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THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

Investing in Mid-Cap Stocks

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(ZBR503) TWST: Would you begin with an overview of Aurora Investment Counsel and your responsibilities there?

Mr. Yucius: We are an independent money manager focusing on separate account management. We just celebrated our 10-year anniversary for our performance record on December 31, 2005. We've been managing money with our Growth at the Right Price investment style, as we call it, for 10 years now with an annualized return of 14.5% through 12/31/05.

Originally, I was brought in to a wealth management shop focusing on high net worth individuals back in 1995, at a small firm here in Atlanta. I basically started running money for that firm and for their clients exclusively. After four or five years, things were going well and the performance was there. We came to the realization that we could broaden our reach and manage more assets for a broader range of people beyond just that one firm. And so we decided to spin off the money management division and that's where Aurora Investment Counsel came from. That was done in 2001, so Aurora as a corporate entity evolved in 2001, but it's been the same process and people running the same money since 1995.

TWST: Do you make up separately managed accounts? Is that the specialty of the firm, customized portfolios?

Mr. Yucius: Yes. We have two composites, one tax-exempt and one taxable. It's a mid-cap core product either way.

TWST: Mid-cap seems to be the sweet spot right now. What is the attraction of mid-cap stocks and what is the investment climate like at this time for mid-cap?

Mr. Yucius: The Russell Midcap benchmark that we use has had some really good numbers over the last one year and three years, but if you look, it's really been over an extended period of time that mid-caps have done well. It's not just one and three, but over one, three, five, seven and 10 years that the Russell Midcap has significantly outdistanced both large and small caps, with pretty good volatility characteristics as well.

Mid-caps have been doing exceptionally well and I think it's caught a lot of people off guard. Particularly with the institutional consultants that we deal with, mid-caps generally get marginalized. A lot of institutional investors are in a four-corner style box framework that doesn't specifically allocate to mid-caps. It's not been on a lot of people's radar, although it is something that has been popping up more and more conversationally.

To me, the reasoning behind the outperformance might be explained best by looking at the fact that these are not small, fly-by-night companies. The mid-cap world is typically defined by market capitalizations between $1 billion and $10 billion. These companies have been around and have some scale. They have staying power, but most of them haven't really graduated to center stage, where they'd get a lot of Wall Street attention. These are good, solid companies with staying power and solid financial underpinnings, but companies that haven't reached the law of large numbers where it's impossible to have high rates of growth. They're still young, they're still nimble enough and they still have enough opportunity to blossom.

If you combine that growth opportunity with valuations for companies that haven't been overly loved, for us, a Growth at the Right Price manager, that dovetails nicely with what we're hoping to do. We're trying to find undiscovered companies that have the same solid growth potential as some of the leading companies in their various market niches.

TWST: What is your definition of mid-cap? What's the capitalization range?

Mr. Yucius: The Russell Midcap Index is the smallest 800 companies of the Russell 1000 Index, which is a large cap benchmark. The median market capitalization of our portfolios has been between $2 billion and $5 billion over the last five to 10 years while the median market capitalization of the Russell Midcap Index is about $4 billion. We typically don't buy companies that are less than $500 million in market cap. Occasionally, we'll buy some larger companies that are above $10 billion, but 60%-70% of our stocks typically fall between $1 billion and $10 billion in market cap.

TWST: Are you always fully invested in equities or do you have other assets in your customized portfolios?

Mr. Yucius: It depends on what our end client is asking us to do. We typically serve in a capacity where we have a very specific equity-only mandate and, to that extent, we remain fully invested. It is not in my investment personality to try to time markets on a macro level. That's not something that I feel confident in doing. To the extent that other clients either don't have the financial wherewithal to hire us as a specialist or they just want us to be more of a broad asset manager for them, we do have the capacity to pick fixed income and international investments, etc., for them. Our equity strategy is an equity-only, mid-cap core, Growth at a Reasonable Price (GARP) strategy. That's what our equity product represents us as.

TWST: How many stocks are generally in the portfolio?

Mr. Yucius: 40-50 issues.

TWST: So it's pretty well diversified.

