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Questioning Market Leaders For Long Term Investors

MONEY MANAGER INTERVIEW

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ALAN B. LANCZ



ALAN B. LANCZ is President of Alan B. Lancz & Associates, the Toledo, Ohio-based professional money management firm. He is also the Editor of The Lancz Letter, Lancz Fax and Sound Investing Basics in addition to monitoring his proprietary research of www.ablonline.com member's only section. Mr. Lancz started his own independent firm shortly after graduating from the University of Toledo. Mr. Lancz has been featured in *The Wall Street Journal*, *Moneyline*, *New York Times*, and *Barron's* over the past decade.

SECTOR – GENERAL INVESTING

(HAU501)(6772)TWST: Have you made any changes in tone in your portfolios in the year or so since you've spoken to our readers?

Mr. Lancz: The market has been extremely volatile, so we have made quite a few adjustments in the past year. Basically, a year ago we were coming off good gains on the cables and we recommended **General Instrument** (GIC), figuring that the cables were already up from our purchases two or three years ago. **General Instrument** is the leading maker of cable boxes, and we thought that they should benefit from the renewed growth and popularity of cable. So that was a specific stock and energy was a particular sector that we just thought was getting down, pricewise, to good valuations. Obviously since then the cables have gone up higher, and **General Instrument** has more than doubled after recently receiving a takeover offer from **Motorola** (MOT), and the energies are up 50% or more. So we're no longer as attracted to those areas we liked one year ago and in fact have actually been taking profits in those areas. We expect a volatile market the rest of 1999, and believe that we have yet to see the lows, so attractive values should be plentiful sometime in the fourth quarter.

TWST: Which factors are most influencing you, Alan — inflation, interest rates, or the global recovery?

Mr. Lancz: I think interest rates are a key. In June and July we were taking profits, but after August and September when the markets were

going down, we started buying a few things. Now with the markets moving back up in the face of higher interest rates, the NASDAQ hit an all-time high yesterday. Basically we think the market is in need of a pull-back soon. If you combine higher interest rates with Y2K, not that anything will happen in Y2K, in our opinion, but I just think it will create an absence of buyers, because of professional investors' fiduciary responsibility to hold off and make sure there isn't a problem. Just this lack of buyers, more than panic selling, I think will create a downdraft in stock prices in general. Combine that with higher interest rates, and that is why we have been raising cash as the market seems vulnerable here.

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Highlights

Alan B. Lancz says his cash positions have increased to over 25% mainly from selling some of the things that have done well. He sees the market as having groups of haves and have-nots; the haves are technology and some biotechs, and the have-nots are the drugs and finance stocks. Another worrisome sign, he thinks, is that the market is being led by a few names. When he finds bargain stocks, he will buy gradually, because of his concerns about the way the market is at present.

Companies include: Disney (DIS); General Instrument (GIC); Bank One (ONE); Mattel (MAT); Boston Scientific (BSX); Adaptec (ADPT); UNUMProvident (UNM); Federal Express (FDX).

Interview Date: September 30, 1999

TWST: Before you talk about the values that you have discovered, how do you approach investing in general?

Mr. Lancz: We individually manage money for wealthy individuals, families, retirement plans and nonprofit organizations, on a case-by-case basis, custom-designed for their specific goals and objectives. We approach investing on a fundamental basis and we place a high priority on management and also special event-type situations. Our objective is to create a portfolio to match an investor's objectives with an emphasis on limiting risk even in our aggressive growth account.

TWST: What do the portfolios look like currently with the caveat that you have raised cash?

Mr. Lancz: Our cash positions increased to over 25% mainly from selling some of the things that have done so well. We started, as I said, back in June and July and we were starting to buy, when prices fell, late this summer, but now with the rally we're building cash again. The market is almost like a group of haves and have-nots; the haves are the technology and some of the biotechs, of which we are selling substantial positions in, and the have-nots are the drugs and the financials which, with higher interest rates, have been getting decimated. But a lot of good quality names are down and to me that kind of gives a good example of the health of the market when you have a **Coca-Cola** (KO) down from \$88 a share to \$48. **Gillette** (G), **Sears** (S), **Avon Products** (AVP) and **Xerox** (XRX) are all down 50% from their highs. I think the markets are being led by a few names and that's another worrisome sign. So that's why our cash position is so high. And when we start to find bargains, we are going to gradually buy, just because of the fears that we just talked about.

TWST: Are you doing any shopping in the group you just mentioned?

