Boyar asset management

*Our favorite holding period is forever.*
*-- Warren Buffett*

January 30th, 2013

**A Look Back at 2012**

The leading stock market indices retreated for five consecutive days prior to the end of the year as it appeared that we were about to go over the so-called "fiscal cliff."

Stocks, however, began a broad based rally in late trading on the last day of the year as it appeared that a deal would be ironed out. On that day, the leading indices were all deeply in the black advancing anywhere from 1.3% to 2.0%. The S&P 500 had its best final day of the year since 1974. Even as investors continued to abandon the stock market in droves, a trend that has been going on for a few years, all the leading indices ended the year with respectable gains. Both the NASDAQ and the S&P 500 were up more than 15%.

Of the major S&P sectors, the financials were the standout in 2012, with a gain of 26% for the year. One of the components, Bank of America, advanced by more than 100%. The second best sector was consumer discretionary, up 22%. The only losing sector was utilities, which lost 2.9% of its value.

Stocks were negative in the fourth quarter, with the S&P 500 down 0.38%. According to CNBC, since 1928, the S&P has declined in the fourth quarter just four times in years when the index also had scored double-digit gains for the calendar year. In each case, the market rose an average of 12.2% in the following year.

**Performance**

The vast majority of accounts managed by Boyar Asset Management, Inc. that employed an equity only strategy and that have been clients of ours for over two years achieved returns that bested all the leading indices including the S&P 500 which gained 16%.[1]

On a risk adjusted basis our returns were even better since most accounts at year-end had fairly substantial cash positions. As mentioned in a client letter during the fall of 2012, "with the market's advance over the past few years there are fewer bargains to be had. So we have been selling more than buying," as a result our cash position has swelled. Until Mr. Market accommodates us, and stock prices decline to more attractive levels creating the margin of safety necessary for us to put excess capital to work, we will maintain high cash reserves.

[1] *Past performance is no guarantee of future results. See the last page for other important disclosures.*

**A Look Ahead**

In last year’s fourth quarter letter to clients we opined, "Election years have typically been very favorable periods for the stock market regardless of the victor. Since 1928, the S&P 500 has appreciated during 17 of the 21 presidential election years, posting an average gain of about 11%. From a historical perspective the third year of a presidential term has seen stocks appreciate the most. Given the modest gains posted by the Dow during 2011, we would not be shocked if performance surprises on the upside during 2012." Obviously, a good call.

By heeding the patterns of history, an investor in the vast majority of instances, should prosper. This year, however there is conflicting data with regard to the future direction of the market. As was pointed out earlier in this letter, when negative stock market results are posted in the fourth quarter, in years where double digit results are captured by the S&P, the following year returns averaged 12%. Conversely, it has long been observed that the worst year for investors is the first year of a president's term. Data going back to 1926, for the S&P 500 stock market index show the total return of first years, has averaged 8.2%. An investor can manipulate data to no end, but a particularly worrying statistic is the market's return the year after an incumbent has been reelected, which has averaged 0.3%.


On an absolute basis stocks are not nearly as inexpensive as they were in 2009. The Dow is now more than 6,000 points higher than it was in March of that year. On the other hand the Fed has green lighted the purchase of risk assets, by announcing it will keep interest rates artificially low for another couple of years. So, we have this Bernanke put cushioning the market. Until the unemployment rate falls to around 6.5% it is O.K. to buy stocks, real estate or commodities. The Fed could not have been more blunt about this.

So far the average investor has not taken the bait; they continue to withdraw money from the stock market in favor of the presumed safety of bonds. And who can blame them? They have been burned so many times during the past decade. First they lost a bundle buying internet stocks, then real estate speculation cost them plenty and the financial crises closed their wallets for the time being. Unfortunately, they do not understand the enormous risk they are taking by holding debt that is being priced at artificially low rates solely because of the Fed's enormous appetite for this asset class.

Make no mistake about it: this is a bubble that will inevitably burst. If the 30 year Treasury yield simply returned to its level of a decade ago, over the next five years investors would suffer a meaningful loss of capital. The principle of the bond could decline by 43%...that would swamp the 14% interest income received over five years.

So, the outlook for stocks during the next year is cloudy. On a relative basis stocks are still the most attractive asset class, perhaps single family homes in certain parts of the country are equally compelling. The Fed continues to be very accommodating which is always a positive for stocks. Individual investors continue to shun equities, a terrific contrary indicator. Tempering our appetite for stocks during the short term include the following:

The problems in Europe have not been fully addressed. Our escalating debt burden which now stands at $17 trillion and is growing at the rate of $1 trillion a year: Medicare, Social Security and healthcare cannot be ignored any longer. Syria, Iraq, Iran and Afghanistan, any or all could implode. The slowing Chinese economy and their sizable real estate problem could impede the global economy. It is never a good idea to fight the Fed, so even with the robust returns of last year, and with opaque visibility stocks could be modestly in the black for a fourth consecutive year.

