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THE WALL STREET TRANSCRIPT
Questioning Market Leaders For Long Term Investors

Investing in Small & Mid-Cap Growth

ROB J. NICOSKI is a Portfolio Manager with Disciplined Growth Investors and a member of the firm's investment team. Mr. Nicoski began his investment career with Piper Jaffray Inc. as an Equity Analyst focused on small cap companies. He later joined U.S. Bancorp Asset Management where he co-managed a small cap equity mutual fund and managed separate small cap portfolios before joining Disciplined Growth Investors. Mr. Nicoski graduated summa cum laude from St. Cloud State University with a BS in Accounting. He is a Chartered Financial Analyst and Certified Public Accountant.

(ZAH503) TWST: Would you give us a brief overview of Disciplined Growth Investors and tell us what you do there?

Mr. Nicoski: Disciplined Growth Investors is a 100% employee-owned, independent investment advisor focused exclusively on small cap and mid-cap growth stocks. We manage approximately $1.3 billion across three products: small cap growth, mid-cap growth and balanced accounts. The equity component of our balanced accounts is invested in our mid-cap product.

We have an experienced three person investment team that applies a singular investment process and philosophy across both our small and mid-cap equity products. I am a portfolio manager and analyst on all of our products.

TWST: What is your client base? Is it largely institutional?

Mr. Nicoski: Approximately three-quarters of our assets under management are held by institutional clients. The balance represents high net worth clients.

TWST: How many companies do you generally have in your portfolios?

Mr. Nicoski: We believe that truly great investment ideas are rare, so we manage relatively concentrated portfolios. Our mid-cap portfolios are typically invested in 40 to 50 stocks, and our small cap portfolios generally have 45 to 55 stocks.

TWST: Does that provide adequate diversification?

Mr. Nicoski: Yes. The concept of diversification is often taken to extremes, i.e., the more names the better. We believe it is a mistake to think that you can minimize risk by spreading investments among businesses in which you have little special knowledge or confidence.

TWST: What is your investment decision-making process. What characteristics are you looking for in the companies you select for the portfolio?

Mr. Nicoski: We believe Disciplined Growth Investors is somewhat unique in the sense that we are growth managers, but as our name implies, we are very disciplined in our fundamental research and valuation methodology.

Our primary investment goal is to purchase outstanding businesses at sensible prices. To that end, our fundamental research process is geared toward identifying companies with defensible business models and attractive long-term growth prospects. The superior return on invested capital that results from a defendable competitive position when combined with compelling growth opportunities can drive significant long-term value creation.

Even great businesses can be bad investments if the valuation is excessive, so we are careful to distinguish intrinsic value from the stock price. We use our assessment of intrinsic value to determine an appropriate purchase price that exceeds our internal expected return hurdles. We maintain a strict discipline of never paying more than assessed value. Our experience with **Yahoo!** (YHOO) is a good example. In early 2000, **Yahoo**'s stock price peaked at a split adjusted $125 per share. **Yahoo** is a great company, but it was a lousy investment at that point because its share price vastly exceeded any reasonable estimate of intrinsic value. The stock fell dramatically as the technology valuation bubble began to burst, and by mid-2001 it was trading around $5 per share. We began purchasing **Yahoo** in 2001 at split-adjusted prices between $5 and $15 per share, a significant discount to our assessment of intrinsic value.

Another critical aspect of our investment approach is our long-term investment horizon. Our preferred holding period is forever. That sounds like a joke, but it's not. We are content to hold a security indefinitely, provided the growth in intrinsic value is satisfactory and the valuation is not excessive. Last year, turnover was 18% in our small cap portfolios and just 8% in our mid-cap portfolios. Our turnover is typically between 15% and 30% in our small cap portfolios and slightly less in our mid-cap portfolios.

Our long-term investment horizon reflects our fundamental belief that the stock market is inefficient in the short term but ruthlessly efficient over the long term. If we do our homework and are patient, we can capitalize on short-term dislocations between market prices and intrinsic value. The market may ignore business success for a while, but we believe that it will eventually confirm it.

TWST: In many respects your valuation and purchase discipline resemble a traditional value investing approach. Can you comment on that?

