



Athena Capital Management



As you may have already noticed, I changed the look of our client letter! I also added four new sections:

- *Identifying Good Investments* examines how I pick investments
- *Investment Spotlight* provides background information on one of our investments
- *Why Is...* explains investment jargon, lore and history
- *Admirable Business People* highlights great people from the business world

I hope you enjoy these new features as well as my regular sections: *How Are We Doing* and *6 Year Market Projection*. As always, I welcome your feedback.

How Are We Doing?

From April 30, 2005 until March 31, 2006, our **growth accounts** averaged returns of 7.71% versus 13.89% for the S&P 500 and 17.31% for the Wilshire 5000. Year to date, we've gained 6.04% versus 4.21% for the S&P 500 and 5.44% for the Wilshire 5000. Our greatest price appreciation this quarter came from Leucadia, a diversified holding company, Level 3, a telecommunications company, and Pier 1, a specialty retailer. Our price declines, on the other hand, came from Fairfax Financial, an insurance holding company, and Montpelier Re, a reinsurance company.

From May 31, 2005 until March 31, 2006, our **equity income accounts** returned 3.35% versus 4.39% returns from S&P-500-yield-plus-inflation. Year to date, we've gained 4.10% versus 2.00% returns from S&P-500-yield-plus-inflation. Price appreciation this quarter came from Kimco, a real estate investment trust, Gladstone Commercial, a commercial real estate company, and Pier 1, a specialty retailer. Price declines, in contrast, came from Fairfax Financial and Montpelier Re.

Pier 1, the specialty retailer that did well this quarter, was the same investment that did poorly last quarter, showing how the market can react even in

the absence of fundamental business changes. On the downside, Fairfax Financial declined because it delayed filing its annual report, and Montpelier Re declined because it continues to feel the pain created by Katrina and her sisters (Rita and Wilma). In the long run, I think both Fairfax and Montpelier are sound investments despite their recent price declines (as in all investing, there are no guarantees).

I'd like to emphasize that I tend to invest in out-of-favor securities that frequently underperform over the first 3 years after purchase, but are likely to outperform in the long run. Our performance since inception is in no way a reflection that something is "wrong," or that something unexpected has happened. I expect to under-perform in the short run so we can out-perform in the long run. I continue to focus on the three to five year time frame and the fundamental performance of our companies. **Things are progressing as I expected and I continue to be optimistic that we can beat our benchmarks over the long run.**

6 Year Market Projection

Speaking of benchmarks, with the S&P 500 at \$1,295 at quarter end, my long term projections for market returns are as follows:

Projected annualized returns over the next 6 years	
S&P 500 (growth account benchmark)	-6.4% to 7.9%
S&P-500-yield-plus-inflation (equity income account benchmark)	3.3% to 6.3%

Interested in my method for deriving these numbers? Visit www.athenacapital.biz under "Free Articles" to see my 7/12/05 article.

Although my projections for the general market have not improved much, **I continue to find good investment opportunities for your accounts.**

In economic news, short term interest rates spent most of the quarter just above and then just below long term rates. In the past, this has indicated a slowing, but not recessionary, economy. The housing market, on the other hand, is showing signs of weakness with both new and existing home sales declining and unsold home inventories rising.

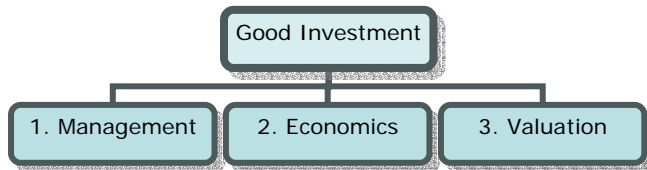


Athena Capital Management

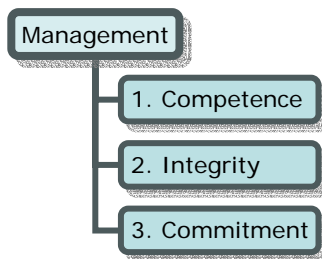
Continued housing weakness will lead to slower economic growth. Both interest rates and the housing market bear watching, but have yet to signal any conclusive direction for the economy as a whole.

Identifying Good Investments

Many clients ask what I look for in an investment. Generally, I look at three things:



In this first of a three-part series, I will describe what I look for in management. The three things I want to see are:



In search of competence. I like to find a management team with a proven track-record of effective execution and a clear expertise in their field.

To screen for effective execution, I look at management's past record through financial statements, annual reports, presentations, etc. I ask myself:

- How has management performed?
- Have they outdone their competitors?
- Do they focus on long term results?

Next, I look to see if they have a clear understanding and expertise in their field.

- Have they been in this business for long?
- Can they clearly describe their business and its dynamics to outsiders?

I read management's periodic reports and listen to their quarterly presentations to form an opinion about their expertise.

Does management have integrity? I love to find a management team that is honest, forthright and will act as a trustee for shareholders.

In screening for honesty, I like to see management freely admit their errors and clearly highlight their opportunities and challenges. If management tries to sugar-coat problems or minimize challenges, I take that as a bad sign.

Further, I like it when management clearly states that their purpose is to build shareholder value over the long term. This may sound obvious, but many management teams dwell on their own operational prowess without even a mention of how they are doing for the shareholders they serve.

I also examine management's compensation. A management team that is well paid regardless of performance is a poor sign. Luckily, publicly available proxy statements provide detailed information on management compensation that allows for a thorough examination and evaluation.

Is management committed? Commitment, to me, means managers are both qualitatively and quantitatively invested in the company.

Qualitatively, I love to see managers who've built a company from scratch. Managers who build a business over a lifetime are more likely to treat it with the loving care of a father. Such managers are emotionally invested in the future success of their business.

