

This issue went to print 7-19-04. Prices and margins quoted reflect levels at this date.

Focusing on Dynamic Profits in the Chicken-Little Markets of 2004-2005:

How fear and passivity keep you from realizing your financial goals



J. Christoph Amberger

June 2004 marked the first privately financed manned space flight: SpaceShipOne rocket-plane pilot Mike Melvill soared 62 miles above the Earth's surface for a flight lasting about 90 minutes.

*"I want you to go to www.space.com," wrote Taipan junior board member and Value Edge guru Brad Colburn on June 21: "On that website, you'll be able to find a minute-by-minute breakdown of SpaceShipOne's record-setting flight this morning. [...] I don't know how long **SpaceDev Inc.***

(SPDV:OTC-BB) will be riding on SpaceShipOne's success. What's probably going to happen is that SPDV will rock and roll for a day or two and then drift down in price. As I told you last Thursday, SSO will race for the Ansari X Prize in August by completing two flights within two weeks.

"Folks, there are a lot of trading days between now and August. Seeing as how this was a play on 'the buzz'—and the buzz is highly positive—I'd like you to sell SPDV. It's trading at US\$2.30 as I write. At our adjusted buy price of US\$1.15, you should have a 106% gain, depending on where you bought in."

Not a bad return on an investment Brad had recommended only three weeks before... the day the June *Taipan* issue was placed online!

Now I can hear what some may say about speculating on the success of a private attempt at space flight: "Too risky!" "Not my style!" "I'm an investor, not a speculator." Those are reasonable responses... perfectly appropriate and downright responsible! And I bet you dollars to doughnuts that they are the result of having lost money on similar "opportunities"... and the consequent fear of losing more.

I can understand fear

Fear of not being able to meet your obligations and responsibilities is the cornerstone of Western prosperity. But when it results in risk avoidance rather than risk control, it becomes an impediment to our future. Bear with me for a moment...

over, please...

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About two months ago, I received a dire warning about the imminent collapse of US real estate. The trigger, according to the wild-eyed authors of the email, was supposed to be the then-impending increase in the US prime lending rate at the hands of Alan Greenspan and the Federal Reserve Bank.

Suffice it to say, yet another doomsday has come and gone without causing as much as a blip on the screens. In fact, just as I had speculated in my daily *e-Dispatch*, mortgage rates (hiked in anticipation of the Fed move by a mortgage industry that is finely attuned to matters of supply and demand) have actually come *down* since the prime lending rate inched up a notch.

Now, don't get me wrong here.

I'm not saying that US real estate is the silver bullet for all your investment needs. (Even though I might point out that *Taipan's* real-estate and mortgage play, **Impac Mortgage Holdings (IMH:NYSE)**, raised its quarterly dividend to US\$0.75 cents per share in early July...)

As with any other asset, there will be up cycles and there will be down cycles. And—unless you like to live dangerously and want to count entirely on your real-estate equity to finance your retirement—residential real estate has the drawback of being a liability rather than an asset, as it produces no yields unless you sell it, with your fingers crossed, or rent it.

Risk avoidance results in fruitless holding patterns

But there is no reason to lose your head just because the mainstream has arrived at the erroneous conclusion that everything that appreciates in value more than the return on a savings account must needs be a bubble of sorts... to be avoided at any cost.

That is the quintessential insight of *Taipan's* Dynamic Market Theory: more money has been lost by investors not essentially dumber than you and I simply because of unmanaged fear. The same fear that leads someone to cash out on a winning investment too early... and to hang on to a losing one in the hope it will eventually regain all its value.

But most importantly, the fear to take risks at all.

A dear colleague of mine recently wrote about a Baltimore acquaintance who considered the appreciation in local real estate “madness” and instead decided to stay on the sidelines until a “correction” occurred. In the meantime, she and her husband will be paying rent.

But the math of this risk avoidance doesn't look all that sound to me: If they were to use their monthly rent payment of, say, US\$850 to pay back a standard 30-year mortgage at 6%, with only US\$5,000 down they could afford a house worth US\$146,772.87. That still buys you a small starter townhouse in Baltimore. (Upping that down payment to US\$20,000, they could afford a total house value of US\$161,772.87 in the suburbs.)

If they indeed took the entire 30 years to pay off their house... and most mortgages are paid off one way or the other after 10 years... they'd have taken US\$45,983.60 in income tax deductions on interest payments of US\$164,227.13. Meanwhile, they'd have built equity, maybe even experienced some gain in value, and leveraged their US\$5,000 down payment to the max.

Instead, they're expecting the market to comply and “correct” down to their level of comfort. To me that seems just as reasonable as waiting for Social Security to provide you with a luxurious retirement.

What goes for real estate goes twice for the stock market

If you accept the reality that stocks can increase and decrease in value and take the most basic precautions—such as establishing and observing trailing stops—you can and ought to take advantage of all the potential the market offers.

Let the Chicken Littles cluck and run for cover at every shadow. With a basic grasp of risk management, true investors should follow Peter Lynch in his assessment of the mainstream's recurring phobias as “noise”... and make the most of what the market has to offer—on both the upside and the downside. [n](#)

The falling Wallendas

The market is hanging on



Adam Lass

Surely, you've seen the Wallendas. They are one of the most famous troops of tightrope walkers in the world, and have been thrilling audiences with their high-altitude gymnastics for well over 200 years.