Mr. Nicoski: I find it interesting that growth and value are often portrayed as competing investment forces. Growth and value are not mutually exclusive concepts. To the contrary, growth and value are fundamentally linked. Growth is a component of a company's underlying value, and assessing the value of a business is always an element of any sound investment philosophy. Consciously paying more than the value of the underlying business in the hopes that it can be sold at a higher price reeks of speculation.

TWST: So then you really are growth investors?

Mr. Nicoski: Yes, we are growth investors. One of our fundamental premises is that growth in the underlying business franchise is a key driver of long-term value creation. Our goal is to identify companies that possess superior long-term growth potential, i.e., rapid growth in their target markets or a structural change in the industry where they are positioned to capture market share. If we can identify these businesses and purchase them at an appropriate discount to intrinsic value, we can hold them for many years as they evolve into much larger entities.

TWST: What is the definition of your small cap and your mid-cap range?

Mr. Nicoski: Our market capitalization range is $50 million to $1 billion for our small cap portfolios and $1 billion to $10 billion for our mid-cap portfolios. This is our market capitalization restriction at the time of purchase.

TWST: What are the benchmarks by which you judge your performance?

Mr. Nicoski: The primary benchmark for our small cap product is the Russell 2000 Growth Index, but we also consider the broader Russell 2000 Index. For our mid-cap product, our clients measure our performance against both the Russell Midcap Growth Index and the S&P 500.

TWST: How have the portfolios been doing over the last 12 months or so?

Mr. Nicoski: Investment results have been good. For the trailing 12 months ended 5/31/05, our mid-cap equity product gained 19.0% and our small cap equity product was up 9.3%. Both of our equity products handily beat their primary benchmarks. Solid one-year returns are encouraging, but long-term investment results hold more meaning for our clients. Since inception in February 1997, our mid-cap equity product has generated an annualized return of 11.8% versus 7.4% for the Russell Midcap Growth Index and 6.7% for the S&P 500 including dividends. Our small cap equity product has returned 10.2% per year since inception versus 3.4% for the Russell 2000 Growth Index.

TWST: Would you say that you have a thematic investment approach?

Mr. Nicoski: Yes, in a sense, but we need to be careful how we define thematic investing because our purchases are ultimately a function of intense fundamental research and intellectual debate on the individual companies. However, it is fair to say that our investments are clearly more concentrated in areas represented by certain broader fundamental themes. These fundamental themes target areas of emerging economic leadership.

There are a number of promising fundamental themes in the technology sector. We are particularly bullish on companies that are leveraging the power of the Internet to gain competitive advantage. There is no question that the Internet is an extremely disruptive technology. It is fundamentally transforming how consumers and business interact and transact. This disruptive force is creating opportunities for a variety of companies including Internet-based franchises, electronic content management companies, and companies that are providing Web facilitating technologies.

Another promising fundamental theme in technology is proprietary intellectual property. Intellectual property is an extremely valuable asset if it can be defended and leveraged to the benefit of shareholders. We are focused on identifying intellectual property companies that have demonstrated a proficiency at monetizing their proprietary knowledge via high margin licensing and royalty arrangements.

In the telecom arena, we are focused on companies positioned to benefit from the convergence of voice and data. We are particularly bullish on companies that provide technologies or services that enable voice over Internet Protocol (VoIP). VoIP is revolutionary technology that allows voice and data to be carried across the same network. This is enabling the delivery of enhanced services that can improve productivity and cut costs.

> *"Yahoo has an extremely profitable business model characterized by 30% plus operating margins and high returns on invested capital. The business requires very little ongoing capital investment, so Yahoo is in the unique situation of being able to aggressively grow the business while at the same time generate over $1 billion in free cash flow on an annualized basis."*

We have two other areas of interest: retail and health care. In the retail area, we seek companies that have clearly differentiated their concepts in the marketplace with proprietary product and multi-channel distribution capabilities. In health care, we are focused on companies that have proprietary medical technology. This generally encompasses biotechnology companies and medical device companies that are developing novel approaches to address large unmet medical needs.

TWST: Would you tell us about some of the companies from your small and mid-cap portfolios to give us a representative feel for your investing and the reasons you were attracted to those companies?

Mr. Nicoski: One of the larger holdings in our mid-cap portfolios is **Yahoo**. **Yahoo** has developed an amazing Web-based media franchise by leveraging the global reach and low-cost distribution capability of the Internet. **Yahoo**'s strong search capabilities and diversified content, much of which is provided free of charge, has attracted a large base of loyal users. At last count, they had over 175 million active registered users from around the world. **Yahoo** aims to continue to expand its user base and monetize these users in two ways.

