

INVESTLETTER



Volume 5 Number 2

Wall Street

- DJ 12354
- S&P 500 1421
- NASDAQ 2422

Home Cookin'

It is always great when we get a chance to eat a little home cookin'. In this instance I am talking about buying products that are going to help stuff your own pockets. I would like to talk a bit about what it is that we own and there is only one logical place to start, Berkshire Hathaway. Berkshire is the classic conglomerate. Conglomerates were all the rage in the early 70's. In the early 80's they became targets of the leverage buyout craze and most conglomerates have long since been bought and broken up. Berkshire has assumed this corporate form through years of acquisitions. The number of products the company represents is staggering. Between the companies they own outright and the companies they have large investments in, it is hard to get through a day without interacting with something the company sells or has already sold you. I'll start at the bottom, from the carpet you walk on.



Trying to whip up a batch of market beating performance

Shaw Industries is a maker of flooring, most notably, carpet. Their carpet is made with a soft backing called SofBac that reduces wrinkling and is less damaging on your walls and woodwork upon installation. Next we have some new shoes from H.H. Brown shoes or Tony Lama boots. Fruit of the Loom provides the drawers, t-shirts and socks. The kids can be outfitted in Garanimals and adults in Russell athletic wear.

You can put your carpet in a new home by Clayton Homes insulated with Johns Manville insulation and painted using Benjamin Moore paints. The home may also take advantage of bricks by Acme Bricks (with great pleasure to Wily Coyote who is not yet owned by Berkshire). The electric wiring will undoubtedly take advantage of Halex electrical connectors. Clean up will be aided by a Kirby vacuum cleaner that can be used to clean up the mess you created with your Ginsu knives or while using your Campbell Hausfeld compressor. Berkshire is also the largest shareholder of Proctor and Gamble with their Brawny towels, Crest toothpaste, Charmin toilet paper, Iams pet foods and other products too numerous to mention.

If you want really smart kids you can read them an entry from the World Book Encyclopedia or an article from the Buffalo News as a bedtime story. Sticking with the Berkshire team may be a bit more hazardous when it comes to your diet. The Coke (a large investment holding), See's Candy and the Dairy Queen treats may not be enough to live on, although I know my kids would take one for the team and give it a shot.

All the while you can rest assured that I will be looking for clues to find our next great investment by perusing press releases from the Business Wire news service.

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Home Cookin'

Berkshire also has you covered with Geico Insurance and numerous other insurance companies. I still haven't mentioned the jewelry, medical devices, furniture stores, flight training, and dozens of other products and companies that are all part of the Berkshire Empire.

Each time you use any of these products or services you are putting a little bit of money back into your own pocket. It is a small way to influence the success of your own investments. At one point in time I owned shares in Intel and used a computer that relied on an Intel microprocessor. I sold my shares around 2000 when I switched over to a computer that ran on an AMD microprocessor. I could no longer justify owning shares of a company whose product I no longer felt compelled to buy. Over the past several years it appears many other computer users have joined me using AMD chips, as they have been stealing market share from Intel since then. Intel's share price has still not reached the level that it was trading at in 1999. If a company sells a product that consumers prefer above all of its competitors it may identify a company that is also a good investment. Think Coke.

Just as a salesman needs to believe in the product he is selling we feel it is important to believe in the products are investments are producing.

Few of the other companies we own produce products for consumers and this gives us less of an opportunity to directly influence the bottom line. OMI provides tankers that ship oil and gas that you can indirectly influence by your level of fuel consumption. At the current prices it is not something that most consumers are looking to increase just to try and get a job for another tanker. Some of the companies we own provide raw materials that get used in products we all use, but it is hard to trace to a specific product. Headwaters provides fly ash that gets used in concrete, but I would be hard pressed to identify a batch of concrete using it. Rayonier manufactures wood fibers that get used in everything from diapers to cigarette filters. I have no urge to take up smoking and have already taken my turn with crappy diapers.

Specialized Health Products provides safety needles with retractable tips, most of which are distributed by other companies. Chesapeake produces natural gas which is termed a fungible good. You can mix it in a pipeline with other companies gas and you can't tell the difference. It makes it a bit difficult if you or I want to purchase Chesapeake's gas. Astronics provides parts to many aircraft manufacturers and K-Tron International provides crushers that crush the coal that is used to fuel electric power plants.

