
J.L. BAINBRIDGE

& COMPANY, INC.

◆PROFESSIONAL MONEY MANAGEMENT◆


2007 ANNUAL REPORT

INVESTMENT RESULTS

For 2007 J. L. Bainbridge & Company, Inc. achieved a 3.8% rate of return on all monies managed in its equity investment program. In conjunction with returns in its equity program for 1994, 1995, 1996, 1997, 1998, 1999, 2000, 2001, 2002, 2003, 2004, 2005 and 2006 returns of 10.2%, 38.4%, 20.3%, 23.2%, 29.9%, 5.6%, 16.9%, -3.2%, -8.5%, 13.8%, 14.6%, 5.1% and 13.3% respectively, a January 1, 1994 investment of \$250,000 has grown to a December 31, 2007 value of \$1,293,279. This equates to an increase of 417% over the past fourteen years or 12.5% compounded annually. These results assume reinvestment of dividends and are after transaction costs and our management fee.

INVESTMENT REVIEW

Our 2007 results fell well short of our expectations and long-term objective. However as explained in this report we are extremely positive on the outlook for 2008 as well as the next several years. 2007 was unusual in that there was much greater disparity in returns among our investments with a 39% gain for T. Rowe Price and a 36% loss for McGraw-Hill. McGraw-Hill suffered from concern regarding the decline in future ratings of collateralized home mortgages which we agree will slow dramatically. However their other financial service businesses around the globe and their education publishing are thriving. In addition to counter a slower growth in mortgage ratings, they are aggressively repurchasing stock. In the first nine months of 2007, shares outstanding fell 7% and in October the repurchase of another 11% was authorized. Thus we expect McGraw-Hill to be a star in 2008.



INVESTMENT STRATEGY

In our view the current prevalent fear that the U.S. economy is heading for a recession is off base for the following reasons:

- First and foremost, the Federal Reserve has clearly signaled its intent, via aggressive interest rate cuts and massive loans to the banking industry, to utilize the many powerful monetary tools at its disposal. These moves are directly intended to prevent mortgage and housing problems from causing a general downturn in the economy.
- Strong global growth is dramatically increasing demand for U.S. exports which will exceed one trillion dollars in 2007, more than a twenty percent increase.
- The weak dollar makes foreign investment in this country more attractive.
- Although there has been some weakness recently, the domestic economy is creating new jobs, particularly service jobs, at a healthy rate and payrolls are holding steady.
- The dramatic decline in new housing starts and resulting job loss has already occurred, and as a result residential construction as a share of GDP is so low there is little room to impact future GDP growth.
- Lastly, government spending at both the federal and state levels is strong.

Notwithstanding the above, our investment strategy is not today nor has it ever been based on our ability to predict the future because there is always a chance the economy could falter. Consequently, our investment strategy has always been to produce double digit long-term growth regardless of the economy. In addition while a recession is not likely, without question the U.S. economy has slowed and will remain sluggish next year. Therefore, our current investment approach is take full advantage of faster growth around the world by owning domestic companies with many years of experience and success internationally. A significant portion of these companies total revenue and profit are from foreign markets with particular emphasis in Eastern Europe, Russia and Asia. We have been expanding our international exposure over the past two years

and the recent addition of Boeing and Disney continues this trend. Currently one-half of the business collectively for our total portfolio of companies comes from international markets.

3M Company is just one example. 3M will derive two thirds of their total business internationally in 2008. When 3M announced better than expected record earnings for the third quarter of last year in October, analysts were obsessed over what they saw as hints 3M's businesses could be affected negatively by a slowing U.S. economy and heightened competition in optical films. Although management stressed these minor problems would be offset by growth in the very same foreign markets listed above, two analysts downgraded the stock and most analysts cut 2008 earnings estimates to low to mid single digit growth. Their stock immediately fell and remained down until 3M held an analysts meeting in December and predicted both revenue and profits will increase at least ten percent in 2008 due to burgeoning growth outside the U.S. Their stock promptly recovered a good portion of the earlier decline despite a weak stock market.

