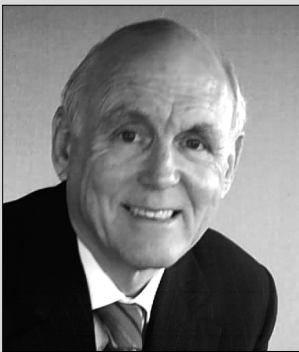


# THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

## Investing in Growth Stocks



RICHARD F. ASTER JR., President of Aster Investment Management, was born in 1940 in Southern California. His formal education included undergraduate and graduate degrees in Economics from the University of California, Santa Barbara. Both degrees were received with honors. Mr. Aster worked for the U. S. Treasury Department and invested privately before joining Newburger, Loeb & Company, a New York Stock Exchange firm, in 1970. He worked for Newburger, Loeb for almost two years as a West Coast analyst before joining Robertson, Colman, Siebel & Weisel (which became Montgomery Securities and subsequently Bank of America Securities, Montgomery Division). The Montgomery Division is considered by most investment managers to be one of the leading research-oriented investment banking firms headquartered outside New York City. Mr. Aster's responsibilities at B of A

Montgomery Securities included formulating the firm's economic overview and investment strategy. His primary areas of research included emerging growth stocks and special situations covering a broad number of industries. Mr. Aster successfully managed accounts on a discretionary basis during this period. He left B of A Montgomery Securities in March 1977 to form Aster Investment Management Co., Inc. In 1984, Mr. Aster started the Meridian Growth Fund, a no-load mutual fund investing in growth stocks. In 1994, Mr. Aster started the Meridian Value Fund, a no-load mutual fund investing in stocks deemed undervalued.

### **(XAF500) TWST: Would you begin with an overview of Aster Investment Management and your investment philosophy?**

**Mr. Aster:** Aster Investment Management manages two funds, the Meridian Growth Fund and the Meridian Value Fund. The Meridian Growth Fund has assets of approximately \$1.2 billion and the Meridian Value Fund has assets of \$2.3 billion. I oversee both funds. We have three analysts who select the stocks for the Meridian Value Fund, and I do all the company research for the Meridian Growth Fund.

The Value Fund searches for companies that have had difficulties for a period of time. We will monitor these companies and when, in our opinion, the problem has been solved and that growth is going to resume, we will purchase the shares.

The Meridian Growth Fund, which I believe we are going to focus on today, looks for small- and medium-sized growth stocks. The universe includes companies with market valuations between \$500 million and \$2.5 billion at the time of initial purchase. We are looking for companies that can grow earnings per share at a rate of 15% or better.

Successful growth companies are different, but do have common characteristics. First, they address a market that's conducive to growth. Second, it is necessary to have an important market share. Third, the financial returns, or return on equity, must be sufficient to support. Finally, companies need to be well managed.

Once we find companies that, in our view, meet these characteristics, it comes down to valuation. I believe this distinguishes us

from most other growth funds. Most growth managers say, “We like the company, so we’ll buy the stock.” If we like the company, we then determine what we can pay for the stock and expect to get an acceptable return, given the risk. This has been important to our performance through the years.

**TWST: How has your performance been this last 12 months?**

**Mr. Aster:** For the last 12 months, we’ve done very well. For the 12 months ending in June, Meridian growth is up 33.7%. Year to date, we’re up about 2.6%. These results, for both periods, are better than the Russell 2000, and better than the average mid-cap growth or small cap growth mutual fund.

**TWST: Have you made any shifts in your Growth Fund since we last spoke to you?**

*“Weight Watchers’ North American business has suffered somewhat recently due to the low carbs phenomenon, and the stock has been under pressure. We believe that the low carb craze is now peaking and that Weight Watchers will start posting better results in the back half of the year, especially in North America. The company has a solid cash flow, minimum capital requirements and a high return on equity.”*

**Mr. Aster:** There hasn’t been a major shift in the portfolio; it’s pretty much as it has been. There have been some purchases and sales. It’s important to remember that, on average, we own companies for three years — so not much turnover. We use a bottom-up approach and do not make sector bets. We are usually more heavily weighted in healthcare, technology, restaurants and financial companies. This is where we find the growth companies in our universe.

**TWST: Do you do any macro analysis on the economy or the market before you select holdings?**

**Mr. Aster:** We try not to. In my past job, in addition to being a growth stock analyst, I did the economic overview and portfolio strategy for a brokerage firm. I learned from that experience that attempting to predict interest rates, forecast the economy and then relate the results to the stock market is not a productive use of one’s time.

