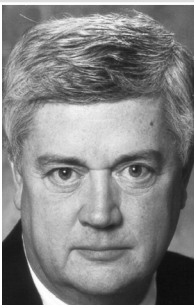


# THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

## Consolidated-Tomoka Land Co. (CTO)



WILLIAM H. MCMUNN is President and Chief Executive Officer and a Director of Consolidated-Tomoka Land Co. He is also President of Indigo Development Inc., a wholly owned subsidiary of Consolidated-Tomoka Land Co., and a broker at Indigo Commercial Realty Inc. His expertise in building and development dates back to 1973 when he first became involved in the building and syndicating of rental apartment projects in the central Florida market. With subsequent changes to the tax laws, he became involved in the designing and construction of high-end custom and spec homes. This involvement later led to him specializing in subdividing raw land for residential development. In 1980, he started planning, development and sales on a 500-acre mixed-use community, located on the east coast of Florida, which included a hospital, shopping center, retirement center, restaurants, offices, etc., and more than 1,250 residential homes. Over the years, Mr. McMunn has specialized in the development and sales of many types of residential and commercial products. In 1990, he became the President of Indigo Development and started the permitting and development of the 4,000 plus acre LPGA International mixed-use community (DRI) located in Daytona Beach. Mr. McMunn's major emphasis is the planning and sale of over 11,000 acres of company owned land. He has been involved in the feasibility, permitting, development and sale of a large variety of real estate projects including all types of residential real estate, improved and unimproved land to major home builders, the sale of all types of commercial real estate including public and private schools, churches, auto malls, convenience stores, restaurants, shopping centers, office, warehouse, industrial, hospitals, and all types of medical uses. In April 1999, he was elected to the Board of Directors of Consolidated-Tomoka Land Co. In June 2000, he became President and COO and in May 2001, he became CEO of Consolidated-Tomoka Land Co. In his current capacity, he directs all parent and subsidiary operations, which include forestry, land development and infrastructure construction, golf course construction and operation of the company's restaurant, banquet and club facilities, and the company's long-term deferred re-investment strategy, which encompasses the acquisition of triple-net lease commercial properties throughout Florida and the Southeast. Mr. McMunn has planned and successfully coordinated a major DRI, as well as the creation of a companion Community Development District and has managed numerous commercial and residential owner associations. He has always been active in his community and, over the years, has served on numerous civic and cultural boards. He was instrumental in Take Part II, a Chamber-sponsored program to revitalize the community image and to promote family-oriented facilities in the beachside redevelopment area and local governmental affairs. Mr. McMunn is a member of many civic groups and Boards including Futures, a business group that supports Volusia County Public Schools through a variety of programs, and he serves as Vice Chairman

on the Board of the Advanced Technology Center, Embry Riddle Aeronautical University President's Advisory Board, the Board of Visitors of Bethune Cookman College, the Board of the Halifax Chamber of Commerce, and the Civic League. On a state level, he is Chairman of the Association of Florida Community Developers, whose membership includes many of the largest development companies and builders in Florida. Mr. McMunn a BA degree in Economics from Rollins College and an MBA degree in Business and Finance, from the Roy E. Crummer School. He is a licensed Real Estate Broker and a State Certified Building Contractor. He is a member of the Volusia Home Builders Association, Executive Board member of Volusia County Association for Responsible Developers, Executive Board member of the Association of Florida Community Developers, Board member of The Daytona Beach and Halifax Area Chamber of Commerce and the Business Development Partnership.

**TWST: We'd like to begin with a brief historical sketch of Consolidated-Tomoka, and a picture of the things you are doing now.**

**Mr. McMunn:** The company is over 100 years old. It's headquartered in Daytona Beach, Florida, and it was in all types of businesses including timber, citrus, cattle, land, oil and mineral rights. In 1999, we were spun off from Baker Fentress, became an independent company and adopted a new business plan, which was to sell our land holdings using 1031 exchanges, and build up a large portfolio of income properties. We still have significant oil and mineral rights throughout Florida, but our remaining 11,200 acres are located in Daytona Beach, Florida. We obtain entitlements on all types of commercial and residential land that we sell to the end user, rather than developing it ourselves, although we do some self-development of select income properties located on our land such as office buildings and warehousing.

