

By Brady Willett & Todd Alway
Wish List 2005, October 6, 2005

The flagship Wish List report is released around December 26th of each year. Quarterly reports are structured in three distinct segments:

- 1) Review and outlook for the economy and stock markets.
- 2) Review and outlook for Wish List related companies.
- 3) Specific findings (i.e. new industries covered, new companies being monitored, and/or general market commentary).

Part I – Third Quarter Review and Outlook

Despite eye popping increases in oil, natural gas, gasoline, etc., the US equity markets traded marginally higher in the third quarter of 2005. This stability in stock prices can partially be explained by the fact that the Katrina/Rita storms conjured up visions of goldilocks – or the warped investor belief that since rising energy prices may compel the Fed to stop raising interest rates sooner rather than later this must be great news for stocks (See Business Week's Amey Stone's 'Death on the Gulf, Delight on the Street'. September 12, 2005). Another force that seemed to be pulling US stocks higher in the wake of twin Hurricane disasters was positive global liquidity trends. In the case of funds, Lipper's preliminary estimates show that the average return on world equity funds more than doubled the average return on the average US stock fund in 3Q05. In other words, US equity funds were higher on the quarter but significantly underperformed the average world equity fund.

Despite stable equity markets, the quarter ended with consumer confidence crashing, consumer spending stalling, and energy prices showing no sign of returning to pre-Katrina price levels. Moreover, the quarter ended with Saudi Arabia trying to talk down oil prices for the umpteenth time, President Bush releasing and trying to release more oil from the Strategic Reserves, and US Energy Secretary, Samuel Bodman, saying that since the next six months will be difficult consumers need to conserve energy by turning off lights and driving slower. Suffice to say, the retort to rising energy prices has not been so much a raised fist, but baseless rhetoric and ineffective actions (in the case of Bush releasing oil, this does nothing to combat the lack of refining capacity currently available in the US).

“The U.S. economy has been remarkably resilient in recent years, but consumers may start to postpone discretionary spending to build some cushion to pay their higher heating bills on top of paying more to fill up their gasoline tanks. In other words, I am not sure that the economy is resilient enough to withstand the one-two punches from the Katrina/Rita tag team.” Ed Yardeni, Oak Associates Ltd.

Mr. Yardeni is not alone in questioning the resiliency of the US consumer in the face of rising energy costs. And while the fear that an exceptionally cold winter could plunge the US economy into recession seems to be a recurring theme, that energy prices have risen well before the cold arrives is exceptionally worrisome. To be sure, unlike discretionary spending, in the case of natural gas millions of Americans have the choice of paying higher prices or freezing.

Along with rising energy prices, the consumer is sure to be challenged – eventually – by a slow-down in the increase in US home prices. This topic has been covered ad nauseam, and those that were early to point out the dangers (i.e. Roach in 2001) have been proven wrong in their timing. This reminds us of the late 1990s, or

when value investors were repeatedly wrong about the timing of the US stock bust. These value investors may have been wrong in their timing, but they nonetheless avoided huge losses from 2000-2003.

As Mario Gabelli pointed out during the quarter, “In 1999, \$11.1 trillion of consumers' holdings were in real estate, while direct equities accounted for \$12.3 trillion. Last year, those numbers were \$18.7 trillion and \$10.1 trillion, respectively.” A flattening of these asset prices is sure to have a negative impact on the US consumer; a consumer that recorded a negative savings rate in each of the last two months; a consumer that is not likely to receive any notable increase in wages despite the fact that energy spending will be up dramatically this year.

Finally, there is the issue of interest rates. The Fed continued to tighten in the third quarter and the yield curve continued to flatten (with some short term spreads actually inverting during the quarter). At risk of belaboring what are already well covered topics, the threat of foreign capital drying up and negatively impacting US interest rates is a constant, the threat of the yield curve inverting is a constant, and the threat of rising interest rates puncturing the US housing bubble is a constant. For these reasons, the interest rate outlook keeps us constantly concerned.

4Q05 Outlook

The immediate outlook for the US consumer is not good. Quite frankly, there does not appear to be any quick fix to rising energy prices, save a notable decline in demand. And although trying to predict exactly when the US consumer will lose their capacity to consume has proven utterly fruitless for many years, this should not stop the macro thinker from trying. To be sure, that the US consumer always seems to find a way to spend and defy the odds does not change the odds. The odds favor a slow-down in consumer spending because 1) energy prices are taking a greater piece of the pie, and 2) rising asset prices, which have supported the consumer's habits, may not rise as strongly going forward.

The outlook for corporate profits is mixed. Certain industries are expected to report explosive growth in 3Q05 (energy, financials), but, more so than in 1Q05 and 2Q05, there is some question about how positive/negative earnings guidance for 4Q05 and beyond will be. Earnings warning season has not yet begun, and the so called ‘Katrina warnings’ – from companies negatively impacted by Katrina – have not been extensive.

