The Commonsense

INVESTLETTER

Volume 6 Number 1

Wall Street:

- DJ 12650
- S&P 500 1378
- NASDAQ 2398

Proxy Fight

It isn't often that shareholders get to make a true difference in the outcome of their investment's future course Our holding, Gencor Industries, Inc., is involved in a proxy battle. A large shareholder has announced his candidacy for the board of directors. In our opinion Gencor has had poor governance practices, led by their two tier ownership structure. The common shares trade on the NASDAQ stock market, the B shares are only held by management and can't be acquired by the general public. The whole purpose is to keep the ownership in the Elliot family with the related control of the company. The common owners elect 25% of the board of directors and the B shareholders elect 75% of the board. He who holds the B shares controls the board of directors and the company. It is all of the benefits of a private company on the dime of very public investors. So it is that with a board of six members, the common shareholders get to elect one member and the B shareholders elect five. The Board who is led by Chairman E.J. Elliot, who is also the CEO (and the largest holder of B shares), has nominated a former employee as the candidate for the common shareholders representative.

Proxy battles are decided by the owners, often showing their support or dissatisfaction with management.

Notwithstanding the fact that we abhor the two tier voting system, the shareholders should at least get to vote on a candidate who is not just technically independent (according to the SEC definition), but one who is truly independent of the company. The board is supposed to represent the shareholders interests and act as a check on management's actions. Lloyd Miller, III, who is the owner of 11.5% of the outstanding shares of the common stock, has announced his candidacy for the board of directors, running against management's candidate, Russell Lee, III. We will be directing all of our votes for Mr. Miller.

Most of you have received proxy material from Gencor by this time. With this material is proxy voting instructions. These instructions are provided by the board and have put forward a proposal that is favorable to their way of seeing things. If you haven't received materials from Mr. Miller yet, you will shortly. His proxy material will contain a gold voting card. That is how you will be able to identify this proxy from management's proxy that is printed on white paper. By voting as prescribed on the gold proxy, you are voting for Mr. Miller and against the 2008 Incentive Compensation Plan. In our opinion this plan is very favorable to the board and management at the expense of the shareholders.

As can be seen in the proxy material, E.J. Elliot owns 1.35 million of the 1.64 million B shares. He also owns 1.06 million or 13% of the common stock. The largest common stockholder owns 2.17 million shares or nearly the same number as the total shares owned by Elliot. Mr. Elliot alone can elect 5 of the 6 shareholders while only controlling about 30% of the company. The

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rest of the shareholders have to struggle to determine one board member. The argument can be made that everything they are doing is legal and you are welcome to take your money and invest elsewhere. However, it is also legal to try and change this arrangement and create a more level playing field for all shareholders.

Is increasing the value of the multimillion dollar company you own 30% of enough incentive to get you to maximize your effort? Gencor's management feels they need to be offered tens of thousands of free shares to get motivated.

Our opinion is that the best chance to enhance shareholder value is to place an independent watchdog on the board of directors to help encourage better disclosure practices and more shareholder friendly approach to utilizing the large cash and investment balance. Companies have plenty of leeway on the information they report. Gencor takes the less is better approach. So much so that the SEC had to step in and prod them to supply all of the information that they are required to in their regulatory reports. We interpret this behavior as a pattern that marginalizes the importance of their shareholders while at the same time attempts to protect their position by regulating the flow of information to their advantage. This was never more apparent than in December of 2003, when management tried to take the company private. Here is a comment from E.J. Elliot in a press release announcing the offer had been cancelled; "We believe the offer, which had to be approved by a majority of the stockholders unaffiliated with management or the company, would have given stockholders liquidity and an opportunity to realize more value than the market has been historically providing to our common stock." Management had offered a low ball $3 per share offer knowing full well that they had partnership income that would soon start rolling in. Management certainly had the option to fully disclose that they had this partnership income that was soon to begin. They made an attempt to take the company private knowing full well that the companies value was likely to rise. The key to Mr. Elliot's statement above is that the shareholders unaffiliated with management need to agree to any offer of this sort.

The incentive compensation program is another questionable action. Here is the explanation by the company why shareholders should vote for the plan:

"Your Board also urges you to vote FOR the 2008 Incentive Compensation Plan (Proposal 3 on the ballot), which will assist in attracting, motivating, retaining and rewarding high-quality employees, officers, directors, and other persons who provide services to the Company. It will enable such persons to acquire or increase a proprietary interest in the Company in order to strengthen the mutuality of interests between such persons and the Company's stockholders, and providing such persons with performance incentives to expend their maximum efforts in the creation of stockholder value. The 2008 Incentive Compensation Plan is necessary to ensure that all employees of the Company continue to have their interests aligned with all other stockholders. We firmly believe that when employees are enabled to acquire some shares of their employer's stock their performance and dedication to the success of the Company increase dramatically. Mr. Miller is asking you to vote against the plan, as he does not apparently see the need for employees to have their interests aligned with yours in the success of the Company."

