# Applied Investment Management (AIM) Program

## AIM Fund Investment Advisory Board Meeting
## Raynor Library Conference Center (Lower Level)

***Wednesday, February 18, 2009***

***International Equity Presentations: 4:00 pm – 5:00 pm***
***Domestic Equity Presentations: 5:15 pm – 7:00 pm***

## AIM Equity Fund Presentations

| Student Presenter | Company Name | Ticker | Price | Page No. |
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| Patrick Abeln | Acergy S.A. | ACGY | $6.23 | 2 |
| Lauren Grebe | Alcon Inc. | ACL | $90.42 | 5 |
| Chris Cebula & David Martin | Brookfield Asset Management | BAM | $15.70 | 8 |
| Karina Moreno | News Corporation | NWS | $7.24 | 11 |
| Alison Bettonville | Banco Santander-Chile ADR | SAN | $36.08 | 14 |
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| Anna Toshach | MercadoLibre | MELI | $16.01 | 17 |
| Kevin Roloff | ATMI Inc. | ATMI | $13.82 | 20 |
| Sarah Schmidt | Calavo Growers Inc. | CVGW | $14.07 | 23 |
| Kyle Zabel | eHealth | EHTH | $14.25 | 26 |
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| Andy Parker | Mueller Water Products | MWA | $3.34 | 32 |
| Andy Verchota | VASCO Data Securities | VDSI | $7.13 | 35 |

**Acergy S.A.**
**ACGY**
Price: $6.23 ($3.53 – 28.10)
Fiscal Year Ends: November 30

February 15, 2009 — Patrick Abeln
iShares MSCI EAFE Index: $38.55 ($35.53 – 78.77) — International Energy Sector

*Acergy (ACGY) is a seabed-to-surface engineering and construction contractor to the offshore oil and gas industry. ACGY was formed in the early 1970s as Stolt Nielsen Seaway, with the name being changed to Acergy in 2006 to reflect a change in management and the company's increased focus on a tighter segment of the offshore market. ACGY focuses on the subsea construction of umbilicals and risers (71.6% of FY07 revenue), while also offering conventional engineering, inspection, and repair services. The company's services include the installation of pipelines used to transport oil and gas underwater, as well as to the production and processing facilities at the surface. ACGY also procures, fabricates, and installs equipment used in field development. Acergy has operated in more than 73 countries worldwide, and at the end of FY07 the company was operating in 19 countries.*

**Recommendation**

Acergy is one of the largest seabed-to-surface engineering and construction firms in the world. Although this work can be quite difficult, due to harsh weather conditions, the company has the experience and expertise in place to compete with other major players. Additionally, in 2006 management released a "Total Acergy Quality Leadership" (TAQL) program that was designed to set Acergy apart from its industry peers. Management has stated that they are "aggressively attacking the cost of non-quality", and this program is likely to give ACGY a distinct advantage in an industry that has been historically driven by competitive bidding. As a part of this initiative the company has been working to shed non-core assets ($13.6M sold in 2007) and focus on the company's strength within the subsea umbilical risers and flow lines market. The company also appears to be financially sound, with roughly $425M in debt (1.3x Debt/EBITDA) and a backlog of approximately $3.3B. Based upon the company's expertise in offshore and deep-water construction, industry-leading quality, and financial health, it is recommended that Acergy be added to the International AIM Portfolio.

| Key Statistics | Feb. 15, 2009 |
|---|---|
| Market Cap | $1,214.56M |
| Shares Outstanding | 194.954M |
| Avg. Volume (3 month) | 635,986 |
| Adjusted Beta | 1.393 |
| EPS (TTM) | $1.02 |
| 2009 Estimated EPS | $1.15 |
| P/E (TTM) | 6.11 |
| WACC | 12.36% |
| Debt/Equity | .6992 |
| ROA | 6.63% |
| ROE | 21.51% |
| Gross Margin | 20.32% |
| Operating Margin | 11.78% |
| Dividend Yield | 3.2% |
| Analyst Coverage | 9 |
| Target Price | $12.80 |

Source: Bloomberg

**Investment Thesis**

- **Offshore Expertise.** Through the company's "SURF" segment, ACGY offers the engineering, procurement, and construction work related to developing subsea wells. This segment has consistently increased revenues and accounted for 72% ($1.9B) of FY07 net operating revenues. Furthermore, ACGY provides services that add value throughout the exploration, development, and production life cycle, which provides the company with a longer-term, visible source of revenue.
- **Improved Quality**. Acergy's "Total Acergy Quality Leadership" Program is designed to give the company a competitive advantage in an industry that is inherently price-driven. Since 2003 the company has renewed its focus on core operations and management has aggressively shed

over $50M in non-core assets during the past two years. This increased focus on the company's core capabilities, as well as a more streamlined operation, should improve ACGY's long-term competitive position.

- **Financial Health.** As of 3Q08, Acergy had approximately $425M in debt outstanding. This represents 1.3x EBITDA and a debt/equity ratio of 0.6992. In addition, Acergy currently has a $400M credit facility that expires in 2011, plus another $200M guarantee that expires in 2013. Finally, as of 3Q08 Acergy had a backlog of $3.3B, compared to $2.7B in 3Q07, representing a 20% increase y/y.
- **Global Presence.** During 3Q08, Acergy generated approximately $278.7M from its Northern Europe & Canada segment, reflecting high levels of SURF activity. At the same time, the company had net operating revenues of $233.4M from the Africa & Mediterranean region, as well as $191.2M from South America. This diverse source of revenues presents a wide range of growth opportunities, and it also serves to protect the company from any significant problems within a particular region.

**Valuation**

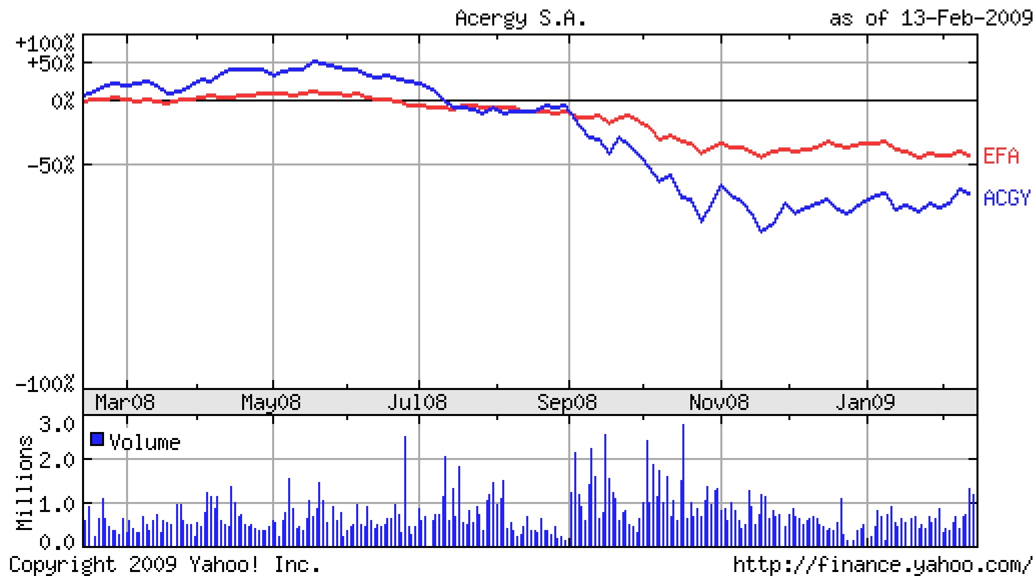
Based on a 10-year DCF valuation (using a WACC of 12.36% and terminal growth of 3%), an intrinsic value of $15.70 was determined. Given the inherent difficulty of using a DCF in this industry, multiple valuations such as P/E and EV/EBITDA were also used. ACGY is currently trading at 6.11x TTM EPS of $1.02, while it has typically traded around 15-20x. Given conservative estimates of 9.5x (based on peers) and 15x (based on historical averages), a price range of $11-16 was established. Finally, an EV/EBITDA multiple valuation yielded a price target of $6.36. Taking all of this into account, a price target of $12.80 was established. The company also pays a 3.2% dividend.

**Risks**

- **Fixed Rate Contracts.** In FY07, 78% of Acergy's revenue came from fixed rate contracts, which puts intense pressure on successful bidding and cost projection capabilities. Management has done a good job of securing long-term profits through fixed rate contracts in the past, but future profit margins are largely dependent upon management's ability to contain costs.
- **Project Delays.** Given the harsh weather conditions in which ACGY operates, project delays pose a significant risk. This can be extremely problematic for a company that typically serves fixed rate contracts, as any unexpected costs can tighten margins significantly.
- **Extended Period of Depressed Commodity Prices.** Although ACGY has less exposure to oil prices than many energy firms in the long run, the short-term collapse of oil prices has led the vast majority of E&P firms to reduce capital expenditures. A prolonged period of depressed commodity prices may result in lower demand for Acergy's services.
- **Political and Economic Instability.** Acergy's operations in Africa and South America are mainly performed in emerging markets such as Angola, Congo, and Brazil. Operating in these markets presents risks such as economic instability, political protests or corruption, and the implementation of new, unfavorable legislation.

**Management**

Jean Cahuzac took over as Acergy's CEO in April 2008. Cahuzac has over 29 years of experience in the offshore oil and gas industry. Prior to joining Acergy, Mr. Cahuzac served as COO of Transocean for eight years and he held various roles at Schlumberger from 1979-2000. Former CEO Tom Ehret, who became CEO in 2003, retired in April 2008. Ehret is largely responsible for Acergy's turnaround, as he aggressively sold non-core assets and reorganized the company's operating structure during his six years with the firm. The majority of ACGY's eight directors have at least 20 years of industry experience.




**Ownership**

| | |
|---|---|
| % of Shares Held by Insiders: | 0.99% |
| % of Shares Held by Institutional & Mutual Fund Owners: | 20.02% |

Source: Bloomberg

**Top 5 Shareholders**

| Holder Name | Shares Held | Percent of Shares Outstanding |
|---|---|---|
| NWQ Investment Management Co. | 3,356,411 | 1.72% |
| Fisher Investments Inc. | 3,005,725 | 1.54% |
| Robotti & Company Advisors | 1,827,758 | 0.94% |
| Sound Energy Partners Inc. | 1,463,200 | 0.75% |
| Natixis Asset Management | 1,054,649 | 0.54% |

Source: Bloomberg

**Alcon Inc.**
**ACL**
Price: $90.42 ($66.64-178.56)
Fiscal Year Ends: December 31

February 12, 2008 — Lauren Grebe
iShares MSCI EAFE Index: $38.97 (35.53-78.77) — International Healthcare Sector

*Alcon Inc. develops, manufactures, and markets surgical, pharmaceutical, and consumer eye care products. The surgical segment (43% sales) is the largest producer of cataract, refractive, and vitreoretinal medical equipment. Ophthalmic drugs (41%) for the treatment of infection, glaucoma, and allergies include TRAVATAN, Azopt, and Patanol, among others. Consumer eye care products (13%) include the contact lens disinfectant, Opti-Free, and over-the-counter eye drops under various brands. They market to distributers, wholesalers, physicians, retailers, and hospitals. Alcon operates in 75 countries and sells in 180 countries, with 45% of sales coming from the United States, 37% from developed markets, and 18% from emerging markets. Alcon was incorporated in 1971 in Switzerland and currently employs 14,500 people.*

**Recommendation**

ACL is the most comprehensively specialized company in eye care and a leader in most of their markets. They are benefiting from diversity in geography and product segmentation. ACL has seen strong growth in global developed markets (18.0% sales yoy) and emerging markets (21.5%) which offset the weakened U.S. economy. The company leads in solutions for glaucoma, retinal disease, presbyopia, and cataract surgery, which are increasing in frequency due to the aging population. Despite a rough 4Q08, ACL posted a solid 4.8% increase in pharmaceuticals, 7.0% in surgical, and 8.7% in consumer products. With a gross margin of 75% and operating margin of 34%, ACL is financially solid. The stock price has yet to recover from the mass sell-off in October which occurred across the entire market. When valuing ACL based on fundamentals, a target price of $100 is reached. Given its strong drivers, 11% upside, and dividend yield of 2.65%, it is recommended that Alcon be added to the International AIM Fund.

| Key Statistics | Feb. 12, 2008 |
|---|---|
| Market Cap | $27.07B |
| Shares Outstanding | 298.73M |
| Ave. Volume (3 month) | 912,516 |
| Adjusted Beta | .92 |
| EPS (TTM) | $5.21 |
| 2009 Estimated EPS | $6.39 |
| P/E (TTM) | 17.36 |
| PEG Ratio | .94 |
| WACC | 9.8% |
| Debt/Assets | 18.25% |
| ROE | 50.46% |
| ROA | 25.50% |
| Gross Margin | 75.03% |
| Operating Margin | 33.63% |
| Dividend Yield | 2.65% |
| Target Price | $100 |

Source: Bloomberg

**Investment Thesis**

- **Strong Product Pipeline.** In an industry defined by product creation and innovation, Alcon leads with the largest R&D commitment to ophthalmology in the world (estimated $619 million for 2008). Results of the recent approvals - Azarga in the EU and AcrySof ReSTOR +3.0 Add and AcrySof IQ Toric in the U.S. - will begin to be realized in 1Q09. Continued R&D is focusing on developing products in glaucoma, retinal disease, dry eye, presbyopia, and cataract surgery.

