



## Hunting the Liquidity Swamp

There are two offers one really cannot refuse. Don Corleone immortalized the first one. The modern credit state has fathered a kinder, gentler version: the zero-interest, no-money-down, non-recourse loan. The crucial similarities between the two are that the general terms of both offers overwhelm any of the details and that both appear under the guise of an economic proposition, but neither actually is.

In an economic offer prices communicate information about asset value, scarcity, demand, and market conditions. But when you are informed that either your signature or your brains will be on a contract within five minutes, your willingness to sign conveys no useful information about the market value of big-band singers.

Similarly, the no-money-down, no-interest, non-recourse loan uncouples price from value for any assets purchased with the proceeds. Lottery tickets become a sound investment.

These thoughts were occasioned by the news that twenty-year Russian euro debt is currently yielding only 5 percent. What can people possibly be thinking? How is it possible to get to long-term Russian paper at 5 percent, just a point or two higher than the major Western governments with long traditions of democracy, free markets, and the rule of law as a reasonable speculation with one's own money?

What is the bet? That Russia will progress seamlessly toward impeccable constitutionalism over the next twenty years with nary a crisis or a panic along the way? Nineteen ninety-eight is only five years ago. Did history end in Russia sometime in the last five years?

No one believes this. The bonds are trading at 5 percent not because the purchasers really believe Russia has achieved permanent economic and political stability, but because they are getting an offer they cannot refuse. But the man making the offer is neither Don Corleone nor even Don Putino, but Don Alan.

The Fed has been trying to convince us for a while that short-term rates will be zero more or less forever: with perpetual zero interest you can finance those twenty-year Russians indefinitely. And though it is not quite possible to borrow 100 percent against such foreign issues, serious players can probably get 85, which is as close to zero down as anybody needs.

But zero down plus zero interest was not quite enough: the feds have been trying to give away free loans for a while with only middling success. They still needed a no-recourse provision to close the deal: Don C would have understood.

So for weeks, Fed spokesmen have been going about like used car salesmen declaring they will take anything on trade-in, no questions asked. Sure the Fed has traditionally bought only Treasury bills. But there is nothing in principle, they now enthusiastically declare, to keep

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GMST • IFLO & SNCI



them from buying long bonds. And they have been positively flirtatious about the possibility they might go further, to agencies or even corporates. Do we hear fallen angels or the S&P index on a bad day? The message is clear: rather than letting the economy take another fall, they will buy whatever they have to.

The inevitable effect of Don Alan's offer is to make market prices unreliable as guides to asset value, an almost perfect definition of a bubble. The most obvious sign that the current rally is primarily a monetary phenomenon rather than an economic phenomenon is that everything is rallying together: stocks, bonds, gold, commodities, foreign currencies, with only the dollar falling. And as always in a credit bubble, companies have started borrowing money for no reason other than that rates are low, Yahoo's recent offering being the most conspicuous example. Even corporate refinancings, however welcome on other grounds, amount to little more than a revaluing of assets against a cheaper dollar.

It is possible to argue that the Fed is right about the possibilities of deflation and that the current campaign is simply right-pricing the dollar, not debasing it, or corrupting market prices. But then what do we make of the housing market? Most of what we have seen over the past three years has been a shift in relative prices, favoring real over financial assets, rather than a general deflation in price levels. Only since the Fed started making its very special offer have investors come back to financial markets with any enthusiasm.

The danger is that the Fed cannot keep this up for very long before "preventing deflation" becomes an obvious attempt to debase the currency, at which point a Greenspan

Fed would almost certainly pull back, jerking the markets around again.

How long? The last staging of this play ran for about eighteen months, from the crash of Long Term Capital when the Fed began to open up the sluices, to March 2000, with the Y2K pump-up and the fading memories of the last comparable crack-up in 1987 helping to extend the run. Today's market should be much more sensitive to danger signals. For what its worth, since we don't bank much on even our own macro outlook, we think the liquidity rally will be over by mid autumn. In the meantime bargain hunting will be a little more challenging, but there are places to look for value, even now.

## HAYES LEMMERZ (HAYZ.OB)

Liquidity-driven markets tend to exaggerate the impact of past buying decisions. In a liquidity drought, people who must raise cash obviously must sell what they already own. But when the dollars start flowing again, buyers driven by a sudden need to put money to work also tend to buy what they already own and understand.

