

APM Class Notes
August 27, 2007

During this last class period, we were privileged to have Mr. Raupp, Mr. Onofrio, & Mr. Thompson, all former APM graduates and currently employed as analysts for Jayhawk Capital Management, as our guests. They advised the class on proper techniques for valuing both LSB and Brooke Corporation. LSB consists of two main, and very non-synergistic, businesses. Climate Control, as the name implies, is focused on the manufacture & installation of heating and air-conditioning units in both residential and commercial properties. It consists of geothermal & traditional HVAC products. The growth in geothermal could be quite promising due to its superior efficiency compared to HVAC. The only roadblocks are its higher initial capital outlay and a shortage of specialized drillers used in installation. For comparable companies in HVAC, see LII, JCT, and ASD. For geothermal use WFI.TO. The Chemical division was our primary topic of discussion however. It is concerned with the synthesis of ammonium nitrate fertilizer, industrial acids, & dynamite. Ammonium nitrate is the product that could unlock tremendous value for LSB due to a major increase in demand for corn, both as a foodstuff and for ethanol production. In addition to the growth in demand for fertilizer, many players in this industry were forced to shutdown due to oversupply in the market over 10 years ago. This combination enables LSB to maintain excellent margins for their product. The three main facilities at El Dorado, Baytown, and Cherokee have an average operation income of \$4 mil, \$3.5 mil, and \$1.5 mil per annum respectively. We were advised that only excess capacity is available to make ammonium nitrate due to contract fulfillment. Also, TRA and AGU were recommended as candidates for use in our relative valuation.

For Brooke Corporation we were pleased to welcome its Chief Operating Officer, Anita Larson. Brooke consists of four primary operating subsidiaries: Franchise, Brooke Credit, Brooke Capital, & Brooke Brokerage. The company, founded in 1986, began franchising in 1996. This strategy of local ownership has proved effective in fueling the dramatic growth of this segment. The recent Oakmont acquisition was a means to raise capital for the lending operation. The most worrisome development for the freshly minted Brooke credit is its ability to weather the current credit crisis. They essentially have three different ways to sell off loans: Banks, Securitization, & through warehouse lines of credit. The credit crunch has made new securitizations particularly challenging, but other sources of funding remain open. Its important to note that Brooke still maintains exposure on the first 20% of loans it sells. The market for insurance is notoriously cyclical and we should bear this in mind with our valuation, according to Professor Shenoy. Anita made mention of how well Brooke has been able to leverage its franchisee distribution network and is not concerned with the threat of competition in the auto arena from direct sellers. Although Brooke's franchisee growth is slowing due to a new marketing campaign, it hopes to attract better owners as a result, thereby reducing its 40% attrition rate.