Economic Indicators

"Economic Indicators: An Update for the 7 Rivers Region" reports on a long-term study of regional economic indicators. The research is ongoing and spans a period of time to enable us to understand and report trends. This project is expected to continuously build on a base of economic information and provide decision makers with valuable tools for strategic planning. The information will also provide a basis for comparison with other regions and a measure of our progress.

State Bank Financial sponsors this research project in collaboration with the University of Wisconsin-La Crosse College of Business Administration and the *La Crosse Tribune*. These programs will continuously build on a base of information and provide decision makers like you with valuable tools for strategic planning.

Specific goals of this project are:

- Support business owners in their business decisions by gathering key local economic indicators and trend information.
- Develop specific economic indicators for this region that are not readily available to decision makers.
- Develop tools to assess our progress in economic growth. Prepare baseline measures that will allow comparison with other regions and measure future progress of the region.
- Track the region's participation in the "new economy" and development in the high tech arena.
- Bring professionals together with business owners for discussion about the local economy and related critical issues.
- Create a business recruitment and retention tool by publishing the information.

Core economic indicators cover the following areas:

- Employment
- Income
- Cost of Living
- Consumer Attitude and Behavior
- Real Estate and Housing
- Interest Rates
- Equity Performance

Economic Indicators and Trends

Taggert J. Brooks, Ph.D., UW-La Crosse Department of Economics

Core economic indicators have been tracked since 2001 to have objective measures for our 7 Rivers Region economy. The special focus of the spring meeting is entrepreneurship. Tom Still from the Wisconsin Technology Council, and a panel of business owners in the region (Mark Platt, president and CEO of Multistack in Sparta; Sue Kolve, owner of Sue Kolve's Salon and Day Spa in Onalaska; and Steve Blue, president and CEO of Miller Felpax in Winona) will talk about the entrepreneurial climate and how a region can improve. Dr. Brooks begins with an analysis of real estate foreclosures and recent actions by the Federal Reserve.

Please note: Dr. Brooks launched the 7 Rivers Region Economics blog, which will contain ideas and writings that may or may not be included in this publication provided at the Economic Indicators breakfast meetings. Dr. Brooks will use the blog to track different topics and collect ideas. The Web address is: http://sevenriversecon.blogspot.com/.

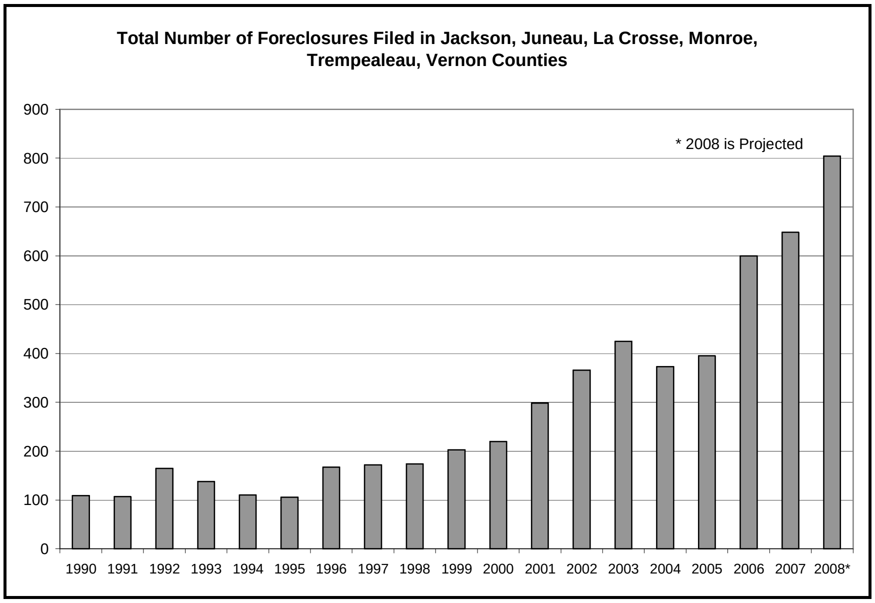
Foreclosures

The economic climate continues to be dominated by uncertainty. Troubles in the housing market have led to a dramatic increase in foreclosures. This has caused financial firms to reassess the risk in their portfolios, which has contributed to liquidity problems. In some cases, the results have been outright financial failure. This is probably the most challenging problem a central bank can face. Its job is to act as the lender of last resort and provide liquidity to the market when no one else will. Its job is not to rescue poorly managed high-risk firms from failure. The billion-dollar question is where to draw the dividing line between the former and the latter. After all, it is illiquid markets that lead to margin calls, which result in failing firms. So the two issues are not nearly as distinct as we wish.

I would like to walk through some of the local data as it relates to the current crisis in order to identify the risk the 7 Rivers Region faces. But I feel compelled to make one large caveat. Many of the problems we are seeing at the moment are as much a result of market psychology as they are a result of market fundamentals. The data I will present does a good job of providing a retrospective view of fundamentals, but I do not pretend to know where the forward-looking market psychology will lead us.

Chart 1 on page 3 provides an update on the number of foreclosures within Wisconsin counties of the 7 Rivers Region. My projection for the number of foreclosure filings in 2007 was just below the actual number of 648. There have already been 134 filings so far this year, which puts us on a pace to top 804 foreclosure filings in 2008.

Chart 1



The above graph is potentially a bit misleading because as the number of housing units increases we would also expect to see the number of foreclosures increase. To put this data into historical context, and adjust for the increase in the stock of housing, Table 1 provides some data on the number of foreclosure filings as a percentage of housing units. The data in Table 1 was graciously provided by my colleague Russ Kashian at the University of Wisconsin-Whitewater Fiscal and Economic Research Center.

Table 1

	Jackson	Juneau	La Crosse	Monroe	Trempealeau	Vernon	Wisconsin Ave
2000	0.21%	0.26%	0.18%	0.28%	0.21%	0.19%	0.25%
2001	0.37%	0.31%	0.25%	0.35%	0.30%	0.21%	0.35%
2002	0.41%	0.50%	0.33%	0.35%	0.37%	0.15%	0.42%
2003	0.40%	0.68%	0.34%	0.47%	0.33%	0.21%	0.45%
2004	0.36%	0.40%	0.28%	0.51%	0.38%	0.19%	0.43%
2005	0.39%	0.51%	0.30%	0.45%	0.33%	0.23%	0.47%
2006	0.58%	0.74%	0.44%	0.67%	0.49%	0.42%	0.59%
2007	0.50%	0.88%	0.51%	0.65%	0.57%	0.33%	0.71%

Foreclosure filings expressed as a percentage of all housing units.[1]

There is no doubt that foreclosure rates have risen in recent years, and Table 1 puts this increase in perspective. While the rate has nearly doubled, our state average is still below the national average in 2007 of approximately 1 percent. Some regions, such as Detroit, have seen rates as high as 5 percent. Other areas suffering higher foreclosure rates include Las Vegas, Miami, parts of California, and Ohio.

[1] Data provided by Russ Kashian of UW-Whitewater and the Fiscal and Economic Research Center.

Chart 2

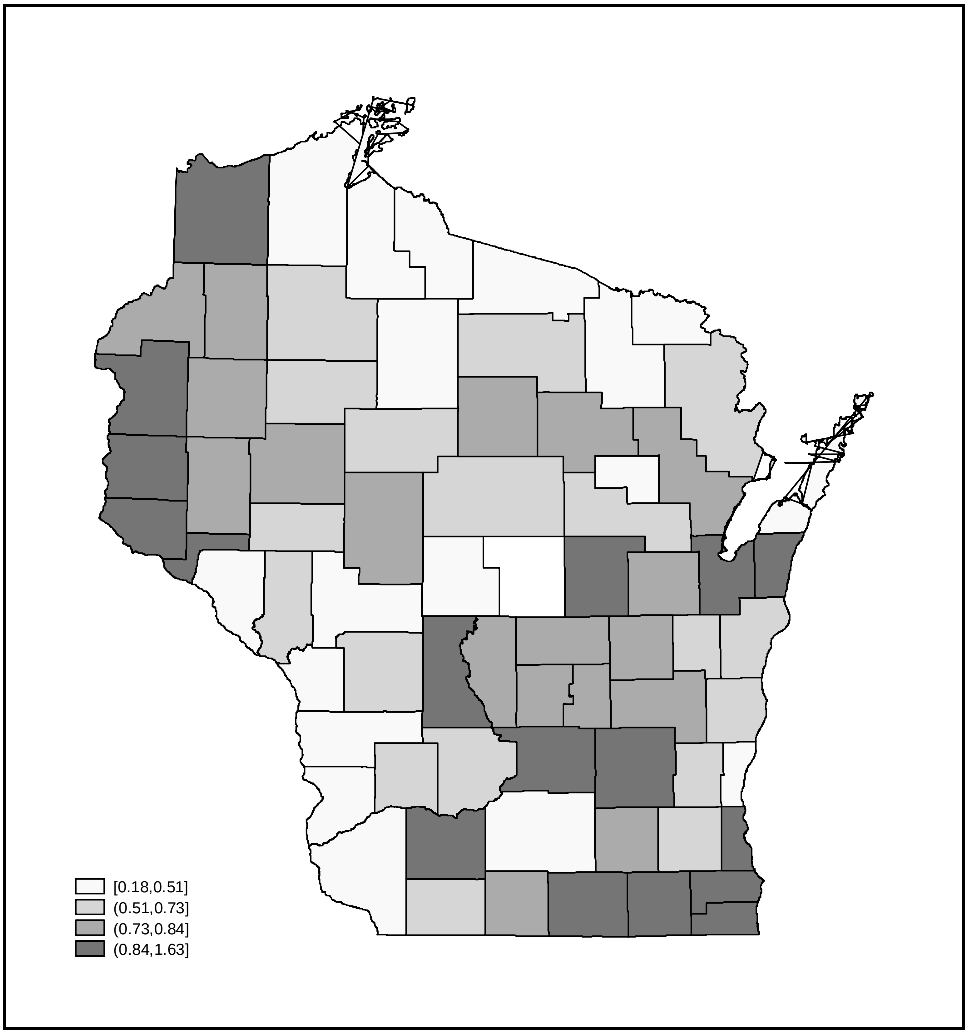
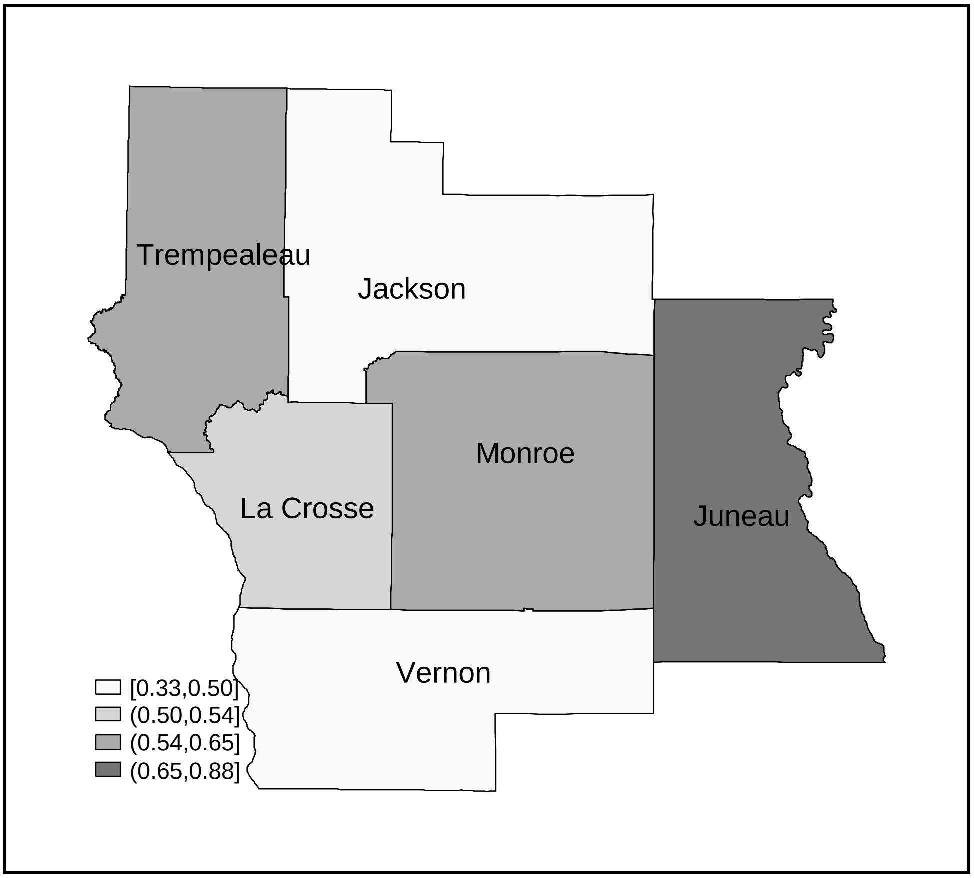