Karl Wallenda had been in the biz for twelve years when John Ringling brought their act to Madison Square Garden in 1928. In their hurry to pack for the trip

across the Atlantic, it seems they forgot to bring certain vital pieces of equipment, and so became the first act to perform their dangerous art without safety nets.

The first serious slip ended without fatalities. Indeed, their grace while falling so enchanted onlookers, an Akron Ohio reporter dubbed them "The Flying Wallendas," a sobriquet that would stick to this day.

Tempting fate

Not satisfied with that level of hyperbolic hubris, in 1947 the Wallendas further challenged both gravity and probability with a new act. Karl called the seven-person chair pyramid—four men standing on a wire 35 feet in the air, with two more men on their shoulders and a woman sitting and then standing on a chair at the top—his crowning achievement.

And you know what? They got away with it for a while. It was another 15 years before the accumulation of risk caught up with them.

On January 30, 1962, at the State Fair Coliseum in Detroit, the front man on the wire quivered for just a moment. In the blink of an eye, the pyramid collapsed. Three Wallendas immediately fell to the ground (two to their deaths, the third

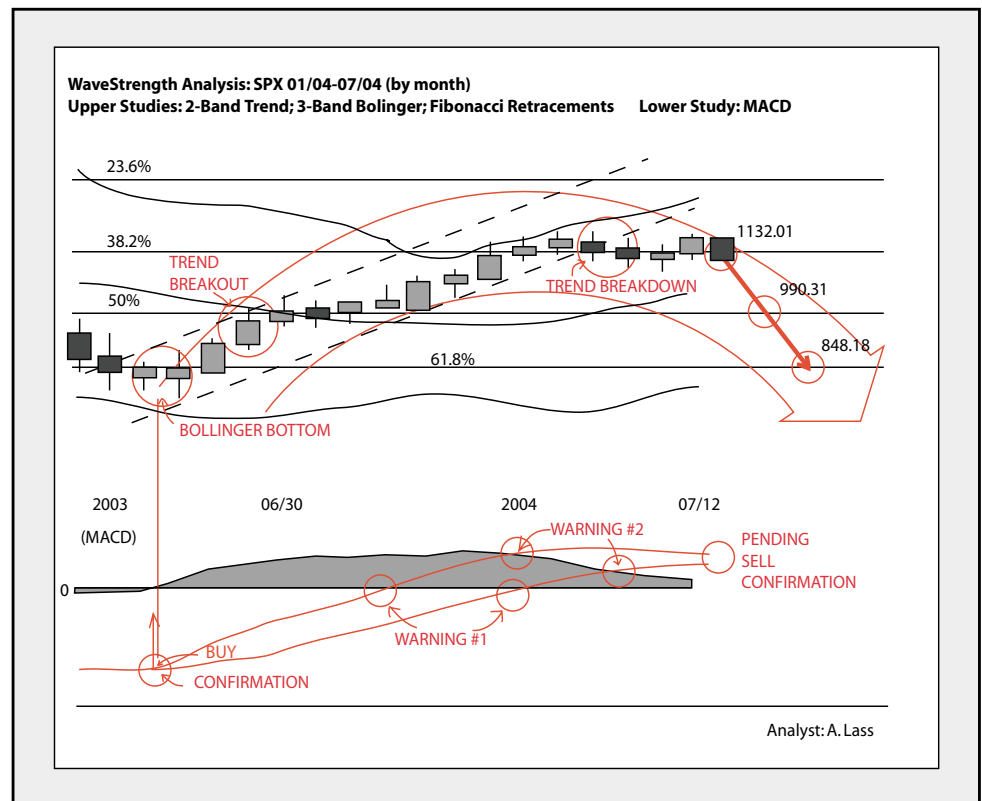
merely paralyzed from the waist down). Karl and his brother Herman managed to grab the wire on the way down and were hanging there precariously when the girl at the top level landed on them.

One must credit Karl with both incredible skill and strength: he held on to her until a makeshift net could be cobbled together and deployed, reducing her injury to a mere concussion. Karl was less lucky: he suffered a cracked pelvis and a double hernia.

If you haven't been to the circus for a while, but still have a voyeuristic taste for danger, take a gander at the S&P 500's chart: it's still holding on to the admittedly exciting gains picked up in the giddy twelve-month rebound from March 2003 through February 2004. But only barely, and the weight on its shoulders is pushing the whole act from "thrilling" through "nerve wracking" and into "sheer terror."

Without a net

It's been six months since the index lost its safety net by breaching the rising trend's bottom



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line. Now the largest representative proxy for the American stock market is dangling by two fingers over 141 points of thin air and hard-packed earth.

There are some who will tell you that the market is just resting, gathering its strength for another skyward vault. Based on a peculiar interpretation of the entrails that foretell bad news—thin margins, mixed corporate profits, rising production costs, vacillating employment—they paint this six-month flat run as a consolidation pattern, as hidden good news, because it will retard the real enemy: Fed rate increases.

