

J.L. BAINBRIDGE & COMPANY, INC.

◆PROFESSIONAL MONEY MANAGEMENT◆

1997 ANNUAL REPORT

INVESTMENT RESULTS

For 1997 J. L. Bainbridge & Company, Inc. achieved a 23.2% rate of return on all money managed. In conjunction with 1994, 1995 and 1996 returns of 10.2%, 38.4% and 20.3% respectively, a January 1, 1994 investment of \$100,000 has grown to a December 31, 1997 value of \$226,040 which equates to an increase of 126% over the past four years. The annually compounded return over the past four years is 22.6 %. These results assume reinvestment of dividends and after transaction costs and our management fee.

INVESTMENT REVIEW

Our 1997 results again exceeded our 15% objective, and the outlook for meeting this objective over the next 5 years is very positive. Last year was another period of volatility marked with the normal pessimism that the current rosy economic picture and bright investment climate cannot continue. We obviously do not share this

view because there is nothing on the horizon that changes the strong competitive position of American companies and the enormous demand for investments due to the unprecedented build up of the next generation's retirement assets. On the other hand, the market has appreciated to a high level, and as a consequence the overall market is not likely to grow at 15% compounded annually over the next 5 years. In fact we believe the easy days are over and future results will require more hard work and a sound, highly disciplined investment program in order to succeed.

INVESTMENT STRATEGY

At the risk of sounding like a broken record, this report repeats the same strategy presented time and again over the past several years. Our strategy has not changed and will not change because buying great companies at a reasonable price and holding for the long term will be more important in the future than in the past. In the past, hap hazard investment schemes bore good results not because

they were good but because the times were good. The craze for direct investments in high risk emerging foreign markets was successful for awhile regardless of the fact governments are corrupt, economies manipulated, stock markets unregulated and accounting standards lax. The party is now over and for many investors the Asian losses are not only painful but in too many instances destroyed retirement dreams.

Our investment program is highly disciplined and consists of the following basic elements:

- Consider for ownership only extraordinary major American companies with established records of consistent growth and exceptional financial positions with limited debt and a high level of excess cash flow.
- Analyze these companies in depth, and buy only if their business is understandable to the extent that future earnings growth can be can be quantified with complete confidence.
- Buy only when the price offers a potential return of 35% over the next twelve months.
- Hold for the long term, but sell when the price appreciates to full value in order to minimize the risk of a decline to more reasonable levels.

Even with the current turmoil in Asia, the long term potential for above average growth in emerging markets remains intact, and therefore our strategy continues to stress those great American companies with global infrastructures in place to take full advantage of this opportunity. To put the current Asian crisis in the proper perspective, one only has to remember back a mere three years when the Mexican crisis was a serious threat to world prosperity. The dire predictions that Mexico's problems would engulf all of Latin America, then emerging markets around the world

and ultimately the United States had more to do with selling newspapers and attracting TV audiences than serious academic analysis. As with Mexico, Asia's problems will be short lived and ultimately result in this regions movement toward open markets and economic reforms with very positive long term implications.

The problems in Asia caused the stocks of American multinational companies to unduly fall which presents a buying opportunity. We are taking full advantage of this situation by increasing our position in Allied-Signal, Avon products and United Technologies. In addition we continue to monitor other extraordinary companies such as Coca-Cola General Electric, Gillette and Proctor & Gamble because should the current panic persist, the stocks of those companies could become attractive again.

Another aspect of our strategy is a balanced portfolio with the goal of offsetting temporary weakness in one area with strength in another. This strategy recognizes that short term hysteria can undermine our goal to provide a consistent return from year to year. To protect against near term international pressures which despite the positive long term outlook will occur from time to time, predominantly domestic companies make up a large portion of our portfolio. Our two largest holdings, Marriott and McGraw-Hill, primarily operate in America with relatively small but fast growing international businesses. Hence these companies offer the best of both worlds; the stability of a large successful business at home coupled with smaller but rapidly expanding foreign presence.

Our third largest holding is Walgreen's which operates the largest drug store chain in America with 2,358 stores. Expansion is proceeding at an accelerating pace with a record 251 new stores opened in 1997 and plans to open 280 in 1998 and 360 in 1999. Ultimately Walgreen's sees the

potential to operate over 6,000 stores in the USA and a formal study of international expansion is under way. This growth is being financed with internally generated cash flow and the company remains virtually debt free. New store designs follow a convenience strategy with free standing corner locations featuring food departments, one hour photo finishing, Hallmark cards and pharmacies with waiting rooms and drive- thru windows. This strategy addresses the time constraints of today's busy consumer and the growing use of prescription and over the counter drugs that is being driven by an aging population. The convenience strategy has also proven to be very effective in entering new markets. For example last year Walgreen's entered the Dallas market with eighteen stores opening on the same day and plans to have over one hundred stores by the year 2000. Despite entrenched competition, sales are exceeding expectations with many stores turning profitable in the first year. This years new markets include Birmingham, Charlotte, Dayton, Detroit, Kansas City, and Norfolk. Walgreen's has a well defined bright future and will remain a major holding until the price rises to a high risk level.

While the previous paragraphs of this report pertain to achieving consistent growth, another equally important aspect of any investment program is the return after taxes and this has become more important than ever with the recently passed capital gains tax cut. With a long term capital gains tax rate less than half the highest tax rate applied to short term capital gains. holding investments for the required 12 months becomes imperative. Our programs emphasis on long term investing is intended to take full advantage of this valuable tax reduction. In addition the value of deferring taxes as long as is prudent is also important to increasing the after tax return. Because paying taxes reduces the amount of money

available for investing, deferring this payment for many years means more dollars invested and more dollars of profit. Accordingly in taxable accounts we strive for a three to five year or longer holding period.

CONCLUSION

The Markets have been volatile for several years and this volatility along with the hype of the media has increased in the past year. At the same time the need has grown for each person to build substantial retirement reserves because life expectancy is increasing and clearly government programs for the elderly will be rationed to the neediest as the population ages and the number of retirees increases dramatically. In this environment a long term, unemotional and rational investment program is more important than ever. We fully recognize this need and are totally focused on meeting our investment objective of 15% growth with minimal risk. Our confidence in meeting this objective is based on the high quality and consistent growth characteristics of the companies carefully selected for investment and the current price versus our analysis of full value. Collectively the companies we own are growing faster than 15% annually and have one year and five year potential to appreciate 39% and 154% respectively. Since these rates are comfortably above 15%, the opportunity to achieve this return is excellent even in a market that is likely to grow at a lower rate.

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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