OUR BEST IDEAS NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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Valuentum Securities Inc.
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Portfolio Return	Benchmark Return	Outperformance
37.8%	10.8%	27.0%

Portfolio Inception Date: May 17, 2011

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Waiting Patiently to Put More Cash to Work

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Recent warnings from global bellwethers like Intel (INTC), FedEx (FDX), Caterpillar (CAT), and concerns about a recession in most of the Eurozone, a slowdown in China, and the coming fiscal cliff have barely moved the market lower from its recent highs. Though we believe the US economy remains resilient (the September Beige Book was telling) and our portfolio is heavily concentrated in pockets of strength (aerospace, payment processing, US automotive), we continue to anticipate that an overreaction to concerns is looming and that a larger correction may be on its way. Still, with a 26% cash position in our portfolio (driven by significant profit taking), we're anxiously awaiting any meaningful pullback to scoop up a couple high-VBI stocks on the cheap (see page 18). Over the long-term, we think the market remains very attractive. The current 12-month forward price-to-earnings ratio on the S&P 500 is just 12.9 times, well below the median during the past 10 years (14.3). And we continue to be focused on widening the outperformance gap (27%) in coming months. Stay tuned!

Google: The Latest Example of the Power of the Valuentum Buying Index

By RJ Towner

After bottoming in early June, shares of Google (GOOG) have been on a tear as of late. On August 20, when we released our updated report on the search giant, shares flashed a rare perfect 10 on the Valuentum Buying Index (see page 23). Since then, the company has rallied nearly 20%. Though the search giant has garnered lots of attention in recent weeks for a bevy of reasons--Apple (AAPL) officially locked Google Maps out of iOS 6 and California legalized Google's self-driving cars—we think Google's positive value-momentum outlook has been driving the stock higher. Search revenues continue to grow at a rapid clip, and market participants seem to have gathered that Facebook (FB) isn't a major threat to Google's core search business lines. We're strongly considering adding Google to our Best Ideas portfolio (see page 8) in the coming weeks.

Winners and Losers Are Clear Again in September Retail Sales Results

By RJ Towner

With GDP growth mediocre at best, employment and wages still weak, and a generally tight consumer marketplace, we saw another month of the zero-sum game that results from weak spending growth. Let's dig into the month's winners and losers.

Nordstrom

As has become the standard, Nordstrom (JWN) reported strong same-store sales growth, with September coming in at 4.4% year-over-year. Though this number was slightly weaker than consensus expectations, total sales still grew 7.4% and eclipsed $1 billion. Yet again, Nordstrom Rack outpaced Nordstrom stores, reporting 6.9% same-store sales growth versus 4% at the flagship stores. We expect this long-term trend to continue, though we see a strong possibility for flagships to outperform Rack in times of very robust expansion.

We really can't say anything negative about Nordstrom, as its execution year-to-date has been nearly flawless, and the firm outlined a plan to aggressively expand its Rack format. However, we believe shares are fairly valued at this juncture.

Gap

Investors have been falling back in love with the Gap (GPS) through the course of 2012, as the retailer's stock performance has been nothing short of fantastic. The trend continued in September, as same-store sales surged 6% on a companywide level thanks to 5% growth at Gap, 4% at the Banana Republic, 10% at Old Navy, and 3% growth internationally. However, we noticed that the store was highly promotional during September, and stores we visited (though a small sample set) seemed like they needed to clear significant summer apparel. We're not sure if the company will see much gross margin expansion during the third quarter.

Gap continues to bet on the correct fashion choices, and we were even more encouraged to hear that the former merchandising director is starting at Old Navy, which should help steer that segment in the right direction. We like management and the company's execution, but we think shares are fairly valued. As such, we're not interested in adding the name to the portfolio of our Best Ideas Newsletter.

Limited Brands

Limited Brands (LTD), owner of cash-cow Victoria's Secret, posted solid same-store sales numbers for September. Aggregate same-store sales increased 5% year-over-year, driven by 6% same-store sales growth at Victoria's Secret, 5% at Bath and Body Works, and 5% growth at its Limited Brand stores (encompassing all units, including Henri Bendel). Sales at La Senza fell 4%, but the segment is much smaller than any other, so it is fairly immaterial to the company's results.

