MARQUETTE UNIVERSITY

Applied Investment Management (AIM) Program

AIM Fund Investment Advisory Board Meeting

October 11, 2005

AIM Fund Portfolio Recommendations

Student Presenter	Company Name	Ticker	Recommended Portfolio Weighting	Recommended Investment	Share Price 10_07_05	# of Shares to be Purchased	Initial Market Value
Holtkamp	Macatawa Bank Corp.	MCBC	2.0%	$10,000	$33.02	300	$9,906
Jensen	Matria Healthcare	MATR	2.0%	$10,000	$37.70	270	$10,179
Rawls	Rackable Systems Inc.	RACK	2.0%	$10,000	$17.00	600	$10,200
Berg	W-H Energy Services Inc.	WHQ	2.0%	$10,000	$28.27	360	$10,177
Toellner	TIM Participacoes	TSU	1.0%	$5,000	$18.55	270	$5,009
Trotter	Select Comfort, Corp.	SCSS	2.0%	$10,000	$18.20	550	$10,010
Hepp	Multi-Fineline Electronix	MFLX	2.0%	$10,000	$26.25	380	$9,975
Kennedy	Ormat Technologies	ORA	1.0%	$5,000	$21.64	230	$4,977
Auth	RARE Hospitality Intl.	RARE	2.0%	$10,000	$25.00	400	$10,000
Wojs	Forward Air	FWRD	1.5%	$7,500	$35.51	210	$7,457
Cunningham	American Equity Investment Life	AEL	2.0%	$10,000	$11.61	870	$10,101
Holtkamp	FPIC Insurance Group	FPIC	2.0%	$10,000	$35.30	300	$10,590
	Sub-Total		**21.5%**	**$107,500**			**$108,581**
	Other Equity		**40.0%**	**$200,000**			
	Cash		38.5%	$192,500			
	Total		**100.0%**	**$500,000**			

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<u>Macatawa Bank Corporation</u>
MCBC
Price: $33.02 ($22.48 - $40.00)

October 6, 2005
Russell 2000: 644.98 Steven Holtkamp

Macatawa Bank Corporation operates as the holding company for Macatawa Bank (the bank) that provides commercial and personal banking services in Kent, Ottawa, and northern Allegan Counties in Michigan. The bank offers various deposit services, including checking accounts, savings accounts, and various types of time deposits to individuals, businesses, associations, churches, nonprofit organizations, financial institutions, and government authorities. It provides residential mortgage loans and multi family and commercial real estate loans secured by apartment buildings, condominiums, small office buildings, small business facilities, medical facilities, and other non residential building properties. The bank offers construction loans to individuals, builders, and developers for the construction of one to four family residences and the development of one to four family lots, residential subdivisions, condominium developments, and other commercial developments. Macatawa Bank offers commercial loans that include loans to finance operations and equipment. As of August 6, 2004, Macatawa Bank operated through 21 branch offices, and a lending and operational service facility. It also invests in U. S. Treasury and U.S. Government agencies securities, and state and municipal bonds. The company is headquartered in Holland, Michigan.

Recommendation

I believe that Macatawa Bank Corporation will be able to grow earnings by 60% in 2005, and 15% in 2006. MCBC has been able to surprise analysts in every quarter since coverage was initiated. This implies that there is an underestimation of the bank's ability to grow. Consensus estimates for 2005, and 2006 are $1.95, and $2.19. It is my belief that earnings will grow to $2.00, and $2.30. Based on these estimates I am putting a price target on MCBC of $40, and recommending a portfolio weighting of 2%.

Key Statistics	MRQ
Portfolio Weighting	2%
Market Cap (M)	338.46
Debt/ Equity	2.20
Dividend Yield	1.81%
NIM	3.80%
Efficiency Ratio	52.86%
ROE	15.71%
ROA	1.20%
LTG Rate	15%
P/E '05E	16.58
P/E '06E	14.41

Investment Thesis

MCBC set a goal to be the leading community bank in Western Michigan. It has achieved this goal in two of the three counties in which it is currently exposed. The Western Michigan marketplace is characterized by higher than average household income, and is less susceptible to economic downturns in the marketplace. Manufacturing only represents 23% of the area's total employment. Also, the areas that MCBC operates have seen its population grow by 8.23%, while the state of Michigan's population grew by 3.74% over the same period. Further, branch expansion is targeted in the Grand Rapids area.

Great markets have lead to fast growth. Assets have grown at an average pace of 38% over the past three years, while loans have grown at a pace of 39% over the same period. Deposits were able to keep pace with loans with an average growth of 39%. Overall, MCBA has a five year average EPS growth of 49.5%. This rate has been more than triple the industry's average.

Balance sheet remains clean. Non-performing assets / total assets was 0.25% in the MRQ, and averaged 0.236% over the past three years. Net charge-offs / loans was 0.18% in the MRQ, averaging 0.21% in the past three years. Reserves / non-performing assets was 450% in the MRQ.

An asset sensitive portfolio will increase net interest margin. At the end of 2004 MCBC had a 65% floating rate loan portfolio. With further rate hikes anticipated into the future this could provide for a wider margin for MCBC. A 100 bps increase in interest rates would cause a 2.6% increase in net interest income. Net interest margin in 2004 was 3.62%, 3.82% in the MRQ, and I am estimating it to be 3.90%.

MCBC has surprised analysts in every quarter in which it was covered. This is a strong signal to me that the market underestimates MCBC's ability to continually grow as fast as it has in the past. A reason for this is that the company does not give earnings guidance, but rather a larger picture of company outlook.

Valuation

Increased net interest margin and interest earning assets are the main contributors to the earnings increases. Management has stated that earning assets will grow at 20% during the year and further NIM expansion is likely. Going forward, I believe that the company will generate a $.52, 3Q EPS. This represents a 152% increase in earnings. EPS in 2005 is estimated to be $2.00, a 62% increase over 2004.

Risks

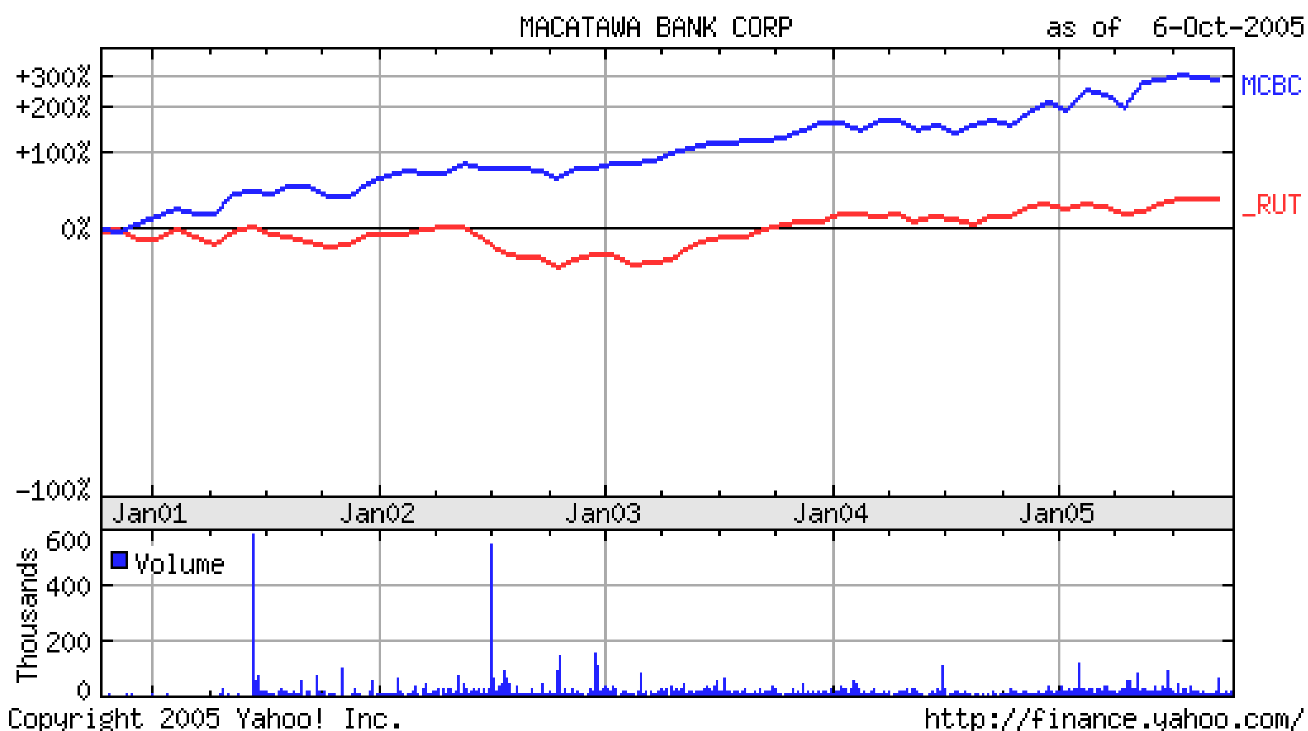
Interest Rate Risk. For MCBC interest rate risk comes more from the Federal Reserve halting rate hikes than from an increase. Flat interest rates will cause a flat if not decrease in the NIM.
Economic Risk. Every firm is susceptible to a downturn in the economy, and MCBC is no different. A major driver for MCBC is asset growth. Loan growth would not be able to grow as expected if there were an economic slowdown.

Management

Benjamin A. Smith. Chairman/ CEO. Salary of 156K. Mr. Smith served with First Michigan Bank and FMB-First Michigan Bank of Zeeland before starting Macatawa Bank Corp in 1997.

Outlook and Growth Assumptions

-Earning Assets will grow at 20%.
-Net Interest Margin will expand at least 8 bps.
-Asset Quality will remain stable.
-Expenses remain stable through 2005 as no further branch expansion is planned.



Major Shareholdings:

% of Shares Held by All Insider and 5% Owners:	8%
% of Shares Held by Institutional & Mutual Fund Owners:	18%
Number of Institutions Holding Shares:	4

Top Institutional Holders

Holder	Shares	% Out	Value*	Reported
BENJAMIN A. SMITH AND ASSOCIATES, LTD.	222,660	2.19	$7,476,922	31-Mar-05
Allianz Global Investors of America L.P.	217,925	2.14	$7,317,921	31-Mar-05
BARCLAYS BANK PLC	193,783	1.90	$6,507,233	31-Mar-05
BANC FUNDS COMPANY, L.L.C.	118,169	1.16	$3,968,115	31-Mar-05

Matria Healthcare Inc.

MATR

Price: $37.71 ($18.09 - $39.61)

Fiscal Year Ends: December 31, 2005

October 6, 2005 — Jaclyn Jensen

Russell 2000 Index: 639.45 (558.36 – 688.51) — Health Care Sector

Matria Healthcare Inc. provides disease management services and related products to self-insured employers, private and government sponsored health plans, pharmaceutical companies, and individual patients. The company operates in North and South America, Europe, and Asia, with 25% of sales generated in the United States. MATR consists of two operating segments: Health Enhancement and Women's and Children's Health. The company offers disease management services for diabetes, cardiovascular disease, respiratory disorders, cancer, obesity, depression, chronic pain, a variety of maternity related problems, and other chronic conditions. MATR also offers a line of diabetes products and provides an online health and wellness site.

Recommendation

Matria's goal of becoming a one-stop shop for disease management services, as well as its strategy of targeting the high-margin self-insured employer segment of the customer base has proven to be a successful growth strategy. MATR's diversified revenue base is an asset for both the company's continued growth and its financial stability. Its domestic disease management segment is expected to grow at a rate of 50% for at least the next two years, with growth primarily stemming from synergies and cross-selling opportunities from the company's two recent acquisitions. Matria's Facet segment is the leading global supplier of three main lines of diabetes products and continues to demonstrate healthy margins and growth. The company's foreign diabetes business provides international growth opportunities and adds to the company's profitability. Finally, the Women's and Children's Health division is on the rebound and looks like it will begin adding to the company's revenue growth this year. Part of the proceeds from the 2004 divestiture of MATR's pharmacy and supplies business went towards acquisitions, therefore if MATR chooses to sell its Facet segment it is likely the funds would be used to make more earnings accretive acquisitions which will further expand its service menu and customer base. Based upon the company's growth potential it should be fairly valued at $43.40 with the potential to generate a 15% gain.

