

# THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

## Long-Term Value-Oriented Investing



**CHRISTOPHER MITTLEMAN** is Managing Partner and Chief Investment Officer for Mittleman Brothers, LLC, and its subsidiaries. From 2002 until 2005, as Senior Vice President of Investments, he managed private client portfolios for Spencer Clarke LLC. From 1990 to 2002, Mr. Mittleman was an Investment Executive at UBS (PaineWebber). He began his career in 1990 at Shearson Lehman Hutton, after attending Phillips Exeter Academy and The Pennsylvania State University.

**TWST:** Please begin with a brief introduction to Mittleman Investment Management, including some of the highlights from your history and a bit about your role there.

**Mr. Mittleman:** Our firm, Mittleman Investment Management, is an SEC-registered investment adviser, and we manage global value equity portfolios for high net worth and institutional investors. I started the firm in December of 2005 with my brother, Phil Mittleman, who manages the day-to-day operations of our business. Phil had a successful background in venture capital, and saw an opportunity in creating the infrastructure necessary to formally market my investment strategy, something I'd never done before. Until now, my business has grown entirely organically, and from word of mouth. My other brother Dave, who is the third partner, joined us in September of 2006, and he leads our client relationship effort.

I started my career at Shearson Lehman Hutton in 1990 and moved over to what was then PaineWebber in September of 1990. I was an Investment Adviser with UBS PaineWebber until January of 2002, at which point I moved on to a small boutique called Spencer Clarke, where I managed assets on a discretionary basis for a variety of client accounts. The reason I bring up the history before our firm was established is because much of my client base, which consists primarily of high net worth individuals, has been with me from that time. So when I talk about the firm and our history, I'm really thinking more about the history my clients and I have that dates back to the earlier days of my career.

Some clients started with me in 1991, and we've been through a lot more than, say, someone who started with us just when our firm was established in 2005. So there is a lot of history there, and that's reflected in our client retention rate, which is extremely high.

As I mentioned, we've never actually marketed ourselves to anybody on a proactive basis and just a couple of months ago, hired our first Director of Marketing, Evan Newman, so that we can begin the process of institutionalizing our firm and grow the business by attracting both high net worth and institutional investors. My role has been pretty much the same over the last two decades. The client accounts that I managed during my tenure at UBS PaineWebber were those who willingly embraced this value-oriented discipline that I've been adhering to for the past 20 years. So there really hasn't been much change in my function, although it is now formalized into the role of Chief Investment Officer at MIM. So I've been managing money the same way I've always done it, which is to try and find great businesses trading at extreme discounts to my estimates of fair value and to limit risk in the process.

**TWST:** Would you tell us a bit more about your investment philosophy?

**Mr. Mittleman:** The investment discipline that we adhere to is not so original. It's a real value-oriented discipline. We look to pursue superior returns through long-term investments in what we deem to be severely undervalued securities, while maintaining our focus on mitigating risk. I think what differentiates the way that we

approach value investing is the degree of selectivity that we employ, as well as our degree of discipline. A lot of money managers may consider themselves to be value investors, and then you see a number of stocks in their portfolios that don't seem to be undervalued at all, stocks trading at multiples that seem hard to justify as a value investment. Perhaps that comes from a lack of discipline, maybe a lack of selectivity. And I think that's why when you look at the way we do it, we stick to the traditions of the true value orientation, which is to really only swing the bat when it's a very, very cheap situation, where we're usually getting something at half or less of what we appraise it to be worth. That's why we limit ourselves to 10 to 20 names, and we adhere to such a concentrated approach. We keep ourselves focused on the best investment opportunities that we can find.

There's a quote that I remember in *Barron's* magazine from the early 1990s, where they were interviewing Joe Rosenberg, a very well-known value investor who managed money for the Tisch family, and they asked him what his secret was to generating outstanding investment returns. And Joe said, "Have opinions at extremes, and wait for extreme moments." I really thought that boiled it down to the essence, which is that we should try to focus on those kinds of situations where you know it's a good company, you know that the Street is overreacting to some short-term indicator and you've identified an extreme moment. When you can wait for those moments and actually take advantage of them, by maintaining patience and selectivity, then you can generate superior results. And we think that we've proven that out.

