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Equity-Income Research

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Insider Buying at BIF: A Case of Manipulation or Hallucination?

Shareholder activists has been blogging in great detail regarding their contention that **Boulder Growth & Income Fund's** (BIF) incestuous relationship of BIF's advisor and its control shareholder ("EHT") have acted in concert for its own collective economic interest to the detriment of fellow shareholders. I thought his case had merit and I wanted to explore his contentions to see if it could be empirically demonstrated.

Conclusion: The actions of the advisor and the control shareholder appear on the face of it to be concerted as demonstrated in the chart below. Notwithstanding, **I'd recommend owning shares of BIF for a 6 to 9 month holding period** for risk-oriented investors looking to piggyback on the actions of the advisor and the related control shareholder. The recent actions by both **constitute "betting with the house"**. I always like those odds.

For the same reasons I like the stock in the short-term, I would not be a long-term holder of BIF by virtue of the enormous potential for conflict of interest. For this reason, I would concur with the activists that shareholders should vote against a staggered board as proposed by management. Good corporate governance requires "checks and balances". BIF appears to have none.

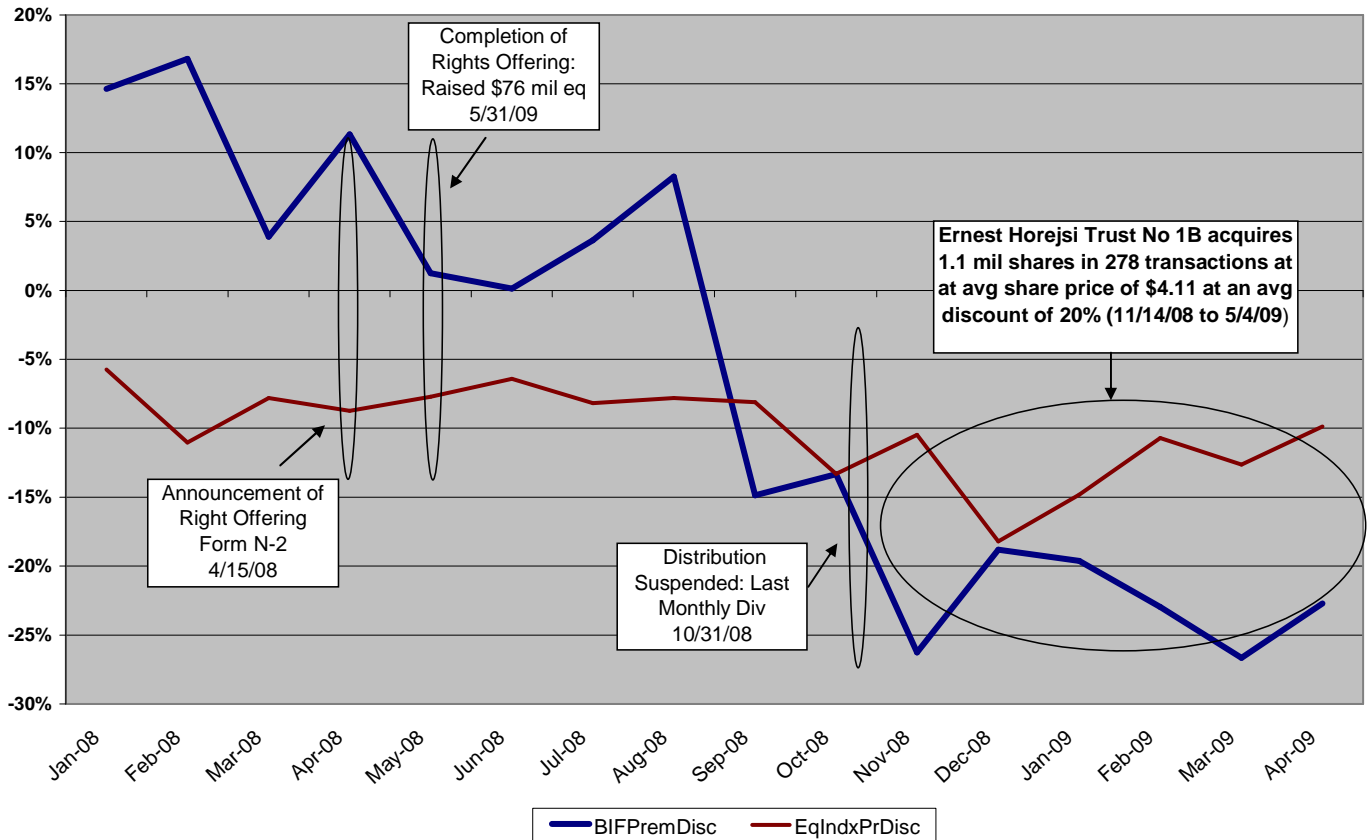
Smoking Gun: I believe the determining factors with regards to whether the actions depicted in the chart below are manipulative are in the end-game. I would conclude that such actions are without question manipulative if after the controlling shareholder completed its acquisition plans: 1) the advisor either announces or implements a plan to aggressively convert its cash holdings into equity investments; 2) the board declares a single, cumulative year-end distribution for all of FY '09 that would include recently accumulated shares by EHT.