**Will Apple Be Able To Maintain Its Mojo?**

In our quarterly letter to clients dated January 31, 2012 we wrote an excerpt entitled "Do Technology and Consumer Electronic Companies Lose their Competitive Advantages Over Time?" We cited examples of companies that have caught the fancy of Wall Street for multiple years, but like shooting stars that brighten the heavens for short bursts of time they ultimately fall to earth and die.

During the 1960's Polaroid was the quintessential technology stock. At its height it soared to over $140 per share and was the first high flyer that we can recall that sported a P/E multiple of over 100. As digital photography began to take hold, instant photography was doomed. Ultimately the company filed for bankruptcy. The Polaroid story taught us how easily a corporate giant that is beholden to a single technology can be crushed when a more exciting alternative bursts onto the scene. Polaroid is a reminder that nothing is forever in a free-market economy and how quickly technology innovation can destroy a ubiquitous product in a relatively short period of time. There are countless other examples of technology businesses that ultimately have gone the way of the buggy-whip or have become much less relevant. Commodore Computer, Atari, Eastman Kodak and more recently Hewlett Packard are just a few examples.


There are very few technology companies that have survived let alone thrived over the last fifty years. Yes, there is IBM, but it is a completely different company than it was at inception. So that brings us to Apple. Can Apple prove to be the exception? When we posed that question almost one year ago, Apple's shares were trading at about the price they are trading for today. Subsequently, the share price rose by about 40%, making it the world's most valuable company. In last year's letter we were hesitant to venture a guess as to whether Apple would continue to thrive. We concluded by saying only time will tell…

Now that the shares have suffered a dramatic reversal of fortune having lost $200 billion of market value from its peak, we thought it appropriate to opine on Apple once again. Today, we are much less certain that Apple will be able to maintain its competitive edge over the long term, and that its common shares will have the capability to retain its cult like aura. So let us enumerate some of the reasons that we believe Apple's common stock may prove to be mortal.

1) Apple must create exciting new devices each year in order to maintain its competitive advantage and high margins. With Steve Jobs at the helm, in a relative short period of time three revolutionary new products (the iPod, the iPhone, and the iPad) were introduced each of which fueled incredible growth.

   Recently however no new products have been introduced; just upgrades or extensions of existing products have been released. The iPhone 4 morphed into the iPhone 5, and the mini iPad was also introduced. It is becoming increasingly more difficult for Apple to sustain top-line growth at levels that will satisfy its current growth oriented investor base. The law of large numbers (Apple's most recent fiscal year revenues were $156.5 billion), will most certainly inhibit Apple's ability to grow as rapidly in the future as it did in the past. Yes, we have heard the rumors about a revolutionary television device that Apple will soon introduce. We however find it very difficult to maintain an investment thesis based solely on speculation about a device that will supposedly transform the way we interact with our television. Then again in fairness to the Apple bulls, we would have said the same thing about Apple introducing a mobile phone that would revolutionize that device.

   Without a revolutionary new product introduction Apple could become a mediocre stock market performer. Evolutionary product introductions cannot sustain Apple's growth rate. For example, in the three months after the iPhone 4S was launched in 2011, 73% of iPhone buyers in the U.S. opted for the latest version of the device. It is estimated that in the three months after the iPhone 5 was launched the percentage of U.S. iPhone buyers opting for it fell to 50%.

2) As Mark Twain once said, "History does not repeat itself, but it does rhyme." In the heyday of its growth Sony Corp. mirrored Apple in a variety of ways:

   - It had a charismatic leader at the helm.
   - Wall Street waited with bated breath for new product introductions such as the Walkman and the Discman. Its Trinitron television line was the cat's meow commanding premium pricing, which bolstered the company's profit margins.
   - Innovation and intense pricing pressure by competitors ultimately led to the company's fall from grace.


3) The bull case for Apple is that it trades at a below market multiple, unlike Polaroid, Microsoft, and Cisco that commanded enormous P/E ratios before they fell out of favor. Apple has never commanded that type of multiple because it really is not a technology company; it is a consumer electronics company, similar to Sony that also never commanded an excessive P/E multiple.