Mr. Yucius: I think so. To that point, we specifically try to be diversified, particularly in industry weightings. In the same way that I don't want to make a lot of macro market calls, I also don't want to make either intended or unintended sector bets very often. To me, 40-50 names does allow for good and adequate sector diversification, but at the same time, 40 names is a reasonably small number so that the security selection emphasis that we go through has the opportunity to add value. Forty names is a lot less than 800 and if one of them goes right or if one of them goes wrong, it does home in on the importance of good stock selection, which is really our reason for being.

TWST: Would you take us through the investment decision-making process and what specific characteristics you look for in potential purchases?

Mr. Yucius: I think the primary way to describe what we do is to begin with a quantitative starting point. We use computer screens to look for and define elements of growth and elements of value to arrive at a list of companies that have both elements of growth and value simultaneously. The primary metrics that define GARP to us are generally price/earnings, price to cash flow characteristics and, to define growth, growth in sales-per-share, growth in earnings per share and profitability ratios. Really what we do is use the computer to undertake fairly simple or common sense criteria to whittle the list of 800 or 1,000 companies down to a much more manageable list of around 300 that I can qualitatively assess.

That's really where I do my tire kicking and looking under the hood to try to understand what the computer is looking at in a practical sense. From there, I spend a lot of time looking at the 10-Ks and 10-Qs, looking at footnotes and understanding the accounting assumptions that go into what results have been reported.

It's not been lost on me that in the Enron times or even more recent times, accounting assumptions (and there are plenty of assumptions to go around) are integral to really understanding what numbers are being broadcast to the public, so I spend a lot of time looking at the footnotes of those 300 companies and understanding those estimates and assumptions. From there, the goal is to come up with 60 or 70 companies where I have confidence in the company being able to sustain the positive results that the computer has identified them for.

TWST: You're generally sector neutral, as you said, but are you finding any overweights at this time or any growth areas in the economy where you're finding more stocks?

Mr. Yucius: Yes. I'd be happy to touch on those. What we haven't been doing in the last year or so is probably as telling or as relevant as what we have been doing.

In the last year or so, we have not been as enamored with some of the more cyclical areas, particularly the energy and homebuilding areas, for different reasons. We've had some energy stocks over the past three or four years and they've all performed famously. They've just done very, very well, with many stocks having doubled or tripled. Our response to that, especially as the valuations (as related to earnings or to cash flows) started to increase significantly, was to lighten up and then to altogether move away from those stocks as they violated the GARP dynamic.

For us, we ended up in an underweight position in that energy area and similarly, with homebuilding, we have had questions about the sustainability of some of the cyclical factors that have been really helping out homebuilders. In the last year or so, especially relative to our benchmarks, homebuilding and energy are two areas where we have been relatively underweight because we have had to remain true to our discipline. We haven't been able to participate in those sectors nearly as much as the benchmarks have and that had a big impact on our 2005 performance.

TWST: What are some of the stocks you'd like to tell us about that you feel are representative of your portfolio investment and the reasons why you found them attractive?

Mr. Yucius: One of those companies would be **Apollo Group** (APOL). They are in the adult learning marketplace and are one of the early movers in that business. They were actually a company that we bought into early on in our history. What's appealing about this company is they have one of the best records of consistent sales and earnings growth of any company that's out there. Morningstar did a search for companies that had grown their sales and earnings at 20% for 10 years consecutively and out of the thousands of companies that are out there, to me it was telling that there were only three that met that criterion. **Apollo** just happens to be one of those three, so for illustrative purposes, it's been a very consistent and above average earnings growth company. That obviously has appeal.

When we first bought into this company, the company was selling for 20-25 times earnings. It had a very attractive growth profile and a very attractive valuation. In the years that followed, the stock did very, very well for us but the multiple started to rise at a faster rate than the stock price and we ended up selling out of it in bits and pieces over a period of a couple of years.

More recently, due to some of the issues that are going on with the education industry, and also due somewhat to company-specific issues, the growth rate has fallen from the high 40s down to the 20s again. In doing so, the stock price has come back as well and so we were able to come back to this company. In my mind, it has vast growth potential, but the valuation of the company has become much more appealing. We're able to invest in the company again and still hold true to our discipline.

