

THE WALL STREET TRANSCRIPT

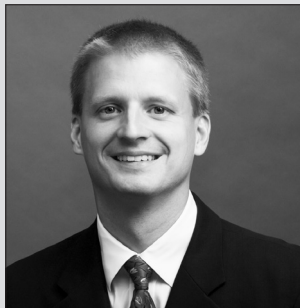
Connecting Market Leaders with Investors

Flexible Value Investing



DONALD YACKTMAN is the President of Yacktman Asset Management Co., and the co-Manager of the Yacktman Fund and the Yacktman Focused Fund. He started the firm in 1992 after nearly 10 years as portfolio manager of the Selected American Shares Mutual Fund where he was named the 1991 Portfolio Manager of the Year by Morningstar. Prior to running Selected American, he was at Stein Roe & Farnham, where he had been a portfolio manager since 1968. He holds a BS degree, magna cum laude in economics from

The University of Utah and an MBA degree with distinction from Harvard University.



STEPHEN YACKTMAN is Vice President, Portfolio Manager and co-Chief Investment Officer of Yacktman Asset Management Co. He is also co-Manager of The Yacktman Funds. He joined Yacktman Asset Management in April 1993 from Brigham Young University where he earned his BS degree in Economics with a minor in Math and an MBA degree.

SECTOR – GENERAL INVESTING

TWST: Let's start with an overview of Yacktman Asset Management and your investment philosophy there.

Donald Yacktman: Yacktman Asset Management was founded in 1992 and we manage two mutual funds and separate accounts. The two mutual funds are The Yacktman Fund and The Yacktman Focused Fund. The investment process or philosophy has evolved over a period of years. Basically, we are investors in businesses and we view the selection process as though we were buying a long-term bond. Our logo is a triangle. The base of the triangle is a low purchase price. We look at businesses as if we were going to buy them and own them for a long period of time. We look at the rate of the return we would earn and the quality of those businesses. The higher the quality

is, the lesser the required rate of return. It's very much like a person buying a bond. But we don't like to calculate returns to the fourth decimal; we try to make sure we have a lot of room for error. Then we try to get as much as we can of the other two sides of the triangle, namely good businesses run by shareholder-oriented managers.

On the good business side, our sweet spot is businesses that have low capital intensity and low cyclicality. One of our largest holdings, for instance, is Coca-Cola (KO). It fits our criteria very well. We will also move away from those components if the rates of return are adequate for the additional unpredictability that comes with the business, whether it has more fixed assets or more economic sensitivity. We have moved in both directions, but we don't typically invest in businesses that have

Highlights

Donald Yacktman and Stephen Yacktman manage two mutual funds and separate accounts. They consider themselves investors in businesses and they view the selection process as though they were buying a long-term bond. They look at the rate of return they would earn and the quality of those companies; the higher the quality is, the lesser the required rate of return. On the good business side, their sweet spot is companies that have low capital intensity and low cyclicality. They evaluate the management of a company on the basis of how well it has invested cash in the past. They have concentrated portfolios. The top ten holdings plus cash will generally be 50% in the Yacktman Fund and 75% in the Yacktman Focused Fund. Rather than trying to call the market and make overall judgments on potential holdings, they look for investments that are dropping in price yet their forward rates of return are going up very much like a bond does. They say that media and finance have shown up as natural purchases because their rates of return were so high.

Companies include: AmeriCredit (ACF); Coca-Cola (KO); Liberty Interactive (LINTA); Viacom (VIA); News Corp. (NWS); The Bancorp (TBBK); Lancaster Colony (LANC); Microsoft (MSFT).

both enormous amounts of fixed assets and cyclicality. The airline industry would be the classic example. **Coca-Cola** is the opposite side of the grid. If you think of it like a bond, we're buying high coupon bonds.

