

# STRATEGIC INVESTING

An Independent Guide to Profitable Opportunities

June 2004 (May11)

## Dear Colleague

We are currently experiencing a classic example of herd mentality as we approach another turning point in the market. The majority of investors are paying close attention to the headlines: rising inflation, scandals in Iraq, election year rhetoric, a slowdown in China.

Headlines of the day do not predict the market beyond the short term--a few days or weeks. The underlying dynamics of the market are strong. Monetary policy, even taking into account a raise in rates, is accommodative; stocks are a better value than fixed income vehicles, and even the contrarian sentiment indexes are now turning bullish. The economy is strong and earnings are rebounding. Now is the time for contrarians to be buying stock not selling it.

This month we are recommending an unknown under-followed company that has a unique technology used in manufacturing fire retardant building materials--**International Barrier Technology**.

We can now be found on the following web sites:

www.investools.com  
www.dickdavis.com

## The Markets YTD

DJIA.....9990.02..... (4.44%)  
S & P 500...1087.12..... (2.23%)  
Nasdaq.....1896.07..... (5.36%)  
Russell 2000..537.86..... (3.42%)

## Fantasy, Reality, and the Market

Warren Buffet, in a 1987 letter to investors, wrote:

In my opinion investment success will not be produced by arcane formulae, computer programs or signals flashed by the price behavior of stocks and markets. Rather an investor will succeed by coupling good business judgment with an ability to insulate his thoughts and behavior from the super-contagious emotions that swirl about the marketplace.

We are currently experiencing a classic example of super-contagious emotions that are swirling about the marketplace. Stimulated by fears of rising inflation, abuse scandals in Iraq, the controversies over increased outsourcing, and election year political rhetoric, emotions are pushing investors to the sidelines. But these emotional decisions are based on daily headlines rather than underlying market fundamentals. Such crowd behavior always offers investors a unique opportunity to take advantage of the herd's mistakes by studying what's

going on underneath the superficial panic. But psychologically, it is the most difficult time to be buying stocks. In the past two months we have recommended that you begin nibbling at companies with undervalued stock prices. We now believe we have entered a period where buying stocks is the prudent and contrarian decision to make. There is currently more risk in lost opportunity than there is falling stock prices. This doesn't mean you will receive immediate gratification. Prices have a tendency to fall beyond the point at which we expect them to turn around, but we're still betting on a strong second half of the year.

Productivity is clearly driving a strong economic recovery. The Bureau of Labor Statistics recently reported that the seasonally adjusted annual rates of productivity change in the first quarter were 4.5% in the business sector and 3.5% in the nonfarm business sector, both of which are higher than the productivity rates in the last quarter of 2003.

As most economists will tell you, increasing productivity stimulates profits while lowering costs per person hour.

*(continued on page 2)*

## Highlighted Stocks

### INTERNATIONAL BARRIER TECHNOLOGY INC.

**Symbol: IBTGF OTC BB**

**5/11/04 Price \$1.17**

Shares out: 20.96 mm

fd Shares: 23.6 mm

Address:

750 West Pender St. #604

Vancouver, BC V6C 2T7

<http://www.intlbarrier.com>

International Barrier Technology develops, manufactures, and markets proprietary fire resistant building materials branded as Blazeguard. The award-winning Blazeguard wood panel uses a patented, non toxic, non-combustible coating with an

unusual capability: it releases water when exposed to the heat of fire. The panels exceed International Building Code requirements in every targeted fire test and application, and they are unique in combining both high strength and minimal environmental and human impact.

### Product

The Company uses Pyrotite technology, which refers to a patented process of producing fire-resistant building materials, and applying it to building products such as plywood or oriented strand board sheathing (OSB). The composite material, the sheathing coated

*(continued on page 2)*

## Fantasy, Reality, and the Market (Cont.)

What worries most investors about this good news is that high productivity means slower job growth because companies are not forced to hire more workers. However, what most folks don't tell you is that this only holds true if demand remains the same. Where consumers begin to feel more confident in an economic recovery, their demand for products increases, eventually to the point which forces companies to hire more workers even as high productivity continues. We won't see this immediately, but it is inevitable.

As productivity continues, we will also see continued low inflation and interest rates. As we told you last month, even when the Fed raises interest rates, it will merely begin to bring the yield curve back toward its normal range. Instead of the 10 year note being 4 times the T-bill, it will come down to twice the T-bill, still giving us a strongly upward slanting yield curve, which historically has always been predictive of an economic recovery. Instead of borrowing money at close to 1% and investing it long term at 4%, you will borrow at 2% and invest it long term at 4%. Under these circumstances both individuals and corporations will increase their personal and capital spending.

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### Recently Published

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**Dr. Richard Geist**

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In addition, higher interest rates in an improving economy have never been known to hurt the stock market.

Last year most stocks went up, although most investors

weren't in the market to enjoy the ride. This year many stocks are fairly valued, so the last half of 2004 will be a stock picker's market. But with profits continuing to go up, analysts continuing to raise the S&P 500 earnings number and, most importantly, the underlying dynamics of the market remaining strong, it is difficult to see major risk in this market (short of the effects of a future terrorist attack). As the economists at Wachovia suggested in their latest commentary, "The rise in forward earnings estimates provide evidence that firms are reinvesting their financial success in capital goods to more efficiently meet growing customer demand. Reinvested profits are key to growth."