*"Using screens has not been something that I felt was necessary, and I think it's been to our advantage that we haven't restricted our universe to something that is produced from a computer."*

**TWST: Obviously, in the current economy there are a lot of undervalued stocks?**

**Mr. Mittleman:** Less so than a year ago, but yes.

**TWST: You have relatively few holdings. Would you actually walk us through your stock selection process?**

**Mr. Mittleman:** We don't use computer screens or digital filters as part of our investment process. I have never used them, because I found that if I would restrict myself to a quantitative screen, I would have missed many of the best names I'd ever been involved with in my career. Because at that moment in time, they might not have had the trailing 12 months free cash flow that they had over the previous five to 10 years.

Over that time period, their valuation may not have been as low against EBITDA as it would normally be if it wasn't for one bad year. So using screens has not been something that I felt was necessary, and I think it's been to our advantage that we haven't restricted our universe to something that is produced from a computer.

The question then becomes where do we find our investment ideas? There's no one answer to that. It comes down to reading, a lot of reading, be it SEC filings, conference-call transcripts, Street research and a variety of industry publications.

Our network of professional contacts also serves as a good source for new ideas, and clients even have contributed some of the better names that we've come out with. So when people ask where we get these ideas, I don't have one answer because they come from all different places. Some ideas literally just come from reading magazines like *Barron's* or *Forbes* or *The Economist*. I've got a few that came out that way.

Ideas have also come to us from investments that we've made in other entities. For example, one of the stocks we own now is a company called **Thaicom** (BAK:THCOM). **Thaicom** only trades in Bangkok, in Thailand. I think we're probably one of the only U.S. investors that have a stake in the company. We would never have known of **Thaicom** either, except

that we had made a successful investment in **Loral Space & Communications, Inc.** (LORL), a number of years ago. And it was during our due diligence process on **Loral** that I became aware of **Thaicom**. **Loral** has a division that manufactures satellites, and one of the biggest orders they had at that time was

### Highlights

*Christopher Mittleman discusses his firm's history and investment philosophy. He shares insights on holdings that he believes are representative of his investment approach, which includes long-term investments in undervalued securities, and his strategy for mitigating risk. He prides himself on avoiding computer-generated investment ideas and rather, relies on his own reading and research. Mr. Mittleman outlines his strategy for investing incrementally and the circumstances under which he would sell a stock.*

*Companies include: Thaicom plc (BAK:THCOM); Loral Space & Communications, Inc. (LORL); Grupo Radio Centro (RC); Carmike Cinemas (CKEC); Pfizer (PFE); Tyco International (TYC); Altria Group (MO); Tele Centro Oeste (TRO) and Vivo Participacoes S.A. (VIV).*

for a very large satellite called IPSTAR, which was ordered by **Thaicom**. So I was curious to see what this company was and why they were buying this state-of-the-art satellite. And when I researched it further, I found a very nice franchise with a few satellites floating in geosynchronous orbits in a very prime location over Asia. And so we made this investment in **Thaicom** with an idea that this company had a lot of room to grow. The market for satellite TV services in Asia is growing very quickly. There's still a lot of excess capacity as a lot of people recognized the opportunity and put satellites up there, but that capacity is being used up. And as utilization rates rise, the free cash flow margins on these businesses get huge. You've seen it with some

of the more mature companies in the satellite services industry, like **SES Global** or **Intelsat** or **Inmarsat**. They have EBITDA margins of almost 80% and free cash flow margins of 50%. Those are the kind of margins that we expect **Thaicom** will attain at some point in the future, but they're still relatively underutilized. So when we talk about where ideas come from, that was one way that an idea came about through our due diligence on another investment. And that happens quite a bit actually.

*"We want to know how much cash is coming back to investors, how predictable that cash flow is going to be and how would I value that relative to the risk-free rate of return. So we're trying to look at a business as you would look at a bond or as a private equity investor might look at a private entity."*

**TWST: What is another example of a holding that demonstrates your approach?**

**Mr. Mittleman:** **Thaicom** is a good example of our willingness to invest globally. When I started out in the business working at Shearson Lehman Hutton, I was in the international sales division. So I was exposed to a lot of international research, and I had a natural interest in looking at things from a global perspective. So ever since the very beginning, I've been investing in stocks across the globe. In Mexico after the peso crisis in 1994, I bought stock in a company called **Grupo Radio Centro (RC)** at a very low price back then and made a lot of money for clients on that. I also bought **Telebras**, which was the Brazilian telephone monopoly back in 1995, when that stock had dropped significantly, and did very well with that.