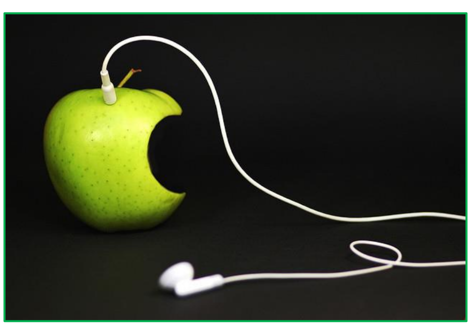
4) According to Sanford Bernstein & Company, 77% of growth funds and 40% of value funds own Apple. Apple is the biggest single holding in a number of the largest mutual funds. It is not uncommon for it to represent 5% to 10% of the value of an entire mutual fund. It appears that growth investors are saturated with Apple, and have begun to lighten up. Value investors have begun to nibble, but it would probably have to get materially cheaper for them to become aggressive purchasers. It is a stock that appears to be over owned by institutions, and if disappointments begin to mount, the downside pressure on the stock could accelerate.

5) It is also a "blind faith," stock. Apple fans are betting that the company will continue to innovate and consistently come up with new blockbuster products after new blockbuster products… Maybe they will, but no other consumer electronic company or technology company in history has ever retained their dominance for a sustained period of time. Furthermore, the vast majority of product innovation was realized when Steve Jobs was alive. If Apple hasn't already released the last devices developed under the direction of Mr. Jobs, it is getting close. The hard work for CEO Tim Cook is just beginning.

6) The iPhone was viewed as a must have product by teenagers and young adults, when it was first introduced. As more and more of them acquired the iPhone, the status of ownership has diminished. They may elect to upgrade less frequently or perhaps try a competitor's phone.

7) Apple is also at risk of losing one of its key competitive advantages over Google's rival Android system with application developers saying they are warming to Google's smartphone platform. In November, Apple had about 700,000 apps available, the same as Android.

Competitors have begun to take a bite out of Apple. Time will tell if Apple will be able to reverse that trend. Furthermore from a stock market perspective the company's sheer size dictates that new product innovations have to be enormous in scope for them to be a driver of revenue growth.



*One of the most powerful tools a long-term investor has at his or her disposal is the magic of compounding. We included an excerpt from the following article not only to remind our investors of this phenomenon but also to point out to clients that the natural tendency to reach for extra yield in this ultra-low interest rate environment does have its risks.*

**How Huge Returns Mess With Your Mind**

Happy New Year, investors.
Enjoy those gains that your portfolios earned this past week. Just don't extrapolate them.

This past Wednesday, the first trading day of 2013, the Standard & Poor's 500-stock index jumped 2.5% after the White House and Congress agreed on a new tax-and-spending package. That was its biggest daily return in nearly 13 months. Even after a tepid employment report on Friday, the S&P 500 ended the week up another 0.5%.... On Wednesday, the yield on the Barclays U.S. Corporate High Yield Index fell below 6% for the first time ever, as investors pushed high-yield, or "junk," bonds to their highest prices on record. And the giddiness is global. Stock markets in Argentina, China, Egypt and Finland all shot up by at least 4% in the first two trading days of 2013, largely in response to the news out of Washington… Starved for good news after a dozen years of bear markets and wrenching volatility, investors need to keep their expectations in check and to avoid taking unacceptable risks in the pursuit of yield.

It is especially important to recognize two related flaws of the human mind: People tend to underestimate how hard it is to earn high rates of return and how much wealth those growth rates would achieve. A 2.5% return doesn't sound particularly hard to sustain, but if the market went up at that same daily pace each of the other 20 trading days in January, investors would earn a 65% return. A full year's worth of 2.5% daily returns would yield a return of more than 50,000%. Because the human mind isn't very good at appreciating the power of exponential growth, thinking realistically about high returns is hard.

Consider the oft-told myth about the inventor of chess: Granted any wish by a grateful king, the inventor asked to be paid with one grain of rice on the first square of the chessboard, with the amount to be doubled on each successive square. The king casually agreed, expecting to pay out a few handfuls of rice, only to discover that by the 64th square he would owe the inventor quintillions of grains—enough to carpet the entire planet with rice pilaf.

According to recent research by economists Joshua Tasoff of Claremont Graduate University and Matthew Levy of the London School of Economics, many people believe that a one-percentage-point increase in compounding is equally valuable at all growth rates. That probably is because compound growth—in which the original amount and all additions to it grow at the same rate—is rare outside the financial world… People with this "exponential growth bias" believe that a boost in the compound rate of return from 2% to 3% will make as big a difference in their final wealth as an increase from 12% to 13% would.

No wonder so many investors are tempted to reach for yield at today's low interest rates, when little gains feel as if they mean a lot. But the math doesn't work in the real world the way it does in investors' minds. Over 10 years, $10,000 compounded at 2% amounts to $12,190; at 3%, it rises to $13,439, or $1,249 more. But the same $10,000 compounded at 12% for a decade yields $31,058; at 13%, $33,946, or $2887 more.