We admire The Limited for being one of the few clothing retailers to create a robust online model thanks to Victoria's Secret consistency in product and fit. The company has proactively prevented itself from getting "Amazon'd" (AMZN), and we continue to like the long-term profile of its brand portfolio. Regardless, we believe shares are fairly valued.

Zumiez

We were very skeptical of Zumiez's (ZUMZ) claim that its back-to-school sales were clustered in September, but the retailer posted same-store sales growth of 5.6% (on top of a 10.1% growth rate during the same period in 2011). Unlike teen retailers like Abercrombie & Fitch (ANF), which have been selling essentially the same products for ten years, Zumiez tends to bring new apparel to market rather quickly and capitalizes on creating partnerships with fast-growing brands. Shares have drifted toward the low end

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*Winners and Losers Are Clear …*continued from previous page

of our fair value range, but we're not fans of betting on the fickle teen consumer, so we won't be adding shares to our Best Ideas Newsletter anytime soon.

TJX Companies and Ross Stores

The TJX Companies (TJX), commonly referred to as TJ Maxx, reported another stellar month, with aggregate same-store sales accelerating 6% and total sales growing 10%. Marmaxx (Marshall's and TJ Maxx) posts 6% comparable sales growth, and TJ Maxx Europe even saw 13% same-store sales expansion. We've outlined many times before why we're huge fans of the firm's value offering, and September results reinforce our conviction.

Ross Stores (ROST) also posted strong same-store sales gains of 5%, higher than consensus expectations. Ross Stores' business model is quite similar to that of TJX, though there tends to be slight differences in product mix and pricing. Nevertheless, the long-term trend is the firm's friend (at least for now).

At current levels, we think both companies are fairly priced, though we remain huge fans of the long-term potential of each business.

Kohl's

So far it seems like every retailer has beat expectations, but we think that was far from the case. Companies that likely saw sluggish growth like J.C. Penney (JCP) and Sears (SHLD) don't report monthly sales figures. However, comparable retailer Kohl's (KSS) still does, and its results were not great. Though the company didn't lower its earnings guidance, September same-store sales fell 2.7% and total sales fell 1.4%.

We think Kohl's faces an uphill battle, especially with its core consumers struggling and younger generations turning away from the department store to similarly-priced fast-fashion competitors. While the firm has been a cash cow during the past several years, we simply aren't confident about the company's future trajectory.

Still, Kohl's should benefit from structural changes at J.C. Penney and weak competition from Sears, and we think it could easily outlast the two—barring a change in consumer's perception of Penney's new business model. We think shares are fairly valued.

Macy's

Macy's (M) same-store sales were also a bit weaker than expected, coming in at 2.5% versus consensus expectations of 3.3%. We think the Street overestimated customer migrations from J.C. Penney, but we don't believe the number was too disappointing. Online sales surged 39% in September, and we think the company has done an excellent job navigating the new retail environment. Shares only score a 6 on the Valuentum Buying Index (our stock-selection methodology), so we're not that interested in the retailer at this time.

We continue to believe that firms found in our Best Ideas portfolio (see page 8) represent the best ideas for the Valuentum investor.

A Slowing Chinese Economy Weighs on Nike

By RJ Towner

Athletic apparel giant Nike (NKE) reported better than expected first quarter results. Revenues surged 10% year-over-year to $6.7 billion (15% ex-currency), which was better than the consensus estimate. Earnings fell 10% year-over-year to $1.23 per share, which was still significantly higher than the consensus expectation of $1.11.

