

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



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Hostages to gold

The apparent calm that has set over the US money and bond markets is about to be shattered. The initiative will have been taken away from the hands of the Federal Reserve: The commodity markets, and in particular gold, will henceforth run the show.

More important than actual inflation (recent data support the view that the US economy can grow for some time rather briskly in an environment of relatively stable prices) is the perception and anticipation of future inflation. The markets in the industrialized world sense a powerful, synchronized, boom in the offing. Anchorless central banks are being put to the test: Verbal reassurances are no longer sufficient.

The Central Banks' credibility gap has spread from the US shores to Europe and Japan and is now virtually universal. This can be observed in Chart 1, which graphs the combined yield curve of the G-6 (G-7 excluding Italy) defined as a ratio of 10-year bond yields to three-month interbank interest rates in the G-6. As is clear from the chart, the G-6 yield curve slope is now more positively sloped than it has been at any time since the great inflation of the mid-'70s.

The orderly but yet sustained rise in commodity prices since the beginning of 1993 need not, by itself, cause alarm. After all, some of the better known commodity indexes such as the CRB (see Chart 2) are still a long way off their 1988 peak, let alone the old time highs recorded in 1981. The CRB index, in real terms (deflated by the CPI), has fallen by more than 60% from 1956 (the year when the CRB index was originally constructed). This observation carries three implications:

- As an asset class, raw material prices are not great inflation hedges — although one should note that the spectacular bull market of the '70s did help commodity prices to preserve their real values.
- For any given rise in commodity prices, the effect on consumer prices is substantially diminished as a much greater portion of the latter is made up of other costs.
- Raw material prices respond to cyclical forces; thus, it is not unnatural — and not necessarily inflationary — to see an index like the CRB rise after the second year of an economic recovery. We mean to emphasize the latter point, because we don't believe that a central bank must be a hostage to an *orderly* cyclical rise in raw material prices. The key words are "orderly," "cyclical," and "raw material prices."

First, "orderly." We do not pretend to know what "orderly" means. Except for severe cases of supply shocks, everyone would probably agree that increases of 10% per month would be excessive and something other than cyclical forces are at work, while 1%-2% per month would be reasonable in view of the much greater volatility characteristics inhering to raw material prices. Again, it makes a difference if commodity prices are cheap in real terms, as they were in 1971 and as they are today, or fully priced, as they were in 1978. A slightly *faster* rise can be accepted under the former than under the latter circumstances.

Second, "cyclical." This needs little explanation, because it is quite normal for commodity prices, and in particular industrially-sensitive commodities, to rise and fall in tandem with cyclical economic fluctuations. In a well behaved

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Contributions by Albert D. Friedberg, David Rothberg, Edison Lee, Daniel A. Gordon, and Michael D. Hart.

Futures and options trading is speculative and involves risk of loss. Past trading results are not indicative of future profits.

We've Moved...

As of May 31, 1994, the offices of the Friedberg Group of Companies have been located at BCE Place, Suite 250, 181 Bay Street, P.O. Box 866, Toronto, Ontario, Canada, M5J 2T3. All telephone and fax numbers remain unchanged.

and stable price environment, the rise in industrially sensitive commodities will be partially or totally offset by the fall of other prices. As an example, beef prices of late have tumbled under the weight of heavy supplies even while base metal prices have soared to new highs. Attention, however, should be paid to very broad advances, because they may indicate that inflationary rather than cyclical forces are at work.

Third, "raw material prices." These are goods whose prices are highly sensitive to fluctuations in demand, resulting from cyclical forces and to supply stocks, resulting from natural catastrophes or wars. Central banks can justifiably discount fluctuations in raw material prices (provided they are orderly, of course) as they are due, in all probability, to one of the two reasons.

Which brings us to gold. Almost alone among the components of the CRB index, gold reflects expectations and fears more than cyclical demand and/or supply shocks. There are more above ground supplies of gold than of almost any other commodity. And almost as a consequence, its production-to-stock ratio is the lowest of any commodity. By implication, fluctuations in usage — be it industrial or jewellery — and production have little effect on prices. Almost alone among commodities (sharing honors with silver), gold lies hidden in the subconscious of mankind representing a basic instinct: the desire for money, wealth, and security. Finally, unlike any other commodity, and perhaps because of its unique characteristics, the demand for gold increases as prices rise.

A rise in gold prices cannot easily be attributable to cyclical forces and/or supply shocks. It must be reflecting the inadequateness of paper money as a store of value. And

the fear that paper-backed interest-bearing obligations will be repudiated. Though not perfect, it is the single most important indicator of inflationary expectations.

Chart 3 depicts a remarkably tight six-month trading range, within a larger one-year consolidation that dates back to the spring of 1993. Heavy forward selling, aided by the proliferation of derivatives (American Barrick is said to have hedged four years of production) and central bank demonetization have kept prices in check just below the \$400/oz. level. A penetration of this \$400/oz. level, *which we believe is inevitable*, will surely make hay of the Fed's smugness. The message contained in the huge slope of the G6 yield curve will have been reinforced.

And central banks the world over will have to take note.

