

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Finding Undervalued, Underappreciated Companies That Will Grow Over Time



GRAHAM TANAKA, CFA, is President of Tanaka Capital Management. He has over 45 years of experience as an analyst and portfolio manager and over 30 years' experience managing mutual funds. He is an engineering graduate of Brown University and received an MBA from Stanford University. He was a metals and mining, farm machinery, conglomerate, housing, building materials and real estate analyst at Morgan Guaranty — J.P. Morgan — and a technology and special situations analyst at Fiduciary Trust International. He has made numerous appearances on CNBC, Bloomberg Television, Reuters Television and Yahoo Finance Live and has been quoted in *The Wall Street Journal*, *Investor's Business Daily*, *Businessweek*, *Fortune*, *Forbes* and *Money* magazine. He is a member of the Electronics Analyst Group, a director of the Council for Economic Education and is the author of *Digital Deflation* — McGraw-Hill 2004.

SECTOR — GENERAL INVESTING

TWST: Could you tell me about the firm?

Mr. Tanaka: Tanaka Capital Management is a registered investment adviser and provides investment management services to individuals, pension plans and endowments and is the adviser to the TANAKA Growth Fund, a fully registered no-load mutual fund. Founded in 1986, we manage all-cap, large-cap, small-cap and midcap undervalued growth equity portfolios, as well as balanced equity and fixed income portfolios.

We blend original top-down macroeconomic research with bottom-up stock selection. Our proprietary economic analysis in areas such as demographics, inflation, productivity, monetary and fiscal policy as well as technology and the economy have enabled us to focus on certain industries and companies that we believe will become more profitable over time. Our investment philosophy is to seek companies that are undervalued and not appreciated for their proprietary platforms that can grow significantly for many years by repeatedly adding new products and services on top of its existing platform. We use a “kick the tires” research process, meaning we actually try to shop the product or service as a consumer.

It also means that we meet company managements so we can ask tough questions to understand if the target company truly has built a proprietary platform on which it can add to for future growth. We want to understand why a company may be misperceived and be able to evaluate obstacles, the likelihood of success, and the opportunities for upside and better-than-expected earnings ahead. We are very fundamentally driven, research-intensive investment advisers. We are known for asking good

questions of company managements and some have become our clients.

TWST: Could you give an overview of the fund?

Mr. Tanaka: The TANAKA Growth Fund is an undervalued growth, multicap or all-cap mutual fund, and the fund has been in existence for over 20 years. I was a subadviser for another mutual fund for 10 years, so I have over 30 years of mutual fund experience. We're multicap in the sense that we own everything from **Apple** (NASDAQ:AAPL) and **Qualcomm** (NASDAQ:QCOM) down to small and midcap companies like **Nanometrics** (NASDAQ:NANO), **NexGen Energy** (NYSEAMERICAN:NXE) and **Ionis** (NASDAQ:IONS). We like to be able to optimize and pick the best names from each market-cap size group.

TWST: Why is it a good thing to have different sizes of companies in a fund rather than just being focused on, let's say, small cap or large cap or medium cap?

Mr. Tanaka: At various points in the investment cycle, different market caps might become more attractive than others. We've seen that over the years. And we also like to be able to look in all those categories. In other words, if we were only looking at large-cap companies, we wouldn't be able to find these small little gems that we run into. We look at hundreds of companies a year. And we don't want to restrict ourselves on being just small-cap or just midcap or just large-cap focused.

We are pretty much mostly domestic. We do like to meet company managements — that makes it a little more difficult for foreign companies. But we do have a few foreign companies. Again, we don't want to restrict market cap so that we can look at the whole spectrum of investment opportunities.

TWST: Did you want to highlight a company that you find interesting now?

Mr. Tanaka: We think perhaps the company that offers the most upside potential is one of our larger holdings, **Amyris** (NASDAQ:AMRS). And **Amyris** is not a very well-known company. Its market cap is about \$300 million.

engineer and use biochemistry, yeast strain engineering and high-throughput screening to develop in pure form larger volumes of something that already exists in nature.

