

# FRIEDBERG'S

## COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



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## More on the US dollar

It is almost a truism to say that the dollar has been falling because holders have lost confidence in it as the global monetary numeraire: As the stock of US dollars inexorably increases, the desirability of holding greenbacks will depend, increasingly, on the perception that the US central bank cares about its value.

As suggested last month, the latest sinking episode was triggered by official pronouncements that suggested economic activity be rated ahead of maintaining the dollar's purchasing power as an objective of central banks.

In an interview granted last Friday to *Financial Times* of London, Ms. Janet Yellen, one of two Clinton appointees to the Fed's seven-member board, confirmed the official position: Central banks should not single-mindedly pursue an inflation goal — a commitment to growth is also important. "It is possible to do two things at once." Conceding that recent economic data are "a little softer than I had expected," she does not yet see any of the strains that normally precede a recession.

She takes a rather constructive view of the dollar's fall, as it has served to cushion the demand pressure on demand. Her adherence to fine-tuning is unquestionable, as according to *Financial Times* she believes that "the hallmark of the Fed's approach is close analysis of the empirical data. Interest rate decisions are based on economic projections prepared by the Fed's technical staff. In 1989, for example, the Fed began cutting rates *even though inflation was above target, because the forecast pointed to significantly weaker growth.*" She conceded that there are "many parallels" between this year and 1989.

Here, then, a third member of the seven-member board of the Federal Reserve confirms what Messrs. Blinder and Greenspan indicated last month: the Fed will try to pre-empt a recession by lowering interest rates, even if inflation stays well above an optimal rate of 1%-2% per annum. And that decision may not be too far off.

We are *not* suggesting that the Fed is irresponsibly lax at this time. If anything, a number of indicators continue to paint a picture of restraint: Adjusted bank reserves have fallen at an annual rate of 4.6% since the end of September, M1 has been flat over that period, total bank credit chugs along at a moderate annual rate of 6.5%, and commodity prices remain below the '94 highs (see Chart 1). Moreover, the

yield curve continues to flatten, with the 3-month/2-year and 3-month/10-year curves tightening to new lows (see Chart 2).

Finally, as the analysts at H.C. Wainwright & Co. have demonstrated, it is not that the US dollar has fallen through the floor; it is, rather, that the yen (and the German mark) have broken through the ceiling. This can be ascertained by measuring the dollar's performance against an objective measure of purchasing power, such as gold. The dollar has been quite stable over the past year and a half even while it has fallen 16% against the yen (and 12% against the mark). The dollar's recent stability is in sharp contrast to its weakness in the late '70s (see Chart 3).

We are suggesting that in the case of the dollar, the bite, as we have seen, is worse than the proverbial bark. Single-minded price stability, instead of doing "two things at once," would have kept the dollar range-bound, generally within the confines of its Louvre Accord zone (with the possible exception of the yen, caught in a spiralling deflation).

But there is more. The above analysis emphasizes the flow of dollars: the Fed's base money generation, the growth of bank credit and money supply, even the trade and current

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Contributions by Albert D. Friedberg, Edison Lee and Sholom Sanik.

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

account deficits. Even minute but unwanted additions to a delicately poised stock of dollars, however, can pressure the currency, tarnish the stock, and turn it into an "overhang."

To reverse this process, the US would have to tighten to a much greater degree, diminishing the stock of money and generating a current account surplus. Under the Bretton Woods regime, this would have caused a shortage of international reserves and could have brought about a global deflation. Under the current floating regime, it would simply strengthen the US unit and buy some additional time for central banks to diversify their holdings, a process that has been well underway for over two decades.

The US dollar "overhang" could lead to recurring, spasm-like, bouts of central bank liquidations, a process that tends to aggravate the current weakness and is very much reminiscent of the official sterling balances problem of the '50s and '60s.

The US has gained a great deal from the dollar's status as a reserve currency, being able to run a long string of budget and current account deficits without having to undergo any type of economic adjustment. Unless the US administration is willing to be single-minded about defeating inflation and about stabilizing its debt/GDP ratio, it will be forced to lose

this privilege. It may well be that current policies are "about" right, but this is not good enough. It must first learn to say the right things. And if that is not sufficient, it must defend its reserve currency status by being — temporarily at least — too tight.

**IMPLICATION:** The yen bubble can be burst only by a massive reflation of the Japanese economy, as we've indicated in past issues. Double-digit money-supply expansion combined with a fiscal deficit of 5%-6% of GDP is a good start. Alternatively, the Federal Reserve takes a stand, raises interest rates by at least 100 basis points, and uses the opportunity to announce unequivocally that it intends to preserve its status as a reserve currency. Since neither of these two routes seem likely, the yen is condemned to continue overshooting.

**STRATEGY:** 1. Remain long June '95 yen, placing stops at 116.50, close only. 2. Remain long June '95 Swiss francs, and raise stops to 86.00, close only. 3. Add to your existing Eurodollar short position: Sell September '95 Eurodollars at the market. 4. The currency crisis will lead to an inversion of the yield curve.

Reuter Graphics

Chart 1 – CRB INDEX

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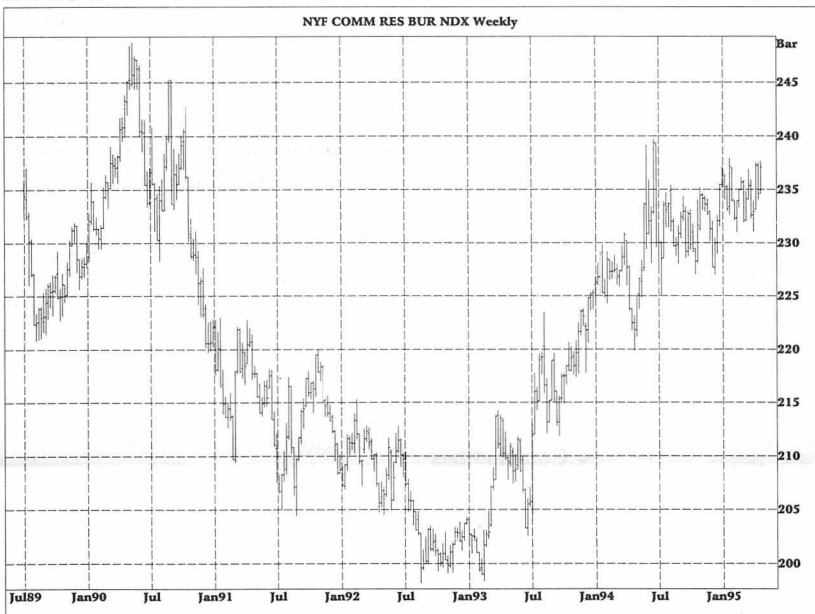
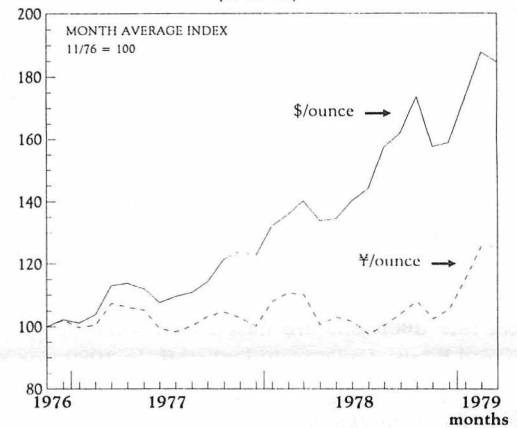