Greenspan spent the third quarter giving arcane speeches relating to housing prices and interest rates. He will spend his final quarter as Fed boss raising interest rates until something, anything, tells him to stop. The inflationary signals do not suggest that the Fed should stop raising interest rates anytime soon. However, a continued decline in consumer confidence and/or a shock to the financial markets and/or housing market is all that is required for the Fed to pause. Greenspan recently commented on the risk hungry attitude of today's investors:

“History cautions that extended periods of low concern about credit risk have invariably been followed by reversal, with an attendant fall in the prices of risky assets” **September 27, 2005. Alan Greenspan.**

Still Bearish After All These Years

Despite reducing its cash position by \$700 million in 2Q05, Buffett's Berkshire is still holding more than \$43 Billion in cash. The media erroneously concluded when Buffett made an investment in Anheuser-Busch earlier this year that he was turning more optimistic on the stock markets. Unless there is a dramatic change in Berkshire's numbers in 3Q05, this is not the case.

BERKSHIRE HATHAWAY	2Q05	1Q05	4Q04	3Q04	2Q04	1Q04	4Q03	3Q03	2Q03	1Q03	4Q02
Cash and equivalents	43,253	44,058	40,020	38,130	35,493	34,683	31,262	26,952	24,425	16,130	10,283
Fixed maturity securities	22,766	22,091	22,846	23,393	23,437	24,947	26,116	27,109	28,883	34,988	38,096
Equity securities	41,320	38,642	37,717	35,054	36,937	36,012	35,287	31,108	31,794	27,402	28,363
Other	2,144	2,260	2,346	2,542	2,370	3,004	2,924	3,001	3,100	3,766	3,752
% Investable Assets	2Q05	1Q05	4Q04	3Q04	2Q04	1Q04	4Q03	3Q03	2Q03	1Q03	4Q02
Cash	39.5%	41.2%	38.9%	38.5%	36.1%	35.2%	32.7%	30.6%	27.7%	19.6%	12.8%
Fixed securities	20.8%	20.6%	22.2%	23.6%	23.9%	25.3%	27.3%	30.7%	32.7%	42.5%	47.3%
Equity securities	37.7%	36.1%	36.6%	35.4%	37.6%	36.5%	36.9%	35.3%	36.0%	33.3%	35.2%
Other	2.0%	2.1%	2.3%	2.6%	2.4%	3.0%	3.1%	3.4%	3.5%	4.6%	4.7%
Does not include investments in MidAmerican Energy Holdings Company											

As for BUD, after the initial run-up following the Buffett announcement shares have declined and reached a new 52-week low to close out the quarter. The difference between Buffett and the average investor is that BUD's share price decline simply makes Buffett want to buy more stock. Such is why Buffett has been hoarding cash for many years: he is waiting to buy more companies at lower prices.

Wish List Performance	
1Q01	25.70%
2Q01	18.07%
3Q01	5.54%
4Q01	3.19%
2001*	52.50%
1Q02	10.01%
2Q02	-4.44%
3Q02	-4.81%
4Q02	9.20%
2002*	9.96%
1Q03	-3.19%
2Q03	14.84%
3Q03	3.82%
4Q03	8.63%
2003*	24.10%
1Q04	16.74%
2Q04	-3.84%
3Q04	-4.32%
4Q04	7.82%
2004*	19.45%
1Q05	-1.37%
2Q05	-1.01%
3Q05	2.37%

*Includes divs

Part II – Wish List Review

Since December 27, 2004 the four Wish List companies selected – on an evenly weighted basis - have declined by 0.004% when including dividend payments. Excluding dividends the four selections in the 2005 Wish List have returned an equally weighted average of -2.12% before taxes and commissions. During the same time (Dec 27, 04 – Sept 30, 05) the Dow Jones Industrial Average lost 1.92%, the S&P 500 gained 1.98%, and the Nasdaq lost 0.11%. Using the first three quarters of 2005 as the reference the Wish List underperformed the S&P 500 benchmark.

During the third quarter of 2005 we failed to select any new companies. Given that we believe stock market overvaluation is still the important theme, and that the US stock markets are fighting to maintain flat price levels, we remain confident that a cash heavy/equities light portfolio is best prepared to take advantage of future opportunities. As for the ‘hot’ areas of the marketplace today - i.e. energy and gold – we owned companies in both sectors as recently as 2003 (TCLP), and 2002 (MDG), but believe momentum rather than undervaluation is the name of the game in these areas today. This is not to say that gold/energy related stocks have completed their impressive run (we would speculate that they have not). Only that our investment approach is not geared towards trying to benefit from momentum driven trends in the marketplace.