**TWST: Which stocks have you been interested in in recent months and why were you attracted to them?**

**Mr. Aster:** Maybe we could talk about a few of our major positions. We have owned **Mercury General** (MCY) for a considerable period of time. **Mercury** is a well-managed California auto in-

surer with considerable growth prospects. The company has an exceptional long-term record, and it’s based on competitive rates, but not at the expense of underwriting standards or service to the policyholders. The company uses a network of independent agents and brokers, and growth will come from continued market share gains in California and geographical expansion. **Mercury**, during the past few years, has started moving into additional major markets, including Texas, Florida, Georgia, Illinois, New York and New Jersey. The potential for growth is unlimited.

**Mercury** has an experienced and strong management team. This is a case in which we trust management to undertake this expansion in an orderly and profitable manner, using the same formula that has been so successful in California. **Mercury** is well-capitalized, and the shares sell at approximately 12 times estimated earnings.

1-Year Daily Chart of Weight Watchers International



Chart provided by [www.BigCharts.com](http://www.BigCharts.com)

**TWST: Do you have companies in health care?**

**Mr. Aster:** Hospital stocks, up until this year, haven’t performed well. We own two rural hospital operators, **LifePoint Hospitals** (LPNT) and **Province Healthcare** (PRV). We will use **Province**

to illustrate the investment thesis. **Province** operates 20 rural hospitals in 13 states. The hospitals are usually acquired from non-profits, at which point they are the only provider in the market. The particular hospital is usually undercapitalized, offers limited services and, as a result, may have only 35% market share in its geographical area. People are driving 30 to 100 miles to a metropolitan hospital to get healthcare services.

the back half of the year, especially in North America. The company has a solid cash flow, minimum capital requirements and a high return on equity. The stock sells at around \$39 and the company is estimated to earn, I believe, \$1.75 per share this year and \$2 next year. The projected growth rate is 15% or better.

**TWST: How many holdings do you generally have in the Growth Fund?**

*“Mercury is a well-managed California auto insurer with considerable growth prospects. The company has an exceptional long-term record, and it’s based on competitive rates, but not at the expense of underwriting standards or service to the policyholders. The company uses a network of independent agents and brokers, and growth will come from continued market share gains in California and geographical expansion.”*

**Province**, after the purchase, will immediately improve the systems, controls and the operation. Doctors, including specialists, are added, facilities are often expanded and improved, and community relations are improved. Market share may increase from 30% to 80% during the next three to 10 years. This, of course, increases revenue and profitability substantially. There is built-in growth. **Province** may acquire two hospitals per year. Also, there is less HMO penetration in rural markets, and special Medicare provisions for community hospitals are more generous. Medicare represents 45%, and Medicaid approximately 10% of revenues.

**LifePoint** is the same story. It has 29 hospitals; they just serve different markets. I believe both of these companies can grow at a rate of 15% a year for a number of years to come, and the shares sell at approximately 15 times estimated earnings in both cases.

We have taken a small position in **Weight Watchers International** (WTW), a controversial company at the moment. **Weight Watchers** is the largest provider, by a substantial margin, of weight loss and weight control programs in the world. The company has 4,200 meeting centers in North America and 9,000 internationally. The weight loss program is based on group support, behavior modification, healthful eating and exercise. I might add that obesity is now the number one health problem in the US ahead of smoking.

**Weight Watchers’** North American business has suffered somewhat recently due to the low carbs phenomenon, and the stock has been under pressure. We believe that the low carb craze is now peaking and that **Weight Watchers** will start posting better results in

1-Year Daily Chart of Mercury General



Chart provided by www.BigCharts.com

**Mr. Aster:** We generally hold 50 or less positions; right now we have 50.

**TWST: Does that cover most sectors of the economy?**

**Mr. Aster:** It covers a number of sectors, but again, our most heavily weighted sectors are usually technology, health care, retail, restaurants and financial. This is where we find the growth.

**TWST: Which technology stocks do you own?**

**Mr. Aster:** We own **Andrew Corp.** (ANDW), **Symbol Technologies** (SBL), **American Power Conversion** (APCC), **Autodesk** (ADSK) and **Vishay** (VSH), to mention a few.

**TWST: Which stocks have been interesting you of late? Have you found anything that is relatively new to the portfolio?**

**Mr. Aster:** A relatively new position is **CBRL Group** (CBRL), which operates restaurants. It has two concepts: Cracker Barrel and Logan's Roadhouse.

The restaurant industry is under pressure due to higher gas prices and rising commodity costs. The Cracker Barrel brand caters to family dining and interstate travelers. The units offer home-style country cooking at moderate prices and are primarily located along interstate highways. Each restaurant has a gift shop that contributes approximately 23% of revenue. We believe this concept will grow at a 10% annual rate and generate substantial cash flow.