Monetary policy remains accommodative, even if we build in a couple of interest rate hikes. Stocks remain undervalued relative to fixed income investments, and we know that money eventually goes to those sectors where it yields the greatest returns. And finally, after several months, the contrarian sentiment surveys, have returned to a bullish position (meaning there are now an abundance of bears once again predicting doomsday scenarios).

Our advice is to begin buying now rather than later. Currently we like **Auto Data Network, Harris Interactive, Tag-It Pacific, Cubic, Openwave, Teva, Education Lending, SeeBeyond, Stewart & Stevenson, DRS Technologies (still very undervalued), Rita Medical, Cryptologic, Applied Materials, Impax Labs, Diodes, Mercury Computer Systems, Express Scripts (on any pullback), Headwaters, Ariad, Rita Medical, Qualcomm, Wave Systems, Kulicke and Soffa, International Barrier, and Axsys.** We still like **Zi Corp as a speculative buy.** **Aura** remains a much more complicated and risky situation. We are also disappointed in **Applied DNA**, which is acting poorly. Don't let it drop below \$1.20 without selling half your holdings. **CGCP** was stopped out when it dropped below our stop loss of \$.72.

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## Highlighted Stocks (Cont.)

with Pyrotite, has been trademarked Blazeguard fire-rated sheathing.

Pyrotite is a non toxic, non combustible, inorganic fire barrier material designed to prevent ignition and inhibit the spread of flames. The Pyrotite coating is chemically inert and does not in any way deleteriously affect the structural properties of the underlying wood. Pyrotite creates a non-combustible barrier between fire and the wood substrate and releases chemically bound water molecules in the heat of a fire.. Since Pyrotite is a non combustible material, flame will not attach to it and the spread of flame along the surface of the panel is zero. And unlike other Fire Retardant Treated (FRT) materials, it does not weaken the structural integrity of the sheathing. Thus Blazeguard exhibits the best strength to weight attributes of wood combined with the best fire protection properties of fire rated gypsum.

### Primary Uses

Blazeguard is best used in several types of situations: in building applications where a Class A flame spread, or "burn through" resistance rating is required by building code; where building owners desire an added sense of protection from fire; where insurance rates may be reduced if the fire safety of a building is enhanced by the materials; and where required by building codes, such as in modular buildings and roofing applications.

### Competitive Advantages

There are very few products in the development and testing stages which are targeted at the same markets as Blazeguard. Blazeguard has obtained code evaluation reports and product listings from Building Officials and Code

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Administrators International (BOCA), Underwriters Laboratories, International Conferences of Building Officials (ECBO), and Standard Building Code Congress International (SBCCI). To the best of Barrier's knowledge, there are no other products currently available, at a competitive cost to BlazeGuard, that are capable of meeting relevant building code standards in their targeted markets. In addition there are no other products on the market, of which we are aware, that combine the combination of strength to weight and fire resistant characteristics.

In addition, in 1994 the International Code Council (ICC) was established by BOCA, ICBO, and SBCCI as a non profit organization charged with developing a single set of comprehensive national construction codes in order to unify building codes in the US. The resulting document, the International Building Code (IBC) was published in January 2000 and is slated to be implemented by year end 2004. If this occurs, it will allow Barrier to change its sales focus from a regional to national one, an important impetus for growth. In combination with a national focus, we also expect fire regulations and codes to become more restrictive given fires in Rhode Island and California, which will clearly benefit Barrier's growth.

### **Targeted Markets**

While there are a myriad of possible applications for the Pyrotite technology and BlazeGuard, five main areas have been targeted for marketing and sales in the short term. These include: multi-family residential roof decks; structural, insulated foam core panels; fire resistive, structural wall assemblies; commercial roof decks; and specialty applications. The market for BlazeGuard in these areas is estimated to be in the hundreds of millions of square feet annually. Currently Barrier largest market, representing the majority of sales, is roof decking for multi-family residential buildings in the Southeast and Eastern U.S. BlazeGuard customers include Centex, D.R. Horton, KB Home, and Lennar. Lowe's Companies and Stock Building Supply are BlazeGuard distributors.

### **Recent Milestones**

Recently Barrier acquired all the relevant patents, foreign patent filings, trade secrets, and trademarks for the entire world. In addition, during the second quarter of fiscal 2004 the company achieved certification from Underwriters Laboratories (UL) for Barrier's new roof deck system for commercial modular buildings, paving the way to a valuable new growth opportunity. Barrier also announced in December 2003 a marketing and sales agreement with Mule-Hide Products Company, a supplier of commercial roofing products. The agreement gives Mule-Hide the exclusive right to market, sell and distribute BlazeGuard fire resistant wood panel products into the commercial modular roofing market. Mule-Hide has agreed to a minimum target purchase volume of two million square feet for calendar 2004, the first year of the agreement. This should essentially double Barrier revenues.

