
CONTRARIAN RESEARCH REPORT

COMPENDIUM

July 2011

Featured Companies

Iridium Communications, Inc. (IRDM)
W.P. Carey & Co. (WPC)
Overseas Shipholding Group, Inc. (OSG)
MannKind Corp. (MNKD)



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The Contrarian Research Report*

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Murray's Musings

FACTORS AFFECTING LONG-TERM EQUITY INVESTING RETURNS

This section highlights four factors that should be taken into account when projecting the long-term return of equities in the United States. The first factor is one that probably cannot be replicated in the future, which is the decline in corporate tax rates subsequent to the Second World War.

The U.S. corporate tax rates at various points in time since 1950 are included in the table below. In 1950, the corporate tax rate was 42%; in 1951 it was 51%; and in 1952 it was 52%. It declined slightly during the ensuing 15 years but, in 1968, it rose again to 52.8%. It was still as high as 46% in 1979, but then it declined to 35% in 1993 where it has remained. Viewed in the light of history, if history is defined as the period subsequent to the Second World War, the current corporate tax rate of 35% is an unusually low.

U.S. Corp. Tax Rates¹

1950	42.0%
1951	51.0
1952	52.0
1964	50.0
1965	48.0
1968	52.8
1970	49.2
1971	48.0
1979	46.0
1987	40.0
1988	34.0
1993	35.0%

The second factor, which is fairly obvious, is the decline in interest rates since 1981. Given how low interest rates are right now, it's hard to imagine how that environment could be replicated. Lower interest rates affect corporate profitability, in that the borrowing costs are lower.

The third factor is related to interest rates and their effect on stock price multiples, even for those companies that are unleveraged, and thus have no interest expense. Clearly, the decline in interest rates subsequent to 1981 has caused P/Es to expand.

¹ Source: <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=65>
See also: <http://www.irs.gov/pub/irs-soi/histabb.xls>

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The fourth and most important factor is the enormous increase in government spending since 1933. I choose 1933 as a starting point because that was when aggressive government actions to aid the economy began. The figures quoted here are all in nominal dollars, not adjusted for inflation, which is important, because stock prices and corporate profits are nominal and not adjusted for inflation. Therefore, in order to understand them in relation to government spending, it's important to use nominal terms.

In 1933, the U.S. Federal Government spent \$4.5 billion, while the estimated spending figure for fiscal 2011 is \$3.8 trillion.² The compound annual rate of growth in government spending for the period from 1933 to 2011 is 9%. These figures do not include state and local expenditures.

Clearly, nominal GDP is not going to grow at 9% per year, and certainly real GDP does not grow at 9% per year. Therefore, it mathematically follows that if the U.S. Federal Government insisted upon growing its rate of expenditure at a 9% annual rate, in the fullness of time, it would inevitably embrace every dollar of GDP produced in the U.S.

Obviously, there must be a limit to government spending. That limit might be the unwillingness of the taxpayers to allow it, or the unwillingness of the bond market to finance it. Whatever the reason, there is a limit beyond which the growth rate of government expenditures will not be allowed. It cannot be sustained. Since that spending, whether through direct expenditures by the government transacting with companies or indirect spending through transfer payments made to individuals who in turn inject that money into the economic system by purchasing goods and services, this growth in government spending has had a positive effect on corporate profits. But, it is simply not sustainable.

The current forecast for the U.S. budget in 2012 is \$3.7 trillion, which would be a decline from the \$3.8 trillion projected for 2011. If the 2012 forecast is accurate, it would be the first decline in Federal spending, albeit small, in many years. However, it's not merely a decline in spending, it's an interruption of the rate of expansion, which cannot but have some impact upon corporate profits. The question is, to what degree?

² Source: <http://www.gpoaccess.gov/usbudget/fy11/hist.html> (Table 1.1).

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Industry Thoughts

INDUSTRY & SECTORAL CLASSIFICATION

How we define industries is important. Readers may recall that in prior editions of this publication, the author has taken the liberty of creating certain industries that are outside the realm of formally accepted industry codes. In fact, it's less of a liberty than might be realized, since there are a variety of industry classification systems, and they have major implications for investing, as will be seen presently.

The most popular system still in use in the U.S. is the Security Industry Classification Code, or SIC Code. It is the most popular system, because the codes are employed by the Securities and Exchange Commission. In the table below, I've selected a subset of the SIC Codes as a way of illustrating problems that can arise from the way they are defined. The selected code numbers range from 7200 to 8700 and fall into the category of Services. The table includes only some of the service categories; there are many more that are not listed here.

Security Industry Classification Code (SIC Code)

<u>Code</u>	<u>Industry Title</u>	<u>Code</u>	<u>Industry Title</u>
7200	Services–Personal Services	7370	Services–Data Processing
7310	Services–Advertising	7372	Services–Prepackaged Software
7311	Services–Advertising Agencies	7385	Services–Telephone Interconnect Systems
7320	Services–Consumer Credit Reporting, Collection Agencies	7500	Services–Automotive Repair
7330	Services–Mailing, Reproduction	7812	Services–Motion Picture Production
7331	Services–Direct Mail	7900	Services–Amusement & Recreation
7334	Services–Photocopying	8000	Services–Health
7340	Services–Dwellings	8060	Services–Hospitals
7350	Services–Equipment Rental & Leasing	8071	Services–Medical Laboratories
7361	Services–Employment Agencies	8700	Services–Engineering

Let's examine some of the categories. Code number 7340: Dwellings. A dwelling is really a subset of real estate, which is generally placed in the financial sector, since real estate is usually financed with debt. However, once a dwelling is purchased, as any homeowner knows, it needs frequent repair and maintenance. From an SIC Code standpoint, those expenditures, whatever the amount, fall into the Services category. So, there's an element of real estate that takes place in the Services category.