Logan's Roadhouse is an existing concept that is being refined at this time. Management plans to expand the Roadhouse concept at a 20% annual pace, beginning in late 2005.

The company has a strong balance sheet, is well-managed, has good cash flow, and the shares sell at approximately 11 times

want to participate in the cycle of informed consensus opinion. Most analysts, in my opinion, get their information from the same source, at the same time, and reach the same conclusions. This method of operation, which many use, is not for us.

I monitor 100-200 companies that we don't own. These are companies that, in my opinion, have good, long-term growth prospects. That is, they can grow earnings for the next three to five years at a 15% rate. Monitoring means I will attend research conferences, listen to conference calls, listen to Webcasts, talk to the management when necessary, read SEC documents and so forth. There will always be a few companies of interest at any time. Maybe the company has resolved a specific problem, or the industry outlook changes. Most of the time, the stock price will come into a range where we will be able to achieve an acceptable long-term positive return. There have been cases where I have monitored companies for three or four years before making a purchase of the stock. This is my process.

*"The Cracker Barrel brand caters to family dining and interstate travelers. The units offer home-style country cooking at moderate prices and are primarily located along interstate highways. Each restaurant has a gift shop that contributes approximately 23% of revenue. We believe this concept will grow at a 10% annual rate and generate substantial cash flow."*

earnings. We believe **CBRL Group** shares will do particularly well over the next few years.

**TWST: What are the advantages of investing in mid-cap stocks?**

**Mr. Aster:** History shows that over time, small and medium-sized companies perform better than their larger counterparts. Historically, large company stocks have returned about 10.2%, and small company stocks have returned approximately 12%. This may not sound like a big difference, but the compounding impact makes a significant difference over a long period of time.

**TWST: How do you do your research? Do you rely mostly on Wall Street research, or do you do independent work?**

**Mr. Aster:** Our research, for the most part, is independent. I very seldom talk with Wall Street analysts or read research reports. This is by design and our Value Fund uses the same process. We attempt to figure it out ourselves and do our own research. We don't

1-Year Daily Chart of CBRL



Chart provided by [www.BigCharts.com](http://www.BigCharts.com)

**TWST: How important is management credibility and performance when you select your stocks?**

**Mr. Aster:** Management is critical. I have a rule that has never failed: “A bad management will wreck a good business every time.” It usually doesn’t take them long to accomplish this either.

To begin with, we check out the management the best we can, and then continue to monitor developments on an ongoing basis. It is important that management build all of their bases in addition to growing sales. They need good people, not only at the top, but at middle management as well. They must develop their systems, controls and capital base. Also, they need to make the right strategic decisions. Judging management is an ongoing process, and it is important.

*“Province operates 20 rural hospitals in 13 states. The hospitals are usually acquired from non-profits, at which point they are the only provider in the market. Province, after the purchase, will immediately improve the systems, controls and the operation. Doctors, including specialists, are added, facilities are often expanded and improved, and community relations are improved. Market share may increase from 30% to 80% during the next three to 10 years.”*

**TWST: Do you have a regional flavor to any of your stocks? Do you like California companies because you keep a closer eye on them?**

**Mr. Aster:** Everything being equal, we would rather have the company close by. However, we would rather own a company in Florida and get a 20% return than a company in California and get a 10% return. Our portfolio is not heavily weighted in California.

**TWST: Tell us what the sell discipline is, and what triggers an exit from your portfolio?**

**Mr. Aster:** We hold an average of three years, so our turnover is low. We don’t do any trading. I don’t trade or sell a company if it is modestly overvalued and then attempt to purchase it back at a lower price. If a company misses a quarter by a penny or two, I won’t necessarily sell the stock. I am focusing on the long-term outlook for the business and the company. This is the key for us. If I believe it is intact, I hang in there. However, should the long-term growth prospects for the business break down, for whatever reason, I will sell the company and move on. We will sell a company if the valuation becomes extreme and the risk/reward ratio moves completely out of line.

In addition, I continuously adjust the portfolio. If I buy a 2% position in a company and the stock does extremely well and thus increases to a 4% position, I will cut it back to 2% or 2.5%. I believe this technique has enhanced our returns and cut the volatility of the portfolio.

**TWST: Have you sold off any stocks in the last few months?**

**Mr. Aster:** Yes. We have recently sold **Men’s Wearhouse** (MW) and **A.G. Edwards** (AGE). These particular sales weren’t for valuation or fundamental reasons. I have another discipline. I’m not going to let the number of stocks in the portfolio go over 50. So if I establish a new position, I force myself to sell something. This is a good practice. We have a preference scale for stocks and there will always be companies in the portfolio we like less.

