April 12, 2004

Enclosed are your statements for the first quarter of 2004.

For the quarter, equity investors saw total returns of 1.69% for the S&P 500, -0.43% for the Dow Jones Industrial Average and -1.41% for the technology-oriented NASDAQ. Since the beginning of 1999, equity investors have seen annualized returns of -0.22% for the S&P 500, 4.25% for the Dow and -1.45% for the NASDAQ. For the same period, equity-based investors of Academy have seen annualized returns of 9.55%.

For the quarter, fixed income investors saw returns of 0.43% for the 1-year Treasury Index, 3.10% for the 5-year Treasury Index, and 4.61% for the 10-year Treasury Index. The riskier 10-year BB- corporate bonds were driven up by 2.75%.

Bubble conditions remain in both stocks and bonds. Fifty-year lows in interest rates support the high valuations necessary for a national spending spree. Although the wildest excesses of the technology boom have not returned, good investment opportunities are currently fewer. At least the Great Bubble of 1999 offered buys in the bond market. This bubble does not.

Our mission is to provide superior performance to the S&P 500 while concentrating on safety of principal. We see, and have seen, these two goals (superior performance and safety) as compatible. This is especially critical, because, "in selecting common stocks, we devote our attention to attractive purchases, not to the possibility of attractive sales." Purchases at unattractive prices create poor results and risk. We learned this the hard way in 1997 from trying to manage accounts that we were required to keep fully invested. The lessons learned were eloquently stated in the latest Berkshire Hathaway annual report: "Our capital is underutilized now, but that will happen periodically. It's a painful condition to be in - but not as painful as doing something stupid. (I speak from experience.)" To which we can say "Amen."

Although the current environment is challenging, we are finding some opportunities. We have continued to invest more in the pharmaceutical area. For an in-depth discussion of this area, please review past letters (dated July 11, 2002 and January 15, 2004, for copies please call Sue Compton). The comments we made in them are, we believe, still accurate. We were also enthusiastic about the opportunity for purchases of Anheuser-Busch during the past quarter. This is a company which we have followed for years, but had almost given up hope of buying its stock at a fair price. A few comments may help you understand why we think this company is so great.

One of the most important competitive characteristics of a business is a brand. Your managers at Academy have spent too much time on farms to be attracted by commodity businesses. Commodities have a few happy years that never compensate for the full cycle of underperformance. BUD is a farmer's dream, taking hops and grains and turning them into a brand valuable beyond imagination. By combining an increasingly dominant position in its industry with smart management, BUD has created extraordinarily high investment returns. Fundamentally, this is not a business overly concerned with the cost of labor relative to global costs; nor is it concerned with changes in technology and the "deepening of capital." This is not a business fixated on the movements in the dollar. This is not a business subject to the wild credit bubble. It is, for us, an ideal type of investment.

One way we judge the investment quality of a business is by analyzing how much additional capital is needed to increase its earnings. It is not difficult to increase earnings with increased capital (for example, just allow money to compound in a savings account and watch the earnings grow). The next two paragraphs get somewhat numerical, but BUD's numbers are so extraordinary that we believe it is worth your attention.

In 1993, BUD's earnings were $980 million. In 2003, BUD's earnings rose to $2,065 million. If we valued BUD at a multiple of ten times earnings, the value of BUD in 1993 would be $9.8 billion and the value in 2003 would be $20.65 billion. This is an increase in value of about $10 billion. While this is not at first glance a stunning rate of growth in value (7.74%), note that BUD achieved this by retaining only $1.365 billion of its earnings to its equity capital. With a more typical return on investment such as 7.5%, a company would have to retain earnings of $10 billion (oftentimes more) to increase the earnings in a similar fashion by 2003. Should a company be commended for increasing business value by $10 billion by retaining $10 billion? We think not, but most are. Such companies usually disguise these characteristics with heavy share issuance and, as a result, the management teams are heavily rewarded. But the BUD story gets better.

BUD's earnings from 1993-2003 totaled $15.2 billion. BUD paid out over $13.8 billion to its shareholders in the form of dividends and share repurchases. This amounts to a stunning payout of over 91% of earnings. To put this in perspective and vastly oversimplify, if a BUD "savings account" were set up in 1993 with $1 million, the account would have grown to $2 million by 2003. In the meantime, the account would have paid out about $1.4 million over the ten years. Compare that to a 10% CD paying out 90% of its interest (an investment we would all look at favorably). Over ten years, the CD would have grown from $1 million to only $1.1 million and paid out $940,000. (As George Lanier, friend, client and editor of the firm commented, "It's not bad, but it's not BUD.") Root for the prices of BUD to come down so we can acquire more shares.

Bubbles formerly occurred "once in a lifetime." In 1999, we all believed that someday we would be telling our descendants about the sights and sounds of that Great Bubble. But now it seems that such bubbles recur in every market cycle, even with the Fed's blessing. However, we have become confident that even if bubble conditions persist, there will be individual opportunities like the one we have seen with Anheuser-Busch. We continue our patient and attentive search for them.

As always, we appreciate the stewardship responsibilities you entrust to us.

Academy Capital Management