Chart 2 paints the foreclosure picture for all of Wisconsin's counties for 2007. The shading represents the percentage of housing units with a foreclosure filing. Darker areas represent larger percentages. Clearly there are a few pockets of problems. The problems are primarily the southeastern counties of Kenosh, Racine, and Milwaukee, along with some of the northwestern counties. But even the worst counties in Wisconsin barely exceed the national average.

Chart 3 on page five focuses on regional differences in our area (please note: the shading is based on different ranges than those in Chart 2). Juneau County is experiencing the highest rate of foreclosures, while Vernon and Jackson are the lowest. Again, I want to emphasize that these foreclosure rates are well below the national average. Chart 3, however, does raise a few interesting questions. To what degree is the rise in foreclosures due to adjustable rate mortgages resetting to higher, less affordable rates? Or is the rise in foreclosures explained by job losses or household liquidity problems?

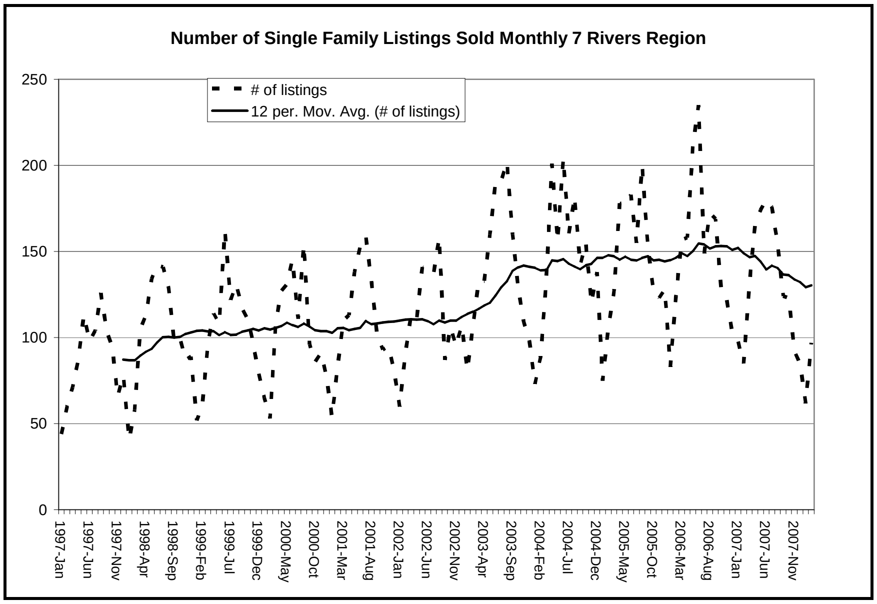
Chart 3



Local Housing Market

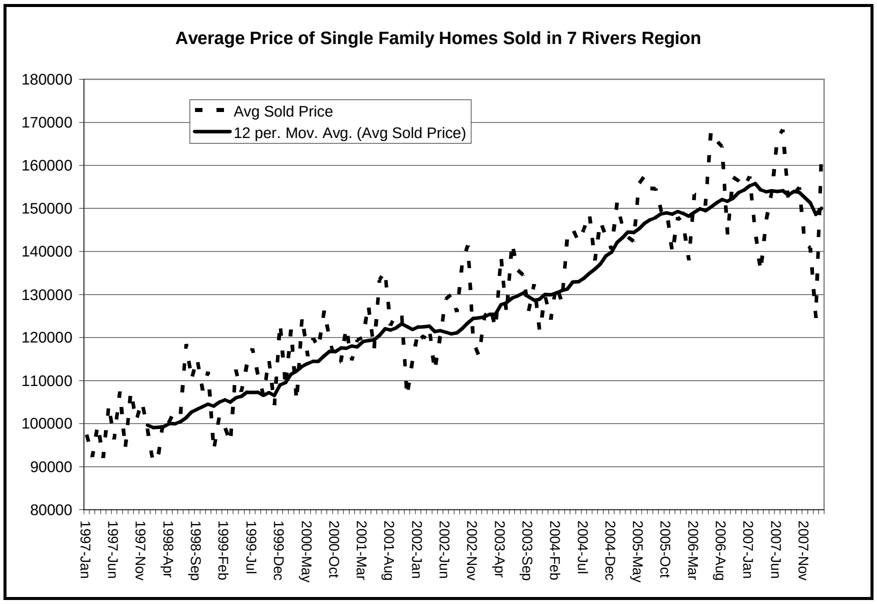
The next few charts will give us some insight into the impact recent economic events have had on our local housing market. Again, we are experiencing softness in the housing market not unlike that seen at the national level, except at a much smaller scale. Chart 4 on page 6 shows, the number of single family listings sold has continued to decline from the peak in the middle of 2006.

Chart 4



The average selling price of a single family home in the 7 Rivers Region, which reached its peak in 2007 of $155,000, has been falling in the last 12 months as shown in Chart 5 on page 7. The selling price has fallen around 3 percent from the peak. Far less than some of the dramatic contractions we have seen in certain bubble markets. Still, this represents a loss in wealth for the typical household, and can lead to contractions in consumption. It certainly has lead to a reduction in consumer expectations as measured by the consumer sentiment index presented below.

Chart 5

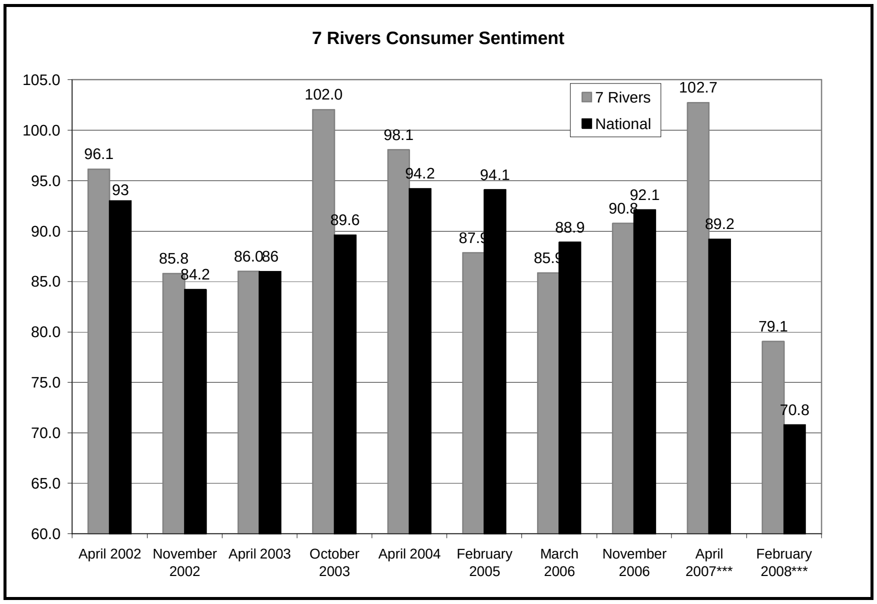


Consumer Sentiment

Starting with the spring of 2007, the 7 Rivers Region consumer sentiment index changed survey methods from random phone interviews with community members to Web questionnaires sent to 7 Rivers Region seminar participants. The index represents 152 responses of 662 possible participants yielding a response rate of 23 percent.

While the overall regional index far exceeded the national level in April 2007, like the national index, it to fell precipitously in February 2008 as shown in Chart 6 on page 8. Much of the difference between the new regional index and the national index can be explained by the vast difference in expectations about future conditions. Clearly, the new sampling technique tends to solicit opinions from more optimistic people. However, the excess optimism we saw in 2007 seems to have diminished somewhat in 2008.

Chart 6



Looking at the current conditions index shown in Chart 7 (which asks people questions about how they feel the economy has been over the last year), a large number of respondents feel recent events in the economy have been negative. Yet the largest change in attitudes relative to national attitudes comes from the forward-looking questions regarding how people feel the economy will be in the next five years. This is consistent with what we have seen in both the national economy and the local economy. Current economic conditions in the region have not deteriorated like they have in other parts of the country, yet the continued bad news from other parts of the country have taken their toll on local optimism.