Barrier also recently closed a non-brokered private placement in the amount of 1.2 million units of the Company at a price of \$0.64 cents per unit for gross proceeds of \$768,000. The shares and underlying shares are subject to hold periods expiring June 2, 2004 and June 3, 2004 respectively (see risks below).

### **Growth Strategies**

Barrier has several methods for increasing their growth prospects. If a national building code becomes effective by the end of this calendar year, we expect the company to be able to

expand nationally rather than focusing primarily on the Southeastern part of the country. In addition there are an estimated 200 million square feet of fire retardant materials per year being produced, so there is plenty of room for taking market share. The company has an optimal plant capacity of about 16 million square feet, so as business begins to take off, we expect them to turn to a licensing business model whereby the large players in the industry can carry out the manufacturing. Barrier can also expand internationally through licensing agreements. The Company can drill deeper into the markets they have already penetrated with additional existing products. And finally, they should be able to expand into new markets such as using BlazeGuard in paints and plastics.

### **Financials (Canadian Dollars--fiscal year ends June 30)**

During the second quarter of fiscal 2004 the company reported revenues of \$561,266, down 7.5% from the same period last year. Six month revenues were \$1.1 million compared to the previous year's 6 month revenues of \$1.2 million. Net loss for the second quarter was \$121,987, compared to a net profit of \$14,851 in the prior year period. Six month net loss was \$258,308, which compares to the prior year's 6 months net loss of \$125,549. High prices for plywood and OSB continued to cause many of the company's distributors to maintain reduced inventory levels of BlazeGuard, resulting in lower sales volume, revenue, and gross profit. At the same time Barrier invested in production trials to prepare for the Mule-Hide Products company product launch.

The balance sheet, as with many companies just beginning to ramp up sales, is poor. At the end of December, the company had cash of \$93,447. Current assets were \$329,163 and current liabilities of \$522,411, yielding negative working capital of \$193,248. Shareholders' deficiency was \$111,652. These figures were previous to the \$768,000 financing, however, and we expect the balance sheet to improve during the first two quarters of the calendar year.

### **Risks**

You should treat Barrier as a post start up and therefore a high risk investment designed for those who can tolerate speculative situations. While we are convinced that the company has a superior product and that the industry is ripe for using it, the risks you face are on the business side. Management must be able to execute on its growth strategies, raise enough money to carry them out, develop a licensing program which avoids having to eventually expand their manufacturing plant, and conduct an education/pr program to educate both the investment community and their niche market about the benefits of the product. The two more general risks facing the company are any reversal of the building codes demanding fire retardant materials and any alternative technologies which may appear unexpectedly. The company will also need to improve the balance sheet in order to get on a listed exchange. There is also the possibility that when the holding period for the recent financing expires in early June, we could see a mild sell off of the stock.

Despite these major hurdles, however, we believe that the company's growth prospects, its potential multiple revenue streams, superior product, growing customer base, and marketing strategy makes this a worthwhile speculation for those who can tolerate high risk.

