Volume 2 Number 6

June 2004

Blue Collar Investment Advisor

BCIA

Wall Street

- DJ 10372
- S&P 500 1134
- NASDAQ 2025

Dividends

Dividends have recently become a more attractive option for companies. Last years changes in tax law provide for a 5% tax rate on dividends for taxpayers in the 15% or lower tax bracket and a 15% tax on dividends for taxpayers in the 25% or higher tax brackets. These are also the same rates that are used for capital gains on the sale of stocks. Dividends used to be taxed as ordinary income. If you were in the 28% tax bracket, you would pay that rate on your dividends. Companies have begun to change their dividend policy as a result of these changes. Like many other changes in corporate America, many companies are slow to adopt changes and some seem to have an ingrained resistance to paying dividends.

Dividends have become more popular due to recent tax law changes.

What are dividends? Dividends are payments made as a result of a company's current or past earnings. A company sells products and/or services with the goal of making a profit. Some or all of this profit may be returned to shareholders in the form of dividends; provided the company has enough cash around to pay for the dividend. A company that loses money in the current year can still pay a dividend if they have made money in previous years. This is an over-simplification but will suffice for our purposes. Companies have no requirement to pay dividends and many don't.

Any current year income that a company does not pay out in dividends is retained earnings. Retained earnings are used to grow a company. They can be used to build a new plant or upgrade equipment, train workers or whatever investment the company feels it needs to increase earnings in the future. Companies often use more money for investment than they make in profits. This can lead to a company borrowing money to be able to make dividend payments. Companies with this kind of rapid growth often do not pay any dividend.

The dividends that a company pays are often compared to the firms stock price. This will give you the dividend yield. A company paying a dividend of $1 per share with a share price of $20 will have a 5% dividend yield. If this same company earns $100 million dollars and pays out $50 million dollars in dividends has a 50% payout ratio. The other 50% of earnings are retained earnings and are used to invest in the business. On the next page we have a chart showing the companies we own and have owned that pay a dividend with the accompanying yield.

Dividends have become more popular recently. This is due to primarily two reasons. The new tax laws encourage companies with large cash and investment balances that do not presently pay dividends to begin paying one. Wealthy investors will now only be taxed at a maximum of 15% on qualified dividends. This is much less than the +30% they previously would have paid. Owners have

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Dividends

a choice whether or not they will sell shares and realize a capital gain. In this regard dividends still are at a disadvantage. Some shareholders will like receiving the dividend and some would rather avoid the taxes, even if they are greatly reduced from previous years. All of this means different investors looking for different things from their investments may be attracted to companies with different dividend policies.

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Another reason dividends are more attractive is because of the lower returns in the market the last few years. When stocks are achieving 20% - 30% rise in prices for years at a time, a paltry 1.5% dividend yield does not seem very important. With returns down at much lower levels a 2% or 3% dividends begin to look more appealing. A 2% dividend is 20% of a stocks yield if it has a 8% rise in price over a years time. Lower returns lead to more importance being attached to dividends.

When should a company pay dividends? The most important consideration is how effectively can a company put its profits to work. Altria group, the makers of Marlboros is a classic example of a companies dividend policy being dictated by its business prospects. Tobacco is an old mature business. The industry is not growing at all. Altria cannot put the money that it generates from selling cigarettes to use in its business so it returns it to its shareholders. You do not need to build new plants when the industry is in decline. Less cigarettes smoked means less capacity is needed to produce them. Altria pays a 5.7% dividend. I bet that is a little more than your savings account is offering.

If a company has great growth prospects and can earn a good return on the investments in new plant and equipment, they are better off retaining their profits than paying them out. A slow or no growth company like Altria is better off returning their profits to their owners, the shareholders. Of course it does not always happen like this in corporate America. Caterpillar is a great example. In the last 5 years the company has increased its sales by $3.0 billion dollars and their earnings by $154 million dollars. Those numbers do not sound to bad until you consider how much money had to be spent to get these results.