Chart 7

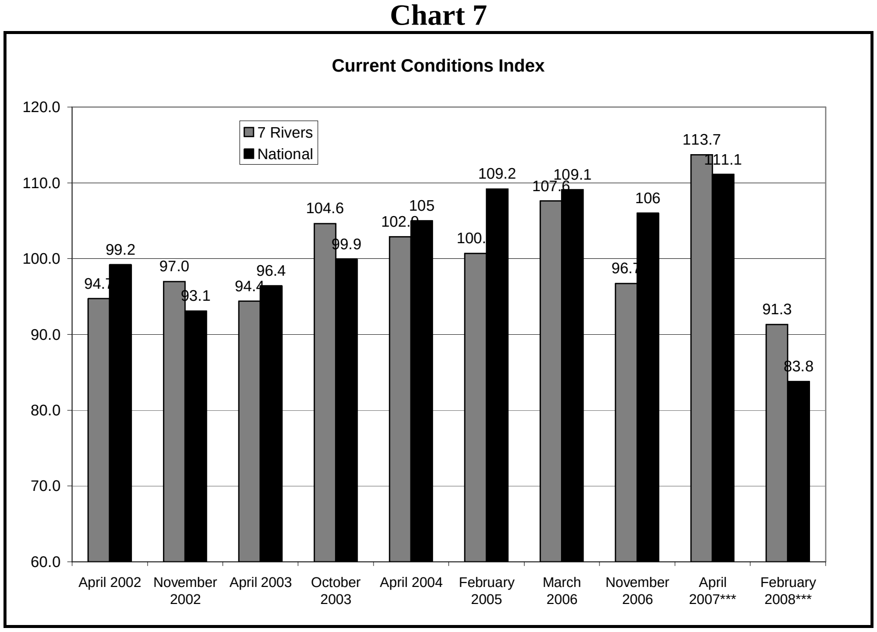
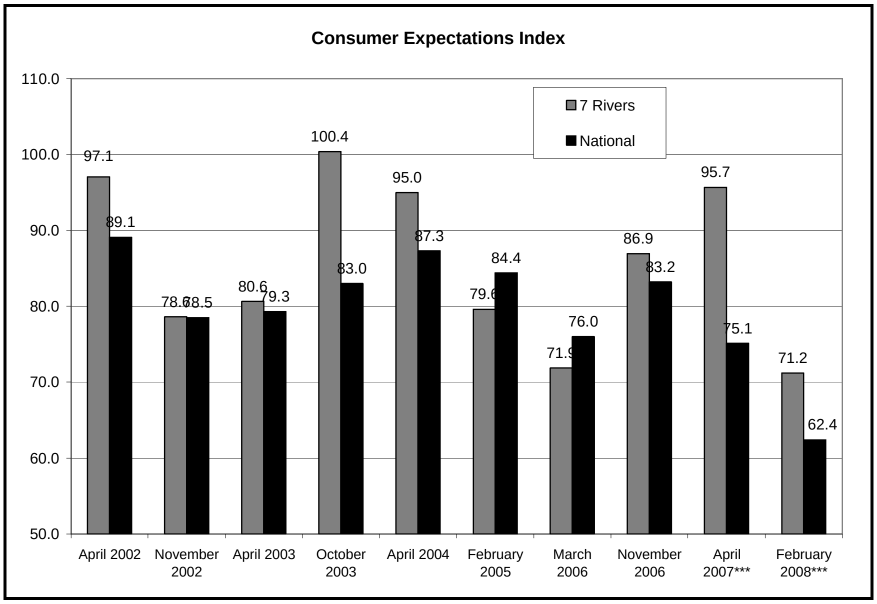


Chart 8



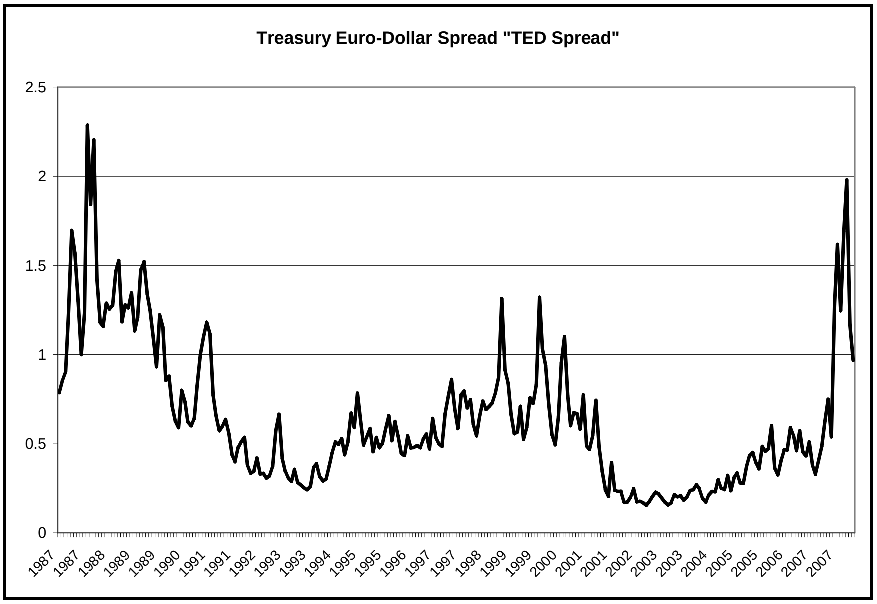
Fed Rate Moves

The Fed Reserve has been in a battle to calm the markets and return investor optimism. It is a battle the Fed does not appear to be winning. The Fed has now lowered interest rates to an unprecedented 2.25 percent from the peak of 5.25 percent just a few months ago. Yet this dramatic increase in liquidity has not led to a similar willingness of banks to lend to each other.

A useful measure of the liquidity problem is the spread between the Treasury futures and the Eurodollar futures, known as the TED spread. However, those series are no longer available so when people currently speak of the TED spread, they are referring to the 3-month Treasury bill and the 3 month LIBOR rate as a measure of interbank lending risk relative to the Treasury rate. The LIBOR rate is not anchored by the FED actions in the same way as the Fed Funds rate, so it is a better measure of risk.

Chart 9 on page 10 shows the TED spread, which spiked in the wake of the stock market crash of 1987, the Long-term Capital Management in 1997, and the recession of 2001. But the current spike has not been seen since 1987. And while this chart is monthly, the daily chart reveals that there have been some dramatic changes in liquidity. Every day seems to bring another financial firm collapse, which sends the bankers into hiding and the TED spread climbing.

Chart 9

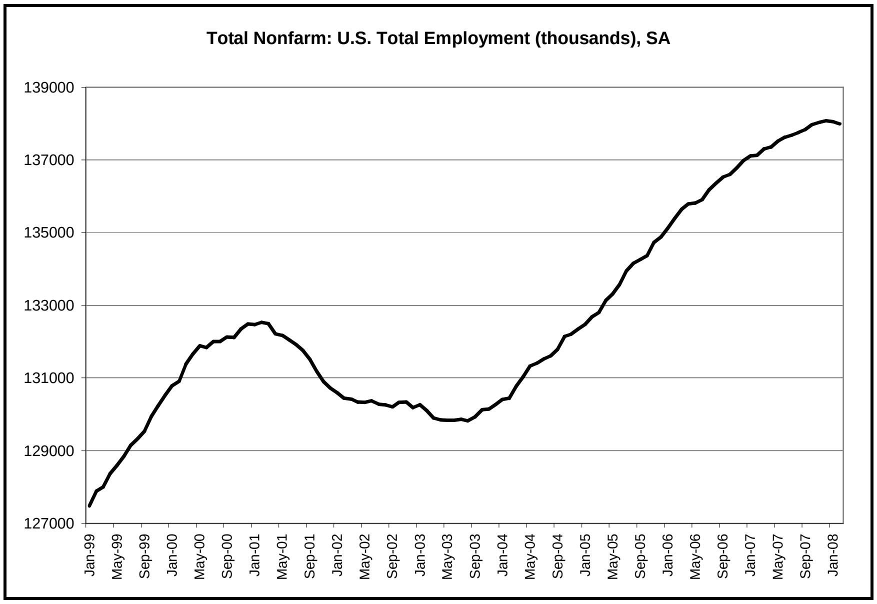


I believe that once the jitters finally calm down, the markets will realize the fundamentals of the economy are sound. However, the question remains whether the economy is strong enough to avoid a recession. I think we will avoid a recession, but I'm increasingly in the minority.

Employment

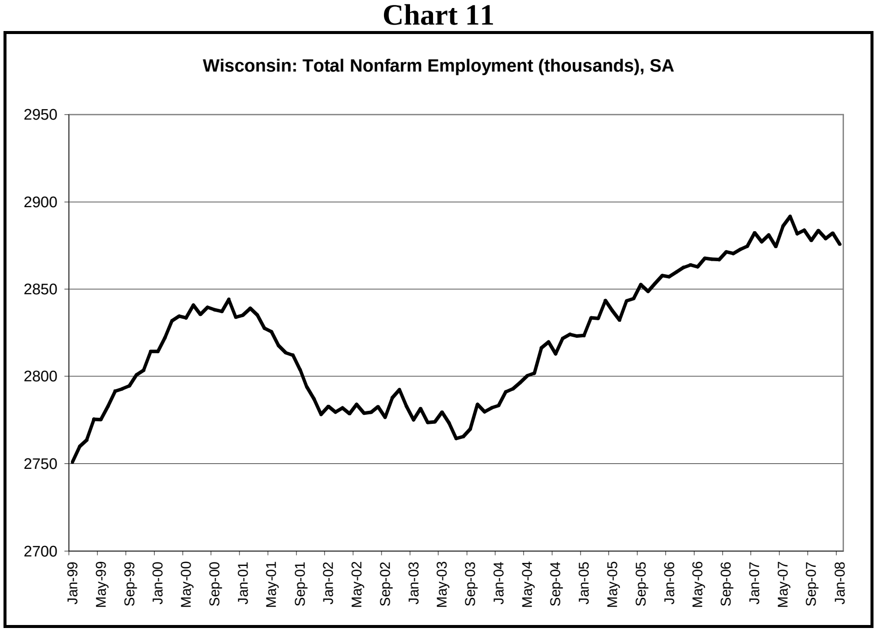
We have seen the labor market begin to stall. Chart 10 on page 11 shows the national level of non-farm employment. Recent months have seen a contraction in the level of employment. Notably the unemployment rate has not changed much, so it is still too early to tell if this is a mere hiccup in the labor market, or the start of a down turn.

Chart 10



The same thing can be seen in Wisconsin's labor market in Chart 11.

Chart 11



Fiscal Stimulus

In an attempt to stave off an impending recession, Congress passed a stimulus plan which, among other things, provides rebates as an advance on a return of the taxes collected from you in 2008. Congress is doing this by basically lowering the first marginal rate on $6,000 to 0 percent from 10 percent. So you are getting a check, to offset the money the government is collecting from you through your paycheck. How will this stimulate the economy? Well it's better than if Congress kept the money, but how much better, and are there off-setting effects?

This is an area of research for economists, which is probably as much religion and ideology, as it is science. One reason is we so seldom have good data to test our theories about how people will behave. Fortunately we did the same thing in 2001 which provides a nice little experiment. Unfortunately, the research comes to different conclusions about the effectiveness of the rebate.

In a recent paper by Sumit Agarwal[2], last September's Economic Indicators guest speaker, we see that the rebate does have an effect particularly on liquidity-constrained individuals, those who are near their credit card borrowing limits. This only represents a small portion of the people who will get the rebate. That is why the work of Matt Shapiro and Joel Slemrod[3] who found that only 22 percent of people actually would spend the rebate rather than using it to pay down debt.

At this point though, the main function of the rebates may be more psychological than fundamental. Few people expect the rebates to have a dramatic effect on everyone's balance sheet, but if they get to the people who need the rebates the most, and the people who don't need the money have their fears assuaged, the rebates could have the desired outcome.

Entrepreneurship

Definition and Measurement

The focus of this Economic Indicators meeting is entrepreneurship. One of the most important ideas to nail down is to define what we mean when we call someone an entrepreneur. Often in the popular press it refers to people who own their own business or individual inventors. Economists have a very particular, if not broad idea, in mind. We think of entrepreneurial activity as organization creation. This can involve legal and productive endeavors include starting one's own business or illegal endeavors such as racketeering, or book making, or even unproductive activities such as "rent" seeking. Economists use the term "rent" seeking to refer to activities that lead to profitable economic rents, which are not the result of productive activity. For example, lobbyists are known as rent seekers since they are often trying to lobby politicians for some sort of preferential treatment that leads to more income or profits for the lobbyist's constituents.

The most often used, though imperfect, measures of entrepreneurial activity are the self employment rate, and sometimes the number of small firms where small might mean less than 10 employees.

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[2] http://www.nber.org/papers/w13694

[3] http://www.nber.org/papers/w8672

I must confess to having very limited prior knowledge of the academic literature on this topic, though more than any other topic, I have real experience. Not my own experience as an entrepreneur but vicarious experience through members of my family. In 1978 my father left Jordan Bulldog, a small packaging subsidiary of Newell Corporation to start his own nuts, bolts and screws packing firm. My uncle, cousins and brother also have their own successful businesses.