In the U.S., where the number of dwellings is large, there is a commensurately large amount of money expended for their maintenance, and it is a very important part of the economy. It's clearly real estate-related, but it is placed in the Service sector, not in the

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Real Estate sector. The fact that some major portion of real estate expenditures actually take place in the Services category appears to be unobserved by index investors. It's even more to the point that certain large retail expenditures, like appliances, carpeting, lamps and so forth, take place in the Retailing sector, but are categorized in the Service sector.

Similarly, data processing is normally in the Capital Goods and Technology sector, but if one buys outsourcing services for one's data processing needs, one is buying a service. Therefore, it is categorized in the Services sector, which is part of the Consumer sector, even though it might be a business expenditure.

A comparable situation exists for the purchase of prepackaged software. It might be argued that if a given individual were to buy prepackaged software from Microsoft for a home computer, for example, most would agree that it should clearly be classified as a consumer expenditure. What if, however, a company were to buy Microsoft Office for business purposes? What if a business buys many thousands of copies of the software? How does one distinguish between a business expenditure and a consumer expenditure? Should a distinction even be made between them? Clearly, some part of Capital Goods and Technology would be happening in the Consumer sector.

For the telephone/internet industry, it's obvious that the telecommunications business is in the Utilities sector and, historically, the equipment was provided by the utility. In the modern era, however, the equipment has to be purchased by the customer. Therefore, those purchases are classified as consumer expenditures, even though they are plainly related to telecommunications regulation. If telecommunications regulation were oriented in a different manner, one might need different communications equipment.

Automotive repair is in the Consumer sector. In the health category, if one is prescribed a given medication, that expenditure is traced back to a pharmaceutical company and is clearly in the health sector. If one is hospitalized, however, and is administered that medication in the hospital, then the hospital is viewed as providing a service in the form of treating a patient, and it is classified as a consumer expenditure found in the Services sector, SIC code number 8060. That's a problem.

Recognizing this and other classification problems, the U.S. Office of Management and Budget, in cooperation with Statistics Canada and the Mexican National Statistics Institute, developed its own classification system called the North American Industry Classification System, or NAICS. This system differs significantly from the SIC code, but it's not without its own difficulties.

Under the NAICS system, Information, which would include data processing, is its own segment. Retail Trade is its own segment. This system does not solve the problem of how to classify prepackaged software. Is the company that makes the software getting credit for it? Is it accounted in the Information sector? Or, is it accounted in the Retail sector,

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because software can be purchased at the retail level, even if online? Or, is it counted twice?

North American Industry Classification System (NAICS)

<u>Code</u>	<u>Industry Title</u>	<u>Code</u>	<u>Industry Title</u>
11	Agriculture, Forestry, Fishing and Hunting	53	Real Estate, Rental & Leasing
21	Mining	54	Professional, Scientific & Technical Services
22	Utilities	55	Management of Companies & Enterprises
23	Construction	56	Waste Management & Remediation
31-33	Manufacturing	61	Education
42	Wholesale Trade	62	Health Care & Social Assistance
44-45	Retail Trade	71	Arts, Entertainment & Recreation
48-49	Transportation & Warehousing	72	Accommodation & Food Services
51	Information	81	Other, except Public Administration
52	Finance & Insurance	92	Public Administration

In the NAICS system, Finance & Insurance is a separate and distinct industry from Real Estate, Rental & Leasing, which would include corporate leasing. In the SIC code system, Finance and Real Estate are essentially one category. This classification issue is very important, because the industry subsets are used by global macro investors as a way of implementing their views on the economy. Some areas of the economy might be strong, others might be weak, and ETFs are typically used to express one's views of the economy.

When one uses the word "economy," one is generally referring to the gross domestic product ("GDP"), which is calculated on a final sales basis. If one were to buy a version of Microsoft Office in a computer store, it can only count once for GDP, even though it was produced by Microsoft. However, in the NAICS system, depending on how many stages of production there are, various types of revenue can be counted multiple times. NAICS doesn't correspond to the method of calculating GDP, because it takes into account the various stages of production, and GDP only takes into account the final sales.

The third system is the Global Industry Classification Standard, or GICS, which was designed by Standard & Poor's and MSCI. This system is designed to have fidelity to the traditional way of calculating the S&P by sector. However, there has been some displacement of certain sectors. Historically, Transportation and Capital Goods were their own sectors in the index but, in the GICS system, they both fall under the sector code number 20, which is the Industrials classification. In some other systems, the Commercial and Professional Services group falls under the Consumer classification, while in GICS it is included in the Industrials sector.

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Global Industry Classification Standard (GICS)

<u>Sector</u>	<u>Industry Group</u>
10 Energy	1010 Energy
15 Materials	1510 Materials
20 Industrials	2010 Capital Goods
	2020 Commercial & Professional Services
	2030 Transportation
25 Consumer Discretionary	2510 Automobile & Components
	2520 Consumer Durables & Apparel
	2530 Consumer Services
	2540 Media
	2550 Retailing
30 Consumer Discretionary	3010 Food Staples & Retailing
	3020 Food, Beverages & Tobacco
	3030 Household & Personal Products
35 Health Care	3510 Health Care Equipment & Services
	3520 Pharmaceuticals, Biotechnology & Life Sciences
40 Financials	4010 Banks
	4020 Diversified Financials
	4030 Insurance
	4040 Real Estate
45 Information Technology	4510 Software & Services
	4520 Technology Hardware & Equipment
	4530 Semiconductors & Semiconductor Equipment
50 Telecommunications Services	5010 Telecommunications Services
55 Utilities	5510 Utilities

There is a separate and distinct Information Technology sector (code number 45), which is an improvement on its historical classification in the Capital Goods group. Information Technology embraces Software and Services (4510), Technology and Hardware (4520), and Semiconductors and Equipment (4530).