Maybe they are right.

Maybe the economy is shrugging off rising oil prices and rising deficits, and will resume a Clintonesque march straight up.

Maybe the Fed will turn a blind eye to the inflationary results of weak monetary policy and flawed if not invisible energy policy and decline to raise rates repeatedly over the next 18 months until they return to the low end of their historic range.

Maybe someone in power inside the Beltway will review the historic record on trickle-down economics, or read any of the numerous memoirs written by its perpetrators conceding that it was a deliberate fraud the sole purpose of which was to bankrupt the Federal Government.

Maybe the next administration, be it Republican or Democrat, will staff its ranks with some clear, original, innovative thinkers who actually understand how global economics really work.

Or maybe not.

The last line

As I currently see things, the S&P is threading the last and lowest line. Indeed, as I sit to write this missive, it is already following the arc of decay I sketched out last month and is now in the gap below resistance between the 38.2% retracement line at 1,132.01 and support from the 50% marker at 990.31.

Not that a spasm or two to the upside is impossible at this juncture. In fact, they are to be expected. Today I watched as several key component stocks gapped down on disappointing reports from Intel, only to see “bargain hunters” step in and buy them back well above the previous day’s high.

Now those same bilge sifters are staring at their winnings and wondering about the value of their supposed bargains. Needless to say, the indices are giving back a major chunk of the day’s gains. I can

just imagine the tenor of the phone calls:

“Henry! Why on earth did you tell me to buy Microsoft at US\$28.36? Everyone else is selling as fast as they can at US\$28.00!”

“Think contrarian, Fred. If this works, we’ll be rich.”

If.

If not, Henry will be rich and Fred will be broke.

So go long if you like. After all, these may turn out to be some of the best prices we’ll see over the next ten years. I doubt it very much, but I’ve been wrong before. But don’t be a Fred (or worse, a Karl). Keep a substantial amount of long-dated index puts in your portfolio.

Maintain your portfolio protection



Bryan Bottarelli

Chart-wise, it’s clear that the S&P offers more risks right now than ever before. That’s why we feel it’s vital that you continue to maintain a high degree of portfolio protection against any long-term market threats (especially terrorist attacks going into the November election).

In past *Taipan* columns, we’ve recommended using a series of medium-term S&P put options to provide this necessary protection. Last month, we purchased the SPX August 1,100 Puts (SPT TT) between US\$26.00 and US\$28.50 per contract. Due to the flat-trending market following that recommendation, these puts were stopped out at US\$19.00. But that doesn’t mean you should abandon your protective strategy. In fact, we feel it’s critical to increase our time horizon on this play. That’s why, this month, we’re recommending you add the **SPX December 995 Puts (SXB XS)** to your portfolio.

As I write, these puts trade between US\$16.10 and US\$17.70 per contract. Pay no more than US\$20.00 for these December contracts. If the S&P trades down to 1,000 in the next 50 days (we’re targeting the days leading up to the November election), these puts would be worth US\$35.00 per contract, good for a 97.7% gain. Protect against losses by placing a stop-loss at US\$9.00 per contract. [n](#)

PEG ratio 0.80, 17% dividend

Buy the world's most undervalued and fastest-growing telecom



You won't see it leading any domestic news broadcast, but the biggest secret in international investing is Brazil's economic comeback. Two years ago, Brazil's economy was left for dead. Its neighbor Argentina was a paragon of fiscal pain. The Brazilian currency, the real, went from 0.37 per dollar to 0.25 per dollar.

Chris DeHaemer Then the Workers' Party candidate, Luiz Inácio da Silva, a.k.a. Lula, was elected President—an ominous sign of calamity to the conservative global marketplace. Many American pundits were spitting out columns in fear of a leftist revolution in Brazil. Foreign investors panicked at the prospect of Brazil defaulting on its foreign debts.

Lula Blair

Lula proved his critics wrong and has governed with remarkable fiscal prudence. In fact, Brazil is poised for rapid growth.

Over the past five years Brazil has ended state-run monopolies on oil, energy, and telecommunications. It has opened its borders and is competing in international markets.

Lula adopted Chicago School macroeconomic policies and moved to get the budget deficit under control.

Let the carnival commence

Brazil is still the world's largest emerging-market debtor. But you wouldn't know it to look at the situation on the ground. After the recent US Fed rate hike, the Brazil's bonds rallied. Their yield over US treasuries narrowed by roughly 150 basis points. Investors had priced in a more benign scenario of gradual rate hikes by the Fed. Now Brazil's financial markets could rally further.

The thinking goes that higher interest rates in the US will suck capital from emerging markets, put pressure on currencies and increase borrowing costs.

This perception has been discounted. Brazil's central bank will still have room to cut interest rates from the current level of 16% to 15% in the next few months. The economy is expected to grow around 4% this year. The trade balance is a positive US\$28

billion and the current account is a positive 1.1% of GDP, up from a 4.6% deficit in 2001. And foreign currency reserves stand at US\$50.5 billion.

This puts Brazil on solid footing. So much so that it has dramatically reduced external financing requirements. Exports grew by 40% in 2003 and will increase by an estimated 20% this year. Brazil's trade surplus rose to US\$3.2 billion in June, the largest since monthly records started in 1991.

