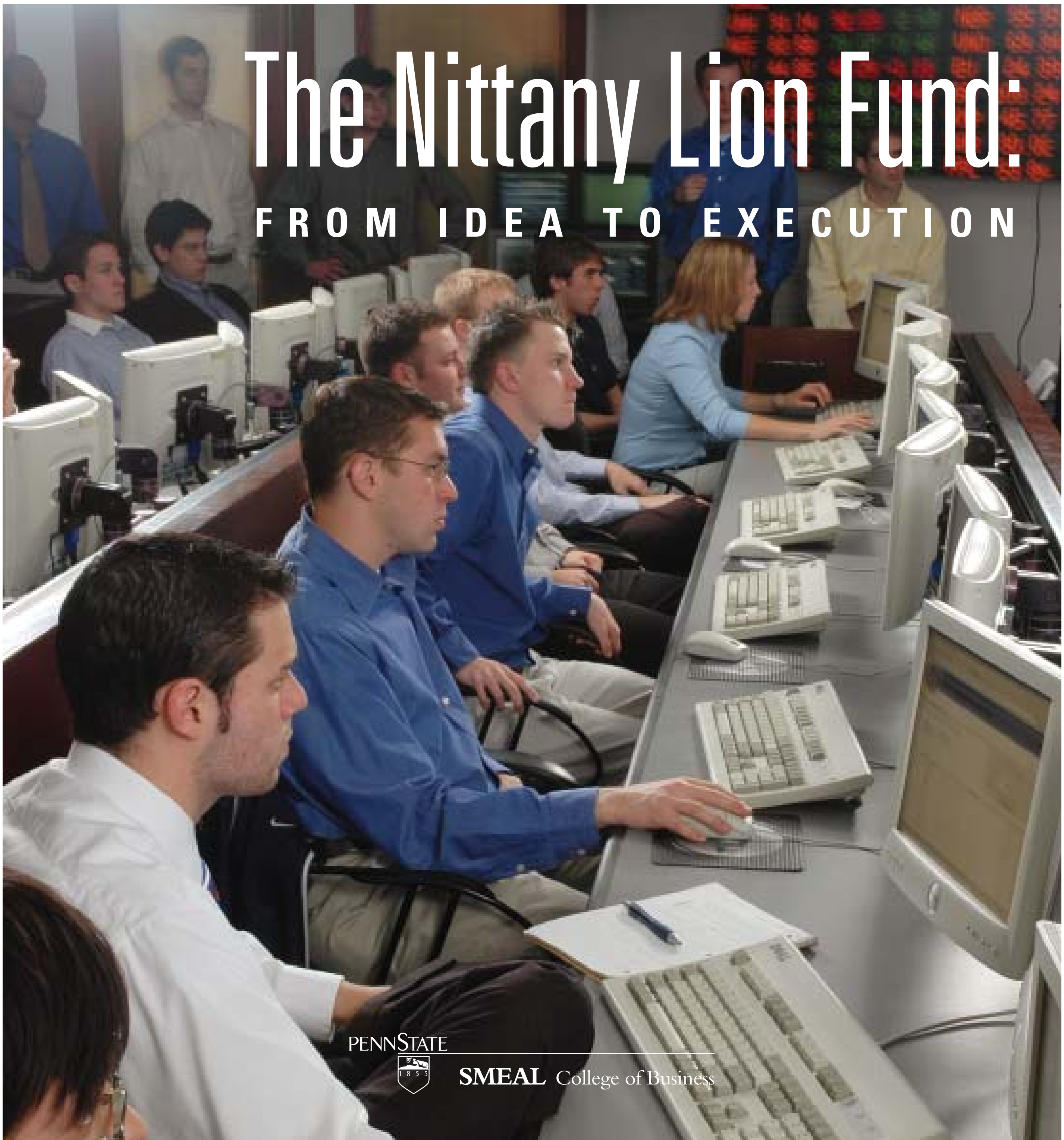
LION Trader

Volume 5

The Official Newsletter of the Smeal College Trading Room

The Nittany Lion Fund:

FROM IDEA TO EXECUTION

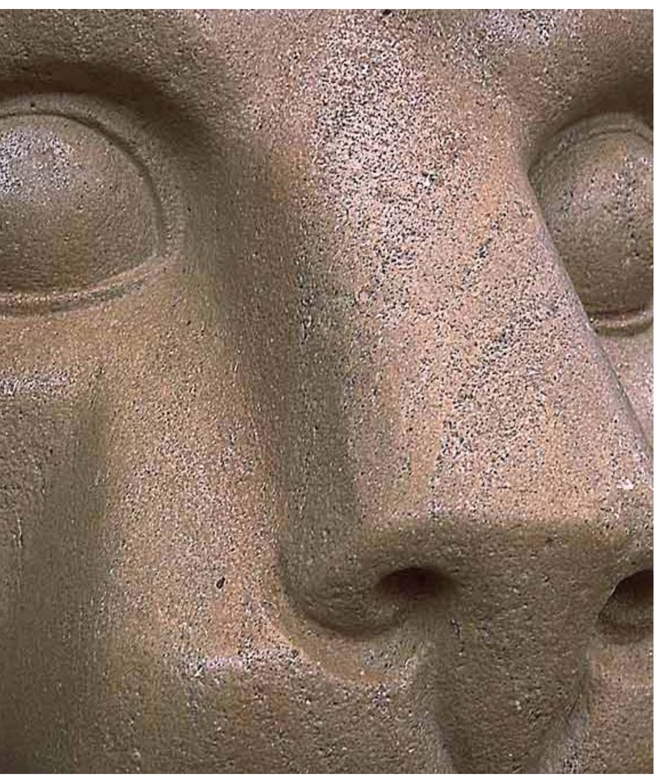


PENNSTATE

SMEAL College of Business

LIONTrader *Inside this Issue...*

FEATURED ARTICLES



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On the cover: Student managers of the Nittany Lion Fund research new investment opportunities.

MESSAGE FROM THE TRADING ROOM

Introducing David Haushalter, New Academic Director

This semester the Smeal College of Business introduced a new member, David Haushalter, to its faculty. David received his undergraduate degree and MBA from West Virginia University. He worked at Fred Kolber and Associates and then later at Susquehanna International Group as an Equity Options Trader.