One's views on the GDP can be expressed differently, depending on which sectoral classification system is used. In other words, very different investment decisions can be made to express the same economic viewpoint if executed using different classification systems. The economy is evolving faster than the classification systems.

Ultimately, the world will standardize on one system, which will provide more accurate information about the flow of funds into the various sectors that ultimately have some degree of impact upon stock prices. Something as simple as a classification system can have the unintended consequences of leading to changes in sectoral valuation, even though it wasn't designed to do so.

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EDUCATION SERVICES

Education Services is poorly defined by the three sectoral classification systems described above. It's not easily embraced by any of them. Nevertheless, every investment practitioner knows that there are publicly traded companies offering degree programs, and it's not a small industry. More than any other sector, the Education Services companies are clear beneficiaries of government spending, either through direct subsidies to students or through very liberal government student lending programs. In recent months, however, the Federal Government has begun to rethink its posture on liberal lending with regard to attendance at these various schools.

<u>Education Services Companies</u>	<u>P/E 2011</u>
Apollo Group, Inc. (APOL)	8.9x
DeVry Inc. (DV)	12.4x
Career Education Corp. (CECO)	7.5x
Corinthian Colleges, Inc. (COCO)	4.5x
Strayer Education, Inc. (STRA)	14.2x
Bridgepoint Education, Inc. (BPI)	9.2x
ITT Educational Services, Inc. (ESI)	7.6x

*Source: Bloomberg
Data as of 6/24/11*

The table above includes the 2011 consensus estimates, which might have less uncertainty attached to them than the 2012 estimates, because 2011 is half completed at this point. As for the 2012 estimates, they are grossly uncertain, since the U.S. Government plans to reduce its emphasis in this area in ways that are imponderable at the moment.

The average P/E of an education services company is less than 10 times; however, they are all meaningless, since no one can postulate what the earnings might be in 2012 and 2013. If one were using P/Es to determine the attractiveness of certain sectors, clearly the Education Services industry would appear very attractive on a valuation basis, except that the P/Es are based on estimates that are very difficult, if not impossible, to calculate accurately.

In the fullness of time, these prices may represent what, in retrospect, looks like very expensive valuations. It's simply impossible to know. What we do know is that the government's expenditure policy has a major impact on this segment. Government spending is probably the most important of all macroeconomic factors; yet, no classification system exists that allows one to distinguish which companies are the beneficiaries of it.

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Facts & Figures

MEGA INSTITUTIONS

The table below lists the largest companies in the world, measured in total assets; not market capitalization or revenue, but merely the total assets on the companies' balance sheets. If I were to ask you which company is the largest in the world measured in total balance sheet assets, what would your answer be? Would you guess Sony? Exxon? The answer may surprise you. Believe it or not, it is Fannie Mae with \$3.2 trillion of assets on its balance sheet. There is no company in the world with more assets. In fact, the Fannie Mae balance sheet assets exceed those of the U.S. Federal Reserve Bank, which are \$2.467 trillion. The second largest is BNP Paribas with \$2.7 trillion of assets. Number eight is Freddie Mac, with \$2.3 trillion of assets.

Largest Companies in the World Measured in Total Assets

		<i>(USD in trillions)</i>
1	Fannie Mae	\$3.2
2	BNP Paribas	2.7
3	Deutsche Bank	2.6
4	HSBC	2.5
5	Barclays	2.3
6	Royal Bank of Scotland	2.3
7	Bank of America	2.3
8	Freddie Mac	2.3
9	Mitsubishi	2.2
10	Crédit Agricole	<u>\$2.1</u>
	Total	\$24.5

These observations are very important, because there now exist companies with balance sheets so large that, were they to expand at the historical rate of roughly 10%, the increase in financial activity might actually be equivalent to the GDP growth of certain countries. For example, the GDP of the U.S. is \$14 trillion. If the U.S. were to grow its GDP by 2%, it would involve \$280 billion of financial activity. If Fannie Mae were to grow its balance sheet by 10%, it would involve \$320 billion of financial activity, and that's merely Fannie Mae.

The expansion and contraction of the mega balance sheet companies in the world is clearly of vital significance in the formulation of one's macroeconomic view. It's obvious that the balance sheet assets of these mega institutions have not grown in the last several years. The reason is nothing other than obvious. The governments of the world are very reluctant to allow them to grow, because of the degree to which their health is systemically crucial to the finances of the world. If they were to grow at the historical rate, and if that rate happens to be 10%, it takes very little imagination to see that in some number of years, the entire

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financial system of the world would be dependent on a relatively small number of mega-institutions.

Of course, if the regulators do not allow them to grow, there's not a readily available substitute. It's a major problem for which there is no obvious answer. Yet, there is no category for mega balance sheet companies in any of the industry codes, even though they are clearly a factor that could affect markets.

FAILURE RATE OF ORIGINAL S&P 500 FIRMS

The table below lists the companies from the original S&P 500 that failed during the period from the index's inception in 1957 to the end of 2003, where failed is defined as a company whose share price involved a 100% loss of the original investment.

Failed Firms from the Original S&P 500

Republic Pictures	Manhattan Shirt
Bethlehem Steel	Monarch Machine Tool
Addressograph Multigraph	Minneapolis Moline
American Shipbuilding	G.C. Murphy
Colorado Fuel & Iron	National Steel
Cornell-Dubilier	New York, New Haven & Hartford RR
Eagle Picher	Pan American World Airways
Eastern Airlines	Republic Steel
Goebel Brewing	Sunbeam
W.T. Grant	Artloom Carpet
Guantanamo Sugar	U.S. Hoffman Machinery
Holly Sugar	Lionel
International Shoe	United States Smelting and Refining
Jaeger Machine	Vertientes-Camaguey Sugar
Joy Manufacturing	White Motors
Manati Sugar	Zenith Radio

Source: Jeremy J. Siegel, *The Future for Investors: Why the Tried and the True Triumph Over the Bold and the New* (New York: Crown Business, 2005), 290-91.

