

The Little Stock That Beats the Market (& An Update on Berkshire Hathaway)

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Value Investing Congress

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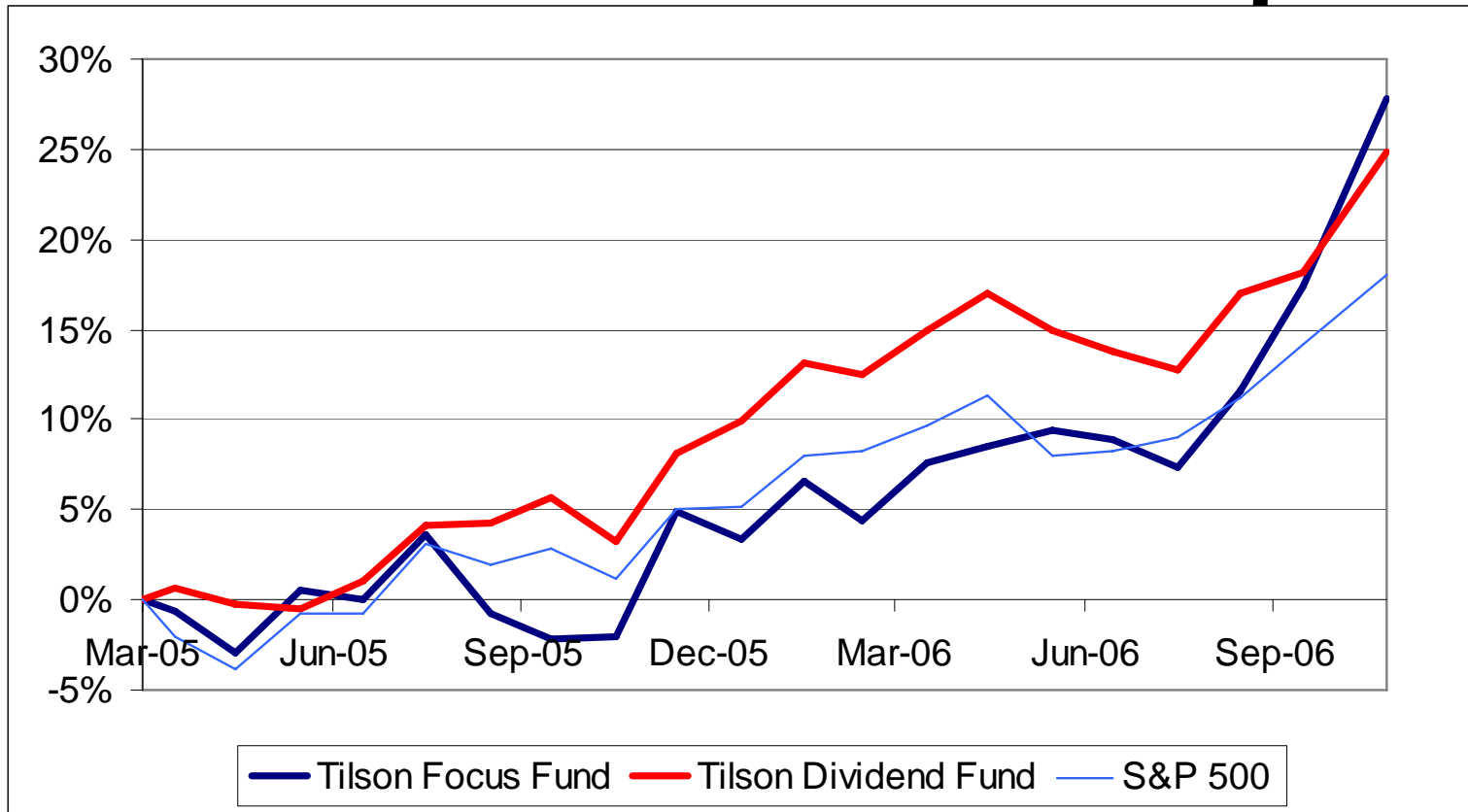
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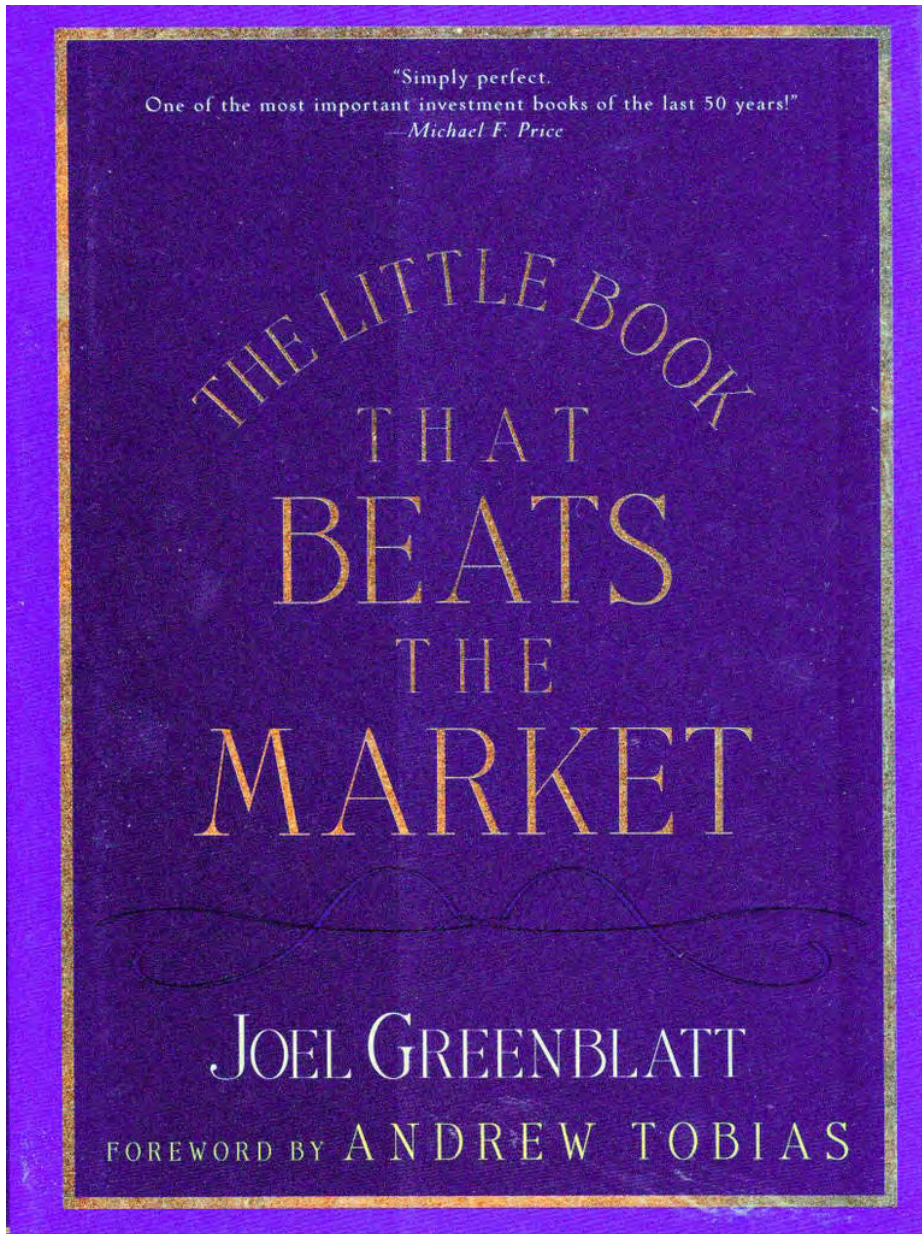
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The Little Stock That Beats the Market (We Hope!)



