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Outstanding Investor Digest

PERSPECTIVES AND ACTIVITIES OF THE NATION'S MOST SUCCESSFUL MONEY MANAGERS.

Volume VII Numbers 5 & 6 June 22, 1992

Investors featured in this Issue:

Other Investors in this Issue:

Companies & Investments in this Issue

ANNUAL MEETING ROUNDUP:
GABELLI, WESCO, SEQUOIA AND SALOMON
SPECIAL DOUBLE ISSUE

Last year, we told you how too much of a good thing had forced us to produce a double issue — our first at the time — so that we might pass along every available investment tidbit from Bill Ruane, Bob Goldfarb and other master investors.

Well, we found ourselves faced with the same dilemma again this year — with more valuable material than pages. And in order to deliver every possible morsel to you, we've

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LABRADOR PARTNERS' STEVE FARLEY
"THE S&P IS GROSSLY OVERVALUED. HOWEVER, WE'RE VERY EXCITED ABOUT OUR STOCKS."

Steve Farley's track record isn't all that long — only seven-odd years. The record of Farley's limited partnership, Labrador Partners is even shorter — only about two years.

However, several things about Farley caught our eye. First, he worked closely with very highly regarded Joe Reich at Centennial Associates. Second, for the 4-3/4 years during which he co-managed Centennial Associates, it earned a compound annual return of 32.4% before fees and expenses vs. 19.0% for the S&P 500 and 10.4% for the Value Line

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BERKSHIRE HATHAWAY'S
WARREN BUFFETT & CHARLIE MUNGER
"WE'RE LOOKING FOR THINGS THAT JUST SCREAM AT US.... THE COMPUTER IN NO WAY MAKES IT EASIER TO INVEST."

Amazingly, $10,000 invested in Buffett Partnership, Ltd. in 1956 and reinvested in Berkshire Hathaway at its termination in 1969 would today be worth over $35 million — *after all taxes, fees and expenses.*

Incredibly, even those figures understate the magnitude of his accomplishment. Before fees, the $10,000 would have grown to an even-more-amazing $65 million (more or less).

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PERKINS CAPITAL MANAGEMENT'S
RICHARD W. PERKINS
"THERE'S A HALF-PRICE SALE IN MANY OTC STOCKS."

While most of our contributors are reporting bargains few and far between, Perkins Capital Mgm't's Richard Perkins is pounding the table. And when Perkins pounds, we listen.

Last year, Perkins' equity accounts were up over 70% after all fees and expenses. He's done OK long term as well. For example, for the 15 years ended December 31, 1991, Perkins' equity accounts earned a compound annual return of a hard-to-believe 24.9% before fees and 23.2% after fees vs. 18.1% for the S&P 500 and 9.2% for the Ibbotson Small

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PERKINS CAPITAL MANAGEMENT'S
RICHARD PERKINS
(cont'd from page 1)

Company Index. Here are year-by-year performance figures for his equity accounts before and after fees alongside those of the S&P 500 and the Ibbotson Small Company Index. (Performance figures provided by Perkins Capital Mgm't.)

Year	Gross Annual Return	Net Annual Return	S&P 500 Total Return	Small Cap Return
1977	+46.4%	+46.4%	-7.2%	+25.4%
1978	+25.0%	+25.0%	+6.6%	+23.5%
1979	+39.8%	+39.8%	+18.4%	+43.5%
1980	+85.2%	+85.2%	+32.4%	+39.9%
1981	+5.0%	+5.0%	-4.9%	+13.9%
1982	+33.7%	+33.7%	+21.4%	+28.0%
1983	+30.6%	+30.6%	+22.5%	+39.7%
1984	-7.3%	-7.3%	+6.3%	-6.7%
1985	+45.7%	+44.0%	+32.2%	+24.7%
1986	+16.6%	+14.9%	+18.5%	+6.9%
1987	-0.7%	-2.2%	+5.2%	-9.3%
1988	+22.2%	+20.4%	+16.8%	+22.9%
1989	+42.8%	+40.9%	+31.5%	+10.2%
1990	-7.5%	-8.8%	-3.2%	-21.6%
1991	+73.9%	+71.9%	+30.5%	+44.6%
1977-91	+27.5%	+26.7%	+14.3%	+17.3%
1985-91	+24.9%	+23.2%	+18.1%	+9.2%

Please note that the figures prior to 1985 represent discretionary equity accounts managed by Mr. Perkins while he was with Piper Jaffray & Hopwood.

Incidentally, when we last spoke with Perkins in early 1991 we ran out of pages well before he ran out of bargains. Therefore, we weren't surprised when he readily justified his table pounding when we called this time.

Here's what he had to say. We hope you find his ideas as interesting as we did:

A HALF-PRICE SALE IN MANY OTC STOCKS....

OID: Most of our contributors are finding bargains few and far between. And yet you're pounding the table. What gives?

Richard Perkins: April and May was just a holy terror for many OTC stocks. While we were off about 5% or so in many of our equity accounts in the first quarter, we may have been off another 5% or so in the month of April alone and more in May. It was just really a massacre.

And that put many stocks down to levels which, I think, make them very attractive.

OID: How is 5% here and 5% there a massacre?

Perkins: Our largest holding is SCIMED Life (SMLS). And that stock had essentially gone from \$90 to \$45 by the end of April. That's a pretty big decline — 50% to be exact!

OID: It's certainly hard to argue with you there. But haven't lots of stocks of companies which disappoint been taken out and shot?

Perkins: True. But that stock went down that much, without, as far as we can see, any change in fundamentals. Now maybe it shouldn't have been at \$90 in the first place. But it was the second time that it had been there. It went to \$90 once before and then back to \$45 and back to \$90. So we've had our second round trip.

And things like that are very painful — especially when it's your largest position.

OID: I can certainly relate.

Perkins: In our latest letter dated April 30, we pointed out to clients how the NASDAQ had declined since its mid-February highs by approximately 12%. By comparison, the Dow was off from its high by only 1%. So you can see the tremendous difference.

