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SANTANGEL'S REVIEW™

Profiles of Undiscovered Investors

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Norbert Lou of Punch Card Capital, L.P.

Punch Card Capital, L.P., an Orlando, Florida-based investment partnership with $115 million in assets under management, has earned a net annualized return of 14.5 percent since its June 1, 2004 inception through September 30, 2011. Over the same period, the S&P 500 has returned 2.2 percent annualized. Thirty-seven-year-old founder Norbert Lou has achieved this return with minimal shorting, no portfolio leverage, average cash balances of 25 percent, and only one down year—a 35.9 percent loss in 2008. Over 90 percent of Norbert's net worth is invested in the fund.

Punch Card's portfolio seldom exceeds six positions. This concentration allows Norbert to know each position thoroughly and creates a natural discipline to filter out all but his very best ideas. To date, he has filled his metaphorical "punch card" with various kinds of value investments, from international equities to special situations and distressed debt. But most of Punch Card's returns have come from Norbert's greatest differentiator, a talent he has demonstrated for nearly 15 years: the ability to identify the rare undervalued and underfollowed company that can compound its intrinsic value at an extraordinary rate for long periods of time.

Over the course of the last year, we spent nearly 30 hours interviewing Norbert, both in Orlando and by phone. We also visited the office of Gotham Asset Management, which seeded Punch Card and handles its back-office operations.[1] We spoke with current Punch Card investors, Norbert's former colleagues at Brown Brothers Harriman and Elliott Management, as well as the fund's prime broker, auditor, and counsel. We wanted to trace the evolution of Norbert's philosophy and learn what makes an investment so good that it earns a rare "punch" in his punch card. We also wanted to understand the reasoning behind Punch Card's unorthodox terms, which include quarterly performance reporting and redemptions at two-year intervals only. Finally, we wanted to examine Norbert's mistakes and their implications for such a concentrated portfolio. In Norbert, we found one of the best—and least known—practitioners of one of value investing's most rewarding niches.

Full quote continued on pg 13

1. Santangel's Review profiled Gotham Asset Management in March 2011. Also, Nadav Manham, co-author of this profile, worked with Norbert at Elliott Management from 2000 to 2004. As former Elliott employees, they are bound by that firm's trade secret and proprietary information agreement.

Behind the Santangel's Name

Luis de Santangel was the treasurer to the royal court of Spain in 1491, the year Ferdinand and Isabella refused for the second time to finance the voyage of Christopher Columbus. Dejected, the then-unknown sailor was on his way to petition the King of France when a rider intercepted him with a message: Santangel had convinced the Spanish monarchs to change their minds. Santangel's quiet role in what became one of history's greatest investments is the inspiration for our name.

"THAT'S CRAZY, BE A DOCTOR"

Norbert Lou grew up north of Hartford in Windsor, Connecticut, a long way—geographically and culturally—from Greenwich and the other wealthy suburbs now associated with hedge funds and the state. Back then, Windsor's largest employers included Combustion Engineering, where Norbert's father worked as a nuclear engineer, and the H.F. Brown tobacco company, in whose fields Norbert spent one summer picking leaves to earn money for college. *"I got paid $5 an hour in 1989, which was pretty good, especially for a 15-year-old,"* he said. *"The next summer I got a cushier job indoors, cleaning lanes and removing garbage at a bowling alley."* Windsor High School, which Norbert attended, recently ranked in the bottom half of Connecticut's public high schools; a quarter of its graduates do not go on to college. It was not a privileged education, but whatever disadvantages Norbert faced there were more than offset by the academic expectations his parents carried with them as immigrants from Taiwan and China:

"My mom always used to say that I couldn't even comprehend the level of academic rigor in Taiwan. She used to say that she was third in her class, and it was the equivalent of being number one out of all the number ones in the US. I believed it, and realized that I had to work hard and give my best effort, because I wasn't that special once you expanded the competitive pool."

Norbert was expected to excel and he did. He studied especially hard for the subjects he enjoyed, such as math and science. *"I used to read the biology textbooks page by page, really slowly, and when I read something I didn't totally process, I'd get concerned and read it again,"* he said, adding that he also studied hard for the subjects he did not enjoy as much, such as the humanities: *"I always felt like the grading was too subjective."* With every academic success—winning the school spelling bee at age 10, taking advanced math courses at the University of Hartford while still in high school, graduating as valedictorian—Norbert's reputation grew among his teachers, even as it sank among his fellow students. *"I wasn't ostracized, but I had that nerd reputation. If you join the math team, and the academic quiz bowl team, you're probably asking for it,"* he said. In hindsight, Norbert believes this experience reinforced his naturally independent temperament:

"When you get that much affirmation through grades and awards, you become confident in your own observations and ability to think through problems. I remember there'd sometimes be mistakes in the back of the math textbooks where the answers were. It was rare, but after it happens once or twice, you start to get into the habit of wondering if what's printed in a textbook might be wrong."

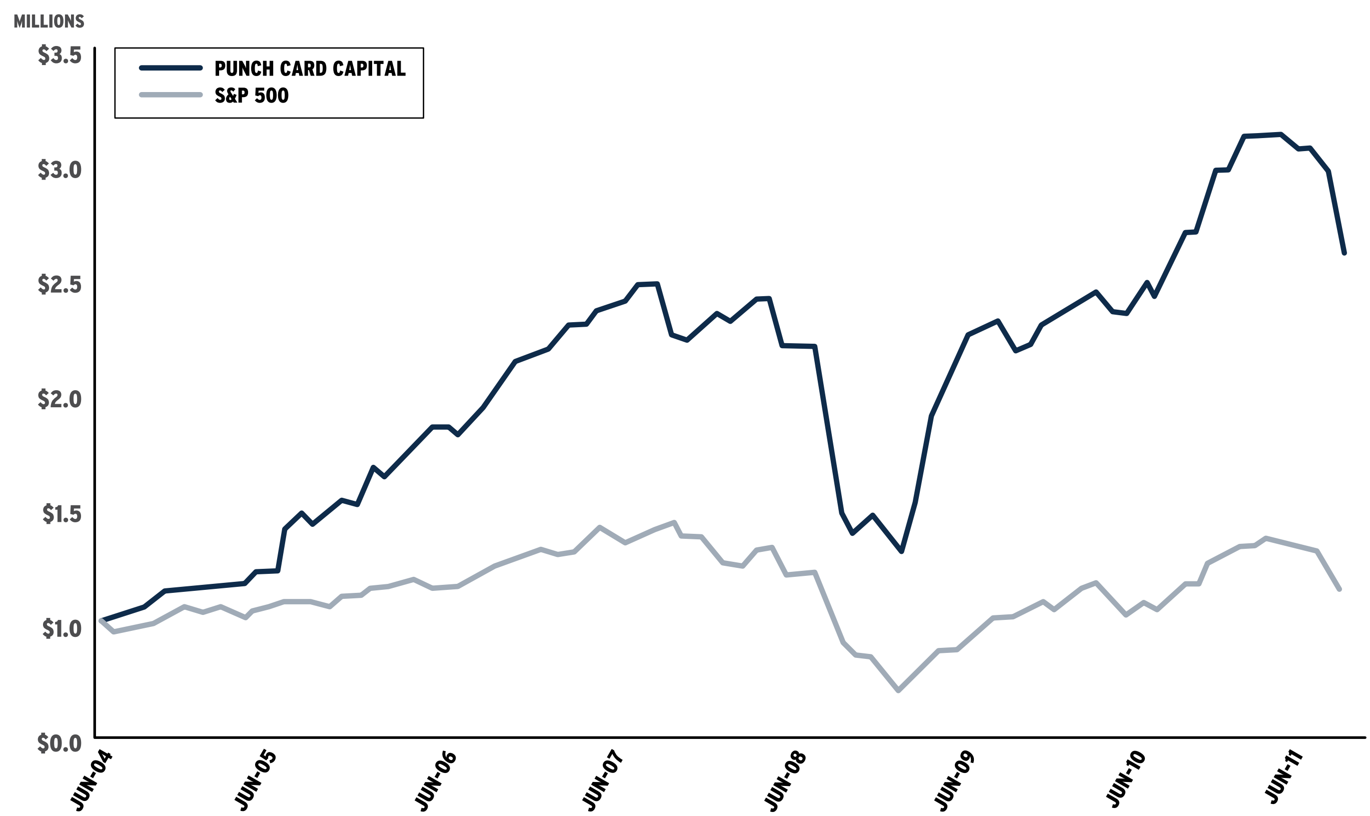
After Windsor High, Norbert enrolled at Cornell University, his future career already mapped out. *"Everyone tells kids who are good at math that they should be engineers. I was definitely going to be an engineer,"* he said. He also opened up socially in college by joining a fraternity, which he later said was *"probably the last thing anyone in high school would have expected me to do."* True to form, however, academics remained Norbert's main focus. He decided to major in agricultural and biological engineering while also completing pre-med requirements. Although his mother worked as an accountant for a utility company, and his father had left engineering to become a stockbroker, Norbert's knowledge of business and investing at this point was limited to comparing interest rates on personal savings accounts. Whatever his father tried to teach him about Wall Street did not seem nearly as coherent and logical to him as math and engineering. *"He was really into technical analysis, and one of the first things he taught me was Elliott Wave Theory,"* Norbert remembered.[2] *"An investment strategy based on identifying patterns in charts seemed like loopiness. If anything, that made me more skeptical of finance."*

Things changed the summer after his sophomore year. Back from Cornell and bored one day, Norbert picked up a copy

2. Elliott Wave Theory is a popular form of technical analysis that relies heavily on using price charts to forecast future stock prices. Invented by Ralph Nelson Elliott and described by him in such books as *Nature's Laws: The Secret of the Universe,* the theory asserts that investor psychology moves in systematic and predictable wave patterns that can be exploited to outperform the market.

NET PERFORMANCE SINCE INCEPTION

Since its June 2004 inception, Punch Card Capital has earned a net annualized return of 14.5 percent. $1 million invested at inception would have grown to almost $2.7 million by September 30, 2011. During the same period, the S&P 500 was slightly positive.



of Peter Lynch's *One Up on Wall Street* from his father's bookshelf. The book introduced Norbert to a much better way of looking at the stock market: as a collection of partial ownership shares in actual businesses. *"Analyzing stocks by analyzing the underlying companies felt logical,"* Norbert said. *"When Lynch talked about identifying investments by analyzing businesses, that seemed like an approach worth exploring."* Lynch argued that stocks in certain fast-growing businesses, when properly identified and analyzed, could far outperform most others. He called them "multibaggers"—stocks such as The Gap, Dunkin' Donuts, and Wal-Mart that had earned investors 10 times their money or more over time. As Lynch's own record managing the Fidelity Magellan Fund demonstrated, anyone who could find future multibaggers could grow his capital at an extraordinary rate. *"It just opened my eyes to what was possible,"* Norbert said.

Returning to Cornell for his junior year in 1994, Norbert loaded his schedule with finance, economics, and accounting courses, while also sending away for dozens of company annual reports and mutual fund prospectuses. The following semester, he made the jump to real money manager when he persuaded his mother to let him manage $60,000 of her retirement money, nearly all of her investible funds at the time. *"With Asian parents it's always 'that's crazy, be a doctor,' but she was crazy enough to let her son handle her savings,"* Norbert said. *"That helped a lot early on, because I was able to start investing for real, which forced me to figure out what works and makes sense."*

Norbert spent the rest of his time at Cornell pursuing his unofficial major in finance, making his first stock picks for his mother's portfolio, and finishing his required engineering coursework. *"I was working like mad,"* he said. A summer internship at J.P. Morgan after his junior year cemented Norbert's desire to work in finance. In his senior year he had several interviews with large investment banks such as Morgan Stanley, and was offered a job at a then-unknown hedge fund firm, Bridgewater Associates. *"I remember thinking it was this small, unusual place in Connecticut,"* he later admitted. He turned Bridgewater down, along with the banks, accepting instead a corporate finance analyst position at Brown Brothers Harriman. Founded in 1818, Brown Brothers was once among the largest banks on Wall Street, but by the mid-1990s, the privately owned firm was considered a boutique in corporate finance. *"I liked that it wasn't a big investment bank,"* Norbert said. *"I also liked how they operated their own private equity funds, and because they hired only three analysts a year, they used the same analysts for both the investment funds and corporate finance."* After graduating from Cornell in 1996 with the highest grade point average in his engineering major, he moved to New York City to try a career in finance.

The young analyst's investment banking experience was typical: long hours and a lot of model building. Norbert took to the private equity side of his job, which allowed him to view companies from the perspective of an actual investor. *"Companies would come in, and they'd say the advantages they had, and describe why purchasing a stake in them would be a good investment,"* Norbert recalled. *"It gave me exposure to a wide variety of companies, and provided a glimpse of how managements think about their companies."* Working at Brown Brothers taught him a lot, but it also gave him a unique chance to learn on his own. The bank maintained a library of public company filings that individual investors could not easily access in the days before the internet. In his free time, Norbert could usually be found in the library researching stocks for his mother's portfolio.

The portfolio, which typically had eight positions at a time, did well in its first two years through 1997. Norbert made his share of mistakes, but he had several winners, too, including Intel, which tripled in price in the two years he owned it. The portfolio's overall return exceeded the market by more than ten percentage points on an annualized basis. It was an encouraging start for a 23-year-old, providing early positive reinforcement that evaluating stocks by analyzing their underlying businesses was the right approach for him.

BETTER THAN ANYTHING ELSE

By mid-1997, Norbert was actively searching for companies that were buying back their shares, seeing them as good candidates for his mother's portfolio. He saw buybacks as a good indicator that a business was generating cash and was disciplined about

ON PUNCH CARD: JOEL GREENBLATT

Joel Greenblatt is managing partner and co–CIO of Gotham Asset Management. He was previously managing partner of Gotham Capital, which launched in 1985. He co–founded the Value Investors Club in 1999 and along with his partners at Gotham, seeded Punch Card Capital. Joel was profiled by Santangel's Review in March 2011.

"I've said it before, Warren Buffett would have done very well choosing Norbert. If he knew who Norbert was he would have loved him."

"After he wrote up his first idea [on Value Investors Club], we spent the next two years talking to him and trying to recruit him to do something with us just because there are few people as brilliant as he is."

