

GTSI Corp(GTSI) - \$5.00 on Mar 28, 2001

A debt-free net net stock, now showing earnings growth and consistency for the first time. Known for its trading range, with the highs in the range usually produced by some bit of good news paired to low float, but there are some changes afoot that should set it free to the upside.

GTSI distributes technology products to the military, the IRS and others. Basically, a B2G distributor. Market Cap at 40 mill, sales over \$650 mill. Low margin stuff. As like any distributor, they have to have hot hands, and by and large they do. Located just outside D.C. New management arrived 4 years ago and has started turning around a money-losing operation. Now, working capital is not overly bloated, they turn inventory well (12 turns/year), and AR increases match AP increases well. They were profitable for the third straight full year new management has been in place, and GTSI is starting to see gross margin enhancement from hawkish working capital management, cost controls, more favorable contracts, and increased sales. The result: \$1.15 in diluted earnings last year, but that was with residual tax losses creating a tailwind.

Management has given guidance, however, that they will beat last year's earnings per share even after full taxes are paid this year. So right off the bat we have an honest PE less than 5, no debt, and an improving business with capable management and increasing contract wins.

Management has bought the stock aggressively up to just under 4, and there is a large outside shareholder in Lacy Linwood, one of the founders of Ingram. Linwood has also been acquiring shares in the open market - he's the one providing all that support around 3 the past few years - and now owns over 25% of the shares. Employees are participating in the employee stock plan but many are also buying lesser amounts of stock in the open market.

In addition to the obvious advantages of having a large outside shareholder with an illiquid stake, Linwood also provides some alleviation to the fear that Ingram or its ilk would jump in and compete GTSI out. If anything, his actions seem to indicate GTSI makes a good takeout for such a company (his stake is very very illiquid in terms of public market exit strategies yet he buys more).

In fact, knowing the business means knowing that such competition isn't much of a risk anyway. As with a lot of government vendor stuff, this is a relationships business. GTSI is well-ingrained into the procurement system, and has expertise in getting the right forms in the right hands at the right time.

GTSI just won the MMAD contract for over \$857 million in technology products to be supplied to the military, IRS, and other branches of government over 5 years. The news of this award sent the stock skyrocketing last year. A protest was lodged, which was resolved in GTSI's favor. The poor stock market has helped stifle any positive reaction in the stock. But the win is indeed real, and the company isn't sure why the stock didn't react like it has in the past to such announcements. Indeed, in the 4 hours or so after the news was announced, only 7,000 shares traded hands.

GTSI will compete with IBM for bids to supply various projects under the MMAD contract. GTSI is confident of getting the majority of the money from this contract because historically they have done so when competing against big name suppliers. Why? Basically GTSI is willing to pay more attention to the process and get down and dirty in the whole government procurement area. They make money for the same reason plumbers get paid well. As well, they have the longstanding relationships on their side.

The trading strategy with this stock has always been to buy just under 3 and wait for a spike - there have been a few - and sell it. The last two spikes have occurred after the last two quarters produced blowout earnings. The stock is starting to stick at higher prices though, as the more permanent nature of the positive changes in the company is getting noticed. For the first time, true fundamental change for the better is starting to gain traction in sustainably higher stock prices. A nice trend to join early.

Also, because the buyer here is the government, there is a tremendous built-in backlog of demand. The computer equipment at the IRS, for instance, was legendary a decade ago. And the demand is seasonal (government is a procrastinator, rushing to buy a lot at the end of contract terms and at the end of years, therefore making contracts more profitable later in the cycle and years more profitable as the quarters wear on), but not cyclical. Moreover, obsolescence is less an issue because the government doesn't demand the latest and greatest. Management is taking advantage of the advantages of working with the government while minimizing the disadvantages.

There is a lot of operating leverage in the business that is just starting to be realized on the positive side (they lost over \$2/share before new management came in), and with few shares outstanding, it would not be surprising if pre-tax income starts to approximate the share price myself and others paid back in the \$3 range last year. Like Buffett's WPO, though on a much, much smaller scale. I'm still accumulating the stock.

A risk is a takeunder. I wouldn't get too extended in my buys from the price the large shareholder and management have paid (which ranges up to 3.75). I'm buying up to 5. Buying at 6 and waiting 3 years to be bought out at 7 wouldn't be very fun.