The Magic Formula correctly focuses on two of the most important factors in value investing:

- 1) High return on capital and
- 2) Low multiple of earnings

Characteristics of the Business

- #1 in industry with 30% market share
- State-of-the-art flexible manufacturing facilities
- Vertically integrated
- Low-cost producer
- Number of competitors has dropped from 18 to 8 since 1995
- Very high barriers to entry
- Time- and battle-tested management team

The Magic Formula Criteria

...Plus a Bonus

- Very high return on capital
 - Greater than 40% return on tangible capital employed (net PP&E plus net working capital, divided by TTM EBIT)
- Very low multiples
 - 5.2x EV/EBIT (TTM)
 - 7.5x P/E (based on TTM EPS)
- Warren Buffett is the largest shareholder (nearly 20% ownership) and was aggressively buying as recently as a month ago at current prices

Top 100 Magic Formula Companies With Market Cap > \$2B

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MagicFormula investing



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Top 100 companies with a minimum market cap. of \$2 billion
Companies are listed in alphabetical order

Name (in alphabetical order)	Ticker	Market Cap (\$ Millions)	Pre Tax Earnings Yield	Pre Tax Return on Capital	Price From Quarter	Most Recent Data
3M Co	MMM	58,482.19	8%	50 - 75%	11/08	09/30
Abercrombie & Fitch Co.	ANF	6,481.36	9%	50 - 75%	11/08	07/31
Accenture Ltd	ACN	19,414.43	9%	> 100%	11/08	08/31
American Eagle Outfitters Inc.	AEOS	6,960.18	8%	> 100%	11/08	07/31
AmerisourceBergen Corp	ABC	9,188.25	8%	75 - 100%	11/08	09/30
AnnTaylor Stores Corp.	ANN	2,886.68	10%	25 - 50%	11/08	07/31
AutoZone Inc	AZO	8,045.06	10%	25 - 50%	11/08	08/31
Bed Bath & Beyond Inc.	BBBY	11,216.62	8%	50 - 75%	11/08	08/31
Biovail Corp	BVF	2,565.11	18%	> 100%	11/08	06/30
Black & Decker Corp (The)	BDK	6,319.31	10%	25 - 50%	11/08	09/30
Block (H&R) Inc.	HRB	7,476.64	9%	> 100%	11/08	07/31
CDW Computer Centers Inc.	CDWC	5,346.40	9%	50 - 75%	11/08	09/30
CGI Group Inc.	GIB	2,268.76	10%	> 100%	11/08	06/30
Career Education Corp	CECO	2,306.82	13%	50 - 75%	11/08	09/30
Caremark Rx Inc	CMX	20,463.10	8%	> 100%	11/08	09/30
Carpenter Technology Corp	CRS	2,651.67	13%	25 - 50%	11/08	09/30
Chico's FAS Inc.	CHS	3,865.82	9%	50 - 75%	11/08	07/31
Claire's Stores Inc.	CLE	2,646.19	10%	75 - 100%	11/08	07/31
Commercial Metals Co	CMC	3,276.65	16%	25 - 50%	11/08	08/31
Crane Co.	CR	2,411.58	9%	25 - 50%	11/08	09/30
Cummins Inc.	CMI	6,101.85	15%	25 - 50%	11/08	09/30
Dun & Bradstreet Corp (The)	DNB	4,878.23	8%	> 100%	11/08	09/30
EOG Resources Inc.	EOG	16,469.46	13%	25 - 50%	11/08	09/30
Encana Corp	ECA	40,221.03	19%	25 - 50%	11/08	09/30

Top 100 Magic Formula Companies With Market Cap > \$2B (2)

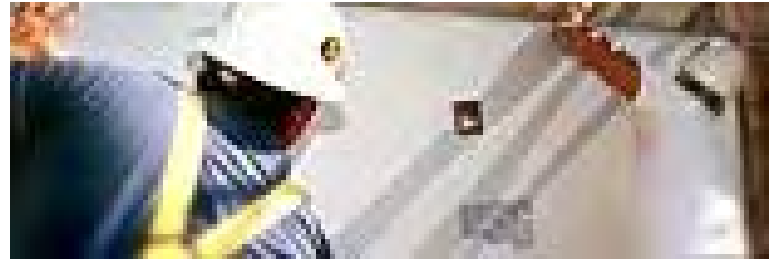
Name (in alphabetical order)	Ticker	Market Cap (\$ Millions)	Pre Tax Earnings Yield	Pre Tax Return on Capital	Price From	Most Recent Quarter Data
Equifax Inc.	EFX	4,799.23	8%	> 100%	11/08	09/30
Expedia Inc	EXPE	5,615.21	7%	> 100%	11/08	06/30
Express Scripts Inc.	ESRX	8,390.32	8%	> 100%	11/08	09/30
Florida Rock Industries Inc	FRK	2,778.46	11%	25 - 50%	11/08	06/30
Fording Canadian Coal Trust	FDG	3,079.65	22%	> 100%	11/08	09/30
Freeport-McMoran Copper & Gold Inc.	FCX	11,051.80	23%	75 - 100%	11/08	09/30
Frontier Oil Corp.	FTO	3,418.14	18%	> 100%	11/08	06/30
Gannett Co Inc.	GCI	13,806.49	10%	50 - 75%	11/08	09/30
Gap Inc. (The)	GPS	16,260.52	10%	25 - 50%	11/08	07/31
Getty Images Inc	GYI	2,536.81	9%	> 100%	11/08	09/30
Graco Inc.	GGG	2,754.66	8%	75 - 100%	11/08	09/30
Halliburton Co	HAL	32,029.35	11%	50 - 75%	11/08	09/30
Harley-Davidson Inc.	HOG	18,696.52	9%	75 - 100%	11/08	09/30
Harris Corp	HRS	5,538.91	9%	50 - 75%	11/08	09/30
Harte Hanks Inc.	HHS	2,012.31	9%	> 100%	11/08	09/30
Herbalife Ltd	HLF	2,747.44	9%	> 100%	11/08	09/30
Hess Corp	HES	12,505.85	21%	25 - 50%	11/08	09/30
Hewitt Associates Inc.	HEW	2,859.35	9%	50 - 75%	11/08	06/30
Home Depot Inc. (The)	HD	76,958.50	12%	25 - 50%	11/08	07/31
Honeywell International Inc.	HON	34,562.87	9%	25 - 50%	11/08	09/30
IDEX Corporation	IEX	2,502.13	8%	50 - 75%	11/08	09/30
IPSCO Inc.	IPS	4,289.68	26%	50 - 75%	11/08	09/30
Illinois Tool Works Inc.	ITW	27,164.79	9%	50 - 75%	11/08	09/30
Imclone Systems Inc	IMCL	2,641.19	14%	50 - 75%	11/08	09/30
Imperial Oil Ltd	IMO	35,755.16	11%	25 - 50%	11/08	09/30
Ingersoll-Rand Co Ltd	IR	12,055.71	11%	50 - 75%	11/08	09/30
Interactive Data Corp	IDC	2,088.91	8%	> 100%	11/08	09/30
International Business Machines Corp	IBM	139,473.14	8%	50 - 75%	11/08	09/30
JLG Industries Inc.	JLG	2,975.15	9%	50 - 75%	11/08	07/31
Kinetic Concepts Inc	KCI	2,421.75	12%	75 - 100%	11/08	09/30
King Pharmaceuticals Inc.	KG	3,826.25	19%	> 100%	11/08	06/30
Lam Research Corp	LRCX	6,461.04	10%	> 100%	11/08	09/30
Landstar System Inc	LSTR	2,591.52	8%	50 - 75%	11/08	09/30
Lexmark International Inc.	LXK	6,577.67	9%	50 - 75%	11/08	09/30
Linear Technology Corp	LLTC	9,874.74	7%	> 100%	11/08	09/30
Lockheed Martin Corp	LMT	36,645.81	8%	75 - 100%	11/08	09/30
Masco Corp	MAS	10,893.15	11%	25 - 50%	11/08	09/30