- **Diversification.** Alcon benefits from both product and geographic diversification. Weakened U.S. pharmaceutical sales have been offset by strong international performance. Emerging markets will be the largest area for future growth. Although U.S. pharmaceuticals have been weak, this has been offset by strong surgical and consumer eye care products.

- **Solid Financial Statements.** Alcon's financial statements boast $2.44 billion in cash, and low debt (Debt/Assets = 18%). Foreseeing the headwinds in the United States economy, ACL recently laid off 260 employees. This is a smart, proactive move for a company focused on minimizing unnecessary SG&A in order to maintain profits.

**Valuation**

A DCF model and relative P/E valuation were used to value Alcon Inc. Using a WACC of 9.8% and a terminal growth rate of 3%, an intrinsic value of $99 per share was determined. The sensitivity analysis table below shows how changes in assumptions impact the target price, resulting in a range of $80.47-$120.28. A P/E valuation using an 18X industry multiple produced a price of $115. Weighting the two methodologies, a target price of $100 was determined which provides an 11% return.

| | | Terminal Growth Rate | | |
|---|---|---|---|---|
| | | 2.5% | 3.0% | 3.5% |
| WACC | 9.0% | $ 107.14 | $ 113.17 | $ 120.28 |
| | 10.0% | $ 91.97 | $ 96.12 | $ 100.92 |
| | 11.0% | $ 80.47 | $ 83.45 | $ 86.83 |

**Risks**

- **General Economic Weakness.** Growth in discretionary segments of eye care, such as elective surgeries and select drugs, tend to trend with the economy. Being well diversified across product lines and geographies will be a major competitive advantage until the global economy recovers.

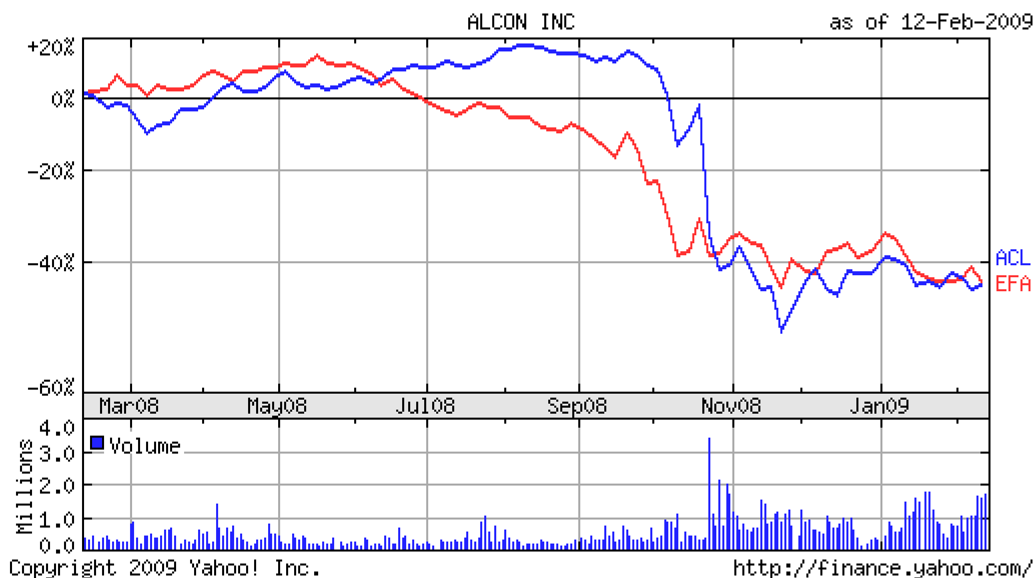
- **Generic Competition.** Alcon is dependent on patent protection with currently about 4500 existing patents and 3200 patents pending. The patent on TobraDex, an eye infection anti-biotic, expired at the end of 2008. Alcon expects to lose market share following the expiration until an improved version, TobraDex SA, is approved by the FDA.

- **Majority Ownership.** Nestle owns 77% of the common shares outstanding since Alcon's IPO in 2002. In 2008, Novartis, a global biotechnology company, agreed to purchase Nestle's shares. With ¾ of the outstanding shares, Novartis will control the appointment of directors and dividend policy. To date this has not been an issue, and synergies are expected to arise from the relationship with Novartis.

- **Currency Fluctuations.** A strengthening US dollar would negatively impact revenues. Alcon has the majority of its currency exposure in the Euro, Japanese Yen, Canadian Dollar, British Pound, and Australian Dollar. While Alcon does not engage in currency hedging, some risk is mitigated because expenses are often incurred in the currency received.

**Management**

Cary Rayment has served as the Chairman, CEO, and President since 2004. Kevin Buehler, Senior Vice President of Global Markets will take over on April 1st when Rayment has planned to retire. The transition should be smooth, as Buehler brings 24 years of experience at Alcon, shared vision with Rayment, and the time needed to transition.




**Ownership**

| | |
|---|---|
| % of Shares Held by Insiders: | 77% |
| % of Shares Held by Institutional & Mutual Fund Owners: | 21% |

Source: Bloomberg

**Top 5 Shareholders**

| Holder Name | Shares Held | Percent of Share Outstanding |
|---|---|---|
| Nestle SA | 156,076,263 | 52.13% |
| Norartis AG | 74,061,237 | 24.74% |
| AXA | 13,190,155 | 4.41% |
| Fidelity Management | 8,367,994 | 2.79% |
| Jennison Associates | 6,168,713 | 2.06% |

Source: Bloomberg

**Brookfield Asset Management**
**BAM**
Price: $15.70 ($11.58-37.19)
Fiscal Year Ends: December 31

February 13, 2009 — Chris Cebula & David Martin
iShares MSCI Canada Index: $16.58 ($14.11-36.22) — International Financial Services

*Brookfield Asset Management is a global asset management company that focuses on owning and operating property, power and infrastructure assets. With over $78B in assets under management (AUM), BAM operates across six platforms including Commercial Property (35%), Power Generation (8%), Infrastructure (8%), Development (10%), Specialty Funds (9%), and Advisory Services (30%). The US and Canada account for over three fourths of revenue, with the remaining generated internationally. The company was founded in 1989 and is headquartered in Toronto, Canada.*

**Recommendation**

Brookfield Asset Management is a well diversified asset manager with a strong franchise and a long history of investing in infrastructure assets. Managing over $78B gives Brookfield the size and scale to operate on a global basis. Infrastructure assets provide cash flows irrespective of the business cycle, insulating the company from the cyclical downturns in the property markets. Because of their strong cash generation, long term investment philosophy, and ability to raise capital, Brookfield is well positioned to take advantage of depressed asset prices in the marketplace. The fact that the commercial property portfolio accounts for 35% of AUM is the primary reason the stock has declined 49.7% in the last 12 months. We believe the market is discounting BAM's ability to realize value in these assets. The prevailing short term sentiment in the investment community has created a discrepancy between the market value of the stock and the intrinsic value of the company. Given BAM's long term investment horizon, strong cash flow generation, and diversifying contribution to the financial services sector, we recommend Brookfield Asset Management be added to the IAIM portfolio with a price target of $22.50.

| Key Statistics | Feb. 16, 2009 |
|---|---|
| Market Cap | $9.42B |
| Shares Outstanding | 600.3M |
| Avg. Volume (3m) | 2.81M |
| P/E (TTM) | 15.39 |
| P/E (Fwd) | 16.19 |
| P/B | 1.76 |
| FFO/Share | $2.33 |
| Cash ROE | 26.10% |
| WACC | 8.78% |
| Debt/Assets | 55.34% |
| ROA | 1.21% |
| ROE | 13.20% |
| Financial Leverage | 10.90 |
| Operating Margin | 37.40% |
| Dividend Yield | 3.31% |
| Analyst Coverage | 13 |
| Target Price | $22.50 |

Source: Company Filings, Bloomberg

**Investment Thesis**

- **Infrastructure as an Alternative Asset Class.** Infrastructure assets are long term investments that generate strong and stable cash flows. This investment focus has helped the company grow FFO/share at a 21.7% CAGR since 1999. These assets also provide a hedge against the cyclicality of the property markets and have a low correlation to broader asset classes. For example, over the 15 years from 1990-2004, Timber had a 0.33 correlation with stocks and a 0.04 correlation with government bonds. These types of real assets are becoming an increasing portion of the investment portfolios of institutional investors.
- **Trusted Franchise**. Brookfield's core area of expertise is in managing infrastructure assets. The long operating history and niche focus of Brookfield has enabled them to establish a strong reputation within the industry. Long term relationships with institutional investors, a reputable franchise, and its large scale provide a significant barrier to entry for new competitors.

- **Property Portfolio.** BAM's property portfolio is attractive due to 1) Low loan-to-value (LTV) 2) Low turnover rate, and 3) Conservative rental rates. Properties are typically financed at ~65% LTV, providing an equity cushion against declines in property values. A 3% annual turnover rate prevents the company from realizing losses in a depressed market environment. Rental rates below market prices protect the company from competitive forces in the space market.
- **Liquidity and Balance Sheet.** In addition to $20B of permanent capital, BAM has over $3.7B in cash and undrawn credit lines. This compares to just $2.3B of long term debt at the corporate level. Coupled with the $2.1B of capital committed by private investors in 2008, this strong balance sheet enables BAM to capitalize on investment opportunities in an attractively priced market.

**Valuation**

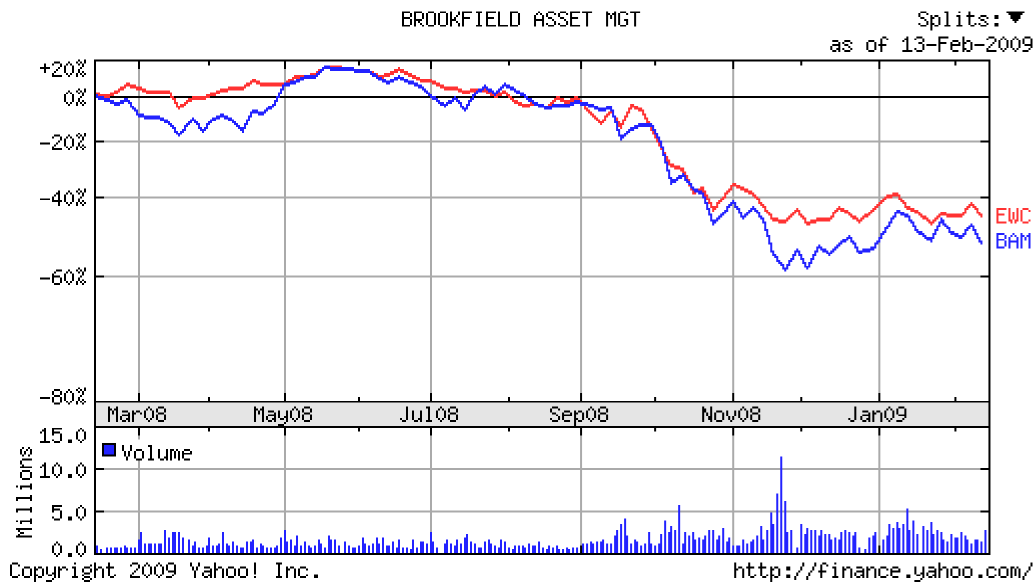
Fees from the asset management business make up less than 4% of total revenues with the majority coming from the management of real estate and infrastructure assets. Therefore, we valued BAM as a Real Estate company. Stabilized net operating income (NOI) was capped at 7.84% and discounted by a WACC of 8.78% to arrive at a price target for BAM. Assuming flat growth for 3 years and varying the time it takes for NOI to stabilize, we establish a target price of $22.50. This represents 44% upside from the 2/13 closing price.

**Risks**

- **Revaluation Losses.** As weaker competitors sell assets into the market at depressed prices, Brookfield may be forced to revalue some of their assets on the basis of these transactions. While the company is unlikely to realize many of these losses due to the fact that they turn over just 10% of their assets per year, it could have a negative impact on Brookfield's financial statements in the near future.
- **Debt Refinancing.** Brookfield has a disproportionate amount of debt due in the next two years ($882M in '09, $860 in '10). The inability to refinance this debt at a reasonable cost would hinder the company's ability to invest capital in attractive projects, potentially limiting the long term value of the business.
- **Financial Position of Investment Partners.** CalPERS has recently asked some of its private equity partners to delay drawing on capital it previously committed to their funds. There is evidence that this may be indicative of an industry wide trend. While Brookfield has not had any investment partners fail to meet their funding commitments, a further decline in the financial position of partners or potential partners could negatively affect the company's ability to raise capital and finance future projects.
- **Recent Investments.** AUM have grown from $49.7B in '05 to $78.7B in '09. Much of this incremental capital has been put to work in recent years. While the company tries to ignore temporary exuberance in calculating the long term value of their projects, investing off a lower than expected base could threaten the targeted 12% return on capital. In addition, the return profile of their projects is subject to the J curve effect. These two factors could depress financial results in the near term.

**Management**

Managing Partner and CEO Bruce Flatt has held various senior management positions at BAM since 1996 before being elected Chief Executive Officer in 2002. Mr. Flatt is one of 42 Managing Partners that collectively own 17% of the company. BAM also invests directly alongside its investment partners in the assets they manage, which aligns management's interests with both their common shareholders and investment partners.