We thought the quarter was a mixed bag, with several extremes. Gross margins fell 80 basis points to 43.5%, though the margin declines have started to moderate (margins were up 70 basis points sequentially). Higher input costs have primarily weighed on profitability, but the company has been able to raise prices across all market segments within the US. Unfortunately for the firm, that ability doesn't necessarily translate globally, particularly in Europe and China, where the economy remains sluggish. SG&A also increased 220 basis points as a percentage of revenue, to 32.2%, driven primarily by the firm's heavy investment in marketing for the Olympics and its new NFL license. Though these expenses undoubtedly hurt profitability during the first quarter, we're confident in Nike's global branding strategy and that these investments will pay off nicely in the long run.

When we look at the geographic breakdown, the varying performance makes it seem like Nike is several different companies. In North America, footwear revenues grew 20% to $1.7 billion. The magnitude of this number is stunning—the most mature of all of Nike's markets, North American footwear, is posting Apple-esque growth rates. Apparel grew 26%, and the total geography grew 23%. The segment's operating profit (EBIT) grew 17%, to $630 million. The quarter benefited from a one-time gain of the NFL license, but we're still encouraged by the strength of new products utilizing Flyknit technology and a strong winter release schedule in basketball footwear. The performance in North America underlies why we think Nike is among the best run companies in the world. We also gather from these results that Under Armour (UA), which does the vast majority of its revenue in the US, will have a very strong quarter.

We also saw strong revenue growth in Central & Eastern Europe, which advanced 16% excluding currency (2% reported), and Emerging Markets, which surged 22% excluding currency (8% reported). Nike's continued focus on product innovation and knowledge of these markets should continue to drive growth in both burgeoning regions in the years ahead. Further, Nike will benefit from a few other drivers: local competition in these markets is weak; the growing middle classes love sports as much as Americans do; and Nike is the premium athletic brand in the world. We think the firm is extremely well-positioned to continue to grab market share in both the Central & Eastern Europe and Emerging Markets regions.

On the other hand, we witnessed weaker-than-expected results in Western Europe and China. Western Europe revenue grew just 6% excluding currency (down 5% reported), mostly a result of strong footwear sales (up 10% ex-currency). There are several factors in play here, but most of the underperformance was driven by poor economic growth and tremendous uncertainty in the region. Additionally, competition in the apparel space from adidas is much stronger overseas than it is in North America—the European consumer is more fashion-oriented than the technical-oriented North American consumer, in our view. In North America, athletic apparel leaks into mainstream fashion, where Nike is strong, whereas adidas is more of a lifestyle brand. We think footwear will continue to sell well in the region, but the outlook for apparel isn't very strong.

In China, revenue grew 7% ex-currency (8% reported) to $572 million. Though the pace of growth is respectable, Nike has been hyping China as the next North America for several years now, but it doesn't appear macroeconomic growth is willing to cooperate in the near-term. We think it's readily apparent that the pace of Chinese economic growth is slowing. Apparel was down 1% excluding currency, and management acknowledged that industry-wide inventories remain elevated. Futures orders, though not a tell-all metric for Nike, declined 6% during the quarter, and management didn't sound too thrilled with its near-term prospects in the region. We think other fashion retailers will face…

Please see *A Slowing Chinese Economy Weighs on Nike…*on next page

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...similar hiccups in the near-term.

Still, footwear revenue grew 12% ex-currency, and we think the nation's growing love for basketball will provide a nice tailwind. We are slightly worried that Kobe Bryant, probably the most popular athlete of all-time in China, is nearing the end of his career, and LeBron James has yet to resonate as much with consumers. In our view, Derrick Rose is the most likely NBA player for Bryant to pass the popularity torch to. Rose endorses adidas products, and his popularity could help adidas gain critical market share with younger lifelong consumers. Luckily, Bryant may want to play for several more years, so Nike won't have to face this challenge just yet.

Overall, we like Nike's business and its focus on bringing innovative products to market that consumers want. The firm announced an $8 billion buyback program last week, which would shrink the share count by 20% at its current valuation. Nike isn't a company that needs to use its buyback program to balance option grants, so we think the move will be accretive to earnings (especially given the paltry yields earned from cash sitting on the balance sheet). However, we don't think it is the best use of capital at this time since shares are fairly. We prefer if firms buy back stock when their shares are underpriced. Further, given Nike's valuation, we're not ready to add it to the portfolio of our Best Ideas Newsletter. However, it may be one we add to the portfolio at the right price (under the low end of our fair value range).