First, **Yahoo** is monetizing its users through increased spending from advertisers. The company's position as a leading online media company should allow it to disproportionately benefit from the secular shift in advertising spending toward more targeted and measurable mediums such as the Internet. Currently US consumers spend about 14% of their overall time devoted to media on the Web, yet only about 3% of the advertising dollars are spent on Internet marketing. Typically, media advertising dollars follow media consumption patterns. We believe this will be the case with the Internet as advertisers gain more confidence in the effectiveness of Internet advertising. In addition, we believe media consumption habits will continue to evolve and ultimately result in a larger percentage of time devoted to the Web at the expense of traditional advertising mediums. **Yahoo**'s deep content and loyal user base uniquely position the company to benefit from both of these favorable secular trends.

The second way **Yahoo** is monetizing its extensive user base is by offering premium fee-based services. The company has had success with a number of fee-based services such as personals, HotJobs, and a DSL co-branding effort with **SBC Communications** (SBC). In addition, they recently re-launched their music downloading service, which is poised to compete with other online music stores such as the highly successful iTunes offering from **Apple Computer** (AAPL).

1-Year Daily Chart of Yahoo!

Chart provided by www.BigCharts.com

Yahoo has an extremely profitable business model characterized by 30% plus operating margins and high returns on invested capital. The business requires very little ongoing capital investment, so **Yahoo** is in the unique situation of being able to aggressively grow the business while at the same time generate over $1 billion in free cash flow on an annualized basis. Looking at the balance sheet, **Yahoo** has significant value in its non-operating assets consisting of over $2 per share of cash, net of debt, and an estimated $4 in present value for its investment in Yahoo Japan.

Another portfolio holding that has capitalized on the power of the Internet to expand its business franchise is **Adobe Systems** (ADBE). **Adobe**'s products are more pervasive than many of us realize. Most of us have had some experience using **Adobe**'s Acrobat Reader software to view documents on the Web. To date, **Adobe** has distributed more than 500 million copies of Adobe Acrobat Reader. This has helped establish the PDF file as the de facto standard for electronic document exchange. **Adobe** also has a dominant franchise with creative professionals. **Adobe**'s Creative Suite of products is the leading platform used to create and publish content in print or to the Web.

Adobe's focus on content creation and electronic document distribution taps into a growing demand to streamline and reduce paper-intensive workflows and facilitate collaboration. The company is addressing this large market opportunity with its Intelligent Document solution. Intelligent documents are dynamic PDF files with varying degrees of built in logic. The logic capabilities allow the PDF files to interact with other content, data or applications.

For instance, a traditional paper-based purchase order could be digitized and programmed to allow a customer to type in the requested information online. The completed purchase order could interact with the inventory management system to check stock levels. It then could be automatically routed to fulfillment and shipping personnel. The document could even prompt the CRM system to e-mail the customer when their order has been shipped. The point is that intelligent document technology is extremely flexible and holds tremendous potential to help organizations improve productivity and reduce costs. This represents a huge opportunity for **Adobe**.

Much like **Yahoo**, **Adobe** has a tremendous business model with 90% plus growth margins and 35% operating margins. Capital needs are modest, so the company generates strong free cash flow that can be invested in new growth ventures or returned to shareholders.

TWST: In what other areas did you buy stocks?

Mr. Nicoski: One recent purchase is a small cap company called **Sonic Solutions** (SNIC). **Sonic Solutions** falls into the intellectual property category. The company is the market leader in DVD authoring technology. Their intellectual property has become the de facto standard across the primary markets for DVD authoring solutions.

Sonic is the market leader for professional DVD production systems. **Sonic**'s technology is used to produce over 80% of the DVD titles released by Hollywood. They are also the market leader for consumer and business DVD authoring software. They have forged relationships with several of the big PC manufacturers such as **Dell** (DELL) and **HP** (HP) and have a significant presence at retail via the purchase of their largest competitor, Roxio. **Sonic** also licenses its IP to other software and consumer electronics vendors such as **Adobe**, **Microsoft** (MSFT), **Scientific-Atlanta** (SFA) and **Sony** (SNE).

