

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Focused Value Investing

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SECTOR – GENERAL INVESTING

TWST: Brian, please start by telling us about Boyle Capital.

Mr. Boyle: Boyle Capital is an SEC-registered investment adviser. We offer several equity-only products for high net worth individuals. The first is a focused value portfolio where we typically have 10 or fewer securities. The other portfolio, which is brand new, is a dividend portfolio consisting of roughly 20 dividend paying companies. By the way, we believe that the high quality dividend paying companies are extremely attractive right now and that is why we established the separate dividend portfolio.

TWST: Tell us about your investment philosophy.

Mr. Boyle: We believe the best way to outperform the market and most other money managers over time is to be concentrated and only swing when you have what Warren Buffett calls a "fat pitch." First, we look for companies that are cheap on an absolute basis. For us, that means we typically look for companies that are trading for less than 10 times free cash flow or earnings. Second, we look for companies with a very strong financial position, so low debt levels are important to us. Next, we focus intensely on the track record of the business and/or the management. Lastly, we believe very much in the Ben Graham and Buffett principle of margin of safety and only invest where we believe we are adequately compensated for the risks involved.

TWST: Do you still keep a focused or concentrated portfolio of stocks rather than a broadly diversified one?

Mr. Boyle: Absolutely. That really comes back to the fact that we believe great investment ideas are very rare and so when we find something that we think meets our strict criteria — there just aren't that many out there — we want it to have a

meaningful impact on our portfolio results. It might mean more volatile or lumpy results, but our study of great investment successes shows that nearly all outstanding records were created by being concentrated.

TWST: Is the portfolio of dividend paying companies in response to more demand for yield on the part of your investors?

Mr. Boyle: With money markets yielding very little, income and yield are certainly a major concern for investors. However, at the end of the day, the dividend portfolio was established simply because we believe there is a great opportunity there. It's no secret the S&P 500 has provided abysmal returns over the past decade and if you look at the components of the Index you will see companies like **Microsoft** (MSFT) and **Pfizer** (PFE) that have provided very little to no return for 10 years. Yet, if you lift up

the hood and study the fundamentals of these companies, you will find a much different story. So what gives? Well, a decade ago these things were trading at 40-50 times earnings. Today, they are trading at 10 times earnings or lower. At the end of the day, investing is all about what you get in return for that you give. With yields of 2%, 3%, 4%, we think we are getting a lot in return for what we are giving, especially compared to Treasuries today.

TWST: How has this last 12 months been for your portfolio investing, with the turmoil in the markets and the weakened economy?

Mr. Boyle: Nobody with a long-only portfolio was immune to the downturn in 2008 and we were no exception. However, we had a number of companies in the portfolio that actually performed very well, despite their declines in stock price. Nobody likes to be down, but we feel like many of the declines we experienced in October and November were not of a permanent nature. If

HIGHLIGHTS

Brian Boyle manages a focused value portfolio as well as a dividend portfolio with about 20 dividend paying companies. Great investment ideas are very rare, he says, and so when he finds something that meets his strict criteria, he wants it to have a meaningful impact on the portfolio results. There are now some bargains that haven't been around since the 1970s. The economy is likely to be faced with some very strong headwinds for the foreseeable future, but with many security prices down over 50%, many of those headwinds are priced in and there are some extraordinary opportunities for the investor who has the ability to look out five to 10 years. Companies include: Fairfax Financial (FFH); Pfizer (PFE); Contango Oil & Gas (MCF); Coca-Cola (KO); Johnson & Johnson (JNJ).

you owned AIG or Lehman Brothers, you will never see that money again. Those are what we talk about when we discuss permanent declines. We didn't have anything like that. Most of our declines were things that went from cheap to insanely cheap. If we just get back to cheap, we'll be fine.

In a sense, the past 12 months have been the best of times and the worst of times. The worst of times in the sense that nobody likes to see their portfolio down in value. However, it is the best of times in the sense that we're seeing some extraordinary bargains that haven't been around perhaps since the 1970s and we feel we have been sowing the seeds of what should be some very good performance over the next five to 10 years.

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TWST: Did you have any shift in emphasis or changes in your portfolio to take these events into account?

Mr. Boyle: We took advantage of the volatility in the markets and the opportunities that were served up only to the extent that we sold cheap to buy cheaper and higher quality names. So probably more than anything we have on average much greater exposure to large cap names than we have had in the past. That is simply reflective of the fact that these large cap high quality names are as cheap as anything out there.

