

The Educated Investor

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Letter from the Editor

by John Sheehy

The month of October saw the MPSIF funds working diligently to invest the excess cash that had accumulated over the summer. During the month, the combined funds made 7 purchases, many of which performed well right out of the box. In terms of performance, the combined funds generated a monthly return of 2%, which was strong but trailed our blended benchmark by approximately 130 basis points. The primary reason for this relative underperformance was the significant allocation of cash in the funds during a month where the equity markets performed well. MPSIF's strongest relative performance was in its Fixed Income Fund, that outperformed the benchmark by approximately 10 bps. The month of November will be important for the funds, as many new ideas are being added to the fund and the existing positions will be examined through the updating process.

This month's edition of *Educated Investor* includes a tale of two companies within the SmallCap fund whose futures changed in October, both resulting in attractive gains for the fund. In addition, we have included our first installment of the MPSIF "Pitch of the Month" segment, highlighting FPL Group, Inc. pitched by Value Fund analyst Jennifer Clarke.

Small Cap Fund or Merger Arb Hedge Fund?

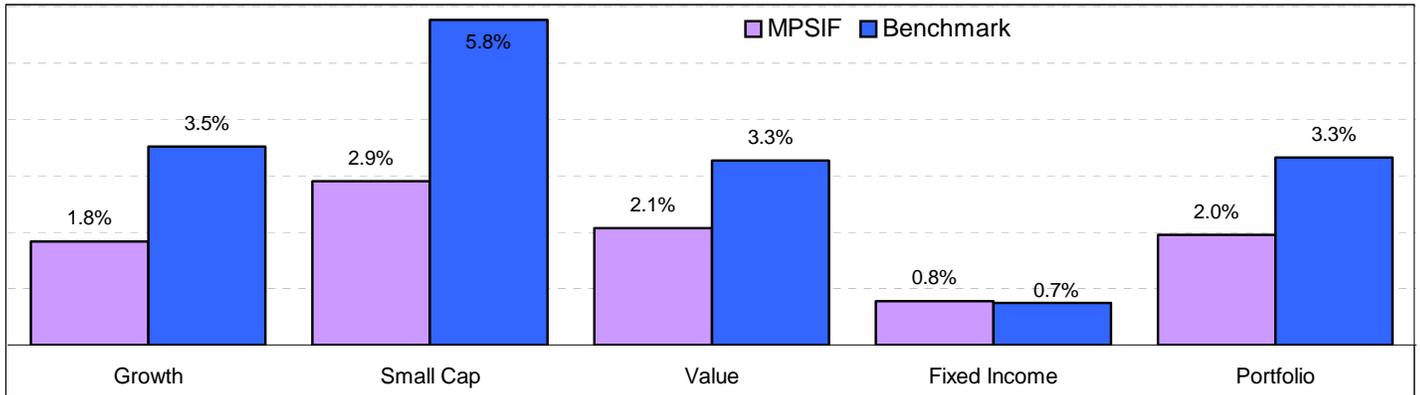
by Ronny Eisemann

Alas, the MPSIF Small Cap Fund did not outperform the Russell 2000 benchmark in October. However, on the bright side, the fund owes a significant portion of their gains to the sizzling hot private equity market. During October, two of the fund's positions, Yankee Candle Company, Inc. (YCC) and Open Solutions Inc. (OPEN) announced that they had received offers to be acquired by private equity firms. The tales of these two positions within the Small Cap fund are very different, but they ended in the same result: excess returns for MPS.

The Open Solutions' buyout offer was first on October 16. OPEN announced an agreement with Carlyle Group and Providence Equity Partners for \$1.3B (\$38 per share), a 25% premium over the previous day's close of \$30.28. Open Solutions sells banking software to integrate e-commerce, internet banking and enterprise processing applications to small and medium sized financial institutions. The company was rapidly growing organically with stable profit growth and predictable demand, making it an ideal take-out candidate. Open Solutions has been in the MPS portfolio since October 2004 and, ironically, the MPS analyst covering OPEN, Kwang Roh, was scheduled to provide the fund with an update on October 16. His recommendation was to hold the OPEN with a price target of \$36. MPS exited the position at \$37.68, representing a 57.3% gain.