In an interview with Scott Shane, the author of a recent book The Illusion of Entrepreneurship[4], he talks about some of the common myths of entrepreneurship. One myth being that the financial risk results in large financial returns. This ignores all of the sole proprietorships that make modest returns for their owners. However, one of the things that resonates with my family experience is that one of the main advantages to being an entrepreneur is the increased level of happiness people enjoy relative to working for someone else. The flexibility owning a business gives someone would require that person earning 2.5 times as much financial return to make one as happy working for someone else.

The relationship between entrepreneurship and innovation leads us to an idea from Joseph Schumpeter who said of capitalism, it is a process of "creative destruction." For example the telegraph lead to the demise of the pony express, the phone led to the end of the telegraph, and cell phones have made large inroads into the world of land lines. Progress involves innovation and obsolescence. How do we innovate?

One need not have spent much time in a large bureaucratic organization to understand that it often acts as an impediment change, rather than an incubator for innovation. In fact, it appears as though many incremental improvements occur in well-financed large corporations, but large changes, such as those I just mentioned, occur in start up firms. Employees of large firms find their innovative ideas are either too hard to implement in the bureaucratic structure, or the employees leave to capture the economic returns to their idea, rather than sharing them with the corporation.

Some Research Findings

Baumol et al.[5] points to some serious challenges facing the small entrepreneur in the coming years. The development of employer based health insurance operates as a tax on small firms. Baumol argues intellectual property rights seem too restrictive and discourage innovation.

Taxes have a peculiar and possibly counter intuitive effect on entrepreneurial activity. High marginal tax rates can actually encourage risk taking as the state effectively bears some of the risk.

Recent changes to bankruptcy laws have made bankruptcy more difficult and more punitive, therefore increasing the risk associated with entrepreneurial failure.

4 http://www.businessweek.com/smallbiz/content/jan2008/sb20080123_809271.htm

5 http://www.bepress.com/cas/vol2/iss2/art1/

Entrepreneurial Climate in the 7 Rivers Region

At the beginning of February, we conducted our regular survey of consumer sentiment, along with asking some questions about the entrepreneurial climate in our region. It was an effort to replicate the work done by the Wisconsin Entrepreneurial Network (WEN) at the state level[6]. We tried to identify differences between regional respondents and the rest of the state.

The results presented below offer some limited insight into these differences. What stands out most when comparing our results to those of WEN is how similar they are to each other. This is surprising mostly because the samples of the two surveys were starkly different. The WEN report was a state-wide survey conducted by the mail, whereas our survey was a local web-based survey utilizing a mailing list for participants in the 7 Rivers Region. One would not expect these two groups to so closely share opinions.

Community Statement	**7 Rivers Mean Response**	**State Mean Response**
My community is supportive of people starting new businesses	2.87 (n=134)	2.87 (n=1105)
My community is supportive of existing small business owners	2.78 (n=133)	2.91 (n=1103)
Where strongly disagree=1, disagree=2, agree=3, strongly agree=4		

Entrepreneurial Climate Statement	**7 Rivers Mean Response**	**State Mean Response**
Those with successful businesses get a lot of attention and admiration	3.07 (n=133)	2.97 (n=1088)
Young men are encouraged to be independent and start their own businesses	2.45 (n=134)	2.50 (n=1080)
Young women are encouraged to be independent and start their own businesses	2.46 (n=134)	2.45 (n=1083)
State and local governments provide good support for men starting new firms	2.50 (n=133)	2.46 (n=1152)
State and local governments provide good support for women starting new firms	2.64 (n=133)	2.48 (n=1048)
Bankers and other investors go out of their way to help new firms get started	2.46 (n=132)	2.36 (n=1056)
There are many examples of well respected people who have made a success of themselves by starting new businesses	3.01 (n=134)	2.95 (n=1088)
Among my friends and family… many of the men have started new firms	2.13 (n=131)	2.09 (n=1100)
Among my friends and family… many of the women have started new firms	2.08 (n=133)	1.96 (n=1089)
Where strongly disagree=1, disagree=2, agree=3, strongly agree=4		

[6] http://www.wenportal.org/uploads/WEN_Report_front_web.pdf

Itemized responses for the 7 Rivers Region Survey of entrepreneurial climate

6.For each of the following statements about your community, indicate your level of agreement.

	Strongly Disagree	Disagree	Agree	Strongly Agree	Response Total
My community is supportive of people starting new businesses.	2.24% (3)	17.16% (23)	71.64% (96)	8.96% (12)	134
My community is supportive of existing small business owners.	2.26% (3)	24.06% (32)	66.92% (89)	6.77% (9)	133
Total Respondents					134
(skipped this question)					25

More detailed breakdown of responses

7. For each of the following statements about entrepreneurial climate in your community, indicate your level of agreement.

	Strongly Disagree	Disagree	Agree	Strongly Agree	Response Total
Those with successful businesses get a lot of attention and admiration.	0.75% (1)	12.78% (17)	65.41% (87)	21.05% (28)	133
Young men are encouraged to be independent and start their own businesses.	2.24% (3)	52.99% (71)	42.54% (57)	2.24% (3)	134
Young women are encouraged to be independent and start their own businesses.	5.97% (8)	46.27% (62)	44.03% (59)	3.73% (5)	134
State and local governments provide good support for men starting new firms.	4.51% (6)	43.61% (58)	48.87% (65)	3.01% (4)	133
State and local governments provide good support for women starting new firms.	2.26% (3)	40.6% (54)	48.12% (64)	9.02% (12)	133

Bankers and other investors go out of their way to help new firms get started.	6.06% (8)	46.21% (61)	43.18% (57)	4.55% (6)	132
There are many examples of well respected people who have made a success of themselves by starting new businesses.	0.75% (1)	15.67% (21)	65.67% (88)	17.91% (24)	134
Among my friends and family many of the men have started new firms.	12.98% (17)	62.6% (82)	22.9% (30)	1.53% (2)	131
Among my friends and family many of the women have started new firms.	16.54% (22)	59.4% (79)	23.31% (31)	0.75% (1)	133
				Total Respondents	134
				(skipped this question)	25

Data Sources:
1. Author's calculations
2. Economagic.com
3. Federal Reserve Bank of Cleveland
4. Federal Reserve Bank of Minneapolis
5. MLSWIS.com
6. Wisconsin Circuit Courts Access
7. Fiscal and Economic Research Center, UW-Whitewater

