

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

Entrepreneurial Investing



LANCE HELFERT is President and co-Founder of West Coast Asset Management, Inc. Before founding West Coast Asset Management, he oversaw a \$1 billion portfolio at Wilshire Associates, and was involved in a full range of financial strategies at M.L. Stern & Co. Mr. Helfert sits on the Board of Directors for Junior Achievement of Southern California and the Tri-Counties Make-A-Wish Foundation. He has been honored as one of the top executives in banking and finance by the Pacific Coast Business Times, and holds a Bachelor of Science degree in Business Administration from Pepperdine University in Malibu, California.

TWST: Would you please start with an overview of West Coast Asset Management?

Mr. Helfert: We are an independent investment adviser registered with the SEC. We primarily provide equity management for high net worth individuals. We also started a hedge fund at the beginning of the year. Paul Orfalea and I started the company in 2000. Paul is the Founder of Kinko's, and the two of us comprise the Investment Committee. We started with about \$25 million under management with six clients, and today, we have about \$425 million and just shy of 100 clients. The most important thing about West Coast is our unique style — we call it entrepreneurial. It stresses the importance of understanding a business, not just its stock. We describe an entrepreneurial investor as focused, opportunistic and involved.

TWST: Would you elaborate on the entrepreneurial style?

Mr. Helfert: We are focused, so we maintain a concentrated portfolio of 10 to 15 stocks. That keeps the choices within our circle of competence. We want to be rewarded when we are right, and we want every choice to matter. We look for strong margins of safety to limit downside potential, and with so few stocks, any upside has a real impact on our returns.

We are also opportunistic, so we don't fit in any of the usual style boxes. We're all-cap; we're "go anywhere managers," which is kind of the buzzword today. We just don't want to be limited by arbitrary distinctions. For us, growth is one component of value. We wouldn't buy anything if it weren't a good value. We actually own **Microsoft** (MSFT) right now, which is our largest market cap company. But we have a couple of companies that are in the \$300 million market cap range. As Paul says, we don't care if a company is large cap, small cap, or beanie cap; we're looking for good deals.

The last component is being involved. We do hands-on research, led by Atticus Lowe, our Chief Investment Officer. We value the companies ourselves, and we understand the business — not just the stock. Plus, and this is really important to our clients, we personally invest in the same stocks that we choose for our clients.

TWST: Are you always fully invested or do you have a cash balance at times?

Mr. Helfert: At times we have a cash balance, because we are very patient about finding the right opportunity to invest. It is not a market call, per se; when we get new money from a client, it can take us a month or two before we get close to fully invested. Again,

we only have 10, 11, or 12 stocks. If we sell something, then we will have cash until we find an appropriate place for it.

TWST: What are the risks and rewards of having such a focused portfolio?

Mr. Helfert: We think it is less risky because we know the companies so well, and there are few surprises. If we had 100 companies in our portfolio, we wouldn't be nearly as knowledgeable about 100 companies as we are with 10 to 15. So we think that risks are mitigated by the fact that we know the companies so well. This is similar to Warren Buffett's style; he probably has about 60% to 70% in three or four stocks.

TWST: Do you have a reserve bench of stocks?

Mr. Helfert: Yes, we follow about 300 companies. They are the companies that we've looked at on some level and that we are comfortable with, but we are waiting for the right price. We monitor those and as the price changes or their business changes, we re-evaluate.

"We like to buy companies that have assets, are available at a bargain, and have some sort of potential catalyst. So if they have cash and real estate, we give them credit for that. We look to see if they have debt, and we account for that. We don't look at the prices as much as we look at the enterprise value."

TWST: What are the investment criteria that you are looking for in potential holdings?

Mr. Helfert: We prioritize a high margin of safety, so we like a company that has a really good balance sheet and cash, or real estate. We call it the ABCs. We like to buy companies that have assets, are available at a bargain, and have some sort of potential catalyst. So if they have cash and real estate, we give them credit for that. We look to see if they have debt, and we account for that. We don't look at the prices as much as we look at the enterprise value.

We like companies that have potential catalysts. They could do a major buyback, sell parts of their business, or they might be waiting on some sort of regulatory news or a patent. So those are the things that we look for. We don't like downside risk, so one of our maxims is that if you take care of the downside, eventually an event will trigger the upside.

TWST: What is your performance history, and is this why there has been such a dramatic increase in assets?