Of all the original 500 companies, the share price of 32 of them went to zero. In fact, that failure rate is 6.4% over nearly a half-century, which is very low. One suspects that the low failure rate is related to government spending, because it was so large in relation to economic activity. In addition, the actions of the central bank in providing a liberal amount of credit, coupled with the actions of mega banks and mega financial institutions in providing even more liberal credit, were so prevalent that it's hard to imagine that most companies didn't benefit, if not directly, then indirectly.

Featured Companies

IRIDIUM COMMUNICATIONS, INC. (IRDM)

Iridium is a global satellite communications provider, with stress on the word “global.” It appears that Iridium is the only international satellite communications provider with truly global coverage, meaning coverage of 100% of the Earth’s surface for voice and data mobile satellite services. The company went bankrupt in 1999, and one of the causes was its leveraged balance sheet. Another could be that the company was ahead of its time. When it first attempted to provide global communications coverage, its phones were very large and bulky, and there was poor reception in various regions of the world. It was simply not viable.

In 2009, Iridium was recapitalized via its purchase by GHL Acquisition Corp., a special purpose entity of Greenhill & Co. Since that transaction, Iridium has been growing at a fairly robust rate, and it actually has earnings. Its market capitalization is \$589 million, and it is expected to earn sufficient money this year to warrant a P/E on 2011 estimated earnings of a mere 13.6 times. It seems reasonable to conclude that it’s likely to grow in 2012 as well. Based on consensus forecasts, it’s trading at 9.4 times 2012 estimated earnings. Iridium trades below book value, and it is a hard, tangible book. It actually trades at a discount to its tangible book value, which is true of very few companies.

Iridium has a fairly sensibly arranged balance sheet. Relative to \$665 million of equity, the company has \$174 million of debt and \$103 million of cash. However, its satellite systems will need to be replaced beginning in 2015, which means that there will be satellite launches subsequent to that year. Towards that end, the company will have to spend a significant amount of money between now and 2012 in preparation for those new satellite launches.

The satellite business is an economy of scale business. Once the devices are launched, if there’s enough usage of the capacity, the business can be incredibly profitable. There is a time element involved here, however. The business must generate a sufficiently high number of customers for it to generate a return on one’s investment, given the lifespan of the satellites themselves. In this particular sense, the 1999 bankruptcy of Iridium was perhaps a little bit of a blessing in disguise because, since it was recapitalized, it has the ability to gather customers with its historical asset base.

Iridium will spend at least \$2 billion over the next several years. It plans to fund it with cash flow from the existing business, and also with a fairly substantial amount of debt. For that reason, it trades below book and at a low multiple. In the current environment, most companies in the world are interested in lowering debt and increasing cash on the balance

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sheet. This company is destined for the reverse and, since a debt-heavy posture for companies has been the source of so much trauma in the marketplace, companies like this one are avoided. However, there is a fairly robust growth of subscribers. The company now has 447,000 subscribers, whereas a year ago it only had 358,000 subscribers.

The company's employment of leverage is not undertaken without some reason. Since as early as 2001, the Federal Communications Commission has been warning of a broadcast spectrum shortage due to the prevalence and expansion of smartphones and iPads, which all make use of it. The shortage hasn't become manifest yet because, until the advent of the iPad and the growing popularity of smartphones, there wasn't really a large-scale increase in consumer demand for voice and data mobile services. Now that demand has increased substantially, the FCC's prophecy, perhaps issued 10 years early, is likely to become a reality by 2014. As a result, the satellite spectrum will become incredibly valuable.

From a regulatory point of view, the FCC has two alternatives for expanding the broadcast spectrum. It can seize spectrum from the television broadcasters that don't necessarily make good use of it, which the commission is clearly loath to do, or it can encourage the use of the satellite spectrum. The satellite companies, especially those in the United States, have been consolidating of late. That trend appears to be motivated by the projected broadcast spectrum shortage that may become apparent to all in not that many years. This company may well be very valuable in the years to come; therefore it is recommended.

W.P. CAREY & CO. (WPC)

W.P. Carey is an unusual real estate company, because it rents out property on a triple-net-lease basis. In real estate, a triple net lease refers to an arrangement in which the tenant is responsible for paying real estate taxes, insurance, and maintenance—the so-called “three nets.” W.P. Carey is structured so that most of the property is owned by an affiliate called Corporate Property Associates, which financed the real estate investments via non-publicly traded REITs. W.P. Carey is an investor in and advisor to Corporate Property Associates and, as such, receives advisory fees from it as well as fees for helping it to raise capital as needed.

In general, triple-net-lease is the lowest-risk real estate there is, because the tenants tend to be of the highest credit quality. According to the company, no full-term investor in a Corporate Property Associates deal has ever lost money.

The company's book of triple net leases is fairly well globally diversified with 275 long-term corporate tenants in 28 industries in 17 different countries. It is also an owner-operated company with 29% of the stock owned by its founder, William Polk Carey. Apparently, he has considerable experience investing in foreign real estate, since he made his first foreign real estate investment in 1960, at the age of 29.

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Another feature that makes this REIT interesting is that W.P. Carey currently controls a recently formed private REIT known as Carey Watermark. This REIT has filed a registration statement with the SEC with a view to engaging in its own IPO to raise \$1 billion for the purpose of acquiring properties in the lodging industry. The lodging industry is one of the more depressed of the real estate sectors. If triple-net-leasing on a long-term basis is the safest kind of real estate, the lodging business tends to be the most volatile because it is all short-term; in other words, it involves renting real estate by the day.