Clients listen to the news and hear that the Dow Jones closed at its 13th new high or whatever. And then they get their statements and see that their account is down. So they wonder what's going on because they see the market making new highs.

But it belies the situation. The NASDAQ was down a great deal from its high. And many OTC stocks, small and large — like SCIMED — were literally cut in two.

Many of those losses were in medical and biotech. And we own, and have for a very long time, substantial positions in medical companies. And those were hurt a great deal more than most.

OID: Weren't they selling at very high P/Es?

Perkins: If you can measure the P/Es. As you know, most of them don't even have earnings — not the medical companies so much as the biotechs.

OID: Certainly reassuring.

Perkins: They did go up more than they should have. But we look ahead to long-term potential. We only sell in two instances — if the fundamentals go awry or if the reason that we bought it ceases to exist or, of course, if we learn that the reason we bought it in the first place didn't exist and we just misjudged it.

If we thought it was overpriced, we would sell. But I think that's easier in hindsight. If you look down the road and see lots of potential, it's not very easy to get out and get back in — especially when we're running over 500 accounts. Therefore, we tend to just hang in there.

OID: Which is usually the right thing to do — especially given taxes and other transaction costs.

Perkins: Even in our tax exempt accounts, it seems that whenever I've sold something because it looks expensive that it works against me. It's tempting to try to sell near the top and buy near the bottom. But more often, you just wind up outsmarting yourself.

So it's an interesting exercise. But if the company is going to be a success for you over the longer term, then it's probably wrong to sell — even in a tax exempt account. That's why we tend to hang in there.

You're usually better off spending your time trying to find wonderful companies that can do well for you than you are spending your time figuring out what you should sell

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PERKINS CAPITAL MANAGEMENT'S
RICHARD PERKINS
(cont'd from preceding page)

and what you should buy for a few points here and there.

OID: Exactly what Buffett and Munger said at Berkshire's annual meeting this year.

But might you tell us about some of the wonderful companies that are on the bargain counter today?

SCIMED LIFE — DOWN NEARLY 50%
FOR NO APPARENT REASON....

Perkins: Did we talk about SCIMED Life last time?

OID: We did, but we edited it out because we felt it wasn't cheap enough. However, it sounds like it may be much cheaper today.

Perkins: It is. And it's doing exceedingly well. SCIMED has tremendous earnings momentum. Earnings this year will come in around $3.30 — possibly $3.40 — and next year they should be in excess of $4.00 — perhaps as much as $4.50.

The company has been growing at 40% a year. The momentum of growth is still there. It's just a terribly attractive stock. It's gone up a bit since its low of $45 — it just closed at $54. It was $85 at the end of December.

I'm not suggesting that it should sell at its growth rate, but it's probably the leader today in the angioplasty business and should certainly sell at more than 15-16 times this year's earnings and 13 times next year's earnings.

OID: So you'd include it in the table-pounding buy category?

Perkins: Very definitely. And we've been buying it for several weeks. We've been buying it for newer accounts because it's already a very large position in most accounts.

OID: Could it be down because investors expect competitive factors and medical reform to shrink profit margins?

Perkins: I can understand those concerns when it comes to hard products. But in terms of services such as an angioplasty procedure, I just find it very hard to accept.

OID: We found poverty hard to accept. But you adjust.

Perkins: Treating a clogged artery with angioplasty is far, far less expensive than surgery and is the procedure of choice. So it makes no sense to me that SCIMED will be hurt in any meaningful way.

Where cost containment will bite is companies selling expensive products and equipment. It probably won't be possible any longer for every major hospital to have an identical piece of very expensive equipment which perhaps is not used to its fullest extent and where the job could be done if one or two hospitals in each city had the equipment. I think that's where there'll be problems.

But I don't see problems in angioplasty procedures and probably not in the heart valve business.

OID: Does management own much stock?

Perkins: The current president — Dale Spencer — came to SCIMED in 1986. And as a manager, his ownership would have come from stock options rather than being a founder.

This company has been here in Minneapolis for many years as a publicly traded company and did not do well in its original business — which was oxygenators. It never made money and had to seek financing every so often.

Then Dale Spencer came in. He didn't come in as president at that time, but it was because of his efforts that the company embarked on the angioplasty business in 1986 and 1987. And the rest is history.

SCIMED has grown to the point where it is very close to number one in the industry. And 5-year revenue growth — from $14 million in 1988 to $184 million for the year ended February 1992 — has been phenomenal.

OID: If you can call 1,200%+ growth in 4 years phenomenal.

Perkins: The reason we got interested in SCIMED back in 1988 — when we bought most of our stock — is because of the change that was taking place there. That's the thing we're always trying to identify — an important change in a company or industry. With SCIMED, the change was getting into the angioplasty business — which was a mighty change.

OID: You mentioned that they'd never made money up to that time. What gave you confidence that the change would be so positive?

Perkins: The people. I met with them and became quite confident that they could in fact do it. Frankly, I didn't think they'd be quite as successful as they have been. It's been a mighty success.

Obviously, as the company gets larger, the growth rate probably has to diminish somewhat. However, I continue to think that they're going to grow and that angioplasty's going to grow. But they also have many new products that they're preparing to bring out. And they're very well managed. As a result, we're still hanging in there.

OID: Could you describe their business in a nutshell?

Perkins: It's balloon catheters. I guess you could say coronary angioplasty catheters.

OID: I'm not sure if I could say that. But I can say, "Susie sells seashells by the seashore".

Perkins: They're inserted into an artery that is blocked with plaque. And when it gets to the blockage, the balloon is expanded and opens it up.

OID: And the competitive situation?

Perkins: If SCIMED isn't number one, they're a very close number two to Lilly. And next would be Pfizer. Both have been involved in various lawsuits with SCIMED based on potential patent infringement.

OID: Couldn't those lawsuits account for the big drop in SCIMED's stock price?

Perkins: No, I don't think so. Those lawsuits have been settled. In fact, this past year a settlement was made with Lilly whereby SCIMED paid Lilly a substantial sum of money as well as an ongoing royalty.

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PERKINS CAPITAL MANAGEMENT'S
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OID: And you're convinced that the settlement doesn't have negative competitive implications?