Top 100 Magic Formula Companies With Market Cap > \$2B (3)

**USG has a
16% pre-tax
earnings
yield and 25-
50% pre-tax
return on
capital**

Name (in alphabetical order)	Ticker	Market Cap (\$ Millions)	Pre Tax Earnings Yield	Pre Tax Return on Capital	Price From	Most Recent Quarter Data
McKesson Corp	MCK	14,924.32	9%	> 100%	11/08	09/30
Meredith Corp	MDP	2,556.03	9%	> 100%	11/08	09/30
Microsoft Corp	MSFT	284,583.60	7%	> 100%	11/08	09/30
National Semiconductor Corp	NSM	7,885.22	10%	75 - 100%	11/08	08/31
Nike Inc	NKE	23,310.09	9%	25 - 50%	11/08	08/31
Northrop Grumman Corp	NOC	22,426.94	9%	50 - 75%	11/08	09/30
Nucor Corp	NUE	17,790.01	16%	50 - 75%	11/08	09/30
Omnicom Group Inc.	OMC	17,471.11	7%	> 100%	11/08	09/30
Oregon Steel Mills Inc.	OS	2,008.92	14%	25 - 50%	11/08	09/30
Oshkosh Truck Corp	OSK	3,290.81	10%	50 - 75%	11/08	09/30
Phelps Dodge Corp	PD	20,126.64	17%	50 - 75%	11/08	09/30
Phillips-Van Heusen Corp	PVH	2,587.62	9%	75 - 100%	11/08	07/31
Pitney Bowes Inc.	PBI	10,527.30	8%	> 100%	11/08	09/30
Precision Drilling Trust	PDS	3,096.36	18%	50 - 75%	11/08	09/30
Quest Diagnostics Inc	DGXI	10,046.03	10%	> 100%	11/08	09/30
Reliance Steel & Aluminum Co	RS	2,567.18	16%	25 - 50%	11/08	09/30
Seaboard Corp	SEB	2,011.30	16%	25 - 50%	11/08	09/30
ServiceMaster Co (The)	SVM	3,304.08	8%	> 100%	11/08	09/30
Sherwin-Williams Co (The)	SHW	8,194.54	11%	50 - 75%	11/08	09/30
Southern Copper Corp	PCU	16,336.64	16%	50 - 75%	11/08	09/30
Stanley Works (The)	SWK	3,955.44	10%	25 - 50%	11/08	09/30
Steel Dynamics Inc	STLD	2,872.18	18%	25 - 50%	11/08	09/30
Sunoco Inc.	SUN	8,155.37	19%	25 - 50%	11/08	09/30
TODCO	THE	2,129.54	10%	25 - 50%	11/08	09/30
Teck Cominco Ltd	TCK	16,485.75	18%	50 - 75%	11/08	09/30
Tellabs Inc	TLAB	4,990.66	9%	50 - 75%	11/08	09/30
Teradyne Inc.	TER	2,740.41	10%	25 - 50%	11/08	09/30
Terex Corp	TEX	5,383.45	11%	25 - 50%	11/08	09/30
Texas Instruments Inc	TXN	43,552.00	9%	50 - 75%	11/08	09/30
Thor Industries Inc.	THO	2,413.99	12%	75 - 100%	11/08	07/31
USG Corp	USG	4,519.40	16%	25 - 50%	11/08	09/30
UST Inc.	UST	8,757.55	9%	> 100%	11/08	09/30
Unit Corp	UNT	2,349.58	20%	25 - 50%	11/08	09/30
United States Steel Corp	X	8,237.12	20%	25 - 50%	11/08	09/30
United Technologies Corp	UTX	65,799.36	8%	50 - 75%	11/08	09/30
Viacom Inc	VIA.B	28,245.04	7%	> 100%	11/08	06/30
W&T Offshore Inc	WTI	2,299.44	13%	25 - 50%	11/08	06/30
Western Digital Corp	WDC	4,279.64	11%	50 - 75%	11/08	09/30
Westlake Chemical Corp	WLK	2,087.33	20%	25 - 50%	11/08	09/30

Background on USG



The Business

- The world's leading producer of gypsum wallboard, joint compound and a vast array of related products for the construction and remodeling industries
 - Flagship brands include SHEETROCK gypsum panels and DUROCK cement board
- Manufactures and markets interior systems products, including ceiling grid and acoustical ceiling tiles
- Distributes construction materials

History

- Incorporated in 1901 as the United States Gypsum Company
- As the inventor of wallboard and ceiling tile, USG created North America's building materials industry
- In October 1987, Wagner & Brown launched a hostile takeover offer
- Company recapped, resulting in \$2.6 billion debt
- Crushing debt load led to pre-pack bankruptcy in 1993
- Asbestos costs led to Chapter 22 (Chapter 11 for 2nd time) July 2001
- In June 2006, USG's Plan of Reorganization was confirmed
 - Fund asbestos trust
 - Rights offering
 - Exited bankruptcy with equity intact