It follows that in a liquidity-driven run-up, like the current rally, a good place to look for bargains is equities of solid companies that for anomalous reasons are narrowly held at present, but should find a wider following and increased liquidity over time. One possibility: venerable enterprises emerging from Chapter 11 whose shares are still concentrated among former creditors, but gradually migrating out to the wider market.

Securities changing markets, passing from one subculture of owners to another, often pass across a liquidity vacu-



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um on the way. Liquidity requires that the value of the asset be easily ascertained, which is why it is associated with currency. If it suddenly became so easy to counterfeit U.S. currency that half of all the real stuff were replaced by fakes, even genuine dollars would be liquidity-impaired by the resulting uncertainty and thus lose value. Similarly when a security is sold out of a market in which it is well known and understood and into a new unfamiliar market, it tends to trade at a discount for the illiquidity of ignorance.

Hayes Lemmerz is the largest maker of automobile and truck vehicles in the world. Founded in 1908, it is a venerable old American company not unlike Dana, the kind that makes you feel you ought to be wearing a three-piece suit when you buy the shares.

At least that's what they were like until the late 1990s. Let's see if you can guess what they did then. Did they . . .

1. make huge acquisitions just as their market was about shrink?
2. acquire more capacity than they could manage, shooting margins to hell?
3. finance all this with mounds of debt whose carrying costs far outweighed the return on the suddenly less productive acquisitions?
4. do this just as the Fed was about to shut down capital markets on the grounds that Americans were becoming too rich and happy for their own good?

If you answered "all the above," you've read this newsletter before. In fact the Hayes Lemmerz story is a lot like the TWR and DRRA stories, only better, because Hayes actually did go bankrupt, probably making its comeback easier.

Turns out that after all these millennia, making wheels is still a pretty good business. Throughout the 1990s Hayes had gross margins in the high teens, with SG&A costs around 4 percent. The gross margins were all the more impressive given a sector-wide eccentricity of the financial reports: depreciation of plant and equipment gets buried in with cost of sales, as do some engineering costs. Separate R&D costs were trivial, and until the late '90s interest expense was nearly so.

Nor has there been much secular degeneration in margins since, despite the inevitable moaning about price pressure. Hayes's leading U.S. competitor, Superior Industries, with somewhat less than half Hayes's sales still gets gross margins in the high teens. It did just over 19 percent in the most recent quarter. During the 1990s the light-vehicle side of the industry did migrate fairly quickly from fabricated steel wheels to cast aluminum, but reinventing the wheel was not a problem

for Hayes, which has plenty of aluminum expertise and helped lead the change.

Hayes's problems were self-generated. As with TWR and DRRA, in the early 1990s Hayes began to feel pressure from the automakers, who wanted to start dealing with fewer

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suppliers for any given part. They also wanted parts to evolve into modules and systems making up larger percentages of the finished car and usable on multiple "platforms." The message to midsize suppliers was simple: consolidate, because we can no longer accept the inventory and design burden of dealing with multiple, small suppliers for similar parts; and move up the value chain because we are going to buy systems, not nuts and bolts.

So after divesting some non-core businesses, Hayes went public in 1992. With a more flexible capital structure, the company made three major acquisitions: Motor Wheel, a U.S. competitor, in 1996; Lemmerz, a European wheel maker, in 1997; and CMI, an aluminum specialist and maker of various things that get attached to wheels, in 1999.

By January 2000 the company's net sales had grown by 275 percent to \$2.3 billion. Unfortunately long-term debt grew by more than 1000 percent, to \$1.5 billion, and the debt-to-asset ratio soared from 20 percent to more than 52 percent. But it's not like they didn't catch any breaks: net interest expense grew by only 900 percent.

Then the business fell apart. There was some sales slippage in a tightening market, but nothing dramatic. Sales peaked in FY99 at \$2.3 billion and slid slowly down to \$2 billion last year for a three-year decline of 15 percent. Not cause for rejoicing, but hardly catastrophic compared to what tech and telecom were going through.

Hayes's catastrophes were in manufacturing. It was not just that strategic acquisitions like CMI and Lemmerz also added some overlapping capacity. Stuff stopped working. For FY 2000 gross margins fell off a cliff from 16.5 to 11.8 percent of sales. Declining sales in North America explained some of the problem, but the real problem was a sudden outbreak of "recurring manufacturing difficulties" and "inefficient operating performance." Hayes's expansion was overwhelming its management.

