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THE WALL STREET TRANSCRIPT
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TWST: Why don't you start with a brief introduction of yourself and an overview of Falcon Point and your investment philosophy there?

Mr. Bitzer: Thank you for your continuing interest in our firm. I am a Senior Managing Director for Falcon Point Capital and have been with the firm for over a decade now. Falcon Point is an SEC registered investment firm. It is now 100% employee-owned after four of us bought out the founder in 2004. The firm was originally started in 1986, so it's been around quite awhile. It has a very successful track record and history of specializing in small and mid-cap growth stocks. We currently have four products. Our flagship product is the Long/Short Hedge strategy, which I have run for the past decade. We also have a Technologyoriented hedge fund strategy, a High Yield strategy, and a long-only Small Cap Growth strategy. Our Small Cap Growth strategy was recently recommended by Russell Investments, one of the preeminent small-cap consulting firms.

TWST: When we last talked to you a couple of years ago, you talked about small-cap growth, what do you want to focus on today or do you want to talk about all of the products?

Mr. Bitzer: Let's focus on the Long/Short Hedge strategy today. Since we run all of our equity portfolios off a common research platform, where we share the best ideas, you will get a sense of how the other strategies are run as well.

Our Long/Short Hedge strategy typically invests in companies with a market cap of $5 billion or less. It runs relatively concentrated portfolios with 30-40 long ideas and 20-40 short ideas. The concentrated funds allow us to have our best ideas working for us. The strategy has done very well over the last three years, generating net positive returns about 5% per year while the Russell 2000 and S&P500 are down around 10% per year. And many hedge funds have had poor returns over the past few years. The HFRX, a common hedge fund benchmark is down nearly 5% per year over that same time period. So we have significantly outperformed both the markets and most hedge funds over the past three years and over the life of the product. Since its inception, the Long/Short Hedge strategy has produced about 15% net annual returns.

TWST: Let's start on that. Tell us about its composition and your investment process Mr. Bitzer:

The Long/Short strategy, as well as our other strategies, is primarily focused on small-to-mid cap growth stocks. We generally look for companies with market caps between $200 million up to $5 billion. We prefer to invest in the smaller size companies because the market is less efficient in this area. We get access to senior management and there are typically fewer sell side analysts covering the companies. On the long side of the portfolio, we look for healthy growing businesses selling at a reasonable price. These are generally companies whose revenue and earnings are showing sustainable growth of 15% per year or better. On the short side of the portfolio, we look for troubled companies; companies where margins are declining and business is deteriorating, or stocks that are over-valued and have a negative catalyst.

Our investment process if highly disciplined. We build multi-quarter earnings and cash flow models, using our own forecasts to come up with a fair price target 12 to 18 months out. As part of our disciplined sell process, if stocks hit our fair price target, we will exit these stocks and replace them with new stocks with higher potential returns. Stocks that decline 20% from our cost are also sold before they become too problematic to the overall portfolio returns. In today's environment, it is much more difficult to find companies that are growing their earnings. Because of this, we have less long exposure than we did last year for instance. We believe that we are entering what will be a very bad and possible long global recession. Earnings estimates are getting slashed across the board for all companies whether they are small-cap or larger cap stocks. As part of our research process, we visit with over 400 companies per year and for most industries, business continues to deteriorate each month. Given the economy continues to slow, consensus earnings for the S&P500 for 2009 is still way too high. We think it'll come in closer to $60-$70 next year, down from about $80 this year. Looking for growth in this environment has definitely been tougher. However, on the bright side for a hedge fund, we have found many shorts that have offset much of the pain from the long side of the portfolio.

There are a number of sectors and stocks we are avoiding today. Technology companies are likely to perform poorly as capital budgets are coming down rapidly. We don't like anything to do with the autos or the supply chains for autos. Despite the bailout talk, their business models are simply broken. We don't like retailers because consumers are entering a de-leveraging period that may last though 2009. There are a few exceptions such as discount retailers who are benefiting from a trade down that we can talk about a little later. We don't like industrials or material stocks including energy as a lot of those stocks benefited from the global growth and inflation trade. We think we're entering a brief deflationary environment. We are avoiding highly leveraged companies as many will not survive this downturn, particularly with the credit markets remaining in a deep freeze. Unfortunately I can't talk specifically about our short positions, but suffice it to say the return on capital from our shorts this year is greater than 60%, which has offset much of the weak returns from the long portion of the portfolio.