After this stint in the business world, David took his knowledge and experience to Purdue University where he earned his Ph.D. He then took a position at University of Oregon as a finance professor. David then moved back to Pennsylvania to work again with Susquehanna in the area of Education and Corporate Research. It was from there that Penn State sought David Haushalter to take on the position as a professor and the Academic Director of the Trading Room. Regarding the move, David said, “It is the perfect place right now for my family and me.”

As the Academic Director of the Trading Room, David has big plans for the Trading Room internship program and all the students in Smeal. David also displays a genuine excitement not only to work in the Trading Room, but also to work with the 40 or so interns in the Trading Room program. When asked what makes the Penn State Trading Room unique, he responds, “The Trading Room really brings everything together. It offers a centralized location for a wide array of data sources. Rather than having all of the systems that we have scattered throughout the University, we have them all there, side by side.”

One of the most useful features of the Trading Room, according to David, is the room’s ability to simulate a marketplace using the FTS software. David is also excited to develop new projects that exploit the room’s facilities. Using systems such as Bloomberg and Reuters, students can gain a better understanding of a specific company, discuss specific events or sequences of events pertaining to that company, make predictions as to what will happen in the marketplace and then compare their expectations with what eventually plays out in the marketplace.

David has some plans to improve the Trading Room as it moves to the new Smeal Business Building. He plans to improve the layout so that it will take on the resemblance of a classroom more so than the current lab-like layout. He also plans to make the workspaces more conducive to collaboration and teamwork.

David’s big goal for his first year as Academic Director of the Smeal Trading Room is to make sure that all business students are exposed to the advantages of the Trading Room, have opportunities to work in the room, and acquire the knowledge to utilize the available systems.

In anticipation of the upcoming years, David says, “I think that this is an exciting opportunity. The challenge is to maximize the potential of these resources.

David Haushalter, Clinical Assistant Professor of Finance, and Academic Director of Trading Room

The room allows us to show students how the skills that they are learning in class can be applied to real world settings and compare decisions that they are making to people’s decisions in the marketplace. It really takes learning to a whole new level.”

— Brian Dunlap, LionTrader Staff

The Nittany Lion Fund:

From Idea to Execution

History of the Penn State Investment Association

The Penn State Investment Association was founded in fall 1999 with the intention of providing students with a strong foundation in the functioning of capital markets. In designing the organization, the primary founders, Ali Chaudhry and Nathan Kline, sought to involve students in the research, analysis, and maintenance of a securities portfolio using a hands-on approach that would effectively bridge the gap between classroom concepts and real-world situations.

Moving forward to spring 2000 semester, the club existed in a trial phase and assumed the role of a provisional organization. At this point, the club maintained its exclusivity and carried out general meetings accordingly. At first, decisions were primarily made regarding geographic regions, and research chairs reflected these areas as well. However, concentration shifted to sectors more closely reflecting the S&P shortly thereafter. Obtaining the authorization of the University for official organization status was of paramount importance during this period and was successfully granted. The founders attribute the ease of acceptance to PSIA's interactive and realistic qualities, which differentiate it from virtually any other organization.

In order to have an efficient organization with a structure that defines leadership and team roles, PSIA started a mock portfolio after becoming an official club. Over the past several years, the club has been growing and operating successfully with this fund management type structure. During the 2003-2004 academic years, the idea of getting real money started to materialize and become a more realistic goal. Under the presidency of Sachin Aggarwal, the board of directors brainstormed constantly about the proposal of managing real money. The leaders of PSIA knew this would be a fantastic opportunity for students to take real risks and force the members of the organization to be more diligent with their research.

It was at the Smeal Board of Visitors meeting in New York City in April 2004 that the idea was officially accepted. The passionate leaders of PSIA finally made the idea of launching an actual fund a reality.

Student managers conduct research as part of the Nittany Lion Fund class.

The Inception of the Nittany Lion Fund

During fall 2004, the ball started rolling on organizing the structure for the Nittany Lion Fund. During this time, the legal structure was being formed as a Limited Liability Corporation, under Penn State, by using a trust account at Mellon Bank. The complicated placement documents spelled out the limits for compliance, such as market capitalization requirements, fund objectives, and risk management. As part of its creation, the management structure was also established.

The Nittany Lion Fund managers are elected from the leadership inside the Penn State Investment Association. In PSIA, the board

Continued on page 6.

Student managers applaud the opening trades of the Nittany Lion Fund.

Portfolio Analysis Group Commentary for the week of March 7, 2005 to March 11, 2005

Here is a look at our portfolio holdings and performance as of March 15, 2005, when we finalized the magazine for print, with commentary from the Director of the Portfolio Analysis Group, Yoichi Takemura.

The overall market shrugged with the S&P 500 Index down by 1.80% for the week of March 7-11. The long-term benchmark 10-year interest rate spiked up to the highest level since last July after the Beige Book reported increasing fears of higher inflation. Furthermore, the U.S. trade deficit widened by 4.5% in January, the second highest gap on record. Oil prices remained high around the $54-55 per barrel range, which pushed the market even lower. The market is likely to continue reacting significantly to changes in inflation expectations, retail sales, the PPI, and new home building numbers coming out over the next few weeks. Also, on March 22 at the regular FOMC meeting, the market is expecting that the Fed will raise the FFT rate by 25bp to 2.75%.

The Nittany Lion Fund portfolio finished higher than the benchmark index, but with a weekly loss of 1.19% on our equity investment. Among the best performers of the week were General Dynamics and L3 Communications, both of which reacted positively to new contracts. On the other hand, Genentech Inc. was down by 4.05% for the week, and is now trading close to its 52 week low of $41. We still believe that Genentech is fundamentally strong, but recent negative momentum has pushed down the stock price.

