

By Brady Willett & Todd Alway  
Wish List 2005, October 3, 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 should be difficult consumers should turn off lights and drive slower (or conserve energy). 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).

“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 there is the fear that an exceptionally cold winter could plunge the US economy into recession almost every year, that energy prices have risen well before the cold arrives is exceptionally worrisome. To be sure, unlike say spending on bubble gum - which would probably decline if prices doubled as chewers decided - in the case of Natural Gas millions of Americans have the choice of paying higher prices or freezing. That natural gas is which rose by 88% in 3Q05 and some see going to \$20 - demand is at its seasonal low point. On.

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 definitely 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 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.” Simple math says that since 1999 consumer holdings in real estate and equities have risen by \$8.2 trillion (or \$2.1 trillion a year). A flattening of these asset prices are 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 by an average of 52% this year (EIA).

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 has not been covered greatly in recent months. The risk, however, still remains. Similarly, that the yield curve is flattening – a reliable indicator of recessions – was being talked about at great length in early 2005 has . These Of course, there is the goldilocks scenario; a scenario wherein

#### 4Q05 Outlook

The immediate outlook for 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. Consumers

Similarly, the outlook for corporate profits

Contrarily, the outlook for US corporate profits is Greenspan spent the quarter giving archaic speeches relating to housing prices, interest rates, . One quote from Greenspan is worth remembering leading into fourth quarter.

"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," Greenspan said.

#### Still Bearish After All These Years

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

<b>BERKSHIRE HATHAWAY</b>	<b>2Q05</b>	<b>1Q05</b>	<b>4Q04</b>	<b>3Q04</b>	<b>2Q04</b>	<b>1Q04</b>	<b>4Q03</b>	<b>3Q03</b>	<b>2Q03</b>	<b>1Q03</b>	<b>4Q02</b>
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
<b>% Investable Assets</b>	<b>2Q05</b>	<b>1Q05</b>	<b>4Q04</b>	<b>3Q04</b>	<b>2Q04</b>	<b>1Q04</b>	<b>4Q03</b>	<b>3Q03</b>	<b>2Q03</b>	<b>1Q03</b>	<b>4Q02</b>
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%

As for BUD, its stock price – after the initial run-up following the Buffett announcement – has declined and reached a new 52-week low to close out the quarter. The difference between Buffett and the average investor is that this decline gives Buffett . Rather, if BUD continues to decline Buffett will probably add to his position and grow.

There has been some isolated industry gyrations lower (airlines, home builders) , and fears over GM, Ford, or Fannie collapse have not vanished. Nevertheless, with only a handful of companies warning on earnings – including Coca-Cola Enterprises (CCE), Cott Corporation (COT), Avon (AVP), Hovnanian (HOV) – there is no reason In fact, probably the only scariest trend is newspapers reaching 52-week lows (TRB,

Housing: earnings miss from Hovnanian ([HOV](#)).

Raw material shortages forced Cooper Tire & Rubber Co.

Cooper has declared 134 dividends in a row. However, the company posted a second quarter loss (primarily because of a strike) and shut production because of Katrina

Nyt ~ tribune company (TRB)

n 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.”

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

Of course, what Ms. Stone was arguing 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. If this is what the final month of the third quarter of 2005 represents we will be surprised.

In short, the only 3Q05 review that is required

We are led to believe that US stock prices rallied following Katrina because the disastrous Hurricane

Although has not followed any predictable timetable, we nonetheless believe a day of reckoning for the US consumer/investor is near.

[http://www.businessweek.com/bwdaily/dnflash/sep2005/nf20050912\\_8437\\_db094.htm](http://www.businessweek.com/bwdaily/dnflash/sep2005/nf20050912_8437_db094.htm)

Wish List Performance	
1Q01	25.70%
2Q01	18.07%
3Q01	5.54%
4Q01	3.19%
<b>2001*</b>	<b>52.50%</b>
1Q02	10.01%
2Q02	-4.44%
3Q02	-4.81%
4Q02	9.20%
<b>2002*</b>	<b>9.96%</b>
1Q03	-3.19%
2Q03	14.84%
3Q03	3.82%
4Q03	8.63%
<b>2003*</b>	<b>24.10%</b>
1Q04	16.74%
2Q04	-3.84%
3Q04	-4.32%
4Q04	7.82%
<b>2004*</b>	<b>19.45%</b>
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, in our opinion, overvaluation is still widespread 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 unvaluation 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 geared towards . Quite frankly, we doubt if this strategy can be implemented with great success by the individual investors (even gifted managers like Soros and Robertson lost billions when they ignored the

onset of the 2000 bear).