By the way, for their product squalane, which is used now in literally hundreds of cosmetics, **Amyris** is already the dominant producer. It's used by **Shiseido** (OTCMKTS:SSDOY) and many high-

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As an industrial biotech, it is really a very interesting hybrid. They use biotechnologies to create different strains of yeast. Think of baker’s yeast. And they are able to tinker with the DNA so they can produce different yeast strains that can produce certain specialty chemicals by feeding them the same input, raw cane sugar. But because they’re able to tweak the DNA, the byproduct of the consumption of sugar by the yeast will produce the preprogrammed output product.

They can produce a variety of molecules — from farnesene used to make jet fuel to products used to make cosmetic ingredients to replenish the skin and make the skin vibrant. They have a new molecule that replicates the best part of the stevia leaf; it’s a no-calorie sweetener. It has a normal taste of sugar, and they’re able to tweak the yeast DNA so it can produce the sweetener molecule at higher volume and lower cost with each tweak.

PureCane is going to be hitting the shelves with a number of partners in the next 12 months. And it’s going to be in products like baked goods and brownies and cake mix and things like that. It’s already in nutritional drinks for **Shaklee**, for example.

And this technology allows them to create a very pure molecule that doesn’t have the impurities of a processed chemical. For example, when you process the stevia leaf from South America, you use various chemicals that allow them to extract the sweetener — it’s called Reb M — but it leaves all these impurities in that compound. And it’s hard to take them out. And so most of these extracted stevia powder products have an aftertaste that’s bitter because of these impurities. **Amyris**, on the other hand, produces a 95% pure product by volume. It doesn’t have those impurities, doesn’t have the bitter aftertaste. They’re able to

end cosmetic lines to brighten up the skin and make the skin younger and more flexible. The prior method of obtaining squalane was from shark’s liver, which obviously is very expensive to manufacture.

So **Amyris** is able to produce specialty chemicals, and their motto is they deliver “all of the good and none of the bad.” They’re

able to produce a more pure version of these compounds at a lower cost and provide more steady production rates at more stable prices than the more cyclically produced compounds from current providers. **Amyris** is a high growth company that has been growing some of their key product lines 80% to 100% a year on the top line.

It’s almost completely emerged now from a stressed-balance-sheet situation. The last 12 months have been difficult in that regard. And in the next few months, we expect them to have emerged with a clean balance sheet and a clean accounting record. They had some complications with their auditor last year and their 10-K has not been fully approved yet. However, we expect that to be approved and filed sometime in the next few months.

And this is what has created the buying opportunity. You can’t buy something that’s growing very rapidly, like 80% to 100% a

year, at a discounted price unless there are some issues, right? So this company has been going through some problems but is taking care of them. And in a few months, we believe the stock will be ready to take off. In terms of our numbers, we’re looking for breakeven to positive cash flow in the fourth quarter, \$0.20 in earnings next year and \$0.70 in earnings the following year, 2021, which is considerably higher than what the Street is looking for. And we are projecting potential for a quadruple in the stock in the next three years.

Highlights

Graham Tanaka discusses Tanaka Capital Management and the TANAKA Growth Fund. Mr. Tanaka blends top-down macroeconomics with bottom-up stock selection. He uses “kick the tires” research where he tries or shops a company’s product or service as a customer. He also meets with company management teams and asks them tough questions. Mr. Tanaka looks for companies that are undervalued and underappreciated but have a proprietary platform that will grow significantly for many years. The TANAKA Growth Fund is a multicap mutual fund that mostly invests in domestic undervalued growth but does hold a few foreign companies.

