Celebrating 100 Years

Applied Investment Management (AIM) Program

AIM Class of 2012 Equity Fund Reports
Spring 2011

Date: May 6th Time: 2:00 p.m.
Location: AIM Research Room (DS488)

Student Presenter	Company Name	Ticker	Price	Page No.
Brian Brophy *Senior Mentor: James Werner*	VeriFone Systems	PAY	$53.68	2
Kristina Gergens *Senior Mentor: Shannon Lawton*	Align Technology	ALGN	$24.14	5
Jon Schwerin *Senior Mentors: Mike Muratore and Tom Molosky*	Shoe Carnival	SCVL	$29.28	8
Alice Wycklendt *Senior Mentor: David Zakutansky*	Quality Distribution, Inc.	QLTY	$11.67	11

For more information about AIM please contact:

David S. Krause, PhD
Director, Applied Investment Management Program
Marquette University
College of Business Administration, Department of Finance
436 Straz Hall, PO Box 1881
Milwaukee, WI 53201-1881
mailto: AIM@marquette.edu
Website: MarquetteBuz/AIM AIM Blog: AIM Program Blog
Twitter: Marquette AIM Facebook: Marquette AIM

VeriFone Systems, Inc. (PAY)
May 6, 2011

Brian Brophy Consumer Goods

VeriFone Systems, Inc. (NYSE: PAY) is a global provider of secure electronic payment solutions. The company generates revenue from two business segments: system solutions and services. In the system solutions segment, VeriFone markets and sells point of sale (POS) electronic payment devices which run proprietary, security, and encryption software as well as third-party applications. In the most recent quarter, this segment accounted for approximately 80% of sales. In the services segment, PAY provides payment systems consulting, software customization, and installation as well as digital media advertising. As a global company, PAY operates in a wide variety of markets including North America, Latin America, Europe, and Asia. In 2010, North American sales accounted for approximately 44% of total revenues where the company is estimated to have a 65% market share. PAY also has a diverse group of customers including financial institutions, payment processors, petroleum companies, large retailers, government organizations, and healthcare companies, among others. PAY was founded in 1981, went public in 2005, and is headquartered in San Jose, California.

Price ($) : (4/28/11)	53.68	Beta:	1.15
Price Target ($):	64.80	WACC	10.48%
52WK H-L ($):	59 - 16	M-Term Rev. Gr Rate Est:	12.50%
Market Cap (mil):	4,736.95	M-Term EPS Gr Rate Est:	15.87%
Float (mil):	86.56	LT Debt/Equity:	180.0%
Short Interest (%):	14.09%	ROA:	10.43%
Avg. Daily Vol (mil):	1.61	ROE:	45.47%
Dividend ($):	0.00		
Yield (%):	0.00%		

FY: Oct	2010A	2011E	2012E
Revenue (Mil)	1,001.54	1,201.85	1,412.17
% Growth	18.57%	20.00%	17.50%
Gross Margin	36.97%	39.50%	39.75%
Operating Margin	10.23%	13.00%	13.50%
EPS (Cal)	$1.13	$1.40	$1.78
FCF/Share	$1.67	$1.96	$2.44
P/E (ttm)	39.40	36.94	29.12
EV/EBITDA (ttm)	29.68	23.17	19.15

Recommendation

The major trend driving the global growth of the payments industry is the movement towards electronic payments, such as credit and debit card transactions, and away from the traditional payments with cash and checks. PAY has been able to capitalize on this trend by recently expanding their product offerings to include devices which support secure "pay-at-the-pump" transactions, electronic transactions in taxis, and wireless payment transactions. Of the estimated 800,000 fuel dispensers in North America, PAY is expected to service 25,000 by the end of 2011 and management expects this to double in 2012. In regards to electronic payment devices in taxis, PAY currently services about 100 taxis and is foreseeing this to grow to approximately 1,000 taxis by the end of the year. Also, the firm has recently released PAYware Mobile which is an electronic device that attaches to either an iTouch or iPhone and allows merchants to transact secure wireless payments. In addition, PAY has beaten analysts' estimates in seven of the past eight quarters. Given the positive industry-wide trends and strong growth opportunities, it is recommended that PAY be added to the AIM Equity Fund with a price target of $64.80 which represents a potential upside of approximately 20%.

Investment Thesis

- **Move to Mobile Phone initiated Payments.** In November 2010, a joint venture branded "ISIS" was announced by AT&T, Verizon, and T-Mobile with the goal to build a nationwide mobile commerce network utilizing smart phones and near-field communication (NFC) technology. NFC will allow consumers to use their mobile smartphones as a contactless payment device at the cash register. For this reason, among others, global mobile payment system transactions are estimated to reach $245 billion in 2014, up from $32 billion in 2010, according to research firm Gartner Inc. Currently, over 51,000 retail locations support mobile initiated payments. As this infrastructure expands, PAY is positioned to benefit as it already offers electronic payment

devices which support this technology and is expected to sell over one million NFC systems in 2011. In addition, it is speculated that Google Inc. is currently developing NFC technology for the Android operating system which will be compatible with the NFC technology of PAY according to the *Wall Street Journal*.