We have an income property portfolio of about \$110 million spread out geographically in Florida, Georgia and North Carolina. They are triple or double net lease properties with credit tenants that produce about \$9 million in revenues per year. The unique thing about our company is that we designed our real estate company to make money during bad economic periods like we are experiencing today. We have virtually no debt, only a \$6.7 million term loan that we took out to show something on our books. If it wasn't for the

prepayment penalty, we would have most likely paid it off by now; secondly, all of our land is carried on our books at very low basis, so our balance is very understated.

**TWST: You say the company was designed to make money during bad periods. Would you explain that?**

**Mr. McMunn:** Obviously, if you don't carry much debt in the bad periods, that helps you. We are not forced to sell off assets at distressed prices to survive. Our portfolio is unleveraged, so we have over \$110 million of value, significant borrowing power should we ever need it. Through the cash flow of our operations, we find that we can generate the money we need to build roads and do the things we need to do. The cash flow from the income properties also allows us to cover our overhead expenses and be slightly profitable without land sales.

Our real estate business has been good and has held up through this down market. The residential market went away a few years ago (2005). We have only been able to sell some apartments or ALF sites, which is a very small part of our business right now. Commercially, which is our bread and butter, that market has stayed reasonably stable. We released our earnings a few weeks ago, and we were only down \$0.10 from where we were the year before. So we had very respectable earnings where many of our peers are in the red and are having some tough times surviving.

**TWST: Would you elaborate on the portfolio?**

**Mr. McMunn:** One of the things about 1031 strategy is that it lets us reinvest by deferring the income taxes hopefully forever that are normally due upon completion of a sale. That supercharges our returns. If we make an investment at say a 7% or 7.25% cap rate, and we are not paying 40% of the profit to Uncle Sam, that gives us the equivalent of 11.5% to 12% returns. The effect of 1031s really helps the company with higher returns.

**TWST: How does the area that you are active in track with the rest of the US?**

**Mr. McMunn:** It's probably about the same. Nationally, I understand that California, Arizona and Florida are probably the worst markets. The worst segment of the market, I think, is condos, ocean front condos, but we are not in that business. The real estate market for residential is pretty tough. If you were once building 300 homes a year, then building 900 homes a year for a couple of years and are now back to building 300 homes a year, obviously your volume has been cut by two-thirds. But if 300 was really what you used to do and you can make money out of 300, it's not that bad.

Building permits in our area are really back to what they were pre-boom, but there are too many competitors scratching for those sales. Too many people got into developing too many lots and have too much inventory. The builders are hurting because of the market constriction. If you really look at the numbers in our area, they are near historic levels before the market got overheated. I don't know if that's true nationally, but sometimes when we talk about how bad things are, they really have just gone back to what they were before everybody and their uncle decided to speculate in real estate.

**TWST: What are the main items on your strategic agenda for the next three to four years?**

**Mr. McMunn:** We will obviously keep focusing on the commercial sites, since that is the better part of the market. The commercial side is still playing catch up because of the residential built in the last few years. There is still a need for shopping centers, big box retailers and other kinds of uses, such as office buildings, warehouses, distribution centers and manufacturing facilities. We are going to branch out and do more self-development. We will be com-

mentary. We are also looking for distressed properties that can yield big returns when the market returns.

**TWST: Within the geographic area in which you are active, are there substantial differences from place to place?**

**Mr. McMunn:** In Daytona Beach, we have two interstates, I-4 and I-95, coming together. Our land is essentially at their intersection with seven miles of frontage along I-95. We have an interchange in the middle of our property, so our land is very unique. We control a large amount of land, 11,000 acres. We don't have a monopoly by any means, but we are the 800-pound gorilla in our market.

To our north is Palm Coast. The numbers are a little softer with unemployment and foreclosures rising. They are about 20 minutes to the north, so that is a little weaker. About 40 minutes to our southwest is Orlando. We are becoming more and more a satellite suburb of Orlando. Jacksonville is 60 minutes north and is growing south. In about 10 to 15 years the cities will grow together into one large metropolitan area and you really won't know when you leave Jacksonville and when you arrive in Orlando.

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encing construction of an office building right now that is about 50% pre-leased. We are currently constructing a flex-office/warehouse commercial project. We will also be developing a large spec warehouse facility, which will be new for us, and that will provide product for customers who need immediate occupancy.