Chart 1

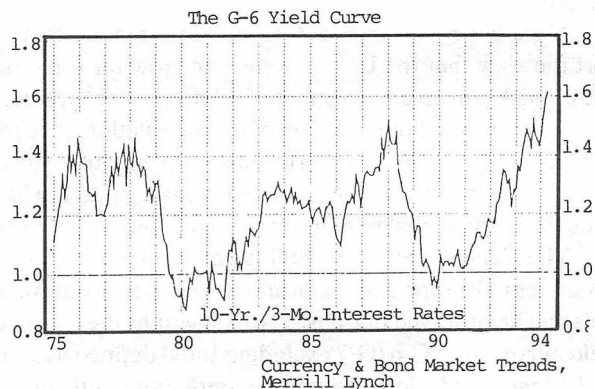
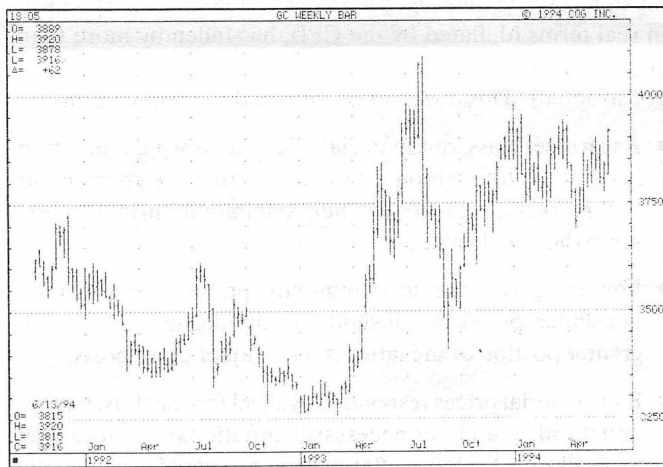


Chart 2
CRB INDEX



Chart 3
GOLD'S TRADING RANGE



INTEREST RATE FUTURES

Incredible complacency

The period comprising early April to May 9 saw a dramatic increase in T-bond open interest. Anecdotal evidence points to heavy hedge fund and dealer community activity, frantically "bastard-hedging" their heavy holdings of CMOs, junk bonds, and derivatives.

While it is questionable whether the hedging proved effective, yields on 30-year bonds were pushed up to 7.63%. Downside pressure was lifted following the Fed's 75 basis point increase in Fed funds and the discount rate, and T-bonds managed to rally more than 5% off their lows.

What is interesting is that since May 9, open interest declined by 123,000 contracts, indicating to us that a very substantial part of the hedges have been lifted. In fact, at 406,250 contracts open interest stood higher than in mid-February, when the nearest contract was hovering around 115. This

remarkable show of complacency points to a new downward leg that should carry long-term yields, initially, to at least 8%.

There is one important caveat. While cyclical considerations and strong inflationary expectations (see our lead article) point to new highs in yields, a simmering disaster in the \$200 billion CMO market may trigger an easing maneuver on the part of the Fed in an attempt to bail out Kidder Peabody (stuck with over \$12 billion of CMOs for their own account) and a host of banks and other financial institutions. A similar course of action was followed during October/November of 1987 as the stock market collapse threatened the integrity of the financial system. Just in case, we advise lowering buy-stops.

STRATEGY: *Remain short; lower stops to 107.15, basis nearby, good anytime.*

Chart 4 – US T-BONDS, SEPT. '94



CURRENCIES

Yen grossly overvalued

May balance of trade figures for Japan confirm the obvious. Only a grossly overvalued currency can generate a jump in import volume of 16% and a fall in export volume of 2.6% in the midst of a domestic recession. As a result, the merchandise trade surplus fell to \$6.54 billion in May from \$7.78 billion the year earlier. The decline marked the largest

monthly narrowing of Japan's politically troublesome trade surplus since December 1990.

Although industrial production for the three months to April was 1.9% higher than the previous three months (which should be reflected in a 2%-3% annualized rate of growth of GDP for the first quarter of the year) caution is still necessary

in interpreting these numbers. In effect, the country has experienced strong growth in the first quarter of each of the past three years, only to see output fall back again later in the year.

At the same time, deflationary forces remain at work. The country's bench-mark money supply — M2 plus certificates of deposit — grew 1.7% in May from the same month last year, a slowdown on the 2.2% rise shown in April. On a year-on-year (YOY) basis, the Japanese Wholesale Price Index (May YOY - 2.4%), export prices (May YOY - 1.3%), and

import prices (May YOY - 9.0%) are all negative. Increasingly, the yen is looking expensive, if not against the US dollar (which has been so weak of late), at least against Continental currencies.

Monetary discipline and good inflation performance make the Swiss franc the ideal leg of our favorite cross trade.

STRATEGY: Remain short Japanese yen against (a dollar-equivalent position of) Swiss francs.

Chart 5 – DM PER SF

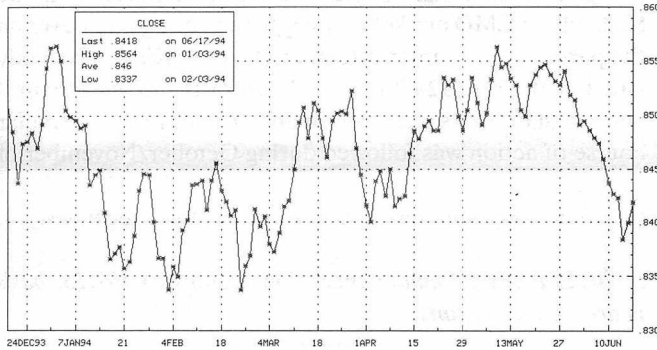
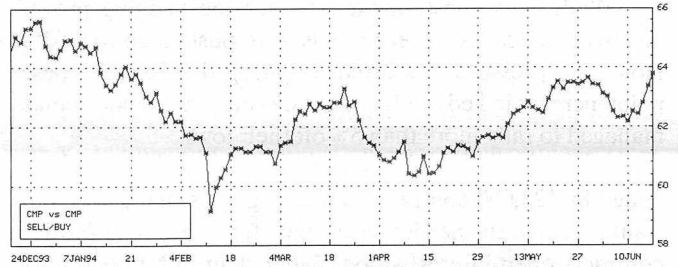


Chart 6
YEN PER DM



HONG KONG DOLLAR

A low-risk speculation

Soaring real estate prices resulting from a combination of negative interest rates, small government land sales, and the China-gate mindset may have begun to lose momentum. Stock prices, on the other hand, are well down from their January highs.