USG's Stock Over the Past Decade



USG Is In Three Businesses

<u>Segment</u>	<u>What It Is</u>	<u>2005 Sales</u>	<u>2005 EBIT</u>	<u>2005 CapX</u>
Gypsum	Manufactures and markets gypsum wallboard, joint treatments, panels, etc.	\$3,222	\$634	\$174
Distribution (L&W Supply)	Specializes in delivering construction materials to job sites	\$2,048	\$149	\$3
Ceilings	Manufactures and markets acoustic ceiling panels	\$707	\$62	\$19

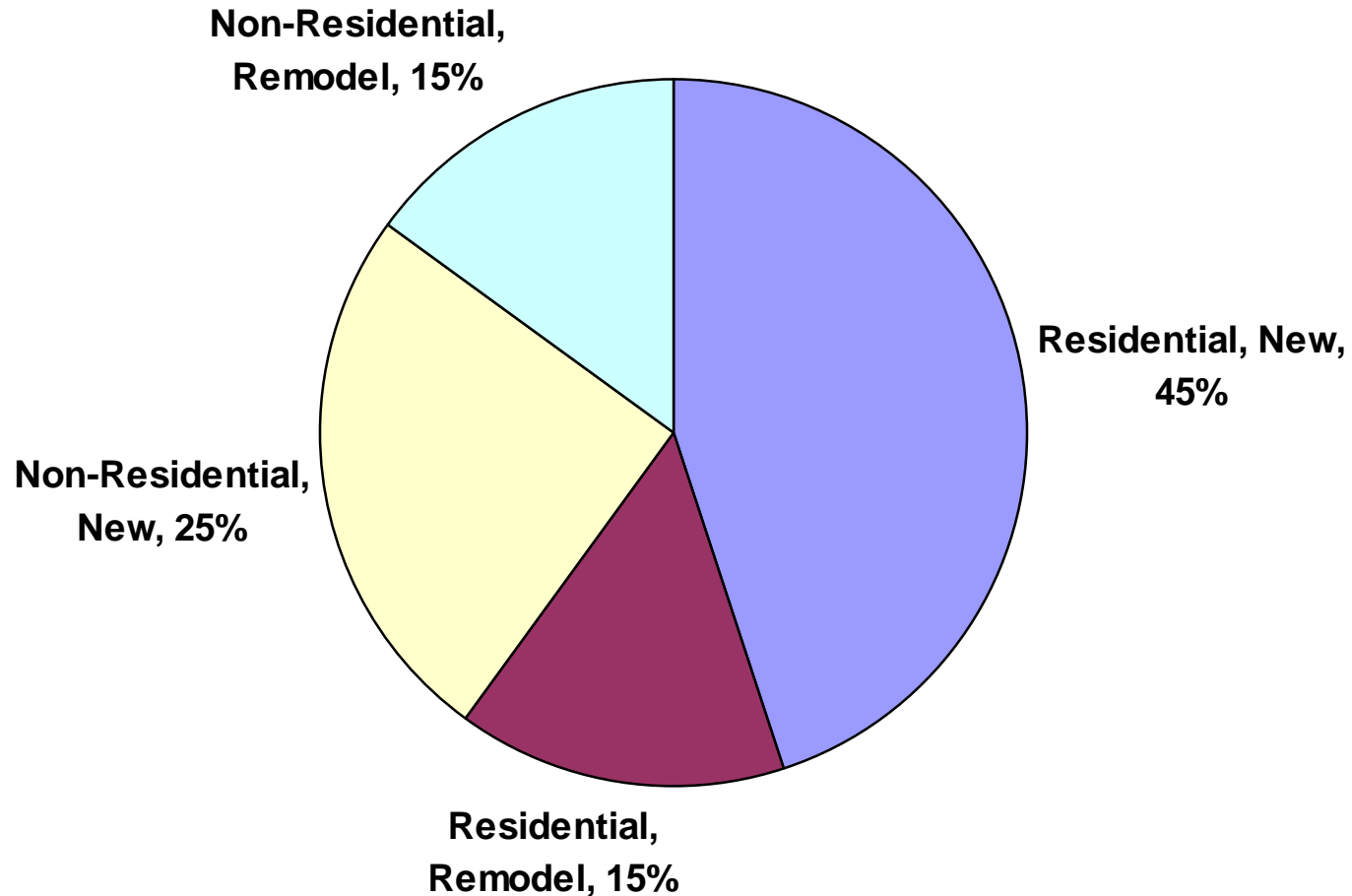
Don't We Know the Housing Bubble is Bursting?

- Indeed we do, BUT:
- USG is a more stable, high-growth, flexible business than one might think