As a side note, on the last conference call, a private investor called in and ID'd herself as an employee of GTSI. This was an error, though I know a few investors whose initial reaction was that something stunk. I was one of them.

Catalyst

Gross margin improvement, better management's effects being felt and recognized, first-ever road show coming up in next few months showcasing new COO (comes from the Executive Office of the President with a lot of government contacts and know-how), expected strong stock price reaction to developing trend of consistently good earnings (40% upside from here just to get to net net value), acquisition target/buyout target, outside shareholder with illiquid, large minority stake and uncertain agenda/exit strategy

Huttig Building Products(HBP) - \$4.3125 on Aug 27, 2000

I just finished entering a bunch of data such as trailing EPS and revenues. Throw it all out the window. Huttig Building Products may be one of the most ignored, misunderstood stocks on the market, and a big reason is that superficial analysis with readily available data is, well, too superficial. Huttig Building Products (NYSE: HBP), spun-off from Crane (NYSE: CR) last year, is a leading distributor of building products such as doors, windows and trim. Value investors may recognize the opportunity that so often occurs with spin-offs. In this case, simultaneous with the spin-off, Huttig issued 6.5 million shares to acquire Rugby USA from Rugby Group PLC. The net is that even the proxy for the spin-off was worthless because it wouldn't account for the acquisition. As a spin-off from an S&P 500 company, Huttig was guaranteed hot potato status anyway. But factor in confusing offering documents and an admittedly poor marketing job, and the stock simply could not avoid the doghouse.

The beneath-the-surface numbers follow. The leader in its very fragmented industry, Huttig has a market share of just 8% and will earn revenues topping \$1.2 billion. Razor-thin margins are offset by industry-leading working capital management. In fact, the company has been profitable since the Civil War. This year, the company will see about \$60 million in EBITDA plus a substantial one-time gain, yet carries an enterprise value (\$89 market capitalization plus \$122 million debt less \$6 million cash) just about \$205 million.

As the industry's most efficient operator (with management firmly ensconced in a shareholder-friendly EVA compensation model straight out of Stern & Stewart), Huttig is ahead of plan to squeeze \$15 million in synergies out of Rugby as well as bring Rugby's poor working capital management more in line with Huttig's other operations. Expect another \$20 million to drip out of working capital within the next year. Because of these savings, Huttig in effect paid just \$40 million for Rugby's \$30 million in annual EBITDA.

While Huttig's management should get credit, some of it must be shared with the motivated seller. Rugby Group PLC is not the world's best-managed company, to put it lightly.

Going forward, Huttig will have tremendous free cash flow. Free cash flow averaged \$21 million per year for the three years before the acquisition of Rugby. Now, EBITDA jumps to at least \$60 million, and free cash flow jumps to at least \$35 million. Plus, in the short term, we get the \$20 million or so that comes out of Rugby's working capital. As a result of this, during calendar 2000 Huttig is well on track to bring its \$122 million in debt down to \$82 million. Management's reasons for the debt-reduction? Reduced interest expense and expanded ability to pursue acquisitions. So what we are looking at is an enterprise trading at just 3.1 times EBITDA, and only about 5.1 times free cash flow. Remember – 130 years of continuous profitability.

Management follows strict return-on-investment criteria according to Stern Stewart's EVA theory and model's operations on GE's Six Sigma program. The Chairman comes from Crane and is known to be a shareholder advocate.

Catalyst

Sheer value is something of a catalyst here, but there are other key aspects to consider. Rugby Group PLC holds nearly a third of Huttig's share and is a price-insensitive seller on the market. This introduces price risk but not business risk. The shares are not liquid, and Seth Klarman is said to have bought up to 20% of Huttig's shares. If so, consider those shares locked up. Klarman is known as an extremely disciplined deep value investor. Once the Rugby Group shares are on the market, look for a buyout of Huttig. The buyout could come from inside (management) and a private market valuation based on recent activity places the shares at a worth over \$12-15/share. Again, the Chairman is a shareholder steward - Crane investment arm still has an investment in Huttig - and would not let the takeout go through much lower than private market value. I'm looking for action within the next year. In the meantime, a large distributor of wholesale doors left the business. Huttig is expanding to meet the demand. Because of this, sales may rise over the next year or two even if, as seems probable, the homebuilding market turns south. Finally, spin-offs often reach a price nadir about one-year after the spin-off date; it takes that long for the knee-jerk sales to stop. By early 2001, the nadir should be behind us.

