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JANUARY 22, 2007

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

THE FOLLOWING REPORT IS EXCERPTED FROM
THE WALL STREET TRANSCRIPT

MONEY MANAGER INTERVIEW

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Founded 1963
Published by Wall Street Transcript Corporation
67 Wall Street, New York, NY 10005

Investing in Dividend-Paying Stocks

R. BRENT BYRNE, DIVI-VEST ADVISORS, INC.

R. BRENT BYRNE, President and CEO of Divi-Vest Advisors, Inc., has managed all client portfolios since the firm was founded in May 1990. From 1983 to 1997, he provided professional financial consulting services to individuals and institutions through affiliations with Bryn Mawr Investment Group, Inc., an NASD licensed broker-dealer in Bryn Mawr, Pennsylvania (1988-1997), and Janney Montgomery Scott, a New York Stock Exchange member firm, in Philadelphia, Pennsylvania (1983-1988). Mr. Byrne has passed three NASD licensing exams (Series 7, 24 and 65). He earned a college degree in Business Administration from Kutztown University, Kutztown, Pennsylvania. On November 5, 1998, he finished first in The Wall Street Journal's Investment Dartboard contest. He has been a lecturer on stock investing at the Pennsylvania State University MBA Program, and numerous other financial seminars. Prior to actual client trading commencing January 1, 1991, Mr. Byrne completed extensive back-testing of Divi-Vest's investment strategy. His research and findings serve today as Divi-Vest's investment cornerstone. He has interests in the fine arts, and acts as Managing Partner for Colorfield Partners, a private general partnership he founded in 1999. Colorfield Partners owns and manages the estate of Leonard Nelson, a first generation New York School painter.

SECTOR – GENERAL INVESTING

(ZDM503) TWST: Would you please give us an overview of Divi-Vest Advisors and its investment philosophy?

Mr. Byrne: We actually started managing on January 1, 1991. We started with our blue-chip account, which has done very well. Over the course of 16 years, we've averaged approximately 13.6% net per year in that account, which equates to about a 200 basis-point outperformance of the S&P 500 through 12/31/2006. In 1996, we launched ALL-CAP Portfolio, our second portfolio, and in 11 years, we've averaged 17.2% net per year versus 14% for the S&P MidCap 400.

We've had success with our portfolios, largely due to how we first go about investing. We acknowledge what creates total return, and of course, everybody knows that total return equals growth plus income minus expenses. What we offer is a strategy that bridges growth and income. We probably do it as well as anybody out there.

TWST: Equity Value is a large cap value portfolio. Is the ALL-CAP Portfolio also value oriented?

Mr. Byrne: We are value oriented to the extent that we pay very close attention to dividend yield. That puts us in the value camp, but the difference between our two portfolios is that the ALL-CAP can go into small caps and mid-caps, whereas our blue-chip account is relegated to large caps.

TWST: What is the investment climate like for your type of investing?

Mr. Byrne: It's always good. Of course, no one knows what the outcome is going to be. This is what perplexes guys like me and investors who have money invested in stocks. You just can't control the outcome. What you can control is your philosophy for investing, as well as your strategy for investing. You leave the outcome open to the gods, and at some point, you know what that outcome is. Starting the year, that's the great mystery facing all managers — you just don't know what's to come.

I would venture to guess that a lot hinges upon what the Fed does in the coming year. Obviously, if we get a rate cut, that's going to be very good for the economy and stocks. Preferably the rate cut at the Fed level would come earlier in the year, and I think that this will be the telltale sign for how well equities do in 2007. But we don't really engage in looking into a crystal ball and coming out with a number or anything like that. That's a mystery at this point.

TWST: How many stocks do you have in your portfolio?

Mr. Byrne: Our blue-chip account has approximately 12 or 13 stocks. Our ALL-CAP Portfolio has approximately 30 stocks.

TWST: What are your thoughts on diversity and what are the advantages of a more concentrated or more focused portfolio?