In FY 2001 gross margins leapt off yet another cliff to 6.5



percent. Of the \$86 million less in gross profit the company reaped from North America that year, more than 90 percent was attributable to those still recurring manufacturing difficulties and operating inefficiencies. Net interest expense was almost 50 percent higher than gross profit. The operating line went negative. There was even a minor accounting scandal. And they went broke.

What a relief! We want to go broke someday. Bankruptcy court wiped out the old shareholders (Hah! Serves those widows and orphans right for speculating on these newfangled wheel contraptions) and turned \$2 billion or so of “liabilities subject to compromise” into \$650 million of debt and 30 million shares of stock. Interest expense is down to about \$56 million a year from nearly \$200 million and is projected to ease down toward \$45 million by the latter part of the decade.

The operational cleanup is well underway. The company, whose manufacturing facilities are vast and far flung, has already consolidated or shut down nine major facilities. Gross margins for FY 2002, which ended last January 31, popped back to 10.4 percent, though much of the shutdown activity took place in the course of the year. The April quarter gross margin was just 10.1 percent, as the company continues to consolidate, but that figure should head back into the mid teens as the restructuring is completed.

What’s it worth? The balance sheet does not do us much good, except that it shows the company is no longer unduly leveraged. Trying to ascertain a meaningful net asset value for a company, many of whose assets are functioning liabilities in the process of being consolidated away, is not a very productive exercise. We must start elsewhere.

Ex-bankruptcy shares issued in satisfaction of creditor claims must be given a value, contestable by the creditors and ultimately approved by the court. That does not make the value accurate, but it gives us some assumptions to review.

Based on fairly broad industry comps, the reorganization plan proposed an initial enterprise valuation of roughly 5.5 x last twelve months’ EBITDA of \$228 million (adjusted to take out one-time costs arising from the reorganization proceedings). Allowing for \$650 million of debt, that valuation would have yielded an equity value of \$600 million or \$20 per share. The creditors and the court bought it, but the market hasn’t so far. Since coming back out in early June, Hayes has been trading around 12, implying an enterprise value of about \$940 million, or just four times trailing EBITDA.

By way of comparison, high-flying rival Superior Industries (SUP) has been trading at an enterprise value of seven to eight times trailing EBITDA. At that multiple, Hayes’s

share price would be pushing \$40. On a sales-to-enterprise value basis, Superior’s 1.25 or better multiple would give Hayes an EV of \$2.5 billion and a share price over \$60.

We suppose this is what they mean by market prices always being right: the company is just out of bankruptcy, nobody’s been watching for a while, bankrupts have a high rate of recidivism, what’s the harm in waiting? Isn’t it perfectly reasonable that Superior, which is not broke, has no debt, has been gaining sales and market share, has GAAP earnings, and pays a dividend should get at least twice the multiple by which Hayes is valued?

Uh, sure, OK. But all that has to happen for Hayes to no longer be “just out of bankruptcy” is for clocks to keep moving in their accustomed direction, a well-established trend. Assume that the “just out of bankruptcy” gap accounts for just 25 percent of the difference in the two companies’ multiples. With the gap closed, Hayes would be at \$16.30.

The bankruptcy plan projects Hayes’s EBITDA growing from \$228 million for the twelve months ended January 31, 2003, to \$296 by FY 2008, a 30 percent rise on a sales increase of less than 10 percent to just \$2,187 million. That implies a smaller increase in margins than we expect from a massive restructuring, yet implies a stock price of more than \$27, assuming the EV-to-EBITDA multiple gets stuck at 5. Increase EBITDA growth just 10 percent and plug in that original EBITDA multiple of 5.5, and the stock hits \$40, even if Mr. Market never loses his cool and makes us an offer we could not refuse.

## SOLECTRON (SLR)

SLR, which had closed up as much as 128 percent from our Oct 22, 2002, \$1.95 entry price, has been slumping since the company announced a \$3 billion loss for the May quarter. We’re hoping it slides for a while, since we still like the shares for the long term and would not mind buying some more.