The explosion in digital data and continued decline in hardware prices is driving strong demand for **Sonic**'s DVD authoring solutions. We believe that within a few years most of the 200 million PCs that are sold each year will have DVD burning capabilities, up from about 20% of PCs in 2004. In addition, there is an emerging opportunity in the consumer electronics market as DVD burning technology is increasingly incorporated into DVD players, cable set-top boxes and other media appliances.

The combination of licensed IP and software sales results in a very attractive business model with 80% gross margins, 25% plus operating margins, high return on investment capital, and significant free cash flow.

"Sonic is the market leader for professional DVD production systems. Sonic's technology is used to produce over 80% of the DVD titles released by Hollywood. They are also the market leader for consumer and business DVD authoring software. The explosion in digital data and continued decline in hardware prices is driving strong demand for Sonic's DVD authoring solutions."

1-Year Daily Chart of Sonic Solutions

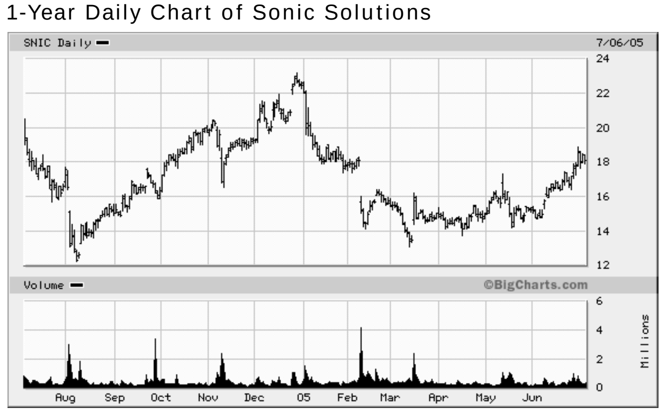

Chart provided by www.BigCharts.com

Another recent purchase in our mid-cap equity product is a company by the name of **Cabela's** (CAB). **Cabela's** is the leading specialty retailer of hunting, fishing and camping (HFC) gear in the United States. **Cabela's** has differentiated itself from the competition by offering the broadest and deepest selection of quality HFC merchandise in the industry. They sell over 235,000 SKUs. This dwarfs the product offering of most of their regional and national competitors, which typically carry between 35,000 and 50,000 SKUs.

Cabela's integrated, multi-channel distribution capability is another important element of their strategy. Shoppers can purchase products either at a retail store or direct via the Internet or various **Cabela's** catalogs. We believe this convenient access to **Cabela's** extensive product offering allows the company to capture a larger portion of the typical customer's HFC expenditures.

The primary growth driver for **Cabela's** is the expansion of the retail store base. **Cabela's** currently has 11 retail stores. We believe that the US market can ultimately support 40 to 50 of **Cabela's** large format stores.

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Cabela's stores can best be described as big and profitable, which is a very good combination of attributes. The prototype store is over 200,000 square feet with about four football fields of selling space. The stores are also highly productive. Sales per square foot and return on invested capital compare favorably to other successful big box retailers.

Cabela's stores are not just big, they are also busy. We have a **Cabela's** store about 75 miles south of the Twin Cities. This store is the second largest tourist attraction in Minnesota in spite of the fact that it is more than an hour drive from any major metropolitan area. The powerful draw and considerable economic activity generated by the stores are coveted by local municipalities. Local governments often offer significant financial incentives to entice **Cabela's** to open a store in their jurisdiction. The financial assistance comes in the form of economic development bonds that typically cover 25% to 75% of the initial investment in the store. This greatly enhances the net return on investment for a new store.

Cabela's direct business is an under-appreciated strategic asset. The $1 billion in Internet and catalog sales and 40-year history of selling direct to consumers has allowed **Cabela's** to amass a detailed database of customer spending patterns by product and geography. **Cabela's** management uses the insight it gleans from this proprietary data to improve merchandising and store location decisions.

One last point on the growth opportunity. There is still significant room to grow the business. The hunting, fishing and camping market is large and fragmented. Consumers spend about $32 billion on hunting, fishing and camping gear each year, and the top 10 specialty retailers capture less than 12% of those sales. This leaves plenty of room for **Cabela's** to capture market share.

The last company I will mention falls into the proprietary medical technology category. The name of the company is **MedImmune** (MEDI). **MedImmune** is an integrated biotechnology company focused on developing drugs that target infectious diseases, immune system disorders and cancer. **MedImmune** is probably best known in the medical community for its blockbuster drug Synagis. Synagis is used to treat respiratory tract infections in high risk pediatric patients.