"We wanted to be involved with a great investor and there are many benefits as a result of being able to collaborate in a small way with someone who is so talented. Our benefit is that we get to invest our own money with him."

"To this day I hand out the first three write-ups he wrote on the Value Investors Club every year to my students at Columbia, to show them what a brilliant, concise, straightforward and clear investment thesis looks like. You can't ask for more than what Norbert wrote."

"What sets Norbert apart is he is incredibly disciplined so he has a very high mark for what he'll invest in and he has incredible patience. That is one thing that I have been incredibly impressed with."

"He went through a tough time in 2008 and he was really unperturbed as far as I could tell. He was serene throughout. He thought what the values were and he stuck with his guns like very few people could. "

"Norbert always does the right thing at every step of the way and goes out of his way to be honest fair and straightforward."

"He has critiqued both of my last two books [before publication] and he is a great help."

ON PUNCH CARD: TIMOTHY HARTCH

Timothy Hartch is a partner at Brown Brothers Harriman (BBH) and the co–head of the firm's public equity investment team. He joined the firm in 1996 as an associate, and worked closely with Norbert Lou on several corporate finance assignments.

"Norbert was just a phenomenal person to work with. He was somebody who always made sense, always was very bright. He also fit in very well from a social perspective; he was well liked and very highly regarded by peers as well as bosses."

"He was always extremely reliable, and very effective in terms of just getting stuff done, but very calm. You could talk to him at nine or ten o'clock at night and say 'we need to get this done,' and when you arrived in the morning it was there. In my opinion, he was the go-to analyst. If you had a tough project, you wanted Norbert on the team."

"When Norbert left and went to Elliott I think that was seen as a big loss for us. He was someone I consciously tried to keep in touch with because I respected him so much."

"Norbert is one of a handful of investors outside of BBH who I know well and really respect. If Norbert recommended a stock, we would definitely take a serious look at it."

"He makes his own decisions and really thinks for himself. Most people are pretty swayed by market sentiment, even people who know that the right framework is a value orientation. Norbert is perfectly willing to take a position that no one else has taken."

"He is understated, and for someone who is very bright and accomplished, very humble in the way he conducts himself."

"A lot of trusting a manager comes down to confidence in the judgment of the person, their integrity and analytical ability, and Norbert is exceptional in all three areas."

returning it to shareholders. One day during some downtime at Brown Brothers, he came across a press release announcing that NVR Inc., a small homebuilder, was initiating a stock repurchase program. When he saw that NVR's buyback was the latest in a series that would total $100 million over four years—remarkable for a company with a market cap of only $275 million—he set out to learn more. *"Basic common sense would have led anyone to investigate a situation where the company was quietly buying back everything it could,"* Norbert said.

In NVR's previous fiscal year, its core homebuilding operations had posted a pretax return on tangible capital of 55 percent, twice that of most of its peers and with much less leverage. For Norbert, this was another positive sign. *"I had done DuPont analysis in college, so I knew the basic principle that it was better to generate more profit with less capital,"* he said. NVR's returns were accompanied by operating income growth of 148 percent from 1993 to 1996 and a stock price that had quadrupled during the same period, substantially outperforming the rest of the industry. No analysts covered NVR at the time, so to figure out why the company was performing so well, Norbert read several years' worth of the annual reports of NVR and its peers. *"That was the bulk of the work—and then just thinking about the facts,"* he said.

Norbert learned that most homebuilders were also land speculators. The dominant industry practice was for companies to buy raw land outright, usually with borrowed money and often well in advance of actual orders for houses. The companies then developed the land into finished lots, with all the necessary zoning and infrastructure in place, and finally built and sold homes on those lots. If the underlying land increased in value during this multiyear process, the homebuilders earned extra profits when the homes were sold. During bull markets in land prices, these embedded profits were significant, especially when fueled by leverage. *"It was hard for homebuilders to turn down the additional profit available when they saw a particular deal on land being sold outright,"* Norbert noted. *"They just couldn't help themselves."*

As successfully as this business model worked in good economic times, Norbert realized that there were two big problems. First, companies had to tie up a lot of capital in land inventory for years, which depressed returns on capital. Second, and more important, when the homebuilding cycle inevitably turned down, land prices would stall, demand for homes would dry up, and all leveraged builders would be caught with heavy debt-service obligations on land that was earning nothing. In short, the land speculation element of the homebuilding industry was an invitation for bankruptcy. *"When housing would go down, all the builders that had levered up would go bust and then start over,"* Norbert said. NVR was itself starting over, having emerged from Chapter 11 protection just four years earlier. By 1997 the stock market was well aware of this pattern of boom and bust, and it had accorded the industry, NVR included, a low multiple. *"Even though the stock was going up, NVR would perennially trade at five to nine times earnings,"* Norbert remembered. But what the market failed to realize, Norbert learned, was that NVR had a new business model. *"The CEO, Dwight Schar, decided he didn't want to go through bankruptcy again,"* Norbert said. *"He hit on this one idea. And it was a really powerful idea."*

Schar's idea was simple: keep the homebuilding and leave the land speculation to others. Instead of borrowing to buy and develop land into finished lots, NVR would obtain options to buy finished lots from local developers, giving it the right to buy the lots for a fixed price at a later date. The options typically cost 5 to 7 percent of the land value, and NVR usually only controlled enough land to meet the next 18 to 24 months of projected demand for homes. Although the cost of options represented an additional expense that traditional homebuilders did not incur, the practice allowed NVR to operate with almost no leverage while avoiding tying up capital in land inventory and assuming far less risk over the course of a full price cycle. In a downturn, the rest of the industry would be forced to take huge write-downs while NVR could simply let its options expire.

Once a homebuilder got out of the land speculation business, what remained was the less glamorous business of building and selling homes. But, as Norbert knew, less glamorous did not mean less profitable. *"That sub-segment was actually pretty decent,"* he said. *"The main product doesn't really change and you don't have to invest in a lot of R&D. If everyone just focused on homebuilding, they could generate pretty decent returns."*

NVR's returns were more than decent; they were extraordinary. And as Norbert continued his research, he discovered why. The company focused almost exclusively on mid-Atlantic markets such as Baltimore and Washington, D.C., where it had built a solid reputation over decades. As a result, NVR could use its options-only strategy to great advantage, negotiating favorable deals with local developers who knew and trusted the company. Though small relative to other homebuilders with national footprints, NVR's geographic concentration made it dominant in local markets populated mostly by small, private competitors. *"When you broke it down to local geographies, NVR was the largest builder, and they had big economies of scale,"* Norbert explained. The company exploited its scale to gain cost advantages in manufacturing, advertising and hiring subcontractors. These cost advantages were reinforced as the company grew, allowing it to gain share in its home markets while also expanding into adjacent markets. *"All of these advantages just accumulated over time, and now they were growing fast,"* Norbert said.

By September 1997, when Norbert finished his initial research, NVR's shares were selling for $23 and change. Because the company disclosed its backlog publicly, he could determine

ON PUNCH CARD: JOHN MOLNER

John Molner is a partner at Brown Brothers Harriman, responsible for managing the firm's M&A business. He has been at the firm since 1991, and oversaw Norbert when he was an analyst.

"Norbert was quiet and thoughtful, but he was clearly very bright. One of my impressions of Norbert was he was an independent thinker from his early days at Brown Brothers."

"Norbert was the sort of guy that you would ask him a question and he would go about his work and come back to you with a lot more than you had asked for. He had usually done his homework. Chances are Norbert had read the stuff pretty carefully, he had thought about it, he had done the analysis. He would look at a company and he would very quickly have a perspective on a situation rather than just an answer to what you had asked him."

"You would look at him and say that is a person that really has conviction in the analysis that he did and is confident in his own conclusions. That can be somewhat unusual for a 22 or 23-year-old working alongside a group of MBAs or executives that have been at it for a long time."

"He had a very good sense of humor. I don't think he took himself too seriously. For as bright as he was I think he had an unassuming cordial personality. He was well liked and with people as bright as Norbert that doesn't always happen. He was a good listener and I remember him as taking other people's views. I just don't remember him being that easily persuaded off his own point of view or perspective, but not in a disrespectful way. He would hear people out and he tended to stay with his point of view on things."

"I think of Norbert as very focused at an early age—he had this investment passion, I remember him making some investments. He enjoyed doing that and he clearly wanted to get into the investment business, he wasn't looking to go to a bigger firm and do bigger M&A deals."

"It was guys like Norbert that led us to believe that we don't want to lose all our analysts after two years so subsequent to Norbert's tenure we increased the class [duration] to three years. It was a loss for Brown Brothers, you can't find investors like Norbert very easily. It's unfortunate we didn't recognize that passion in 1998 and put him in our wealth management practice - we should have."

that its immediate future looked bright. *"You could see that volumes were increasing, prices were going up, and cash flow would be higher in the next 12 months,"* he said. Running through every element of his thesis, he concluded that NVR, with its combination of low risk and high potential growth, was the best stock he had found in three years of managing his mother's portfolio. NVR had little debt, was a low-cost provider of a basic necessity, and had been around for decades—and yet was growing rapidly. Despite these advantages, and the company's willingness to buy back its stock, NVR traded at only seven times that year's after-tax earnings. Norbert bought NVR over the next two months, accumulating enough shares to make the position his mother's largest at 35 percent of her portfolio:

"In college I had seen a study that said a portfolio of six to eight stocks could get you most of the statistical benefits of diversification, so I never started out with the idea that you had to have 50 to 100 stocks to be prudent. And I hadn't been drilled into believing that a position over 5 percent was considered big, which I might have if I'd started working at Fidelity or somewhere like that. I knew NVR was better than anything else I had seen to that point, and I knew that I should buy as much as I could stomach."

BUFFETT'S METAPHOR

As his two-year analyst program drew to a close in 1998, Norbert knew he wanted to be a professional investor. But he did not see his future in private equity. *"A lot of the deal flow would come through brokered transactions, and it's hard to get great prices that way,"* he said. *"I could also see that the real key to sourcing proprietary deals was through cultivating relationships, and I didn't see that becoming a strong suit."* Public market investors did not face those constraints, so he began to apply for hedge fund jobs.

After interviewing with several firms without success, a headhunter put Norbert in touch with Elliott Management, a $1.4 billion fund founded in 1977 by Paul Singer. From its roots in convertible arbitrage, by the late 1990s Elliott had expanded into various strategies, including merger arbitrage and distressed debt. Norbert knew little about these, but accepted Elliott's job offer in the spring of 1998. *"It sounded like I would be able to look at a bunch of different things, and that I could learn a lot and get a lot of responsibility if I earned it,"* he said. He settled in quickly, and found that Elliott's environment suited him well. *"It was a serious place that valued hard work and conservatism. Everyone was focused on reducing risk and staying on top of every detail,"* he said.

In his spare time, Norbert continued to look after his mother's nest egg. With three-plus years of investing experience under his belt, he decided to review his performance. Based on a rate-of-return analysis of all of his stock picks, roughly 20 altogether, he noticed an interesting pattern: His largest positions had tended to perform the best, and accounted for most of the overall return. *"The other positions, for all the effort of looking and analyzing and buying and selling just right, didn't amount to much in comparison,"* he said.

No winner was bigger than NVR, which nearly doubled in the first year Norbert owned it and was now approaching half of the portfolio. But Norbert was not motivated to sell. *"I knew taking profits just to take profits wasn't rational, especially when taxes are factored in,"* Norbert said. Moreover, he believed that even after NVR doubled, the right way to analyze it was to weigh it against all the other stocks he was looking at. *"The guiding question was: 'Is there a more attractive investment for my mom to buy?'"* he said. With the company's business model intact, earnings growing at an extraordinary rate, and the stock trading at a similar multiple to when he first purchased it, Norbert concluded the answer to his question was "no." So he decided to keep the entire NVR position, and even added more in early 1999 when the stock dipped to $40 per share.

Norbert enjoyed his job at Elliott, and was excelling at it, but he observed that Elliott's strategy was highly time-intensive. Most of the firm's positions required constant monitoring by a team of analysts, portfolio managers, and traders. *"At Elliott we were this constant hive of activity,"* he remembered. *"It generated substantial returns for its investors in a way that is difficult for other funds to reproduce, but it didn't really suit my nature even though it was working well."*

Norbert could not help noticing how much easier it was to watch NVR compound over time, now that the hard work of analyzing it was already done. By March 2000, the stock was above $54. *"By buying a great stock and just hanging on, I ended up seeing how that could work out better than a lot of strategies,"* he said. *"That really had an impact later on how I viewed the ideal investment."* Around this time, Norbert began to read the writings of Warren Buffett and Charlie Munger, who explained in greater detail what "a great stock" looked like, thus reinforcing Norbert's growing sense of the best way for him to invest.

In their shareholder letters, essays, and speeches, Buffett and Munger emphasized the fundamental importance of owning great businesses. The best quantitative measure of a good business was its consistent ability to earn high returns on capital over time, they declared.

Norbert already knew that NVR earned high returns on capital, but after reading Buffett and Munger he gained a deeper appreciation of its importance. *"The Buffett/Munger emphasis on quality of business and return on capital really explained why NVR was working so well,"* Norbert said.

Any great business could become cheap enough to buy and still earn a good return, but Buffett and Munger strove to find a certain kind of great business: one that not only earned high returns on its capital, but could also reinvest the cash it generated at similarly high returns. The "right" to reinvest capital was the real secret of NVR's growth, even more than the share buybacks Norbert had initially focused on. The company's ability to plow back the capital it generated into new and equally profitable projects propelled it from a company with $70 million in operating profit in 1997 to one that earned over $270 million in 2000. *"You actually want the companies that have such bountiful reinvestment opportunities that they don't buy back any shares,"* Norbert realized. *"I know a lot of people talk about a company's ability to reinvest as being important, but I think even then it's underappreciated. It's very hard to beat a business that's compounding at a naturally high rate of return."*

Owning great businesses with the ability to reinvest was much less work-intensive than owning a typical Elliott position. But because these companies were both rare and rarely undervalued, Buffett and Munger counseled patience. They advised investors to tune out everything else and simply wait, for years if necessary, until an opportunity became cheap—and then pounce on it. Buffett liked to illustrate this point with a metaphor:

"I always tell students in business school they'd be better off when they got out of business school to have a punch card with 20 punches on it. And every time they made an investment decision, they used up one of their punches, because they aren't going to get 20 great ideas in their lifetime. They're going to get five or three or seven, and you can get rich off five or three or seven. But what you can't get rich doing is trying to get one every day."