Foreign debt and exposure to currency volatility have fallen. Net foreign debt fell from 36% of GDP in 2002 to an expected 26% of GDP by year's end. The government has also reduced its dollar-linked domestic debt by US\$26 billion to 16.6% of its total public debt, from 37% in December 2002.

PEG ratio of 0.80 and 17% dividend yield—buy TSP:NYSE

Telecomunicações de São Paulo S.A. (TSP:NYSE-ADR) is a fixed-line telecommunications company in the state of São Paulo. It is an offshoot of the once famous Telebras System. At the end of 2002, they had 14.4 million installed lines, including public telephone lines, of which 12.5 million lines were in service.

The company has a PEG ratio of 0.80, a forward P/E of 10, and last year it paid a staggering 17% annual dividend—US\$0.66 for the quarter in April. Over the last four quarters (going back in time), EPS has been reported at 0.29, 0.16, 0.14 and -0.18. That's called growth, my friends.

But wait, it gets better

Yesterday, Brazil's Federal Appeals Court ruled that fixed-line telephone tariffs should be calculated using the IGP-DI General Index rather than the IPCA Consumer Price Index.

This bit of governmental nonsense may mean nothing to you, but it means plenty to Brazil's telecoms. You see, until last year, tariffs were set according to the IGP-DI index.

In mid 2003, however, the government decided to replace the IGP-DI with the IPCA to adjust phone rates. This makes a difference because the IPCA rate rises faster than the IGP-DI.

The upshot is that phone tariffs could be hiked

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Project BioShield a “GO”



Bryan Bottarelli covered the story right here in the pages of *Taipan*.)

So you can imagine my surprise when Project BioShield was passed by a 414-2 House vote on Wednesday, July 14, and wasn't even covered in the following day's Wall Street Journal. On CBSNews.com, it was shoved to the back page. So, since the popular media don't feel compelled to cover this story, allow me to fill you in.

Why? Because today's news could ignite shares in a few small vaccine companies.

Here's the skinny...

Project BioShield is a US\$5.6 billion program that passed the House, passed the Senate, and is now awaiting President Bush's signature. The project was established in order to develop a massive stockpile of antidotes to biological and chemical weapons. A new anthrax vaccine for 25 million people is first on the government's wish list. After that, federal health officials want antidotes for botulism, a safer smallpox vaccine, and a children's version of an anti-radiation pill. Under the program, every state would have these stockpiles within two years.

Of course, the initiative was developed to provide a first line of defense against biological weapons and bioterrorism. But the government is not manufacturing these vaccines. Instead, the government is a guaranteed buyer for the pharmaceutical companies that are developing them.

The government wants to sign the necessary contracts to stockpile 75 million doses of a new-generation anthrax vaccine by late August. So who's in the running to score this contract? Two companies, VaxGen and AVecia, head the list. Also in the mix is Canada's Cangene, which will increase the small supply of botulinum antitoxin. (Botulinum is the most deadly toxin in nature, and experts fear it could widely contaminate the food supply.)

Early on, I like Vaxgen the best. Still, there's a handful of other companies that could benefit from Project BioShield. To get the details on these five companies, please visit www.taipanonline.com and log on to the "Project BioShield" page. [n](#)

Here's a story you're not hearing about in the Wall Street Journal—and the list of companies that'll benefit:

Project BioShield is a news story I've been following for a while. And I consider it pretty big. After all, the amount of funding it'll receive is more than what was allocated to map the Human Genome back in 1999. (This, if you remember, set off a biotech buying spree like never before. We

by as much as 16.5% in 2004. In the wake of this news, Brazil's telecommunications regulator authorized an immediate boost in rates of 7% on average for fixed-line carriers. This is well above Brazil's 5.2% inflation rate.

BUY Telecomunicações de São Paulo S.A. (TSP:NYSE) under US\$16.50. It is currently trading at US\$15.56. Contact: Telecomunicações de São Paulo S.A., Rua Martiniano de Carvalho 851, 17 andar, 01321-001 São Paulo, Brazil, tel. 212-815-2345, fax 212-571-3050, website www.telefonica.net.br. [n](#)

Predictable returns from an unpredictable market



Martin Denholm

Many investors are feeling the summer heat as the stock market continues to reward them one minute, only to chew them up and spit them out the next.

As stocks continue to bounce around, wouldn't it be nice if your portfolio contained a few solid, stable investments that actually paid you on a regular basis? It's not as tough as you may think. And there's one utility company ready to put some money in your pocket.

Based in Atlanta, *Southern Company* (SO:NYSE) is a holding company for five regulated electric utility firms in four states across 120,000 square miles of the Southeast United States—one of the fastest-growing regions in the country.

Southern Company owns Georgia Power, Gulf Power (Florida), Mississippi Power, Alabama Power and Savannah Electric. And with a combined 39,000 megawatts of generating capacity, a hefty US\$21.7 billion market cap and over 500,000 shareholders, Southern is one of

America's biggest utility companies. Fortune magazine ranks Southern Company 178th among America's 500 top corporations.

Who needs gimmicks when you can have profits?

