

# INVESTLETTER



Volume 4 Number 8

## Wall Street

- DJ 11679
- S&P 500 1336
- NASDAQ 2258

## How Do We Know Our Limit

Knowing what you don't know is almost as important as what you do, when it comes to investing. Here is a quick partial summary. I don't know retail. If I get out shopping to any place other than the grocery store, drug store or the liquor store more than once a month it is a lot. How much do you think I am going to be able to tell you about the retail segment? Zilch! No trendy products like Callaway Golf (ELY). I know practically nothing about pop culture. No fancy high tech companies like Advanced Micro Devices. I can't tell you what factors will make AMD's computer chips more desirable than Intel's.



Everyone comes from different backgrounds and strengths in different areas. There are some companies that just about anyone can understand. You don't have to have any special understanding to figure out how Coke makes their money or the factors that influence a consumer's decision to buy their products. Determining with a reasonable degree of certainty whether Corning's fiber optics cable is superior to that of their competitors is beyond most peoples abilities, myself included. I have no special insight that would make my analysis any better than yours.

**Knowing your limit is important, whether it pertains to your social activities or investing.**

At one point in time I was an owner of Callaway Golf, the maker of the Big Bertha Driver. This was at the time that the Big Bertha was all the rage. I made several mistakes buying the company. I failed to pay attention to climbing inventory which was an indicator that sales were slowing. I also underestimated the fact that although I golf, I know absolutely nothing about equipment trends. Everyone and their brother introduced titanium head, oversized drivers. I lost a large percentage of my money in a hurry. With my nose regularly buried in regulatory filings, it is easy for me to lose touch with trends, fads and pop culture in general.

I end up focusing on companies that I can easily understand or that I have an advantage understanding over others. After buying OMI as a severely undervalued company I have had the opportunity to learn a great detail about the oil tanker business. This is the basis on which I continue to hold shares in OMI. Without the detailed knowledge I have acquired as a result of owning them, I would have sold them long ago. My knowledge gives me an advantage in analyzing the company. Over the years I have become much better at recognizing business' I do not understand and have the discipline to avoid them. You may be a much better judge of an industry you are familiar with than I am. I know a few of you hold investments in companies that I don't hold in the Investletter portfolio, and that is great. I encourage each one of you take advantage of any specialized knowledge you have to gain an advantage in your investing. We at BCIA would be glad to help you interpret the financial picture of a company but you will need to analyze the business conditions the company competes under. Ultimately this will enhance your abilities as an investor and provide a rewarding learning experience. Just know what your limits are.

BD

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## Watch List

We are still waiting to grab shares of Rayonier (RYN) at a price we find agreeable. Our analysis of RYN revealed the company is looking better than ever. They have made some very shrewd moves over the past couple of years. They sold off their low margin medium density fiberboard operation and are now left competing in three core segments. They still sell timber and have their performance fiber business. They also sell off or develop what they call their higher and better use land (HBU). With over 200,000 acres of land out of their 2.2mm acres tagged as HBU, it will take some time to dispose of it all. The land has sold for an average of about \$9k an acre this year. With a conservative value of \$6k placed on the land, we obtain a value for this segment of over a billion dollars. The sale of any of this land will have little impact on the timber or the performance fiber businesses. Our analysis of those two segments yielded a value of \$4b. The total value of the company is comfortably above \$5b total. Wall Street pegs their value at \$3b based on their market cap (the total number of shares times the share price). We are willing to bet we are right.

The fact they own all of the land they do gives us great comfort. It acts as a giant anchor to help keep the price from dropping too far. Their performance fiber business just signed a five year contract for 80% of their current production capacity. Guaranteed revenue for the next five years; it doesn't get any better than that. The land sales are going to be a bit lumpy. That suits us fine. We love companies with earnings that swing all over the place. It creates more opportunities for us to add shares cheap. Lastly the company pays a nice 4.7% dividend yield. (Better than any checking or savings account.) Now we sit back and wait for the shares to move close to the \$60 value the company is worth. Did I mention that RYN will be sending you some nice dividend checks while you wait?

We have again been tinkering with our watch list. We have removed CSPI and added two new companies, Arch Coal (ACI) and Universal Forest Products (UFPI). How's that for high tech? We added another company that makes wood and a coal mining outfit. It is almost as bad as the companies we hold in our portfolio. Some of the high tech products from the companies we own are mattress fabric, asphalt plants, crushers, coal washers, medical syringes and boats. It's the MacGyver portfolio (we try and make something out of nothing). In our defense, the idea (the company) has to meet our characteristics, we won't change the characteristics just to meet the idea. This is where all of the good ideas have led us. Maybe next year will be different.