Appendix A: Additional Graphs and Charts

Chart 12

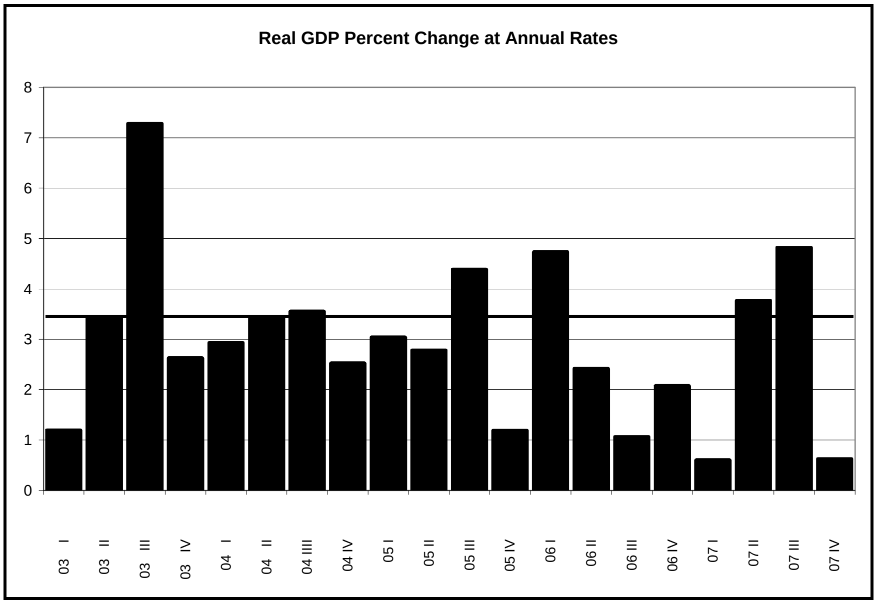


Chart 13

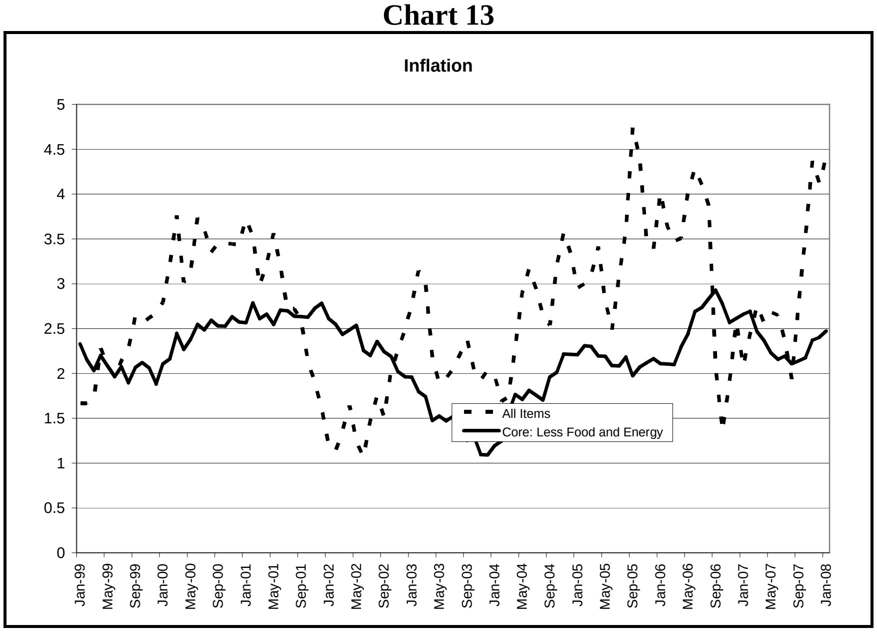


Chart 14

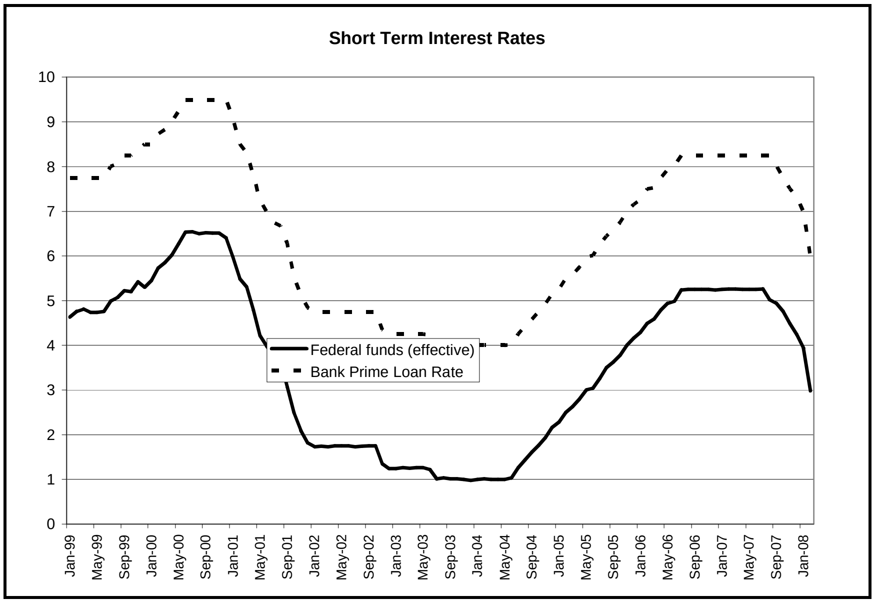


Chart 15

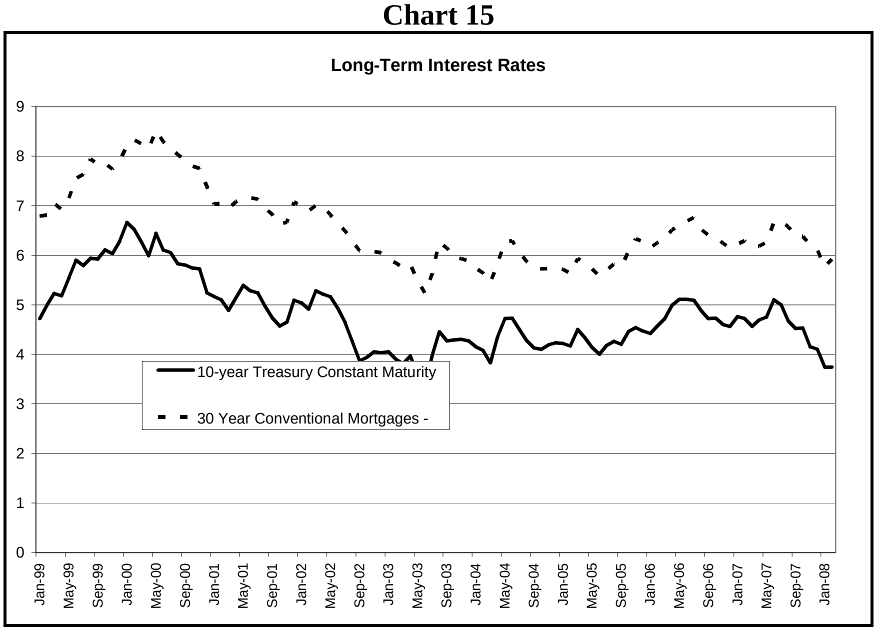


Chart 16

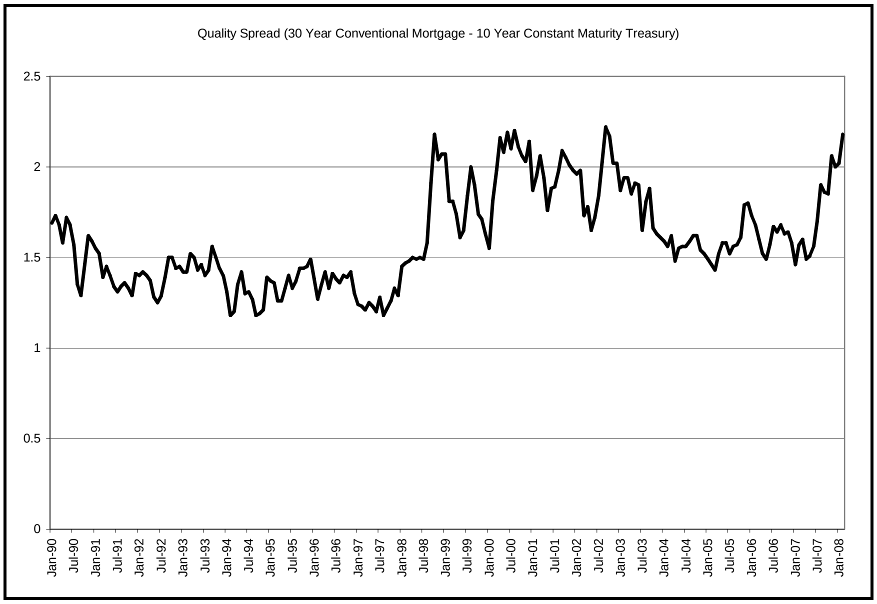


Chart 17

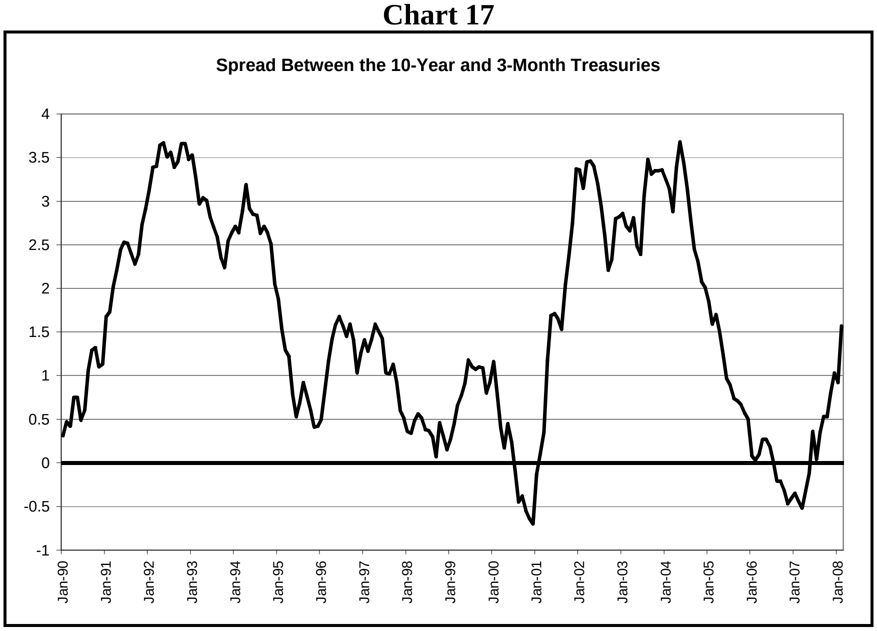


Chart 18

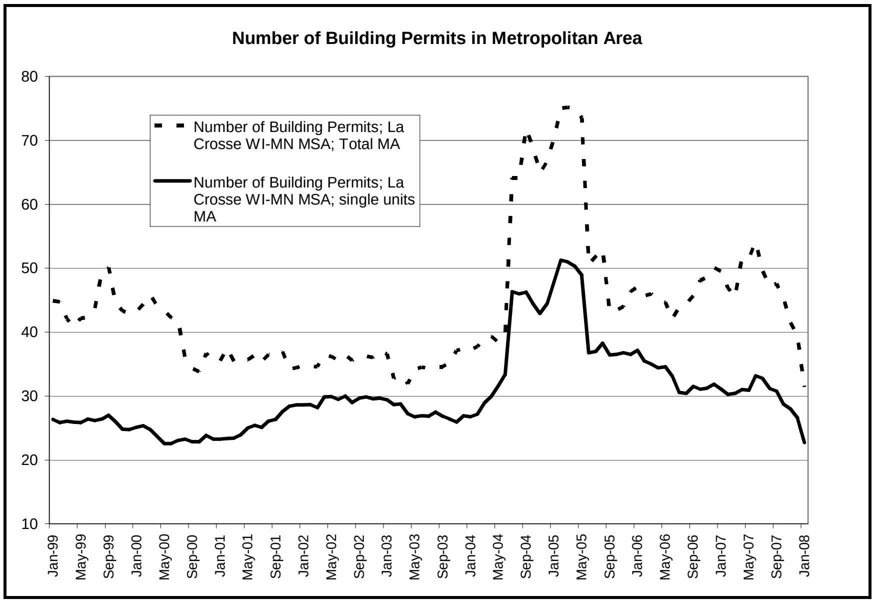


Chart 19

Chart 20

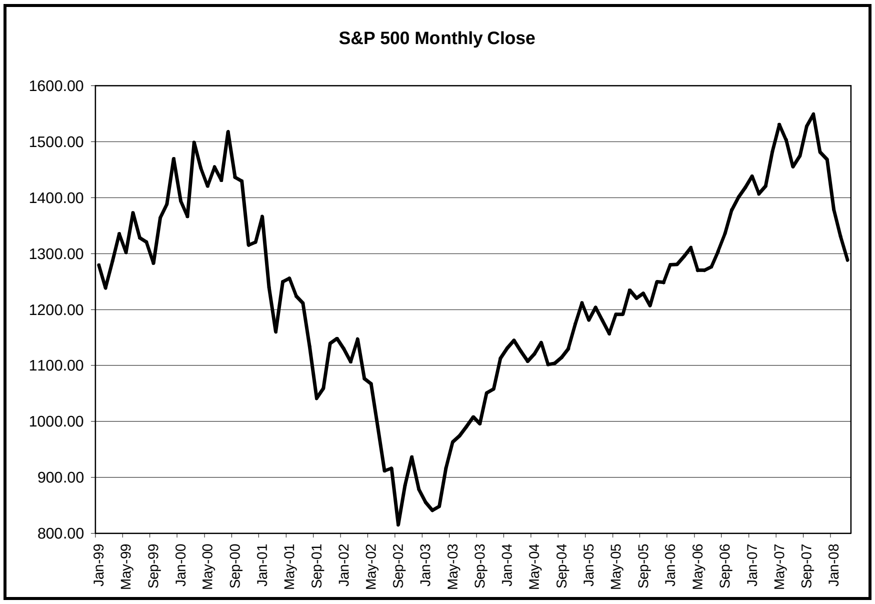


Chart 21

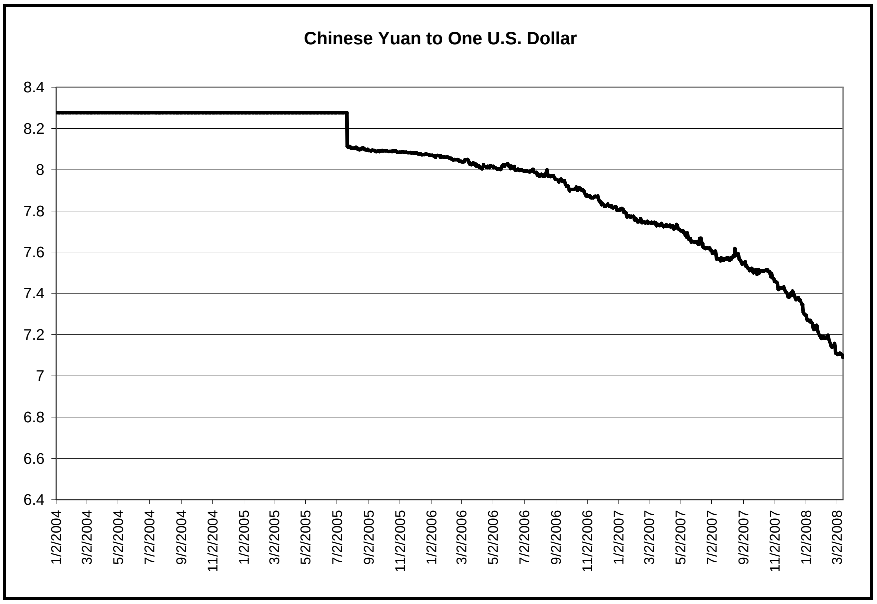


Chart 22

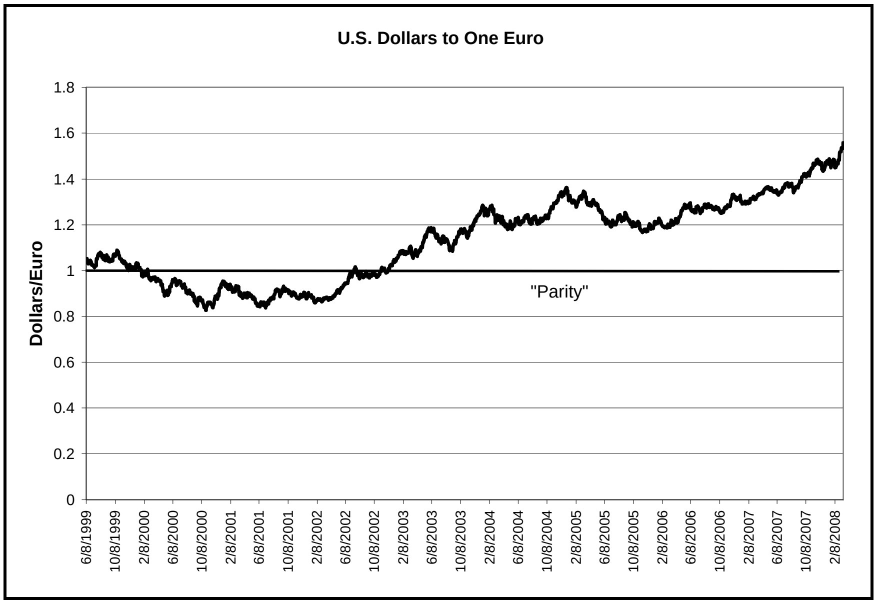


Chart 23

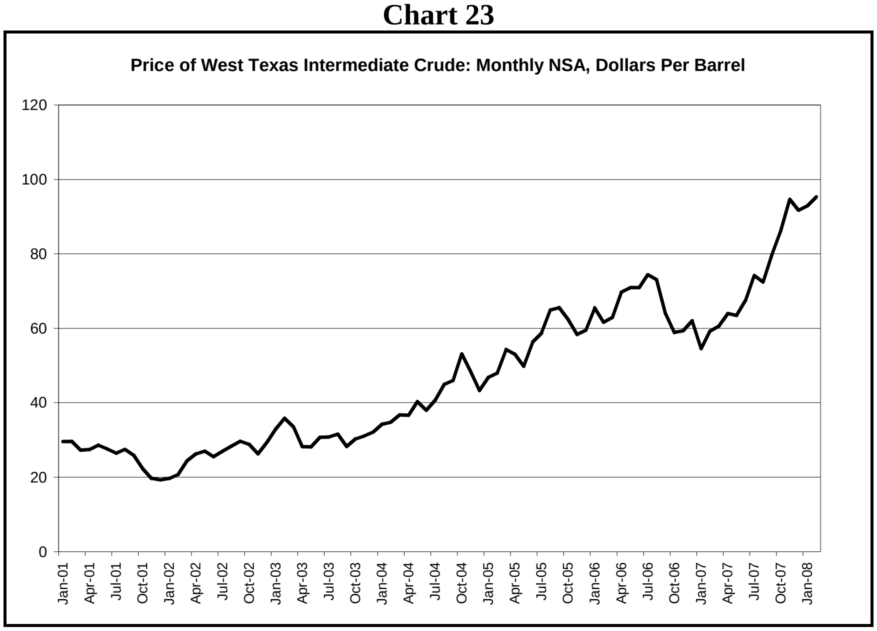


Chart 24

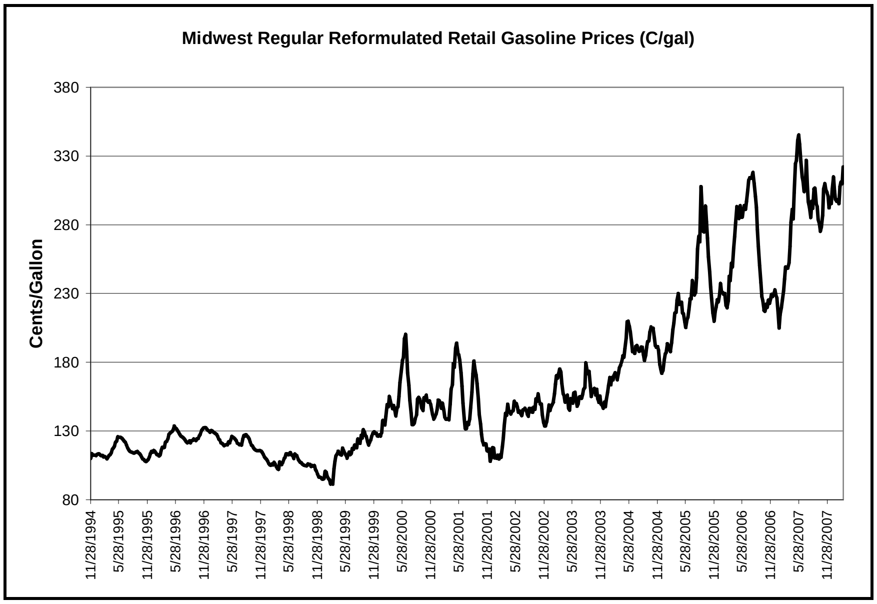


Chart 25

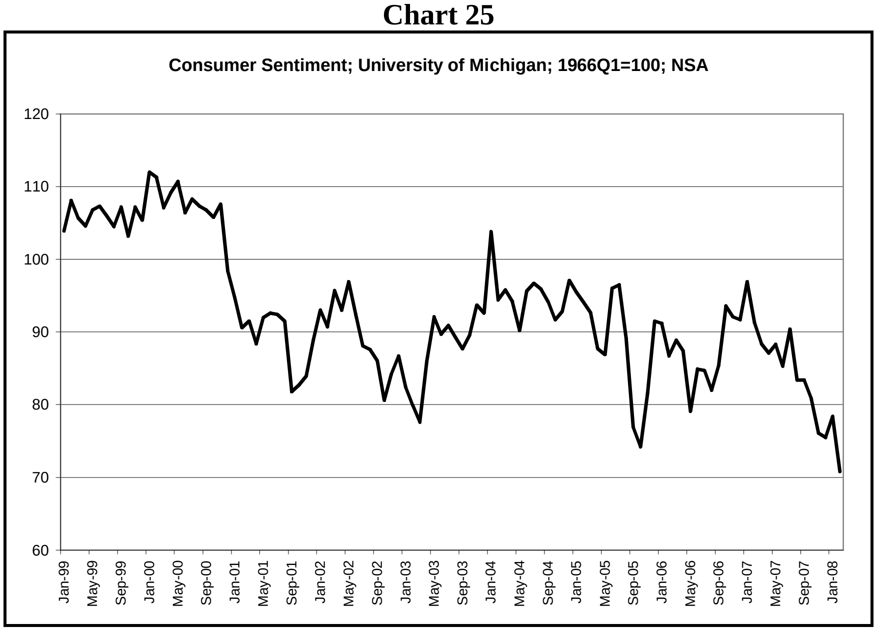
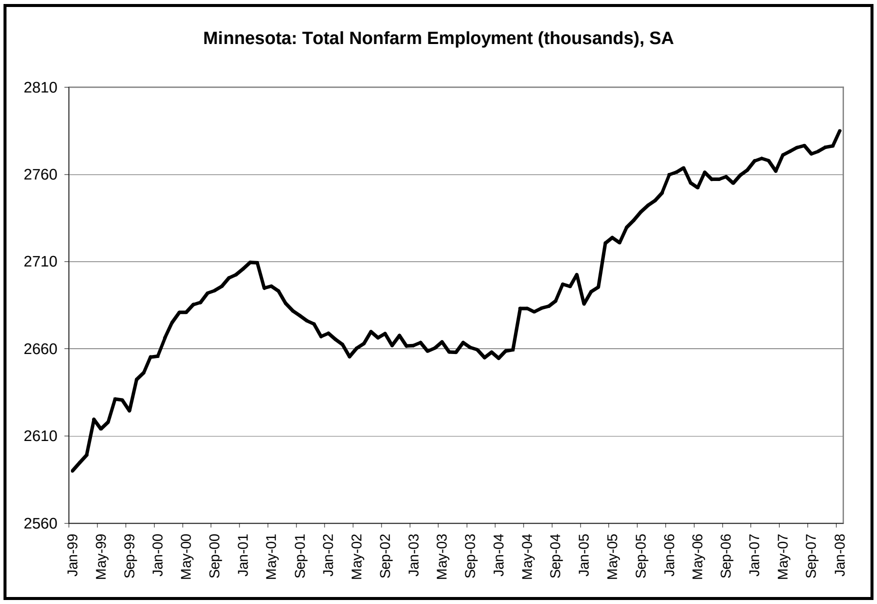


Chart 26


Minnesota: Total Nonfarm Employment (thousands), SA
2810
2760
2710
2660
2610
2560
Jan-99
May-99
Sep-99
Jan-00
May-00
Sep-00
Jan-01
May-01
Sep-01
Jan-02
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The 7 Rivers Equity Index: Fundamental Reason for Reversal of Fortune

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The 7 Rivers Equity Index of publicly traded stocks has been developed and maintained by Dr. Krueger to create a baseline (January 2000) and measures changes over time. The index tracks changes in performance of firms within 100 miles of La Crosse and compares their performance to national benchmarks.

Introduction

This report covers the share price performance and provides a fundamental financial analysis of companies headquartered in the 7 Rivers Region over the seven-month period from August 2007 through February 2008. What a change from a year ago! Last spring's report referred to stocks as "the new holy grail of investing … [because]…the [stock] markets had not dropped by over 2 percent from a previous high, and had not fallen by over 10 percent for almost four years!" One