Key Statistics	06 Oct 2005
Market Cap	$773.620M
Shares Outstanding	20.520M
Average Volume†	173,820
Beta	0.77
2004 Actual EPS†	$0.70
2005 Estimated EPS	$1.10
P/E (TTM)	41.75
P/Book (Q2:2005)	3.24
Cash Flow/Share	$3.72
FCF/share	$3.28
Debt/Assets	1.33%
ROE	19.11%
Gross Margin	42.34%
LT Growth Estimate†	25.00%

*Source: Bloomberg (except †)

Investment Thesis

- **Pressure to control employee health care costs fuels growth in the disease management business.** MATR focuses primarily on Fortune 1000 self-insured employers, a market group that has grown in both size and disease management interest level recently. This customer group tends to offer higher margins than those negotiated through private and government health plans. Furthermore, Matria's focus on this group helps to isolate them from the industry's larger players whose primary customer targets are large health plans.

- **Medicare interest in disease management programs.** Medicare has been suffering from rising costs and recent legislature enacted nine disease management demonstration programs to determine the potential benefits to the program. Some states are looking into similar programs for Medicaid. Most analysts have not priced in the potential for Medicare and Medicaid revenues

which could provide a significant boost in share value if phase one of the demonstration programs goes well.

- **Proprietary TRAX technology.** MATR uses its TRAX technology to operate more effectively and to provide quality of care improvement. The company believes that its technology is superior to that used by its competitors. Matria feels that its TRAX system is poised to capitalize on President Bush's plan to build a national electronic health information infrastructure.

- **Growth through acquisitions of smaller, single-focus disease management companies.** Matria is working towards its goal of being a one-stop shop for disease management needs. MATR compounds the growth gained from new services offered by acquired companies by cross-selling its current programs to the acquired company's customers.

Valuation

Based on my discounted cash flow model, Matria should be valued at $43.40, which indicates that the stock is currently undervalued by 13%. MATR is currently trading at a P/E of 41.75, which indicates that the company is undervalued relative to its peers which are trading at an average of 44.25 times earnings. Based on a relative P/E valuation, MATR should be trading at $48.86. The average valuation of the nine analysts providing a price target for MATR is $41.72, with actual price targets ranging from $37 to $46. I believe that a target valuation of $43.40 is reasonable for the stock.

Risks

- **Speculation that MATR will divest its Facet subsidiary.** The Facet subsidiary, which offers a line of diabetes related products, does not fit with the direction of MATR, and while profitable, it is expected to be spun off in the near term. Uncertainty surrounding potential disposition charges, the sale price, and use of the proceeds could have a negative impact on share price.

- **Expiration of contract with Facet's primary supplier.** The exclusivity provisions of Facet's agreement with its primary supplier expire in December 2005. Termination of the agreement could result in an interruption of supply which would negatively affect revenues from the segment.

- **Exchange Rate Risk.** Approximately 22% of 2004 sales were denominated in a foreign currency. The company does not expect to be adversely affected by exchange rate fluctuations and therefore does not currently hedge its foreign currency risk. In the past the company has experienced gains on foreign currency transactions, however there is no guarantee that this will persist.

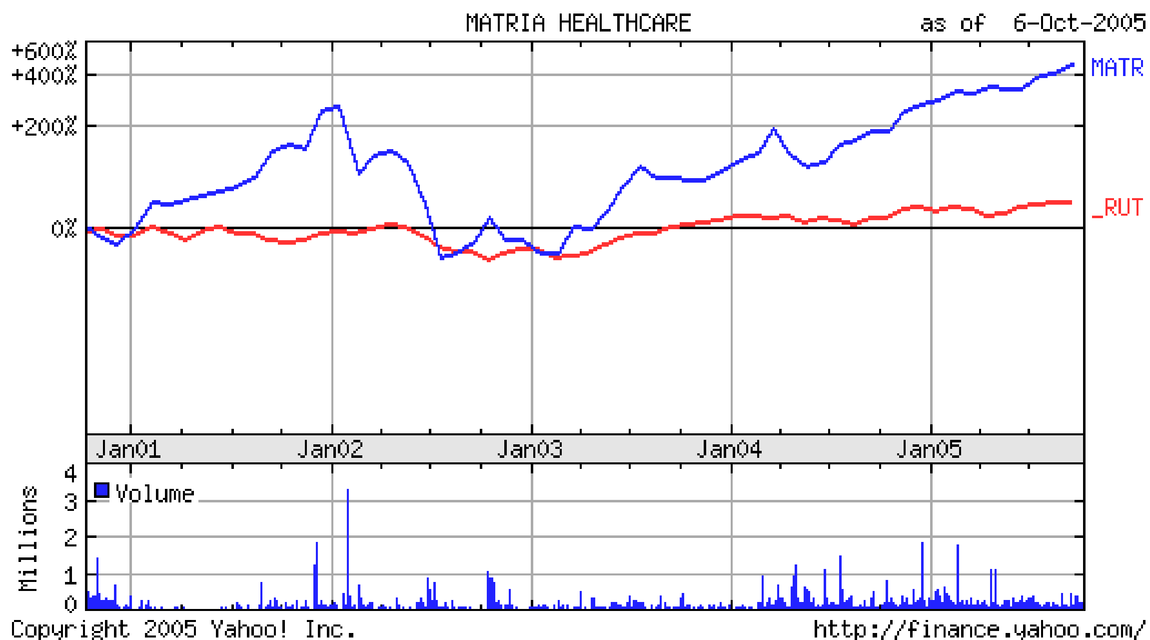
- **Competition.** Matria is the fifth largest competitor in the disease management industry with only 6% of total industry revenues. While its program offerings meet or exceed that of the larger players in the industry, the company may have a hard time gaining additional market share.

Management

Parker "Pete" Petit, the Chairman and CEO of MATR, was the founder of Healthdyne which merged with Tokos Medical Corp in 1996 to form Matria. The executives of the company currently hold approximately 4.6% of the shares outstanding. Overall the corporate governance of the company seems shareholder friendly.

Other Notable Information

- MATR is headquartered in Marietta, Georgia and has facilities throughout the United States and in England and Germany.
- Matria recently cleaned up its balance sheet by redeeming $85 million in convertible debt, leaving the company with $22 million in cash and only $2 million in long-term debt.



Top 5 Institutional Holders

Holder	Shares Held	Percent of Shares Outstanding
Wellington Management	1,437,000	7.01%
RS Invest Management	1,085,000	5.29%
Fidelity Management	830,700	4.05%
Earnest Partners	773,097	3.77%
Next Century	601,463	2.93%

Rackable Systems Inc.

RACK

Price $13.84 (11.15 - 14.50)

Fiscal Year End: Jan.

October 6, 2005 Greg Rawls

Russell 2000: 639.45

Rackable Systems develops servers and data storage for large corporations' world wide at a lower total cost of operating then competitors. Rackable's Foundation Series servers' line was developed in 2000 and has quickly helped them become a leader in high-density serves worldwide. Rackable also offers low cost high capacity storage systems.

Recommendation

Key Statistics	October 2005
Portfolio weight	2%
Market Cap	$269 million
LT Debt/Total Cap.	0
Dividend Yield	0
ROE	NA
LTG Rate (5 yr)	30
Thomson Consensus Rating (1=Buy 5=Sell)	2
P/E Fiscal '05E	28.9
P/E Fiscal '06E	24.4
Morningstar Sector	Hardware
EPS 2005	$.48
EPS 2006	$.57
EPS 2007	$.80

Rackable is well positioned to grow in the coming years due to their competitive advantage of selling low total cost servers to large companies. The patented features of their Foundation series servers include a denser design, thermal management, remote management and a build-to-order model. RACK will also continue to benefit from increasing sales of their low cost storage systems. Rackable's competitive advantage for their storage systems is that they sell at half the cost of industry leaders and still earn a margin in excess of their servers.

Investment Thesis

- **The market for high-density servers that operate at a low total cost is a growing market**. Rackable's high-density server market consists of mainly large companies that are growing and need additional servers. The majority of Rackable's customers are internet-based companies such as Amazon and Yahoo. Currently only 15 of the top 100 internet companies in North America are using Rackable servers, thus leaving plenty of growth opportunities. Rackable is also beginning to see increasing interest from other industries including semiconductor design, federal government, entertainment and financial services.
- **Rackable's server technology.** Rackable's Foundation servers offer large companies several advantages including a denser design, thermal management, remote management and a build to order model. Rackable's server technology is patented and has been legally defended on four occasions. The benefit of a denser design allows companies to fit twice the number of servers into a computer room compared to traditional servers. The thermal management feature of the servers helps reduces cooling cost for the computer room by 10% to 30%. The remote management feature allows companies to use several different program bases including Microsoft and Linux. Rackable's ability to develop customized products for customers over time helps to ensure a high degree of customer satisfaction.
- **Rackable's low cost storage product.** RACK's storage product is a growing area due to their competitive pricing structure. They are able to sell storage at half the price of the industry leaders, such as EMC, and still receive a profit margin that is higher than the margin they receive for their servers.

- **Growth has been spectacular and should continue to grow as more companies learn of the advantages of Rackable's products.** Rackable sales have grown by an annual average of 225% over the past three years as more companies learn about their products. Rackable EPS has grown 31.4% in the last year. In the second quarter of 2005, Rackable added 50 new customers including Amazon.com.
- **Blade servers are not as beneficial for large companies as Rackable servers.** Despite the fact that blade servers are comparable in size to Rackable servers, the total cost benefit of Rackable servers outweighs the total cost of blade servers for large companies.

Valuation

Rackable is currently undervalued at $13.84 and should be trading at $17.10 using the cash flow discount model. The five year projected growth rate is 30%. The transitional 12 year time period growth rate is 5.2%. The EPS estimates are $0.49 in 2005, $0.57 in 2006, and $0.80 in 2007. Currently, four analysts have outperform recommendations for Rackable.

Risks

- **Increased competition.** RACK has seen increasing competition in the server and storage markets. Fortunately, the company has continued to gain market share in the high-density computer server market.
- **Size of the firm relative to competition.** With competition from large companies such as Dell, HP and IBM, Rackable is vulnerable to pricing pressure.
- **Customer concentration.** New customers sometimes can account for over 30% of sales, as was the case in 2002 and 2004. There is a risk that Rackable will not be able to secure a large customer orders in the future to sustain growth.

Management

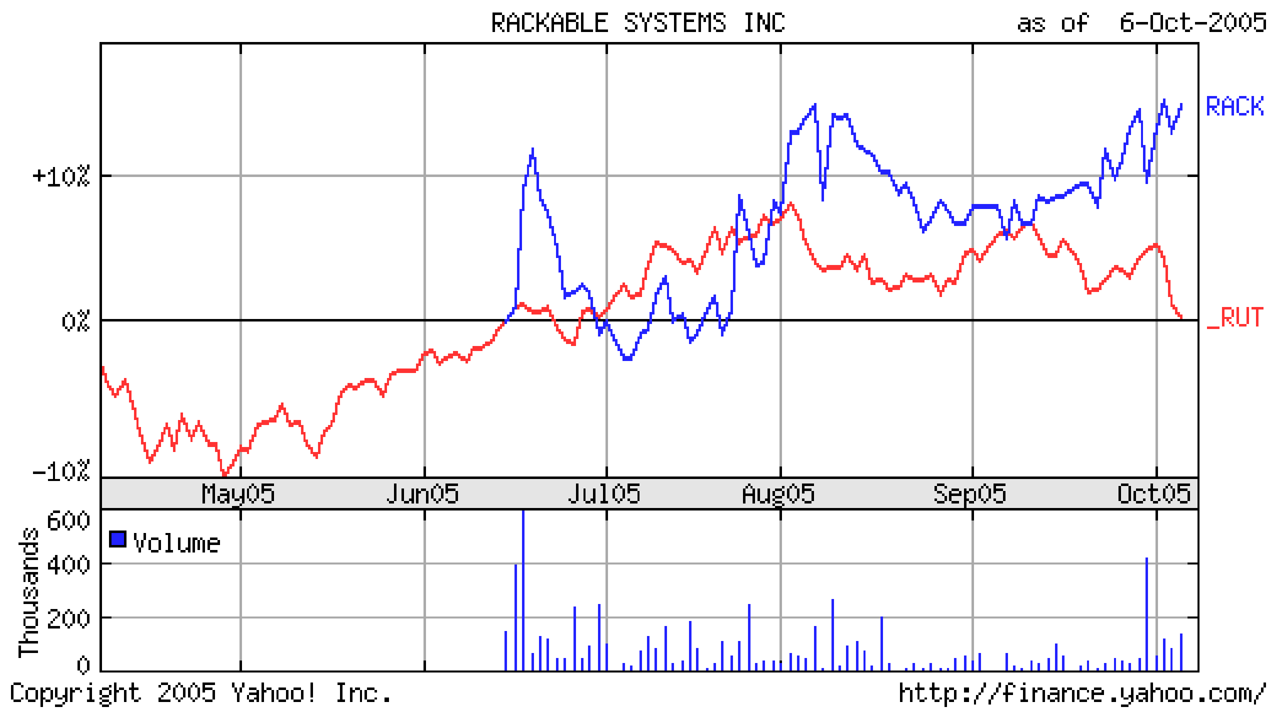
Tom Barton joined Rackable as CEO in 2002. His past experience includes working as CEO at Cygnus Solutions until they where acquired by Red Hat. Co-founders include Giovanni Coglitore, Chief Technology Officer and Director, Nikolai Gallo, Chief Procurement Officer, and Jack Randall, Vice President of Information Systems. Currently management owns 19% of the shares outstanding with the three co-founders' each owning 6%.