The third part of the triangle is the management. The difference between a stock and a bond is with a bond, the investor reinvests the cash flow most of the time. In the case of an equity owner, a lot of the reinvestment is done by the manager, so we like to evaluate the manager on the basis of how well he has invested cash in the past. We look at five basic options the manager has. The first option is putting the money back into the business through R&D, marketing, cost reduction, distribution, etc. The second option is making acquisitions, but the acquisitions should be synergistic and the manager should not pay too high a price for them. The problem is, in a lot of cases, the egos of managers get in the way of doing a proper job. Another option is buying back stock, which is buying more of the same. The fourth is paying a dividend and the fifth option is paying

down debt or letting it accumulate, which is pretty much the same thing. We also tend to be very concentrated. The top 10 holdings plus cash will typically be 50% in The Yacktman Fund, and 75% in the Yacktman Focused Fund.

TWST: How has your investment approach been able to deal with the turbulent events of the last several months? Do you feel that you are poised now for the rest of the year?

Stephen Yacktman: One of the things about our approach is we're always trying to minimize our risk. Going into this downturn, we had some cash, but we also had a lot of defensive stocks, the Cokes and the Pepsis (PEP) of the world, and these companies initially held up quite well. On the financial side we purchased AmeriCredit (ACF), which is our largest finance investment. We purchased it heavily in the last quarter of 2007. It is very different from banks in the sense that it finances short loans — auto loans — that have higher spreads and it uses less leverage and thus has a larger margin for error. This margin for error gave them flexibility in terms of how the loans performed. Going into the downturn, AmeriCredit performed well relative to the large banks, which are very difficult to analyze. We were also able to take advantage of the downturn by using our cash to purchase other bargains.

After the cash was gone, we were able to essentially rotate out of consumer staples, the Cokes and the Pepsis that had held up well, and rotate into consumer-based cyclical stocks. Some cyclical stocks were trading at extremely high cash yields. So we bought USG (USG), and the retailers Williams-Sonoma (WSM) and Abercrombie & Fitch (ANF). By the time it was all done, we were buying Bank of America (BAC) and Barclays (BCS). So we were able to take advantage of the pricing disparity. Since the market's bounce off the bottom, those stocks have performed quite well. The other area we bought into heavily was media — companies like Viacom (VIA) and News Corp. (NWS). We've managed to outperform on both the downside and the upside.

Looking forward, we will objectively examine our options. If we are going to get the same return, we'd rather own Coke than a bank stock or a cyclical stock. At that point, we

1-Year Daily Chart of News Corp.



Chart provided by www.BigCharts.com

can move back into the Cokes and Pepsis of the world and be protected. Right now, they're not participating in the rally, so their relative rate of return is getting higher and higher. We love market volatility; it just creates opportunity. The more volatility, the better it is for us, and I think that's evident in our results.

TWST: What shifts in emphasis did you make to your portfolio when you were in a challenging environment and what have you changed since the stock market has started to recover somewhat?

Donald Yacktman: We have a very long horizon time. Rather than it being 10 days, 10 weeks or 10 months, it's more like 10 years. By looking at the forward rates of return an investor gets by holding an investment for a very long period of time, a natural selection process occurs. As Steve was pointing out, as investments start to drop in price, their forward rates of return go up very much like a bond does. So selecting investments almost takes care of itself by looking at it this way rather than trying to call the market and make overall judgments. Media and finance showed up as natural purchases because their rates of return were so high.

difficulties so the stock cratered harder than the other media stocks at first. They've got great properties — MTV, Nickelodeon, Comedy Central, etc. Their cable channel businesses are much better businesses than owning network television. Plus they have a great library. One of the best ways to look at Viacom and their strength of position is when they got into their spat at the end of the year with a cable provider. They were able to toe the line and get their rate increase, and I think the comment they made back then was, "We're only 2.5% of your cable bill, yet we are 20% of your viewing time." So they're in a competitively strong position compared to other media companies. We had a premier media company trading at a big discount with Paramount as a throw-in. It has a huge library that the market puts little value on because it currently doesn't really make any money. If they were somehow able to sell that asset or monetize it, the stock would most likely be valued significantly higher. Basically, looking at those two companies, we were able to put a huge chunk of the cash to work and rotate out of some consumer names and get what I consider were extremely high rates of return.