Southern Company's website sums it up: "Glamorous? Nope. Exceptional? Yes." It may be in the electric business, but there's nothing particularly electrifying about the firm. It's simply a solid performer, with an emphasis not on flashy frills and gimmicks, but on reliable, safe electric supply, strong leadership, customer satisfaction and excellent results.

Part of Southern's success comes from its diversification. While its core business is electricity, it also has divisions focused on nuclear power (Southern Nuclear), natural gas (Southern Company GAS), fiber optics (Southern Telecom), and wireless communications (Southern LINC).

In fact, the G8 Summit Planning Committee recently employed Southern LINC to provide communications for the June 8-10 summit at Sea Island, GA. Summit officials used 450 of Southern LINC's wireless handsets based on the company's familiarity, coverage and system capacity in the region.

Focus on the financials

As an investor, you shouldn't care how exciting a company is. Your focus should be on the bottom line. Companies like Southern know how to generate consistently good results and save investors from a migraine at every earnings report.

Take the first quarter of 2004, for example. Southern's revenues climbed 8% to US\$2.75 billion and earnings grew to US\$331 million. That translated to EPS of 45 cents—thrashing Wall Street estimates by 8 cents. The 11.8% EPS gain so far in 2004 compared with this time in 2003 means the company is already well ahead of its goal to increase EPS by 5% per year. In 2004, it expects EPS to land between US\$1.94 and US\$1.99.

Those results came after a 71,000 jump in Southern's customer base from Q1 2003. While residential usage rose 5.3%, the company also enjoyed stronger electric demand from businesses. In fact, CFO Tom Fanning said the economy was the "star of the show," with industrial usage increasing 5% from Q1 2003 and commercial electricity revenue rising 3.4% to the levels of the economic boom in 2000.

Southern now has 4.1 million total customers and is aiming for 1.5% customer growth per year. And you can bet that those 4.1 million folks having their air conditioners belt out plenty of cool air during another hot and sticky southern summer should

heat up Southern's revenues, too.

Keeping the punters happy

While some folks may scowl at the high prices their electricity provider charges, Southern is increasingly popular with consumers. Its retail prices are a full 15% below the national average.

Thanks to strong customer service, Southern claimed its sixth National Customer Service Award for best overall service in 2003 in a national survey of residential and commercial customers.

Southern also won J.D. Power's Electric Utility Business Customer Satisfaction Study for overall customer satisfaction for the fifth straight year in March 2004. Hardly surprising, as the company has spent the last four years as the top ranked energy utility in the American Customer Satisfaction Index. Electric Light & Power magazine named Southern Company "Utility of the Year" for 2003.

Right or wrong, some folks are ethical investors. For example, they won't buy tobacco stocks or companies that make missiles. No problem here. Southern Company enhances its already sound reputation by investing more than any other utility firm in conserving the environment.

Since 1990, it has invested US\$1.5 billion to reduce emissions of nitrogen and sulfur dioxide by 40% while boosting production 30%. It has reduced carbon dioxide gas emissions by 74 million metric tons and cut sulfur hexafluoride greenhouse gas emissions by 80%. Southern is also conducting research to find safer, more efficient ways of producing energy. Over the next decade, it will invest US\$5 billion in such programs, including US\$1 billion to reduce oxides in Atlanta, GA, and Birmingham, AL.

Beefing up the balance sheet

Southern has spent the last three years holding the top position on Fortune's list of "America's Most Admired Companies" within the Electric and Gas Utility industry. This award is tilted more towards the financial side, and one look at the financials tells you why...

Southern scooped up US\$11.4 billion in revenues (\$15.56 per share) in the 12 months to July 2004, resulting in solid earnings per share of US\$2.05. Over the same period, gross profit totaled US\$7.75 billion, resulting in a net profit margin of 13%—well above its electric utility peers which, on average, fail to muster any profit at all.

The first quarter left Southern with US\$325.5 million in cash, while the last 12 months produced US\$3 billion in cash from operations and US\$1 bil-

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lion free cash flow. That leaves the operating margin at an impressive 25.7% and puts the company in a much stronger position to achieve its goal of creating 1,240 megawatts of additional electrical capacity by June 2005.

Investors are always searching for ways to maximize their returns. Surprisingly, though, they often treat dividend stocks with suspicion. This is puzzling, because the dividend tax cuts enacted in mid 2003 enable you to keep more dividend income instead of forking it over to the Feds. The truth is, dividend-yielding stocks are beneficial in any market because they give you a stable return whatever the wider economy is doing.

Since 1926, dividends have accounted for over 40% of the S&P 500's total return, and America's companies forked out US\$155 billion in dividend payments in 2003. In a bid to rouse investor interest, 241 S&P 500 companies raised their dividend payments in 2003.

Dividend-yielding stocks are effectively thanking you for investing and minimizing your risk by pay-

ing you a dividend. That incentive results in less volatility, since investors are often persuaded not to sell. In addition, a company cannot simply keep diluting shares if it's committed to paying a dividend on each one.

In any case, when a company has the ability to pay a dividend, you know it's generating cold, hard cash.