Industrias Bachoco is the \$1 Billion sales leading poultry producer in Mexico, where chicken is the number one meat. IBA is a NYSE-listed ADR that is as cheap as ever. Bachoco is the giant in an ultra-fragmented industry.

Summary financials (in US \$) and ratios as of their most recent earnings release 10/24/02 (not carried on Yahoo news):

Market Cap \$426 million
Total Cash \$186 million
Total Debt \$ 24 million
Enterprise Value \$264 million

9 mos Net Income \$104 million
9 mos OCF \$127 million
9 mos Depreciation \$ 23 million

* FCF roughly approximates Net income, and 2002 NI will be about \$130-\$140 million.

* The company has been pouring its cash flow into debt paydown after its 1999 acquisition of the industry #4 (which smartly provided both horizontal and vertical integration benefits), and is now nearly debt-free.

* The payout is around 25% of net income - so the dividend yield will be in the upper single digits.

Put in perspective, net income trends:

1998: 92.9
1999: 85.8
2000: 126.8
2001: 117.6
2002: roughly 130-140

* Nominal PE (Market Cap/NI) is 3.2

* EV/2001 EBITDA (will be higher this year) is $264/164 = 1.6$

* Adj for net cash and related net interest, adj P/E is $264/125 = 2.1$

Shareholders' Equity is \$871 million, nearly all of which is tangible.

So P/B is $\sim .50$

Over last 5 yrs, ROE has been between 12 and 17% despite growing cash drag.

Return on Assets has been ranging 10-15%.

IBA's net profit margins are in the low double digits.

Comparatively, TSN and CHX, both of which have a validating presence in the Mexican market but rank behind Bachoco, carry relative valuations 3-5X higher than IBA despite profit margins less than 2% and

poor ROE's. Labor and costs are one major advantage at IBA, which continues to improve its operating margin - now 11.96%.

Risks:

- 1) A recent Hurricane damaged production at a small portion of IBA's farms. This is a minor, temporary issue, but appeared to hurt the stock.
- 2) The company is dealing with reduced protection by tariffs, which were cut in half on Jan 1 2002 and will be phased out completely in 2003. 2002 was supposed to be difficult because of this -helping to depress the share price - but the company has been faring much better than anyone expected. Pilgrim's Pride was supposed to be a big threat here, but they keep stumbling over themselves and have a weak balance sheet. This issue cuts the other way in a couple years ways when IBA gets to access feed at cheaper prices thanks to NAFTA. IBA may also be able to leverage its low costs into an export business into the US, per the CEO.
- 3) There is the potential that the company will lose a favored tax status, though it is unclear that this would disadvantage it significantly in relation to competitors facing similar issues. Apparently the tax would be a VAT, which would increase the prices consumers pay. This has been hanging over the company for some time, also depressing the share price.

Summary: 2X free cash flow; leading market position; large scale; tremendous financial strength with no net debt; big dividend while you wait; a statistical anomaly of a valuation

Catalyst

Resolution of tax issue, resolution of hurricane fear, and continued good cash production through tariff relief are potential catalysts. Mainly, security just needs some serious consideration by a few smart investors (most of whom won't give a Mexican chicken company the time of day). At this 2X free cash flow valuation, the share price should track cash accumulation - over \$2/year - no matter whether multiple expansion occurs or not.

Pillowtex(PWTX) - \$3.20 on Sep 20, 2002

Pillowtex makes pillows, blankets, comforters, sheets under the Royal Velvet, Fieldcrest, Cannon, Charisma brand names. PWTX emerged from Ch 11 late spring 2002, having erased nearly 900 million in acquisition-related debt, closed a baker's dozen plants, and laid off 4500 fewer employees. Also has 533MM in NOLs.

The current stock quote is 3.20, down from 6 at emergence and down from 9 within a month or so of emergence. Roughly 20 mill shares out give a 64 mill market cap.

POR projections, assuming no growth in the industry and stable economic conditions, projected reaching a 3.5% net margin, 7.3% op margin on 1.07 bill sales by 2004. This trajectory would provide 28 mill net income in 2003 (1.40/sh), 37 mill net income in 2004 (1.85/sh). Normalizing working capital (thanks to normalizing vendor, retailer relationships) would provide a boost to free cash flow, which would be around 35-40 mill/year before principal payments on debt.