- **Significant Penetration in Emerging Markets.** The growth in Eastern Europe, Latin America, and emerging Asia has led to rapid adoption of electronic payment transactions. According to consulting firm McKinsey & Co., approximately 5% of the Chinese population has at least one credit card compared to about 60% of the United States population. In addition, the number of credit cards issued in China is expected to reach 300 million in 2013, up from 75 million in 2007. PAY is poised to benefit from this growth as it is currently either the largest or second largest provider of electronic payment solutions in Latin America, China, India, and developing Europe.
- **Increasing Focus on Payment Security.** In September 2006, the major credit card companies, including Visa and MasterCard, formed Payment Card Industry Security Standards (PCI SSC). PCI SSC is responsible for overseeing and unifying industry standards in payment card data security. These standards required merchants to replace unapproved devices by the end of 2010; however, numerous major merchants have received extensions on this deadline and are expected to upgrade their payments systems in the near future. This, along with future changes in industry standards, will continue to drive growth for PAY in the future.

Valuation

To find the intrinsic value of PAY, a ten-year DCF was conducted. A computed WACC of 10.48% and a terminal growth rate of 3% yielded an intrinsic value of $64.03. A sensitivity analysis accounted for variations in WACC from 9.5% to 11.5% and in the terminal growth rate from 2% to 4%. This analysis found a range in values from $51.35 to $85.10. In addition, an EV/EBITDA multiple of 29x was used to calculate an intrinsic value of $67.09. Applying a 75% weight to the DCF and a 25% weight to the EV/EBITDA multiple provides a target price of $64.80. With the stock currently trading at $53.68, the target prices would yield an approximate 20% return. The company does not pay a dividend.

Risks

- **Move to Online Shopping.** As online retail gains in popularity and becomes a larger portion of total retail sales, businesses may begin to close more brick and mortar locations. The numerous store closures in 2008 and 2009 contributed significantly to the company's poor financial performance during that period. Therefore, future retail closures could have a significant impact on the profitability of PAY.
- **Recent Acquisition of Hypercom Corp. (HYC).** In November of 2010, PAY entered into an agreement to purchase Hypercom Corp. in an all equity offer. Because this is a recent acquisition, there are numerous risks surrounding the deal including approval by regulatory agencies. This is a concern because PAY will control an estimated 80% of the North American market if the deal is approved. PAY may be forced to sell a portion of their North American operations in order to comply with government regulations. In addition, if management is unable to properly implement the cost saving synergies of the two businesses, the company's profitability could suffer significantly.

Management

Douglas G. Bergeron has been the CEO for PAY since 2001. Before PAY, he was Group President of Gores Technology Group from 2000 till 2002. In addition, he served as CEO of Geac Computer Corp. from 1999 till 2000. Robert Dykes has served as Senior Vice President and CFO since 2008. Prior to PAY, he was the Chairman and CEO of NebuAd Inc., a provider of targeted online advertising networks. He has also served as CFO of Juniper Networks, a provider of network infrastructure, and Symantec Corp., a provider of software and services addressing information security.

Ownership

% of Shares Held by All Insider and 5% Owners:	2%
% of Shares Held by Institutional & Mutual Fund Owners:	95%

Source: Yahoo! Finance

Top 5 Shareholders

Holder	Shares	% Out
Vanguard Group, Inc.	4,680,650	5.30
Lord Abbett & Co.	3,860,147	4.37
Goldman Sachs Group Inc.	3,120,645	3.53
Alliance Bernstein, L.P.	2,774,912	3.14
Waddell & Reed Financial Inc.	2,515,700	2.85

Source: Yahoo! Finance

Align Technology, Inc. (ALGN)
May 6, 2011

Kristina Gergens | Healthcare

Align Technology, Inc. (ALGN) is a world leader in developing, manufacturing and marketing the Invisalign system which cures misalignment of the teeth. Invisalign corrects misalignment by using a series of clear, removable appliances that help move teeth to a desired final position. Because it does not rely on the use of metal or ceramic brackets and wires, Invisalign reduces the aesthetic and physical limitations associated with braces. ALGN's products include Invisalign Full (67.8% of 2010 revenue), Invisalign Teen (11.3%), Invisalign Express/Lite (9.6%), and Invisalign Assist (6.1%). In addition, ALGN offers ancillary products comprising cleaning material and adjusting tools for dental professionals and Vivera retainers, comprising 5.2% of revenue. In order to provide excellent service to its patients, all orthodontists and general practitioners must complete an Invisalign training course. ALGN distributes its products directly to orthodontists and general practitioner dentists in North America, Europe, the Asia Pacific, Latin America, and Japan (77% domestic/23% international mix). Align was founded in 1997 and is headquartered in San Jose, CA.