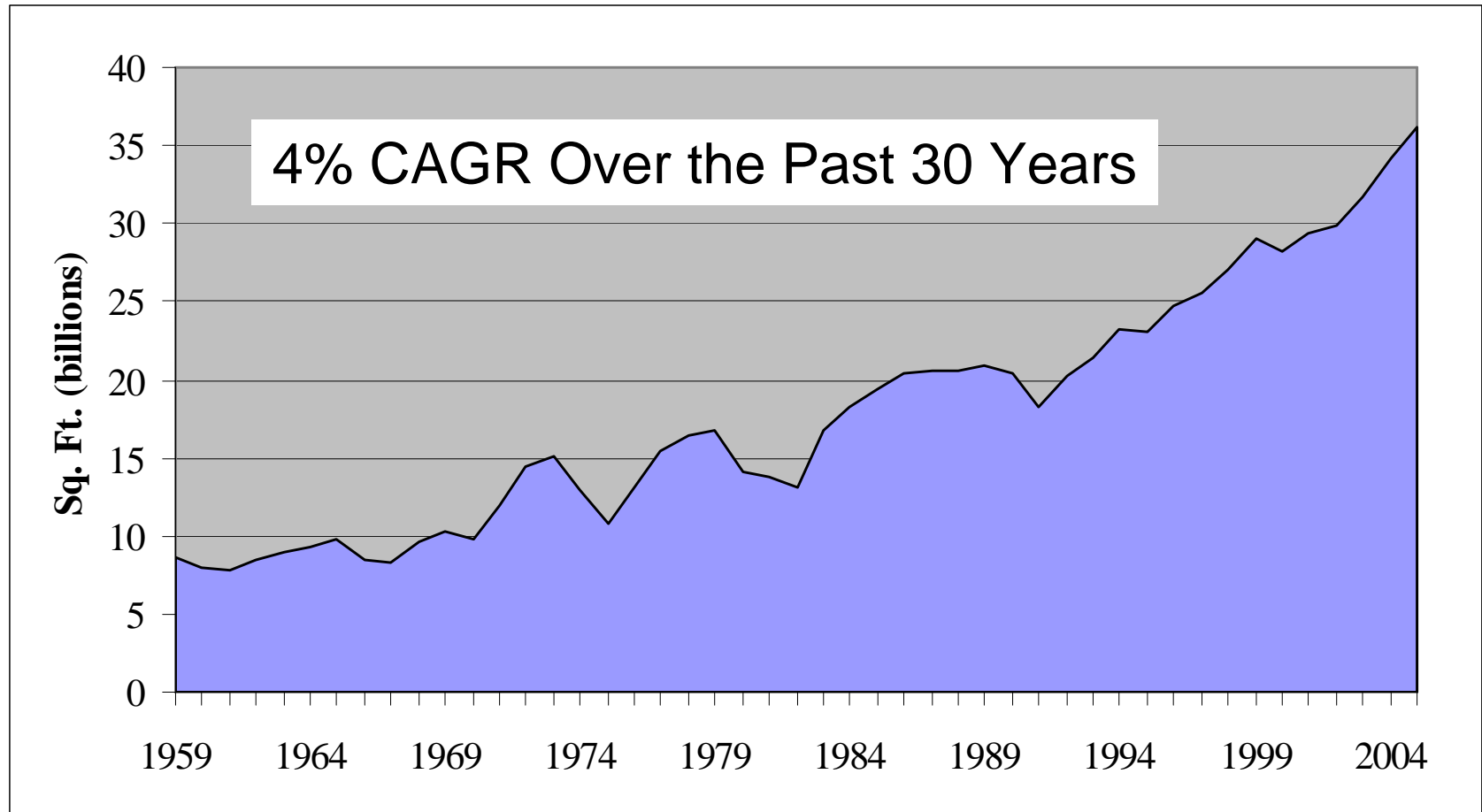
USG Has Diversified End Users

40% Non-Residential; 30% Remodel

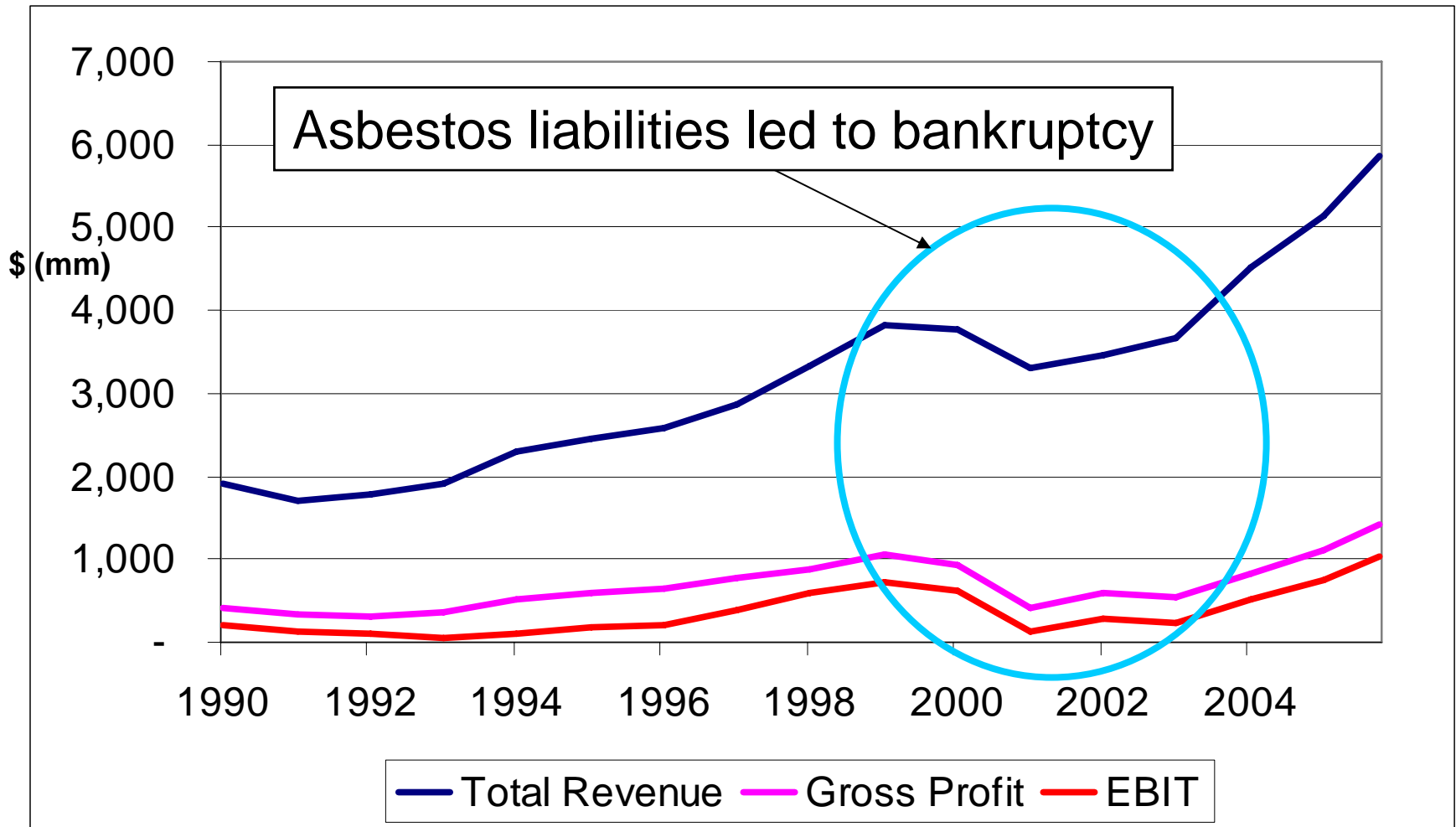
A Decline in Housing Starts Doesn't Reduce Revenues Dollar for Dollar