Although we continue to believe that the investor would be well served to own gold/silver as a hedge against the U.S. dollar’s decline, a smart rally in gold in September 2005 has left us concerned about a near term pull back. Combating these concerns is the fact that gold traded higher in September even as the US dollar (index) rallied. Despite isolated instances of ‘decoupling’ in the past, September 2005 may be the first time that decoupling has been sustained. Longer-term we remain confident that the imbalances plaguing the American economy will lead to a weakening greenback and hence a rising price of gold.

Below is a brief recap of the 4 companies selected in the 2005 Wish List and our current outlook on each.

Caldwell Partners - CWL-NVA (Toronto)	
Bought - Dec 26, 01 - \$1.14	2005 Gain: 9.7%
Hold - Sept 30, 05 - \$1.86	Total Gain: 73.50%

Caldwell’s operating income slipped from \$388,000 in 3Q04 to \$255,000 in 3Q05. However, a pick-up in investment income helped the company record a 10% increase in year-over-year net income. Revenues were up by 4.5%. These numbers are not as strong as the year-over-year comparisons the company was registering a year ago, but the financials continue to tell the story of stability rather than decline. The company’s annual report for the year ended August 31, 2005 should be released in late October/early November.

Our outlook for Caldwell remains positive, and is grounded upon positive posting trends (off of the Caldwell website), along with the stable Canadian economy/jobs market. Moreover, we believe that Caldwell’s dividend should serve to support the company’s stock price. The caveat we would reiterate, however, is that the company’s outlook can materially change quickly.

Caldwell remains on the Wish List and we still carry corporate expectations over the longest of terms. Specifically, we expect Caldwell to remain an industry leader in Canadian executive placement. Our previously

stated selling target of \$2.00/share is still in place. We do not rule out the possibility of selling/removing Caldwell at current trading prices.

Hancock Fabrics - HKF

Bought - Dec 27, 04 - \$10.10
Hold - Sept 30, 05 - \$6.73

2005 Loss: -31.58

Hancock is a turnaround story that has not yet reached a thickening plot. High single digit same store sales declines continue to be registered as the crucial year end (i.e. make or break) season nears.

We believe that at current market prices Hancock shares are pricing in little more than corporate survival. However, to reiterate what has been said before: 'if the company does not benefit from seasonal forces in late 2005, corporate survival may indeed be the issue in 2006.'

Hancock remains on the Wish List. As patient as we are, we must continue to ask whether or not Hancock is likely to remain a viable business.

High Liner Foods - HLF.to (Toronto)

Bought - Dec 27, 04 - \$9.65
Hold - Sept 30, 2005 - \$9.80

2005 Gain: 3.10%

The company's US operations remains in a state of flux, not only because of unpredictable currency and club store issues, but also because the company has to deal with 'one time' launch costs associated with new products (i.e. Captain's Cut in August). That the Captain's Cut line (in the US not in Canada) is not expected to be profitable until 2006 is not the concern. Rather, the real concern is that by mid-late 2006 a new replacement to Captain's Cut may be required to instill growth.

Given that the majority of High Liner's business is predicated on creating and maintaining a collection of popular consumer brands, year-to-year performance will be choppy. We knew this going in. However, the challenges High Liner faces in the US stem from the fact that the company is trying to push products into the marketplace rather than pulling products alongside already well regarded and well distributed products. This strategy is full of risk, and ensures that it will be some time before High Liner's US operations even begin to resemble its Canadian side.

In short, we do not see any reason for explosive stock price appreciation. In fact, we are fully prepared for a share price decline should investors begin to value High Liner based solely upon the company's unattractive valuations. Nevertheless, the company represents a long-term investment opportunity because of its leadership position in an industry that is growing, and expected to continue to grow in the future.

Intrado Inc. - TRDO

Bought - Dec 27, 04 - \$11.62
Sold - Feb 4, 05 - \$13.60

2005 Gain: 17.04%

We removed TRDO on February 4, 2005 because we believed the turnaround expectations we noted on December 27, 2004 had become priced into the stock. Our intention is never to buy/sell a company as quickly as we did Intrado. Rather, our decision to remove Intrado was in reaction to the company's 'better than expected' 4Q04 financial performance and/or a dramatic stock price increase.

Our concerns relating to Intrade's balance sheet, SOx 404, and stock options have not had a negative impact on Intrade's stock price. Instead the company is signing up countless Enhanced 9-11 clients and trying to move into China. Unfortunately, after the most recent run in the company's stock price we no longer see TRDO as an undervalued equity opportunity.

All of our Wish List and Watch List companies can be found within the 'Companies' area off of the members' homepage.

