

Just Dreaming!

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"The stuff that dreams are made of." Bogie as Sam Spade in The Maltese Falcon.

- I dreamt that the Bureau of Labor Statistics issued a new press release highlighting the unadjusted (raw) data they gathered from the employer survey, in addition to their adjusted data. If they did issue one in reality it would become clear that their Birth/Death Model 'adjustment' provides an altogether new meaning to the word 'adjustment'. The following table lists the estimated 'non seasonally adjusted' number of total non-farm jobs added during the year from July 2003 through June 2004, along with the Birth/Death Model adjustments. The Birth/Death Model is supposed to account for the businesses that either have been recently started but are not in the BLS sampling universe or businesses that have expired but are still in the sampling universe. As stated on the BLS website, 'There is an unavoidable lag between an establishment opening for business and its appearing on the sample frame and being available for sampling. Because new firm births generate a portion of employment growth each month, non-sampling methods must be used to estimate this growth'. All numbers below are in thousands.

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Total
Total Reported	(1,349)	31	623	789	147	(209)	(2,672)	596	1,030	1,162	903	444	1,495
Birth/Death Adjustment	(83)	124	33	45	30	62	(321)	115	153	270	195	182	805
W/O Adj.	(1,266)	(93)	590	744	117	(271)	(2,351)	481	877	892	708	262	690
Adj. As %													117%

* Data from BLS for the one year spanning July 2003 through June 2004. All numbers here are not adjusted for seasonality, as the Birth Death Model estimates on the BLS site are based on data not seasonally adjusted.

The President himself has said that we've had a total of 1.5 million new jobs since last August. The question is - what are these new businesses that have added 805,000 jobs?

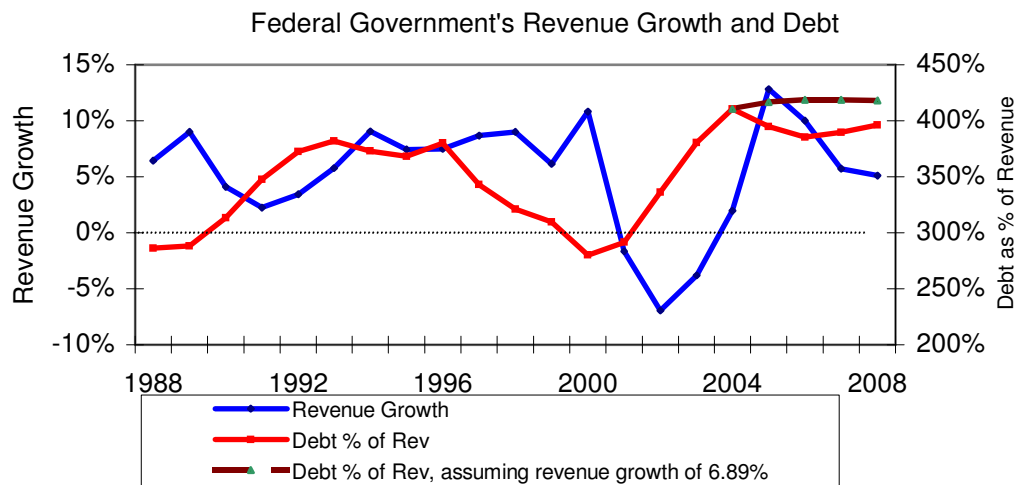
P.S. Numbers for July were just released by BLS. Total (non-seasonally adjusted) employment losses were 1206, the Birth Death Adjustment was -91, leaving job losses of 1,115 before the Birth/Death Model addition.

- The government entered into another one of my dreams the other day. I had gone to my banker, Mortgage Mary, a.k.a. MM, to get approved for a mortgage to buy a five bedroom six SUV-garage home. The lender did a routine credit check and approved my mortgage. Being somewhat crazy, I tried to understand her decision making process by asking her a few questions.

I: "My total debt right now is 50% of my annual income. Aren't you concerned about approving me for a mortgage that is 400% of my annual income?"

MM: "Well, you see, we follow the standards set by the government. In 2003, the federal government's total debt was 381% of its revenue, and in 2004, it is up to 410%."

She pulled out the following chart:



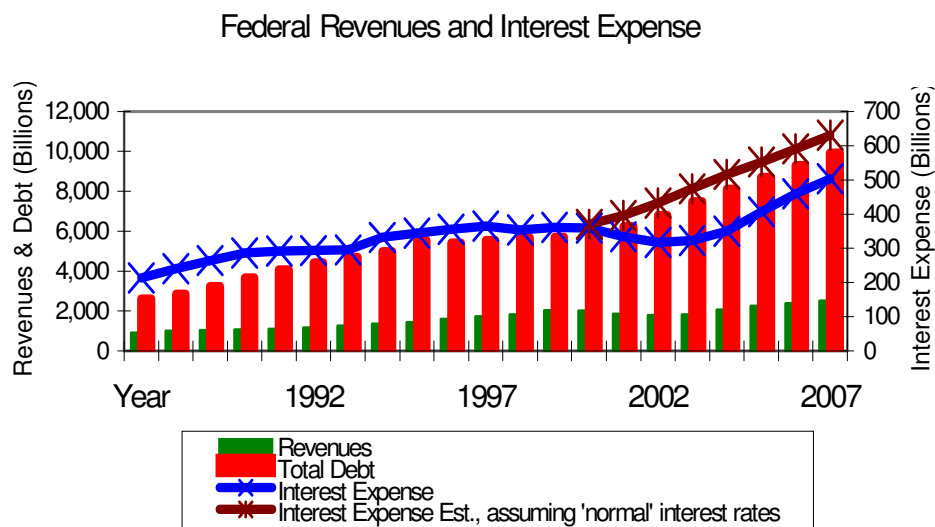
*Data from government sources including CBO, Treasury, White House.