Companies discussed: Apple (NASDAQ:AAPL); Qualcomm (NASDAQ:QCOM); Nanometrics (NASDAQ:NANO); NexGen Energy Ltd. (NYSEAMERICAN:NXE); Ionis Pharmaceuticals (NASDAQ:IONS); Amyris (NASDAQ:AMRS); Shiseido Co. LTD. (OTCMKTS:SSDOY); Canopy Growth Corp. (NYSE:CGC); Intel Corporation (NASDAQ:INTC); Tesla (NASDAQ:TSLA); Aflac Incorporated (NYSE:AFL); CBS Corporation (NYSE:CBS) and Viacom (NASDAQ:VIA).

TWST: And it seems that they’ve been able to find really diverse uses of their business process and products. And is there any reason not to believe that that will continue?

Mr. Tanaka: We like to look for companies with platform technologies. And this is a perfect example. **Amyris** has accumulated much of the intellectual property in the space, where they can take and refine and design new strains of yeast to produce a variety of different compounds in different industries for different uses. About 15 years ago,

1-Year Daily Chart of Amyris

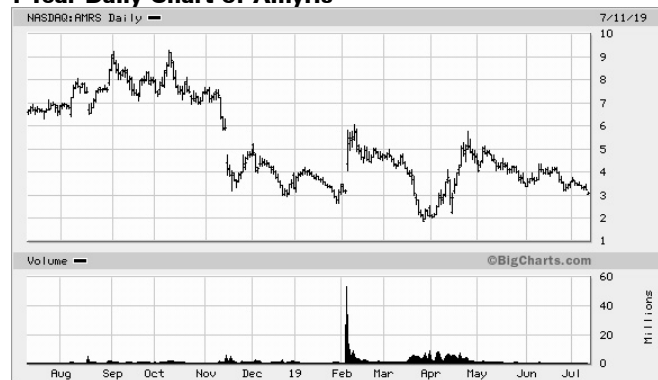


Chart provided by www.BigCharts.com

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1-Year Daily Chart of Apple



Chart provided by www.BigCharts.com

they identified 20 compounds that they thought would be attractive large markets where they can provide a better performing, more pure, lower cost, more attractive product over the years. And they’ve now commercialized a few of them.

One of the first originally was jet fuel, but that became a highly cyclical business as you might imagine. They finally got out of this more commodity type and focused on higher-value-added products addressing more attractive, higher-margin vertical markets like cosmetics, flavors and fragrances. They have produced vitamins and flavor ingredients, the

most recent flavor being a new no-calorie sweetener that is launching this year. The lead product in cosmetics is the squalane line and includes their own brand, **Biossance**, which is the fastest-growing clean beauty line at **Sephora**. They will soon launch **Pipette**, a new line of baby skin care products.

Next year, they will roll out production of its more pure version of CBD, or cannabidiol. CBD is one of the active ingredients from hemp and the marijuana plant. It is not hallucinogenic or addictive. It is a compound that actually has therapeutic value as an anti-inflammatory and a relaxant. It’s been approved in Canada and is approved in some states in the U.S. The hemp product has been approved in the U.S. for production.

But **Amyris** is about two years ahead of everybody else because they already began working on developing its CBD-producing yeast strain. We expect **Amyris** to have a pure version of CBD that they can produce from their yeast manufacturing process at a fraction of the cost of currently produced CBD that you hear from people like **Canopy Growth** (NYSE:CGC) and others whose stocks have gone into billions of market cap value. We think that the CBD alone will be worth in the hundreds of millions within a year for **Amyris**, and the market cap is of course only \$300 million now.

As they use their platform to address new verticals, they’re able to use their proprietary unique technology to manufacture a more

pure product that is better performing — in the case of sweetener, better tasting; in the case of cosmetics, better for your skin; and in the case of CBD, a more pure version of the CBD molecule, which we believe the FDA and others will see as a safer version because it doesn’t have any of the THC molecules in the mix that the marijuana-growing versions of CBD have. Currently, farmers grow the marijuana plant or hemp plant, they try to extract the CBD, but along with it comes the THC, which is the psychoactive part of the marijuana plant. **Amyris** bypasses this whole process by starting from scratch with the molecule they want, which is the CBD. They can produce it via its customized yeast manufacturing plant.

