

J.L. BAINBRIDGE

& COMPANY, INC.

◆PROFESSIONAL MONEY MANAGEMENT◆

1996 ANNUAL REPORT

INVESTMENT RESULTS

For 1996, J. L. Bainbridge & Company, Inc. achieved a 20.3% rate of return on all money under management. In conjunction with 1994 and 1995 returns of 10.2%, and 38.4% respectively, a January 1, 1994 investment of \$100,000 has grown to a December 31, 1996 value of \$183,478 which equates to an increase of 83% over the past three years. The annually compounded return over the past three years is 22.7%. These results assume reinvestment of dividends and are after transaction costs and J. L. Bainbridge & Company's management fee.

INVESTMENT REVIEW

1996 was another year of fulfilling our objective to achieve long term results of 15% compounded annually in a consistent manner with a strong return in positive market environments and a good return in negative market environments. More importantly, the high quality companies selected for investment continue to produce strong earnings growth and

aggressively expand their businesses globally. Therefore the prospect for achieving 15% returns for many years to come is extremely bright.

In the simplest terms our investment approach is to own only the highest quality extraordinary companies, buy only when the current price represents good value with a potential return of at least 35% over the next twelve months and sell when the price reaches full value. However, since previous reports covered this aspect of our program in considerable detail, this report will focus on our strategy to manage risk in a turbulent market.

INVESTMENT STRATEGY

The current environment is contrasted on one hand by a very favorable economy marked by moderate growth, low inflation and reasonable interest rates and on the other hand by a relatively high stock market which fluctuates almost daily from exuberance to despair. Hence the challenge is how to manage short term market related risks without

jeopardizing long term results. Many so called market seers are presently calling for a sharp market decline over the next several months and yelling “sell everything”. These experts seldom have any responsibility whatsoever for managing clients funds and are seldom held accountable for their rash predictions.

On the surface selling everything is appealing, but in reality is a foolhardy idea because predicting market declines is virtually impossible. Hence in the vast majority of instances the anticipated decline never materializes, occurs at an unexpected time or occurs as expected but the decline is minor and recovers quickly leaving the great seers in the dust. In all of these instances the long term success of one's investment program is jeopardized. Thus an investment strategy that appears at first glance to be reducing risk is actually a high risk venture with almost certain failure of achieving a long term growth return.

Contrast the above with our strategy of focusing on the long term ownership of truly outstanding companies and completely ignoring the market. Since these companies over the long term will provide a return commensurate with their long term earnings and dividend growth, a strategy of buying at reasonable prices and holding for several years assures long term success. The key to holding investments through a general market decline is our extreme confidence that high quality growth companies will recover quickly and move on to new highs.

A question clients often ask is would we ever hold cash as a way to avoid the risk of a market decline? The answer is yes, but not very often. Our approach is to sell a great company's stock when the price reaches full value and reinvest the proceeds into another great company whose stock is available at an attractive price. In the event the market and our

investments continue to appreciate rapidly in 1997, inevitably we would sell fully valued positions and be unable to reinvest the proceeds because no great companies would be available at an attractive price. In this situation we would patiently hold cash until quality investments with good value emerge.

Getting back to the current situation, we are fortunately faced with an unprecedented market environment where some quality companies have ascended to very tenuous levels while others languish. Consequently good value continues to be available. In this environment, we have liquidated the high priced stocks of Coca-Cola, General Electric, Gillette and Proctor & Gamble and purchased at value oriented prices shares of Allied Signal, Black & Decker, Burlington Northern, CSX, Disney, McDonald's, McGraw-Hill, Charles Schwab and Walgreens. Hence while the market has escalated, we have restructured our portfolio to reduce risk and enhance the potential return for 1997 and many years thereafter.