True to its form, W.P. Carey wishes to engage in this activity in a ring fenced entity, meaning it will raise money in an IPO of Carey Watermark that, as such, would be financed by the public. Of course, W.P. Carey would earn advisory fees from that transaction. Success of the Carey Watermark offering would assist in growing the W.P. Carey earnings and revenues to some degree.

According to W.P. Carey's summary financial information, from 2006 to 2010, a period of severe decline in real estate, the company didn't fare too badly. For example, revenues declined from \$245 million in 2007 to \$214 million in 2008. Net profit nevertheless increased from \$60 million to \$69 million, and the dividend increased as well. By the end of 2010, the amount of money that the company has been investing in real estate reached an all-time high.

This company trades at 12 times estimated 2012 funds from operations. It has a \$1.5 billion market capitalization, and it yields 5.5%. To achieve a double-digit return from this company, only a little bit of growth is required, by inflation, expansion of the balance sheet, or the success of one of its affiliates. It is recommended on that basis.

	W.P. Carey			
	<i>(USD in millions, except per share data)</i>			
	<u>Revenue</u>	<u>Net Profit</u>	Dividends per <u>Share</u>	Net Real Estate <u>Investments</u>
2010	\$255.34	\$78.60	\$2.03	\$947
2009	217.44	63.80	2.00	884
2008	214.04	69.64	1.96	919
2007	245.24	60.86	1.88	919
2006	\$258.98	\$85.57	\$1.82	\$850

Source: Company Reports

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OVERSEAS SHIPHOLDING GROUP, INC. (OSG)

Overseas Shipholding is a global tanker company. It owns a total of 122 vessels, 111 of which are of modern capacity. Of the total, 88 operate in the international market, and 23 in the U.S. flag market, which is a different market because it's protected by various laws.

The tanker market is under pressure at the moment, for many reasons. One stems from the over-building that occurred in the earlier part of the previous decade. One might have expected the over-building to have had a negative effect on the earnings of Overseas Shipholding; however, since many very large crude carriers were used to store oil during the 2008 crisis, it was not as big a factor as one might have expected. It may be recalled that oil dropped from a very high price to under \$40 a barrel at its low. In response, many companies used tankers to store oil while waiting for price recoveries. Once higher prices were attained, many of those tankers were released to the market, and therefore the real damage to earnings occurred recently.

At the moment, Overseas Shipholding is not profitable. As a consequence, it has a negative P/E for 2011. It may or may not be profitable in 2012; it's too early to make a judgment. The company trades at 44% of book value, has almost \$1.8 billion of equity, \$2 billion of debt, and \$257 million of cash on the balance sheet. All the debt is long-term. The company certainly has the balance sheet to be able to survive during the downturn.

Generally, downturns in this industry have a self-equilibrating tendency because, to the extent that tankers are used, they have a certain life span. There are always vessels being scrapped. In addition, new building has been vastly reduced. Ultimately, the market will come into balance. In general, the only times when one can buy a shipping company of this quality at a reasonable price are when the market is very bad, as is the case at the moment.

The table below lists the price-to-book-value ratios of Overseas Shipholding for the last decade.

Overseas Shipholding			
	<u>Price to Book</u>		<u>Price to Book</u>
2010	0.60x	2005	1.06x
2009	0.63x	2004	1.52x
2008	0.66x	2003	1.33x
2007	1.27x	2002	0.79x
2006	1.01x	2001	0.95x

Source: Company Reports

The company never really trades at a huge premium to book value; its largest was in 2004, when it traded at 1.5 times book. Currently, it's trading at an unprecedented 44% of book

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value. However, the book value might somewhat erode, given the losses of the company. Nevertheless, once the firm returns to profitability, its shareholders' equity will grow again. If it does trade at a premium to book value two or three years from now when the tanker market self-corrects, one could earn a fairly high rate of return. However, one needs to be patient, because it is unclear when the tanker market might improve, at least to this observer. The company is recommended on that basis.

MANNKIND CORP. (MNKD)

MannKind Corporation is an *Ultra Contrarian* recommendation, which is very different from a regular *Contrarian*. Formally defined, an ultra-contrarian type of company is one that might provide a very substantial increase in earnings and stock price, but that also entails a sufficient degree of risk such that one might lose all or nearly all of one's investment. This company fits that description.

MannKind is in the process of developing an inhalable insulin, known as AFREZZA. The company has been working on developing this product for quite some time. In January of this year, when the company presented the treatment's test results to the FDA, that agency refused to approve it, and requested that more studies be undertaken.

MannKind is controlled by Alfred Mann, a billionaire in his own right, and probably the most successful venture investor of all time. He is not merely a venture investor; he is also a scientist of very high caliber, which is unique for a venture capitalist. This situation offers an unusual example of an owner-operator, because Mann is not only an investor who acts as the management of the company; he's also a scientist who, presumably, well understands the science of this insulin delivery system. Mann has invested over \$900 million of his own money in MannKind.

As a venture investment, MannKind essentially spends \$12 to \$15 million per month to sustain its research, largely in AFREZZA. At the most recent reckoning, MannKind had \$47 million in cash, enough to sustain it for three to four months. It had \$235 million of debt and nothing but losses. If MannKind is not ready to present to the FDA in a month or two, it's obvious that Mann will have to provide further funding.

The issue of the company, of course, is the willingness of Mann to personally continue funding it. If he were to cease funding the company, it would be a largely worthless investment. However, he does not appear inclined to cease funding it.

Some years ago, Pfizer developed an inhalable insulin drug known as Exubera. Although it had been approved by the FDA, it was withdrawn from the market in 2008 on concerns that its use caused lung cancer. The study data upon which that concern was based had a sample size of more than 4,700 patients who were taking Exubera. Of that total, six developed lung cancer. Out of a control group of equal size, one developed lung cancer.

