

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

Investing in All-Cap Growth Stocks



SCOTT A. CHAPMAN joined Lateef Management Associates in March 2002 as a Senior Portfolio Manager. He brings to Lateef Management over 20 years' experience performing investment analysis, managing portfolios and investment professionals. Mr. Chapman shares LMA's investment philosophy of selecting undervalued businesses that are highly profitable, have a sustainable competitive advantage and possess outstanding management. He enjoys the fulfillment of making a positive difference in building clients' capital. Prior to joining Lateef Management, Mr. Chapman was a Senior Portfolio Manager, Large-Cap Team Leader and Director of Research from 1998 at Founders Asset Management in Denver where he managed the Dreyfus Founders Growth Fund, Dreyfus Founders Focus Fund, the domestic portion of the Dreyfus Founders Worldwide Fund and several separate accounts and sub-advised funds. From 1991 to 1998, he was the Director of Growth Strategy for San Francisco-based HighMark Capital Management, Inc., a subsidiary of Union BanCal Corporation where he designed and managed the investment discipline for the HighMark Growth fund that earned a top five-star rating by Morningstar rating agency. Mr. Chapman taught investment principles to CFA candidates in San Francisco for seven years. He also developed and instructed investment seminars called "Lessons from the Masters" which profiled the investment principles and case studies of stocks used by Warren Buffett, Peter Lynch and John Templeton. His previous positions included a Securities Analyst with McCullough, Andrews & Cappiello and a Senior Financial Analyst with Cooper Development Company and Castle & Cooke, Inc. Mr. Chapman earned an MBA degree in Finance from Golden Gate University and a Bachelor's degree in Accounting from Santa Clara University. Additionally, he is a Chartered Financial Analyst and a member of the Security Analysts of San Francisco.



RYAN F. WILLSON joined Lateef Management Associates in 2000 as Director of Marketing and Client Relations, and became a General Partner in 2001. In prior years, he was Founder and President of Willson Investment Management, Inc., and prior to that, held account executive and financial consultant positions at Dean Witter and Merrill Lynch respectively. Mr. Willson earned a BA degree from USC.

(YAQ503) TWST: Gentlemen, would you start with an overview of Lateef Management Associates, its history and its investment philosophy?

Mr. Willson: We were founded in 1974. We have \$1.3 billion under management, including an office in Portland, which uses a different investment process. All of our assets and all of our clients are separately managed accounts for individuals and institutions. We're 100% owned by five general partners. Al Lateef, Roland Underhill and Scott Chapman are the portfolio managers. Justus Leachman is our Director of Operations and I am the Director of Marketing.

We use a team approach. All research and portfolio management decisions are made on a consensual basis by the team. We have one dominant style. It's all-cap growth, US equity. We invest in 15-20 companies per portfolio. Our focus is capital preservation first, and second, we strive to outperform the S&P 500.

Our Non-Taxable Equity Composite has outperformed the S&P 500 for the last six years in a row. On average over the last 10 years versus the S&P 500, it captured over 100% of the upside while not capturing any of the downside. Actually, on average the composite made about 3% per year in the down years. Our beta to the S&P 500 is 0.62. The composite's annual performance net of fees versus the S&P (updated through to the end of 2004) for the three-year av-

most people would have been thrilled having only lost 4% in 2002 when the S&P lost over 22%, yet it was a very sad time here.

We're truly long-term focused. We make sure that all of our clients' interests are aligned with that, so we don't feel the short-term pressures month to month or even quarter to quarter to worry about whether we're slightly outperforming or underperforming our benchmark. We see our job as being, first, not to lose money and, second, to make as much money as we can while taking as little risk as possible. Long-term focus really allows us to keep our eye on the ball and be very, very patient in the decision-making process, as well as very careful. With a portfolio of only 15-20 companies, we have to be right when we make an investment. Our turnover is only 15%-20%, so we're really committing to these companies for the long term.

Mr. Chapman: The other factor that has contributed to our success is our flexibility in our all-cap style. By that I mean that we're simply looking for the best business to invest in with an outstanding management team at a reasonable or a bargain price, no matter what size the company is. That flexibility to be able to invest in large size companies, mid-sized companies or small size companies proved to be fortuitous for us because while large caps were expensive five years ago, when the market hit its peak the S&P 500's p/e ratio was 30 times earnings in March 2000.