Chart 3

The Carter Dollar  
The Dollar and the Yen in Terms of Gold (1976-79)



The Clinton Dollar  
The Dollar and the Yen in Terms of Gold (1992-1995)

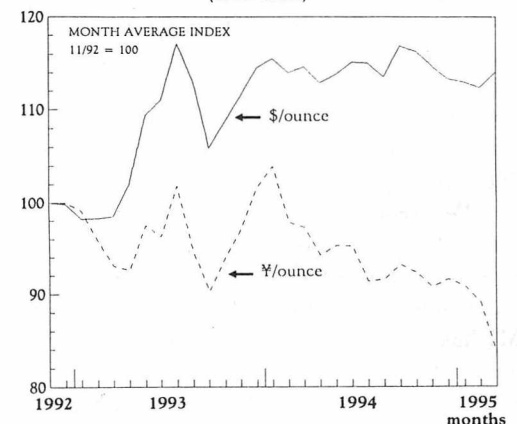


Chart 2  
FAIR MARKET YIELD CURVES

	#1	#2	#3	#4
3MO	5.77	5.99	5.14	3.81
6MO	5.94	6.40	5.66	4.32
1YR	6.12	6.78	6.14	4.83
2YR	6.42	7.23	6.82	5.54
3YR	6.53	7.34	7.05	5.93
4YR	6.64	7.42	7.26	6.20
5YR	6.75	7.50	7.48	6.47
7YR	6.76	7.49	7.49	6.56
10YR	7.00	7.58	7.81	6.90
20YR	7.17	7.64	7.89	7.05
30YR	7.33	7.70	7.97	7.21

Bloomberg

#1 = 4/21/95 : ACTIVE GOVERNMENTS  
 #2 = 1/31/95 : ACTIVE GOVERNMENTS  
 #3 = 10/31/94 : ACTIVE GOVERNMENTS  
 #4 = 4/21/94 : ACTIVE GOVERNMENTS

H. C. Wainwright & Co. Economics, Inc.

Chart 4

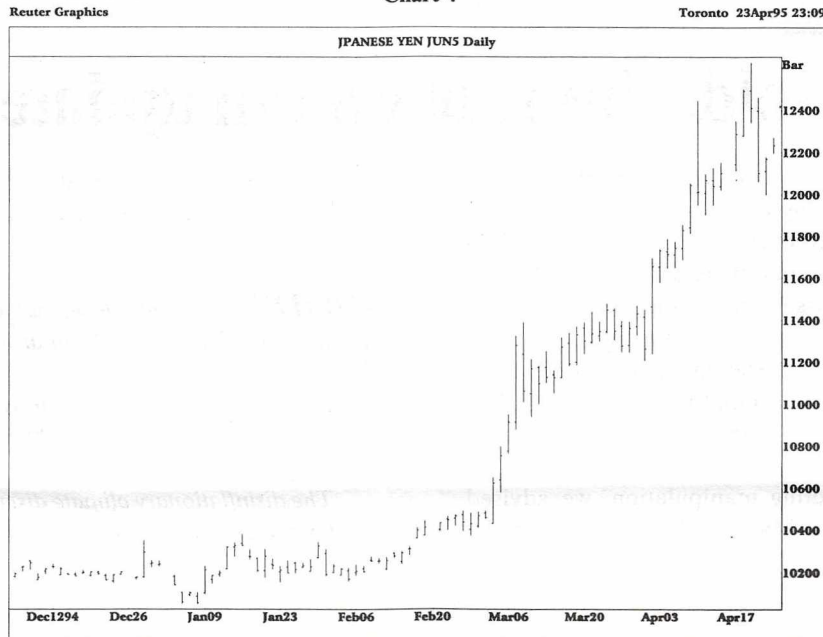
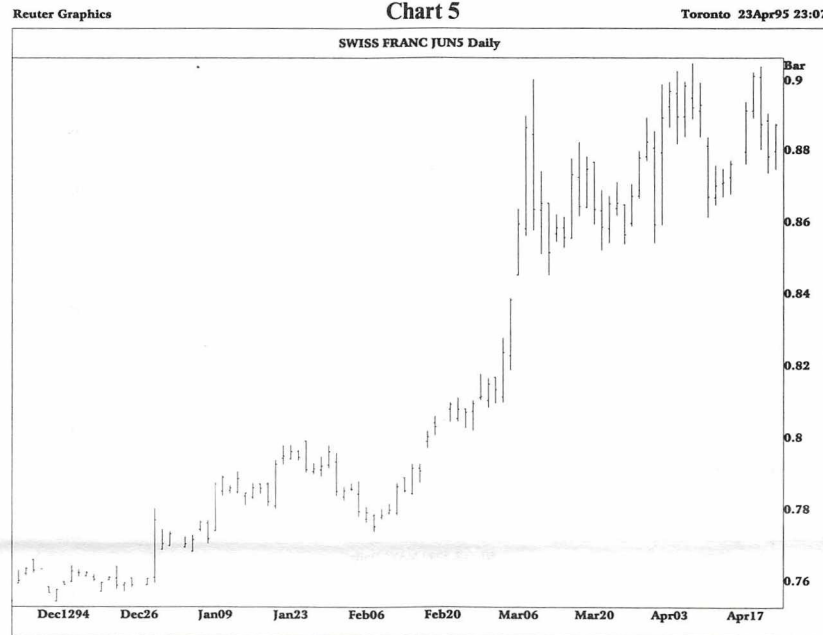


Chart 5



**COMMODITIES**

**A disinflationary scenario**

Monetary conditions in the US are consistent with relatively stable commodity prices. This "stability" is manifested by continuous rotation among commodity groups such as grains, base metals, or precious metals, with little follow-through and little breadth.

A climaxing currency crisis could force the Fed's hand and bring about an unwanted tightening. Understandably, its impact on commodity prices could be severe.

**STRATEGY:** A prudent strategy would dictate the simultaneous holding of some long and some short positions across the commodity spectrum, selling strength and buying weakness, and generally avoiding trend following.

Our recommendation to buy sugar (see story) and a new recommendation to sell July '95 copper and other LME base metals fall into this category. Place stops on July '95 copper at 134.00, close only.