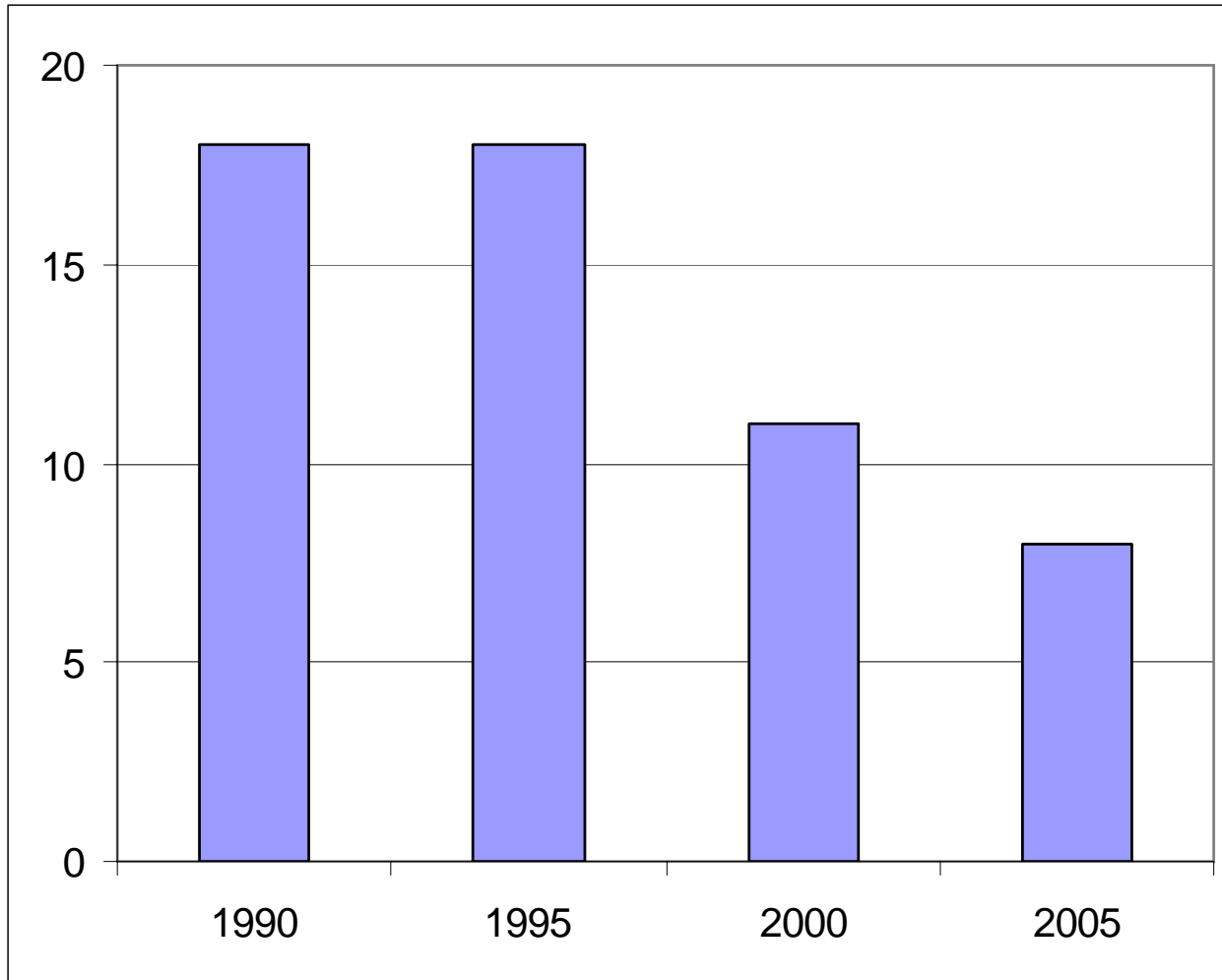
U.S. Wallboard Shipments Have Grown Strongly Over Time With Only Moderate Cyclicalality



USG Has Had Positive EBIT Every Year Since 1990



The Number of Wallboard Competitors Has Fallen Sharply



There are significant barriers to entry:

- Unique nature of product
- Shipping economics
- Customer relationships
- Price vs. certainty

USG's vertical integration adds value and reduces costs

How Would YOU Spend Big Profits While in Bankruptcy?

USG built state-of-art manufacturing facilities

- High-speed and flexible
- Six new plants with 3.5 BSF capacity
- New production line to manufacture DUROCK brand cement board completed
- New plant to produce SHEETROCK brand joint compounds completed
- New gypsum wallboard plant to serve Northeast markets (expected completion Q2 08)
- New low-cost wallboard line at Norfolk plant (expected completion Q2 07)
- New self-unloading ship to lower delivered costs to wallboard plants (expected completion late 2007)
- New gypsum wallboard plant in Mexico (expected completion Q2 07)
- Mill modernization at Plaster City gypsum wallboard plant (expected completion mid-2007)
- Ready-mixed joint compound line at Baltimore plant (expected completion mid-2007)
- Ready-mixed joint compound line at Jacksonville plant (expected completion mid-2007)

USG Has Strong Growth Opportunities

- Complementary Products
 - Performance Finishes
 - Performance Substrates
 - Paints (HD test)
 - Tools
- Continued high-cost plant rationalization

We Believe USG Will Deliver an IRR of 21-27% Over the Next 3-5 Years

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Sales	\$5,700	\$5,900	\$6,100	\$6,300	\$6,500
EBIT	825	855	885	915	940
Net Income	460	480	495	515	538
Shares	92	86	80	75	70
Less: Repurchase	6	6	5	5	5
EOY Shares	86	80	75	70	62
Normalized EPS	\$5				\$8.25

<u>Ending P/E</u>	<u>Stock Price*</u>	<u>IRR*</u>
13	\$107	21%
15	\$130	27%

* Stock price at end of 2010, assuming forward P/E on 2011 EPS.

An Update on Berkshire Hathaway

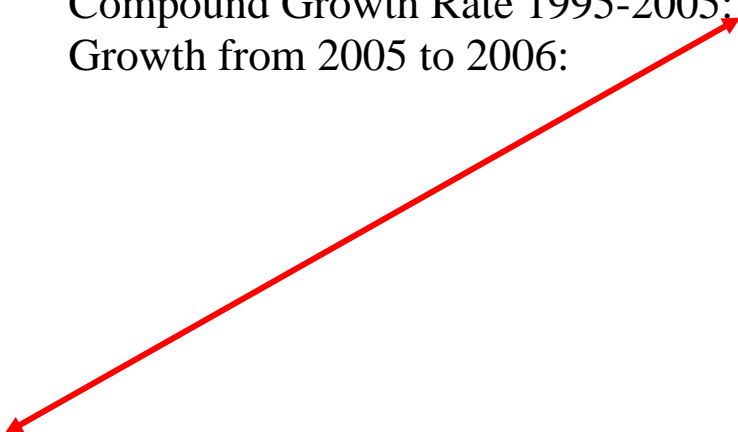
Berkshire Hathaway is One of the Fastest Growing Large Companies in America

<u>Company Name</u>	<u>Market Cap (\$mm)</u>	<u>% Growth Rate*</u>
Exxon Mobil	413,472	18.4
General Electric	366,170	8.5
Microsoft	279,869	20.8
Wal-Mart	205,825	13.4
Pfizer	201,827	19.8
Johnson & Johnson	200,715	14.3
Procter & Gamble	199,017	10.5
American International Group	172,766	18.0
Altria Group	166,786	7.8
Cisco Systems	149,429	21.0
Chevron	143,485	29.1
International Business Machines	136,625	1.7
AT&T	133,771	4.3
Intel	123,053	8.8
Verizon Communications	109,572	10.0
Coca-Cola	109,509	5.0
Hewlett-Packard	107,860	3.4
Pepsico	103,139	9.2
ConocoPhillips	100,285	33.2
Merck	99,319	5.6
Oracle	98,610	19.3
Genentech	87,564	29.9
Amgen	86,564	20.9
Comcast	79,484	31.2
Abbott Laboratories	74,526	7.5
Average		14.9