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.

<b>Caldwell Partners - CWL-NVA (Toronto)</b>	
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 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.

<b>Hancock Fabrics - HKF</b>	
Bought - Dec 27, 04 - \$10.10	2005 Loss: -31.58
Hold - Sept 30, 05 - \$6.73	

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. Since we started publishing our investments in 2000 we have never removed/sold a company for a loss, but there is no guarantee that Hancock will not be the first. As patient as we are, we must continue to ask whether or not Hancock is likely to remain a viable business.

<b>High Liner Foods - HLF.to (Toronto)</b>	
Bought - Dec 27, 04 - \$9.65	2005 Gain: 3.10%
Hold - Sept 30, 2005 - \$9.80	

A challenging second quarter is expected to lead to further challenges in the remainder of 2005. 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 is.

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 undoubtably 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 waiting for products being pulled into the marketplace.

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.

### **Intrado Inc. - TRDO**

Bought - Dec 27, 04 - \$11.62

2005 Gain: [17.04%](#)

Sold - Feb 4, 05 - \$13.60

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 Intrado's balance sheet, SOx 404, and stocks options have not had a negative impact on Intrado'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](mailto:members@fallstreet.com).

## Part III – New Research and Selections

In the International Best selling book, Blue Ocean Strategy, the authors argue that there are ‘red ocean’ and ‘blue ocean’ industries. Red Ocean industries are those that are tapped, and and Blue Ocean industries are new industries that are created and offer . Continuing this train of thought, the others add:

“People no longer insist, as in the past, that their laundry detergent is Tide. Nor will they necessarily stick to Colgate when Crest is on sale, and vice versa.”

Generally speaking the authors are correct. To be sure, top selling brand names, be it in laundry detergent, toothpaste, or . However, what the authors neglected to mention in their haste to point out how aging industries are overrun with , is that there is always certain products that the consumer believes are non negotiable. To be sure, some consumers will purchase Gillette razors regardless of the price of a Shickt, some consumer will purchase Pampers without batting an eye at the price of Huggies, and still other consumers will purchase Captain High Liner without so much as looking at Ocean Jewel. Point being, while the discovery of new and/or emerging industries offers the potential for great returns, understanding old industries can offer predictable returns.

Keeping the idea of ‘predictable returns’ in mind, we have made our first new Wish List selection since December 27, 2004. We have also added one company to our Watch List. Combined these two companies have roots dating back more 220 years. Clearly these companies are centered in ‘red oceans’,

### **Angelica Corporation - AGL**

Investment Position: Long-term Holding

### **History and Competition**

Although Angelica has roots that date back to 1878, after a mind-boggling series of divestitures and acquisitions the historical financial data has been rendered somewhat irrelevant. The company is currently focused on providing linen services to healthcare facilities. There are few barriers of entry into the linen services are few, Angelica has an economies of scale advantage over current and future competitors.

We are selecting Angelica for the Wish List because we believe the company will emerge from restructuring as a profitable business operating inside of a stable/growing industry. We also believe that strike costs, rising energy prices, and other have depressed the company’ stock price.

### **Financial Overview**

Over the last 8-quarters the company has reduced the amount of natural gas . Given that This has turned out Thus, no financial overview is the key number in the immediate term is the price of natural gas. Should natural gas continue to rise this winter the company’s financial results will be negatively impacted. The company has sought to hedge against this uncertainty (currently 19% of 2006 has been purchased), but admits to being unable of taking natural gas issue out of play.

One of the long-term goals for the company – a goal that keeps getting pushed back further (now 2008) – is to achieve 20% gross margins. The historical data (remember how it is influenced by divestitures/takeover!) suggests that this goal is attainable, but probably not before some debt is taken out of the equation.