As with most such headline-making losses these days, this one was nearly meaningless, driven by an SEC mandated \$2 billion write-down of “goodwill” and other intangibles we never counted above zero anyway. Much of the rest came from a \$721 million write-down of deferred tax assets, which we also never banked on, as they tend to come and go. Another \$223 million—40 in cash—came from yet another restructuring charge for the good work of further rationalizing the company’s far-flung production capacities, acquired during its helter-skelter acquisition days at the close of the last century.

Mr. Market ought to know by now that it is quite difficult for a company to really lose \$3 billion on sales of \$2.8 billion, yet these things continue to throw him into a tizzy, no matter how transparent. The recent discovery by many Wall Street types of a heretofore little-remarked document called a balance sheet, not to mention their vague sense that GAAP earnings are IN while EBITDA et al. are OUT, only adds to the confusion. Oh yes, they are all hard-riding, butt-kicking, value-scouring fundamentalists now, too, you know, and they jus' ain't gonna be fooled by any of that "pro forma" shilly-shallying.

Of course we also take GAAP statements seriously: their tendency to mean the opposite of what they say is of great assistance in our work. Consider that back when Solectron was acquiring other contract manufacturers for prices several times their measurable value, thereby piling up debt, interest charges, and operating costs considerably exceeding the earnings power of the acquired assets, the full purchase prices of the acquisitions were nevertheless capitalized, largely as goodwill, and used to anchor the indebtedness that nearly destroyed the company. Surely such overpayments would more sensibly have been described as expenses and charged against profits then and there, possibly giving management second thoughts about running up the bill in the first place.

And now that the company is rationalizing its business, enhancing asset quality by dumping unproductive bricks and mortar, machines, and men, and banishing vast mirages of goodwill, the result is expensed off current income and shows up as \$3 billion quarterly losses. It is not for nothing that the favorite calculators of CFOs everywhere use something called Reverse Polish Notation.

No matter. We bought SLR in the first place precisely because it was so evidently troubled and thus probably selling at an even deeper discount to its potential than its two leading American rivals FLEX and SANM (though we would not mind owning SANM). Like Corning, which we bought on the same day, we liked SLR as an eminently fixable and thus underpriced mess. We still like it.

The company has taken three more restructuring write-downs in the three quarters since we recommended it, for a total of nine in a row, with more to come. But in the same nine months the company has reduced net debt by \$700 million and interest expense from \$244 million in FY

2002 to a current burn rate of \$200 million. As we have noted previously, \$1.1 billion of its current \$3 billion in gross debt is convertible to equity at the company's option. The dilution, dependent on the share price at the time, could be unpleasant, but the conversion option makes the balance sheet much stronger than it appears at first glance, potentially boosting the company's net tangible assets by more than \$1 billion.

A bit harder to track is the pace of progress on operating costs. In the August 2002 quarter, which was also the last of the fiscal year, SLR's SG&A costs peaked at 8 percent of sales. For all of FY 2002 that figure was 6.8 percent. That number has dropped every quarter since and was down at 6.1 for the May 2003 quarter, though sales were down as well. In absolute terms the last nine months' SG&A costs were down \$53 million or 9 percent from the same period last year. That's good, but there is lots of room for improvement: pre-boom those costs centered around 4 percent of sales.

Progress on gross margins is much harder to follow during a massive restructuring. Margin improvements lag restruc-

**Mr. Market ought to know it is quite difficult to really lose \$3 billion on sales of \$2.8 billion, yet these things continue to throw him into a tizzy.**

turing efforts. Some crucial restructuring costs are buried in costs of sales rather than broken out, including much of the cost of moving production from high-cost to low-cost countries, mostly in Asia, a big focus of SLR's current efforts. In December 2000, only 30 percent of SLR's production capacity was in such low-cost regions; the target is to have 70 percent by August 2004. The costs of moving production probably suppressed gross margins by a point last quarter, pushing them down to 5.81 percent. The overall trend, however, has been favorable, with the first half of FY03 running about a point ahead of last year. But what we are really hoping for is a much more dramatic swing by the time the restructuring is mostly complete, from today's effective 7 percent back to around 10. Along with getting SG&A down to 4 percent that would make the company robustly profitable at the operating line. That seems like a reasonable result from an effort that will ultimately reduce 114,000 employees to less than 60,000 and nearly 24 million square feet of manufacturing space to 13 million or less.