In short, a little bit of extra return isn't nearly as valuable in a low-rate world as people intuitively believe it to be. Some investors—foremost among them Warren Buffett—feel the power of exponential growth in their very bones. Even as a young man, according to his biographer, Alice Schroeder, Mr. Buffett developed the habit of regarding any money that he didn't invest as a reduction in the rate at which his future wealth could expand: "Do I really want to spend $300,000 for this haircut?"…
In short, considering that just about all financial assets are at or near record highs in today's markets, the sensible thing for investors to do isn't to ratchet up their risk, trade faster or try squeezing out every last drop of yield. Instead, save more, stretch out your horizons as long as you can and let the power of compounding—even at low rates—do its quiet work.

*Condensed from an article appearing in the WSJ on 1-4-13 by Jason Zweig*

*Boyar Asset Management shares many of Mr. Altman's sentiments in the opinion piece below especially regarding a potential U.S. housing recovery and its ramifications for the entire economy. As regular readers of our quarterly letters have observed, we have been bullish on U.S. housing related names for quite some time now. With the run up in many of these stocks in 2011-2012 some of these companies are not as attractive as they once were on a valuation basis. With this in mind, from a valuation perspective one of the best ways to play an eventual recovery in the U.S. housing sector is through shares of some of the major U.S. banks that have a large mortgage exposure.*

## How the American Economy Could Surprise Us All

In the past three years, the most noteworthy aspect of the US recovery has been its weakness. The headwinds arising from the 2008 financial collapse, especially against household finances, housing and lending, have held annualized growth at the meager 1.7 percent rate we saw in the last quarter. They have prevented an improvement in the labor market, as evidenced by the recent 30-year low in the proportion of the workforce in employment. These headwinds are now beginning to abate but it may be another four years before they fully subside.

***But when they do, it is possible that the US economy will surprise on the upside. A housing revival, the revolution occurring in energy, a rejuvenated banking system and a leaner industrial base could lead to US growth beyond the 2.5 percent rate that is widely seen as its long-term potential. In other words, the famine could be followed by a feast*** [emphasis added]…

There are five factors that suggest there could be a surge in US growth. First, the housing sector is improving. Between 1980 and 2005 it accounted for an average 4.5 percent of gross domestic product and before the crash it employed more than 3m Americans. But in 2012 it represents only 2.4 percent of GDP and 2m jobs. Almost 1.5m mortgages are still in foreclosure. But the first signs of renewal have appeared: prices are rising in almost half of the country's major housing markets. Pent-up demand is huge. Goldman Sachs expects housing starts to hit 1.4m annually by 2015, up from 700,000 this year. After 2015, the total will rise further and boost GDP, as household formation rates and the starts-to-population ratio revert to historical norms.

The second cause for optimism is the breathtaking increase in oil and gas production. Data from the US Energy Information Administration support this. Natural gas output reached an all-time high this year, with shale gas accounting for half of it. On the oil side, US production fell 48 percent from its 1970 high to only 5m barrels a day in 2008. Driven by shale, it is up almost 20 percent from 2008 to 2012…. Within five years, the oil gains alone could add more than 1 percentage point to annual GDP growth and up to 3m jobs. The fall in natural gas prices will reduce the average utility bill by almost $1,000 a year. It will also reinvigorate the US petrochemical industry and some manufacturing sectors.

Third, amid the political controversy and negative publicity, the US banking system has recovered faster than anyone could have imagined. Capital and liquidity have been rebuilt to levels unseen in decades. Legacy mortgage problems are fading. Profits are very strong. Lending is growing quickly: total bank credit outstanding now stands at $9.8tn, according to Fed data, a record high…

Fourth, the US has made a huge leap in industrial competitiveness. Unit production costs are down 11 percent over the past 10 years, while costs have risen in almost every other advanced nation. The differences in labor costs compared with China are narrowing... Furthermore, personal savings rates are up to 4 percent – from near zero before the crisis – and are expected to stabilize. This will spur higher levels of private investment and even further productivity gains… Many leading economists would challenge this surge theory. They foresee another decade of continued headwinds and mediocre growth. That may be the mainstream forecast but an alternative, better scenario is coming into view.

*Condensed from an article that appeared in The Financial Times on 9-4-12 by Roger Altman*

**Saudi America**

Sometimes the revolution politicians seek isn't the one they get. Consider the irony—and the opportunity—in Monday's report that the U.S. is likely to surpass Saudi Arabia as the world's largest oil producer as early as 2020. In its annual world energy outlook, the Paris-based International Energy Agency (IEA) says the global energy map "is being redrawn by the resurgence in oil and gas production in the United States."

The U.S. will increase its production to about 23 million barrels a day in 10 years from about 18 million barrels a day now, the IEA predicts. That's more optimistic than current U.S. government estimates and a change from a year ago when the IEA said Russia and the Saudis would vie for number one.