Perkins: It did at the time. When the stock was $90 the first time around, the reason it dropped to the $45 level was because of the lawsuit. But a settlement was made last year — $28 million plus an additional $10 million licensing fee amortized over a five-year period.

The stock went back to $90. This settlement was very good for SCIMED because the product in question was their fastest growing product — a catheter called The Shadow.

OID: "The Shadow"!? Is it a catheter or a TV series?

Perkins: Believe it or not, that's what they call it. Now they can market it without any problem. So that should not be a problem with respect to the stock.

Quite frankly, I don't know why it went from $90 to $45 a second time other than weakness in the OTC market and perhaps a misjudgement on the part of some investors that this company and its procedures should be thrown into the pot with other medical companies that are going to be hurt by cost containment.

OID: SCIMED's earning heart stopping returns, even if it is trading at fairly high multiple of book.

Perkins: There's not much book value in things like SCIMED or St. Jude. They have tremendous margins. Their gross margins have continued to expand. Last year, they should have earned much more than $2.25. But they had the payment to Lilly which they expensed.

OID: What kind of earnings growth are you expecting from SCIMED over the next five to ten years?

Perkins: I think 30% is a very, very good number.

OID: It's certainly a very, very good number. In fact, it's one of our favorites. But is it what you expect in terms of earnings per share growth?

Perkins: I expect 30% per year for the next several years, at least.

OID: Where will their growth come from?

Perkins: Their growth is going to continue to come from taking market share from other companies, just as it has, as well as from new products. From a standing start in 1987 when they had a zero share, they've taken a substantial portion of the market. In large part, that has come out of the hide of competitors. And the market is growing somewhat.

OID: If your earnings growth guesstimate is even close, 13 times next year's estimate certainly isn't expensive.

Perkins: It certainly isn't.

MEDICAL GRAPHICS: 20% PER YEAR GROWTH — CONSERVATIVELY SPEAKING....

OID: Where else is a half-price sale in progress?

Perkins: Another one that recently had a 50% haircut is a company called Medical Graphics (MGCC). It had been as high as $18. In April, it fell to $8-1/2 and it's now $9.

OID: And your cost?

Perkins: We began buying it last year at $8 or $8-1/2. And I've paid as much as $14 or $15 for the stock. I suppose the average is somewhere above today's price.

This company makes equipment that is used to detect pulmonary problems and also potential cardiac problems. It analyzes your breath to determine whether or not you have any of these problems.

OID: Amazing.

Perkins: It has some very sophisticated software. And their equipment — they manufacture several different units — sells for up to $40 thousand each. Some of the smaller versions are being made for use right in doctors' offices.

This goes under the label of prevention. If problems can be detected early enough, something can often be done about them. And this is a totally non-invasive procedure.

OID: Tell us about the fundamentals, if there are any.

Perkins: This is a very small company with revenues around $20 million. It has very few shares outstanding — something on the order of 2.2 million. So even at today's $10 price, the stock is only selling at one times revenues, whereas SCIMED is selling at three or four times revenues and St. Jude is selling at five or six times revenue.

OID: Sounds very cheap and very promising. What can you tell us about management?

Perkins: I like the management. I don't know if you can compare them to management at St. Jude or SCIMED because they're much more seasoned. The founder and president of this company is a woman named Catherine Anderson. She's called Kye (rhymes with pie).

She developed this equipment while she was at the University of Minnesota and founded this company. She did have some other people managing it for awhile. Her board of directors told her that a founder/entrepreneur could never be successful bringing a company beyond $10 million in revenues. So she turned the reins over to other people several years ago. And they were not very successful.

So she returned onto the scene about three years ago. And since then, it's been a totally different story.

OID: And would you categorize it as a buy?

Perkins: Our feeling is that based on the potential this company has that it's selling at too low a price.

OID: Sounds like a yes to me.

Perkins: Incidentally, there is some big potential here, too, from something else. Infectious hepatitis, a new strain of tuberculosis and, very possibly, AIDS can be spread through a device such as this where you are breathing into the equipment. It's very possible for a bacteria or virus to escape from an earlier patient and infect a later one.

Therefore, they've invented a disposable mouthpiece for their equipment — it's called a Pneumotach — that eliminates the problem altogether.

In contrast, their competitors — and there are two

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other companies out there that do the same thing — do not have the luxury of having something like this. So I think this augurs very well for the future of Medical Graphics.

OID: In other words, they don't have an exclusive on the razor, but they do on the blade. It sounds exciting.

But if that's so, why is the stock so cheap?

Perkins: What happened was that a new piece of equipment that required FDA approval did not get it during the quarter in which it was supposed to come. And, therefore, the latest quarterly earnings didn't materialize. Earnings were 4¢ instead of the 7¢ some were expecting. Here's an excerpt from a Medical Graphics' press release:

"In late '91, we introduced our new disposable product line featuring the disposable Pneumotech. Sales in the U.S. were delayed pending FDA clearance. The company had filed with the FDA in early July '91 and expected to receive clearance in mid-February '92."

"But approval took nearly three times longer than usual due to the FDA's recently adopted cautious approach to new product review."

Revenues were pretty much in line with expectations — up 17%. But earnings were down. And, in fact, they were down because of costs associated with introducing two new products during the quarter.

In 1991, it earned 29¢ versus 16¢ in 1990. In 1992, it was expected to earn 45¢. Instead, it looks like Medical Graphics will earn 40¢. So that's what happened. As you said, the market doesn't take any prisoners.

I happen to think it doesn't make any difference in Medical Graphics' future. This disposable Pneumotach has the potential of giving leadership to this company because their competitors don't have such an item. Nor are they likely to be able to get around Medical Graphics' patents. So I think it's a very exciting story.

And the market's decided that Medical Graphics' stock should take a 50% haircut because of a 10% downward revision in this year's earnings.

OID: Is there substantial management ownership here?

Perkins: Yes, there is. Kye Anderson and her husband own 15% of the company.

Incidentally, an aspect of this company that I find interesting is that the founder of Medtronic, Earl Bakken, is on Medical Graphics' board. And Kye Anderson always talks about how important his contributions are to board meetings and strategy.