Yankee Candle was purchased by MPS on September 18 for \$27.12 on the premise that YCC, unlike OPEN was an LBO candidate. The analyst, Marc Regenbaum, presented his LBO model and analysis, giving YCC an LBO value of \$31.25 per share. Marc believed that YCC was a prime candidate for an LBO due to its strong competitive position in the scented candle market and stable operating cash flows. Additionally, Yankee Candle had publicly announced that it was exploring "strategic alternatives" in July 2006. On October 25 Madison Dearborn Partners offered \$1.4B for YCC (\$34.75 a share), a 21% premium over the previous day's close of \$28.72 and a 28.1% premium over our purchase price. The difference between Marc's LBO analysis and what actually occurred roughly one month later was the buyer's assumption of a higher debt load in the proposed deal.

Fund Performance vs. Benchmark in October



Best Returns of October

Worst Returns of October

Fund Ticker	Company	Price	Return	Fund Ticker	Company	Price	Returns
MPS OPEN	Open Solutions	\$37.68	30.8%	MPV SAFM	Sanderson Farms	\$26.53	(18.0%)
<i>Comment: Accepted offer to be purchased by PE consortium</i>				<i>Comment: Falling chicken prices adversely impacting stock price</i>			
MPS YCC	Yankee Candle Company	\$34.75	18.7%	MPS WDFC	WD-40 Company	\$31.48	(11.8%)
<i>Comment: Accepted offer to be purchased by PE consortium</i>				<i>Comment: Missed 4Q Earnings est, issued lower guidance for FY07</i>			
MPV/G ZQK	Quiksilver	\$13.95	14.8%	MPS ASFI	Asta Funding	\$34.04	(9.2%)
<i>Comment: Benefited from positive retail news in October</i>				<i>Comment: CEO announced sale of insider stock</i>			
MPV HAL	Halliburton Co.	\$32.35	13.7%	MPV PFE	Pfizer	\$26.65	(6.0%)
<i>Comment: Strong Q3 results and news of KBR IPO</i>				<i>Comment: Beat earnings; released expectations of no rev grwth untill '09</i>			
MPG MOGN	MGI Pharma	\$19.02	10.5%	MPS FVE	Five Star Quality Care	\$10.31	(4.2%)
<i>Comment: 3Q profits beat expectations on a 43% incr. in rev</i>				<i>Comment: Market reacted negatively to 80MM convertible note issue</i>			

Purchases

Fund	Ticker	Company	Price	#Shares	Value
MPS	SEB	Seaboard Corp.	\$1,297.00	15	\$19,455
MPS	GST	Gastar Exploration Ltd	2.15	4650	\$9,984
MPV	WMT	Wal-Mart Stores	48.17	330	\$15,896
MPV	FPL	FPL Group	46.44	345	\$16,022
MPV	AIB	Allied Irish Banks	54.64	295	\$16,119
MPV	THO	Thor Industries	43.89	365	\$16,020
MPG	PENN	Penn National Gaming	38.13	536	\$20,438
MPG	WFT	Weatherford	41.10	240	\$9,864

Liquidations

Fund	Ticker	Company	Price	Value	%Change
MPS	RARE	RARE Hospitality Int.	\$31.17	\$20,261	2%
MPS	OPEN	Open Solutions	37.68	\$48,419	57%
MPS	WDFC	WD-40 Company	31.46	\$23,283	16%
MPV	ZMH	Zimmer Holdings	70.87	\$17,221	7%
MPV	UNM	UnumProvident Corp	20.84	\$17,089	9%
MPV	FSL	Freescale	38.65	\$28,601	129%
MPV	XEC	Cimarex Energy	33.28	\$19,003	(24%)
MPG	HST	Host Hotels & Resorts	18.30	\$3,916	116%

PM Spotlight - Growth Fund by Aaron Trent

We asked the Growth Fund's Adam Lilling and James Woods to describe their challenges as they've taken on the Co-PM role this semester:

"The main challenges are looking at the fund from a broad perspective and following several stocks at once. It's important to see how the fund allocates capital relative to the benchmark and to know of any news developments impacting stocks in the portfolio.