Stephen Yacktman: AmeriCredit is our largest finance investment. We purchased it heavily in the last quarter of 2007. It is very different from banks in the sense that it finances short loans — auto loans — that have higher spreads and it uses less leverage and thus has a larger margin for error. This margin for error gave them flexibility in terms of how the loans performed.

TWST: One of the interesting aspects of your portfolio appears to be the increase in weighting in media stocks. Would you tell us about that and the stocks that you have found interesting at this time?

Stephen Yacktman: Depending on what investment restrictions there are, we start going down the pecking order by buying our favorite one first, our next favorite second, and so on down the line. One of the companies we own is Liberty Interactive (LINTA) and some people classify it as a media company but we feel it is more of a retailer. They own QVC, which is an at home cable shopping retailer. Viacom and News Corp. are the two we consider media and we have big positions in them. News Corp. got down to around 3 times cash flow. It's an interesting media conglomerate. The history is quite spectacular. Rupert Murdoch has done a great job with Fox News and the Fox channel that came out of nowhere. We had a three network system and he made it a four network system. The stock got extremely cheap. It was 3 times cash flow from the way we look at things; it was a no-brainer, unless you thought the world was going to end, and even if it did, it'd probably be fine.

The other one is Viacom, which was the first one we headed into. It got hurt initially due to Sumner Redstone's need for cash on a personal level. He got himself into some leverage

1-Year Daily Chart of The Bancorp



Chart provided by www.BigCharts.com

TWST: In what other areas have you been increasing your weighting to take advantage of the events that are taking place?

Stephen Yacktman: Things are changing very rapidly. First we went into the retail and media areas and then into financials. On a forward-looking basis, we're looking to go back to where we were. In the middle of the first quarter of this year, we bought more AmeriCredit but hit our limit. We bought other financials such as The Bancorp (TBBK), a small Philadelphia bank, and now own almost 15% of it. We're very excited about

the prospects for this bank. They've managed to gather a lot of assets and Philadelphia is not a market that has taken a hit like the rest of the country. They don't have loan issues to the same degree of any of the other banks.

The other area we bought into was the larger banks. We spread it around in bits and pieces. We bought American Express (AXP), Bank of America and Barclays. In Q1, people were afraid of a complete collapse of the financial system. We were able to take advantage of that fear and a lot of these financials have moved up quite rapidly.

to play out. The good news though is that 8% a year of excess return is accruing in the background. Then it will just explode to the upside when the market finally realizes what we realize. Lancaster Colony is the classic example. It had been accruing excess return in the background over a number of years and then realization of that excess return happened at one time.

We're not really worried about whether or not the market recognizes it right away. The good thing is when the market does finally recognize it and also presents us with other opportunities, we are able to move rapidly from one to the other. In the recent

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1-Year Daily Chart of Microsoft



Chart provided by www.BigCharts.com

The other thing that happened in Q1 was the change in attitude about Lancaster Colony (LANC). We bought it many years back at a cheap price and it had gone for years without realizing its potential because it was getting hurt by the cost of soybean oil, which was hitched to oil prices. At first, they were hesitant to raise their prices and exhibit their pricing power. Finally, they raised their prices and then soybean oil came down at the same time and their margins opened right back up to where they had been historically. The stock did quite well. We basically had a consumer staple company whose stock went up in a down market and allowed us the opportunity to rotate out of it and into other opportunities that were presenting themselves.