**PRECIOUS METALS**

# Gold, silver, platinum update

Gold has once again found it difficult to overcome the \$400/oz. barrier, despite the collapsing dollar and a powerful silver rally. Very little has changed over the past few weeks: Gold remains an unattractive commodity below \$400/oz., but potentially a very attractive asset once it successfully crosses the Maginot Line. (See our comments last month).

Since our last issue, silver prices have risen a spectacular 30%, aided by steady and substantial withdrawals of silver stocks from Comex-approved warehouses and an option-squeeze play that caused prices to gap over a weekend by more than 22¢/oz. Suspecting manipulation, we advised tightening stops to 5.69, basis May '95, close only. Friday, the

May '95 contract closed at at 5.68, triggering our stop and locking in a 93¢/oz. gain in a little over 5 weeks.

**STRATEGY:** Clients closed out long silver positions as per the close of Friday, April 21, at around 5.68 (see our Hotline Update for April 20).

Please note the revised stops on platinum and gold: \$440.00, basis July '95 and \$390.00, basis June '95, respectively, close only.

The disinflationary climate discussed in our earlier article is not conducive to strong precious metals' gains.

Chart 6

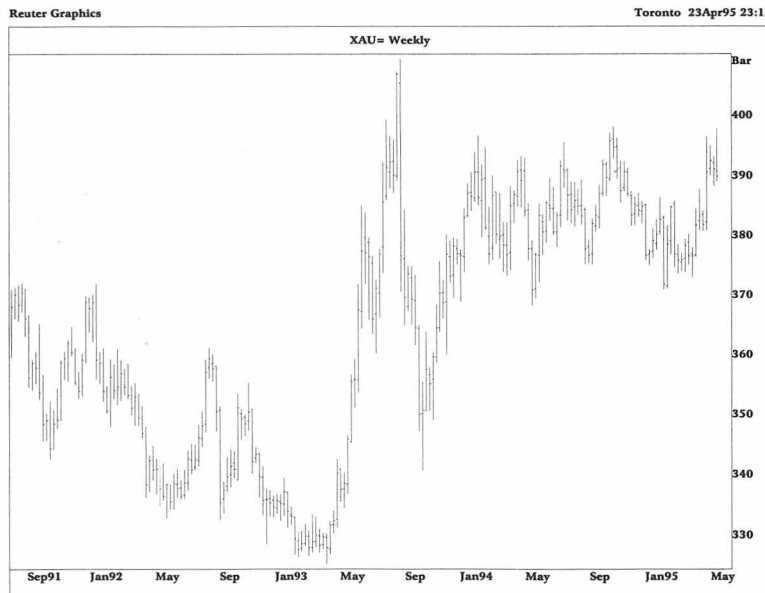
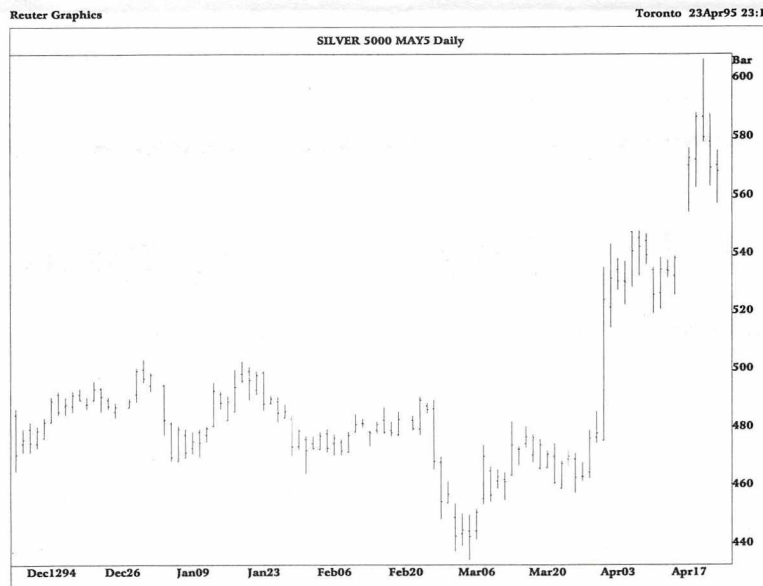


Chart 7



**SUGAR**

## Down but not out

There's one sure sign that a trader is on the run: He claims to be a fundamentalist, but when faced with a losing position he dusts off his charts and tries to rationalize his stance. Nobody wants to hear it. So we'll spare the reader the gruesome "fibonacciesque" details. Suffice it to say that a glance at a long-term chart of sugar (Chart 8) shows a commodity well within the confines of a long-term bull market.

The market had been conditioned into accepting bumper crops from India, Brazil, and Australia and was focusing on buoyant demand from the likes of China and Russia to lap it up and thus maintain the production/consumption deficit at least through 1995. The straw that broke the camel's back, however, was little-talked-about Thailand.

Just a few months ago the Thai crop was thought to be about 4.7 million tonnes. As recently as April 4, Thai government figures showed that as of March 31, 4.96 million tonnes had been harvested, with a month yet to go. By April 10, the government figures were revised to over 5 million tonnes. What really threw the market for a loop was that on the same day, respected statistician ED&F Man raised its forecast for the Thai crop to 5.3 million tonnes, which, if accurate, would spell the end of three years of world deficits — and a year ahead of schedule to boot.

Clearly, looking only at the supply side of the story, the bull has no case.

What keeps us interested in this market is the tightness represented by the May/July spread. The price of sugar peaked early in January and has fallen by over 20%. The spread, however, remains at an unbelievably stubborn 129 points. This is truly phenomenal for a falling market. Since we drew the analogy to cotton in last month's issue, it promptly reversed a sharp correction and made new contract highs, demonstrating the perils of messing with persistent backwardation. All of which leads us to conclude that the drop we experienced in this market is the work of commodity funds' jumping on what they think is a new trend. Evidence of this can be easily seen in a sharply rising open interest (it should be falling) with commercials happily taking it off the speculators' hands, which is a matter of official record (Commitment of Trader's Report).

She's down but not out.

**STRATEGY:** *You are long July '95 sugar at around 12.00 as per our flash update of April 20. Place stops at 11.31, good anytime.*

— Sholom Sanik

**STOCK MARKET INDEXES**

## DJIA: A solitary walk

Typical of major stock market tops, market strength has concentrated in a small number of issues, primarily some of the blue chips that comprise the Dow Jones Industrial average. This lack of breadth comes despite the fact that positive earning surprises as reported by IBES thus far exceed negative earning surprises by a margin more than 2-1.

The bull's days are numbered.

**STRATEGY:** *You are short June '95 S&P around 509.20 as per flash update of Tuesday April 18. Leave stops at 515.05, good anytime.*

**FRIEDBERG CAPITAL MARKETS**

# Argentina: From depression to euphoria

Decisive official action in support of the Convertibility Law unleashed a formidable rally in financial assets. Argentine debt instruments are already trading, in some cases, higher than at the start of the Mexican crisis. Bic V and FRBs, our two favorite investment vehicles, have produced astonishing 70% total returns, if and when bought at the depths of the crisis.