Mr. Helfert: From our inception, our annualized number has been 11.7%, and the S&P is 1.3%, according to our latest audit by Ashland Partners. If you look at our performance, for the first two years after we started our business, the S&P was down almost 15% in 2001 and we were up 2.47%. The next year, the market was down

22.1% and we were only down 5.04%. So although we weren't making a lot of money, we saved quite a bit of money those first two years. Our cumulative performance is 87.12% from inception; the S&P is around 7.57% during that same period. Naturally, complete performance disclosures are available upon request, and can also be viewed on our Website: www.wcam.com.

TWST: Is this year looking positive?

Mr. Helfert: As of November 17, our composite is up around 21.45% and the S&P is about 14.17%.

TWST: What is the investment climate like at this time? What is your outlook as we enter 2007?

Mr. Helfert: We are really fundamental, bottom-up researchers, so the fact that we only need 10 to 12 stocks is great because there are always opportunities out there. You don't need too many; we don't have to find 50 or 75 names and be fully invested with names that we may not want. When you are an entrepreneurial

investor and you focus on finding a handful of really great companies, it is not so much of a macro issue as it is about just knowing our companies and buying the right ones at the right price.

TWST: You describe your approach as looking at the business, the people, and the price. Would you describe that for us?

Mr. Helfert: We look at prospective investments in that order. The first is the business. Is it an understandable business that we think has the right attributes, such as recurring revenue, sustainable competitive advantages and good management? In the management, do they have inside ownership? Are they buying the stock? Are they good capital allocators? If you get through those two categories, you have to know if you are buying it at the right price. We want to make sure that we are paying a fair price with good potential upside in the stocks that we own.

TWST: You mentioned Microsoft within your portfolio. Tell us what attracted you to Microsoft.

Mr. Helfert: It's similar to the things that we discussed. They have big inside ownership, with Bill Gates and the rest of the insiders owning such a large portion of it. They have a lot of cash, and when we purchased the stock around six months ago, it had suddenly dropped into the low \$20s. They had a free cash flow yield of about 7% or 7.5%, which means that enterprise value — what we

compare to the free cash flow — was only at 15 times. We gave them credit for their cash. If you look at the price to earnings ratio on the S&P 500 today, it is around 18, and that does not take debt into account.

Microsoft is still growing, but it is not growing at 30% like it was in the early 1990s. However, it is a growth company. They are growing their top-line revenues at 10% and they can grow their earnings per share closer to 15% with buybacks. It is a growing company.

“Microsoft is growing their top-line revenues at 10% and they can grow their earnings per share closer to 15% with buybacks. It is a growing company. It has a wonderful business with huge competitive advantages, big inside ownership, great management in order to allocate the capital, and plenty of new ideas, from Xbox, to updating the new operating systems — you name it.”

It has a wonderful business with huge competitive advantages, big inside ownership, great management in order to allocate the capital, and plenty of new ideas, from Xbox, to updating the new operating systems — you name it.

There are so many things that they can do, and you are buying a premier brand at a huge discount to the market. It’s a company that has no debt, but if it had debt, it would be an AAA rated company. So when we can buy a big business with a great brand, a great company and great management at a big discount to the market, that’s ideal.

TWST: Yet the stock price didn’t move much for a long time. It has gone up slightly this year.

Mr. Helfert: We are long-term investors, and you never know when catalysts are going to happen. It might be in two or three months, it might be in four or five years. Sometimes you can get stuck in a value trap, but with **Microsoft**, we were able to buy the stock after it dropped nearly 15% in one day. Based on what we knew about the company, we really felt an increase was just a matter of time. If you take a really big position in a stock with a high probability of upside, you can make a lot of money with a modest percentage increase.

TWST: What about another stock that you feel is representative of your investment approach?

Mr. Helfert: We own a company called **Noven Pharmaceuticals** (NOVN). It is a smaller company. We owned it a few years ago for only four or five months because it went up fairly quickly, so we seized the opportunity to sell. They are a drug delivery company with a best-in-class patch technology that allows drugs to get into your bloodstream faster. It bypasses the liver on the first pass, and it is a better way to administer drugs for elderly people and kids.

The first patch they had was in the hormone replacement therapy business, and there was a study about four years ago that really hurt everybody in that space. All of the related companies went down, and it allowed people to buy this at the right price. The market cap of **Noven** right now is just over \$500 million, and they have about \$150 million worth of cash and net working capital. They have a great pipeline, and they also own some real estate — their headquarters and the manufacturing plant.