# Model Portfolio

## Current Recommendations

NAME	SYMBOL	DATE PURCHASED	EXCH	PURCH. PRICE \$	RECENT PRICE \$	YIELD %	CHANGE	STOP/ LOSS
<b>LARGE CAPS</b>								
Bristol-Myers Squibb	BMY	05/27/92	NYSE	\$18.00	\$25.38	4.90%	45.90%	
Williams	WMB	08/31/98	NYSE	\$23.13	\$10.69	2.60%	-51.18%	
JP/Chase	JPM	08/31/98	NYSE	\$53.00	\$35.41	2.60%	-30.59%	
Express Scripts*	ESRX	05/17/99	NASD	\$32.78	\$74.51	0.00%	127.30%	
Qualcomm	QCOM	04/15/01	NASD	\$53.00	\$64.73	0.00%	22.13%	
Siebel Systems	SEBL	03/22/01	NASD	\$31.94	\$10.14	0.00%	-68.25%	
Applied Materials	AMAT	10/14/02	NASD	\$12.86	\$19.55	0.00%	52.02%	
Sun Microsystems	SUNW	10/14/02	NASD	\$2.81	\$3.75	0.00%	33.45%	\$3.75
Nokia	NOK	7/17/03	NASD	\$14.38	\$13.64	0.00%	-5.15%	\$13.00
Pepsi	PEP	1/7/04	NYSE	\$47.00	\$53.29	0.00%	13.38%	
<b>MICRO-CAPS</b>								
Sanmina	SANM	05/11/94	NASD	\$3.23	\$10.00	0.00%	209.60%	
Harris Interactive	HPOL	01/31/95	NASD	\$0.78	\$7.70	0.00%	887.18%	
Air Methods Corp	AIRM	9/19/02	NASD	\$5.90	\$8.12	0.00%	37.63%	\$7.50
Zi-Corp*	ZICA	1/2/1996/9/2/98	NASD	\$3.31	2.42	0.00%	-26.89%	
Excel Technologies	XLTC	08/27/97	NASD	\$13.13	\$31.04	0.00%	136.41%	
Astronics	ATRO	2/19/99/4/12/99	NASD	\$10.16	\$5.25	0.00%	-48.33%	
Safety First	SAFT	04/12/99	NASD	\$4.25	\$13.88	0.00%	226.59%	
CryptoLogic	CRYP	06/14/99	NASD	\$11.71	\$17.97	0.00%	53.46%	
Zi-Corp*	ZICA	07/14/99	NASD	\$2.19	\$2.42	0.00%	10.50%	
DRS Technologies	DRS	02/17/00	AMEX	\$9.94	\$27.30	0.00%	174.65%	
Boston Life Sciences	BLSI	07/14/00	NASD	\$10.93	\$0.95	0.00%	-91.31%	
Diodes	DIOD	11/14/00	NASD	\$9.25	\$22.08	0.00%	138.70%	
Rita Medical	RITA	12/16/00	NASD	\$5.50	\$5.82	0.00%	05.82%	
Aura Systems*	AURA	01/21/01	OTC	\$0.37	\$0.04	0.00%	-89.19%	
DRS Technologies	DRS	02/21/01	NASD	\$16.50	\$27.30	0.00%	65.45%	
Ariad	ARIA	03/22/01	NASD	\$3.06	\$10.87	0.00%	254.94%	
Impax	IPXL	06/17/01	NASD	\$11.05	\$21.75	0.00%	96.83%	
Gaia	GAIA	09/23/01	NASD	\$14.05	\$6.60	0.00%	-53.02%	
Teva (Sicor Inc.)	TEVA	10/16/01	NASD	\$43.04	\$62.70	0.00%	45.68%	adj for buyout
Hain	HAIN	11/19/01	NASD	\$25.16	\$18.00	0.00%	-28.46%	
Perma-Fix	PESI	2/13/02	NASD	\$2.63	\$1.72	0.00%	-34.60%	
Aura Systems*	AURA	4/15/02	NASD	\$0.26	\$0.04	0.00%	-84.62%	
DynTek	DYTK	6/13/02	NASD	\$1.75	\$1.05	0.00%	-40.00%	
Cytec Corp.	CYTC	7/14/02	NASD	\$8.32	\$18.44	0.00%	121.63%	\$15.00
Openwave*	OPWV	11/11/02	NASD	\$3.66	\$9.49	0.00%	159.29%	
Education Lend.*	EDLG	12/12/02	NASD	\$3.85	\$15.76	0.00%	309.35%	
SeeBeyond	SBYN	1/27/03	NASD	\$2.14	\$3.35	0.00%	56.54%	
SFBI International	SFCC	2/9/03	NASD	\$17.00	\$37.01	0.00%	117.71%	
Cubic Corporation	CUB	3/13/03	AMEX	\$14.27	\$21.72	0.00%	52.21%	
Tag-It*	TAG	4/8/03	AMEX	\$3.70	\$5.08	0.00%	37.30%	
Stewart & Steve	SVE	5/20/03	NYSE	\$12.94	\$15.34	0.00%	18.55%	
Cleveland-Cliffs	CLF	6/12/03	NYSE	\$16.32	\$42.04	0.00%	157.60%	
Mercury Computer	MRCY	7/11/03	NASD	\$18.47	\$22.50	0.00%	21.82%	
Headwaters	HDWR	8/17/03	NASD	\$13.99	\$21.60	0.00%	54.40%	
Auto Data Network*	ADNW	9/14/03	OTC	\$2.36	\$2.87	0.00%	21.61%	\$2.50
Applied DNA*	APDN	11/6/03	OTC	\$2.96	\$1.30	0.00%	-56.08%	\$1.20
Sigma Designs	SGMA	1/13/04	NASD	\$8.90	\$5.05	0.00%	-43.26%	
Wave Systems*	WAVX	2/19/04	NASD	\$1.61	\$1.28	0.00%	-20.50%	
Axsys Tech	AXYS	3/18/04	NASD	\$13.28	\$17.98	0.00%	35.39%	
Kulicke & Soffa	KLIC	4/18/04	NASD	\$11.20	\$11.19	0.00%	-00.09%	
Internat. Barrier*	IBTGF	5/11/04	OTC	\$1.17	\$1.17	0.00%	00.00%	
<b>FOREIGN STOCKS</b>								
Telefonos de Mexico	TMX	01/07/92	NASD	\$32.85	\$31.60	1.60%	-02.21%	
Scandinavian Broadcast	SBTV	12/28/93	NASD	\$15.26	\$33.05	24.00%	140.58%	
<b>SMALL CAP MUTUALS</b>								
Heartland Value		800-432-7856						
Wasatch Sm.Cap Growth		800-551-1700						

\*Owned by FSI or related parties  
%FSI research report available on request

## Portfolio Notes and Update

**KULICKE & SOFFA** announced net revenues for the second quarter of \$221.8 million compared to \$153.9 million in the prior quarter and \$122.3 million in the comparable year ago quarter. Net income was \$29.1 million or \$0.44 per fully diluted share versus net income in the prior quarter of \$0.7 million or \$0.01 per fully diluted share, and a loss for the year ago quarter of \$19.3 million or \$0.39 per diluted share. The company is forecasting revenues for the third quarter ending June 30 to be \$180 to \$200 million. Cash and equivalents at the end of the quarter were approximately \$83.7 million. Continue to buy.