The industry issues with the education companies have to do with accreditation. A couple of companies have run afoul of the accreditation agencies, and there have been more and more audits and more and more regulatory questioning of all the companies. **Apollo** has not been totally immune, but they have not had nearly the number of apologies to make or the issues raised in that auditing process as a lot of other companies. My perception is that they're getting lumped in with a lot of other companies when they've basically been above the fray.

The company-specific issues are that they have come out with a new marketing direction, where they're increasing the focus on some less intensive degrees. There are a couple of reasons why that's perceived to be a smart move. It's going to enhance their growth potential and broaden the number of people who they can reach out to and, hopefully, those graduates of lesser degrees will end up becoming people

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1-Year Daily Chart of Apollo Group

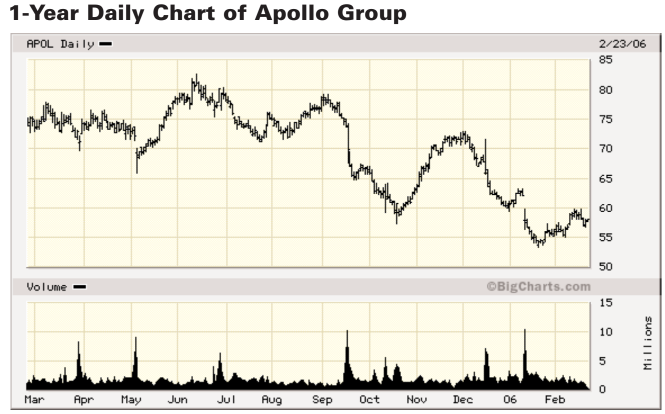

Chart provided by www.BigCharts.com

who are familiar with **Apollo**'s services and stick with them for a longer period as they continue to educate themselves and earn advanced degrees later. But in the short term, those programs cost less and therefore, less revenues are recognized and they have a little bit lower margins, which has caused some angst among investors in the short term.

Ceradyne (CRDN) is a defense company and their primary focus is on body armor. Given our country's armed forces status, body armor is very pertinent. What is special about **Ceradyne**'s products in that niche is they focus on ceramic side plates or ceramic body armor. It's lighter weight. It's a composite material that is somewhat difficult to manufacture and to a soldier on the ground, it allows for broader coverage because you can have bigger plates due to the lower weight, and it's very effective at deterring injury. The Department of Defense has been fairly keen on making sure that their troops are well protected and on improving body armor for just about all of their branches.

Ceradyne has gotten a lot of traction recently with U.S. Army orders and they've gotten particularly good orders with their latest and greatest version, the enhanced SAPI product, to outfit many of their troops. They've got an order for almost 1 million side plates that could also lead to additional front and rear plates as well. They also do some vehicle armor work. Essentially, this is a company that's in an area that's doing very well, given the cause of their major customer, the Department of Defense and the US government. The technology in the particular aspects of their products is a differentiating factor when the government is looking to protect their troops.

Another interesting thing about **CRDN** is, because of the difficult materials that go into the composite that creates this armor, they have a manufacturing advantage over competitors and they have a supply of a particular chemical, boron carbide, that is a step up from the silicon carbide that other manufacturers had been using. And it's not easy for their competitors to just turn a switch and begin using this enhanced boron carbide material. There's hopefully some advantage there relative to their competition.

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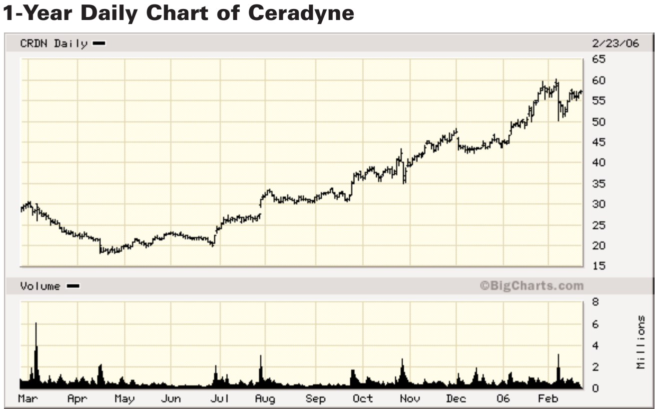
FedEx Corporation (FDX) is a name that most people are familiar with. It's a larger company than we typically find ourselves involved with, but in my mind, I look at them as three separate units, each of which has appeal and each of which is performing fairly well. Everybody knows the trucks that you see and what they compete with, relative to **UPS** (UPS), but they have a freight business, they have a ground business and an express business. Each of those, for varied reasons, is performing fairly well. There's been volume growth in each of those markets, but there have also been fairly healthy price increases on the order of 7%-10%.

