George Inve$tment View

Winter 1999 Volume 5, Number 1

WELCOME! We begin our fifth year with a new visiting Roland and Sarah George Professor of Applied Investments – Prof. Frank G. Castle, CFA. Last year's visiting professor, Dr. Christopher Ma, returned to full-time investment management. Changing visiting professors in the Roland George Investment Program is similar to a football team changing coaches: new plays, but the students must still carry the ball. The class approach is outlined in this edition of our newsletter.

By Professor James E. Mallett, Director

WHICH WAY DID HE GO?

Mr. Market has been as elusive as a ping-pong ball in a cage, and everyone is wondering what's going to happen next. There are papers floating around saying "Dow 15,000", "Dow 20,000", and "Dow 7,000". Does anybody have the right answer? Probably not, since they are basing their decisions on situations that they don't understand. People think that they can "guess" the market, but in reality the market is a living breathing entity that can change its mind at the drop of a hat. That's not to say that some of these papers don't have good points, but they certainly can't say that they know where the market will end up at any point in time. That is our point of view. Who among them guessed that within a five-month period we would see the market hit its fifty-two week high then its fifty-two week low then decide that it liked it better at its fifty-two week high? That kind of market volatility is severe, rarely seen, and was not forecast by any of the Wall Street prognosticators.

We have seen the market jump around because of many factors: global deflation, the Fed.'s cutting of interest rates, unstable Asian economies, Russia's breakdown, slow growth, Brazilian budget problems, etc. Each of these factors by themselves was able to cause volatility in global markets. The market took a huge hit when Asia fell apart; it climbed back up when the Fed cut interest rates; and we bounced around trying to figure out what effect Russia might have on our markets. In retrospect we remind ourselves that the long and perhaps tired bull market which began in 1982 was at first driven by the long and steady decline of interest rates, the result of Paul Volker's actions to stamp out inflation. Dramatic improvement in this nation's return on equity and earnings per share growth then drove the equity markets higher through the nineties, the result of dramatic business reorganizations, severe corporate cost cutting, and government de-regulation policies. Now the market appears, perhaps, overpriced, but the tremendous liquidity flows into the market and the dramatic cash flows spent on mergers continues to drive the market to what we now perceive as "overvalued and unsustainable levels".

We rely on Don Hays (www.Wheatfirst.com.) and others for market commentary, but we have long since concluded that people today are still worrying about all of the aforementioned problems, but are hopeful of further market rewards. But Asia has failed to rebound economically; growth is still a problem even with the improved liquidity. Moreover, the market believes that the Fed will continue to increase the money supply and keep downward pressure on short term rates. On top of all these worries is the market's valuation problem. With the market average multiple at its highest level ever, 29.5, professional investors are very cautious. More than ever, prudent investors perceive the market to be at an unsustainable level. Experienced market fundamentalists are puzzled by the extreme valuations of Internet companies in particular, and the large cap stocks in general. Unprofitable Internet stocks are soaring to levels heretofore never seen in the marketplace. Mix the global problems with our extreme market valuations and the problems at the White House, and we have what appears to be a perilous investment environment. The market definitely has a lot to absorb, but as Don Hays said "the stock market, like life, requires humility to really succeed". With our experience to date, we can't wait to see the market next year.

By Shaun Upjohn

Table of Contents

Introduction	1
Which way did he go?	1
Growth Portfolio Update	2
Growth Portfolio Objectives	2
Frequency Electronics (FEI)	3
Gulfstream Aerospace (GAC)	4
Paxson Communications Corp. (PAX)	5
Small Talk with the Managers...	6
Meet the Faculty	7
Comments & Disclaimer	8

Growth Portfolio Update

As of 12/31/98, the total portfolio value of the Roland George Program was $2,047,162.31 and the growth fund had a value of $1,021,756.79. This is a well above the market value shown on 5/31/98, which was $975,195. This increase was as a result of increases in the stock prices of equities currently in the portfolio, dividends paid on them, and a series of buys and sells. Allied Healthcare Products, Cooper Tire & Rubber, Dillard's, Hycor Biomedical, IBP, Merrill Lynch & Co., and Phelps Dodge were all sold because they had or were expected to incur losses. The buys were Au Bon Pain Inc., Frequency Electronics, Gulfstream Corp., and Paxson Communications.

