

CONTENTS

Two ways
to look at risk

Verifone's risk list

Gentex: a one-
product wonder?

Innovators
in the Internet
marketplace

Rockefeller and
Gates: Déjà vu?

Humor by
Mankoff

▲
*You can find us
on the Web at
www.wpam.com*

Telephone:
317-228-0800

Toll-free:
888-868-3855

Fax:
317-334-1795

e-mail:
thotfull@in.net

Taking A Look At Risk Systems

Risk is a joy of life. Risk stimulates and emboldens. It encourages adventure and advancement. Risk is a universal ether through which we travel and commit our energy and our capital.

Financial theorists assume two forms of risk: systematic and unsystematic. Systematic risk is the inescapable uncertainty of an entire system. In this sense, our neighborhoods are "systems," locations that provide an essence of life while inextricably exposed to vagaries of weather, communicable disease, failure of utility services, crime, flood, or even war and civil strife. We accept these risks without thought because we love our neighborhoods. We immensely enjoy conversations with our neighbors about the risks that we have assumed. You can hear those conversations: "Remember the blizzard of '78. . ." "Did you notice that Sam did not pay his neighborhood assessment . . ." "Did you hear that Jody's daughter has Lyme disease . . ." "What are we going to do about our sidewalks . . ." "I think that the stock market will . . ." Without common risks, cocktail party banter would be limited to . . . to . . . , well, to what?

Unsystematic risk is more specific, more subject to individual discretion. While we must assume risks inherent to our neighborhoods, only a few assume risks of roller blading, painting a home, cutting down a tree, or acquiring a volatile stock. Unsystematic risk is assumed by personal choice.

World financial markets are a system. No matter who we are, what we do, or how we act, no person can escape the indefiniteness of the financial system because even the most certain outcome

might change or disappear in unusual conditions, such as inflation, political turmoil and unexpected personal need. However, we can choose to incur, or not to incur, unsystematic risks. We, individually, can decide whether to roller blade, to sail, or to buy a stock, and we can control the degree of unsystematic risk assumed. We can ameliorate risk by traveling slowly on those roller blades, sailing conservatively, and by diversifying among investment securities. Here's why.

*"Risk is a
good subject for
cocktail party
banter."*

One stock is one unit of unsystematic risk in the system called a stock market. That stock has unique risks and opportunities *in addition to* risks and opportunities of the entire stock market. General personal risk becomes more like systematic stock market risk when you acquire two stocks, or three stocks. In fact, the more securities you acquire, the more the magnitude of the investment risk you have taken on approaches the risk of the market itself. If an investor acquires every stock in the stock market, he/she no longer owns unsystematic risk. Instead, he/she owns only systematic risk, which are the uncertainties—and opportunities—of the entire system.

— continued on page 2

Taking a Look at Risk Systems

— *Con't. from page 1*

"I've had enough," you say. "Too much theory. Not enough practical stuff." OK. Let's move on. Stories in this issue present specific opportunities, and risks, that challenge and excite. From the past, we look at a short history of **Verifone**, the credit card verification company that had the gumption to list the risks of its business in its 1996 annual report. Then we look forward.

We study **Gentex**, inventor and manufacturer of the automatic-dimming rear view mirror. Finally, we present **Cyber-Cash** and **Amazon.com**, two innovators on the Internet. WP&M, its clients or principals, own these companies. We like them, but we understand the risks. Our goal in this issue is to consider the risks, to describe potential rewards of incurring those risks, and to suggest that innovative companies deserve our attention because they give us valuable products and services that make life stimulating. These companies are good subjects for cocktail party banter; they give us additional reasons to live and to learn. ■

Thoughtful Wealth Planning&Management

is published six times per year by Wealth Planning&Management, LLC. All rights reserved. Reproduction in whole or in part is strictly forbidden. News services may quote from this periodical with proper attribution. A one-year subscription is \$110. Mail checks to Thoughtful Wealth Planning&Management, P.O. Box 40994, Indianapolis, Indiana, 46240-0994. New subscribers will receive the most recent issue plus the next six issues. Single-issue price is \$25. This issue was completed November 21, 1997 with the DJIA at 7881.07. The S&P 500 was 963.09.

Publisher: John W. Guy
 Editor: Lois Sherman
 Design: The Art Room

Verifone Is Up-Front About Risk

VERIFONE provides hardware and software systems that enable secure electronic payment among consumers, merchants and financial institutions." These words describe an essential service, like electricity, or telephone. Credit and debit card use is so routine that our society no longer can function without instant verification that payment will be made.