Mr. Byrne: Return. You don't dilute your return and handicap your wealth-generating capacity — the more stocks you have, the more you look like the indices. So, from my vantage point, portfolio management is about building wealth and protecting principal, and it makes no sense for investors to diversify to the extent that they are invested in stocks that don't really have a good chance for future performance. I invest to the extent I feel certain about the likely outcome for investment return.

I don't subscribe to the idea of adding stocks to a portfolio for the sake of diversity. Diversity doesn't make you money. Diversity helps limit your downside hopefully, although in the bear market of 2000, diversification didn't help anybody protect principal. The S&P 500 lost approximately 40%, which is a very well diversified fund. So I'd be careful with diversity. Diversifying is a smart thing to do, but too much of it really ties up your potential for wealth generation. You want to be invested in stocks that match your strategy and philosophy. You don't want to go overboard and add stocks just for the sake of adding stocks.

TWST: Presumably your screens look for dividend-paying companies, but what are other characteristics of a potential holding?

Mr. Byrne: That's where we start. We start with the idea that it's all about growth and income. Growth and income is what you need to focus on with stocks, and that is capital gains or losses and dividends. Buy low, sell high, but also buy low, sell high, and add in a lush dividend. That's really the key behind Divi-Vest. So we start with a yield screen. We want to target stocks that pay at least

Highlights

R. Brent Byrne is a value-oriented investor to the extent that he pays very close attention to dividend yield. He manages two portfolios, one that is large cap stocks and the other is all-cap. He says that if you invest in high dividend-paying stocks, you will have somewhat of a protective zone around your portfolio when you enter tough times in the market. His stocks actually kept rising in a bear market. His strategy accounts for both growth and income styles as it is very important for long-term investors to focus in on all of the factors that decide total return.

Companies include: Traffix (TRFX); American Software (AMSWA); Briggs & Stratton (BGG); Westwood One (WON); D&E Communications (DECC); Waddell & Reed (WDR); ConAgra (CAG); Coca-Cola (KO); ATT&T (T).

50% to 100% over the average market. The idea is to concentrate on stocks that pay a high yield, and by doing that, you really exaggerate that component to total return.

"To the extent that you invest in high dividend-paying stocks, you are going to have somewhat of a protective zone around your portfolio when you go into tough times. The tax incentive is important; also, after you've done some homework on what happened in the bear market, you come to the conclusion that maybe you should have dividends in your portfolio."

Then you can bridge over to growth, because in many instances, a high yield paying stock is also a stock that is underpriced and ideal for investment. So you have an opportunity to buy low and sell high with these stocks, while collecting a high yield. By doing that, you really put yourself into a great situation to win, because you are targeting the main drivers of total return. Our screens from that point forward are all geared toward making sure that these companies that we invest in can continue to pay a high yield. We look at other fundamental screens such as debt to equity and payout, which give us a little bit more visibility on the prospects for high yield continuing.

Our secondary screen would be dividend growth. So if we can find stocks that pay high yields and grow their dividends, that brings our path into focus to a greater degree. So it's a combination of high yield and high dividend growth. If you go for growth, it is very difficult to get yield, and therein lies the problem with a lot of managers and strategies. There is always that push to find the next **Microsoft**, which is very difficult, but when you do that, you really close the door on the yield component to total return, and that's where you run into some problems.

We start with yield first, but we are able to bridge over to growth, and that's really the key to get both factors working in your favor. That's why Divi-Vest has been able to generate such handsome returns over time — the targeting of all the components that decide total return.

TWST: When you first started in this dividend business, it was mostly just the large caps, but now even small cap companies are dividend-paying. Have you noticed a burgeoning of dividend-paying companies and more interest because of the tax relief?