Price ($) (4/29/11)	24.14	Beta:	1.2
Price Taget ($):	31.68	WACC	11.8%
52WK Range ($):	13.18-25.94	M-Term Rev. Gr Rate Est:	12.5%
Market Cap:	1.89B	M-Term EPS Gr Rate Est:	12.5%
Float	58.70M	Debt/Equity	0.0%
Short Interest (%):	11.5%	ROA:	17.3%
Avg. Daily Vol:	752.7 K	ROE:	21.5%
Dividend ($):	N/A		
Yield (%):	N/A		

FY: December	2010A	2011E	2012E
Revenue (Mil)	387	484	605
% Growth	23.95%	25.00%	25.00%
Gross Margin	78.40%	78.50%	78.50%
Operating Margin	25.50%	24.00%	24.50%
EPS (Cal)	$0.96A	$1.01E	$1.29E
FCF/Share	1.48	1.48	1.88
P/E (Cal)	25.28	23.95	18.73

Recommendation

Align's patented product line has significant growth opportunities as the number of Americans seeking orthodontia help is on the rise. Approximately 50 - 75% of the population in major developed countries is affected by misalignment of the teeth; however, only about 6.8M people seek treatment annually. ALGN specifically targets adults because the product provides benefits that standard braces do not, most importantly, a more favorable appearance. ALGN has increased its patient volume by appealing to more teenagers, increasing the company's teen sales by 20% YoY. In October 2010, ALGN launched Invisalign G3 which incorporates many technological advances to its product. ALGN also announced its plan to complete its acquisition of Cadent Holdings, a private company, in May 2011. Cadent will provide Align with intra-oral scanning equipment that will provide the company an advantage over its competition because the new scanners will optimize case assessment and planning for Invisalign treatments. Furthermore, the acquisition will lead to revenue synergies in the short run and cost synergies in the long run. Due to ALGN's recent acquisition announcement and increased innovation, ALGN experienced revenues of $104.9 M in Q1 2011, the company's highest revenues to date. Given the exceptional growth prospects and potential rapid market penetration of ALGN, it is recommended ALGN be added to the AIM Equity Fund with a target price of $31.68, offering an upside of about 31%.

Investment Thesis

- **Synergies from Acquisition.** ALGN's current announcement to acquire Cadent Holdings ($190M in cash) should provide significant synergies. In the short term, Align expects the acquisition to increase revenues and increase expenses; however, in the long term this acquisition is expected to have a beneficial impact on ALGN's costs. Cadent provides ALGN with technology not currently available to its main competitors. CAD/CAM use has been growing rapidly and intra-oral scanning is a critical part of enabling new technologies and practices. Over the next five years, third party research projects that intra-oral scanners will become widely used

in dental practices, with growth rates that could exceed a 20% CAGR over that time. Management believes Cadent will account for approximately 10% of annual revenues once the acquisition is completed. Cadent will also provide Align with a greater sales force which will help ALGN market their product on a larger scale.

- **Increased Customer Volume.** Align Technology constantly expands its client base in both the United States and internationally. Expansion into China before the end of Q2 will be beneficial for Invisalign G3 because more complex cases will be available. ALGN had a record number of 26,890 orthodontia cases in Q1, a 23% increase from Q4. The demand for the Invisalign Full product has increased by about 21% over the past year due to the increased demand in orthodontia care. Utilization rates in Q1 were at a record high throughout the U.S. at 6.5 cases per orthodontist which demonstrates continued penetration of more engaged orthodontia practices. North American GP utilization also increased to 2.8 cases per doctor throughout Q1. In addition, ALGN plans on allocating more funding to marketing and advertising expenses throughout 2011 to attract more customers. The company's current international advertising campaign is expected to increase international revenue to 25%.
- **Product and Clinical Innovation** Invisalign G3 was released in October 2010 and was designed to deliver even better, more predictable clinical results; furthermore, G3 is offered to make it easier for doctors to treat more complex cases. Invisalign G3 will be released internationally in May and is expected to provide continued revenue growth for ALGN. Align Technology's recent innovations have helped Invisalign Teen grow from 2% of total revenue to 14% over the past three years. The Invisalign Teen product also grew to 7,930 cases in Q1 of fiscal year 2011.