The actions of the Investletter subscribers is not enough to make any kind of large impact on any of the companies we own. (Unless one of you has a Dairy Queen addiction of monumental proportions.) Nonetheless, when you speak to friends, neighbors and work associates don't hesitate to slip in a good word. Even tiny contributions can add up over time.

When you get the chance and you are faced with a choice like Coke or Pepsi remember we own a large stake in Coke through Berkshire Hathaway. If you are going to hunt for cheaper car insurance give Geico a chance, you can even get a discount being a shareholder. So when you have that urge this summer to go out for an ice cream head over to your local Dairy Queen and you can do it almost guilt free by justifying that you are helping your bottom line even if it is at the expense of your waistline.

Watch List

Our drought continues. Although we allocated 4% or 5% of our assets to American International, we have not been able to find a company we feel warrants putting big dollars into. This is a process that takes shape over years and not weeks or months. Our positions in OMI and Astronics have grown to be quite large but we have not found a sure bet (or as close to a sure bet as you can get) to replace our investment in Consolidated Tomoka. This issue becomes even more timely now that we face the possible loss of OMI as an investment. If, and we stress the if part, OMI is sold as part of an all cash deal we will have plenty of cash with no clear investment opportunity awaiting. Our lack of success has not been related to any lack of sniffing around. We have looked at hundreds of companies and have not been able to find that big bargain yet. At some point we are bound to stumble on to something interesting.

Our latest addition is an interesting little company, American International Industries. They are a mini conglomerate. They own an interest in a company that wholesales products for the automotive after-market industry including a variety of booster cables sold under the brand names "Mechanix Choice" and "Bitty Booster Cable." They also provide portable hand lamps, cord sets, a variety of battery testers, battery repair kits and miscellaneous battery accessories.

Another subsidiary, Delta Seaboard Well Services provides well site services including work-over services, plugging and abandonment, and well completion and re-completion services. They also reclaim and re-sell drill pipe which is in high demand due the increase in drilling activity that accompanies high oil prices.

Their Hammonds Technical Services, Inc. unit manufactures a line of fuel additives, fluid powered technology, fuel treatment products, hydrostatic testing equipment, and water chlorination systems. How is that for variety?

Hammonds is growing at an extremely rapid rate. They also lost several million dollars last year. If they can move close to break even this year, as planned, it will portend good things for the company.

The primary reason for our investment revolves around the 287 acres of waterfront property for sale in Galveston County, Texas. If the company can close the sale it will mean \$16,000,000 in cash, most of which will drop straight to the bottom line. This will give a tremendous boost to the value of the company and our portfolio.

Company	March price	February price	Change from February	P/E	52 Week High	52 Week Low	Estimated '07 EPS	Dividend Yield
Alico/ALCO	\$57.33	\$47.56	20.54%	97.0	\$62.92	\$44.58	n/a	1.90%
Alliant Techsystems Inc./ATK	\$87.92	\$86.56	1.57%	16.9	\$91.12	\$74.41	\$5.20	n/a
Altria Group, Inc./MO	\$87.81	\$84.80	3.55%	15.7	\$90.50	\$68.36	\$5.60	4.00%
Arch Coal/ACI	\$30.69	\$31.16	-1.51%	18.5	\$56.45	\$25.85	\$1.66	0.80%
Bioanalytical Systems, Inc./BASI	\$6.70	\$6.60	1.52%	n/a	\$7.80	\$4.75	n/a	n/a
Canadian Natural Res./CNQ	\$55.19	\$50.30	9.72%	17.1	\$63.93	\$40.29	\$3.22	0.50%
Graham Corp./GHM	\$16.45	\$15.15	8.58%	19.3	\$23.00	\$12.55	n/a	0.60%
Kensley Nash/KNSY	\$30.50	\$28.66	6.42%	41.2	\$33.69	\$23.73	\$0.74	n/a
Landauer, Inc./LDR	\$50.48	\$50.87	-0.77%	24.0	\$57.29	\$43.11	\$2.10	3.90%
Markel	\$484.83	\$486.85	-0.41%	15.0	\$505.89	\$325.00	\$32.30	n/a
ModPac/MPAC	\$11.09	\$11.18	-0.81%	n/a	\$12.50	\$8.00	n/a	n/a
QLT Inc./QLTI	\$7.83	\$8.40	-6.79%	23.7	\$9.92	\$6.09	\$0.33	n/a
Servotronics Inc./SVT	\$9.30	\$8.76	6.16%	12.9	\$10.46	\$5.80	n/a	n/a
Tejon Ranch Co./TRC	\$47.30	\$47.43	-0.27%	n/a	\$57.09	\$37.55	n/a	n/a
Universal Forest Products/UFPI	\$49.55	\$51.83	-4.40%	13.5	\$80.28	\$43.61	\$3.68	0.20%