Is It Time to Bet on Radio Shack?

By RJ Towner

Electronics retailer Radio Shack (RSH) has been awash with news lately. In addition to getting removed from the S&P 400 Midcap Index, the company announced CEO James Gooch will leave the company immediately. CFO Dorvin Lively will take his place on an interim basis. So the question arises, are shares of the beleaguered retailer finally attractive?

Before we address the business, we'll speak to the senior management team. We have been incredibly baffled by the firm's capital allocation strategy. When it was clear the company had structural issues, the company decided to take on debt to repurchase stock and pay a sizable dividend. At best, Gooch seemed to be in denial of what was happening to his business. Lively, on the other hand, doesn't have any track record leading a company. He's been a CFO or corporate controller for the past several years of his career. However, under his brief reign, Radio Shack's debt has been reduced to a junk rating, and the firm continued to pay its dividend until July. We're not sure if Gooch forced his hand with regards to the situation, but we ultimately don't think Lively will run the company for long.

The business itself remains incredibly challenged as it transforms its perception and business model. We think most consumers still see Radio Shack as a place for hobbyists and those unwilling to adopt new technology, while, in reality, the company is attempting to become a hub of mobile phone sales and information. However, sales have yet to decline precipitously, as same-store sales were basically flat during the second quarter and aggregate sales were up 1.2% year-over-year. Yet, margins are deteriorating precipitously, and competition within the smartphone space is fierce. Not only does Radio Shack have to compete with the mobile carriers, but Best Buy (BBY) will also invest heavily in the space, and Amazon (AMZN) sells smartphones (and seemingly doesn't care about near-term margins).

That leaves Radio Shack as a brand with negative perception that is trying to transition a business model that will only face stronger competitors. On the positive side, the firm's balance sheet hasn't completely deteriorated—yet. Operating cash flow is down 77.4% year-to-date relative to last year, and the firm isn't debt free by any means. We've previously questioned the liquidation value for equity holders in the event of a bankruptcy, and our doubts remain. Though the firm trades a tremendous discount to our fair value range, we prefer staying on the sidelines in situations where the business might decline too quickly for investors to extract value from the balance sheet.

Until we see a healthy uptick in free cash flow and a successful transition to a business model we view as sustainable, Radio Shack remains a classic value trap.

September Auto Sales Roundup

By RJ Towner

Following the solid trends we saw in August, September was another strong month for auto sales. The SAAR for September came in at 14.94 million units, the highest figure we've seen since 14.95 million units in March 2008. Let's take a look at the major industry players.

Ford

Best Ideas Newsletter holding Ford (F) saw sales slip 0.1% year-over-year to 174,976 units, but retail sales grew 4% year-over-year. The numbers were approximately as expected, and we saw exceptional results from small cars (up 73% YoY), driven by powerful momentum from the Ford Focus (up 91% YoY). With fuel prices elevated, consumers are flocking toward fuel-efficient models, which is right in Ford's wheelhouse. As a result, aggregate car sales grew 2.6%.

Utilities were surprisingly strong, in our view, surging 9% year-over-year. Sales of the new Escape accelerated nearly 15%, and sales of the Explorer increased considerably, growing 19%. The only weakness in the report came from truck sales, which declined almost 8%. Though the F-series continues to sell at record levels thanks to more fuel-efficient models, the firm clearly suffered from its decision to seize production of the Ranger pickup in the US. We think Ford had assumed consumers would simply switch to the fuel efficient versions of the F150, but instead it looks as though they are flocking toward the Chevrolet Colorado (GM), which saw sales grow 30% year-over-year.

Ultimately, the firm is losing some share it had acquired in 2011 to the foreign manufacturers, but this is not a surprise and does not change our thesis on the company. During the innovation lull of the early 2000's, Honda (HMC), Toyota (TM), and Nissan (NSANY) stole meaningful market share from the US manufacturers, so both Ford and GM will have to fight tooth-and-nail to regain market share. Still, we think Ford offers fantastic total return potential from current levels.