The two previous annual reports covered McDonald's and Marriott which continue to be our largest holdings and have significant further appreciation potential. Therefore, this report will feature McGraw-Hill, currently our third largest investment. As is the case with most of the companies carefully selected for investment, McGraw-Hill has expanded globally to take advantage of the growth potential in emerging markets. Their international presence is evidenced by a thriving government and corporate debt rating service which stretches from the United States, throughout Latin and South America, Europe and the Pacific Rim and into China and India. In addition, books are printed in 16 languages from 23 publishing centers around the world.

McGraw-Hill's largest division is Educational and Professional Publishing which is the largest producer

of text books in the world. This business is benefiting from growing school enrollments and the introduction of new technology. For example, new middle and high school courses in accounting and biology were introduced this year that incorporate software, CD-ROM, video disk and videotape along with the traditional textbook. The biology CD-ROM contains more than 1400 photographs, numerous illustrations and over two hours of full motion video and is designed for both the English and Spanish markets. By changing a single setting, the entire CD-ROM, both text and audio, converts immediately from English to Spanish. The added value of this product commands a higher price and enhanced growth for McGraw-Hill.

The next largest division is Financial Services. Standard & Poor's and a myriad of other data services which provide market and economic information to every corner of the world are McGraw-Hill's fastest growing businesses. Virtually every stockbroker on earth has a computer terminal with access to Standard & Poor's vast, instantaneously updated, data bases of information. The capitalization of free markets in emerging countries has been driving growth at the financial services division and this trend will continue well into the next century.

The third division is Information and Media Services which has moderate growth potential but provides the cash flow to aggressively expand the other two divisions and fund the corporate share repurchase program. This division includes four ABC affiliated television stations in Bakersfield, Denver, Indianapolis and San Diego, F. W. Dodge construction information services and Business Week magazine. Business Week is gaining market share in the United States and publishes international editions in Asia, Europe, Latin America and Middle East.

In view of the potential to further grow both here and abroad, we are confident earnings will grow at 13% compounded annually over the next five years. Based on this rate of growth, McGraw-Hill's stock has the potential to appreciate to \$63.50 by the end of 1997 or 37% above the current price. A 3% dividend yield is also attractive.

CONCLUSION

The last page of this report presents our mission statement. Relative to our mission to clients, we fully recognize achieving a 15% annually compounded return over many years is a very challenging objective and requires a sound logically based investment program. We also recognize achieving these results are essential in order to fulfill our clients expectations. For example, achieving 15% means a \$250,000 retirement rollover grows to over \$500,000 in five years and over \$1,000,000 in ten years. Thus we will continue to diligently analyze companies in a relentless search for outstanding companies with strong consistent earnings growth. We will also employ the discipline to minimize risk by purchasing these companies only when their shares are available at an attractive price.

Looking forward our current portfolio has the potential, based on the relative size of each holding, to return 43% in 1997 and 152% over the next five years. Therefore, although a short term market decline could cause our results to temporarily fall below objective, we will stay the course confident we are positioned for and have the disciplined investment program in place to achieve 15% compounded results long into the future with considerably lower risk than other growth investment strategies.

In accordance with SEC regulation, a current copy of J. L. Bainbridge & Company's SEC registration form ADV Part II is available upon request free of charge.

ENHANCING CLIENTS' LIVES

At J.L. Bainbridge & Company, Inc. our business is dedicated to “enhancing clients’ lives” by providing long term professional money management service totally focused on helping clients finance their children’s education, build and preserve the resources for an enhanced retirement and achieve a meaningful higher standard of living.

The foundation of J.L. Bainbridge & Company, Inc.’s business philosophy is based on the full understanding that our future and success is completely dependent on client satisfaction and delivering to clients a consistent long term investment service of the highest level of quality, competence and integrity.

Our commitment to “enhancing clients’ lives” is a guiding light that governs our professional daily activities and demands every decision and action be assessed as to exposure to investment risk as well as the long term benefit to clients.

J.L. BAINBRIDGE
& C O M P A N Y , I N C .

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