You will be notified via e-mail of any future changes to the Wish List. If you did not receive email notification announcing the release of this report please contact members@fallstreet.com.

Part III – New Research and Selections

We have made our first new Wish List selection since December 27, 2004. We have also expanded our investment opinion on one Watch List company.

National Beverage Corp. - FIZ

Investment Position: Long-term Holding

History and Competition

National Beverage Corp. was founded in 1985 after the acquisition of Shasta (which has roots back to 1889) and has continued to expand its subsidiaries base every since (notably Faygo in 1987). The company develops, manufactures, markets and distributes a portfolio of beverage products throughout the United States using 14 manufacturing facilities located in major metropolitan markets (12 of which are owned). The company also has 'Allied Branded' sales – which are soft drinks made by FIZ for retail grocery chains, warehouse clubs, mass-merchandisers and wholesalers as well as soft drinks for other beverage companies – but has in recent years the company has slowly exited these 'lower margin' businesses.

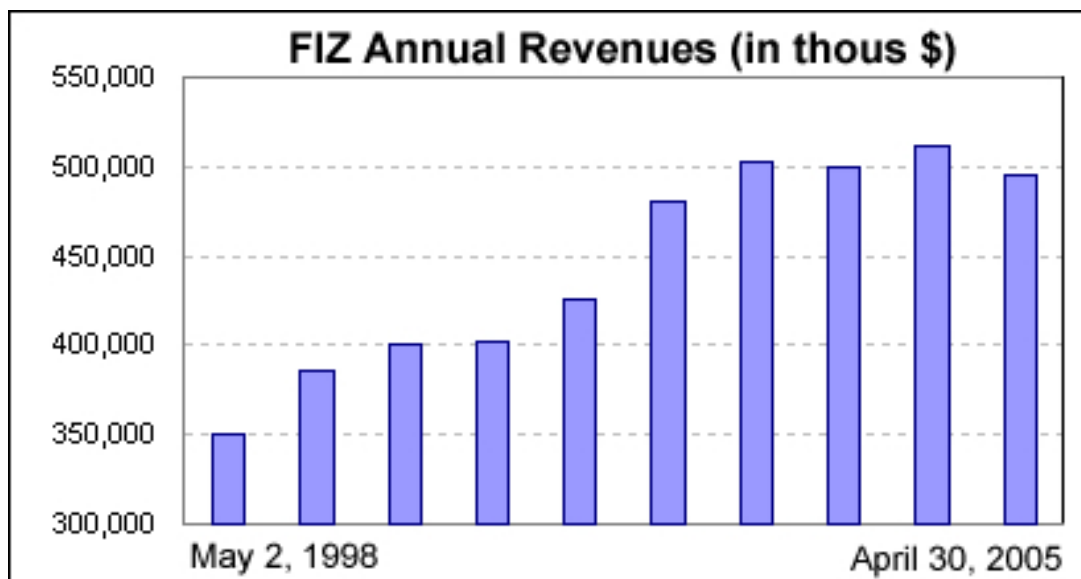
We are adding National Beverage Corp. to the Wish List because the company produces strong free cash flows, has an attractive balance sheet, and could declare another special dividend in the near term.

Financial Overview

FIZ is one of those rare companies that has an impeccable set of historical financial numbers. Also, the company does not waste many words – FIZ's 48-page 10K report significantly less engrossing than competitor Coca-Cola's 148-page 10K.

Some attractive financial highlights in recent years are 1) declining interest expense and debt, 2) consistent cash flows, and 3) steady net/gross margin trends. Quite frankly, these are some of the sturdiest financial numbers you will find anywhere.

FIZ (in thous \$)	30-Apr-05	1-May-04	3-May-03	27-Apr-02	28-Apr-01	29-Apr-00	1-May-99	2-May-98
Interest expense	106	132	316	857	2,110	2,789	3,304	4,175
Long-term debt	0	0	300	10,981	24,136	33,933	40,267	41,600
Cash From Ops	32,897	21,321	35,988	23,357	21,467	19,647	6,738	23,983
Property additions	13,003	8,696	8,936	7,162	6,049	8,559	6,772	7,312
Gross Margins (%)	31.35%	32.95%	32.97%	32.57%	32.61%	32.85%	33.14%	31.36%
Net Margins (%)	3.41%	3.65%	3.51%	3.29%	3.12%	3.19%	3.27%	3.27%
Diluted Outstanding	38,254	38,166	38,120	37,984	37,680	38,036	38,556	38,646



Some unattractive highlights in recent years include 1) choppy revenues. That is all.