**Ownership**

| | |
|---|---|
| % of Shares Held by Insiders: | 17% |
| % of Shares Held by Institutional & Mutual Fund Owners: | 83% |

Source: Company Filings

**Top 5 Shareholders**

| Holder Name | Shares Held | Percent of Share Outstanding |
|---|---|---|
| Morgan Stanley | 25,147,639 | 4.39% |
| RBC Asset Management Inc | 23,429,034 | 4.09% |
| Third Avenue Management LLC | 23,198,342 | 4.05% |
| Bank of Nova Scotia | 15,030,465 | 2.63% |
| Barclays Global Investors UK | 14,794,779 | 2.58% |

Source: Bloomberg

**News Corporation**
**(NASDAQ: NWS)**
Price: $7.24 ($5.83 – 20.49)
Fiscal Year Ends: June 30

February 12, 2009 Karina Moreno
iShares MSCI EAFE $43.71 (37.50 – 84.67) International Media Sector

*News Corporation is a diversified global media company operating in more than 100 countries and 32 languages, primarily located in the US, Europe, Asia, Australia, and Latin America. The company operates eight segments: filmed entertainment, television, cable network programming, direct broadcast satellite television, magazines and inserts, newspapers, book publishing and other. Some of their primary businesses include Fox Entertainment, National Geographic, MySpace , Sky Italia and Dow Jones. Revenues are primarily driven by advertising (35-40%) and subscriptions (60-65%). News Corporation generates 53.3% of its total revenues from the US, 31.7% from Europe and 15% from Australia and other countries. They are headquartered in Australia with over 37 offices worldwide.*

**Recommendation**

News Corp. is a globally diversified media company with the expertise and assets to compete worldwide. With $62.2 billion in assets and their diversified asset mix, they have been able to generate $875 million in operating profits during 2008. A continued focus on quality entertainment and aggressive acquisitions will enable News Corp. to grow further from its current 11% CAGR. Although the advertising market is experiencing a downfall, only 58% of their total revenues are generated from advertising, limiting their exposure to the declining market conditions. Fox Interactive Media is a business driver that currently accounts for about 20% of their revenues and is expected to grow to 40% by 2011 with further investment into new markets. News Corporation's strong balance sheet, effective management and diversified media assets position them to sustain the current economic downturn and achieve strong long-term growth. With a current price of $7.24 and a price target of $15.00, a potential 51.7% upside, NWS is recommended to be added to the International AIM Equity Fund.

| Key Statistics | Feb. 12, 2009 |
|---|---|
| Market Cap | $17,653.23M |
| Shares Outstanding | 798.52M |
| Ave. Volume (3 month) | 6.21M |
| Adjusted Beta | 1.33 |
| EPS (TTM) | $1.09 |
| 2009 Estimated EPS | $0.73 |
| P/E (TTM) | 6.64 |
| PEG Ratio | 1.36 |
| WACC | 10.84% |
| Debt/Assets | 0.22 |
| ROE | 17.51% |
| ROA | 8.64% |
| Gross Margin | 37.55% |
| Operating Margin | 16.31% |
| Analyst Coverage | 16 |
| Target Price | $15.00 |

Source: Bloomberg

**Investment Thesis**

- **Strong Balance Sheet.** The media industry is highly dependent upon advertising revenues that are currently decreasing. News Corp. has $14.4 billion cash on its balance sheet allowing them to withstand the current economic downturn and cover its debt maturities through 2015.
- **FOX Interactive.** Although brand recognition hasn't traditionally been a major differentiator for media companies, it is quickly becoming a major player in the success of a company. News Corporation is able to expand its market through quality proprietary content that FOX Interactive delivers to its customers. Operating 140 channels worldwide, News Corp. has been able to realize a 13% international CAGR within the Pay-TV industry over the most recent four year period. FOX is ranked as the #1 in entertainment provider in Latin America, Spain, Italy and Japan capturing 59%, 55%, 50% and 30% of market share, respectively. Their ability to expand into

new markets and penetrate further into their existing markets will continue to allow the business to grow.

- **Global Vertically Integrated Company.** News Corporation's ability to tap into all venues of the media business globally has positioned them to outperform their competition. From film entertainment (20.3% of revenues) to magazines and inserts (3.4% of revenues), News Corp. is able to sustain the economic downturn through its diversified media assets. Only 53.3% of their revenues are generated in the United States, protecting the company from the current downturn of the US advertising market.
- **Strong Management Team.** With the continued deteriorating economic environment, it is crucial for media companies to have a strong management team that will enable them to overcome the short-term and be profitable in the long-term. Rupert Murdoch's expertise and execution has allowed NWS to expand into new markets and segments. Recently, he has become a leading investor in the satellite, internet and film industry, allowing the company to capitalize on its brand in these markets. NWS management's strategic vision and execution will allow the firm to be stronger than most of their competitors.

**Valuation**

Based on a 5 year DCF analysis with a computed WACC of 10.84% and a terminal growth rate of 2%, an intrinsic value of $16.15 was obtained for News Corp. A sensitivity analysis adjusting for a range of long-term growth rates and WACCs, yielded price targets between $12.76 and $20.58. With an EPS of $1.09, News Corp. is currently trading at 6.64x TTM EPS. Using an average P/E of 16x and an 2009 EPS estimate of $0.73, an intrinsic value of $11.68 is reached. Taking into account both valuations, a stock target of $15.00 was obtained which represents a 51.7% return potential.

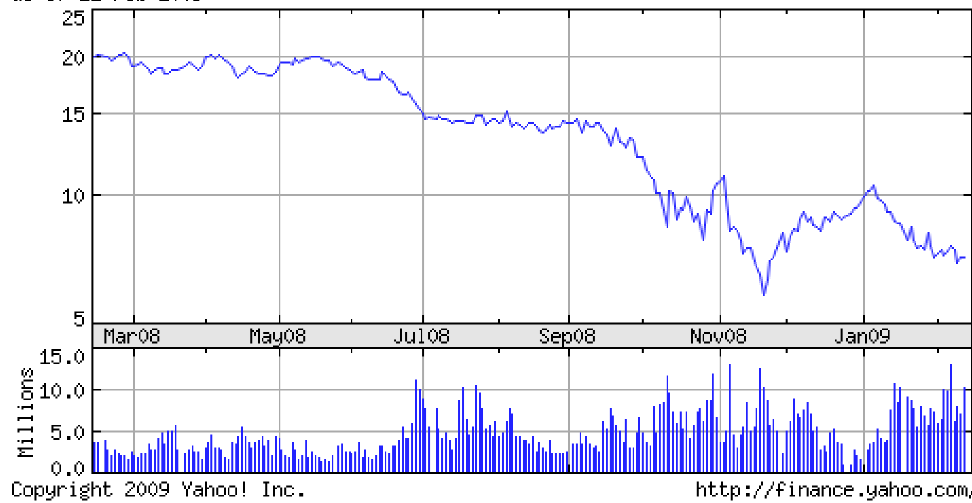
| WACC | Terminal Growth 1.0% | 1.5% | 2.0% | 2.5% | 3.0% |
|---|---|---|---|---|---|
| 10.0% | $ 16.75 | $ 17.54 | $ 18.43 | $ 19.43 | $ 20.58 |
| 10.5% | $ 15.57 | $ 16.25 | $ 17.01 | $ 17.87 | $ 18.84 |
| 11.0% | $ 14.53 | $ 15.12 | $ 15.78 | $ 16.51 | $ 17.33 |
| 11.5% | $ 13.60 | $ 14.11 | $ 14.68 | $ 15.32 | $ 16.02 |
| 12.0% | $ 12.76 | $ 13.21 | $ 13.71 | $ 14.26 | $ 14.87 |

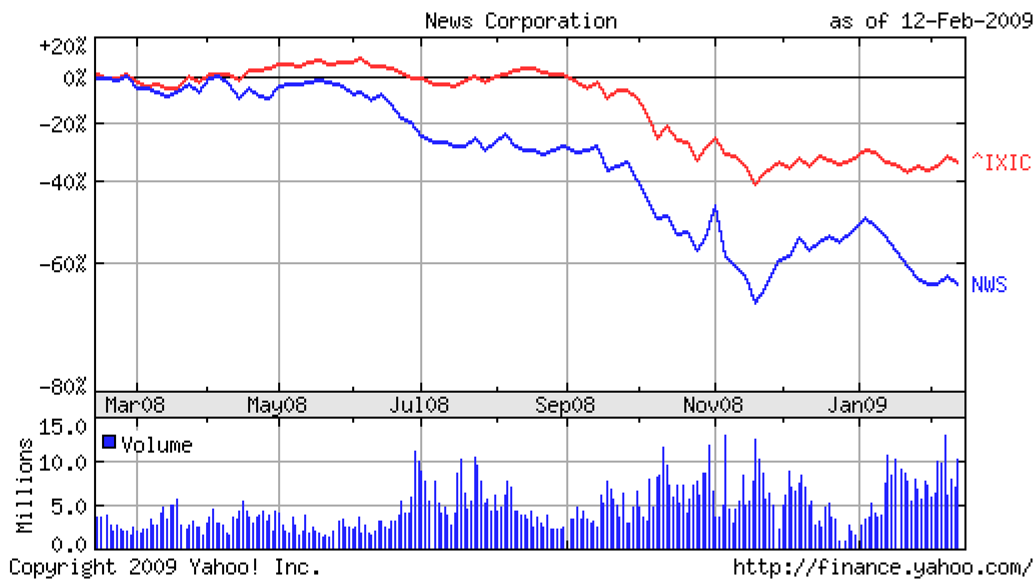
**Risks**

- **Regulation.** The television and broadcasting industries are highly regulated regarding media ownership, programming and licensing. Any change in regulations, whether direct or indirect, could cause a disruption to NWS business operations.
- **Reliance of advertising revenues.** News Corporation derives a substantial amount of revenues from the sale of advertising throughout the various segments. 35-40% of the company's total revenues are driven by advertising sales; of which 70% comes from their newspapers and broadcast TV segments. Ad revenues will likely continue to decline in 2009 and could adversely affect the financial stability of the firm.
- **Piracy.** Increases in technology makes it easier to duplicate and 'pirate' NWS materials which could depress revenues. If NWS is not able to limit or control this activity, revenues could be adversely affected.

**Management**

Rupert Murdoch has been CEO of the company since 1979 and Chairman since 1991. Mr. Murdoch has a 40% controlling stake of the company's voting stock. The board is comprised of 10 members, including Lachlan Murdoch, director, and James Murdoch, a current nominee, who are both sons of Rupert Murdoch.




## Ownership

| | |
|---|---|
| % of Shares Held by Insiders: | 59% |
| % of Shares Held by Institutional & Mutual Fund Owners: | 18% |

Source: Yahoo! Finance

## Top 5 Shareholders

| Holder Name | Shares Held | Percent of Share Outstanding |
|---|---|---|
| Morgan Stanley | 20,606,640 | 2.58% |
| Taube Hodson Stonex Partners Limited | 15,836,210 | 1.98% |
| Clearbridge Advisors, LLC | 11,543,420 | 1.45% |
| Bank of New York Mellon Corp. | 11,367,023 | 1.42% |
| Shaw D.E. & Co., Inc. | 10,528,201 | 1.32% |

Source: Yahoo! Finance

**Banco Santander-Chile ADR**
**SAN**
Price: $36.08 ($25.18-55.60)
Fiscal Year Ends: December 31

February 11, 2009 — Alison Bettonville
iShares MSCI Emerging Markets Index: $24.01 (18.22-52.49) — International Financial Services

*Banco Santander-Chile is the largest bank in Chile by both loans and deposits, holding 21.1% and 21.3% market share, respectively. Created in the 2002 merger of Banco de Santiago and Banco Santander-Chile, SAN leads the Chilean banking sector in nearly every category, including loans, deposits, credit cards, branch locations, and ATMs. Santander lends in four segments: "individual" or retail (58.5% of 2007 loans), institutional (1.7%), "middle-market" or commercial (21.6%), and global wholesale (16.6%). Headquartered in Santiago, Chile, SAN is 76.91% owned by Banco Santander Central Hispano, the Spanish financial services conglomerate, and is considered an operating subsidiary. One ADR share represents 1039 common shares traded on the Santiago Stock Exchange.*

**Recommendation**

SAN is the strongest financial services company in Chile, Latin America's most stable country. Given the relative stability of the Chilean economy over the past few decades, coupled with the country's future growth prospects (IMF predicts a 4.6% CAGR in GDP for 2008-2013), Santander-Chile will have many opportunities for expansion. With the support of its larger, more experienced parent company, SAN has cemented a dominant position in its core product offerings, evidenced by a 20% or greater market share in consumer loans, mortgages, foreign trade loans, deposits, mutual funds, checking accounts, ATMs, and branch locations. Furthermore, the company has felt minimal affects from the financial crisis—SAN lacks exposure to the US financial system which leaves it well capitalized and poised to gain even greater market share. SAN has widened spreads across loan classes (commercial loans up 45 bps yoy and consumer loans up 75 bps yoy) during the crisis, sustaining profits and offsetting some of the expense of additional loan loss provisions while cautiously expanding loan volume. Therefore, because of SAN´s market-leading position in a strong economy and positive long-term profitability prospects, SAN should be monitored for potential future addition to the International AIM Equity Portfolio pending an updated valuation reflecting the 1Q09 earnings release that incorporates the IFRS accounting change.

| Key Statistics | Feb. 18, 09 |
|---|---|
| Market Cap | $6.54B |
| Shares Outstanding | 181.37M |
| Ave. Volume (3 month) | 299,000 |
| EPS (TTM) | Ch$1.74 |
| 2009 Estimated EPS | Ch$1.95 |
| P/E (TTM) | 11.89 |
| P/B (TTM) | 2.71 |
| Tier 1 Capital Ratio | 13.80% |
| Loan-to-Deposit Ratio | .94 |
| ROE | 23.00% |
| ROA | 1.87% |
| Net Interest Margin | 6.10% |
| Loan Growth (yoy) | 19.10% |
| Deposit Growth (yoy) | 18.10% |
| Analyst Coverage | 6 |
| Target Price | pending |

Source: Bloomberg

**Investment Thesis**

- **Market Leader.** The Chilean financial system (Ch$63.74T in total deposits as of FYE2007) is concentrated—six of Chile's 25 banks control 80% of the country's loans. Santander-Chile leads nearly every category of banking services, including total loans and deposits. It is also one of the best capitalized banks (13.8% total capital ratio at FYE 2008) and has produced one of the greatest returns on equity (23.0% for FY2008). Santander also boasts one of the highest credit ratings in Latin America (Aa3/A+/A+/stable).
- **Opportunity Stemming from Crisis.** The global financial crisis has created an opportunity for Chilean banks, such as SAN, to pick up clients from large international banks. The company

expects this trend to last through 2009, and will take advantage of it by increasing loan volume through more selective lending to their highest quality borrowers: corporations and high net worth individuals. Santander improved its risk profile in 2008 by increasing loan volume to these lower-risk clients—loans to high-income individuals increased 35.9%, while loans to mid- to low-income individuals decreased 11.9%.