The company spent $6.4 billion dollars to generate this increase. This is a whopping 2.4% increase in earnings… over 5 years. Not exactly my idea of a great company. They have to spend oodles of money just to stay in business with very little chance to flourish. To be fair they do pay out 45% of their earnings. The should strive to pay out as much as they possibly can. Every dollar they are forced to invest in their business generates pathetic returns for their shareholders.

With dividends becoming more popular and the recent persistent low interest rate environment, it is convenient to compare dividends to the coupon payments of bonds. When you buy a bond you will receive semi-annual interest or coupon payments at a fixed percentage rate. High quality corporate bonds are now paying between 4% and 7%. You can find plenty of stocks that are paying over 2% dividend yields. Why might you be better off buying a stock to give you income rather than bonds? Bonds are most often sold in $1000 increments. Suppose you buy a $1000 dollar bond paying 10%. This means that twice a year you will receive a check for $50 and when the bond matures you will receive your last $50 check and the return of your $1000 investment. Everything is very predictable. We again will use Altria for our example. Suppose that you bought 50 shares of Altria in 2000 when it was selling at $20 per share. This would give you the same $1000 investment that you had with the bond. Back in 2000 Altria paid a $2.02 dividend which means you would have received

Dividends

$100 dollars per year, or a 10% yield. In 2004 Altria pays a dividend of $2.72. Now you are receiving $135 each year in dividends and the share price has jumped up to $47. Your yield on your original $1000 dollar investment is now 13.5% ($135 divided by your original $1000 investment) and your investment is now worth $2350. A 10% bond would definitely be classified as a junk bond which describes a more risky bond. Altria is also a risky stock because of all of the lawsuits they face regarding their tobacco sales. We are comparing apples to apples in this example as far as risk. When you invest in a stock you can collect a dividend and take part in the increase in the share price. Many times the dividend payouts will increase over time. Your yield on you original investment will increase over time. With a bond neither of these events will occur. You will however receive your original investment back when the bond matures. You will not face the any loss in value of your original investment as you could owning a stock.

AFLAC, a company we held until recently, has seen their dividend double over the past five years and increase fourfold over the past 10 years. Their yield has gone from 1.7% to a equivalent of 6.8% on an investment back in 1994.

We do not actively seek out companies paying dividends. Sometimes we have held companies like Altria that pay significant dividends and oftentimes we hold companies like Astronics that pay no dividend. We have no real preference either way. We look to make our returns by buying companies that are undervalued. If they pay a large dividend we do prefer to hold them in a tax free account like an IRA to completely wipe out any tax consequences.

You may have different objectives that may benefit by having a few dividend paying stocks throwing off income to you. We have two candidates in our portfolio that should pay increasing dividends over time. Both OMI and Consolidated Tomoka should have plenty of cash to distribute to owners and are both growing at rapid rates. This should drive their future dividend payments up nicely.

Company	Ticker Symbol	Current price	Dividend per share	Dividend Yield
Aflac	AFL	$40.40	$0.38	0.94%
Altria	MO	$47.80	$2.72	5.69%
Consolidated-Tomoka Land	CTO	$37.00	$0.24	0.65%
Freddie Mac	FRE	$62.01	$1.20	1.94%
OMI Corporation	OMM	$11.89	$0.20	1.68%

Read A Good Book Lately

There are many sources of information that can help you learn more about investing. Magazines like Business Week, Barrons and Outstanding Investors Digest. Many online sources provide a great deal of help. We are partial to MSN Money and the SEC information that has a link there. Several individual investor friendly sites can be valuable to members. The NAIC (National Association of Investment Clubs) and the AAII (American Association of Individual Investors) have great

sites for members and are both very involved in educating investors.

We happen to be partial to books when it comes to learning about investing. Here are some of the books we feel are helpful in learning more. You have heard us talk frequently about Warren Buffett. We have several books about him that we strongly recommend. One is a compilation of his writings from the Berkshire annual reports arranged by topic. The book is "The Essays of Warren Buffett : Lessons for Corporate America" by Lawrence Cunningham. Another Lawrence Cunningham book on Buffet we like also covers his mentor Ben Graham, "How to Think Like Benjamin Graham and Invest Like Warren Buffett". This book is very technical and requires a fairly deep understanding of finance to be understood well. Graham's classic, "The Intelligent Investor" is required reading. This book was written in the 1940's and uses many companies as examples that no longer are around. This in no way diminishes the usefulness of the message which is timeless.