Verifone, now a division of Hewlett-Packard, was a pioneer. It manufactures the small boxes through which cards are passed to determine electronically if the card is valid. Competition abounds, especially from cash register manufacturers, but Verifone has a management style that keeps it ahead of the game. Every Verifone executive carries a laptop computer—at all times, in any part of the world. The executive must check for e-mail several times a day. This management culture facilitates rapid development of business proposals. An executive in one part of the world can start a proposal and then send it electronically to another so that someone is working to advance the proposal 24 hours a day.

Verifone listed risks of its business in its 1996 annual report. A positive effect of this published list must have been to motivate employees, for no one reads an annual report more closely than employee-shareholders. Hence, every employee can act and plan to avoid listed risks. The list was titled "Factors

That May Affect Future Results and the Market Price of The Company's Stock:"

■ "Variations in quarterly results," the risk that the stock price might decline if a quarterly earnings report is down. Since Verifone operates without a significant backlog of orders, current earnings are unusually dependent on new orders.

■ "Changes in gross margins," caused by price competition and by increasing volume of government-related orders that result in lower margins.

■ "New markets and products." Verifone was attempting to participate in the

growing number of transactions on the Internet, but could not promise that its vision and technology will win over other technologies and competitors.

■ "Growth Dependencies," the requirement to keep up, to put capital into research.

■ Other risks listed were "Acquisitions, International Operations, Competition, Third-party distributors, Sole Suppliers, Excess or Obsolete Inventory, Security Features of Products, Proprietary Technology, Hiring and Retention of Employees, Regulatory Requirements, and Stock Market Fluctuations."

While most risks listed are normal, Verifone added a unique uncertainty: "Seismic Risks," the possibility that its manufacturing, administrative and sales

— *continued on page 5*

"Verifone manufactures the small boxes used to determine whether a credit or debit card is valid."

"Verifone's earnings are unusually dependent on new orders."

Two Innovators See Opportunities in Internet Commerce

CYBERCASH AND AMAZON.COM are Internet innovators. They both believe that Internet commerce will grow spectacularly.

CyberCash, Inc. provides secure Internet payment services that permit a consumer to send encrypted credit card information with an order. The merchant processes the order and passes the still-coded payment information to CyberCash which decodes the information, sends it to the bank or credit card company and then informs the merchant and the consumer whether the transaction has been approved. The company also created and operates "CyberCoin" for transactions between 25 cents and \$10, a previously excluded price level because revenues did not cover transaction costs. CyberCash was founded in 1994 by Bill Melton, who also was a founder of Verifone and Transaction Network. In 1997, CyberCash made a number of strategic moves:

- It created an alliance with Coopers & Lybrand to provide PayNow Secure Electronic Check Services.
- It increased merchant affiliations from 530 in the first quarter to over 1,100 at the end of the second quarter.
- It introduced payment components for Microsoft's Internet commerce software.
- It integrated payment solutions with Netscape Publishing System and Oracle Internet Commerce Server.
- It created joint ventures in Japan and Germany.

But this is a fledgling business, and has all the risks of the new and untried. For the first nine months of 1997, revenues were only \$2,481,999. Yet this was an increase from only \$76,793 the year before. The reported loss for the

"This is a fledgling business with all the risks of the new and untried."

first nine months was \$21,090,182, and few expect profits before 1999.

Amazon.com also is a new business. It went public in May, 1997, and has traded wildly ever since. It is the leading book seller on the Net with more than 2.5 million available titles, a list which, if printed, would be the size of almost a dozen New York City telephone books. My personal experience confirms the company's statement that most books are delivered within two or three days. The personal

— continued on page 5

Gentex: One Product; 90 Percent Market Share

GENTEX has an important product: the automatically dimming rear view mirror, better known as the Gentex Night Vision Safety Mirror (NVS). Interior NVS Mirrors are equipped with a glare control feature that automatically darkens the mirror to reduce glare from headlamps of vehicles approaching from the rear. The brighter the glare, the darker the mirror becomes. Aspheric NVS Exterior Mirrors combine auto-dimming with technology that greatly increases field of vision, often eliminating the well-known "blind spot."

In my view, NVS Mirrors will become required safety devices. A recent study discovered that even momentary

exposure to rearview mirror-reflected glare causes an after-image (temporary blind spot) to remain on the retina. Once experienced, this "Troxler Effect" impairs the ability to see forward and reaction time slows. According to Dr. Alan Lewis, Dean of Ferris State University's College of Optometry, the Troxler Effect causes a reaction delay of 1.4 seconds, which equates to 123 feet stopping distance at 60 miles per hour on dry pavement. This is added to normal stopping distance of about 137 feet for a total of 260 feet, more than two-thirds the length of a football field. Wet pavement requires an additional 18 feet.