Mr. Lancz: Similar to our talk last year, when we felt **3M** (MMM) was a good bargain at \$65-70 a share, it seems **Disney** (DIS) in the low \$20s offers great long-term appeal with limited risk. We think it has a risk of 10-15%, while the upside potential is that it's back to the \$35-40 area within a year or two. It's just misunderstood on Wall Street and there's a lot of value with what they are doing on the Internet side. Those are the types of situations, like **3M** last year when it was hitting new lows, that you want to participate in during this type of market. Obviously it's all a matter of price, but we still think **Coke** and **Xerox** are too pricey, even though they have been almost cut in half.

Two stocks we are starting to buy now are **Boston Scientific** (BSX) and **Mattel** (MAT), both down substantially, trading at new lows. These are situations where we think if the company doesn't turn around on its own, we'll probably see restructuring or takeovers, and that's the kind of added event that we like.

1-Year Daily Chart of Disney

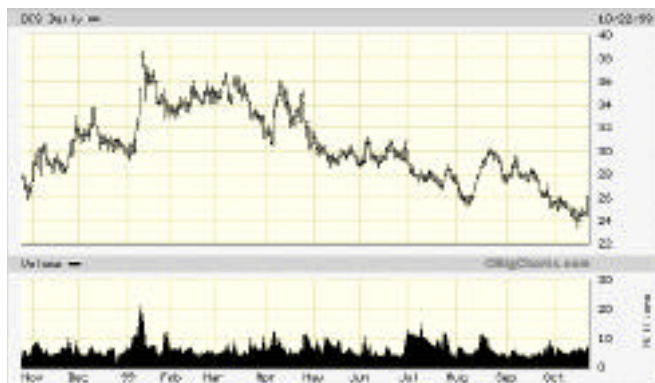


Chart provided by www.BigCharts.com

TWST: Now, **Mattel** seems to be down for a reason.

Mr. Lancz: Both are down for good but temporary reasons. **Mattel** has been poorly managed and I think at \$12 a share, it's a situation where the stock is worth more not even including The Learning Company and yet, The Learning Company is still profitable. So at a minimum **Mattel** is worth 50% more than where it is trading right now. It reminds me of **Adaptec** (ADPT), which we talked about last year when it was down from \$30 to \$8-10 despite having over a \$6-book value; it's a situation where the management, whether it's Jill Barad or new management, is either going to turn **Mattel** around or it's going to be taken over.

TWST: Speaking of an **Adaptec**, how would you advise investors to play the technology sector?

Mr. Lancz: **Adaptec** has gone from \$8 a year ago to \$43 and we were selling some today in the low to mid-\$40s. But the technology

sector is one of the few sectors (biotechnology and energy being the other two sectors) that has really done well for us. We think it's prudent right now to take some money off the table like we are doing with **Adaptec** and buy companies that are beaten down like **Adaptec** was a year ago. That's part of our strategy in this market: to sell companies that are becoming overvalued like an **Adaptec** and then buy things that are newly attractive bargains. The market has been good at creating opportunities with rotational corrections — two years ago the cables, last year the energies, and now the financials and some of the select special situations and the drugs are cheap and are beginning to offer some good upside potential. So we'd rather take some money off the table in **Adaptec** and **Amgen** (AMGN) and buy **American Home Products** (AHP), Warner Lambert (WLA) or a **Pfizer** (PFE) on weakness here. This should not only improve our long-term performance potential but also greatly reduce our risk.

TWST: Have you found any values in the financial sector or in the special situation area that you've just mentioned?

Mr. Lancz: Yes, there are a number of exceptional values. I think even with interest rates going up we would gradually be buying **Bank One** (ONE). The stock has plunged 50%, which we think is more of an overreaction based on a poor quarter, and they reserved more money on a recent acquisition than what they really needed to do. This stance will pay off this time next year. But right now it's in an industry that nobody likes and where you report bad earnings or disappointments in an industry that's out of favor, then get an overreaction in the stock price, much like what we saw with the energy last year or even **Adaptec** and **Amgen** for that matter.

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UNUMProvident (UNM) is a leader in the disability and special risk insurance area, and when they reported a \$0.07 shortfall in earnings last quarter, the stock literally went down 40% in one day. To us it might take a year or more for it to turn around, but being a leader in an industry where we see 12 to 15% growth potential annually, we think those are the companies you want to buy when they are out of favor and expectations are minimal.

TWST: Do you continue to find opportunities in initial public offerings?