An important aspect of our investment philosophy has always been an intense focus on minimizing risk because the primary cause of investment failure is due to incurring a permanent loss of hard earned investment dollars. Accordingly, our longstanding policy has been not to invest in financial stocks for two reasons. Firstly they have no obligation to disclose detailed information regarding neither their loan portfolios nor investments until after problems surface. Secondly because higher risk loans and investments pay higher rates of interest, they have an incentive to participate in higher risk in order to increase earnings more rapidly. To quote Warren Buffet, "Banks don't have to do stupid things, but they often do." This is exactly what occurred in the sub-prime mortgage mess. Will investors in Citicorp, Countrywide, Merrill Lynch, Washington Mutual, etc. ever recover their losses? Our policy did not appear to be very wise when earnings and stock prices of the financials were flying high, but once again this policy protected clients from heavy losses. We have an obligation above all other responsibilities not to speculate with clients' money, and we will not.

CONCLUSION

Last year's annual report emphasized two reasons for poor investment results; rearview mirror investing and fear of losing money. An example of rearview mirror investing is buying a stock simply because the stock has appreciated over some period of time with no regard to either the stock's price being overvalued or the company's business fundamentals and financial condition. Rearview investing also applies to expectations of future investment returns. Eight years ago when the market peaked, expectations were unrealistically high and today after eight years of a stagnant NYSE and a 47% lower NASDAQ, expectations are low. From a logical point of view, the opposite view would prevail. Fear of losing money is understandable given the media's constant hype of imaginary pending disasters. However, to achieve meaningful investment results, one must realize this fear does not prevent losses but actually causes just the opposite result. Fear of losing money provokes panic selling of an individual stock that is declining as well as liquidating an entire portfolio when the market is declining and media hype is hysterical. In both instances short-term losses are converted into a permanent loss of capital.

Today, rearview mirror investing results in most analysts projecting single digit returns over the next several years, and fear of losing money entices investors to abandon their holdings via panic selling. This is very much like 1981 when the stock market had been dismal for several years. In fact, one prominent business magazine carried a cover story proclaiming the death of equities in the spring of 1981 just weeks ahead of the beginning of a major bull market. In our opinion, the next major bull market is on the horizon because the global economic outlook is bright. We are even more bullish for our portfolio because the companies we own are fully participating in the global economic boom. What makes today even more compelling for our program are the facts earnings are growing faster, free cash flow is greater and growth companies' stocks are selling on par with the market.

Specifically, our companies are growing earnings per share fourteen percent annually and converting almost all of earnings to free cash flow versus only about one-half in 1981. The higher level of free cash is the result of better management of accounts receivable, inventory and capital expenditures which is extremely beneficial. Earlier we cited 3M and the growth they are achieving internationally. 3M is also a story of free cash flow which funds twenty or more small to medium sized acquisitions annually, significant stock repurchases and a healthy dividend. Relative to the market, our stocks are valued at par with the S&P 500 even though earnings are growing almost twice as fast. Historically, our stocks would be selling at a twenty to thirty percent premium. Assuming no change in the evaluation of earnings per share for the stocks carefully selected for investment, clients would achieve a 15% return going forward from earnings per share growth plus dividends. Further assuming over the next five years they move back to the historical twenty to thirty percent premium and the return would reach twenty percent compounded annually. While we certainly cannot predict the future, based on historical trends this analogy is logical and portrays the potential today versus eight years ago when analysts and the media were euphoric. In our opinion, today is the time to be fully invested, confident and optimistic.

It should not be assumed that past results will be achieved in the future or that a loss could not be incurred. Furthermore it should not be assumed that a 15% compounded return will be achieved or that future results will exceed market indexes.

In accordance with SEC regulation, a current copy of our 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

& COMPANY, INC.

Managing more than \$450 million for over 900 clients nationwide.
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