Chapman: McGraw-Hill is expecting double-digit earnings growth this year, excluding the impact of acquisitions. They're benefiting from the No Child Left Behind spending. They're benefiting from the Global Research Settlement that's allowing for more spending from Wall Street research for independent firms such as their Standard & Poor's division.

erage is 13.45% per year versus 3.55% for the S&P. Over the last five years, it's 10.56% versus negative 2.31% per year on the S&P, and over the last 10 years, it averaged 19.18% versus 12.04% on the S&P.

We're ranked the number one all-cap growth manager by both *InvestorForce* and *Money Manager Review*, and over the long term we're consistently in the top 1% of our peer group. Percentages and rankings aside, if you just look at the raw numbers, over the last 10 years, \$1 million invested with the S&P 500 with dividends would have grown to \$3.2 million. But with Lateef (net of fees) it would have grown to \$5.6 million.

TWST: To what do you attribute your success? What is your investment decision-making process?

Mr. Willson: One of the things that I think separates us from the typical institutional or even mutual fund money manager is that although some firms say their primary focus is downside protection, it's truly our mantra here. The composite's biggest down year over the last 15 years is a negative 4% net of fees in 2002. I think

1-Year Daily Chart of McGraw-Hill



Chart provided by www.BigCharts.com

Yet with the Value Line Index, which is a reflection more of the average company's valuation because it measures 1,500 companies rather than the S&P's 500 and is equally weighted and not market-cap weighted like the S&P, the median p/e ratio was only 13 times in March 2000. That showcased how much opportunity there was to rotate into much more attractively priced mid-sized companies, and our firm did just that at that time. We're simply looking to do what makes the most investment sense. The ability to rotate primarily between mid- and large sized companies is important and has allowed us to achieve the record we have.

TWST: You certainly have more flexibility in looking for your stocks, and with a concentrated portfolio, you only have to find very few stocks each year.

Mr. Willson: That's exactly right. With that low turnover and 15-20 companies in the portfolio, if you're looking at a 20% turnover per year, we really only need four ideas a year. That's not to say we only have that. We typically have 2 or 3 times that many new ideas per year.

The other thing I'd like to mention about our success is that we only have three portfolio managers here, and there is over 100 years' experience between these three guys. They've each been Directors of Research. They're very deep in their knowledge and their experience, and having a small experienced group allows us the benefit of their knowledge. We're also small enough to be able to make consensual decisions rather easily. We don't have a huge team with a lot of bureaucracy.

TWST: What are the specific characteristics of the companies you select for the portfolio? What are you looking for?

Mr. Chapman: We actually have a set of 25 distinct criteria that we use to assess every new company that we buy. We insist that a new purchase meet at least two-thirds or 17 of those 25 criteria. Rather than go into all the details of those 25 criteria, they center around three areas. We like to call them the three Ps.

The first P is the people or the management of the company. We're looking for a management team that we trust and admire and where we could even imagine working for the CEO. We want the management to be communicative, responsive, owner oriented and candid in their reporting and their accessibility to us. We also want them to have an owner orientation. Two ways they can reflect that is by having the company buy stock opportunistically and also by owning the stock themselves. We're also looking for a proven track record where the management team is respected by their peers and by us.

The second P relates to the product or the actual business itself. This is one of the most important criteria for us. We're looking for companies that have a sustainable competitive advantage. By that we mean some advantage in the marketplace that the company enjoys almost to the degree where they're a one-of-a-kind type of company. We want that sustainable competitive advantage to indeed be durable and visible to us far into the future because we're long-term focused. We are really after a one-of-a-kind company in their respective industry. Typically, that sustainable competitive advantage delivers the attributes of the businesses we like — that is, a high return on invested capital, substantial free cash flow, low or no debt and strong organic revenue growth.