These instruments' familiarity to foreign investors and their high degree of liquidity have made them extremely popular. Thus, they've become overpriced in relation to other, less well-known debt instruments. Following are two interesting swap suggestions.

## Great Swap Opportunities

**Issuer:** Central Bank of Argentina

**Security:** BOCON Pre 1

**Currency:** Argentine peso

**Coupon rate:** based on savings account interest rate in Argentina, reset daily

**Maturity:** April 1, 2001

**Recent price:** \$55

**Yield to maturity:** 30%

Given the recent rally in the BIC V bond (from the recent low of \$40 to \$64 on April 21), we believe it is time for investors to take profit and swap into the the BOCON Pre 1.

The BOCON Pre 1 is an Argentine peso-denominated bond issued to pay off pension liabilities. The coupon rate is based on the average savings account interest rate paid in Argentina, as opposed to the basis of funding cost on the BIC V. Payment of interest does not start until May 1, 1997, and all the accrued interest is being capitalized and added to the principal. Therefore, the principal, or par value, of the BOCON Pre 1 is currently \$128.90.

The central bank will also start paying down the principal on the first day of every month starting from May 1, 1997. Each payment is 2.08% of the bond's par value (except for the last payment, which is 2.24%). The bond currently provides a yield pick-up of approximately 100 basis points over the BIC V.

We expect the yield spread to widen with the BIC's yield going down substantially. The coupon rate of the BIC V, which is based on average funding cost in Argentina, should

decline to a long-term average of 19% to 20% from the current 27% when the crisis is over. In that case, the BIC's yield will decline to below 20%. In other words, the projected yield pickup by swapping into the BOCON Pre 1 can be as much as 1,000 basis points.

In addition, the current yield spread is due to the zero coupon nature of the bond for the time being, which implies a risk premium for holding Argentine paper that is not currently paying. Our continued long-term bullishness on Argentina led us to believe that the risk premium is not justified and investors should take advantage of the unsustainable yield spread.

**Issuer:** Central Bank of Argentina

**Security:** BOCON Pre 2

**Currency:** US dollar

**Coupon rate:** 30-day LIBOR, reset monthly

**Maturity:** April 1, 2001

**Recent price:** \$73

**Yield to maturity:** 21.2%

On the US dollar side, we recommend swapping from the FRBs into the BOCON Pre 2. The BOCON Pre 2 is the same series as the Pre 1 discussed above but denominated in US dollars. The par value of Pre 2 is currently \$118.66. Its coupon rate is based on one-month LIBOR. Both Pre 1 and Pre 2 have exactly the same principal amortization and interest payment schedule.

The Pre 2 currently provides a yield pick-up of approximately 400 basis points over the FRB. The yield spread is even wider than between the BIC V and the Pre 1. The main reason is that the FRB is considered a more liquid issue widely traded by foreign investors, whereas the Pre 2 is largely a domestically traded issue in Argentina. Furthermore, as in the case of the BIC V versus the Pre 1, the Pre 2 is not paying until 1997, while the FRB is currently paying.

**STRATEGY:** As a long-term investor in Argentina, swap into the Pre 2 from the FRB to benefit from the higher yield. The yield spread will narrow once the sentiment on Argentina improves.

— Edison Lee, CFA

**FRIEDBERG CAPITAL MARKETS****Digital Equipment Corp.****Security:** Common stock**Exchange:** New York Stock Exchange (Symbol: DEC)**Current price:** \$45**52-week range:** \$18.375 - \$46.75**Shares O/S:** 147 million**Market cap:** \$6.6 billion**Company Profile**

Digital Equipment Corp. (DEC) has finally made the transition from a mini computer platform based on its VAX system to an open client/server system platform based on its Alpha AXP architecture. It returned to profitability from a cumulative loss of \$5.95 billion since fiscal 1991. It had been profitable in the last two fiscal quarters, and the profit figures for both quarters were at the high end of analysts' estimates.

The turnaround at DEC is built around its Alpha AXP computer server systems and a range of Alpha AXP-based and Intel-based personal computers. The Alpha AXP systems use 64-bit, reduced instruction set computing (RISC) architecture and are designed to support multiple operating systems. DEC developed the Alpha servers as a way to capitalize on the trend of open/client server computing, in which different computer systems from different vendors can be linked up to run as a smooth network. Sales of its Alpha servers and personal computers have been very strong.

Services are also an important source of revenue for DEC. Services contributed 46% of total revenue in fiscal 1994 (ended June). Over half of the service revenue comes from maintenance, which is mainly associated with the installed base of the VAX systems. Since the VAX systems are being phased out and the Alpha AXP servers require less maintenance, service revenue from this source is expected to decline slowly over time.

The other two major services are system integration and strategic consulting. In combination they represented 37% of service revenue in fiscal '94. These services are expected to lead the growth in the service segment of DEC as they are often sold as a package with the company's hardware.

Chart 9 outlines the projected revenue of DEC in fiscal 1995 broken down by product lines. It also gives the relative weighting and estimated gross margins. These figures were extracted from a recent report on DEC by Goldman Sachs.

**Financial Performance**

DEC has shown year-on-year sales growth in the last three fiscal quarters. We believe the growth has been mainly driven by the Alpha AXP server and personal computer sales. Service revenue has been flat, owing to shrinking maintenance revenue offset by healthy growth in system integration and strategic consulting.

Since its introduction in 1992, DEC has shipped more than \$1 billion worth of Alpha AXP-based systems. DEC has recently unveiled the AlphaServer 8400, which in conjunction with software developed by Oracle, they claim runs databases faster than any other machines on the market. When more companies embrace the concept of open/client server com-

puting, the Alpha AXP line will be the major engine of growth in the next few years for DEC's product sales. We projected the product sales of DEC to rise from \$7.2 billion in fiscal 1994 to \$8.7 billion in fiscal 1996, and the total revenue from \$13.4 billion to \$15.2 billion over the same period.

The gross margin on product sales has declined significantly in the past few years owing to the rapid decline in the VAX systems. It dropped from 44.8% in fiscal '92 to 30.9% in fiscal '94. When the VAX systems are approaching the end of its phase-out and the Alpha servers start taking over, the gross margin should stabilize. However, both the Alpha servers and personal computers, where the future growth lies, are lower-margin items. Therefore, the overall gross margin on product sales should continue to decline, albeit slowly. The projected gross margin on product sales is 29% in fiscal '95 and 28% in fiscal '96.

On the other hand, the gross margin on services has been relatively stable. Nevertheless, when maintenance services, which have the highest margin among all services, become less important in the overall mix, the average gross margin should also decline. The projected gross margin on services is 36.4% in fiscal '95 and 35% in fiscal '96. Hence, the companywide gross margin should drop to 32.4% in fiscal '95 and 30.9% in fiscal '96, from 33.7% in fiscal '94. It will be at the low end of management's target of 30% to 32%.