Outlook and Growth Assumptions

- EPS for the second quarter where $0.12, that was above the street's estimates of $0.09. EPS guidance for the third quarter of 2005 is $0.12.
- Average analyst estimates EPS for fiscal 2005 to be $.30.

Long-term financial goals:

- The 5 year growth rate average is 30% and 5.2% growth for twelve transition years.
- Rackable operating margin is currently -0.3%.



Share Ownership

Owner	Percent Owned of Total Shares Outstanding
Gallo, Nikolai	6%
Randall, Jack	6%
Coglitore, Giovanni	6%
Jennison Associates LLC	3%
Friess Associates Inc.	2%
Fiduciary Trust Company	1.5%
Fidelity Management & Research	1.25%
Constitution Research & Management	1.25%
Barton, Thomas	1.15%

Select Comfort, Corp.

SCSS

Price: $18.20 (14.75-24.73)

October 7, 2005 David Trotter

Russell 2000: 653.00 (558.36 – 688.51)

Select Comfort is a leading developer, manufacturer and marketer of premium quality, adjustable-firmness beds. The air-chamber technology of the propriety Sleep Number bed allows adjustable firmness on each side of the mattress and provides a sleep surface that is clinically proven to provide better sleep quality and greater relief of back pain in comparison with traditional mattress products. Select Comfort was founded in 1987 in Minnesota.

Recommendation

I believe Select Comfort will be able to achieve 20 to 15% sales growth for the next several years. Growth will be fueled by an increase in store base, average selling price, and sales per store. The company has a strong balance sheet with $1.50 of cash a share and no long-term debt. Select Comfort will also continue to improve its operating margin by leverage in selling expenses, and in its existing infrastructure. The company believes that its major barrier has been brand awareness, and plans to conquer it by increasing media spending. Select Comfort is undervalued at current multiples. I have given it a target price of $24.00 and a lower limit of $16.00.

Key Statistics	September 2005
Portfolio Weighting	2%
S&P Rating	N/A
Market Cap.	$715 mill
LT Debt/Total Cap.	0%
Dividend Yield	0%
P/E Fiscal '05E	16.50
P/E Fiscal '06E	13.00

Investment Thesis

- **Superior Product.** Currently about 85% of Americans are using an old spring mattress. The air-chamber technology of the Sleep Number bed is clinically proved to provide better sleep quality and greater relief of back pain in comparison to the tradition products. Select Comfort is an excellent pure play for people becoming increasingly aware of a healthy sleep.
- **Business Model.** Select Comfort is a vertically integrated from production through sales, delivery, and customer service. Unlike traditional bedding manufacturing this allows the company to control quality, cost, price, and presentation. The integrated model allows the company to adapt to customer trends faster than its competitors.
- **Diverse Distribution.** The company operates through four channels: 370 retail stores in 45 states, direct marketing through call center, selectcomefort.com, and wholesale through furnishing retailers and the QVC shopping channel. Retailers have had a stronger demand for the Sleep Number bed compared to other bedding competitors.
- **Economic moat.** Select comfort's business model gives it greater scalability than its competitors, allowing it to stay at the most competitive pricing points. As stated before, the company is far more adaptable to changes than any of its competitors. Select comfort will continue to have and advantage because competitors won't find it easy to replicate SCSS's superior vertical model.

Valuation

- **Earnings Multiple.** Right now the company is currently trading at 16.50 x 2005 EPS. Given the company's superior business model, it should at least have an earnings multiple equal to or better than its peers. If you gave the 2005 EPS a multiple of 22, the price would be fairly valued around $24.00 a share, inline with my price target. (22x EPS is '04 P/E ratio) If a 22x multiple was put on the 2006 earnings, the price would be 30.80.
- **Discounted Cash flow.** Using discounted cash flows, I arrived at a price of about $23.73. That assumes a discount rate of 9.5% and a long term growth rate of 18%, and terminal growth rate of 3.5%. Inline with my target price.

Risks

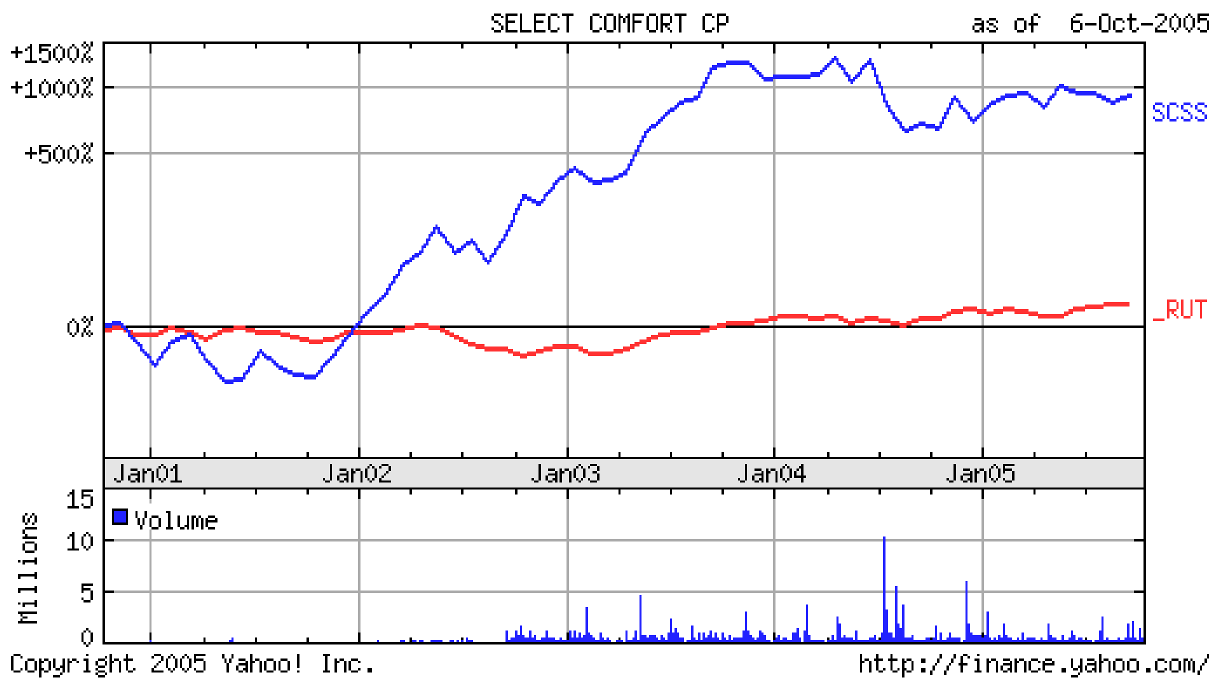
- Risks include: economic downturn, increase raw material and fuel costs, supply shortages because of hurricanes.

Management

- CEO William R. McLaughlin, 48, joined in March of 2000. Also elected to the position of Chairman of the Board in May of 2004.
- VP of Sales Keith C. Spurgeon, 50, joined in February 2002.
- VP of Marketing Noel F. Schenker, 51, joined in November of 2000.
- VP of Operations Gregory T. Kliner, 67, joined in August of 1995.

Outlook and Growth Assumptions:

- **Sales growth.** Assuming sales to grow 24% in 2005 to 690 compared to 557.6 in 2004. In 2006, I estimate that sales will grow by 16%. I think that sales will continue to grow between 20% and 15% for several years.
- **EPS growth.** I'm assuming that EPS will continue to grow around 20 to 30% for the next several years. EPS will be driven by its operating margin leveraging in selling expenses, and in its existing infrastructure.
- **Balance sheet.** SSCS has a great balance sheet with more than $60 million in cash and no debt. I think that the extra cash might be used for store expansion and perhaps in the longer term an increase in production capacity.
- **SSCS appears undervalued and a 2% portfolio weighting is recommended.**



Major Direct Holders

Name	Shares	%
MCLAUGHLIN, WILLIAM R.	182,834	0.47
ST PAUL VENT CAP VI, LLC	593,660	1.51
SHAMES, ERVIN R.	125,000	0.32
HOPF, PATRICK A.	178,511	0.45
ST PAUL FIRE&MARINE INSURANCE CO	564,121	1.44

Major Institutional Holders

Name	Shares	%
ROYCE & ASSOCIATES, INC.	2,640,000	6.71
BAMCO INC.	2,383,700	6.07
GOLDMAN SACHS GROUP INC	1,884,968	4.80
NEUBERGER BERMAN, LLC	1,853,945	4.72
NOMININGUE ASSET MANGEMENT, LLC	1,781,252	4.53

W-H Energy Services Inc.

WHQ

Price: $28.27 ($19.36-$33.90)

Fiscal Year Ends: December 31, 2005

October 6, 2005 Ryan Berg

Russell 2000 Index: 639.45 (558.36-688.51) Energy Sector

W-H Energy Services Inc.'s principal activity is to provide products and services used for drilling, completion and production of oil and natural gas wells. It operates in two segments: Drilling and Completion. Drilling segment provides products and services used for drilling of oil and natural gas wells. Completion segment provides products like wireline logging and perforating, polymers and specialty chemicals and tubing. The operations are focused on conducting operations onshore in Canada, Brazil, Europe, North Africa and the Middle East and offshore in the North Sea, the Persian Gulf, the Gulf of the Suez, the Mediterranean Sea, off the coast of Brazil and the United States.

Recommendation

Key Statistics	29 Sept 2005
Market Cap	$794.53M
Shares Outstanding	28.11M
Average Volume	223,179
Beta	1.08
EPS(ttm)	$1.10
2005 Estimated EPS	$1.65
P/E (TTM)	25.72
Forward P/E	13.09
ROE	6.95
2004 EBIT Margin	9.5%

Because of its strong growth prospects, cheap relative valuation, and solid fundamentals, W-H Energy Services represents the best small cap energy services play available. Based on the continued growth in U.S. oilfield activity and improvement in product and service pricing, the company should be able to generate strong revenue and earnings growth for the next several years. Furthermore, WHQ is trading at a significant discount to its peers with a forward P/E of 13.09 vs. an industry average of approximately 19. Finally, WHQ has very respectable fundamentals for a small cap energy services firm with a 5 year average ROIC of 10.8% versus an industry average of 9%. These factors combined with a very favorable industry environment make WHQ an attractive investment opportunity. Therefore, I am implementing a buy recommendation for WHQ.

Investment Thesis

- **Favorable Industry Conditions:** The profitability of energy services firms is largely driven by the oil and natural gas price environments. Currently, we are in a very high price environment, and the rise in demand for additional rigs has been substantial. This high demand coupled with a current supply shortage has pushed rig day rates to extremely high levels, leading to record profits for energy services firms like WHQ. Moreover, drilling projects are becoming more complex, which is yielding even higher revenue and margins per job with the same equipment. It is widely believed that we are likely to see some weakness in oil and natural gas prices in the not so distant future, which could spark a sell-off in the energy services space. However, as long as oil and gas prices remain at levels where it is economical and profitable to undertake additional drilling projects, WHQ will continue to see great results. The general consensus is that E&P firms will continue to invest heavily in upstream activities as long as oil and gas prices remain above $40 per barrel and $5 per mcf respectively. In the event of an oil/natural gas price driven sell-off, I believe the market will correct itself once it realizes that energy services will continue to do well in that environment.

Therefore, I think WHQ is a relatively safe play in the small cap energy space in terms of oil price sensitivity.

- **Industry Leading Growth:** Conservative street estimates are calling for revenue growth of 15-20% through 2007. While much of their growth in the past has been driven by acquisitions, near-term growth will be driven primarily by the increasing drilling activity we are seeing in this high oil price environment. Also, better pricing due to tight capacity and strong demand can be expected to drive some margin expansion. Furthermore, increasing well complexity requires higher technology applications, longer run times, and a greater diversity of product rentals. These factors should drive higher revenue per rig and improved margins, as much of this incremental revenue comes on top of relatively fixed costs.

