

Challenger

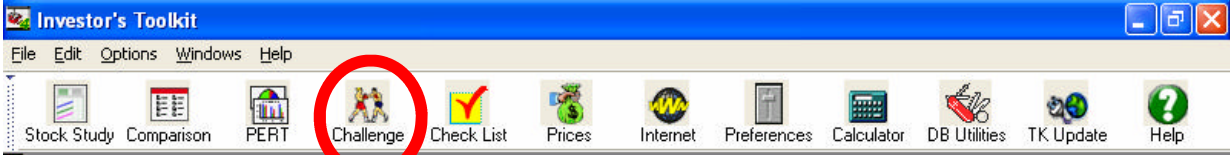
This is the first in a series about the Challenger. The purpose of the Challenger is to compare the consequences of selling a company you own with a potential replacement.

We know that we should always have a replacement in mind for purchase when we are thinking about selling a company in our portfolio, after all, one of our principles is to stay fully invested.

The Challenger gives us a framework for making that replacement decision. However, it cannot “analyze” the situation for you. If you input unrealistic data into it [eg, a total return that is too high], you will get unrealistic output.

On the following pages, we compare the consequences of selling Applebees and buying Fact Set Research. In order to do this we must have previously completed SSGs on each company.

The Challenger graph shows you at what point you begin to break even from selling APPB and buying FDS. On page 3, you can see that this occurs at about the one year point. It also computes the “selling penalty” caused by commissions and capital gains taxes.



On the overhead toolbar click on this icon. The screen on the next page appears.

[NOTE: In upcoming tips in this series, we will cover other parts of the Challenger.]

Toolkit Challenger

A

B

Enter Challenge Parameters

Select Company You Own

Portfolio: *Stock Library*

name	ticker	exchange
AMER INTL GRP	AIG	NYSE
AMER POWER CONV	APCC	
Amgen	AMGN	NASDAQ
ANN TAYLOR STRES	ANN	NYSE
AOL Time Warner	AOL	NYSE
Applebees Int'l	APPB	NASDAQ
Applied Materials	AMAT	NASDAQ
APTARGROUP INC	ATR	NYSE
ARKANSAS BEST	ABFS	
AT&T	T	NYSE

Select Challenger

Portfolio: *Stock Library*

name	ticker	exchange
ENRON	ENE	NYSE
Ericsson Tel [ADR]	ERICY	NASDAQ
Expeditors Int'l	EXPD	NASDAQ
Factset Research	FDS	NYSE
FAIR ISAAC & CO	FIC	NYSE
FASTENAL CO	FAST	NASDAQ
FED SIGNAL CP	FSS	NYSE
First Data	FDC	NYSE
First Tennessee Nat'l	FTN	NYSE
First Union Corp	FTU	NYSE

Enter for Company you own:

Number of Shares to Sell: 100.0

Average Price Per Share: 10.00

Tax Rate: 20.0

Brokerage Fees:

Full Service Broker

Discount Broker

Flat Rate Sale: 8.00 Purchase: 8.00

Ok Cancel ?

C

D

PURPOSE: To compare the consequences of selling a company you own with a potential replacement.

A - This list of companies is the ones you already own.

B - This is the list of potential replacements.

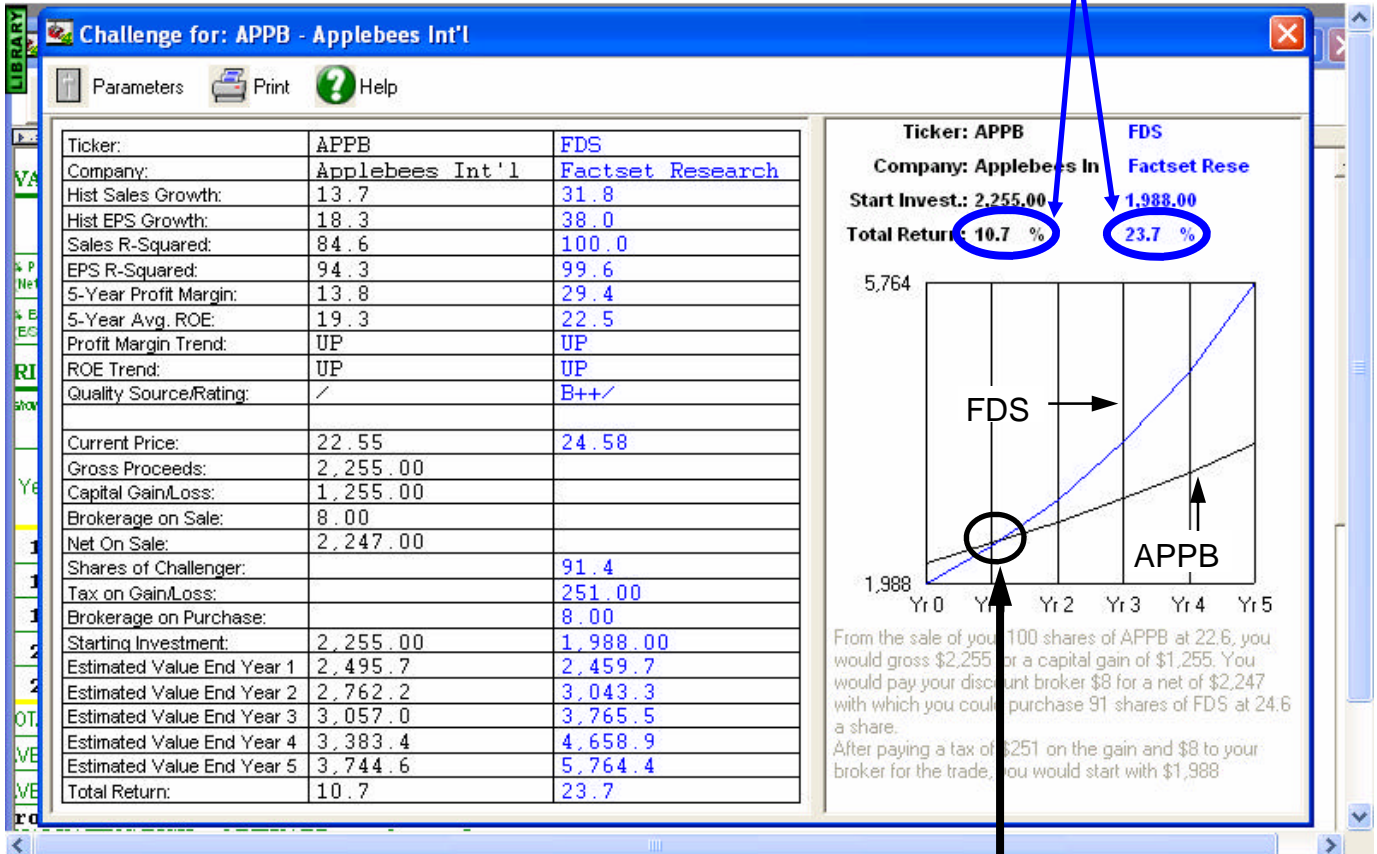
C - Average cost per share you paid for APPB.