Buffett's metaphor further reassured Norbert that his decision to hold on to NVR was the right one, and that a highly concentrated portfolio was the right approach for him. *"It gave me a little more courage to apply it,"* he said. *"I felt that I wasn't being an irresponsible lunatic."*

THE VALUE INVESTORS CLUB

In 2001, Norbert attended his first Berkshire Hathaway annual meeting. Leafing through a free copy of The Essays of Warren Buffett he had picked up outside the entrance, he came across a promotional insert for the Value Investors Club. Founded by Joel Greenblatt and John Petry of Gotham Asset Management, the club was an online idea-sharing forum for investors. Applicants were admitted only after an initial idea write-up was approved by a panel of Gotham judges. Intrigued by the site and still researching equities for his mother's portfolio at night and on weekends, Norbert applied in June 2001 with the stock he still felt was better than anything else he could find: NVR.

NVR's stock now stood at $143 per share, more than six times what Norbert had paid to acquire his first shares in the fall of 1997. The homebuilder's business was stronger than ever, having exploited its scale advantages to gain even more market share, and was riding the tailwind of the early housing boom. NVR was still more profitable than its peers, even though they were benefitting directly from rising land prices much more than NVR was. Yet the company's dramatic success had not convinced the stock market to award it a higher earnings multiple: NVR still traded at only seven times that year's earnings. *"Sometimes the best investment opportunities are things that have already appreciated a lot,"* Norbert concluded.

The Value Investors Club allowed its members to comment on write-ups, and several veterans expressed skepticism that a stock which had appreciated so much could still be undervalued. *"I view NVR as a trading opportunity to be sold on any run-ups,"* one member wrote. *"This is a good healthy baby that is bound to be thrown out with the bathwater sometimes,"* added another member, who preferred to wait for a better entry price. Norbert disagreed with both of them. *"Some investors were now doing the same analysis and coming to the same conclusions, but if little irrationalities cancel out your analytical work, then you really cost yourself a lot,"* Norbert said. The NVR write-up earned Norbert a membership in the club, as well as the site's Idea of the Week award. Both Norbert and the judges were right about NVR: Within a year, the stock was up another 140 percent to $344.50. In only five years, NVR had become a 15-bagger, while proving to be a great example of the value of being patient, investing in great businesses, and holding on to them. *"I was lucky to buy a stock early on that taught and reinforced so many good habits,"* Norbert said.[3]

A few weeks later, partly to meet the club's requirement that members

ON PUNCH CARD: JOHN PETRY

John Petry is a principal at Columbus Hill Capital Management, an opportunistic credit and distressed oriented hedge fund. Formerly a partner at Gotham Capital, he is a co–founder of the Value Investors Club, which Norbert joined in 2001. Along with his partners at Gotham, he seeded Punch Card Capital.

"What you saw in Norbert was someone who had an obvious passion for investing: The way he wrote about his ideas, the way he wrote about other people's ideas, the questions that he asked. He had a sincere curiosity about investing."

"Some of his best insights were found in his comments on other people's ideas. You could see in him someone who at two in the morning would have a thought about someone else's idea and just felt compelled to post a question about it."

"Norb was just the sort of person you wanted to be partners with. He really loved doing this, and it was clear that he is an incredibly talented investor and a good person. If you stepped back and thought about the characteristics that you want in a business partner, Norb has all of them. Talent, brains, hard work, integrity."

"I think he is an enormously talented manager and has the ability to put up outstanding numbers over the long term. I don't know what opportunity sets are going to be in front of us over the next decade, but whatever the opportunities are, Norbert is going to take advantage of them better than just about anyone."

3. Norbert's mother kept most of her NVR shares until February of 2007, when Norbert sold them at $711 per share.

NVR INC. (MAY 1997 TO FEBRUARY 2007)

post two write-ups per year, Norbert followed up with a second idea: Winmill & Company, a $3 million microcap fund management firm selling at a large discount to its cash. Winmill represented a detour into Benjamin Graham's "cigar butt" investing, where the quality of a business matters less than the value of its liquid assets. Winmill was the best idea Norbert could find at the time, and although it did triple in three years, he did not envision making cigar butts a large part of his mother's portfolio. *"It's really not the best way to compound money,"* he later said. *"Those can be decent when it's really extreme, but when it comes down to it you have to ask if it's worth the effort and attention, or is it better to wait for something that can be a bigger home run."*

An answer came in November 2002, when Norbert wrote up what he described as *"the first investment idea in over a year that I have found worth posting"* on the club's site. NII Holdings, Inc., which owned the international wireless assets of Nextel International, was trading mostly ignored with a small float on the OTC market after emerging from bankruptcy. Digging through several hundred pages of the company's bankruptcy disclosure statement, Norbert figured out that the company was trading at only 2.8 times EBITDA. It was a steep discount for a wireless carrier that owned valuable spectrum rights in several Latin American countries and benefitted from the network effects related to its popular "DirectConnect" walkie-talkie technology. Like the NVR write-up, NII was voted the club's Idea of the Week, and it rocketed from $3.41 to more than $34 in less than two years. *"NII reinforced my focus on hunting for a small number of large winners,"* Norbert said. *"That one really compounded at crazy rates of return, and you didn't need to do anything except read the bankruptcy disclosure documents and hold on."*

Between 2001 and 2003, and working in his spare time, Norbert posted five ideas on the Value Investors Club. All five beat the market soundly, three won the site's Idea of the Week award, and two—NVR and NII Holdings—were among the top performing stocks in the entire market during the period. Norbert's record was among the best in the site's history, and eventually attracted the attention of the club's founders, Joel Greenblatt and John Petry, who invited Norbert to meet them in person. Norbert bought all but one of these ideas for his mother's portfolio, which otherwise seldom had much turnover. When he tallied its overall results at the end of 2003, the portfolio's total annualized return came to 38.5 percent over nearly nine years. His mother, who had been crazy enough to give her son $60,000 while he was still in college, was now a millionaire. Her portfolio's growth erased any remaining doubts Norbert had about his ability to apply the punch card

YEARLY NET PERFORMANCE OF PUNCH CARD CAPITAL

	PUNCH CARD	S&P 500
2004*	18.3%	9.2%
2005	33.0%	4.9%
2006	42.1%	15.8%
2007	5.3%	5.5%
2008	-35.9%	-37.0%
2009	57.1%	26.5%
2010	28.9%	15.1%
2011**	-11.9%	-8.7%

*June 1, 2004 Launch ** Through September 30,2011

approach. *"The counterargument some people make to the punch card approach is that you can never know in advance what your best ideas are,"* Norbert said. *"But that just didn't seem to be what I was experiencing."*

At the end of 2003, Norbert, who by then had been promoted to portfolio manager, was offered the opportunity to help launch and run Elliott's new Asian office. Fearing that administrative duties would take away from time spent on research, and worried that his main advantage as an investor—his diligent reading of complex documents—would suffer from language barriers, he declined the offer. The decision prompted a period of introspection about his future, and it culminated in Norbert's resignation from Elliott in early 2004. *"Continuing at Elliott would have been lucrative, but by that point I had saved some money and wanted to invest it the way I had my mother's portfolio,"* he said.

Following an extended vacation through South America, Norbert returned to New York. He then met with Greenblatt and Petry again. They offered to help him set up a partnership that would allow Gotham's own fund of funds, as well as other outside investors, to invest alongside him. Norbert was interested, but he wanted to minimize the negative influences that can accompany managing outside money. He came up with a fund structure and set of terms that, while unconventional, was designed to allow him to behave as if he were only investing his own money. Norbert decided he would report his performance to limited partners only twice a year. *"If you have to report monthly, you start being concerned about what the monthly numbers are and it's just hard to be unaffected by it,"* Norbert said. *"Everyone thinks they are immune, but if you are checking the quotes every day or even every month, it's just a bad habit."* He also knew that the vast majority of hedge fund withdrawals happened on December 31 so he decided to make his new fund's withdrawal date June 30. *"It's to try to avoid this year-end redemption madness,"* Norbert explained. *"The idea was if everyone in the hedge fund universe ever tried to redeem on December 31, I didn't want to be facing the same issue."* Finally, he wanted an extra restrictive lock-up policy. It required initial investors to keep their money in the fund for two years. *"Actually, it's a little worse,"* he admitted. *"If you invest in December, it would take two and a half years to get to the point where you could redeem on June 30."* After that, investors who did not withdraw had to commit to the fund for another two years—and then continue to recommit for two-year periods in perpetuity. *"I wanted to weed out those who weren't the type who could be long-term holders,"* he said.

Norbert proposed these terms to Gotham, along with another decision he had made: he did not want to hire any analysts, planning to do all of his own research. *"I didn't want to remove myself from the critical details of an investment by installing a layer of analysts,"* he said. Greenblatt and Petry agreed to all of these terms, and on June 1, 2004, Punch Card Capital launched with $10 million under management, with Norbert working from Gotham's office in New York City.

MULTIPLE FORCES WORKING TOGETHER

A few years before he started Punch Card, Norbert had read a speech in which Charlie Munger reverse engineered the success of the Coca-Cola Company. Even though Munger did not intend it as a stock pitch, Norbert later called the speech *"the best stock write-up ever."* Unlike almost everyone else on Wall Street, Munger spent no time focusing on the balance sheet, income statement, or earnings multiples. Rather, he spoke almost exclusively about qualitative factors, such as economies of scale, universal appeal, and a strong brand that helped turn Coca-Cola into the world's most dominant beverage company. *"You can identify certain business momentums in the real world that aren't necessarily in the financials and allow for sustained returns on capital,"* Norbert learned. He had already seen business momentums at work in some of his biggest winners: economies of scale in NVR, for example, and network effects in NII Holdings. Norbert also realized that the qualitative factors that drive sustained returns on capital are not always obvious at first. *"NVR's management didn't even know how great the company was,"* Norbert noted. *"There is no universal test for a great company."* Another lesson of

ON PUNCH CARD: JOSH ABRAMOWITZ

Josh Abramowitz is the chairman of Deep Creek Capital LLC, an investment firm in New York. Along with its other investment activities, Deep Creek is a limited partner in numerous value-oriented funds. Josh was an analyst and portfolio manager at Viking Global Investors LP from 2004 to 2009. From 2001 to 2004, he was an analyst at Elliott Management Corporation. He has been an investor in Punch Card since 2008.

"In my opinion, there are very, very few people in the investment business with Norbert's level of talent."

"I think of Norb as an 'investor's investor' in the vein of folks like Seth Klarman. He is not widely known, and is one of the most self-effacing, modest people in the investment business. But among those that do know him, he is always spoken of with a sort of reverence."

"Norb has an exceptional talent for calmly and rationally filtering out the noise in the investment world, and then thinking in a creative, profound, and insightful manner. He doesn't care if something is called a stock, a bond, an option, or a macguffin. Rather, his fund is focused on finding value, wherever it may lurk."

"I remember reading in Lowenstein's biography of Buffett that there was a businessman in Omaha who didn't invest with Buffett in his early days because Buffett wore a T-shirt and worked from home. Yes, Norb does have an office. And I don't think I've seen him in a T-shirt. But I think he has a similar, Buffett-type view that great investing is all about substance and not about style."

"Norb has run his business like someone who cares about performance, not about gathering assets. If he played the usual hedge fund game, got a fancy office on Park Avenue, a stuffed shark for the lobby, and an IR person, I bet he'd be managing 30 times as much money as he does now. But I think Norb doesn't want to live his life like that. He wants to be an investor. He wants to read 10Ks. I have huge respect for that."

"There is a bit of a Charlie Munger phenomenon, in that I find that even many things Norb says in passing contain the seeds of great investment ideas."

"Norb will be the first to tell you that Punch Card is a vehicle for 'like-minded' investors. You need to have a tolerance for a concentrated portfolio and the volatility that that can bring, you need to accept the fact that you will get very little hand-holding, and you need to be a true long-term investor."

"I feel very lucky to be an investor in Punch Card. In my view, Norb is both an extraordinary investor and an extraordinary person."

Munger's speech: on those occasions when several of these qualitative factors occur together, the results can be outstanding. *"Supernormal results are usually achieved through the combination of multiple forces working together,"* Norbert said. While these situations occur only rarely, Punch Card Capital was set up to find them. *"When you can be really patient and selective, you have the luxury of waiting for that confluence of multiple forces,"* Norbert said. He did not have to wait long for one such confluence, which led to the largest of Punch Card's handful of positions in its first three years.

One of the countries Norbert visited just before starting Punch Card was Argentina, where he noted the ubiquity of Quilmes, the local beer. *"I remember seeing it everywhere,"* he said. *"Sometimes alternatives were not even available."* With Munger's lessons on the advantages of a branded beverage company in mind, Norbert had already read the annual reports of several beer companies, including Colombia's Bavaria, Chile's CCU, Heineken, and Anheuser-Busch. This was despite the fact that none of them looked cheap at the time. *"At a lot of other funds, people run from fire to fire looking at stuff that's blown up, trying to ascertain whether they are good businesses,"* Norbert said. *"I try to learn about high-quality companies in advance. My time is pretty unstructured, and I can go months without doing any trades at all, so I can afford to read about companies that I think are good and then just wait."*

In the summer of 2004, Norbert read in a press release that Quinsa, the company that brewed Quilmes beer, was pursuing a Dutch tender for a large portion of its shares. As with NVR, the news was a signal for Norbert to take a closer look.