One thing I would like to point out is, if we're looking at a company and it has a forward rate of return of 12% and another one has a forward rate of return of 20% and we buy it, we don't necessarily get that extra 8% a year right away. The market might not recognize what we see and the market may take a few years

downturn, we went from consumer staple companies like Coke and Pepsi into media companies, and finally at the very bottom, the most cyclical of companies like USG and the financial companies. The market has run all of these things up quite a bit so we're now looking at medical companies. In the healthcare area, there are a lot of opportunities, because these stocks have gotten hurt. Since they have nothing to do with an economic recovery, no one cares about them right now.

So the portfolio we have reported is a lagging indicator of what has worked, not what is going to work. I'd say right now we're in an in-between phase. There is still a lot of value in these media companies. They were extremely cheap when we bought them, but there are a lot of other things to look at now. Some other portfolio stocks have caught fire so the excess return spreads are going to open up in other directions.

But who knows what the future is going to hold? We take advantage of the opportunities that are presented to us; we don't create opportunity. If we have a market where everything is priced in line with everything else, we end up going into a holding pattern. We stick with what we have and we wait. In the current market, we will take advantage of opportunity when it presents itself.

Donald Yacktman: We pride ourselves on objectivity.

TWST: What about the technology area? I see Microsoft is in the top 10 holdings of both of your Funds.

Stephen Yacktman: Two things showed up in the technology area, and those were eBay (EBAY) and Microsoft (MSFT). Microsoft at this multiple of cash flow is extremely cheap. It has a dominant position. Vista has been a disaster. I pride myself in my technical expertise and I've worked with Vista personally on a technical level and I can't stand it. But again, we put our personal feelings aside and look at the market position of Microsoft and hope they're going to come out with a better product. Clearly, they were able to deliver

an inferior product to the market and people had to accept it anyway, and if that doesn't show market positioning, I don't know what does. When we look at Microsoft, we see a couple of things. One, they have a lot of expenses which they'd call investments; I'd call them expenses and I'd question their necessity. There is a lot of room for improvement there. If they deliver a good product consumers actually want, we can have a lot of traction in terms of earnings power on the upside. In the meantime, at this price, it makes a very attractive investment in terms of rate of return. Generally, we don't end up with technology stocks. The Microsoft position was first initiated in the low \$20s a few years back and it has performed quite well on a relative basis. It was cheap then and it's cheap now.

1-Year Daily Chart of Coca-Cola



Chart provided by www.BigCharts.com

Stephen Yacktman: Microsoft at this multiple of cash flow is extremely cheap. It has a dominant position. Vista has been a disaster. But we put our personal feelings aside and look at the market position of Microsoft and hope they're going to come out with a better product. If they deliver a good product consumers actually want, we can have a lot of traction in terms of earnings power on the upside. In the meantime, at this price, it makes a very attractive investment in terms of rate of return.

TWST: What triggers an exit from your portfolio? Do you set sell targets?

Stephen Yacktman: Many people set a price target by saying, "Okay, I think it is worth \$X." Well, we don't think that way. We look at what the forward rate of return is, stack it up against other investments and determine which one is the highest and which one is the lowest and what risk we are taking to get that rate of return. We account for things like leverage, cyclicalities of earnings, and the quality of the business. An investment that is going to make it into the portfolio with the lowest rate of return would be a company like Coca-Cola that has high predictability and good management. We can just go into autopilot. It becomes our AAA bond.

A sale is triggered by two things. If the rate of return is not sufficient or if there is a better opportunity elsewhere with a larger margin of safety to get a similar or higher rate of return, we'll sell it. The overall market dropped and consumer product names held up and the media companies got killed. News Corp. went from the \$20s to \$5. That drop opened up a huge rate of return gap and encouraged us to sell some of our Pepsi and buy News Corp. We viewed that decision as going from a low teens rate of return to something that was going to make a 20% return. There's no price target ever set, it's just a function of the environment. What ends up happening, unfortunately, in an environment where everything goes up, is fewer of these returns are satisfactory and we end up more heavily in cash. It's not that we're trying to time the market; it's just there's nothing to buy.

