



APM Quarterly

1st Quarter 2003

a publication of Applied Portfolio Management, KU School of Business



APM Portfolio Performance: Up 14%

Take a look at what we've bought and sold this Quarter
APM Returns: 1stQuarter 03 – 14% 12 Month – 2%

Kevin Rauckman visits class.
See Page 4

A Message from the Dean

The School of Business is prominent among U.S. universities as a leader in international business education. We provide numerous opportunities for students to study abroad through the School's Italy Programs and the Center for International Business Education and Research. Thirty percent of business students took advantage of one or more of these opportunities during the 2002 academic year. This is the highest percentage student involvement in study abroad programs among leading public business schools.

The international opportunities involve not only students, but our faculty as well. In a typical year, between one third and one half of the faculty members from the School of Business travel abroad to teach, conduct research and present papers at international conferences.

I'm proud that the APM class is an important contributor in this area of the School. Over the years, APM classes have evaluated numerous international equities and have had invited representatives of these firms into the classroom. More recently, Kent has been taking APM on the road to Italy. Consortium Institute of Management and Business Analysis (CIMBA) is an MBA program located in Asolo, Italy. KU is the degree granting institution for the CIMBA program that is supported by a consortium of 30 leading U.S. universities. For the last three years, Kent has taught an intense, week-long session of APM in Asolo. I hear frequently from the CIMBA students that this is one of the most valuable classes they have during their program.

Plans are now underway to take APM to China. Cathy Shenoy is developing a study abroad opportunity for students interested in APM. The course will involve a 10-day trip to Beijing and the investment communities of China, and will include visits to the China stock market and several firms that have been an important part of the APM class recently. Cathy and Kent will offer this course starting either in January or June of 2004.

These are very exciting additions to the School of Business. APM classes are now being offered at both the graduate and undergraduate levels, and on three continents. I want to thank Kent, Cathy, Allen Ford, Paul Koch, and others who have been instrumental in developing APM for their excellent work. These efforts make a significant contribution to the reputation of the School and the education of our students.

William L. Fuerst

Dean and H.D. Price Professor of Business



Kirk Hinrich and teammates celebrate after the Marquette victory. Kent McCarthy and lots of APM students were on hand to watch KU in the Final Four. The APM portfolio has funded a basketball scholarship for the past eight seasons. Kirk was the recipient of this year's scholarship.

Photo courtesy of Topeka Capital Journal/CJOnline.com

Inside This Issue

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China Trip Postponed

Due to the SARS travel advisory, the APM in China trip is postponed until January. If you would like details about the trip as they become available e-mail or contact Cathy Shenoy (cshenoy@ku.edu 785-864-7519)

Check out the group reports!

Be sure to see the best APM group reports for each of the stocks we've covered this semester. See the **Research** link on the APM homepage: <http://www2.bschoool.ukans.edu/apm/research.htm>.

**APM Portfolio Performance (1Q 2003)**

Returns	1-Jan-03	31-Mar-03	31-Mar-02	1st Quarter 2003	Last 4 quarters
NASDAQ	1,336	1,341	1,863	0.42%	-28.00%
S&P 500	880	848	1,147	-3.60%	-26.04%
APM Portfolio	\$271,034	\$296,116	\$290,255	9.25%	2.02%
APM Portfolio (adjusted for expenses)	\$271,034	\$309,356	\$303,495	14.14%	1.93%

Spring 03 APM Students

Group	Student Members	Group	Student Members
1	Grant Butler	4	Ryan Chappell
	Ben Durham		Travis Nordwald
	Eric Gephart		Ignatio Silva
	Brian Paugoulatos	Ryan Edwards	
	Chris Sedigzad	Drew Keihm	
2	Matthew Bloomfield	5	Aaron Mesmer
	Mike Csrnko		Marcus Cheang
	Clark Foy	6	Lori Keeshan
	Laura Haught		Brad Kreiger
	Peter Johnson		Liz Meyer
3	Willy Chen	7	Candice Bassell
	Jeremy Lill		Sophia Chang
	Erin Nichols		Craig Dugan
	Jason Nicolay		Richard Holt
			Renee Transue

1st quarter 2003 Portfolio Performance Report

The APM Portfolio began the quarter at \$271,033.60. It ended the quarter valued at \$296,116.46, an increase of 9.25%. This compares to a NASDAQ gain of 0.42% and an S&P 500 loss of 3.60%. The portfolio value is net of the \$13,240 used to pay for portfolio management fees incurred during 2002. Without this expense, the portfolio's value was up 14%. Over the last 4 quarters the portfolio gained 2% versus the NASDAQ 28% decline.