1-Year Daily Chart of Microsoft



Chart provided by www.BigCharts.com

They came to market in July with their first patch for ADHD, so children who are six to 12 who have ADHD can put this patch on their hip and it’s time released, so if parents only want their children to have it on for three hours, they can take it off. There are huge benefits to this, and it has been selling really well. They have a great partner, and it is a great business that has all of the attributes we are looking for — good management, recurring revenue, a huge competitive advantage and a lot of assets. We are buying it at a bargain price, and there are multiple catalysts. They have so many things in their pipeline, so if anything takes off, it has plenty of upside.

TWST: A lot of these drug delivery companies have partnerships or alliances. Who are Noven's partners?

Mr. Helfert: Noven's partner for the hormone replacement therapy, which is the big part of their business at this point, is **Novartis** (NVS), a \$130 billion plus company. They partnered with **Shire** (SHPGY) for the ADHD business. They also have partnerships in development with **Procter & Gamble** (PG) and **Endo Pharmaceuticals** (ENDP), so they have great partners.

We owned another drug delivery company a few years back called CIMA LABS. It was a wonderful business. They had a fast-dissolve technology, so a pharmaceutical company would pay them to develop the formula to put into the fast-dissolve tablets. It would get into your bloodstream faster, it was more efficacious, and you needed less of the drug to make it work. They would get an upfront milestone payment to develop it, so there was virtually no way they could lose money because they were getting paid up front. If they were able to formulate something and get it to market, they got the manufacturing profits as well and sometimes shared in additional profits. So they had everything going for them.

Big Pharma right now is very concerned about all of the drugs coming off patent, and with CIMA, they were able to potentially extend the patent. They got a new patent for some of these drugs, so they were in a great space. CIMA also had about \$10 per share in cash and \$5 a share in real estate. We were the third or fourth largest shareholder, and they got an offer to be taken out by **aaiPharma**, which is a company that we didn't think they should merge with. We let them know, and we issued a press release saying that we didn't think this was a good deal.

It was not a merger of equals. CIMA was a great little gem of a company, and they ended up getting an offer from **Cephalon** (CEPH), and then **Endo** actually came up with a higher offer. CIMA's stock was trading around \$23 at the time of the original agreement, and then a few months later, when the final offer from **Cephalon** came in, CIMA was bought out for \$34 a share in cash. They had many of the attributes we like — we were buying assets at a huge discount, it was a cash flow positive company, and they had multiple catalysts.

TWST: You say, "We refuse to let Wall Street become a crutch. It is only the beginning of our research process." Would you explain your research process?

Mr. Helfert: When we say we don't let Wall Street become a crutch, a lot of people read the research reports and see that a company will come out with their annual or quarterly numbers and Wall Street will downgrade or upgrade it as they see fit. But a lot of times, it is based on 10-year models; we really look at the business and evaluate it ourselves. We monitor the Wall Street research, because if everyone has a strong buy rating, there is not really much more that Wall Street can do. We are contrarian in the sense that we want companies that have holds or even potentially sells on them if we think they are good values. Eventually, we expect Wall Street to realize the value that we believe we are seeing.

We find companies in a myriad of ways. We look at the competitors of all of our companies. For example, when we owned CIMA LABS, we became familiar with everybody in the drug delivery space, so it allowed us to get familiar with other names and put those on our watch list and look into them to see if there was a potentially good price where we could purchase those.

I mentioned **Microsoft**. They are obviously a little easier to find, but we screen for some of these smaller hidden names. Again, the first thing we look for is the assets because that is the easiest thing to screen for. What is their cash balance? Do they have real estate? Do they have tangible assets that we think provide a huge margin of safety? If a company has a \$100 million market cap and they have some cash and real estate equal to \$100 million, that is a lot of downside protection.

For research, our secret weapon is Atticus Lowe, our Chief Investment Officer. He's a CFA charterholder, and directs our research operations. Atticus absorbs details about a company with remarkable speed and he's got terrific analytical abilities. He's put together a really good team, which is important because however many screens you run, there's no substitute for hands-on, human research.

TWST: Would you say that that drug delivery approach was a secular theme? Are you thematic at all?