Inflation in Mainland China coupled with a rapidly deteriorating merchandising trade deficit are moving Beijing to adopt an increasingly tighter fiscal monetary policy. This in turn is causing a great deal of social discontent and the cancellation of foreign capital-driven projects.

Clearly, China is becoming increasingly less attractive and hospitable (at least in the medium term). This carries very negative consequences for Hong Kong. As capital inflows turn into outflows, the currency could begin to weaken (within the parameters of a fixed peg around Hong Kong

\$7.80/\$) and interest rates begin to rise.

Projecting a medium-size crisis, we can foresee a fall in the spot rate to HK\$7.85/US\$ and a one-year forward rate above HK\$8.00 (resulting from short-term interest rates in Hong Kong exceeding US equivalent rates by 200 basis points). In a more extreme scenario, the actual peg would collapse under the weight of flight capital and Beijing's desire to unify the Hong Kong dollar with the yuan, presently trading at 8.7 to the US dollar.

STRATEGY: Selling Hong Kong dollars carries very little risk, because the one-year forward discount is an exceedingly small one-quarter percentage point. *Conservatively, the rewards could be five or six times the risk.*

Chart 7 – HANG SENG STOCK INDEX



STOCK INDEXES

The bear marks time

A belabored advance, struggling in the face of a weak bond market. A Fed bailout of the CMO market (see our interest rate futures piece) remains a distinct probability, in which case stock prices could be pushed to new highs. Odds are, however, that the cycle of rising interest rates will finally doom the bull market.

STRATEGY: *We are short, once again, around 460.60, basis September (see flash update June 7). Lower stops to 469.50, good anytime from initial stops at 471.50, as this represents slightly more than a two-thirds retracement of the February-April decline.*

Chart 8 – S&P SEPT '94



PRECIOUS METALS

Maintain aggressive long positions

The consolidation for silver, platinum, and gold is nearly over. *A very important upside breakout is in the making.*

STRATEGY: *Maintain aggressive long positions with stops at 5.22, 396, 385 for September 1994 silver, October 1994 platinum, and December 1994 gold, respectively, good on close only. This revises previous stops.*

Chart 9 – DEC. '94 COMEX GOLD

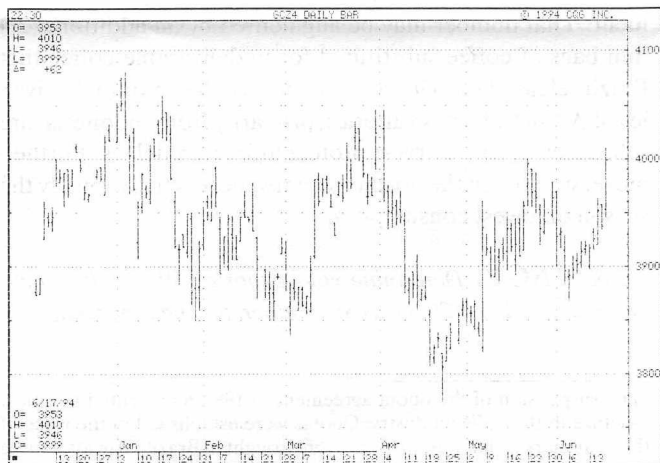


Chart 10 – SEPT. '94 COMEX SILVER



COMMODITIES

Cocoa

The bull market is fully established. By this time next year cocoa will trade at or above 2,000 per tonne.

During the past month, a spate of bearish news has appeared. The European Commission announced it intends to harmonize vegetable fat usage with manufacturers in the UK, Denmark, and Ireland where 5% of confectionery items can be made with tropical oils at the expense of cocoa butter. The ICCO (International Cocoa Organization) met to discuss a crop reduction scheme in order to maintain prices, which the organization, implicitly, believes will come under pressure in 1996. Dealers in Hamburg and London report "product demand...still falling sharply in eastern Europe" and ample origin supply from West Africa. Finally, Ghana announced a 127% increase in prices paid to farmers.

Despite the negative news, prices have held firm above US\$1,300 per tonne. They have done so despite the New York July futures contract moving into delivery June 17 when registered stocks totalled five times the open interest. This clearly indicates the market has realized that the salient points are the long-term, structural issues discussed in these pages for the better part of the past year.

Cocoa production is near capacity. Significant new production can come only from Indonesia. Additional production will have to come from increased yields, which given the poor husbandry performed over the past several years, may or may not be possible. A fourth consecutive year of deficit production yawns. In *nominal* dollar terms cocoa is trading at 60¢ a pound, or in a range of prices that existed in the 1940s, '50s, and '60s. In terms of yen, deutschmarks, Swiss francs, sterling, etc., cocoa is trading at levels that are probably lower than have ever existed.

The breakout from a decade-long downtrend indicates the market has reappraised the terms it will use to price cocoa. The terms today are *possible* shortages. By next year, the market will begin valuing cocoa in terms of likely or even actual shortages. We have little doubt by then the market will be at \$2,000 per tonne.

STRATEGY: *Remain long, raise stops to \$1,100, basis nearest futures.*

Coffee

A preliminary forecast made by the USDA (US Department of Agriculture) puts 1994-95 production at 90.6 million (mln) 60-kilo bags. The number is startlingly bullish. In light of it, we advised reassuming long positions. The volatility makes us wary, however. We expect weakness over the next several months will provide us a buying opportunity.

The USDA's first forecast of 1994-95 world green coffee output put production at 90.6 mln bags. This compares with

production during the current 1993-94 season of 94.2 mln bags. Like cocoa, coffee production is suffering the effects of the years of derelict plant husbandry that has resulted from years of numbingly low prices paid to growers.

Most importantly, the report predicts next year will be the fifth in a row in which consumption will equal or exceed output. Since consumption in producing nations can be estimated reliably at 22-23 mln bags, and consumption in consuming nations can be estimated reliably at 72-73 mln bags, stocks in producing nations should stand at no greater than 40 mln bags. That's 4 mln bags lower than they will be at the end of this year, or 42% of usage. That stocks certified at the CSCE (Cocoa, Sugar & Coffee exchange) have fallen by 50% since the start of the year — they currently stand at less than 3.0 mln bags — indicates that inventories in consuming nations no longer provide a level of comfort to roasters.