Company	September price	August price	Change from August	P/E	52 Week High	52 Week Low	Estimated '06 EPS	Dividend Yield
Alliant Techsystems Inc./ATK	\$81.06	\$76.49	5.97%	19.0	\$84.90	\$68.21	\$5.06	n/a
Altria Group, Inc./MO	\$76.65	\$83.53	-8.24%	15.1	\$85.00	\$68.36	\$5.31	4.40%
Arch Coal/ACI	\$28.91	\$32.75	-11.73%	30.3	\$56.45	\$25.85	\$1.97	0.70%
Bioanalytical Systems, Inc./BASI	\$5.26	\$5.56	-5.40%	n/a	\$7.80	\$4.75	n/a	n/a
Canadian Natural Res./CNQ	\$45.06	\$52.59	-14.32%	12.9	\$64.38	\$36.64	\$2.86	0.60%
Kensley Nash/KNSY	\$29.27	\$27.08	8.09%	n/a	\$33.69	\$19.32	\$0.97	n/a
Landauer, Inc./LDR	\$50.75	\$47.92	5.91%	27.5	\$54.70	\$43.11	\$2.20	3.40%
Markel	\$410.66	\$363.33	13.03%	21.8	\$413.87	\$307.41	\$28.53	
ModPac/MPAC	\$11.20	\$10.78	3.90%	n/a	\$12.50	\$8.00	n/a	n/a
QLT Inc./QLTI	\$7.60	\$7.71	-1.43%	22.9	\$8.45	\$5.93	\$0.36	n/a
Rayonier/RYN	\$37.80	\$39.50	-4.30%	22.4	\$47.50	\$35.75	\$1.77	4.80%
Servotronics Inc./SVT	\$6.15	\$6.80	-9.56%	8.6	\$10.30	\$4.02	n/a	n/a
Tejon Ranch Co./TRC	\$42.43	\$43.39	-2.21%	n/a	\$49.74	\$37.55	n/a	n/a
Universal Forest Products/UFPI	\$49.05	\$48.76	0.59%	13.0	\$80.28	\$46.35	3.62	0.20%

## The Investletter Portfolio

September was rather uneventful for our portfolio. You can see from the chart below that all of our larger holdings showed relatively little change in price. We expect to fair better after earnings season begins for us in late October. We made no changes and have failed to put any of our idle cash back to work. The large amount of cash we are carrying is characteristic of what you can expect when prices in general are high. With the Dow Jones average pushing towards record territory we have found it increasingly difficult to make purchases at prices we find attractive. A couple of times we have been close to pulling the trigger but have been shut out as prices will abruptly move back up. The only current holding we have that we find attractive is Chesapeake (CHK).

As winter approaches it is highly likely that we will see the weak natural gas prices start to firm up. Temperatures are predicted to be 5.9% colder (by the National Oceanic Atmospheric Administration (NOAA)) this winter than last years mild effort. Lower temps means higher demand which translates into higher prices. Prices have moved up about two dollars from the \$4.20 low in mid September. Prices for homeowners are expected to average \$12.23 this winter compared to last winter's \$14.64. If this prediction by the EIA (the Energy Information Administration) holds, it will be the first time in a few years that consumers will pay less for the heating season.

Chesapeake will benefit some from the higher prices but not as much it may initially appear. With nearly 70% of their product prices pre determined by futures contracts. The main benefit they can hope to gain is the ability to lock in more long term arrangements at the higher prices. Currently the price on natural gas for February delivery has crept up to more than \$8. Fortunately CHK has hedged at prices even higher.

Over the longer term the mechanics in the natural gas market are tilted decidedly in our favor. Gas consumption continues to increase as production continues to decline. If you have an aging furnace, this is the type of information that can help tilt you in favor of replacing an aging furnace with a new higher efficiency model. Or, just wait for the supply/demand equation to help reset your shares of CHK to a much higher level and use that as both a hedge against higher natural gas prices and to fund your new furnace.

We would love the chance to add shares at less than \$30. If you see 'em don't hesitate to grab 'em. We are going to double our position to represent approximately 7.5% of our portfolio. We will also be sending out an email alert to officially announce the changes to our portfolio.