OID: Guesstimating earnings for a company like this is hard enough, much less earnings growth. But what does your crystal ball say here?

Perkins: The growth rate here is not, nor has it been, as high as SCIMED. But 20% per annum is what I think we should be seeing here — and I think very steadily.

Now that doesn't include any contribution from this new disposable device. I don't know how to evaluate how much might be added because of it. That's very difficult to quantify. How well are their competitors who don't have it going to do? That's going to be the difference, I think.

Incidentally, revenues in 1991 were up 19.7%. And revenues for 1992 are estimated to be up 20%. So I think you'll be able to look for a 20% growth rate in this company — to which you can add whatever benefits there are going to be from this new disposable device. I'm very optimistic about it.

OID: Could you roughly bracket what that contribution might be — order of magnitude or whatever?

Perkins: That is very difficult because it's new. But I expect the real benefit to be an edge in the sale of equipment, although sales of the disposable mouthpiece will also be beneficial.

OID: At this year's Berkshire Hathaway annual meeting, Buffett observed how growth isn't necessarily positive — that it hasn't made airline shareholders rich, for example. How high should the returns be in this business?

Perkins: Not as high as a SCIMED or a St. Jude because Medical Graphics is selling a piece of hardware — a piece of equipment that goes into a hospital, clinic or doctor's office. So you will not see margins nearly as high as you will on a catheter used in a medical procedure, or a heart valve. And I think you'll find that to be the case in medical equipment companies generally.

CRAY COMPUTER HAS NO CUSTOMERS, BUT IT HAS SOMETHING BETTER: SEYMOUR CRAY.

OID: Last time, you told us about Cray Computer (CRAY) and we edited it out because we felt it wasn't cheap enough. I understand it's come way down lately. What's your latest thinking there?

Perkins: Cray Computer was spun off from its parent, Cray Research, in July 1989 so Seymour Cray, who is considered by many as the father of supercomputing, could continue design and development work on his current new project — the Cray 3 which is the first super computer based on gallium arsenide circuit technology.

We had a round trip in Cray Computer. We bought it at $4-1/2 to $5-1/2 and watched it run up to $19-5/8. What caused the runup, I think, was research comparing Cray Computer to Cray Research at similar stages in the firms' histories. And it surprised me as much as anyone.

And then the one contract that Cray Computer had was canceled because they were running behind schedule. Incidentally, they were running behind not only on their software development, but also on some of their hardware. So the customer canceled its contract with Cray Computer and went to Cray Research instead of waiting around for Seymour Cray to solve his problems.

OID: So Cray Computer lost 100% of its business.

Perkins: That's right. And Cray Computer's stock went below the $5 level. It went as low as $2-7/8 — call it $3. And it's $3-3/8 to $3-5/8 today — which is very near its lows.

OID: Is it a bargain?

Perkins: We've been buying some Cray here. And we've been adding to our positions in some accounts.

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(cont'd from preceding page)

OID: What's your investment rationale?

Perkins: I have no reason to do it other than the fact that I'm making a bet on Seymour Cray and his gallium arsenide technology. In my opinion, there is no other Seymour Cray. He's been successful on two prior occasions.

OID: Twice? Where else was he successful besides Cray Research?

Perkins: He was the architect of the very large computer that Control Data ultimately scrapped. In fact, Seymour worked for ERA Associates which was merged into Sperry. In 1955 or 1956, Bill Norris and Frank Mullaney left Sperry to start Control Data. Six months later, Cray left Sperry and joined them. He's been in the computer business in Minneapolis all his life.

OID: Incidentally, I believe that Tom Watson observed that Sperry could have prevented IBM from becoming the industry leader if they'd kept their eye on the ball.

Perkins: Interesting. Cray didn't like the bureacracy at Control Data and left to form Cray Research. But he was the architect of much of Control Data's computer success while he was there and then again at Cray Research. Now he's doing the same thing at Cray Computer.

I'm also betting on the technology — gallium arsenide technology rather than silicon. Of course, that's what's made it so difficult — making gallium arsenide chips and getting enough of a yield from each batch.

Gallium arsenide technology is very tricky. But when it's perfected, it should make supercomputers much more efficient and allow them to be much smaller. I'm also told that this gallium arsenide technology can be used in a variety of other ways or licensed to others.

So I think that's a large part of the equation as well.

OID: They'll have some valuable patents in the area?

Perkins: I don't think so, but they'll have some proprietary technologies.

OID: What are the biggest negatives?

Perkins: The company has announced that they have sufficient funds to carry them at their present rate for about a year and that they expect to get additional clients...

(continued in next column)

OID: Always a plus.

Perkins: And the company's also announced that they've almost succeeded in solving the remaining problems — which, incidentally, has been confirmed by an analyst who follows this company very closely.

OID: Sounds risky all right — in a very tough business without any customers. And when Cray succeeded the other times, wasn't there a great deal less competition than there is today?

Perkins: No question about it. There's a great deal more competition today — including competition from what's called massively parallel computers.

OID: Which means that instead of using one or a few super fast chips, that many, many chips are used to accomplish super fast processing.

Perkins: That's right.

OID: How many shares does Cray Computer have outstanding?

Perkins: Cray Computer has approximately 25 million shares outstanding.

OID: Or roughly $85 million in equity capitalization.

Perkins: That's right. What's it worth? I don't know. Will Seymour Cray be able to pull the fat out of the fire this time? I don't know. But I think he'll succeed.

A CLOSE-OUT WHOLESALER/RETAILER
AT A CLOSEOUT PRICE....

OID: Any other half-price bargains for us?

Perkins: I told you about Universal International (UNIV) in our last interview. And I think that it's very definitely a buy.

OID: You don't have to hedge with us.

Perkins: Universal International started life as a wholesaler of close-out merchandise to stores. And that's what they did for many years. However, about a year ago, they decided to get into the retail store business as well. They figured that after all they had the merchandise and they felt like they knew the business, so why not do both.