Suffice to say, FIZ is a consistent free cash producer operating inside of an industry that is undergoing change (i.e. softening cola growth versus stronger growth in water/alternative drinks). There is little in the data alone to suggest that patchy sales trends are about to infiltrate the company's solid balance sheet. Rather, the argument could be made that after the company's first dividend ever in fiscal 2004 – a one time \$38 million (\$1/share) dividend - that the balance sheet is already ready to support a similar dividend payout today.

FIZ (in thous \$)	30-Apr-05	1-May-04	3-May-03	27-Apr-02	28-Apr-01	29-Apr-00	1-May-99	2-May-98
Working capital	81,962	64,967	79,785	70,164	62,444	54,907	57,504	50,398
Property—net	62,879	59,535	60,432	60,658	62,215	62,430	56,103	55,945
Total assets	224,587	205,378	218,195	205,685	203,868	197,754	180,404	182,327
Holder's equity	143,296	125,376	143,292	125,677	108,488	93,686	82,005	69,980
Working capital and shareholders' equity decline after massive dividend								

Business and Financial Outlook

Given unfavorable trends in soft drink industry, FIZ is unlikely to grow its revenues without new product launches, increased distribution, and/or further acquisitions. Moreover, the company is unlikely to maintain margins without further price increases and/or a continued decline in the allied branded side of the business. While concerning, it should be pointed out that softening revenues and margin pressures is an industry wide threat, and with FIZ focused on managing regional/niche brands the company is more nimble than many of its competitors at attacking negative pricing/product trends. You could say that FIZ swims in the opposite direction of the saying 'one size fits all'.

That being said, while FIZ has a degree of operating flexibility because its myriad of subsidiaries operate like independent companies, this flexibility comes at the cost of margins (i.e. selling 1 product nationally is less costly than selling 20 products regionally). While Coke, Pepsi, and Cadbury Schweppes produced gross margins of 65%, 57%, and 51% respectively in 2004, National Beverage Corp. had gross margins of 31%.

Pros

Company operates in what many believe is a recession resistant industry.

Company has financial means to declare dividend(s).

Current, and the company's only CEO, Nick Caporella, owns 77% of the company.

Cons

Current, and the company's only CEO, Nick Caporella, owns 77% of the company. An investment in FIZ is an investment in Mr. Caporalla (who manages FIZ through his management company at a rate of 1% revenues a year).

Rising raw material costs (fuel and resin) forced the company to raise prices in fiscal 2005 and this negatively impacted case volumes. Pricing pressures show no immediate sign of alleviating.

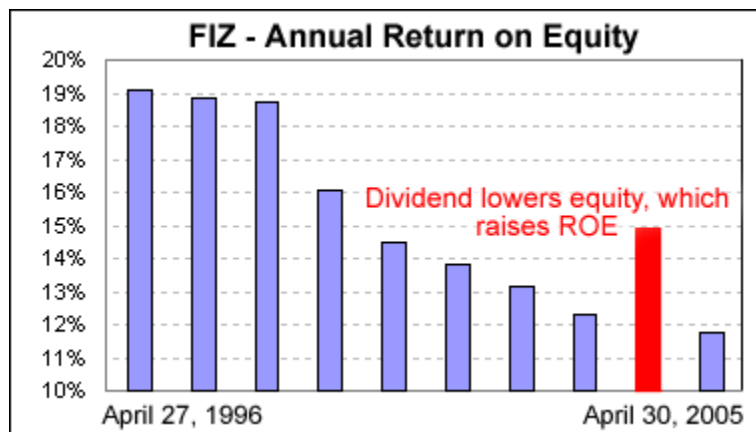
Company does not do a good job, as in not at all, of breaking down sales trends of its different subsidiaries.

Investment Opinion

At \$7.39 a share (yesterday's close), FIZ trades at 10.74 times trailing free cash flow, 16 times trailing (options expensed) earnings, 0.57 times sales, and 2.1 times tangible book value. These numbers alone warrant serious investment consideration.

Other numbers that convinced us to select FIZ for the Wish List are 72 and 38. \$72 million was the company's working capital position when it declared a \$38 million dividend. Today the company has \$82 million in working capital.

FIZ's ROE figures are in decline because the company can not find a way to efficiently utilize its increasing capital base. Unless a acquisition or major new launch is imminent, we anticipate a special dividend will be declared. Mr. Caporella has done a good job during difficult times and deserves a bonus.



Angelica Corporation - AGL

Investment Position: Potential Long-term Holding

Initial Investment Opinion

“...One major misstep could stop the acquisitions binge or the dividend increases. Any misstep may be an opportunity to buy a company that is well situated to benefit from demographic trends with a recurring revenue model in the coming years. The current share price leaves little room for error. Watch List target price of \$20.”
2Q05 Wish List

With \$20 being broken we have updated and expanded our opinion accordingly.