So based on POR projections, the stock is trading at less than 3X 2003 earnings, less than 2X 2004 earnings, and at about 1.5X free projected free cash flow. Post-reorg/fresh start book value is around 200 mill, so at 64 mill we're at .32X book and at around 6% of sales.

Clearly the market doesn't believe the projections. The market is actually pricing in a catastrophic miss, and a high risk of ch 22. I don't believe the projections either - although I do believe they are attainable on a lengthened timeline, and I certainly don't take the market's view of the equity.

Of course, the market isn't entirely rational right now. All stocks have had a rough go, but reorganized equities are getting slammed especially hard as distressed securities funds find themselves in some distress courtesy of all the 2nd, 3rd, 4th, and 5th foot dropping going on in WCOM, KM, etc. PWTX is in a Buffett-certified 'bad business' and as I've heard, no price is too low for some of the sellers in the stock. As well, Westpoint Stephens' situation is worsening, spooking watchers of the sector.

The stock was distributed to bank debt holders, including vultures. Oaktree owns 20%. Lehman and BofA ended up with multi-million share chunks too. Share volumes are double counted, so it's been in distribution essentially since it emerged. A lot of it is coming through CRT in case you want to buy in volume. Just today I cleaned out a guy at 3.20 that had received stock in the distribution. A Nasdaq listing is hoped for by the end of the year, although we can't expect wide sponsorship.

A crucial point is that the company has hired new management that is widely respected. Pre-reorg management was simply horrid and attracted short sellers in droves - many of the savviest hedgies know PWTX as a great short from a few years ago. Things are different now though. Dave Perdue comes from Reebok where he has a big background in buying everything, making nothing. His position at Reebok focused on international vendor relationships. He recently replaced the restructuring-era COO with a guy who worked with Dave at Sara Lee, where they oversaw significant growth in the underwear division. Sources in the textiles industry view these

hires as very good hires. I would hope and expect the addition of more talent in the executive suite.

The strategy of the new management is emphasizing branding vs. manufacturing. They are actively seeking relationships with overseas manufacturers, and I would expect that they have some success with this, given the CEO and COO's backgrounds at places that outsourced everything. They are searching in particular for one large vendor in order to have greater control over quality.

The risks in the story are primarily in management execution of the branding over manufacturing strategy. As well, the strength of the consumer is an issue, as PWTX in present form is subject to tremendous operating leverage. PWTX, while leveraged, is not over-leveraged and has the cleanest balance sheet in the industry at present.

A good comp is Springs Industries, which was taken private by management and Heartland, advised by CRT, in late 2001. Taken private at 1.24 bill by financial buyers in a 5:1 recap. Management controlled 71% of the voting, exerting pressure on the price extracted. At that price, Springs traded at an 11.7X forward PE, 12.7X trailing PE, EV/EBITDA 5.2X, EV/EBIT 9.4X, EV/Sales .57. Springs had 3.1% net margins, 11% EBITDA margins, 2.3 bill sales. Revenues were in decline, and Wal-Mart was a big customer at 27% of sales, not unlike PWTX. The brands at Springs include Wamsutta, Springmaid, Regal, Dundee, all of which generally have slightly lower price points than PWTX's better brands. Putting any of these numbers on PWTX gets PWTX's common stock price well over \$10/share - indeed, nearer \$15/share. Again I'd note that the buyer of Springs was financial and the transaction was well-levered.

Other comps are relatively poor because WXS has a different mix of business, scary capital structure. DRF is lower end/different mix of biz. Springs is really the best comp, though 2X as large as PWTX. PWTX at 1 bill plus in sales is no small potato though.

Catalyst

Completion of distribution and securing of stock in stronger post-reorg, non-distressed, stock-guy hands. Appreciation potential on cessation of dumping is tremendous. Jumped 35% in one day when the sellers disappeared at the onset of the July rally. 7-8 in next 6 months are pure technical rebound is possible, with operational improvements account for remainder of appreciation to 10+.

Quipp, Inc(QUIP) - \$19.85 on Apr 20, 2001

A stock that can be played multiple ways for value realization, Quipp designs, manufactures, installs, and services post-press material handling equipment for newspapers. Equipment goes by names like Bottomwrapper, Newspaper Stacker, Automatic Cart Loading System, Newspaper Gripper and Conveyorm, Automatic Palletizer, etc. They service and sell spare parts for the equipment after market as well. A neat little cyclical but growing business, with 10%/year revenue growth over the last ten years, during which they have increased earnings from 100K to \$5 million. Has generated gobs of cash which does come back to shareholders.