Southern Company is one of them. The first quarter marked the 226th consecutive three-month period, dating all the way back to 1948, that Southern paid a dividend to shareholders—35 cents per share. So you can see why return on equity sits at a lofty 16%. Annually, that's US\$1.40 per share, or a 4.8% dividend yield. Energy companies are enjoying a nice run at the moment—a trend that's likely to continue for a while yet. Add a solid dividend-yielder like Southern Company to your portfolio and you should reap the benefits.

Buy Southern Company (SO:NYSE) under US\$30. n

Take it from me—this stock could rock while it shocks



William Colburn

Summer is officially here. Birds are chirping. Children are flocking in droves to their local pools. Lemonade is being consumed by the gallon.

Everybody is letting out some pent-up energy... and this could be dangerous. But that danger could put more dollars in the pockets of **Complex Technologies Inc. (CMPX:NASDAQ)**.

I know firsthand about this danger and how CMPX could be in a position to make some good money in the next few months.

I took a nasty fall one day during college marching band practice. I played the sousaphone and had the thing wrapped around my body when I fell. I stood up after the fall somewhat bloodied—and embarrassed to the nines.

I couldn't stand up the next day. In fact it took me ten minutes just to get out of bed. Turns out that I had fractured the L5 vertebra in my lower back. The cure? Powerful narcotics and several dates with a physical therapist.

One aspect of that therapy was electro-stimula-

tion. Sounds painful—and it was at first—but it helped immensely. CMPX deals exclusively with physical therapy electro-stimulation, and there are three main types:

- **Interferential:** Two electrical stimulations are combined to block pain messages sent from nerve fibers to the brain.
- **Microcurrent:** Amplifies the pain inhibitors already floating through your body.
- **TENS:** Combines interferential treatment with an endorphin-boosting current.

Here's the foundation of electrotherapy. Stimulation increases activity in large nerve fibers. The increased activity acts as a sort of gate, which prevents pain signals from reaching the brain. It's not too highbrow a concept, but I could fill pages writing about it.

Just know these two things: electro-stimulation works, and CMPX makes the machines.

Increased activity isn't limited to nerve fibers

After a strong start to 2004, CMPX has barely budged over the past three months.

Trading over the past few days has been showing signs of life. Volume has spiked here and there. CMPX's price looks to be gaining some momentum.

It's that early momentum that could turn CMPX into an electrifying stock for the future. And it's all based on one number.

Let me refresh your memory: PEG is an acronym for Price/Earnings to Growth. It's a ratio that measures whether a company is fully valued or undervalued based on its own earnings growth.

If you follow my work over at *Value Edge*, then you'll know where I'm headed. CMPX has a PEG of 0.9. You can see that CMPX is a good candidate for a run.

Just how much of a run? My calculations have CMPX trading above US\$42 by the end of 2005. Is that possible? All things are possible, and this 652% run would be wonderful... but I can't make a buy recommendation based on something that could happen two Thanksgivings from now.

Don't get me wrong, though, I trust my system. It works. I think it would be safer if we considered this a pure PEG play.

Buy Complex Technologies (CMPX:NASDAQ) at current levels anywhere between US\$5.50 and US\$7.00. Stocks with PEG's lower than 1 are prime pickings for investors. So far, the sharks don't know about CMPX. But that won't last for long. [n](#)

Glittering profits from a cash-hungry industry



Erin Beale

It seems that Americans have been cultivating a favorite new pastime lately... and it doesn't involve baseball or apple pie.

A new study by the American Gaming Association found that Americans are making roughly three times as many trips to casinos as to ballparks. That's about 310 million trips to the nation's 443 slots venues and casinos.

Over 53 million Americans spent a whopping total of US\$27 billion on trips to gambling venues in 2003—and the numbers are only growing.

A CBS Market Watch article notes, "While that is less than the US\$41.5 billion Americans spent on fishing, it tops the US\$23.8 billion spent on DVD/VHS rentals and sales, the US\$10.3 billion shelled out at amusement parks, and the US\$9.5 billion dropped at the movie box office."

When Americans fork over this much cash at the drop of a hat (or the pull of a lever), we'd be foolish not to invest at the source and ride the profit wave. It's like our neighbors are literally handing over their wallets.

As the economy continues to recover, more and more baby boomers are retiring with a little extra cash to throw around. Americans aged 45 to 59 comprise 18% of the population and control roughly 34% of the income. And gambling seems to be a great way to spend it.

A TV-induced trend not likely to fade

The casino and gaming industry has been red-hot lately, proving that gaming is a trend, not a fly-by-night sort of fad. The recent US\$7.9 billion merger between Vegas giants MGM Mirage and Mandalay to create the world's largest casino operator again thrust the sector into the spotlight.

And according to Forbes, "Since late 2001, just after employment in the industry peaked, the share prices of casino stocks as a group have been rising dramatically, much faster than the market averages."

TV watchers can't escape the clench that Las Vegas has on the medium. Who knew a city could be so powerful! Ads with the slogan "What happens in Vegas stays in Vegas" pepper billboards and commercial slots. An NBC drama called simply "Vegas" has quickly attracted a cult following, and the other major networks have followed suit with shows like "Casino," "Dr. Vegas" and even a Vegas reality show.