Prices have doubled in less than six months. Not surprisingly, the sudden run-up has created the illusion current prices are "high." They are high only relative to what they were last year. As Chart 12 shows, they are barely at a level consistent with prices that prevailed before the suspension of the ICO (International Coffee Organization) quota agreement¹ in 1989. From 1987 through 1989, *at a time when stocks in producing nations represented 70% of usage*, prices traded in a range of \$1.10-\$1.40.

Coffee prices seem destined for higher ground, probably the 170 level and — if there should be an untoward weather event — perhaps as high as 260.

At issue is strategy. In the immediate term there exists the risk of a correction of some magnitude. Now that all trigger-prices that producers established as part of their retention scheme — surely the shortest-lived and arguably most effective production management plan ever devised — have been surpassed, the (estimated) 4 mln bags of coffee retained by producing nations are freely available for shipment. That number may be augmented by an additional 2.4 mln bags of coffee substituted for undeliverable coffee that Brazil released onto its domestic market last month. Deliveries of Asian Robustas varieties, primarily from Indonesia, are scheduled after a harvest protected by rain delays. Furthermore, summer in the northern hemisphere is traditionally the season of lowest consumption.

STRATEGY: *Determine your exposure. Buy half at market. Place bids at 120, basis September, for the other half.*

¹The suspension of the quota agreement in 1989 represented a critical juncture in the coffee industry. Quotas were established in the wake of the bear market that followed the 1986 drought in Brazil in an attempt to cope with gross overproduction. Anxious that the quotas would be re-introduced based upon market share that prevailed during non-quota, free-market conditions, producer nations shipped to capacity. The burdensome consumer inventories that just this year, are being worked off, were the direct result of the suspension of the quotas in 1989.

Soybean Meal

In its June 1 forecast, the USDA put domestic soybean plantings at 61.1 acres, 2.8% higher than last year. The department put yields at 35 bushels per acre, 9.7% higher than last year. Quite clearly, the burden is upon yields. What will determine yields is weather. Last year's yields were low because of flooding. This year's are put at the average of the past five years. If the field, so to speak, runs according to the odds, this year's production will jump, the dangerously low stocks will be replenished, and prices, according to the USDA, should fall between 10%-20%. If the field plays against the odds, i.e. if there is a yield-reducing weather problem, prices should rise by 40%-50%.

No, we don't know what the weather will be over Missouri in July. All we do know at this point is that our proprietary technical indicators are telling us we are in an uptrend. The uptrend has all the earmarks of a bull market.

STRATEGY: We advise remaining determinedly long but in close contact with our hotline and/or brokers.

Sugar

We liquidated our long position. Long-term fundamentals appear constructive. They are, however, outweighed by a heavy speculative overhang and few apparently bullish events on the immediate horizon.

The current 1993-94 deficit is known. Next year's crop has been predicted in balance. The Australian crop is virtually guaranteed to be a record 4.2 mln tonnes. The Thai crop, which is not harvested until autumn, will probably determine the direction of prices in '94/'95.

STRATEGY: At this point we would only buy dips of a penny or more.

— David B. Rothberg

Chart 12 – COFFEE (Monthly)



FRIEDBERG CAPITAL MARKETS**Review of Glycomed Inc.****Security:** 7.5% convertible subordinated debentures**Maturity:** January 1, 2003**Recent price:** \$56.25**Yield:** 17.6%**Recent stock price:** \$2.25**Conversion price:** \$14

The price of Glycomed's common shares have slid to its all-time low in response to the news that its R&D chief, Neil Ackerman, resigned and then to the announcement that the development of Astenose would be completely halted. Simultaneously, the convertible bonds have fallen from \$80 to the current level.

Astenose is an anti-restenotic drug that prevents the re-narrowing of blood vessels following an angioplasty or coronary bypass surgery. Glycomed developed Astenose with Eli Lilly; however, because of inconclusive toxicology results, Lilly sold the marketing rights back to Glycomed. New information about the complexity of the disease and strong market competition (mainly from Centocor's CentoRx) led Glycomed to the decision of halting its development.

Although the failure of an R&D program always hurts a biotech company's prospects, we prefer the program to be halted early enough so that no more money is sunk into the clinical trial stage. We believe Glycomed has made a responsible decision. Even without the Astenose program, Glycomed's leadership in developing carbohydrate-based drugs still has strong potential and other promising products are in the pipeline. Both its stock and convertible bonds have been oversold and they should be ready for a rebound.

Glycomed is still the most advanced and strongest company in the carbohydrate-based drug development field. Its Galardin-MPI drug for infected corneal ulcer is in Phase II/III clinical trial, and we expect it to be ready for a New Drug Application in late calendar 1994.

Although its FDA approval will only reduce Glycomed's financing requirements rather than turn the company profitable, other uses of Galardin-MPI including treatment of cornea transplant rejection, diabetic retinopathies, and vascularized cancers are in preclinical trials, and these combined represent a much larger market size and thus profit potential. In addition, currently there are no competitive products in existence or being developed by other biotech companies.

The long-term potential of Glycomed remains its cell adhesion inhibitor program, which deals with a wide range of inflammatory diseases. The lead product in this program is GM-1998, which treats adult respiratory distress syndrome and is presently in preclinical trial. An investigational new drug application is expected in calendar 1995. Despite the loss of its R&D chief, we believe its remaining team and collaborations with Genentech and the Alberta Research Council still keep Glycomed's research capabilities the strongest in its field.