Kulicke & Soffa is a supplier of semiconductor wire bonding assembly equipment. K&S is the only major supplier to the semiconductor assembly industry that provides customers with semiconductor wire bonding equipment along with the complementing packaging materials and test interconnect products that actually contact the surface of the customer's semiconductor devices.

**STEWART & STEVENSON** announced that their Tactical Vehicle Systems, LP has been awarded a contract modification by the US Army valued at approximately \$63.4 million. The exercised option calls for 482 Family of Medium Tactical Vehicles Trucks and 167 Trailers, which have seen extensive duty in Operation Iraqi Freedom. Slowly buy surely S&S seems to be building some momentum. Continue to dollar cost average into the stock.

Stewart & Stevenson manufactures, distributes, and provides service for a wide range of industrial products and diesel-powered equipment to key industries worldwide, including power generation, defense, airline, marine, petroleum, and transportation.

**HEADWATERS** announced it has entered into a purchase agreement to acquire the ownership interests of Eldorado Stone, LLC, a leading manufacturer of architectural manufactured stone in San Marcos, California. It is being purchased for approximately \$202 million and provides Headwaters the opportunity to expand the use of environmentally friendly coal combustion materials in high-growth, branded building products. Subject to approvals, the acquisition is expected to close in May, and is expected to be accretive to Headwaters' EPS in 2004 and 2005 without including potential synergies. Eldorado's sales grew approximately 24% in 2003 and it has recorded annual sales growth of about 22% over the last three years. EBITDA will be in excess of 20%. The company had revenues of approximately \$100 million in 2003. The Company also reported second quarter revenues of \$119.5 million, up 39% from \$86.1 million in last year's second quarter. Net income increased to \$18.6 million or \$0.55 per diluted share, compared with \$6.8 million or \$0.24 per diluted share in the prior year's second quarter. Headwaters reduced its senior secured debt to \$50 million as of March 31st, and replaced the remaining \$50 million with a new conventional bank credit facility that carries a lower interest rate. Management is forecasting between \$1.70-\$1.85 per diluted share for fiscal 2004. Continue to buy.

Headwaters is focused on providing services to energy companies, conversion of fossil fuels into alternative energy products, and adding value to energy. The company generates revenue from managing coal combustion products (CCPs) and

from licensing its innovative chemical technology to produce an alternative fuel.

**DYNTEK** announced that the Kansas Department of Social and Rehabilitation Services has awarded the company a renewal contract valued at \$2.5 million to manage the state's child support program operations through June 2005. This stock has clearly been a laggard for us, but the contracts appear to be coming in belatedly, so we'd continue to accumulate the stock slowly.

DynTek provides technology, management and cyber security solutions to the state and local government market.

**SEEBEYOND** announced that Zurcher Kantonal bank (ZKB), the third largest bank in Switzerland, has deployed SeeBeyond as its strategic platform for the integration of business processes and the electronic processing of customer payments. ZKB's underlying goal is to further extend its eBusiness and associated eBanking applications for corporate clients. The integration solution from SeeBeyond simplifies data transfer between the bank's internal and external systems and expedites inter-bank transactions. Continue to buy.

SeeBeyond helps organizations rapidly assemble and deploy enterprise scale end user composite applications built on existing systems and infrastructure to improve business operations.

**CYTYC** reported first quarter revenues of \$80.7 million, up 11% from the same quarter last year. Net income for the quarter was \$1.5 million or \$0.01 per diluted share, compared with \$19.8 million or \$0.17 per diluted share for the same period in 2003. Excluding non recurring charges related to the acquisition of Novacept, net income was \$20.6 million or \$0.18 per diluted share. Acquisition charges include acquired in-process research and development costs of \$19.1 million. The company also reported that their aggressive rollout plan for the ThinPrep Imaging System is ahead of schedule and that they have begun patient enrollment for their SEDE trial for the FirstCyte Breast Test. At the end of the quarter the company had cash in securities of \$220.6 million. Buy on any pullback.

Cytc is a medical device company that designs, develops, manufactures, and markets innovative and clinically effective products primarily focused on women's health. Cytc products include cervical cancer screening, breast cancer risk assessment, and treatment of excessive menstrual bleeding. Their ThinPrep System is the most widely used method for cervical cancer screening in the US.

**TAG-IT PACIFIC** announced fiscal 2003 revenues of \$64.4 million compared to \$60.1 million for fiscal 2002. Net loss was \$4.8 million, and loss per share was \$0.46 compared to positive earnings of \$0.14 last year. Restructuring charges of \$7.7 million, or approximately \$0.72 per share were recorded for the year. The most significant news in 2003 was the implementation of the company's new ERP system from Oracle, expanding the Managed Trim Solution with the addition of a new E-Commerce application called TrimNet, and entered into a full package supply arrangement with a large jeans manufacturer, and completed two private placement transactions that contributed approximately \$29 million to equity. The year was about what we expected, and not terribly impressive on the financial end. But

the progress on the business front was strong and should lead to a good 2004. Continue to buy.