During the quarter, the portfolio's biggest gainers included: Sohu (up 71%), Garmin (22%), LSB Industries (21%), American Italian Pasta Company (20%), Guidant (17%), and Chinadotcom (15%).

The portfolio also underwent a few changes during the first quarter. The class closed its positions in CNET, Westar, and Guidant; and purchased two shares of Berkshire Hathaway (Class B). The portfolio also invested excess cash in additional shares of Garmin, Chinadotcom, Anadarko Petroleum, LSB and Internacional de Ceramica SA.

Thanks to all APM speakers, friends, and mentors for their help. Your patience, guidance, and knowledge provide an invaluable learning experience for the students.

Thanks also to **Paul Koch** for his recommendation to sell Guidant. On March 26 Paul presented Guidant (GDT) in class. On March 27, the class decided to sell at \$36.50. The class purchased GDT based on Koch's recommendation on October 7, 2002 at \$26.65 – up 37% in six months.

Our current mentor stocks

Ticker	Company	Mentor	% of Portfolio
APC	ANADARKO PETROLEUM CORP	Todd Ludgate	2.83%
DUSA	DUSA PHARMACEUTICALS INC	Betsy Rowe	0.43%
FST	FOREST OIL CORP	Brett Young	2.05%
GRMN	GARMIN LTD	Matt Taylor	3.46%
JNS	JANUS CAP GROUP INC	Mark Hirschey	1.19%
JOSB	JOS A BANK CLOTHIERS INC	Jim MacMurray	2.70%
LTD	LIMITED INC	Brendan Woodbury	0.87%
RDN	RADIAN GROUP INC	Brian Murray	1.11%
REMC	REMEC INC	Greg Greenberg	1.17%
TGT	TARGET CORP	Jessica Reuss	0.98%
VLO	VALERO ENERGY CORP	Robert Tracy	0.88%
WMB	WILLIAMS COMPANIES	Mark Hirschey	1.10%

Radian Group Inc. (RDN)**by Group 2**

Radian Group Inc. (RDN), a leading provider of financial guarantee insurance and mortgage insurance, reported 1st Quarter earnings on April 16. Net Income increased to \$105 million this year, up from \$104 million in 2002. Their earnings per share were \$1.11, which was lower than the street's prediction of \$1.14. Their Mortgage Insurance accounted for 65% of their earnings, while the Financial Guarantee Insurance made up the other 35%.

Thanks

Thanks to Group 3 from the Fall 2002 APM class for recommending Garmin for the portfolio. Group members included **Rosalie Ast, Cara Lance, Todd Ludgate** and **Matt Taylor**. Matt invited and made arrangements for Kevin Rauckman to visit this Spring's class. Rosalie was also able to attend.

Since the GRMN purchase of 250 shares on December 6 at \$24.19 and another purchase of 50 shares at \$35.56, the current price is \$37.28. Up 54% since initial purchase.

Garmin manufactures global positioning systems (GPS) for automotive, aviation, and personal use. The new Geko is aimed toward a younger audience and includes games and a simple interface. Another new product that APMers could use is the iQue™ 3600, a PDA with a GPS.

SOHU.COM: The Transparent Company

By Renee Transue (Group 7)

Corporate Governance has always been an issue, though the independence and strength of a company's Board of Directors can easily be pushed to the back burner in times of rapid expansion and strong financial performance. During the 1990s, one of the most wealth-producing booms to ever occur enveloped the economy, and meaningful attention to Corporate Governance all but ceased. Then, of course, came Enron. And Tyco. And WorldCom. Since these first large-scale debacles, the Securities and Exchanges Commission has been swamped, uncovering numerous scandals that range from insider trading to blatant lies on financial statements.