PORTFOLIO HOLDINGS & PERFORMANCE: MARCH 15, 2005

Company Name	Symbol	Close	Shares	Value	Paid	$ Gain	% Gain	Sector	Yield	P/E
Apple	AAPL	40.96	2,400	$98,304.00	36.575	$10,494.00	12.0%	Information Technology	N/A	65.0x
Abercrombie & Fitch	ANF	56.55	2,100	$118,755.00	49.960	$13,809.21	13.2%	Consumer Discretionary	0.9%	24.7x
Aptar Group	ATR	51.46	500	$25,730.00	47.798	$1,801.00	7.5%	Materials	1.2%	20.7x
Avaya	AV	12.72	1,800	$22,896.00	14.410	($3,072.00)	(11.8%)	Telecommunications	N/A	20.7x
Bank of America	BAC	45.54	2,500	$113,850.00	45.630	($255.00)	(0.2%)	Financials	3.9%	12.4x
Consol Energy	CNX	45.12	800	$36,096.00	44.850	$208.00	0.6%	Energy	1.2%	35.9x
CostCo	COST	45.32	1,800	$81,576.00	44.830	$874.00	1.1%	Consumer Staples	0.9%	22.3x
Cytec Industries	CYT	52.12	500	$26,060.00	52.200	($48.00)	(0.2%)	Materials	0.8%	18.3x
Danaher	DHR	54.25	1,900	$103,075.00	55.250	($1,930.00)	(1.8%)	Industrials	0.1%	23.7x
Genentech	DNA	54.25	2,000	$108,500.00	46.660	$15,150.00	16.2%	Healthcare	N/A	75.3x
Eaton Vance	EV	24.60	4,600	$113,160.00	24.390	$936.46	0.8%	Financials	1.3%	23.5x
FedEx	FDX	98.63	1,100	$108,493.00	94.170	$4,876.11	4.7%	Industrials	0.3%	23.6x
General Dynamics	GD	109.00	1,000	$109,000.00	102.340	$6,630.10	6.5%	Industrials	1.5%	18.4x
Johnson & Johnson	JNJ	67.26	1,500	$100,890.00	64.500	$4,110.00	4.3%	Healthcare	1.7%	23.9x
Kinder Morgan Partners	KMP	46.16	800	$36,928.00	45.770	$282.00	0.8%	Energy	6.4%	21.0x
L-3 Communications	LLL	75.23	350	$26,330.50	70.290	$1,699.00	6.9%	Telecommunications	0.7%	22.7x
Microsoft	MSFT	24.91	3,300	$82,203.00	26.150	($4,122.00)	(4.8%)	Information Technology	1.3%	27.3x
Northwestern Natural Gas	NWN	36.15	500	$18,075.00	33.190	$1,450.05	8.7%	Utilities	3.6%	19.5x
Panera Bread	PNRA	54.66	2,200	$120,252.00	50.650	$8,792.00	7.9%	Consumer Discretionary	N/A	43.5x
Texas Instruments	TXN	25.72	3,800	$97,736.00	25.880	($637,62)	(0.7%)	Information Technology	0.4%	25.0x
UST Corp.	UST	54.18	1,600	$86,688.00	49.500	$7,458.00	9.4%	Consumer Staples	4.1%	16.8x
Western Gas	WGR	35.86	1,300	$46,618.00	30.020	$7,562.00	19.4%	Energy	0.6%	23.5x
Totals				**$1,681,215.50**		**$76,067.30**	**4.7%**		**1.2%**	**29.6x**

The Nittany Lion Fund *continued*

Dr. J. Randall Woolridge, The Goldman Sachs and Co. and Frank P. Smeal Endowed University Fellow and Professor of Finance; President, Nittany Lion Fund, LLC.

of directors consists of a President, Vice President, Secretary, and Treasurer which all help oversee the process and procedures in the organization. The functional board consists of directors of Equity Research, Economic Analysis, Portfolio Analysis/Trading, and Compliance. Historically, PSIA was an undergraduate club, but now several Smeal MBA's hold crucial positions in the Economic Analysis and Trading groups.

A Fund Manager class was set up for spring 2005 in order to formalize the meeting times and responsibility for these fund managers. The Fund Manager class operates under the direction of Dr. Randy Woolridge, CEO of the Nittany Lion Fund. Each Monday, Wednesday, and Friday at 10:00 a.m. the class meets to discuss portfolio activities. Typically, there are economic and market related discussions, presentations of new equity ideas, and meetings with professionals in the industry who advise on the fund strategy.

The corporation was approved in late 2004. We completed fund raising in January 2005. The Nittany Lion Fund raised $2.275 million for initial inception, and the Fund will be reopened periodically for additional investments.

— Sean Spillmann & Jonathan Wyss, LionTrader Co-editors-in-chief

Who's Who in the Nittany Lion Fund

Co-Managers

Dr. Judy Olian

Gary Schultz

William Krakaw

Board of Directors

Edward Hintz, *Chairman*

Dr. J. Randall Woolridge, *Chief Executive Officer*

Dr. Judy Olian, *ex-officio*

J. David Rogers

Arthur Miltenburger

Alumni Oversight Committee

Blake Gall

Charles S. Lipson

Edward Sebastian

Donald Wallace

Fund Manager Board of Directors

- Sean Spillman *(Nittany Lion Fund Director & former President, PSIA)*
- Jonathan Wyss *(Nittany Lion Fund Director & former Vice President, PSIA)*
- Ryan Miller *(Current President, PSIA)*
- Frank Howard *(Current Vice President, PSIA)*
- Andrew Repine *(Secretary)*
- Patrick McShane *(Treasurer)*
- William Hoffman *Director, Compliance)*
- Eugene Weissberger *(Director, Equity Research)*
- Yoichi Takemura *(Director, Portfolio Analysis Group)*
- Andrew Woolridge *(Director, Economic Analysis Group)*
- Ben Leax *(Undergraduate Director, Economic Analysis Group)*

Fund Managers & Sector Lead Analysts

- Emily Alcorn *(Lead Analyst, Consumer Discretionary)*
- John Beberus *(Lead Analyst, Information Technology)*
- Michael Boarts *(Lead Analyst, Telecommunications)*
- Celena Cross *(Lead Analyst, Financials)*
- Phillip Hawkins *(Lead Analyst, Materials)*
- Chan Hei Io *(Fund Manager)*
- Daniel Kokini *(Lead Analyst, Utilities)*
- John Nelson *(Lead Analyst, Healthcare)*
- Chirayu Patel *(Lead Analyst, Energy)*
- Allison Pavlick *(Lead Analyst, Consumer Staples)*
- Michael Schuman *(Fund Manager)*
- Matt Seiler *(Lead Analyst, Industrials)*

www.smeal.psu.edu/fund/

Bloomberg Global Product Certification Program Comes to Penn State

The Smeal College of Business has always sought to supplement traditional in-class learning with additional opportunities for students to enhance their education. In accordance with this objective, the finance department, along with the Smeal Trading Room, has taken considerable steps to make Bloomberg Professional certification courses an ongoing and more importantly, on-campus, program at Penn State.