These new acquisitions and sell offs have impacted the portfolio in the following way:

- the sector weightings for financials, consumer staples and consumer durables have been reduced while industrial cyclicals, services and retail have increased;
- the investment style has also been affected, showing more medium and small growth stocks and a decrease in value stocks;
- the portfolio beta has been increased marginally from 1.14 to 1.24.

By Shiran Samarawickrama

Growth Portfolio Objectives

Growth Portfolio Goals

Our aim is to:

- Generate equity investments suitable for the George portfolio, seeking preservation of capital and above-average, full cycle total return.
- Achieve an above-average risk-adjusted real return (alpha) by following a disciplined strategy of emphasizing both hidden intrinsic values and depressed, oversold values as defined in our Investment Strategies. Virtually all portfolio investments will be relatively out of favor when purchased; patience is needed in order to achieve our goals.
- Control portfolio relative volatility (beta) through liberal emphasis on stocks with low P/Es, stocks generating above-average portfolio income, and a full managed equity/reserve ratio. We stress adequate category diversification of stocks. Our goal is to build a portfolio which should not closely track the broad stock market indices.

Growth Investment Strategies

There is more than one legitimate definition of value and/or growth. Stocks selected and owned will fall into one of our value growth categories, several of which we have listed herein. We believe that the market will, from time to time, focus on the under-valuation of our individual securities and adjust their values upwards.

Hidden or undervalued asset situation

* Understated good will, real estate, inventory, or natural resource assets that ultimately should be better recognized by investors.

Corporate earnings recovery and margin improvement situations

* Internal management bootstrap operations and oversold cyclical recovery situations.

Inordinately low relative or absolute P/E situations

* Sound growth companies inordinately depressed because or market panic or negative company image even though they have strong, enduring customer franchises or good product lines which build in highly visible future growth.

Special situation takeover, liquidation, or restructuring candidates

* High cash flow and/or free cash per share, often with undervalued assets.
* Gap between public and private value.
* Attractiveness dependent on regulatory and economic climates.

Frequency Electronics (FEI)

— Investment Thesis —
RECOMMENDED FOR GROWTH INVESTORS

Recommendation	**Buy**
Exchange	**Amex**
Current Price	**9**
Beta vs. SPX	**1.04**
P/BV	**1.16**
EPS Est 1999	**.395**
Market Cap	**69.14 M**

Company Description

Frequency designs and manufactures time and frequency control products and components for commercial space applications and PCS wireless communications markets. The Company's products are primarily components, instruments, or systems used for PCS, satellites, space, radar, sonar, ships, and other applications.

We recently selected FEI as an undervalued small-cap equity investment that would participate in the fast growing cellular and aerospace equipment markets. We chose FEI for its leadership in transponder design, its low cost manufacturing position, the accelerating markets for FEI's products, and the superior margin of safety provided by FEI's balance sheet and technology leadership.

FEI's Markets in Cellular and Satellites are Exceptional

FEI's has doubled sales in each of the last four years in PCS and is a preferred supplier in the $1.8B Cellular Wireless timing device market. Wireless sales for 1999 are expected to grow 50% to $20MM with 2000 sales estimated at nearly $30MM. Current 33% gross margins should expand to 39% in 2000. FEI's competitive entry into this industry has been successful to date and has damaged competitors badly.

Estimates for FEI's satellite market are for up to 1,800 satellites to be launched in the next ten years at an estimated contract cost of $75B. FEI can bid on up to $7.5B of the hardware, including timing clocks, transponders, and timing devices. FEI has thirty years of experience in this market and is the dominant manufacturer of "timing clocks" for satellites. However, although FEI has been a preferred supplier to Loral, Alcotel, Hughes, Lucent, and Motorola in the past, much of the aerospace market is new to them, and we are not depending on this business to make this investment successful.

Given their competitive advantages, though, FEI should be able to be a major provider of timing devices in this market. If successful in this market, FEI would be a "home run" equity investment. We conclude that FEI should be able to grow in excess of 50% per annum driving sales to nearly $200M by the year 2002.

Margin of Safety

We believe FEI is undervalued in terms of its P/BV (Price per Book Value), P/WC (Price per Working Capital) ($5/sh in cash), and future EPS (Earnings per share) potential, a situation caused in part by historically poor performance, and a misunderstanding of the company's new strategy of becoming a low cost producer of transponder components. EPS are estimated to be $.50 for 1999 and $1.25 for 2000, and $2.50 for 2001.

