



# APM Quarterly

## 3rd Quarter 2001

November 1st, 2001



### Class is Back in Full Swing!

We are pleased to announce that Applied Portfolio Management is back from its brief hiatus! Following the Spring 2000 semester, Kent decided to re-evaluate the mechanics of APM and its future goals. The result is a plan that maps out the future of the course for the next decade. With the enrollment into the program of 26 talented and ambitious students ranging from full-time MBA and MAIS students, to part-time MBA's working as engineers and financial analysts, it is obvious that the road ahead will be paved with success. The class has already resumed its reputation of bringing in talented, highly successful company executives as guest lecturers, with eight such persons having presented to the class thus far.

The class has been working diligently under the watchful eyes of Kent McCarthy, Cathy Shenoy, and Denise Bergin. Denise has been invaluable in organizing and directing the students to ensure that they get the most out of the APM experience. Cathy's mini-lectures on finance fundamentals, and the use of technology in investment analysis, have strengthened the knowledge base of the students. She also keeps Kent and Denise out of trouble by keeping them in line with Business School protocol. And we all know that Kent brings the genius and energy to the class. The chaos of real world investing, now combined with the organization efforts of a full-time focused management team should take the APM program to new levels of success.

As the financial markets continue to suffer, the class is counterintuitively put into a position of opportunity. As we all know, it is easy to make money in a hot market. But now that the markets are in disarray, as the world economy becomes weaker and weaker, the class has the unique chance to learn how money is made in a down market. This semester should be exciting and challenging as volatility and uncertainty are the buzzwords of the day. We hope all of you, at some point in the semester, will join us for the ride.

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#### Fundraising Highlights:

- Steve Farley donated \$1000 to the class last quarter, while Atlee Vernon contributed \$50 to the fund! Thanks to both Steve and Atlee for their continued commitment to the success of APM.
- Kent is still matching alumni gifts 2 for 1, so now is a great time to make a donation. All the information you need is on the last page.
- KU is conducting its annual telephone drive again. If you are called, any funds you donate can go directly to the APM Portfolio, but be very assertive about your wishes for the funds to go to APM!

### APM Kicks Off Fall Semester with a Tailgate Party

APM began the fall semester with a tailgate party after the KU/UCLA football game on September 8th, letting everyone know that we're back and stronger than ever. This event provided current students an opportunity to mix and mingle with some class alumni who have gone to work in the investment industry. About 35 people came out to watch the Jayhawks play, and even though they didn't win, the party was a big

success. Among those present were current students, APM class alumni, KU Business School professors, and Kent. We were especially honored to have Bill Fuerst, Dean of the Business School, in attendance. Thanks to everyone who helped make the party a success. We hope to do it again in the future – hopefully with better results on the football field.



Current students networked with alumni and Business School professors at the APM Tailgate Party on September 8th. Left to Right: Mark Hermes, Andy Steinbach, Bill Stewart, Frank Sciara, Shane Parr



## Portfolio Performance



Wall Street felt the effects of a slowing economy during the third quarter.

The third quarter was a rough one for everyone. Unfortunately, we were no exception. The portfolio began the quarter with 25 stocks valued at \$342,345. It ended with 26 stocks (3 sells, 4 buys) at \$284,507—down 16.89%. This compares to the S&P loss of 15%, the Dow loss of 16% and the NASDAQ loss of 31%. On the upside, Novastar Financial (NFI), Boston Scientific

(BSX), Cerner (CERN), Procter and Gamble (PG) and Guidant (GDT) posted gains of 28%, 21%, 18%, 14% and 7% respectively. Kudos to the alumni who chose them!

During 3Q, the portfolios also underwent a few changes. We reduced our position in Anchor Gaming (SLOT) and threw in the towel on Arch Wireless (ARCH)

and Aether Systems (AETH). New purchases include Yang Zhou Coal (YZC), Chinadotcom (CHINA), Enron (ENE) and Radian Group (RDN). Thanks to alumni Jessica Reuss and Brian Murray for these last two suggestions.