This effort by the university has been extremely popular. Within hours of its announcement, the first class, set for almost two weeks later, completely filled its maximum occupancy level of 100 students. Ravi Menon, a senior finance undergraduate student, luckily enough to register in time, spoke of the course with particular enthusiasm, describing the opportunity as "a chance to gain hands-on skills and applicable knowledge prior to entering the real world."

On January 27, 2005, Pablo Castro, a Bloomberg representative, kicked-off the much anticipated certification program — a basic introduction to the software with focuses on both 'level-one' fixed income and equity data applications—to a packed classroom in the Willard Building.

The value of a certification in Bloomberg Professional stems from the far-reaching influence the software has on global financial markets. As the world's leading in-depth financial information provider, Bloomberg offers its users extremely pertinent and comprehensive data at a real-time pace. Those well trained in its functionality are able to swiftly navigate through the immense financial database, utilize the many analytical tools, and gain significant advantages in the market place. Furthermore, the pervasive nature of the Bloomberg service in major corporations makes those familiar with the product more attractive to employers.

Since 2001, Bloomberg University has offered the Bloomberg Certification Program to recognize various levels of proficiency in Bloomberg Professional Software. Bloomberg's well-structured certification program provides coverage for introductory to advanced functions in Equity, Fixed Income, and Foreign Exchange. Each of these three specified certification tracks are offered at three levels in which a certificate of proficiency is issued.

Bloomberg users interested in starting a full certification track begin by enrolling in five introductory courses that include basic functionality common to all three tracks. This includes Bloomberg introductory commands, real-time monitoring, charting, news and economic release information, and data exportation to Microsoft Excel. Upon completion of the introductory courses, the Bloomberg user continues the structured training by selecting one or more tracks to complete. In each track, all Level I and II courses are mandatory for certification of those or subsequent levels (all courses are mandatory for Level III of Foreign Exchange as well). The number of courses in Level I and II range from 3 courses per level to 6 courses per level. However, after successfully completing Levels I and II of the Equity and Fixed Income tracks the participant is given the option to select four Level III electives which include highly specialized topics that will help optimize the participant's performance on work-related tasks. Examples of Level III courses include "Equity Portfolio Management Strategy," "Merger and Acquisition Analysis," "Credit Derivatives," and "Foreign Exchange Option Analytics."

After attending each course seminar, participants are required to pass a ten-question multiple-choice online exam on course-specific functionality. Through the

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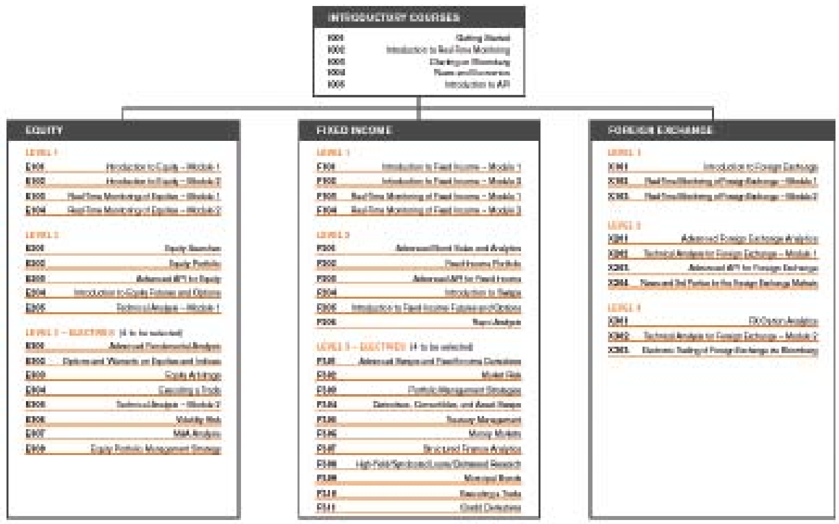
Bloomberg Global Product Certification Program Comes to Penn State *continued*

full attendance of the required courses and the satisfactory completion of the online exams, the participant is issued a certificate verifying that user's proficiency and competency in the Bloomberg Professional software.

While many participants complete the course training via live seminars at Bloomberg offices around the world, it is also possible to fulfill course training through arrangement of exclusive sessions provided by a Bloomberg representative at the client's location as well as the option to complete course modules via teleconference/interactive tutorials through the client's Bloomberg terminal.

In order to accommodate the surplus of students interested in Bloomberg, the Smeal Trading room has developed a shorter, more simplified, lecture series to be presented by trading room interns on a frequent basis. These classes, which mimic the material discussed in the Bloomberg certification classes, have been split up into two one-hour classes, each in a different area of focus: Bloomberg-Equity and Bloomberg-Fixed Income. Although students cannot receive their Bloomberg Certification by attending these classes, the knowledge and skills gained are very similar. Moreover, the program both enables and encourages a larger volume of students to take advantage of the two Bloomberg terminals available in the trading room.

—Eric Chambers & Morgan Samet, LionTrader Staff



Source: Bloomberg
For more information, visit http://www.bloomberg.com, or CERT <GO> on Bloomberg Professional.

Smeal Update



Construction crews and equipment are some of the common sights that Penn Staters often see on their daily travels through campus. Penn State is an ever-expanding school with an ever-expanding student body. The Smeal College of Business is a part of this activity, as they construct a brand-new, 210,000 square-foot building, which will, at the beginning of the fall semester 2005, be the largest academic facility at Penn State. This new building will finally bring the entire Smeal College of Business together under one roof. The halls of the building will be filled with twenty-two classrooms, an auditorium, and offices for business clubs, advisors, and faculty. Presentations can be given in the auditorium or videotaped and critiqued in breakout rooms located within the building. As the Dean Judy Olian says, "this new building will be the 'home away from home' for all of Smeal students." The new building will be equipped with lounges and common areas as well as a café and outdoor plaza, making it easy for students to relax and refuel. The completion date for the new building is set for the summer of 2005. It will be completely occupied by the start of the fall 2005 semester.

Other big news for Smeal comes from *US News and World Report* which has ranked the college's full-time MBA program as 37th overall, 18th among public universities, and 8th in Supply Chain Management.