Tag-It Pacific specializes in the distribution of a full range of trim items to manufacturers of fashion apparel, specialty retailers, and mass merchandisers. Tag-It acts as a full service outsourced trim management department for manufacturers of fashion apparel such as Abercrombie & Fitch, Tarrant Apparel Group, Kentucky Apparel, and Azteca Production International.

**OPENWAVE SYSTEMS** announced revenues for its third quarter of fiscal 2004 were \$74.2 million, an increase from \$71.8 million during the preceding quarter and an increase of 16.9% from \$63.5 million during the March quarter last year. Net loss for the third quarter was \$5.7 million or \$0.09 per diluted share compared to a net loss of \$9.4 million or \$0.15 per diluted share for the preceding quarter and a net loss of \$23.2 million or \$0.39 per diluted share in last year's third quarter. At

the end of the quarter the company had cash and equivalents of \$345.9 million. Current outlook for the fourth quarter is revenues of \$74 million, plus or minus \$5 million and net earnings per diluted share between positive \$0.01 and a loss of \$0.14. Management held an upbeat conference call, expects to be break even in the September quarter, and stated that business momentum continues to build. The Company also announced a multi-million dollar contract to provide Telstra a new email messaging platform for its BigPond ISP service. The stock lost \$18% on the news. We think it's a good opportunity to buy more.

Openwave is the leading provider of open software products and services for the communications industry. Products include mobile phone software, multimedia messaging software, email, location and mobile gateways.

## **Portfolio Notes and Update, Cont.**

**ZI CORPORATION** announced it has signed licensing agreements for its new Version 6 of eZiText predictive text technology with five Asian handset manufacturers. Under the terms of the various license agreements Zi receives up front fees and ongoing royalties based on the number of handsets embedded with its technology that are sold by each manufacturer. The manufacturers include Bluewing Co., Ltd. Pos & Tech Inc., Sungil Telecom Co., Ltd, and Codial Tech Co. Ltd, all located in Korea, and Hong Kong based Advanced Wireless Group Limited.. All five customers have a focus on penetrating the Chinese markets with the licensing of both traditional and simplified Chinese products. Continue to buy in speculative accounts.

Zi Corporation is a technology company that delivers intelligent interface solutions to enhance the user experience of wireless and consumer technologies. The company's intelligent predictive text interfaces allow users to simplify text entry providing consumers with easy interaction for short messaging, e mail, ecommerce, web browsing, and similar applications in almost any written language.

**CUBIC** has received the first major production order from the US Air Force to provide its advanced rangeless air combat training system to three Air Force locations. The deliver order was valued at \$14.7 million. The complete contract is potentially valued at \$525 million over 10 years and calls for the development of the next generation common air combat training system for the Air Force, Navy, Air National Guard and the Marine Corps.

Cubic Defense applications group is one of Cubic's two major segments, and provides realistic combat training systems for military forces as well as simulation, force modernization, educational services and operations, maintenance and manufacturing services. Cubic Transportation Systems designs and manufactures automatic fare collection systems for public mass transit authorities.

**CLEVELAND-CLIFFS** reported first quarter revenues of \$240.8 million compared with \$161.5 million in the same period last year. Net loss was \$0.6 million and a loss of \$0.16 per diluted share, reflecting the effect on 2004 of \$1.1 million preferred dividends related to the January 2004 preferred stock

offering. Also included was \$4.5 million pre tax accrual for stock based compensation reflecting a higher Cliffs stock price, and a \$1.6 million pre tax increase in the provision for customer bankruptcy exposures. Excluding these items Cliffs' after tax earnings would have been \$4.3 million. Net income for the first quarter of 2003 was \$2.2 million or \$0.21 per diluted share. At the end of the quarter Cliffs had \$179.7 million of cash and cash equivalents and no outstanding debt. According to management the steel industry fundamentals in North America remain strong, with solid demand and good pricing. The first quarter was a disappointment, but management expects to reduce operating costs, increase sales volume and with full price realization produce positive results for the full year. Buy on pullbacks.

Cleveland-Cliffs is the largest producer of iron ore pellets in North America and sells the majority of its pellets to integrated steel companies in the United States and Canada. The Company operates six iron ore mines located in Michigan, Minnesota and Eastern Canada.

**SFBC INTERNATIONAL** reported revenues for the first quarter of 2004 were \$33.5 million compared to \$18.7 million for the same quarter last year, an increase of 79.4 percent. Net earnings for the quarter increased 91.8% to \$3.7 million compared to \$1.9 million for the first quarter of 2003. Earnings per fully diluted share were \$0.36 compared to \$0.26 per share last year, an increase of 38.5%. Based on current business trends, SFBC raised its guidance to approximately \$131-\$138 million in revenue and earnings per share of \$1.52-\$1.62 for fiscal 2004. The company also announced a 3 for 2 stock split which will take place on June 10, 2004. Continue to buy.

SFBC is a contract research organization, providing a range of specialized drug development services to pharmaceutical, biotechnology and generic drug companies. The company is a provider of early clinical development services, specializing primarily in the areas of Phase I and Phase II clinical trials and bioanalytical laboratory services. The company also provides a range of complementary services including early clinical pharmacology research, biostatistics, and data management.