TWST: Have you been finding some winners even in this market downturn?

Mr. Boyle: We're certainly finding attractive investment opportunities. As I said, there were very few companies whose stock prices were positive last year. There were a few exceptions, however, and one of our largest positions, **Fairfax Financial** (FFH), actually hit the cover off the ball in 2008. **Fairfax** is a property and casualty insurance company out of Toronto. They were the best performing North American P&C company last year, with book value gains in excess of 20%. You would think a company with that kind of performance would be everybody's darling, right? Not so. Investors are able to pick up **Fairfax** at nearly the same price as a year ago, despite the gains. We think **Fairfax** is very attractive today for a long-term oriented investor.

TWST: Would you tell us about some of the stocks that you feel are representative of your process and the reasons why you were attracted to them?

Mr. Boyle: One that we find very attractive today is the pharmaceutical company **Pfizer** (PFE). **Pfizer** trades for around \$15 a share right now. If you go back 10 years ago to late 1999, **Pfizer** was trading at \$50, nearly 60 times earnings. Well, clearly it was overvalued at 60 times earnings and it should come as no surprise that the stock did horribly. But look at the fundamentals. Sales per share are up over 70% since then, cash flow per share is up nearly 200% and the dividend is up over 100%. So whereas 10 years ago at 60 times earnings it was an unattractive investment, at 6 and 7 times earnings today, it's extremely attractive in our opinion.

Take a look at what you are getting today with **Pfizer**. You are getting an investment grade company with \$17 billion in annual free cash flow, the largest distribution network in the world and you are getting paid a dividend in excess of 4% annually. What's more, they announced earlier in the year the acquisition of **Wyeth** (WYE), which will fill a big hole in revenues that was set to happen when

Lipitor went off patent. Still not convinced? They also have hundreds of drugs in their pipeline at various stages and who knows what comes of that, but at today's prices, you don't have to worry as we don't think you are paying for that. In fact, at today's levels, **Pfizer** is trading for less than what the net present value would be if they put all of their patented drugs into runoff. We didn't even mention mature products or generics, which **Pfizer** has made a huge push into and is I believe already the sixth or seventh largest generic company in the world. There is simply a ton of value in **Pfizer** in our opinion, which is why it is one of our largest positions.

1-Year Daily Chart of Fairfax Financial



Chart provided by www.BigCharts.com

TWST: What about their dividend?

Mr. Boyle: I'll come back to that, but when you look at the demographics of the country, right now health care is about 15% of GDP spending. It's no secret that people want to live longer and live better. With the aging population, expenditures on health care are going to continue to rise and by 2020 are projected to overtake defense for the largest expenditure of GDP. Another reason we like **Pfizer** so much is that we think they are more recession resistant than a lot of other companies and if, God forbid, we experience something like Japan, we think the demographics help **Pfizer** much more than others.

TWST: Would you tell us more about Fairfax?

Mr. Boyle: **Fairfax**, as I mentioned, is an insurance company based out of Toronto. Prem Watsa, the CEO of the company, is one of the best investment minds on the planet and clearly is aligned with investors, having 99% of his net worth in the company. **Fairfax** stands for fair and friendly acquisitions and since 1985 Watsa has primarily grown the company from nothing by making a number of strategic acquisitions in the property and casualty space. While the ride has been anything but smooth, very few other companies have matched the success **Fairfax** has been able to achieve. Since 1985, book value has grown at about 25.5% annually, with the stock returning about 23% a year over the same time. So they've done an absolutely remarkable job of growing the company over the past 23 years.

As I mentioned earlier, in 2008 they grew their book value in excess of 20% and **Fairfax** was the top performing property and casualty

insurance company in North America. By the way, that is no small feat when you consider the likes of a **Berkshire Hathaway** saw book value go down roughly 10% last year. When you buy a company like **Fairfax** you are really buying into their investment management arm, Hamblin Watsa. Hamblin Watsa, which runs the investment portfolio at **Fairfax** and its subsidiaries, has put together outstanding investment results over the past five, 10 and 15 years and is the main reason their book value was up last year. Worried about a storm that very few saw coming and even fewer profited from, **Fairfax** purchased credit default swaps as early as 2005. In late 2007 and 2008 when the storms hit, **Fairfax**'s credit default swaps yielded billions in profits. What's more, they had the majority of their investment portfolio invested in long-term Treasuries, which benefited greatly from the flight to safety in late 2008.