Students at all levels from Penn State's Smeal College of Business have successfully participated in a variety of competitions during the spring semester. Smeal MBA students came in first in both the **Annual Big Ten MBA Case Competition** and in the **International Logistics Case Competition.** A team of four undergraduate students finished third in the **Rotman International Trading Competition.** (See back cover.) Another team of four undergraduate students also took a third place finish in the **Marshall International Case Competition.**

—Brian Dunlap, LionTrader Staff

Conversation with Alumni:

Tackling the Job Market Head First

LionTrader *recently spoke with two new alumni and a recruiter about the state of the job market.*

When the economy began its downward fall in 2002, companies put hiring on hold and were even letting go of thousands of employees. The graduating class was going through a tough time, scrambling for jobs and even having to take alternative routes such as graduate school or a temporary job unrelated to their field of study. Fortunately, the economy has picked up considerably in recent years with an upward trend in merger and acquisition deal volume as well as hiring.

Sachin Aggarwal, an investment banker at Merrill Lynch, recalled William Schreyer's monumental visit to Penn State in 2002 with Merrill Lynch Head of Global Markets and Investment Banking Group (GMI) recruiter, Joe Casey. This turning point and declaration of Penn State as a target school, made future graduates even more marketable to other bulge bracket investment banks like Goldman Sachs and JP Morgan, who began to recruit on campus thereafter. Out of the 404 people in Aggarwal's incoming class at Merrill Lynch, 20 were Penn Staters.

Citigroup Sales and Trading Analyst and alumnus David Hua opened up his own job possibilities by applying online to firms not listed for on-campus recruiting.

As a member of the Goldman Sachs recruiting team and an analyst in the Investment Banking division, Alicia Cheng can attest to the level of hiring she's seen this year and the increased competition among the applicant pool.

"Students are doing more than ever to competitively position themselves for analyst programs at investment banks. For example, the typical resume of a college senior now lists two or three summer internships, whereas in previous years, internship experience was more of a rarity," said Cheng.

At Merrill Lynch, Aggarwal has noticed a growing need for more investment bankers, but flatter hiring in sales and trading due to a lack of need. Though the job market is strong now, Aggarwal is quick to remind graduates that hiring is forever dependent on the economy.

"I don't anticipate a tech bubble again with people being promoted and hired like crazy and given obscene bonuses. Something like that is hard to believe. You need to ask yourself 'Is the economy saturated at this point?' Who knows what the future will hold?" said Aggarwal.

Aggarwal noted that the biggest change in the job market has been the accounting and financial services industry scandals and the negative media surrounding it. "It's not like anything has changed greatly and people have all of a sudden become evil. It's just the way things have progressed. The catalyst has been the question," said Aggarwal.

With this in mind, it is vital to know what recruiters are looking for in candidates today. Cheng stated that in addition to an eagerness to learn and creativeness, Goldman Sachs looks for team players because the firm's environment is so collaborative. In addition, because of their worldwide scope, Goldman looks for "leaders who can work effectively with leaders," said Cheng. Hua added that some constants employers look for are people who are able to think on their feet, have the drive to succeed, and can maintain a positive attitude. One thing Aggarwal has noticed is that the culture and fit of a candidate to the firm are just as important to recruiters.

The job search is never an easy one and at times, can be disappointing, stressful, and frustrating. Cheng advised the importance of talking to people in the industry to gain perspective on the job and its fit, as well as to gain a deeper understanding and insight in preparing for interviews. She also suggested that students get involved in the Penn State Investment Association, Trading Room Internship, and *Lion Trader* to demonstrate their genuine interest to recruiters and gain a competitive edge. Aggarwal cited the importance of hard work and self-motivation, especially at a school as big as Penn State where it is easy to get lost. "Know what you want and go after it; don't back down. Chaos breeds opportunity and if you're able to harness that opportunity and use the infinite resources at Penn State such as the alumni network, you'll be able to make yourself more marketable," said Aggarwal. But with all that in mind, the job search still comes down to one thing—being proactive and hungry for the job you are seeking.

"It is up to the student to find what job they want. Not many firms out there knock on the doors of their potential employees. It is up to the student to pursue the firm," said Hua.

—Annie Chang, Lion Trader Staff

Stock Selection Strategies with Richard Gould

Richard Gould, founder of the Rockland Small Cap Fund, paid a visit to Penn State to discuss his success as a fund manager and provide insight for students about how to run an investment fund.

Richard Gould entered the Penn State MBA program from the world of corporate finance. He quickly learned that in order to get into a competitive position in finance, you need to take advantage of your contacts, so he did. Using his mentor at Penn State, Professor Randall Woolridge, Gould met with various alumni on Wall Street. Upon graduation, Mr. Gould thought his most educational experience would be at PNC Provident Capital, choosing them over IBM, who offered him nearly double the salary.

Within Provident Capital, Gould concentrated his efforts in the Equity Research department, taking all the small cap industries that senior employees detested—trucking, technology, and insurance. (He added Microsoft to the firm's portfolio after recognizing the company's potential.)

Gould left PNC in 1994 after seven years to join Greenville Capital, but quickly realized that he did not believe in Greenville's investment strategy and wanted to branch off on his own. Therefore, in 1996 with $140 million in capital, Gould started the Rockland Small Cap fund, which would focus on investing in firms with less than a $1.6 billion market capitalization.

Gould discussed his strategy on picking the best companies out of this volatile class of equities. The beauty to his technique is that it can and should be applied to every investment strategy, regardless of market cap standards. The four main ways that Gould suggests to analyze a corporation are:

1) gauging a company's executive management
2) public announcements
3) tradeshows
4) timing

According to Gould, small cap companies love to talk about their company, but the problem is that they are always looking for ways to talk them up. The difficulty comes in measuring their responses to questions because it involves qualitative judgment in the reactions of people. Little things make a big difference, from the length of a pause to body language. More than just reading body language, however, you want to know that a company has set clear, distinct goals for five, ten, and fifteen years down the road.

Tradeshows go hand-in-hand with gauging a company's executive management because they give you the opportunity to have discussions with a CEO in a less casual environment. Gould's advice is to use tradeshows to discover things about a firm's supply chain that you may not have already known. Ask the CEO questions like, "Who do you do the most business with on the east coast?" Take that information and go find out how that business is actually doing on the east coast. Use every angle you can to make sure you are investing your money in the right company. This is something personal investors never go to great lengths to do. Perhaps this is why some fund managers beat the S&P, while the majority do not.