We think they’re going to have the best product at a lower cost, more pure and become a major participant in a very rapidly growing CBD market in the next five years. What is key to understand about **Amyris** is that this is just one of many products that will come out of the labs utilizing its platform technologies.

I went to the investor day last month in California and met management in manufacturing and sales, the Chief Biology Scientist, the Head of R&D and others. These people have accumulated over 15 years of experience actually being able to tinker with this yeast process for producing specialty chemicals of all kinds of varieties, addressing many different verticals. And that’s the key to understand. It’s a platform.

This is a company with a handful of products on the market now that’s going to become two handfuls in about two years, and three handfuls and four handfuls, etc. The upside is, we believe, unlimited. It’s

going to require execution, but we think they can do it. We think they have the management team, they have the expertise and the scientific know-how, and we think this is going to be a home run.

TWST: Did you want to mention another company?

Mr. Tanaka: Our largest holding is **Apple**. I've been a tech investor now for 25 years and visited many tech companies. We were long-time investors in **Intel** (NASDAQ:INTC) and the PC platform. About a dozen years ago, I visited **Apple**, and they persuaded me they were a totally different company offering a very unique platform offering consumers the best experience.

And that means best-designed products, not just the cheapest products that work. We want the best products, because in the end, consumers will demand more than just processor speed or memory. And we were persuaded that design matters and that **Apple** was going to become the king of design and have the most user-friendly ecosystem. And they have since created the best technology brand in the world with its products and ecosystem that is all completely tied together.

You buy an Apple Watch, you buy a Mac laptop or an iPhone, and they all communicate. And it's what consumers really want. **Apple** didn't see this as pieces of hardware to sell; they saw it as a total solution

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that can grow with consumers, new technologies, new uses and applications and become the best ecosystem for providing these features and functions that consumers will want in the future.

As investors, we like to look for these platforms where the company is dominant and providing the best solution for the consumer. **Apple** is doing it in consumer electronics, but of course, we see them moving into other areas like health care with the Apple Watch. It's very helpful for retrieving and providing health data inputs, but we believe that this is just the beginning. They're moving more into services and are now offering an Apple Card.

Apple's platform has high brand value, and they get paid for it. Their returns on capital and margins are fairly high, so **Apple** can invest heavily and more than self-finance their growth into new markets while also efficiently shrinking their capital base. Every time I visit them, they talk about how their R&D pipeline is the best ever and that there will be other new product categories or services that we don't know about yet, which could provide further upside.

But we do know **Apple** has a dominant position where they are, providing surplus cash flow and earnings with a growing dividend currently yielding 1.8%. **Apple's** consensus estimate is it will grow 12% a year in earnings per share. We think it could be higher than that, with an opportunity for multiple expansion. The stock has become cheap due to a recent slowdown in smartphone sales due to the lengthening of the smartphone replacement cycle. With new products and services and more stock buybacks on the horizon, we think that more rapid growth is ahead for **Apple**.

TWST: They've done very well with the iPhone, but if the popularity doesn't continue or there isn't the same volume of popularity in a refresh cycle, do they have other stuff in the pipeline that people will like? Is there just too much reliance on the iPhone?

Mr. Tanaka: **Apple** will become even more important in people's lives. Yes, we can point to the smartphone as slowing down in its growth rate and penetration. It does have other smartphone markets they've identified. Of course, India, which is barely penetrated. They've got some other emerging markets where they can grow their iPhone base into.

They do have a very large base already of customers, and that is something that they're leveraging by providing other services. I would expect more services, a lot in the health care space as well as in the way of entertainment. We would not be surprised to see more additions to the hardware part of their ecosystem as we have seen with the AirPods. And that was a surprise success in the marketplace.

I think **Apple** will be able to come up with innovative new hardware and software and services while the iPhone continues to get better. There'll be faster, better cheaper sensors, processors and other semiconductors that will allow iPhones to offer more functions and be used even more broadly. So I think **Apple's** opportunities for growth ahead are there.