The last P is the price. Even for a great company, we have to insist that we buy it at an attractive price. That's what has also led us to achieving very high returns with low risk. Each investment decision we make in a portfolio has to stand on its own investment merits. We are very focused and disciplined about the prices we're paying for each company. We assess the inherent or intrinsic value for each company, and then we assign a discount to that, which is in effect our margin of safety. Below that price is the price that we're willing to pay in the open marketplace. We simply perform our ongoing due diligence and wait for those attractive opportunities that inevitably present themselves at some point during the year.

All in all, we try to minimize the two risks that we think are important. One is the risk of buying a poor business that would eventually erode the permanent capital of the business and, therefore, the share price. We also want to minimize the price risk of paying too much, even for a great company.

TWST: When you talk about sustainability and recurring revenues, do you make allowances for cyclical growth opportunities?

Mr. Chapman: Yes, we do. We have a separate set of criteria for cyclical growth companies, and there we're looking for the inevitable companies where it's not a matter of whether or not they're going to return to profitability and success. It's simply a matter of time. Some of those cyclical growth companies were very attractive in the first quarter of 2003 in the midst of the SARS crisis and the buildup to the Iraq war. Companies like **Walt Disney** (DIS) and **Tiffany** (TIF) were timeless gems that were selling cheaply because at that time, fewer people were traveling to Florida, for instance, and fewer people were buying discretionary jewelry, but we knew that the economic cycle would come back and that they would be successful in generating revenue, which they did. We're open to those situations.

TWST: Would you like to do a review of the performance of the holdings you talked about last year and then go on to any new stocks you've acquired over the last 12 months?

Mr. Chapman: We recommended three companies in our interview with you in April 2004. **Valassis Communications** (VCI) rose 20%, **McGraw-Hill** (MHP) was up 19%, and **Gentex** (GNTX) was down 16%. This is all excluding dividends. It's price only. By comparison, the S&P 500 is up about 9.5%.

All three of these companies shared the characteristic of having very high returns on invested capital and high free cash flow yield. Free cash flow yield is simply the cash flow from operations of the company less the capital spending divided by the number of shares outstanding, then taking that figure and dividing it by the stock price. From an owner point of view, it's as though the company could dividend out that amount if they so chose and generate an owner yield. In the case of **Valassis**, that is 6%, **McGraw-Hill** also 6%, and 4% for **Gentex**. These yields are very attractive, especially compared to the 10-year Treasury yield, which today is yielding about 4.2%. We are comfortable that the cash flow for these companies will grow over time in contrast to the static 10-year Treasury coupon.

In terms of fundamentals, **Valassis** is a company that delivers promotional media to the home, including Sunday newspaper coupon inserts, which account for about 47% of revenues. The company does business with 80 of the country's top 100 advertisers. More and more companies are choosing **Valassis**' promotional media to target customers directly. The do-not-call registry, satellite radio, TiVo and the iPod are challenging consumer product companies to access consumers directly. The other half of **Valassis**' business is doing very well by using cluster targeted, or one-to-one, marketing to effectively target and promote its clients' products to consumers. For example, they'll put product samples in a poly bag wrapped around a newspaper, hang product samples on doorknobs, and use loyalty shopping card-based direct mail promotions.

They've recently announced that they're going to be resuming repurchasing their own shares, up to 75% of their free cash flow that they generate each year. They've doubled their sales force in the last five years, and since we last spoke, they've also announced an effort to raise prices in the freestanding insert (that's the Sunday supplement coupon business) against their primary competitor. There are only two companies in the world that do what they do, and **Valassis** has a 35% manufacturing cost advantage over its competitor since **Valassis** owns its own printing facilities. The competitor is News America Marketing, which is a division of Rupert Murdoch's **News Corporation** (NWS). It doesn't make sense for a duopoly to have a price war indefinitely, so we think there have been some signs of price stabilization in the marketplace in the freestanding insert portion of the business. Once that has stabilized, if that were to go back to the 2001 pricing (that is actually down 19%), the earnings per share of the company could be lifted by another \$1.40. We think the stage is set for a real rebound in earnings there with significant operating leverage.