We also sell to customers who build their own building, but it takes some 12 to 18 months to get into their building. So we are going to develop a limited amount of inventory for our customers who need to move in quickly. That's a new project that we are involved in, and we will continue to do that based on market demand. If the market is slow, why would I build additional buildings until the market picks up? As the market picks up, we'll add more to the in-

**TWST: Can you foresee any new challenges or problems that might occur in the next few years?**

**Mr. McMunn:** The present period is the biggest challenge our industry faces, plus the junk mortgage problems. It's certainly going to take a few years to work the problems through the system. I do anticipate that the next few years are going to be rather tough overall for the economy because of that, especially real estate. We can't control the national stuff; we have to work with it. Florida has some issues that they are trying to address right now. With the boom in the assessed real estate values going up, we have become less affordable. Residents and non-residents are taxed differently if they own a home.

We are seeing a real transition now, and a lot of people believe that home prices will readjust down about 20%. That readjustment downward is needed to bring housing back into balance. Several years ago, we passed an initiative similar to California called "Save our Homes," which capped the value increase of existing homes at 3% per year. Historically that kind of cap didn't do a whole lot, but during the real estate boom with 10%, 12%, 15% and 20% appreciation, it made a difference. We are working through that issue on a state level, and that has to be fixed. There are a number of initiatives going on. It would take a crystal ball to figure out what exactly is going to happen, but that has to come back into balance so that people can afford to move to Florida. Keeping up with population growth is an area that Florida and our company constantly face. We have done some creative things as a company. We loan money to the government to build roads. We might owe one-third of the cost of the road, but the government doesn't have the money for the balance or only has some of the money. We have entered into agreements to loan money so that needed roads can get built. It's good for us because you get the roads and we get paid back later from other new development.

**TWST: I would think that loaning money to the government to build roads is extremely creative. How often is that done?**

**Mr. McMunn:** It has been done a little more in the last few years because that is the only solution to get certain roads built because the need has outstripped the government's ability to do it. In areas where the government is willing to provide a payback, private enterprise will respond and help.

**TWST: What would you expect the company to look like in about three to four years?**

**Mr. McMunn:** We had predicted that about 2005 was when the housing downturn would hit, and it did. If you look at those numbers, it hit in the fall for condos and then around Christmas 2005 single family collapsed and everything went downhill from there. We originally predicted that 2010 would be when the market would turn around. Some of my friends in the business thought I was a pessimist; now they are hoping that I am correct. Unfortunately, I think it could now go into 2011 or even 2012; I hope that's not the case. We do have a few more years of tough times, and then the increase will be gradual. It is not going to go back to the level that it was in 2005, and that's good because we had a housing industry with a very high inflationary period and unpredictability of prices. I hope it never gets that hot again.

We will continue to expand our 1031 inventory geographically. We have significant agricultural land. We grow hay and trees on our property and we work every day on entitlements. In other words, we get the zoning, comprehensive plans and roads approved. We can take our agricultural land and make it valuable for shopping centers, offices and residential communities; all types of these uses raise the value of our land significantly. We exchange our land for triple net lease properties, and this geographically diversifies our portfolio. Avoiding having all our assets in Daytona Beach helps improve the company, and we will continue to grow the company that way. It lets us realize the real value of our land, and we can still self develop certain products on our Daytona Beach lands.

Three years is not a long window but overtime we will grow into a much larger holder of income properties, with a very diversified portfolio, much larger earnings and more predictable cash flows. We also will be doing more self development. Part of our strategy right now is looking for land and opportunities in this down market. We are an unleveraged company. We are not yet seeing the good land deals, but they will happen. I am talking about a range of \$0.50 on the \$1 worth in good times. They have to be at least that or less before we would buy, and that hasn't happened yet. But I do expect that's going to happen, so we are going to keep looking to buy some property and take advantage of the downturn. When things turn around in three or four years, we think we can make quite a bit of money on that investment.

**TWST: Would you tell us about your own background and expertise, and the same for one or two of your colleagues?**

**Mr. McMunn:** I came to Florida and went to Rollins College. I graduated in 1969 with an economics degree, then went to graduate school and earned an MBA in Finance. I started in sales working for Xerox Corporation, but my real interest had always been the real estate development business. As a little kid, I wanted to be an architect, and I actually started college to be an architect. A few years after I got out of college I learned how to sell. I think learning to sell is a skill that everybody should know if you are in the business world. I went to work for a development company. It was a great place to begin and get some broad-brush experience. I worked in market research, investor relations, site development and built condos, apartments and single-family homes. Needless to say, I worked the gamut of all areas of the real estate business.