We believe reduction of overhead remains the single most challenging task at DEC. Workforce reduction has been the most important source of overhead savings. The number of employees has come down from 113,800 in fiscal '92 to 82,800 in fiscal '94. It dropped further to 63,100 at the end of March 1995. According to the company's announcement earlier this year, the headcount should be down to approximately 62,600 at the end of June 1995. In other words, a total of 20,200 jobs will have been eliminated during fiscal '95.

Operating expenses (SG&A) as a percentage of revenue declined from a peak of 33.6% in fiscal '92 to 27.6% in fiscal '94, and then down to 24.8% for the last 12 months ended March 1995. A drop from 33.6% to 24.8% of revenue translated into savings of \$1.2 billion in annual SG&A. Unfortunately, the rate of overhead reduction is not fast enough to avoid operating losses given the rapid gross margin erosion (from 41.6% in fiscal '92 to 33.7% in fiscal '94). We estimated that the headcount reduction in fiscal '95 should translate into additional SG&A savings of approximately \$700 million in fiscal '96, and should reduce SG&A to slightly below 20% of revenue. This will further translate into earnings per share of \$3.1 to \$3.5 in fiscal '96, which is at the upper end of Wall Street's estimates.

Bob Palmer, CEO of DEC, stated that the company's interim financial goals were to reduce R&D expenses to between 7% and 8% of revenue and SG&A to between 15% and 18% of revenue. While the R&D goal is not difficult to achieve (currently at 8.6% of revenue), our estimate shows that DEC will not meet the SG&A goal in fiscal '96 with only the current headcount reduction. However, if DEC can achieve further cost reductions through more rationalizations and hit the upper end of its SG&A target (18%), it would boost its fiscal '96 earnings per share (EPS) to \$4.30, which trans-

lates into a prospective price/earnings ratio (P/E) of only 10X. Hitting its aggressive SG&A target of 15% of revenue will translate into EPS of \$7, or a prospective P/E of 6.3X.

In short, DEC has three operating challenges: revenue growth, gross margin maintenance, and overhead reduction. Based on our assessment, the single biggest uncertainty right now is still overhead reduction. The above analysis shows that DEC's bottom line is highly sensitive to its operating expenses. If DEC can continue its past efforts to further reduce its SG&A, it will be a true winner in the computer industry.

### Valuation

DEC's valuation should be broken down into three elements: personal computers, servers/workstations, and services. The reason is that these three businesses have different cost structures and competitive environment. However, since DEC provides only revenue breakdown but not operating profits breakdown by product lines, a valuation estimate has to be based on price-to-sales ratios from comparable companies. The price-to-sales ratios assigned to DEC's different businesses are based on its relative gross margins (Chart 10).

The personal computer business of DEC was assigned a price-to-sales ratio of 0.45 based on its gross margin, which is lower than those of the pure PC play on the market. That puts a value of \$941 million on its personal computer division.

The server business is combined with the peripherals business, because the latter is closely associated with server sales. The gross margin on servers alone is 40% (which is still lower than those of the three pure server makers) and that on peripherals is 26%. Owing to the high growth potential of DEC's Alpha servers, a multiple of 0.7 was assumed and that gives a valuation of \$4 billion.

The only comparable public companies in the service segment (systems integration and consulting) are Computer Sciences Corp. (CSC) and Electronic Data Systems (EDS). DEC's service business has a much higher gross margin mainly because of the maintenance service component (46% gross margin). Since the maintenance service business is shrinking, DEC's average gross margin in this segment should be on a decline. In addition, for the same reason as mentioned, the revenue growth will be much slower than either CSC's or EDS's. Therefore, despite DEC's much higher gross margin,

a very conservative multiple of 1.2 was assigned to its service business. That implies a valuation of \$7.6 billion.

Consequently, the aggregate valuation of DEC based on the three business segments is approximately \$12.6 billion, versus the current \$6.6 billion. The valuation is equivalent to 0.89 times projected fiscal '95 revenue or 0.82 times projected fiscal '96 revenue.

We understand that the above projection using a point estimate is highly subjective and has its limitations. However, we believe the valuation does indicate that DEC's fundamental business, measured in terms of revenue-generating and gross-profit-making ability, should be worth much more than the current value. Whether the projected valuation can be realized depends heavily on how fast it can reduce its operating expenses to a truly competitive level.

Based on their cost-cutting efforts to date, their projected fiscal '96 operating margin should be 4%, which is still lower than IBM's 7.8%. Projected revenue per employee at \$226 for fiscal '95 will still be below IBM's level. Therefore, there should be additional room for cost squeeze at DEC by more headcount reduction and/or more streamlining of operations. As discussed above, valuation using earnings multiple indicates that there is strong upside potential, even if DEC reaches only the upper end of its SG&A target.

Last but not least, a comparison of DEC with IBM and Hewlett-Packard provided in Chart 11 (all three companies are in servers, personal computers, and services) shows that DEC's valuation is much lower than the other two on the basis of price-to-sales and price-to-book multiples. The major reason is DEC's much lower operating profitability (financial position is comparable). Therefore, it is consistent with our view that a further containment in its operating expenses will boost DEC's valuation significantly.

**STRATEGY:** DEC is in an early phase of a turnaround. Based on a blended valuation, we believe DEC has the potential to double its market capitalization. The key is whether DEC can get its operating expenses in line quickly enough. The effect of headcount reduction that has taken place over the last nine months is not yet fully felt. A further decline in its operating expenses should produce positive earnings surprises in the next few quarters, which will boost the stock price substantially.

Chart 9

Digital Equipment Corp.  
Projected Revenue - Fiscal '95

	Projected Revenue (\$ million)	% of total
<b>Products:</b>		
VAX systems	725	5.12
VAX/Mips workstations	75	0.53
Alpha systems	1,200	8.48
Alpha workstations	750	5.30
Server/workstations subtotal	2,750	19.43
Compatible PCs	2,050	14.48
Alpha-based PCs	40	0.28
PCs subtotal	2,090	14.76
Peripherals/others	2,958	20.90
Total products	7,798	55.10
<b>Services:</b>		
Maintenance	3,676	25.97
System integration	2,175	15.36
Strategic consulting	360	2.54
Outsourcing	147	1.04
Total services	6,358	44.90
Total sales	14,156	100

Source: Barry Willman, Goldman Sachs, January 27, 1995

Chart 10

Valuation of Digital Equipment Corp.

