite 333
Lake Oswego, OR 97035
(503) 885-8807
(800) 835-9556 — TOLL FREE
www.auxierasset.com