General Motors

GM's sales were slightly better than expected, with sales growing 1.5% year-over-year to 210,245 units. Total retail sales grew 2.8%. As with Ford, small cars drove sales gains, growing 97% year-over-year. Even the much maligned Volt saw sales accelerate nearly 3-fold, posting its best ever month, and the Sonic grew over 425%. We were also surprised to see Buick sales increase 8%, as it appears the brand is starting to regain some of its footing--though its brand reputation is still a far cry from what it was in the 1950's.

Unfortunately for GM, one of its strongest segments, light trucks was incredibly challenged during the month of September. Sales of the Escalade, Yukon, Tahoe, and Suburban all fell at least 38%, though management cited the timing of fleet orders as the major downward driver. Still, we think consumers aren't very interested in large gas guzzlers at this time, as evidenced by the surge in popularity from small, fuel efficient vehicles. Further, sales of the Silverado fell nearly 17%, suggesting the F-Series and Toyota's pickup offerings (which grew 45% year-over-year) are more favored alternatives.

Though shares are now trading in the lower end of our estimate of its fair value range, we were encouraged by the strong August performance and hedge-fund manager David Einhorn's positive remarks on the firm during the Value Investor's Conference. If the company can earn $6 per share in 2014, as Einhorn anticipates, we think shares will converge towards our fair value estimate, if not, the high end of our fair value range.

Please see *September Auto Sales Roundup...*on next page

*September Auto Sales Roundup...*continued from previous page

Toyota Motor

Toyota, coming off of last year's supply-chain disruption, saw sales increase 41.5% year-over-year to 171,910 units--even better than consensus estimates. As with Ford, Toyota has an incredibly strong small car lineup, driven by the Prius, which more than doubled sales, and the Corolla, which saw sales increase 43%. As a result of last year's supply-chain issues (resulting in easier comparisons), sales strength at the company was broad based. However, we also believe it is making some market share gains, particularly against GM. We already noted the share improvement the firm garnered in pickups, but it also appears the decline in light truck/SUV sales at GM coincides with strong sales gains from Lexus SUVs, which increased over 36% year-over-year.

Overall, Lexus sales grew 36%, and we think the luxury car maker may be pushing back against Audi (VLKAY), which has stolen much of the same mid-tier luxury market. Nevertheless, we thought Toyota's results were very strong, and we think the automaker remains one of the best run firms in the world. We think shares are undervalued, and we are strongly considering the name for addition to the portfolio in our Best Ideas Newsletter.

Honda

Honda also posted better-than-expected sales gains due in part to easier comparisons stemming from the supply-chain disruption in the year-ago period. Sales surged 31% to 117,211 units in the period. The newly redesigned Accord led the way, with sales growing 57% year-over-year. Civic sales also increased 57%, while CR-V sales grew 14%. We are a bit surprised by the results, especially the strength of the Civic, because we weren't particularly impressed by the redesigned model, though it received fairly strong reviews. Shares trade at the low end of our fair value range, but we aren't particularly interested in the company at this time. Its peers represent much more interesting opportunities.

Volkswagen/Chrysler

Though other automakers have posted strong results, Volkswagen's resurgence has been the US story in 2012. Sales surged 34% year-over-year to 36,339 units, as the company posted its strongest September since 1972. In fact, nearly every month this year has been Volkswagen's strongest since 1972, as the company has refocused its attention to designing cars specifically for the US, rather than simply importing German models. The Passat, as well as several Audi models, have surged in popularity and continue to drive market share gains.

Chrysler also continues to return to prosperity, with sales surging 12% year-over-year to 140,041 units. Strength was broad-based across all brands, with the Dodge Avenger and Fiat 500 growing particularly quickly, up 89% and 51%, respectively.