Universal International's first public offering was at $5. They did another one at $10, I believe, and some additional shares at $12-5/8. And the stock went to $20. So we've had a round trip here as well because it's back at $5-1/2.

And here there was a very good reason for the decline.

OID: Don't look at me....

Perkins: What happened is that the earnings shortfall was significant. They opened six new pilot stores. And they simply didn't live up to expectations. And the reason is that they were simply not merchandised correctly.

They've come up with a new merchandising approach. I've been in their pilot stores and in one of their new ones. And I think it makes a great difference. I believe that the new merchandising approach will enable them to live up to our original expectations and to their original promise.

They've scaled back the number of stores that they're

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PERKINS CAPITAL MANAGEMENT'S
RICHARD PERKINS
(cont'd from preceding page)

going to open this year. At the annual meeting this year, they announced that instead of opening thirty new stores this year, they're probably going to open about twenty.

There are several reasons why. First, they're going to stay more in the upper Midwest closer to home until they're further up the learning curve. Second, they think that they need to retrofit the six or seven prototype stores to the new merchandising format and to make sure that the new format is what they believe it to be.

OID: In effect, work the bugs out.

Perkins: That's right.

OID: Tell us about the new format.

Perkins: They've implemented the new format in two stores. I went to one in Rochester — down in southern Minnesota. And I talked to the manager there and to some of the other people in the store. It turns out that in their third week of operation, they were doing more business in a smaller store than any of the other six prototype stores.

OID: Certainly encouraging.

Perkins: I think that's going to make the difference. But management wants to make sure. So they've reduced the number of new store openings from thirty to twenty.

OID: Sounds prudent.

Perkins: It's prudent, but that in turn has caused us to reduce our earnings estimate.

OID: This one has earnings?

Perkins: Universal International earned about 55¢ last year. And while there was some dilution involved, we thought they could earn something over $1.00 this year. But it looks now like 1992 is likely to be below 1991. Earnings could turn out to be around 40¢.

But they could double from there in 1993 to 80¢ — really anywhere from 75¢ to $1.00.

OID: So that Universal International is selling at only 7-1/2 times the low end of your estimate for next year?

Perkins: That's right.

OID: What are your expectations for earnings growth?

Perkins: We had thought that this company could grow at 40% a year until they get to 100 to 150 stores. And we still do.

I think their stock price will move back up as well. However, because it came down so much, I think it's difficult for the stock to move above $10 to $12 over the near term — the reason being that we had two offerings at that level.

OID: And may I ask your cost?

Perkins: Most of what we own cost us around $5. Then we bought a few shares around $7 and a few more shares for some new accounts at $12.

OID: It sounds highly unpredictable.

Perkins: Yes, it is. But I haven't lost any faith at all in this concept. If anyone can pull off a large number of stores in the close-out merchandise area, it's these guys — because they're wholesalers in that area in the first place.

OID: Some would suggest that being wholesalers would make it less likely for them to succeed in retail — having two balls in the air, conflicts and so on.

Perkins: I don't think so.

None of the other close-out stores are quite like these. They have ten different price points in the merchandise — $1, $2, $3, $4 and so on up to $10. So what they've done instead of having all of these different price points of merchandise scattered throughout a store, they've organized it by price — according to aisle or side of the aisle, etc. They've segregated the merchandise by price point.

OID: Is that really what customers want?

Perkins: It made a great deal of sense to me. And, more importantly, the people in the store said it made sense to the customers — that some people come into the store looking for the $1 and $2 items. They want to buy a bottle of shampoo that would be $5 at another store. And they know that it's going to be $2 there.

OID: Heaven help them if it's on special.

Perkins: We bought some cameras — Concord automatic focus, 35 millimeter camera with batteries and a roll of film for $10.

OID: To hell with stocks. How do we get the cameras?

Perkins: Exactly. That camera sold regularly for $40. And, in fact, we saw the camera advertised at another store for $29.95. It's just a slightly newer version. This was the closeout of the prior version. Again, it was only $10. So we bought four of them.

I went down just to look at the store and I walked out with a bill for $79.

DELIVERY SYSTEMS FOR
THE MAGIC BULLET....

OID: Any others?

Perkins: In some of our portfolios, we own a company called Lifecore Biomedical (LCBM). And Lifecore makes something called sodium hyaluronate — commonly called HA or HY — which they make through a fermentation process.

Because of our knowledge of Lifecore, we learned about a company in Toronto called Hyal Pharmaceutical that's been using this product in the treatment of pain and in the treatment of cancer with some very interesting success.

OID: Have they tried it on acne?

Perkins: It's just possible that this product — also called hyaluronic acid — is the magic bullet that medical science has been seeking for many years.

It's a component in quite large quantities in our joints and elsewhere. It's a moisturizer. What evidently happens when you have an illness is that the HA in that area is depleted. And when you introduce synthetic HA into the body and include with it some drugs — either pain drugs or

PERKINS CAPITAL MANAGEMENT'S
RICHARD PERKINS
(cont'd from preceding page)

chemicals for cancer treatment — the HA and the drugs combined with it automatically go to the site of depletion. It's as though it's targeted to go where it's needed.

OID: Wow.

Perkins: It's really quite exciting — and something that could very well be a big, big, big thing.

So this little company up in Canada with very modest revenues has been spending, we understand, a lot of money getting worldwide patents on the technology of combining various drugs — be it pain killers, cancer treatment drugs or whatever — with HA to make what amounts to a new drug. And patents are being granted to the company one by one. It could be very interesting.

OID: What can you tell us about management?

Perkins: I've met the management of this company. The president used to work with one of the leading U.S. pharmaceutical companies. And I like him. I don't know him that well, but he had very good experience in the American pharmaceuticals business and wound up going to this company and getting some ownership. And he's very optimistic about what he has.

But the problem is he's up there and we're down here. If they were located here, I could go talk to people who know management and find out a lot of things. It's not so easy with something like this. So it has to go into the category of being much more of a speculation.

But it embodies some of the things we're looking for. We're always trying to identify some large change that could be taking place. If they're able to secure these patents, then they could have something that could be very big. So we've taken a bit of a flier on it in some accounts.