Skeptics argue the gross margin challenge can't be solved by cost cutting because the real problem is price



pressure, especially for companies like SLR with so much exposure to telecom. There is price pressure, but it comes mostly from the very overcapacity SLR and its rivals are shrinking away. There is an extraordinary human tendency to imagine that a historical cycle has ended—because it has peaked. With even modest sales growth, there will be an acute capacity shortage before the last analyst has finished bemoaning the glut.

In the event, growth will probably be more than modest, driven by the ongoing trend for OEMs to increase their outsourcing to the EMS industry. The annual Bear Stearns outsourcing survey shows the relevant OEMs still do 70 percent of their manufacturing in-house, but on average would like to reduce that to 50 percent or less. If that 50 percent goal roughly defines the long-term trend, the EMS industry stands to double or triple in size over the next decade or so.

We bought SLR hoping to get in on the bottom of a cycle. We think we have and will happily accept Mr. Market's repeated offers to sell us his shares at panic prices.

## AMERICAN AIRLINES (AMR)

Our AMR bet, placed @ \$6.95 on June 2, 2003, was that with union concessions and other cost containment in place the shares had a reasonable shot at \$20-\$25 over the next two years. The downside was a still non-trivial chance of bankruptcy, which the credit markets were pricing at roughly 10 percent a year, and which we estimated at up to 25 percent over the life of the bet.

Our level of confidence is a bit higher today. Merrill Lynch's sector analyst team, headed by Mike Linenberg, points out that, even as we were writing, the company was improving its cash position by \$200m or so, better than 10 percent. Linenberg and company also pointed out a detail of the creditor renegotiations we had missed: the waiver of a covenant on an \$834 million line of credit that otherwise would have required full repayment by the end of this month. Under the new agreement the next cash flow coverage test does not come until March of next year.

Perhaps as a result of absorbing such details, credit markets have become almost gleeful about AMR, which was upgraded two notches to B- in mid June. Senior debt issues trading in the low twenties or teens right before the union settlement, and in the 40-50 range last month, are now in the low to mid sixties, implying a materially lower risk of a bust than when we placed our bet.

On the operating side there has also been a sprinkling of good news. As expected, total traffic figures for AMR and the industry as a whole were down for May, YoY. But traffic shrunk less than capacity was cut, meaning load factors went up, and fewer empty seats were being flown around at 75 cents a gallon. Unit revenue (a measure of revenue per unit of capacity) was up 1.8 percent industry wide but 4 percent at American, which Merrill believes led the sector. AMR's load factor (percentage of seats filled) rose to 73.7 percent, up 4.1 points from a year ago. When AMR is in fighting trim, its breakeven load factor is in the high 60s or very low 70s. It is probably around 80 percent today, but descending rapidly. Merrill projects it at 72 percent for 2004.

We note that the Merrill team still projects AMR to lose \$700 mil in 2004 (about 40 percent less than they had been projecting), whereas we are betting AMR will make a billion or so in either 2004 or 2005. But Merrill assumes 2004 fuel costs @ 85 cents a gallon, virtually unchanged from their 2003 estimate and 10 cents higher than today. Essentially they are assuming another war in the Middle East, which is possible. That does give clarity to the bet: to get to our \$20-\$25 price in 2004-2005, you have to assume an improved economy, nothing like 9/11 happening again, and that in one of those two years fuel prices will range around 65 cents, rather than 85.

Against that, consider that the shares are up around \$11 from \$7 in a month. We expect them to be generally supported as the risk of bankruptcy declines, but \$11 is not cheap at this stage. We do not want to own airlines long term and 60 percent profit in a month is a lot. It would not be unreasonable to rebalance down and bank a portion of it.

## TOWER (TWR)

Why did TWR raise \$250 million on unsecured notes yielding 12.5 percent to replace \$200 million in convertibles paying 5 percent and due in August 2004, thus raising net after tax interest costs by more than 20 cents a share?

Because if the equity markets are incorporating a significant possibility of bankruptcy into your share price, you go to the credit markets when you can, rather than waiting for them to close on you. And because one way to relieve that drag on the share price is to shore up your liquidity position, even if higher interest payments depress earnings for a while.