Quantitatively, I like to see managers that are compensated reasonably and have a large stake of their own money invested in the company. Stock handouts awarded by the board of directors don't count because such shares did not come out of management's own pocket. I greatly prefer managers that invest a significant chunk of their own net worth.

Although there's more to examining management than described above, I hope the qualities I highlighted give you some idea of what I look at when I say I search for good management. Although I rarely find all of these wonderful characteristics in one business, I like to find as many as possible before investing.



Athena Capital Management

Investment Spotlight: Kinder Morgan Inc.

Kinder Morgan, Inc. is a leading North American energy transportation and distribution company with approximately 40,000 miles of natural gas and petroleum transportation pipelines, 1.1 million natural gas distribution customers, and 150 storage terminals.

The company mainly transports natural gas and petroleum (both refined and unrefined) products. They also own and operate a natural gas distribution business serving 243,000 customers in Colorado, Nebraska and Wyoming. In the smallest part of their business, they operate a gas-fired electric generation facility.



Why do I like the company? **Kinder Morgan's business is very stable because they rent their pipelines to others instead of engaging in the riskier business of buying and selling natural gas and oil.** Further, it's difficult to compete in the energy pipeline business because building pipelines is inordinately expensive. This serves as a barrier to entry that protects Kinder Morgan's future earnings stream.

Why do I like management? **The chairman of the company is paid only \$1 a year and owns 19% of the company.** He's so frugal he brags about traveling coach when he flies. Not surprisingly, this also means he runs a tight ship by keeping costs low.

Most importantly, **the chairman is a very shrewd purchaser and operator of pipeline assets.** He has been in the business his entire career and understands the dynamics as well as or better than any other person in the industry.

Kinder Morgan clearly exhibits two of the characteristics I look for in an investment: strong and defensible economics, and competent and committed management.

Why Is...

...Wall Street Called Wall Street

New York was originally founded in the 1620's as the Dutch settlement of New Amsterdam. In the 1650's, New Amsterdam had become so prosperous that the English started to covet the trading post and its excellent harbor.

When the First Anglo-Dutch War broke out in 1652, **the Dutch governor of New Amsterdam decided to build a defensive wall along the town's northern edge.** When the English finally attacked the city in 1664, they did so *not* by land from the north, but by sea from the south. Under threat of the British Fleet's guns, the town surrendered and was renamed New York, after the younger brother of Britain's King Charles II, James, Duke of York.

In 1698, the wall, which had become useless, was torn down. The space behind the wall had long been reserved for troop movements, so no building had been allowed there. As a result, this space logically became an excellent through-way for New York's crosstown traffic. **In time, it came to be named Wall Street.**



Brokers often met in good weather to carry on their trading at 68 Wall Street, where a buttonwood tree stood. **On March 21st, 1792, twenty-one individual brokers and three firms signed the Buttonwood Agreement, which created a formal organization of these traders.** This arrangement was the seed that later became the New York Stock Exchange (originally located at 40 Wall Street).

Because of this history and that of so many great financial firms located in and around Wall Street,



Athena Capital Management

the term “Wall Street” has become a general term for the American financial center in New York.

Admirable business people: Les Schwab

I recently finished reading the autobiography of Les Schwab, who built a remarkable tire business in the Northwest U.S.

Les Schwab grew up in and around a logging camp in Oregon from 1917 to 1934. He worked his way through high school (yes, I mean high school) as a paper delivery boy. By the time he graduated, he was making more than his high school principal (during the Great Depression!). Over time, he worked his way up to circulation manager of the paper he delivered.

Always wanting to go into business for himself, Les Schwab bought his first tire store in 1952 at the age of 34. He showed up to work the first day having never changed a tire in his life. Since he didn't know how to change tires yet, he had to stall his first customer while waiting for his employees to arrive. Despite this inexperience, he increased annual sales by 368% in his first year. You might say he was a good salesman.



Schwab rolled his profits from that first store into another store. After doing that over and over again for more than 50 years, he now has over 300 stores throughout the northwest U.S.

There are several things that make Les Schwab Tire Stores unique. These characteristics were built into the business by Schwab from the beginning.

1. Schwab's tire stores share a passion for customer service. This focus on service has made for some of the most loyal customers in the business. At one time, Schwab's stores fixed any flat tire free of charge (regardless of where it was purchased) just to build goodwill with potential customers. It worked.

2. Schwab delegates both rewards and responsibility to individual stores. A manager of a Les Schwab Tire Center can become rich from their effort because of Schwab's profit sharing plans.

But, if a manager doesn't perform, he won't be in charge of a store for long.

3. Schwab clearly understands that you can't run a tire store on price alone. If you bargain down your prices too far, you can't make any money. And if that happens, you can't continue to grow the company and provide more opportunity to future store managers.

Les Schwab is a remarkable person both in terms of his business success and his ability to manage people. To understand the Les Schwab story, you must understand that these two things are one and the same.

To find out more about Les Schwab, read his autobiography called *Pride in Performance, Keep it Going!* Or, visit my website for a link on how to find this book.

Updated Website

For those interested, **I recently updated my website.** In addition to changing the wording and tone of the site (to make it more my voice and style), I also added a bunch of new articles, suggested reading ideas, and links to investing websites of interest. Stop by and check it out, and tell me what you think! www.athenacapital.biz

Also, I'd love to hear what you think about my services. Feel free to contact me any time with your questions, comments and suggestions.

And, *if you know anyone who might benefit from my unique service and approach*, send them my website and contact information.

Thank you for your business, and I look forward to hearing from you over the next quarter.

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