I'm told that the company's going to be listed on NASDAQ here relatively soon. I think that there are about 10 million shares outstanding. There will be more. They're just now completing a private placement of about $12 million with Canadian financial institutions that will result in more shares outstanding when it's done.

OID: And the stock price?

Perkins: It's about $6 Canadian. And I imagine that the offering will be done at some lower price. After it's done, there'll probably be at least 15 million shares outstanding — which is a fairly large number of shares.

OID: Here's another tough one to predict. But what do you see in this company's future?

Perkins: Their future lies in getting these patent positions and then going to major pharmaceutical companies and licensing their technology and their patents. It's probably a lot of years away. They're doing some human clinical trials in Europe right now. I think that they'll continue to do that.

And my guess is that it would cost too much money for a little company like this to try to do it on its own. But I think it could be very, very exciting. So we've taken a little position in this thing.

OID: And reading between the lines, I gather that you think it could be a fairly significant thing.

Perkins: Oh, I think it could be immense — just absolutely immense. A friend of mine who's a president of a local medical company says that he thinks that it could be the magic bullet that medical science has been seeking for umpteen years — because it automatically goes to the site of the problem.

There could be applications in the treatment of cancer, the treatment of pain and many other infectious diseases. When you get an anti-biotic currently, you either take it orally or you take a shot. But it goes throughout the body, not just to the infection.

OID: Imagine how wonderful it would be if it could be used in chemotherapy.

Perkins: That's what they're doing. There's a clinic in Toronto that uses it to administer cancer treating drugs. I haven't seen the studies, but I'm told that they are prolonging lives of people who are terminally ill and who should have been dead. They haven't eliminated cancer, but they've effectively treated it.

I'm also told that they've produced a topical formulation to treat skin cancer — basal cell carcinoma. And they've done a pilot study with fifty individuals and had a 100% cure rate. That's in the annual report, as well as other information about what they're doing.

OID: If all of that's the case, why do they have only about $80 million of equity capitalization?

Perkins: Many people have negative associations with Canadian stocks. I would feel much more comfortable if it were listed on NASDAQ. That would add a level of scrutiny.

OID: May I ask your cost?

Perkins: We've paid anywhere from $3-1/2 to $6-1/2 in U.S. dollars. And the Canadian dollar is around 87¢ or 88¢ U.S.

I think it's currently around $5 U.S. It's come down. It was up around $8 Canadian.

THE GREATEST POTENTIAL
OF ANY COMPANY I'VE EVER SEEN....

OID: Are there any more where those came from?

Perkins: Another stock that's taken a big hit that we like a lot is Education Alternatives (EAIN). It's selling at $8 — down from a high of $14. And it shouldn't have been selling at $14. That I'm freely willing to admit.

But here is one of the most interesting companies that I've run across in years.

OID: What an introduction. Educate us, please.

Perkins: I don't know if the company is going to be successful or not. But I believe that it has the greatest amount of potential of any company that I have probably ever seen.

OID: Coming from you, that's an extraordinary statement.

Perkins: I've owned a lot of companies. But the change that we see here is in the education industry.

(continued on next page)

PERKINS CAPITAL MANAGEMENT'S
RICHARD PERKINS
(cont'd from preceding page)

Education has gone downhill mightily in the U.S.

OID: Despite the fact that — as I understand it — expenditures on education have doubled or tripled in real terms over the last few decades.

Perkins: That's correct. And even President Bush has pledged to do something about education in America.

OID: That's certainly reassuring....

Perkins: And yet no one knows what to do or how to go about it.

OID: Is it knowing what to do or the will to do it? I'm told that most Americans at all socioeconomic levels favor choice and/or vouchers, but that teachers' unions and the politicians they finance don't.

Perkins: Everything that you say is absolutely true. But change is inevitable. It is going to happen.

OID: People are certainly fed up with politics as usual.

Perkins: Exactly. And I believe once this company gets a couple more contracts that things will fall into place.

There are approximately twenty-five different school districts where Education Alternatives has made presentations and is being considered in one form or another to manage anywhere from one to many schools.

This little company is located in Minneapolis. And it's president, John Golle, had a very successful business in Minneapolis called Golle and Holmes. These two men built a business in corporate education selling training services.

Then, Golle became frustrated with how his child was being educated in the public school system.

OID: Not exactly an unusual sentiment.

Perkins: No kidding. So he went out and founded Education Alternatives.

OID: Better to light a candle than curse the bureacracy.

Perkins: You've got it. Golle owns 763 thousand shares personally. And he hired David Bennett — who was superintendent of schools in St. Paul for a number of years — to be President.

THEIR MOST VALUABLE ASSET: THE TESSERACT APPROACH.

OID: The people side sounds good. What about the educational product?

Perkins: It's terrific. Educational Alternatives has a proprietary educational product called the Tesseract Way. And at the moment, they actually manage three schools — two of which are private and one of which is public. Of the two private schools, one is here in a suburb of Minneapolis and one is in Arizona.

And the public one is in Miami Beach in Dade County. He has a five-year contract to manage that elementary school using this system. And it has been successful — although the company is not making money on these contracts.

OID: I can certainly relate.

Perkins: But they claim that by using this system, they can produce significant academic gains. For example, in two of the schools where they've been measuring it, they claim that their students advance 1.7 grade levels per year.

OID: Wow. How far back can they go to demonstrate the results of their educational approach?

Perkins: I believe it goes back about four years.

OID: That sounds like a big advantage and, potentially, a very valuable asset.

Perkins: I think so — especially considering all of the positive publicity they've gotten from it. And it *does* work.

I've been to their school in Miami Beach. It's enough to make you cry. It's a public school called South Pointe Elementary. It's got a mixture of kids — all races, creeds and colors. They've come from all over into Miami Beach. And it had always been a problem. But no more....

The Tesseract Way is so different. There's a teacher plus an assistant, but it's an open form of learning where all the children are always participating. It isn't like a traditional school.

When I go to see my grandchildren at the local school, it's just like the school we always had. We sat at a desk, there was a blackboard and the teacher lectured in front.

Here there aren't any desks — at all.