The stock is at 19.85, and the company has announced a Dutch auction self-tender for a little over 1/3 the float, or over 1/4 total shares outstanding, at 20-23, to commence any day now. It was announced two weeks ago. So there is an arbitrage opportunity, though it is very possible that the offer will be oversubscribed, resulting in pro-rata cash out.

That's not the only special aspect of this situation, though. The Dutch auction came about after a buyout fell through on financing and the deteriorating economy. During the time the legal documents were drawn up the stock was trading in the mid-high 20's. It is likely the buyout offer would have been for \$30 or higher. There has been a string of MBOs and LBOs that have fallen apart on financing since last fall, and it is becoming a common story (and a ripe field for finding value, IMO). It doesn't change that there was a private financial buyer willing to pay a significant premium to the current price. A strategic buyer would pay more, though one doesn't seem readily available.

The valuation is fairly compelling. With 1.9 million shares out, the market cap sits around \$38 million. There is about \$17 million in cash and securities, the result of slowing capital expense, and no significant debt. 2000 EBITDA ex-cap ex and ex-interest income was \$6.5 million.

Free cash generation has been great relative to market cap. Total cap ex the last three years was only about \$1 million, and Total operating cash flows the last three years were \$14.4 million. With EV at just over \$20 million, that's pretty cheap. Two years ago, the company paid a \$7/share special dividend because of the cash build up. Book value rebounded to near pre-dividend levels in just two years, and the share price recovered within 1 1/2 years. Margins are good, and ROA, ROE and ROIC have all been trending strongly higher with increased scale economies, offset by economic slowing.

So you have a stock in a company that generates lots of cash and does not reinvest it in the business to any great length (R&D at 2% of sales, cap ex at just a few hundred thousand - nearly all maintenance). So every few years a sizable cash and investment portfolio accumulates. Two years ago it paid the \$7/sh special dividend, and this year it is buying back 1/3 the shares in a Dutch auction. Over the years the stock has been steadily appreciating. In recent years, cash flow has really jumped, and it has not been reflected in the share price.

The fall-off in operating performance at newspapers has had an effect. No single newspaper accounted

for more than 10% of sales, though Gannet and Knight Ridder were 18% and 12% of sales last year. That concentration is down from 1998, when Gannett was 32% of sales. Also, foreign sales are at 13%. At year end, backlog was \$1.5 million higher than last year, but the incoming orders have slowed as much as 50% in the first quarter. International avenues for growth are being pursued, but its two biggest competitors worldwide are Swiss and German in origin. Given the company's small size and low-tech, brandable product line, growth should nevertheless be good through cycles and in excess of the industry trends.

The stock sold off after the buyout fell through - the stock is fundamentally illiquid and those hoping for a quick buyout were natural sellers when it fell through. This is a readily overlooked stock, and buyers didn't materialize to catch the shares. The Dutch auction is meant to shake out remaining weak holders without wreaking havoc on the share price. Management have not been buyers recently (not a surprise since legally they couldn't be), and they own about 21%. The buyer was a financial one - strategically, it is not clear that there is a shoe-in for a potential buyer, but the industry for newspaper equipment is relatively stagnant to shrinking, which is spurring consolidation. There is some evidence that there is a brand here with a good reputation.

There is some logic in not tendering shares here and just awaiting or instigating for value realization. After the tender, assuming it goes off at about 21 or so, you'll still have a stock bought at \$19.85 with \$4/sh cash and history of value creation for shareholders as well as strong free cash flow averaging \$3.30/share the last three years. So market cap/ avg FCF (over last three years) is around 6. Back out the cash and it falls to less than 5. Don't need growth or even less-than dramatic long-term revenue shrinkage to make that attractive. EV/EBITDA (ex-cap ex, ex interest income) is $15.85/4.81 = 3.3X$ on last year's strong (but not all-time peak) numbers. It is not terribly hard to buy shares, as the largest shareholder has been steady liquidator and to my knowledge a disinterested wholesaler has a large block ready to go at 19.80-19.85.