Moreover, FEI's CAPX development spending has been completed, and we anticipate free cash flow to nearly equal EPS in the near term. Critically, should FEI slip in its strategy, we believe there would be a bidding war for FEI's critical technology by its customers at a price well above our cost.

By Student Analysts Jerra Fortner & Ryan Cournoyer

Gulfstream Aerospace (GAC)

Recommendation
Buy

Exchange
NYSE

Current Price
55.5

Market Cap
4024.50 M

Beta vs. SPX
1.06

EPS 1998 (est.)
2.97

— Investment Thesis —
Recommended for Growth Investors

Company Description

Gulfstream Aerospace designs and manufactures intercontinental business jet aircraft. The company's clients include corporations, governments, and individuals. Its principal products are the Gulfstream V and Gulfstream IV-SP aircraft. In addition to building new aircraft, the company also markets preowned Gulfstream aircraft. Forstmann Litt, a private investment firm, owns approximately 42% of Gulfstream Aerospace's common stock. The company has sold more than 960 large business aircraft since the introduction of its product line in 1958.

Large Backlog of Jet Orders

GAC has secured orders for 126 aircraft ($3.9B+ or two years of production). Cash flow generated from this backlog will be used to retire debt and stock. CAPX (Capital Expenditures) will be negligible for several years. With $3.9 billion in cash flow, GAC is strong financially.

Back-log and Margin Growth Predict Explosive Growth

EPS have accelerated since the company went public, rising from $.39 in 1995, to $.60 in 1996, to an impressive $3.12 in 1997. Estimates for 1998 EPS are $2.96 and should grow to $3.72 in 1999, as backlog revenue is realized. Profits from increased revenues have been supported by large reductions in the previous R&D costs associated with GAC V. Profit margins will expand further as the company comes down the manufacturing learning curve.

GAC's GulfStream V Is A Valauable Franchise (#1 in Status)

GAC has improved its reputation as the Rolls-Royce of the business jet industry with its introduction of the Gulfstream V. This ultra-long range business jet was awarded the Robert J. Collier trophy, which honors the year's top aeronautical achievement in the United States. The Gulfstream V is the status jet desired by every CEO who is in the market to buy a corporate aircraft.

Industry Demand High Due To New Technology And Retired Aircraft

An overlooked factor in the industry is the zero net introductions of business jets for the past decade (between 1985-94 there were 10 new models introduced and 11 retired). From 1995-99 there will be 16 new models introduced and 9 cancelled. Gulfstream V appears to be the clear winner.

K-C Aviation Acquisition will Help GAC Manage Demand

GAC recently acquired K-C aviation from the Kimberly-Clark Corporation for $250MM. K-C is the largest independent completion center for corporate aircraft in North America and the leader in the industry. This backward integration provides GAC with in-house customization and refurbishment of high-end aircraft. GAC now controls the premier finisher of corporate aircraft in North America.

Growth of Fractional Ownership will Draw in New Customers

Industry experts conclude that 25% of corporate aircraft demand will be driven by a concept called fractional ownership. The program allows companies to purchase eighth, quarter, and half shares of Gulfstream IV aircraft. This concept allowed GAC to expand its customer base, allowing businesses with limited travel requirements to own the world's most prestigious jet. Warren Buffet's leading travel jet company is a major purchaser of the Gulfstream V's.

By Student Analyst William Laird

PAXSON COMMUNICATIONS CORP. (PAX)

— INVESTMENT THESIS —

RECOMMENDED FOR VALUE INVESTORS

RECOMMENDATION	BUY
EXCHANGE	AMEX
PRICE	9
MARKET CAP	469.11 M
BETA VS. SPX	.74

COMPANY DESCRIPTION

Paxson Communications Corporation owns and operates a nationwide network of 73 owned, operated, and affiliated television stations. The company also launched its "PAX TV" family entertainment network. Paxson's network schedule consists of "Touched By An Angel", "Promised Land", "Dr. Quinn Medicine Woman", "Life Goes On", I'll Fly Away", "Christy", and other television shows.

✣ *Enormous Potential for Profit*

Due to Paxson's massive collection of stations, it operates under a hybrid model whereby the network owns the stations instead of paying affiliate fees to local stations.

✣ *Management with a Track Record for Success*

Bud Paxson founder of Home Shopping Network and CEO Jeff Sagansky formerly with CBS.