1-Year Daily Chart of Tesla

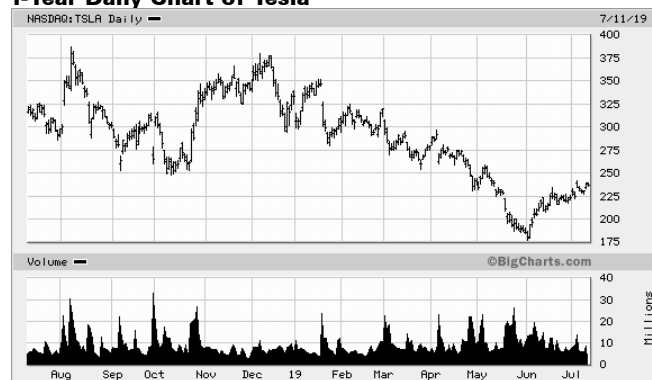


Chart provided by www.BigCharts.com

TWST: Did you want to mention another company?

Mr. Tanaka: How about **Tesla** (NASDAQ:TSLA). I'll mention this in the context of how we do our research. We like to look for trends from a top-down macro basis, major changes going on — in this case, electric vehicles and the need for clean energy and a clean environment. And we are aware of the cost of developing and introducing new technologies. So that cost of development, the R&D costs are the drag on earnings. We know that that's what creates an opportunity.

What we're looking for is a company that's investing heavily in a product that will deliver very high returns in the future. And we like

to time it so that we can get in after they've made most of those investments and they're about ready to start to capitalize on those returns. In this case, I was one of the first buy-side analysts to visit **Tesla** when the stock was \$35, but at the time, it was too early. They were only selling a few thousand Model S's. But they had a road map for other vehicles. The new SUV looked interesting.

I later drove the car, and I couldn't believe not only how much torque and instant acceleration there was but how much fun it was to drive, how different it was to drive, how quiet it was to drive. And I thought the design was, again, kind of leveraging the **Tesla** learnings in **Apple**, how important design was for a new EV. I thought the consumer would like it. We said back then we're putting this on our radar screen. It was too early for us, but we did buy it later. We had a significant gain before trimming above \$320. **Tesla** goes through these major cycles.

And yes, the management, we think, is brilliant. And we think even a management has to go through a learning process. And I think Elon Musk has done a fabulous job. He's an innovator extraordinaire. And he is able to motivate his team. He's got a high-quality management team, some of whom I've met.

They recently had an Autonomy Investor Day for the autonomous driving car. I was able to go out there and ride in a car that actually had full autonomy, and it drove for 20 minutes from the parking lot out onto the street. There was one of their demo people in the driver's seat, but she didn't have to touch any controls as the

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autonomous **Tesla** got on the highway, got off the highway safely, went through various intersections, including boulevard stops and lighted intersections. It was able to wait properly and cross the intersection. It did all these things by itself.

I was an engineer, and I understand how difficult it is to produce these products. I also understand how valuable it is to create a proprietary data-gathering network. Again, this adds further onto their platform of already having the best, most efficient batteries, which is the most expensive part of electric vehicles. I talked to Franz von Holzhausen, head of design. Speaking with him confirmed our belief they still have a five-year lead over competitors on batteries.

Like **Apple**, they have the best hardware, they have the most efficient hardware, they have the best design, it's really attractive, and they have the best-performing products. And they now have cars on the road that are generating, I believe, about 1 million miles a day of data records of these cars driving on existing roads, highways, access roads and intersections and on the street as they stop for cars, people, dogs or bicycles. They're working on the technology to be able to have a full self-driving car, they believe, in the next year. They want to have a robo taxi that'll be able to drive you to the airport without a human driver.

They believe they'll have that technology in the next year. I don't believe it's going to be on the market in the next year in all honesty. I think it's going to take possibly as long as two or three years for regulatory authorities to approve it. But **Tesla** has the highest probability

of success in achieving full self-driving cars, autonomous cars for consumers and for taxi-type use in the next few years because they have a network with the most data being added to it.