We believe the market has considerably undervalued Glycomed's common shares and convertible bonds. At the

end of March 1994, it had a combination of cash, short-term investments and long-term securities investments of \$93 million. With current liabilities at \$6 million, the cash coverage of the convertible bonds is 1.74x. Its market capitalization is presently \$28.4 million, putting the price-to-cash ratio at an incredibly low 0.41, or a negative technology value (market cap minus cash) of \$64.6 million, which is among the lowest in the biotech industry.

Based on an increasing burn rate, we believe Glycomed may need additional financing of \$50 million in fiscal 1996. If other product candidates go into clinical trials as expected, we expect another round of financing of \$75 million in fiscal 1998. These financings should be in the form of stock sales to reduce interest expense.

Without the Astenose program, our projections showed that Glycomed would be profitable by fiscal 2000 (instead of fiscal 1998 projected previously), with estimated earnings per share of \$1.2. Using a P/E of 35 in fiscal 2000 and a discount rate of 45% (instead of 35% used before to reflect the higher risk), the fair value of Glycomed's common shares should be between \$4 and \$4.5. When sales of its first product, Galardin-MPI, start in fiscal 1997, its share price should be boosted to \$15 to \$20. In fact, given the incredibly cheap valuation, we believe Glycomed is susceptible to a takeover by other biotech or pharmaceutical companies.

STRATEGY: *Both the common stock and convertible bonds of Glycomed are ready for a rebound in view of the incredibly low valuations. Interest payments on its convertible bonds are guaranteed up to January 1996, and they are not callable until then. With Glycomed's large cash position, we believe these bonds provide reasonable downside protection and the opportunity to take advantage of any major upside movement in the stock, especially when Galardin-MPI obtains FDA approval in fiscal 1995. These bonds are definitely a strong hold!*

Onex Corporation**Security:** Common Stock (Symbol: OCX)**Exchange:** Toronto Stock Exchange**Market cap:** C\$580 million**52-week high/low:** C\$19/C\$10.75**Recent price:** C\$14 per share**Summary**

Onex Corporation is a leveraged-buyout specialist and has an outstanding track record profiting from its acquisitions. Its common shares are now trading at a 38% discount to their estimated net asset value. Onex has a large amount of cash and is looking for more acquisitions. We believe the shares should trade up to the C\$22 range in the next 12 to 24 months.

Onex and LBOs

Onex is a Toronto-based diversified holding company, currently with interests in airline catering, automotive parts manufacturing, restaurant supplies, and courier services. Mr. Gerald Schwartz, the company's chief executive officer and

controlling shareholder, set up Onex in 1984 as a vehicle for doing leveraged-buyout (LBO) deals. He currently owns 21.3% of the shares outstanding. With extensive Wall Street experience, Schwartz is considered the most prominent LBO deal maker in Canada.

In an LBO, an individual or a small group of investors buys out a company by putting up only a small amount of equity capital, and financing the shortfall by borrowing against the assets of the acquired company. Therefore, most LBO targets are companies that have an established business and plenty of debt capacity.

Most LBO investors make money in one of two ways. One is to break up the company upon acquisition and sell off assets to repay debt. This is viable if a company's break-up value is greater than the price paid for it. The other way is to restructure the company to improve its profitability so that the entire company can be sold later at a higher price. The second route typically takes a longer time but the potential reward also can be much larger.

Onex plays the LBO game via the second route. Sometimes it co-invests with other firms to share the risk. It targets companies that are underperforming their competitors but have a strong balance sheet. It then finds someone who has significant operating experience in the industry to become the chief executive officer. Often, the CEO and senior management will be given an equity interest as an incentive. Furthermore, the acquired company may undertake LBOs of other firms in the same industry if that is necessary to achieve economies of scale or scope. Finally, when the turnaround is complete, Onex will sell the company to a third party or through an initial public offering (IPO). The desired time frame between purchase and exit is usually five to seven years.

Since its inception in 1984, Onex has bought and sold over 20 companies. Based on these LBO deals, they have an excellent track record in investing in companies that can be turned around and eventually sold at a much higher price.

Current Portfolio

At present, Onex has majority interests in five companies and minority interests in four others. A description and our valuation of each of them are given below:

Automotive Industries. Acquired in 1990 with Hidden Creek Industries, Automotive Industries is a leading US manufacturer of interior-trim systems and blow-molded products for cars and light trucks. In 1993, it acquired ASAA International, Inc., which makes automotive interior panels and trim components, to broaden its product line. Automotive Industries was taken public in 1993, and its shares are currently trading on NASDAQ. Onex made an initial investment of C\$23.1 million to take a 35% stake. Following the IPO, it has sold 14% of its interests for C\$48.8 million. Its remaining 21% ownership is currently valued at approximately C\$109 million.

Johnstown America. Onex put up C\$8.9 million cash to acquire 54% of Johnstown America in 1991, which is one of the largest rail car manufacturers in the US. Following successful restructuring, Onex took it public in 1993. It has realized C\$50.8 million from the sale of shares and is still holding 4% of the company, which is currently valued at approximately C\$9.6 million.

Scotsman Industries. Together with Matt Diggs Corp., Onex acquired 79% of Delfield Corp. in 1991, which is a major refrigeration equipment supplier for restaurants in the US. Through the same partnership, Onex acquired in 1992 78% of Whitleng Drink Equipment, one of the largest manufacturers of soft drinks and beer dispensing systems in the United Kingdom.

Total equity investment of Onex in these two companies was C\$6.2 million. Besides receiving a dividend of C\$12.3 million from Delfield in 1992, Onex sold the two companies in January 1994 to Scotsman Industries of Illinois for C\$45 million (\$20 million cash, \$10 million common stock, and \$15 million convertible preferred stock of Scotsman). If the two companies can meet certain earn-out criteria, Onex can receive an additional 300,000 shares of Scotsman, which will increase its stake in Scotsman to 16%. Scotsman is the world's leading manufacturer of commercial refrigeration products, and its shares are listed on the New York Stock Exchange.