Catalyst

Low tech, cash-generating business offers several catalysts 1) Arbitrage with Dutch auction 2) Ultimate sale of company at a nice premium from current price once economy turns/debt markets recover 3) Await realization of value in market. 4) Not really a catalyst, but ultimately, if one wants a control situation, management are not majority owners here, and the cash flow could substantially eclipse purchase price over next 5+ years. Two largest shareholders are non-management, which provides some undefinable but real catalyst as well. To the extent one wants out, as seems to be the case, it also creates additional pressure on an illiquid stock that will not last forever.

ValueClick, Inc.(VCLK) - \$4.4375 on Nov 6, 2000

ValueClick is an internet asset play trading below cash and equivalents, with no debt and with an expectation of positive operating earnings by the end of the next fiscal first quarter. Join the crowd, right? There's more, but please do read the disclaimer at the bottom of this entry.

Most intriguing is a 53% ownership stake in ValueClick Japan valued at about \$135M. This is largely in addition to \$117M in cash and about \$10M in Doubleclick (DCLK) shares, but you won't find it glaring at you on the balance sheet, since the operations are reported together. There is about \$25M on the Japan side that you don't want to double count. Nevertheless, add these things up and with a \$124M market cap, we're being paid a pretty penny to take the US and non-Asian business. ValueClick took in a little over \$1M in cash last quarter by selling just 17 shares of ValueClick Japan, so the stake is very real - and there are over 8000 more shares where those came from. In recent years, these situations have been limited mainly to apparel retailers loaded with inventory, so net current assets was next to meaningless. Here, though, the assets are quite real, and there is no inventory to verify.

There are reasons to believe the natural price level for the business - and the shares - should be higher. Therefore I see a margin of safety in the current price even without playing the obvious arbitrage.

The business is in transition but still growing. What is the business? An internet advertising network whereby advertisers pay ValueClick, and ValueClick in turn pays the publisher, only when a web surfer clicks on the advertiser's banner. They are pruning their customers, taking it from 82% dot coms to 72% dot coms, while maintaining their absolute numbers. Overseas contribution will be 50% by the end of next year, and revs should hit \$63M. Advantageous is that ValueClick has been able to maintain its pricing and streamline operations on the cost side, resulting in gross margin growth even as the general market for internet advertising gets hit - thanks to the performance-based model, which is more attractive in times of uncertain effectiveness of internet advertising.

VCLK is acquiring competitor ClickAgents with stock. This seems like the bonehead move of the century. The stated reason is that the deal was negotiated with the stock up at \$10+, and they would have had to pay more in cash. Still, sheesh, I say buy with cash, and I admit I do not buy the CFO's reasoning. Advertising.com is a private competitor with similar revenues, but with worse profitability measures relative to ValueClick, or so I understand.

Doubleclick owns 28% of ValueClick, with rights to buy up to 45% at nearly \$22/share. There is a significant lock-up on these shares that takes us well past 2001.

Founding investors and insiders had margined themselves somewhat heavily on this stock, and had to sell as it fell below five. The general lock-up on shares ended in September, precipitating a fall as well. Together, these things caused a pretty serious spike down to the 3 5/8 range, from which the stock has yet to really recover. Hence, I believe it is in a rather artifactual trading range caused by massive margin calls and abandonment by the growth and momentum fiends. Clearly it will take some time for the value

guys to embrace an internet play, but the ValueClick Japan factor should make it relatively easy once open minds prevail.

Already management is starting to hear less inquiries from investors about click-through rates (they're stable) and more inquiries regarding quality of accounts receivable (relatively small and high-quality, or so I'm told). I don't expect the value guys to take too long to catch on. I'll try to answer a few questions if they come up, but I must admit I won't support this idea as much as I did Huttig - my time pressures are greater now than then [not to say that they are greater than yours ;)]

DISCLAIMER: I benefit from this stock's appreciation, and have acquired it at a price significantly below the current one. I do not have a specific exit price in mind at this point, and make no promises that I will notify people here when I sell. I therefore prescribe two grains of salt and a ton of due diligence. You never know my motives, although I will say that I am just trying to put a second idea up in accord with the requirements of VIC, and in good faith.