Public announcements are another great way to add content to your analysis of a company. This is where a lot of experience in equity research paid off for Mr. Gould. When a company makes a public announcement, it is imperative to check the information against your estimates, especially when a company meets or beats the Street. According to Gould, "If a company beats earnings expectations, and you see a large increase in accounts receivable, this could be an irregular increase to accounts receivable and subsequently net income. Moreover, days-sales-outstanding explodes, and the company's management may have dishonestly beefed-up earnings by pushing managers to sell whatever they can by the end of the quarter." Gould's advice is to "Sell if you are already an owner or do not buy the stock if a balance sheet irregularity such as this appears. Dishonest management is an added risk not worth taking. In the end it will only do an investor harm."

Another angle to public announcements again requires discussion with management. One of Gould's favorite questions to ask a CEO is, "When you report earnings, if you miss Wall Street estimates, what would your post-boardroom response be?" He said that sometimes a CEO will simply laugh at you and other times they will give you hypothetical situations. If a CEO gives you a hypothetical situation, Gould said, "You have to take it seriously and decide whether it is a realistic situation or not."

Lastly, but very important, is timing. Timing is a factor in both buying and selling equities. One of Mr. Gould's favorite times to buy a stock is a couple weeks before a conference, which is abnormal for the rest of the industry. Most analysts will go to a conference, do their research, and two or three weeks after the conference, the firm will buy shares of a viable company. Gould's philosophy takes advantage of investor psychology during that period. A few weeks before the conference, after he has completed his research on the company or companies holding the conference,

Continued on page 13.

Snap Judgement: The Rise and Fall of Snapple

The following account outlines the remarks of Michael Weinstein in a lecture in the Smeal College of Business Trading Room in fall 2004.

It began in 1972 with three men. Two window washers and a health food store owner decided to break out of the mold and market drinks that were *Made from the best stuff on earth.* The company began by marketing fruit juices, seltzers, and sodas in 1986, but did not find its claim to fame until a year later when it began to brew a Ready-to-Drink tea.

Soon after, in 1992, Unadulterated Food Products, Inc. was purchased and quickly renamed Snapple. Gaining momentum in the public's eye through an advertising campaign with personalities like disc-jockey Howard Stern, talk show host Rush Limbaugh, and Wendy Kaufman and her "Greetings from Snapple" ads, Snapple began to expand rapidly in the Ready-to-Drink tea market.

With the success that Snapple exhibited in the early 1990's, it drew a great deal of attention from the larger beverage companies and those trying to establish themselves within the Ready-to-Drink tea market. On December 6, 1994, Quaker Oats purchased Snapple for $1.7 billion. The purchase price was seen as a grossly overpaid investment for Quaker Oats (purchasing Snapple at 28.6x earnings and 3.3x revenue), but Quaker was confident with its purchase after having incredible success with Gatorade. Quaker was going to follow the blueprint of Gatorade and try to prove the critics wrong.

After Quaker Oats purchased Snapple, it began to implement marketing and sales strategies previously successful with Gatorade. Business quickly turned sour. Quaker ran into several problems including excessive inventories, low demand for container sizes greater than 16 ounces, and troubled retail sales. Quaker was running Snapple into a weakened state, while Lipton and Nestea were growing fat on Snapple's market share. As a result, Snapple suffered a $75 million loss in 1995. Snapple's sales growth had slowed from double digits to -5%. *BusinessWeek* published an article calling Quaker's acquisition of Snapple "one of the Top Ten worst mergers of the 1990's." Snapple was in a tailspin and falling quickly to depths from which most companies would not be able to recover. But, two years after the acquisition, Triarc, a small beverage company, acquired Snapple from Quaker for approximately $300 million. Over the two years that Quaker Oats held onto Snapple, they lost an average of $2 million a day.

Triarc decided to try and save a falling star. The challenge for them would be to appoint a new leader with the ambition to turn the brand around. With previous experience and success in the beverage industry, Michael Weinstein was the man for the job. After first being approached with the task, Michael accepted with belief that Triarc did not have the resources to obtain the giant Snapple. Fortunately for Snapple, Triarc was able to complete the purchase and install Michael Weinstein as CEO of their beverage group.

Immediately, being a perceptive marketer, Weinstein began to change everything that Quaker did. Michael was not there to simply try to take what Quaker had given him and let the Snapple name continue to disintegrate. Instead, Weinstein came in with the purpose to break all of the rules that Quaker established. Reviving the name Snapple would be a tough task that few would be willing to take on. Risking his reputation, Weinstein went head to head with the beverage giant that had sent Quaker reeling to its heels and began making changes immediately.

Marketing is Weinstein's claim to fame within the beverage industry, and he would not let Triarc down. Bringing back personalities like Howard Stern, Rush Limbaugh, and Wendy Kaufman, the brand quickly regained its quirky image that loyal drinkers loved and new ones were attracted to. During this process, Weinstein introduced new products to the Snapple line. With WhipperSnapple, Elements, and Wendy's Tropical Inspiration in homage to Wendy's return, the brand began to increase sales and regain attention from all of the companies in the Ready-to-Drink tea business. Eventually, Cadbury Schweppes would purchase the company for $1.45 billion, and included a position for Weinstein promising not to tamper with his distribution or marketing anytime soon. Weinstein successfully brought back the giant that was all but given the ten-count.

How was Michael Weinstein able to do the unthinkable and bring back a product once seen as a lost cause? In his words, he would tell you there are a few things you need: confidence, passion, and rule breaking. It was those rules that led him to be the topic of case studies everywhere.

When his Trading Room Lecture Series presentation came to an end, he left everyone with three rules to remember for the corporate world:

1. Avoid buzzwords.
2. Avoid Acronyms.
3. Always break the rules.

It was the final piece of advice that truly stood out the most. After all, it was that attitude that placed his name in the Beverage Hall of Fame.

—William Hoffman, LionTrader Staff

CEO PERSPECTIVE

Stephen Courter on the Corporate Restructuring of NEON Communications

The Smeal College Trading Room recently welcomed Stephen Courter, Chairman and CEO of NEON Communications, as part of its continuing Lecture Series. Courter, a Penn State Smeal alumnus and former ROTC cadet, obtained his B.S. in Finance in 1977. Beginning his career at KPMG LLP, Courter later moved to IBM, and would finally join NEON Communications in December 2000. Last November, Courter discussed with Smeal students his career experiences and the recent debt restructuring and merger activity of NEON Communications.