The company has recently finished allocating the shares they had on their previous stock option plan and executive management were the only beneficiaries of this program that we are aware of. Here we have a management team that has an absolute lock on the control of the company, owns more than 30% of the company and are complaining they need free shares to motivate them and keep them working for the company. If seeing $42 million of

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your net worth tied up in the value of the company is not enough to motivate you to give your "maximum efforts" then we need new management, not more lavish rewards.

Over the next few months we expect to see extremely strong operating results coming from GENC. We are projecting record revenues and operating earnings this next quarter. The company has a large backlog, a sizable amount of customer deposits and a large inventory. At times a growing inventory can be a warning sign especially when sales are slowing, that is not the case with GENC. In the three months ending December 31, 2007, the company reported sales rose 50% over the quarter ending December 31, 2006. This is a strong leading indicators of the results to come. The shares have a chance of hitting $20 over the next 3 months. If they receive any kind of residual payment for their partnership interest this will be another reason for the shares to respond positively. The one item that could derail our scenario is the company announcing an acquisition. They have investment bankers working with them to identify possible candidates. The last large acquisition that management made resulted in the company filing for bankruptcy, not exactly the track record we are looking for when a company make acquisitions. Ultimately, the shareholders may have the final say in any large acquisition providing our best defense against their attempt at empire building. Building a larger empire is often a way to justify a larger paycheck regardless of how well your empire performs.

We have waited years for this opportunity and are glad to see it arrive. After having dozens of phone calls to management go unanswered it is nice to be able to send a message they will hear loud and clear. (I have personally called and left messages dozens of times over the past 3 or 4 years.) It also is a chance to protect my investment by preventing dilution through the granting of stock options. Management's strong response is a sign that they are concerned they may lose a bit of the absolute control they have over the company. Our votes are aimed at validating their concern. At Investletter we encourage you to read the competing proxy material and reach your own conclusions.

Company	January price	December price	Change from December	P/E	52 Week High	52 Week Low	Estimated '07 EPS	Dividend Yield
Alico/ALCO	$42.70	$36.50	16.99%	n/a	$65.00	$35.35	n/a	2.50%
Alliant Techsystems Inc./ATK	$105.85	$113.76	-6.95%	16.7	$120.90	$81.75	$6.35	n/a
Altria Group, Inc./MO	$75.79	$75.58	0.28%	16.0	$87.85	$63.13	$4.75	3.90%
Arch Coal/ACI	$43.95	$44.93	-2.18%	39.8	$45.69	$27.76	$1.13	0.70%
Bioanalytical Systems, Inc./BASI	$7.44	$8.67	-14.19%	n/a	$9.39	$5.33	n/a	n/a
Canadian Natural Res./CNQ	$63.81	$73.14	-12.76%	15.8	$87.17	$48.33	$4.05	0.50%
Culp/CFI	$6.82	$6.96	-2.01%	12.9	$12.30	$5.68	$0.52	n/a
Graham Corp./GHM	$31.45	$52.40	-39.98%	18.7	$60.96	$11.11	$2.08	0.30%
Kensey Nash/KNSY	$27.15	$29.92	-9.26%	28.6	$31.80	$22.26	$0.95	n/a
Landauer, Inc./LDR	$47.44	$51.85	-8.51%	19.3	$54.46	$45.50	$2.46	4.10%
Markel/MKL	$463.00	$491.10	-5.72%	15.0	$554.95	$394.99	$35.24	0.40%
ModPac/MPAC	$6.96	$7.49	-7.08%	n/a	$11.90	$6.05	n/a	n/a
QLT Inc./QLTI	$3.67	$4.42	-16.97%	28.2	$9.92	$3.20	$0.13	n/a
Servotronics Inc./SVT	$14.70	$14.50	1.38%	21.2	$17.45	$8.20	n/a	n/a
Specialized Health Products/SHPI	$0.79	$0.87	-9.20%	31.1	$0.99	$0.66	n/a	n/a
Tejon Ranch Co./TRC	$37.55	$40.85	-8.08%	n/a	$55.44	$34.50	$0.34	n/a
Torm/TRMD	$32.37	$35.24	-8.14%	3.3	$47.10	$26.52	$2.30	16.70%
Universal Forest Products/UFPI	$36.20	$29.46	22.88%	20.3	$54.61	$26.26	$1.78	0.40%