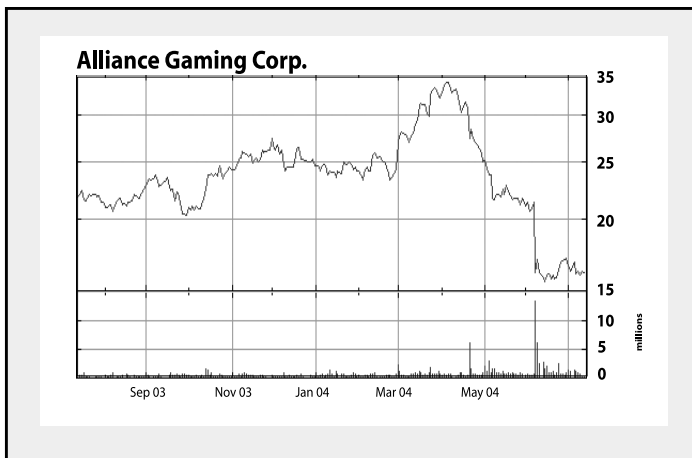
In 2003, Las Vegas actually raked in more revenue on its glittering three-mile strip than Hollywood generated in box-office ticket sales.

One-armed bandits

Our profit opportunity resides in Sin City, where it "designs, manufactures and distributes gaming

over, please...

machines and computerized monitoring systems for gaming machines." In other words, this outfit makes slot machines. The company is **Alliance Gaming Corp. (AGI: NYSE)**.



Headquartered in Las Vegas, Alliance conducts its operations under the name of Bally Gaming and Systems and makes many entertainment-themed slots like "Playboy" and "Saturday Night Live," in addition to popular games like "Cash for Life" and "Millionaire Sevens." They also have a video lottery division called Sierra Design, a poker and racetrack unit called Video Services, and they operate the Rainbow Hotel Casino in Vicksburg, MS.

Alliance has not been a Street darling over the past few months. In fact, shares plummeted more than 20% in one day last month, and have lost more than 30% of their value in the past year. So why would I recommend a stock that has been spiraling downward?

Alliance has excellent potential in a very popular sector that only seems to be gaining steam, and the company is far from fundamentally bankrupt. The selloff they have experienced is overdone, and prices will begin to recover soon. We need to get in now while shares are "on sale."

Alliance began the year on the right foot, reporting in March that revenues rose 20% to US\$326 million in the previous nine months. The trouble began when they lowered their earnings expectations from US\$1.04 per share to between US\$0.96 and US\$1.00 per share. The selloff ensued, and Alliance was swiftly slapped with multiple downgrades from big brokerages.

2005 targets estimate that Alliance will experience a minimum of 20% growth and rake in earnings between US\$1.20 and US\$1.30 a share. Still not shabby.

Currently trading for about 14 times its forward earnings and with a PEG of 0.76, Alliance has its competitors beat in the fundamentals department. Rival game makers like WMS Industries (WMS: NYSE) and Shuffle Master (SHFL:NASDAQ) sport P/E's in the 30's range.

Truth be told, Alliance does bear a considerable burden of debt. But debt is nothing new to Las Vegas and casino culture—MGM carries US\$5.6 billion in debt, Mandalay has US\$2.9 billion, and it's well known that the Donald's Trump Hotels have long been debt-ridden. Competitor International Game Technology is swimming in US\$1.15 billion of debt. Consider that, and Alliance's debt problem doesn't seem as troubling.


Beyond Sin City

It used to be that the only places for jackpot-crazed gamblers to flock to were Vegas and Atlantic City. No so these days. First casinos moved offshore to riverboats, then onto Indian reservations. Then slot machines began to creep into states like Delaware and West Virginia as a way to gain state revenue without raising taxes.

The latest slots buzz has emerged from the unsuspecting Quaker State, and could cause an East Coast domino effect in neighboring states. Pennsylvania recently passed a law allowing 14 different sites to install up to 61,000 slot machines in the state. That's more slots than in Atlantic City and on Mississippi's riverboat casinos. The monies collected will actually go to fund a reduction in property taxes, a promise current Governor Ed Rendall made in his campaign.

If an East Coast neighbor like Maryland were also to approve slots to prevent their residents from taking that short northbound trip, another new market could quickly erupt.

On the West Coast, Alliance is perfectly positioned to become a key player in what some are calling "California's next Gold Rush." You see, Governor Schwarzenegger recently signed a deal giving five Indian tribes unlimited slots on their land. Already, ten other tribes are clamoring for deals as well.

Buy shares of Alliance Gaming (AGI:NYSE) on dips under US\$18 to capitalize on America's gaming obsession. Contact: Alliance Gaming Corp., 6601 South Bermuda Road, Las Vegas, NV 89119, tel. 702-270-7600, fax 702-454-2125, website www.ally.com. 