TWST: Where are you finding the shorts and where are you putting the longs?

Mr. Bitzer: The shorts are in some of those areas that we talked about, which includes highly leveraged companies in many sectors, it includes technology and industrial stocks and some material stocks. To give you an idea on the technology area, in the last three to four weeks we've heard about the terrible earnings guidance from **Cisco** (CSCO), **Nokia** (NOK), and **Intel** (INTC), three big bellwethers in networking, cell phones, and semiconductors. This is just the beginning of the poor guidance we are about to witness. Technology stocks are going to have a very tough next six to twelve months.

Despite the recent economic turmoil, there are a few areas where we have found earnings growth and we do have some long positions. However, most of the positive returns in the last 12 to 18 months have come from the short side. Our net exposure today is about 20% net long. We have about 60% gross long and about 40% short exposure. So the longs that we will talk about in a minute are part of the 60% long exposure. This is less than the fund typically runs.

In today's market, the two types of stocks we're looking for on the long side, given that we think the U.S. is entering a very severe recession, are (1) companies that we think can grow their earnings next year, and this may be a much tougher task given the macro-economic environment. And (2) super cheap stocks of high quality companies, despite the fact that earnings may be down next year. On this second category, the stock needs to be significantly undervalued, have positive cash flow, and a good balance sheet. Those are the two threshold criteria that we're applying to longs at this time.

Areas that we like today, where we see growth, are education, deep discount retailers, healthcare and a few select business service stocks. Education is one of our favorite areas. We own four companies in this industry as they tend to be counter cyclical. A weakening economy and job market is providing a tailwind to student enrollment growth. In a bad economy, people tend to go back to school to learn a new trade or further their education. In addition with fewer jobs available right out of school, particularly jobs where little training is needed, more high school graduates are electing to go to college or trade school. These for-profit education companies have relatively fixed cost structures, so when enrollment improves; much of the incremental revenue falls to the bottom line. Most also have excellent balance sheets and throw off significant free cash flow.

The four names we own are **Apollo Group** (APOL), **DeVry** (DV), ITT **Institute** (ESI), and a small position in **Universal Technical Institute** (UTI). These names have various characteristics we like, but the key has really been enrollment growth. New student starts have been accelerating across the board recently. Higher student enrollment will lead to higher earnings next year for most of these companies. For instance, so far this year, **DeVry** has grown its revenues by about 20% and earnings close to 30%. New student enrollment growth was 12% in the most recent quarter and the stock is up 7% this year in a 40% down market. We expect new student enrollment growth will accelerate this quarter. We've owned the stock for a little over a year now, purchasing it in the high $30 range. It is a high quality company with top-notch management. They offer BA degrees in various areas, including business, accounting and technology. DeVry has a nursing school as well as a medical and veterinarian school. However, there is still plenty of appreciation potential remaining. At $55 per share, it trades at just 18 times our estimate for the next calendar year. DeVry will grow earnings by over 20% in the next several years. We think the stock will appreciate to $75 a share or 25x our CY2009 earnings estimate of just over $3.00 a share during the next six to twelve months.

Apollo Group is another stock we like a lot and it operates the University of Phoenix, which has the largest online enrollment in the country. They offer both associates degrees, BAs and Masters Programs. The associates' degrees are through its Axia College. The average age of their BA or Master's students is over 30 years old while AA program caters to a younger student. All of its programs will be beneficiaries of the enrollment trends I have talked about. The stock is up a bit this year and it's outperforming the market significantly. It is one of the bellwether stocks in private education, yet is currently one of the cheapest names in the group. Given the large size of its enrollment (over 360,000 students) it takes more students to move the total enrollment growth so it is perceived as slower growing. However, student retention is improving and the cost of advertising for new students continues to fall. These positive dynamics will drive low double digit top line growth and mid to high teens bottom line growth over the next few years. Apollo is a 17 to 20% earnings growth story, with a pretty high certainty of achieving that growth, currently trading for only 17x our CY estimate of nearly $4.00 share. Given the scarcity of companies that will achieve earnings growth in 2009, it is likely that multiples for companies that can achieve earnings growth will expand. Our price target, applying a 20x to 25x multiple to our $3.90 of earnings is $80-$90. As we ultimately roll into 2010 earnings by the end of next year, we see Apollo hitting $100 per share.