- **Advanced Infrastructure.** As a result of its relationship with Grupo Santander, SAN boasts more sophisticated infrastructure than its domestic peers, especially in terms of computer hardware and software. SAN believes this infrastructure affords the company a significant competitive advantage in the ability to drive sales through cross-selling fee-based services, such as asset management, insurance, and credit cards. Fee-based income rose 9.7% in 2008.

**Valuation**

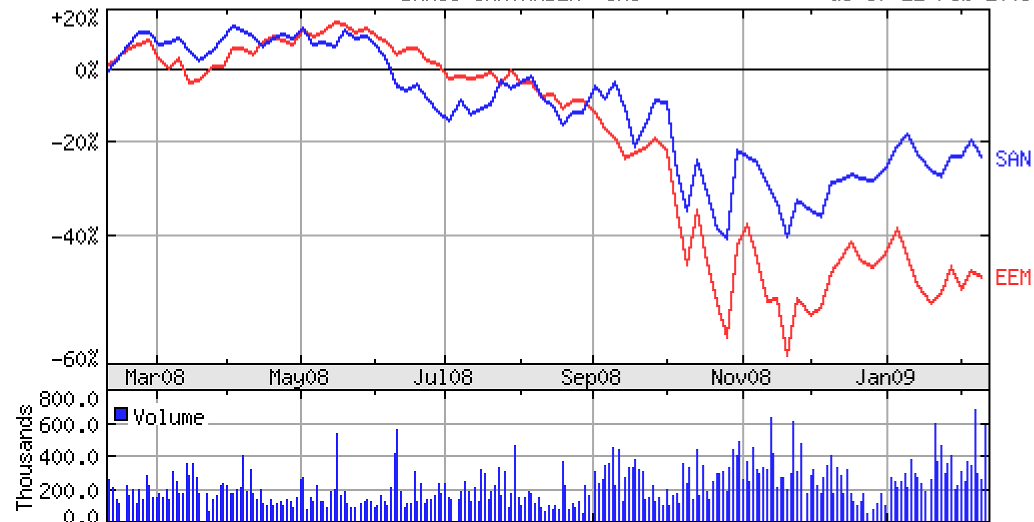
Due to its market leadership position, Santander-Chile trades at a premium P/B multiple relative to its competitors—3.5x versus 2.7x for Latin American peers. Currently, SAN trades at 2.5x book value, a considerable discount to its historical multiples. Factoring in the systematic change in the global financial system, SAN should trade around 3x its book value, leading to an intrinsic value of $38.41. Given the impending change to IFRS accounting and its unknown implications on SAN's balance sheet, a definitive target price cannot be set at this time.

**Risks**

- **Uncertain Economic Future.** Chile has not been heavily impacted by the financial crisis, but the effects of global economic pressures are beginning to appear. SAN expects deflation in the economy during 1Q09; consensus GDP estimates predict the growth rate to decline to 2.5% in 2009, down from 5.2% in 2007, and unemployment to increase from 7.75% to 8.55%. Additionally, Chile's economy is largely export-driven (current account as a % of GDP was 4.46% in 2007; expected to be -2.63% in 2009), with an especially large dependence on copper and trade with the US.
- **Asset Quality Deterioration.** Management expects to see greater deterioration in the quality of its assets in 2009; as such, additional provisions for loan losses have been made (at 4Q08 provisions had increased 50.6% yoy). Past due loans as a percentage of total loans has also risen, from .95% of total loans at FYE 2007 to 1.10% at FYE 2008. Should assets deteriorate more quickly than management projections, SAN could face unexpected losses.
- **Exchange Rate Fluctuation.** Although Santander-Chile operates only in Chile, the bank takes deposits and makes loans in foreign currency, most notably US dollars and Euros. SAN hedges its exposure to all major currencies, including the Unidad de Fomento, Chile´s inflation-indexed unit of account on which many financial transactions (especially mortgages) are based. A mismatch of foreign currency assets and liabilities could negatively impact the bank.
- **Uncertainty in Change to IFRS.** The Chilean banking system will switch from Chilean (inflation-based) accounting to International Financial Reporting Standards (IFRS) as of January 1, 2009. In their 4Q08 conference call management projected that given the new requirements, the non-performing loan ratio will increase to 2.4%, the value of equity will decrease by approximately 5%, and 2008 ROE will be restated to about 30%. These numbers are preliminary, but demonstrate the significant effect in switching accounting standards.

**Management**

CEO Mr. Oscar von Chrismar has been with the company since 1990. He served as CEO of Santander-Chile prior to the merger and then stayed with the firm as Manager of Global Banking. He was appointed CEO in August 2003. Mr. Mauricio Larraín Garcés, chairman of the board of directors, previously worked for Chile's financial regulatory body, the Superintendency of Banks, the Central Bank of Chile, and as a Senior Finance Specialist for the World Bank.




**Ownership**

| | |
|---|---|
| % of Shares Held by Insiders: | 0.00% |
| % of Shares Held by Institutional & Mutual Fund Owners: | 95.35% |

Source: Bloomberg

**Top 5 ADR Shareholders**

| Holder Name | Shares Held | Percent of Share Outstanding |
|---|---|---|
| Aberdeen Asset Management Plc | 4,362,929 | 2.41% |
| Barclays Global Investors UK | 3,131,867 | 1.73% |
| JP Morgan Chase & Co. | 2,158,843 | 1.19% |
| T. Rowe Price Associates | 1,825,299 | 1.01% |
| Mondrian Investment Partners Ltd. | 1,163,257 | 0.64% |

Source: Bloomberg

**MercadoLibre**
**MELI**
Price: $16.01 ($7.91-$57.71)
Fiscal Year Ends: December 31

February 18, 2009 — Anna Toshach
Russell 2000 Index: 448.36 (371.3-764.38) — Consumer Services Sector

*Founded in 1999, MecrcadoLibre, Inc. (MELI) operates the largest online marketplace in Latin America. Incorporated in Delaware, U.S., although headquartered in Argentina, the company has operations in 12 countries, including Brazil, Chile, and Mexico, serving a market of more than 500 million potential customers. Currently it is divided into two segments: The original operation, MercadoLibre, is an e-commerce trading platform where items are bought and sold using both auction and fixed-price formats. Additionally, in 2003 the company launched MercadoPago (mPago), an online payments solution which facilitates payments and fund transfers both in MercadoLibre marketplace and outside that platform.*

**Recommendation**

In spite of significant depreciations of the Argentinean Peso, Brazilian Real, and other Latin American currencies, to the U.S. Dollar, MELI had a positive year in 2008, growing its gross merchandise value 38% (GMV), total payment volume 62% (TPV), net revenues 57%, successful items sold 22%, and confirmed users 36% y/y. As an online marketplace, the company earns revenues through fees paid by sellers for their online listings, as well as ad revenues, similar to EBAY and AMZN. Operating in a market which has significant room for technology growth, MELI is well positioned to capture growing market share as Latin American countries continue to develop. Also, through further growth of its payments system, the company is expanding its existing online presence and attracting a broader range of customers. Because of this strong market potential, as well as the current attractive valuation of the stock, it is recommended that MELI be added to the AIM small cap equity portfolio with a target price of $30.

| Key Statistics | Feb. 18, 2009 |
|---|---|
| Market Cap | $1.2B |
| Shares Outstanding | 44.4M |
| Ave. Volume (3 month) | 513,297 |
| Adjusted Beta | 1.47 |
| EPS (TTM) | $0.40 |
| 2009 Estimated EPS | $0.64 |
| WACC | 11.1% |
| Total Debt/Cap | 15.8% |
| ROE | 16.9% |
| ROCE | 22.2% |
| Gross Margin | 77.7% |
| Operating Margin | 24.6% |
| Analyst Coverage | 6 |
| Target Price | $30 |

Source: Bloomberg

**Investment Thesis**

- **Steadily growing market place.** MELI currently operates in 12 countries in Latin America and has 34 million confirmed users. As an online marketplace, the business model is targeted toward developed economies with sophisticated internet and payment mechanisms. Although there is considerable penetration of these advanced technologies in Latin America, statistics collected by Gallup Inc. over the last two years show that for Brazil and Argentina, MELI's largest markets, home computer access is only 30% and 36%, and home internet access is 23% and 22% respectively. As these rates increase, MELI will also grow its customer base and online offerings.
- **Development of MercadoPago.** Although an initial escrow product version of mPago has been utilized since 2003, an upgraded version was introduced into the largest market countries in 2008. Comparable to PayPal in the US, this version incorporates direct payments, seller commissions, and a simplified transaction process which make it attractive to users outside the existing MELI marketplace.
- **Ad Sales Opportunity.** Currently MELI earns 90% of its revenues through product listing, additional option, and final value fees charged to sellers. As the marketplace grows and the

economy rebounds, the company plans on growing advertisement revenues by increasing inventory sales, selling CPC keywords, and creating a marketing service for its ad clients.

**Valuation**

A DCF model using a WACC of 11.09% and a terminal multiple of 7x provided a target price of $45. Also, conservative industry average EV/EBITDA and P/E multiples using 2009 estimates derive price targets of $28 and $23 respectively. Considering these methods provides an overall price target as $30 which provides an upside of 87%.

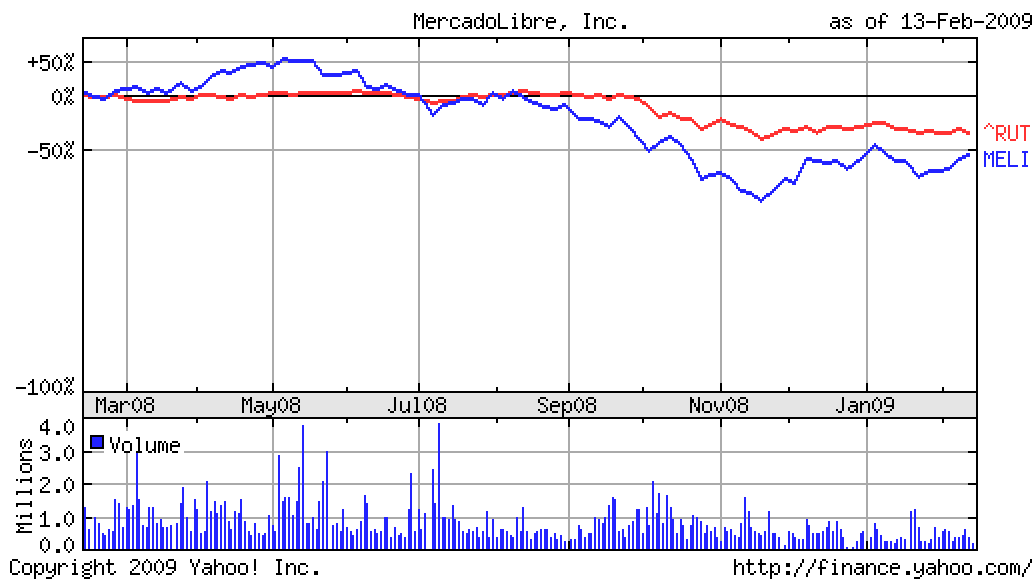
| | | WACC | | | |
|---|---|---|---|---|---|
| | | 9% | 11% | 13% | 15% |
| Terminal Multiple | 6 | $43 | $40 | $35 | $32 |
| | 7 | $50 | $45 | $42 | $38 |
| | 8 | $58 | $53 | $448 | $43 |

**Risks**

- **Credit Availability.** Increased interest rates puts pressure on the purchasing power of customers who finance their online shopping through credit cards. It also increases financing costs for company receivables. Although the company is currently switching from internal to external receivables financing, which will be an increase in costs, the new payments system also passes on interest costs to the customer, which benefits the company in tight credit environments.
- **Continued Economic Pressures.** Suppressed internet growth and economic development in the Latin American region provides a large risk of delaying the company's growth plan.
- **Exchange Rate Fluctuation.** As shown in pre-announced 4Q2008 numbers, the significant decline of Latin American currencies versus the USD has a negative effect on company metrics. In particular, the Argentinean Peso and Brazilian Real foreign exchange rates have a large impact on the company's financials. The company does not currently hedge foreign currencies.
- **Sovereign Risk.** Because the company operates in many different countries across a wide geographic span, its operations are subject to many various laws, regulations, and tax codes. Any significant changes in these regulations could have a material impact on the company's operations.
- **Large Concentration of Shareholders.** As shown in the chart below, roughly 50% of the company is held by only five shareholders. Any material sales of these positions would have a significant detrimental effect in the equity value of MELI.