Catalyst

I feel value makes a great catalyst, but in this case you have artifactual trading pressures due to margin calls, tax-loss selling, and insider lock-up expiration. All of these pressures, once released, may provide catalysts for near-term price appreciation as we move into 2001. Doubleclick owns a bunch of the stock, and it would not be terribly surprising to see a takeout, although I have not investigated this aspect very thoroughly yet. The industry is consolidating, and we're talking at the most expensive a free business here. Positive net income next year will likely put the operations on the valuation map, which could take the shares to \$10 with only the slightest change in perception.

Wellsford Real Properties(WRP) - \$16.60 on Jun 1, 2001

WRP is an opportunity to buy real estate at as little as 50 cents on the dollar (and at most 61 cents on the dollar), with a plan for value realization in place and virtually no downside. Wellsford Real Properties is a real estate operating company (REOC) and as such its value is in wealth creation rather than earnings distribution. Third Avenue (Whitman's group) has a nice dissertation on why REOC's can be superior to REITs in its latest semi-annual. Third Avenue's also been accumulating this stock.

The stock's at \$16.50. Book value is \$26.93 and understates true net asset value. For four years others have done the waiting for me (and are likely to sell now in pure disgust), and now I do believe the next couple years will see value realization - and hence a nice return/risk ratio. Here's why:

Wellsford is an incomplete liquidation story now divided operationally into three strategic units:

1) Wellsford Commercial (\$10/share book value, liquidating, no recourse debt) - primary asset is a 39% interest in Wellsford/Whitehall, a joint venture with Goldman, valued at 86 million at March 31st. This value will continue to increase. W/W has been in the business of buying up turnaround properties and putting some sweat equity into them, then filling them. This naturally causes book value to drastically understate net asset value. This is important because Wellsford/Whitehall is being liquidated on a 3 year plan at Wellsford Real Properties' insistence. Two recent properties sold at 25% and 40% premiums to book, respectively. Today, the Parsippany announcement - a 43 million book value property sold for 61 million. There was \$582 million in assets on W/W's books (213 mill in equity) at last report - but the realizable value is higher.

Just looking at the Parsippany sale, equity in W/W pre-tax will jump over \$18M - that's nearly 8 mill to Wellsford. Wellsford only has 8.35 million shares, so that's a pre-tax gain of roughly 84 cents/share on the sale of just one property representing just 6.9% of the JV's assets. With the stock at 16 1/2 and book at 27, you can see where this is headed.

Management certainly considers the \$582 million number to understate the true asset value in Wellsford/Whitehall. I've heard management laugh at that number. A 25% premium to book realized on the liquidation of these assets would jump Wellsford's book value nearly \$6/share to \$33/share. The most recent Parsippany sale went at a 40% premium, and another recent sale went at roughly a 25% premium. Obviously not all will go at such great prices, but it's a good trend. Management told me earlier the 25% premium they fetched earlier was on one of their average properties, and implied there was better stuff to come. Today's 40% premium with the Parsippany sale is consistent, and certainly doesn't make management a liar.

Why liquidate W/W? According the Chairman, "I know real estate. I have fundamental way of analyzing this, and we're in the 9th year of a 7 year boom" and hence he thought it was a good time to start liquidating the Goldman JV. Goldman disagreed. Both offered to buy the other out (Goldman first), but both bid low and neither accepted. So, an arrangement was worked out where WRP sent its employees

working on the JV to Goldman and Goldman's man manages it with a newly created company. Goldman has since decided it too doesn't want to expand this business anymore given the stage of the real estate boom. So now, essentially, they're presiding over the liquidation of the JV. Expect good news to come out of this liquidation (like today), with more readily identifiable cash assets appearing on the balance sheet. To be clear, the liquidation is occurring primarily because it is the smart thing to do given the cycle, and a secondary effect is it will make the value more obvious to those reading the balance sheet.

Commercial ADJUSTMENT to book get to NAV: + \$3 to \$7/share; but again, we've already got a big discount to book, so the key is that there is a liquidation ongoing.