The issued of NG and debtloads aside, the company has

*Stable customer base*—Our large and diverse customer base, high customer retention rates and long-term contracts provide us with a stable revenue base. As of March 31, 2005, we served approximately 800 hospitals, 350 long-term care facilities and 3,300 surgical and physician clinics in 24 states. In fiscal 2004, no individual customer represented more than 10% of our total revenue. Our annual customer retention rate is approximately 93% of total revenues and our average contract length is approximately 3 years.

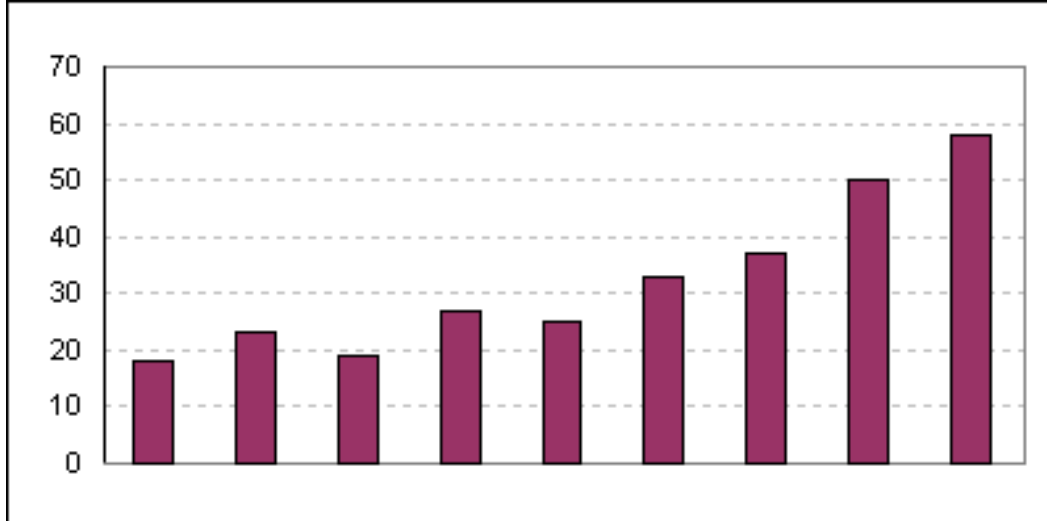
Since November 2003, we have completed ten acquisitions for an aggregate consideration of \$126.0 million that we believe have created numerous benefits to our market position and our customers.

The total cost of natural gas in the second quarter and first half ended July 30, 2005 was \$5,158,000 and \$10,278,000, respectively. To reduce the uncertainty of fluctuating energy prices, the Company has entered into fixed-price contracts as of July 30, 2005 for approximately 18 percent of its estimated natural gas purchase requirements in the next 12 months. 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

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 10K (2005)

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

The Company has provided certain indemnities to the buyer in connection with the sale of Life Uniform. Although indemnification claims are generally subject to an aggregate limit of \$6,000,000, the Company believes the likelihood of making any payments for indemnification claims is remote and has reserved accordingly.



**Collectors Universe Inc. (CLCT)**

Since issuing shares at \$20 a share on , CLCT shares have fallen by 34%. In other words,

Collectors Universe is a speculative Watch List addition. We believe that although the company is messily acquiring assets related to its business the end result could be a clean leadership position. This position

We are covering Collectors Universe today for the sake of interest moreso than immediate investment. We believe that after a major downcycle in the collectors CLCT could emerge as the clear force behind coin/stamp/auto . In our opinion CLCT could eventually become a company in the shape of Moody's (one of the top four US rating agencies). However, rather than resulting regulations, CLCT must continue to gain the trust and . Other competitors must vanish or be taken over before the

**Transcend Services Inc. (TRCR)**

**Allied Healthcare Products Inc. (AHPI)**

Investors do not think logically during a bear market. What appears to be a no brainer – JNJ offers a secure div - . To be sure, there are very few 'recession stocks'. A Tobacco company yielding 5% may do better than a non-yielding tech company when , but the To. Case in point,

We believe that the coming bear market/recession will be a realignment of historical valuation norms as aggregate capital n 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.