- **Niche Strategy has Advantages:** Unlike its larger competitors like Halliburton and Baker Hughes, which market standardized product/services packages to integrated oil companies, WHQ offers high tech, specialized products and services individually to independent producers. This strategy allows WHQ to bid a range of products from the smallest, where the larger firms typically don't compete, to larger projects, where WHQ can compete with larger firms on the basis of pricing and better technology. Furthermore, in pursuing this strategy, WHQ has forged strong relationships with many of the smaller producers, and has been awarded many long-term contracts as a result.

- **Strong Fundamentals:** Considering that WHQ is competing in a market dominated by competitors much larger and more diversified than itself, its relatively solid fundamental performance is very impressive. WHQ's ROIC(ttm) is 9.9% versus a peer group average of 7.7%. Also, its 3-year average ROIC is 7.1% versus a peer group average of 4.5%.

Valuation

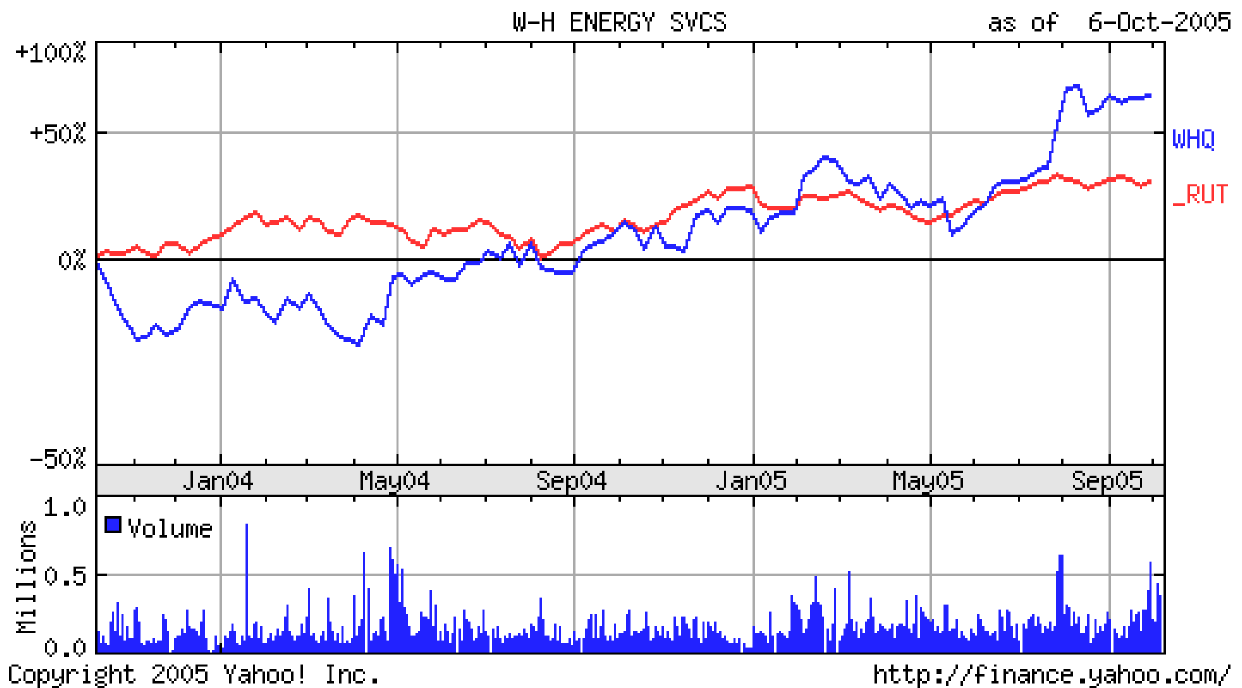
Because of its limited scale and the greater risk associated with its smaller size, WHQ trades at a significant discount to its larger peers. Its forward P/E of 13.51 is a steep discount to the peer group average of approximately 20. Also, it is trading at a significant discount on an EV/EBITDA basis, with a multiple of 7.72 multiple compared to an industry average of approximately 11. These discounts more than reflect the disadvantages associated with WHQ's size limitations. Due to its strong growth prospects, I believe the risk premium associated with this discount will diminish as the company continues to grow and its business becomes inherently less risky. Apparently, the street is of a similar opinion, as the average price target is $38, with 8 of 11 analysts recommending this stock as a buy.

Risks

- Investing in the small cap energy space is inherently risky, as stock prices fluctuate greatly due to sensitivity to oil and natural gas prices.

- WHQ is a small firm competing in an industry composed of many large and powerful players. The smaller customers they serve extremely sensitive to commodity prices, thus making WHQ commodity price sensitive as well.

- Since WHQ is smaller and more leveraged than its competitors, it faces the disadvantage of having to pay more for the capital it needs to grow its business. This limits its financial flexibility.



Insider and Institutional Holdings

- The CEO, Kenneth White, holds approximately 2% of the company's shares.
- Altogether, insiders hold approximately 5% of the shares.

Top 5 Institutional Holders

Institution	% of shares held
T. Rowe Price	12%
David L Babson	7%
AXA	6%
Barclays Global	5%
Artisan Partners	4%

TIM Participacoes

TSU

Price: $18.55 ($11.76-$20.03)

Fiscal Year Ends: December

October 2, 2005 Jason Toellner

Russell 2000: 667.80 (562.83-688.51)

TIM Participacoes S.A., through its subsidiaries, provides cellular telecommunications services in the southern and northeastern Brazilian states. It provides time-division multiple access technology (TDMA) and global system for mobile communication technology (GSM) based cellular services. The company also offers automatic roaming services to its TDMA and GSM customers; interconnection services to fixed line and cellular service providers; and various value added services, such as short messaging, multimedia message, voice mail, call waiting, call forwarding, and conference calling services. In addition, it sells cellular handsets to its customers. The company is headquartered in Curitiba, Brazil. TIM Participacoes S.A. is a subsidiary of TIM Brasil Servicos e Participacoes S.A.

Recommendation

TIM Participacoes will be able to achieve double digit earnings and revenue growth over the next several years. TSU provides cellular services for the majority of Brazil which is one of the fastest growing markets in wireless communication. TSU's business model generates solid ROE, OM, and dividend yields compared to the industry. TSU pays a dividend yield of 2.5% and has an intrinsic value of $22.98; it is a buy recommendation for the portfolio.

Key Statistics	Oct. 2005
Weighting	1%
Market Cap	$890.3M
LT Debt/Capital	1.68%
Dividend Yield	2.50%
ROE	18.97%
Operating Margin	15.77%
Current P/E	10.20
EPS 05E	$1.59
Rev 05E	$1205.3M
Free Cash Flow	$74.2M
Morningstar Category	Telecommunications

Investment Thesis

- **Rapid wireless growth in Latin America.** It is evident that the growth in the wireless industry is now occurring in emerging markets such as Asia, India, and Latin America. Estimated handset growth globally through 2010 is going to be between 10-15% annually. TSU is well positioned in the Brazilian market to capitalize on the wireless communication adoption that is occurring in the region. TSU has already experienced 14.5% subscriber growth from last year to the first half of this year. Substantial subscriber growth in the region will contribute to solid revenue and EPS growth for TSU in the future.
- **Strong player in market combined with technology advances.** TSU has a stable market with a few competitors and is well positioned within a growing market for wireless services. TSU currently provides TDMA technology which is currently inferior to wideband code-division multiple-access (WCDMA); however, many countries are beginning to move towards the latter technology and 3G handsets. Adoption of this technology will move a little slower within Latin America, but in the future the adoption of WCDMA in Latin America will be occurring with TSU leading the initiation.

- **Rapidly growing, efficient business model.** TSU has had rapid growth within revenues and earnings over the past few years due to the rapid acceleration of adoption of wireless services within Brazil. TSU currently generates solid ROE and margins comparative to the industry. TSU also has a substantial amount of free cash flow, a strong operating margin of about 16%, and pays a solid dividend yield of 2.3%.

Valuation

Using the dividend discount model an intrinsic of $22.98 was computed using growth rate of 15%. This indicates that currently the stock is undervalued by 23.7% compared to its computed intrinsic value.

Risks

- **Regulatory Issues.** The entire telecommunications industry has been under numerous regulatory issues over the years and additional unexpected issues could arise at any time. Since TSU is under different government regulations, they are exposed to country specific risk that may not be prevalent for U.S. based companies.

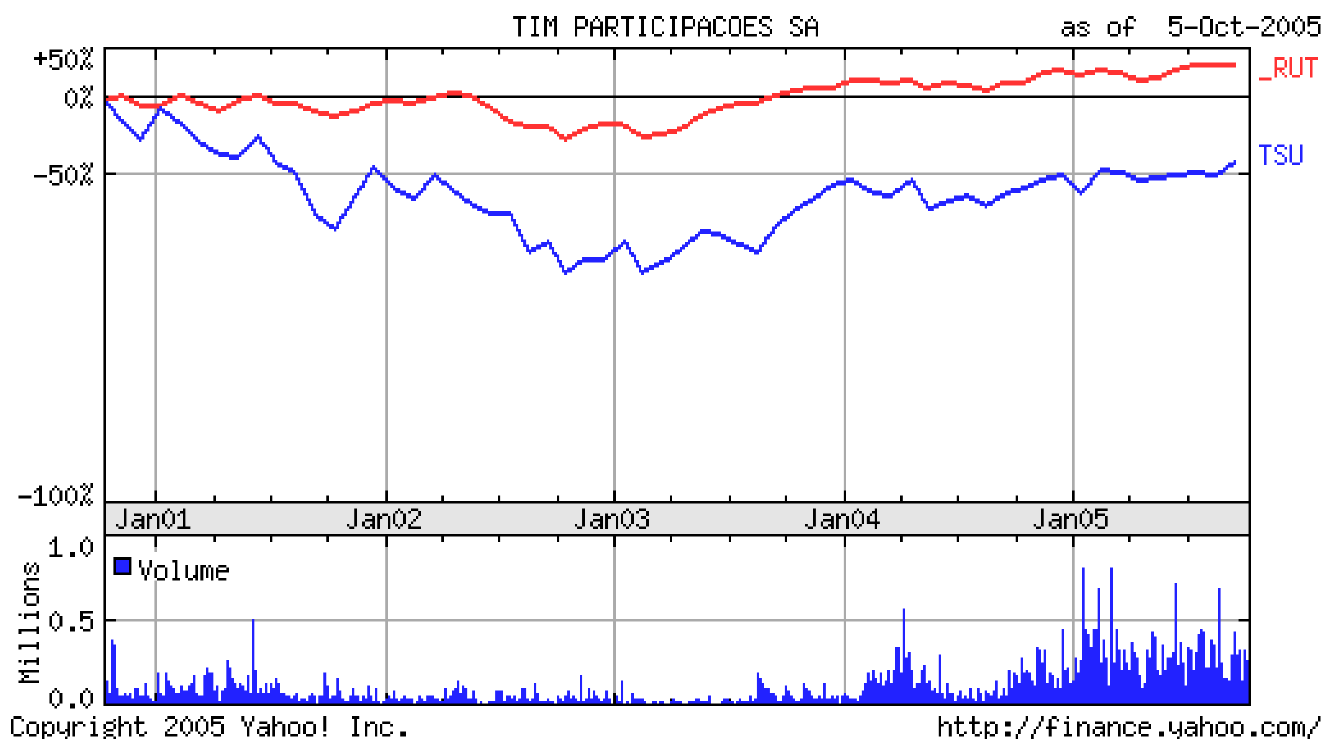
- **Competition and Pricing.** Within Brazil there are two other competitive companies that could take away sales from TSU. Since the only way to differentiate between companies is through pricing, it could lead to possible margin erosions for TSU as pricing trends downward in the industry.

Management

The management team has been an efficient group that has been viewed as high quality by its peers. The current CEO is Alvaro Pereira de Moraes Filho is 56 years old and has been in that position since 2003. Since he has taken over the position TSU has experienced rapid growth in revenues and EPS.

Outlook and Growth Assumptions

Revenue is expected to grow between 8-10% and EPS is expected to grow by about 15% in the years to come. Current estimates for 2005 include revenues of $1205.3M and an EPS of $1.59. With a 2.50% dividend yield and large amount of Free Cash Flow, TSU is buy recommendation.



Breakdown of Ownership

% of Shares Held by Institutional & Mutual Fund Owners:	33%
Number of Institutions Holding Shares:	70

Top Institutional Holders

Holder	Shares	% Out	Value	Reported
POPE ASSET MANAGEMENT, LLC	1,189,300	4.49	$18,790,940	30-Jun-05
AXA	1,084,681	4.10	$16,281,061	31-Mar-05
EMERGING MARKETS MANAGEMENT LLC	1,056,425	3.99	$15,856,939	31-Mar-05
MELLON FINANCIAL	992,774	3.75	$14,901,537	31-Mar-05
CITIGROUP INC.	806,718	3.05	$12,108,837	31-Mar-05
CAPITAL INTERNATIONAL, INC.	6,224,342	23.51	$93,427,373	31-Mar-05

Multi-Fineline Electronix, Inc.