Donald Yacktman: Think of everything being priced against the long-term Treasury, and we want to see a large spread over what the long-term Treasury yield is.

Stephen Yacktman: But in the present environment the dollar is being deflated and the Treasury rate of return is very low. At some point we say, "Hey, the rate of return of an investment is not acceptable to us." We walk away. It's the hardest thing to do because we have to wait for something else to come along. We can't create something out of nothing.

TWST: What risk management techniques do you incorporate in your process?

Donald Yacktman: Ultimately, in our minds, risk is losing money. There are two ways to minimize risk. One is by making sure the forward rate of return is significantly higher than Treasuries or at least is high enough on a historical basis to justify making the purchase. The other thing is to take into account quality measures so the amount of risk taken as a business owner is warranted. We take into account things like cyclicalities, leverage, management and other kinds of considerations that would influence the rate of return. We used to comment on the difference between Coca-Cola and Tyco as being like comparing a AAA bond with a single A bond. We basically come back to the grid of looking at the forward rate of return and level of quality.

Stephen Yacktman: To give you an idea of a practical example of risk measurement, one of the companies we bought in 2003 was AmeriCredit. It ran up in price and we sold a big chunk of it, then it ran all the way back down and started selling at a

discount to book in the fourth quarter of 2007. The stock was at \$10 and we said, “Well, book is in the mid- to low teens.” If they stopped making loans and just liquidated all the assets, we’d end up getting more than our money back. So we ended up buying AmeriCredit, which is a subprime auto financier, in the fourth quarter of 2007. If we said to people who don’t know anything about AmeriCredit, “We just bought into the subprime auto finance business in the fourth quarter of 2007,” they would have thought a disaster had occurred. In AmeriCredit’s case, we sit here a year and a half later and the stock is at \$11. It’s not down. If anything, it’s slightly up since late 2007.

1-Year Daily Chart of AmeriCredit



Chart provided by www.BigCharts.com

Donald Yacktman: *We were just recently informed there are 450 mutual funds classified as large cap value by Morningstar and our Funds are ranked numbers one and two over the last 10 years in performance. In the short term, we can't predict what will happen, but in the long term, we think things will work out.*

What happened? First, the company had a tangible book value we felt was going to be flat and would possibly even rise. If we try to analyze something like Bank of America in the same way, we don't have the data. We're not inside the bank. We have no idea what's there. We're making assumptions on somebody else's assumptions. We have to assume what the other guys have assumed from all of the inter-party transactions. Essentially what we have is a whole intertwined interdependency risk. That's not attractive to us. So we bought AmeriCredit. They're not as dependent on the financial system as the banks are. While they have to securitize loans, the portfolio liquidates down so quickly, the banks will more than likely be willing to work with them in a difficult period. Also, the Fed will likely step in and make an effort to control unemployment, and not let it explode like it did in the Great Depression. People pay down their car loans, things are not going to get that horrific that fast, and even if they do, by

that time, the duration on their loans are so short they're going to get paid back.

That scenario played out, so the value we saw is still there. It didn't get destroyed; we didn't get wiped out by leverage or by being liquidated out at the bottom. To us, that's risk management, looking at the individual security and making sure we were correct about our assumptions and know what we bought and have a high degree of confidence we are going to get our money back in the worst-case scenario.

That being said, if we were ever going to take risk, the time to do that was mid-Q1. We bought Bank of America and people said, “You said you'd never buy financials like that.” While there are a lot of assumptions about what's going to happen, at some point, looking at different case scenarios and the most likely outcomes of what's going to happen, the odds are stacked enough in our favor that we'll purchase something that is less understandable. However, we're probably still better off buying things we know, like AmeriCredit. However, in this case, we were at the limit of our position size, so that wasn't an option available to us.

Donald Yacktman: There is no substitute for knowledge.