"There's a bubble and it's got to be broken," said Gabelli, whose investment companies hold stakes of about 13 percent in Gaylord Entertainment Co. and 12 percent in Thomas Nelson

First the good news: in an attempt to find new undervalued equity opportunities we researched insider trading trends in 4,703 different companies. Now for the bad: our hope of finding a new equity opportunity by first analyzing insider purchases was not fulfilled. Instead we are left with a mountain of data and company notes.

Regardless, some of our findings were as follows:

\* 29.3% of the 4,703 companies we looked at (which excluded many smaller BB stocks) had at least 1-insider purchase over the last 6-months.

\* But only 13.37% of the companies we looked had more insider purchases than sales over the last 6-months.

We plan on referring to our insider searches in future months. The file is available for download alongside this report, and may help you in your own research endeavors.

On the topic of Wish List additions we also have some mixed news. First the bad: we were unable to find any new equity additions during the quarter. Now for the good: we are making 5 new Watch list additions and remain resolute in the opinion that we are not, to put it rather bluntly, stock picking has been.

**Cooper Tire & Rubber Co. - CTB**  
Investment Position: Potential Turnaround Investment

### **Arctic Cat – Potential Long-term holding**

On May 12, 2005 Arctic Cat missed First Call Earnings estimates and shares plunged by more than 11%. On May 13 we began to investigate the company. Today we have a rounded opinion of the business.

### **History and Competition**

ACAT has been producing all-terrain vehicles (ATV) since 1995, and snowmobiles since 1985. The company also made an unsuccessful bid to sell power water crafts in 1993, but discontinued these money losing operations in 1999. The ATV market is extremely competitive, and ACAT differentiates itself from competitors primarily by product quality and reputation. The snowmobile side of the equation has fewer competitors, although lack of snowfall in recent years has stunted growth.

CHART COMPETITION.

(Cher Herr).

Financial Overview

Artic Cat has been able to outgrow the ATV industry trend in recent years, and in doing so has recorded an impressive historical record. The shareholder equity trend is a little misleading because of the company's history of buy backs. However, the SE per share trend leaves little doubt that ACAT is, historically, a strong performer.

With a clean balance sheet and nil interest debt payments, the company has the luxury of using cash from operations to fund dividends, capital investments, and, potentially, acquisitions.

## Business Outlook

Artic Cat is not as aggressive a company as competitor Polaris, which is currently vying to take on Harley Davidson with its 'Venture' unit. However, the cost structure of each business is similar, with both ACAT and PII placing a high percentage of earnings into capital investments. These investments are why each companies outlook is brighter

## Investment Opinion

With the exception of a potential influx of Chinese ATVs, no immediate obstacle appears insurmountable for Artic Cat. Rather, near term uncertainty in the stock has been derived from commodity pricing pressures, and from the uncertainty that comes from the company suggesting that it is looking at carving a new path (an acquisition, or geographical expansion have been suggested).

ACAT current trades at a respectable 2.19 times book, with a dividend yield of 1.4% (with a seemingly manageable 20% average payout ratio over the last 5-years). Our interest rests on the possibility of owning ACAT shares at a more attractive price.

At March 13, 2005 ACAT had 1.28 million stock options outstanding with a weighted average exercise price of \$18.56. Assuming the company stands true to its word to 'purchase Company common stock primarily to offset the dilution created by employee stock option' (10K), we believe that ACAT shares would be worthy of further consideration around this price level. A further deterioration margins and/or a slowdown in ATV sales may be what is needed to send ACAT shares to this level. Snowfall trends are the wildcard.

## Angelica Corporation (AGL)

Provides linen services for healthcare facilities. Aggressively adding leverage to acquire other companies, and currently pays an attractive dividend. 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. Share price leaves little room for error. Watch List target price of \$20.