year later, the dollar is setting record lows against the euro, the labor market is soft, the housing sector is weak, and economic growth seems to be sputtering. Commodity prices on items ranging from corn, oil, and wheat are soaring to new records. Consequently, stock and bond holders are fleeing to different markets. Making matters worse for investors in local companies, over the past year the 7 Rivers Equity Index has dropped faster than either the Dow Jones Industrial Average or the Standard & Poor's 500!

As this article is being written in early March, investors are trying to sort out whether this correction is a much-overdue, short-term pullback or a sign of a weaker stock market and economy ahead. The next section of this report will examine the changes in the list of public local companies. Investment returns of the 7 Rivers Equity Index are then compared to national stock market performance. The remainder of this report provides a synopsis of managerial performance at local companies based on nine financial ratios. Three popular ratios are taken from each of the companies' most recent income statements, balance sheets, and statements of cash flows. For the most recent analysis of security prices and local firm return forecasts, please refer to the September 2007 edition of 7Rivers Region: An Economic Update.

The 7 Rivers Equity Index

Two criteria must be met for inclusion in the 7 Rivers Equity Index. One, the firm must be publicly held with share price data available from the financial press or Internet sources. Two, the company's headquarters must be within 100 miles of La Crosse, which includes the 7 Rivers Region. A listing of such companies is generated with the assistance of *ReferenceUSA*, a data service allowing one to screen public corporations by state. The thirteen companies currently within the 7 Rivers Equity Index set are identified in Table 1 on page 31.