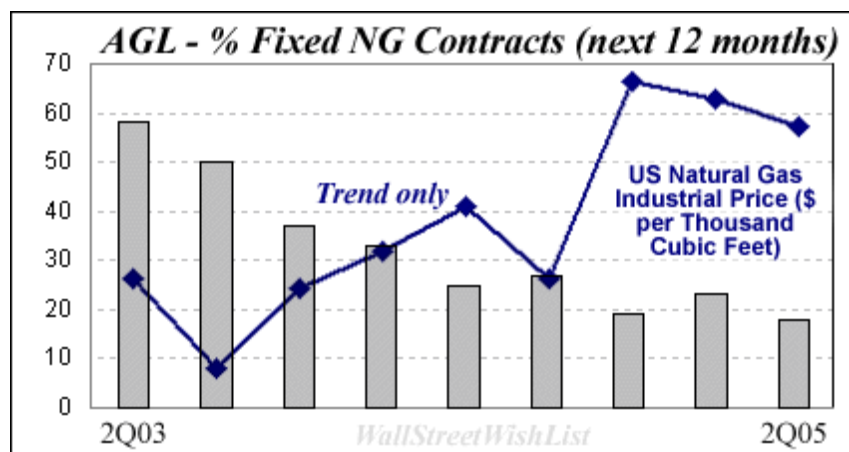
History and Competition

Although Angelica has roots that date back to 1878, after a mind-boggling series of divestitures and acquisitions the longer-term historical financial data has been rendered somewhat irrelevant. The company is now focused solely on providing linen services to healthcare facilities.

We are selecting Angelica for the Watch List with a ‘buy on sharp weakness’ moniker because we believe that the company will eventually emerge from restructuring as a profitable business operating inside of a stable/growing industry. We also believe that costs associated with strikes, rising energy prices, and other potentially transient negative issues have taken the company’s stock price down to depressed levels. However, we are unable to add the company to the Wish List at this time because we believe further pricing pressures are inevitable in the near term, and the company has yet to prove that its new focus on linen services will succeed longer-term. What concerns us most is the low barrier of entry into linen services industry, and the fact that the company is seemingly unable to take advantage of economies of scale.

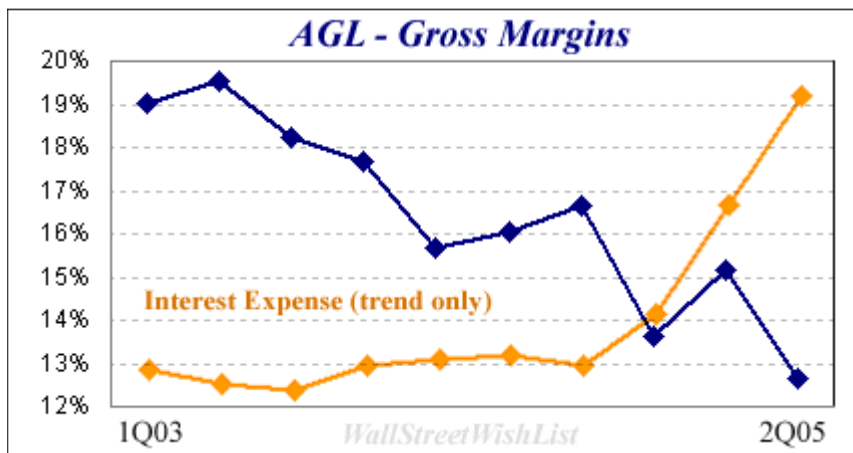
Financial Overview

Over the last 8-quarters the company has reduced its holdings of natural gas forwards. With natural gas surging following Katrina/Rita, and with US Minerals Management Service saying that 79% of natural gas production was offline leading into October, the decline in natural gas hedges could not have come at a worse time (NG expenses were at 4.9% of revenues in the latest quarter, 4.3% of revenues in 2004, and 3.8% of revenues in 2003).