Mr. Byrne: Obviously, there is more incentive for companies to reward shareholders. That's the whole idea with stocks — reward the shareholder. It's what keeps shareholders coming back. Raising dividends is just one facet of rewarding shareholders, and certainly with the tax advantage, it encourages more interest in this whole dividend thing. Since I've been in business, there have always been great stocks paying high yield. So I haven't really noticed a surge in opportunities versus 20 years ago. There were always great companies to invest in that have those attributes that we are looking for.

1-Year Daily Chart of Traffix

Chart provided by www.BigCharts.com

I would say that there is more interest in the investment community nowadays, because many dividend-paying stocks held up well in the bear market. It's easy to make money in a bull market — the tough part of investing in stocks for the long term is navigating the bear markets. To the extent that you invest in high dividend-paying stocks, you are going to have somewhat of a protective zone around your portfolio when you go into tough times. The tax incentive is important; also, after you've done some homework on what happened in the bear market, you come to the conclusion that maybe you should have dividends in your portfolio.

Coming into the bear market of 2000, we knew that if we got into tough times in the stock market, our portfolios would hold up well. We didn't know that we would actually keep rising in the bear market. We knew we would hold up well, but actually furthering the ball through it was somewhat of a surprise, but a very welcome one for our investors.

1-Year Daily Chart of American Software

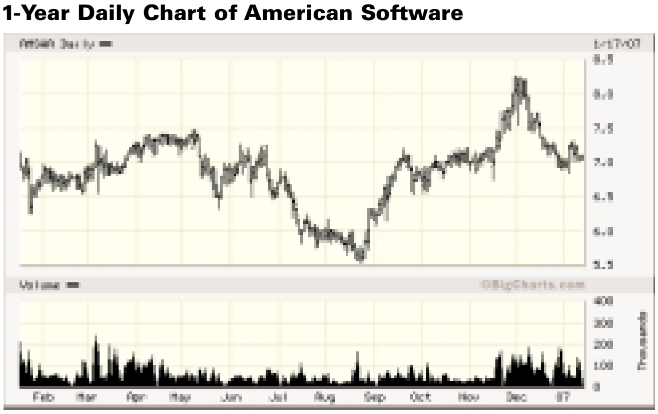

Chart provided by www.BigCharts.com

TWST: What are some of the names in your blue-chip value fund and your ALL-CAP fund that you feel are representative of your investment?

Mr. Byrne: In the ALL-CAP Portfolio, we invest in large cap, mid-cap and small cap companies. Larger companies that we are invested in currently include **Merck** (MRK) and **General Motors** (GM). Mid-cap companies are represented by **Lyondell Chemical** (LYO). An area that we like right now are the drug companies. We have a very wide cross-section of names and industries in our portfolios. We don't try to concentrate on sectors or companies based on any macro criteria. We are looking for specific yield criteria that allow us to be invested in those companies that are the most attractive in this regard. Smaller cap names that we like in the ALL-CAP Portfolio would include **American Software** (AMSWA) and **Traffix** (TRFX).

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TWST: Would you tell us about those two small cap companies? We don't hear much about dividend-paying small cap companies.

Mr. Byrne: What I like about **American Software** and **Traffix** is that they have little or no debt. But in the case of **American Software**, at the current quote, they pay approximately 4.5%, which is over twice what the S&P 500 pays. **Traffix** pays in the neighborhood of 5.9% at the current quote. So with both companies, you are being rewarded to hold and sit tight, while these two management teams hopefully boost earnings and profitably execute their growth strategies.

What I look for in smaller companies is a little less leveraged environment where you are not saddled with a lot of debt. When small companies run amuck or get into trouble with too much debt, it's not a good sign going forward. But if large companies get into trouble with a lot of debt, there are many things that they can do because of their size, their ties with Wall Street and their brand recognition. **Traffix** and **American Software** are asset-rich companies with low debt, good yields and exciting growth stories. We like these stocks.

Another stock that looks pretty attractive here is **Briggs & Stratton** (BGG). **Westwood One** (WON) is an interesting story to consider. They've cut their dividend, but that presents an intriguing opportunity as well.