1-Year Daily Chart of Ceradyne



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They've had to deal with some cost challenges as the price of oil, gas and jet fuel rise. The challenge is that they've had to swallow higher operating costs in light of those commodity pressures, but they are also able to add surcharges and pricing charges on top of that to accommodate those pressures after the fact. In my view, to the extent that I don't believe the commodity pressures are likely to be recurring or very, very long term, the pricing increases they've had are going to be something that could create a tailwind for them on top of good volume growth. They've had good yield and volume management in each of their divisions.

In my view, they've done fairly well relative to their major competitors. I look at **UPS** and my perception is that **FedEx** has been receiving better pricing and has not been as price sensitive as their competitors in this environment. They've done a very good job of operating and managing their operations in a tough cost environment so that, as the dust settles and as those cost pressures subside, I believe they're going to be a better and more profitable company.

The other side of **FedEx** and their peers is that as commerce has gotten more global and as production is more and more international, these companies have been making significant investments in Asia and China. **FedEx** has just begun the process of acquiring all of a China subsidiary, which should only enhance their exposure to that region. There are some other demand-side aspects that I think will be favorable for the industry as a whole. Internet commerce and international and globalization demand issues are going to help the industry as a whole, but in my view, **FedEx** is a little bit better operator and in terms of recent results and valuation, they're the better purchase.

Costco Wholesale (COST) is another company we like. Retailing is very, very competitive, and it's hard to have a differentiated focus when customers actually have such an affinity with online retailing and with the number of stores in this country. It's hard to have a unique shopping niche, but I think **Costco** makes a fairly good attempt at that. They are not the only wholesale club out there, but what they have tried to do to differentiate themselves is to focus on a fairly narrow range of product SKUs or focus in on the absolute most demanded areas. For instance, if flat screens are something they perceive a fair amount of demand for, they're going to go out and find what they believe to be the four or five highest-demanded vendors and really align themselves with those products and vendors and use whatever scale they can muster to deliver a fairly narrow range of product in a highly sought after market demographic.

What that leads them to is a fairly high rate of turnover. Their inventory does not sit for very long and that fits in very well with the warehouse format. The thing that appeals to me about **Costco** from a financial standpoint is that their comparable store sales have actually been above plan, above the 5%-6% that they've been shooting for. Their same-store sales growth, which to me is one of the prime metrics in retailing, has been consistently better than that of companies in their peer group and for retailing in general for quite some time. To me, that's one of the best indications of a retailing enterprise. They've also been able to add a number of stores to increase their square footage growth, which has been healthy and additive to their growth rate as well. They also may be contemplating a membership rate increase, which will be additive.

Another potential growth aspect is that they are relatively geographically concentrated. They should have the opportunity to expand to new markets where they're not so prevalent. I believe that the combination of same-store sales growth and square footage growth is going to allow their top line to grow.

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1-Year Daily Chart of FedEx

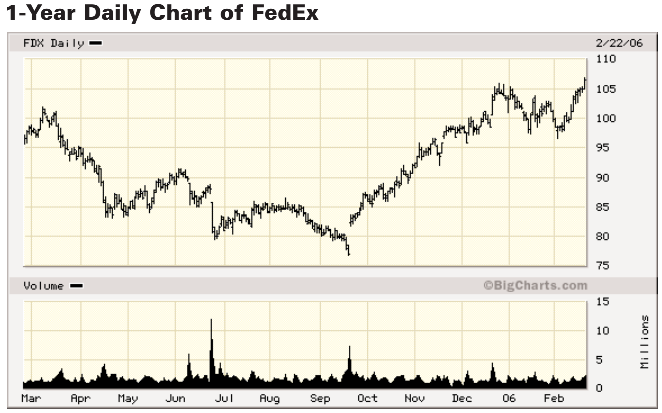

Chart provided by www.BigCharts.com

They manage their costs well and have used their scale well which translates from solid revenue growth down into very appealing earnings per share growth at a reasonably valued company. They're not the cheapest retailer and they're not the cheapest wholesale club, but if you compare their growth rate and their valuations, it's compelling to us as a GARP investor.