1-Year Daily Chart of Province Healthcare



Chart provided by [www.BigCharts.com](http://www.BigCharts.com)

**TWST: How do you manage risk in your portfolio?**

**Mr. Aster:** There are two ways that I manage risk. First, I pay attention to valuation. Our portfolio will not own companies selling at 50 or 100 times earnings.

Second, as I have explained, if a company does well, I will cut back the position. On the other hand, if I buy a 2% position in a company and the stock declines, say it drops from a 2% position to a 1% position, and my research indicates that the business is solid, I will increase the position to 2%.

These measures have clearly lowered the risk and volatility in the Meridian Growth Fund.

**TWST: Do you take advantage of volatility at all, or is it an overall detriment to your style of investing?**

**Mr. Aster:** I don't pay attention to it. I believe there are inefficiencies in the market and in specific companies in the short run. Remember, I need to take advantage of these dislocations. I monitor 200 companies or so. The idea is to know these companies well, understand the business, and have the courage to purchase the shares when they are out of favor. This is how I hope to achieve better than average returns.

forecast interest rates, and I'm not particularly concerned that interest rates will soar over the next two years. Higher rates, if they do go up, will impact companies differently.

**TWST: In what ways would you say your firm is able to provide a great service to investors, different from the many other growth funds that are out there?**

**Mr. Aster:** There is only one thing that can make us different or special, and there is one reason why people will invest with us, and that's performance. We don't have a large family of funds, we don't market or pay for distribution. So we need to perform better than average, not every day, but in the long run. I have tried to structure the business here to perform well. The investment professionals who work here do research only. They are not asked to do marketing, they don't do administration, they do research. This is pretty much the same with me. Compensation is based, to a large degree, on performance. I have been the only manager

*"We don't have a large family of funds, we don't market or pay for distribution. So we need to perform better than average, not every day, but in the long run. I have tried to structure the business here to perform well. The investment professionals who work here do research only... I have been the only manager of the Growth Fund since its inception in 1984. This is different than big fund outfits where they switch managers every two years or so."*

**TWST: Can you give us a profile of your typical investor? Is it mainly institutional or retail?**

**Mr. Aster:** I'm not exactly sure. We have more than 150,000 shareholders for both funds. That means the average size of an account is somewhat over \$20,000. The accounts include individuals, IRAs, pension and profit sharing plans, etc.

**TWST: How do you manage expectations of investors during this time? And what concerns have you been hearing expressed in recent months?**

**Mr. Aster:** I haven't heard anything particularly, and I can't manage expectations. We run the business, follow our philosophy and stick with our discipline. We believe that over time this will lead to good, long-term returns. This is all I can do.

**TWST: Has the specter of rising interest rates impacted your investment at all? Do you have interest rate sensitive stocks?**

**Mr. Aster:** Higher interest rates are a factor, and I'm sure, subconsciously, I take this into consideration when investing. I don't

of the Growth Fund since its inception in 1984. This is different from big fund outfits where they switch managers every two years or so. I believe I am the largest individual shareholder in the Growth Fund.

**TWST: Are you concerned with tax efficiency?**

**Mr. Aster:** Yes. The Growth Fund, as I have already stated, has a turnover of less than a third. Over 95% of our gains are long term. Our plan is to buy good growth companies, hold them for three to five years, get good returns and then pay 15% capital gains. That is about as good as it gets. The 15% long-term capital gains tax rate is a big advantage of investing in small and medium-sized growth stocks. Our Value Fund is similar but not quite as good on a tax-efficiency basis.

**TWST: A lot of smaller stocks have become acquisition targets or are interested in acquiring others. Is that a factor in your investment?**

**Mr. Aster:** We don't buy companies with the idea that they are going to be taken out; we buy them based on the fundamental growth prospects of the business. If they get taken out, so be it.

**TWST: What advice would you give to our readers today about investing in this current market? Do you consider it a stock-picker's market?**

**Mr. Aster:** The market is not as attractive as it was a year or two ago on a valuation basis. Stock selection is now more critical to returns.

My advice to investors would be to get their portfolio allocation right. They need to be comfortable with the amount of money they invest in stocks. Then select a good mutual fund or funds and stick with them. Individuals should have at least a three- to five-year time horizon with their stock investments. This will enhance their chance for success.

**TWST: Is there anything that you'd like to add?**

**Mr. Aster:** I believe we've got a good, fundamental, long-term strategy. We work hard, we have experience, and if we can continue to execute well, we should continue to do well for our shareholders.

**TWST: Are you optimistic about the market going forward?**

**Mr. Aster:** I'm positive on the market. I don't believe you're going to get extraordinary returns like you did in 2003, but I believe you'll get positive results and, most important, it will come down to stock selection.

**TWST: Thank you.**

*Note: Opinions and recommendations are as of 7/16/04.*

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