APM Quarterly

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Special "Thank You" to Josh Selzer and Professors Allen Ford and Paul Koch from the Spring '04 APM Class

by Joan Huber

We very much missed **Cathy Shenoy** our "regular" APM instructor, and her knowledge and guidance about the portfolio while she was away in Denmark during the Spring Semester. However, due to the generosity of time and knowledge by **Josh Selzer**, an alumnus, and **Allen Ford**, and **Paul Koch**, past instructors of the course, the class had the unique benefits of a historical perspective of APM , and the likes of guest lecturers at every class meeting because of their presence in the classroom.

Josh brought a unique perspective (and stories!) to the class from his involvement in the class in the mid- '90's, as well as experience from his current and past jobs in the financial services industry. Because of these experiences, he also was able to bring new contacts in to speak to the class, including **Thomas Hoenig**, President of Kansas City Fed, **Bill Zollars**, CEO of Yellow Freight, and **Shane Parr**, a financial analyst with a private equity firm within George K. Baum in Kansas City.

Allen also brought past experience from teaching the class in the late '90's. He contributed a more rigorous view and dialog about accounting issues with the companies studied, as well as a special session on tax considerations involved in investing. In addition, the APM team that went to the RISE Symposium and Competition in Dayton, OH was grateful for his accompanying them, as well as the time and guidance he provided in the development of the presentation and during the "at home" practices of the presentation given before industry professionals at the Symposium.

Paul taught the class in the late '90's as well, and brought that experience and his knowledge of finance to the class' discussions. Paul also contributed his special expertise on options, and engaged the class in active discussions on whether options would be appropriate relative to existing stocks in the APM portfolio.

In all, it was a successful experience for the students (as noted in their group profiles later in the newsletter) and everyone appreciated these leaders for their team effort!

The Applied Portfolio Management Class is #1 at the RISE Symposium

Six students from the current and past Applied Portfolio Management classes attended the Fourth Annual Global Student Investment Strategy Symposium at the University of Dayton on April 1-3, 2004. The symposium, known as RISE (Redefining Investment Strategy Education), consisted of a two-and-a-half day educational experience that included keynote sessions, panel discussions, workshops, student portfolio presentations, poster sessions, and also a competition among student groups who manage real-money investment portfolios.

Over 900 participants from more than 100 colleges and universities participated in the symposium. Among the many notable keynote session presenters were John Bogle (Vanguard), Don Phillips (Morningstar), Robert Hormats (Goldman Sachs), and Samuel Zell (Equity Group Investments).

Prior to a February deadline, collegiate investment groups that wanted to engage in the competition submitted their results for the year 2003 and were assigned to one of five different investment style categories: Fixed Income; Equities - Growth; Equities - Blend; Equities - Value, and Hybrid (use derivatives, short sales).

The University of Kansas was rated #1 in the Hybrid category for the undergraduate division with a return of 122% in 2003. The University of Brunswick was rated #1 in the Hybrid graduate division with the next highest return overall of less than 40%.

Twelve teams were allowed to give a 20-minute presentation to a panel of three professional money managers about their portfolio's strategy, style, 2003 performance, and expectations for the future. KU's APM team was one of the twelve teams to make an oral presentation.

The KU team that represented the APM class consists of: **David Brown**, **Joan Huber**, **David Iliff**, **Jeremy Richardson**, **Jacquelyn Summers**, and **Ivo Voynov**.

Professor Allen Ford attended the symposium with the team. **Cathy Shenoy**, who was in Denmark during the Spring Semester, is the instructor for the APM class, which meets during the fall and spring semesters.

See RISE Results on page 2

Inside This Issue

2004 R.I.S.E. Competition Results

	Undergraduate	Graduate
Fixed Income	Stetson University	
Equity – Growth	University of Northern Colorado	Purdue University
Equity – Blend	Moravian College	Rice University
Equity – Value	Concordia University	
Hybrid	University of Kansas	University of New Brunswick

Self-Giving

by Group 4

A special thanks goes out to KU Men's Basketball Coach **Bill Self** for his generous $500 contribution to the APM class. Self completed his first season at KU with a 24-9 record, 3 victories against arch-rival Missouri, a second place finish in the Big 12, and an Elite Eight appearance.