Valuation

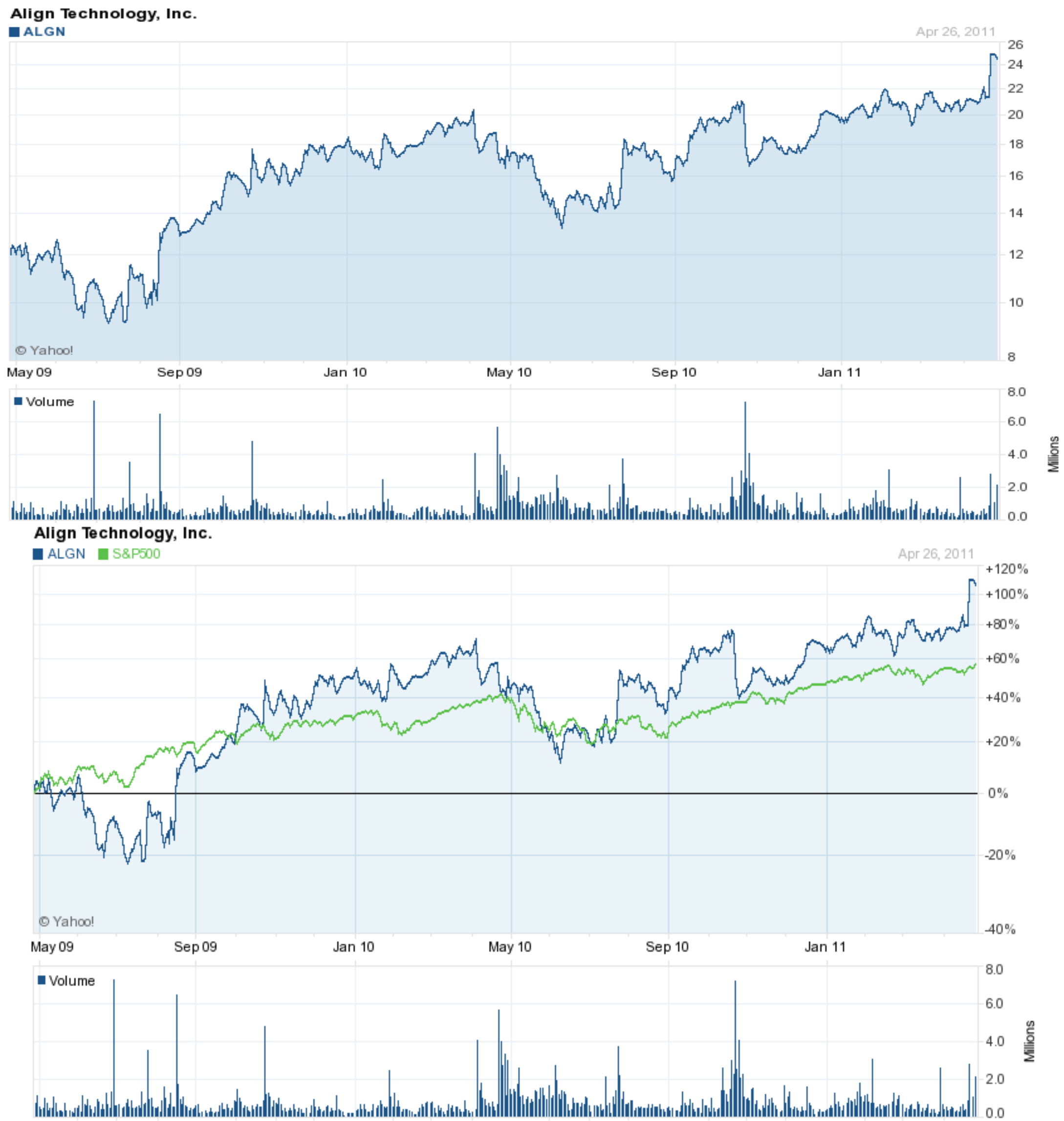
Using a 10-year DCF with a computed WACC of 11.8% and a LT growth rate of 3%, an intrinsic value of $31.38 was determined for ALGN. The DCF model grew revenues in the near term at an average of 25% per year and maintained operating margins at around 25%. In addition, a 25x PE multiple was applied to 2012 EPS forecast of $1.29 and yielded an intrinsic value of $32.58. Taking both methods into account, a $31.68 price target was established, representing a potential 31% upside. ALGN does not pay a dividend.

Risks

- **General Economic Conditions.** ALGN is sensitive to the current downturn in the macro economy because its product is unique and expensive. Customers adjust their spending on orthodontia during bad economic conditions which could adversely affect ALGN. If the economy worsens, ALGN could see a drop in revenues.
- **Competition.** Intense competition exists in the medical device industry. ALGN ($1.9B) competes against experienced dental companies who provide patients with standard wire and bracket braces. ALGN's biggest competitors are 3M's Unite ($69.12B) and Ormco Orthodontics, which is a division of Danaher Corporation ($36.74B). All traditional bracket players have higher unit share and great customer relationships. ALGN is a unique product which serves a niche market; whereas, standard braces are well-known and used by most people seeking orthodontia care.