The Investletter Portfolio

When the market has a sour mood everybody gets a dose of punishment, whether they deserve it or not. Any appearance of weakness is punished with the most severe punishment available. Since the end of January our investment in Astronics has been seen a very sharp decline in price. The company reported lackluster earnings and the shares promptly dropped 40% from their already depressed price. The shares now are trading at prices they last saw a year ago. The CEO also announced they will be increasing E&D (engineering and development) activity which will decrease earnings in 2008. They still expect 7% to 10% revenue growth in 2008. These are not the type of numbers a high flying stock can announce and see their share price continue to spiral upwards. However, a drop from $53 to $19 is completely detached from reality.

The last time the company increased their E&D spending they saw the most recent huge spike in revenues as a result. This increase in spending is directly related to opportunities the company sees in the market place. Management was also unusually upbeat about their prospects. The large plant addition and the recent community newspaper employment ads also indicate continuing growth. Small companies don't normally experience a constant, predictable growth pattern and Astronics is no exception. The current prices will be a bargain over the next 18 months.

The lower revenues that the company projected in early 2007 came in exactly as predicted. Investors were still surprised when the results matched what the company called originally projected. Astronics has a very leveraged business model. Higher revenues result in a sharp increase in operating profits. The company should have strong revenues in each quarter of 2008. The first two quarters 2008 will be make for tough comparisons with the extremely strong first two quarters of 2007. The third and fourth quarters of 2008 should look much better when compared to the weaker third and fourth quarter of 2007. It may take 6 to 9 months or more before Astronic's share price responds to the improving revenue and earnings picture. Astronics is still so small that revenues can be extremely variable. It is tough to factor in large contracts like the content they will supply for the Joint Strike Fighter that will slowly add revenue over the next several years. Large volumes may not be seen until 2010 or 2011.

As usual we can't tell you when, only that things will get better. We place a great deal of faith in management and it has been well earned. With no large changes in the business, we see no need to make any large changes in our Astronic's holdings.