At the time, Argentina was a pariah among foreign investors, having defaulted on its sovereign debt in 2001 and, in the following three years, experienced a currency devaluation and rampant inflation. *"You would just say 'Argentina' and people would stop listening,"* Norbert remembered. *"It was pretty off-limits."* Interest rates on Argentine debt were sky-high and the country's stock market traded at depressed levels. All of which gave Quinsa, whose stock was also illiquid, one of the lowest earnings multiples of any beer stock in the world, at six times operating income. Norbert did not consider himself an expert in macroeconomics, but as he thought through the conventional wisdom, he decided that Argentine stocks did not have to be off-limits to him. *"Because I am naturally suspicious that conventional wisdom might be wrong, the fact that it was in Argentina didn't prevent me from*

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>
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>
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>
> A CIO would be proud of his/her own analysts for producing a report of this caliber. I can, even though it is not in my self-interest, highly recommend this publication. Just don't tell too many of your friends!"
>
> – Jay Namyet
>
> *Chief Investment Officer, University of Oregon Foundation*

looking," Norbert said. He knew that a country's sovereign bonds could be mispriced just like any other publicly traded security, that many of the country's macroeconomic statistics were superior to those of the U.S., and—perhaps most important—that a country's problems did not necessarily affect all of its companies. *"A critical thing was having some belief that just because it's Argentina doesn't mean you can't have a good company, and if the country blows up it doesn't mean all the companies will be a disaster,"* he said.

Norbert began a deep dive into Quinsa that took several weeks, during which he read everything he could about the company and the alcoholic beverage industry. Founded in 1888 and domiciled in Luxembourg, Quinsa enjoyed a market share of 80 percent in Argentina and almost 100 percent in the neighboring countries of Bolivia, Paraguay, and Uruguay—extraordinary for any company without a government-sanctioned monopoly. Norbert noted that the dominance was not unique to Quinsa; rather, it fit a pattern that existed for many beer markets worldwide. *"One of the things that is so special about beer is there is this natural tendency for the industry to consolidate and for all the advantages to accrue to the largest player,"* he said.

Norbert attributed the natural tendency to two factors. The first was beer's inherent status as a product that consumers selected—with the help of massive advertising—based on its brand and popularity. *"People go around saying 'I'm a Budweiser man,'"* Norbert said. *"They identify with it."* And because even expensive beers take up only a small fraction of a consumer's income, it is hard for a competitor to underprice the market leader successfully. *"It's really rare to see someone ask what the prices are when the bartender says 'What do you want to drink?'"* Norbert said. *"Even a small* *observation like that tells you a lot."*

The second factor was the massive and self-reinforcing economies of scale a leading beer company enjoys in its local market. Quinsa spent more on advertising, including its long-time sponsorship of Argentina's beloved national soccer team, than its competitors earned in total revenues. But because those advertising expenses were spread over a huge volume of beer, Quinsa was actually the lowest-cost advertiser on a per-serving basis. The company also spent far less per-serving than its competitors spent on bottles, caps, barley, and other inputs of the brewing process, an advantage that contributed to the highest gross margins of any beer company in the world. Finally, Quinsa's vast distribution network, which competitors could not afford to match, ensured that Quilmes beer was available everywhere in its markets where consumers wanted a drink.

To Norbert, the combination of brand power and economies of scale made Quinsa nearly invulnerable to competition. Not even well-financed overseas competitors had made a dent in its market share. For Quinsa, the dominance translated into a consistent 60 percent pretax return on capital, not to mention a company that had survived more than a century of wars, military coups, and hyperinflation. *"When a company has been around for decades, people overlook how meaningful that proof of durability is,"* Norbert said. *"There are underlying reasons why it has survived, and there are intangible advantages it has developed that are sometimes not fully appreciated."*

If the thesis had stopped there—a dominant brand in an industry that rewarded dominant brands, selling at an artificially low valuation—it might have been compelling enough for many value investors to add Quinsa to their portfolios, had they found it. But as Norbert continued to learn about Quinsa, he discovered a final factor at work that would earn the company a punch in his punch card.

THE POWER OF PRICING POWER

Norbert knew that the vast majority of public companies could grow their revenues only by growing expenses as well. *"I would read about AT&T or something and get frustrated,"* he recalled. *"I'd see that revenues went up 8 percent, but then I'd see that operating expenses went up by more."* These companies either had to spend on labor and physical capital to grow, or they had to raise prices to keep up with cost inflation.

But there existed a minority of companies that could grow revenues without increasing expenses. Most did it through operating leverage, growing volume over a large fixed cost base. The rest did it through true pricing power, enjoying the rare ability to raise prices in real terms without sacrificing volume. The effect was powerful. If a company earning 15 percent operating profit margins raised prices by just 5 percent a year, while holding volume and expenses steady, its operating income would nearly triple in five years. That kind of pricing power, Norbert realized, was a huge and often overlooked driver of growth in intrinsic value:

"Since the vast majority of companies don't have pricing power, people are not used to seeing it. And the end price of a product is not always well known or monitored or disclosed by a company. And maybe there's a lack of appreciation for the math. But pricing power is so vital. It's such a simple thing, but it can profoundly increase cash flow."

Quinsa, Norbert discovered, was one of those rare companies with true untapped pricing power. Its majority shareholder, the Bemberg family of Buenos Aires, had controlled the company for generations, content to run the company without maximizing its profits. For years, the Bembergs had neglected to raise the price of Quilmes enough to keep up with inflation, which in inflation-prone Argentina meant that the product kept getting cheaper in real terms. *"There was this latent pricing power building up,"* Norbert said. And best of all, the pricing power was finally being unleashed.

In 2003, the Bemberg family entered into a put/call agreement with AmBev, a Brazilian brewer that merged with Belgium's Interbrew one year later to form InBev. The agreement gave the Bembergs the right to sell their stake in Quinsa to AmBev, and at the same time, it gave AmBev the right to buy those same shares on certain future dates in the coming years. The details were very complicated, but the net effect was simple: At some point in the future, the Bembergs would choose or be forced to sell their Quinsa stake to InBev.

The most crucial part of the put/call agreement was the exercise price. The Bembergs' stake would not change hands at a fixed price. Rather, the ultimate price would depend on a complicated formula that Norbert unearthed in an exhibit attached to an SEC filing. *"SEC filings typically have many exhibits with potentially hundreds of pages of legalese that people don't like sifting through,"* Norbert said. When he parsed the formula, he realized that it varied directly with Quinsa's future level of consolidated EBITDA. The higher the EBITDA, the higher the change in control price, which meant that for the first time in years, now that they planned to sell their company, the Bembergs were incentivized to maximize Quinsa's earnings. Raising prices was the easiest way to do just that.

By the time Norbert began his research on Quinsa in the middle of 2004, the process was already underway. In March 2003, Quinsa raised prices by 10 percent, followed by another 10 percent in September, and a third increase the following year. Volumes went up despite these price increases, proving to Norbert that the company's pricing power was real. Yet Quinsa's stock still traded at only six times operating income. Quinsa's low risk, low valuation, high returns on capital, and massive untapped pricing power provided a textbook example of the combination of forces that Munger had spoken of in his speech. *"It was kind of crazy,"* Norbert said. *"Quinsa's market share was tremendous. It was one of the lowest-cost producers, it had all this untapped pricing power—and it was the cheapest of every single beer company in the world."* He started buying Quinsa shares in August 2004, and quickly accumulated a 15 percent position for Punch Card, at an average price of $17 per American Depository Receipt.

In the year and a half after Norbert first bought Quinsa, the stock rose to over $30. The company's EBITDA, already up 48 percent year over year in 2004, rose another 40 percent in 2005 as Quinsa continued to raise prices, grow volume, and keep expenses in line. Management was sharply increasing capital expenditures, a move not penalized by the put/call formula, but that would lift future EBITDA and lead to a higher price under the formula. At the same time, the company was buying out its minority interests, which would also increase consolidated EBITDA as defined in the formula. *"It seemed clear that Quinsa's owners were focused on maximizing the company's value under the formula,"* Norbert said of the moves he noticed. Punch Card kept buying shares, bringing the position to over 20 percent of capital. Norbert liked Quinsa enough to write it up for the Value Investors Club in July 2005, a decision he later regretted when the stock subsequently rose, forcing him to pay more for his future shares. *"I shouldn't have written it up,"* he said later. *"The situation kept improving."* At this point, Punch Card's 35.7 percent net annualized return in its first 18 months was attracting interest from potential limited partners. But Norbert liked Quinsa so much that he turned down the capital rather than dilute Quinsa's concentration in his portfolio. *"The stock was a little bit illiquid, so I didn't know if I could buy more if I had more capital,"* Norbert said. *"Quinsa was my best idea, and I didn't know if my second or third or fourth best idea—that I would have had to add to—would be as good as Quinsa."*

In early 2006, with the ADRs trading at $37.65, the Bembergs announced that they would sell their controlling stake in Quinsa to AmBev, at a price under the put/call formula of $67.07 per ADR. It was a great deal for the Bembergs, but the announcement said nothing about the fate of Quinsa's minority shareholders, who owned the 9 percent of the company that AmBev was not buying. Uncertainty about whether AmBev would also make an offer for the minority shares weighed on the stock price, which increased to only $44 after the announcement.

ON PUNCH CARD: AMIT BHATIANI

Amit Bhatiani is a partner at CX Partners, a private equity firm based in New Delhi, India. From 2006 to 2009, he was a partner and portfolio manager at Duma Capital, a global macro and value hedge fund firm. Duma and Punch Card were part of the investor group that negotiated with Quinsa and AmBev beginning in 2006.

"I have met a tremendous number of investors in my time. Norbert is one of maybe three or four in the world that I would give money to manage."

"I first encountered Norbert when AmBev tried to take control of Quinsa at an unfair price. It became clear to me that if we could get a group of shareholders together we could be in a blocking position. The obvious suspects were Punch Card, which was by then the largest shareholder, Bleichroder, which was the second largest, and Duma, which was the third largest."

"I would say that of the three [shareholders], the person who was most involved and the most knowledgeable about the situation was Norbert. He was incredibly thoughtful, incredibly detail-oriented, and a very meticulous reader of corporate filings. Every 8K that Quinsa ever filed, that AmBev ever filed, Norbert was a very careful reader of those."

"Norbert's initial Quinsa thesis was spot-on. He is probably one of the clearest thinkers about business, and can understand all the various layers of what makes a great investment. He understood that Quinsa was one of very, very few businesses of its kind in the world. He understood exactly how good it was."

"He judged the situation very astutely, including the likelihood that AmBev would come to us to negotiate directly rather than just leave us hanging. He parsed every action of AmBev and Quinsa very carefully."

"I always thought Norbert was incredibly calm. He kept his cool and played the game very well. He was also very loyal to the group, and proved himself to be a great team player."

"As great an investor as Norbert is, he should be managing several billions of dollars."

Believing that Luxembourg law favored mandating AmBev to make a fair offer for the minority shares, Norbert bought more after the announcement, bringing the Quinsa position to 40 percent of Punch Card's capital, the fund's biggest position by far. The fund was now Quinsa's largest outside shareholder. Norbert made inquiries about whether an offer was forthcoming, and when he heard nothing, he began to be suspicious. He worried that AmBev could try to induce a temporary drop in Quinsa's operating results, and then just scoop up the shares it didn't own after the stock plummeted. *"It wasn't like you were going to be a silent partner alongside Buffett,"* he said. *"They were eventually going to try to buy out shareholders at the best price they could get."*

Norbert began to press AmBev to offer the same price to minority shareholders as it had offered to the Bembergs, and he hired lawyers and an advisory firm to work on his behalf. *"I didn't have an absolutely bulletproof case that AmBev would have to make an offer for the minority shares,"* Norbert said. *"But if you're an upstanding Global 500 company like AmBev's parent InBev was, and wanted to preserve your reputation as a desirable acquirer, you would avoid a public relations nightmare and make a fair offer."* He teamed up with Quinsa's two other largest independent shareholders, Duma Capital and Bleichroeder, and began a public campaign directed at both Ambev and InBev. *"I thought if there was someone publicly shaming them, it would increase the odds of a fair outcome,"* Norbert said.

It seemed as if Norbert's efforts had paid off when at the end of 2006, AmBev offered to pay Quinsa's minority shareholders the same $67.07 per ADR that it had paid the Bembergs. But the transaction was scheduled to close in the spring of 2007, a full year after the Bembergs had sold their shares. In the interim, Quinsa's EBITDA had continued to increase and Norbert believed the $67.07 price was no longer enough. *"The results had improved and time had passed, so they couldn't say that paying $67.07 per ADR then was as fair as paying $67.07 the year before. It was not really the same compensation,"* Norbert said. He and the shareholder group rejected the offer and pressed for a higher price.

Norbert flew to Argentina in August of 2007 to make his case in person. *"I sort of invited myself down there,"* he said. *"It helps sometimes to show up because they see you're serious and not some hooligan."* The meeting was inconclusive, but in December of 2007, AmBev finally acquiesced. The brewer's parent company InBev was in the process of trying to buy Anheuser-Busch, and the brewer could not afford any negative publicity. AmBev agreed to pay Punch Card and other minority shareholders $82.50 per ADR—nearly five times what Norbert had paid for his first Quinsa shares in August 2004. Although both the Bembergs and Punch Card ultimately received a high price for their shares, Norbert believes that neither was the biggest winner. *"InBev will get the best result as the ultimate owner of the operations of Quinsa,"* he said. *"It's usually so much better to hold these great businesses for decades—and let the dynamics of the business compound operating profit at a high rate."*

At the beginning of 2008, roughly the mid-point of Punch Card's life to date, the fund's net annualized return stood at 27.0 percent. Three new investors had joined the partnership the previous year, which along with additional contributions from Gotham and internal compounding brought assets under management to $176 million. Norbert was now living in Orlando, Florida, where his parents and several other family members had moved, and which he discovered was a good place to practice his style of investing. *"In New York everyone works at a hedge fund, and a lot of people are constantly discussing investment ideas,"* he said. *"It's hard not to be subconsciously influenced, and it's not optimal when your strategy is to wait around and not do anything until it makes a lot of sense."* He rented a two-room office near his house, in a building next to a supermarket, and decorated it with some vintage Quilmes advertisements he had bought as souvenirs for himself and his fellow Quinsa shareholders.

ON PUNCH CARD: CHARLES DEMOULIN

Charles Demoulin is a partner at Deminor, a company that offers corporate finance, corporate governance and engagement, damage/asset recovery, and focused asset management services to shareholders in European companies. Deminor was engaged by Punch Card Capital for advisory services related to its investment in Quinsa.

"There were some Quinsa investors who contacted us, but the one who really started the case was Norbert. He was the driving force."

"We did have a very good relationship with him. What I liked about the collaboration was that I knew and I clearly felt that I was working for and with a professional. It was a very good professional relationship."