If TWR survive it will eventually thrive and the stock will climb back to \$10 or more over two or three years. What's been worrying equity markets is not how long it will

take to get to \$10, but whether it will go to zero. As the company allays liquidity concerns, the shares will begin to attract conservative, long-term value types. We'll meet them at the finish line, but our average basis will be lower. We are buying up to \$4, with \$10 still the target over a realistic timeframe of two to three years.

As for our other auto systems makers, we still see DRRA as a long-term play with a target of \$15 to \$21 over two to three years. We would buy up to \$10. On present information, Dana has become reasonably priced at \$11.60 or so, which means we are holding a free option on the Clayton Christensen thesis that value and profits in the auto industry will migrate toward the top systems makers. We will sit and watch the grass grow for now.

## GEMSTAR (GMST)

**B**ecause we bought GMST for the TV Guide franchise we continue to be pleased to see the new Murdoch team taking control and shifting management's emphasis in that direction. They are doing just the right thing with the magazine, raising prices and letting circulation slide, while upgrading editorial in pursuit of an audience of core, devoted readers who will pay more and respond better to advertisers yielding lower costs and higher ad rates per reader.

There has already been a bit of improvement on the ad side. Though that may be driven largely by a generally better ad climate, it's better news than if the mag were not rising with the tide. Rising revenues at the TV Guide Channel don't surprise us; it's good. Our bet continues to be that the Murdoch people will not waste the real options inherent in a 9 million circulation magazine that they know has to change because its old mission is going away. Don't be surprised if the 3 million circ. version is a lot more profitable. We're holding for now, while noting this is a speculation and those happy with 50 percent in six months should act accordingly.

## I-FLOW (IFLO) & SONIC INNOVATIONS (SNCI)

**T**hese companies were similar propositions when we bought them: small caps, fueled by the promise of innovative medical devices, but past the develop-

ment stage, and dramatically undervalued, assuming they even partly fulfilled their potential.

Today they present very different challenges. I-Flow's regional anesthesia product, which replaces postoperative narcotic painkillers with a continuous flow of local anesthesia, is clearly winning both plaudits and customers in the medical community, especially in elite, trendsetting hospitals, including Yale, which is doing a study. Add that to YoY growth of more than 60 percent in this product last quarter, and the company has begun to gain attention, pushing its valuation into speculative growth regions. Barely had we raised our price target to \$6-\$7 from \$4-\$5 when it zoomed a dime or two past the upper range. As we write, IFLO has gained over 120 percent since we first recommended it on March 3.

What to do, what to do? We don't like paying growth prices. On the other hand, it is very hard to find a near-term bump in the road for I-Flow. With another good quarter report, which we expect, the stock should have an even bigger audience. And though we are not insiders, we follow IFLO closely enough to have real conviction in both the technology and the business plan.

If we were opining not betting, we would say I-Flow goes relatively easily to \$12-\$15 within another twelve months and possibly to \$20 in the next year, if it is not bought up first. Still it gets harder to double your money as you go, and there

**I-Flow's regional anesthesia product is winning plaudits and customers in elite, trendsetting hospitals, including Yale, which is doing a study.**

are other opportunities in the world. It would be good discipline to take a bit of your profit now, but we think prospects are too exciting to let go entirely.

Once again, Andy and partners own almost 5 percent of this stock and it is RV's largest holding. Neither of us has any immediate plan to sell, though that could change before next issue.

SNCI is in a somewhat different position. Although academic studies say its hearing aids work better than competitors' under noisy conditions, and some users love them, the anecdotal verdict is not unanimous. Even very good hearing aids often disappoint users who come to the product with high expectations: reproducing human hearing convincingly is very difficult. The SNCI products are doing decently in a currently very tight U.S. market, where the distribution system for hearing aids is also inefficient and fraught with conflicts of interest. They are doing much bet-



ter abroad where insurance more commonly covers the products and where SNCI has bought a number of successful distributors. But there has been no dramatic acceleration of sales as with I-Flow, and last quarter sales were sequentially down for the first time ever.

The case for SNCI is still largely in its price. It is a well-managed company with some hard-to-define degree of technology advantage, growing reasonably well up to now given tough market conditions. It just completed its product line, which should help broaden sales. It is aching close to being

profitable, and assuming it gets there, it is still far undervalued compared to its profitable competitors.