On **McGraw-Hill**, the company is expecting double-digit earnings growth this year, excluding the impact of acquisitions. They're benefiting from the No Child Left Behind spending. They're benefiting from the Global Research Settlement that's allowing for more spending from Wall Street research for independent firms such as their Standard & Poor's division. The company also continues to buy back stock. They bought back \$400 million last year, and they're going to be buying back more shares this year, too.

Gentex stock is down from last year because of lower production volumes from domestic OEMs, especially **GM** (GM). Despite that, **Gentex** grew their mirror shipments by 13% in 2004. **Gentex** produces automatic dimming rearview mirrors with high intellectual content. Since we last spoke, the company has launched a product called SmartBeam, which is a feature that has a camera on a silicon chip on the front side of the rearview mirror that regulates the high beam function for cars automatically. It automatically raises or lowers the high beams without drivers having to flick it on and off themselves. That is doing well, so that should bode well for increasing average selling prices and volumes.

Also, despite **GM** representing 30% of their business and therefore, as **GM**'s weakness goes, so goes **Gentex**, **Gentex** is gaining

platforms. The worldwide market is only 16% penetrated for interior automatic dimming rearview mirrors, and despite **GM**'s current weakness, we think that **Gentex**'s ability to penetrate additional car platforms should allow them to grow their mirror shipments at their historical rate of the mid-teens over time. That's a brief recap of last year's stocks.

TWST: What has attracted your attention over the last 12 months?

Mr. Chapman: We're on the constant search for companies to add to our portfolios. Our business is a separate account business. Each new account that we get that's an all-cash portfolio needs to be invested in new ideas that are attractive today and not necessarily attractive last year or the year before, so we're always on the hunt for new ideas that are attractive. We don't operate with a model portfolio, and therefore, our clients' portfolios may not look alike in the first year or two but eventually they should look similar.

Although we still like **Valassis**, **McGraw-Hill** and **Gentex**, there are three other companies that we think are attractive, as well.

The first is a company called **TECHNE** (TECH). **TECHNE** has a market capitalization of about \$1.5 billion. They have about a 55% market share of research reagents, which are a highly purified protein that is used in the drug discovery process. It's part of a biological toolkit. If you recall the Gold Rush in California in 1849, it's often said that those who made the most money were those who provided the picks and shovels. In the same way, **TECHNE** is providing the picks and shovels of the gold rush of drug discovery. They are providing the essential proteins and antibodies used in the building blocks of drug research.

It's an amazing business for **TECHNE**. They have 50% operating margins, greater than a 50% return on capital (if you exclude the cash and equivalents that they have on their balance sheet, which is almost \$6 per share), and they recently announced a \$100 million share repurchase, which is about 7% of their total outstanding shares. That's testimony to the value that they see in the stock price, which was \$35 yesterday. In one fell swoop, the company was able to make a very accretive purchase in the business they know best: their own. They think that transaction itself will lift earnings by about \$0.10 a share.

They're on track to produce 1,500-1,600 new products this year as compared to 800 just three years ago. As more genes are discovered, they'll develop new reagents for them. Management is extremely owner oriented and very accessible. Tom Oland is the Chairman and CEO, and he's a dream CEO in terms of accessibility and responsiveness to us and the ability that he has to manage the company as a true owner in the best sense.

They're not promotional. They don't do quarterly conference calls. They don't do road shows and try to court Wall Street, but they're very responsive if you go to their headquarters in Minnesota or talk to them on the phone. The stock is selling for about 18 times this year's earnings if you exclude the almost \$6 a share in cash and investments on the balance sheet. They're able to return about a 50% return on capital, and they have a free cash flow yield of 5%. That's one we like.

On the larger cap side, we like **Disney**. We mentioned that we bought **Disney** in the first quarter of 2003 when it was about \$15 or \$16 a share. At \$28 a share, we still like it for different reasons. The company expects to grow earnings at a double-digit rate through at least 2007 off of their strong rebound in 2004. The stock is down from a high of \$43 a share to \$28 a share, but their earnings are at an all-time high.