NEON Communications, an advanced optical networking service provider, primarily operates in the Northeast and mid-Atlantic regions, particularly in tier two and tier three cities. The company was formed in 1998 during the Telecom boom, and after landing its first two major customers, NEON went public through an IPO valued at $46 million. NEON's revenue figures were initially impressive, amounting to $24 million annually, however the company's balance sheet was laden with over $200 million in debt and yearly capital expenditures were nearly $20 million. Still, Courter saw opportunity. NEON was a company with a strong network, solid revenues, and little competition, factors that led Courter to join NEON as CEO in 2000.

Upon entering the company, Courter prepared NEON for a major debt restructuring. He conserved cash by freezing headcount, reevaluating contracts, and reducing capital expenditures. He also went on roadshows in attempts to raise additional capital. Courter also met with bond investors and arranged for the sale of NEON's debt at a discount of twenty cents on the dollar. However, NEON was unable to raise the additional capital required, and debtholders began to pressure NEON's Board of Directors for the negotiation of a Debt-for-Equity Swap. In 2002, Stephen Courter obtained Board approval for a Debt-for-Equity swap, and met with bondholders to negotiate the terms. Arranging for a pre-packaged bankruptcy, Courter gained Court approval in June 2002 to exchange $12 million in debtor-in-possession financing for NEON's debt. While in bankruptcy, NEON was also able to cut other costs by eliminating excess warehousing, leases, and unnecessary contracts. These restructuring efforts eliminated the majority of NEON's excessive costs, allowing it to emerge from bankruptcy in 2003 with over $40 million in annual revenue and positive cash flow. When asked to contrast NEON's healthy recovery from bankruptcy with the continuing struggles currently plaguing the airline industry, Courter identified the uniqueness of NEON itself as being the differentiating factor. "We had a unique footprint in the Northeast," Courter stated. "In order for a bankruptcy to work, it needs to have a unique survivable business underpinning it."

From this point on, Courter focused his interest on acquiring other companies; however, as a privately traded company, NEON was in no position to make competitive offers. The only feasible solution was for NEON to solve its acquisition currency issues by merging with a publicly traded company–Globix, an applications web-hosting company. Although Globix is a highly leveraged company, the merger makes sense strategically. Courter says, "We could solve Globix's debt problems with our cash flow, and Globix could solve our currency problems by making us public with this merger. In the capital markets this merger [makes] a lot of sense." The merger also makes sense to investors. The vertical integration of the two companies should create synergies, reducing major costs and exploiting complementary products that would stimulate revenue growth. The combined company is projected to produce about $152 million in revenues and approximately $34 million in EBITDA.

The merger was officially announced in July 2004, filed with the SEC in October, and was expected to close in early January 2005. NEON is currently identifying post-merger objectives and developing strategies to optimize the operating synergies of the combined company. Other post-merger strategies include purchasing other networks and web-hosting companies, strengthening the balance sheet, and providing liquidity to investors.

Courter concluded his presentation with some valuable advice for Smeal students: First, "Seek opportunities early, stay flexible, and relocate." Courter attributes many of the opportunities he received to the fact that he was willing to work in six different countries during his career. Second, "Manage people as early as you can. This is the one skill set that will never erode," stated Courter. "My skill set is not fiber optics, and it's not finance; it's my ability to manage people and manage processes." Third, "Have a passion for change; it creates opportunity." Fourth, "Know where the money comes from and know where it goes." He elaborated, "Take as much accounting as you can stand. Without accounting knowledge you're flying blind in the business world. Also, learn a second language, and specialize in a unique one." Courter is fluent in German, and admits that it has helped him get where he is today. "Above all," said Courter, "Do what's right. Develop your business compass early, and follow your gut. Chances are your instinct is right."

—Jamie Gresh, LionTrader Staff

Stock Selection Strategies with Richard Gould *continued from page 10*

Gould may buy one of the stocks at, say, $16. During the conference the market bids the company up to $18 or $19, and when analysts finally recognize the value in the firm, they have bid the stock up to $22. At this point Gould sells a percentage of his holdings in the company after having easily taken advantage of the price increase.

When buying, Gould also uses technical analysis to take advantage of trend divergence and "scratches and claws for every quarter of a penny." If the action observed is unusual, he will get right on the phone with the CEO to see what the issue is. Gould's decision to sell a stock is largely technically based. When he observes sustained selling in bulk, he gets out. Almost never though, does he unwind 100% of his holdings in a single equity at once. He says the thing to remember is "News is always best at the peak." When there are large blocks of shares coming off the table, 25-100 thousand shares at a time, it is usually another institutional investor with a larger stake in the company. The greater portion of a company that you own, the more frequently you will receive information and the more reliable it will be." Gould takes advantage of this inevitable discrepancy between the little guy and the big investor by tracking a stock and checking it several times a day.

When Gould is confident that institutional investors are dumping their shares, why not dump the entire stake in the company? Institutional investors have an edge on the market that is only surpassed by CEOs, dumping it all would make sense. However, to sell all your shares at once usually requires selling them at a discount to the market. Therefore, by dumping all your shares at once you often sacrifice any gains for convenience and speed.

At the end of his presentation Mr. Gould left his audience with some advice, "Learn as much as you can, in any possible way and prove that you are learning by becoming a Certified Financial Analyst (CFA)."

—Daniel Kokini, LionTrader Staff

STUDENT RESEARCH ARTICLE

A Look Into Hedge Fund Regulations

Hedge fund regulation has recently become a highly debated topic in the United States, with strongly contested positions on both sides of the argument. Scandals in many U.S. businesses and industries have almost become commonplace, and many people believe that more regulation will prevent these abuses of power. On the other hand, many feel that new regulations would diminish the benefits of investing in hedge funds. Additionally, the SEC already has enough work on its plate, and it does not have sufficient resources to be policing another industry.

It is interesting to follow the progress of SEC regulation on institutional investing during the past few years, especially in light of the increasing scrutiny placed on accounting practices, mutual funds, investment banks, and, now, hedge funds. One could argue that the proposed hedge fund regulation is the end result of a chain of scandals beginning with the highly publicized accounting scandals of Enron, World Com, and various other comp-anies. Hedge funds are just the most recent industry to debate new regulation and attract the watchful eye of New York Attorney General Elliot Spitzer.

In the past, hedge funds were generally ignored by regulation entities such as the SEC. Loose wording of the Investment Advisor's Act of 1940 has allowed hedge fund managers to avoid registering as an investment advisor (a requirement of most mutual fund managers). Under the definition of this act, managers do not have to register if they have fewer than 15 clients. Many hedge fund managers have voluntarily registered in an attempt to exercise clean practices, but the majority of hedge fund managers are still unregistered.