## Mile Marker International (MMRK.OB)

On the surface there is a lot to like about Mile Market: the company produces a patented product (hydraulic winches) that continue to be well received in the marketplace, the stock yields 4% in dividends, and the two top

two insiders – Richard and Leslie Aho – control 40% of the float. However, below the surface obstacles loom: the company has been relying on US Army Humvee sales for a lot of growth, the dividend payout is close to eclipsing profits, and at 20 times earnings the company's stock price leaves little room for error. We are adding Mile Market to our Watch List with a \$3.00 target.

### **Overland Storage (OVRL)**

Originally covered in the 2Q02 Wish List, the storage industry has shown steady improvement during the current US capital spending recovery. Storage Tech was the company we focused on back then (2Q02 Report). Overland Storage is the company we are monitoring today.

Based upon ROE Overland (a mid-range data storage competitor), was in the mid-range of the group two years ago, and remains in the mid-range of the group today. However, we are more attracted to Overland today than in previous years because it has entered the disk market with a well received product (Neo), and is planning on raising capital spending in the coming 12-months to further build its product offering base. With Overland encountering operational slow down and threats of a price competition mentioned during the company's latest conference call, we believe the investor can be patient when sizing up OVLR (larger disk players such as Seagate recently lowered prices and others have followed).

Although Overland does not pay a dividend, the company's balance sheet and cash flow statements make for exciting reading: 20% average return on equity over the last 5-years (lowest year 12%), cash handily covers total debt, an free cash has been generated, without exception, since 1997. Currently priced at \$9.43 a share, any further dip in stock price could see OVRL shares trading at an attractive 10-times free cash.

So what is the problem with OVRL? As positive as the storage spending trends might seem (see IDC), Overland is current experience pricing pressures. That an increase in capital spending is arriving as these pressures begin to take hold could be bad news for the balance sheet.

Other companies researched but not being covered at this time.

**Educational Development Corp (EDUC)**, distributor of Usborne Children books in America, could easily raise its annual dividend. But we will not find out if they will until 2006..

Although not as explosive a company as competitor Scholastic (of Harry Potter fame), EDUC has managed to almost double revenues since 2000. What we like about the company is that it generates sales in a non capital intensive manner (i.e. home shows and book fairs). The business model works profitably so long as Usborne books remain popular. Shares could be worth owning depending upon the dividend outlook later this year.

**Government Properties Trust Inc (GPP)** is a REIT that has been on, and is still on, an acquisitions binge. When the music stops the company should have an impressive portfolio of properties leased under long-term leases to the U.S. government. Owning shares for the distribution is dangers now because, eventually, the acquisition funds will run dry and operations may not support the current payout. GPP is a REIT to keep in mind.

### **Conclusions**

With expansion in the 1960s and the sale of their manufacturing business in 2002, Angelica has outgrown its uniform business that began in 1878. Today the company is focused on providing linen services for healthcare facilities. AGL has been aggressively adding leverage to acquire other companies, and currently pays an attractive dividend. 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.

The Fed has tightened short term interest rates over the last year, but long term rates (and mortgage rates) have still fallen. Accordingly, some have suggested that the Fed lacks the tools necessary to slow a budding bubble down. The very suggestion that the Fed is helpless when it comes to directing asset prices is nonsensical. To be sure, if the Fed really wanted to slow the housing market they could take page from China and start increasing bank reserves, or repeatedly state to speculators and bankers that slowing the housing market is a policy goal, or even use aggressive open market operations to combat the interest rate ‘conundrum’ Greenspan has so famously labeled. However, the Fed – which would start cutting the historically low Federal Funds rate at any sign of economic trouble tomorrow - has a policy of ignoring asset bubbles until they pop. Some would argue these policies encourage asset bubbles. This thought is hardly new to Austrian followers.

It is the investment ideology that ‘things are different this time’ that, in large part, sustains asset price bubbles. More specifically, it was the belief that a ‘new economy’ had arisen that sent stock prices to unsustainable levels in the late 1990s, and it is the belief of US home owners that prices will never fall that is positively influencing home prices today.

The historical record suggests that economic and stock market activity tends to oscillate from periods of boom to periods of bust...we believe the bust is near.

That is our story and we are sticking to it.

Sincerely,

Brady Willett  
Todd Alway

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