Management

Thomas Prescott has served as President and CEO of ALGN since March 2002. Prior to joining Align Technology, Mr. Prescott was CEO and President of Cardiac Pathways, Inc., a publicly-traded medical device company, from May 1999 until its acquisition by Boston Scientific in August 2001. While at Cardiac Pathways, Mr. Prescott launched new products and substantially grew revenue over a two year period. Mr. Ken Arola was appointed Vice President, Finance and CFO in December 2007. Mr. Arola has over 25 years of experience in the medical device and technology field. Prior to joining Align, he spent 14 years at Adaptec.



Ownership

% of Shares Held by All Insider and 5% Owners:	13%
% of Shares Held by Institutional & Mutual Fund Owners:	83%

Source: Yahoo! Finance

Top 5 Shareholders

Holder	Shares	% Out
Kornitzer Capital Management, Inc.	7,184,675	9.35
Bank of New York Mellon Corporation	6,504,624	8.46
Vanguard Group, Inc.	2,922,737	3.80
BlackRock Institutional Trust Company, N.A.	2,814,031	3.66
Blair(William)&Company, LLC	2,504,242	3.26

Source: Yahoo! Finance

Shoe Carnival, Inc. (SCVL)
May 6, 2011

Jonathan Schwerin — Consumer Services

Shoe Carnival is one of the nation's largest family footwear retailers. SCVL owns 315 stores in 30 states primarily in the Midwest, South, and Southeast regions of the United States. SCVL offers a distinctive shopping experience, a broad merchandise assortment and value to their customers, while maintaining an efficient store level cost structure. Their stores combine competitive pricing with a highly promotional, in-store marketing effort that encourages customer participation and creates a fun and exciting shopping experience. They believe this highly promotional atmosphere results in various competitive advantages, including increased multiple unit sales; the building of a loyal, repeat customer base; the creation of word-of-mouth advertising; and enhanced sell-through of in-season goods. SCVL is an Indiana corporation that was initially formed in Delaware in 1993 and reincorporated in Indiana in 1996.

Price ($): (4/28/11)	$ 29.28	Beta:	1.59
Price Target ($):	36.55	WACC:	11.06%
52 WK H-L ($):	16.24-30.09	M-Term Rev. Gr Rate Est:	5.00%
Market Cap (mil):	387.84	M-Term EPS GR Rate Est:	5.00%
Float (mil):	9.2	Debt/Equity:	0%
Short Interest (%):	3.60%	ROA:	7.77%
Avg. Daily Vol (mil):	74.59	ROE:	10.35%
Dividend ($):	N/A		
Yield (%):	N/A		

FY: Mar	2011A	2012E	2013E
Revenue (Mil)	$ 739.19	$ 820.50	$ 886.14
% Growth	8.32%	11.00%	8.00%
Gross Margin	29.97%	29.50%	29.50%
Operating Margin	5.73%	5.50%	5.50%
EPS (Cal)	$ 2.05	$ 2.12	$ 2.28
FCF/Share	$ 2.37	$ 2.62	$ 2.81
P/E (Cal)	14.28	13.84	12.82
EV/EBITDA	5.84	5.43	5.04

Recommendation

Shoe Carnival takes a unique look at the retail industry in that they offer one of today's most unique retail shopping experiences. SCVL promotes a high-energy retail environment by decorating with exciting graphics and bold colors, and featuring a stage and barker as the focal point of their stores. This has allowed SCVL to grow revenues over the past several years, including a most recent 8.32% YoY increase in revenue compared to other apparel retailers averaging 5.08% YoY. Shoe Carnival also maintains solid free cash flow as they have not had a negative free cash flow in the last eight years. SCVL has recently launched their e-commerce website, which should help increase top line growth by providing a need for economically insecure individuals to find value in name brand shoes. According to Cliff Sifford, executive vice president, SCVL already has a loyal fan base that visits the website regularly; however, SCVL could face severe competition in Amazon and Zappos, which have dominated the e-commerce retailing business. In addition to their website, SCVL plans to open 20 new stores in existing geographic markets, which should drive revenue growth. Because of these reasons and an attractive intrinsic value of $36.55, it is recommended that SCVL be added to the AIM Domestic Equity fund, offering a potential upside of 24.8%.

Investment Thesis

- **Efficient Store Level Cost Structure.** SCVL's cost efficient store operations and real estate strategy of leasing their stores enable them to price products competitively. Low labor costs are achieved by housing merchandise directly on the selling floor in an open stock format, enabling customers to serve themselves, if they choose. This reduces the staffing required to assist customers and reduces store level labor costs as a percentage of sales. SCVL prefer to locate stores predominantly in strip shopping centers in order to take advantage of lower occupancy costs and maximize their exposure to value oriented shoppers.
- **Distinctive Shopping Experience.** SCVL's stores combine competitive pricing with a highly promotional, in-store marketing effort that encourages customer participation and creates a fun and exciting shopping experience. SCVL promotes a fun and exciting retail environment by

decorating with stimulating graphics and bold colors, and by featuring a stage and barker as the focal point in each store. With a microphone, this barker, or "mic-person", announces current specials, organizes contests and games, and assists and educates customers with the features and location of merchandise. The mic-person offers limited-duration promotions throughout the day, encouraging the customers to take immediate advantage of the value pricing.