The Investletter Portfolio

In our last newsletter we spent some time talking about what route OMI may follow to generate solid returns for 2007. The company recently announced they are going to explore strategic alternatives. Among the options they listed are sale or merger of the company, continue doing what they are doing, or something else. The reason they specified is to increase shareholder value. While we are not entirely sure they have any plans to sell or merge the company, the shareholder value has already benefited. OMI's shares are already up 28% this year. This is after more than 20% gains last year and around 9% the year before. The company is getting closer to selling for what they are worth. We project that any sale of the company will happen between \$31 and \$34 per share. Currently the shares are trading at \$27. They also just paid their dividend.

We plan on hanging around until a decision is made with hopes of catching another 15% to 25% of upside. OMI is primarily responsible for our fast start in 2007. The downside is that from the chart below you can see they now represent over 22% of our portfolio. If they are bought for cash we will have a whopping 49% of our funds sitting in cash. Ah, how smoothly we worked in our monthly bemoaning about our overly plump cash levels. Our readers have come to expect this whining and we did not want to disappoint.

While other building material stocks have gotten pounded, Rayonier has held up nicely. Their large sales of performance fibers and land sales offer a nice buffer to the downturn in the construction business. If the shares drop we may add more. At some point new home sales are bound to rebound. We aim to be fully loaded when they do. If you have any families with young children who use diapers urge them to use more. The fibers that go into LCD production make this a good time to upgrade to that new LCD monitor or TV. Not only will Rayonier be the beneficiary, but they use about 15% of the energy of a cathode ray tube. (Hopefully you get your electricity from a power plant generated by coal so your lower electricity usage does not reduce the need for all that natural gas Chesapeake is producing.)

Last month we were singing the praise of OMI's management team. This month it is K-Tron's (KTII). K-Tron's management has been tacking on acquisitions that have been accretive to earnings. It is difficult for companies to add businesses and have them be an immediate boost to earnings. K-Tron's management team has done this while keeping an extremely tight lid on expenses. For a manufacturer, they have big fat 8.7% net profit margins. They return right around 20% on shareholders capital and the company has extremely healthy cash flows. At the level they are selling at currently, they are a mild bargain. When a business is run as well as they are, we have a much easier time allocating more capital to them. With their recent completion of an acquisition in China, a coal equipment producer, we expect many more years of strong results from them. Their management has proven they have the capability to tack on businesses without missing a step, a skill that is bungled a majority of the time. This management team is disciplined enough not to overpay, sorta like us. It is a good fit for our portfolio.

Company	Portfolio Percentage	March price	February Price	Percentage Change	Buy Price (less than)	P/E	Dividend Yield
Astronics Corporation/ATRO	15.00%	\$17.60	\$17.90	-1.68%	\$16.95	25.4	n/a
Berkshire Hathaway B/BRK.B	8.60%	\$3,640.00	\$3,523.00	3.32%	\$3,100.00	15.3	n/a
Cash	27.00%	\$1.00	\$1.00	n/a	n/a	n/a	n/a
Chesapeake/CHK	7.30%	\$30.88	\$30.44	1.45%	\$30.00	7.1	0.80%
Headwaters/HW	2.10%	\$21.85	\$23.64	-7.57%	\$22.00	12.4	n/a
K-Tron International/KTII	6.80%	\$71.73	\$72.29	-0.77%	\$71.00	15.6	n/a
OMI Corporation/OMM	22.30%	\$26.86	\$22.32	20.34%	\$22.00	5.9	2.30%
Protein Design Labs/PDLI	1.00%	\$21.70	\$19.09	13.67%	\$21.00	n/a	n/a
Rayonier/RYN	8.10%	\$43.00	\$44.66	-3.72%	\$41.00	19.1	4.40%
Specialized Health Products/SHPI	1.50%	\$0.85	\$0.90	-5.56%	\$0.40	n/a	n/a
Terra Systems/TSYI	0.30%	\$0.30	\$0.38	-21.05%	\$0.30	n/a	n/a