Sky Chefs. Onex bought 84% of this former catering arm of American Airlines in 1986. Total investment over the years is C\$58.4 million. To broaden its market, Onex sold 25% of Sky Chefs to Lufthansa Airline last year, and realized C\$53.3 million from the sale. Its remaining 60% of Sky Chef has an estimated value of C\$288 million.

Purolator Courier. Purolator is one of the few money-losing deals. Onex bought 78% of Purolator in 1987 and has invested C\$80.9 million in the company. Owing to fierce competition in the courier industry, Onex has found it difficult to drastically improve Purolator's profitability. In 1993, Onex sold 75% of Purolator to Canada Post, and realized C\$37.8 million from the sale. It still maintains a 20% stake, which we valued at C\$8 million.

ProSource Distribution. Onex acquired this foodservice distribution arm of Burger King in 1992, and renamed it ProSource Distribution. The primary business of ProSource is supply food and related items to multi-unit fast food restaurants. Onex invested approximately C\$22 million in the acquisition and currently has a 78% equity interest, which is worth between C\$58 million and C\$92 million based on our estimate.

R. J. Tower. A high-quality US manufacturer of automotive structural-steel components and assemblies, R. J. Tower was acquired by Onex and Hidden Creek Industries in 1993. Onex currently holds a 74% interest in the company, and we estimated its value to be between C\$49 million and C\$57 million. R. J. Tower recently announced the acquisition of Edgewood Tool and Manufacturing Company of Michigan, a supplier of hood and deck hinges and other structural metals products. Since detailed information of Edgewood is not available, we made a conservative assumption that the acquisition would not increase the value of R. J. Tower.

Dura Mechanical. Another joint investment with Hidden Creek Industries, Dura Mechanical manufactures parking brakes and window regulators for automobiles. Onex undertook the investment in 1990 and currently holds an 80% interest. Our estimated value is between C\$18 million and C\$19 million.

Dayton Superior. Dayton Superior is an Ohio-based manufacturer and distributor of concrete accessories for construction. The depressed construction market and excess leverage have made the turnaround proceed very slowly. Onex recently announced a debt restructuring for Dayton in which some debt was converted into equity and a C\$5.5 million capital injection was made by Onex. Based on a drastically reduced debt burden, we estimated the value of its 52% holdings to be between C\$4 and C\$15 million.

Valuation of Onex

Our estimated value of Onex based on its various subsidiaries' net worth is summarized as follows:

Holdings	Interests of Onex	Estimated Value (C\$m)	
		Low	High
Automotive Industries (NASDAQ)	21% of equity	109	109
Johnstown America (NASDAQ)	4% of equity	9	9
Scotsman Industries (NYSE)	Common & convertible preferred stock	29	29
Sky Chefs (private)	60% of equity	288	288
Purolator (private)	20% of equity	8	8
ProSource Distribution (private)	78% of equity	58	92
Dura Mechanical (private)	80% of equity	18	19
R.J. Tower (private)	74% of equity	49	56
Dayton Superior (private)	52% of equity	5	15
Cash & equivalents		350	350
Total estimated net asset value		923	975
Estimated per share value		\$22.5	\$23.8
Current price		\$14	

In arriving at the above valuation, we divided the subsidiaries into three groups. Group one includes Automotive Industries, Johnstown and Scotsman, which are publicly traded and whose values are based on the most recent market quotes. Group two consists of Sky Chefs and Purolator. Although these two companies are private, approximate market values can be obtained by reference to their recent sales of interests to Lufthansa and Canada Post, respectively.

Valuation of group three, which includes all the remaining private companies, is the most subjective. We used comparable companies that are publicly traded and adjusted the valuation parameters based on these subsidiaries' profitability and size. The main valuation parameters used are enterprise value (market value of equity and long-term debt) to earnings before interest, tax, depreciation, and amortization (EBITDA) and enterprise value to sales.

We estimated an enterprise value range of each subsidiary in group three using our adjusted valuation parameters. Then we deducted the long-term debt of each subsidiary from the estimated enterprise value to obtain an estimated equity value. We used enterprise value in our valuation instead of just market capitalization because the latter does not allow for these subsidiaries' high leverage.

We recognize the fact that many holding companies are trading at a discount to their net asset value. The discount is usually a result of investors' concerns whether the assets actually can be sold at the current market prices, whether the holding company is willing to sell their assets, and whether the company is willing to distribute the profits realized to shareholders.

To address the first concern, we further adjusted the estimated equity values. For companies in group three, we

assumed a 20% discount on the estimated equity value to account for lack of marketability as non-public companies. For group two, we assumed a 35% minority interest discount for the 20% ownership of Purolator. Also we added a 20% premium to the implied value of the 60% interest in Sky Chefs to account for the controlling interest status. No lack of marketability discount is necessary in this group since it should have been imbedded in the recent sale prices of these companies. Finally, for group one, we took a 10% to 15% discount on the market values of the holdings to allow for any price concessions necessary to effect such block share sales.

Regarding the investors' second and third concerns, it is difficult to address in our valuation model. However, the track record of Onex shows that they are willing to realize profits when they believe the timing is right. They have bought and sold over 20 companies since 1984. For example, they raised C\$145 million in 1993 by selling out the entire or partial interests in five subsidiaries. Therefore, investors' concern in this respect should be small.

Finally, we believe the dividend policy of Onex shows that the company is willing to distribute cash profits to its shareholders. Since it started paying dividends in 1987, the annual regular dividend per share has grown by 11% compounded. Besides, there are two special dividend payouts — C\$1.50 per share in 1988 and C\$3.50 per share in 1991. In effect, Onex has distributed a total of C\$168 million in dividends, equivalent to C\$4.10 per share based on the 41 million shares currently outstanding.