**Management**

All top executives have been at company since 2000. Marcos Galperin, 37, Co-Founder President and CEO, wrote the MELI business plan while getting MBA at Stanford. He still owns 12% of the company's outstanding common shares. Hernán Kazah, 38, Co-Founder and COO, Nicolás Szekasy, 44, CFO, as well as the two Sr. VP's all have vested options in company.




**Ownership**

| | |
|---|---|
| % Shares Held by Insiders: | 34% |
| % Shares Held by Institutional & Mutual Fund Owners: | 62% |

Source: Bloomberg

**Top 5 Shareholders**

| Holder Name | Shares Held | Percent of Share Outstanding |
|---|---|---|
| EBAY Inc. | 8,126,062 | 18.34% |
| Galperin Macros | 5,391,800 | 12.17% |
| Tiger Global Management, LLC | 4,333,097 | 9.78% |
| General Atlantic, LLC | 3,936,140 | 8.89% |
| TCW Group Inc. | 1,803,320 | 4.07% |

Source: Bloomberg

**ATMI Inc.**
**ATMI**
Price: $13.82 ($8.70-$31.11)
Fiscal Year Ends: December 31

February 11, 2009 Kevin Roloff
Russell 2000 Index: 447.95 (371.30 – 764.38) Hardware Sector

*ATMI is a leading supplier of high performance materials, such as reactant gases, chemicals, and polishing slurries, that are consumed in the manufacturing process of microelectronics. The company also provides patented safe-delivery systems, mixing systems, and high-purity containers. ATMI's target customers include semiconductor manufacturers (81% of 2008 revenue), flat-panel display manufacturers (10%), and biotech companies (9%). ATMI sells and distributes the majority of its products through a direct sales force. Geographically, the company's 2008 revenue of $339M was derived as follows: 64% from Asia, 23% from North America, and 13% from Europe. ATMI employs 761 and has operations in eight countries. The company was founded in 1986 and is headquartered in Danbury, Connecticut.*

**Recommendation**

Most of ATMI's customers are in the semiconductor industry, an industry that is currently plagued by intense competition, oversupply, and thin profit margins. ATMI's products and solutions offer value to customers by maximizing manufacturing process efficiency, reducing capital costs, and shortening product development cycles. Despite the fact that sales fell 8% year-over-year in 2008, management expects to achieve annual long term growth of 15%. The majority of the projected growth is expected to be driven by technological advances in semiconductors. ATMI's customers constantly look for ways to make faster, more advanced, and less expensive products. Increasingly complicated manufacturing processes result in rapidly changing material requirements. ATMI is well positioned to capitalize on the demand for new materials by maintaining working relationships with the world's top chip manufacturers (like Intel and Texas Instruments) and by leveraging its extensive R&D capabilities (11% of 2008 sales). Additionally, as consumers drive semiconductor demand in gaming, computing, networking, and communications, ATMI stands to benefit indirectly from that growth while avoiding the unattractive features of the semiconductor industry. ATMI has relatively few competitors, which is reflected by its healthy margins, and a strong balance sheet with $97M in cash and no long term debt. With chip capacity utilization rates at record lows of less than 50%, it is a relative certainty that ATMI will report losses in the next couple of quarters. However, with an attractive valuation and management's reputation for successfully dealing with cyclical downturns, this stock is being recommended for addition to the AIM portfolio with a target price of $20.00, representing a potential upside of 45%.

| Key Statistics | Feb. 11, 2009 |
|---|---|
| Market Cap | $444.30M |
| Shares Outstanding | 32.149M |
| Ave. Volume (3 month) | 324,642 |
| Adjusted Beta | 1.232 |
| EPS (TTM) | $0.74 |
| 2009 Estimated EPS | -$0.35 |
| P/E (TTM) | 18.68 |
| PEG Ratio | 1.42 |
| WACC | 13.16% |
| Debt/Assets | 0.00 |
| ROE | 7.90% |
| ROA | 7.05% |
| Gross Margin | 49.11% |
| Operating Margin | 11.77% |
| Analyst Coverage | 12 |
| Target Price | $20.00 |

Source: Bloomberg

**Investment Thesis**

- **Management Experience.** Management knows how to deal with the cyclicality of the semiconductor industry. During the correction of 2001, management took actions that subsequently allowed the company to grow at a 14% CAGR through 2007. Since the start of the current correction, management has cut its workforce by 15%, reduced board and executive

compensation, and decreased planned capital expenditures for 2009 to 50% of 2008 levels. With a healthy balance sheet, management was able to increase R&D to 14% of sales in Q4, repurchase $60M of stock, acquire LevTech for $27.4M, and spend $10M on strategic equity investments.

- **Adoption of Copper Wiring.** The migration from aluminum to copper wiring in semiconductors requires many new materials to be developed, such as barriers, insulators, and cleaners. Copper wiring allows for smaller circuits, lower power consumption, and increased IC speed.
- **R&D Capabilities**. With the adoption of high productivity development capabilities, ATMI is able to rapidly screen thousands of materials, identify promising candidates and combinations, and perform dozens of experiments in a short amount of time. The rapid introduction of new products serves as a significant competitive advantage for ATMI.
- **Customer Relationships**. ATMI leverages its ability to improve manufacturers' return on investment to build strategic partnerships with customers. With customers' valuable insight, ATMI's products are produced quickly and precisely to customer specifications. ATMI is also able to glean information about future technological advances in the industry, and they can assess what opportunities those advances may present for the firm.
- **Product Line Differentiation.** While they are still in the early stages, ATMI has strategic plans to realize opportunities in sustainable energy and environmentally-responsible products. Not only will this broaden their customer base and increase revenues, but these new initiatives should dampen the effects that the cyclicality of the semiconductor industry has on the firm's operations.

**Valuation**

Based on five year normalized EPS of $0.75 and a median P/E ratio for the semiconductor equipment industry of 20.43x, a bear case scenario yields an intrinsic value of $15.32. A base case scenario yields a value of $23.86, assuming that the stock trades at a P/E of 25.47x (its lowest P/E from 2002 to 2008) and EPS of $0.80. A bull case assumes that ATMI trades at 33.25x (its average P/E prior to the downturn) with EPS of $0.80, yielding a value of $26.60. Erring on the side of caution in an uncertain market, a price target of $20.00 was established, representing a 45% upside. ATMI does not pay a dividend.

**Risks**

- **Industry Cyclicality.** It is hard to anticipate changes in demand for semiconductors. While ATMI's management had anticipated weak fourth quarter results, a 19% sequential decline in revenue was a surprise to them. The timing and magnitude of a rebound are equally uncertain.
- **Foreign Currency.** Though the majority of the company's sales are in USD, approximately 9% of 2007 revenue was denominated in Japanese Yen. ATMI does use forward foreign currency exchange contracts to hedge the Yen exposure.
- **Supplier Management.** ATMI has hundreds of suppliers that provide various materials used in its business. Many materials can be obtained from multiple sources, but ATMI may rely on a single or limited number of suppliers for certain materials.
- **Competition.** ATMI has a number of competitors that are much larger in scale. Among those competitors are DuPont, Air Products and Chemicals, and Rohm and Haas. ATMI believes that its ability to compete with those companies is grounded in its high-purity liquid materials NOWPak technology and its reputation for innovation.

**Management**

Doug Neugold has been President of ATMI since 2000 and has been the company's CEO since 2005. Doug served as President of Johnson-Matthey's Semiconductor Packages Group before joining ATMI in January 1998 as the VP of an acquired company (NovaSource). Tim Carlson (CPA) was appointed CFO in 2007. Prior to joining ATMI in 2000, Tim served in a number of positions at Campbell Soup Company, including Finance Director, internal audit, strategic planning, and mergers & acquisitions. He also has experience in public accounting with Ernst & Young.

**Ownership**

| | |
|---|---|
| % of Shares Held by Insiders: | 7% |
| % of Shares Held by Institutional & Mutual Fund Owners: | 93% |

Source: Bloomberg

**Top 5 Shareholders**

| Holder Name | Shares Held | Percent of Share Outstanding |
|---|---|---|
| Ziff Asset Management | 2,076,811 | 6.46% |
| Barclays Capital | 2,062799 | 6.42% |
| Westfield Capital | 2,031,098 | 6.32% |
| Jennison Associates | 1,809,110 | 5.63% |
| Artisan Partners | 1,657,800 | 5.16% |

Source: Bloomberg

**Calavo Growers Inc.**
**CVGW**
Price: $14.07 ($6.00-$21.00)
Fiscal Year Ends: October 31

February 12, 2009 — Sarah Schmidt
Russell 2000 Index: $447.95 ($371.30-$764.38) — Consumer Goods Sector

*CVGW procures and markets avocados and other perishable commodities as well as prepares and distributes processed avocado products both domestically and internationally. It operates in two segments: Fresh Products (87% of net sales) and Processed Products (13% of net sales). The fresh products line is comprised of avocados, tomatoes, pineapples, onions, papayas, coconuts and mushrooms. These products are generally grown in California, Mexico, and Chile. The processed products segment produces guacamole and is looking to begin the production of salsas. CVGW sells its products to food distributors, produce wholesalers, supermarkets, and restaurants worldwide. It was founded in 1924 and is headquartered in Santa Paula, CA.*

**Recommendation**

CVGW is the largest packer and shipper of avocados and other fresh produce in the United States. During 2008 CVGW experienced a 19% increase in net sales; and an increase in overall profit of 5%. A significant portion of the revenue increase was seen during the fourth quarter when the United States economy was in the depth of an extreme recession. During the fourth quarter of 2008 CVGW saw its net income quadruple compared to the previous year, from $1M to $4M. CVGW has positioned itself well to continue to grow into the future. It has done so through entering agreement with Limoneira Company, the second largest avocado grower in the United States and by appealing to the rapidly expanding Hispanic population within the US. CVGW distributes an annual dividend of $0.35 per share, which equates to a dividend yield of 2.49%. Therefore, because of CVGW's current position in the market, its fundamentals, and its long term potential, it is recommended that CVGW be added to the AIM Equity Fund at a target price of $18.00.

| Key Statistics | Feb. 12, 2009 |
|---|---|
| Market Cap | $202.87M |
| Shares Outstanding | 14.419M |
| Ave. Volume (3 month) | 48,179 |
| Adjusted Beta | 0.646 |
| EPS (TTM) | $0.54 |
| 2009 Estimated EPS | $0.78 |
| P/E (TTM) | 26.06 |
| PEG Ratio | 0.81 |
| WACC | 7.21% |
| Debt/Assets | 0.2735 |
| ROE | 11.07% |
| ROA | 5.88% |
| Gross Margin | 9.18% |
| Operating Margin | 3.39% |
| Dividend Yield | 2.49% |
| Analyst Coverage | 2 |
| Target Price | $18.00 |

Source: Bloomberg

**Investment Thesis**

- **Leading Market Share.** CVGW is the leading packer, grower, and shipper of fresh avocados in the United States. In 2008 CVGW handled 28% of the California avocado crop, 37% of the avocados exported from Mexico, and 6% of Chilean crop. The company is looking to increase its market share in the future. In June 2005 CVGW entered into a joint marketing and growing agreement with Limoneira Company, which is California's second largest avocado producer.
- **Larger Consumption of Avocados in the US.** Over the past ten years avocado consumption in the US has more than doubled. During that time period the US became the largest importer of avocados. One of the main reasons for the increase in avocado consumption is the health benefits contained in the fruit. Research has shown that avocados can help regulate blood pressure, prevent heart disease and stroke, and protect against various types of cancers.
- **Growing Hispanic Population Within the US.** The Hispanic population currently accounts for approximately 15% of the US population and is expected to triple by 2050. Avocados are

considered a staple item purchased by Hispanic consumers. Research conducted by the World Avocado Congress shows that 96% of Hispanics in the US buy avocados at least once a year, while 60% purchase them on a weekly basis. On average the Hispanic population buys approximately five avocados per purchase.