Our Best Ideas Portfolio

By Valuentum Analysts

Portfolio Return	Benchmark Return	Outperformance
37.8%	10.8%	27.0%

Portfolio Inception Date: May 17, 2011

The period since the publication of the previous edition of our Best Ideas Newsletter can best be described as one where we digested some of our recent large gains. Apple (AAPL) and EDAC Tech (EDAC)—two firms that have generated significant alpha for us in recent months—put in orderly price corrections during the period. One of our larger holdings Ancestry.com (ACOM) continues to mull take-over offers, though the market has grown skeptical whether a deal will go through before years' end. Still, Visa (V) and the Health Care SPDR ETF (XLV) continue to plow ahead. We're expecting a strong showing during third-quarter earnings season from portfolio constituents, despite broader economic concerns.

Below we outline the constituents of our portfolio and their respective weightings and returns thus far. Each subsequent issue discusses Valuentum's latest changes to the portfolio, a summary of new names on our watch list (please see page 18), as well as analysis and trends impacting companies on our Best Ideas List. We currently have about 26% of our portfolio in cash, a level we're looking to bring down in coming months. Typically, we like to have the most cash when the market is making new highs (like now) and fully invested when the market is putting in short-term lows. Still, we think patience and executing successfully on our systematic process—the Valuentum Buying Index—trumps any sudden urge to put cash on the sidelines haphazardly to work. We continue to anxiously await a market pullback.

Our investment process is completely transparent and easy to implement in your own portfolio. The goal of our Best Ideas Newsletter is to outperform the S&P 500 Index and to generate positive returns each year regardless of the market environment. Firms added to our Best Ideas portfolio are the cream of the crop based on our stock-selection methodology.

OUR BEST IDEAS -- as of October 12, 2012									Best Ideas Portfolio Inception Date: May 17, 2011		
Portfolio Holdings	Symbol	Initial VBI*	Current VBI**	First Purchase Date	Cost Basis/Share ($)	Total Shares	Total Cost ($)	Current Value/Share ($)	Current Value ($)	% of Portfolio	% Return
Bullish											
Apple Corp.	AAPL	10	7	17-Jun-11	328.99	16	5,270.84	629.71	10,075.36	7.3%	92.0%
Altria Group	MO	8	3	28-Jun-11	26.43	252	6,667.36	33.12	8,346.24	6.1%	33.8%
Ancestry.com	ACOM	10	7	17-May-11	32.43	298	9,663.76	28.49	8,490.02	6.2%	-12.1%
Astronics	ATRO	10	7	6-Jun-11	24.93	141	3,522.13	29.91	4,217.31	3.1%	19.7%
Buffalo Wild Wings	BWLD	7	3	13-Jul-11	65.42	77	5,044.34	88.00	6,776.00	4.9%	34.3%
eBay	EBAY	10	7	3-Oct-11	31.04	200	6,207.00	47.85	9,570.00	6.9%	54.2%
EDAC Tech	EDAC	9	9	6-Jun-11	5.23	673	3,536.79	13.45	9,051.85	6.6%	155.9%
Financial Select SPDR Fund	XLF	NA	NA	9-Jan-11	13.46	150	2,026.00	15.81	2,371.50	1.7%	18.4%
Ford Motor	F	7	3	12-Sep-11	10.69	650	6,955.50	10.12	6,578.00	4.8%	-4.8%
Health Care ETF	XLV	9	9	22-May-12	36.60	125	4,582.00	40.31	5,038.75	3.7%	11.1%
Intel	INTC	6	9	12-Sep-11	19.89	100	1,996.00	21.48	2,148.00	1.6%	11.9%
Intuitive Surgical	ISRG	5	3	22-May-12	532.13	5	2,667.65	494.58	2,472.90	1.8%	-7.3%
Precision Castparts	PCP	8	3	6-Jun-11	152.07	40	6,089.80	162.41	6,496.40	4.7%	6.8%
SPDR S&P Bank ETF	KBE	NA	NA	9-Jan-12	21.07	100	2,114.00	23.65	2,365.00	1.7%	13.2%
Republic Services	RSG	8	9	19-May-11	31.42	201	6,329.42	27.80	5,587.80	4.1%	-5.6%
Rio Tinto	RIO	9	6	22-May-12	46.40	75	3,487.00	48.69	3,651.75	2.7%	6.3%
Visa	V	7	6	30-Nov-11	107.46	60	6,461.30	139.12	8,347.20	6.1%	29.6%
Cash									36,173.99	26.3%	0.0%
Bearish											
Please see companies with low VBI ratings (1 or 2) on our watch list for ideas.											
Best Ideas Portfolio Value							100,000.00		**137,758.07**		**37.8%**
S&P 500 Index (SPY)				17-May-11	132.69	754	100,000.00	142.89	107,687.09	97.2%	
Cash									3,092.92	2.8%	
Benchmark Portfolio Value									**110,780.01**		**10.8%**
Relative Outperformance											**27.0%**