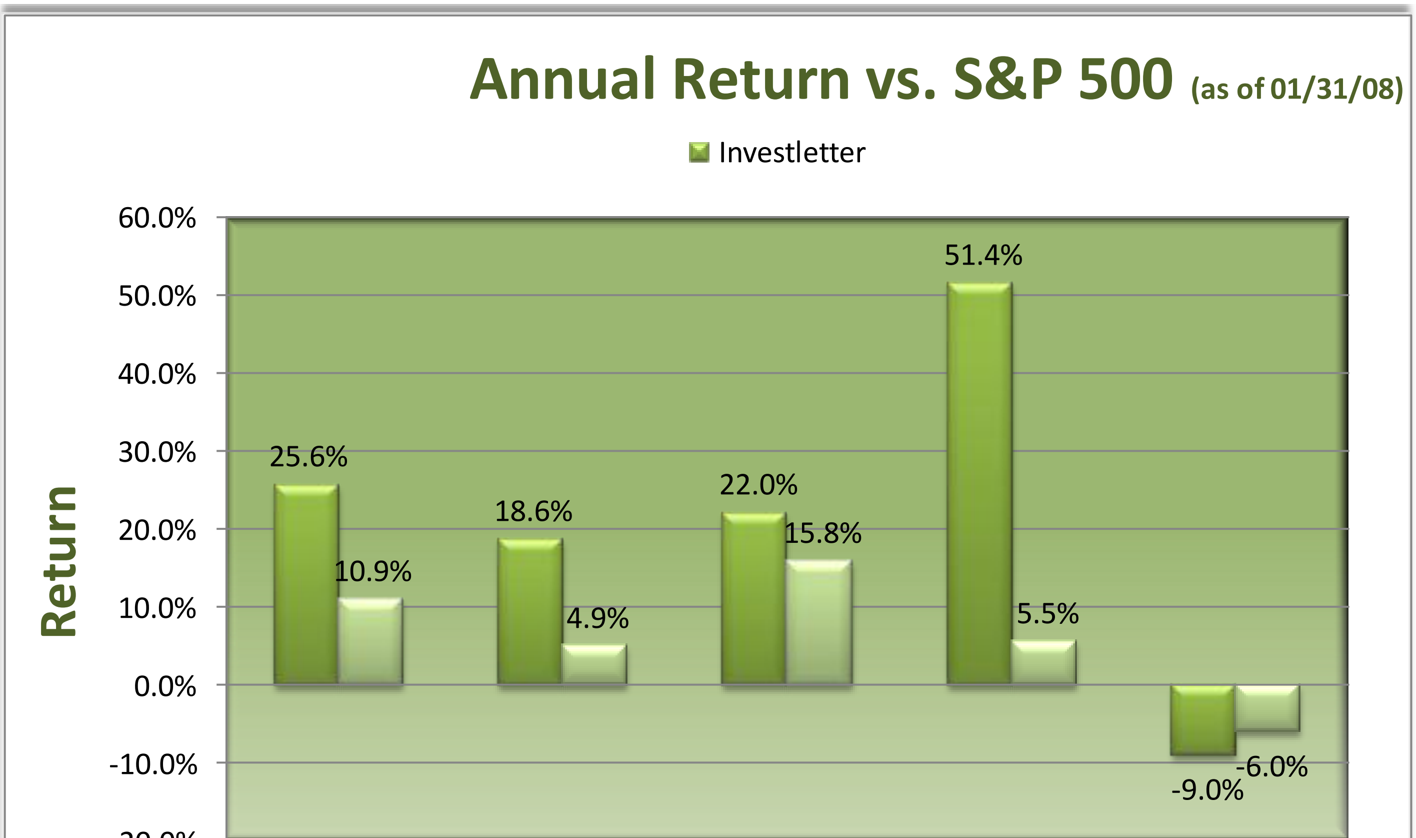
Company	Porfolio Percentage	January price	December Price	Percentage Change	Buy Price (less than)	P/E	Dividend Yield
American International/AMIN	4.80%	$4.35	$4.78	-9.00%	$4.95	n/a	n/a
Amtech Systems/ASYS	4.90%	$10.22	$12.99	-21.32%	$11.15	20.4	n/a
Astronics Corporation/ATRO	16.00%	$32.78	$42.50	-22.87%	$35.00	17.4	n/a
Atrion/ATRI	7.30%	$122.58	$125.00	-1.94%	$93.00	17.5	0.80%
Berkshire Hathaway B/BRK.B	6.90%	$4,550.00	$4,736.00	-3.93%	$3,800.00	15.2	n/a
Cash	2.60%	$1.00	$1.00	n/a	n/a	n/a	n/a
Chesapeake/CHK	5.70%	$37.16	$39.20	-5.20%	$33.00	12.1	0.70%
CSP Inc./CSPI	1.90%	$7.38	$6.69	10.31%	$7.00	7.2	n/a
Gencor/GNCI	9.80%	$10.20	$10.25	-0.49%	$9.70	5.4	n/a
Griffin Land & Nurseries/GRIF	4.20%	$34.01	$36.50	-6.82%	$35.00	30.3	n/a
Headwaters/HW	0.70%	$11.27	$11.74	-4.00%	$14.00	9.5	n/a
K-Tron International/KTII	9.40%	$110.24	$119.25	-7.56%	$90.00	16.1	n/a
Protein Design Labs/PDLI	0.50%	$14.93	$17.52	-14.78%	$15.00	n/a	n/a
QEP Corporation/QEPC	10.30%	$9.36	$10.31	-9.21%	$12.00	12.9	n/a
Rayonier/RYN	8.20%	$42.32	$47.24	-10.41%	$41.00	20.1	4.20%
Transmeridian Exploration/TMY	1.60%	$1.42	$1.97	-27.92%	$1.45	n/a	n/a

Year to Date

There are no better words to describe it than a rout. Our performance in January was abysmal. Not only did the value of our portfolio plummet, but we underperformed the S&P 500 market average. I don't know if we have ever had a month were the value of our portfolio has dropped more. Hopefully this month will hold the record for a very long time.

When the r (recession) word starts getting tossed around small companies often suffer. Amtech Systems and Astronics were both down over 20%. Astronics went from the Belle of the Ball to the Ugly Duckling over the course of two months. Fortunately only in the eyes of Wall Street. The share prices of many of our holdings have dropped significantly over the past two months. The value of the businesses have changed very little. It is the market in the throes of a manic fit that is the root of our problem. The businesses we own are as strong or stronger than ever. QEP Corporation is an excellent example. They announced very strong earnings and reiterated the fact that they have sales shifting to higher margin products and see revenues rising. They were promptly rewarded with a 10% drop in price.

Many investors reflexively shift from small companies to large companies when recession worries crop up. In the short term lots of insanity can occur. In the long term, strong performance is rewarded. Continued strong results give us little reason to worry.