- **ProRipeVIP Avocado Ripening Program.** This program allows CVGW to deliver avocados that are evenly ripened according to its customers' specifications, which allows CVGW's customers to accelerate the sale of the avocados through their stores. CVGW uses an Aweta AFS (acoustic firmness sensor), which measures the firmness of the entire piece of fruit. This program gives CVGW a competitive advantage over its competitors, who use less accurate mechanical tests, which uses pressure and calculated averages to measure firmness.
- **Strong Fourth Quarter.** During the fourth quarter of 2008 while the United States was in the midst of a recession CVGW had a 72% increase in its gross profit from the previous year. 59% of this increase can be attributed to the Fresh Product segment, namely tomatoes, pineapples, and mushrooms which proved to be solid revenue drivers.

**Valuation**

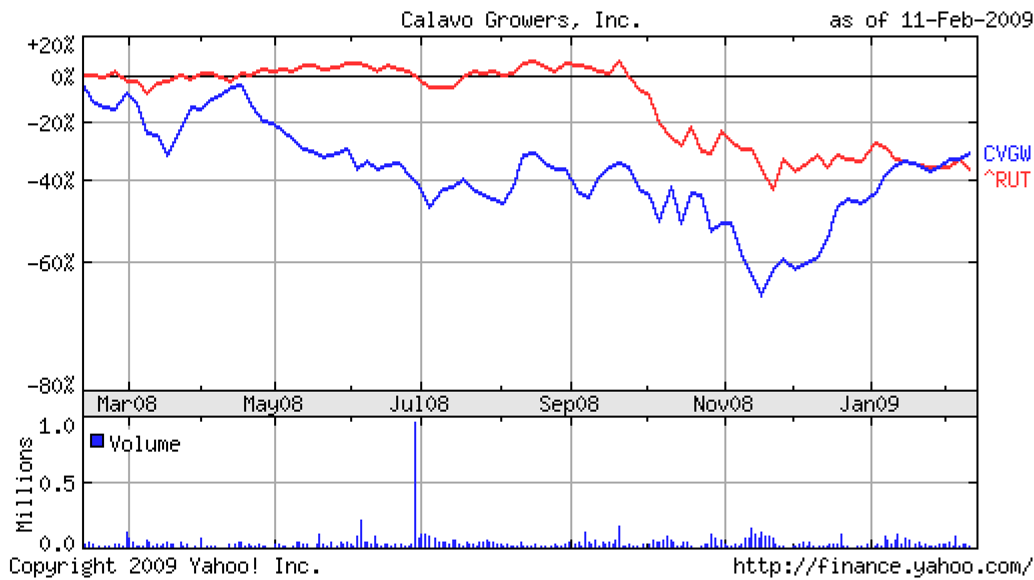
The $18.00 price target is supported by a DCF valuation and a Dividend Discount Model. A 5-year DCF yielding $18.27 per share was computed using a growth rate of 5.50% and a conservative WACC of 7.21%. A sensitivity analysis adjusting for assumptions in WACC and long-term growth potential gave a price range between $14.95 and $20.55 per share. The Dividend Discount Model yielded an intrinsic value of $20.91. Considering the valuation metrics and company guidance, an $18.00 price target was reached, which offers a 28% upside in addition to the 2.49% dividend yield.

**Risks**

- **Poor Avocado Crop.** A poor avocado crop out of California or Mexico could have a negative impact on CVGW's net sales. If there is a limited supply of avocados in the market, CVGW will have to increase its prices, which could likely cause consumers to reduce their purchases of avocados especially given the current economic conditions both in the US and worldwide.
- **Intense Competition from other Avocado Handlers.** Even though CVGW currently holds the largest market share, it has numerous competitors who are looking to overtake it. CVGW must consistently pay its growers a competitive price for their avocados or these growers will chose to sell to one of CVGW's competitors.
- **Inherent Farming Risks.** Inherent farming risks can have a negative impact on the supply of avocados. The main farming risks that exist are adverse weather and growing conditions, pest and disease problems, and government regulations on farming. CVGW has hedged against these farming risks by varying the countries where it grows its avocados.

**Management**

Several of CVGW's board members and top executives have extensive experience within the avocado industry. Lecil Cole (CVGW's Chairman, CEO, and President) has been affiliated with the company since 1982 and grows avocados and papayas on 4,400 acres of land in California. Robert Wedin (Vice President) has been with CVGW since 1973 and has previously served a ten year term as the Director of the California Avocado Commission.




**Ownership**

| | |
|---|---|
| % of Shares Held by Insiders: | 26% |
| % of Shares Held by Institutional & Mutual Fund Owners: | 25.08% |

Source: Bloomberg

**Top 5 Shareholders**

| Holder Name | Shares Held | Percent of Share Outstanding |
|---|---|---|
| Lecil Cole | 1,695,492 | 11.76% |
| Limoneira Co. | 1,000,000 | 6.94% |
| Babson Capital | 610,000 | 4.23% |
| Leavens J. Link | 474,665 | 3.29% |
| Barclays Global | 462,366 | 3.21% |

Source: Bloomberg

**eHealth**
**EHTH**
Price: $13.95 ($8.38-29.13)
Fiscal Year Ends: December 31

February 13, 2008
Russell 2000 Index: 448.36 (371.30-764.38)

Kyle Zabel
Financial Services Sector

*As the leading online source of health insurance for individuals, families, and small businesses in the US, eHealth's e-commerce platform enables consumers to research, analyze, compare, and purchase health insurance products that best meet their needs. The firm simplifies and streamlines the traditionally complex, lengthy, and paper-intensive process of acquiring health insurance. Revenues are primarily in the form of monthly commissions from partnered insurance carriers. EHTH currently offers the most extensive line of health insurance products (over 10,000) from a network of over 175 leading insurance carriers across the country. Rather than underwrite risk, ETHH provides existing carriers an additional distribution channel. The Mountain View, CA, company was founded in 1997, went public in 2006, and is an officially licensed insurance provider in all fifty states.*

**Recommendation**

EHTH represents one of the few attractive growth plays remaining in the small-cap financial services sector amidst challenging economic conditions. While its complex, robust online platform and its scalable, efficient business model are largely responsible for EHTH's impressive 38% revenue CAGR over the last five years, the company's greatest assets may be its strong carrier partnerships as a result of first mover advantage. Technologically integrated with many of the top individual healthcare providers, EHTH holds a firm position in a growing industry. Individual & Family insurance plans (IFPs) are seeing increased demand as workers lose jobs and some small business owners cannot afford to provide coverage to employees. The real value-add in EHTH's business comes from the health insurance industry's regulated, fixed-pricing environment. Because plans/products must be sold at set prices, it does not matter whether someone buys from a traditional broker/agent, direct from a carrier, or through EHTH's website. As a consumer, the only way to achieve true affordability is to view and compare all products in the marketplace. EHTH provides such a platform, and a 31% CAGR for new membership over the past five years shows the positive consumer response. Trading well below target price, EHTH is recommended as an addition to the AIM Equity Fund.

| **Key Statistics** | **Feb. 13, 2008** |
|---|---|
| Market Cap | $349.83M |
| Shares Outstanding | 25.08M |
| Avg. Volume (3 mo.) | 69,171 |
| EPS (ttm) | $0.55 |
| EPS 2009 Est. | $0.60 |
| P/E (ttm) | 25.4x |
| Member growth (y/y) | 19.81% |
| Revenue growth (y/y) | 27.22% |
| Operating Margin | 19.03% |
| ROE | 9.75% |
| Debt/Assets | 0.00 |
| Beta | 1.10 |
| WACC | 10.70% |
| Analyst Coverage | 11 |
| Target Price | $20.00 |

Source: Bloomberg, EHTH Financials

**Investment Thesis**

- **Market potential.** EHTH is the dominant online player in an extremely underpenetrated market for affordable individual health insurance. With an estimated addressable market of 115M potential members, EHTH currently has less than 4% market share versus more traditional sources of insurance. This presence will grow as the secular shift toward individual/family products continues. There are currently about 50M uninsured Americans and 40% of EHTH's new applicants come from the previously uninsured population.
- **Robust technology platform.** A key to EHTH's success has been its proprietary e-commerce platform that brings together functionality, scalability, and ease of use. 80% of all business transacted at www.ehealth.com requires no human interaction, clearly demonstrating the system's power. A

major growth driver will be the newly introduced 'eApproval' technology which allows for application review, approval, signature, and delivery in just minutes. This drastically reduces time to coverage and increases the likelihood of member acquisition.

- **Impressive business model.** Revenues are smooth and visible with recurring monthly premium commissions while EHTH's fixed cost base remains relatively static. High operating leverage exists because of long average customer lives (2 years), favorable member acquisition costs ($65 per new member), extensive online scalability, and low capital requirements in terms of both labor and infrastructure (440 total employees and only about $2M in annual Capex).
- **Strong balance sheet/cash flows.** EHTH has an abundant supply of cash/equivalents ($150M) and no debt, both of which are extremely favorable in this economic environment. The business model also provides healthy free cash flow generation (16% of revenues). Management recently announced a share repurchase agreement of ~$30M to put some of their extra cash to use.

**Valuation**

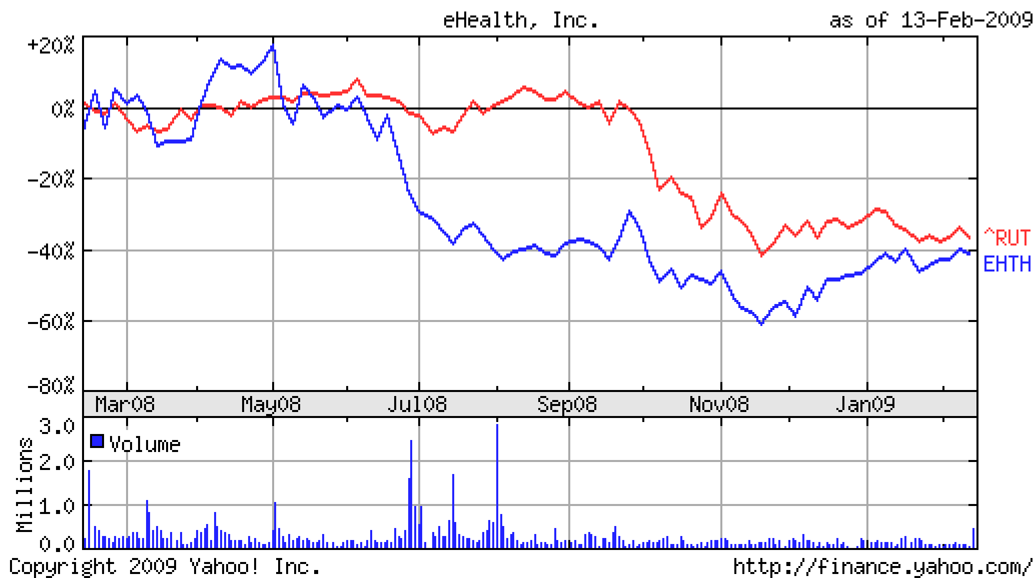
EHTH is currently trading at 25.4x TTM EPS. A conservative historical P/E average of 30x estimated 2009 EPS of $0.60 yields an $18.00 price target. Based on a 7-year DCF analysis with a WACC of 10.70% and terminal growth rate of 3%, an intrinsic value of $20.95 per share was obtained. A sensitivity analysis adjusting both terminal growth rate (2-4%) and WACC (10-12%) generates a price range of $17-$25. Due to near-term consumer headwinds and unclear medium-term governmental policy, a price target of $20.00 per share has been set. This yields a 43% return.

**Risks**

- **Economic headwinds.** While rising unemployment brings more potential customers into EHTH's target market, the length and depth of this recession may cause some individuals to forgo health insurance altogether in order to preserve cash. Even assuming demand increases for short-term roll-over products, EHTH has not been public long enough to demonstrate true resilience during a deep recession.
- **Heath care reform.** Mandated health coverage run by a government-sponsored national insurance exchange would be the worst-case scenario for EHTH, but such drastic reform is both impractical and unaffordable during Obama's first term (according to EVP of Public Policy Government Affairs, John Desser, who has been involved in several recent discussions with Obama's staff). Likely reforms, however, would be those that can leverage technology and the existing private-system to make health care more affordable (through subsidies, tax relief, etc). This plays exactly to EHTH's strengths and could actually be a positive catalyst in the future.
- **Carrier concentration.** UnitedHealthcare, Wellpoint, and Aetna contributed to 48% of EHTH's 2008 revenue. Damaged relationships, lost contracts, or carrier consolidation would be devastating to future business; however, many of these partner carriers are embedded technologically and receive a large share of their new applicant inflows from EHTH.
- **Competition.** If other new or existing e-commerce firms can somehow license themselves nationally, replicate EHTH's robust platform, and impede on EHTH's growing brand recognition; this would indeed pose a challenge to the profitability and pricing potential of the industry.

**Management**

Gary Lauer, with a rich technology and finance background, has been CEO since 1999. Dr. Sheldon Wang has also been with the firm since 1999 as EVP of Technology. Chief of Business Operations Bruce Telkamp, CFO Stuart Huizinga, and Sales President Sam Gibbs all started with the company in 2000. This seasoned management team is directly responsible for the growth and success of eHealth over the past decade. Management has a strong vision: "To be the online distribution standard through which all individuals and businesses can find and purchase the right health insurance." They also correctly recognize eHealth's position as an e-commerce business first and foremost.