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While the number of patients who developed lung cancer was not statistically significant enough for the Food and Drug Company to require withdrawal of the product, it was sufficiently significant for the legal advisors of Pfizer to recommend the voluntary withdrawal of the product. Thus, it was withdrawn.

At the moment, there is no inhalable insulin on the market. Since diabetes is so widespread, and injection of insulin is, generally speaking, a problem, if an effective inhalable insulin were to be developed, it's not difficult to imagine that it would be an enormously successful product. Therefore, it's not difficult to imagine why Mann has invested so much of his own money in this company. He must believe that the venture will ultimately be successful.

Thus far, the short sale community has taken issue with MannKind. At the moment, the short interest on this company is 22 million-plus shares. Note that the market capitalization of MannKind is \$521 million; the short interest only represents \$88 million of the market value (at a current share price of roughly \$4.00). However, a large part of the market value is owned by Mann, as one can imagine. So, those 22 million shares, in relation to the average trading volume, is 22 million shares versus the 599,000 shares that trade on the average day.

Either the short community will be right, in which case this investment would be largely worthless, or Dr. Alfred Mann will be right, in which case this company will be very successful, and there will be an enormous short squeeze. We do know that it is scientifically possible to develop an inhalable insulin that is acceptable to the Food and Drug Administration. As an *Ultra Contrarian*, MannKind appears to be interesting.

How They Did It

ELEANOR LAMBERT

Eleanor Lambert was at the center of American fashion for 70 years. It can be said, with very little fear of exaggeration, that she placed American fashion design on the worldwide stage. Lambert had a spectacular career and died at the age of 100 in 2003.³

In the 1940s, Lambert founded the International Best Dressed List. She also founded the Coty Fashion Critics' Award in 1943, which was sponsored by Coty Fragrances. It is now called the CFDA Award, which stands for the Council of Fashion Designers of America. Lambert founded the Costume Institute at the Metropolitan Museum of Art. While press editor of the New York City Dress Institute, she founded the New York City Fashion Week. In addition, she represented American artists as an agent, and created an international following for them. Her clients included Jackson Pollock, Jacob Epstein, and Isamu Noguchi.

For many years, Lambert was the official representative of American fashion on behalf of the United States Department of State. That position had major ramifications. For example, in 1973 she produced a fashion show at the Palace of Versailles that is famed as one of the most iconoclastic ever. It became known as the Battle of Versailles. Its purpose was to showcase American fashion designers in a realm that had previously been dominated by the French. American designers Halston, Anne Klein, Bill Blass, Oscar de la Renta and Stephen Burrows were introduced to the European public. They were essentially challenging the established French designers at the show, who included Givenchy, Pierre Cardin and Yves Saint Laurent. The French were sufficiently concerned by the challenge that they invited Josephine Baker, the American expatriate singer, to perform on behalf of the French at this Versailles gathering. At that show, American fashion was launched on the international stage.

The point of discussing Lambert's accomplishments is to illustrate the concept of demand creation. Fashion products are examples of those that might be desired, but are not necessarily needed. As the study of economics is generally understood, expansion and contraction of demand is a function of customer needs. If that it is true, then with adequate promotion and proper planning, demand can be created in the absence of need. That statement raises a whole series of questions because, if demand is, to a very large extent, a question of personal preference as can be seen in the example of the fashion industry, how can that phenomenon be mathematically modeled? If such an important concept can't be modeled mathematically, what is the value of all the mathematical econometric models?

³ Nemy, Enid. 2003 "Eleanor Lambert, Empress of Fashion, Dies at 100." *The New York Times* October 8. <http://www.nytimes.com/2003/10/08/nyregion/eleanor-lambert-empress-of-fashion-dies-at-100.html>.

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If it cannot be modeled, then how does one perform genuine macroeconomic analysis, if demand is a matter of preference, not need, and preference has a certain unpredictable element to it? If it is very difficult, in that light, to engage in macroeconomic analysis, how does one formulate proper government macroeconomic policy? Phrased alternatively, how is it possible to have a robust government macroeconomic policy if the very underpinnings of demand are a function of preference rather than need?

Lambert created tremendous demand for products that are certainly not needed and she was a factor in the gross domestic product of the U.S., and even of the world. Influence like hers might be viewed as representative of the exogenous event risk in mathematical modeling.