If you look at what they've done since the beginning of 2009, you will see that they have significant unrealized gains from their sizable investments in financials like **Wells Fargo** (WFC) and **U.S. Bancorp** (USB). Simply put, they've done a remarkable job capitalizing on the volatility in the markets and this is what you get when you buy into a company like **Fairfax**.

We think that their portfolio today is situated for sizable book value growth over the next five to 10 years. We estimate that their book value today is around \$305 a share, and it currently trades for about \$250 a share. As I said earlier, they've grown that book value at about 25% a year over the past 23 years. We think that they can do least 15% annually over the next five to 10 years and we think at some point the stock price is going to trade at the upper end of its historical book value range, which would put the company at around 1.5 times book.

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As you can tell, we clearly have a tremendous amount of respect for what management has done. What's more, they eat their own cooking, they are a conservative bunch, the balance sheet is as strong as it has ever been and this current environment of volatility is tailor-made for their investment team. Consequently, we believe **Fairfax** warrants a heavy weighting in our portfolio.

TWST: Are there any other companies from either portfolio that you find attractive at this time?

Mr. Boyle: One last one I would like to mention is a company called **Contango Oil & Gas** (MCF). **Contango Oil & Gas** is a smaller company. As I said, we have a much larger allocation to large cap companies than we've had historically, but one smaller company that we do have in the portfolio is **Contango Oil & Gas**. **Contango** was started in 1998 by a gentleman named Ken Peak who is the CEO and Chairman. They have only six employees. They are based out of Houston, Texas, and essentially they are involved in the discovery and exploration of natural gas and oil. Ken Peak owns roughly 19% of the company and we think he is just a tremendous capital allocator. When they started the company in 1998, Peak went out and raised \$61 million. He then took that money and acquired the rights to land. They turned the drill bit to the left and they discovered vast quantities of natural gas and oil, in fact, some of the largest finds ever off the Gulf of Mexico. They've sold off some of these discoveries and they've kept some. They've taken their profits and then gone back and repeated the process.

We think today that this company is extremely attractive as the stock has plunged along with natural gas prices over the past year. Today, natural gas prices are trading around \$4/Mcf. At this time a year ago, they

traded around \$12/Mcf. At that particular time, Ken Peak put the company up for sale. He was worried about taxes going up under a new administration and wanted to capitalize on the enormous value they had created. So they did an open room process where companies came in, did their due diligence and then had the opportunity to make an offer for parts or the entire company. As the economy turned south and with it natural gas prices, they weren't getting the kind of offers they felt the company warranted. Consequently, they pulled the company off the market and shut the process down. At that time, the stock was around \$90 per share. We think natural gas prices will eventually rise, as very few make money at these levels, and when they do, Contango will benefit.

1-Year Daily Chart of Contango Oil & Gas

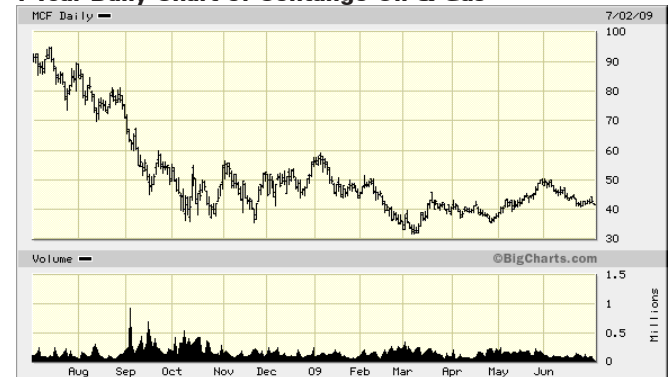


Chart provided by www.BigCharts.com

The company has no debt. They've bought back 1.2 million shares since September 2008 and today, when you are buying into **Contango**, each share represents 22/Mcf of natural gas. They have a break-even cost of \$2.25/Mcf. So even at these low prices they are making money. When prices are at \$6, \$8, \$10, \$12/Mcf, this company gushes cash. One thing that amazes us about this company is the fact that they raised \$61 million prior to going public and since then they've repurchased 3.6 million shares for a total of \$64.7 million. That means the net capital of this company is negative and my guess is there are very few other publicly traded companies, if any, that can make such a claim. So with 22 Mcf of proved developed reserves per share, no debt, and a \$2.25/Mcf breakeven cost, we really like **Contango** at these prices.

TWST: What about the sell process? What triggers an exit from your portfolio?