# The Many Influences of Affect

In recent years behavioral finance experts have begun to focus on what they conceptualize as the “affect” heuristic, in essence a reliance on feeling when making decisions. Affect, as defined by these researchers, is a quality such as good or bad, attractive or unattractive that is assigned to an investment possibility, or any decision. It is assumed that these feeling states influence investor choices. There are times when reliance on affect is extremely helpful to our decisions and other times when such affective influences contribute to major mis-judgments.

As Paul Slovic and his colleagues conclude in their paper on the implications of the affective heuristic for behavioral economics, “The affect heuristic appears at once both wondrous and frightening: wondrous in its speed, and subtlety, and sophistication, and its ability to ‘lubricate reason’: frightening in its dependency upon context and experience, allowing us to be led astray or manipulated--inadvertently or intentionally--silently and invisibly” (Journal of Socio-Economics 31, 2002).

Clinicians who treat patients have known for over a century that affects are an essential subsystem that provide direction, orientation, and structures (emotional convictions) that help us organize and navigate the complex decisions of everyday life. Experiential affects lend meaning and direction to our analytic reasoning. As I pointed out in *Investor Therapy*, most investors make decisions based on experiential affect rather than analytical reasoning. It is only when these affects are understood, however, that we can use them to enhance our rational choices. But in order to understand them, we must eschew the old wisdom of “park your emotions at the door” and begin to understand how and under what circumstances our emotions can become a positive force in investment success.

## Affective Systems: The Important Components

To understand how emotions influence investment decision making, we must begin to become much more familiar with the richness and complexity of our affective system. Toward that end, here are some interesting psychological facts about affects around which we need to structure further research

1) **Affects always have opposites**, although not necessarily the usual ones. As Richard Wilbur once wrote,

What is the opposite of two?  
A lonely me, a lonely you.

Whenever we feel intense emotions in the market, we tend to heighten one emotion and suppress or split off its complementary partner. Which is why there is often an all good or all bad feeling about our stocks, companies, or management. Only very sophisticated investors allow the many shades of gray to enter into their decisions. We love or hate America Online;

we have only positive feelings for the stocks we own; we embrace the herd and accept their confirmation that we are correct without questioning how we might be wrong. Some psychologists believe that all emotions are ambivalent, although the evidence for this belief is not as strong as they believe it is. But when making decisions under conditions of risk, you can be sure that you will emphasize one strong emotion while excluding another (e.g. activity is good, passivity is bad, and therefore not to be considered). But investors are likely to change very quickly between embracing one emotion (fear) and its opposite emotion (grandiosity).

2) **Affects are the most revealing parts of our personality.** We know people by their feelings and moods, which tend to be repetitive over time. But we tend to ignore affective signals which will give us clues into the behavior of investors as well as the managements that run our companies. Too many times I’ve heard investors say something akin to “I knew when I first met management (or heard them on a conference call), I knew there was something wrong, but I thought it must be me because everyone else felt so positive.” Pay attention to your affects.

3) **Affects are at the heart of our motivations.** When it comes to actions, what we feel always outweighs what we think. There may be periods of time when, through cognitive efforts, we can overrule our affective system; but eventually our affects break through and influence our investment choices. It is the rare investor whose “system” does not break down in the face of strong affect--excitement, fear, depression, grandiosity, etc. Unless we understand what affects are motivating our choices and why, we remain at the mercy of these feelings.

4) **How are our affects being used?** Investors who are in touch with their feelings often don’t realize that those feelings are being used to cover over affects that are less tolerable. For example, an investor whose stock is going down will often feel the potential for loss. When the affect of loss is rekindled, s/he may become excited about buying more stock at a lower price. This feeling of excitement, however, may be covering over past losses that s/he wishes to deny by feeling excited. In the same way Internet chat boards are often filled with rage that covers over feelings of loss or sadness related to a mistake in investment choices.

These are just a few of the many ways that affects can influence our investment decisions. What is important to recognize is that this affective system functions side by side with our more rational analytic system, although the two are often split off from one another, and we become unaware that the two influence one another.

## Portfolio Notes Cont.

**RITA MEDICAL SYSTEMS** announced that total sales for the first quarter were \$4.6 million, up slightly compared to \$4.5 million for the year earlier period. Sequentially sales grew by 11% compared to sales of \$4.2 million in the fourth quarter of 2003. Net loss was \$2.2 million compared to \$2.9 million in last year's first quarter. Net loss per diluted share was \$0.12 compared with \$0.17 last year. Continue to buy.

Rita Medical develops, manufactures, and markets products for patients with solid cancerous or benign tumors. The proprietary Rita system uses radio frequency energy to heat tissue to a high enough temperature to ablate it or cause cell death. The company's current focus is on Liver cancer and metastatic bone cancer, but the company believes that its minimally invasive technology may in the future be applied to other types of tumors, including tumors of the lung, breast, uterus, prostate, and kidney.