Philip Fisher's "Common Stocks and Uncommon Profits and Other Writings" covers techniques for researching companies. He encourages investors to invest in companies that are showing growth in sales and earnings. Peter Lynch has two books we love. The first is "Learn To Earn." This book covers the basics of how the stock market works. His other book is "Beating The Street." This book covers his career with the Fidelity mutual fund company and how small investors can be as successful or perform better than the pros. He encourages investors to look at companies whose products they use everyday as promising investment candidates. This is close to what we preach when we say we only invest in what we know.

We have a text that gives a sarcastic, humorous view of the shenanigans that occur on Wall Street. The title says it all, "Where Are The Customers Yachts?" by Fred Schwed, Jr. On a more spiritual note we recommend "Jesus CEO" by Laurie Beth Jones. This book is one of the best at explaining the role of managers and how they should act and perform in corporate America. If more managers followed these principles we would have many more satisfied workers and many more profitable companies. Another moving book is "Spiritual Investments" by Sir John Templeton, another legendary investor. He brings to light spiritual ideals that you can also apply to your financial life. Another favorite we have is "Who Moved My Cheese?" by Spencer Johnson. The story is a parable about two mice Sniff and Scurry and two little people Hem and Haw and how they learn to deal with change. The story takes place in a maze with hidden cheese and it manages to cover many valuable lessons. The book is short and can be read in 45 minutes. You will read it over and over. It is that good.

Another book many will find helpful is written by two researchers who are experts in personal finance. The book is "The Millionaire Next Door" by Thomas Stanley and William Danko. This book dispels many myths about the wealthy and helps show readers how many people can become millionaires. It is not how much you make, it is about how much you keep. Many junkyard owners are millionaires and many doctors are not. You never know when you may have a millionaire next door, especially when you find out their vehicle of choice is often a Ford pickup truck. We hope you enjoy our selections and even take a chance and try one.

Book List	Author
The Essays of Warren Buffett : Lessons for Corporate America	Lawrence Cunningham
How to Think Like Benjamin Graham and Invest Like Warren Buffett	Lawrence Cunningham
Intelligent Investor	Benjamin Graham
Common Stocks and Uncommon Profits and Other Writings	Philip Fisher
Learn To Earn	Peter Lynch
Beating The Street	Peter Lynch
Where Are The Customers Yachts?	Fred Schwed, Jr
Jesus CEO	Laurie Beth Jones
Spiritual Investments	Sir John Templeton
Who Moved My Cheese?	Spencer Johnson
The Millionaire Next Door	Thomas Stanley and William Danko

Company	Ticker Symbol	Portfolio Percentage	Current price	Buy Price (less than)
Amgen	AMGN	4.50%	$53.27	$60.00
Astronics Corporation	ATRO	6.00%	$5.37	$5.15
Berkshire Hathaway B	BRK.B	17.00%	$2930.00	$3050.00
Cash		16.00%	$1.00	n/a
Cell Genesys, Inc.	CEGE	3.00%	$10.33	$12.75
Consolidated-Tomoka Land Co.	CTO	26.00%	$37.03	$36.00
Freddie Mac	FRE	10.00%	$62.82	n/a
OMI Corporation	OMM	13.50%	$11.89	$10.00
Protein Design Labs	PDLI	1.50%	$18.57	18.50
Ultralife Batteries	ULBI	2.50%	$19.80	$20.00

The BCIA Portfolio

Again price moves over the last month have been pretty uneventful. Last month we reported OMI announced they were in merger talks with another shipping company. This deal has since fallen through. They have however, purchased six more ships and eight that are presently under construction. This will work out much better than the merger they were attempting. The new ships will add to earnings this year which is great news.