On the domestic side of the portfolio, which in aggregate represents about 70% of client portfolios on average, an interesting name to talk about would be one of our smaller current positions, which is **Carmike Cinemas (CKEC)**. **Carmike** is the fourth largest movie theater operator in the United States. They can't get the same types of efficiencies and are less profitable than the larger companies in the industry, like **Regal (RGC)** or **Cinemark (CNK)**, because they focus on rural communities. But **Carmike** has a good business because they tend to be the only theater in the smaller towns that they operate in, which provides a nice moat around the business, as Warren Buffett would say. When you operate the only theater within 20 miles, you're not really worried about what's going on across the street, because you're not going to get into a price war. So their business does have a certain amount of defensibility to it. My history of researching **Carmike** dates back to when **Carmike** went into bankruptcy in 2000 or 2001, and I bought their bonds in bankruptcy, I think, in the mid-\$20s and sold them in the \$70s. We ended up buying the stock between 2007 and early 2010. We sold about three-quarters of our holding in **Carmike** in the beginning of last year, between \$12 and \$19; now it's back down to around \$7. But our estimate of fair value is around \$17, and the reason we remain invested in it is because the company generates a very steady and fairly

predictable stream of free cash flow. We want to know how much cash is coming back to investors, how predictable that cash flow is going to be and how would I value that relative to the risk-free rate of return. So we're trying to look at a business as you would look at a bond or as a private equity investor might look at a private entity. **Carmike** is not a very fast-growing company, it's really barely growing at all. But it does generate a very strong stream of free cash flow every year, and

we can feel comfortable that we're going to get around \$20 million, maybe more in free cash flow every year out of this business. And at a reasonable multiple, which I would say is about a 10 times multiple of that, you've got a stock that should be trading around \$15 a share.

**1-Year Daily Chart of Carmike Cinemas**



Chart provided by [www.BigCharts.com](http://www.BigCharts.com)

**Carmike** also did something kind of unique recently. They were able to monetize the relationship they have with a company called **Screenvision**. For many years, **Carmike** and **Screenvision** worked together to provide advertising that you see at the beginning of a movie, that you're essentially forced to sit through for at least a few minutes. They had not previously formalized an arrangement with **Screenvision** in terms of how they would be compensated for allowing **Screenvision** to do this in their theaters beyond just the revenue share that they received. So what **Carmike** did was negotiate a deal and signed a long-term contract with **Screenvision**, and it's just closed at the end of last year. They received a \$30 million cash payment, which is a lot for them. That's basically more than \$2 per share. And they were able to obtain a 20% equity stake in **Screenvision**, and I estimate that's probably worth another \$2 to \$4 a share. So that's a lot of equity that was created by that deal, especially relative to a stock price that's only in the \$7 range right now.

So the way I look at **Carmike** is that if you look at the value of the business alone, you value it at seven times EBITDA. EBITDA should be around \$75 million in 2011 and free cash flow should be around \$20 million. So seven times EBITDA and 10 times free cash flow gets to a \$15 stock price, and if you add, say, \$2 a share for **Screenvision**, there's \$17. And that's against a stock that's currently trading at \$7.30. We don't know if it's going to be a good year or a bad year in the movie business, but we do know that over time the industry rarely experiences fluctuations of more than 5% in any given year. So maybe it'll be a 5% drop; that's not going to be the end of the world. If that happens year after year, that becomes a problem, but the box office receipts despite all of the new at home technologies that have come into play over the last 30 years have been growing. I'm not saying that the movie theater business is going to grow like Google. I'm just saying that if it just grows a tiny bit or stays even close to where it is right now, we should be able to make a good deal of money from **Carmike** at these levels.

*"We're not attracted to small stocks just because they're small — we're completely agnostic about capitalization. We'll go wherever we can find the best value."*

1-Year Daily Chart of Pfizer

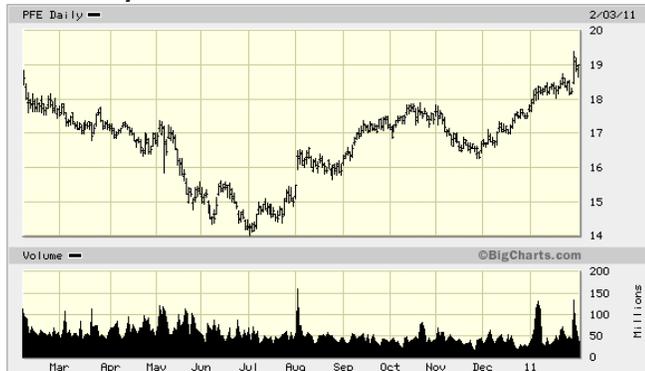


Chart provided by [www.BigCharts.com](http://www.BigCharts.com)