Berkshire Hathaway

<u>Year</u>	<u>Earnings per Share</u>
1965	\$4
1975	\$4
1985	\$52
1995	\$175
2005	\$2,441
2006E	\$3,874

Compound Growth Rate 1965-2005: 17.2%
 Compound Growth Rate 1995-2005: 30.2%
 Growth from 2005 to 2006: 58.7%

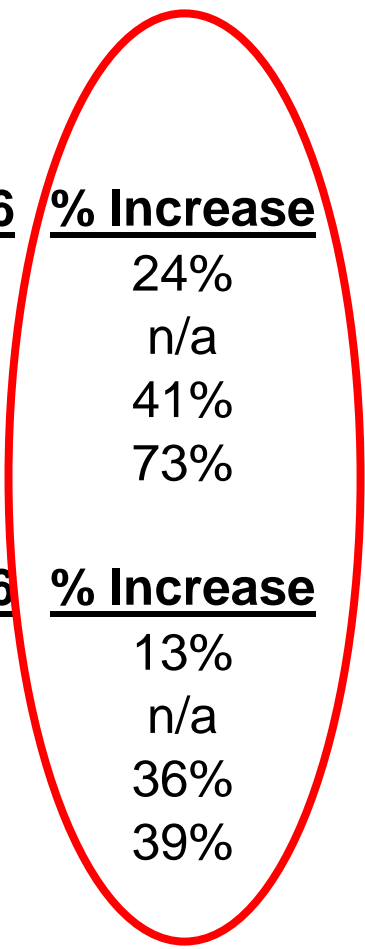


* Compound annual growth rate of EBIT (earnings before interest and taxes) through 2005.

Berkshire Hathaway is Firing on All Cylinders

	<u>Q3 05</u>	<u>Q3 06</u>	<u>% Increase</u>
Revenues	\$ 20,533	\$ 25,360	24%
Ins. Group Underwriting Earnings	\$ (1,170)	\$ 917	n/a
Oper. Businesses' Earnings	\$ 696	\$ 978	41%
Cash Flow from Operations	\$ 2,560	\$ 4,431	73%

	<u>YTD 05</u>	<u>YTD 06</u>	<u>% Increase</u>
Revenues	\$ 53,305	\$ 60,118	13%
Ins. Group Underwriting Earnings	\$ (475)	\$ 1,618	n/a
Oper. Businesses' Earnings	\$ 1,962	\$ 2,673	36%
Cash Flow from Operations	\$ 5,653	\$ 7,882	39%



Buffett's Comments on Berkshire's Valuation Lead to an Implied Multiplier of Approximately 12

<u>Year</u>	<u>Investments Per Share</u>	<u>Pre-tax EPS</u>		<u>Intrinsic Value</u>	<u>Implied Multiplier</u>
		<u>Excluding All Income From Investments</u>	<u>Year-End Stock Price</u>		
1996	\$28,500	\$421	\$34,100	\$34,100	13
1997	\$38,043	\$718	\$46,000	\$46,000	11
1998	\$47,647	\$474	\$70,000	\$54,000	13
1999	\$47,339	-\$458	\$56,100	\$60,000	

- 1996 Annual Letter: "Today's price/value relationship is both much different from what it was a year ago and, as Charlie and I see it, more appropriate."
- 1997 Annual Letter: "Berkshire's intrinsic value grew at nearly the same pace as book value" (book +34.1%)
- 1998 Annual Letter: "Though Berkshire's intrinsic value grew very substantially in 1998, the gain fell well short of the 48.3% recorded for book value." (Assume a 15-20% increase in intrinsic value.)
- 1999 Annual Letter: "A repurchase of, say, 2% of a company's shares at a 25% discount from per-share intrinsic value...We will not repurchase shares unless we believe Berkshire stock is selling well below intrinsic value, conservatively calculated...Recently, when the A shares fell below \$45,000, we considered making repurchases."

Applying the 12 Multiple: 2001 – 2006 Estimate

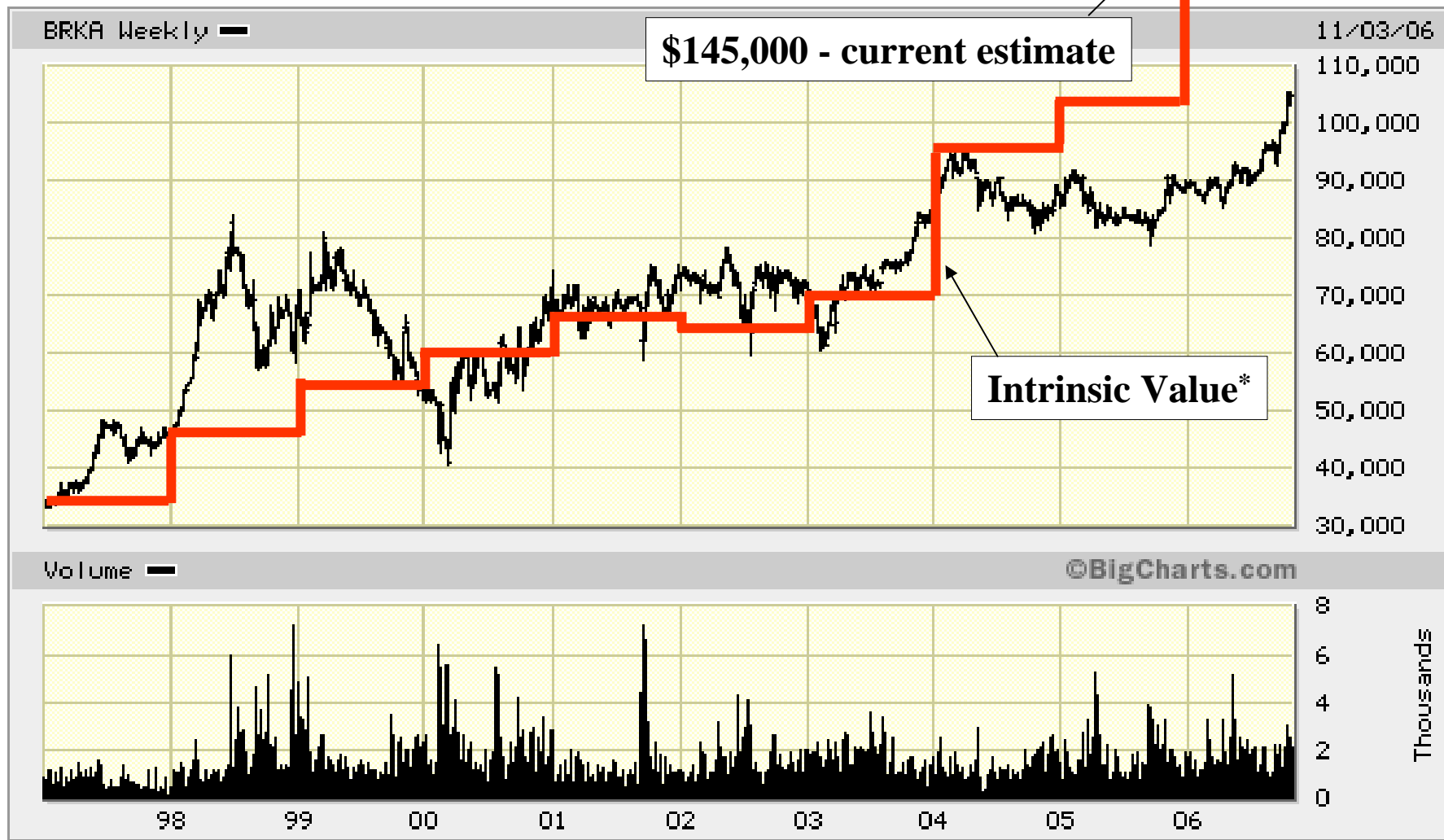
<u>Year</u>	<u>Investments Per Share</u>	<u>Pre-tax EPS Excluding All Income From Investments</u>	<u>Intrinsic Value Per Share</u>	<u>Subsequent Year Stock Price Range</u>
2001	\$47,460	-\$1,289	\$64,000	\$59,600-\$78,500
2002	\$52,507	\$1,479	\$70,000	\$60,600-\$84,700
2003	\$62,273	\$2,912	\$97,000	\$81,000-\$95,700
2004	\$66,967	\$3,003	\$103,000	\$78,800-\$92,000
2005	\$74,129	\$2,441	\$103,421	85,700-\$107,850
2006*	\$80,000-\$82,000	\$5,200-\$5,400	\$142,400-\$146,800	?