Amgen, Berkshire, Cell Genesys, and Ultralife Batteries are the only companies selling at less than our buy price. If you have not purchased one or more of these companies, now is a great time to pick them up at fairly reasonable prices.

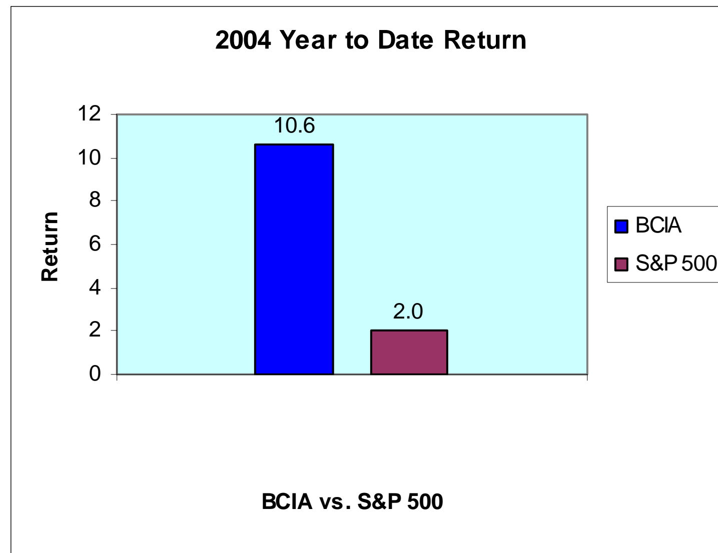
Consolidated Tomoka announced another significant land sale in early June. This one was for $17 million dollars. They have several large sales in their backlog waiting to close. If a couple come through in a single quarter or in successive quarters, their share price could really jump. We like their business model so much we have been searching for other companies with significant land holdings. One we are awaiting information on is Tejon Ranch symbol TRC.

The table above shows our investments and the proportion of our portfolio they represent. As you can see we are heavily weighted towards four stocks. This is considered extremely risky by the popular investment community. We feel perfectly comfortable with it. Our trial issue on the website briefly delves into the issue of how you should build your portfolio. To achieve the same returns we will receive, you can buy all of the stocks we own in roughly the same proportion. You may be able to do better by purchasing the stocks we feel are worthy buys presently. These stocks are represented as the companies that are selling for less than our buy price.

Still Outpacing S&P 500

This past month has given our portfolio a nice boost. Our portfolio is up 10.6%, while the S&P average up 2.0% over the first nearly half a year. That gives a healthy 8.6% lead. Second quarter earnings season arrives in early July. Everything points to another strong quarter for stocks. We already mentioned that Consolidated Tomoka is poised for a strong quarter. OMI is also enjoying extremely strong day rates in their shipping business. The rebound in the U.S. economy and the increasing demand in China for oil should keep these rates strong over the next several years. By then there should be more shipping capacity as new build boats continue to launch. Cell Genesys has still targeted the end of the month for the launch of their first phase three clinical trial.

We had mentioned before that we have plans to sell our stake in Freddie Mac. The price is at $62 per share. This is close to where we planned to get out. They are scheduled to announce their earnings for 2003 and the first quarter of 2004 on June 30. This announcement should lift a great deal of uncertainty surrounding their business. This could cause a nice bump up in their price. We may have an email alert coming as these events unfold.



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Amgen

Back in early 1998 when we first purchased Amgen they were the first biotechnology company to become profitable. Since that time many other biotech have turned a profit, but none is as profitable as Amgen. In the past year they made a profit of $2.3 billion on sales of $8.4 billion. That is a whopping 27% after tax profit margin comparable with high profit companies like Microsoft. They invested well over $1.6 billion in research and development efforts to uncover and test promising new drug candidates. Many biotech companies do not even have $1.6 billion in sales yet alone that much to pour into research.

At George Burns 95th birthday party five very good looking young girls brought in a large birthday cake. After looking each of the five over he said, "Girls, I am 95 now, one of you is going to have to come back tomorrow."