For example, they showed us how it recognizes a bicycle. They have eight cameras and other sensor devices on the car to monitor its surroundings. And they can determine, for example, whether the bicycle is on the back of the car or is riding behind the car on the streets. So this is all proprietary technology and an extensive database on the road conditions and whether there's a detour temporarily or a bridge is closed. They have this in real time being accumulated, adding to the database every day.

At our firm, we have a philosophy that we call “kick the tires” research. We go out and visit companies, experiment with their products and services, shop for and buy them in stores. In this case, I test-drove a **Tesla** car. I liked it so much I actually bought a Model X. And I actually see many innovative features not available in most other cars, such as automatic door opening, lane centering, car following and safe lane changing.

What is the value of all that? Well, it's very high. Owners like it, which is reflected in the high **Tesla** vehicle resale values and high consumer satisfaction. The **Tesla** Model 3 has been ranked already as the highest-selling premium car in the United States. And they are able to do it and provide more features and functions downloaded free after purchase every month or two to the consumer.

This is a company that has a road map for growth. Again, like **Apple**, they have an extensive R&D pipeline and road map. The Model 3 has come out as being a more moderately priced electric vehicle — EV — but it's still a high-end EV value for a decent price. We believe that the perceived value of the Model 3 is much more than the selling price. The average configuration is about \$45,000. We believe that the value to consumers is actually \$10,000 more based on our analysis of its unique features and most importantly that **Teslas** are the safest vehicle on the road today.

In 2020, **Tesla** is going to come out with a compact version of their SUV. The current Model X is a large SUV; it's a high-premium-value car with a high price at \$90,000 and up. The Model Y, which will be ramping next year, is going to become their midsize SUV, which today is the largest and fast-growing auto market segment in the world. That's going to add a lot of demand for units.

And then, they're going to come out with a pickup truck. We believe the **Tesla** pickup is going to be a premium-value, premium-price pickup that will have more features and functions that'll blow away current pickup owners. For electric vehicles, one of its biggest attributes is high torque. You can have instant acceleration. You don't have to go through shifting gears at all. Just hit the accelerator, it takes off.

That is what pickup drivers want. They want high torque. They want to be able to pull a stump out of the ground. They want to be able to haul a bunch of heavy stuff to the dump or pick up heavy items. We

believe that the demand for the pickup is going to be very high. And again, it's already a high-margin product in the industry. Most of the profit pool for Detroit is SUVs and pickups.

The stock has corrected because of the first-quarter slowdown and a possible slowdown in demand in the second quarter. And a lot of that first-quarter weakness was company-specific changes in their manufacturing and longer shipping transit times to overseas destinations, markets like Europe and Asia. So they lost about a month supply of sales in the first quarter as cars were in transit.

In addition, there was a reduction in **Tesla's** EV tax credit in the U.S. As a result, there was a natural drop-off, but we expected that drop. Recently, the stock has been coming back up as people realize demand hasn't disappeared. It's still strong for the Model 3 and holding up for the S and X as we understand.

Looking ahead, **Tesla** is building a plant in China for sales in that market beginning by the end of the year. This will allow **Tesla** to bypass high shipping costs and tariffs. **Tesla** is the first foreign auto manufacturer allowed to build a wholly owned plant in China, and we believe that **Tesla** sales in China will ramp very quickly with decent margins over the next two to five years.

Although there is some concern that there may be an economic slowdown in 2020, it should be an exciting year for **Tesla**. The China plant should be ramping at volume, and the new Model Y compact SUV will add higher incremental margins to the mix. There will be increasing excitement over the new pickup truck and even the semitruck, which

who really has all the best intentions in the world in terms of creating a more environmentally sound, long-term plan for mankind to survive on Earth. If you extend out over the next few decades, yes, internal combustion engines are really going to make the planet less habitable. Elon Musk wanted to have sustainable transport, meaning being able to use renewable energy, like solar and wind energy, to produce the power to run the electric cars and to store that power when it is not being used. But it is totally consistent with his grand plan of having a sustainable planet.