- **Organic Growth and E-Commerce.** In view of the recent improvement in consumer spending and commercial real estate development, in fiscal 2011, SCVL expects to open approximately 20 new stores. These new stores will primarily be located in existing geographic areas. The intention is to fill-in certain under-penetrated markets with additional stores, thereby increasing the performance of the overall market. SCVL also intends to enter new smaller markets that they can fully penetrate with one or two stores. SCVL can generally advertise more effectively in these markets, which helps to create immediate brand awareness. In addition to opening new stores, in fiscal 2011 SCVL will be launching an e-commerce site during the second half of the year to sell shoes and related accessories through their website, www.shoecarnival.com.

Valuation

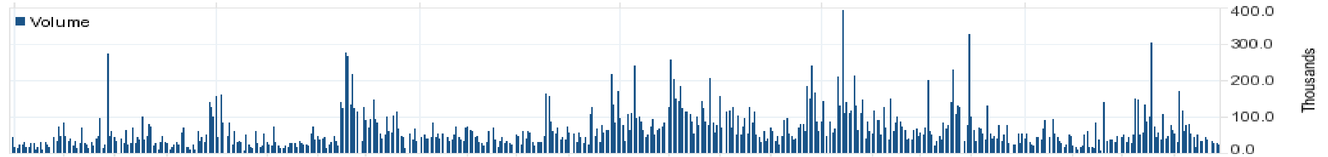
SCVL is currently trading at a 5.84x EV/EBITDA multiple. Applying a conservative 5.0x EV/EBITDA multiple to the 2011 EBITDA of $56.12M generates a price of $32.82 per share. Based on a five-year DCF analysis with a WACC of 11.06% and a terminal growth rate of 2.5%, an intrinsic value of $37.80 was obtained. A DCF sensitivity analysis that adjusts both the long-term growth rate (1.5-3.5%) and the WACC (11-13%) generates a price range of $29.86-$41.38. After weighting the EV/EBITDA multiple 25% and the DCF analysis 75%, a target price of $36.55 was established offering an upside of 24.8%. The company does not pay a dividend.

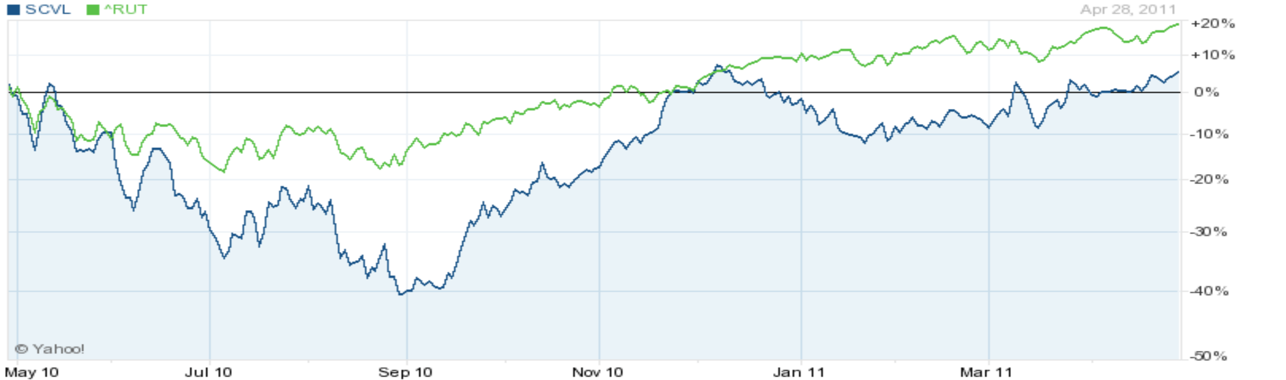
Risks

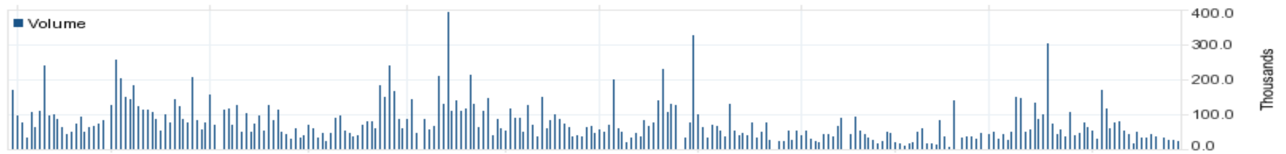
- **Economic Conditions.** The merchandise that SCVL sells generally consists of discretionary items. Adverse economic conditions and unemployment rates, and any related decrease in consumer confidence and spending may result in reduced consumer demand for discretionary items. Any decrease in consumer demand could reduce traffic in their stores, limit the prices they can charge for products and force them to take inventory markdowns, which could have a material adverse effect on their business, results of operations and financial condition.
- **Competition.** The retail footwear industry is highly competitive. SCVL competes primarily with department stores, shoe stores, sporting goods stores and mass merchandisers. Many of their competitors are significantly larger and have substantially greater financial and other resources than they do. Economic pressures on or bankruptcies of their competition could result in increased pricing pressures. This competition could adversely affect their results of operations and financial condition in the future.