BIF's Timeline: The chart below is a timeline of BIF's advisor's actions and those of its control shareholder from the beginning of 2008 to April of 2009. The chart

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also shows the premium/discount (“prem/disc”) of BIF and the Eqcome Prem/Disc for the General Equity Funds for the same period.

BIF Timeline & Prem/Disc Comparison: BIF Vs Eqcome Indices



The chart depicts four significant events in relation to the comparative prem/disc of BIF and its peer group.

1. The first is the announcement of the rights offering in April of 2008. At that time BIF was trading at a premium to its NAV. It's always a good time to issue equity when a stock is trading at a premium to its NAV. (The corollary is also true: buying back stock when it's at a material discount to NAV—as it is currently).
2. The completion of the rights offering which raised an additional \$76 million of shareholder equity at the end of May '08.
3. The suspension of the dividend in October '08. (Another factor listed in the annual report but not represented on the chart is the advisor's decision not to deploy the funds raised in the rights offering).

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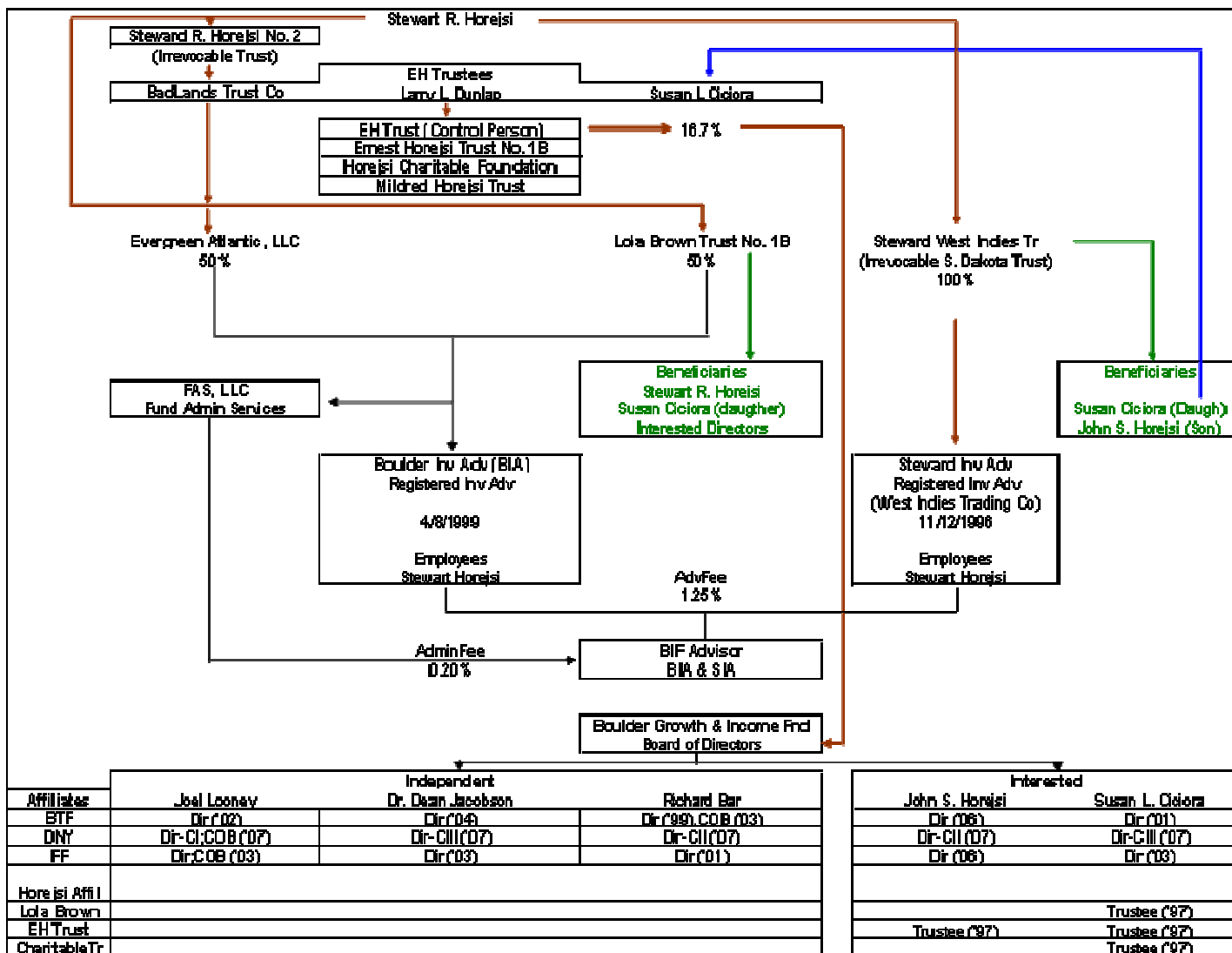
4. The accumulation of shares by EHT, the control shareholder (person), from November 14, '08 to May 4 '09. During this period EHT accumulated 1,074,293 shares in 287 transactions for an average cost of \$4.11 per share. During this period, EHT increased its holdings 33.5% to 4,267,825 shares for an ownership stake of 16.7%. Prior to November of 2008, EHT was a seller of BIF.