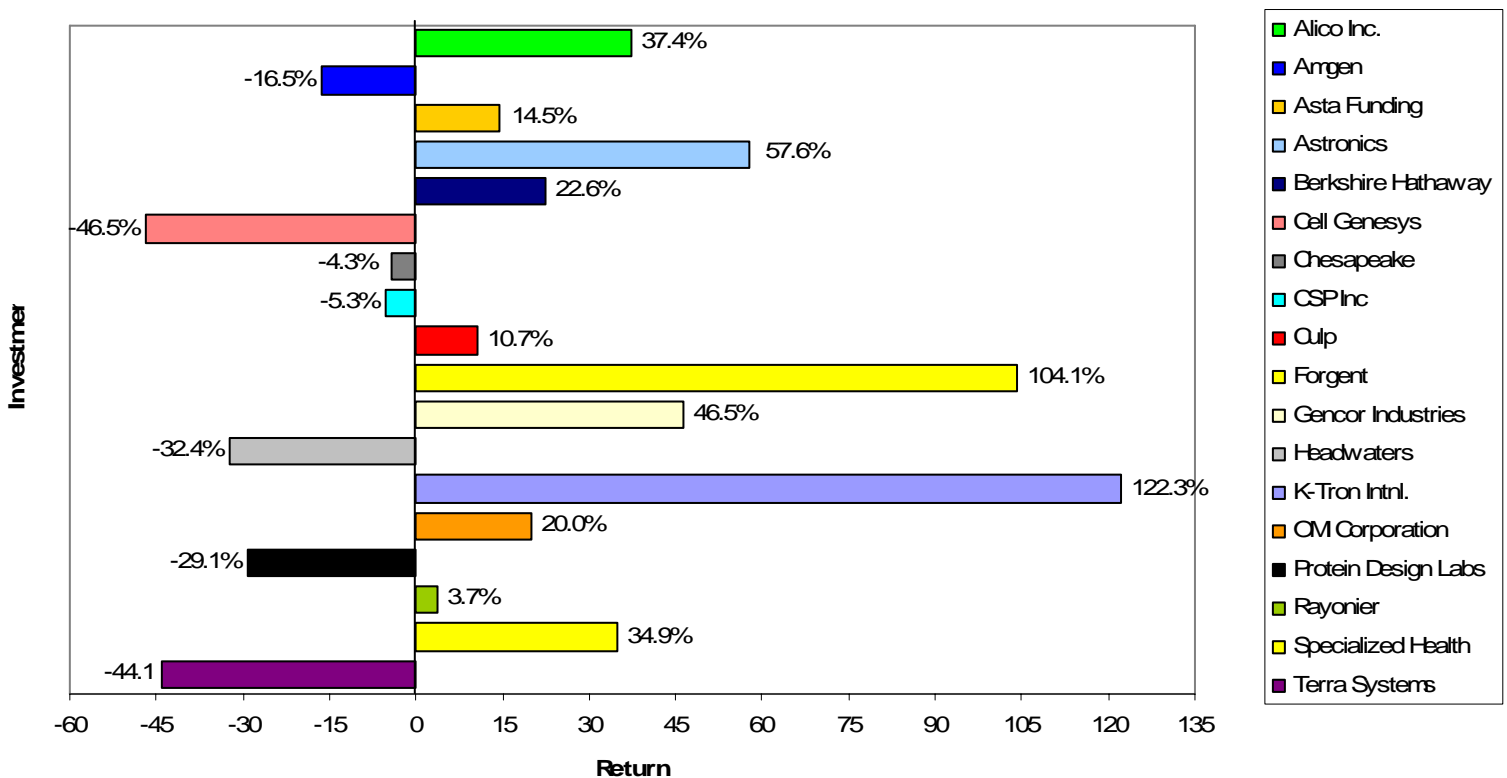
Performance Comparison

Here is the list showing the performance of our investments in 2006. From the list below you can see that several of our investments had stellar results last year. Astronics has had two solid years in a row. In 2005 they generated 112% for us and this past year another 58%. They are the type of pick that can make up for a lot of mistakes... and we had our share that we needed to cover for last year. Cell Genesys and Headwaters are two prime examples. Cell Genesys suffered from very poor management. They excelled at poor judgment and over optimistic expectations. They continually announced deadlines that they then failed to meet. They have exceptional products that could truly turn into blockbusters. Before that happens it is a distinct possibility that the company could go bankrupt. They have mismanaged themselves to the point where shareholders will pay (are already paying) for managements mistakes.