OID: So that's how they save money....

Perkins: They sit around tables and interact with each other all day long on whatever project's being worked on. The only desks used are the ones the computers are on.

It's just amazing to see it work, to talk with the teachers and to see the progress that the kids are making. And other people who've been there say the same thing.

OID: Whether they own stock or not, I presume.

Perkins: Last year, I visited the Tesseract school in Egan, Minnesota. And I was given a letter while I was out there from one of their students. And it was so amazing what this 9-year old girl had written about the stock market that I included it with my letter to clients.

OID: It was a wonderful letter. That 9-year old displayed a far greater understanding of investing than most financial journalists — although I'm not sure how much of a compliment that is....

Perkins: So anyway, they've achieved tremendous success with the Tesseract System. And they think that similar results can be achieved elsewhere without spending the kind of money that's being spent in public schools.

OID: If they ever get the chance, of course.

Perkins: And that's the question. Incidentally, Golle has two joint venture partners — Peat Marwick and Johnson Controls. Peat Marwick has a significant presence in schools throughout the country — more than any other accounting firm — doing the number crunching for schools. And Johnson Controls has a very significant building maintenance business — managing janitorial services.

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PERKINS CAPITAL MANAGEMENT'S
RICHARD PERKINS
(cont'd from preceding page)

They formed an alliance called Schools that Work. Peat Marwick will handle the numbers and provide the information systems and software. And Johnson Controls will provide the janitorial services and so forth.

Education Alternatives has had the opportunity to negotiate with a large number of school districts. And the only contract that they've gotten was in Duluth, Minnesota, where they were paid a very small sum of money to manage the schools and to find a new school superintendent.

They've come close in a couple of other places — one of them being Greenbrook Township, New Jersey, where it was put on the ballot and voted down. By that, I mean that when they voted for school board members, everyone knew where each candidate stood.

And the candidates who would have given the contract to Education Alternatives were not elected. Therefore, they didn't get the contract.

OID: I'm surprised.

Perkins: However, they're dealing with schools in numerous other places including California, Kentucky and Florida. The Florida Commissioner of Education has encouraged school districts in Florida to consider Education Alternatives based on the progress that's been made at that school in Miami Beach.

I really don't know if it's going to work or not. But I believe that the potential here is so great that revenues could go from nothing to several hundred million dollars and way beyond that in a very short period of time once the contracts start to come.

OID: And talk about the potential for incredible good — aside from our freedom, what could be more important than the education of our children?

Perkins: As John Golle says, he hopes to do well by doing good.

I believe that there's a change that's going to take place in the education industry. It *has* to take place. It *will* happen. It's only a question of when and what magnitude and who will benefit.

I believe that this company has the opportunity to benefit handsomely by fulfilling a critical need. As a result, I've taken a major position in this stock.

HOPING FOR 20% PRETAX MARGINS.
BUT SO WHAT IF THEY'RE 10%...

OID: Might I ask your cost?

Perkins: It came public at \$4. But we bought stock at \$5 after the IPO. And we bought stock at \$3. I suppose our average cost is somewhere in the \$4 to \$5 range.

Then, some other people heard of it. It was written up in *Forbes*. And then the stock — having gotten the attention of some people — moved to a high of \$14. And who's to say that it isn't worth \$14. I don't know.

OID: What's the current stock price?

Perkins: It's \$7-1/2 to \$8. During April, it was as low as \$6. There are 3-1/2 million shares outstanding, maybe even a little less. And if you took a stock price of \$14 times 3-1/2 million shares, that's a \$50 million market cap.

I can show you many biotech companies with no earnings, where they're selling based on the potential down the road where the market caps are \$100 to \$150 million.

OID: No thank you.

Perkins: They literally have no revenues or earnings. We see them all of the time.

So who's to say that a company like this shouldn't sell at a higher market cap even without earnings?

OID: A negative capitalization? Speaking of which, how well capitalized are they?

Perkins: Probably not terribly well. In fact, they have been in registration for about six weeks to raise some additional money — maybe something on the order of \$5 to \$8 million.

But they're dragging their feet a little bit on it. There are reportedly some private companies that want to put money into this company. And they're apparently debating whether they want to stay independent and raise money via the usual route of a public offering or take some of this other money that's being made available to them.

OID: There are how many shares in registration?

Perkins: About a million shares. But there's usually a green shoe of 15%, or another 150 thousand shares. And there are probably some options and what not. So after the offering, figure a total of about five million shares.

OID: Can you tell us anything about its fundamentals?

Perkins: They're usually paid under a contract — like the one in Florida — that pays them a certain number of dollars per year per student. They're essentially being paid to manage the educational process including teachers and everyone else — the whole thing.

They claim that they can do this and do it efficiently. If you take, for example, a school where the annual cost per student is let's say \$5,000, they run the school for no more than is being spent now and believe that they can turn out a better educated student and make money besides.

OID: What kind of margins and returns do you expect this business to generate?

Perkins: John Golle says that he believes that they can ultimately achieve 20% pretax margins. It remains to be seen because he doesn't presently have any large contracts. So there is an open question about whether he can reduce the waste enough and redirect the dollars being spent and still leave room for that kind of profit.

But if they only earn 10%, what's wrong with that — if you're looking at hundreds of millions of dollars of revenue?

OID: And there's not a great deal of capital required, is there?

Perkins: No. In fact, the only capital requirement really is for what's happening right now — namely funding their efforts to get new business. Once it's obtained, they receive progress payments. So there really isn't even a need for working capital.

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PERKINS CAPITAL MANAGEMENT'S
RICHARD PERKINS
(cont'd from preceding page)

OID: And that would end the dilution of having to issue more shares to pay for the sales force.

Perkins: Exactly.

OID: And it sounds like the Tesseract Way name could be a very valuable asset for purposes of marketing.

Perkins: The name Tesseract comes from a children's book by Madeleine L'Engle and denotes a fifth-dimension corridor for traveling to new worlds. In other words, it reflects the approach they're taking in education.

OID: But might not profit be a dirty word because of the nature of the beast no matter how much good they do?

