REPRINTED FROM JULY 12, 2010

THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Investing in Companies that Buy Back Stock

DAVID FRIED, a Cornell graduate, is one of the few money managers to have also founded a company listed in Inc. magazine's annual "Inc. 500" list of the 500 fastest-growing private companies (1989). He is the Editor and Publisher of The Buyback Letter, the only investment newsletter devoted to finding opportunities among companies that repurchase their own stock. His asset management firm, Fried Asset Management, Inc., offers separate investor advisory and money management services that use the "Buyback Strategy" principles. Mr. Fried has been a featured guest on Bloomberg Television and CNBC's "Money Club," as well as "Squawk Box" and "Market Wrap" with Bill Bresnan in New York City. He has also been profiled in the New York Times, Los Angeles Times, USA Today, Barron's, Bottom Line Personnel, Kiplinger's Personal Finance, Forbes, Fortune, Business Week and numerous other publications. He was listed as one of "50 Great Investors" in Fortune's Investors Guide 2004. He is also an approved guest speaker for the American Association of Individual Investors. In 2008 he helped found First Commons Bank of Newton, MA. Mr. Fried served on the board of directors of L.A. Family Housing from 2002 to 2008. He also completed a rigorous training program led by former Vice President Al Gore and was named one of Gore's select "Global Warming Messengers" in 2007. Through grassroots speaking engagements and local outreach to businesses, schools and individuals, he has spread the message about the threat of and solutions to global warming.

SECTOR – GENERAL INVESTING

TWST: How did you come up with the methodology of using stock buybacks as a criteria for investment?

Mr. Fried: There was some research available at the time from the University of Chicago, and it was published in the Journal of Finance, about companies that had recently announced stock repurchases and how they would outperform the general market. The testing was done given portfolios of companies with equal market cap. I took that research, and I took it to the next level and studied companies which actually did repurchase stock.

TWST: What are the advantages of a company buying back its own stock?

Mr. Fried: When a company buys back its own stock, it does a number of things for the shareholders. On a mathematical basis, there are fewer shares outstanding, so the earnings are spread over fewer shares, so the p/e changes in a favorable way. The p/e gets lower, and that is assuming that they buyback enough shares to have a net decrease in shares outstanding, which is what we look for because sometimes companies can simply buyback to offset dilution and not necessarily have a negative share count. So we look at where the share count is actually negative. That's the primary advantage for the investor, I think, and the company. It makes the shares more dear, but what's kind of in between the lines or not necessarily quantifiable is that they do this at times which are favorable.

TWST: How much of your investment process is quantitative and how much of it is qualitative?

Mr. Fried: It really depends how you look at it. The entire pool is a quantitative model. In other words, we pick our candidates for investing based on quantitative analysis, and then we screen within those based on quantitative analysis. However, there are times when there is no effective difference statistically between one stock and another. In those cases, we'll look at some qualitative things as well. So I would say that it is a quantitative

system with some qualitative touches around the edges. For example, right now we own a position in **SkyWest** (SKYW). **SkyWest** has bought back stock and their net cash on the books is more than the purchase price right now. So basically you get the business for free. This is a case where even if the buyback waned a little bit, or right now when the stock is broken down on a technical basis, we'll hold the stock and add to the position. And that's a qualitative call.

TWST: In general, what factors need to be in place for you to recommend a stock? What are you looking for?

Mr. Fried: First, we are looking at the share repurchase. So we're looking at companies with negative share count. Even before we do that, we take a look at the universe of stocks, the database of our stock universe, and we will throw out anything with poor financial quality, and we will throw out anything with a market cap of under 100 million. That's at the start of the screening. Then we'll take the remaining universe — and that cuts out about 60% of the stocks in the universe — and we'll take the top half of the market cap. To begin with, we are left with companies with substantial market cap, generally $1.5 billion to $2 billion or up — the financial quality of what would be equivalent to a "B-" or better S&P rating. So our universe is left to about 1,000 companies, which to begin with are of a substantial financial base and good quality.

Highlights

David Fried says that companies that make stock repurchases often outperform the general market. When a business buys back its own stock there are generally fewer shares outstanding, so the earnings are spread over less shares and the p/e changes in a favorable way. The p/e gets lower, assuming that they buy back enough shares to have a net decrease in shares outstanding. He looks at where the share count is actually negative, which is the primary advantage for the investor and the company.

Companies include SkyWest (SKYW); VMware (VMW); Intel (INTC).

Mr. Fried: It's publicly available in the sense that every time an earnings report is issued, the earnings report is issued and expressed as earnings per share, so the share count from quarter-to-quarter and year-over-year can only have three relative values to the prior share count — they can only be positive, negative or neutral, there is no other choice. Of course there are databases which can be subscribed to which will break it down for you, but for the most part it's publicly available. If someone is tracking an individual stock, they can look at it. And in fact, on the financial reports, when they compare to previous quarter, generally financial reports have quarter-over-quarter, and prior quarter and the quarter to the prior year, and just as they show sales and expenses and profits etcetera, they'll show shares outstanding. And there will be a positive or negative number for that, just like for all the other numbers in the financials of the report.

TWST: How many stocks would a typical $5 million portfolio hold? What type of diversification methods would you use?