1-Year Daily Chart of Cabela's

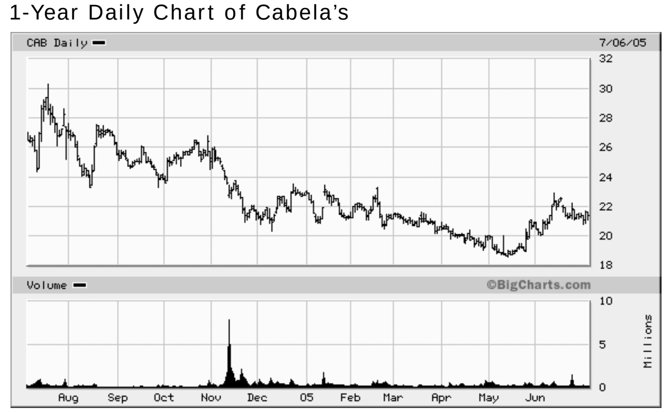

Chart provided by www.BigCharts.com

MedImmune stumbled badly a couple of years ago when the launch of their highly anticipated inhalable flu vaccine, FluMist, fell well short of expectations. The clinical data on FluMist was compelling, particularly versus traditional injectable flu vaccines. However, the initial marketing strategy was flawed, distribution was complicated, and the label granted by the FDA was too narrow.

Despite this high profile misstep, we still believe FluMist has significant potential. **MedImmune** is in the process of correcting their marketing strategy. They are now focusing on educating physicians rather than marketing to consumers. This strategy more effectively leverages their existing sale force and distribution partners. **MedImmune** is also conducting broad-based Phase III clinicals to expand the label. Our confidence level of a positive outcome is higher than it would typically be for Phase III trials, given **MedImmune** generated favorable results from similar studies conducted abroad.

Even if we discount the future success of FluMist, we are still encouraged about the outlook for **MedImmune** because the company has a deep pipeline of promising drugs in development. Several are in late stage clinical trials including a promising vaccine for HPV, Human Papillomavirus, the leading cause of cervical cancer; the next generation of Synagis called Numax, which is believed to be 50 to 100 times more potent than Synagis; and a novel anti-angiogenesis cancer agent.

Unlike many biotechnology companies that are captive to the capital markets to fund expensive drug development efforts, **MedImmune** has the resources to internally fund its development projects. The company has $1.4 billion of cash and marketable securities on the balance sheet, net of debt. In addition, the stable of five currently marketed drugs generates over $1 billion in annual revenue and significant free cash flow.

TWST: In what way would you say the portfolios have changed their emphasis from this time last year?

Mr. Nicoski: The emphasis has changed very little since last year with perhaps one exception, our energy holdings. Energy stocks have appreciated significantly over the past few years and now appear to be discounting very high oil and natural gas prices. We have trimmed several energy holdings to fund purchases of companies with higher expected returns.

TWST: Are you interested in the natural resource arena? Is that an area where you have been looking, outside of energy stocks in particular?

Mr. Nicoski: We do not arbitrarily dismiss any area for potential investment; however, natural resource companies are not an area of emphasis. At the end of the day they are still selling a commodity. We tend to shy away from commodity companies in general because it's difficult to develop a competitive edge in a commodity business. Absent a distinct cost advantage, long-term value creation is largely dependent on increasing commodity prices.

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TWST: What are your criteria for selling a stock?

Mr. Nicoski: Rather than limit the discussion to our sell discipline, let me talk more broadly about our overall risk management process. We manage risk at the individual security level. We have developed a real-time risk management model to monitor individual security risk. This model tracks four key risk factors: valuation risk, execution risk, financial risk and allocation risk.