Gentex introduced this form of "electrochromic" mirror technology in 1987, and has about 90 percent of the worldwide market. However, only about three percent of vehicles produced in the world, and ten percent produced in North America, include these mirrors. Hence, potential growth is huge.

From 1994 to 1996, sales increased from \$89.8 million to \$148.7 million, net income from \$16.5 million to \$24 million and earnings per share from \$.49 to \$.67. But do not forget the risks: Gentex growth depends on one product that might not be successful or that might be nudged out of the market by other technologies. ▀

O P I N I O N

Dr. William H. Joyce, Chairman and Chief Executive Officer of Union Carbide, missed the point when he offered to forfeit a full year's base salary unless the company makes \$4 per share in 2000.

First, Dr. Joyce lent credibility to the belief that CEOs "pay themselves" by setting agendas on which compensation is based, as well as by controlling nominations to the board and by appointing board members to the compensation committee. His unspoken message was, "I have been setting my own salary all these years, but gee whiz, I'll be really nice and give some of it back if we do not make \$4."

Second, by linking personal income to earnings per share, Dr. Joyce incorrectly assumes that corporate earnings are society's most important standard of executive performance. He ignored objectives such as creation of new products and investing in a safe environment that might temporarily reduce earnings per share. He did not acknowledge that society also compensates corporate leaders to be active in communities, to make important charitable contributions, and to take care of employees in good times and bad.

Third, Dr. Joyce and his board appeared insensitive to Union Carbide's employees who do not establish their own compensation. Instead of offering to reduce his compensation, he should have offered to pay bonuses to all employees if profit objectives are achieved. He

also stated that reducing costs (i.e., laying off employees) might be necessary to achieve the earnings goal. He put his self-interest above the interests of employees.

Finally, Dr. Joyce incorrectly assumed that Union Carbide is a focus of the national debate about executive compensation. The real focus is Disney and other companies that pay tens of millions to CEOs. He did a disservice to Union Carbide and to its other executives by putting UK in the spotlight.

The debate about compensation is not a debate about numbers. Society cares little about \$4 per share. Society accepts compensation related to personal achievement, such as inventions, literary skill, athletic prowess, and media stardom. We understand that Bill Gates has changed our lives, and that Michael Jordan is worth seeing. What citizens, shareholders and employees resent is the executive class that has arrived at its position by means that we do not understand and cannot affect, which then pays itself from general corporate profits that could be more widely distributed. ▀

Note: WP&M is not concerned that the net worth of one person increases more rapidly than the net worth of another. Instead, we are concerned that very large compensation packages or unusual compensation programs might negatively affect corporate governance and the American social balance, resulting in disorganization and public protest.

THE WALL STREET JOURNAL



DOLLARS & NONSENSE reprinted by permission of United Feature Syndicate, Inc.

An Observation about Monopolies

In listening to the recorded book, “John D.,” by David R. Hawke (1980), I was struck by the similarity between John D. Rockefeller’s organizing Standard Oil and Bill Gates’ creating and promoting Microsoft.

In the 1870s, Rockefeller organized the most powerful oil company ever known. He did it by horizontal and vertical combinations. Horizontally, Standard Oil was an efficient refiner and marketer of petroleum products. Vertically, it had either control of or special

deals with transportation companies, suppliers, and even banks. Standard gained control by acquiring other companies. Some companies joined Standard because the deals were too good to pass up. Others were forced to join because Standard consciously acted

“Having risen to a point of profound power, Bill Gates sounds like Rockefeller.”

to destroy their businesses. Rockefeller and his associates appeared to believe that their actions were moral because consumers benefited through efficiencies and lower prices. His work took on the atmosphere of a crusade. By 1882,

Rockefeller controlled almost all US oil refining and distribution, and a disproportionate share of world oil trade. In 1892, the Ohio Supreme Court dissolved The Standard Oil Trust into a holding company, Standard Oil of New Jersey. In 1911, The US

Supreme Court ordered dissolution of the New Jersey firm.

Today, Bill Gates passionately defends his company against Justice Department claims that Windows products inherently restrict competition by tightly weaving ancillary services into

the operating system. He states that consumers benefit by the work of Microsoft, and that the Justice Department represents only bitter competitors. Having risen to a point of monumental wealth and profound power, Bill Gates sounds like John D.

Microsoft should be proud of its accomplishments and it should defend its point of view. Nevertheless, I suspect that government will require Microsoft to break up. The reason is that our society does not tolerate such substantial power in one set of hands.