Challenges lie ahead for the KU program. Self will spend the off-season searching for a new assistant coach since current assistant Norm Roberts has been hired to coach the St. John's team. Freshman center David Padgett and freshman guard Omar Wilkes will be transferring from KU. The team loses some front court muscle in senior Jeff Graves.

Despite the departures, Self has a top ten recruiting class coming in for the 2004-05 season. The class is led by New York prep star Russell Robinson, a 6-2 shooting guard. Centers Alexander Kaun, of Siberia, C.I. Giles, of Seattle, and forwards Darnell Jackson, of Oklahoma City, and Alex Galindo, of Newark, NJ, round out the class. With juniors Wayne Simien, Aaron Miles, and Keith Langford returning, the 2004-05 season should be another memorable one for KU basketball fans.

KU Men's Basketball Coach Bill Self

AsiaHedge Awards

Jayhawk China Best Single Country Fund

Kent McCarthy's Jayhawk China fund was awarded the best Single Country Fund at the 2003 AsiaHedge Awards Dinner.

Nominees for each of the main categories were selected by looking at those with the best Sharpe Ratios over the previous twelve months. The winner among these nominees was then picked based on the fund with the best return.

AsiaHedge Newsletter November 2003 reported, "Kent McCarthy's Kansas City-managed Jayhawk, despite a soft September when the fund was actually down slightly, held off its rivals to come through to win the award, not only with a solid Sharpe, but also a highly commendable relative performance."

Congratulations to Kent and his staff for this great honor!

Chairman of the Kansas City Federal Reserve visits APM

by Group 5

On March 31, 2004 Chairman of the Kansas City Reserve, **Mr. Thomas M. Hoenig** visited the APM class and gave a brief synopsis of how the Federal Reserve works; more specifically monetary policy making. He also gave a synopsis of his role on the Federal Reserve board. Mr. Hoenig addressed some of the current issues facing the American economy such as interest rates, long term cost of capital, and many more. Even though we did not extract any information regarding how high interest rates would increase or when they would increase, the whole class found his visit to be very informative and enjoyable.

Yellow Roadway Corporation CEO visits APM

by Group 6

Bill Zollars was named to his current position as CEO in November 1999. Prior to that, Zollars was President of Yellow Transportation, Inc., a position he accepted in September 1996, as part of a major management transition for the company. From 1994 to 1996, Zollars was Senior Vice President of Ryder Integrated Logistics, a $1.5 billion division of Ryder System, Inc., based in Miami, Florida. Previously, Zollars spent 24 years in various executive positions at Eastman Kodak, including assignments in London, Toronto and Tokyo.

Zollars holds a Bachelor of Arts degree in Economics from the University of Minnesota and is a member of Phi Beta Kappa.

The first time the headhunter called about the top job at Yellow Freight System, Bill Zollars said that he wasn't interested. He was perfectly happy as a senior vice president at another big transportation company, Ryder, where he had helped build the integrated-logistics unit into a $1.5 billion business. But the recruiter kept urging Zollars to reconsider his chance of building a new company out of one that's been around for more than 70 years.

It was an opportunity that Zollars couldn't resist. He signed on with Yellow to help a troubled company start over. And today, nearly eight years later, Yellow is quite a different company. It still transports primarily big, heavy freight – minimum 100 pounds – called "less-than-truckload" (since a single shipment doesn't fill an entire trailer, workers load multiple orders on the same vehicle). But how and when those parts and products reach their destination is another story. The one-dimensional long-haul approach and the complacency ingrained from years of regulation are gone. In an attempt to offer what Zollars calls "one-stop shopping," Yellow has added a variety of services, including regional and expedited shipping, to satisfy a broader range of transportation needs.