I earned my real estate brokerage license and my contractor's license and went off on my own and built custom homes for a

while. Then I got into building subdivisions (lots) for builders. I came to Daytona Beach in the 1980s to run a company called Coastline Enterprises; we built the first large planned community in the market. It had a hospital, banks, restaurants, single-family homes and shopping centers. After that, I went off with some partners and we built residential communities. We developed communities in Orlando, Melbourne, Jacksonville and Daytona Beach.

In 1990, Consolidated-Tomoka hired me to run their development company. They had at that time over 28,000 acres of land and I wanted to do much bigger projects than a 500-acre community project. They needed somebody to come up with the ideas of how to create a product, market it, develop the land, and get the entitlements. I have now worked almost 18 years for the company. I went from running the subsidiary to becoming the COO of the parent company, Consolidated-Tomoka Land Co., and am now CEO and President of Consolidated-Tomoka Land Co., which I have been for the last several years.

Our number two, Bruce Teeters, is a “Reformed CPA” with major accounting firms. He started before I did at Consolidated-To-

sure we are positioned properly for the future. In the last few years, I have done more of that. I am still involved in the day-to-day operations, and I still get involved firsthand in some of the larger sales and in a lot of the land planning of our communities, I always physically inspect every 1031 property prior to purchase. I participate in a lot of regulatory work. I was the Chairman of the statewide organization of the large developers, called Association of Florida Community Developers (AFCD). I worked on a lot of lobbying and legislative work in that position to try to get legislation passed that would be helpful for our industry. Although my term is over, I am still pretty involved in AFCD, but I now have more time to work on our business. I’m very involved in community affairs. Our community is very important to our company. Since we are headquartered here and our entitlements are earned here, we will always be very involved in things that are good for the community from economic development to social services; our company is always very involved. We also think our employees should be involved in whatever particular area of our community they have an affinity for. We want them out and involved in the community, so virtually everybody is.

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moka and ran the finance and accounting function of the business. Over the years, Bruce has gotten much more involved in development. He runs our 1031 programs, negotiates a lot of our large contracts with buyers and handles investor relations for us. He still oversees finance, but another key employee has taken over the financial part of the business. Bruce has been a very key person. He has been with the company about 28 years.

**TWST: What occupies your own attention most on a day-by-day basis?**

**Mr. McMunn:** Number one, I have to look toward the future, 10 years or more and, I also focus on what is happening in three years, one year or six months. An awful lot of changes have occurred in our industry. Therefore, I have to look at where we are and make

**TWST: You spoke about working on things that could be helpful for the industry. What would those be?**

**Mr. McMunn:** We need some improvement on regulations. Because the economy slowed down and the DRI (Development of Regional Impact) process didn’t recognize that, we were able to get a three-year extension on the timelines. Since sales slowed down, people were faced with having to build a certain road by a certain date and had no sales to justify building it. It was really causing problems. We were able to buy some time while the market adjusts.

There are some regulations that unfairly single out large developments, which is too bad because you should encourage larger well-planned developments. It’s the kind of place where you can both work and play and build a total community. Unfortunately the regula-

tions tend to make it harder to do that. They encourage people to do smaller developments that aren't as well planned. We tried to improve that as best we could, and we will continue to work to encourage governmental agencies to improve the regulations.

**TWST: Is the company understood by the investment community?**

**Mr. McMunn:** We are pretty small, unknown. We were spun off from Baker Fentress in 1999. They liquidated Baker Fentress, gave cash for every share and gave stock in our company. Most of the stockholders had no idea who we were. We were very concerned about what was going to happen. We went from having one

67% of the company. We have gravitated to a lot of sophisticated value investors who have analyzed the company and made a determination about the future value of our company; remember, our land cost is carried on the books at our 1905-type prices so our balance sheet is understated. Our major shareholders all do their estimates on what they think the company will be worth over time. That has made a lot of people buy our stock, so we have gone through quite a transformation. We have a lot less shareholders now, probably in the 5,000 range. If the top 20 make up 65%, there are a lot of very small shareholders. Most of our sophisticated owners are in it for the long haul. We are a different company now.