There are several drivers for the earnings. One of them is a rebound in the ratings at the ABC network, driven by successful shows including “Desperate Housewives,” “Extreme Home Makeover,” and “Lost.” In fact, “Desperate Housewives” is attracting 3 times what they call the scatter rate, which is what an advertiser would have to pay today at the last moment, versus what they had contracted earlier last fall before they had these successful shows. When the next fall season occurs for advertising renegotiations, we should see a huge lift in ad rates for ABC because of their higher ratings. They’ve gone from number four to number two in overall network ratings in the last year.

By the end of this year, **Disney** will have 11 theme parks around the world. The newest opening will be Hong Kong Disney,

In addition, there is a creative renaissance occurring at the **Disney** animation area, which has essentially been written off by Wall Street due to the glowing success of **Pixar Animation Studios** (PIXR) and **DreamWorks Animation SKG** (DWA). But underneath it all, there has been a quiet rebirth of the creative drive at **Disney** to reinvent itself with computer-generated animation. You’ll see the first efforts of that in the “Chicken Little” movie coming out in November and in another one called “Rapunzel Unbraided,” which is being led by the animation efforts of Glen Keane, who is considered a living legend at **Disney**. He was the animation driver behind the most recent spate of successful movies by **Disney**, including “Beauty and the Beast,” “Aladdin,” “Pocahontas” and “Tarzan” among others. He has now embraced computer-generated animation, and for the first time ever, they were able to make flesh tones on characters very realistic, as though blood were flowing through their veins, and also make freckles on faces appear realistic. We’re excited about the creative renaissance in digital animation at **Disney**. There are some good live action movies coming out such as “The Chronicles of Namia” and the next “Pirates of the Carribean,” as well as strong DVD releases such as “The Incredibles” due out in the next year.

Chapman: TECHNE has a market capitalization of about \$1.5 billion. They have about a 55% market share of research reagents, which are a highly purified protein that is used in the drug discovery process. It’s part of a biological toolkit... TECHNE is providing the picks and shovels of the gold rush of drug discovery. They are providing the essential proteins and antibodies used in the building blocks of drug research.

which opens in September and which **Disney** paid only \$316 million. They’ll own 43% of the venture out of a total \$1.7 billion infrastructure cost. We think Hong Kong Disney will be an extremely successful location and driver for the company as they get exposure to the immense population in China. In fact, 50% of the world’s population is within a five-hour flight of that resort.

TWST: Are there any political risks associated with that?

Mr. Chapman: I don’t think so because the Hong Kong government itself is the other partner. They own 57% and funded the remaining portion of that \$1.7 billion infrastructure cost.

The other driver for the theme park business will be the world-wide celebration of the 50th anniversary of Disneyland. For the first time ever, all of their theme parks around the world are going to have a concerted celebration, which they’ll call the Happiest Celebration on Earth. We think that will help drive traffic into the theme parks for the next 18 months. It will be an 18-month anniversary celebration, so we hope that will translate into us being the happiest shareholders on earth.

1-Year Daily Chart of TECHNE



Chart provided by www.BigCharts.com

The other significant event is that by June of this year, the Board of Directors is committed to name the successor of CEO Michael Eisner. That will be a catalyst for the next generation CEO who will only be the sixth CEO in the 80 years of the company's history. There has been a lot of speculation about who that successor might be. Bob Iger is the current internal leading candidate, but the Board is committed to an open consideration of all leading candidates, inside or outside the company.

The Board has also changed its composition pretty dramatically in the last couple of years. Half of the Board members are new in the last two years, and they've reduced the Board's size from 16 to 12. The majority of them are now independent, and they're required to own at least \$100,000 of **Disney** stock. We think that will bring more of an honest, candid appraisal, and the appropriate candidate will hopefully be as creative, inspiring and productive a leader as Walt Disney himself was.

From a financial point of view, **Disney** has a 5% free cash flow yield, is buying back stock for the first time since 2001, and, as I mentioned, has record earnings despite the stock being at \$28 down from \$43 in the year 2000. We think it's attractive to continue purchasing.

Chapman: We bought Disney in the first quarter of 2003 when it was about \$15 or \$16 a share. At \$28 a share, we still like it for different reasons. The company expects to grow earnings at a double-digit rate through at least 2007 off of their strong rebound in 2004. The stock is down from a high of \$43 a share to \$28 a share, but their earnings are at an all-time high.