As readers of these pages know, the key to this U.S. energy boom has been technological innovation and risk-taking funded by private capital. Specifically, the private oil and gas industry pioneered the use of horizontal drilling and hydraulic fracturing (or fracking) to tap unconventional deposits such as shale that once were technologically out of reach. **It also wouldn't have happened if the industry wasn't able to drill on private land, free from federal regulation** {emphasis added}...

One point to keep in mind is that this U.S. energy revolution wasn't inevitable and could still be undone. The Sierra Club and other environmentalists are demonizing fracking the way they have coal, never mind that increased use of natural gas instead of coal is helping to reduce carbon emissions. They hate carbon energy—period. New York State has imposed a moratorium on fracking, even while the economy of neighboring Pennsylvania is being transformed by the exploitation of the Marcellus Shale that lies under both states. The French, who import 98% of their natural gas, have also banned fracking, despite sitting on shale reserves estimated to be the second-largest in Europe…

The biggest potential threat may come from federal regulation in Mr. Obama's second term. Though he tried to take credit for the fracking revolution in his second debate with Mitt Romney, his EPA has long wanted to supplant state regulators and will grab any opportunity to do so. Perhaps the election of pro-fracking Democrats like soon-to-be Senator Heidi Heitkamp of North Dakota (home to the monster Bakken Shale field) can give the new energy revolution some needed bipartisan buy-in. Historians will one day marvel that so much political and financial capital was invested in a green-energy revolution at the very moment a fossil fuel revolution was aborning. But politicians failing to spot the trend until they start taking credit for it is an old story. Let's hope they don't ruin it now that they've noticed.

*Excerpt from the WSJ 11-13-12*

*We echo the author's point that yield hungry investors have bid up the price of high yield securities to dangerous levels. With CCC rated junk bonds yielding on average 8.2%, the only thing we can say for investors looking to invest in this asset class is caveat emptor!*

**Junk-Bond Prices Point to Return of the Bulls**

The junk bond market is sending a bullish signal for the global economy in 2013, with investors in US high-yield securities earning higher returns so far this year than those who have bought investment-grade debt.
High-yield bonds are an acute barometer of risk appetite and rises in their prices have often signaled a turn in sentiment. With yields for US junk bonds below 6 percent, investors are indicating they believe the global economy is on firmer footing and the risk of a financial crisis is diminishing.

However, the appeal of junk bonds also has been boosted – unduly, in the eyes of some – by the overall low level of interest rates. Yield-hungry investors have few alternatives, and inflows into junk bond funds last week reached their highest levels since mid-September, according to EPFR…


But Jody Lurie, a corporate credit analyst at Janney Capital Markets, said: "With debt ceiling discussions still a few weeks away, investors are taking this window of opportunity to load up on higher yielding assets."
So far this month, investors are sitting on a total return – income, plus price gains – of 1.3 percent from US-dollar junk bonds, according to Barclays indices. By contrast, investment grade bonds have returned a negative 0.15 percent.

The biggest gains in the junk bond market have been registered in its lowest-rated corner – triple-C debt, which yields an average of 8.2 percent, down from 11.5 percent in one year. Investors in these bonds have earned a total return of nearly 2 percent this year…

The total return for US junk bonds was 15 percent last year, spurring such large bond managers as Pimco and BlackRock to warn that investors were not being properly compensated for the risks they were taking…

*Excerpt from The Financial Times 1-15-13*

**New Ideas Are Not Always the Best Ones**


Last week, I attended the reunion for an advertising agency I worked for 28 years ago. Remarkably the business, BMP, still exists and occupies the same building in Paddington it did then. The occasion was a reminder of how unusual such corporate longevity is in the business world, especially in a field as transient as marketing services. Most companies do not last – even successful ones rarely survive for long after their founders depart. Their assets are scattered, their staff move on, their products are supplanted by new competitors.

I keep a poster in my study of the history of the Dow Jones Industrial Average. It shows graphically the rise and fall of companies and industries. Almost nothing endures – they either go bankrupt or merge. From Wright Aeronautical, Studebaker and Remington Typewriter to Eastman Kodak and Woolworth, the list of old component stocks attests to the restless nature of capitalism. Such benchmarks demonstrate how technology, economics, laws and tastes shift over the decades.

Entrepreneurs are usually the source of fresh ideas that overthrow the establishment…Any start-up might embody an invention or concept that could undermine the market leaders. Many founders believe they can do something better, cheaper or with more flair than the incumbents – that is partly what drives them.

But do most consumers want the newest product? We live in an era in which older people are becoming a larger percentage of the population. Within two decades, the average European will be aged almost 50, and the largest single cohort will be the over 65-year-olds. **Not only will these groups be numerically dominant – they have all the money** {emphasis added}.