Conclusion

Of all the current investments of Onex, the only ones that we believe may be a problem are ProSource and Dayton Superior. Their estimated values are both below the purchase prices Onex paid. Dayton may be ready for a turnaround following the debt restructuring and in the face of a recovery of construction activities. The other three major holdings, namely Sky Chefs, Dura Mechanical and R. J. Tower, are all improving their bottom lines and benefiting from a better economy. In fact, we would not be surprised to see an IPO of either R. J. Tower or Dura in the next 12 months.

Consequently, we believe our estimated per share value range for Onex is fair and realistic. In line with the old adage "value will out," we believe the stock should, in due course, reflect this.

STRATEGY: *Onex has an excellent track record in selecting LBO targets, turning around operations, and realizing profits at the right time. Furthermore, it has intelligently structured all the deals so that any debts will remain only at the subsidiaries' level, without any guarantee by or recourse to Onex. Sitting with C\$350 million cash, Onex is again looking for deals. We believe its share price should slowly trade up to our estimated level; a new deal or further profit realization on existing investments may trigger the re-rating.*

— Edison Lee

Chart 13
Breakeven exchange rates for US\$-based investor

This analysis shows a "snapshot" of the relationship between interest rate differentials and rates of exchange. The breakeven rate measures how far the foreign currency has to devalue (for NZ\$, A\$, DM, DKr, BP, FFr, ECU, CD, SAR, ITL, ARG and FIN) or revalue for SF, JY, before the interest rate advantage/disadvantage is overcome by currency depreciation/appreciation. Rates as of June 16, 1994.

	US. \$	NEW ZEALAND	DEUTSCHEMARK	SWISS FRANC	JAPANESE YEN	DANISH KRONE	BRITISH POUND	FRENCH FRANC	EUROPEAN CURRENCY UNIT	CANADIAN DOLLAR	SOUTH AFRICAN RAND**	ITALIAN LIRA	ARGENTINEAN PESO	FINNISH MARKKA
1 year	5.10%	C.I.L. '96 yields 26.98% (.49 NZ/US)												Finland '95 yields 7.84% (5.613 FIM/US)
2 year	5.77%		Bk for E.A. '96 yields 18.25% (2.047 US/DM)		World Bk '96 yields 2.96% (98.17 US/¥)	Denmark '96 yields 7.23% (6.5909 US/DK)	Sweden '96 yields 6.68% (1.4914 BP/US)				ESCOM '96 yields 11.47% (.1903 SAR/US)	NIB '96 yields 9.67% (1.7272 ITL/US)		
3 year	6.12%							Credit Lyon '96 yields 6.52% (5.649 US/FFR)		R.B.C. '97 yields 8.67% (1.489 Cdn/US)				
4 year	6.41%		Argentina '98 yields 8.57% (1.775 US/DM)	G.E. '98 yields 4.38% (1.2763 US/SF)										
5 year	6.59%													
7 year	6.91%								UK '01 yields 8.06% (1.2655 US/ECU)				BIC V '01 returns 15.26% (1.6894 US/ARG)	
Spot Exchange Rate	-	.392	1.6379	1.3785	103.60	6.4125	1.5172	5.586	1.1742	1.3867	.2114	1.6065	.9980	5.47

*For example, since a US\$-based investor would receive 91 basis points (668-577) by holding the Sweden BP bond, the BP/US can depreciate to 1.4914 from the present spot exchange rate of 1.5172 BP/US

over the next 2 years for the BP investment to break even with current US\$ rates of interest. Assumes that bonds are held to maturity, and coupons are reinvested.

**NOTE: These bonds pay interest in commercial rand, which presently trades at a premium to the financial rand used for this table.

Chart 14

Although we monitor these issues specifically, we also can fill any order in any foreign bond

RECOMMENDED CURRENT PORTFOLIO ALLOCATION			
1. GOLD/YEN BOND	20%	6. FRB/BIC V	15%
2. TRANZ RAIL NZ\$	5%	7. U.K. FRN	20%
3. CIL NZ\$	5%	8. DM FLOATER	10%
4. NEW ZEALAND GOV'T	20%	9. EUROPEAN	2.5%
5. BK. FOR. ECO DM	2.5%		

HOTLINE UPDATE

Tuesday, May 24:
No new recommendations.

Friday, May 27:
No new recommendations.

Tuesday, May 31:
No new recommendations.

Friday, June 3:
No new recommendations.

Flash Update, Tuesday, June 7, 9:10 am:
We have three new recommendations:
1. Cover short September Canadian dollars at the market, presently trading at 72.70.
2. Sell September S&P at the market place initial stops at 471.50, good anytime, also;
3. We favor the British pound over the deutschemark; therefore, buy British pound, sell deutschemarks on an equal dollar value.

Tuesday, June 7:
No new recommendations. However, we are repeating this morning's flash.
1. Cover short September Canadian dollars at the market, presently trading at 72.70.
2. Sell September S&P at the market place initial stops at 471.50 good anytime; also please note: *the S&P opened at 460.60*
3. We favor the British pound over the deutschemark; therefore, buy British pound, sell deutschemarks on an equal dollar value; also please note, *the D-mark/British cross was 251.40.*

Friday, June 10:
One new recommendation for today and recapping this week's updates.
1. Reinstate long positions in silver, buy September silver at the market, risking 531, close only (opening price on Monday, June 13 was 538.50).

Repeating this morning's flash.
1. Cover short September Canadian dollars at the market, presently trading at 72.70.
2. Sell September S&P at the market place initial stops at 471.50 good anytime; also please note: *the S&P opened at 460.60.*
3. We favor the British pound over the deutsche mark; therefore, buy British pound, sell deutschemarks on an equal dollar value; also please note: *the D-mark/British cross was 251.40.*

Flash Update, Tuesday, June 14, 10:00 am:
Liquidate the long British pound/short deutschemark cross position at the market.