1-Year Daily Chart of MedImmune

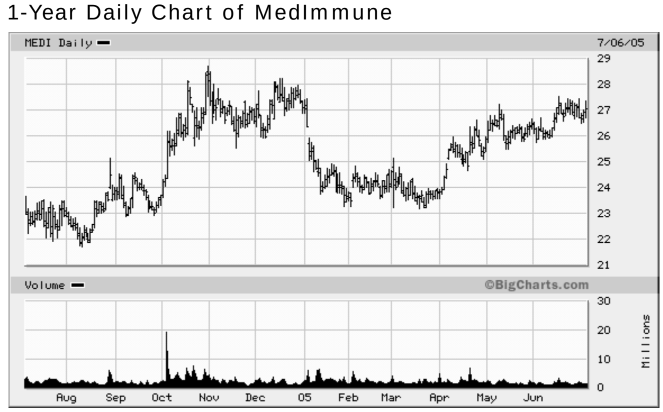

Chart provided by www.BigCharts.com

Valuation risk is objective and easy to quantify. It is the inverse of the expected return of the stock. A high expected return equals low valuation risks and vice versa.

Execution risk is a little more subjective. Here we are more interested in directional changes. For instance, we assess management's execution relative to their business strategy. Are they meeting the milestones we laid out in our investment thesis? We examine compensation and corporate governance practices. Is the company treating shareholders fairly? We believe our long holding period gives us a distinct competitive advantage gauging execution risk because we can get to know the companies, the management teams and their strategies better over time.

Financial risk measures the quality of the balance sheet. For example, if you have two companies that are both expected to earn $1 in EPS and one has $500 million in cash and no debt and the other has no cash and $500 million in debt, the latter clearly has more financial risk. The other element of financial risk is business model risk, i.e., companies that have higher gross margins conceptually have less financial risk because they have more potential cushion in their operating structure.

Allocation or portfolio position size risk is an objective measure of the size of the holding within the portfolio, i.e., a company that has a larger position size in the portfolio is riskier than a smaller position size. This is the one lever we have to adjust the overall risk profile of the portfolio.

TWST: What companies have you trimmed back on over the last year?

Mr. Nicoski: We have done very little active selling in the past year. We trimmed a few of our energy holdings for the reasons I previously mentioned. We also pared back our position in **Apple** late last year. **Apple** had grown to a 7.4% position in our mid-cap product due to the strong performance of the stock. Although financial and execution risk had decreased with the enormous success of the iPod and iTunes music site, it was not enough to offset the increase in valuation and allocation risk so we reduced **Apple** to a 5% position.

Then in the early 1980s, IPO activity spiked and large cap stocks proceeded to outperform small caps for most of the decade. In the latter part of the 1980s, IPO activity tailed off briefly, and that set the stage for a short period of small cap outperformance in the early 1990s. That small cap cycle was short-lived because IPO activity surged over the balance of the decade, and small cap stocks continued an extended period of underperformance.

The relationship between IPO activity and small cap performance is relatively straightforward. We believe increased IPO activity brings well-financed competition into the market. Heightened competition pressures financial performance. Poor financial performance leads to subpar equity performance. In recent years, IPO activity has been relatively modest. This provides a favorable backdrop for small cap performance in the years ahead.

The second reason we are encouraged about the outlook for small and mid-cap growth stocks stems from our internal valuation work. Our valuation analysis is showing relatively high expected returns for our portfolio holdings. Now this is admittedly a small sample, but we have found it to be a reasonable gauge of future return potential for the respective asset classes.

Lastly, I would comment on the low interest rate environment and the positive implications this has for small and mid-cap equities. Both real and nominal interest rates have declined significantly over the past several years. In mid-2000, the six-month T-Bill was yielding over 6%. Today it is yielding just over 3%. The yield actually declined below 1% at one point before the Federal Reserve began its latest round of tightening. The same holds true on the long end of the yield curve. The 10-year Treasury yield has been hovering around 4% despite the fact that the Fed has significantly boosted policy rates.

"I would encourage investors to insulate their thoughts and actions from the noise and emotion of the market. Investors should focus their attention and efforts on buying outstanding businesses at reasonable prices. The rate at which the market recognizes intrinsic value is not that important as long as intrinsic value grows at a satisfactory rate."

TWST: What is your macro outlook for small and mid-cap growth stocks?

Mr. Nicoski: There seems to be a consensus on Wall Street that the relative outperformance of small and mid-cap stocks over the past few years is poised to reverse. We, quite frankly, disagree with that notion. We are still encouraged by the outlook for small and mid-cap growth stocks.

Our research indicates that small cap performance is closely correlated with IPO activity. From 1974 to 1982, small cap stocks significantly outperformed large cap stocks. If you recall, that was a period of rising interest rates, high inflation and sluggish economic growth — not exactly an environment commonly associated with small company outperformance. IPO activity during that period was muted.