MFLX

Price: $26.25 ($9.26 – 29.30)

Fiscal Year Ends: September 30

October 6, 2005 Michael Hepp

Russell 2000 Index: 667.80 (562.83 – 688.51)

Multi-Fineline Electronix, Inc. is a global provider of printed circuit and value-added component assembly solutions to the electronics industry. The company is one of a limited number of manufacturers that provides seamless, integrated end-to-end flexible printed circuit solution for its customers, ranging from design and application engineering, prototyping and high-volume manufacturing to turnkey component assembly and testing. Current applications for its products include mobile telephones and smart mobile devices, portable bar code scanners, personal digital assistants (PDAs), power supplies and consumable medical sensors.

Recommendation

Revenue growth for Multi-Fineline Electronix is one of the most notable features of this company. Driven by the demand for electronic devices with more flexibility, more content, and more technology along with the company's ability to capture new customers will drive revenue growth well above 25% for the next two years. Since the company faces slightly reduced margins due to economies of scale, EPS growth will be around 15%. With an intrinsic value of $34, Multi-Fineline Electronix is a buy recommendation.

Key Statistics	Sept. '05
Portfolio Weighting	2%
S&P Rating	N/A
Market Cap	$698.57M
LT Debt/Equity	0.0%
Dividend Yield	0.0%
ROE LTM	27.56%
P/E Fiscal '05E	20.28
P/E Fiscal '06E	18.03
Morningstar Sector	Ind. Materials

Investment Thesis

- **More flexibility, more content and more technology** – There is a heightened demand for personal electronics manufacturers to design smaller and more flexible electronic devices. Cell phones are the most common application of flexible circuitry, as it allows for light-weight flip-phone designs.
- **Differentiation through innovation –** Innovation is a main driving force of growth at Multi-Fineline Electronix, which sets it aside from most electronic manufacturing service (EMS) companies who mainly focus on assembly rather than R&D.
- **Acquisitions** – The acquisition of Applied Optics will provide Multi-Fineline Electronix with the opportunity to expand and improve upon its product offerings using small digital cameras. The camera phone, which uses both small digital cameras and flexible circuitry, has become a standard in the industry, and there is still opportunity for growth in this area. A similar application of this technology is found in medical devices.
- **Management and engineering teams –** The Company's engineers have a unique set of proprietary knowledge regarding flexible circuitry. Applying the customers' specifications to flexible circuitry often requires engineers from both sides to work together in product design.

Valuation

Based upon a free cash flow to equity model, the intrinsic value of Multi-Fineline Electronix is $34 versus a current price of $26.75. This model was built off the assumptions of a 10.75% cost

of capital and a 9% long term growth rate at maturity. Analysis of P/E ratios provides a similar valuation. Circuit board manufacturers trade at an average multiple of 21x earnings, while MFLX only trades at 18x next year's estimated earnings. Given MFLX's strong position within this industry, it should trade at a much higher multiple. However, the stock should be discounted to reflect the WBL Corporation's majority ownership. Therefore, a multiple of 21x next year's earnings will be appropriate for the valuation. Applying a P/E multiple of 21, MFLX should be trading at about $34, which is in agreement with the free cash flow to equity model.

Risks

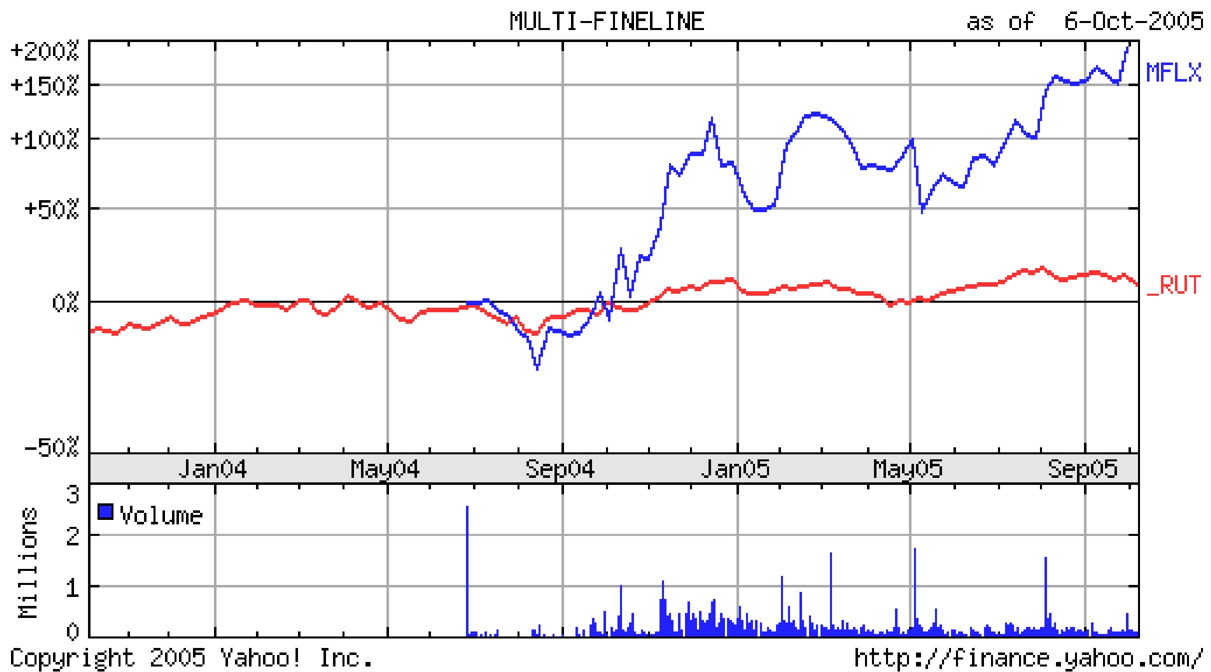
- **Sales to Motorola –** About 80% of Multi-Fineline Electronix's net sales are generated though its relationships with Motorola and its subcontractors. If Motorola or any of its subcontractors choose to find another source of flexible circuitry, the company's net sales will be substantially reduced. Fortunately sales to firms other than Motorola are on the rise, as the company seeks to expand its customer base.
- **WBL Corporation's ownership** – The WBL Corporation owns about 62% of the Company's outstanding common stock, which gives it substantial control over the company's management, operations, and potential corporate actions.
- **Retention of personnel –** The Company is highly dependent on its management to make incremental business opportunities with new customers. There is also a strong need to retain engineering personnel. Through experience in engineering and manufacturing flexible circuitry, the Company's engineers have developed the unique knowledge-base that has allowed them to accommodate the new needs of their customers.
- **Competition** – There is significant competition from large manufacturers of printed flexible circuitry and other EMS companies in China, Japan, and Taiwan. The Company thrives on providing its customers with value-adding components, and assessing their needs successfully, will give the Company a strong advantage over its rivals.

Management

Chief Executive Officer Philip A. Harding has served in his current position since January 1988. In 2003, he assumed the role of Chair of the board of directors. Prior to joining the company, he served as CEO for Weltec Digital Corporation.
The WBL Corporation holds about 62% of the company's common stock, while only 27% is held by institutions. The WBL Corporation will have a significant influence over the operations of the business. It has agreed to nominate less than 1/3 of its representatives to the board of directors.

Outlook and Growth Assumptions

- Market conditions prove to be favorable to the growth of printed flexible circuitry. Revenue from Motorola is expected to increase by 13% in 2005 and 2006, as Motorola takes a greater share of the cellular phone market. Revenue growth in other areas should be substantially higher as the Multi-Fineline expands its business with non-telecom companies. The market for flexible circuitry is expected to grow at a rate of 15-25% in the near term.
- EPS growth should be in the 10-15% range for F2006. This figure is somewhat lower than top line revenue growth due to economies of scale and costs related to the expansion of Applied Optic's engineering team.



Major Holdings

% of Shares Held by All Insiders:	2.531%
% of Shares Held by Institutional & Mutual Fund Owners:	28.68%
Number of Institutions Holding Shares:	70

Top Institutional Holders

Holder	Shares	%	Value	Reported
WASATCH ADVISORS	739,996	3.11	$13,060,929	31-Mar-05
NATIONAL CITY	681,441	2.86	$12,538,514	30-Jun-05
PEQUOT CAPITAL	550,100	2.31	$9,709,265	31-Mar-05
ALLIANZ GLOBAL	522,850	2.20	$9,228,302	31-Mar-05

Ormat Technologies

ORA
Price: $21.64 (13.88 – 24.10)
Fiscal Year Ends: December

October 5, 2005
Russell 2000: 644.98

Scott Kennedy

Ormat Technologies is engaged in the geothermal and recovered energy power business. They design, develop, build, own, and operate clean and environmentally friendly geothermal power plants and sell the electricity generated. The geothermal power plants are owned and operated in various countries including Kenya, Nicaragua, the Philippines, Guatemala, as well as Nevada, California, and Hawaii. The equipment manufacturing operations are located in Israel, and the company is headquartered in Sparks, Nevada.

Key Statistics	Oct. 5, 2005
Portfolio Weight	1%
Market Cap	683M
Dividend Yield	0.50%
Gross Margin	36.47%
Operating Margin	26.55%
ROA	4.93%
ROE	16.48%
Sector Category	Electric Utility

Recommendation

I believe that Ormat will be able to achieve up to 15% annual earnings growth over the next five years. Its expertise in using geothermal energy at a time when America is searching for more energy sources will greatly benefit ORA going forward. Even though only 5% of the nation's energy needs are supplied by renewable fuel, only 6% of that is geothermal. The recently passed Energy Bill will encourage more states and utilities to sell power generated by geothermal sources. The company's stock price has appreciated since the Energy Bill, but my valuation for this company expects further growth and it should be priced at $25-26.

Investment Thesis

- **Energy Bill.** The federal and state governments now split the royalties that companies pay when they lease public lands for geothermal power. In the future, the state will get half and the federal and county governments will each get 25 percent. The 2005 Energy Bill includes an extension of production tax credits for geothermal companies. This, along with requirements in Nevada and other states that utilities generate or buy more electricity from renewable sources like geothermal or solar, should give a real boost to the industry. There is going to be a greater interest in alternative energies and that will lead to more growth opportunities than the geothermal industry has experienced since it began in the 1980's. ORA is permitted to claim approximately 10% of the cost of each new geothermal power plant in the United States as an investment tax credit against federal income taxes.
- **Renewable and Energy Source.** Geothermal power uses steam from wells driven into hot spots to turn turbines and generate electricity. It is a process that emits no poisonous gases and its inputs will not run out. Thus, countries with suitable areas of geothermal enrichment will begin asking Ormat to build plants for them. Also, it only takes 12-18 months for Ormat to complete production of a plant. After that, they realize the gains of each product through the timely sale of all electricity that those plants produce.
- **Higher fossil fuel costs.** Since Ormat's electricity does not require the use of costly oil and natural gas inputs, their electricity is cheaper to produce and they will not be adversely affected by input volatility. It is now cost competitive with electric utilities

that use costly natural gas and coal. More nations that have adapted the Kyoto Protocol, and want higher renewable energy output may turn to Ormat.

Valuation

Ormat's long term growth rate should be about 15% over the next 10 years as it continues to manufacture plants and produce electricity at a cheaper cost structure than its fossil fuel counterparts. Earnings per share projections for 2005 are $0.65, with 2006 estimates increasing to $0.98. My price target for ORA shares is $25.