Mr. Helfert: No, not really. Perhaps it seems that way because of the businesses we are attracted to — we like recurring revenue, huge competitive advantages, and good balance sheets. A lot of the drug delivery companies have those attributes, so it leads us to those types of companies. Again, we are fundamentally bottom-up, so if there was a company that didn't have one of those components, that business really wouldn't be of interest to us.

TWST: Do you have a contrarian stock pick that you can tell us about?

Mr. Helfert: One historical example is Saucony. It's a running shoe company, and it's not so much like **NIKE** (NKE) in the sense that it's a fashion or a fad type shoe. We bought that one in mid-2003. When we bought Saucony, the market cap of the company was about \$88 million and they had cash and working capital of \$70 million. They own the real estate; the headquarters is \$10 million. They had free cash flow of \$13 million, and we were buying the company basically for \$8 million. So it was a ridiculously low-priced stock, and the reason it was contrarian is because we understood the company's history better than most. Saucony had reintroduced a line of shoes that was popular decades before and it became a fashion statement for a while. Kids loved it and it exceeded everybody's expectations, and like Wall Street normally does, they overreacted on the upside and the stock just went up tremendously.

But if you really follow the stock and you looked into it, you realized that this was just a one-time event. This wasn't their core business running shoe; it was a classic running shoe, reintroduced for nostalgia marketing. So there was an interesting little spike in sales, but when comparables started coming out in the next couple of years, people said, "Oh! Why are sales and earnings going down?"

If you followed the company, you knew it was just a one-time deal. Wall Street, again, overreacted on the other side and penalized them because sales and profits were down so much. But if you looked inside the company and saw their core running shoe, it was a stable business. It was a very slow grower, but this was the shoe preferred by the serious runners, and that market wasn't going away. So the business was still stable and in great shape, but the sellers were just looking at the numbers and not looking into it.

That's when we bought Saucony, and then after the tax laws changed and made it more efficient to pay dividends, they paid a spe-

They have a well they are drilling right now called the Mega-Mata well. Their partner and operator is **Petrobras** (PBR). **Carrizo** sourced the well, they put this deal together, and they are only paying 5% of it, and they get 25% of the net working interest in the well. Its reserve potential is 1 trillion cubic feet of natural gas. They are logging the well now and we should hear any day if they hit or not. If they do, **Carrizo's** portion of that well would probably be worth about \$500 million. The market cap right now is around \$700 million. So we like oil and gas companies that have good stable businesses with a potential catalyst for large, large upsides.

“Carrizo Oil & Gas has the most acreage in the prime Barnett Shale area for an independent of its size, with about 85,000 net acres, and it provides a stable base for the business. That's the core of the business. They have a well they are drilling right now called the Mega-Mata well. Their partner and operator is Petrobras. Carrizo sourced the well, they put this deal together, and they are only paying 5% of it, and they get 25% of the net working interest in the well. Its reserve potential is 1 trillion cubic feet of natural gas.”

cial one-time dividend of \$4 a share, and then the company ended up getting bought by **Stride Rite** (SRR).

It's a great story. It's a brand that a lot of people know, especially the runners. They all know Saucony.

TWST: Do you have any other stock picks that you have had in the past or in the present that you feel show off your investment prowess?

Mr. Helfert: We have been involved in energy companies — oil and gas — mainly with small and mid-cap names, since the first year we were in business. It's not a new thing for us, and similar to the other industries, we like companies that have a good stable business with a potential catalyst. One that we have owned for a while is called **Carrizo Oil & Gas** (CRZO), and it's based in Texas. They have the most acreage in the prime Barnett Shale area for an independent of their size, with about 85,000 net acres, and it provides a stable base for the business. That's the core of the business.

They have twice the acreage in other shale plays than what they have in the Barnett Shale, and they are going to drill their first well next month in the Floyd Shale. They also have some properties in the Gulf Coast, in East Texas, in the Rocky Mountains and in the North Sea. Some of these projects have really big potential and could eventually propel the company to 3 times today's value. But again, we like this company because if they don't hit anything, we are still buying it at the right price.

1-Year Daily Chart of Carrizo Oil & Gas



Chart provided by www.BigCharts.com

TWST: If you had an inflow of money today, what stock would you like to put it into at this time?