"I've learned how to encourage discussion to attain optimal class participation by working with people to help them achieve their goals." --Adam Lilling, Co-Portfolio Manager - MPG

"I think the biggest challenge for me has been the constraints of running real money in an academic setting. In particular, it hasn't been easy to see our performance lag as we carry an outsized cash position due to stop loss liquidations over the summer. However, I believe strongly in the discussion and vote system and do not think PMs should have greater autonomy, as that would dilute the educational value of the course in my opinion. Nevertheless, it's hard knowing you have to answer for the underperformance that, in this case, has come with a huge cash allocation.

"In addition, what I've learned is how difficult it is sometimes to maintain discipline when it comes to your investment choices. For example, we previously held a stock that we received as part of a spin-off that did not fit the criteria for a growth stock. The covering analyst rightly proposed liquidating the position, but it did cross my mind that we'd be making a tough cash situation worse. We did vote to liquidate, which I think was the right call." --Jim Woods, Co-Portfolio Manager - MPG

October's MPSIF "Pitch of the Month" – FPL Group, Inc. (FPL)

This installment of MPSIF's "Pitch of the Month" features FPL Group, Inc. (FPL) pitched by Jennifer Clarke on October 16 for the MPSIF Value Fund. The purpose of the "Pitch of the Month" is to credit MPSIF analysts who have generated ideas over the past month that have already resulted in significant capital gains for their particular fund. Below, Ms. Clarke summarizes her investment thesis for this security, the key questions brought up during her pitch presentations, and the key developments that have occurred since her pitch.

Stock Pitched: FPL Group, Inc.
Date of Pitch: October 16, 2006
Ticker: FPL
Sector: Utilities
Fund: Value

Analyst: Jennifer Clarke
Original target price: \$52.00
Purchase Price: \$46.44
Current Price(10/31/06): 51.00
% Appreciation since purchase: 9.82%

Company Background: FPL Group is based in Juno Beach, Florida and engages both in the generation of electric energy for sale in over 20 states as well as the transmission and distribution of electric energy to over 4 million customer accounts in the east and lower west coasts of Florida.

Summary of Analyst's Investment Thesis:

1. Since a merger was announced with Maryland's Constellation Energy in December 2005, the stock has underperformed close peers. The merger deal ran into problems with Maryland regulation. The Maryland regulatory body announced it would have an official response to the proposed deal by February 2007. However, general sentiment in the market was that the deal was not beneficial to FPL and that it would most likely not go through.
2. FPL's stock suffered during recent years because of the charges the company had to take in order to rebuild after the damage incurred during the 2005 hurricane season.
3. As FPL is located in an attractive region of the United States, the company will benefit from a growing population as Baby Boomers retire and move south and demand for electricity increases over time in this region.

Discussion points considered during pitch:

1. The sensitivity of the electric utilities industry to changes in the housing market. (i.e. new home building)
2. The extent to which this is a value play – I believe that FPL is a very solid electric utility and should be trading at a higher multiple to its peers. Its slight discount on a 2007 Forward P/E basis makes this a cheap stock to purchase for the premium it should command.

Developments since purchase: Since the stock was purchased in the middle of October, the proposed merger between FPL and Constellation Energy was cancelled, causing a surge in the stock price. On October 30, FPL reported higher than expected earnings resulting from its non-regulated electric generation business segment, leading to a further increase in prices. The stock is currently is almost at our target price. The target price will be reevaluated in early November to determine our next move for this position.

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