And governments in different countries are very appreciative of electric vehicles and their ability to help provide a more sustainable, clean energy profile in the U.S. and in the world. There are other countries that are much more progressive on this, mandating electric vehicles being a certain percent of sales versus internal combustion cars. And we think that this is a trend with significant momentum. It's just going to accelerate. And we think that **Tesla** is leading the way.

Regarding **Tesla's** cash flow and balance sheet, we believe that it could become earnings positive in the final three quarters of 2019 and approach positive cash flow by early next year as the China Gigafactory and the new Model Y SUV go to scale at strong margins. In addition, we believe that an unappreciated aspect of the Model 3 is like the **Dell** computer PC model; it also has a negative working-capital profile. Customers pay for the car before **Tesla** has to pay its suppliers for the Model 3 parts because consumers buy the car in advance. This creates cash and is more capital efficient than people realize.

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may be launched in 2021 or 2022. We suspect that the semitruck is also going to have a high-margin profile as commercial shippers are already showing great interest in reducing fuel costs per mile by 50%.

So we think that **Tesla** has crossed the chasm from an emerging growth company to being an actual real rapid growth company with multiple products, addressing multiple end markets and with improving finances. **Tesla's** profitability should improve significantly over the next two years as it goes to scale on the Model 3, the China plant ramps up and as the Model Y compact SUV begins to ship. This should help **Tesla** improve its balance sheet and move closer to becoming more self-financing. We believe that **Tesla** will grow earnings 50% per year over the next three years. Our target for **Tesla** is about \$800 in three years.

TWST: And it seems like there also is a growing interest on the part of regulators and environmentalists and politicians in some countries to encourage the population of the country to get an electric vehicle, and that's going to be a continuing trend looking a few years out.

Mr. Tanaka: Yes, absolutely. And in fact, this is one of those rare examples where we have an innovator, an entrepreneur,

I think, in the end, investors will realize that this company will be able to self-finance much of its growth rate in the future and won't have to depend on going back to the capital market every six months. I think all of these positives will come out in the next 12 to 24 months. And then, you will end up with a company in two or three years that is still growing at very rapid double-digit rates, throwing off nice cash flow and earnings with more new products to layer on over its current platform

We can dig deep and go into detail with our companies because we do only own 20 to 25 companies in our portfolios. And we want to be able to own them long term, buy them at a discount and then reap the rewards as the company's returns accrue from their investments and compound over time. Ideally, we will hold a company for many years.

We've owned **Aflac** (NYSE:AFL) for 30 years. Our lowest cost is about \$0.90 a share. **Aflac** has been a phenomenal stock. Again, it's the platform, cancer insurance products that they have grown in Japan and are being enhanced with other new product.

This is a model that we like to replicate and hold over multiple years. It's a more efficient portfolio management and research model for us because we don't have to research 30 or 50 new stocks a year to buy. We just need to find five, six or seven new stocks a year and keep

holding the stocks we've held for five or 10 years and get the value of the compounding on the purchases of these stocks at lower prices. So we try to find something that's underappreciated, buy it at an entry-level discount because they've been investing heavily and the costs are temporarily hurting earnings, be there for the beginning of a recovery in earnings, and then hold on as the utilization of its platform technology has broadened out and is applied to more products, services and end markets, ultimately getting the power of compounding off that low cost base. That's our model. We are excited as we still see many opportunities out there in technology, health care and other industries.

CBS (NYSE:CBS) is another large-cap company with a market cap of about \$18 billion. **CBS** is unbelievably cheap and fits our model of platform companies that are temporarily underappreciated. **CBS** has the most watched shows on network TV, some of the highest-quality premium content in Showtime and one of the fastest-growing over-the-top platforms in CBS All Access and Showtime OTT, which can be obtained over the internet. You don't have to have a TV cable contract. And they did this from scratch. It is way ahead of its peers in the industry — two or three years ahead in some cases.