Picture-perfect profits and a 0.41 PEG to boot

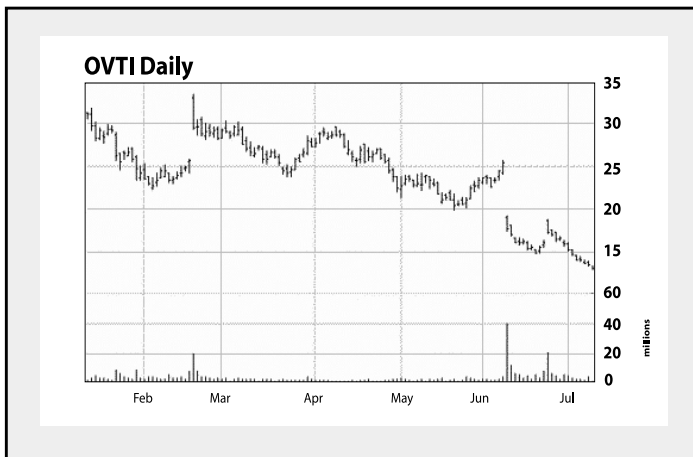


Ian Cooper

While camera phones only accounted for 10% of the 533 million mobile phones shipped in 2003, projections are that they could reach close to 40% by the time 2006 rolls around. And you can bet that the wireless carrier companies will be pushing this option, since every time subscribers sends a photo, their bills only get heftier as the company's pockets get deeper.

Nokia is projecting global camera phone sales to hit at least 100 million units in 2004 and 300 million units by the time 2007 comes into view.

Oversold, with a PEG of 0.41, 60% growth projected from 2004 to 2005, no debt, and close to US\$4 in cash per share, here's one company that stands to benefit handsomely from the future of imaging technology and the recent downgrade of the semiconductor sector.



OmniVision Technologies (OVTI:NASDAQ) designs the CameraChip used to capture images in a variety of consumer and commercial mass-market applications, including still cameras, mobile phones, security cameras and even video game consoles. Big names like Samsung, LG and Ericsson use these chips for their products.

Of earnings and overreactions

When OVTI hit shareholders with news that it would delay fiscal year 2004 results because of a restatement and lowered estimates for Q1 2005

below Street forecasts, it was reflected in a one-day 30% selloff. The damage was done, leading many lawyers to push the "sue now" button on behalf of investors, alleging misconduct by OVTI management.

Whether the lawsuits are waste of time is anyone's guess. The restatements were legitimate and revised upward.

While the company did find errors that affected the timing of revenue recognition on some sales numbers, forcing it to restate results for Q1, Q2, and Q3 2004, the restatement actually added US\$8.9 million to revenue, US\$2.7 million to net income, and another four cents to diluted earnings.

End result—the stock is oversold. We're only here to play the bounce and then we're out.

Bloodbath in Semiconductor-Land

According to stochastics, the stock is clearly oversold at US\$13. Legal issues and downgrades aside, there's plenty of opportunity to turn a profit here. The company has about US\$4 in cash per share, no long-term debt and projected 2005 EPS of US\$1.45, which could put this company with a PEG of 0.41 north of US\$20 in the near term. Should the gap down be refilled, we could see US\$25.

According to Merrill Lynch, while stock prices in the chip sector have already declined, they have the "potential to decline further." The big boys at Merrill have cut their 2005 revenue forecast for the sector from 16% to 6%.

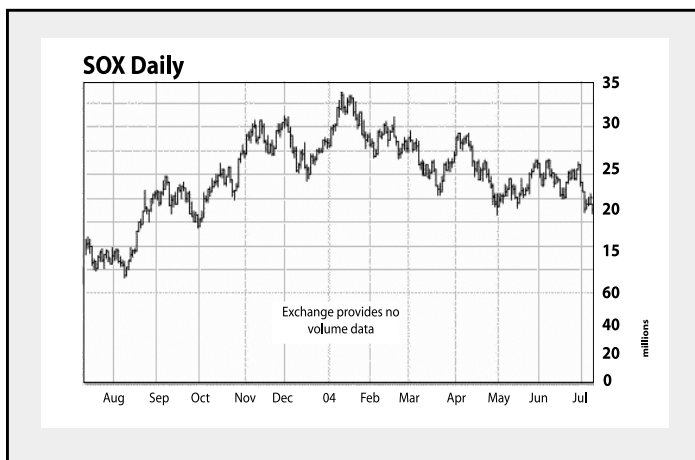
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over, please...



While Merrill Lynch cut its rating on the semi sector to "neutral" from "buy," we're hoping for a bounce out of over-sold territory.

It's not as if there's a problem with growth potential here. In addition to phones, image technology will be used in home security systems, medical instruments and even automobiles. Even better, the company expects to ship 3-megapixel chips by year's end, a huge leap beyond the current 1.3-megapixel picture quality.

The stock is cheap at ten times forward earnings, with earnings growth projected to

skyrocket some 60% in 2004 and 2005.
Contact: 1341 Orleans Drive, Sunnyvale, CA 94089, tel. 408-542-3000, fax 408-733-3061, website www.ovt.com. □

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Publisher:

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Taipan (USPS#008-049) is published monthly for US\$129 per year by Agora Taipan LLC, 808 St. Paul St., Baltimore, MD 21202, USA. Periodicals Postage Paid at Baltimore, MD, and at additional mailing offices.

Postmaster: Send address changes to *Taipan*, 808 St. Paul Street, Baltimore, MD 21202 USA.

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