Despite the limited area and the size of the 7 Rivers Equity Index, every report seems to bring with it a revision in the index. This report is no different. TenderCare International, Eau Claire's marketer of chlorine-free natural diapers and baby wipes was acquired by Hain Celestial on December 10, 2007. Hain Celestial is a leading U.S. natural and personal care products company. Over the 25-months that TenderCare was a member of the 7 Rivers Equity Index, it provided a 40.2 percent annualized rate of return.

Off-setting this loss, Winona's Merchants Financial Group was added to the 7 Rivers Equity Index. This community bank, which has been offering financial services for over 130 years, went public on October 7, 2003. Due to the low number of shares traded, *ReferenceUSA* did not consider Merchants Financial Group to be a public company until recently. Reviewing transactions data, 2006 was the first year that Merchants Financial Group shares were traded in every month. Consequently, Merchants Financial Group has been added to the 7 Rivers Equity Index effective December 31, 2005, resulting in a slight revision of under 2.5 percent in the 7 Rivers Equity Index over the December 2006 through July 2007 period. Merchants Financial Group's stock symbol is MFGI.PK, the "PK" reflecting the fact that it trades on the pink sheets, which is an electronic quotation system that displays quotes from many broker-dealers. Merchants Financial Group paid a $1.03 dividend over the past year and has a beta coefficient of 0.40.

Performance of the 7 Rivers Equity Index, an equally-weighted index of local companies, is presented in the first column of Table 2 on page 32. Index values are estimated using the following equation, which assumes that investors reinvest their funds in public 7 Rivers Equity Index companies on a monthly basis. The 7 Rivers Equity Index, like the comparison benchmarks described below, excludes dividends.

$$\text{Index Value}_1 = \text{Index Value}_0\,(1+\text{ Average Percentage Change in Share Price}_1)$$

Share prices were obtained from *Yahoo!Finance*. Since 1999, 11 firms within the 7 Rivers Region have been acquired or went bankrupt, and are listed at the bottom of Table 1. The performance of these firms is included in calculation of the 7 Rivers Index during the period they met the 7 Rivers Equity Index criteria.

Values in Table 2 represent the value of $100 invested in local shares on 12/31/1999. For instance, in 2000, the value of 7 Rivers Index dropped 9.3 percent to 90.7, meaning a $100 investment would have lost $9.30. Over the first seven years, through December 2006, the 7 Rivers Equity Index rose 60.6 percent to 160.6. This value would equate to a rise of about 7 percent per year. Meanwhile, between 2000 and 2006, $100 invested in the Dow Jones Industrial Average rose to only $108.40 and the Standard and Poor's 500 fell to $96.50, as exhibited in the center and right hand columns of Table 2.

Fortunes changed dramatically during 2007, with the 7 Rivers Equity Index dropping 8.5 percent, while the Dow Jones Industrial Average rose 6.5 percent and the Standard & Poor's 500 rose 3.5 percent. Stated another way, 7 Rivers Equity Index firms underperformed the national benchmarks by 15 percent and 12 percent, respectively. Looking at the individual months of 2007, one will notice a relatively strong showing by the 7 Rivers Equity Index over the first four months of 2007. As the sub-prime mortgage problems came into view, local firms dropped as the national market measures surged. The relatively high percentage of banks (five out of 14 firms, including TenderCare International) may account for the relatively poor performance of 7 Rivers Equity Index. By comparison, only 38 of the 500 companies in the S&P 500 are financial. Analysis of the five financial companies in the 7 Rivers Equity Index revealed that HMN Financial and Heartland Financial lost 30 and 35 percent of their value during 2007, respectively. In total, the drop by financial firms accounted for 57 percent of the 7 Rivers Equity Index's decline.

Entering 2008, the impact of the banking crisis brought on by defaulting subprime mortgages had spread beyond the banking sector. The 7 Rivers Equity Index actually rose slightly over the first two months of 2008, while the Dow Jones Industrial Average fell 7.5 percent and the Standard & Poor's 500 fell 9.3 percent. Although finally rising above the initial $100 during 2007, the Standard & Poor's 500 Index was down to 90.6 as of Leap Day 2008. Both local financial and non-financial firms, on average, experienced stock price increases during the first two months of 2008. Leading the way were returns exceeding 5 percent at Citizens Community Bank, Flexsteel, and Marten Transportation. These returns were more than enough to offset the largest loss, which was a 6 percent decline posted by Renaissance Learning.

Fundamental Characteristics of Local Firms

Forecasting whether 7 Rivers Equity Index firms will continue to outperform national averages, or that there again will be a reversal of fortune, is difficult. In order to gain insight, the remainder of this report studies the local firms' financial health. Following past precedent, this spring report studies fundamental financial characteristics of firms in the 7 Rivers Equity Index. Morningstar.com and *Yahoo!Finance* were the sources of financial ratios and income statements, balance sheets, and statements of cash flows (when ratios were not available), respectively, for 2004-2007. In most instances the 2007 information covers all of 2007. In the three instances where information was not available for the last quarter of 2007, the final quarter of 2006 was included so all ratios are based on 12 months of data. The 2004-2006 averages reported below are based on an average of individual calendar years in the 2004-2006 period.

Due to their unique characteristics, the averages of the three financial companies covered by Morningstar.com and *Yahoo!Finance* are reported separately. Baraboo Bancorporation, with an ".OB" following its ticker symbol, is traded on the Over-the-Counter Bulletin Board, a regulated trading service offered by the National Association of Security Dealers, which shows real-time quotes, last sale prices, and volume information. As noted above, Merchants Financial Group is listed on the "pink sheets," which is a daily publication compiled by the National Quotation Bureau with bid and ask prices of over-the-counter stocks, including the market makers who trade them. Companies quoted on the pink sheets system do not need to meet minimum requirements or file with the SEC. Neither firm is included in reports by Morningstar or *Yahoo!Finance.*

Income Statement Insights

Gross profit margins (gross profit/sales) represent the percentage of revenues not consumed by the cost of producing products and services. As shown in the first 2007 column of Table 3 on page 33, the gross profit margin of non-financial local companies is 34 percent, which implies that $.66 of every dollar of revenue is used to produce the goods being sold. At the high extreme, the gross profit margins of Renaissance Learning and Fastenal are 75 percent and 51 percent, respectively. Wausau-Mosinee Paper's gross profit margin is only 10 percent, leaving little room to pay sales and administrative expenses. The comparable ratio for financial concerns is net interest margin. As one can see on the bottom panel in the first column, net profit margins are virtually identical and average 59 percent in the local financial firms with data available.

Net profit margins (net income/sales) represent the percentage of revenue remaining after paying all expenses, including interest and taxes. As shown on the non-financial firms average line on Table 3's 2007 middle column, 6 percent (or $.06 per dollar) of revenue is normally available for retained earnings and dividend payment. Among non-financial firms, Fastenal (11 percent) is again at the high end. During 2007, none of the 7 Rivers Equity Index companies lost money. The two highest net profit margins were attained in the banking sector. In fact, the financial firms average net profit margin is 10 percent (16 percent versus 6 percent) higher. HMN Financial leads the local firms with a 24 percent margin.

Return on equity (net income/total stockholders equity) reflects the amount of return earned per dollar invested by shareholders. As shown in the right 2007 column of Table 3, 11 percent (or $0.11 per dollar) invested by shareholders in non-financial firms is returned to them in the form of dividends or retained earnings on an annual basis. Although Fastenal (24 percent) leads in this category, Hormel's return on equity is 16 percent. The financial firm's average ROE is just slightly less at 9 percent.

The most striking feature is the similarity of the 2004-2006 averages to 2007 income statement values. On an individual firm basis, the greatest absolute changes were Fastenal's 14 percent increase in gross profit margin, Renaissance Learning's 14 percent drop in net profit margin, and 12 percent drop in return on equity were the most extreme, though its return on equity is still an average-beating 12 percent.

Banks within the 7 Rivers Equity Index had fairly consistent levels of income statement ratios. Despite the decline in bank share prices, local bank net interest margin and net profit margins were higher in 2007 than the average of the prior years. In fact, HMN Financial's net profit margin rose 8 percent (16 percent to 24 percent).

Balance Sheet Insights
Current ratios (current assets/current liabilities) provide insight to firm liquidity. As shown in the first 2007 column in Table 4 on page 34, on average non-financial firms had 3.8 times as many dollars in cash, accounts receivable, and inventory as they had in accounts payable and accruals. Rochester Medical's current assets were over 10 times the size of current liabilities. At the other extreme, Renaissance Learning only had $0.80 in current assets per $1.00 in current liabilities. Considering the potential that some customers will not pay their bills or inventory may not be sold, it is easy to see that Renaissance Learning is in a precarious position.

The comparable figure among financial firms is financial leverage, which compares a bank's total assets to equity. A comparison across the banks reveals that Citizens Community Bancorporation has much less financial leverage. According to Morningstar, "companies with higher debt in their financial structure are typically riskier." This may explain the lesser decline in Citizens Community Bancorporation's share price during 2007.

Long-term debt ratios (long-term debt/total assets) indicate the amount of long-term borrowing used to acquire assets. Non-financial firms borrowed about $.17 per dollar of total assets, as shown in the middle 2007 column of Table 4. Fastenal and National Presto do little debt financing, while the debt ratio of Wausau-Mosinee Paper is 43.4 percent. Wausau-Mosinee Paper has greater financial leverage, which works well for highly profitable firms, but brings with it a greater interest expense.

Although the long-term debt ratios at local financial institutions are fairly constant, there are striking differences across banks. The use of long-term debt almost doubled at Citizens Community Bancorporation, was cut in half at HMN Financial, and stayed roughly the same at

Heartland Financial. Obviously, managers at these banks are taking different approaches to handling the current banking crisis.

HMN Financial also stands out when it comes to fixed asset turnover (sales/fixed assets). HMN Financial's revenues per dollar of assets are almost three times greater than found at either Citizens Community Bancorporation or Heartland Financial. Despite the difference, each bank's 2007 value is not out of line with its 2004-2006 average.

Returning to the top panel, total asset turnover on average was the same in 2007 as it was in the 2004-2006 period. On an individual firm basis, total asset turnover ranges from 0.6 times at Rochester Medical to 2.3 times at Flexsteel. The most significant improvements were National Presto raising its total asset turnover from 0.6 to 0.9 times (a 50 percent growth rate) and Wausau Mosinee Paper from 1.2 to 1.6 times (a 33 percent growth rate).

Cash Flow Statement Insights

Cash is the monetary lubricant that permits a business to operate. Cash is also required to pay dividends and expand operations. Consequently, the statement of cash flows is another important financial statement. These statements describe the change in cash in terms of a firm's operations, investing (in fixed assets) activities, and financing (with stocks and long-term bonds) activities. Each of these activities will be examined below. In order to adjust for firm size, each cash flow amount is divided by the firm's total assets value reported on the balance sheet.

Cash from operations starts with net income, adds back the non-cash deprecation charge, and makes adjustments for changes in current asset and current liability accounts. Operations at the average non-financial firm took in $0.16 per dollar of assets during 2007, as exhibited in the first 2007 column of Table 5 on page 35. Rochester Medical brought in $0.47 per dollar of assets, while National Presto's cash flow from operations was only $0.02.

Cash flow from investing activities was negative in 12 of the 13 instances, as companies bought fixed assets to replace those worn out or expand operations. On average non-financial companies replaced $.11 per dollar of total assets, as shown in the middle 2007 column of Table 5. Updating its medical facilities, Rochester Medical replaced 44 percent of its asset base. Meanwhile, Rochester Medical replaced 16 percent of its assets. Only Renaissance Learning sold more assets than it purchased, selling 23 percent of its assets during 2007.