The other education stocks we own are **ESI** and **UTI** and without going into detail both are performing well and should continue to grow their earnings during the tough recession. ESI students require more company financial aid and a thawing out of the private student loan market would benefit them next year. UTI is a turn-around play in the sector. Its curriculum is focused on auto and motorcycle repair. The stock has appreciated by over 50% since our purchase price and is very near our price target at this point. All these stocks performed well during the last recession. So the education sector would be one of our favorite areas right now probably for the next eight to twelve months, or longer if the economy continues to tumble.

TWST: Do they have international operations?

Mr. Bitzer: Most of these are all domestic. **Apollo University** has some very small international operations, but they are looking to expand further globally. Greg Cappelli, one of their executives is in charge of expanding their international presence and they're doing that in conjunction with a private equity firm that has experience there as well. International revenues are less than 2% of the company's business today, but you'll probably see that grow over time. There is plenty of domestic enrollment growth available. The average enrollment growth across the education space in recent quarters has been close to 15%. This compares to 8 to 9% over the last three years. Another positive attribute of these businesses is pricing power. With the umbrella of continually rising state school tuition, these for-profit schools typically raise tuition by 4% to 6% per year. Combining accelerating enrollment with a little tuition increase provides nice earnings leverage across the sector.

The other area we like and have owned a few names is the deep discount retailers. Companies that we still currently own are **Dollar Tree** (DLTR) and **Family Dollar Stores** (FDO). Retail is a tough space right now, but the deep discounters are doing pretty well as strained consumers trade down to the stores that offer the best values. **Wal-Mart** (WMT) is the king of everyday low value prices and its stock has performed well this year, up about 10%. Of course, that's too large a market cap for us. DLTR and FDO are smaller sisters of **Wal-Mart** with everyday low pricing. They offer great values on many everyday necessities such as food, clothing, and household products. All the Dollar stores have been performing pretty well during these trying times so far and are likely to continue to outperform in 2009. **Family Dollar**, for instance, is $3.7 billion market-cap deep discount retailer that operates over 6000 neighborhood discount stores that sell basic goods at everyday low prices, the average ticket is around $7 to $8 and shoppers return frequently. For the most recent quarter, the company grew sales by 10%, earnings by 20%

and at $26 it trades at just 15 times our $1.70 estimate for 2008 and 13x the $1.90 we think they will earn next year. Their balance sheet is rock solid with over a $1 per share in cash and minimal leverage and it's an excellent business that generates a 19% ROE on an underleveraged balance sheet.

Dollar Tree is a similar concept we own. It's a little smaller with 3,500 stores and it operates at a dollar price point or less for all the goods in the stores. Historically inflation can be a problem for these single price point retailers, but this management team has managed it well and we actually see inflationary pressures turning to deflationary worries, which should be a tailwind for the single price point stores like Dollar Tree. The stock is actually up 48% this year, it's one of the best performers in the market but it still was recently valued at $38 and it trades for 12.6x our 2009 earning estimates of just under $3 a share.

We previously owned **99 Cent Stores** (NDN), which is another dollar store concept in the midst of a turn-around. Its stock rallied by 42% this year and it hit our price target. Its’ PE was approaching 26x the $0.45 we think they will earn next year, so we elected to take our profits on this one.

Another discount retailer that we've sold earlier in the year is **Ross Stores** (ROST), which is a discount clothing merchandiser that performed admirably during the last recession. That stock had approached our price target earlier in the year and we exited near $40 but it is back down in the mid $20's now and we are currently evaluating whether we should repurchase this stock. It has an excellent management team and one of its biggest competitors (Mervyns) is liquidating. This may hurt near term results, but should be a positive for them next year. I would say those two sectors, as well as health care, are our favorite areas for long ideas today. These are some of the areas where we expect earnings growth next year.

TWST: What areas of healthcare are you finding growth?