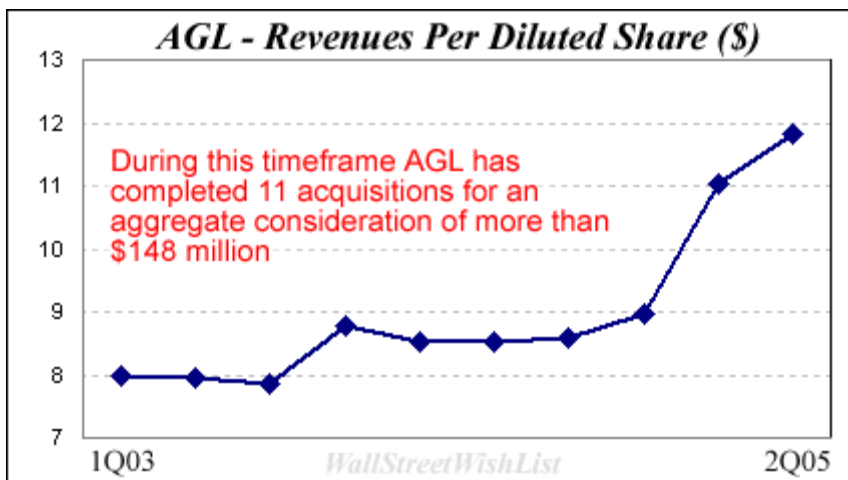


Before any company investigation can be done it is important to remember how reliant Angelica is on natural gas. At least in the near term, there is no quick fix for this. Longer-term the company is working on better ways to manage natural gas exposure, including more effective customer contracts and new hedging programs (the old program offered cost certainty but, as the above chart demonstrates, it was not maintained).

One of the long-term goals for the company – a goal that has been pushed back to 2008 – is to achieve 20% gross margins. The historical data suggests that this goal is attainable, but probably not before, and if, raging natural gas is taken out of the equation. As for some other corporate goals such as debt reduction and overall cost containment initiatives, the company has thus far produced mixed results. On the plus side SG&A expenses have been trending lower as a percentage of sales. On the negative side the company has offered no validation to its contention that it is serious about reducing debt (a recently announced goal). Suffice to say, when viewing the company’s income statement two ominous trends emerge: the top line is being negatively impacted by rising energy costs, while the company’s bottom line is being crimped by escalating interest expense.



On the plus side of the income statement revenues have dramatically increased, not only because of acquisitions, but also from growth in the core business.



When turning to the balance sheet the investor is comforted by the fact that even after its acquisitions binge (the latest major deal being a \$45 million takeover of ‘Royal’ on March 21, 2005), the company still has a strong working capital base of \$42 million. Moreover, there is the possibility that the company can unlock some hidden worth from property holdings via asset sales, as it has done in the past.

However, these reasons alone are not enough to conclude that AGL has a stellar balance sheet. Rather, acquisitions have brought about a rise in intangible assets and a dramatic increase in total debt. Moreover, working capital excitement quickly wears off when the company's current ratio is slipping in each of the last 7-quarters.

Given a stock price of \$18 a share, AGL's book value figures are attractive. However, a stricter net wealth per share test displays a book value closer to \$5 a share rather than \$16 (we embellished this ratio* somewhat by including all 'other' assets as intangibles). In our opinion, since the assets acquired by AGL are not yet yielding the expected return, the most realistic book value estimate is significantly south of \$16.79 a share.

AGL (in thous \$)	30-Jul-05	30-Apr-05	29-Jan-05	30-Oct-04	31-Jul-04	1-May-04	31-Jan-04
Current Assets	109,631	111,293	93,429	88,152	92,463	109,060	108,677
Goodwill & Other	108,152	112,522	93,859	48,310	48,118	44,657	44,852
Total Assets	326,514	329,351	288,953	228,749	232,420	246,199	235,781
Current Debt	67,312	68,026	55,718	47,705	49,641	54,428	52,950
Total Debt	174,232	176,642	137,597	80,487	85,385	100,156	89,121
Shareholders' Equity	152,282	152,709	151,356	148,262	147,035	146,043	146,660
Working Capital	42,319	43,267	37,711	40,447	42,822	54,632	55,727
Quick/Current Ratio	1.629	1.636	1.677	1.848	1.863	2.004	2.052
Equity Per Share (\$)	16.79	16.40	16.59	16.20	16.09	16.04	16.37
Tangible Equity PS*	4.86	4.32	6.30	10.92	10.82	11.14	11.37

Historically AGL has been a reliable free cash producer, with the only slip made in the last decade being in 1997. However, and to reiterate, longer-term historical financial data has been rendered somewhat irrelevant because of divestitures and acquisitions. Accordingly, a more recent look at cash flows is applicable.

AGL (in thous \$)	30-Jul-05	30-Apr-05	29-Jan-05	30-Oct-04	31-Jul-04
Cash From Operations	1,388	2,391	6,483	4,306	2,782
Expenditures	7,014	4,341	5,773	3,356	2,986
Basic Free Cash Flow	-5,626	-1,950	710	950	-204
Dividends Paid	1,012	1,009	992	989	986
Cost of businesses/assets acquired	476	49,491	54,882	49	512
	1-May-04	31-Jan-04	25-Oct-03	26-Jul-03	26-Apr-03
Cash From Operations	4,191	5,333	9,952	9,808	-1,278
Expenditures	3,199	6,072	3,964	8,209	4,607
Basic Free Cash Flow	992	-739	5,988	1,599	-5,885
Dividends Paid	983	976	882	881	880
Cost of businesses/assets acquired	6,988	14,300	-34	58	48

The bolded blue numbers above represent the quarters when AGL produced enough free cash to cover quarterly dividend payments. There are far too few bolded blue numbers to conclude that the company is operating from a position of strength today.