Sohu.com, however, is different. Group 7 (Renee Transue, Candice Bassell, Craig Dugan, Richard Holt, and Sophia Chang) was recently given the task of examining two of the APM portfolio's holdings, Sohu.com and chinadotcom, and a third Chinese Internet competitor NetEase.com, for strengths and weaknesses in each company's respective Corporate Governance structure. Using a *Business Week* article from October 7, 2002 entitled "The Best & Worst Boards; How the corporate scandals are sparking a revolution in governance," as our guide, the Group evaluated Sohu.com, chinadotcom, and NetEase.com on the following criteria:

- Independence
- Stock Ownership
- Director Quality
- Board Activism

The following table lists more specific criteria and how each company fared in the given category. An "X" denotes fulfillment of the chosen criteria for the respective Board and its directors.

	<u>SOHU</u>	<u>CHINA</u>	<u>NTES</u>
2 current or former executives	X		
Committees separate	X		
150,000 in equity, each director	X	X	X
75% meeting attendance, each director	X		
Evaluate own performance	X		
Member of 4 Boards	X		X

Though a final report is currently pending, preliminary results have been compiled and exhibit a very strong Governance structure within Sohu.com. Accompanying the above characteristics of good Corporate Governance are stark financial statements and invisible compensation plans for Sohu. The company has taken extensive measures to ensure the strength of its Governance and to be transparent in all areas. Sohu.com is currently far superior to chinadotcom and NetEase in terms of Corporate Governance.



The Chinese Economy

by Group 1

The economy of China is one of the most promising in the world. As China emerges from a state controlled system to enter into the World Trade Organization (WTO), its economy continues its impressive growth. In 2002 the gross domestic product grew 8%, and is expected to grow more than 7% in 2003. Much of China's growth is fueled by state spending. A key driver of the economy is fixed-asset investment which increased 16% last year to 4.32 trillion yuan (\$521.9 billion). China finances these increases in spending through deficit spending. Currently, China's public debt is at 16% of the \$1.2 trillion economy. In order to obtain the targeted 7% growth for next year, the new Premier Zhu Rongji announced on March 6 that China would continue to issue bonds to cover increased government spending. The deficit is expected to rise 3.2% to a record \$38.6 billion.

As a result of free-trade commitments made to the WTO, China is opening up its economy to even more foreign investment. To facilitate the change in the economy, several new regional economic ministries are being set up by the Premier Zhu's regime, virtually ending the system of a centrally planned economy. While the number of ministries has only been reduced by one to 28, much clearer lines of authority have been established for banking, trade and state enterprises. In one of the most significant structural moves, the People's Bank of China will lose its supervisory power over the banking industry to focus on monetary policy. A new Ministry of Commerce has been established to move both foreign and domestic trade issues under one roof. Two other new agencies have been created, the State Development Reform Commission and the State Asset Management

Commission. Both are expected to expedite the privatization of the economy.

These economic developments as well as the expected future growth of the Chinese economy will help the APM portfolio. We are currently holding positions in two companies and one fund that are based in China. The China Fund (CHN 3.3% of the portfolio) is a closed end mutual fund with equity investments based in the PRC and Taiwan. Both SOHU.com Inc. (SOHU 15.5%) and Chinadotcom Corporation (CHINA 14.9%) are integrated Internet companies. Currently, China represents 9% of the world's IT market, approximately \$1,000 billion dollars. Economists expect that market to double by 2005, making China 33% of the world's IT market.



More Potential Chinese Investments? by Group 3

In recent years China has begun to raise substantial amounts of foreign capital from the U.S. stock market. Analysts believe that a prosperous and strong China will enhance economic growth for the United States, as well as the rest of the world. Now investors have the opportunity to buy into yet another market in one of the world's fastest growing economies – the Chinese insurance industry.

Three of the largest Chinese insurance companies have announced planned IPOs – China Life Insurance, People's Insurance Company of China, and Ping An Insurance. Revenue from insurance premiums in China rose over 50% in 2002 with no signs of slowing down soon.