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TWST: Is the sell discipline you employ a reverse mirror image of the buy process?

Mr. Yucius: Yes, it is. We break it out into two categories, but essentially that's what we're trying to do. We try to sell companies when the valuations no longer make them appealing relative to a company's growth rate. That typically happens when things are working out very well and maybe almost better than we expected, such as if a company comes in with 15% sales growth quarter in and quarter out, 20% earnings growth quarter in and quarter out, and the stock goes from a multiple of 12 times earnings to 30 times earnings. Ideally we've identified those companies at a fairly nice discount to their growth rates, but it's the way of the world that stocks don't move in a very consistent fashion, and there are times when a steady-growing company stock may appreciate at a much faster rate. So if the multiple expands from 12 to 30 and it's no longer at a discount to its growth rate, then we'll be forced to sell that company based on valuation. Those are typically happy sales and happy events.

The second sell discipline we rely on is when a company does not carry through with its revenue and growth expectations or at least they don't match my expectations. Those are typically cases where the stock is down in response. It's not typically a case where we're going to have huge gains to realize, but the longer I've been in this business, the more I've found that the faster we identify those situations and the faster we jettison them, the better off we've been. And so we have a happy and a sad sell discipline.

TWST: What is the average turnover of a portfolio?

Mr. Yucius: 30%-40%.

TWST: That's pretty low.

Mr. Yucius: Yes. Ideally, I like to keep it as low as possible and not just for our taxable clients. What I'm really trying to do is find steady, consistent and not-so-cyclical growers that I can ride for three to five to 10 years. That would be the ideal situation. The hang-up is that there aren't many of those companies that can actually deliver such attractive growth year-in and year-out. The other truism is that stock prices don't move on a day-to-day basis in lock step with earnings and so we have to be somewhat responsive to what the market takes and gives away.

1-Year Daily Chart of Costco Wholesale

Chart provided by www.BigCharts.com

TWST: Do you have an example of the two types of sell disciplines, companies you have sold off in the past year or so?

Mr. Yucius: XTO Energy (XTO) is an energy company that will fit in with that backdrop that I mentioned in the beginning. **XTO Energy** is a very good, well-run company. They have a very sound operating strategy and they've been proceeding with their strategy for a good number of years. We bought them at a fairly attractive price back in 2003. The stock did nothing but appreciate very, very well. In the summer of 2005, we decided that the valuation of the company was not so much reflective of how good an operator they were or how sound their operating strategy was, but was more reflective of a reliance on what commodity prices were going to dictate their results would be. The valuation certainly went up and went up at a much higher rate than we felt their organic ability to grow was dictating, so that was sort of a happy scenario and we're very sad to see a good company go.

A disappointing company was **Yankee Candle** (YCC). They're a retailing company that focuses on candles, a fairly narrow and mundane market niche. For some time, they had been doing fairly well in terms of same-store sales and then they ran into some margin and operating issues. We bought into them with the expectation that they were going to resume the growth rate that they had displayed in the past. While they had some same-store sales success when we initially bought into them, in the quarter or two subsequent to our purchasing them, they ended up coming in not only below their plan, but less than was needed to deliver the earnings growth we were hoping for. The stock was below where we purchased it — maybe not significantly, maybe 10%-15%, but where we weren't able to see hard and fast evidence of our fundamentals thesis, so we needed to let it go to stay true.

TWST: What about investment risk in the portfolio? How do you attempt to control risk factors?

Mr. Yucius: To me, that's something that doesn't get enough attention or at least enough weight for people who have a risk consciousness, which we like to think that we do. The volatility of our portfolios and our composites as exhibited by our track record is significantly less than our benchmark (the Russell Midcap) and really significantly less than many of the other managers that we find ourselves in competition with. While we're very proud of our overall performance and the net results of our returns, it does tend to set us apart to be able to have those return patterns with the lower levels of volatility that have come through as a result of our process. That's something we focus on very much and we think is very important.