## Kent's Market Prognosis

Most of us know that Kent has been bearish on the U.S. markets for years. But now these markets have drawn back significantly. Has this given Kent a reason to change his mind? Here's what he has to say:

"The bursting of the tech bubble has left the US economy with

tremendous amounts of excess capacity (fiber optics, chips, wireless capacity) that will not go away as easily as typical inventory problems endemic to most recessions. Furthermore, rate cuts do not do much to destroy this excess capacity hence a longer and deeper recession is my prognostication - much lower

long-term rates and stock market levels significantly lower. Intel and Cisco still are not cheap at these levels. Finally, post-bubble growth is never as fun as bubble growth - stock picking will be the key."

"APM is truly a capstone finance course that offers a demanding real world quality."

—Jessica Sieren, Current APM Student and Financial Analyst at American Century

## Terrorist Attacks Affect Students, Faculty, Alumni

Almost two months after terrorist attacks on Washington and New York, the nation is finally starting to recover. The flood of media coverage on the possible business implications has left the campus community wondering "Now what?" Stephen Lane, current APM student, expresses his thoughts:

"While I like to believe that terrorism cannot slow down progress, the truth is that it can. We all have experienced this slow down over the past few weeks. These attacks have further dampened the psyche of the average investor - like myself. While I like to believe that the worst is over, there's that 10 percent of me that thinks about what if... What if we have another massive terrorist attack? What if the economies of the world catch the flu because America caught a cold? What if Greenspan's moves do little to stimulate the economy? What if we go into a period of deflation that rewards saving versus con-

suming? You get the idea. All of these thoughts are running through my mind and our fellow classmates minds each time we send more hard earned money to the stock market. Fortunately, like I said, it's about 10 percent. The other 90 percent says - over the long run - the stock market beats other investments. I'm still buying."

Jade Shopp, an APM alum, currently works for Deloitte and Touche in New York City. His main client is Merrill Lynch, whose employees have been displaced from 4 World Trade Center to alternate locations throughout the area. "Even though [moving its operations] was extremely costly and damaging to earnings, Merrill Lynch will fully recover from the event and will have better support systems and business resumption plans as a result." As for Jade's market prognosis? "I think the events of the 11th will have a major effect on the way that business is done in the future. In the past, so many

companies felt is was so vitally important to have all of their most important people in centers like New York. Now the focus will probably be to make sure that they are not, or at least not all at the same time. You will see companies spending a lot of capital to produce viable alternative operation sites and work arrangements that will (in the short run at least) have an effect on investor returns. Most importantly though, I think that companies will be much more cognizant of the safety of their employees and sensitive to desires for alternative working arrangements."



The campus community reflects on the business implications of terrorism.



## Chancellor Hemenway Visits APM

On October 10<sup>th</sup>, KU Chancellor Robert Hemenway, accompanied by School of Business Dean Bill Fuerst, made his way to the Edwards Campus to take in an APM session. Though the Chancellor did not get the full experience of a lecture, as Kent didn't pick on him for not knowing the long bond rate, the Chancellor did

participate by addressing the students and assuring them of the value of real world experience classes like APM. Chancellor Hemenway noted the importance of APM as a stronghold program in the School of Business, and recognized that the class was an invaluable choice for students wishing for a career in invest-

ing. We applaud Chancellor Hemenway and Dean Fuerst for their recognition of APM and hope that other important academic and business leaders in the community will follow in their footsteps.