A) Personal Computers				
	DEC	COMPAQ	AST	DELL
Revenue (\$ million)	2,090	10,866	2,311	3,475
Gross margin	19.0%	25.1%	12.3%	21.2%
Price to sales	0.45	0.77	0.24	0.51
Projected value of DEC's PC business				\$ 941
B) Client/Server & Peripherals				
	DEC	NET-FRAME	TRICORD	AUSPEX
Revenue (\$ million)	5,708	89,135	81,121	92.8
Gross margin	32.8%	52.6%	37.3%	54.0%
Price to sales	0.7	0.90	0.72	2.30
Projected value of DEC's client/server business				\$ 3,996
C) Services				
	DEC	CSC	EDS	
Revenue (\$ million)	6,358	3,085	9,960	
Gross margin	36.4%	20.4%	24.4%	
Price to sales	1.2	0.81	1.93	
Projected value of DEC's service business				\$ 7,630
<b>Projected total value of DEC</b>				<b>\$ 12,566</b>
Implied aggregate price to sales				0.89
Projected per share value				\$ 85.5

Chart 11 – Comparative Valuation of Computer Companies<sup>1</sup>

Ratios	DEC	IBM	Hewlett-Packard
Price to book	1.91	2.30	3.15
Price to sales	0.45	0.81	1.23
Prospective P/E	16.12	14.10	16.16
Gross margin	31.3%	41.6%	37.7%
Operating margin	-1.5%	7.5%	10.8%
EBITDA margin <sup>2</sup>	1.1%	17.0%	14.6%
Revenue per employee	\$221.7	\$237.9	\$331.8
Current ratio	1.57	1.41	1.60
Debt to equity	2.02	1.00	0.28

(1) based on the latest twelve months' results for the respective companies.  
 (2) EBITDA = earnings before interest, taxes, depreciation and amortization.

## Update on Onex Corp.

(All dollar and cent figures below are in Canadian currency, unless otherwise stated)

**Security:** Common stock (TSE: OCX)

**Recent price:** \$13 per share

**52-week range:** \$12-\$15.75

**Market capitalization:** \$533 million

Onex Corp. (Onex) recently announced its 1994 full-year results. All underlying businesses performed satisfactorily and most subsidiaries, Sky Chefs and Dayton Superior in particular, showed significant profit improvements.

Sky Chefs, the airline catering operation, is currently the largest asset in Onex's investment portfolio (38% of total net assets, 60% ownership). It showed a 36.5% rise in operating income on a mere 2% revenue increase. The drastic margin improvement was mainly due to the cost-reduction program in place two years ago. Therefore, the rapid bottom line growth is unlikely to be sustained.

However, we expect revenue growth to be healthy as Sky Chefs expands internationally, using Lufthansa's networks in Europe. Sky Chefs was valued at \$400 million based on the price that Lufthansa paid for a 25% stake in 1993. We believe the valuation, which implies a price-to-sales ratio of 0.61 and an enterprise-value-to-EBITDA multiple of 5X, is conservative, especially when we take into account the substantial profit improvement in 1994.

Another important investment of Onex is Pro-Source Distribution (78% ownership), originally the foodservice division of Burger King. Pro-Source registered a 20% increase in both revenue and operating income in 1994, helped by the acquisitions of Valley Food Services and Malone Products in the last two years. However, pricing was very competitive in the industry, and Pro-Source has not been successful in improving its margin. It recently completed the acquisition of the National Accounts Division of The Martin Brower Company for approximately \$185 million.

The two companies combined will have annual revenue of \$5 billion and serve over 14,000 restaurants in the US. However, management indicated that it would take at least two years to integrate the two operations and achieve the desired synergies. While we attached a very low valuation to Pro-Source as it is now, there should be strong upside potential once the synergies are realized.

Dayton Superior (52% ownership), a leading supplier of chemicals used in concrete construction, achieved a turnaround in 1994 following the debt restructuring. Onex initiated a recapitalization by injecting an additional US\$3.5 million in equity. The result was to reduce Dayton's total debt from US\$64 million to US\$24.4 million. For 1994, revenue of Dayton grew by 9% and operating earnings by 21%. It turned a net profit of US\$3 million before restructuring gain versus a US\$4.7 million loss in the previous year. Although Onex's interest dropped to 52% from 85% owing to the recapitalization, we estimated its value to have gone up from zero to approximately \$15 million.

Onex has a substantial interest in the automotive industry through its 19% interest in Automotive Industries (listed on Nasdaq), 33% in Tower Automotive (listed on Nasdaq), and 40% in Dura Automotive. Dura Automotive was formed by merging Dura Mechanical and Orscheln Co. with a view to becoming a major supplier of parking brakes. This group experienced strong performance in 1994 owing to booming car sales. Nevertheless, valuation has come down in the last quarter owing to the market perception that the cyclical boom is near its end.

Moreover, there are currently two non-core investments. One is a 20% interest in Purolator. According to a previous agreement, Onex has to sell this interest to Canada Post (which is now the 80% owner of Purolator) at the end of 1996 at fair market value. In addition, Onex holds 16% of the common shares of Scotsman Industries, a restaurant equipment supplier listed on the NYSE. The shareholding was a result of the sale of The Delfield Company and Whitleng Drink Equipment Ltd. to Scotsman Industries in 1994. We believe Onex is ready to liquidate the shares of Scotsman soon.

At the end of December 1994, Onex had approximately \$320 million in cash at the parent company, which included a \$16.5 million investment in Alliance Communications' convertible debentures. Chart 12 shows our estimated net asset value of Onex and its breakdown, which is between \$800 million and \$870 million, versus the current market value of \$533 million.

Onex announced three weeks ago a share buyback program in which a maximum of 10% of its outstanding shares will be bought back over the next 12 months. This vindicates our view that the shares are substantially undervalued (trading at a 32% discount to net asset value).

Recently Onex indicated that it was considering making a bid for John Labatt Ltd. While details are not yet available, it seems that Onex is not the only party that is interested. Furthermore, we believe Onex's ultimate interest is in the entertainment businesses of Labatt (the Toronto Blue Jays, the SkyDome, and several cable television channels) rather than the brewery business, which may be sold off upon acquisition.

While the stock has not moved in response to the news, and has been relatively stable since our first recommendation, the basic story of Onex has not changed. It keeps generating enormous capital appreciation from its leveraged buyout investments and the stock is still trading at a deep discount to its asset value. The long-term return on an investment in its stock should come from either a shrinkage in the discount over time or continuous share buyback coupled with occasional special dividends, or both.

**STRATEGY:** *We continue to rate the stock a buy.*

– Edison Lee, CFA

Chart 12 – Estimated Net Asset Value of Onex Corp.

