

Seeking Broken Angles

Most research shows that it is very difficult to beat the market, but Meridian Value Fund has discovered one area that over time has done that. That is investing in temporarily broken growth companies because the market tends to discount those at an extreme level. Fund managers Rick Aster and James England try to capitalize on that opportunity using a value investing strategy with a focus on the long-term earnings growth potential of companies.

Q: What is your investment philosophy?

A: Research shows that it is very difficult to beat the market, but there is one area that over time has done that. That is investing in temporarily broken growth companies. The market tends to discount those at an extreme level and we try to capitalize on that emotion and opportunity.

We therefore look into any company, from any industry that has had fundamental difficulties in its business resulting in declining year-over-year earnings. If we believe the company has since fixed these problems and is likely to resume long-term earnings growth, and valuation is reasonable, we invest.

Q: How does this investment philosophy translate into an investment strategy?

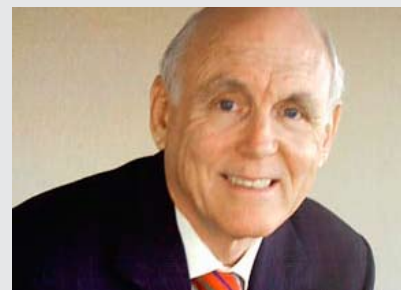
A: Our investment approach is very bottoms up. We follow two cardinal rules: understand the long-term growth potential of the companies and pay attention to valuation. Our primary valuation measure is analysis of normalized earnings. We try to look past currently depressed earnings and determine what we think the

company could earn in a few years when its problems are fixed. We believe that in the long term, earnings growth is the most important driver of stock performance.

Our ideal investment candidate would be a good company having problems that we believe are temporary. It is otherwise a leader, with a solid market share in a growing industry and where we see a clear path to returning earnings growth. The other criteria are a good balance sheet, stable or growing free cash flow, sustained returns on capital and a good management team.

We run screens to identify companies that are having declining earnings. We analyze these to find the best candidates and then we monitor these companies to determine whether or not we believe the problems are fixed and earnings growth will resume.

Overall, we believe the investment business is both an art and science but in the end it comes down to our estimate of intrinsic value. The science is in the financial statistics and the art is that people reach different conclusions when looking at the

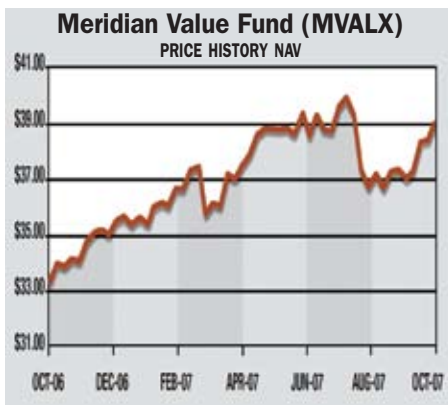


RICHARD F. ASTER, JR. started the Meridian Growth Fund in 1984, the Meridian Value Fund in 1994 and the Meridian Equity Income Fund in 2005. He holds an undergraduate and graduate degrees in economics from the University of California, Santa Barbara.

Aster worked for the U. S. Treasury Department and invested privately before joining Newburger, Loeb & Company in 1970. Two years later he joined Robertson, Colman, Siebel & Weisel (which became Montgomery Securities). In 1977 he left Montgomery to form Aster Investment Management.



JAMES H. ENGLAND, JR. joined Aster Investment Management in August, 2001. He is a CFA and has degrees from McGill University and the Ivey School of Business at the University of Western Ontario. England worked for three years at The Seidler Companies, a Los Angeles-based regional brokerage firm, and then he worked at Goldman, Sachs & Co. in New York, while pursuing his master's degree. He spent two years at Toronto Dominion Securities as an equity derivatives trader following business school.



same valuation parameters and business characteristics. Consequently, we would pay more for some companies than for others. For example certain companies may be growing rapidly but we might not pay a lot for them because we don't believe their growth rate is sustainable. It's not a hard science.

Q: How is your research process organized?

A: We have a research team of three analysts - James England, Jim O'Connor and Larry Cordisco. I meet with them daily and we pool our inputs. The day-to-day research on all the companies is carried out by the research team.

We always talk to management before we invest in a company. We also peruse their financial statements, attend investment conferences and

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listen to conference calls. We occasionally look at broker research but we heavily research the companies ourselves.

Q: How do you gain the expertise to evaluate different companies from different sectors?

A: The members of our research team are all generalists, but over time people have gravitated to certain areas of expertise. Moreover, most of these companies have problems that fit into a few specific patterns, and this carries across all industries. Problems typically arise from general economic conditions, industry-specific conditions or company-specific difficulties.

For instance, in the case of macro events such as a recession most companies will face tough times. Sometimes it is industry-specific as in the case of the paper industry where business conditions are tough in North America and Europe as people continue to cut paper use.

Company-specific problems can be due to any number of reasons. It can be the result of poor management, problems with an acquisition, distraction due to pursuing areas other than core business, a missed product cycle, or overly aggressive growth leading to lack of control.

In most cases one need not be an industry expert to figure out the problems and understand if the company can overcome them. When we need more in-depth industry information we can access broker research and talk to other companies in the industry. We also find that sometimes too much detailed industry knowledge can obscure the forest for the trees.

Q: Can you give some examples of companies or industries under your radar that you are still monitoring?

A: The entire housing and related industries are currently having significant problems that are going to persist for some time. We are monitoring many interesting companies in that area that display the long term characteristics we are looking for and at some point we will make investments in that area. We are not ready to go there yet.

Q: Can you give a couple of specific examples of your portfolio holdings?