Chancellor Hemenway encouraged APM students to maintain contact with the University after graduation

## Alumni Picks: 26% of Portfolio

<u>Name</u>	<u>Class</u>	<u>Stock</u>
Bart Baldwin	Spring '00	PG
Greg Greenberg	Spring '96	SPCT
Guan Hwee Lim	Spring '00	SV
Brian Murray	Fall '96	RDN
Chris Rasmussen	Fall '98	BKS
Jessica Reuss	Spring '95	ENE
Betsy Rowe	Fall '95	DUSA
Joe Searle	Fall '95	CERN
Robert Tracy	Fall '98	SLOT

Most of you know that we would like to increase the percentage of the portfolio picked by class alums from the current 26% to around 75%. To do this, we need some of you brave investment pros to lay your reputations on the line (and risk being tormented in future newsletters) and send

us your picks (see information below). Otherwise, we'll have to result to laying down the stock quotes section of the newspaper, letting Kent's dogs go to work, and randomly assigning the "selected" names to class alums.

### Trading Suggestions

To make suggestions please follow these guidelines:

1. Email the ideas to Denise at [dbergin@ku.edu](mailto:dbergin@ku.edu)
1. Send one page broken down by the following three sections: company profile, fundamentals, analysis and conclusion.

Include an email address and phone number where current students or teaching assistants can contact you.

### *Did you know...*

*Only 26% of the stocks currently in the portfolio were chosen by class alumni? Help us increase the percentage!*

## Chinadotcom

Since the tech bubble burst over a year ago, herd mentality investing has kept all eyes away from Chinadotcom. The stock has gone from almost \$80 to \$2.00 in a little under two years. As such, the number of analysts covering the company has decreased significantly. But consider the fundamentals: the company trades at less than half of its

cash per share, and the burn rate of this cash position is expected to slow as the company concentrates less on its unproven portal business and more on its solid e-consulting operations. Daniel Widdecombe, Chinadotcom's CFO, recently spoke to the class to ensure the company's legitimacy as a tech leader in the fast-growing Chinese market.

Since China's economy seems somewhat sheltered from the turbulence in most financial markets, Chinadotcom should be considered a high-growth stock at a value stock price.



*With the U.S. market looking dismal, APM, with some guidance from Kent, has turned its attention to China.*



## Stock Highlights

### Enron (NYSE: ENE)



*APM currently holds Enron in the class portfolio based on a recommendation from Jessica Reuss, a portfolio manager at Bank of America. Here are Jessica's comments on the stock: "Our analyst's favorite segment in the energy sector is energy marketing. It should have the best long term growth rates and has low direct exposure to weak natural gas prices. Enron's risk management operations should benefit from high vol-*

*tility in commodity prices. Enron is expected to grow earnings 15-20% over the next five years and currently trades at 16x next year's forecasts."*

*As many of you know, Enron very recently announced a write-off to third quarter earnings of over a billion dollars just a few weeks after the company's CEO left for "personal" reasons. At the same time, allegations are rising over some shady trans-*

*actions that took place between Enron and some partnerships controlled by Enron's CFO. The stock has crashed from \$50 to \$16 over the past three months amidst these announcements, but the fundamental business of the company seems to not only remain intact, but growing strongly. A good buying opportunity?*

### Cerner (NASDAQ: CERN)

*"The stream of positive results has kept [Cerner] from suffering the price pressure that most stocks are facing these days."*

*APM currently holds Cerner in the class portfolio based on a recommendation from Joe Searle, a Cerner associate. Marcos Garcia, another Cerner associate, is in this semester's APM class and had the following comments: "Cerner stock has outperformed the market over the past year, and the company has beat expectations for seven straight quarters. The*

*company enjoys a significant technical advantage over its competitors, and the market for software solutions to automate healthcare is expected to continue to grow. Cerner is in a great position. It just needs to continue to execute properly"*

*Trading at 3.68 times ttm sales, the company's advantageous position is certainly built*

*into the stock's price. The stream of positive results has kept the company from suffering the price pressure that most stocks are facing these days, although the stock is highly volatile. A bad quarter could make some investors jittery. Does the company's potential justify its price?*