So we are often perceived to be a small-cap manager, because we do tend to skew towards the small-cap arena, and that's where we've found some of the best value. So naturally that's where we end up going, but we have a lot of experience and history with larger capitalization stocks. It's just that those names don't often fall into our valuation range, but it does happen. **Pfizer** (PFE) is an example of a mega-cap stock that I watched for 20 years. It never got cheap enough for me over that time to buy it, but it did recently. In July and August of last year, we bought a stake in **Pfizer** between \$14-\$15, and the stock carried about a 5% dividend yield at that price. The stock has gone up a bit and is trading around \$18.50 now, but our estimate of fair value is \$24. So **Pfizer** is an example of a company that, despite being a mega-cap stock, was trading at a multiple that was so

below what we thought it was worth that we felt compelled to take a position. If it's big it doesn't matter. We're not attracted to small stocks just because they're small — we're completely agnostic about capitalization. We'll go wherever we can find the best value.

I did this also back in 2002 when **Tyco** (TYC) was coming apart. Before **Tyco** split apart into different pieces, it was one company. It had been built up over the years. I had watched it while it was being built up, and I came to admire the kind of companies they were acquiring as they were buying good businesses, businesses that I liked, businesses that I sometimes wished I had bought before they bought it. These businesses were clearly real, sustainable, good franchises. **Tyco** really did a good job of growing the company. It's unfortunate that the CEO and CFO turned out to be thieves, but the point is that when it came apart, it fell from \$70. I think we started buying it at \$15, in the summer of 2002, and *The New York Times* was saying the company was going to go bankrupt. The

compliance officer of the firm I was with at the time was asking if I was insane. I knew those businesses and I knew they were real businesses, and it didn't matter how much money was being stolen from the CEO's suite because it hadn't changed the cash-generating characteristics of these businesses. So we bought it at \$15, and two weeks later, we were buying more of it at \$7. It literally just went straight down. But then two years later, we were selling it between \$25 and \$35, somewhere in that range. That's an example of a large-cap name.

Also, **Altria Group** (MO), which was then known as Philip Morris Companies back in 1999 — when **Philip Morris** was under severe pressure from Bill Clinton and Janet Reno, they were arguing at that time that **Philip Morris** should be made to pay for the health care calamity that they've caused the United States for the past 30 years. And it was like hundreds of billions of dollars of liabilities being discussed, and people were starting to prepare for the prospect of a government-caused bankruptcy. I bought that stock beginning in the low \$40s in 1999. It had been down from the upper-\$60s, and I ended up averaging down as low as \$19 in 1999. This was during the dot-com craze and what was going in the other direction. A very large name and what we actually said at that time was that if you could believe that the corporate veil would separate the liabilities of **Philip Morris USA** from the other companies owned by the **Phillip Morris** holding company, which we believed was the case — the other companies being **Philip Morris International** and **Kraft Foods** (KFT) and **Miller Brewing** at the time — then you could cordon off that potential liability and the value of the other three businesses alone would be \$50 a share against, at that point, the low of \$18, \$19 stock price with 10% dividend yield. I wrote a

letter to my clients in October 1999 when the stock was \$25, outlining my argument for a break-up value of \$65, and we eventually got more than that over the ensuing years. So it's something that we don't often get credit for, because it doesn't happen that often where we see a big-cap stock get really, really cheap. When it does happen, we're pretty good about taking advantage if we can see it. And we don't always see it. Sometimes the situation is a little bit too opaque. For example, **British Petroleum (BP)**, when it was down recently, some value investors were talking about it, but I just couldn't — I didn't feel confident that I could really figure out what the liabilities might be. So we missed that one. We don't always get it right.

**TWST: What triggers you to sell a stock?**

**Mr. Mittleman:** Well, we generally sell under three circumstances. If stock rises to a price that is approaching or hopefully exceeding our estimate of fair value, we will sell, but we won't reflexively sell it because a lot of times what happens is that I may think the stock is worth a particular price, but it may continue to advance much higher than my fair value estimate. And that often occurs because my estimates tend to be on the conservative side.