Britons under the age of 45 have so much debt that it just about equals their assets. They have much less buying power than older consumers. Their preferences might appear to drive fashions, but perhaps copywriters at places such as BMP are wrong – maybe an increasing proportion of customers don't want radical or innovative. Perhaps they want familiarity, with names, brands and products they can trust.

I have sold to the 50-plus age group and it isn't easy. They are inherently conservative in their loyalties and are generally not early adopters. They have far less promiscuous shopping habits than twenty-somethings. One way to reach this grey market is through the revival of classics: capitalizing on a brand's heritage while updating it for the 21st century.

Revived brands such as Old Spice aftershave and Brylcreem hair gel are examples of almost dormant products that were restored by thoughtful marketing. Each benefited from a huge legacy of advertising spend and product recognition stretching over decades. I am convinced there are hundreds of similar, unloved products that have been discontinued or neglected – but that could be brought back to life with the right sort of attention. In some cases, part of the appeal is nostalgia in a time of uncertainty…

Organizations such as The Himmel Group in the US and Brand Cellar in the UK have specialized in revitalizing "ghost" brands such as Ovaltine and Dewhurst meats respectively. Inevitably they target much of the relaunch at mature consumers who know the product – despite an absence for many years.

Commercial empires may rise and fall, but the consumer brands they own have residual awareness among the public. It can be far more cost effective to resurrect an old name than experiment with a new one. The business world tends to forget the past swiftly, but demographics mean that more and more buying power is in the hands of those who might seek comfort in reassuring brands from the past – witness Nissan's plans to bring back Datsun.

Inevitably entrepreneurs want to create something original. But giving a vintage brand a second act can be a more profitable exercise – especially if it appeals to the baby boomers.

*Excerpt from The Financial Times of 1-15-13 from an article written by Luke Johnson*

On the following two pages, please find reports on Bank of America & Dole Food that were featured in our year end institutional research publication *The Forgotten Forty*. Since these are names that appear in many of your portfolios, I thought you would appreciate seeing the type of research that goes into selecting companies we buy on your behalf. As always, if you have any questions, please do not hesitate to contact me directly.

Best regards,

Mark A. Boyar

| | |
|---|---|
| Symbol: | BAC |
| Exchange: | NYSE |
| Current Price: | $11.00 |
| Current Yield: | 0.40% |
| Current Dividend: | $0.04 |
| Shares Outstanding (MM): | 10,476 |
| Major Shareholders: | Insiders own <1% |
| Average Daily Trading Volume (MM): | 149.5 |
| 52-Week Price Range: | $11.00-$4.99 |
| Price/Earnings Ratio: | 29.7x |
| Stated Book Value Per Share: | $20.40 |

Balance Sheet Data

| *(in millions)* | 2011 | 2010 |
|---|---|---|
| Cash | $120,102 | $108,427 |
| Total Securities | 311,416 | 338,054 |
| TOTAL ASSETS | 2,129,046 | 2,264,909 |
| Total Deposits | $1,033,041 | $1,010,430 |
| Long Term Debt | 372,265 | 448,431 |
| Shareholders Equity | 230,101 | 228,248 |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY | $2,129,046 | $2,264,909 |

**Catalysts/Highlights**

Housing recovery will strengthen balance sheet and earnings

Runoff of legacy assets could refocus investors on BAC’s normalized earnings power

BAC’s capital ratios approaching historically high levels portends return of capital to shareholders

## *INVESTMENT RATIONALE*

Bank of America shares have surged by greater than 100% since the 2011 Forgotten Forty despite the Bank’s paltry 1.48% return on equity YTD 3Q 2012, reflecting just how far from Wall Street’s favor BAC had fallen by late last year, when shares were trading at 0.4x tangible book value. Despite the surge, we believe there is still a strong case for additional upside in 2013. BAC shares are still down 12% over the past 2 years and still trade at an 18% discount to tangible book value despite improving earnings and balance sheet quality.

BAC’s marginal profitability in 2012 reflects the continued drag from legacy bubble-era activities. This includes $3.4 billion of expenses YTD in legacy assets and servicing within the consumer real estate services subsidiary; $3.0 billion in litigation expenses; and $1.0 billion in additional representations and warranties liability provisions. While recognition of additional liabilities and charges will continue to bleed into earnings for years to come, the pace has markedly slowed in 2012. At the same time, operating performance has shown material improvement. Investment Banking fees increased 42% Y/Y to $1.3 billion in 3Q 2012 and Global Wealth and Investment Management income increased 16% to $1.6 billion YTD. Although the Consumer and Business Banking segment net income was negatively impacted by the Durbin Amendment and loss of consumer protection product revenues, at least the loan portfolio continues to improve. Thirty day delinquencies on BAC’s once-ugly card services portfolio reached a record low 3.1% and net charge-offs declined 170 bps to 4.6% in 3Q12.