Cash flow from financing is typically positive when firms issue new stocks and bonds, but negative otherwise as firms pay dividends or retire stocks and bonds. Only the rapidly expanding Rochester Medical took in more money through security sales than it paid out in dividends or security purchases in 2007. Renaissance Learning, which was selling off assets, paid $0.29 cents out of its total assets to shareholders. Since Renaissance Learning's long-term debt ratio rose, it seems unlikely any of the cash flow was directed towards bondholders.

We can see cash from operations at non-financial companies rose by $.05 per dollar of assets when comparing 2007 to the average results over 2004-2006. Fixed asset investing remained at the same level, while the cash outflow to investors rose slightly. Taking all of the average numbers together, cash on the balance sheets rose by an average of $.02 ($0.16 - $0.07 - $0.07) per dollar of assets during 2007. In the three prior years, cash outflows exceeded cash outflows by two cents per dollar of assets.

Across the years, and unlike income statement and balance sheet values examined above, there is more variation in cash flows at 7 Rivers Equity Index banks than non-financial companies. When it comes to cash flows from operations, HMN Financial saw its cash flow from operations dip by 71 percent, from $0.14 to $0.04 per dollar of assets. All three banks cut back investing, with HMN Financial cutting investment by 50 percent, from $0.44 to $0.22 per dollar of assets. Cash flows from financing jumped at Citizens Community by 123 percent, from $$0.13 to $0.29 per dollar of assets. The other two banks reduced the number of dollars they took in from outside sources, but unlike the non-financial firms, all took in more money from investors than they paid back in the way of dividends. Overall, the cash reported on a bank's balance sheet actually rose during the period by $0.02 ($0.02 - $0.18 - $0.18) versus dropping by $0.01 ($0.05 - $0.22 + $0.16) per dollar of assets.

Summary

As of February 2008, there are 13 publicly-held firms in the 7 Rivers Region. Firms within the 7 Rivers Equity Index have been a good investment choice over the last seven years. However, a portfolio of these companies hit an all-time high last April but has since given up 13.8 percent of its value. Nonetheless, the 7 Rivers Equity Index has held up well recently as major market indexes have fallen.

Firm fundamentals do not explain the reason for the sell-off of local shares. Both gross profit margin (for non-financial firms) and net interest margin (for financial firms) were higher in 2007 than they have been on average over 2004-2006. Balance sheet values in 2007 are similar to average values over the prior year. The one warning signal is the 60 percent decline in cash flows from operations at financial companies, although they have risen by 45 percent at non-financial firms. Given the generally good values, one might expect the recent strength of 7 Rivers Equity Index firms to continue through 2008.

Table 1: 7 Rivers Equity Index

The headquarters of each of these public firms is within 100 miles of La Crosse

State / Company	Headquarters	Primary Business
Wisconsin		
Baraboo Bancorporation (BAOB)	Baraboo	Retail banking
Citizens Community Bank (CZWI)	Eau Claire	Retail banking
Marten Transportation (MRTN)	Mondovi	Trucking
National Presto (NPK)	Eau Claire	Cookware
Renaissance Learning (RLRN)	Wisconsin Rapids	Educational software
Wausau-Mosinee Paper (WPP)	Mosinee	Paper products
Minnesota		
Fastenal (FAST)	Winona	Threaded fasteners
HMN Financial (HMNF)	Spring Valley	Savings and loan
Hormel (HRL)	Austin	Pork and turkey processing
Merchants Financial Group (MFGI)	Winona	Retail banking
Rochester Medical (ROCM)	Stewartville	Urinary treatment products
Iowa		
Flexsteel Industries (F LXS)	Dubuque	Home furnishings
Heartland Financial USA (HTLF)	Dubuque	Retail banking

Firms previously included in the 7 Rivers Equity Index (no longer publicly held):
- Ag Services of America – acquired by Rabobank (1/2004)
- Bone Care International – acquired by Genzyme Corporation (6/2005)
- Featherlite – acquired by Universal Trailer Holdings (10/06)
- First Federal Capital Corporation – acquired by Associated Banc-Corp (10/04)
- La Crosse Footwear – relocated to Oregon (3/2001)
- Land’s End – acquired by Sears (6/2002)
- Northland Cranberries – privatized (11/2005)
- Pemstar – acquired by Benchmark Electronics (1/07)
- Sheldahl – bankrupt (4/2002)
- State Bank La Crosse – privatized (2/2003)
- TenderCare Interational – acquired by Hain Celestial (12/07)

Table 2: Comparative Index Performance

Since 12/31/1999 Index Value of 100
(Year-to-Year Change in Parentheses)
[12/2006-to-Month Change in Brackets]

	7 Rivers Equity Index		Dow Jones Industrial Average		Standard & Poor's 500	
12/1999	100.0	(n/a)	100.0	(n/a)	100.0	(n/a)
12/2000	90.7	(-9.3%)	93.8	(-6.2%)	89.9	(-10.1%)
12/2001	98.6	(+8.7%)	87.2	(-7.0%)	78.2	(-13.0%)
12/2002	98.1	(-0.4%)	72.6	(-16.7%)	59.9	(-23.4%)
12/2003	114.0	(+16.2%)	91.0	(+25.3%)	75.7	(+26.4%)
12/2004	135.8	(+19.2%)	93.8	(+3.1%)	82.5	(+9.0%)
12/2005	136.5	(+0.5%)	93.2	(-0.8%)	85.0	(+3.0%)
12/2006	160.6	(17.7%)	108.4	(16.3%)	96.5	(+13.5%)
January 2007	161.0	[0.2%]	109.8	[1.3%]	97.9	[1.4%]
February 2007	161.6	[0.6%]	106.7	[-1.6%]	95.8	[-0.8%]
March 2007	170.6	[6.2%]	107.5	[-0.9%]	96.7	[2.1%]
April 2007	172.5	[7.4%]	113.6	[4.8%]	100.9	[4.5%]
May 2007	161.8	[0.8%]	118.5	[9.3%]	104.2	[8.0%]
June 2007	162.7	[1.3%]	116.6	[7.6%]	102.3	[6.0%]
July 2007	156.3	[-2.7%]	114.9	[6.0%]	99.0	[2.6%]
August 2007	157.4	[-2.0%]	116.2	[7.2%]	100.3	[3.9%]
September 2007	160.1	[-0.3%]	120.9	[7.2%]	103.9	[7.7%]
October 2007	155.6	[-3.1%]	121.2	[11.5%]	105.4	[9.2%]
November 2007	147.6	[-8.1%]	116.3	[7.2%]	100.8	[4.4%]
December 2007	147.0	[-8.5%]	115.4	[6.5%]	99.9	[3.5%]
January 2008	151.5	[-5.7%]	110.3	[1.5%]	92.1	[-2.7%]
February 2008	148.7	[-7.4%]	106.7	[-1.6%]	90.6	[-6.1%]

Table 3: Analysis of Income Statement Information

Non-financial Firms	Gross Profit Margin (% of sales)		Net Profit Margin (% of total revenue)		Return on Equity (% of equity)	
	2007	2004-06 Average	2007	2004-06 Average	2007	2004–06 Average
Fastenal	51%	37%	11%	11%	24%	18%
Flexsteel	19%	19%	2%	2%	9%	6%
Hormel	23%	23%	5%	5%	16%	17%
Marten Transportation	31%	39%	3%	5%	7%	12%
National Presto	18%	18%	9%	9%	11%	6%
Renaissance Learning	75%	83%	6%	20%	12%	24%
Rochester Medical	48%	37%	9%	7%	4%	5%
Wausau-Mosinee Paper	10%	8%	3%	-0%	6%	-1%
Non-financial Average	34%	33%	6%	7%	11%	11%

Financial Firms	Net Interest Margin (% of interest income)		Net Profit Margin (% of total revenue)		Return on Equity (% of equity)	
	2007	2004-06 Average	2007	2004-06 Average	2007	2004–06 Average
Citizens Community Bank	59%	52%	5%	6%	2%	3%
HMN Financial	59%	52%	24%	16%	12%	11%
Heartland Financial	60%	51%	19%	16%	12%	12%
Financial Firm Average	59%	52%	16%	13%	9%	9%

Table 4: Analysis of Balance Sheet Information						
Non-financial Firms	Current Ratio (Times Current Liabilities)		Long-term Debt Ratio (% of Total Assets)		Total Asset Turnover (Revenue/Total Assets)	
	2007	2004-06 Average	2007	2004-06 Average	2007	2004–06 Average
Fastenal	6.4	7.3	1.3	1.6	1.9	1.6
Flexsteel	3.3	2.7	14.6	13.6	2.3	2.5
Hormel	1.8	1.9	24.9	24.0	1.9	1.9
Marten Transportation	1.5	1.7	30.6	30.6	1.3	1.4
National Presto	4.3	4.9	2.4	5.9	0.9	0.6
Renaissance Learning	0.8	1.9	7.7	2.2	0.9	0.9
Rochester Medical	10.4	7.2	7.6	11.1	0.6	0.7
Wausau-Mosinee Paper	1.9	2.0	43.4	44.3	1.6	1.2
Non-financial Average	3.8	3.7	16.6	16.7	1.4	1.4
Financial Firms	Financial Leverage (Total Assets/Equity)		Long-Term Debt (% of Total Assets)		Fixed Asset Turnover (Revenue/Total Assets)	
	2007	2004-06 Average	2007	2004-06 Average	2007	2004–06 Average
Citizens Community	4.9	8.7	25.0	14.9	1.1	1.1
HMN Financial	11.8	11.0	8.5	16.5	3.1	3.2
Heartland Financial	14.4	14.8	8.4	7.5	1.2	1.2
Financial Firm Average	10.4	11.5	14.0	13.0	1.8	1.8

Table 5. Analysis of Cash Flow Statement Information						
Non-financial Firms	Cash Flow from Operations ($/Total Assets)		Cash Flow from Investing Activities ($/Total Assets)		Cash Flow from Financing Activities ($/Total Assets)	
	2007	2004-06 Average	2007	2004-06 Average	2007	2004–06 Average
Fastenal	0.20	0.10	-0.03	-0.06	-0.13	-0.06
Flexsteel	0.06	0.03	-0.03	-0.04	-0.03	-0.01
Hormel	0.10	0.13	-0.08	-0.06	-0.03	-0.04
Marten Transportation	0.18	0.19	-0.17	-0.24	-0.00	0.06
National Presto	0.02	0.03	-0.02	-0.06	-0.04	-0.06
Renaissance Learning	0.22	0.25	0.23	0.04	-0.29	-0.39
Rochester Medical	0.47	0.10	-0.44	-0.13	0.01	0.08
Wausau-Mosinee Paper	0.07	0.05	-0.01	-0.03	-0.04	-0.03
Non-financial Average	0.16	0.11	-0.07	-0.07	-0.07	-0.06
Financial Firms						
Citizens Community Bank	-0.00	0.01	-0.26	-0.13	0.29	0.13
HMN Financial	0.04	0.14	-0.22	-0.44	0.19	0.28
Heartland Financial	0.01	0.01	-0.07	-0.08	0.05	0.07
Financial Firm Average	0.02	0.05	-0.18	-0.22	0.18	0.16