2) Wellsford Capital (\$12/share book value; continuing; no recourse debt) -As the real estate market peaks, the Chairman wants to get out of equity, but sees future potential for buying real estate debt on the cheap as things turn sour. So Capital is an ongoing operation with more to come in the future. Management is quite dismissive of "S&L's on steroids," mortgage REITs, and the structure of entities such as CMM. They feel they can be much safer and smarter than using those strategies, and yet by buying smart earn great returns despite not taking on substantial risk.

a) \$35.4 mill direct investment in 11.5% mezzanine loan, 277 Park Avenue (DLJ's building, well known to some of you I'm sure 'hedge fund hotel')

b) 51% interest in Second Holding, LLC, another JV that invests in real estate debt. They have been ramping this up. Carried at equity method and equity in Second Holding is roughly \$27 mill. That's the limit of their liability. Debt/equity in Second Holding at 12X but of course debt within the JV is non-recourse to WRP. This is the current main vehicle for investment in debt, and it has recently raised several hundred million, which for now is just sitting, earning slightly more than its cost. How this will be used is an unknown, but presumably they'll be smart about it. The stock hasn't been recognized, but management has been creating value, and Capital is a bet they ought to be able to in the future. Again, the equity value at risk here is only a little over \$3/share.

c) \$7 mill investment in REIS, a real estate information services company - I write this down simply because there's a family relation behind this investment, but it is possible the 6.9 million may even underrepresent the value of that asset.

d) VLP is being liquidated - another \$11 million or so to come.

Capital ADJUSTMENT to book to get to NAV: -1 buck for the nepotistic investment in REIS, though it might work out. One only need look at Homestore.com to see that real estate e-commerce ventures have not been the terrible bombs so characteristic of the .com genre. REIS is not infrequently cited in respectable press, and may have a niche.

3) Wellsford Development (\$4/share book value; liquidation?; \$99 mill mortgage debt) - 86% interest in an JV with Equity Residential (EQR) which is an 1800 unit multifamily development in a nice area south of Denver. 760 units being rented. Converting 264 more units to condos, and first sales have gone well at nearly \$200K/pop (they cost about \$166K/pop to build). Sold a 344 apartment project for 22.5 mill last year, for a gain of 3.5 million. Totalling up the value of the various pieces here and I get a small premium to book value. The key is that portions of it are being liquidated at a slight premium.

Development ADJUSTMENT to book to get to NAV: none, maybe +1 buck/share on the upside. Chairman talks this one up as a "no-brainer" but I'm unwilling to give much credit yet.

That's it; because of the nature of the turnaround properties, I don't anticipate much long-term downside there from the book level. Potential losses in Capital are maybe \$3/share in book value. Face value of a \$25 mill convertible preferred is more than offset by cash on hand. As time goes by, earnings will add about \$1.25 to \$1.50 per share to book value each year as well.

The company has been buying back shares when blocks become available, retiring 2 million shares in this fashion in the last couple of years. The Chairman vows to continue doing so, claiming the illiquidity of the stock is the greatest impediment - he doesn't want to run it up. BTW, a strong advocate of share buybacks in undervalued securities, I have never found myself on the receiving end of a management lecture on why buying back stock is such a good idea. That's what I got from this Chairman. "Look, I know what I got..." He gets points for mentioning Berkshire Hathaway in his annual letter, too: "Our business strategy model, based on the Berkshire Hathaway model of net asset value growth being reflected in share price, has thus far not been transferable to the real estate industry."

The history of Wellsford is that management presided over Wellsford Residential Property Trust - of which WRP was a subsidiary - from 1992-1997. The Trust merged with Equity Residential Properties at a price that gave a 23% annualized return since inception to shareholders. The stock had done nothing for years and then ran up for the buyout. Still, that's a source of pride for the Chairman, who points to the annualized return rather than the long stagnation, and I don't believe he is adverse to selling out again so he can have a similar "achievement" here. He is not comfortable with the lack of recognition in the public markets. In any case, WRP was a subsidiary of the Trust, and was spun off immediately prior to the merger. A private placement for 6,000,000 shares at book value ensued the next month. And the stock hasn't done anything since, even though value has been created.

Franklin Mutual (Beacon, Qualified) owns 24% of the common from the initial private placement, and Morgan Stanley owns 17% of the common from the same. Neither have been buyers recently. MJ Whitman Advisors upped its position 25% during the 1st Q.

A decent sized seller (probably Fleet or Advisory Research or both) has been offering shares whenever a decent-sized order comes up to buy, so in my experience at least the illiquidity is less a problem than it appears.

Catalyst

Liquidation of real estate per plan with \$200 million in properties being marketed for sale right now; possible sale of whole company; commitment to share buyback at deep discount to intrinsic value; dollar on sale for 50-60 cents with no significant downside; possible Russell 2000 inclusion on June 30th but is one of the few such candidates that hasn't really moved yet.