*"I didn't go into Thailand for the sake of being in Thailand. I didn't go to Germany for the sake of being in Germany. That's where we just happened to find some of the better businesses trading at really cheap valuations. So there is no top-down focus on being in or out of a certain country or region of the world."*

So what I found through experience is that I should be somewhat slow to sell in a situation driven solely by a rising stock price, because there will generally be a good deal of positive momentum occurring in the stock. I know it sounds strange that a value investor is talking about momentum and things of that nature, but when you are value-oriented you tend to be buying stocks when they are on the decline. And there is a certain amount of negative momentum with that, and it usually behooves you to buy them slowly because you often begin buying the stock at a price that may be higher than the level it may ultimately bottom at, so we do invest incrementally. When we sell stocks that have been great successes, it's usually the opposite that occurs. And it's typically prudent to sell the stock slowly.

That being said, we will sell something more precipitously if we think the price has moved into really untenable levels. We are not shy about selling out of positions when I see an extreme in the opposite direction or if the fundamentals appear to be deteriorating.

Clearly, any meaningful deterioration in the fundamentals would be a trigger for us to sell. Sometimes this occurs before we have made profit in the stock, so we will exit the position at a loss. So even though we tend to hold stocks for some time — our average holding period is around two-and-a-half to three years — we make sure that we don't fall in love with individual stocks. We try to hold stocks as long we can, simply because we've found that by holding we usually get better returns rather than trying to

jump in and out of things. But if something does seem to be deteriorating, then we will try to sell it as quickly as we can. The other reason for selling a stock would be if there was a better opportunity that came around, if we identify something that by our estimates has 100% upside and everything else in the portfolio may only have 50% upside, we must then sell something from the portfolio in order to make room for the better opportunity. So those are the three reasons for selling — hitting or exceeding our price target, deterioration of fundamentals or if a better opportunity emerges.

**TWST: There is a lot of focus these days on the emerging markets. You mentioned your keen interest in investing internationally, but your holdings are primarily in the U.S. with a few select holdings in the U.K., Thailand, Germany and Japan. Would you tell us a little bit about how you have come upon that geographic distribution?**

**Mr. Mittleman:** There is nothing deliberate about the selection of countries. That's more of just a symptom of where we found good companies whose stocks were trading at irrationally cheap levels. If you had looked at my client portfolios a few years ago, we were invested in Brazil when the country was on its

heels. It was 2002, they were going through an election where the newly elected president was perceived to be a little bit too communistic, and a lot of people thought Brazil was going to go against a lot of the capitalistic reforms that they had embraced in the years prior. So we bought into that downdraft and we made a great deal of money buying stocks right. Well, again **Telebras** had now split up into pieces. I had bought **Telebras** in 1995, but by 2002 **Telebras** had split into 12 different companies, and we invested in the company called **Tele Centro Oeste (TRO)**, which was one of the larger cell phone companies in Brazil. And it traded under the symbol **TRO** at that time, and I think we made five times our money on that stock, as it was bought out by a larger Brazilian cell phone company called **Vivo (VIV)**.

And so when you look at the breakdown of stocks in terms of geographic distribution, there is nothing deliberate about that. I didn't go into Thailand for the sake of being in Thailand. I didn't go to Germany for the sake of being in Germany. That's where we just happened to find some of the better businesses trading at really cheap valuations. So there is no top-down focus on being in or out of a certain country or region of the world. What we are trying to do is just find good companies trading at very low prices and take advantage of the opportunity that we have identified. Obviously we are not going to buy into a foreign stock that we perceive to carry significant risk. We do need to consider currency risk, the political climate, there are considerations to be made when you are venturing overseas, and

that is something that we do. But if the valuation is cheap enough, if the business is good enough, then obviously there is a risk/reward calculation, which encompasses the political risk and all those other risks that come from investing overseas.