In the chart, I compared the prem/disc of BIF with that of the Eqcome CEF Equity Prem/Disc Sub-Index. The purpose of the comparison was to discern whether the actions of BIF's advisor had an impact on its prem/disc independent of its peer group. It would appear that BIF's dramatic deterioration of its prem/disc could not be totally explained by changes in the prem/disc of its peer group.

On the face of it, one could argue these series of transactions were designed to drive the share price down in an effort to allow the control shareholder to accumulate additional shares and later affect changes in investment and distribution policies that would drive the stock higher.

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Incestuous Relationships: The chart below depicts the interlocking relationships among BIF's shareholders, Trustees, employees and beneficiaries. There is almost complete control of BIF by the Horejsi affiliated entities and the potential for conflict of interest is significant. I will not spend any time here outlining these relationships and refer you to Dan's blog articles.



Let's Push the Numbers: Let's make the major assumption that BIF's advisor/owners carefully planned to manipulate the stock. Then you'd have to go back to March of 08, prior to the rights offering as a baseline. BIF shares at that time were trading at premium of 3.9%. BIF's prem/disc has devolved to a 22.7% discount as the end of April '09. This is far greater a swing than its peer group during the same period.

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EHT purchased 1.1 million shares at an average cost of 4.11 per share for a total of \$4.4 million at an average month end discount during the acquisition period of 20.3%. Based on the end of April 09's NAV, which I believe is a conservative assumption, if the stock price were to again go to a 3.9% premium it enjoyed prior to the rights offering then the return on investment of the incremental shares would be 39.0%. Let's be more conservative. Let's use the current discount for BIF's peer group which is a discount of 8.8%; the return would then be 22.0%. This is without taking into account any subsequent, declared distributions.

Items to be considered: There are two items that are curious with respect to maximizing the economics of such concerted manipulation.

The first would be: Why would the advisor discontinue the monthly return of capital distributions during the period of EHT's accumulation? In theory the distribution would help fund EHT's purchases by providing it with 100 cents on the dollar while it was buying the shares at a 20% discount. The answer to this question may be that maintaining the dividend would support the stock price and increase the cost of acquisitions.

The other item is less easy to explain away. The suspension of the dividend would constitute an opportunity cost of implementing this strategy. Since EHT owned 3.2 million shares prior to its recent accumulation, it incurred a loss of approximately \$2 million of tax-free income (return of capital distributions) to EHT if the dividend were based on a 10% managed distribution policy at the time the dividend was eliminated (10/31/08). Including the lost of dividend on existing shares, the return on the incremental share investment by EHT is reduced to the range of 7.5% to 18.8%. Still moderately attractive based on conservative assumptions. (The returns are very sensitive to the managed distribution assumption. If the managed distribution assumption were set at 8.0%, then the return range would expand to 11.2% to 27.7%)

Importantly, investors who purchase the shares at this juncture don't assume that opportunity cost and enjoy the higher levels of return.

Joe Eqcome (Disclosure: Owns BIF and would increase that position)