The last one is **Harley-Davidson** (HDI). **Harley-Davidson** is also buying back stock. They have a 20 million share repurchase authorization. They bought back more stock last year in 2004 than the previous five years combined. **Harley** has over \$1.6 billion of cash on the balance sheet. That equates to about \$5.50 per share of cash and investments. If you were to exclude that from the current share price, you'd be left with a p/e multiple of 16 times this year and 15 times next year's earnings. We've found that over the last 15 years, **Harley-Davidson** has had a trough p/e multiple of 17.5 earnings. We think it's a very reasonable price to pay for a company that's growing its unit volume about 7%-9% per year. Its earnings over the last 10 years have grown at about a 25% rate. We also think it's a very reasonable price to pay for a one-of-a-kind company. There aren't many companies where the customers actually tattoo their company's label on their body.

It's a legendary brand, a one-of-a-kind company that's similar to the others in that it has good, strong free cash flow. Its return

on invested capital is 22%, so we're buying it at a p/e ratio that's less than its return on capital, which is what we like to do.

TWST: Harley-Davidson celebrated its 100th anniversary and did extremely well. Are you worried that you might be on the downward slope now that that's over and done with?

Mr. Chapman: They just recently lapped the toughest comparisons versus that anniversary celebration, and we think that has given rise to the attractive stock price. There was a lot of anticipation and excitement over that celebration, but the company has nevertheless enhanced its visibility and the acceptance of riding motorcycles as a result of that celebration.

One other driver for **Harley-Davidson** has been a new product called a VRSCR Street Rod, which was just introduced last month. It's a motorcycle that can turn at a much sharper angle than the previous bikes. It has really been developed for the European market, which has a more aggressive riding style with sharper turns. The foot pedal has been moved from the front of the bike (which had forced a more upright sitting position) to the middle part of the bike, which creates a more aggressive riding style and a leaner angle. They've also added a five-gallon tank to allow for longer drives. Pre-

1-Year Daily Chart of Disney



Chart provided by www.BigCharts.com

liminary dealer feedback has been terrific in Europe, which has been a hard critic of **Harley-Davidson** bikes. We think that will be an additional driver for the next few years.

The 100-year anniversary celebration raised the visibility. It did create tough comparisons for the company, but they still grew

make room for the company that's most recently come into the buying range. Those are really the only five reasons historically that we've sold a company. It's never from a market-timing standpoint. We never move to cash. Over the last 31 years, on average our portfolios have never had more than about a 3% or 4% position in cash.

Chapman: We've found that over the last 15 years, Harley-Davidson has had a trough p/e multiple of 17.5 earnings. We think it's a very reasonable price to pay for a company that's growing its unit volume about 7%-9% per year. Its earnings over the last 10 years have grown at about a 25% rate. We also think it's a very reasonable price to pay for a one-of-a-kind company.

unit volume growth. We believe that they will continue to grow volume in the 7%-9% range going forward.

TWST: It must be very hard for you to actually sell one of your stocks because you get to know them so well. What triggers an exit from your portfolio to make room for your new holdings?

Mr. Willson: There are five reasons that we would sell a company. The first reason, going back to our focus on capital preservation, would be if we make a mistake. I've been really impressed with the portfolio management team in that they have not allowed their egos to get in the way of situations where we've gotten involved in a stock where we either missed something or perhaps management wasn't totally honest with us. As soon as that mistake is recognized, we get out.

Every position in the portfolio starts at 6%, so every position is equally weighted. A 6% position would imply a 17-company portfolio. If a position increases to 12% or up to 15% (doubling the position) we'll trim that back down to around a 6% holding. If the position continues to appreciate (as happened in the late 1990s) where we think it's extremely over valued, we'll get out of that position totally, watch it, and hope that it comes back down into our buying range.

If any of the core reasons why we bought the company originally change or if there are deteriorating fundamentals, if the industry changes, if the competitive landscape changes, or perhaps if there's a management change that we're not comfortable with, we'll get out. Basically, if anything happens that we feel threatens the long-term sustainable competitive advantages of that company, we will get out.