*“Our business plan is very unique with the 1031 exchanges, where we unlock shareholder value. I think that we are going to grow significantly over time, and we will have a fair amount of holdings in Daytona, but not what we have now. We will have a huge amount of holdings geographically spread out and good properties that can be worth a lot of money with good cash flows all over the Southeast.”*

80% shareholder and maybe 1,000 other shareholders that only had 20%. People didn't know anything about us.

A fellow by the name of Warren Buffett happened to own shares of Baker Fentress, and when we were spun off, he ended up owning more than 5% of Consolidated. I'm not sure that was his plan, but he had to file that he owned over 5% of our company. That made a lot of investors wonder what Consolidated was all about since Warren Buffett owned shares. So we started to get some investor attention, Warren Buffett sold down below the 5% level so he doesn't report anymore. We don't even know if he's a shareholder anymore, but that got the fancy of people. *Barron's* did an article about Consolidated, which got a bit more information out there. And then Marty Whitman, of Third Avenue Fund, who has a great reputation in real estate, increased its position to over 11% of the company. The combination of Warren Buffett followed by Marty Whitman led to our company being acquired by a number of savvy value investors.

We have now moved to approximately 10 shareholders who own about 50% of the company. Our top 20 shareholders own maybe

**TWST: What would be the two or three best reasons for the long-term investor to look very closely at Consolidated-Tomoka?**

**Mr. McMunn:** We have a record of creating long-term value and great potential. Our business plan is unique and it has been proven that we will do well during bad periods. When I look at some of my competitors, some of whom have filed for bankruptcy and some of whom are facing really hard times, a lot of them will give up a tremendous amount of shareholder value during these bad times. We perform as well or better than they do during the good times, and we really will outperform in the bad times. If you have a company and a business plan that can perform both in good and bad times, it's unique in our industry.

Two, our business plan is very unique with the 1031 exchanges, where we unlock shareholder value. I think that we are going to grow significantly over time, and we will have a fair amount of holdings in Daytona, but not what we have now. We will have a huge amount of holdings geographically spread out and good properties that can be worth a lot of money with good cash flows all over the Southeast.

**TWST: Thinking about the subprime problem, how could so many smart people be so dumb?**

**Mr. McMunn:** I sit on a bank Board, and they didn't do any subprime lending, but they still got caught up in it. The subprime mortgages weren't sold to people like in the old days with junk bonds. You knew you were buying a junk bond and you got a different rate for it, but with the subprime, they mixed those mortgages in with good ones. When they sold \$1 billion to a European company, they put just enough of those in so they could still get their insurance and their rating. In that rated package there was some good stuff and some real junk. The problem reminds me that when the dot-coms were at their peak, I didn't understand that. I didn't get into it because it made no sense. I figured a few businesses would make it, most of them wouldn't, and I never speculated in them because I couldn't figure them out. To me, the second coming of dot-com was when real estate got hot. People were flipping condos and then flipping houses and they were saying, "I bought a house for this amount and sold it in six months for this amount." Pretty soon, other people got into it.

One of the big things I saw from the banking side was that people would lie about whether it was a second home or an investor home. There was no national exchange to track that, so they go to the bank searching for a loan and say, "We are buying a second home down here," and they look good on credit, so they made them a loan. But it wasn't their second home, it was their third, fourth or fifth investment property. They were going to flip, and I think those became the junk mortgage. When the market turned, it was condos or extra homes, and they couldn't sell them. They had four or five, and people started walking away from them.

**TWST: Is there anything you'd like to add, especially regarding strategies, long-term objectives and reasons for investors to look at the company?**

**Mr. McMunn:** Don't look at our company if you are not looking long term. We do not want people in our stock just for the short term. They should be looking at the company with a horizon of 10 years. You could have less, but when you start looking for five years, you ought to be into something else. But if you are looking even further to 15 or even 20 years, it's a great company to invest in. It has a bright future and the value is going to be seen over time.

We try to discourage the day traders or short sellers. There are a lot of short sellers right now in the market because real estate is in decline. It's going to go down, but you really should be looking long term. You should be a value investor and be patient and analyze the company well.

You ought to come down and meet with us and see our property. My advice is to do your homework and find out about a company like ours. If you are looking for a horizon where you want to do well, whether it's 10 years, mid-term or short term, be patient and it will do very well.

**TWST: Thank you.**

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