Berkshire had operating earnings of \$4,483/share in the first *three quarters* of 2006, but it was a relatively benign super-cat year

* Estimate assumes:

- 1) 8-11% growth of investments per share
- 2) Normalized year for super-cat losses
- 3) No new acquisitions

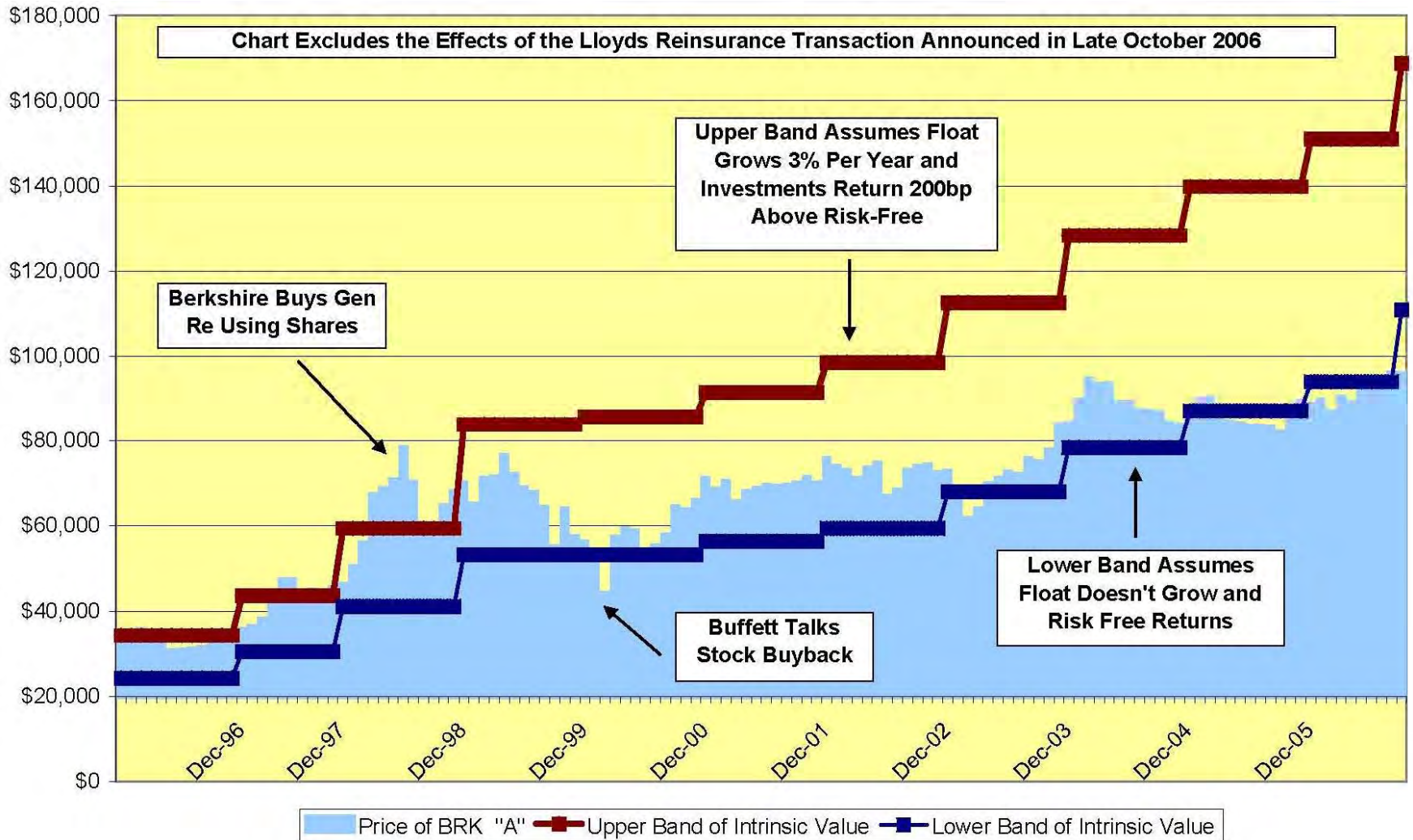
A Large and Rare Gap Has Emerged Between Berkshire's Share Price and Its Intrinsic Value



* Investments per share plus 12x pre-tax earnings per share (excluding all income from investments) for the prior year. Final bar is based on 2006 estimate, which assumes 2nd-worst year ever for super-cat losses.

Float-Based Valuation

By Fairholme Capital Management, LLC



Appendix

USG Capitalization Table

Pro Forma for Rights Offering

	<u>12/31/06</u>	<u>12/31/07</u>
Non Contingent Note	\$0	\$0
Contingent Note	\$0	\$0
IRB's	\$239	\$239
New Term Loan	\$1,000	\$1,000
New Tax Bridge Loan	<u>\$1,150</u>	<u>\$0</u>
Total Debt	\$2,389	\$1,239
Stockholders' Equity	\$1,484	\$1,484
Total Capitalization	\$3,873	\$2,723

Note: Pro forma reflects \$1,797mm gross proceeds of rights offering and payment of contingent notes; does not include earnings or losses after June 30, 2006.

Housing Starts Since 1959