CONTRARIAN RESEARCH REPORT COMPENDIUM

Money Manager Index

From Jan 1983 to June 2011

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Yr. End	Index	Yearly return	Annualized return
																(since inception)
1983								1.00	0.81	0.76	0.87	0.75	1983	0.75	(60.5)%	(50.2)%
1984	0.75	0.71	0.70	0.66	0.67	0.67	0.61	0.83	0.79	0.76	0.67	0.65	1984	0.65	(13.5)%	(26.5)%
1985	0.92	0.93	0.99	0.95	1.20	1.30	1.32	1.38	1.28	1.50	1.86	2.02	1985	2.02	211.8%	33.7%
1986	2.46	2.78	2.47	2.31	2.36	2.33	2.03	2.23	1.98	2.37	2.34	2.34	1986	2.34	15.9%	28.2%
1987	3.21	3.27	3.16	2.55	2.37	2.30	2.39	2.47	2.22	1.56	1.44	1.52	1987	1.52	(35.0)%	9.9%
1988	1.80	1.87	1.78	1.79	1.69	1.94	1.92	1.96	2.01	1.97	1.95	2.07	1988	2.07	36.0%	14.3%
1989	2.42	2.37	2.54	2.63	2.64	2.64	2.93	3.12	3.07	3.05	3.23	3.26	1989	3.26	57.8%	20.2%
1990	3.12	3.15	3.53	3.06	3.47	3.45	3.30	2.70	2.68	2.40	2.52	3.02	1990	3.02	(7.3)%	16.1%
1991	3.08	3.49	3.70	3.68	3.71	3.61	3.86	4.05	4.07	4.69	4.47	5.72	1991	5.72	89.4%	23.0%
1992	5.76	5.61	5.30	5.12	4.98	4.99	5.93	6.06	6.19	6.56	7.25	7.36	1992	7.36	28.6%	23.6%
1993	8.06	8.04	8.20	7.94	8.15	8.57	9.05	10.00	9.99	9.31	8.97	8.90	1993	8.90	21.0%	23.4%
1994	9.52	8.73	8.05	7.85	7.81	7.53	7.66	8.31	8.15	8.52	7.88	7.95	1994	7.95	(10.6)%	19.9%
1995	7.74	8.38	8.72	8.77	9.20	9.35	9.93	10.78	11.22	10.53	10.89	10.40	1995	10.40	30.8%	20.8%
1996	11.12	11.50	11.33	11.62	11.86	12.53	11.91	12.36	13.32	14.03	14.42	15.02	1996	15.02	44.4%	22.4%
1997	16.04	16.81	15.32	17.27	18.42	20.29	22.28	21.39	25.31	24.95	24.95	25.50	1997	25.50	69.8%	25.2%
1998	25.67	29.00	29.89	30.60	28.90	30.44	27.67	21.33	21.74	25.16	27.27	25.41	1998	25.41	(0.4)%	23.3%
1999	26.00	23.71	23.92	26.77	28.94	29.74	28.78	26.74	25.89	27.73	28.54	30.55	1999	30.55	20.2%	23.2%
2000	31.07	31.19	36.01	35.60	35.20	40.32	43.58	45.75	45.62	48.69	44.05	49.84	2000	49.84	63.1%	25.2%
2001	50.23	46.41	44.27	46.96	48.90	49.98	50.67	49.70	46.47	44.81	48.04	51.91	2001	51.91	4.2%	23.9%
2002	53.62	53.74	55.11	52.52	52.83	50.48	42.58	44.92	41.54	42.66	45.78	43.17	2002	43.17	(16.8)%	21.4%
2003	42.72	41.18	42.36	45.98	49.02	50.71	53.47	53.97	53.46	56.12	55.83	58.49	2003	58.49	35.5%	22.1%
2004	64.38	65.08	64.63	61.68	60.86	62.30	58.71	64.08	65.73	68.86	73.53	78.16	2004	78.16	33.6%	22.6%
2005	76.46	77.94	74.06	72.83	77.02	80.25	83.59	83.07	86.03	89.19	96.58	97.35	2005	97.35	24.6%	22.7%
2006	107.62	111.44	110.75	111.88	101.89	100.61	100.62	104.98	114.61	116.64	113.78	118.05	2006	118.05	21.3%	22.6%
2007	125.73	123.77	122.62	127.58	133.57	134.68	126.61	124.07	133.57	148.09	135.13	135.56	2007	135.56	14.8%	22.3%
2008	127.53	115.76	115.94	121.58	130.51	115.68	119.94	120.55	109.69	72.70	62.95	67.91	2008	67.91	(49.9)%	18.1%
2009	57.51	51.76	65.63	79.49	85.67	90.79	99.97	101.69	107.32	107.36	110.94	115.01	2009	115.01	69.4%	19.7%
2010	106.84	110.32	118.13	114.91	100.18	88.17	97.65	89.64	103.59	108.29	108.64	119.58	2010	119.58	4.0%	19.1%
2011	122.80	128.28	127.94	127.97	126.06	121.03							2011	126.06	5.4%	19.0%

S.No.	Ticker	Name	Initial Amount Invested	Shares Purchased	Date of Investment	Current Index Value
1	AMG us equity	Affiliated Manager	\$22,947	1377	11/30/1997	139,677
2	ALNC us equity	Alliance	\$7,633	491	4/30/1994	15,128
3	BLK us equity	BlackRock	\$23,205	1658	9/30/1999	320,207
4	WDR us equity	Waddell & Reed	\$27,513	1587	3/31/1998	57,698
5	EV us equity	Eaton Vance	\$2,641	3998	1/31/1986	120,871
6	TROW us equity	T. Rowe Price	\$2,423	2014	4/30/1986	122,140
7	BEN us equity	Franklin Resources	\$908	1263	4/30/1985	166,153
8	LM us equity	Legg Mason	\$1,000	462	8/31/1983	15,178
9	FII us equity	Federated Inv	\$26,381	2206	5/31/1998	52,593
10	FIG us equity	Fortress Investment Group	\$102,249	3389	2/28/2007	17,098
11	PZN us equity	Pzena Investment Management	\$122,426	6317	10/31/2007	35,881