One risk associated with an investment in a Chinese insurance company is high interest rates in China. Rate increases without offsetting premium increases resulted in an estimated overall \$6.04 billion in losses in 1999. The companies are now taking steps to restructure such interest rates.

Chinadotcom – SMS in China ! by Marcus Cheang, Group 6

Chinadotcom Corporation is a leading Internet company offering technology, marketing and media services for companies throughout Greater China and the Asia-Pacific region, the U.S. and the U.K. The company completed its acquisition of Newpalm (China) Information Technology Co., a leading short message service (SMS) mobile software platform developer and application service provider in China, through its mobile applications and portal arm and 81% owned subsidiary, hongkong.com corporation.

Newpalm has shown significant progress in terms of growth of subscriber base. During March 2003, Newpalm has added over 300,000 new paid up subscribers to an aggregate of over 3 million, representing a 10% increase over the previous month and a 40% growth rate. Chinadotcom plans to integrate Newpalm into its portal network to develop additional service such as news channels and interactive games. The acquisition of Newpalm will further strengthen and broaden chinadotcom's existing portal community services such as e-Match and Love Skyby, integrating Newpalm's popular X-City service.

Because of the completion of the acquisition, this allows the company to consolidate the entire Q2 2003 financial result of Newpalm and will bring more than U.S. \$2.5 million in additional high-margin, earnings-accretive revenues to the chinadotcom for the quarter. The integration of Newpalm with the chinadotcom's portal network will also further strengthen the company portal market position in China and will develop additional services and products to the subscribers. The company will be expected to have significant growth due to the recent fast growing SMS mobile messaging in China, which is a great potential market for the company in the near future.

Speaking with Kevin Rauckman, CFO, Garmin Limited (GRMN)

By Group 5 (Ryan Edwards, Drew Keihm, Aaron Mesmer)

On March 5th, **Kevin Rauckman**, chief financial officer at **Garmin**, visited Lawrence and discussed the long-term operational and financial objectives for the company with our APM class. While his comments on Garmin provided an excellent learning opportunity, it was Rauckman's personal thoughts that provided more insight. Rauckman is a KU School of Business alum (BS 1985 and MBA 1986). He attributes his career success to a willingness to work harder than the next guy. Rauckman believes this work ethic is an advantage that more KU graduates should exploit as they compete with graduates from better-known or more prestigious schools for jobs or promotions.

Rauckman also believes that being open and honest provides the best opportunity for personal and professional growth. This belief was reflected in the Garmin's employees. **Polly Schwerdt**, manager of investor relations for Garmin, was happy to help answer questions we had while researching the company. As well the company has readily-available financial materials on its website. Garmin has been an excellent stock for the portfolio simply because it has satisfied all the portfolio criteria, which include being useful in class, having a mentor relationship such as our relationship with Rauckman, and the stock has earned a decent return.

United States Economy Group 6

There is much controversy around the current state of the U.S. Economy. The reason is that there are so many factors that affect the economy.

To begin with, the amount of money consumers have is an important factor in our consumer-driven economy. Any factor that reduces the extra money for consumers is having a negative impact on the economy at this time because it is reducing the disposable income of consumers. Important factors that relate to this issue currently are local taxes, increased energy prices (including gas and utilities), and medical bills.

According to **John Mauldin**, a manager of investment managers, if increases in any of these "are not balanced by an increase in income somewhere else," consumers will have less to spend, which would "slow the economy if not precipitate a recession." Reducing consumer spending hurts the economy by increasing costs to businesses. The increased costs are then either added to the consumers' costs, deducted from company profits, or a little of both. In all three instances, businesses must then adjust costs to stay profitable, which could mean laying off employees. That, in turn, increases the unemployment rate.