However, investors should not be concerned, because the sum of all parts of Microsoft trading as separate and independent securities will be worth more than the whole of Microsoft today. ▀

Two Innovators See Opportunity

— *Con’t. from page 2*

convenience is astounding for any buyer who knows what he/she wants—no drive time, no lines, available at any hour, and prices appear to be competitive.

Morgan Stanley Dean Witter analyst Mary Meeker thinks that Internet book sales will be less fragmented than book store sales. She states that Barnes & Noble has 17 stores in New York City, or one store for every 88,000 Manhattanites, but on the Web, in effect, there is one store for 35 to 40 million users.

While Ms. Meeker recommends Amazon.com, and believes that its prospects are huge, she also knows the risks. She believes that the “v-valuation . . . gives heartburn of gargantuan proportions.” (The stock

price is high relative to earnings.)

She also lists what can go wrong. There is a “65 percent probability that the current price is too high, a 50 percent probability that AMZN will have to commit capital to businesses other than books, thereby changing its financial model, a 25 percent probability that orders will exceed capacity, a 20 percent probability that her growth estimates are too high, a 15 percent probability of a Web book price war, and a 15 percent probability that her financial model will not play out. In other words, investors—including herself—might be too optimistic. ▀

Verifone

— *Con’t. from page 2*

facilities could be seriously damaged by an earthquake along a nearby fault.

In addition to being the first company I have observed to specifically list risks, Verifone also is the first to provide essential annual report information in seven different languages. From reading this report, my conclusion was that Verifone is a very well-managed enterprise. ▀

Note: I first encountered Verifone at the Sunrise Restaurant: Meal done, bill presented, walk to the cashier, present bill and debit card, cashier takes card and passes it through a small box, and... Then I looked carefully at that unpretentious box to see what company had created a system now so essential to our way of life. The company was Verifone, which my clients acquired between 1991 and 1996, first as an over-the-counter emerging company, then as a New York Stock Exchange stock. During that time, sales went from less than \$225 million to over \$472 million, and operating income from about \$31 million to almost \$40 million. Depending on purchase date, some investors saw value quadruple and now own Hewlett-Packard, the company that acquired Verifone.

Risk, Revisited...

The unsystematic risks of the four companies discussed are greater than average because each is involved with new technologies and new forms of commerce. We are willing to bet on Gentex, CyberCash and Amazon.com (and we wish that we could still bet on Verifone), because the risk-reward equations seem right. Yet, we do not know for sure. No one knows for sure.

Technology always creates wealth, but not every investor becomes wealthy. Wealth is a byproduct of assuming prudent risks with full knowledge of what can go wrong. 📌

NEW TECHNOLOGIES		
Company	Recent Price *	12-month Range
Gentex	24 ¹⁵ / ₁₆	16 ¹ / ₄ 26 ¹ / ₄
Amazon. com	53 ⁷ / ₈	15 ³ / ₄ 66
CyberCash	15 ³ / ₄	10 ¹ / ₂ 30

* November 21

Note: Most of the above information is from company-sponsored sources, such as annual reports and Web sites. Data provided by companies usually is accurate, but might be configured in the most positive light. WP&M does not guarantee the accuracy of the information, but we do our best to get it right.

A Reflection Worth Remembering

A popular belief is that the best time to buy a stock is when no one else wants to buy it. Here is a different version of that hypothesis: THE BEST TIME TO BUY A SECURITY IS WHEN YOU DO NOT WANT TO BUY IT.

This is not a word game. Instead, it is a practical way to think about stocks. A stock is inexpensive when no one,

including yourself, wants to buy it. The “bargain” stock is not only unattractive and unacceptable to “everyone else,” it is unattractive to you. And no scientist or philosopher can ascertain whether your view is truly independent, or whether your view is part of the large group known as “everyone else.”

Therefore, the next time that you hear

yourself saying, “I will never buy a stock like XYZ,” take a second look. Your opinion is likely to be shared by a large group whose concerted inaction is causing XYZ to sell at a price below its intrinsic value. 📌

PLEASE READ THIS DISCLAIMER: Clients and principals of Wealth Planning&Management, LLC, may own securities mentioned in this newsletter. This newsletter is designed to stimulate thought, to help readers to formulate investment philosophies, and to encourage the assumption of risk. However, WP&M does not in any way warrant results from the use of information in this newsletter. WP&M does not guarantee the accuracy of this information. The information is not an offer to sell, or a solicitation of an offer to buy, any security. Readers should not assume that recommendations herein will be profitable or will equal past performance. The possibility of loss is inherent in making any investment, and no information source, including this one, can present all facts and all risks.