D - Broker fees

You must have completed an SSG on each company that you consider in the Challenger

Toolkit Challenger

Total Return from part 5 of SSG.



Break-Even Point

After a little over a year, you reach the break-even point. After that, it is more profitable to own FDS

Keep in mind that the total return is critical to this process. Be realistic and conservative.

Selling "Penalty"

\$2255 — Sell APPB
 - 16 — Commissions
 - 251 — Tax @ 20%

 \$ 1988 Available to buy FDS
 Penalty = \$ 267

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In the first tip [see # 28] we examined the consequences of selling Applebees and buying Fact Set Research in its place. We saw that the growth lines crossed at about a year out, the “break-even” point. After that, it was advantageous to own FDS.

However, there is sometimes no break-even point in the near future. You can tell this when the growth lines do not cross.

On the following pages, we compare the consequences of selling DRI [Darden] and buying OSI [Outback.]

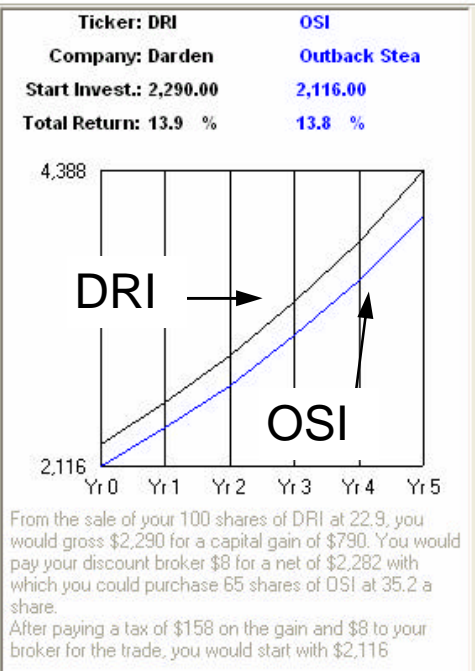
The parallel growth lines indicate that there is no advantage from selling DRI and buying OSI [in fact, you would actually have less of a value because you will pay capital gains taxes and a commission on each end.] This result, “no advantage,” assumes that you have built your SSG realistically for each; that your projected total returns from part 5 of the SSG are prudent and based on realistic inputs for such fundamentals as future high price, future high PE, etc.

Toolkit Challenger

No “Trade-off”

This area to be addressed in future tips

Ticker:	DRI	OSI
Company:	Darden	Outback Steakhou
Hist Sales Growth:	6.7	28.0
Hist EPS Growth:	38.6	20.4
Sales R-Squared:	88.6	91.2
EPS R-Squared:	65.9	92.1
5-Year Profit Margin:	6.7	11.1
5-Year Avg. ROE:	15.4	17.2
Profit Margin Trend:	UP	DOWN
ROE Trend:	UP	DOWN
Quality Source/Rating:	/	S&P/
Current Price:	22.90	35.19
Gross Proceeds:	2,290.00	
Capital Gain/Loss:	790.00	
Brokerage on Sale:	8.00	
Net On Sale:	2,282.00	
Shares of Challenger:		64.8
Tax on Gain/Loss:		158.00
Brokerage on Purchase:		8.00
Starting Investment:	2,290.00	2,116.00
Estimated Value End Year 1	2,608.1	2,408.9
Estimated Value End Year 2	2,970.4	2,742.4
Estimated Value End Year 3	3,382.9	3,122.1
Estimated Value End Year 4	3,852.8	3,554.3
Estimated Value End Year 5	4,388.0	4,046.3
Total Return:	13.9	13.8



The data and graph summarize the consequences of selling DRI and buying OSI. This includes tax and broker’s commission.

There is no “trade-off” since the lines run almost parallel. In fact, OSI is projected to grow at a slower rate.

REMINDER

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There are times when you want to quickly change one or both companies addressed by the Challenger. A short-cut to do this is shown on the following page.