Amgen has five drugs that generate most of their sales and profits. All five generate more than one billion dollars of sales. Epogen is the largest seller with $2.4 billion in sales. Epogen is used to treat patients with anemia. It is most often used with dialysis patients. The dialysis process destroys red blood cells that carry oxygen. Without enough red blood cells patients may have symptoms of fatigue and shortness of breath. Formerly the treatment for this condition in dialysis patient involved frequent blood transfusions. This was a more costly an more complicated treatment. Epogen has improved the life a many dialysis patients.

Amgen competes against Procrit from Johnson and Johnson. Procrit is essentially Epogen that was licensed to J&J for anemia that is not related to dialysis. Early in the companies history, before they were profitable, they sold the marketing rights to J&J to raise funds to allow the company to continue in business. J&J holds these rights in the United States for all treatments other than dialysis and for all conditions in Europe..

Amgen's second drug is Aranesp which is the second generation version of Epogen. It has a less frequent dosing schedule which simplifies treatment. It is also cleared for use in cancer patients with anemia. The biggest benefit of Aranesp for Amgen is that it can compete directly against J&J's Procrit and has been stealing its market share.

Neupogen was developed to treat neutropenia which could be referred to as the white blood cell version of anemia. A type of white cell called neutrophils which defend against infection are affected by disease and often during chemotherapy treatment. A low neutrophil count can lead to infection which can be very serious in patients with suppressed immune systems, like those being treated for cancer.

Neulasta is the second generation version of Neupogen. Neulasta require less frequent dosing than Neupogen. It was launched in 2002 and its sales have already matched the $1.2 billion that Neupogen generates.

The last major drug that Amgen markets is Enbrel. Enbrel is used to slow the progression of rheumatoid arthritis (RA). In effect it can drive RA into remission. In 2003 Enbrel sales increased nearly 270%.

The company has several promising candidates in late stage development. Sales and earnings growth will be driven by their current products over the next several years. You can expect growth in the 20 % range for the next several years.

Amgen

We are attracted to Amgen's shares based on their high profit margins and their strong growth prospects. Our original shares were purchased at about a split adjusted $12. The company's market capitalization (the value of all of the company's shares) is $68 billion. Earlier we mentioned that they had 2003 profits of $2.3 billion. This gives them a earnings yield of (2.3 divided by 68) 3.4%. This is not a real high number, mainly because the company is expected to grow fast and is so profitable. If the company double their earnings in four years so would your earnings yield on an investment made today. You are in effect paying a premium price now for their earnings in the future. That is fundamental to how you value a company.

Several problems could derail their growth. The most prominent is other companies developing products that either work better or products that perform equally as well but are sold cheaper. Patent expiration is also a concern. It is encouraging that they have second generation products of their two original drugs. This will have the affect of extending their patents on this technology.

Sometimes you pay more for quality.

Amgen is a good company and sometimes you have to pay for quality. We feel comfortable owning a company with such a promising future.

Security

The internet has brought a great deal of information into people's homes. Because it is an open system, there is not always the greatest security. Recently there has been a Trojan horse loaded on open servers including many that host financial web sites. It is extremely important that you keep your computer up to date and have good security practices.

At BCIA we have recently installed a free web browser that replaces the use of Internet Explorer. This was in response to the Trojan mentioned above that had the capability to supposedly log your keystrokes. Internet explorer does not have a patch available at this time to close this hole. Other browsers are not affected by this problem, including Mozilla Firefox, the browser we recently installed. Firefox is a great product and has some neat features that are not found in Internet Explorer. We will feel comfortable using Internet Explorer as soon as they issue a patch for the problem. However, now we will probably use Firefox more often. It is funny how some events force you to try something new and you find out you actually like it better.

One other security note we encourage you to consider implementing is the use of strong passwords if you do not already use them. A strong password uses upper and lowercase letters, numbers and symbols to create a password. A strong password should contain at least eight characters. An example would be +f2<Rm8KtrL. A password constructed in this fashion is much more difficult to crack than one based on common words. Any password for information involving sensitive personal or financial information should use a strong password.

BCIA

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