So, as you can see, there are many pieces to the puzzle of the U.S. Economy, which makes it complicated to see the whole picture. Increased prices at the pumps, lack of tax cuts, winter storms on the east coast, and pending international issues have all had an effect on the recent conditions of the economy and our portfolio. Decreases in consumer spending could have a negative impact on our retail stocks, like Limited and Target. Yet, increases in consumer spending could help those stocks, as well as H & R Block, Capital Federal, and Willshire Financial because mortgage rates are the lowest they have been since the early 1960s. This provides a push to buy a new home and increases consumer spending. Energy and oil prices will have an affect on Anadarko Petroleum, LSB Industries, Valero, and Westar because their products depend on oil, energy, or both. As of right now, oil prices are decreasing, which is good for our portfolio, and we will continue to watch all of the issues above.¹

¹ <http://www.2000wave.com>



Mark Norwald, Cargill, tells all about the U.S. fertilizer industry

The class has been busy investigating fertilizer, keeping an eye on crop production and on **LSB Industries**. The APM portfolio holds. On February 26, 2003 we spoke with **Mr. Mark Nordwald**, U.S. Fertilizer Distribution Manager for **Cargill** in Minneapolis. We asked him about the troubles in the U.S. fertilizer business, and why the U.S. fertilizer industry is in a secular decline. He gave us a general industry-wide picture of the ammonium nitrate business from an agricultural view. He noted that the last time there was anything resembling a good fertilizer market was about 4-5 years ago. A large part of the problems in the industry is due to cheaper natural gas prices in foreign countries. American fertilizer businesses are at a competitive disadvantage to foreign competitors. Currently, the U.S. is buying natural gas for around \$9/unit, while foreign producers are buying it for about \$1/unit. Mark is current APM student Travis' father.

Speakers this semester at APM

Speakers in Q1

Speakers for the first quarter were:

Frank Remar – CFO, Dillon's; VP, Kroger. Frank updated us on Kroger's strategy. He made an excellent presentation. Students asked lots and lots of questions.

Alex Verbov – APM alum and Associate Director, Leverage Finance, West LB. Presentation on Beru AG. (We bought.)

Mark Norwald – US Fertilizer Distribution Manager, Cargill; and Travis' (current APMer) dad. Discussed world fertilizer prices, supply and demand.

Kevin Rauckman – CFO, Garmin, Ltd. KU grad. He updated us on our investment.

Jim Sight – Investor, LSB, Industries. Great explanation of LSB's strategy.

Many thanks to **Frank Remar** and **Jim Sight** for making it two semesters in a row.

Speakers in Q2

Speakers for the second quarter will be:

Allen Ford - Taxes and Investing

Paul Koch – Guidant (We sold.)

Al Simmons – our A.G. Edwards broker discussed MLP investments

John Sherman – Inergy CEO (We bought.)

Hsulin Peng – Inergy, Manager of Corporate Finance, and former Business School T.A.

Jim MacMurray – Black & Veach, APM alum and JosB Investor

Kent Gasaway – Buffalo Fund manager and Sr. VP, Kornitzer Capital

Steve Farley – founder and managing partner, Labrador Partners L.P.

Scott Jones – APM alum, real estate entrepreneur, recently resigned analyst – A.G. Edwards

Kent in Class

Kent McCarthy kicked off the semester with a bang. We discussed LSB, Sohu, and Chinadotcom – three stocks where he holds major positions. Kent also came to class on February 26 when Mr. Nordwald called. Kent discussed the secular downtrend in the U.S. fertilizer business and the opportunity for LSB in that industry. Kent also came to class on April 23 and helped wrap up things on May 7.

Thank you for your contributions!

LSB

by Aaron Mesmer

Over the course of this Spring, many changes have occurred in the fertilizer industry. The weather for this year's planting season has brought corn production down slightly, and natural gas prices have pushed the price of ammonia and ammonium nitrate much higher than in years past.

However, because of previous agreements, **LSB** was able to produce and sell ammonium nitrate profitably. The Koch purchase of four domestic Farmland plants for \$171 million also provides an estimate of the value of LSB's plant in Pryor, OK, which LSB is trying to sell.

Over the past few weeks, LSB's stock price has been climbing and is currently trading around its 52-week high of about \$5 per share.

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.

Kent McCarthy is still matching alumni gifts 2 for 1, so now is a great time to make a donation.

Contact Patrick Mikesic
1-800-444-4201 ext. 461,
PMikesic@KUEndowment.org
for more information. ■

If you would like to contribute to the portfolio

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