**Ownership**

| | |
|---|---|
| % Shares Held by Insiders: | 26% |
| % Shares Held by Institutional & Mutual Fund Owners: | 76% |

Source: Bloomberg

**Top 5 Shareholders**

| Holder Name | Shares Held | Percent of Share Outstanding |
|---|---|---|
| T. Rowe Price Associates | 2,642,258 | 10.54% |
| Capital Research Global Investors | 2.085,000 | 8.31% |
| Capital World Investors | 1,830,000 | 7.30% |
| Questmark Partners LP | 1,743,982 | 6.95% |
| J.P. Morgan Chase & Co. | 1,720,951 | 6.86% |

Source: Bloomberg

**HealthSpring, Inc.**
**HS**
Price: $15.62 ($12.18-22.63)
Fiscal Year Ends: December 31

February 13, 2009 Maggie Hughes
Russell 2000 Index 442.68 (371.30-764.38) Healthcare Sector

*HealthSpring, Inc. is a managed care organization in the United States, specifically operating a government-approved Medicare Advantage (MA) program. Historically MA programs offered more benefits than traditional fee-for-service Medicare, while improving the cost structure by leveraging economies of scale. In addition to its prominent MA segment, HS also offers a stand-alone Prescription Drug Plan (PDP). The Center for Medicare and Medicaid Services (CMS) biannually revises its risk adjusted payment system, which accounts for revenue on a per enrollee basis. These Medicare premiums accounted for 94% of 2007 revenue. As of December 2008, the company served 162,000 Medicare members and had 282,000 PDP participants. HS offers its MA plan in Tennessee (32%), Texas (26%), Alabama (18%), Florida (17%), Illinois (6%) and Mississippi (1%). HS also has a small (<1% premium revenues) commercial health plan segment in Alabama and Tennessee. HS was founded in 2000 and IPOed in 2006; it currently employs 1,663 people and is headquartered in Franklin, TN.*

**Recommendation**
Unlike some of HealthSpring's larger competitors, they are truly focused on offering improved Medicare services and additional benefits. HS has opened Living Well Centers to better accommodate older, less mobile patients and improve service offerings, a distinguishing factor compared to other MA programs. HS is a young company, having IPOed in 2006. Their large cash balance and consistent free cash flow generation will assist them in future growth initiatives; however, due to the uncertainty of possible healthcare reform and government funding adjustments, the entire Managed Care industry has recently been oversold. Although there are prominent near-term headwinds, HS's focus on quality care and effective cost containment should continue to spur growth as the company matures. In addition, the AIM Healthcare sector does not have any exposure to the Managed Care industry, and HS will be a crucial holding as the United States looks to cut its healthcare costs while maintaining quality. Therefore, it is recommended that of HS be added to the AIM Equity Fund with a target price of $21.

| Key Statistics | Feb. 13, 2009 |
|---|---|
| Market Cap | $880.31M |
| Shares Outstanding | 55.90M |
| Ave. Volume (3 month) | 639,373 |
| Adjusted Beta | 0.87 |
| EPS (TTM) | $2.12 |
| 2009 Estimated EPS | $2.13 |
| P/E (TTM) | 7.37 |
| PEG Ratio | 0.60 |
| WACC | 11.28% |
| Debt/Assets | 19.93% |
| ROE | 16.73% |
| ROA | 8.82% |
| Gross Margin | 21.41% |
| Operating Margin | 8.77% |
| Payout Ratio | NA |
| Analyst Coverage | 10 |
| Target Price | $21.00 |

Source: Bloomberg

**Investment Thesis**

- **American Recovery and Reinvestment Act of 2009.** Although the $819 billion stimulus bill that was passed on February 13 does not have an explicit impact on the United States Medicare system, $117 billion was allotted for healthcare initiatives. Most of this funding is going towards an expansion of the Medicaid and COBRA systems to those recently unemployed and uninsured. 10 million Americans could be added to the federal health system in the next month, adding an estimated $1.2 billion to 2009 Medicaid costs. Given both the cost and participant increases, it will be difficult for the government to maintain sufficient, quality care. HS and other managed care organizations may benefit from the misalignment of patients and necessary care.

- **Quality Care Initiatives.** HS is opening Living Well Health Centers to improve the quality and cost-effectiveness of patient care. There are currently three operational clinics, each designed specifically to accommodate the Medicare-age population; these facilities improve service levels and patient satisfaction. The company believes they can capitalize on the deterioration of fee-for-service Medicare with these unique service centers, not offered by industry competitors.
- **Near-Term Medicare Growth.** With the continued aging of the 78 million baby boomer population in the United States, the demand for Medicare will steadily increase. By 2025, 20% of the population will be Medicare participants versus the current 14% level. These participants will strain the financial ability of the program, while trying to maintain adequate care. Medicare Advantage programs will capitalize on this overflow of participants, as they can better monitor quality of care and offer additional benefits compared to the strained fee-for-service Medicare.
- **Balance Sheet.** HS boasts an impressive balance sheet with ample liquidity ($282M in cash in 2008) to support their expansion initiatives. Historically HS has increased its geographic and member exposure by acquiring smaller, local HMOs. Recently they acquired Florida-based MA, LMC Health Plans, for $355M in cash. Consistent historical free cash flow ($150M in 2008) instills confidence that the company will be able to continue funding these ventures**.**

**Valuation**

HS is currently trading at 7.4x TTM EPS of $2.15. Two year historical P/E ranges from 8.80-15.60x TTM earnings, so a conservative 10.5x my 2009 EPS estimate of $2.04 yielded a $21.46 price target. A 5 year DCF analysis with a computed WACC of 11.28% (1.5% margin of safety included) and a terminal growth rate of 1.50% yielded an intrinsic value of $25.77. A sensitivity analysis that adjusts both the long-term growth rate (1-2%) and the WACC (9.28-10-28%) generates a price range of $24.52-$35.72. Due to the near-term uncertainty in the Medicare Advantage industry along with potential government intervention, a conservative price target of $21 per share was set. With the stock currently trading around $15, this $21 price target would yield a 40% return.

**Risks**

- **Decrease in Medicare Advantage Subsidy.** The Medicare Advantage program currently costs the Federal government 12% more than the cost of its traditional fee-for-service Medicare program. There is negative sentiment surrounding this premium, as some officials believe this reimbursement rate should be at parity with fee-for-service Medicare. Should the government decrease its MA subsidy, the industry would experience significant margin compression.
- **Government Funding Dependence.** 94% of 2007 total revenue was derived from Medicare premiums (including PDP) funded by the Federal government. These reimbursement rates have recently come under political pressure and will negatively impact revenue if contracted.
- **CMS Adjustments.** Every two years, CMS revises its risk adjustment payment system that aims at improving the accuracy of payment and incentivizes MA programs to treat higher risk patients. In 2007, 100% of MA revenue was derived from this risk-based premium; if patient risk level varies drastically from this national benchmark rate, profitability will be compromised.
- **National Healthcare Reform.** In addition to government spending risk, any structural or policy changes to the current healthcare system pose significant risk to the entire Medicare Advantage industry. The lack of detail regarding the new administration's healthcare reform makes it difficult to quantify any changes but instead must be monitored on a go-forward basis.

**Management**

Herbert Fritch (59), current Chairman of the Board of Directors and CEO, boasts over 30 years of experience in the managed care industry; he served as an executive for HealthSpring's predecessor, NewQuest, LLC since 2000. HS has recently experienced notable management turnover with the resignation of CFO, Kevin McNamara (52) and the appointment of Michael Mirt as president.

**Ownership**

| | |
|---|---|
| % of Shares Held by Insiders: | 14.53% |
| % of Shares Held by Institutional & Mutual Fund Owners: | 98.14% |

Source: Bloomberg

**Top 5 Shareholders**

| Holder Name | Shares Held | Percent of Share Outstanding |
|---|---|---|
| Fritch Herbert | 4,208,039 | 7.19% |
| Barclays Global Investors UK | 3,261,647 | 5.57% |
| Lord Abbett & Co. | 2,540,087 | 4.34% |
| Fidelity Management & Research | 2,399,910 | 4.10% |
| Wellington Management Co., LLP | 2,099,685 | 3.59% |

Source: Bloomberg

**Mueller Water Products**
**MWA**
Price: $3.34 ($3.06-12.71)
Fiscal Year Ends: September 30

February 13, 2009 | Andy Parker
Russell 2000 Index: $450.42 ($371.30-764.38) | Industrial Materials Sector

*Mueller Water Products manufacturers and markets products used in water distribution networks and water treatment facilities. MWA operates in three business segments: Mueller Co. (39% of 2008 revenue); U.S. Pipe (29% of 2008 revenue); and Anvil (32% of 2008 revenue). Mueller Co. manufactures fire hydrants and engineered valves. U.S. Pipe produces ductile iron pipe and generally sells its products directly to municipalities. Anvil manufactures pipe accessories such as fittings, couplings, and supports. Anvil uses distributors to market its products to the end user. MWA manufactures and markets its products almost exclusively in the US and Canada to customers in three end markets: residential construction (30%), non-residential construction (30%) and municipal projects (40%). The three business segments were spun-off from Walter Industries in 2006 to form Mueller Water Products. The company employs 6,000 full time employees and is headquartered in Atlanta, GA.*

**Recommendation**

MWA's stock price dropped almost 50% after the company released Q109 earnings in early February. MWA reported adjusted EPS of $0.00 and a goodwill impairment charge of $400M. Management guided lower for Q209 pushing consensus EPS estimates to ($0.04) from $0.04. The market is now concerned the company will break through debt covenants later this year. MWA recently lowered executive pay by 20% and temporarily suspended operations at a few of their plants to match production with demand. With the doomsday scenario of failed debt covenants already priced into the stock, MWA looks very attractive at its current price. Though fear of failing the debt covenant is real, the market has overreacted. MWA is still the market leader in water distribution products, an industry with tremendous staying power. Management expects revenue to grow at a 5% CAGR for the next 5 years. Supporting this claim is an estimated $1 trillion in repairs and replacement needed in the next 20 years to modernize the US water infrastructure system. The company's business model remains solid providing FCF of $94M last year. MWA is expected to generate FCF around $100M in 2009 after favorable adjustments in working capital. With a $5.00 target price, MWA is recommended for addition to the AIM Fund.

| Key Statistics | Feb. 13, 2009 |
|---|---|
| Market Cap | $386.14M |
| Shares Outstanding | 115.61M |
| Ave. Volume (3 month) | 1,064,440 |
| Adjusted Beta | 1.30 |
| EPS (TTM) | $0.39 |
| 2009 Estimated EPS | $0.12 |
| P/E (TTM) | 8.56 |
| Dividend Yield | 1.90% |
| WACC | 8.71% |
| Debt/Equity | 1.20 |
| ROE | (32.12)% |
| ROA | (12.82)% |
| Gross Margin | 20.40% |
| Operating Margin | 3.45% |
| Analyst Coverage | 13 |
| Target Price | $5.00 |

Source: Bloomberg

**Investment Thesis**

- **Strong franchise still exists.** 75% of 2008 revenue came from products that have a leadership position in their respective markets. MWA products are compatible with water systems in the nation's 50 largest metropolitan areas. Management claims to have the largest installed base in the country for many water system markets (3M hydrants and 9M iron valves), which positions them well for aftermarket business with brand recognition and strong customer relationships.
- **Long term demand for products**. Water distribution systems are deteriorating nationwide. Last month, the American Society of Civil Engineers graded the US water infrastructure at a D-minus.

The EPA estimates that the US will need to spend around $1 trillion within the next 20 years to ensure safe, drinkable water. Two-thirds of this amount is scheduled specifically for water distribution, the market MWA serves. As a rare "pure-play" on water infrastructure, MWA is set to benefit as a leader in a very attractive market.

- **Volume to grow with seasonality and stimulus.** The 20% quarterly drop in state and local spending cannot be sustained and was likely slowed in anticipation of an economic stimulus bill. State and local government spending has declined in only two quarters since 1960, and in both cases spending bounced back in the next quarter. The current stimulus has about $6.5B set aside for water infrastructure development. Although it is tough to define exactly how much MWA will benefit from the current stimulus package, two things are certain: 1) the package will improve the financial health of state and local governments, and 2) bringing closure to the stimulus discussion will release municipal spending from the holding pattern it has assumed in anticipation of the bill.
- **Margins set to expand with more volume and more efficient production.** Q1 operating margin was 3.5% compared to 7.9% last year. The decline was due in large part to lower volume and the higher cost of raw materials. MWA uses FIFO, so materials purchased at peak prices last summer are not completely off the books. Management expects to see a $20M reduction in raw material costs from Q109 to Q209. Also, automated manufacturing operations at a state-of-the-art ductile iron pipe plant in Alabama will be fully functional in FY09, helping US Pipe margins.