A key problem that the new CEO faced immediately was that the old Yellow gave customers a rough estimate of when a shipment would arrive. The new Yellow is faster, more precise, and more profitable. It has gone from being a company that thought it was in the trucking business to being one that realizes it's in the service business.

In order to address the issue Zollars knew he needed the support of every employee in the company. Therefore in early 1997, after a few months on the job, Zollars hit the road. For the next year and a half, he regularly visited terminals around the country, where he conducted a series of town hall meetings.

Again and again, he reminded employees of the company's new focus: customers. He knew that this represented a different way of thinking about the business. When customers contacted the old Yellow, its representatives didn't ask them when they wanted their freight. Instead, the reps told customers when Yellow could deliver it. The schedule was convenient for Yellow, but not necessarily for its customers. The attitude was, "We're as good as anyone else in the industry".

At the town hall meetings, Zollars would ask employees to guess the defect rate: how often shipments were picked up or delivered late, billed wrong, or damaged. Usually, they'd say it was 10% or 20%. Try 40%, he'd tell them. "I'd never seen a defect rate in any industry that bad," he says.

If Yellow was going to satisfy its more than 300,000 customers as never before, it needed to hear from them. Since then, the company has been surveying 600 different customers a month. Those 15-minute conversations are vital and help the company better understand its clients' needs.

Zollars is currently using his experience in revamping troubled companies to successfully integrate Roadway, which was acquired by Yellow in December last year. Some of the problems with Roadway, such as high defect rate, customer dissatisfaction and unwillingness to change, are familiar to Zollars and he believes that he will be able to tackle them. Overall, he praised the merger as a combination of two great companies, which will be in a better position to take advantage of a booming economy.

In conclusion Bill Zollars' visit to class was a great experience for the APM class. His affable personality and passion made a lasting impression on everybody. For most of us getting a chance to chat with the CEO of a major U.S. company is an incredible opportunity to better understand how businesses really works.

by Group 3

On Wednesday, April 7, **Bill Zollars** of Yellow Roadway Corporation attended Applied Portfolio Management's class to share his views about Yellow, and to answer any questions the students had. As Chairman, President, and CEO of Yellow Roadway Corporation Zollars leads one of the largest and most recognizable global transportation service providers.

Zollars provided very insightful information to the questions that students posed. One area of concern voiced by students was the rising fuel prices present in our economy today. Zollars outlined some of the different ways to deal with these price increases. Hedging can be used to mitigate the risk of price increases, along with holding fuel surpluses, and passing the associated higher costs to the customer. However, passing costs on to the customer can result in decreased revenues because of decreased customer orders.

Another point that Zollars discussed during the class was regulatory risk issues that face Yellow. He highlighted some of the different risks inherent to the domestic trucking industry as a whole. First is the possibility of continued border deregulation, which would open the gates to cheaper Mexican trucking companies and force price-cuts. Additionally, there is the risk of increased security measures governing transportation in the United States, which could increase costs and decrease delivery time and efficiency.

Call to Alumni

Send in your news, personal or professional. We would love to hear from you.
To keep in touch, email *apm@ku.edu*.

Todd Preheim, KU graduate, returns to APM as a guest lecturer

by Group 6

In an effort to get a diverse sampling of investment strategies, **Todd Preheim**, a KU graduate, spoke to the APM class on April 28. Preheim's strategy consists of establishing long and short positions in comparable companies, while at the same time making short-term trades to capitalize on a company's price movements resulting from certain company or industry specific events. This "events-based" trading method emphasizes price movements around a company's earnings report, industry conferences, and other significant events that would drastically affect a company's price. Preheim also discussed his use of "before and after market" trading to take advantage of market inefficiencies.