**TWST: Would you briefly review your 2010 performance for us?**

**Mr. Mittleman:** Preliminarily, our client composite was up 65% after fees in 2010, versus the S&P 500, which was up 15%. So a roughly 65% return for 2010 is obviously a great year, but we think there's still a lot of upside potential left in the portfolio. I'm sure it's no surprise that 2008 was the most challenging year our firm has ever experienced, but it was also one of the most validating. Client account values dropped significantly, nearly 63% in 2008, a year in which the overall stock market suffered its worst loss since the Great Depression. Although it was an extremely unpleasant period of time to endure, we retained 94% of our clients. The experience proved to be the ultimate stress test of our portfolio, which strongly rebounded in the following years by rising 145% in 2009 and about 65% last year. So from Dec. 31, 2007 through Dec. 31, 2010, our composite generated a compounded annual growth rate of 14.6% versus -2.9% for the S&P 500. I believe that our client loyalty and strong performance through varying market cycles underscores our ability to weather storms both for our firm and our clients.

*We intentionally do not invest in the stock market as a whole; we choose a select group of stocks. We focus our time on identifying and investing in the best undervalued companies that we can find, and if it is a good company, it should be able to ride out that storm better than most.*

**TWST: Do you anticipate more upside in 2011 balanced by some leveling off?**

**Mr. Mittleman:** I never really have a strong outlook for what is going to happen in the coming year. I have never felt that you can really predict with any useful degree of precision what's going to happen from one year to the next in terms of generalized market moves. So rather than waste any mental energy doing so, we just make sure that we are positioned properly so that no matter what happens, our clients are in good shape.

Now I know that might sound strange after what we experienced in 2008, you might think, well, wouldn't you want to make sure that you are raising cash the moment you think it's the right thing to do and try to be more proactive in that regard? But I don't think that's the lesson of that time, I really don't. In 1999 when the markets seemed incredibly overvalued in terms of what the averages were at, I was very bearish. I was as bearish as you could be and very vocal about it in all my writings that I sent out, and on every phone call. And I was fully invested at that time, but fully invested in stocks that I believed to be severely undervalued, names like I've mentioned, like **Philip Morris** and a few other stocks that were unpopular with many people in the investment community. I was actually able to generate a decent return for my

clients over that three-year period, the first bear market of this century. I think the market was down some 38% over those three years, and the clients that were with me back then — again, this is before Mittleman Investment Management existed — those clients were up around 25% cumulatively for those three years. So I don't see much value in guessing what the overall market might do from one year to the next.

We intentionally do not invest in the stock market as a whole; we choose a select group of stocks. We focus our time on identifying and investing in the best undervalued companies that we can find, and if it is a good company, it should be able to ride out that storm better than most. And we saw that even recently. Even though we endured this horrible volatility in 2008, when you look at the businesses and how they performed and you actually look at the cash flows, most of those businesses didn't miss a beat. They didn't shrink, and most of them actually grew straight through that recession, which is pretty impressive when you look at the earnings hit that occurred in the S&P 500. And I think that performance was reflected in the extreme snapback we experienced in 2009 of over 145%. So I think when people ask me what I expect for this year, I never really have a strong sense of what's going to happen. And that's not false modesty, I really have no clue. But I do know that if we continue to focus on these kinds of situations, we should be able to generate a good return for our clients and hopefully do

something comparable with what we have done over the past. Our composite starts December 31, 2002, as the results for the three-year period predating the formation of the firm are portable according to GIPS standards. So over the past eight years ending 2010, we have compounded our clients' assets at a rate of 21.5% a year net of fees, versus the S&P 500's return of 6.7%. So if we could continue that trend over the next 10 years I would be very happy.

**TWST: How would you describe the investor who is the ideal match for Mittleman Investment Management?**

**Mr. Mittleman:** That's a very good question and is something I really would want to stress as we go out and actually start marketing ourselves for the first time. I really want to have like-minded investors. Our clients must be long-term oriented. Our strategy is not for investors who want to be involved with a heavy turnover-type portfolio. We want investors who would look at us like we look at the guys who I grew up admiring. When I was starting out, I looked to the most successful value investors that I could find, guys like Warren Buffet, Richard Rainwater, Tweedy Browne, even some of the private equity guys. When you look at how they actually do business, they are very long-term oriented. And so we are looking to attract those types of investors,

and I think anyone else really wouldn't be suitable. A prospective investor who is going to be very nervous and short-term oriented is not going to be happy in this kind of strategy. We need the benefit of time for our investment thesis on the portfolio to play out. Whether that's three years or five years, it cannot be measured in days, weeks or months. So I am really hopeful that by telling our story the way that we have and talking about the discipline that we adhere to, we'll be able to attract investors who have a similar sensibility.

**TWST: Thank you. (MES)**

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