Mr. Helfert: Carrizo is definitely the one we would put it in. Another company that we really like in the oil and gas businesses is called **Contango** (MCF). It's managed by Ken Peak, who we think is one of the best capital allocators in the oil and gas business. It's a small company. He owns personally about 22%, and he is still buying more shares today. There are really three main parts to the

business. They have a shale play similar to Carrizo's, but Contango's is in the Fayetteville Shale, and they have 44,000 acres. They also just had a nice discovery offshore in the Gulf of Mexico. They have part of the Freeport LNG terminal off of Texas that's going to be coming online in 2008. So it's three separate and valuable parts of the business.

They only have six employees in the whole company, and it's a \$200 million company. They have \$9 million in net cash, no debt, and, as I said, we really think that Ken Peak, the gentleman who runs the company and started this, is one of the best capital allocators. The people who generate their prospects for these wells are some of the most well-known and well-respected people in the business.

"Contango is managed by Ken Peak, who we think is one of the best capital allocators in the oil and gas business. He owns personally about 22%, and he is still buying more shares today. There are really three main parts to the business. They have a shale play similar to Carrizo's, but Contango's is in the Fayetteville Shale, and they have 44,000 acres. They also just had a nice discovery offshore in the Gulf of Mexico. They have part of the Freeport LNG terminal off of Texas that's going to be coming online in 2008."

TWST: Are you on close terms with the managements of all your stocks? Is that one of the advantages you have with a smaller portfolio?

Mr. Helfert: Yes, it definitely allows us to get to know the management. A common theme among most of our companies is high inside ownership. So it really helps when you are dealing with small and mid-cap type companies. With a larger one like Microsoft, we don't have a relationship with the management there, but on the small and mid-cap names, we definitely like to get to know them. We follow them and make sure they are allocating capital right and making good decisions, and we try to meet with them at least annually.

TWST: What do you like to see companies do with their free cash flow?

Mr. Helfert: If the stock is still at a good price and we are buying it at that price, we love to see shareholder buybacks. Dividends are fine too, but if it were such a big bargain, we would prefer that they use that cash to buy back the stock. We don't ever like to see them diversify just for the sake of it; we don't want them to just buy a business to get bigger. If it makes sense and it's in the same business and they are able to realize synergies, then that's okay, but buybacks are always great.

TWST: What triggers an exit from your portfolio, or do you mostly just trim back?

Mr. Helfert: We do trim back if the stocks run up, and if the company comes down, we might add to it. But if we are selling out altogether, it is usually for one of four reasons. One is if there is a better opportunity, so if we are fully invested and we find something that's just a great value at this price, we really want to buy it. If we can't just pare something back, we will sell something to go into a better idea.

If management is unsatisfactory and is not allocating the capital correctly, there is new management, or the management is not doing what we would like to see them do, those would be reasons we would sell.

1-Year Daily Chart of Contango

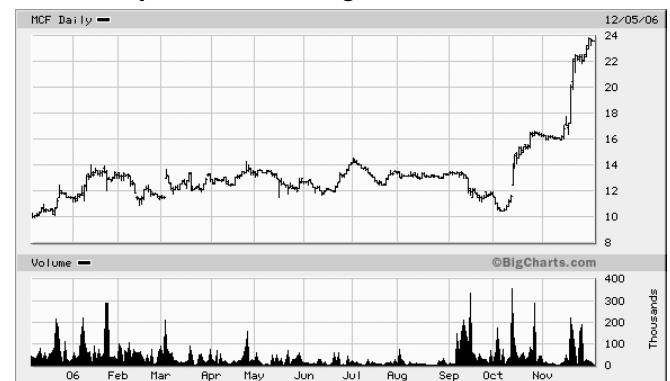


Chart provided by www.BigCharts.com

If something happens in the business that we don't like, we call it a cockroach. We think there are probably other issues there, so we might sell for that reason.

Also, we can manage tax efficiently because we manage separate accounts. So, if at the end of the year there is an opportu-

nity to take a loss and we don't want to give up our allocation to that position, we might use the wash sale rule to manage the position tax efficiently.

TWST: Risk is an integral part of a portfolio that only has a few holdings. What are your risk management techniques?

Mr. Helfert: If you're buying a company that has 75% of their market cap or even 50% of their market cap in true, hard, tangible assets, that mitigates the risk quite a bit. There have been times where we have purchased stock that we were hoping would go up that just didn't. Nothing was going right for the business, but they

A lot of firms are totally obsessed with Wall Street and the market. We're totally obsessed with the individual companies; an entrepreneurial investor wants to really understand how a company makes money and how it can make money for us.