The way that we deal with risk begins with our quantitative underpinnings. The GARP approach, by definition, builds in elements of risk control by virtue of the fact that we're conscious about the price we're willing to pay for growth. In my mind, there are numerous examples of great companies with fantastic growth, but you run into a lot of problems when you have good companies that don't equal good stock investments because of valuation. And so the prime place to start managing risk is in being conscious of the price that you're willing to pay.

It's not been lost on anybody who has been with us or in the market in general that when the Internet stocks were doing so well — and it wasn't even real growth that you could see and touch — the valuations that were being applied to whatever growth those companies might have was just exorbitant to the point where we would never find that a prudent trade-off. There were plenty of Internet companies that did do well, that did carry through on their promises to grow, but the valuations that were required to purchase those stocks not only didn't make them appealing as far as growth potential to us, but they were prohibitive because of the risk that was involved. And so price is the first place that we look to mitigate risk and we do that by baking price and valuations into our quantitative underpinnings.

Beyond that is diversification, which we touched on earlier. We do not want to be very good stock pickers but find out that we've made such a tremendous bet on any one sector that we've not been able to keep pace with the overall market in the short run or in the long run because we've not been diversified enough. To me, being a stock picker and focusing on company specifics in a disciplined fashion is a very good way to mitigate risk. The proof is in the pudding — the result of being a disciplined, Growth At a Right Price investor and by focusing on stock selection and being diversified, which has the intended consequence of dampening volatility.

TWST: Are there any other differentiating factors that distinguish your investment approach from that at other firms that have a GARP approach?

Mr. Yucius: It's hard to say. It's hard to describe exactly who your peers are and exactly what they're doing all the time in a sound bite. I believe that Aurora's GARP implementation is somewhat unique because we haven't really changed the metrics of the underpinnings very much to suit what's been, over these 10 years, a fairly varied set of market environments. Our metrics and our application of the GARP definitions that we employ have been fairly consistent. Even when you've had energy stocks being such an important driver last year and when you've had Internet stocks that had such a dominant impact in the late 1990s, we remained consistent.

What we did during those periods is the exact same thing that we did when those short-term drivers were not present. We consistently look for steady-growing companies that are selling at discounts and cheap valuations relative to the growth that we have at hand.

TWST: What other things would you like to touch on?

Mr. Yucius: Mid-caps offer a lot of the opportunity for active management that may be lost in the large cap world, where you have teams of 20 and 30 analysts looking for nuggets of information among these very well-covered companies. And yet at the same time, mid-caps don't have the volatility that's obviously associated with a lot of the smaller cap benchmarks. It's not a total accident that the volatility has been lower in mid-caps and that the returns have been more appealing than in some of the very large cap dominated and very small cap dominated benchmarks.

For the life of me, I do not understand why it's been so hard, particularly for institutional investors, to commit to an allocation specifically for mid-caps. Asking a large cap manager to drop down a little bit and a small cap manager to creep up a little does not yield the same results as a pure mid-cap play. The return patterns of the benchmarks and of the managers that operate in the mid-cap world are significantly different and significantly appealing to where a separate allocation is compelling.

What we're trying to do is find companies that show the elements of being undiscovered in that they have lower-than-average valuations and yet they have the growth potential of companies that haven't reached the law of large numbers. Whether they have geographical opportunities to expand or are just in a relatively undiscovered niche without a lot of competition, whatever the operating reasons may be for a company's potential, I feel our GARP approach allows us to cull out the opportunities that mid-caps can offer.

TWST: Who are your typical investors? Are they mostly high net worth individuals or do you have a mix?

Mr. Yucius: Our beginnings were with high net worth individuals almost exclusively. In the past year or two, we have started to reach out to the institutional world via consultants and wealth management intermediaries. We are starting to market ourselves to institutions and via separate account platforms, but to date, the large proportion of our book of business is high net worth individuals.

TWST: Thank you. (PS)

Note: Opinions and recommendations are as of 2/22/06.

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