Looking forward to 2013 (and beyond), we continue to view Bank of America as an attractive way to play a domestic housing recovery. BAC has approximately $100 billion in residential home loans and home equity loans on its books, not to mention tens of billions of dollars in legacy MBS-related exposure. Further real estate market appreciation would vastly improve BAC’s balance sheet quality, while a pickup in new home construction and home sales would be a tremendous tailwind for BAC’s lending operations. There are already some signs of improvement, with first lien mortgage originations up 19% Y/Y to $20.3 billion in 3Q 2012 and core mortgage banking production revenue up 20% YTD to $2.7 billion.

Despite the improvements in credit quality and mortgages, BAC’s loan book is still shrinking, down 4.2% TTM, and overall net interest margins contracted 15 bps YTD to 2.35%. This partially reflects prudent risk-reduction strategies given the current economic environment, although the continued declining interest rate environment has made lending and securities investment more difficult. Deposit spreads have declined by another 28 bps YTD, confounded by the zero bound problem (inability to lower deposit rates below zero percent). However, BAC largely stabilized overall net interest spreads over the last 2 quarters thanks to ongoing efforts to reduce higher-cost long-term debt (long-term debt is down $112 billion TTM).

Although it is impossible to predict when we will see a normalized lending and interest rate environment, we continue to believe BAC’s stable, low-cost $1.0 trillion deposit base is extremely valuable and BAC’s long-term earnings power is far above current levels. For example, a return to 3.0% net interest margins (versus 2.35% currently) implies ~$52 billion in net interest income alone. BAC’s normalized earnings power should also benefit from progress with the ‘New BAC’ cost cutting initiative, which targets $5 billion in cost savings by 2014. BAC is rapidly shuttering unprofitable local branches and has already reduced employee count by 6% over the past year. While the era of high-teens ROEs among the global money center banks is almost assuredly over given the new regulatory and interest rate environments, even assuming BAC can eventually return to 10% ROE would imply long-term earnings power of upwards of $2 per share. BAC’s billions of dollars in NOLs should also shield taxes for years to come. Nonetheless recognizing this may still be years away, we estimate BAC’s intrinsic value is approximately $15 per share applying a conservative 1.0x multiple to 2014E tangible book value. Return of capital to shareholders could also materialize as a real catalyst for BAC in the next couple years. BAC declined to submit a proposal to the Federal Reserve for increased return of capital heading into 2012 following its rejection in the prior year. But BAC’s tangible common equity ratio is up 70bps Y/Y to 6.95% and BAC is now well ahead of its initial capital schedule under the new Basel III accords, with estimated Basel III Tier 1 Capital up to 8.97% at September 30, 2012 versus an estimated 7.95% the previous quarter. This may spur management to revise the Company’s capital allocation plan over the next 12 months.

| | |
|---|---|
| Symbol: | DOLE |
| Exchange: | NYSE |
| Current Price: | $11.59 |
| Current Yield: | N/A |
| Current Dividend: | N/A |
| Shares Outstanding (MM): | 88.2 |
| Major Shareholders: | David Murdock: 40% |
| Average Daily Trading Volume (MM): | 1.3 |
| 52-Week Price Range: | $14.35-$8.05 |
| Price/Earnings Ratio: | 14.1x |
| Stated Book Value Per Share: | $10.22 |

Balance Sheet Data

| *(in millions)* | 10/6/2012 | 2011 | 2010 |
|---|---|---|---|
| Cash | $82 | $129 | $221 |
| Current Assets | 1,755 | 1,810 | 1,898 |
| TOTAL ASSETS | $4,235 | $4,270 | $4,257 |
| Current Liabilities | $1,170 | $1,080 | $1,203 |
| Long Term Debt | 1,635 | 1,652 | 1,572 |
| Shareholders Equity | 901 | 793 | 792 |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY | $4,235 | $4,270 | $4,257 |

**Catalysts/Highlights**

Improved financial position following sale of Asia Fresh and Worldwide Packaged Foods businesses

Free cash flow acceleration due to significantly lower interest expense following debt reduction from divestiture proceeds

Value of non-core/idle land represents ~50% of the Dole's current market cap

## *INVESTMENT RATIONALE*

On September 17, 2012, Dole announced that it had signed a definitive agreement to sell its Worldwide Packaged Foods business and Asian Fresh business to ITOCHU Corporation for $1.7 billion in cash. These businesses accounted for $2.5 billion (37% of total) and $188 million (43% of total) of Dole's 2011 revenue and adjusted EBITDA, respectively. The deal is expected to close in late 2012. In our view, Dole is receiving a very attractive price for its Worldwide Packaged Foods and Asia Fresh businesses, which we estimate are being sold at approximately 12.0x and 7.0x 2011 EBITDA, respectively. Dole intends to utilize proceeds from the sale (~$1.4 billion after-tax) to reduce its debt, which stood at $1.6 billion at October 6, 2012. In conjunction with the transaction announcement, Dole stated that it would be rightsizing its remaining businesses and expects to realize ~$50 million in annual cost savings when the restructuring is complete at the end of FY 2013.