**TEVA PHARMACEUTICAL INDUSTRIES** reported that for the first time quarterly sales exceeded \$1 billion, reaching \$1.1 billion, up 39% compared to the first quarter of 2003. The first quarter loss was \$248 million or \$1.44 per share, but this reflects one time charges mainly related to purchase accounting for the Sicor acquisition. Adjusted before one time charges net income for the first quarter of 2004 was \$205 million, up 49% over the comparable quarter of 2003 and adjusted fully diluted EPS reached \$0.64, up 28%. According to management the integration of Sicor is proceeding smoothly. The Board also declared a cash dividend for the first quarter of 2004 of approximately \$0.10 that will be effective May 12, 2004. The Company expects sales for the full year to exceed \$4.5 billion and adjusted, before one time charges, fully diluted earnings per share to reach a range of \$2.70--\$2.74. Continue to buy.

Teva is among the largest generic pharmaceutical companies in the world. The company develops, manufactures and markets generic and innovative human pharmaceuticals and active pharmaceutical ingredients. Close to 90% of Teva sales are in North America and Europe.

**AXSYS TECHNOLOGIES** announced that sales for the first quarter were \$23.4 million compared to \$20.4 million in the same quarter last year, an increase of 14.9%. Net income was \$1.6 million or \$0.35 per share, compared to net income of \$0.09 million or \$0.19 per share in the first quarter of 2003. Bookings, sales, operating profit and backlog within all three of the company's business units have increased compared to the first quarter last year. Backlog is at a record level of \$76 million. The company is currently re-evaluating the guidance provided on April 8th. At that time they had anticipated revenue growth of 11% to 14% and operating income growth of 48% to 54%. Continue to buy, but remember the stock price is volatile so try to buy on any pullback.

Axsys is a vertically integrated supplier of precision optical and motion control components and assemblies for high technology applications, serving the aerospace, defense, semiconductor, graphic arts and health imaging markets.

**IMPAX LABORATORIES** reported record revenues of \$38.9 million for the first quarter, up more than 240% compared with revenues of \$11.4 million in last year's first quarter, and up more than 131% over revenues of \$16.8 million in the fourth quarter of 2003. The steep increase was primarily due to shipments of their generic versions of Wellbutrin, which were approved by the FDA during the quarter. Net income for the quarter was \$9.1 million or \$0.14 per fully diluted share compared with a net loss of \$3.2 million or \$0.07 per share in last year's first quarter. Cash, equivalents, and short term investments

were \$19.5 million at the end of the quarter, compared to \$15.5 million as of December 31, 2003. This is the first profitable quarter in the company's history. Impax currently has seventeen applications pending at the FDA, including five tentatively approved, which address over \$5.4 billion in US branded product sales for the 12 months ended February 2004. Continue to buy.

Impax is a technology based specialty pharmaceutical company applying its formulation expertise and drug delivery technology to the development of controlled release and specialty generics in addition to the development of branded products.

**DIODES** reported first quarter revenues of \$41.4 million, an increase of 40.7% from the first quarter of 2003. Net income for the quarter increased 152% to \$4.9 million, compared to \$1.9 million for the three months ended in March 2003. Diluted earnings per share were \$0.32 as compared to \$0.14 in the same period last year. According to President and CEO C.H. Chen "Sales of our existing value added products continued to push Diodes' share of the addressable market to new highs and boost our gross margins. Given the robust pattern of bookings and brisk pace of design wins, we expect to build on this momentum over the course of 2004." Looking forward the company expects another quarter of record revenues with a 4%-6% increase and a slight sequential expansion in gross margin with continued earnings per share improvement. Continue to buy.

Diodes is a leading manufacturer and supplier of high quality discrete semiconductor products, primarily to the communications, computing, industrial, consumer electronics and automotive markets.

**HARRIS INTERACTIVE** announced third quarter revenues of \$35.4 million, up 10% versus \$32.1 million for the same period last year. Net earnings were \$1.6 million or \$0.03 per diluted share. This includes a tax provision of \$997,000, a non cash expense. A tax provision was not booked in Q3 of fiscal 2003, thereby preventing a comparison of net income with a year ago, according to the company. Internet revenue grew 42% and now represents 61% of total revenues. For the fourth quarter the company is forecasting revenues in the range of \$41 to \$43 million, with pre-tax income of \$0.10 to \$0.12 per share. Revenue for the full fiscal year will reach \$146 to \$148 million and produce pre tax income of between \$0.24 and \$0.26 per share. Continue to buy.

Harris Interactive is a worldwide market research and consulting firm best known for the Harris Poll, and for pioneering the Internet method to conduct scientifically accurate market research.

**AURA SYSTEMS** announced it received authority to proceed with a \$1 million subcontract in support of the US Army Advanced Vehicle Technology Development On Board Power Generation Project. This constitutes the initial phase of a \$3.5 million AuraGen VIPER R7D Line item approved in the FY04 budget and has an expected 12 month duration. The follow-on phase, consisting of an expanded field operational evaluation, is being planned and is anticipated to generate as much as \$1.5 million in additional revenues within the same time period. Aura also announced it has secured a postponement of the planned foreclosure sale of its headquarters facilities until June 4, 2004. They are in negotiations with a purchaser of the facilities to allow the Company to remain in its current location under a lease arrangement. Remains highly speculative.

Aura develops and sells AuraGen mobile induction power systems to the industrial, commercial and defense mobile power generation markets.