MM: "Did you know that the average federal revenue growth between 1988 and 2000, which excludes the recent recession, was 6.8%? If you were to use this rather than CBO's 13% and 10% growth in 2005 and 2006 respectively, the federal debt as a % of revenue stays in the 418% area. So you are in good shape. By the way, your debt as a percent of GDP is 0.00000043%, which is nothing compared to our government's total debt to GDP ration of 65%. You are OK."

I: "Can't argue with that. But I am concerned about the size of the interest payment on the loan, MM."

MM: "What's there to worry about?"

She pulled out another chart:



* Data from government sources including CBO, Treasury, White House.

MM: “The federal government pays about 25% of its revenues as interest expense if you use historical interest rates rather than the negative real interest rates of the past few years. By our calculations your total interest expense is only 21% of your revenues, so you have ways to go.”

I: “Thanks for the lesson, MM. Now where do I put my signature?”

- I dreamt that the ‘ethical’ pharmaceutical companies announced publicly that they are more ‘sales and marketing machines’ rather than ‘R&D intensive’ organizations and therefore request that the patent life for new drugs be reduced from seventeen years to seven years, and that copycat or line extension drugs do not need patent protection.

As a review of the following FY 2003 data for the makers of the ‘wonder drugs’ Viagra, Cialis, and Levitra attests, major pharma companies spend more than two dollars on SG&A for each dollar spent on R&D. Based on my many years of consulting experience in this industry it is a safe assumption that more than 60% of the SG&A is spent on Marketing and Sales. All numbers are in millions.

	Pfizer		Eli Lilly		Glaxo	
		% of		% of		% of
Revenues	\$ 45,188	Rev.	\$ 12,583	Rev.	£21,441	Rev.
COGS	\$ 9,832	22%	\$ 2,675	21%	£4,188	20%
SG&A	\$ 15,242	34%	\$ 4,055	32%	£7,563	35%
R&D	\$ 7,131	16%	\$ 2,350	19%	£2,770	13%
Operating Profit*	\$ 12,983	29%	\$ 3,502	28%	£6,920	32%

As a frame of reference we can look at an R&D-intensive high tech organization like Intel where the R&D and SG&A dollars are more comparable.

	Intel (FY2003)	
		% of
Revenues	\$ 30,141	Rev.
COGS	\$ 13,047	43%
SG&A	\$ 4,278	14%
R&D	\$ 4,360	14%
Operating Profit*	\$ 8,456	28%

* Operating Profit listed here may differ from the company’s reported number due to other items.

- I dreamt that all the corporate Chief ‘Something’ Officers suddenly accepted accountability and paid for all corporate write-downs from their own pockets. Here are a some gross examples:
 Time Warner (Steve Case, Chairman, and Richard Parsons, CEO) - \$98.684 Billion goodwill impairment charges in 2002.
 Nortel Networks (L.R. Wilson, Chairman, and Frank Dunn, CEO)- more than \$13 billion in goodwill impairment and inventory reserve charges in 2001 and 2002. Nortel is yet to file its annual report for 2003.
 Lucent Technologies is a special case. It went from a ‘positive’ shareholder equity of \$26.2 billion on 9/30/2000 to a shareholder deficit of \$4.239 billion on 9/30/2003.

5. When I recently saw KMRT (Kmart) on the tape trading about \$77 a share, I thought I was dreaming. I had stopped following this company when it had entered bankruptcy, and could not expect that the new prison clothing line by Martha Stewart might propel its earnings to \$5 a share to get to that share price. Intrigued I looked up Kmart's numbers for the first quarter of 2004. It reported earnings of \$93 million on declining sales of \$4.615 billion, for an earnings per share of \$0.94- still not enough to justify the \$77 share price. I woke up to reality when I read a report from Deutsche Bank that said Kmart's real estate could be worth as much as \$150 per share, and that Kmart has agreed to sell dozens of its stores in recent months. It mentions that the average Kmart lease has 17 years remaining with an average rent of \$2.03 per square foot that compares with the average of \$10.07 per square foot for the total retail group. I had never realized that the retailers were actually in the commercial real estate business, and not in the retail business. Further, if Kmart has a "lease obligation" for seventeen years a rational investor would expect this to be reflected on the liability side of the balance sheet but of course it isn't. The off-balance sheet world is alive and well in reality. I am also wondering why Deutsche Bank has not already tendered an offer for all outstanding shares of Kmart, if it is such a compelling value.
6. In another of my dreams SEC and Eliot Spitzer were explaining to the public the meaning the phrase 'neither admit to nor deny wrongdoing.' They were using as an example, the \$1.4 billion settlement of alleged 'conflicts of interest' charges with Wall Street investment bankers when these corporations 'neither admit nor deny' charges that they had misled investors. I thought that if a company did not admit to wrongdoing, then it would not have to pay any fines. Unfortunately, I was on the phone with my broker from Smith Barney so I missed the education from Spitzer. It is a small matter that the ten banks that were part of the settlement earned approximately \$52.5 billion in net income in 2003, so the payout for the alleged misdeeds is about 2.7%. From here on, I suppose that the financial companies will set aside a small percent of net income every year as reserves for the routine cost of doing business with regulators.

My latest dream was that all the 'undecided' voters had made up their minds so that the next voter poll announced the winner of the next presidential election, and we got to watch the upcoming Olympics and the next football season without any interruptions related to the elections.