Mr. Bitzer: The names that we like are some of the emerging pharma and biotech names, as well as a few healthcare service stocks. While there is always the risk of government price cuts or policy changes in health care, that's true whether you're in good times or bad. Health care is an area where we can find some exciting growth stories whose business should not be affected by the rapidly deteriorating macro environment. Some of our favorite names here include **Gilead Sciences** (GILD), **Cephalon** (CEPH), and **ICON Plc** (ICLR). I'll briefly touch on these. We've owned **Gilead** for three years and the business remains very strong. They have built the dominant franchise for AIDS drugs in the US, are expanding it globally, and have a growing franchise in Hepatitis drugs. In their key HIV segment, the company continues to take market share from competitors with its two main drugs, Atripla and Truvada. Some of the competing drugs have recently been found to have more severe side-effects which have helped the company expand its share. In addition, Atripla has only just been approved in Europe and the company is rapidly gaining market share over there. These rapidly growing chronic disease markets, combined with geographic expansion and market share gains are driving solid revenue and earnings growth. Revenues will be up about 25% this year and earnings will grow close to 20% as they continue to invest in new drug therapies, some of them outside their core HIV franchise. Despite its recent pull-back in this difficult market, the stock's held up very well this year. At $46, the stock trades at 18x the $2.50 estimate we have for next year. GILD will be an excellent stock to own during these turbulent times and should grow its earnings irrespective of what happens to the economy next year.

Cephalon (CEPH) is another one I'll touch on briefly. CEPH manufactures biopharmaceutical drugs for the treatment of neurological disorders and cancer. Its two main drugs, Treanda for oncology and Amrix, a muscle relaxant continue to gain market share and outpace street expectations. Its stock price has also held up well this year. Earnings are growing 20% and the stock should trade for at least 16-17x those earnings, driving our $90 to $100 target price. I won't go into detail on **ICON** or the other healthcare names we own at this time, but ICON's business is healthy, it's a market leader in the Clinical Research Outsourcing space and its stock offers significant appreciation potential as investors realize that pharma and biotech companies will need to continue outsourcing their drug trail management.

TWST: How do you limit the losses and exposure in your hedge fund strategies?

Mr. Bitzer: It's done several ways; first we employ a 20% stop-loss on stocks from our purchase price. If we buy a name and have a full position on and it's not working, we are not hesitant to kick it out of the portfolio so that it doesn't drag down our returns. This stop-loss is employed both on the long and short side of the portfolio. I remember the last interview we had, I think was in 2005, when many of the shorts were going up despite poor earnings and so we were forced to use the stop-loss more for several of them. Now, our shorts have been performing very well for the past year or so, but we have been stopped out of more longs of late. It's been a very fertile market for shorting but a challenging environment for longs.

The second way we mitigate losses is simply the fact that the portfolio is always hedged. We always have both longs and shorts in place, which reduces the volatility of a hedged product relative to a long only product tremendously. The standard deviation of our returns is about half the market’s, despite market beating performance over the years.

Lastly our very experienced investment team here is constantly monitoring all the stocks in our portfolio. If a business is not performing up to what the Street or management had previously guided to, we do not hesitate to get out of a name before the problems are widely known. These are the three key drivers for mitigating losses in what has been a really difficult tape for the past eighteen months.

TWST: Who are your typical clients and what are you doing to talk about their concerns and risk management?

Mr. Bitzer: We have a mixture of investors. We serve large institutional clients as well as high net worth individuals and family offices. In fact, we recently received a $25 million funding from an S&P500 Company into our long/short hedge strategy. They like the low correlation to the general markets, understand the value (alpha) we have added over the years, and have confidence in our organization. Despite much of the bad press about hedge fund outflows, most of our strategies are experiencing net new investments this year due to significant long-term out performance over their relative benchmarks.

TWST: You monitor the portfolio a lot and keep in touch with the clients?

Mr. Bitzer: Yes, the portfolios are monitored daily. We talk to the companies regularly, read all data about them and often about competitors and customers. Managements of some companies are contacted several times per quarter if required, while other holdings require less frequent interaction. We leverage our contacts in the field to continuously monitor our companies. As far as our client service, we have a top-notch client service department which regularly interacts with current and prospective clients. In addition, the portfolio managers are always available to discuss investment performance as well.