Risks

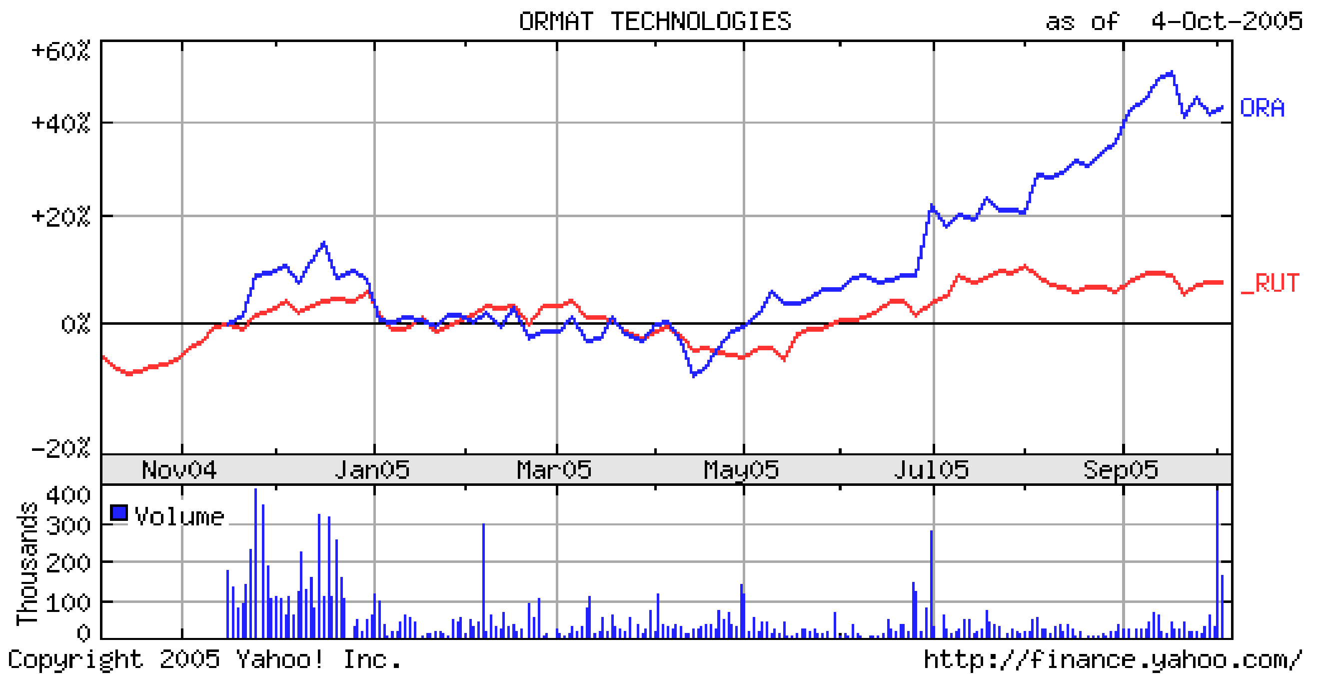
- **Competition within the power industry.** Ormat competes with other renewable energy companies (wind, solar, etc.) for clean resources contracts. Domestic electricity firms are CalEnergy, Calpine, and Caithness. State-owned international companies may also pose a risk. In the products business, they compete with companies such as Mitsubishi, Siemens of Germany, Alstom of France, and Kaluga of Russia. However, none of their competitors competes both in the sale of electricity and the products business.
- **Foreign operations are subject to political, economic, and financial risks.** Operations in Israel accounted for approximately 25.6% of operating expenses in 2004. ORA is involved in several other projects such as the ones in Kenya and the Philippines that are considering an increase in state interference of electricity prices. In addition, the company is exposed to currency and interest rate risks of several sovereign nations.
- **Resource uncertainties and increases in the cost of raw materials.** There is the possibility that this company may not find adequate geothermal resource projects in the future. In addition, their manufacturing operations are dependent on the supply of various raw materials such as steel and aluminum. Future cost increases of such materials, if not passed onto the customer, will adversely affect their profit margins.

Management

The company's Chairman of the Board of Directors is Lucien Bronicki, age 70, who has worked in the power industry since 1958. Mr. Bronicki has a postgraduate engineering degree in Nuclear Engineering. His wife, Yehudit Bronicki, is the company's CEO and has worked in power industry since 1965. Key members within senior management also have extensive career backgrounds within the power industry and average 20 years of industry experience.

Outlook and Growth Assumptions

- 2nd quarter profit rose 16% on stronger sales
- Tax incentives for renewable energy resources
- Dividend increases over the past two years
- Predictable revenues attributable to long-term contracts
- Revenue in 2004 increased by 83.5% (from $119.4 to 219.2 million)
- Expansion: operating income increased from $25.5 to $62.4 million



Major Shareholdings

Shares Outstanding	32.00 Mil
Institutional Ownership (%)	18.30
Top 10 Institutions (%)	13.54
Mutual Fund Ownership (%)	11.59

Top Institutional Holders

Holder	Shares	%	Value	Reported
SCHRODER INVESTMENT MANAGEMENT GROUP	1,049,700	3.33	$16,438,302	31-Mar-05
JENNISON ASSOCIATES LLC	625,000	1.98	$9,787,500	31-Mar-05
OPPENHEIMERFUNDS, INC.	448,600	1.42	$7,025,076	31-Mar-05

RARE Hospitality International, Inc.

RARE

Price: $25.66($24.81-32.59)

Fiscal Year End: December 31

October 11, 2005 Ray Auth

Russell 2000: 644 (558.36-688.51)

RARE Hospitality and their subsidiaries operate and franchise restaurants. The group operates 225 LongHorn Steakhouse's, 22 restaurants called The Capital Grille, and 29 under the name Bugaboo Creek Steak House. They also operate two additional specialty restaurants: Hemenway's Seafood Grille and Oyster Bar and The Old Grist Mill Tavern. LongHorn Steakhouse restaurants are casual dining, full-service establishments serving both lunch and dinner. The Capital Grille serves classic steakhouse offerings, such as chops, large North Atlantic lobsters and fresh seafood. Bugaboo Creek Steak House restaurants are designed as family-friendly establishments featuring liquor service.

Recommendation

I believe that RARE has the potential for excellent growth in the next 5 years. Revenue growth should be at 16% along with 19% earnings growth. Earnings estimates are expected to be $1.52 in 2005, $1.84 for 2006, and $2.15 in 2007. Restaurants account for 4% of U.S. Gross National Product, yet the industry still has room to grow with working families having less time to cook. This bodes well for RARE which is planning to double the number of restaurants they operate over the course of the next 5 years. During the next twelve months, RARE plans on opening 27 LongHorn Steakhouses, three Bugaboo Creek Steak Houses, and three Capital Grilles. This should keep earnings and revenues in a growth phase for the coming years.

Key Statistics: Sept. 2005	
Weighting:	2%
Revenue:	872M
Profit Margin:	5.59%
Op. Margin:	8.90%
Forward P/E:	18.6
Price/Book:	2.07
Price/Sales:	1.00
EPS Growth:	19%
OCF:	$63M
Cash:	$25M

Investment Thesis

- **Expansionary Vision:** RARE is looking to expand upon their already extensive restaurant portfolio. They currently have 280 stores with a vision to double that number in the next five to seven years. This should produce ample revenue and earnings growth opportunities for RARE shareholders in the coming years. Their main competitors are: Outback Steakhouse, Texas Roadhouse, and Lone Star Steakhouse- all sharing equally aggressive growth prospects.
- **Demographics:** It is no secret that the two-working adult families are on the rise. A recent statistic revealed that men and women over the age of 35 vaulted from 12% in 2000 to 16% in 2005. This equates to an additional 12 million Americans who are likely to increase their restaurant expenditures. This is an attractive number for the entire restaurant industry. In addition, many people feel that eating out is no longer just for special occasions. Dining out at a favorite restaurant is more of a convenience factor

Valuation

RARE should experience annual revenues and earnings growth of 16% and 19%, respectively. This is based on their growth philosophy for the next five to seven years. Based on these predictions, the discounted cash flow model reveals a fair value of $35.89. At this value, RARE is currently undervalued by almost 40%. RARE's P/E stands at 18 times versus the group average of 19.4. Their PEG is currently at .89. Standard and Poor's gives a target price of $32.00 and Raymond James prices RARE at $30.00. Of the sixteen companies who follow RARE, nine have buy recommendations while seven have hold recommendations.

Risks

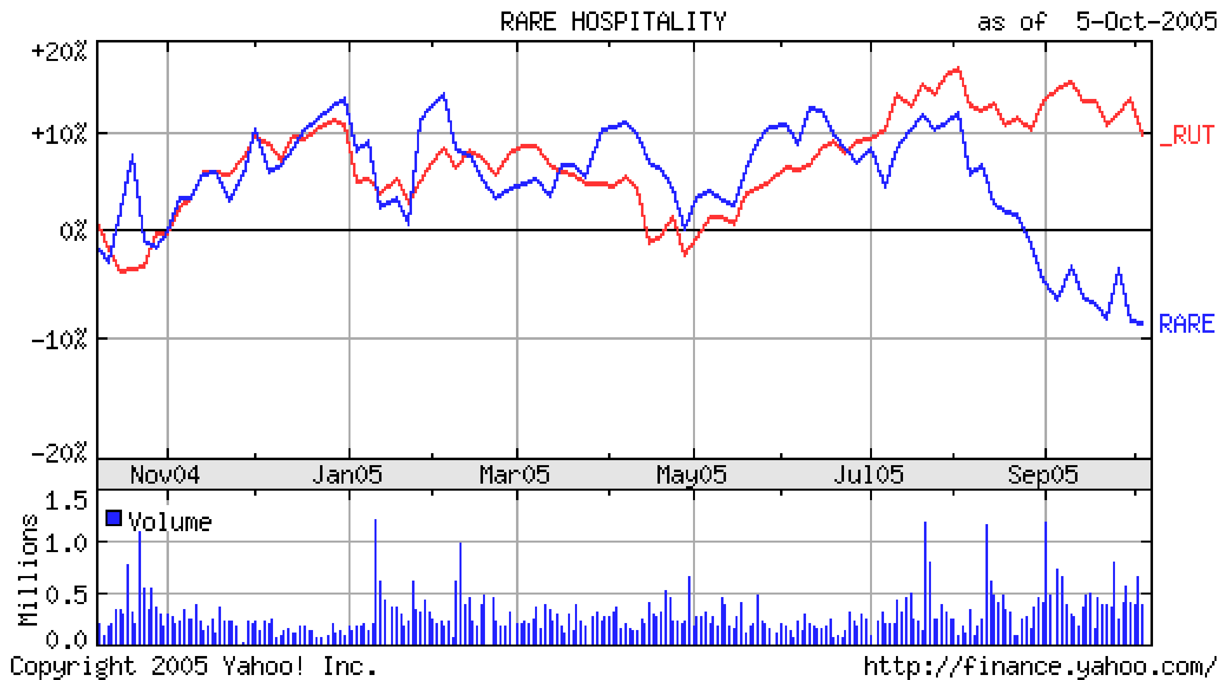
- The competition in the restaurant industry is highly competitive. Consumers have a wide variety of restaurants to choose from, which is an inherent risk in the industry.
- Commodity prices are always a risk for RARE along with its competitors. Beef prices are a key statistic to watch for RARE, as this is the primary focus on their menus.
- The doubling of their restaurants in the next five to seven years creates pressure for the management team at RARE. They need to keep pursuing timely placements in key areas while staying under budget. This is a challenging task to undertake and should be monitored over the coming years.
- Continued increases in oil prices should be watched as discretionary income decreases. This could have a direct adverse affect on the consumer spending and therefore negatively impact revenues and earnings of RARE.

Management

The management team at RARE is headed by Chairman and Chief Executive Officer, Mr. Phillip J. Hickey Jr. He is fifty years old and is reasonably compensated at $980,000 per year. The president is Mr. Eugene I. Lee, whom is 43 years old. Currently, there are no red flags within the management team.

Outlook

- RARE generates an operating margin of 9.30% compared to the industry average of 8.51%. The margin has increased from 7.52% in 1999. Gross margin for RARE is 63.15% compared to 26.24% for its competitors.
- RARE has continually decreased debt over the past five years. Currently, they have a Debt/EBITDA margin of .34 compared to the industry average of 1.59.
- Same-Store Sales:
    1. LongHorn Steakhouse: increased 2.2% for the second quarter compared to the same period in 2004.
    2. The Capital Grille: increased 5% for the second quarter compared to the same period in 2004.
    3. Bugaboo Creek Steak House: decreased 3.6% due to a decrease in average meal checks and a slight decrease in customer counts.
- The Capital Grille continues to attract customers around the country as they are rated as one of the top steak houses in several cities. For example, they were recently rated as one of the top 10 steak houses in Houston by a national rating service.



Major Shareholders

Name	Shares	Percent
Philip J. Hickey Jr.	853,126	2.40%
Eugene I. Lee Jr.	402,880	1.20%
T. Rowe Price Associates, LLP	3,998,048	11.60%
Wellington Management Company, LLP	2,071,886	6.00%
Barclays Global	1,297,000	3.81%
Westcap Investors	1,249,000	3.68%

<u>Forward Air</u>
FWRD

Price: $35.51 (22.03 – 37.01)
Fiscal Year End: December

October 6, 2005 Tim Wojs
Russell 2000: 639.45 (562.83 – 688.51)

Forward Air (FWRD) is the leader in scheduled airport-to-airport surface transportation for the deferred air freight market. Deferred air freight, while time-definite, is not as sensitive to time as regular air freight. Their primary customers are domestic and international freight forwarders, but they also handle overflow for airlines and integrators like UPS and FedEx. With 80 domestic terminals located close to airports, 8 regional hubs, and 1 central sorting facility, FWRD has one of the most flexible and efficient sorting systems in the industry.