✣ *Huge 'Margin of Safety'*

In the $16 per share liquidation value of the stations, and Paxson's 30% interest in the Travel Channel which it is expected to sell for approximately $50 million, PAX has excellent private market value.

✣ *Growing Market*

According to Lowell Paxson, founder of Paxson Communications, the average age of Americans is now 41, but it is projected to be at 50 in ten years. The increasing size of this market combined with Paxson's ownership of this distribution medium will allow them to compensate for the lower rates paid for this type of audience.

✣ *Barriers to Entry and Competition*

Paxson Communications owns and operates the largest group of broadcast television stations in the United States and reaches over 74% of U.S. television households. PAX TV is the only television broadcaster with full-power stations in all of the top 20 U.S. markets.

✣ *Good Businesses*

PAX TV currently leads the industry in number of stations owned. Company revenue and growth will come from advertising sales.

✣ *The Worries and the Opportunities*

A major recession could hurt Paxson's advertising revenue substantially. The FCC could also restrict the number of stations a network may own, but this is an unlikely scenario. Currently, Paxson's stock price is below its intrinsic value based on normalized industry earnings multiples of 15 to 18 times annual earnings. PAX TV needs to earn a 1.0-primetime rating and .5 nonprime rating to be profitable. With a target audience of aging Americans, Paxson Communications should have little problems turning profitable in the short-term after the network launch.

— RECENT NEWS —

❋ *11/16/98*

Paxson Communications reported financial results for the nine months and quarter ending Sept. 30, 1998. For the nine months, total revenues rose 49% to $91.4 million. Operating losses before depreciation, amortization, stock-base compensation, time brokerage, and affiliation fees decreased to $20.9 million. PAX TV launch costs and additional operating costs associated with the company's broadcast television station group were the reasons for the continuing losses.

❋ *12/22/98*

In its sixteen weeks on the air, PAX TV has maintained a 1.1 weighted average (NSI) during its primetime weekday line-up.

❋ *1/7/99*

PAX TV received its highest Nielsen NSI regular weekly rating ever. PAX posted a 1.2 primetime rating during the week ending January 1, 1999.

By Student Analyst Josh Kingdon & Dennis Clark

SMALL TALK WITH THE MANAGERS . . .

Gerald T. Kennedy was the Roland George visiting professor from 1982-1989. He is the President of Kennedy Capital Management, Inc., based in St. Louis, Missouri. Kennedy Capital Management, Inc. has been ranked among the top investment advisors by SEI with about $2billion dollars under management. Kennedy Capital Management, Inc. distributes a newsletter to help small companies with good fundamentals get discovered. On November 16,1998, Mr. Kennedy spoke to the Roland George Investments class in the Lynn Business Center. The following is a summary of an interview conducted with Mr. Kennedy regarding some of his investment philosophies.

Do you prefer to use the "top down" or the "bottom up approach" in your selection of equities?

Kennedy: "Bottom up". The bottom up approach involves extensive research and analysis of individual companies. Shares are selected based on the company's future prospects and fundamentals, not on any significant economic and market cycles.

Where do you see the small caps going in the next year?

Kennedy: I see the Russell 2000 outperforming the Dow and the S&P in the upcoming year regardless of the direction in the movement. If the market goes down then I expect the DOW and the S&P to fall further than the Russell 2000 and the same would hold true if we carry on the bull market.

****How does KCM find attractive companies?***

Kennedy: The simple answer is hard work! KCM tries to screen every earnings report that is released. If the company is one with low institutional ownership and with few analysts and if we are intrigued by the published earnings, we start digging. In most cases, we call the company to learn more about them. We ask the company if they know what they look like to outside analysts. In addition, Kennedy Capital has been investing in invisible companies since 1981. During this period we have developed a data base on small companies. For example, we have been collecting cash flow data on small companies. Cash flow figures are not in any generally published data bases. This experience and the proprietary data, may be just enough to give us an insight.

What is your approach to IPO's?

Kennedy: We look for stocks with good fundamentals that have fallen 30-50% below their original offering price within 18 months.

Would you consider buying any Internet stocks?

Kennedy: Yes, I would consider buying Internet companies if they meet my criteria. One stock that we own now is Market Guide, Inc. (MARG).

