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Interview With David J. Winters
CEO, Wintergreen Advisers

Good Teachers, Great Student

By Lawrence C. Strauss

DAVID WINTERS CUT HIS TEETH AT MUTUAL SERIES FUNDS, WHERE he learned the art of value investing from two masters: the late Max Heine, and Michael Price. By the time he left the firm in 2005 to launch his own shop, Wintergreen Advisers in Mountain Lakes, N.J., he had acquired 18 years' experience and accumulated knowledge of how to find good stocks far off the beaten path, study them intently and buy them with conviction.

Winters' due diligence—which ranged from deciphering complicated financial documents to visiting the facilities of companies that interested him—paid off handsomely during his tenure at the helm of **Mutual Discovery Fund** (ticker: TEDIX) from 2000 to 2005.

A global value investor, Winters occasionally takes an activist role as a shareholder. For instance, he convinced **Potlatch** (PCH) several years ago to convert into a timber real-estate investment trust.

Winters believes in running a concentrated portfolio, and the **Wintergreen** Fund (WGRNX) has only about 50 holdings. The top 10 account for roughly half of the $1.6 billion under management. In 2006 Wintergreen returned a total 20.1%, in the middle of Morningstar's world-equity category. Last year it clocked a total return of 21.1%, placing in the top 10% of its peer group. So far this year the fund is down 5% amid a challenging market for equities, though it ranks near the top of its peer group once again. While the selloff in stocks has been painful, Winters prefers to focus on the abundant bargains now available to value investors. He should know.

Barron's: The markets are off to a lousy start in 2008. The Standard & Poor's 500 is down about 8%, and bond spreads have widened considerably. Is this any way to greet a new year?

Winters: We view this as a gigantic after-Christmas sale. There has been a lot of indiscriminate selling at any price. Certainly, some securities and companies have been adversely affected by what has been going on, and these are securities to avoid. But almost everything has been tarred with the same brush. We continue to be very careful about what we are buying. We want to buy companies that generate a lot of free cash flow that's growing; have even more attractive prices these days, and are run by people who are motivated to do the right things for all shareholders. So we view this recent period in a very constructive manner. To have markets just go up all the time doesn't help a long-term investor.

Before we talk about what you're buying, let's discuss your career path. Where did you go to school, and what did you study?

Gary Spector for *Barron's*

"If you buy real estate cheaply, it is unencumbered by debt and you are patient, you can make tons of dollars." David Winters

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DOWJONES

I went to Cornell, majoring in economics, but I spent a lot of time at the hotel school learning practical things. I came to Mutual Series, the value shop run at the time by Michael Price, in 1987, and worked on the distressed-debt desk. When I started there, we had about $2.5 billion in assets, compared with more than $35 billion when I left in '05.

Mutual Series, which Franklin Templeton (BEN) acquired in 1996, has a reputation for exhaustive research and strong fundamental security selection. It was founded by Max Heine and later run by Price. What did you learn there?

The key lesson was to do the work, and also think about the debt side of a situation as well as the equity side. Also, think about arbitrage opportunities. If you really did the work, you could take a lot less risk and still outperform. But you generally did that by working on companies off the beaten track. Michael Price encouraged me to research not just little companies but also bigger companies. One of the first companies I really did some work on was the Richmond Fredericksburg & Potomac Railroad, which was a debt-free asset play.

What else did Price emphasize to you?

To roll up your sleeves, be willing to do very detailed analysis and to try to learn more about the company than other people knew. He also taught me to think about companies that were in distress, and to know there are opportunities in bankruptcies. From a very early point, Michael was just fine with the idea of shareholder activism, namely that you thought and acted like an owner, and that if you didn't like something going on, or didn't feel it was in the shareholders' interest, you could act accordingly and try to change it.

After 18 years at Franklin Mutual Advisers, where you had become chief executive, chief investment officer and president, you left to start Wintergreen. Why didn't you start a hedge fund instead, where you could earn an annual management fee of at least 1%, and keep 20% or more of annual profits.

I didn't feel comfortable with the incentive structure of a hedge fund because it seemed to incentivize you too much in the short run. Also, a lot of the money was very short-term in nature. And if there was a lesson from Max Heine, it was to think long term and don't go where the crowd goes. The mutual-fund industry had gone through the scandals of 2003 and '04 and had largely, in my opinion, become an index-hugging enterprise really dominated by marketing as opposed to investing as its primary motive. So I had this epiphany, and I called my friend Liz Cohernour to tell her that we could put together a global value, no-load mutual fund with maximum investment flexibility. (Cohernour, Wintergreen's chief operating officer, handles the business side of the firm while Winters heads up the investment side, which includes two research analysts.)

Winters' Picks

Company	Ticker	Recent Price
Wynn Resorts	WYNN	$102.36
Japan Tobacco	2914.Japan	¥586,000
Berkshire Hathaway	BRK/B	$4,701.00
Jardine Matheson	JM.Singapore	28.00
Consolidated Tomoka Land	CTO	53.95
Compagnie Financiere Richemont	CFR.Switzerland	61.60CHF

Source: Bloomberg

The Wintergreen Fund has grown very quickly, from $54 million at the end of '05 to about $1.6 billion today. Has managing that growth been a problem?

I came from an environment where I was running $35 billion. At Wintergreen we started very, very small, and we have grown, but we have the ability to handle this growth and more.

Have you looked at any investments in the credit markets, or are you sticking with equities for now?

We've been looking at credits but continue to focus mostly on equities. We haven't seen any spectacular bankruptcies yet, though that will happen at some point. The difference this time is that the underlying quality of a lot of the assets that were leveraged wasn't spectacular to start with.

What worries you about the current economic situation?