"What I appreciated about Norbert is that I felt I could trust him and rely on his backing while I was executing the agreed engagement plan."

"I didn't have the impression that I had someone who was nervous or anxious about anything. I've sometimes had clients who were shouting over the phone but with Norbert it was always very smooth."

RISKS OF A CARD PUNCHER

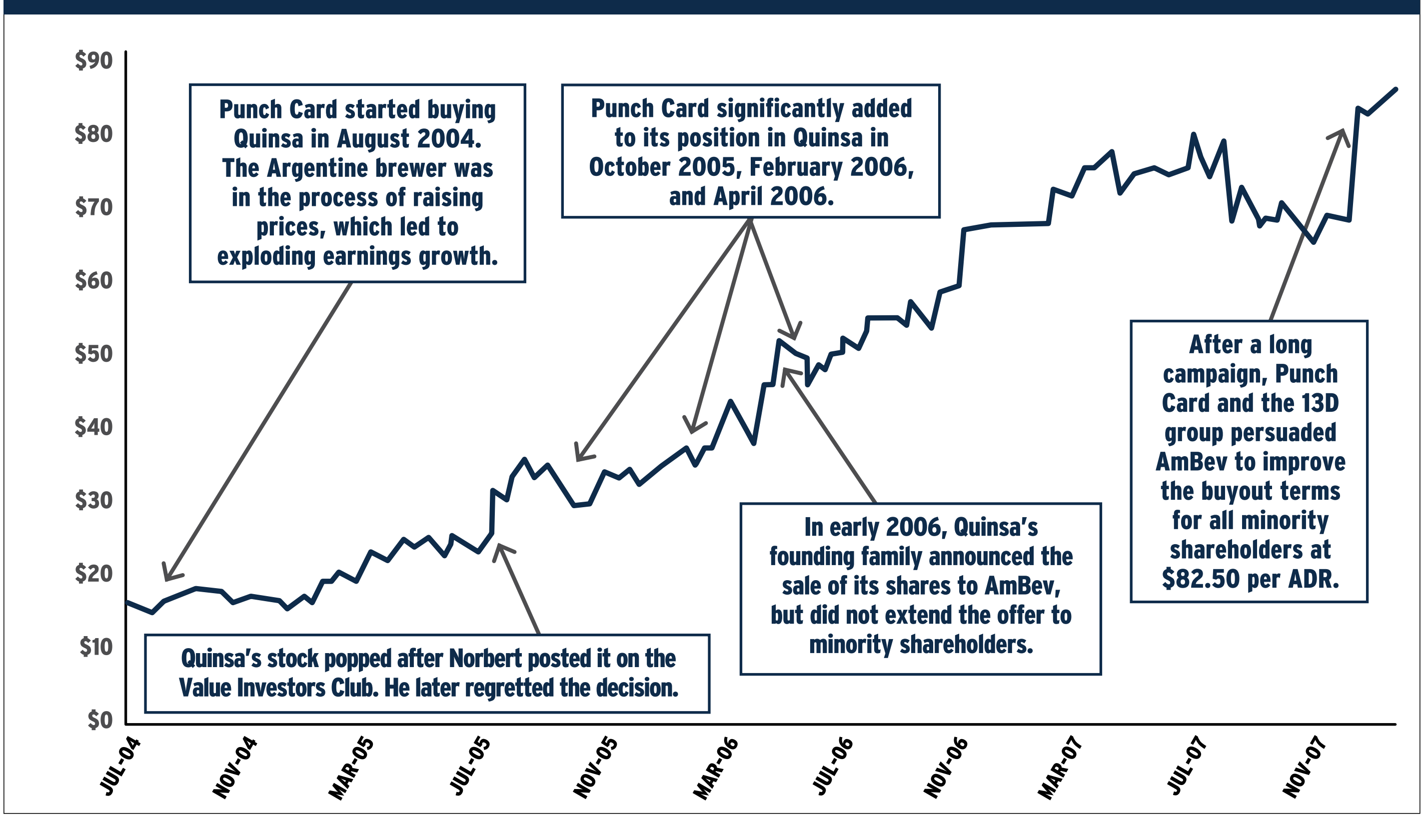
The ideal Punch Card investment is a company that, like NVR and Quinsa, can compound its intrinsic value at an extraordinary rate for years. Because such investments are rare, and Punch Card is set up to bet big on them, errors of "omission"—in which Norbert finds a "punch" yet for some reason does not buy—have a real opportunity cost.

Norbert's most notable such error was his failure to buy Morningstar Inc. when it went public in May 2005. The company was widely respected in the investment industry for its databases and rankings of mutual funds, stocks, and other investment products, information that it packaged and sold by subscription to individuals and institutions. *"The Morningstar brand was really important and difficult to replicate,"* Norbert said. *"They were an established seal of approval, and people were willing to pay for the ratings and analysis."* Its revenue was growing by over 20 percent per year, and Norbert believed that, like Quilmes beer, its products had untapped pricing power. *"I remember thinking the products were a bargain,"* he continued. *"The customer base could really absorb significant percentage price increases, because the expense was not significant relative to the improvement in returns they could generate from the information."* The customers also paid for their subscriptions up front, generating "float" that the company used to fund its growth.

Morningstar had spent 20 years compiling its databases at significant expense, dampening profits. But Norbert knew that once the company made that initial investment, the same data could be sold over and over again to different users with little marginal expense or additional capital required, and could also be repackaged and sold to different types of customers. *"Those databases were enduring sources of revenue,"* he said. The company had become profitable in 2004, earning operating margins of 10 percent on revenues of $180 million. At that level of profitability, the company was trading at a whopping 66 times normalized earnings based on its expected IPO price. But Norbert could see that Morningstar's subscription growth, pricing power, and operating leverage could combine to produce geometric growth in cash flows. He also noted that the company's CEO, Joseph Mansueto, was a long-time Buffett acolyte who operated the company with shareholders in mind. *"You could see a lot of Buffett influence throughout the company,"* he said. *"That's really attractive."*

As Morningstar's IPO, structured as a Dutch auction, drew near, Norbert did extensive research and decided to make a bid for some shares. *"I recognized that there were qualitative factors that made it worth paying up for,"* he said. *"But I had to set a cut-off point. I was willing to*

QUINSA (AUGUST 2004 TO FEBRUARY 2008)



pay $13 to $14 per share." However, the auction priced at $18.50 and the stock drifted higher throughout the day. Norbert was unwilling to chase it. *"It was a higher multiple of operating income than I was comfortable with,"* he said. Unfortunately, Norbert's cut-off point proved too conservative: Morningstar's IPO price of $18.50 turned out to be the lowest the stock ever traded. By the end of 2007, the stock was trading at $80 per share, after revenue nearly doubled and operating income increased 150 percent in only two years. *"I was foolish,"* Norbert admitted. *"I severely underestimated how well it could do and should have seen that it was actually reasonably priced relative to its future potential."*

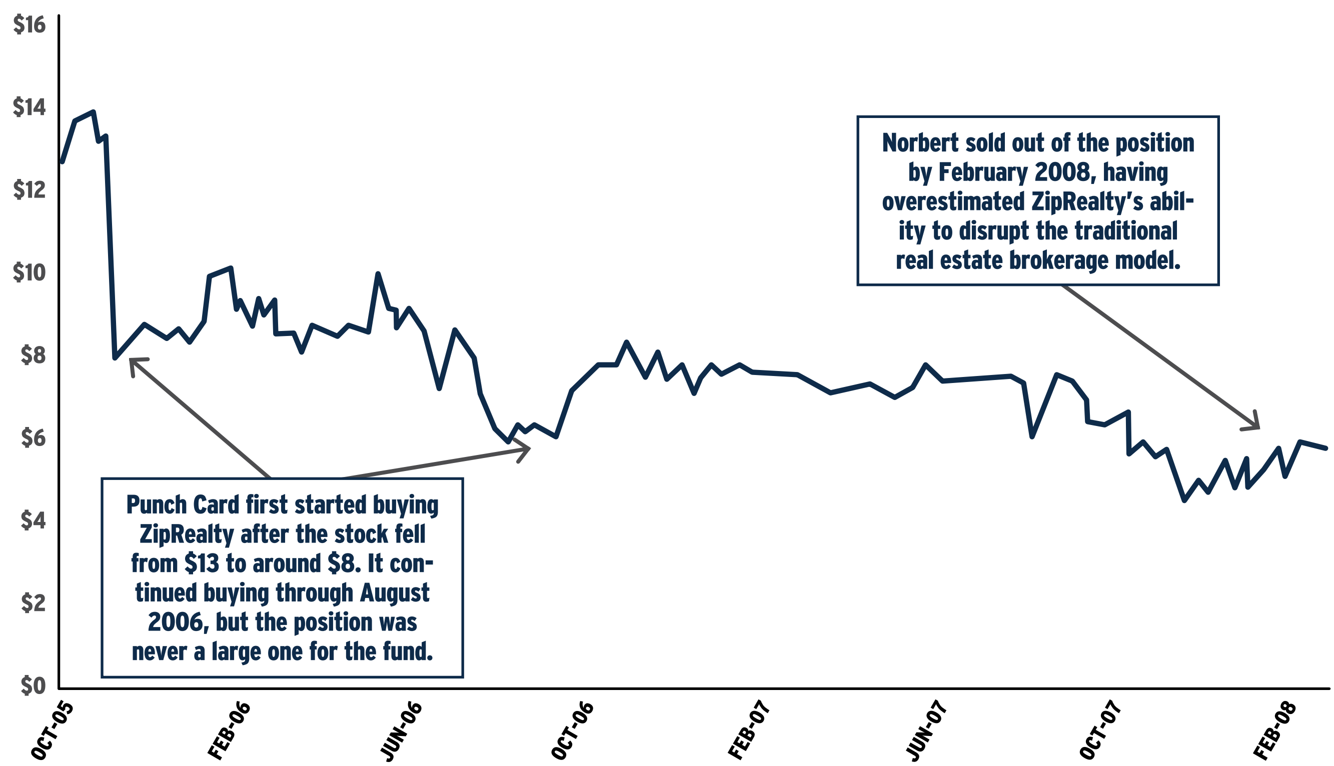
Many investors regret "the stock that got away," but such errors are especially painful for Norbert because of the disproportionate effect one great investment can have on his overall performance. For example, NVR's impact on his mother's portfolio was so great that had every other stock she owned at the end of 1997 immediately gone to zero, the compound annual return of the portfolio as a whole over the following decade would still have exceeded 20 percent.

Notwithstanding the ability of Punch Card's winners to overcome its losers, Norbert does not tolerate losers as the inevitable cost of finding winners, as a venture capitalist might. He strives to avoid stock-specific mistakes by seeking out companies with low leverage, low valuation, and a high degree of certainty about their futures, and by trying to understand them extremely well. Sometimes, though, his judgment about a business proves incorrect, and he uses a "punch" on the wrong company.[4]

In late 2005, Norbert bought a significant position in ZipRealty, a residential real estate broker founded in 1999. For decades, real estate brokerage firms employed armies of agents who worked from offices, generated their own leads, and showed houses to potential buyers. ZipRealty hoped to upend the traditional model by using web-based technology to lower costs dramatically. Its website, which listed detailed information on houses for sale, generated a large volume of traffic and drove potential buyers directly to ZipRealty's brokers at a fraction of the cost of traditional bricks-and-mortar lead generation. Since ZipRealty

4. Ambassadors Group, which Norbert describes as "the fund's most disappointing stock," has been covered extensively in Punch Card's letters to partners and is not discussed in this profile. At the time of publication Punch Card no longer owned the stock.

ZIPREALTY (NOVEMBER 2005 TO JANUARY 2008)



clients had already seen the houses on the internet by the time they met their ZipRealty broker, the agent could on average sell a house faster than the competition. The savings and increased broker productivity was then passed along to home buyers in the form of a 20 percent discount off the traditional 6 percent broker's commission—a huge savings for what is generally the largest investment an individual will ever make.

ZipRealty was not yet profitable in 2005, but it was earning returns on capital of 100 percent in its most seasoned markets, which indicated that the company's new business model was working. As Norbert studied the company, it reminded him of The Charles Schwab Corporation, which during the late '70s and early '80s, had become the country's largest stockbroker by using information technology to lower costs, then passing on those savings to customers. Norbert thought ZipRealty had a chance to replicate Schwab's success in the real estate brokerage business. If ZipRealty could continue to attract and keep customers through lower fees, Norbert predicted it would eventually be able to dramatically increase its share of the highly fragmented real estate industry. *"The industry was huge and they only had a small percentage of it,"* he said. *"I thought the opportunity to roll this out was great."* Punch Card began buying the stock in November 2005 at around $8 per share.