<u>Recommendation:</u>

I believe that Forward Air is the best small cap option for exposure to transportation. They have tremendous financials, which represent the efficiency of both their transportation network and management expertise. Also by using owner-operators, the company is able to quickly adjust to changes in volume and demand. With fuel prices still high, I like FWRD's lower cost option compared to the cost of transporting deferred freight solely by air. Earnings for the third and fourth quarters of this year should be solid because of increased demand, especially since we are approaching peak transportation season. I am only recommending a 1.5% weighting for the portfolio because FWRD's current price does not provide huge upside potential when compared to my price targets.

Key Statistics	October 6
Proposed Port. Weight	1.5%
Market Cap	1.12 Bil
Actual EPS '04	$1.05
Est. EPS '05	$1.38
Est. EPS '06	$1.61
P/E TTM	29.42
Forward P/E	22.0
Operating Margin	20.1%
LT Revenue Growth	10%
LT Earnings Growth	15%
Debt/Capital	1%
ROE	23%
ROA	19%
Dividend Yield	0.8%
Shares Outstanding	32.7 Mil
Morningstar Category	Bus. Serv.

<u>Investment Thesis:</u>

- **Ability to pass on fuel increases to customers.** FWRD has successfully been able to pass on the cost of higher fuel to its customers. For the majority of their business (airport-to-airport), customers have accepted slightly higher prices. Using the surface transportation that FWRD provides is significantly cheaper than exclusively using air transportation. Therefore, even though Forward Air has increased their prices to offset higher fuel costs, their services are still considerably cheaper than air transportation. They also compute a monthly fuel surcharge from the national average fuel price that is computed by the Department of Energy on the last Monday of every month. This surcharge is applied to two areas – freight which is considered less than less than truckload capacity and customers who have exclusive vehicle agreements.
- **Undisputed leader in its market**. With its flexible transportation network, FWRD has experienced high amounts of success. 80 locations near high traffic airports, 8 regional hubs, and 1 central sorting facility give FWRD the flexibility in shipping customer orders. They can take the cargo to either one of the eight regional hubs for sorting or to the nearest delivery airport terminal, which allows them to be more cost effective. FWRD has a 98% on-time delivery rate, which is huge compared to competitors. They also have less damaged goods than competitors due to less handling of customer's cargo. The network that they have developed is also hard to emulate, and would require a significant amount of capital and expertise by any new competitor, giving FWRD a healthy economic moat. In regards to demand, Forward Air mainly uses owner-operators to satisfy their shipping needs, giving them the ability to add drivers when demand increases, and decrease drivers when demand is

lower. With their latest acquisition of competitor Xpress Global Systems, they are really one of the only companies in the airport-to-airport deferred freight market.

- **Low cost growth initiatives available.** With large amounts of available square footage at their terminals and hubs, FWRD can offer logistics services like warehousing, customs brokerage, and shipment consolidation to customers without significantly increasing its costs. This low cost growth is a key to FWRD's future growth.
- **Strong Financials.** In my opinion, FWRD has some of the strongest financials in the industry. They currently have free cash per share approaching $3. Their operating and net margins are well above the industry averages at 20.1% and 13.4% respectively, and have increased year over year for the past four years. This indicates the unbelievable efficiency of their flexible transportation network. FWRD currently has a LT Debt to Capital ratio of less than 1% and a current ratio of 5.5.

Valuation:

Using a discounted cash flow model, I estimate a fair value for Forward Air of approximately $40.00 using a growth rate of 20%. Using a forward P/E of 23-24 (which is slightly higher than their historical forward P/E of 22) and a forward EPS of $1.70, I computed a price range of $39.50-$41.00. I justify using this higher multiple because of their strong financials and competitive edge in the marketplace.

Risks:

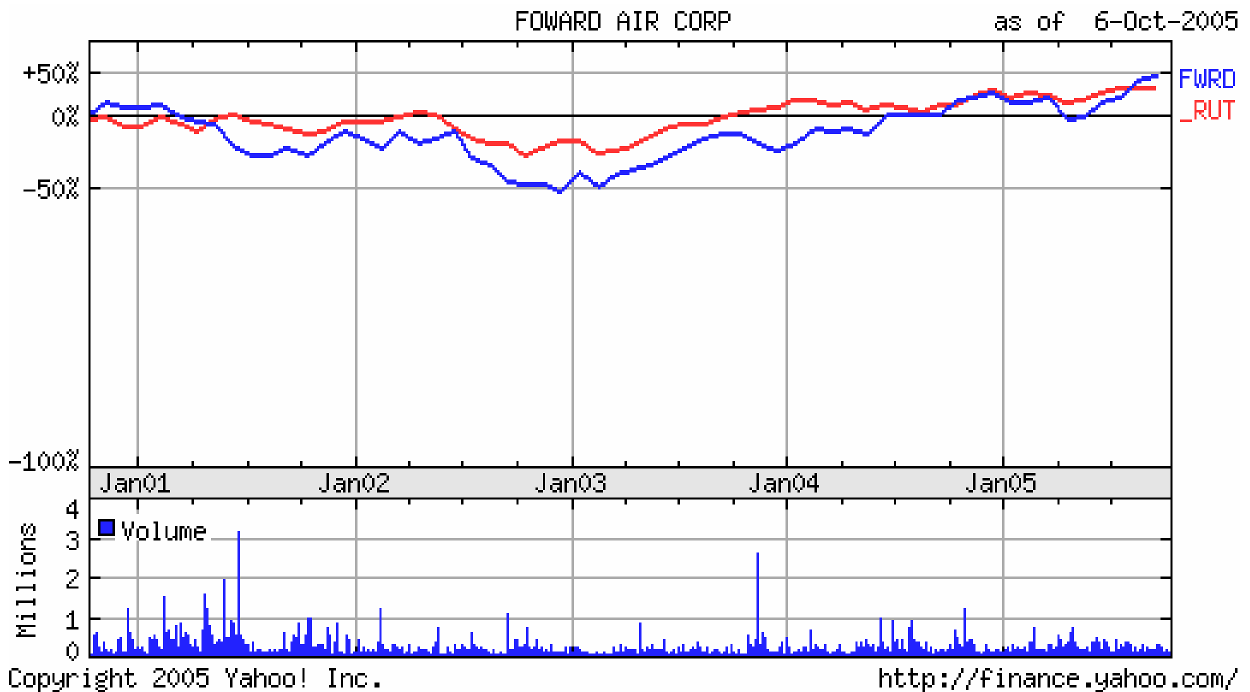
- **Customers refuse to pay higher fuel surcharge.** If fuel prices continue to rise, customers may be less accepting of price increases. This could result in customers finding alternative ways to ship their freight. This is not a huge risk in my opinion right now. The price that they charge customers, which takes into account a premium for their superior service and a fuel cost premium, is still significantly lower than using air freight.
- **Failure to increase logistics services as percentage of revenues.** Forward Air's main airport-to-airport business accounts for about 85% of revenues, while its logistics services account for less than 10%. Growth in the airport-to-airport segment will come organically, and will largely be driven by volume. FWRD must utilize their current available square footage for logistics services. Since the space is already available, this is a low cost growth opportunity that must be implemented for success, in my opinion.
- **Failure to successfully integrate any new acquisitions.** FWRD has had success integrating acquired companies. If they fail to continue this successful integration, FWRD could experience lower margins, resulting in lower profits and earnings.

Management:

Forward Air's CEO is Bruce A. Campbell. He has held various positions with FWRD since 1990 and has been the CEO since October 2003. All other senior management has been with the company for at least four years, and all of their prior work has been related to the industry.

Outlook and Growth Assumptions:

- 2Q F'05 was solid for FWRD. Reported 13.3% increase in operating revenues. Net income rose 41.2% and EPS was $0.37, an increase of 42.3%. Shows FWRD's ability to integrate new acquisition effectively (operating margin actually increased).
- Management indicates that growth will occur organically and through acquisition. Increase in logistics services is key to long-term growth. Has a stranglehold on airport-to-airport market. Transportation volume should increase in the third and fourth quarters due to the holiday season.
- I see FWRD growing revenues at 10% long term. Revenue growth could be in the 15% range depending on the success of acquisitions and their logistics services expansion. Improving margins should continue. I forecast long-term EPS growth of 15% (or 20% if logistics services expand and acquisitions are successfully integrated).



Insider Holdings (As of 12/31/04):

Bruce A. Campbell, CEO	1.4% shares outstanding
All Directors & Board Members (12)	3.3%

Top Institutional Holders (As of 9/31/05):

FMR Corporation (Fidelity)	6.85%
Kayne Anderson Rudnick Inv. Mgmt.	6.67%
Franklin Resources	5.89%
Columbia Wanger Asset Mgmt.	5.43%
Barclays Banks PLC	4.13%

<u>American Equity Investment Life Holding Company</u>

AEL

Price $11.61 ($9.41 – $12.92)
Fiscal Year Ends: December)

October 7, 2005 Christopher Cunningham
Russell 2000: $670.53

American Equity Investment Life Holding Company, through its wholly owned subsidiaries, engages in the development, issuance, administration, and marketing of annuities and life insurance. It underwrites annuity and insurance products. The company's products include fixed rate annuities, index annuities, variable annuity, and life insurance. The company is headquartered in Des Moines, Iowa. AEL currently employs 200 with offices in 49 states and the District of Columbia. Fifty percent of annuity sales are in index-equity investments, the other half are in fixed income products. The target market group for AEL is people between the ages of 45 and 75.

<u>Recommendation</u>

AEL is a very attractive company in its market due to a number of factors including strong operating margins and impressive growth. The company's earnings multiple is well below the industry average of 11.7. AEL has the best ratio of revenues to employees of its peers and I believe should be selling at an earnings multiple of at least 10. This puts the company at a fair valuation price of $13.80 this year based on estimated earnings, an 18% undervaluation from its current position. AEL pays a 2% dividend.

Key Statistics	October 2005
Revenue (ttm)	$514 mil
Market Cap.	$446 mil
Debt/Equity	2.54
Debt/Total Cap	33.6%
Dividend Yield	2%
ROE	20.84%
P/E Fiscal '05E	8.2
P/E Fiscal '06E	6.6
S&P Sector	Fin. Serv.

<u>Investment Thesis</u>

- **Great growth story.** The company has experienced growth of 20% or more for the last five years and shows no signs of slowing. AEL has only been public for a year and I don't believe that the market has fairly valued the company based on its growth potential. In the next 3 years the company is expected to grow revenues at roughly the same levels in previous years, between 18% and 20%. 84% of annuity deposits collected from last year were in index annuities. This lowers the business risk of the company and its future revenues because index annuities are typically less risky than ordinary annuities due to diversification.

- **Strong, knowledgeable management team.** The founders of this company were a select group from another savings company, The Statesman Group. These executives have proven their competence and abilities in growing this company substantially since its founding in 1995. Revenues alone have grown over 550% since 1999. Effective management has also placed AEL in a favorable position among its peers. The price/book ratio is 1.3 for AEL, while the industry average is around 1.7. This shows AEL's assets are priced lower on the market than the average for the industry. AEL has one of the lowest credit losses as a percent of invested assets in the industry at .01%.

With an ROE of 20.8%, AEL is superior to most of its larger competitors as the industry average trails at 12%.

- **Large market penetration presents possibilities for future growth.** AEL currently offers its services in 49 states and in the District of Columbia. With such widespread coverage, the company has the opportunity to expand in markets where its presence is already known. Total industry sales increased 69% last year, according to LIMRA International, as quoted by AEL in its financial statements. The insurance market is expecting intermediate-term future growth of around 20%, which could help stimulate growth in well-managed companies. AEL will profit from effective management and industry growth in the near- and intermediate- term.

Valuation

Industry average earnings multiples are over 11. The company currently has a multiple of 7.5, but with earnings growth of 35% I don't feel that a 10x earnings multiple is outlandish or undeserved. At only a 10x multiple, the fair value of the stock price is $13.80 based on current fiscal year's projected earnings of $1.38.

Risks

- **Relatively small company in a highly competitive industry.** Larger competitors have greater financial resources and potentially better ratings by ratings agencies because of them. Due to these hurdles this company is valued well below the industry even with financials performing above competitors.

- **Risk of credit downgrade.** Insurance companies rely heavily on the credit ratings bestowed on them by credit agencies. The company has a financial strength rating of BBB+ from Standard & Poor's. If this were downgraded it would adversely affect annuity sales.