Despite these favorable developments, Dole's shares have declined by nearly 20% subsequent to the September 2012 sale announcement. In our view, the recent share price decline largely reflects indiscriminate investor selling. On November 1, 2012, David Murdock (age: 89), Dole's Chairman, settled a $300 million personal loan backed by ~22 million in Dole stock (25% of Dole's outstanding shares). While some may have an unfavorable view of Chairman Murdock's decision to settle his loan in stock rather than cash (it reduced his equity stake in Dole from 65% to 40%), we would note that Mr. Murdock deployed over $60 million toward the purchase of nearly 5 million shares between July 24th and August 16th of 2012 (average price: $12.21 a share).

Following the proposed transaction, Dole's Fresh Fruit segment (bananas, pineapples, etc.) will represent nearly 80% (up from 70%) of total revenue. While the Fresh Fruit segment is less predictable than the soon to be divested packaged foods unit, the business remains a strong cash generator and should be an ongoing beneficiary of demographic tailwinds (fruit consumption increases as consumers age). Dole boasts a high market share position in bananas, which represent a disproportionate amount of segment sales, including the number 1 market share in the U.S. (34% share) and number 2 position in Europe (7% share). The remaining 20% of Dole's total revenue will be derived from the Company's Fresh Vegetables segment, which generates the vast majority of its revenues from value-added products such as packaged salads (32% share).

Aided by lower post transaction interest expense due to reduced debt levels (interest expense of ~$15 million going forward vs. $142 million in 2011), we estimate the remaining businesses should be able to generate ~$150 million of annual free cash flow (15% FCF yield). The Company's strong free cash flow generating abilities coupled with low leverage (pro forma net debt to EBITDA of 0.5x-1.0x compared with 4.0x pre-transaction) should provide the Company with plenty of capacity to both return a significant amount of value to shareholders through dividends/share repurchases and allow the Company to pursue growth opportunities in the fruit industry.

Dole has a significant portfolio of hidden assets, which provides investors with a good margin of safety. Notably, Dole owns 113,000 acres of land including ~25,000 acres of mostly idle land located in Oahu, Hawaii. Dole management recently estimated the value of its non-core land to be $500 million (~50% of Dole's current market cap), a value that is understated on the Company's balance sheet and is likely conservative in light of recent transactions. While the Hawaii land represents the crown jewel of the Company's hidden assets, it is also worth noting that Dole has nearly $1.4 billion of operating loss carryforwards for a combination of federal, state and foreign tax purposes. These valuable tax assets will likely minimize Dole's cash tax payments for many years to come.

At current levels, we estimate that Dole is trading at less than 5.0x EV/EBITDA on a pro forma basis for the transaction and debt pay down. We believe this valuation is inconsistent with Dole's soon to be improved financial position, strong cash generating abilities and meaningful hidden assets. In deriving our estimate of Dole's intrinsic value we have applied a 7.0x multiple (a discount to peers and below the multiple being paid for the Company's less profitable Asia Fresh business) to our estimate of the Fresh Fruit's segment 2014 EBITDA. For the Company's Fresh Vegetables segment, we have applied an 8.0x multiple to our 2014E EBITDA reflecting that business' superior profitability and more consistent results. After adjusting for projected net debt, corporate expenses and the Company's underfunded pension, and assigning a conservative $300 million valuation for the Company's non-core assets, we derive an intrinsic value for Dole of $22 a share, representing nearly 90% upside from current levels. We would not be surprised to see a sale of the entire Company in the not too distant future. Chairman Murdock turns 90 next year and has made a number of recent moves that suggests he is interested in streamlining his estate, including the sale of his Hawaiian island (Lanai) and his apartment on the Upper East Side of Manhattan. In December 2012, Dole announced that Mr. Murdock would also be assuming the CEO position (the prior CEO is joining ITOCHU) and that its long-time general counsel (who was instrumental in completing the ITOCHU transaction and received a "special bonus" for doing so) with no operating background would be taking on the added responsibilities of President/COO. Taken together, these recent moves suggest that there is a high probability the entire business could soon be sold.

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*The S&P 500 performance referenced on page 1 of this letter is for the January 1, 2012 through December 31, 2012. The major indices referenced include the S&P 500 TR, the Russell 2000 Total Return, the NASDAQ OTC INDEX-Composite, and the Russell 3000 TR.*