After two years, however, it became clear to Norbert that even though the company's 20 percent discount was attracting home buyers, ZipRealty was having trouble lowering its costs enough to make its sales profitable. It turned out that the money ZipRealty saved on office space and advertising relative to its traditional competitors was not significant. Nor could the company's brokers achieve the increased productivity that was supposed to make up for the lower fees they earned per transaction. *"The ZipRealty agents would get leads cheaply through the website, which was good, but then they would still have to show the customer roughly 14 houses before the customer made a bid, which was not much better than traditional brokers,"* Norbert said. *"The productivity was slightly higher, but it just wasn't high enough."* Despite its new technology, ZipRealty's total expenses did not look much different from those of its old-fashioned competitors. *"It turns out that there isn't much you can do to take out costs in real estate brokers,"* Norbert realized. *"The more I learned, the less it seemed like ZipRealty's business model was revolutionary or sustainable. I should have realized the problems much sooner than I did."*

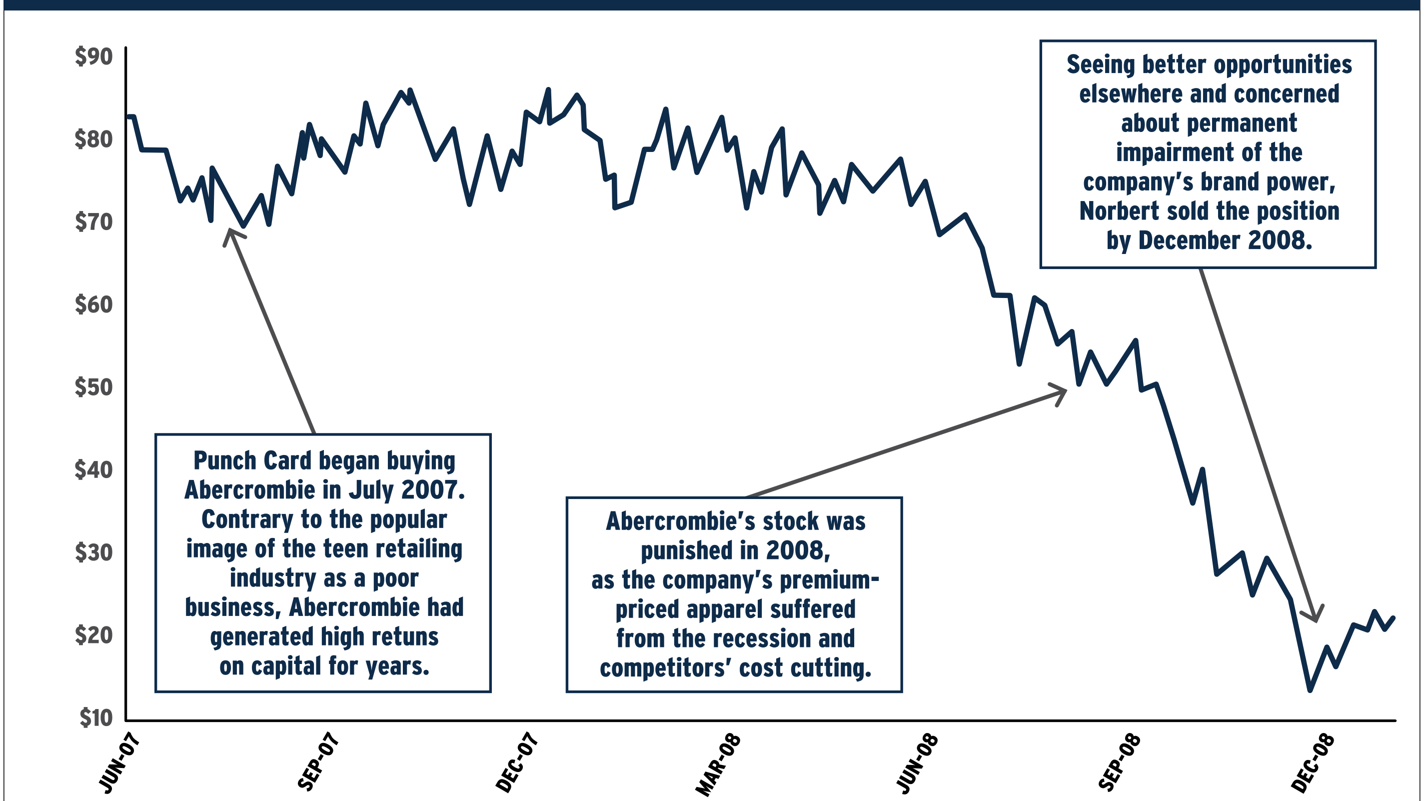
Norbert exited the position by February 2008, at an average price of $6. Three and a half years later, the stock now trades below $2 a share. *"ZipRealty eventually realized that the discount model was not sustainable, and finally eliminated the discount approach in 2011,"* Norbert said. While Punch Card sold early enough to avoid more damage, ZipRealty was a reminder of the hazards of looking for "punches" among young companies with potentially disruptive business models. *"They are harder to identify [than companies that have been around forever], and I am not quite as good at it,"* Norbert said. *"Sometimes you don't buy it and it's a Morningstar, and sometimes you do buy it and it's a ZipRealty."*

In 2007, Abercrombie & Fitch was the world's leading clothing retailer for teens, a status it had held since its repositioning in the 1990s from a seller of hunting goods. Norbert had been reading the company's annual reports for a decade and was impressed by pretax returns on capital that consistently exceeded 70 percent. *"Most people think of teen retailing as a fickle industry prone to fads,"* Norbert said. *"But several generations of teens had seen Abercrombie's products and they all were willing to part with a large portion of their money to buy them."*

Abercrombie's ability to generate high returns on capital rested on a powerful brand, created through mastery of marketing. *"Everything from the lighting in the stores to the pricing of the products to using shirtless models in stores,"* Norbert said. *"They created an upscale aspirational brand, and whatever they put their name on became popular."* Abercrombie's popularity translated into a massive pricing premium, which, in turn, gave Abercrombie the highest operating margins in the industry. The company protected its brand premium by refusing to offer discounts or promotional sales—despite frequent Wall Street pressure to make quarterly numbers. Norbert also saw that the company was reinvesting its free cash flow into new stores, which quickly equaled the profitability of existing ones. With more room to add stores in the U.S., and the company's international expansion just beginning—the brand appeared to be even more popular overseas than in the U.S.—Norbert believed the company had a long runway of future earnings growth. *"The great thing about retailers is once you perfect a concept, you can just roll it out and replicate it,"* Norbert said. *"I felt like Abercrombie had a good chance to reinvest future cash flows at the same high rates of return it had achieved in the past."* Norbert started buying shares in July 2007 at six times operating earnings, after the stock fell due to a negative same-store sales report. *"Same-store sales is a short-term metric that is not always directly related to profitability,"* he said. *"No one really cared that they were generating high returns on capital, were really cheap year after year, and would grow earnings."*

As the world entered a recession in

ABERCROMBIE & FITCH (JULY 2007 TO DECEMBER 2008)



2008, the stock dropped, and Norbert added to his position throughout the year, believing the weakness represented a buying opportunity. It turned out to be a bad decision. Over the previous few years, while Abercrombie had been ramping up its growth in new stores, a group of competitors, including American Eagle and Aeropostale, had been successfully copying its marketing methods and clothing styles.[5] When times were good, there was enough apparel spending to support three growing specialty-teen retailers. But when the recession hit, it became clear that the increased competition was starting to damage Abercrombie, especially since Aeropostale was willing to use promotional pricing to drive volume. After missing its earnings numbers, Abercrombie's stock price plummeted to below $20 before Norbert sold it. *"It turned out not to be as bulletproof as I thought,"* he said. *"I'm pretty sure in 10 years the company will still be around, it will have a lot of stores in Europe and Asia, and its cash flows will certainly be higher. But I bought it expecting a certain rate of return over the next decade and it was set back because of the recession and how much progress the copycats made."*

THE RIDE YOU SHOULD EXPECT

The Abercrombie mistake, which cost Punch Card permanent capital, coincided with a period in which the fund also experienced a temporary loss of capital. Part of this temporary loss was due to Norbert's reluctance to engage in short selling. In his 2008 year-end letter to Punch Card's limited partners, Norbert explained why the partnership has almost never shorted stocks. He noted that a concentrated "punch card" approach to shorting mirroring his long philosophy would be extremely difficult to carry out. *"It would require taking large individual short equity positions, which would introduce an unpredictable amount of risk for the overall portfolio,"* he wrote. He does not believe that maintaining a more diversified portfolio of shorts, an approach adopted by most hedge funds, was a better alternative: *"I think this is an illusory solution,"* he continued. *"Each additional position has theoretically unlimited loss potential; the difficulty of carefully researching the increased number of positions is increased; and when markets move against short-sellers, the positions all become highly correlated, so the diversification does not provide protection when it is most needed."*

In addition to avoiding short selling, Punch Card does not attempt to hedge market exposure by liquidating positions and staying in cash until a better time to buy stocks presents itself. *"If you are picking individual securities on a fundamental basis, and the occasion presents itself to buy one at an attractive price for the long-term, and you pass because you are trying to time a short-term market view, then in a way you are avoiding your duty to stick to the value investing principle that you set up,"* Norbert said.

Norbert is not completely indifferent to such short-term swings, as they create the opportunity for a strategic or private equity buyer to "steal" a business he'd rather hold for a long time. *"If someone else is interested in a company I own, I do worry about the stock getting knocked down and then that setting some historical moving average for an investment banker to use in a valuation opinion,"* Norbert said. However, for the most part, exposure to short-term swings is *"the ride you should expect"* when investing in Punch Card, he said, and that is something he takes care to make clear to his investors. *"The fund will limit itself to investors who are not concerned with short-term results,"* he wrote in his first letter to partners in 2005. *"It will stick to this practice even if it means fewer assets to manage."*

The combination of stock-specific mistakes and short-term swings caused Punch Card to post a 35.9 percent net loss in 2008, reducing the fund's net annualized return since inception to 9.4 percent. The partnership's largest investor, Gotham's fund of funds, was forced to redeem capital from Punch Card in order to meet its own redemption requests. Although Gotham's principals maintained their own personal investments in Punch Card, the redemption and the portfolio's decline brought assets under management to $60 million. However, each of Punch Card's remaining investors stuck with the fund. *"When you have LPs, it's a massive burden on your conscience because you worry about the returns they'll receive during their part of the Punch Card ride,"* he said later. *"I'm glad the remaining LPs, including the Gotham principals and their families, held on through the worst part of the downturn."*[6]

Norbert took away several lessons from Punch Card's most difficult period. For one thing, he learned to care more about the liquidity of a stock. *"I used to think that the liquidity of an underlying security didn't really matter, because if you plan to hold it for a long time, it shouldn't matter that you can't trade in and out of it every day or month,"* he said. But, as he discovered in 2008, illiquidity makes it difficult to swap out of a position when you find something better to buy. *"I don't avoid illiquid things now, but there is a potential opportunity cost that I now take note of that I previously did not place any weight on."* He also learned that it was a mistake to rely so much on one limited partner whose sudden withdrawal could affect his ability to deploy capital. *"I probably should have spent more time trying to diversify the LP base the first few years of the fund, when the performance record was 37.1 percent net per year."* A

5. American Eagle was a good enough copycat that Norbert bought some of its shares in 2007. He sold the position at a small loss in 2008 to redeploy capital elsewhere.

6. In 2009, to accommodate existing and prospective investors, Norbert changed Punch Card's performance reporting policy from semi-annually to quarterly.

ON PUNCH CARD: ROBERT GOLDSTEIN

Robert Goldstein is managing partner and co–CIO of Gotham Asset Management. From 1989 to 1997, he was Managing Partner of Metropolis Partners, L.P. He has been a limited partner in Punch Card Capital since 2004 and owns an equity stake in the management company. Rob was profiled by Santangel's Review in March 2011.

"Norb thinks as clearly as anyone you will ever meet."

"He is a great analyst. But what really sets him apart is his ability to gain tremendous conviction and to act upon it—that is a very rare quality. He's got 90 percent plus of his net worth in the fund so it's a recipe for great success."

more diversified investor base would have given Norbert the flexibility to be more aggressive in 2008, instead of having to play defense and worry about redemptions.

THE UPSIDE OF A CRISIS

Although 2008 was difficult for Norbert, it also allowed him to find some great bargains. Several of his purchases during the crisis period were departures from the normal Punch Card-type investing style, more closely resembling special situations. The most interesting purchase was the stock of Bear Stearns. On Sunday, March 16, 2008, with the markets in a state of near-panic, J.P. Morgan announced a deal to acquire the investment bank at the fire-sale price of $2 per share, in a deal brokered by the federal government. Like many investors, Norbert followed the deal in the newspapers. Unlike many investors, when the merger documents were released on Bear's website the following Tuesday, he decided to read all of them. *"It's my nature,"* he admitted. *"I read a lot of stuff, including footnotes."* Buried among the minutiae of the guarantee agreement, Norbert noticed a crucial detail: As part of the merger, but before the deal actually closed, J.P. Morgan agreed to immediately guarantee all of Bear Stearns's liabilities. However, the agreement neglected to release J.P. Morgan from its guarantee obligation in the event the merger was not approved by Bear's shareholders. In other words, as Norbert realized, should Bear's shareholders vote down the merger, J.P. Morgan would still be on the hook for guaranteeing Bear's liabilities. *"I remember thinking 'this is crazy' and immediately worrying about where it was going to start trading tomorrow. It was clear to me that it was a mistake,"* Norbert said.

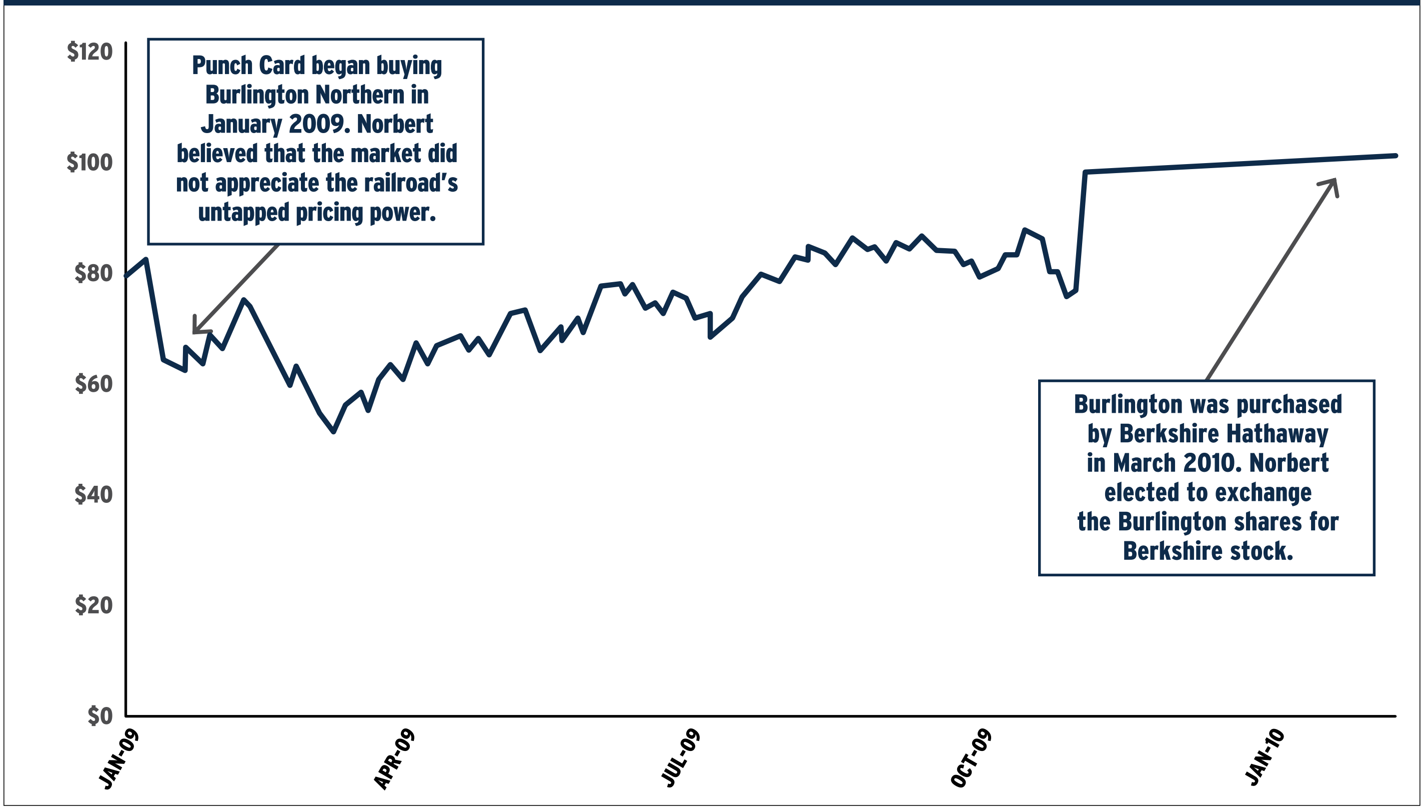
The next day, Bear's stock was already trading above the $2 deal price on rumors that Bear's bondholders were buying shares to make sure the deal would go through. Punch Card bought one million Bear shares at an average price of $5.49 per share, sizing the position smaller than usual. *"With things like this, it could still blow up for multiple reasons,"* Norbert said. He knew there was still a risk that J.P. Morgan wouldn't raise its bid, and he considered starting a public campaign to alert Bear's shareholders to the mistake in the contract. At one point, he even tried to contact Joe Lewis, the well-known British investor who owned 7 percent of the company. But before long, J.P. Morgan recognized its mistake and made a second offer for the company at $10 per share. Even though Punch Card nearly doubled its money in less than two months, Norbert considered the position a detour from his fundamental strategy: *"I prefer to wait around for good businesses, but on rare occasions these unusual opportunities come up and are hard to pass up,"* Norbert said. *"You can generate excess returns that way, but it's not as good as latching onto something that is compounding at a high rate and then sitting back."*