Mr. Fried: We will typically hold 30 stocks. Generally, just by the way it works, we're diversified over multiple sectors. However, we don't necessarily seek diversifications and there

"We will typically hold 30 stocks. Generally just by the way it works, we're diversified over multiple sectors. However, we don't necessarily seek diversifications and there are times when you will get 10% to 20% in one sector. If that sector has been out of favor and has gotten too out of favor, and you see a lot of buybacks in one sector, then we'll have more than a market weighting in that sector. But we won't get to the point where we have 25% or 30% or 50% in one sector."

are times when you will get 10% to 20% in one sector. If that sector has been out of favor and has gotten too out of favor, and you see a lot of buybacks in one sector, then we'll have more than a market weighting in that sector. But we won't get to the point where we have 25% or 30% or 50% in one sector. That would make us a sector fund, and we haven't had that experience. But we have had times where we've had 15% to 20% homebuilders or 15% to 20% financials. Right now a lot of the insurance and reinsurance companies are appearing on the stock screen because a lot of them are selling for discounts from their net asset value.

TWST: Do you track insiders who buy back stock?

Mr. Fried: We track what the company is doing with the public flow. I will look at insiders from time to time because that would fit into the qualitative side of the equation. The literature written on insiders pretty much states that the buys mean more than the sells because a lot of times they are always getting stocks and always selling stocks, and sometimes you look at a lack of selling as well. If nobody has sold for a long period of time, then that could be a good sign.

TWST: Is all this data publicly available or do you have other methodologies for obtaining the information?

TWST: What triggers a sell in the portfolio?

Mr. Fried: We can sell for a couple of reasons. The primary reason has been that the buyback waned. But over the last year or two, we've begun to enact some technical analysis to enhance our return. So if the buyback slows but the stock is smack in the middle of an uptrend, we'll hold on to it for more and then sell it based on technical. The reverse is also true — if a stock comes into the portfolio based on its fundamental but gets stopped out, we'll sell. We have established stop-losses, which for the first part of our history we didn't have. Then we can sell for that reason as well. Let me give you an example: Right now we're still holding on to **VMware** (VMW), which we purchased in the mid $40s and the buyback has waned. We've held on to it because it's one of the strongest stocks in the market currently, and we've probably gotten an extra 20% out of **VMware**. We'll sell it when the uptrend breaks based on some technical moving averages.

"We can sell for a couple of reasons. The primary reason has been that the buyback waned. But over the last year or two, we've begun to enact some technical analysis to enhance our return. So if the buyback slows but the stock is smack in the middle of an uptrend, we'll hold on to it for more and then sell it based on technical. The reverse is also true — if a stock comes into the portfolio based on its fundamental but gets stopped out, we'll sell."

TWST: Does your strategy work better in different market environments?

Mr. Fried: The strategy has worked very well in all environments with one exception. That exception was October and November 2008. Coming into 2008, we were up approximately 200% versus about a 40% gain for the S&P since inception. Coming into October 2008, we were down about 10% for the year versus about 22%, 23% of the S&P at that point. But over the course of the madness of October and November of that year, we underperformed for those two months. We were down about 40% for those two months versus about 23% for the S&P 500. During those months, the rules were just totally thrown out, but we've taken steps to ensure that doesn't happen again. That's one of the reasons we've adopted some of the technical analysis, and stop-losses and trailing stop-losses to avoid that kind of debacle in the future. But it's pretty much worked in most markets, and we were very successful through the bear market early in 2000, 2001 because we weren't loaded up with tech stocks.

TWST: Who is your typical client?

Mr. Fried: A typical client can be anything. We have modest-size pension and profit sharing, and some high net-worth individuals, and we also have people who would be considered probably the low end of the high net-worth individuals. So it really varies.

TWST: What advantages do you have over the larger competitors? What do you do differently?

Mr. Fried: I think we have some very big advantages over the larger competitors. One of the things is that we don't sell any other products, we're not commission based, we don't have our own funds that we're trying to feed clients into, we don't have an insurance arm, so we've really set up a company and a business model where there is absolutely no conflict of interest. Being fee based, if the portfolios go down, our fees go down, as the number, the percentage, stays the same, but the fees go up and down based on the value of the portfolio. I think it's a big advantage. You can really look the client in the eye and say, "We're right in there with you." A lot of the big companies haven't shown the same level of interest in the client, and many have huge conflicts of interest. This recent news from Goldman Sachs where they were basically selling products to clients which they knew were sub-par products, and the justification was that the client was sophisticated and should have conducted research — we find that kind of despicable. Because something is legal doesn't make it right, but we don't have those issues. Our goals are much more aligned with the client goals than some of the larger institutions. I have an example: A number of years ago, **Intel** (INTC) was buying back stock and there had been absolutely zero sale of insiders for quite a period of time before we bought it, so that figured into our thinking. If they weren't selling but the company was buying back, that was a good sign to us.

TWST: Thank you. (LMR)

DAVID FRIED
Fried Asset Management, Inc.
15415 Sunset Blvd.
Suite 200D
Pacific Palisades, CA 90272
(310) 459-9196
(888) 289-2225 — TOLL FREE

© 2010 The Wall Street Transcript, 48 West 37th Street, NYC 10018
Tel: (212) 952-7400 • Fax: (212) 668-9842 • Website: www.twst.com