Obviously cash flows data, and all financial data for that matter, must be understood in the broader context of the business.

Business and Financial Outlook

The largest acquisitions are behind AGL, and the company must now act to ensure that these investments produce acceptable returns. The company is likely to reduce capital expenditures in the years ahead as its core businesses sustain themselves on the outsized expenditures made in 2003 (plant building) and 2005 (general

improvement expenditures). Accordingly, 2004 may prove to be more of the norm in the years ahead - when the company produced \$2.4 million in free cash before dividends.

As for the dividend payments, after being reduced in 2000, dividend increases beginning in 2002 have been unjustified. This is not to say that they will not be sustained, however, as the company seems inclined to return money to shareholders even if it requires borrowing money to do so. The dividend picture should improve in the next 15-months, provided that natural gas costs do not continue rising. On the plus side of this thought, rising natural gas costs could quicken the decline in demand and/or help spark a recession, which may then lead to a significant decline in energy prices. If this happens AGL stands to benefit from a recession.

Pros

Company operates in an industry that is, for the most part, recession proof.

Company recently resolved an 18-month labor dispute.

Company currently pays a quarterly dividend

There is some insider interest near current price levels, including continued interest from Steel Partners II LCC. (run by Warren G. Lichtenstein).

Company recently amended the terms of their credit facility that relaxed financial covenants.

Cons

The company has proven incapable of passing along rising energy costs to customers and does not expect to achieve 20% gross margins until “after the competitive marketplace fully reflects current energy costs in pricing proposals” **in 2008**. The industry norm is for 3-year contract periods, which is why 2008 was noted by the company.

The dividend may be cut if business conditions do not improve in the near-term.

The company currently does not expense stock options. Although hardly an options abuser, over the last two years the company’s earnings would have been lower by 12.5% and 5.8% if options had been expensed.

Investment Opinion

** A hypothetical 10 percent increase in the cost of natural gas not covered by these contracts would result in a reduction of approximately \$960,000 in annual pretax earnings. Oct 2004 ~ 10Q*

** A hypothetical 10 percent increase in the cost of natural gas not covered by these contracts would result in a reduction of approximately \$1,577,000 in annual pretax earnings. April 2005 ~ 10K*

** A hypothetical 10 percent increase in the cost of natural gas not covered by these contracts would result in a reduction of approximately \$1,686,000 in annual pretax earnings. Latest 10Q*

As the above quotes aptly demonstrate, Angelica is being held hostage to rising natural gas/energy prices. We believe that regardless of where natural gas prices are headed, the company will be able to take energy prices out of its play, but perhaps not before some further hedging/customer challenges are conquered. AGL does have contracts with escalating features, but they return only a small part of the company’s rising energy costs.

After dealing with energy issues, the company, with a 93% customer retention rate, could be on firm footing in a growing industry. Moreover, if capital expenditures can be curtailed for a few years, the company could ultimately end up trading at reasonable valuation levels (a 12-15 times multiple to free cash is not impossible by fiscal 2007). The stock has been beaten down to today's levels because the near term worries are covering longer term opportunities. Any further decline (i.e. investor capitulation) could open a longer-term opportunity. With the price of natural gas soaring and AGL's financials deteriorating rapidly, such a decline could arrive at any moment. How badly do insiders want to own more AGL stock?

Conclusions

On September 12, 2005 Business Week's Amey Stone quoted some talking heads and made some remarkable claims:

"The market's surge doesn't mean investors' relish disaster, just that they see cheaper oil and low rates not so far down the road."

http://www.businessweek.com/bwdaily/dnflash/sep2005/nf20050912_8437_db094.htm

Interesting. In Ms. Stone's mind Katrina would either cause enough disruption in the US economy to force the Fed to stop raising interest rates, or Katrina would cause oil to rise so high that it would have no place to go but down. Apparently Katrina was just what dreary investors wanted?

Of course, what Ms. Stone was touting in "Death on the Gulf, Delight on the Street" was the goldilocks scenario; a scenario wherein the Fed doesn't tighten interest rates one too many times; a scenario where the perfect inflationary balance is attained to the delight of investors.

We didn't buy into this scenario in 2000 and we don't again today. Rather, the asset reliant US consumer is close to taking a pause and US stock prices have completely lost the momentum generated in 2003/late 2004. What is required now is a notable event – either relating to interest rates, energy prices, hedge funds, the US dollar, etc. – to end the decline in volatility in 2005. Only when volatility returns will the resumption of the bear market arrive, and with it more attractively priced stocks.

Sincerely,

Brady Willett
Todd Alway