A: One of our larger holdings is Beckman Coulter. It is a leading provider of clinical lab testing equipment and consumables. Earnings declined because it changed its sales model on some of its expensive systems from a sales to a lease model. Beckman was also updating its product line and associated spending on R&D and marketing had impacted earnings. Our research concluded that the earnings weakness was temporary.

Currently, earnings are growing as the company has anniversaried the change in its sales model and the new products have gained traction in the market. Revenue growth has also accelerated to high single digits from the previous low single digits. The company has several promising growth opportunities in both new product areas and international markets. The balance sheet is healthy and the company has a very good history of investment returns and strong management.

The current year earnings estimates are for \$3.20, and the stock is in the high \$60's. It doesn't appear to be particularly cheap on that basis, but we believe, with all the opportunities the company has, that in three to five years the normalized annual earnings could approach \$5, which does make it quite appealing. Moreover, since clinical lab testing is not linked to

the vagaries of economic cycles, the stock would be attractive even during tough macro economic situations.

Q: How do you build your portfolio? What is the benchmark against which you are measured?

A: We construct the portfolio from the bottom up. We do not make any fixed allocation to specific sectors. We are also not bound by companies' market caps as long as there is sufficient liquidity in the stock. We take each case on its merits.

Similarly, we do not manage the portfolio to be weighted like any index. We are, however, conscious of market weights and we do not significantly overweight or underweight any sectors unless we have good reason. We believe, in the long term, the S&P 500 is the benchmark against which we are measured.

The portfolio is well diversified. We own around 60 stocks in 25 main industry groups.

Q: What is your buy and sell discipline?


A: It is not easy to find companies that meet all of our criteria. We normally avoid companies we believe are in a secular decline. We do not invest in any company that, by our analysis, cannot grow earnings for at least two years. Reasonable valuation on normalized earnings is vital. The companies we invest in are not necessarily cheap on current earnings because the earnings are depressed. What is a key to us is that they fix their problems and they get back to a normal or a higher earnings level in three to five years. If we believe they can do that, and valuation is reasonable for that earnings level, then we will invest in the company and expect that the market will reward it at that time. We are not a

deep value strategy where we think if something looks very cheap on its assets, we will invest in it. Rather, we believe that earnings growth is the catalyst needed to unlock undervalued assets.

One reason we sell is that a company fixes its problems and achieves a few years of earnings growth and performs well. Even though we may still like the company, at this point it is no longer representative of our strategy so we sell and reinvest the proceeds in a company that is currently having problems.

Another reason to sell is that the original problem cannot be fixed and causes continued earnings decline. Our research may have led us to believe it was a temporary phenomenon but if it turns out to be otherwise, we will sell the stock. We will also sell if significant new problems crop up that we did not foresee.

Q: What kinds of risks do you monitor and what do you do to mitigate them?

A: We think our investment strategy is innately risk averse. Our focus is on companies and industries that are having difficulties. Usually the stocks have suffered so a lot of the risk has already been sucked out. That explains why we didn't buy the internet companies when they were all doing great and selling at very high valuations. We did not buy the housing stocks in the last several years when they were soaring. We are only now starting to look at that area, where many of the stocks have fallen 60% to 70%. Furthermore, we typically monitor companies for several quarters or even years before investing in an attempt to ensure that the problems have been fixed. In essence, the strategy that we use limits our risk, augmented by our research and diversification. 

Meridian Value Fund

| | |
|-----------|---|
| Symbol | MVALX |
| Website | www.meridianfund.com |
| Address | Aster Investment Mng Company INC, 60 East Sir Francis Drake Blvd Wood Island Suite 306 Larkspur, CA 94939-1714 |
| Tel. No. | 800-446-6662 |
| Inception | 02/10/1994 |

PORTFOLIO

| | |
|------------------------------|----------|
| Total Net Assets* | \$1,740 |
| Avg Mkt Cap (\$ Weighted)* | \$18,400 |
| Average Price/Earnings Ratio | 23.00x |
| Average Price/Book Ratio | 4.29x |
| Turnover Ratio | 58% |

INVESTMENT INFORMATION

| | |
|----------------------------|---------|
| New Investment | Open |
| Min Initial Investment | \$1,000 |
| Min Subsequent Investment | \$50 |
| Min Initial IRA Investment | N/A |

RISK (AGAINST S&P 500 - 3-YEARS)

| | |
|--------------------|-------|
| Alpha | -0.06 |
| Beta | 1.11 |
| R-Squared | 0.77 |
| Ann. Std Deviation | 9.38 |
| Sharpe Ratio | 1.01 |

RETURNS VS. S&P 500 INDEX

| | MVALX | Index |
|---------------|--------|--------|
| 1 Year (Cum.) | 16.80% | 16.44% |
| 3 Year (Ann.) | 13.86% | 13.14% |
| 5 Year (Ann.) | 17.33% | 15.45% |

RETURNS VS. RUSSELL MID CP TR INDEX

| | MVALX | Index |
|---------------|--------|--------|
| 1 Year (Cum.) | 16.80% | 17.87% |
| 3 Year (Ann.) | 13.86% | 17.34% |
| 5 Year (Ann.) | 17.33% | 20.90% |

FEES AND EXPENSES

| | |
|-----------------------------|-------|
| Max Sales Charge - Front | 0.00% |
| Max Sales Charge - Deferred | 0.00% |
| Max Redemption Fee** | 2.00% |
| Total Expense Ratio | 1.08% |

PORTFOLIO MANAGER

| | |
|-----------------------|------|
| Richard F. Aster, Jr. | 1994 |
| James H. England, Jr. | 2001 |

*millions **within two months of purchase

Data through: 09/30/2007

Source: Company Documents; Lipper

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