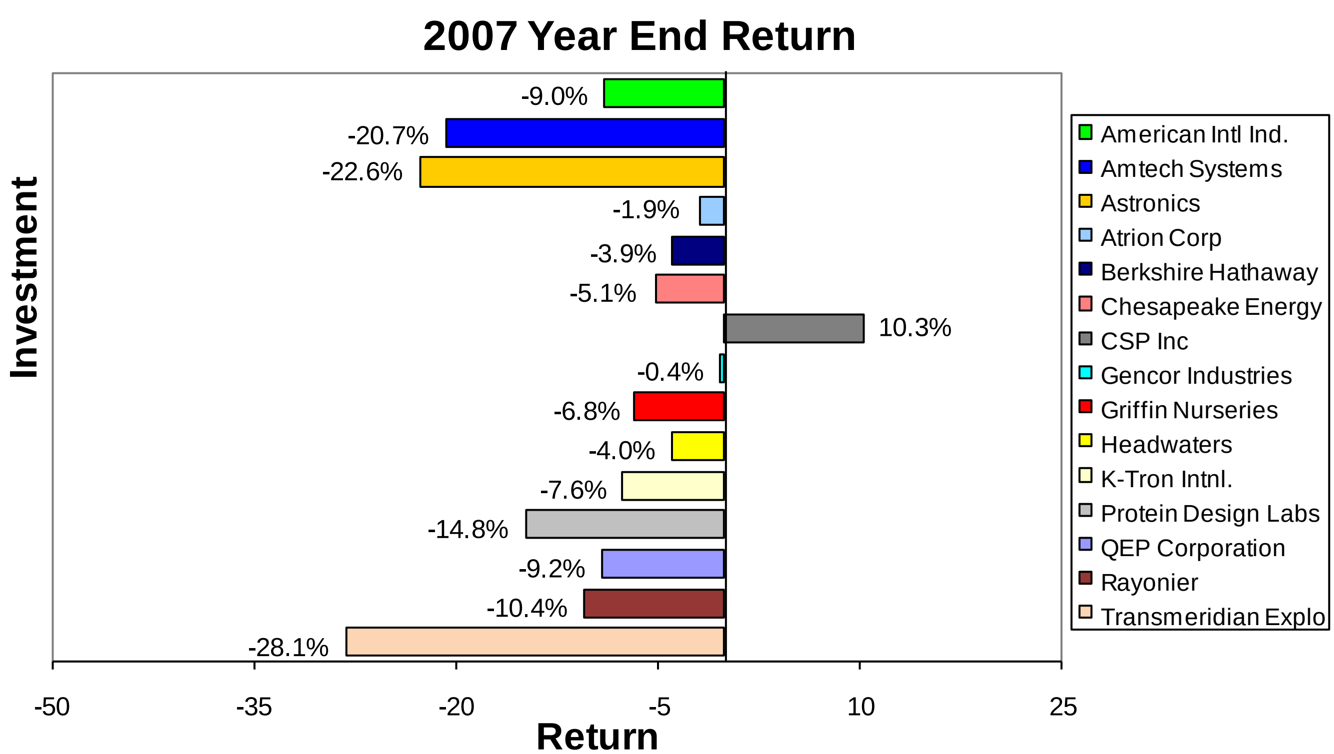


	2004	2005	2006	2007	2008
Investletter	25.6%	18.6%	22.0%	51.4%	-9.0%
S&P 500	10.9%	4.9%	15.8%	5.5%	-6.0%

Performance

Our slow start is not uncommon. In three of the five past Januarys we have trailed the S&P 500 average at the end of the month of January. The graph below says it all. Only one of our investment showed positive returns in January. Several, like Astronics, Amtech and Transmeridian Exploration showed greater than 20% declines. With the large market declines it was nearly impossible to escape the carnage. All companies pay the price for the sins of a few. This abrupt change in sentiment is nothing new. It marks the point in the market cycle that not only creates remorse and skepticism, but allows cheap shares to be accumulated leading to outperformance on the next leg up.

It is never easy buying when everyone else is screaming sell, sell, sell. Knowing it feels uncomfortable is the feedback you need to help gauge that you are doing the right thing. If it felt right everyone would be buying at this time. When the price of that HD TV you have been eyeing goes on sale, it doesn't become less desirable, you immediately think bargain. The popular investment media has conditioned investors to fear prices dropping. Seeing your portfolio's value drop on a daily basis is never fun. The opportunity to buy shares of companies cheap brings out our "kid in the candy store reaction". Our most recent buying spree has left us with little more than pocket lint as far as our cash balances are concerned. Now all we have to do is wait for the market version of Prozac to kick in and we can return our accounts to normal, and then some.



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