CONTRARIAN RESEARCH REPORT COMPENDIUM

International Money Manager Index

From Jan 1983 to June 2011

Year	31-Jan	28-Feb	31-Mar	30-Apr	31-May	30-Jun	31-Jul	31-Aug	30-Sep	31-Oct	30-Nov	31-Dec	Yr. End	Index	Yearly return	Annualized return (since inception)
1986											1.00	1.02	1986	1.02	10.0%	10.0%
1987	1.25	1.37	1.48	1.48	1.37	1.33	1.39	1.40	1.33	0.81	0.76	0.73	1987	0.73	(27.7)%	(23.3)%
1988	0.75	0.92	1.02	0.95	0.80	0.89	0.88	0.82	0.86	0.88	0.89	0.93	1988	0.93	26.4%	(3.4)%
1989	1.03	1.02	1.06	1.17	1.19	1.18	1.25	1.16	1.17	1.20	1.21	1.28	1989	1.28	37.8%	8.1%
1990	1.24	1.24	1.18	1.19	1.22	1.24	1.26	1.26	1.23	1.24	1.25	1.33	1990	1.33	3.7%	7.0%
1991	1.34	1.52	1.56	1.58	1.57	1.47	1.52	1.64	1.81	1.89	1.94	1.92	1991	1.92	44.8%	13.5%
1992	2.01	1.93	1.88	2.14	2.19	2.13	2.08	1.99	1.95	1.77	1.76	1.96	1992	1.96	1.9%	11.5%
1993	1.98	2.03	2.20	2.39	2.42	2.45	2.54	3.05	3.01	3.07	3.01	3.30	1993	3.30	68.7%	18.1%
1994	3.72	3.39	3.17	3.04	2.99	2.89	3.01	3.14	3.13	3.19	3.15	3.15	1994	3.15	(4.7)%	15.1%
1995	3.07	3.12	3.28	3.41	3.56	3.59	3.87	3.76	3.76	3.77	3.70	3.73	1995	3.73	18.6%	15.4%
1996	3.76	3.85	3.70	3.79	3.96	3.90	3.75	3.96	4.16	4.47	4.90	4.86	1996	4.86	30.3%	16.8%
1997	5.11	5.37	4.99	4.96	5.43	5.94	6.57	6.32	7.45	7.24	6.80	7.19	1997	7.19	47.9%	19.3%
1998	7.12	8.05	8.78	9.25	8.95	8.74	8.91	6.67	6.08	7.01	7.51	7.71	1998	7.71	7.3%	18.3%
1999	7.99	8.21	8.68	9.07	8.71	8.61	8.63	8.43	8.47	8.79	9.80	10.79	1999	10.79	39.9%	19.8%
2000	11.23	12.27	13.95	13.50	13.73	15.39	15.85	16.82	17.07	16.31	14.43	16.76	2000	14.43	33.8%	20.7%
2001	17.42	15.88	13.46	15.14	15.84	15.15	14.21	13.61	10.77	11.43	13.90	14.12	2001	14.12	(2.2)%	19.1%
2002	14.74	13.78	15.09	15.11	16.38	14.14	12.92	12.10	11.23	11.06	11.33	10.50	2002	10.50	(25.6)%	15.7%
2003	10.18	9.52	9.69	10.62	12.17	13.04	13.98	15.38	16.67	17.88	18.16	18.07	2003	18.07	72.1%	18.4%
2004	20.00	22.41	29.98	35.46	26.68	30.80	25.37	25.20	23.67	23.34	27.56	31.48	2004	31.48	74.2%	20.9%
2005	32.19	32.57	31.88	27.79	27.36	29.05	30.38	31.49	33.39	32.24	32.95	37.18	2005	37.18	18.1%	20.8%
2006	41.01	40.97	43.69	46.45	42.39	41.58	40.60	43.32	43.55	43.70	44.58	49.38	2006	49.38	32.8%	21.3%
2007	50.95	51.18	53.59	56.09	58.16	56.37	53.90	48.65	50.96	57.03	48.21	45.75	2007	45.75	(7.3)%	19.8%
2008	38.71	39.71	38.59	40.18	39.25	35.10	34.59	33.33	26.09	18.72	14.50	15.79	2008	15.79	(65.5)%	13.3%
2009	14.62	13.24	14.96	19.63	22.82	23.73	26.14	27.05	28.41	28.53	28.69	29.83	2009	29.83	89.0%	15.8%
2010	28.50	27.58	29.90	29.58	25.53	24.72	27.82	26.74	30.36	33.68	31.85	34.52	2010	34.52	15.7%	15.8%
2011	34.91	36.17	36.51	39.63	37.86	35.31							2011	37.86	9.7%	15.9%

S.No.	Ticker	Name	Initial Amount Invested	Shares Purchased	Date of Investment	Current Index Value
1	IGM CN Equity	IGM Financial Inc	\$1,000	73	31/11/1986	3,888
2	FCAM LN Equity	F&C Asset Management Plc	\$1,203	485	5/31/1989	584
3	IVZ US Equity	Invesco Plc (Previously Amvescap)	\$1,357	1,153	1/31/1991	13,484
4	SDR LN Equity	Schroders Plc	\$1,208	505	3/31/1991	12,550
5	RAT LN Equity	Rathbone Brothers Plc	\$1,208	736	3/31/1991	13,368
6	ADN LN Equity	Aberdeen Asset Mgmt Plc	\$1,208	1,827	3/31/1991	6,551
7	CIX CN Equity	CI Financial Corp.	\$2,585	3,224	6/30/1994	76,811
8	EMG LN Equity	Man Group Plc	\$2,862	6,344	10/31/1994	18,958
9	AGF/B CN Equity	AGF Management Ltd-CI B	\$3,343	1,346	1/31/1996	26,114
10	8739 JP Equity	Sparx Group Co Ltd	\$11,762	108	12/31/2001	10,730
11	HGG LN Equity	Henderson Group Plc	\$14,447	8,666	12/31/2003	16,998
12	RAB LN Equity	RAB Capital Plc	\$24,603	37,395	3/31/2004	5,750
13	AZM IM Equity	Azimut Holding Spa	\$21,908	4,977	7/31/2004	46,473
14	EFG AU Equity	Everest Financial Group Limited	\$23,437	23,191	4/30/2005	2,929
15	CCAP LN Equity	Charlemagne Capital Ltd	\$36,848	22,300	3/31/2006	6,091
16	PGHN SW Equity	Partners Group-Reg	\$36,848	578	3/31/2006	102,200
17	INRE LN Equity	Invista Real Estate Inv Mngt	\$36,589	21,540	9/30/2006	4,672
18	ASHM LN Equity	Ashmore Group Plc.	\$36,688	9,873	10/31/2006	63,196