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TWST: Do you invest in real estate investment trusts?

Mr. Byrne: I wish I did. We've made money over the years in a few of them, but that's more like a sector bet. When the stock market crashed, everybody went into hard assets. The real estate investment trusts were just too open to taking in all the momentum, and they've really just been gangbusters. But at this time, we are not really invested in those types of companies, regrettably.

TWST: What about the Canadian royalty income trusts? Have you ever looked at those?

Mr. Byrne: That's a different story. We generally don't buy foreign companies — we prefer to buy US companies that have overseas growth potential. One of the problems I see in investing in foreign companies is the currency and political risk attached to them. So we've always taken the tack that it's difficult enough to pick good US stocks; trying to pick good foreign stocks with the added challenges of currency and political overlay is something that is a little bit more outside our realm of comfort. We don't have problems finding good US stocks to buy. If we ever have a situation where we've run out of great opportunities at home, we'd probably be forced to look overseas, but that has never happened.

TWST: Traditional dividend-paying companies, of course, are in the utility and telecom sectors. Do you have any utilities in your portfolio?

Mr. Byrne: Not so much in the utility realm, but yes in telecom. We own **AT&T** (T) and a company called **D&E Communications** (DECC), which is a local telephone company here in Pennsylvania. So we have exposure to that area, and that was actually a pretty good area last year, so we are happy with our exposure there. But all in all, we like unregulated high dividend-paying stocks like **Coca-Cola** (KO), **ConAgra** (CAG) and **Waddell & Reed** (WDR). These stocks worked out very well for us in 2006.

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

Mr. Byrne: It's really the reverse of our buy process. We like to buy stocks when they are paying 50% to 100% over the average stock, and we like to sell companies when they've risen in price to those levels where their dividend yields are no longer above average. We have no interest in hanging on to stocks paying average yield; at that point, they become sell candidates. Of course, we like to take sales proceeds and reinvest back into stocks that pay high dividends. According to our process, it's important to always maintain a high dividend yield because we are very cognizant of the influence of reinvested dividends on portfolio return. It's better to have more than less when it comes to dividends.

"What I look for in smaller companies is a little less leveraged environment where you are not saddled with a lot of debt. When small companies run amuck or get into trouble with too much debt, it's not a good sign going forward. But if large companies get into trouble with a lot of debt, there are many things that they can do because of their size, their ties with Wall Street and their brand recognition. "

TWST: What is the average turnover?

Mr. Byrne: Approximately 30%. We are a buy and hold shop. We will hold on to stocks for two to three years. This is really a byproduct of our philosophy and strategy. We like to buy stocks that are low in price and are paying a high yield. We wait for them to rise to levels where they no longer pay those high dividends, and that can take some time. But while we are waiting for our stocks to appreciate in price, we are getting paid a high rent, which makes it attractive for us to hold and be patient.

TWST: Your yield base philosophy lessens risk, but in what other ways do you attempt to control risk in your portfolio?

Mr. Byrne: That's a good question, because our basis for having high yield stocks is that they are lower-risk items largely as a group. We don't engage in any kind of hedge strategy, option strategy, timing strategy or apply weightings to our portfolio holdings, because we do have a strategy that largely deals with risk even before we buy stocks. When you buy high yield stocks, invariably these stocks have already crashed or come down in price. A lot of the risk has already been exacted on their share prices. That's why they are paying a high yield to begin with. So the portfolios that we invest in are really portfolios of stocks that have already corrected and had their wringing out.

That's the advantage. Once we get invested, we don't have to engage in all of these different kinds of strategies to lessen risk. Our stocks already account for that element; that's the advantage. So it makes for a nice experience for our investors.

TWST: Who are your typical investors?