Although Punch Card also earned some profits that year by buying a few select distressed bonds, Norbert's main goal during 2008 was to latch onto something that would compound at a high rate. He established a position in Burlington Northern Santa Fe, the largest railroad company in the western United States. Burlington Northern had been around forever and was just starting to unleash untapped pricing power that Norbert believed the market did not fully appreciate. *"Burlington Northern's prices had actually fallen for decades and only recently did prices start to reverse after the industry deregulated and consolidated,"* Norbert said. He bought a position for Punch Card in early 2009. With pricing power and a monopoly-like position in its geographic areas, Norbert expected Burlington Northern to compound at very high rates for years to come. However, in the fourth quarter of 2009, he found out that his newest "punch" was being stolen by another punch card investor: The company announced that it was being acquired by Berkshire Hathaway. Norbert elected to take Berkshire Hathaway shares in the merger, giving him the chance to continue to own Burlington Northern indirectly while also getting the services of the world's best capital allocator at what he considered to be a bargain price.

CURRENT PORTFOLIO

Punch Card rebounded from 2008 by earning 57.1 percent net in 2009, bringing the fund back above its high-water mark. The fund's comeback continued in 2010, with a 28.9 percent performance, mostly from stocks that remain in the portfolio today. The fund currently has six significant positions, four of which are discussed in this profile. Most of the positions have been knocked down in the recent

BURLINGTON NORTHERN SANTA FE CORP (JANUARY 2009 TO FEBRUARY 2010)



market turmoil, and the fund as a whole is down 11.9 percent through the first three quarters of 2011.

Punch Card still holds the Berkshire Hathaway shares it received in exchange for its Burlington Northern position in early 2010. Although Norbert believes the new Burlington Northern subsidiary will grow its earnings at a high rate over time, he concedes that Berkshire as a whole is now too large to grow at anything resembling the "ideal" Punch Card stock. *"It's growing at a decent rate,"* he said. *"But I don't have any insight about it growing faster than anyone realizes."* The attraction of the stock for Norbert is its current valuation, which more than makes up for slower future growth. *"I'd buy AAA bonds if I could get a 20 percent yield to maturity on them,"* he said. *"This is akin to that."*

Traditional investors have always been repelled by the lumpiness of Berkshire's results, and even value-oriented hedge fund managers have trouble explaining to their investors why they own it instead of something sexier. *"Who wants to try and get paid one and 20 by buying Berkshire and touting it?"* Norbert said. Moreover, for all the attention paid to Buffett himself, the company remains poorly understood, and requires careful reading of its financial statements in order to analyze properly. *"It's a complex company, there's a lot of stuff written about it, but it's not easy to value,"* Norbert said. *"You can't just look at the P/E ratio."*

Norbert believes Berkshire's total value is materially higher than the current market cap. He notes that the company's huge portfolio of cash equivalents, bonds, and stocks exceeds $90,000 per share, almost as much as the stock price. Berkshire's operating companies, of which Burlington Northern is now the largest, generated $12.6 billion of pretax income over the past 12 months. The historical core of Berkshire is its group of insurance companies, which regularly generate underwriting profits—roughly $1.8 billion per year on average since 2002. Norbert believes that these cash flow streams, while lumpy, deserve an earnings multiple of their own. The final piece of Berkshire's value is one that, in Norbert's opinion, many investors do not fully appreciate. Berkshire's insurance companies not only generate underwriting profits, but they also generate growth in float year after year, as customers pay premiums in advance of any claims. This float growth, which has averaged $3.1 billion annually in recent years, is a recurring tax-free source of cash for the company to invest. As such, Norbert believes it has significant value for Berkshire's shareholders. *"There is a value to float growth that most people don't recognize,"* he said. *"The multiple shouldn't be zero in my opinion."* Berkshire's recent announcement that it would repurchase its own shares was, in Norbert's opinion, confirmation that the stock is very cheap.

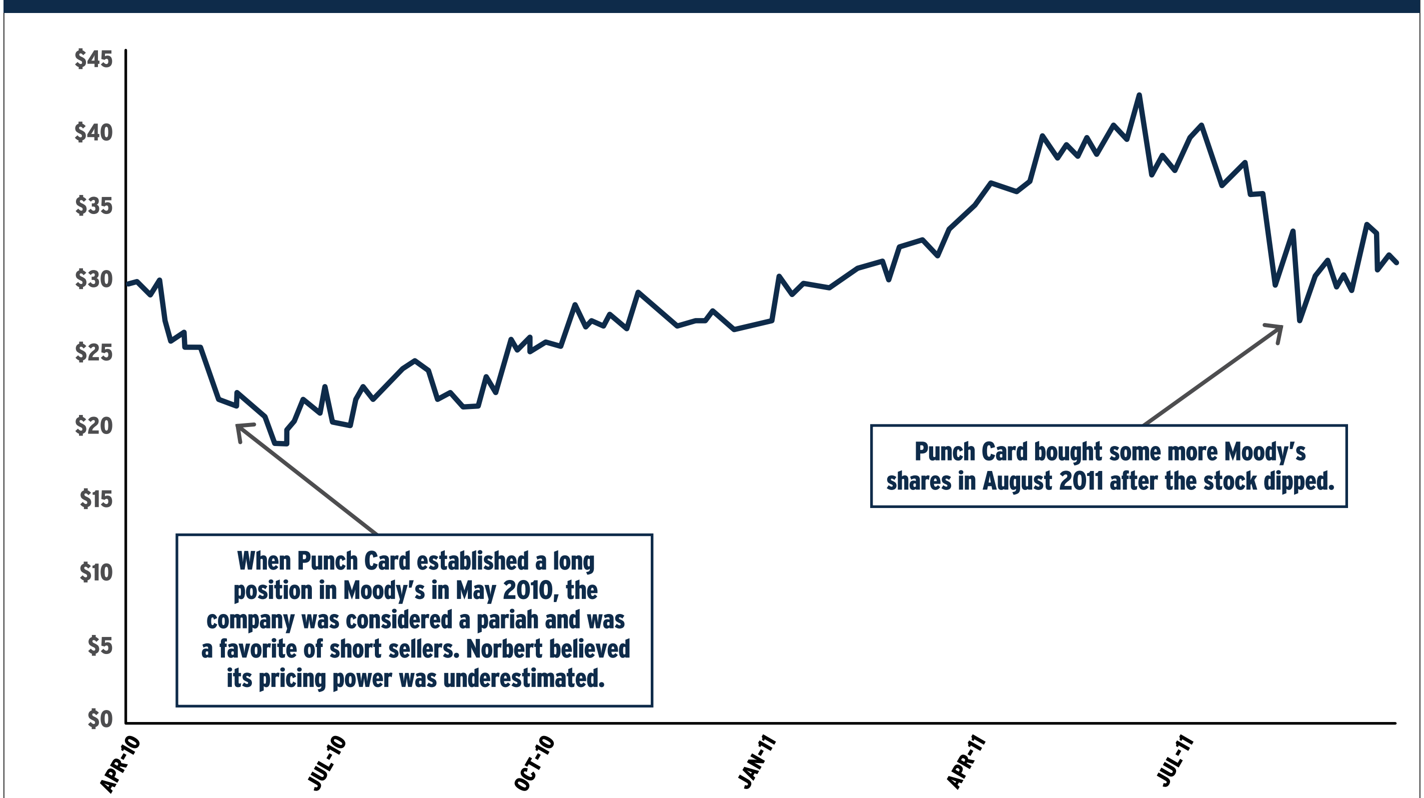
While the main knock on the stock is the fear of a disappearance of the "Buffett premium" when Berkshire's CEO inevitably dies, Norbert believes that a quick sum of the parts analysis shows there is no longer a premium. *"There is a conglomerate discount, if anything,"* Norbert said. *"The subsidiaries will continue to generate cash flow after he dies and the culture will remain."* In the meantime, until the proverbial bus hits, Norbert sees another advantage to investing in Berkshire. *"I also think current management is pretty good,"* he said.

Another of Punch Card's current positions is Moody's Corporation, which, ironically enough, Berkshire Hathaway has recently been selling. *"Buffett bought Burlington from me, now I guess I bought some Moody's from him,"* Norbert remarked. The fund initiated its position in the world's largest bond ratings agency in May 2010 at an average price of $22, approximately 10 times after-tax earnings. At the time, the company was a favorite of many short sellers. Some held it largely responsible for the financial crisis because of its incorrect ratings on structured products tied to subprime mortgages, and the company faced both litigation and government investigations. Moody's structured products business, a large contributor to earnings before the crisis, had been decimated, and even the plain-vanilla corporate bond ratings division faced stalling volume as the world entered a period of de-leveraging. In the aftermath of the crisis, some bears questioned the company's entire business model, claiming that any system in which the issuers paid for ratings was hopelessly corrupt.

Norbert thinks the bears are seriously overstating their case against Moody's. Worldwide economic forces much larger than any single company contributed to the increased leverage throughout the financial system that ultimately ended in crisis. He also does not believe that the company's business model is doomed. Going back decades, Moody's has had a good record of measuring bond risk, so there is no real evidence that the issuer-pay model is fatally flawed. On the contrary, Norbert believes the world needs a company like Moody's. *"There is some use to having one or two ratings agencies by convention,"* he said. *"Once they have power, you want it to continue because you don't want the guys issuing the ratings to be bullied by their customers. If there were a dozen agencies, it would be much easier for issuers to shop for the easiest grader."* Finally, for all the criticism Moody's has received, it and Standard & Poor's continue to win nearly all ratings assignments.

With a market cap close to $8 billion, Moody's is a widely followed company. Norbert believes, however, that most people, even the bulls, do not fully

MOODY'S CORPORATION (MAY 2010 TO PRESENT)



appreciate the main factor working in the company's favor: its massive untapped pricing power. *"I don't know how many analysts are covering Moody's, but you don't see many of them discussing the price of the product,"* Norbert said. The company currently charges an average of five basis points per corporate bond deal, up 52 percent from the 3.3 basis points it charged in 2002. Yet a bond rating is considered so essential that companies have no choice but to pay the increased fee. *"If you're the average CFO of a bond issuer, it's a pretty easy decision to pay five basis points to get a rating, because it might cost you multiples of that when you price your bond if you forgo a rating,"* Norbert said. *"If tomorrow, both ratings agencies said, 'OK, it's 10 basis points,' you may complain about it, but you'd still pay it."* Despite the sharp fall-off in structured products issuance and the stalled growth in corporate bond ratings, Moody's total operating income now approaches its pre-crisis levels, thanks mostly to price increases. *"With price increases, you can make up for a lot of lost volume, and you can pay for a lot of fines, litigation, and additional staff to comply with new regulatory requirements,"* Norbert said. Punch Card added to its Moody's position during the recent market dip.

Punch Card also owns the TARP warrants of a U.S. bank, which Norbert declined to name because the position is illiquid. He also believes that in the past, his decisions to disclose positions have hampered his ability to purchase more when prices fell.

In 2008, amidst the financial crisis, TARP warrants with a 10-year expiration date were issued to the U.S. Treasury in exchange for injections of capital into most of the country's major banks. Two years later, the Treasury decided to dispose of its warrants by auctioning them off. *"Whenever the government is selling, it makes sense to look,"* Norbert said.

Norbert saw that the government was a motivated seller, one that even admitted to potential buyers that it would rather get rid of the warrants for political reasons than try to obtain the best prices for them. The Treasury used the Black-Scholes method to value the securities, an approach not designed for long-dated warrants. *"An irrational seller is interesting, but an irrational seller who also uses flawed valuation methods really piques Punch Card's interest,"* Norbert wrote in his semiannual letter in 2010.