**Valuation**

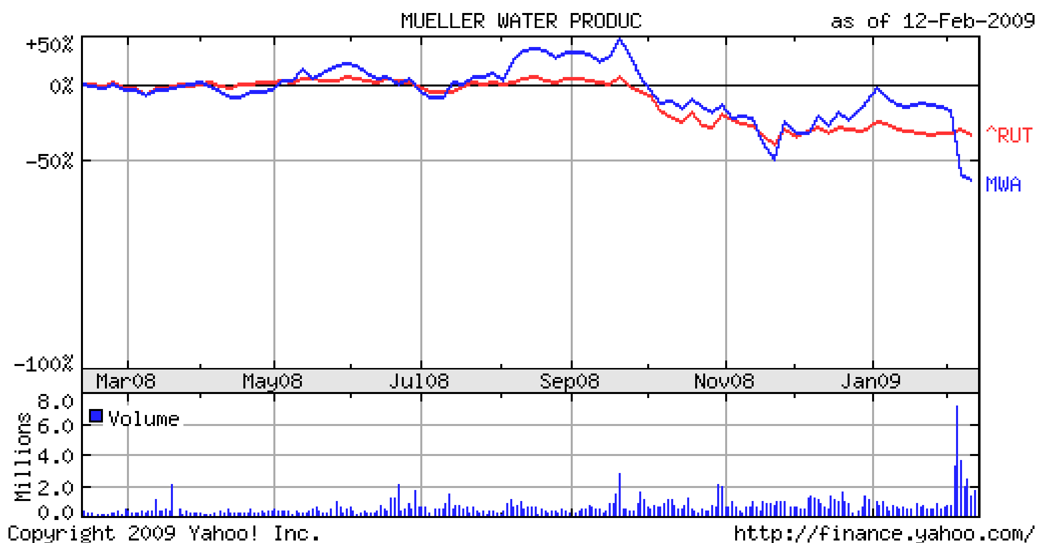
Using a terminal growth rate of 3.5% and a calculated WACC of 10.07%, my DCF model valued MWA's shares at $5.47 in the base case. A sensitivity analysis on my DCF returned a price range of $4.07-7.76 when adjusting the long term growth rate from 3.0-4.0% and the WACC from 9.5-10.5%. An EV/EBITDA valuation generated a price estimate of $5.55, using a 7x multiple versus a 7.8x historical average. Given the near-term uncertainty, a conservative target price of $5 appears reasonable. The $5 price target would yield a 50% return at the current stock price of $3.34.

**Risks**

- **Slowed construction spending.** Construction, both residential and commercial, drives over 50% of MWA sales. Housing starts are expected to decline 5% in 2009. The Architectural Billings Index, a leading indicator of non-residential construction, hit an all-time low last November.
- **Debt Covenant Issues.** MWA is dangerously close to breaking through its debt covenant of a 5.0x leverage ratio (net debt/EBITDA ttm). At the end of Q109, MWA's leverage ratio was 3.8x. They expect to feel more pressure toward the end of FY2009 as new Q3 and Q4 numbers replace stronger 2008 numbers. MWA needs to maintain an estimated $175-180M in EBITDA(ttm) to stay below 5.0x. Even the most bearish analysts predict 2009 EBITDA at $190M. MWA reported EBITDA of $262.5M, $311.4M, and $257.5M in FY06, FY07, and FY08, respectively.
- **Fluctuations in raw material costs.** MWA operations require large amounts of scrap iron, steel, brass, and other raw materials. Price increases in 2008 had a detrimental effect on margins and overall firm profitability and serve as a future risk.
- **Competition from low cost manufacturers abroad.** MWA competes with lower cost foreign producers in their Anvil segment particularly. This competition could potentially have a negative effect on pricing and margins.

**Management**

Current Chairman and CEO Gregory Hyland has years of industry experience. He previously served as CEO of MWA's former parent company, Walter Industries. CFO Jeffery Sprick was hired when Walter Industries spun off MWA to help with the new public filing responsibilities. Bonuses make up a large part of management compensation. Management has displayed their long term focus by investing in low-cost manufacturing processes amidst current short-term pressures.




**Ownership**

| | |
|---|---|
| % of Shares Held by Insiders: | 2.3% |
| % of Shares Held by Institutional & Mutual Fund Owners: | 43.5% |

Source: Bloomberg

**Top 5 Shareholders**

| Holder Name | Shares Held | Percent of Share Outstanding |
|---|---|---|
| Fairholme Capital Management | 6,986,500 | 6.04% |
| Barclays Global Investors UK | 5,054,318 | 4.37% |
| Pictet Asset Management | 4,484,630 | 3.88% |
| KBC Group | 3,610,951 | 3.12% |
| Keeley Asset Management | 2,743,130 | 2.37% |

Source: Bloomberg

**VASCO Data Securities**
**VDSI**
Price: $7.13 ($6.11-19.15)
Fiscal Year Ends: December 31

February 11, 2009 — Andy Verchota
Russell 2000: 447.95 (371.30-764.38) — Software Sector

*Vasco Data Security provides Strong Authentication Solutions for global clients in financial, educational, and governmental institutions. VDSI products include DIGIPASS tokens, VACMAN Middleware, and aXs Guard Authentication. Distributed through direct and distributor sales channels, VDSI holds a customer base of thousands in two key verticals, banking (80%) and enterprise (20%). They provide hardware and software solutions to secure transactions and data for users. Through development of user-friendly and cost-effective products, VDSI stands to capitalize on increased regulation to secure internet banking and data access. VDSI has used their expertise in the banking sector to expand into over 100 countries. Founded in 1997, VDSI is headquartered in Oakbrook Terrace, IL.*

**Recommendation**

VDSI maintains dominant market share of Strong Authentication Solutions in the banking industry (referred to as a vertical market), driving growth in the ~$3B internet security industry. Market expansion has been inhibited by RSA, a subsidiary of EMC, who holds dominant market share in enterprise solutions. With economically priced products, VDSI has begun focusing on expansion into the enterprise market to diversify away from the volatile banking sector. VDSI has recorded strong financial performance over the past two quarters (revenue growth of 32.45% and 9.15% in Q3 and Q2, respectively). Further, VDSI has shifted product mix towards software sales, away from hardware units, providing margin improvement (70.1% GM in 3Q08 from 66.6% 3Q07). In a preannouncement of 2008 earnings, management lowered revenue guidance citing delayed orders and slowed market spending (9-12% revenue growth down from 15-25%). A recent selloff in the stock, presents an interesting entry point; however, due to a lack of visibility in the banking vertical, it is recommended VDSI be put on the software watch list for the AIM Equity Fund.

| Key Statistics | Feb. 11, 2008 |
|---|---|
| Market Cap | $266.20M |
| Shares Outstanding | 37.34M |
| Ave. Volume (3 month) | 329,322 |
| Adjusted Beta | 1.054 |
| EPS (TTM) | $0.65 |
| 2009 Estimated EPS | $0.62 |
| P/E (TTM) | 10.80 |
| P/E (2009) | 11.69 |
| WACC | 13.12% |
| Debt/Assets | 0.00 |
| ROE | 30.95% |
| ROA | 22.86% |
| Gross Margin | 70.11% |
| Operating Margin | 28.81% |
| Analyst Coverage | 8 |
| Target Price | $9.00 |

Source: Bloomberg

**Investment Thesis**

- **Infiltration of US Market.** Many US banks have highlighted the customer acceptance and cost effective benefits of online banking. VDSI offers solutions to ensure customers in B2B transactions that their personal information will remain safe. A TowerGroup study in 2007 stated that US online banking is growing 27% annually. Outside of the US, 50% of revenues are generated from consumer banking solutions. Although VDSI holds one thousand banking clients internationally, their penetration of the US market has lagged. Only 38 of the top 100 banks do business with VDSI at present date. As the regulatory environment intensifies, more banks could look towards VDSI products to capture customer confidence.
- **Market Creation.** In management's recent conference call they expressed a need to expand operations in developing markets to sustain a steady growth profile. In 3Q08, 92% of revenues

were generated outside the US highlighting VDSI's ability to create markets across the globe. VDSI's business model is based on establishing a foothold in new markets through their banking vertical. Once inroads have been established, VDSI begins marketing to the enterprise vertical where they serve other institutions with sensitive data (e-commerce, university, and gaming).

- **New Opportunities.** BRIC countries have been highlighted as a significant opportunity. In China, 7 out of 8 banks licensed to do business are VDSI customers. Recently, VDSI has been successful converting new business from outside their core markets, generating over $9M in revenues from "other markets", a 200% increase yoy. As regulation of these new markets increases, the demand for VDSI products will likely follow.
- **Regulatory Mandate.** The Federal Financial Institutions Examination Council (FFIEC) is a governing body of acceptable banking practices. The FFIEC has been on the forefront of setting standards for security in online banking. In October 2005, the FFIEC determined that single-factor authentication had been deemed "inappropriate" to protect customer information. Single-factor authentication involves having a static user name and password. Using VDSI products, one time passwords (OTPs) can be used to limit the effectiveness of phishing and keytracking attempts by internet hackers. Businesses participating in large transactions can utilize VDSI's hardware and software technology to secure payments.

**Valuation**

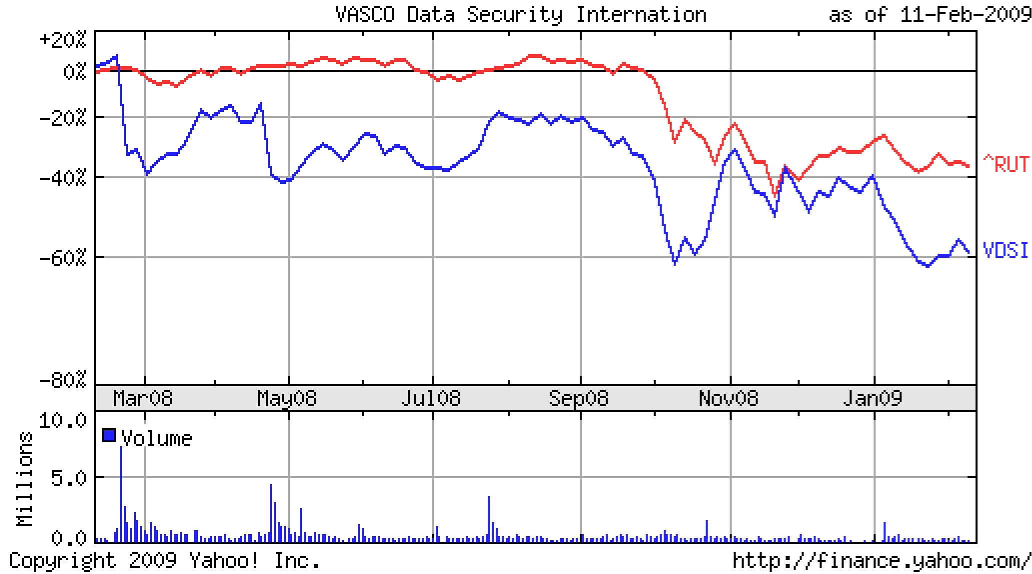
VDSI is currently trading at 10.8X TTM EPS of $0.65, a significant discount to an industry multiple of 16.0X. A discount P/E multiple of 14.5X expected 2009 EPS of $0.62 yields a $9.00 price target. Utilizing a ten-year DCF, a price target range of $7.64-11.10 was yielded. Management has guided revenue growth of 9-12%, which was assumed in each DCF scenario. In a base case scenario, revenue growth expectations were capped at 20%, resulting in a price target of $9.10.

**Risks**

- **Financial Industry Dependence.** VDSI has sustained the greater portion of their growth through a significant dependence on the banking industry. In Q3 2008, 82% of revenues were generated within the banking vertical. Historical levels have hovered around 80%, recently peaking in Q2 2007 at 87%. Well observed struggles within the banking industry pose a significant threat to VDSI's installed base. HSBC, Rabobank, ING Bank, Fortis Bank, and Wachovia are existing VDSI customers. Notably, Wachovia's ongoing merger with Well Fargo presents risk and opportunity for VDSI. Management cites the opportunity to expand their customer base during this period of consolidation, while the risk of cancellation persists.
- **Customer Concentration.** Although VDSI's management touts thousands of customer relationships, a small collection comprise a significant portion of revenues. The top ten customers provided 45% of revenue in the first nine months of 2008 compared to 46% in 2007. Many of these customers are the large banks previously discussed and a loss of these customers would have significant adverse effects on the growth of VDSI.
- **Currency Risk Assessment.** In Q3 2008 95% of total revenue and 74% of operating expenses were generated outside the United States. Since customers are billed in the local currency, revenues values may fluctuate if there are currency shifts relative to the US Dollar. Weakness in the US Dollar compared to the Euro and Australian Dollar resulted in additional revenue of $1.775M. With recent strength in the USD/Euro exchange rate, Q4 earnings will be susceptible to depressed billing values. The company does not participate in any currency hedge strategies.

**Management**

Ken Hunt has served as CEO since November 2002, following another term that ended in June 1999. Hunt has been involved in numerous early-stage tech companies, providing relevant experience to VDSI. Jan Valcke, President and COO, has held an officer position with VDSI since 1996. Clifford Bown has served as CFO since 2002, providing a strong auditing background. Collectively, management has vision and experience regarding the VDSI business model.




## Ownership

| | |
|---|---|
| % of Shares Held by Insiders: | 25% |
| % of Shares Held by Institutional & Mutual Fund Owners: | 41% |

Source: Yahoo! Finance

## Top 5 Shareholders

| Holder Name | Shares Held | Percent of Share Outstanding |
|---|---|---|
| Cortina Asset Management | 1,474,430 | 3.95% |
| Barclays Global Investors UK | 1,317,222 | 3.53% |
| UBS Global Asset Management | 921,934 | 2.47% |
| Vanguard Group | 916,026 | 2.45% |
| Smith Asset Management Group | 797,689 | 2.14% |

Source: Yahoo! Finance