During Preheim's visit to the APM class, he used Garmin's earning release earlier in the day as an example of an event that, if interpreted correctly, could be capitalized upon. Garmin's stock price dropped nearly 20% from the close on Tuesday, April 27 to the close on Wednesday April 28 because of diminishing margins, a result of intensifying competition in the GPS market.

Preheim emphasized the importance of accurate and timely information in order to profit from a sudden price move such as Garmin's. Preheim credits his contacts for supplying him with much of such needed information. Preheim was successful in building strong contacts, starting with his graduation from KU in 1995 with a degree in math. While at KU, Preheim took APM in the fall of 1995. Following his graduation, Preheim became a junior analyst at RBC Capital, covering software stocks for two and a half years before becoming a financial analyst at Sprint PCS. He then continued his education at the University of Texas Graduate School of Business. Between his first and second years of business school, he worked at Goldman Sachs in New York. After completing his MBA, he briefly traded electricity at Duke Energy before starting his own money management company in October 2001.

All along the way, Preheim was able to meet professionals and students who remain instrumental to this day by providing him with investment ideas and quality research. Preheim credits hard work and experience, but acknowledges that "I get a lot of my ideas and Wall Street research from other investment professionals that I met at Texas and in the business world. These relationships are truly invaluable in supporting my investment style."

Although the APM class does not typically try to capitalize on short-term trades, Preheim's discussion of his investment style, as well as the importance of an investment network, gave a valuable insight into another way to manage money.

Beru AG

by Dragan Trajkov (Group 3)

Beru AG (BZKG.DE) is a German automotive part manufacturer. It was established in 1912 and went public in October 1997 on the German stock market. The company is driven by its research and development capabilities. It has established itself as a market leader in glow plugs and instant starting systems for diesel engines, and the diesel segment is the main portion of the business.

Due to the high gas prices and diesel engine efficiency, the company believes that 50% of the European and 24% worldwide cars will use diesel engine by 2008. United States remains a large untouched market for diesel with good potential for future growth. Some noticeable customers around the world include GM, Ford, Isuzu, Hyundai, Mercedes-Benz and VW Golf. The company also has a large market share in ignition technology (spark plugs), sensors and electronics (tire pressure monitoring systems - TPMS). The TPMS was internally developed and has a big future potential in the car safety area.

With high solvency and low long-term debt, the company has a strong financial position. At the 2003 year end the company reported nearly 16% increase in sales and $40 million in operating cash flow, which was in line with management's expectations. However, 2004's first quarter performance was not particularly good.

Alex Verbov, a former APM student and the stock's mentor who currently works in the investment area in Germany, provided the class with his view of the current position of the stock via teleconference. He suggested the stock had a good run due to two contributing factors: company's performance and U.S. currency depreciation. Based on the fact that the currency depreciation seemed to be at the peak, and on Alex's recommendation, the class decided to close APM's position in Beru. The stock was purchased at the average cost of $43.59 and was sold on 17th of February at $79.22.

Beru provided excellent learning opportunity for the students. It involved research of global markets and companies that are not listed on the U.S. stock exchanges. It also provided an opportunity to analyze exchange rate effects on foreign investments. Overall the Beru case was a unique opportunity to study and analyze the increasingly important foreign markets.

Wilshire Financial Update

by Group 2

Wilshire Financial Service Group (NASDAQ: WFSG) became an even more attractive investment in the first quarter, as on January 16 the company announced the signing of an agreement to sell its wholly owned mortgage-servicing subsidiary, Wilshire Credit Corporation, to Merrill Lynch Mortgage Capital Inc., a division of Merrill Lynch. The agreement provided that WFSG will receive a cash purchase price of approximately $52 million, with WFSG netting $47 to $48 million net of fees, according to CEO **Steve Glennon**.

This creates approximately $18 million in additional book value for the company, which, as mentioned in *APM 3rd Quarter 2003* newsletter, is our valuation matrix. Taking the assets and liabilities of Wilshire Credit Corporation out of the balance sheet, WFSG is worth $97.582 million in book value, or $5.27 per share (18.51 million shares outstanding).