Headwaters was on the receiving end of high oil prices last year. This investment did not work the way we had initially envisioned it working. The high oil prices dented the amount of income they generated from their business that benefits from the Internal Revenue Code Section 45 tax credits. The high oil prices caused the phaseout of easy profits for Headwaters. The creep up in oil prices has stunted their growth this year also. The lower oil prices in January looked promising but have faded as we have moved through the first quarter of 2007. They have many blossoming opportunities that make the company attractive for their value five years down the road, but we certainly paid too much for them.

K-Tron is another solid performer. Two years ago they had a return of 26% to go with this past years 122% return. Forgent was a great example of market mis-pricing in action. We made over 100% in a couple of weeks. Finally, to prove our point you don't have to get them all right, we had four of our picks plunge more than 29% last year and seven total finish down for the year. We wouldn't have changed a thing overall.

2006 Yr End Investment return

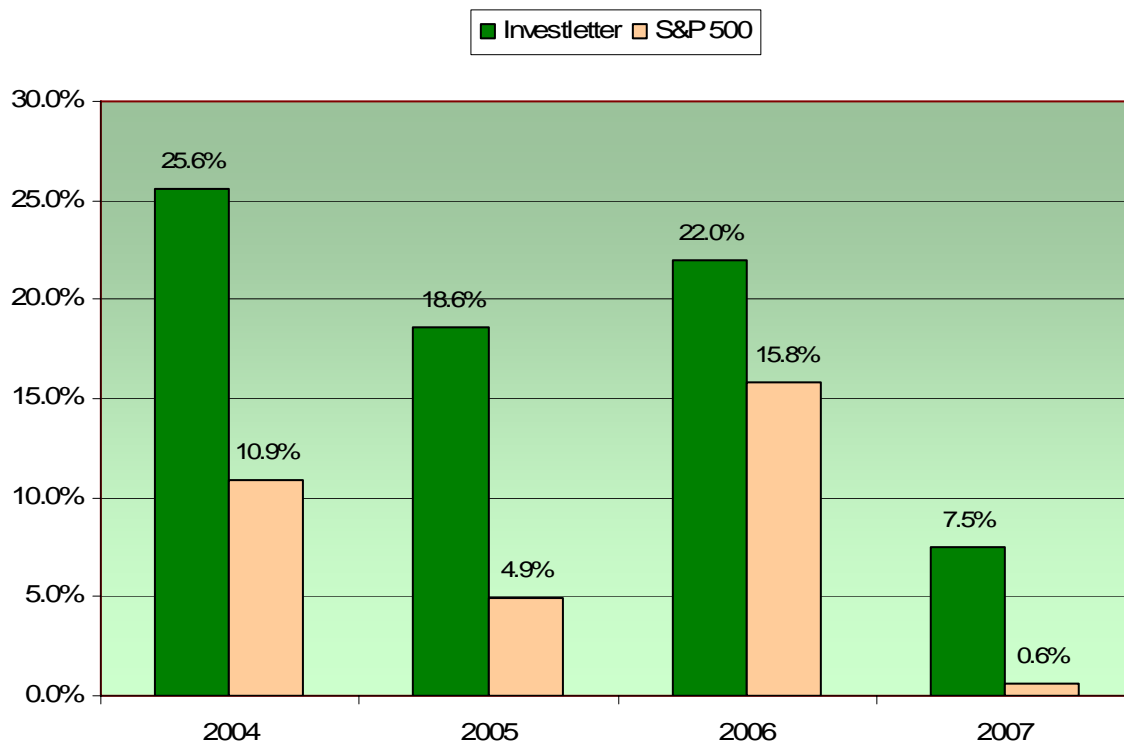


Performance

February and March have been very good for our portfolio. Our lead over the S&P 500 has widened to just shy of 7%. Most of our strength has been as a result of the surge in OMI's price due to their exploration of strategic alternatives for the company. When one of our large positions does well, we do well. When the companies you own are undervalued their price often moves up suddenly. A small event many times is the catalyst of a sizable change in share price. We moved from \$22 and change to \$26 and change over one press release that said the company is going to "look into" alternatives. The implication is that the company must be undervalued if they are looking into alternatives or they may already have received an offer. We have maintained that the company has been undervalued for years. Now a few more investors are aware of it and we are reaping the rewards.

We are fast approaching our goal of doubling our portfolio every five years. In our first 39 months we are up 95.8% compared to the 34.9% the S&P 500 has generated. With another strong month or two we will move past the 100% mark. Which company will be the next to drive our portfolio growth?

Investment Returns 1/1/2004 to 03/31/2007



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