Holdings	Total value (C\$ million)	Onex' interest	Value of Onex' interest	Adjustment	Adjusted value to Onex
Scotsman Industries*	213	16%	34	15% block sale discount	34
Tower Automotive*	147	33%	49	Nil	49
Johnstown America*	156	2%	3	Nil	3
Automotive Industries*	609	19%	116	15% block sale discount	98
Sky Chefs	400	60%	240	20% controlling interest premium	288
Purolator*	64	20%	13	35% minority interest discount	8
ProSource Distribution	0.93	78%	0.73	20% lack of marketability discount	0.58
Dura Automotive	0	40%	0	same as above	0
Dayton Superior	32-43	52%	17-22	same as above	13-18
Cash & cash equivalent					320
Estimated total net asset value					809-871
Current market value					533

\* Publicly listed companies.

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, CD, SAR, ECU, ITL, and ARG) or revalue for FIM, SF, JY, before the interest rate advantage/disadvantage is overcome by currency depreciation/appreciation. Rates as of April 20, 1995.

	U.S. \$	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	6.14%		VEB 7% '96 yields 12.06% (DM/US 1.4617)								ESCom '96 yields 14.12% (SAR/US 0.2588)	NIB '96 yields 11.50% (ITL/US 1.8158)		Finland '95 yields 4.53% (FIM/US 4.2036)
2 year	6.41%				World Bk. '96 yields 1.33% (JY/US 75.4185)	Denmark '96 yields 7.12% (DKr/US 5.5098)	Sweden '96 yields 7.24% (US/BP 1.5868)	Cr. Lyon '96 yields 7.68% (FFr/US 4.9782)		R.B.C. '97 yields 7.52% (CDN/US 1.4003)				
3 year	6.53%													
4 year	6.64%		Argentina '98 yields 8.76% (DM/US 1.4979)	G.E. '98 yields 4.92% (SF/US 1.0706)										
5 year	6.75%	Tranz Rail '99 yields 9.55% (US/NZ 0.5913)												
6 year	6.82%								UK '01 yields 8.02% (US/ECU 1.2432)				BIC V '01 yields 28.00% (ARG/US 2.9604)	
8 year	6.97%													
9 year	7.02%													
Spot Exchange Rate	–	0.673	1.3845	1.1425	83.17	5.437	1.6117	4.8615	1.3294	1.3715	0.2783	1.7285	1.00	4.2683

\*For example, since a US\$-based investor would receive 280 basis points (955-675) by holding the Tranz Rail NZ\$ bond, the NZ/US can depreciate to .5913 from the present spot exchange rate of .6730 over

the next 5 years for the NZ investment to break even with current US\$ rates of interest. Assumes that bonds are held to maturity, and coupons are reinvested.

Chart 14 – FOREIGN CURRENCY BONDS

DATE: April 20, 1995 We offer the following Bonds subject to change without prior notice: Minimum US \$5000 (CDN \$7000)

ISSUER / COUPON / MATURITY DATE	BID	OFFER	YTM	CURR. COUPON	NEXT INTEREST PAYMENT DATE
<b>DEUTSCHE MARK DENOMINATED BONDS</b>					
Bank of Nova Scotia 5 5/8% 7/5/96 RRSP eligible	99.50	-	-		May-07
World Bank 5 7/8% 4/02/97 RRSP eligible	101.55	102.40	4.42		Feb-04
World Bank 9% 13/11/00 RRSP eligible	112.10	112.95	6.16		Nov-13
Kingdom of Denmark 6 1/8% 15/04/98	99.80	100.65	5.88		Apr-15
Argentina 8% 5/10/98	96.90	97.75	8.76		Oct-05
Bk. Foreign Eco. Affairs 7% 29/3/96	94.90	-	-		Mar-29
Kgdm. of Spain (Floating) 29/6/02 (semi)	98.94	99.24	-	5.4375	Jun-29
<b>FINNISH MARKKA DENOMINATED BONDS</b>					
Rep. of Finland 11% 15/6/95	99.95	100.80	4.53		Jun-15
<b>ITALIAN LIRA DENOMINATED BONDS</b>					
Nordic Inves. Bk 12 3/8% 19/04/96	99.90	100.75	11.50		Apr-19
<b>SWISS FRANC DENOMINATED BONDS</b>					
General Electric 4 3/4% 2/7/98	98.65	99.50	4.92		Jul-02
<b>DANISH KRONE DENOMINATED BONDS</b>					
Kgdm. of Denmark 9% 15/11/96	101.75	102.60	7.12		Nov-15
<b>ECU DENOMINATED BONDS</b>					
United Kingdom 9 1/8% 21/02/01	104.10	104.95	8.02		Feb-21
<b>BRITISH POUND DENOMINATED BONDS</b>					
Kdgm. of Sweden 8 3/4% 29/5/96	100.65	-	-		May-29
<b>FRENCH FRANC DENOMINATED BONDS</b>					
Credit Lyonnaise 9 1/2% 23/12/96	101.80	102.65	7.68		Dec-23
<b>JAPANESE YEN DENOMINATED BONDS</b>					
World Bank 5 3/4% 7/8/96 RRSP	104.70	105.55	1.33		Aug-07
<b>CANADIAN DOLLAR DENOMINATED BONDS</b>					
Ontario Hydro 10 7/8% 8/01/96 (semi) RRSP eligible	101.10	102.35	7.33		Jul-08
Eksportfinans 7 3/4% 5/11/97	98.30	-	-		Nov-05
Royal Bank of Canada 9 1/8% 7/1/97 RRSP eligible	101.15	102.40	7.52		Jan-07
<b>SOUTH AFRICAN RAND DENOMINATED BONDS</b>					
ESCOM 12% 1/5/96 (semi)	97.25	98.10	14.12		May-01
<b>AUSTRALIAN DOLLAR DENOMINATED BONDS</b>					
Commonwealth Bk. of Australia 9 3/4% 15/5/96	100.35	-	-		May-15
<b>NEW ZEALAND DOLLAR DENOMINATED BONDS</b>					
World Bank 12.5% 25/7/97 (semi) RRSP eligible	108.90	109.75	7.69		Jul-25
New Zealand Gov't 10% 15/7/97 (semi)	103.05	-	-		Jul-15
New Zealand Gov't 8% 15/7/98 (semi)	99.75	100.60	7.78		Jul-15
Fletcher Challenge 10.75% 15/12/97 (semi)	102.30	103.15	9.37		Jun-15
Fletcher Challenge 10.15% 30/11/98 (semi)	101.15	102.00	9.48		May-30
Corporate Investment Ltd. 13 1/2% 19/6/95 (semi)	89.90	92.40	12.00		Jun-19
Tranz Rail Ltd. 10% 15/10/99 (semi)	100.75	101.60	9.55		Apr-15
DB Group 7% 30/6/96 (semi) matures @ 85	95.50	-	-		Jun-30
Seabil Ltd. 9% 27/6/99 (semi)	89.85	-	-		Jun-27
<b>ARGENTINEAN PESO DENOMINATED BONDS</b>					
BIC V Fixed/Floating 1/5/2001 Callable in full on every interest date	61.75	63.75	IRR	28.00	4'th day of mth.
<b>MEXICAN PESO DENOMINATED BONDS</b>					
Government of Mexico "CETES" 27/4/95		available on request			every 2 weeks
<b>U.S. DOLLAR DENOMINATED FIXED CONV. BONDS</b>					
Burnup & Sims 12% 15/11/00 CV@16.79 p/sh (semi)	96.25	97.75	12.57		May-15
Atari Corp. 5 1/4% 29/4/02 CV@16.31 p/sh	48.25	49.75	18.69		Apr-29
Coeur D'Alene 6% 10/6/02 CV@26.00 p/sh	91.25	-	-		Jun-10
Glycomed 7 1/2% 1/1/03 CV@14.06 (semi)	58.25	59.75	17.10		Jun-01
California Microwave 5 1/4% 15/12/03 CV@28.44 p/sh (semi)	106.25	107.75	4.17		Jun-15
<b>U.S. DOLLAR DENOMINATED FIXED RATE BONDS</b>					
World Bank 7 1/8% 27/9/99 (semi) RRSP eligible	101.00	101.85	6.63		Sep-27
Farm Credit Corp 7 3/4% 10/06/96 RRSP eligible	101.35	102.20	5.70		Jun-10
T.W.A. 10% 3/11/98 (semi)	62.25	63.5	26.52		
<b>U.S. DOLLAR DENOMINATED FLOATING RATE NOTES</b>					
Kgdm. of Denmark 25/3/97 (Gold call, JY put),(semi)	71.2	72.2	-	8.45	Sep-25
United Kgdm. 30/9/96 3 mo.LIBID-1/8 (qly),callable @100	99.85	100.15	-	6.00	Jun-30
Bocon 1/4/01 (30 day LIBOR) starts accruing May 1,1997	69.70	70.55	23.48		May-01-97
Argentina: Series L-FRB 31/3/05, 6 mo. LIBOR+13/16 (semi)	59.75	61.25	18.01	7.3125	Sep-29