TWST: What is your background? How did you get into this business?

Mr. Helfert: We started the company six years ago, and previous to that, I worked at Wilshire Associates in Santa Monica. They are consultants to some of the largest institutions. I worked in the asset management division.

“Noven Pharmaceuticals is a drug delivery company with a best-in-class patch technology that allows drugs to get into your bloodstream faster. It bypasses the liver on the first pass, and it is a better way to administer drugs for elderly people and kids. We are buying it at a bargain price, and there are multiple catalysts. They have so many things in their pipeline, so if anything takes off, it has plenty of upside.”

had enough cash or enough real estate or tangible assets, so it didn't go down. So the business might not have performed as we had hoped or expected, and then we were able to get out for either a minimal loss or no loss because they had assets.

That's really the biggest protection we have — having a small amount of stocks and paying attention to the assets and looking at the balance sheet of the companies. We are much more concerned about the balance sheet and the free cash flow than we are with just the market cap of the company. If there is a lot of debt in the company, that's something that we typically would shy away from. That's not always true, because we are opportunistic. We can do what we want and go where we want, but if all things are equal, we would like to see a good balance sheet.

TWST: What differentiates this investment approach at West Coast Asset Management from that at other firms? What are you bringing to the table that others might not?

Mr. Helfert: Concentration is definitely a big one. There are very, very few firms that are managing a portfolio with just 10 to 15 stocks. My partner Paul is the Founder of Kinko's, and he brings a unique perspective in the sense that he built a company from one store to 1,000 stores with 25,000 co-workers. He really wants to know about things like the culture of the company, how they are looking at their inventory, and find out what is really going on. There are not a lot of money management firms that have an entrepreneur like him who has been so successful at creating a huge business in the United States, so he is definitely a big attribute for us.

1-Year Daily Chart of Noven Pharmaceuticals



Chart provided by www.BigCharts.com

TWST: Although you are a bottom-up investor, do you see any possible challenges or problem areas for your type of investing?

Mr. Helfert: When you only have 10 to 12 stocks, you want to do as much research as you can and ask, “What are the demographics? What is going to happen to my stocks if the demographics change? If there are Democrats versus Republicans in office, how does that affect our individual companies?” At the end of the day, with, for example, a company like **Noven**, no matter what happens with the US dollar or the euro, people will still use their

patches. We know the recently elected Congress is already talking about having prescription drugs from Canada come in, and/or empowering our government to buy at volume discounts. But we are not buying companies that are so dependent on macro issues.

TWST: Do you want to talk about the hedge fund that you started this year?

Mr. Helfert: We have a fund available only to accredited investors, but I think that's all our compliance officer will let me say in this interview.

TWST: Is there anything else that you would like to add that we overlooked and that you wanted to bring out?

Mr. Helfert: One thing is that we recognize the importance of giving back to the community. We borrowed an idea from Warren Buffett — we take 1% of our revenues and donate those to charities of our clients' choosing. It's just a nice thing to do that allows our clients to decide where to give back.

We are opportunistic. We can go anywhere. We are not constrained by a box, and you asked before how we are different. There are a lot of small cap growth, mid-cap value, and all sorts of style managers. There are all sorts of people trying to figure out the best stocks in each box. We just don't understand why you would want to be limited. If you find a great company that has a \$200 billion market cap, and you find a great one that's \$350 million, you should be able to buy either. We can do just that, and we also don't know why anyone would add money to their 100th best idea if they can add money to their number one idea. So we are opportunistic and we can go anywhere, and it affords us multiple opportunities.

TWST: Thank you.

LANCE HELFERT

West Coast Asset Management, Inc.

2151 Alessandro Drive

Suite 100

Ventura, CA 93001

(805) 653-5333

Note: Opinions and recommendations are as of 11/30/06.

This material is for informational purposes only. No recommendations to purchase or sell securities are made, nor does this constitute an offer of any kind. Data were obtained from publicly available sources which we believe are reliable. West Coast Asset Management makes no warranty or representations as to the accuracy or usefulness of this information. The principals, co-workers, directors and clients of West Coast Asset Management may or may not own shares in the companies discussed. A complete list of companies reviewed in our audio recordings, presentations, newsletters and other publications is available on request. Prospective investors should always remember that past performance is no guarantee of future results.