The stock sells at 8.9 times this year's earnings, 7.6 times next year's earnings. Their long-term growth rate in terms of what the Street is looking for is 16% a year in EPS, a dividend yield of 1.5%, and it's 8.9 times this year's earnings. Well, you like to look for these opportunities. Why so cheap? There's always a reason. In this case, it's uncertainty over management change and uncertainty over whether they're going to merge with **Viacom** (NASDAQ:VIA).

CBS and **Viacom** are both controlled by the Redstone family. Shari Redstone has already indicated she wants a merger. We think they're going to be merged. What's the result going to be? Most analysts are looking for something like a 20% EPS accretion if you're a **CBS** shareholder in the event of a statutory merger. We don't believe that **CBS** is going to have to pay a premium or much premium at all and that the companies will be able to create efficiencies as a single combined company.

We believe that based on **CBS'** talent pool, they'll be able to help **Viacom's** assets grow faster and be able to use them on both of their over-the-top platforms. **Viacom** has Nickelodeon, Comedy Central, Paramount Pictures, and we think that these assets will boost the value of **CBS'** content library. The 20% accretion to **CBS'** earnings per share will make the stock even cheaper. If **CBS** is 7.6 times next year's earnings, how does it sound to be 6.5 times next year's earnings? I mean, this is really cheap.

And at some point, the uncertainty over a possible merger — Who's going to be running the combined company? How is it going to be run? — will be resolved. And this is going to be one of the best assets in the content-creation space, **CBS** along with **Viacom's** assets. That'll be a very powerful package that will be distributed over traditional TV, over-the-top streaming platforms and even services like Apple TV Channels. It will be distributed worldwide.

Speaking of worldwide, **CBS** has a great opportunity to expand their assets internationally. So in addition to being the top-rated content creator for linear cable television, they are going over the top by distributing some of its unique content for their own over-the-top CBS All Access platform. And we think they are pressing all the right buttons and making the right moves. And they're making a lot of investments.

Again, this is the same model that we have, looking for companies that are investing heavily in its proprietary platform for future growth. Despite heavy investing, **CBS** has been able to grow its EPS 10% a year over the last five years. Over the next five years, we think they will grow low- to mid-teens growth rates, especially with the merger. And where can you buy something where the p/e is half the growth rate?

I tried to provide you with a variety of different examples but with the same investment research and portfolio management model that we have. We like to look for companies with platform technologies, good brands, good finances or improving finances, high margins, high returns on capital so they can become self-financing in the next few years and rapid double-digit growth rates when we can invest at an entry-level discount due to heavy investing or a temporary issue or problem. In the case of **CBS**, it was management change and a possible merger.

We like to tell our investors and clients that we meet managements to ask better questions and get better answers. Many of them would like to do this themselves but just don't have the opportunity or maybe even the industry know-how or expertise to be able to ask **Tesla** the right questions about its battery advantages or **Apple** the right questions about its new services and content or **Amyris** about its next five new verticals they're going after and what they have to do to get there.

We like to ask questions. It can be a lot of fun to discover what other investors don't quite see yet. For example, we did a blind taste test in our office for **Amyris'** new no-calorie sweetener that validated the company's claims of no aftertaste, and it was fun for everybody. We like to do the "kick the tires" research that helps us find the things that people don't quite understand or appreciate yet in companies. It's these underappreciated companies that we've been able to find successfully over the years, and we will find more in the future for clients at Tanaka Capital and for TANAKA Growth Fund shareholders.

TWST: Thank you. (ES)

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The TANAKA Growth Fund's prospectus contains important information about the Fund's investment objectives, potential risks, management fees, charges and expenses, and other information. Please read and consider it carefully before investing or sending money. You may obtain a current copy of the Fund's prospectus by calling 1-877-4-TANAKA.