Mr. Lancz: The initial public offerings have been exciting. The hardest part in that area is to get a good allocation, because we won't commit in the aftermarket at just any price. The key is trying to get enough shares at the IPO price and basically that's where the main action has been in the IPO marketplace. We really haven't had too many good IPOs outside of the high technology and specifically the Internet realm, and basically that's probably going to stay that way at least through the end of the year.

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1-Year Daily Chart of Mattel

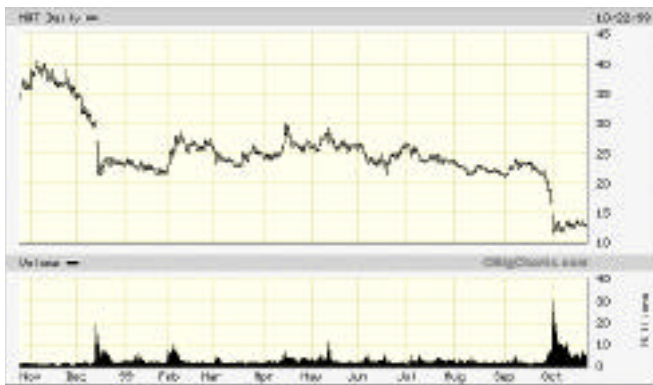


Chart provided by www.BigCharts.com

TWST: How do you find the companies? Give us an idea of how you approach the sector for investment.

Mr. Lancz: The hardest thing for us to value and analyze are companies in the Internet arena. After management, then you have to feel comfortable with their business plan on a long-term scale and project future cash flow, because a lot of times these companies won't have earnings for three to four years. To tell you the truth, a lot of times if the stock moves up very substantially from the IPO price we'll actually sell it, but on a long-term basis we'll hold it if we still see attractive potential in the company. But with the way the market has been valuing the Internet sector, we just think that a lot of times it's better just to take profits and be happy with the gains rather than try to find the one in 20 or whatever that will be extremely successful.

We've also set up, for our sophisticated, wealthier clients, a venture capital side where we get in at the early stages of these companies. So even though the risk may be greater the valuations are so much more reasonable compared to the IPO price that we can diversify into select early stage Internet/technology entities. And then if you are fortunate enough to have a successful situation, you not only reap the benefit as you would if you discovered a successful company, but you also reap the benefit of the degree of excess valuation because of the Internet. So because of this added kicker, we deem it worthwhile to get in at the early stages, because the potential rewards are so dramatic.

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TWST: Is this an area where you might try to identify themes or trends to help you know where to put venture capital?

Mr. Lancz: We're doing it more on the Internet side, so it's a matter of trying to be a visionary on what areas of the Internet will offer profit potential. This way we have the added incentive of getting a multiple increase of valuation, if this becomes a successful Internet entity through takeover or IPO, and that's what we deem is worthwhile. But normally on the venture capital side, it's been very difficult, volatile and risky. Because of the Internet, if you are selective, and because of this added Internet valuation bubble, if you want to call it that, it definitely is rewarding to take some risk. If you don't get the Internet valuation down the road, you still might have a successful entity and get a normal return on your money. We feel the Internet will continue to expand, and this is a good way to play and have a chance of even greater rewards. Now, of course, that's for wealthy, more sophisticated and risk-oriented clients. For our typical client, a way to play the Internet would be like **Federal Express** (FDX) when it went down the last few weeks from \$60 to the mid-\$30s. I think **Federal Express** is much more of a technology company than what people realize and we like that situation. When there's a misunderstanding on Wall Street on what a company really does and as the Internet grows, **Federal Express** and a company like UPS will be reaping the benefits of that growth of the Internet. Or a company like **Sterling Commerce** (SE), which does the software for the back office of companies like **Cisco** (CSCO), **Amazon.com** (AMZN) and **Procter & Gamble** (PG) for their e-commerce. So these are ways to play the growth of the Internet without

those outrageous valuations. **Sterling Commerce** is another stock down 50 or 60% from its highs despite being the leader in its industry.

TWST: Alan, is there anything else new in the products or services you provide clients?

Mr. Lancz: Our Sound Investing Program is for mutual fund investors that are looking for more of an educational approach in coordinating their portfolios in low-cost funds based on their specific goals, objectives, and risk tolerance. It's a way for the average investor to still have a professional overlook his or her portfolio even though the portfolio might not be suitable or large enough for a direct money manager. Also, investors may simply want a second opinion regarding their portfolios... making sure that the mutual funds they are selecting or their brokers are selecting are tax-efficient and adequate according to their risk and tax parameters. We found over the past two decades that everyone seems to understand performance, but total cost, risk and tax ramifications are generally misunderstood. Sound Investing focuses on understanding total risk, total cost and the tax implications, as we do on our money management side, in addition to the performance. This not only covers the cost that they are incurring in their mutual funds, but also within their 401(k) plans. And that's one area that we've seen a high area of interest in, and I think it will only grow as the market doesn't perform at the 30% levels that it has in the past three or four years.