Once again, we are waiting for the quarter, albeit with some more trepidation than with I-Flow. With all the product introductions the company did in April, to see sales remain stalled as they did last quarter would be a disappointment. But if there is significant sales progress, we will feel much more confident about this as a long-term play, headed into the low teens or better.

—Andrew J. Redleaf & Richard Vigilante

June 30, 2003

## Performance to Date

### CLOSED POSITIONS

STOCK	POSITION OPENED	CLOSED	GAIN (LOSS)
GLOBESPAN VIRATA (GSPN)	JUL 1, 2002 @ \$3.48	NOV 26, 2002 @ \$4.54	30%
WESTERN DIGITAL (WDC)	JUL 24, 2002 @ \$3.07	NOV 4, 2002 @ \$7.05	129%
ATMEL (ATML)	OCT 22, 2002 @ \$1.30	NOV 26, 2002 @ \$4.05	211%
CORNING (GLW)	OCT 22, 2002 @ \$1.61	MAR 28, 2003 @ \$6.00	272%
LUCENT (LU)	OCT 22, 2002 @ .72	NOV 26, 2002 @ \$1.79	148%
ARRIS (ARRS)	NOV 26, 2002 @ \$3.14	MAY 30, 2003 @ 5.20	65%

### OPEN POSITIONS

STOCK	POSITION OPENED	JUNE 27 CLOSE	CURRENT GAIN (LOSS)	RECOMMENDATION
COMCAST (CMCSA)	AUG 29, 2002 @ \$24.53	\$29.20	19%	HOLD
COX (COX)	AUG 29, 2002 @ \$25.77	\$31.95	24%	HOLD
SOLETRON (SLR)	OCT 22, 2002 @ \$1.93	\$3.54	83%	BUY
SOMERA (SMRA)	OCT 22, 2002 @ 1.95	\$1.51	(21%)	HOLD
GEMSTAR (GMST)	DEC 20, 2002 @ \$3.25	\$4.92	51%	HOLD
APPLE (AAPL)	MAR 3, 2003 @ \$14.65	\$18.73	27%	HOLD
I-FLOW (IFLO)	MAR 3, 2003 @ \$2.24	\$7.24	123%	REBALANCE
SONIC INNOVATIONS (SNCI)	MAR 28, 2003 @ \$2.06	\$3.65	77%	HOLD
DANA (DCN)	APR 29, 2003 @ \$9.28	\$11.60	25%	HOLD
DURA (DRRA)	APR 29, 2003 @ \$7.45	\$9.75	30%	BUY
TOWER (TWR)	APR 29, 2003 @ \$2.58	\$3.67	42%	BUY
AMERICAN AIR (AMR)	JUN 2, 2003 @ \$6.95	\$11.32	63%	REBALANCE

### BIOTECH BASKET

STOCK	POSITION OPENED	JUNE 27 CLOSE	CURRENT GAIN (LOSS)	RECOMMENDATION
CELL GENESYS (CEGE)	JAN 31, 2003 @ \$9.95	\$9.20	(8%)	HOLD GROUP
HUMAN GENOME (HGSI)	JAN 31, 2003 @ \$7.04	\$12.57	78%	HOLD GROUP
MAXIM (MAXM)	JAN 31, 2003 @ \$2.99	\$5.85	95%	HOLD GROUP
MILLENNIUM (MLNM)	JAN 31, 2003 @ \$7.41	\$15.64	111%	HOLD GROUP
VERTEX (VRTX)	JAN 31, 2003 @ \$13.84	\$15.31	10%	HOLD GROUP

Position is "opened" when we first recommend the shares and "closed" on a "sell" call. All share prices are for the close on the day the WMO was published with the buy or sell recommendation, except for sells made by special e-mail advisories. WDC and ARRS sell calls were issued by special e-mail advisories. "Position opened" prices are for first-buy recommendation only. Long-standing positions may have had multiple, subsequent buy recommendations at both higher and lower prices. We may have recommended rebalancing or reducing holdings of current open positions at higher or lower than current price; no position is described as "closed" until we have listed it as a "sell." **In case you have forgotten, the authors, their colleagues, clients, families, friends, kissing cousins, and poor relations, barbers, bar pals, bookies, and taxi drivers not only may have active positions in these companies, they probably do, and those positions, long and short, may be frequently adjusted without reference to the publication date of this newsletter.**