Perkins: I don't think there's any question about that. But look at the profit margins that St. Jude Medical has on heart valves. And the same thing goes for drugs. And those two are both under government and public scrutiny.

OID: Not as much as they're going to be....

Perkins: But we will have to pay a price to have our children properly educated.

OID: What about the competitive situation — especially from Whittle Communications?

Perkins: What Whittle wants to do is to build schools. He wants to do the bricks and mortar and the whole thing.

OID: Sounds like a tough road.

Perkins: I really question it.

OID: Is there any serious competition aside from Whittle?

Perkins: I don't know of *any* other than Whittle. And again, Whittle's a different kind of thing.

NOT FOR THE FAINT OF HEART
— BUT NO GUTS, NO GLORY.

OID: Are there any risks we haven't mentioned? Obviously, this is a crapshoot — especially given the hurdles they have to overcome.

Perkins: This company needs to get a major contract from someplace. That's the major risk — that they keep working at it and working at it, but aren't able to overcome the hurdle of the unions and the objections that come from fears about losing jobs.

In reality, teachers shouldn't be fearful of losing jobs because the company isn't going to import new teachers. That's what they're afraid of, but that isn't the case.

OID: And talk about having the political deck stacked against you...

Perkins: That's right. On the other hand, there are many school districts in the U.S. that are just plain broke. In California and Kentucky, for example, there are some school districts that may just have to be shut down.

OID: In other words, desperate.

Perkins: You've got it. The only direction they can go is to some outside help — someone like this company. I don't think they have any alternative.

OID: What do you think the odds are that they manage to pull it off?

Perkins: I guess if you ask enough girls to give you a kiss, one of them's going to.

OID: I've always heard that, but whenever I...

Perkins: If you make presentations to enough school districts and other entities, you're going to get a contract. And again, I understand that Education Alternatives is being seriously considered for a contract to manage one or more schools in excess of 25 places — from one school to an entire district.

In fact, it's been suggested to me by someone outside the company that one of the potential contracts could be in excess of $100 million. Others would be, I'm sure, much, much smaller than that.

So ultimately I believe it's going to happen. Once a single district or even a single school is signed up, then the ice will have been broken. And it will be much, much easier for them to receive additional contracts.

So I think that's the whole key.

[Editor's note: Subsequent to our interview, Perkins informed us that Education Alternatives reported receiving a letter of intent to manage nine schools in Baltimore.]

OID: It sounds fascinating — and very risky.

Perkins: In trying to find opportunity, sometimes — oftentimes really — you have to identify a concept or identify change early and place a bet. Perhaps when you make it, it may even be looked at as a gamble. But if you do that enough times, you're going to wind up with some SCIMEDs and some St. Judes.

I can remember when I bought St. Jude, they were literally out of business. They were down to only a few sizes of heart valves because they were having this big fight with Intermedics. A new man came in who thought that he could solve the problems and he did. But it was a big bet.

We've taken one on Education Alternatives based on this concept of change that we see. Hopefully, it'll work.

OID: Hopefully for you and hopefully for society.

Perkins: It's something that is bound to happen. There's a huge amount of change here waiting to take place. And I want to be there to participate in it.

OID: Keep us posted.
Thank you, Mr. Perkins.

—OID

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Conversation with OID — June 1992

WARREN E. BUFFETT, BERKSHIRE HATHAWAY

"When I got out of Columbia, the two people I respected most in the world — my dad and Ben Graham — both generally encouraged me about eventually going into the securities business. But they both thought it was a terrible time because the Dow had risen above 200. And there had never been a year in history when the Dow had not at some point sold below 200. And both of them thought it might be a good idea to wait."

"I had about $10,000 then. And if I'd waited, I'd probably still have about $10,000...."

Comments to Berkshire Hathaway shareholders — April 27, 1992

CHARLIE MUNGER, WESCO FINANCIAL

"At the Berkshire annual meeting, I said that the last 12 years had been sort of a hog heaven period for investors. By their nature ... property casualty companies are big investors. And that's cured a lot of troubles in casualty insurance."

"But if, in the future, casualty insurers have way worse investment results — which I consider to be almost certain — then I think that there will be substantial strains."

Comments to Wesco shareholders — May 12, 1992

Dear Subscriber,

You can live a full, fruitful life without ever thinking about timing issues. In fact, you're no doubt far more likely to do so without thinking about what many would consider the unknowable.

As Charlie Munger observed at this year's annual meeting of Berkshire Hathaway shareholders, "We're predicting how certain people and companies will swim against the current, not fluctuations in the current."

Labrador Partners' Steve Farley and Perkins Capital Mgm't's Dick Perkins present a strong case for such beasts at bargain prices in the small cap area. And we're pleased to report again that this issue contains more than its share of them (interviews with Farley and Perkins begin on pg. 1).

However, your editor is struck by the stark contrast between sentiment and valuation. On the valuation side, Bill Ruane, Steve Farley and others point out that stocks appear near their historical highs by several benchmarks — e.g., dividend yields, P/E ratios and price-to-book ratios. (That's bad.)

On the other hand, John Templeton and others observe that sentiment remains very negative. (That's good.)

Conveniently, some of you asked us to call Wally Gaye to learn his latest thoughts — especially with respect to whether he was hedging with put options. So we did.

For a long list of reasons — involving sentiment and contrary opinion — he's not. As Gaye explained to us, "Everyone knows the market's overvalued. Therefore, it can't be useful information." He believes that we're very unlikely to see a major correction until few worry about it.

While we've generally endeavored to ignore sentiment, our impression is that Gaye's assessments have been remarkably accurate. And while your editor's opinion has probably been far more valuable as a contrary indicator than anything else in the past, we suspect he's right.

That said, another classic line at this year's Berkshire meeting was Buffett's: "You can always sit down and list a hundred favorable or unfavorable factors affecting the economy or the stock market. The weight you put on any particular one and whether you place it on one side of the ledger or the other may reflect what you ate for breakfast that morning, your political views or a host of other things. We've just never found it useful to think in those terms."

Needless to say, they're rich and I'm not.

Until next issue,

Henry J. Emerson

Your Editor

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