Additionally, the book value will increase by $2.60 per share in the second quarter upon receipt of the cash from Merrill Lynch, netting a book value of $7.87 per share. Traditionally, banks trade for anywhere from 1.75 to 2.5 times book value, with the average price to book ratio for the financial sector today at 2.4.

We believe WFSG warrants a price of at least 2.0 times book, or $13.14 per share. We were also excited about potential investor friendly things WFSG could do with the $47 million, such as share buybacks and/or an establishment of a dividend, which could also increase our valuation.

On May 3, 2004, WSFG announced the completion of the sale to Merrill Lynch, which netted $48 million. WSFG also declared a regular dividend of $.125, yielding 5.12% at the close of trading. We were a bit disappointed with the size of the dividend, but we still feel it adds value to an already undervalued stock.

	Assets	Liabilities	Equity
WFSG	975.144	847.842	127.302
Servicing	42.56	12.84	29.72
Net	932.584	835.002	$97.582

America Service Group

by Group 4

America Service Group (ASGR) is headquartered in Brentwood, TN and provides private correctional healthcare. It currently serves 23% of the outsourced correctional healthcare market in the U.S.A. It is a small-cap stock which has a market capitalization of $260 million and its current stock price is $37.80 (7 Sept 04). In 2003, it had revenues of $549.26 million and net income of $11.88 million.

The firm showed improvement in its top-line growth and gross margin in the first quarter of 2004. However, the company took a hit of $358 thousand on its first quarter bottom-line. The net loss is reflective of a recent $5 million settlement with the Florida Attorney General concerning improper Medicaid payments.

America Service Group

The company's future revenue growth will depend in part on continued privatization of healthcare services for correctional facilities by agencies. Though the company believes that more than $55 million in annualized correctional healthcare contract revenues were newly privatized in 2002 by governmental agencies, there can be no assurance that this market will continue to grow at historical rates, or at all, or that existing contracts will continue to be made available to the private sector. There is pressure on legislators and other elected officials to turn in a balanced budget (required by many states) without raising taxes or cutting essential services, such as education and health care, measures that are politically unpopular. Outsourcing services such as medical care for correctional facilities is viewed as a cost-cutting measure that will save tax dollars for the citizenry and help legislators in forming a balanced budget.

According to a recent *Wall Street Journal* article, state budgets are slowly but surely closing their budget gaps. The WSJ reports that 32 states will finish with surpluses for fiscal 2004. Thus, the pressure to privatize may not be as enormous as it has been in recent years.

Revenue growth could also be adversely affected by material decreases in the inmate population of correctional facilities. The United States prison population is 2 million inmates, the highest incarceration rate for any industrialized nation. The incarceration rate has leveled off in recent years to 476 inmates per 100,000 populations. With crime rates decreasing, one should not expect the sharp increase in inmates that occurred in the 1980's and early 1990's.

For 2004, America Service Group, Inc. believes $200 million in potential revenues is up for grabs. This source of revenue all depends on whether states reward America Services Group with a contract to provide medical care for inmates, something investors should look for throughout the year. As it stands now, the correctional healthcare industry is a $7 billion market, of which $2.8 billion is outsourced to private entities. America Services Group, Inc. provides healthcare services to 10% of the prison population and hopes to increase that percentage by tapping into the $4.2 billion market that has not been outsourced.

A special thanks to **Jim MacMurray**, a F'02 APM alum, for his generous donation of $500.00.

Kent McCarthy is still matching alumni gifts 2 for 1, so now is a great time to make a donation.
Contact Greg Lamb, KU Endowment 785-832-7462, for more information.

If you would like to contribute to the APM portfolio, please mail your donation to:

KU Endowment Association
McCarthy Fund
% Greg Lamb, Director of Development
School of Business
1300 Sunnyside Avenue
Lawrence, Kansas 66045-7585
Phone: 785 832-7462