The last reason is that if we have a portfolio that's fully invested and a new or an old company, for that matter, comes into buying range, we may sell something in the existing portfolio simply to

1-Year Daily Chart of Harley-Davidson



Chart provided by www.BigCharts.com

TWST: One of the risks in a concentrated portfolio, of course, is if a stock is volatile. What are the ways you try to protect the portfolio from risk?

Mr. Chapman: The market has not been volatile over the last year or two compared to its history, but individual stocks have certainly been volatile. The way we try to minimize our own internal volatility is to minimize the two risks I identified earlier: buying the wrong company even though it may seem cheap and buying even a wonderful company at too high a price and suffer the price risk either way. By having the patience and discipline to wait for the right company at the right price (all we have to wait for is about three or four situations per year, rather than worrying about a 100-stock portfolio and having to constantly buy and sell with a 100% turnover), our turnover rate is only 15%-20% a year. We're just looking for three or four good ideas a year, and usually we're able to find those.

Mr. Willson: In the process of minimizing the business risk, we visit virtually all of our companies, not just through conference calls or at trade shows, but actually at their headquarters. That's an important part of our due diligence process. We're really trying to remove absolutely any shadow of doubt before getting involved or investing in a company. Part of that process is an intense amount of due diligence spent at the company's headquarters.

TWST: Last year Mr. Lateef said the biggest risk in your business is neglect, and when you have only 15-20 you don't neglect your stocks.

Mr. Willson: That's true.

TWST: What other advantages do you have that distinguish you from other money management firms that have an all-cap growth portfolio? What are you bringing to the table that others might not?

Mr. Chapman: One thing would be that we're trying to identify terrific businesses, and we have a very business-like approach to our investment process. Other money managers might have more of a traditional value approach, although we think we're buying our companies at a great value, but other money managers think that any company can be had at the right price and that you can make money on virtually any company. We want to align ourselves with the best businesses that have the best returns on capital that is sustainable and generate strong free cash flow, have excellent balance sheets and are masters of their own destiny.

We're willing to be patient and wait for the opportunity to buy into those companies, ride their earnings growth going forward, and realize the business appreciation that goes with that rather than thinking that we can time the purchase of GM, let's say, or some commodity paper or chemical company better than the next guy, sell it a few points later, and then rotate into something else. That's a game that we don't pretend to be good at or want to be good at. We simply want to align ourselves with the best businesses America has to offer at the best prices and let them do their job, and we'll grow with them.

In fact, because our approach is so businesslike and because we're looking for a lot of the same attributes that a practical business person would look for, we've seen that several of our companies have had takeover offers or, as in one case, have been taken over altogether. One was Gillette (G). Procter & Gamble (PG) recently announced their intention to acquire the company. Since we spoke last year, Disney had an acquisition offer by Comcast (CMCSA), which was rejected. Another one of our companies has had an informal offer to be acquired, which they rejected, and they responded with an accelerated share repurchase program. Sometimes we're a little chagrined by the fact that some of our companies are

going away or being absorbed by others, but again, it's a testimony to the types of businesses that we're attracted to. I think that helps distinguish us from other managers who might have an all-cap style.

Mr. Willson: I mentioned this earlier, but I can't emphasize enough the difference as far as the culture here being not focused on the benchmark and not focused on the short term. Over the last 10-20 years, money managers have become beholden to their benchmark. Because they know their clients or consultants are judging them against that benchmark, I think over the years many money managers have become overly focused on how they're doing versus their benchmark.

How we see our job is first not to lose money and second to make money. It removes that distraction, if you will. I would say that at the most we take a look at how we're doing versus the benchmark on an annual basis, but it's really an afterthought.

The second way I think the industry has changed over the years is that with the proliferation of money managers and with the proliferation of the information available both online and through conference calls, many money managers these days, especially considering the size of the portfolios that most managers have, are content to do the work internally. We visit these companies and get to know the people — not only the executives but also people throughout the company and throughout the industry. That makes a big difference in our ability to determine whether these companies are going to be successful or not.

TWST: It comes down to your three Ps again.

Mr. Chapman: That's right. And it's having conviction about those.

TWST: Thank you.

Note: Opinions and recommendations are as of 03/09/05.

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