SEC regulators are now proposing a change in this convention, making it mandatory for hedge funds with total assets equaling $25 million or greater to register under the Investment Advisor's Act of 1940. Furthermore, it is believed that the SEC will propose that hedge funds be required to follow through with the ensuing list[1]:

- Develop best practices standards.
- Provide brochures describing their investment strategies as well as other e nhanced disclosures.
- Follow a standardized portfolio valuation process.
- Develop a culture of compliance.
- Provide more information about their layered fee structure as was indicated by recommendations made by SEC staff in September of 2003.

Under these new regulations, the SEC would ultimately mandate that hedge funds more openly communicate their firm's practices and fee structure, which could have a variety of effects on the industry.

Naturally, many hedge fund managers oppose these restrictions because they would lose many significant advantages that they have in their investment strategies, while increasing costs for registration and maintenance fees. Jonathon Bean, managing director of the hedge fund management organization Mellon HBV Alternative Strategies in New York, makes the comparison that "the U.K. has regulated hedge funds for years and it's clear that it has severely damaged the industry there. Many individuals don't believe that it even deters fraudulent practices, which is the whole purpose of the regulation."[2]

SEC Chairmen William H. Donaldson contends that there would be many benefits of registration requirements. With control of close to $1 trillion dollars in assets, the hedge fund industry has a significant effect on the economy and the financial markets. According to one *Business Week* article, a single hedge fund manager, at times, can induce a 5% shift in the daily volume of trading on the New York Stock Exchange[3]. With this magnitude of an influence, it seems regulation and forced registration is needed to increase the SEC's ability to detect and prevent fraud. This is especially true given the fast pace with which hedge funds are growing and the increasing number of smaller investors with exposure to them.

No regulations have been finalized, but it is widely anticipated that the proposed legislation will be passed. It will be interesting to measure the effects of the impending decision, but until then, interested parties on both sides of the issue are relegated to watching from the sidelines.

Andrew Repine, Lion Trader Staff

[1] Christine Williamson, "Don't underestimate the SEC in its pursuit of fraud cases, warns Paul Roye," Pension & Investments Vol.32, Iss. 14, 12 July 2004, pg 1.

[2] *Ibid.*

[3] William H. Donaldson to U.S. Senate, 15 July 2004, "Testimony Concerning Investor Protection and the Regulation of Hedge Funds Advisers", U.S. Senate, Washington D.C.

Book Reviews

Book Review: Ugly Americans by Ben Mezrich

Ugly Americans tells the story of John Malcolm, an Ivy League graduate and ex-football star who builds a successful sales and trading career in Japan. The story begins with the typical employment search for the above-average student, interviewing extensively for that big-time Wall Street opportunity. After minimal success, Malcolm finally stumbles upon an irresistible offer from an American expatriate who had already realized much financial success in Japan. He would eventually accept the offer, launching what would be a remarkable career trading on the Nikkei.

This success would not come easy for Malcolm, however, as he experiences much conflict both on the desk, grappling with the volatile Asian financial markets, as well as outside of work, with gangs, night-club dwellers, and women. Despite such obstacles, Malcolm's dynamic personality would shine, from executing $25 million worth of transactions his first day on the job to realizing a climactic arbitrage opportunity towards the end of the novel.

Mezrich introduces the climate of the 1990's Asian financial markets and the nature of Japanese culture in a breathtaking novel. For those who are interested in sales and trading and international finance, *Ugly Americans* is a must-read.

—Ryan Miller, Lion Trader Staff

Book Review: Hidden Risk: Understanding Off-Balance Sheet Accounting by J. Edward Ketz

Corporate frauds related to improper accounting procedures have tainted the reputations of many firms in recent years such as Cendant, Duke Energy, AOL Time Warner, Waste Management, Boston Chicken, Sunbeam, Qwest, and Tyco. Creative accounting tactics used by these firms included inaccurate depreciation/amortization charges, premature revenue recognition, and misleading business combination accounting.

In *Hidden Financial Risk*, Ketz focuses on failures that attributed to the understatement of corporate liabilities and debt obligations. Such examples in recent history involved Adelphia, Global Crossing, WorldCom, and Enron. He begins with an overview of how financial leverage affects stock prices, bond ratings, and financial risk. Ketz specifically clarifies how each of the perpetrating firms hid debt via the use of the equity method, lease accounting schemes, pension accounting procedures, and the development of corporate subsidiaries known as SPE's. Furthermore, he explores the failures of managers, directors, financial statement auditors, regulatory bodies, and investors in detecting the financial risks that were prevalent in these scandals. Ketz concludes by advocating for high ethical business standards, professional skepticism, and support for the "public interest." His closing recommendations on how to restore credibility and comprehension to financial statements prove to be beneficial to investment professionals and individual investors alike.

Financial reporting and accounting ethics expert J. Edward Ketz is an Associate Professor of Accounting at Penn State. He has 30 years of experience studying the intricacies of fixed income and derivatives accounting.

—Eric Chambers, Lion Trader Staff

PSU Team Succeeds at the Rotman International Trading Competition

On February 18 and 19, Alex Keller, DeJian Fang, Eugene Weissberger, and William Hoffman represented Penn State in the second annual Rotman International Trading Competition at the University of Toronto. This team was created after a series of competitions held at The Smeal College Trading Room where each team member held the top cumulative cash positions after simulated trading competitions using FTS.

The first day of competition consisted of an Open Outcry Simulation. The Penn State team, competing against 24 other schools, began on the right foot and finished in third place in the first of three competitions. On the second day, the Penn State team competed in another Open Outcry simulation based on an index that was composed of six economic indicators. The Penn State team finished second.

Soon after the second competition, the last competition began. Penn State's strategy was to retain its current position. The last part of the competition got off to a slow start due to problems with the team's model, which erroneously calculated the intrinsic values of the stocks and bonds being used. With some quick revisions, it didn't take long for the team to get back on track, finishing third in the last competition.

In the end, Penn State earned a third place finish, but first out of all the United States teams. Although they lost to a team from England and another from Canada, they beat out teams from MIT, Carnegie Mellon University, University of Texas, and big ten rivals Ohio State and Michigan.

—William Hoffman, LionTrader Staff

The Penn State Team after the competition: (l-r) Eugene Weissberger, DeJian Fang, Alex Keller, and William Hoffman

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