We are concerned about inflation. We want to own companies that have the ability, over time, to raise prices to offset inflation. Tobacco companies are a good example, along with gaming companies, because they can raise prices and people will continue to pay.

You've developed a reputation over the years for being a shareholder activist as a way to create value. Anything going on for you on that front these days?

We own about 26% of **Consolidated Tomoka Land** (CTO). The market cap is about $300 million. We've put one director on the board, and we proposed another three. The company essentially has liquidated its land holdings into a 1031 tax exchange. We have suggested that instead of selling off this property, they should look at developing it. What are the alternatives we can do to create growing streams of income? They've been fairly receptive to what we have said. We're in an environment now where nobody wants to know anything about real estate. Yet, over time, if you buy real estate cheaply, it is unencumbered by debt and you are patient, you can make tons of dollars.

Given the current real-estate environment, it's not surprising Consolidated Tomoka's stock has fallen to around 54 from the high-70s a year ago. Let's talk about some of your other holdings.

We've been very interested in luxury goods. For example, we have been active in shares of **Compagnie Financiere Richemont** [CFR.Switzerland], based in Switzerland. This is truly a special situation. Behind every share of Richemont is 0.7 of a share of another company, **British American Tobacco** [BTI], and there is a pile of cash. Their brands include Cartier, Montblanc, Jaeger-LeCoultre and IWC. You are getting a luxury-goods business at about 10 times earnings, versus a 20-type multiple historically. People think the world is coming to an end, but women are still going to want jewelry, and men are still going to want watches. Maybe business isn't as ebullient for some time. But when you can buy the best jewelry company in the world that is debt-free at effectively a single-digit price- earnings multiple, that is pretty exciting. The shares are trading at around 62 Swiss francs, down from their 52-week high of CHF83. The stock has gotten slammed this year, but it's mostly perception over reality.

Your largest holding is Wynn Resorts (WYNN). Why are you putting so many of your chips on Steve Wynn? The stock's around 102, way down from its high of 176.

One of the things that struck us about **Wynn Resorts** is the company's attention to detail. They really, really care about how everything looks, how it functions and how they treat their clients. They don't want dust in the corners, little things like that. And, management owns an enormous amount of stock. They have

also learned from their previous experiences how to do things better. If you can find a management that lives, breathes, eats and sleeps how to make this a better company, that's a wonderful thing.

From a financial perspective, what got you interested in the stock?

It was beaten up. It's a complicated company, because it's in the process of developing a property in Macau. Most Americans have never been to Macau and still don't understand what is going on in the Far East. Macau is essentially the monopoly for mainland China for gaming entertainment. Wynn, the high-end player in Las Vegas, is now in Macau. There's a complexity about this company that makes it hard for Wall Street, which wants simple, short-term stories. So much of Wall Street is focused on not only today, but how they can make their monthly numbers.

Let's hear about another holding.

Japan Tobacco [2914.Japan] is not something that a U.S. investor can just go out and buy. It is the third-largest global tobacco company. It was a domestic company that acquired R.J. Reynolds International [in 1999] and, more recently, Gallaher Group, which was a U.K. tobacco company. Japan Tobacco has transformed itself. It had about $7 billion in cash earning 1% in yen on its balance sheet. They used that as equity, and borrowed the balance to acquire Gallaher at a blended rate of 3.25%-3.5% in yen and sterling. That $6 billion effectively has a 14% return on equity. The analysts haven't picked this up.

How do you get to that return? Please do the math.

Gallaher had $1.4 billion in earnings before interest, taxes, depreciation and amortization. JT used $7.1 billion in cash to buy Gallaher and financed the rest. The interest payments JT must cover on the additional debt amount to about $400 million per year. If you subtract that $400 million from Gallaher's $1.4 billion in Ebitda, you get $1 billion in additional pretax profits to JT. A billion dollars divided by the $7.1 billion cash spent on the deal works out to a 14.1% return.

What else does Japan Tobacco have to recommend it?

The company is complicated for most people to understand. You have to go through the documents. Because JT isn't very promotional, most people don't focus on them. We don't advocate cigarette smoking. But we believe we live in a world of relatively high inflation, and there are few products whose producers can raise prices and customers will still consider them. That includes cigarettes.

You're also a fan of Berkshire Hathaway, a stock Barron's recently called too expensive.

We bought most of our **Berkshire Hathaway** [BRK/B] shares at lower prices. The B shares are at about 4,701, roughly 7% off their 52-week high. For Berkshire, having $40 billion in cash seemed like a pretty dull thing to do, but now it doesn't seem so dull. Because Berkshire is the ultimate complicated conglomerate, it's very hard for most people to get their heads around a company that does everything from making paint to selling auto insurance. It's clearly not as attractive as it was six months ago. But we think it generates oodles of free cash flow. In a world where there are serious liquidity issues, having a pristine balance sheet and a whole treasure trove of businesses that generate cash is a great thing. It provides a lot of downside protection.

How about one more holding?

Jardine Matheson [JM.Singapore] is a conglomerate of Scottish heritage, but it is listed in Singapore. The primary assets are in Southeast Asia, including cars, financial services and retailing. It's a very conservative, well-run company and a wonderful way for us to participate in Asia. It's trading at about $28, compared with its 52- week high of $31.

We have about a third of our assets in Asia and try to take a lower- risk approach to investing overseas. Jardine is an old company with fabulous assets that is run to make the shareholders richer over time. It is a very comfortable place for us to have a lot of our money. It's our third-largest holding. But it is not an exciting story and the stock is not in any index. The company doesn't promote itself. They own a big stake of the Mandarin Oriental Hotel Group. To give you a sense of the value of the company, Four Seasons Hotels was taken private last year for a big premium.

Thanks very much, David. ■