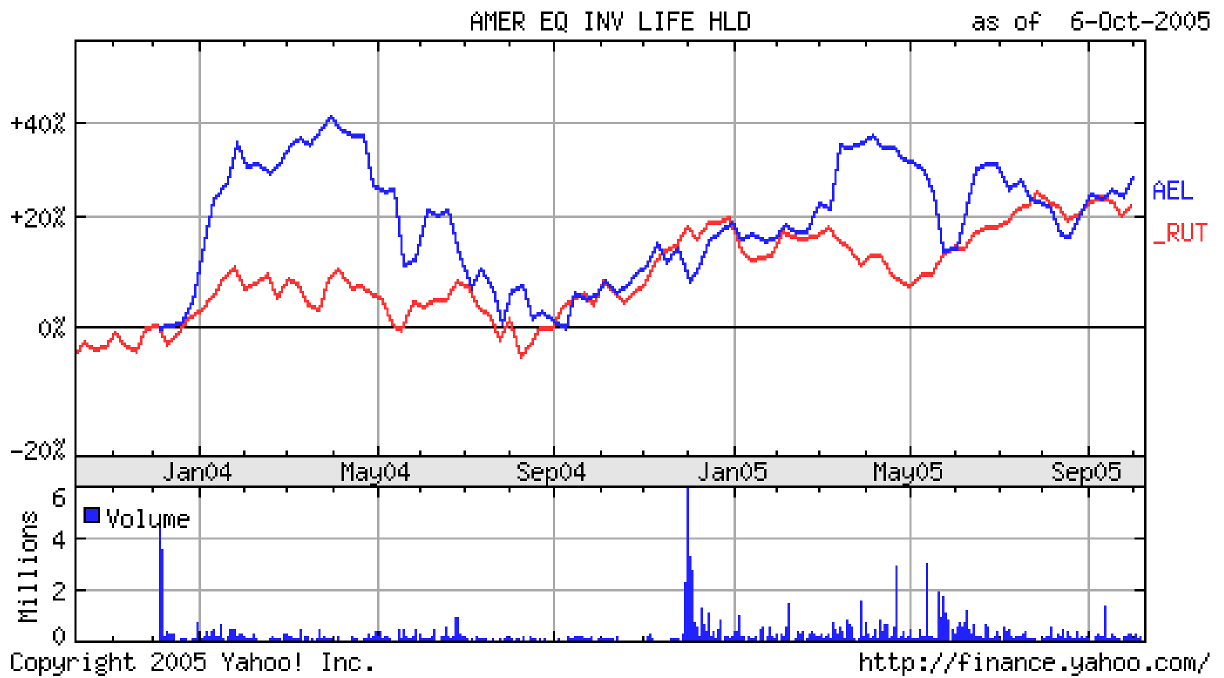
- **Interest rate and investment Risk.** Continual revenues from investors are based entirely on performance of managements' shrewd investments and the ability of those investments to earn predictable returns by managing spreads and risk.

Management

AEL was formed in 1995 by a core senior management team from the Statesman Group. These are experienced investment managers who have worked under a range of interest rate environments and still succeeded. The executive officers are fairly paid, with no gross over-compensation for performance. It seems that the majority of the higher executives' salaries are based on stock performance and holdings in the company.

Outlook and Growth Assumptions

- **Sales Growth**. Total revenue increased by 18.7% in FY '04 and 21% growth is expected this year. Major drivers are expected to be increased annuity sales, mainly indexed annuities.
- **EPS Growth**. Expected EPS growth is 35% from last year and 25% next FY.
- **Customer Base**. AEL's current target consumer group is individuals between 45-75 years of age. Individuals aged 65+ currently accounts for 12% of the overall population according to U. S. Census Bureau, and is expected to increase to 20% of the overall U.S. population by 2030. This presents some unique growth opportunities for AEL long-term.



Major Share Holders

% of Shares Held by All Insider and 5% Owners:	12%
% of Shares Held by Institutional & Mutual Fund Owners:	74%
Number of Institutions Holding Shares:	93

Top Institutional Holders

Holder	Shares	% Out	Value	Reported
ALLIANZ GLOBAL	2,497,500	6.51	$31,943,025	31-Mar-05
WELLINGTON MANAGEMENT	2,412,870	6.29	$30,860,607	31-Mar-05
PUTNAM INVESTMENT	2,000,693	5.21	$21,547,463	31-Dec-04
FIDELITY MANAGEMENT	1,833,000	4.78	$23,444,070	31-Mar-05
PEQUOT CAPITAL MNGT	1,805,200	4.70	$23,088,508	31-Mar-05
BECKER CAPITAL MNGT	1,748,965	4.56	$22,369,262	31-Mar-05
WELLS FARGO	1,625,238	4.24	$20,786,794	31-Mar-05

FPIC Insurance Group, Inc.

FPIC

Price: $35.30 ($24.13 - $37.00)

Russell 2000: 641.82
Date: 10/05/05 Steven Holtkamp

FPIC Insurance Group, Inc. provides specialty property and casualty insurance, as well as insurance management services in the United States. It offers medical professional liability insurance products and related risk management services for physicians, dentists, and other healthcare providers primarily in Florida and Missouri. In addition, the company provides insurance management services to other insurance carriers, as well as offers administrative and claims management services to municipalities and other employers that maintain group accident and health, workers' compensation, liability, and property self insurance plans. FPIC Insurance provides its products and services primarily in Florida, Georgia, and Arkansas. The company is headquartered in Jacksonville, Florida.

Recommendation

I believe that FPIC will grow earnings at 17% in 2005, and 10% in 2006. FPIC has a dual business model of insurance and insurance management. Through this model the company has lower capital requirements, while increasing income opportunities. The company has focused its attention on Florida, and New York in the last year to grow their core bases. Management has been able to develop relationships with customers that keep pricing pressures and competition to a minimum. My current valuation of the company is $41, which is an undervaluation of about 15%. I am recommending a portfolio weighting of 2%.

Key Statistics	MRQ
Weighting	2%
Market Cap (M)	$370.1 M
Dividend Yield	0.00%
Loss Ratio	76.00%
Expense Ratio	12.90%
Combined Ratio	88.90%
ROE	14.89%
ROA	2.59%
LTG rate	10%
P/E '05E	12.63
P/E '06E	11.36
Price/Book	1.5x
Morningstar Sector	Financial Services

Investment Thesis

Insurance management provides a fee income to FPIC. In 1999, FPIC acquired AFP, a firm which specializes in marketing, legal, underwriting, risk, and financial management services. FPIC is the second largest provider of medical malpractice insurance in New York, which allows the firm to gain underwriting commissions, without having to front significant capital. This, in turn, provides for excellent profit margins. In the first half of the year insurance management represented 16% of revenues, and 26% of income.

FPIC is a market leader in two of the largest markets in the nation. New York is the largest MPL insurance market in the U.S., while Florida is third. In Florida FPIC has been the market leader for 28 years. The company is exclusively endorsed by state and local medical associations. In 2004 the company exited other regional markets in a strategic move to grow their core base in Florida. This allowed FPIC to cut expenses, and commissions while keeping premiums essentially neutral.

The company is focused on a niche market. FPIC only insures individuals in a professional practice, not the practice itself. They do not cover hospitals or nursing homes. By focusing on professionals FPIC is able to create a relationship with its customers that keeps them relatively

immune to rate increases. The retention rate of policyholders was 93% in 2004 and 90% in 2Q'05. Florida rate increases have over doubled since 2000, with additional increases in 2005.

FPIC shows solid fundamentals and solid growth. The firm has strict underwriting criteria in that any new business must be ten years without a material loss. As a result, the company has become increasingly profitable. The combined ratio was 103% in 2003, 97.5% in 2004, 92% in 2005, and 89% MRQ. This resulted in an increase in net income of 70% in 2004 and a 27% increase YTD. Compared with its peers, FPIC is a premier insurance provider. Peer ROE has a median rate of 12.71% and a combined ratio median of 93.9% LTM. FPIC has an operating margin of 11.92%, while the peer median was 8.39% LTM.

Valuation

I believe FPIC will grow earnings in 2005 to $2.91 per share and $3.15 in 2006. Given that FPIC is a premium MPL insurance carrier, I believe that a higher P/B should be awarded to the company over its current 1.55x. FPIC warrants a P/B in line with other premier MPL insurance carriers of 1.8x. At this valuation I am setting a price target for FPIC insurance of $41.

Risks

Claims Risk. In the second half of the year FPIC is no longer involved in any reinsurance agreements. If many large claims were to come against the company earnings could be damaged.

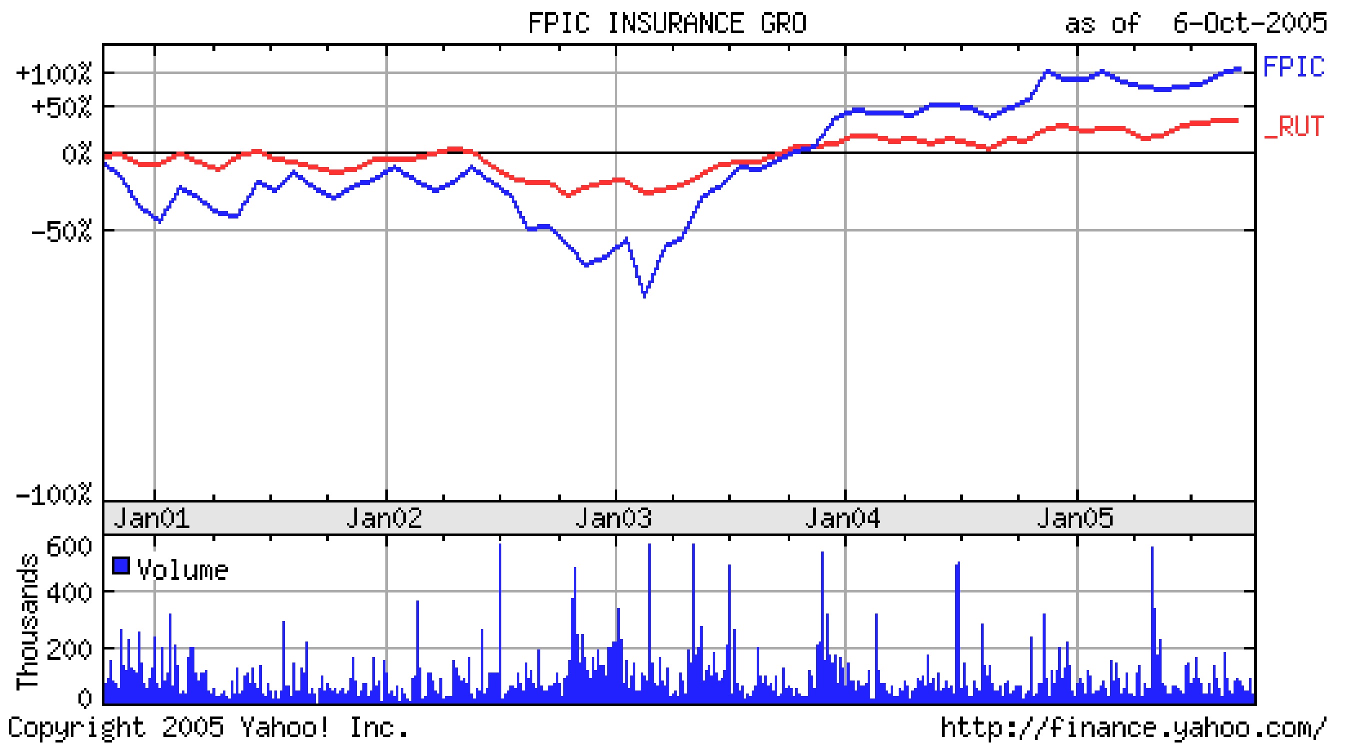
Legal Risk. Insurance is a heavily regulated industry. Insurance companies are subject to many local, state, and federal laws. Such laws as rate caps could come into play and hurt future earnings.

Management

John R Byers. President/ CEO. Compensation $833k. Mr. Byers joined the company in 1998, and worked his way up to president in 2000. Before joining FPIC Mr. Byers was a partner in the law firm Leboeuf, Lamb, Greene, and Macrae.

Outlook and Growth Assumptions

-Growth in premiums written.
-Stable fee income from insurance management segment.
-No significant claims against the company.



Top Institutional Holders

Dimensional Fund 7.93%
Bricoleur Capital 5.6%
Davis Selected Advisors 4.75%

Total: 78%

Top Insider Holdings

John Byers 3.6%
Kim Thorpe 1.6%
Robert Baratta 1.0%

Total: 8.8%