Mr. Byrne: We are pretty much diversified in that regard. We service institutional/public accounts that we've had for many years. Our largest group is high net worth investors, and we do have a weighting in the retirement corporate area with 401(k)s and those kinds of plans. So we have a wide-ranging client base.

TWST: What differentiates your investment approach from that at other firms? What are you bringing to the table that others might not?

Mr. Byrne: We hit upon it a little bit earlier, and that is that our strategy accounts for both growth and income, the two main drivers to total return. Most firms concentrate on growth only, and a good way to evaluate that is to look at the yields on their portfolios. If their yield is 1.5% or less, they are not focusing on yield. If you don't focus on yield, you really turn your back on half of the total return equation.

What makes Divi-Vest different is the fact that our strategy accounts for both growth and income, which is huge. We all know that in a bull market, growth can account for three-quarters of total return, and yield may be a quarter of total return. But in bear markets, yield might account for everything. So it's very important, especially if you have a long-term horizon for investing in stocks, to focus in on all of the factors that decide total return. When you focus in on just one, you leave holes in your strategy. Those holes turn into losses with different market cycles.

So Divi-Vest is very unique in this regard. There are few managers, at least among the managers that we're aware of, that are able to bridge growth and income as well as we do. That's a real advantage to investors who invest with us.

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TWST: Have you come across any misperceptions held by investors about dividend-focused funds?

Mr.Byrne: I think everybody understands the importance of yield, but actually integrating it into your strategy is more of a unique feature. The significance and importance of yield has been widely discussed but the problem is actually finding an investment medium that delivers it. You can call it a misperception, but I think it's really just a situation where yield is being usurped at the management level. In terms of evaluating and doing some analysis on funds out there, there are very few funds invested in US common stocks in particular that pay generous yields. The yield on these portfolios is largely average to less than average, and I think that's a mistake.

TWST: What advice would you give to investors about companies that are planning to cut dividends?

Mr. Byrne: If you bought a stock that is paying a higher-than-average yield and then the company cuts the dividend the next day, our message is not to cut and run — use the high yield as a barometer for value and price. If you bought a stock paying a high yield, chances are the stock has already come down in price substantially.

When the Board decides to cut the dividend, that could actually be a good sign, because if you're telling shareholders what they don't want to hear the most — that you are going to cut their yield — you had better follow up with some other measures as well, and a lot of companies do just that. They won't stop by just cutting the yield; they'll make the necessary changes managerial-wise to right the ship and bring that company back to where it needs to be. They might sell off divisions that have been losing money. They might engage in a round of layoffs to bring their expenses back down to earth. They could do many things, and usually the dividend cut is just the tip of the iceberg.

So, from our vantage point, you have to evaluate each stock on a stock-by-stock basis, but in a situation where you are invested and the dividend cut comes about, I don't think it's prudent to just automatically assume that it's over and you should sell the stock. There have been many instances, at least from our experience, where it's actually the time to buy these stocks — assuming you get that wide-roaming turnaround strategy that usually follows the dividend cut with other aspects of running the company.

TWST: Do you have any final thoughts that you want to bring out in this interview?

Mr. Byrne: In summation, I think investors are wise to take a long-term approach toward their investing. Investing to build wealth by taking a long-term view is very important. Also, if you choose to invest for the long term, you should assume that you are going to go through bull markets and bear markets. I think it's best for investors to find those kinds of investments that can perform in both markets. Otherwise, you are faced with the prospect of doing very well in a bull market and then, when the bear market comes, giving most of it back. I think that's a mistake.

Investors should take a long-term approach and also invest in companies vis-a-vis a strategy that bridges growth and income in bull and bear markets. If you can find that, you are going to have a happy experience in stocks. Too many investors coming into the bull market of 2000 weren't situated that way and lost a lot of money, and I think you can prevent that. There are ways to navigate both bull and bear markets. You just have to do a little homework and find those investments that can perform accordingly.

TWST: Thank you. (PS)

Note: Opinions and recommendations are as of 1/16/07.

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