Stephen Yacktman: If we're right about our assumptions and we're right about our facts and we properly analyze something, there should be no problem. The stock can get creamed in the short term, but eventually if we're correct in what we bought, the investment will work out. When we don't have a high degree of confidence in our assessment, we take a smaller

weighting. Risk management is more a function of our ability to analyze the opportunity and be comfortable with our assessment of it.

Donald Yacktman: They say the proof is in the pudding. We were just recently informed there are 450 mutual funds classified as large cap value by Morningstar and our Funds are ranked numbers one and two over the last 10 years in performance. In the short term, we can't predict what will happen, but in the long term, we think things will work out.

TWST: **Your investment approach clearly does do better than the indices in a struggling economy. Would you give us an idea of the performance track record compared with your indices?**

Stephen Yacktman: If you look in the three-, five- and 10-year time frames, we're in the top 10% in the different relative categories. Generally speaking, people get caught up with

performance in different market environments and time periods. We're normally known for doing well in down markets and not as well in up markets. We did well from 2000-2003 and then we lagged after that because we weren't willing to chase what was working. This time around is different because we invested in the areas that will participate in a recovery. We've outperformed the Index in an up market. It's a matter of what got cheap enough and what the rate of return was and where we are.

Is there a particular market that we perform well in? Yes. We do well in a market that is not too expensive. At the same time, we do well over a long period of time in an expensive market because we don't do foolish things with the capital; it just

Donald Yacktman: Over the last 10 years, both of the Funds have been compounding money at 9% a year higher than the S&P 500. That's an enormous spread compounded over 10 years. It works over time. But we can't predict the short term. At this point in time, we've done well over every time frame.

1-Year Daily Chart of Viacom



Chart provided by www.BigCharts.com

could take a while for it to play out. If the market stays at the valuation levels we're currently at, I would anticipate we will do very well. If the market goes straight back up to where it was, we're going to participate in the recovery, but after it fully recovers, it could be slow going if everything is really expensive. But in any type of environment, using our approach over a long period of time will produce good results. Recently our approach has also worked over a short period of time. The only time we will have a lag is if we are in an overpriced market with no opportunities for a long periods of time. So the approach may not work in the short term, but it really works in the long term.

Donald Yacktman: Over the last 10 years, both of the Funds have been compounding money at 9% a year higher than the S&P 500. That's an enormous spread compounded over 10 years. It works over time. But we can't predict the short term. At this point in time, we've done well over every time frame.

Stephen Yacktman: It's just what the market gave us. What opportunities the market gives us, we will take advantage of. Right now, it's a great environment.

TWST: What differentiates you from your peers?

Donald Yacktman: One is objectivity. We're very objective in the way we analyze things. Two, we do our homework. We really look at what we're buying because ultimately, it's what you buy and what you pay for it that matters. And three is our horizon time. We have a very long horizon time. Most people in this business unfortunately have a much shorter horizon time and they think of it being more like betting in Las Vegas than like buying businesses.

Stephen Yacktman: One of the things you'll see value investors say is, "I bought this stock at X and I think it's worth Y. Therefore it's going to go from X to Y and that's how I'm going to make money." The problems are first, you end up with huge distortions with leverage. Also, you are focused on what the stock will go to and not its current value. Our approach of looking at the forward rates of return allows us to look at all the cross sections of the capital structure. As an example, in December 2008 we bought heavily into the bonds of Interpublic. They are due in 2011 and 2014 and were trading at 50 cents on the dollar. The yield to maturity was huge and the company is not going out of business. We looked at the balance sheet. The market afforded us an opportunity to go way up in the capital structure and pick up a huge excess rate of return. We're willing to look where the opportunity is. We're willing to buy whatever is most attractive. We have flexibility and we focus on rates of return.

TWST: Thank you. (PS)

Note: Opinions and recommendations are as of 5/19/09.

DONALD YACKTMAN
STEPHEN YACKTMAN
Yacktman Asset Management Co.
6300 Bridgepoint Parkway
Building One
Suite 320
Austin, TX 78730
(512) 767-6700