The current interest rate environment is encouraging for equity investors. There is $6.5 trillion in money market funds, savings accounts and other low-yielding fixed income instruments in the US. We believe the low rates of return being recognized on these investments will eventually prompt money to flow into higher return asset classes such as small cap and mid-cap equities.

TWST: What do you think differentiates your investment approach and Discipline Growth Investors from that of other peer firms?

Mr. Nicoski: Our singular investment philosophy and process gives us a competitive advantage. There is no distraction from non-related products or competing investment philosophies. We believe this targeted approach sharpens our decision-making capabilities. In addition, we frequently graduate holdings from our small cap product into our mid-cap product. We believe our ability to leverage this cumulative base of knowledge also contributes to better investment decisions.

Another point of distinction is our experience and focus on identifying and owning emerging mid-cap superstar stocks. These are smaller companies that have the potent combination of sustainable competitive advantage and attractive long-term growth prospects. Many critical pieces have to fall into place for them to fully realize their potential, but if they do, the rewards for our clients can be significant as they develop into vastly larger entities.

Our long-term investment horizon also gives us a competitive advantage. It allows us to capitalize on inefficiencies in the market that may take years to fully work out. This patient approach prevents us from giving up too early on companies that may be experiencing short-term operating difficulties but are still well positioned to generate significant long-term value.

Finally, perhaps our most significant competitive advantage is our willingness to remain intellectually honest. Our core investment philosophy and process have changed very little over time, but this is not for lack of constant critical examination. We routinely challenge many aspects of what we do in an attempt to sharpen our fundamental execution and improve long-term investment results.

TWST: Are you concerned with tax efficiency?

Mr. Nicoski: Our equity products are naturally tax efficient due to our low turnover. That said, we do honor client-directed requests in our taxable accounts.

TWST: What are the industries or areas of the economy that are not so attractive for investors at this time?

Mr. Nicoski: One area where we have minimal exposure is financial services. It may seem hard to believe but the strongest performing sector over the past couple of decades has been financial services. People like to focus on the NASDAQ and the technology valuation bubble, but this bubble only lasted two and one-half years — hardly long enough to create a sustained market excess. We believe the real institutionalized excess of the past two decades was high nominal and real interest rates.

High interest rates throughout the 1980s and 1990s allowed financial service companies to flourish. In 1980 the financial services sector accounted for 5.7% of the market value of the S&P. This increased to 20.7% by the end of 2004. The financial services group as a whole returned 15.6% per year during that period, which far outpaced the 11.2% annual price appreciation of the NASDAQ and the 10.1% annual gain of the S&P.

Today, financial services companies no longer have the benefit of high real and nominal interest rates. Most of the excess return has been squeezed out of the yield curve. We believe the collapse in nominal and real rates portends a long period of subpar performance for financial services companies.

We also believe that there is a surplus of lending capacity available today. Anecdotal evidence such as the flood of credit card solicitations and abundance of mortgage companies willing to lend on incredibly favorable terms certainly supports our contention. This excess lending capacity should also pressure returns for the financial services sector.

In the financial services area, we are focused on companies that are uniquely positioned to thrive in an environment of increased competition and lower returns such as **E*TRADE Financial** (ET) and **Metris Companies** (MXT). **E*TRADE**'s low cost delivery model leverages the Internet to provide full-line brokerage and banking services. **Metris Companies** is a small, independent credit card company that targets the subprime and near-prime market place. We believe **Metris** is positioned well, given their specialized expertise in an under-appreciated niche.

TWST: What advice would you leave with investors today who are looking to enter the market?

Mr. Nicoski: The best advice I can offer investors is to echo the wisdom of Benjamin Graham. He captured the essence of the stock market when he explained that "in the short run the market is a voting machine, but in the long run it is a weighing machine." Graham rightfully warned investors not be seduced by the short-term fluctuations of the market. I would encourage investors to insulate their thoughts and actions from the noise and emotion of the market. Investors should focus their attention and efforts on buying outstanding businesses at reasonable prices. The rate at which the market recognizes intrinsic value is not that important as long as intrinsic value grows at a satisfactory rate. Eventually the market will weigh the business accurately and prices will more fully reflect the true underlying value of the business.

TWST: Thank you.

Note: Opinions and recommendations are as of 7/6/05.

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