### Radian (NYSE: RDN)



*APM currently holds Radian in the class portfolio based on a recommendation from Brian Murray, a fall 1996 alum. Here's why Brian recommends it: "When I looked at the PMI (Private Mortgage Insurance) market, and Radian financials, I realized the Radian bonds were worth buying. If you have a mortgage and couldn't put 20% down, you have to pay PMI to protect the mortgage lender in case you default. The PMI business has few*

*competitors and is very profitable because mortgage default rates have historically been very low, and PMI rates to customers are very high. Radian has a strong #2 PMI business market share."*

*With the expected boom in refinancing home loans over the next two years, Radian's prospects look very good. The company takes a very conservative approach to loss reserves, which aids in manag-*

*ing future claims. This is particularly key in a down economy when mortgage loan defaults may increase. An analyst told one group of students that Radian has good "balance sheet discipline", which is important, because in essence, an insurance company "rents out its balance sheet to others".*



## Internacional de Ceramica

On September 12, the Fall 2001 APM class enjoyed a candid conference call with Victor Almeida, CEO of Internacional de Ceramica. Mr. Almeida openly discussed the challenges inherent in a global commodity industry and ICM's strategic focus on operational efficiency and product differentiation.

In face of existing capacity restraints and low-end cutthroat margins, ICM upgraded its tile production to 90% first class. This modification has boosted average selling price 30%, halved scrap to 9% and bettered penetration to the higher gross margin end-user consumer. Additionally, Mr. Almeida stated that ICM has reduced headcount 20%, struck a supply chain deal with Oracle, and expects to refi-

nance its debt three basis points down by 2Q 2002.

ICM recently reported record sales and EBITDA for their third quarter. Despite these results, the price of the stock remains down. Jesús Olivas, CFO, gave us some insight as to why. Mr. Olivas believes that a small cap company like ICM is often overlooked by investors in emerging markets, who often allocate a percentage of funds to the entire country, not to a specific company. Additionally, the liquidity may be an issue for some: "Much of our stock is in the hands of investors with long-term strategies."

Although it isn't reflected in the stock price, Mr. Olivas explained that the fundamentals of the Mexi-

can economy are strong. "Inflation is under control, in the single digit range for the last twelve months. The Cetes rate [Mexican equivalent of the T-Bill] is very low, the lowest in a long time. Cash reserves are high and the peso is very strong. The fundamentals are there, however it remains uncertain how deep and how long the U.S. recession will be." Although this has not affected the company yet, Mr. Olivas said that ICM is preparing for lower consumption in the 4th quarter and the first half of next year.

Our class thanks Mr. Almeida and Mr. Olivas for taking time out of their busy schedules to speak with us. The inside perspectives offered insights no outside research could provide.



Internacional de Ceramica is taking wall tile to the next level. Pictured above is a tile from the Safari collection.

## Message from Management

Thanks to Group 2 for their efforts on the newsletter this quarter. We are back teaching and are impressed by our current students, who bring a wide range of expertise to the classroom. Several of them were crying "uncle" with regard to the workload a few weeks ago. Our response is that our alumni consistently write to say that the work was tough, but they would not have had it any other way.

I want to add my thanks to our third quarter speakers – to Victor Almeida, for calling in from Mexico City, and to Jack Golsen, who called in from Oklahoma City, and who will be joining us in person on December 5<sup>th</sup> for a follow up case. We are hopeful that we can persuade Victor to visit Kansas in the spring.

Thanks to Daniel Widdicombe for allowing us to call him in China at 7:00AM his time, and we are especially grateful to Steve Glennon and Bruce Weinstein for flying in from Portland on September 19<sup>th</sup>, just a few days after airlines resumed service.

What can we say about September 11<sup>th</sup> that has not already been said? First, we can tell you that the campus response was fast and appropriate. Chancellor, Hemenway communicated quickly with faculty and students, and provided many opportunities for sharing knowledge and lending support. As with the rest of the country, people rallied together in patriotism. The September 13<sup>th</sup> Faculty Convocation became a "Conversation" about current events. A capacity crowd filled the Lied Center for an ecumenical service on September 14<sup>th</sup>. There was a candlelight vigil at the Campanile and a blood drive at Allen Fieldhouse.