Norbert examined the underlying businesses of the banks whose warrants were being auctioned. He had no interest in complicated investment banks such as Goldman Sachs, Citigroup, or Bank of America. Rather, he concentrated on traditional banks that stuck to taking in deposits cheaply and making sound loans. He discovered that old fashioned banking is a better business than it's often given credit for, and can earn relatively high returns on equity without excessive leverage. *"Customers have gotten tied a lot more closely to their banks in the past 10 years,"* Norbert said. *"The switching costs are high because of direct depositing, because people like their branches to be close by, and because they've set up their online bills with one bank and don't feel like doing it again."* The stickiness has created cost advantages for the banking industry as a whole, which is now able to pay less for deposits. *"And on top of that, there are some banks that, because of their brand or their penetration in certain regions, have an advantage over others,"* Norbert said.

In 2010, he successfully bid for TARP warrants of one of the few banks whose common stock he would ever consider buying outright. It has an attractive deposit base, sizeable pretax, pre-provision profits, moderating loan losses, and growing deposits. At the time he bought the warrants, the bank's common stock was weighed down by cyclical concerns that it would not be able to deploy its capital at attractive rates. With the warrants trading at a discount to the value of the common stock, Norbert felt that he had two layers of undervaluation, along with a leveraged bet on a favorable outcome. *"I was only risking maybe one-third or so of the capital I would have had to risk if I were to establish a regular long equity position,"* he said. *"Getting inexpensive, non-recourse leverage through warrants on something that's already leveraged, as all banks are, is an interesting way to create an asymmetric payoff profile."*

Norbert added to the position in 2011, and the price of the warrants is now about 15 percent higher than when he first purchased them, despite the severe downturn in financial stocks in general. *"The discount of the warrant relative to the common has narrowed,"* he said. *"But the underlying common is still undervalued."*

The current Punch Card position that seems most similar to NVR, Norbert's biggest winner ever, had its genesis in 2003. In that year, Berkshire Hathaway tried and failed to acquire Seitel Inc., a then-bankrupt provider of seismic data to oil-and-gas exploration and production (E&P) companies. Seismic data provides E&P companies with a virtual map of the earth's subsurface, highlighting those areas where oil and gas are most likely to be found. A seismic data survey is crucial in helping E&P companies to determine where to drill, particularly offshore where a single project can cost up to $300 million and a successful find can generate billions in revenue. The high

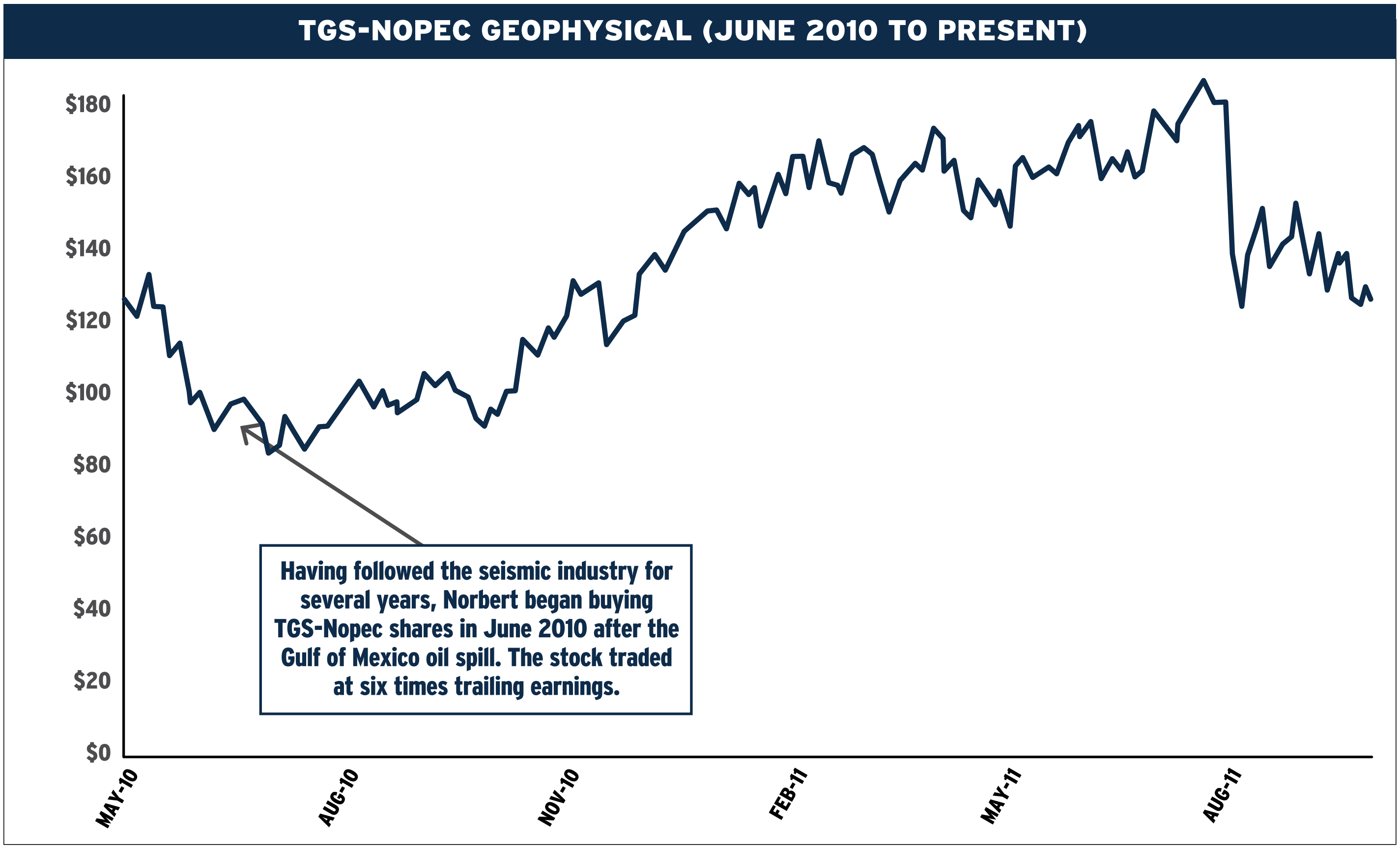
NOTE FROM THE PUBLISHERS

The subject of our current profile, Norbert Lou, has earned excellent long-term returns by following a policy of extreme concentration, demonstrating the wisdom of Warren Buffett's "punch card" approach to investing. However, our last profilee, Stephen Bauer of Truffle Hound Capital, has shown that it is also possible to outperform with a portfolio of a hundred or more positions. And the profilee before that, Gotham Asset Management, has devised portfolios designed to outperform with over one thousand positions.

Successful investing comes in many different shapes and sizes. The common threads among all three of these profilees, as well as most successful investors we've studied and written about, are a commitment to buying securities at a discount to their intrinsic value, an almost religious focus on making rational decisions, and the ability to think independently about which investing approach works best for them. When we evaluate investors, these threads matter much more than an ideal level of diversification or concentration.

Thank you for reading.

Nadav Manham and Steven Friedman, CFA



stakes for an offshore driller more than justify the $50,000 to $500,000 that E&P companies pay for a standard seismic survey.

Berkshire's failed bid for Seitel caught Norbert's attention, given that the company seemed to be an atypical purchase for Berkshire. He began studying the seismic industry, and learned that it included several good companies. Years later, in 2010, the British Petroleum oil spill caused a short-term panic that allowed Norbert to snap up for a cheap price what he considered to be the best company in the industry: Oslo-based TGS-Nopec Geophysical.

TGS-Nopec is one of only five principal providers of marine seismic data, a level of concentration that gives the group inherent leverage over the hundreds of E&P companies it serves. *"When there is such a large customer base relative to the guys putting together the surveys, the advantages lie with the small group,"* Norbert said.

Of the five main players, TGS-Nopec is unique in that it does not own the ships used to conduct surveys. Such specialized vessels, which feature huge sonar devices that are dragged behind the ships over large areas of water, must be ordered years in advance, and they cost hundreds of millions of dollars to build, operate, and maintain. The companies that own their own ships use them primarily for contract work, in which an individual E&P company pays for a specific seismic survey of an area of interest. While contract work keeps ships from lying idle and boosts the revenue and market share of the companies that do it, it is a low-margin business vulnerable to cyclical downswings in demand and competition from smaller players. More important, it forces the companies to tie up hundreds of millions of dollars in ship ownership, depressing returns on capital. *"It's much like the way that land ownership depresses returns on capital for all homebuilders except NVR,"* Norbert noted.

Rather than owning its own ships, TGS-Nopec leases them only when needed to complete projects, thereby reducing the invested capital required to operate its business and obviating the need to engage in low-margin contract work that keeps ship utilization rates high. By avoiding contract work, TGS-Nopec, alone among all the seismic data companies, can concentrate nearly exclusively on the highest-margin part of the seismic data business: the coordination of multi-client seismic surveys.

In a multi-client survey, several E&P companies will agree to underwrite roughly half the costs of a given survey in advance, with the remainder underwritten by the seismic data company itself. The resulting survey data is then shared among the E&P underwriters. *"The E&P companies don't need to have exclusive access to the seismic* *data because they each do their own interpretation and analysis,"* Norbert explained. *"It's like all the hedge funds out there: they all get access to the same raw data, market feeds, and SEC financials, but then they apply their own strategy and insight to them."*

Multi-client surveying is much less competitive than contract work, because only the largest seismic companies have the scale necessary to coordinate surveys of that size. Moreover, market leadership is itself an effective barrier to entry. *"If I'm a customer, I'm not going to pre-fund a project with a small, unestablished company if everyone else is coalescing around the main operators,"* Norbert pointed out. *"I'm only going to commit to purchase data from the group that everyone else is purchasing from."*

Once a multi-client survey is completed by a company such as TGS-Nopec, the seismic company retains ownership of the survey data and can continue selling it to new customers at little incremental expense for years into the future. This is crucial, because the company that completes a given multi-client project automatically becomes the low-cost source of seismic data in that particular area. No E&P company would pay to redo a survey when it could simply license existing data for one-tenth the price. This also gives the holder of the seismic data the pricing power associated with a local monopoly. *"Companies might gripe about whether the price of multi-client data should be cheaper, but there's not a lot of haggling,"* Norbert said. As icing on the cake, the know-how a company acquires from conducting a multi-client survey in one area makes it inherently more likely to be chosen to coordinate future surveys in adjacent areas, reinforcing the company's competitive position over time.

What makes TGS-Nopec unique in the industry is its almost singular focus on multi-client surveys, as well as its asset-light business model. *"If you go back and read the annual report from 1998, the CEO of TGS-Nopec talks about how they're going to do it differently,"* Norbert said. *"Over the last decade, that's what they've done."* The company's unique focus has produced operating margins of 40 percent and pretax returns on capital in excess of 60 percent over the last decade—both are the highest in the industry by far. *"There are certain parallels with NVR,"* Norbert said. *"Both companies have the discipline to stick to their model even though the rest of the industry does it differently."*

Another parallel with NVR is that TGS-Nopec's high returns also come with the "right to reinvest." Offshore E&P companies must constantly work to replenish depleting reserves by finding new locations to drill. In addition, advances in drilling technology regularly make previously uneconomic offshore areas viable to explore. Finally, the world continues to demand more oil while traditional onshore sources of supply from places like Saudi Arabia are dwindling. As a result, new supply will likely come from offshore—especially deepwater—sources like Brazil, the west coast of Africa, and new discoveries in the Gulf of Mexico. All of this means that demand for multi-client surveys should continue to grow, allowing TGS-Nopec to reinvest in new projects while also continuing its recent practice of paying periodic special dividends and buying back shares. *"Ideally you want them to keep investing in projects, but it's nice to see them weighing that against returning excess capital to shareholders,"* Norbert said.

Norbert watched TGS-Nopec for seven years without buying any shares. Then, in April 2010, the Deepwater Horizon offshore drilling rig leased by BP suffered a blowout in the Gulf of Mexico, releasing five millions barrels of oil into the water in three months. The U.S. government immediately imposed a moratorium on drilling in the Gulf, and both Congress and President Obama directed strident rhetoric against the oil and gas industry. TGS-Nopec, which derives roughly half its business from the Gulf, saw its stock price trade down to six times after-tax earnings. *"TGS-Nopec was priced as if the Gulf of Mexico would never re-open,"* Norbert said. *"And with the constant stream of negative headlines in newspapers every day, it was easy to see how investors could get scared away."*

Norbert determined that such fears were likely temporary. While TGS-Nopec's earnings from the Gulf would suffer from the moratorium, its seismic data library would retain its long-term value. Moreover, the safety record of the region over four decades was good, and Gulf drilling provided hundreds of thousands of jobs and also 25 percent of the U.S. supply of oil, making it politically unfeasible to permanently curtail exploration there. Punch Card began accumulating a position in June 2010. During the second half of the year, the stock appreciated 90 percent in U.S. dollar terms as the drilling moratorium was lifted, and it rose another 30 percent in the first half of 2011. The stock currently trades at roughly 11 times after-tax trailing earnings after adjusting for cash, and Norbert still likes it even at its higher price. *"The moratorium has been lifted, activity in the Gulf of Mexico has begun to normalize, and the fundamental advantages of the business are still there,"* Norbert said.

CONCLUSION

In the nearly two decades since he first picked up Peter Lynch's book, Norbert has found a remarkable number of multibaggers of his own. The number is even more remarkable considering that Norbert has made fewer investments in his entire life than many managers make in a year. His ability to find multibaggers and willingness to concentrate heavily on them have produced an excellent long-term record that began even before he started Punch Card Capital.

When he started the fund, Norbert committed to a fund structure and terms that would best allow him to continue to apply this approach, and he believes that they are working. *"I do feel like a lot of the positions I own, I wouldn't be able to own if I hadn't set up Punch Card the way it is,"* he recently said. Such a commitment, however, carries a price: Punch Card's concentration, infrequent reporting, and unusual lock-up repel many investors, and limit the fund's growth in assets. Norbert remembers one potential investor even telling him that the fund's reporting policy was *"the stupidest thing I've ever heard."* Although Norbert could manage a multiple of his current assets if he relaxed his terms, he won't compromise his potential returns to attract more capital.

Punch Card boasts a dedicated group of limited partners—including the principals of Gotham Asset Management, who have never redeemed from the fund—but Norbert would like to diversify his investor base. *"I would rather have twice the investors with the same amount of assets than twice the assets with half as many investors,"* he said. He most likely won't have to decide, as it is only a matter of time before the rest of the industry discovers what we have: that Punch Card's investors can look forward to even more punches in the years to come. ■

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