**GOLD** (in ounces, at market prices, can also be held in your bond account) client eligibility determined at point of sale.

Chart 15 – Recommended current portfolio allocations

1. Mexican Cetes	5%	5. CIL NZS	5%
2. Seabil Ltd NZS	5%	6. FRB/BIC V	20%
3. New Zealand (8%) '98 Gov't	35%	7. DM issue	15%
4. Tranz Rail NZS	15%		

**HOTLINE UPDATE**

**Tuesday, March 28, 1995:**

Good morning for Tuesday, March 28, 11:20 am. This is a flash update. Buy June Swiss francs at the market, presently trading at 8736. Place stops at 8500, close only. Have a great trading day.

**Tuesday, March 28, 1995:**

Good afternoon for Tuesday, March 28. There are no new changes or recommendations. We repeat the flash update of 11:20 am this morning. Buy June Swiss francs at the market, presently trading at 8736, placing stops at 8500, close only. The market letter is in the mail. Have a great trading day.

**Thursday, March 30, 1995:**

Good afternoon for Thursday, March 30. This is a flash update. Sell June T-bonds at the market. Place stops at 105.16, close only. Have a great trading day.

**Friday, March 31, 1995:**

Good afternoon for Friday, March 31. We have one new recommendation. Sell June S & P at the market, risking 513.00, good anytime.

The following is a recap of this week's recommendations.

On Tuesday morning, via flash update, we advised to buy June Swiss francs at the market, then trading at 8736, placing stops at 8500, close only.

On Thursday, via flash update, we advised to sell June T-bonds at the market, placing stops at 105.16, close only. June T-bonds opened this morning at 103.29. Have a great trading day.

**Monday, April 3, 1995:**

Good morning for Monday, April 3, 8:40 am. This is a flash update. Buy June Japanese yen at the market, presently trading at 116.90. Have a great trading day.

**Tuesday, April 4, 1995:**

Good afternoon for Tuesday, April 4. We have 2 new recommendations.

Raise stops on May silver to 520, close only.

Raise stops on July platinum to 420, close only.

Please note that this will be the last update on this phone line, as the new phone number update was mailed to you with your March 26 newsletter. Have a great trading day.

**Friday, April 7, 1995:**

Good afternoon for Friday, April 7. We have no new changes or recommendations.

The following is a recap of this week's recommendations.

On Tuesday, we advised to raise stops on May silver to 520, close only and on July platinum to 420, close only. Have a great trading day.

**Monday, April 10, 1995:**

Good evening for Monday, April 10, 6:00 pm. This is a flash update. We have 3 new recommendations.

Lower stops on short June S&P to 510.90 from 513.00, good anytime.

Raise stops on long Swiss to 8575 from 8500, close only.

Raise stops on long May copper to 136.00, good anytime. Have a great trading day.

**Tuesday, April 11, 1995:**

Good afternoon for Tuesday, April 11. We have no new changes or recommendations. The next regularly scheduled update will be Thursday afternoon. Have a great trading day.

**Thursday, April 13, 1995:**

Good afternoon for Thursday, April 13. We have one new recommendation. Raise stops on July platinum to 440.00, close only.

The following is recap of this week's recommendations.

On Monday, via flash update, we advised to lower stops on short June S&P to 510.90 from 513.00, good anytime. We also advised to raise stops on long Swiss to 8575 from 8500, close only, and to raise stops on long May copper to 136.00, good anytime. Have a great trading day.

**Tuesday, April 18, 1995:**

Good morning for Tuesday, April 18, 9:35 am. This is a flash update. We have one new recommendation. Sell June S&P at the market, presently trading at 509.20, placing stops at 515.05, good anytime. Have a great trading day.

**Tuesday, April 18, 1995:**

Good afternoon for Tuesday, April 18. We have no new changes or recommendations.

We repeat our flash update of 9:35 am this morning. Sell June S&P at the market, then trading at 509.20, placing stops at 515.05, good anytime. Have a great trading day.

**Thursday, April 20, 1995:**

Good afternoon for Thursday, April 20. We have four new recommendations.

Raise stops on May silver to 569.00, close only.

Raise stops on July platinum to 440, close only.

Raise stops on June gold to 390, close only.

Buy July sugar at the market, placing stops at 11.31 stop, good anytime.

This is a complete summary since our last market letter dated March 26, of all liquidations of open positions and new recommendations that remain outstanding.

On Tuesday March 28, via flash update, we recommended to buy June Swiss francs at the market, then trading at 87.36. Stops were placed at 85.00, and subsequently, on April 10, were raised to 85.75, close only.

On Thursday, March 30, via flash update, we recommended to sell June T-bonds at the market, placing stops at 105.16, close only. June bonds opened on March 31 at 103.19.

On Monday April 3, via flash update, we advised the purchase of June Japanese yen at the market, then trading at 116.90.

On Tuesday April 18th, via flash update, we advised to sell June S&P at the market, then trading at 509.20. Stops were placed at 515.05, good anytime.

This is our last update of the week. Have a great trading day.

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