Management

Mr. Lemond has been employed as President and Chief Executive Officer since September 1996. From March 1988 to September 1996, Mr. Lemond served as Executive Vice President, Chief Financial Officer, Treasurer and Assistant Secretary. On February 3, 1994, Mr. Lemond was promoted to the position of Chief Operating Officer. Mr. Lemond has served as a Director since March 1988. Mr. Jackson has been employed as Executive Vice President - Chief Financial Officer and Treasurer since August 2004. From June 2001 to August 2004, Mr. Jackson served as Senior Vice President – Chief Financial Officer and Treasurer. From September 1996 to June 2001, Mr. Jackson served as Vice President – Chief Financial Officer and Treasurer.







Ownership

% of Shares Held by All Insider and 5% Owners:	29%
% of Shares Held by Institutional & Mutual Fund Owners:	63%

Source: Yahoo! Finance

Top 5 Shareholders

Holder	Shares	% Out
Dimensional Fund Advisors LP	1,025,826	7.74
Fidelity Small Cap Opportunities Fund	552,714	4.17
Fidelity Stock Selector Small Cap Fund	524,847	3.96
Ameriprise Financial, Inc.	499,765	3.77
Friess Associates Inc.	448,300	3.38

Source: Yahoo! Finance

Quality Distribution, Inc. (QLTY)
May 6, 2011

Alice Wycklendt Business Services

Quality Distribution, Inc. operates the largest chemical bulk tank truck network in North America with an estimated 14% market share. The firm is the largest North American provider of ISO container and depot services through its wholly-owned subsidiary, Boasso. QLTY reports these two financial segments as Logistics (72% of 2010 revenue), Intermodal (16%), and Fuel Surcharge (12%). The company transports a broad array of liquid and dry bulk chemicals and provides logistics through 29 independent affiliates with 91 trucking terminals and 3 company-owned terminals. In 2010 the network included 2,901 tractors (27% owned) and 5,738 trailers (70% owned). Affiliate relationships are long-term in nature and comprise 95% of transportation revenues. The company is a core carrier for chemical processing companies such as Ashland, Dow, DuPont, Honeywell, & Unilever, and provides services to most of the top 100 chemical producers with US operations. Boasso operates through 8 terminals near ports in the eastern half of the US, providing over-the-road transportation services, as well as tank cleaning, heating, testing, maintenance, and storage services. The tank truck industry is highly fragmented, with competition from more than 200 smaller, regional carriers. Boasso competes with various companies based on location at the same ports. QLTY went public in November 2003 after beginning as MTL, Inc. in 1994 and acquiring Chemical Leaman Corporation in 1998; Boasso was acquired in 2007. QLTY is headquartered in Tampa, Florida.

Price ($): (4/28/11)	11.67	Beta:	1.05	FY: Dec	2010A	2011E	2012E
Price Target ($):	16.00	WACC	8.84%	Revenue (Mil)	$686.6	$723.3	$788.0
52WK H-L ($):	4.6-12.4	M-Term Rev. Gr Rate Est:	14.8%	% Growth	11.90%	5.34%	8.95%
Market Cap (mil):	250.36	M-Term EPS Gr Rate Est:	40.7%	EBITDA Margin	7.68%	8.81%	8.40%
Float (mil):	11.18	Debt/Total Capital	183.7%	EBIT Margin	5.35%	6.80%	6.40%
Short Interest (%):	2.8%	ROA:	2.39%	EPS (adj)	$0.30	$0.46	$0.51
Avg. Daily Vol (mil):	0.964	ROE:	N/A	FCF/Share	$0.59	$1.71	$1.77
Dividend ($):	0.00			P/E (adj)	38.56	20.59	18.58
Yield (%):	0.0%			EV/EBITDA	9.68	8.01	7.71

Recommendation

QLTY maintains substantial market share in a highly fragmented industry and has the network to leverage volume and pricing improvements in the industry as specialty truckload rates were up an average of 15% year over year each week of 2010 and are up an average of 8% for each week in 2011. With an asset-light model and recent restructuring of its debt, the company is well-positioned to take advantage of both modest improvements in its core business of chemicals transportation (6% CAGR 2010-2012) and of a substantial revenue opportunity in water transportation for horizontal natural gas well fracturing operations throughout the United States. Therefore, based on a 5 year DCF valuation, it recommended that QLTY be added to the AIM Equity portfolio with a target price of $18.00.