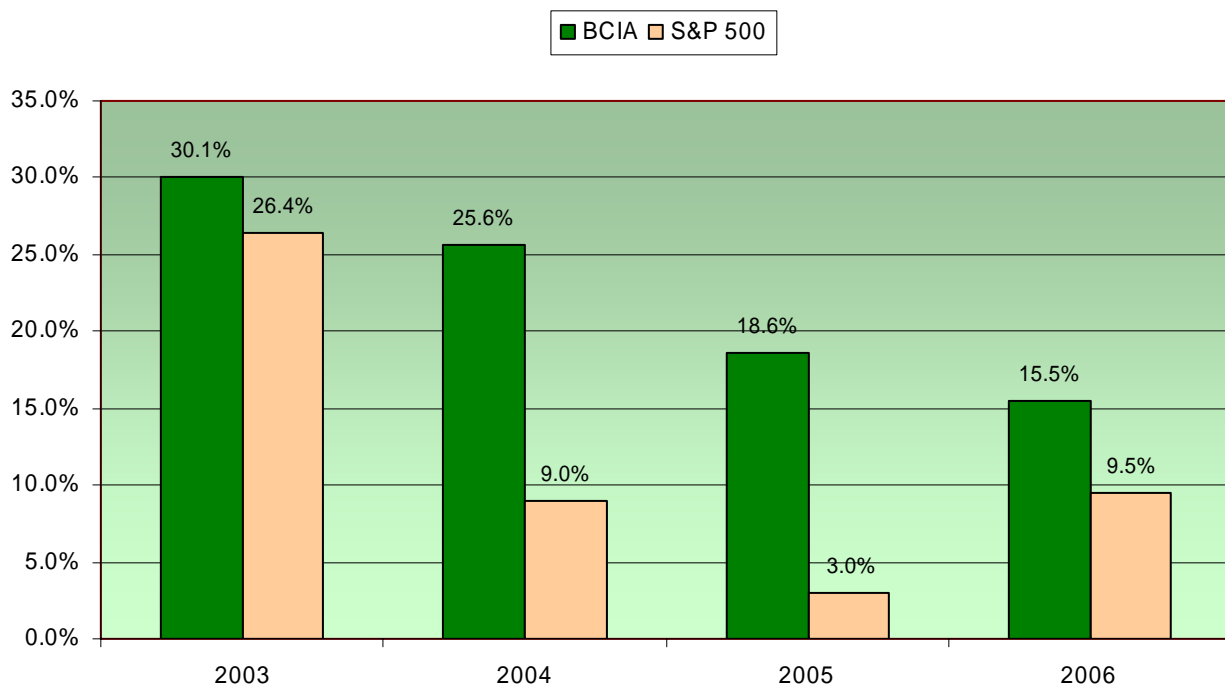
Company	Porfolio Percentage	September price	August Price	Percentage Change	Buy Price (less than)	P/E	Dividend Yield
Alico/ALCO	6.30%	\$58.51	\$58.78	-0.46%	\$50.00	48.0	1.80%
Astronics Corporation/ATRO	15.20%	\$15.75	\$15.95	-1.25%	\$14.25	25.2	n/a
Berkshire Hathaway B/BRK.B	8.50%	\$3,174.00	\$3,203.00	-0.91%	\$2,900.00	14.5	n/a
Cash	22.90%	\$1.00	\$1.00	n/a	n/a	n/a	n/a
Cell Genesys, Inc./CEGE	2.20%	\$4.57	\$4.99	-8.42%	\$5.00	n/a	n/a
Chesapeake/CHK	3.90%	\$29.82	\$31.57	-5.54%	\$30.00	7.2	0.80%
Culp/CFI	2.90%	\$5.47	\$5.09	7.47%	\$4.40	19.6	n/a
Gencor/GNCI	7.00%	\$9.25	\$9.25	0.00%	\$8.50	5.4	n/a
Headwaters/HW	2.50%	\$23.35	\$22.12	5.56%	\$25.00	9.2	n/a
K-Tron International/KTII	5.10%	\$63.22	\$58.12	8.77%	\$42.00	19.6	n/a
OMI Corporation/OMM	20.40%	\$21.71	\$22.52	-3.60%	\$22.00	7.1	1.70%
Protein Design Labs/PDLI	1.00%	\$19.20	\$19.70	-2.54%	\$24.00	n/a	n/a
Specialized Health Products/SHPI	1.30%	\$0.65	\$0.67	-2.99%	\$0.40	n/a	n/a
Terra Systems/TSYI	0.80%	\$0.50	\$0.50	0.00%	\$0.50	n/a	n/a

## Performance

September was not nearly as kind to us as was August. The S&P 500 average showed a 5 percentage point increase in year to date returns while our funds showed a drop of .3% from our year to date total. We make the effort to compare ourselves to the S&P 500 average merely as a benchmark. We in no way intend to track the market. Our portfolio at times will exhibit performance that diverges greatly from the market averages. Overall this is a good thing when our performance exceeds the market average. You may have noticed we do not spend much time analyzing where the market is headed or why it has performed as it has. We have no special knowledge in this area and have little interest in what the market as a whole does. We use it as a measuring stick and nothing else.

The overall level may give us a general indication of what relative level stocks are trading at but again this only has limited value. We are all owners of individual companies. It is their fate we are interested in. This is where we expend our efforts. Making sure we understand the businesses we own and the markets they operate in. This also applies to the companies we investigate in looking for prospective investments. We have our limits and we aim to stay within them.

Investment Returns Since 1/1/2003 to 9/30/2006



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