1-Year Daily Chart of Bank One



Chart provided by www.BigCharts.com

TWST: What's your thinking on what's ahead for the market?

Mr. Lancz: We expect a downturn between now and year-end, because of the problems we mentioned earlier, but then there will be a great buying opportunity. We would definitely start to buy **Bank One**, **UNUMProvident**, **Mattel** and even **Monsanto** (MTC), which, considering the value of their Searle division, is trading very cheaply in the low \$30s, and it's a situation where I think you have to take advantage of the volatility. So if we get a sell-off between now and year-end we'll be buying and the more dramatic the sell-off, the more we'll utilize our cash.

I guess the best example I can give is **Boston Scientific**. This is the sixth time in the last three years the stock has gone down into the low \$20s or below from the \$35 to \$45 area. In other words, you could have bought it at around \$20 and sold it at around \$40 on five previous occasions in the last three years. We have been managing money for 20 years and from the very beginning we've always stressed a three- to five-year outlook and a long-term approach and we still do that with every account we set up. Sometimes, even taking taxes into consideration, it's good to take some profits like we're doing with **Adapttec** right now or even **Amgen**. If you bought **Boston Scientific**, whether it was six months or three years ago, at around \$20-22 and rode it to \$40 on four or five separate occasions but never sold — well, now it's back in the low \$20s — you've accomplished nothing.

"UNUMProvident is a leader in the disability and special risk insurance area, and when they reported a \$0.07 shortfall in earnings last quarter, the stock literally went down 40% in one day. To us it might take a year or more for it to turn around, but being a leader in an industry where we see 12 to 15% growth potential annually. We think those are the companies you want to buy when they are out of favor."

1-Year Daily Chart of UNUMProvident



Chart provided by www.BigCharts.com

One thing that this market has taught us with its added volatility is that sometimes you have to look at it on a shorter-term approach. There are still ways to maximize the tax efficiency. As an example, with **Adapttec** we bought some at \$8 for clients and we bought some at

\$18, because we were buying it as it was dropping, and we are now selling the \$18 stock and keeping the \$8 stock. So the tax hit is not so dramatic. Also, there are ways to balance out such gains that you take, even if they have to be shorter term. But we see doing more of that than we ever have and a lot of it is just because the market's volatility is forcing us to do it.

TWST: Finally, Alan, what are you hearing from your clients?

Mr. Lancz: It's interesting, the clients who have been with us a long time are very geared toward adding money when the market's down and they like seeing situations where the market goes down, because they know that volatility allows us to buy bargains. The newer clients a year ago were worried because the market was hitting new lows during the first week of October last year and basically they've seen a nice rebound since then. Hopefully they'll understand that if it goes down between now and year-end, as we expect, then that will be a buying opportunity just like it was last year near this time. Basically, we've never seen so much divergence among our clients, not only in having a wide variety of clientele, but we've also never seen so much divergence in the portfolios because of the volatility. As I said, clients who started a year ago had a lot of energy stocks, yet clients who are starting now won't own energy, at least at these levels, nor the high techs that we were buying a year ago. Because of that volatility and the extremes that we're seeing in these specific sectors, the portfolios have been more diverse and varied than they have been in prior times.

A CPA who has referred us business came in last week to add monies to his account and said his clients who were new with us were somewhat surprised that we were not more fully invested by now, but we have no pressure to put more in the market unless prices become more attractive.

TWST: Is there anything else you wanted to say from your end?

Mr. Lancz: Just last week we were quoted in "Barron's" on how a market sell-off due to Y2K and interest rate concerns would bring a great opportunity similar to late 1990. Back then, buyers were absent because they waited for results from the Persian Gulf war in January before buying. We feel the greater the sell-off sometime in the fourth quarter, the greater the surge in prices (due to pent-up demand similar to once the war actually started) into the new year. Also, we should mention that next month our Web site will have a "members only" section to complement our Lancz Fax subscribers that will have proprietary research, my real-time personal and our investment advisory portfolios as well as details on our venture capital activity. The address is www.ablonline.com.

TWST: Thank you.

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