Mr. Boyle: Several different things. Admittedly, in this environment we're a lot more aggressive in selling than we have been in the past just because of the volatility in the market. Number one, we look at the price of the company relative to what we think the true value is. If the company gets close to or above what we think it's worth, we will sell. Another reason we would sell a company is fundamental deterioration. If we believe that the business fundamentals have deteriorated, that we were wrong in our thesis for investing, we will sell. As noted earlier, just because the stock price is down doesn't mean that the business fundamentals have deteriorated. It is important, especially in this environment, to distinguish between the two. Lastly, we are comparing against the opportunities that are out there. In the past couple of months, you have had

opportunities to buy things at 3 to 4 times free cash flow. So if we have something at 10 times free cash flow that we might think is attractive, but something has come up that is at 3 or 4 times free cash flow, we're certainly going to consider switching to the cheaper. So lately we have been finding ourselves selling cheap to buy cheaper.

TWST: So the turnover has been more than usual?

Mr. Boyle: Turnover has increased certainly in the last six months because of the opportunities that have come up. At the end of the day, we are trying to assemble a portfolio that has the highest upside potential and what we believe is the lowest risk of permanent impairment of capital. Therefore, selling cheap to buy cheaper just makes sense to us.

"Contango Oil & Gas is a smaller company. The company has no debt. They've bought back 1.2 million shares since September 2008 and today, when you are buying into Contango, each share represents 22/Mcf of natural gas. They have a breakeven cost of \$2.25/Mcf. So even at these low prices they are making money. When prices are at \$6, \$8, \$10, \$12/Mcf, this company gushes cash."

TWST: What about the risk management that you incorporate within your process?

Mr. Boyle: The biggest thing is that we spend a lot of time figuring out how something can go wrong. As Charlie Munger likes to say, "All I want to know is where I am going to die and then I won't go there." If we feel we can't kill the idea, then we may be onto something. We also try to make sure that the portfolio positions are sized relative to liquidity. If the position is not highly liquid, there is no way it is going to be a big position for us in the portfolio. Today that is not a huge problem given the number of large cap companies that we own. Lastly, as companies approach our estimate of intrinsic value we will scale back the position.

TWST: Do you have a measure of dividend performance in your holdings?

Mr. Boyle: In terms of the dividend portfolio, we are looking for companies that, number one, have a consistent track record of dividend payments. So we want to go back over 10, 15, 20 years and see that the company has consistently paid a dividend. So that is the first thing. The second thing is, we have a very intense focus on the balance sheet of the company and we believe if the company has a low level of debt relative to the equity and relative to the assets of the company, the company is going to be more likely to sustain the dividend. Lastly, and what we think makes the most sense when you are buying a company for the dividend, we want to be invested in a company that has a great franchise. Take for example, **Coca-Cola** (KO). We think that **Coca-Cola** is a company that will likely do well in an inflationary environment or a deflationary environment. We look at the likes of a **Johnson & Johnson** (JNJ) and we think that **Johnson & Johnson** is a company again whose products are necessary and a company whose products are likely to do well in an inflationary or deflationary environment. So we look for the quality of

the franchise. We think a lot of the protection in terms of your dividend comes in the quality of the franchise. The weaker the franchise, the more elastic the earnings stream in our opinion.

TWST: What do you think gives your firm its edge? Doesn't your team also own the securities within your own portfolios?

Mr. Boyle: Absolutely. That's something I have always felt puts religion in the process. We don't allow ourselves to own any other publicly traded securities than what is in our clients' portfolios. Our portfolio weightings differ only to the extent our objectives differ. It doesn't guarantee results, but it certainly does align our interests with clients.

I've always believed that if it is good enough for the clients, it better be good enough for me. Quite frankly, we don't understand why anybody would put their money with somebody that doesn't feel the same way.

TWST: What would you like to add?

Mr. Boyle: I think it was the late Shelby Davis, founder of the Davis fund family, who used to say, "You make your money in a bear market; you just don't realize it until later." There are a lot of challenges out there in the world today and the economy is likely going to be faced with some very strong headwinds for the foreseeable future. But with many security prices down over 50%, we think that many of these headwinds are priced in and there are some extraordinary opportunities for the investor who has the ability to look out five to 10 years. We think five to 10 years from now people who put money into some of these high-quality companies are going to feel very good about the decisions that they made. That would be the message that I would leave investors with today.

TWST: Thank you. (PS)

Note: Opinions and recommendations are as of 6/30/09.

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