The afternoon of September 11<sup>th</sup> in Lawrence was filled with chaos, with traffic halted, as people lined up to fill their gas tanks. Class response on September 12<sup>th</sup> was an odd contrast, without the usual level of chaos, our 26 students, representing at least 7 different countries, listened quietly to Victor Almeida speak to us from

Mexico City. Kent followed with his thoughts on the US and China markets. Our portfolio reaction, was careful, buying a few stocks that we anticipated would represent bargains when the market opened on the 17<sup>th</sup>.

We all want to make a difference in these challenging times. We hope that in addition to teaching about our nation's pride; its capital markets, that part of our contribution is furthering our global understanding: from our increasingly international alumni network, to Kent's participation in the CIMBA program, to our study of international markets and companies.

We temporarily halted our fundraising in recognition of the needs of others. However, we are now ready to resume, and are also planning to begin pursuing more bargain opportunities for the portfolio. Look for us to be in touch soon for your donations and trading ideas. In our next newsletter, you will find highlights of our incredible 4<sup>th</sup> quarter line up!

"APM offers students a realistic preview of the challenges today's investors face."

—Amanda Urquhart,  
Current Student and  
Full-Time MBA



Tim Webster, American Italian Pasta Company CEO, celebrates a successful speech to the APM Class in the hallway at the Edwards Campus



**Thank you for your contributions!**

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

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**Guest Speakers Make Fall Semester Stand Out**

September 5th: Jack Golsen, CEO, LSB Industries (LSBD.OB) Mr. Golsen phoned in to answer some questions and talk to the class about the future of his business.

September 26th: Dave Reynoldson, Analyst, George K. Baum and Associates Mr. Reynoldson is an APM alum. He spoke to the class about valuation techniques for IT consulting firms.

October 17th: Josh Selzer, President, Iron Horse Investments Mr. Selzer helped the class gain a better understanding of short selling.

September 12th: Victor Almeida, CEO, Internacional de Ceramica (ICM) The class had a teleconference with Mr. Almeida, who gave us some insight on the future of the ceramic tile industry.

October 3rd: Daniel Widdecombe, CFO, Chinadotcom (CHINA) Mr. Widdecombe woke up very early to teleconference with us from China.

October 24th, Tom Dreyer, Founder, Trilogy Capital Advisors, LLC Mr. Dreyer spent an afternoon telling the class what it takes to run a hedge fund.

September 12th: Brock Wilkerson Mr. Wilkerson shared with us his experience with the chemical industry and some thoughts on LSB Industries.

October 10th: Tim Webster, CEO, American Italian Pasta Company (PLB) Mr. Webster dropped by to share some of his pasta and the secrets of his successful people management strategy.

Additionally, we'd like to recognize and thank some class alumni for taking the time to stop by:

September 19th: Steve Glennon, CEO, and Bruce Weinstein, CFO, Wilshire Financial (WFSG.OB) Mr. Glennon and Mr. Weinstein flew in from Portland to field some tough questions about the specialty finance industry.

October 17th: Jack Gaumnitz, Professor Emeritus, KU Professor Gaumnitz shared some of his expertise on real estate.

Shane Parr, George K. Baum and Associates

Chris Rasmussen, Deloitte & Touche

We sincerely appreciate the time all of our speakers have given us.

**Coming Up...**

November 7th: Jim Wineland, Waddell and Reed

November 7th: Derek Palaschuk, SOHU Webcast

November 14th: Scott Hartman, Novastar Financial

November 28th: Al Simmons, AG Edwards

December 5th: Jack Golsen, LSB Industries

December 12th: Steve Farley, Farley Capital

Class meets at 3:20 in Room 208 at the Edwards Campus in Overland Park.