Investment Thesis

- **Transition to Asset-Light Model.** QLTY has substantially shifted its operating structure by moving to an affiliate-based network, increasing affiliate terminals by 68% since 2008 while reducing company terminals from 54 to 3. Under the new ‘asset-light’ model, QLTY receives 15% of gross revenue on the contract and another 8% if, as is typically required, the affiliate leases the trailer from QLTY. Management indicates that the company’s focus on trailers over tractors reduces capital expenditures to 1% of operating revenues compared to the truckload average of 10%. Additionally, asset-light logistics companies tend to trade at higher multiples than truckload carriers—13.8x vs. 7.2x EV/EBITDA & 37x vs. 35x P/E—and as QLTY begins to realize the benefits of its new structure it should experience expansion in its multiples.

- **Improving Chemical Industry.** US chemical railcar loadings are up 3.4% yoy in April 2011, and are projected to grow approximately 6% for the year; chemical railcar loadings are approximately 85% correlated with QLTY's revenue. Estimates for companies in the S&P 500 Chemicals Index and the S&P400 Chemicals Index have revenues projected to grow at a CAGR of 6.2% from 2010 to 2012. While this growth is modest, improving demand in the core business will continue pressuring capacity in the industry, leading to a more positive pricing environment on increasing volumes.
- **Shale Water Hauling Opportunity**. By the end of Q1 2011, Quality expects to have 30 tanks hauling water for horizontal natural gas wells in the Marcellus shale region in the Eastern US as the first stage of its move into adjacent markets. The equipment utilization in the space is approximately 3x greater than that of QLTY's core business. Roughly 3,300 gas well permits were issued for the Marcellus shale in 2010 and thousands more are likely to be drilled over the next two decades. Chesapeake Energy estimates that hydraulically fracturing a Marcellus well typically requires an average of 5.5 million gallons of fresh water. In addition to this initial need for water, the well continues to produce wastewater 24/7 that must be hauled away, providing constant revenue opportunities for tank haulers. As a recent entrant in the market, Quality's opportunity in the market is compelling with significant leverage in the model—at 8% EBIT margin, $50 million in revenues contributes $0.11 to EPS. The industry is currently served by smaller, regional players which create an opportunity for QLTY to capture market share by leveraging its larger network of independent affiliates.

Valuation

A five year DCF model was conducted to determine the intrinsic value of QLTY. A WACC of 11.33% was utilized to reach and intrinsic value of $17.12 on varied sales growth rates and a terminal cash flow growth of 3.00%. A sensitivity analysis produced a target range of $9.40-$24.00 based on variations in WACC and terminal growth. An EV/EBITDA multiple of 10x based on a 1x premium to historical average was applied to 2011 EBITDA of $66.2 million to yield an intrinsic value of $16.14. Given equal weighting these approaches result in a target price of $16.00, a 37% upside to the current price. The company does not pay a dividend.

Risks

- **Balance Sheet.** QLTY has total debt of $317 million on the books, and total debt to total capital is 183.66%. Despite recently extending the maturity of its debt structure to 2018 and lowering interest expense, significant balance sheet risk remains and becomes problematic if the company is unable to generate cash to meet its obligations QLTY's interest coverage ratio is 1.26.
- **Driver Shortage.** The recent introduction of Compliance, Safety, Accountability (CSA) 2010 regulation may help to create a driver shortage as it is required that all drivers be monitored and scored on a number of factors designed to increase safety in the industry. Scores are to be published in order to force carriers to improve the quality of their drivers or risk losing customers on the basis of safety deficiencies. As a result, the need for more reliable and well-qualified drivers may make it extremely difficult for QLTY and other carriers to recruit and hire without large increases in compensation. A prolonged or severe driver shortage would limit QLTY's earnings ability.

Management

Gary Enzor, 48, was named CEO in June 2007 after joining QLTY in December 2004. Enzor previously served as CFO of Swift Transportation beginning in 2002 after holding executive positions with Honeywell International and Dell Computer. Stephen Attwood, 59, joined the company as CFO in July 2008 and was named COO in July 2010. Joseph Troy, 47, was named CFO in August 2010.

Ownership

% of Shares Held by All Insider and 5% Owners:	35%
% of Shares Held by Institutional & Mutual Fund Owners:	38%

Source: Yahoo! Finance

Top 5 Shareholders

Holder	Shares	% Out
Apollo Management Holdings, LP	7,882,530	33.49
FMR LLC	1,957,329	8.32
Ancient Art, LP	1,093,413	4.65
Dimensional Fund Advisors, LP	699,303	2.97
Vanguard Group, Inc.	498,840	2.12

Source: Yahoo! Finance