TWST: How is this small-to-mid cap focus, which is your specialty, how is that doing compared with the large-cap arena?

Mr. Bitzer: Right now all the US markets seems to be down close to 40% so there is not much of a difference. However, the markets have been so volatile with movements of 5% to 8% per day that it changes rapidly. The S&P is down a little over 40%, almost 41% year-to-date and the Russell 2000 Index is at a similar level. There's not much difference between large and small cap indices right now and the correlation between stocks and sectors is very high at the moment. We prefer to invest in the small-to-mid cap segment where we get better access to management and the markets are less efficient. It is one of the factors that allow us to generate the alpha that we have over the long-term.

TWST: Tell us about your risk controls, what risk management do you incorporate into the process to protect client capital?

Mr. Bitzer: Our risk management includes some of the things we have already touched on, including our stop-loss discipline, no more than 5% of the portfolio in any one stock, reasonable sector weighting constraints and the daily monitoring of positions. We have portfolio committee meetings weekly where the investment team gets together and talks about problem stocks, recent trends or concerns, which companies we met with the previous week and general thoughts on the portfolios. With quick communication amongst all the investment team here we're generally pretty fast to identify problem areas to get out or attractive areas to make new investments. Finally, the long/short product always holds both long and short positions, so it is hedged. This reduces its volatility, which runs less than half of the market. We also periodically run value at risk calculations and stress-test the portfolio using one and two standard deviation changes in prices of the securities.

TWST: What do you think gives your firm its edge? What differentiates your approach with the long/short strategy from that at other firms?

Mr. Bitzer: I think the three main things are focus, discipline, and quality. Let me explain each one a little bit. The focus of our firm has always been on small-cap and mid-cap growth stocks. In addition, we run relatively concentrated (or focused) portfolios with 30-40 long holdings. This way we have our best ideas working versus diluting them with 60-100 other ideas. This relates to our disciplined buy and sell criteria, to the stop-loss and to building earnings and cash flow models to help us better understand the key earning levers and to formulate our price targets. Because the three investment principals have similar investment philosophies, the three equity-based products typically have 50% to 60% of long ideas in common. Lastly, quality relates to the significant experience of the investment professionals and the quality of the growth stocks we tend to purchase. I've been doing this for a little over 20 years and my two portfolio manager colleagues, Michael Mahoney and Michael Thomas have been doing it for 20 and 15 years, respectively.

TWST: What challenges do you see looking ahead for your type of hedge strategies?

Mr. Bitzer: I think the outlook for our product is pretty favorable over the next one to three years. I think we're going to have a very big shake out of the hedge fund industry with probably 30% to 40% of the funds going out of business. Many of these are the highly leveraged funds who have lost much of their investor’s money. In addition, I expect that dollars will flow out of some of the new 130-30 funds that have performed poorly during this tough market. And so I am actually looking forward to having less competition on the short side as we go forward.

The biggest challenge near-term has been the precipitous decline on the markets and the high correlation between stocks and all asset classes. There have been few places to hide. When you have months like the second half of September, October and November, where everything just falls precipitously, it's temporarily a bit tougher to add alpha. However, what we found from our past experience that continuing to seek the well-run, growing businesses for the long side, and by shorting declining companies, we can provide significant out-performance over time.

TWST: What advice then would you give to potential investors who are nervous about the hedge fund environment and what reasons would you give them to say that Falcon Point Capital is different and would be wise to invest with you?

Mr. Bitzer: I call it “the get rich slowly strategy.” We've been doing this for 20 years. I have run the long/short strategy here for a little over a decade now and have the majority of my net worth invested in it. We are producing almost double market returns over the long-term with half of the volatility or the risk. While every year isn't up, we don't run highly leveraged portfolios, we have a disciplined process, and quality investment personnel with high motivation. Others have recognized the value we add over time. That is why I am excited that we have a Fortune 500 company investing into our Long/Short Hedge strategy. It is their first direct investment into a hedge fund versus fund of funds and I frankly expect we'll see more of that over the next few years as some of the less successful hedge funds are winding down their operations.

TWST: Thank you. (PS)