Friday, June 17:
This is a complete summary since our last market letter, dated May 23, of all liquidations of open positions and new recommendations that remain outstanding.
1. On Tuesday, June 7 via flash update 9:10 am, we advised the sale of September S&P at the market; S&P opened at 460.60.
2. On Tuesday, June 7 via flash update 9:10 am, we advised you to cover short September Canadian dollars, then trading at 72.70.
3. On Friday June 10, via flash update 10:00 am, we advised you to purchase September silver at the market, which opened on Monday at 538.50.

Chart 15
FOREIGN CURRENCY BONDS

DATE: June 16, 1994 We offer the following Bonds subject to change without prior notice: Minimum US \$4000 (CDN \$6000)

ISSUER / COUPON / MATURITY DATE	BID	OFFER	YTM	CURR. COUPON	NEXT INTEREST PAYMENT DATE
DEUTSCHE MARK DENOMINATED BONDS					
Bank of Nova Scotia 5 5/8% 7/5/96 RRSP	99.6	100.45	5.36		May-07
World Bank 5 7/8% 4/02/97 RRSP	100.9	101.75	5.25		Feb-04
World Bank 9% 13/11/00 RRSP	109.8	110.65	6.87		Nov-13
Kingdom of Denmark 6 1/8% 15/04/98	98.05	-	-		Apr-15
Argentina 8% 5/10/98	97.1	97.95	8.57		Oct-05
Bk. Foreign Eco. Affairs 7% 29/3/96	83.25	84.1	18.25		Mar-29
FINNISH MARKKA DENOMINATED BONDS					
Rep. of Finland 11% 15/6/95	102	102.85	7.84		Jun-15
ITALIAN LIRA DENOMINATED BONDS					
Nordic Inves. Bk 12 3/8 19/04/96	103.4	104.25	9.67		Apr-19
General Electric 11 1/2% 7/02/95	100.6	101.45	8.67		Feb-07
SWISS FRANC DENOMINATED BONDS					
General Electric 4 3/4% 2/7/98	100.5	101.35	4.38		Jul-02
DANISH KRONE DENOMINATED BONDS					
Kgdm of Denmark 9% 15/11/96	102.85	103.7	7.23		Nov-15
ECU DENOMINATED BONDS					
United Kingdom 9 1/8% 21/02/01	104.4	105.25	8.06		Feb-21
BRITISH POUND DENOMINATED BONDS					
Kgdm of Sweden 8 3/4% 29/5/96	102.375	103.625	6.68		May-29
FRENCH FRANC DENOMINATED BONDS					
Credit Lyonnaise 9 1/2% 23/12/96	105.75	106.6	6.52		Dec-23
JAPANESE YEN DENOMINATED BONDS					
World Bank 5 3/4% 7/8/96 RRSP	104.8	-	-		Aug-07
CANADIAN DOLLAR DENOMINATED BONDS					
Ontario Hydro 10 7/8% 8/01/96 (semi)	103.15	104.65	7.62		Jul-08
Eksportfinans 7 3/4% 5/11/97	95.85	-	-		Nov-05
Royal Bank of Canada 9 1/8% 7/1/97	99.4	100.9	8.67		Jan-07
SOUTH AFRICAN RAND DENOMINATED BONDS					
ESCOM 12% 1/5/96 (semi)	99.95	100.8	11.47		Nov-01
AUSTRALIAN DOLLAR DENOMINATED BONDS					
Commonwealth Bk of Aust. 9 3/4% 15/5/96	103.15	-	-		May-15
NEW ZEALAND DOLLAR DENOMINATED BONDS					
New Zealand Gov't 10% 15/7/97 (semi)	107.55	108.4	6.91		Jul-15
Fletcher Challenge 10.75% 15/12/97 (semi)	105.3	-	-		Dec-15
Fletcher Challenge 10.15% 30/11/98 (semi)	104.25	-	-		Nov-30
Corporate Investment Ltd. 13 1/2% 19/6/95 (semi)	80.8	83.3	26.98		Dec-19
Tranz Rail Ltd. 10% 15/10/99 (semi)	102.25	103.1	9.24		Oct-15
DB Group 7% 30/6/96 (semi) matures @ 85	87.9	88.75	6.55		Jun-30
ARGENTINEAN PESO DENOMINATED BONDS					
BIC V Fixed/Floating 1/5/2001 Callable in full on every interest date	76.9	77.75	15.26		4th day of mth.
U.S. DOLLAR DENOMINATED FIXED CONV. BONDS					
Datapoint Corp. 8 7/8% 1/6/06 CV@18.11p/sh (semi)	60.75	62.75	15.94		Dec-01
Burnup & Sims 12% 15/11/00 CV@16.79 p/sh (semi)	93	95	13.17		Nov-15
Atari Corp. 5 1/4% 29/4/02 CV@16.31 p/sh	57.75	59	14.25		Apr-29
Coeue D'Alene 6% 10/6/02 CV@ 26.00 p/sh	88.25	90.25	7.68		Jun-10
Glycomed 7 1/2% 1/1/03 CV@14.06 (semi)	56.25	-	-		Jul-01
T.W.A. 10% 3/11/98 (semi)	66.4	67.25	22.07		Aug-01
U.S. DOLLAR DENOMINATED FIXED RATE BONDS					
Farm Credit Corp 7 3/4% 10/06/96 RRSP	102.75	103.6	5.76		Jun-10
U.S. DOLLAR DENOMINATED FLOATING RATE NOTES					
Kgdm of Denmark 25/3/97 (Gold call, JY put) (semi)	98.5	99.5		3.02	Sep-25
United Kgdm 30/9/96 3mo.LIBID-1/8 callable @100	99.56	99.86		3.625	Jun-30
Bocon 1/4/01 (30 day LIBOR) starts accruing May 1, 1997	80.3	81.15	12.59		May-01-97
Argentina Series L:FRB 31/3/05, 6mo. LIBOR+13/16 (semi)	74.875	75.625	10.81	5	Sep-30

GOLD (in ounces, at market prices, can also be held in your bond account)

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