****Why are some emerging growth companies invisible?***

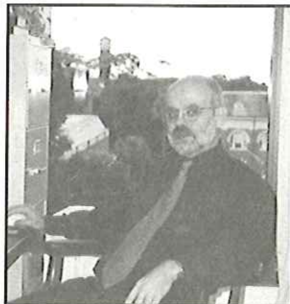
Kennedy: There are numerous reasons. First, some companies are just too small to be looked at by large investors. At KCM we follow these tiny companies and when they are almost large enough to attract institutional investors, we start to acquire our positions. Second, investment banking firms earn substantial fees "taking companies public" and they have been very busy at this enterprise. Since 1991, there have been over 5,000 IPOs with a market value of $350 billion. Almost all these IPOs are "covered" by analysts — at first. However, the analysts' attention often wanes as their affiliated investment bank brings new companies to market. In addition, if an IPO has a problem, analyst attention can be very short-lived. While KCM rarely invests in new IPOs, we watch these fledgling concerns and look for those which have strong fundamentals but have been abandoned by analysts. There are many. A third reason why companies can be overlooked is the wide-spread use of computer data bases and computer screening techniques. This is an efficient way to locate attractive companies. But if data are missing or inaccurate, as they often are with small under-followed companies, the "screen" will remove companies from consideration, when perhaps they should be given more attention.

* **Indicates information taken from the website of Kennedy Capital Management at http://www.kennedycapital.com**

By Russell Kelton and Dennis Clark

PROF. FRANK G. CASTLE, CFA
Visiting George Professor of Applied Investments

Prof. Castle has worked in investments and banking for twenty-eight years since graduating from Miami University in Ohio with a B.S. in Accounting. He has an MBA from Babson College and attended the Stonier School of Banking at Rutgers University. After performing economic research for the National Security Agency, Prof. Castle worked for Bank of Boston in the Investment, International, and Merchant Banking divisions. Following the Bank of Boston, he worked for Feeley & Willcox, a Wall Street research and investment company. In 1994, Professor Castle moved to the Middle East as a manager and teacher for the Abu Dhabi Investment Authority, returning to his own firm, Andover Research, in 1996.



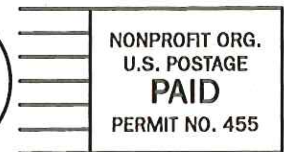
DR. JAMES E. MALLETT
Associate Professor of Finance

Prof. Jim Mallett has been teaching in the Finance Department at Stetson University since 1984. He also serves as the director of the Roland and Sarah George Investments Institute in the School of Business Administration. Prof. Mallett completed his Ph.D. in Economics at Wayne State University in 1981. At Stetson University, Jim Mallett teaches personal finance, investments, money and banking, and international finance. Prof. Mallett has written articles in investments and personal finance. He also serves as an investment committee member for Orange County, Florida.

Check out our new George Investments Institute web site and Prof. Mallett's Personal Finance site:

http://www.stetson.edu/departments/finance/institute.htm
http://www.stetson.edu/~jmallett/finplan.htm

School of Business Administration
George Investments Institute
421 N. Woodland Blvd., Unit 8398
DeLand, FL 32720-3774



Comments & Disclaimer

The Roland George Investments Program was created in 1980 by Sarah George to provide a unique experience for future investment professionals. This bequest was intended to honor her husband, Roland, who, after completing his education, began to ply his trade and promptly lost money. Mr. George decided that serious flaws were evident in the traditional educational process for future investors since by over-coming his formal education he was able to master investing, and in short accumulate wealth.

From this start, Mr. George formed the ideas of creating an investment curriculum that combined academic theory with real world experience. This dream came true when Sarah George funded the Roland George Investments Program. This program provides support for the applied investments program at Stetson University where students manage a $2 million dollar portfolio. Insights are gained through contact with professionals such as Gerald T. Kennedy of Kennedy Capital Management, Inc.

For information on the Roland George Investments Program contact Dr. James Mallett at 904-822-7442.

George Investments Institute Staff

Director:
James E. Mallett, Ph.D.
james.mallett@stetson.edu
www.stetson.edu\~jmallett

Advisor:
Frank G. Castle, CFA
Visiting Roland and Sarah George Professor of Applied Investments

Editor:
Derek S. Mears, Graduate Assistant

Publications Specialist:
Lynn Thompson

The *George Inve$tment View* is intended to be an educational document. Investment views belong to the authors and not Stetson University.