This portfolio is not a real money portfolio. Data as of October 12, 2012. Cost basis includes commissions. Results include dividends, but not interest received on cash balance.

* VBI score at the time we added the firm to the portfolio.

** See our methodology regarding the Valuentum Buying Index (VBI).

Standard Disclaimer: Our Best Ideas List is for information purposes only and should not be considered a solicitation to buy or sell any security. Valuentum is not responsible for any errors or omissions or for results obtained from the use of our Best Ideas List and accepts no liability for how readers may choose to utilize the content.

Discover's Strong Results Underscore Strength in the Payments Industry

By Valuentum Analysts

Discover Financial Services (DFS) reported stronger than expected third quarter results. Revenue grew 9.8% year-over-year to nearly $2 billion, which was slightly better than the consensus estimate. Earnings grew 2.5% year-over-year to $1.21 per share, which was far better than the drop in earnings the consensus was predicting.

Unlike competitors Visa (V) and Mastercard (MA), Discover assumes credit risk on the outstanding consumer loan balance of its cards. Still, the firm is benefiting tremendously from the continued shift to a cashless society, with payment services dollar volume surging 13% during the period, to $50.3 billion. This resulted in a 31% increase in payment services operating income. Credit card loan performance was also strong, with loan delinquency rates falling to 1.81% (down 62 basis points year-over-year) and net charge-off rates falling to 2.43% (down 142 basis points year-over-year). Its credit card loan portfolio grew 4% during the quarter, to $48.1 billion.

Total loans at the company grew 9% to $59.2 billion, driven by the firm's acquisition of student loans. Performance from these loans will no doubt improve as the economy strengthens, but there's still a risk of prolonged unemployment and cumbersome loans that former students won't be able to pay off. Fortunately for the owners of this debt, a defaulter simply can't walk away like a mortgage or any other personal debt in the US. As the law is currently written, it's incredibly difficult for the creditor to lose money on student loans. However, we're not sure that this law for student loans will last forever, particularly with unemployment rates of recent college graduates so high.

Overall, Discover's net interest margin, a metric used by banks and other financial services firms to gauge profitability, increased 18 basis points year-over-year to 9.44% (thanks to lower cost of funds). However, the firm's credit card yield actually decreased 19 basis points to 12.27%, as credit card users are paying down debt and carrying lower balances. This trend is positive for the state of personal finance, but it could harm Discover's profitability.

Going forward, we expect Discover to grow its payment processing business at a nice clip, though it will have to pay $200 million to cardholders who allegedly were deceptively sold products on identity theft and other items. Still, this didn't prevent the firm from repurchasing $350 million in shares during the quarter, reducing its share count 1.9% on a sequential basis. The stock isn't expensive at under10x 2012 earnings, but we prefer Visa and eBay (EBAY) as payment processor names and hold both companies in the portfolio of our Best Ideas Newsletter (see page 8).

Why We Continue to Like Apple and Microsoft

By Valuentum Analysts

In yet another negative blow to the PC market, Gartner reports that PC shipments fell 13.8% year-over-year during the third quarter. The big losers, yet again, were the PC giants Dell (DELL), HP (HPQ), and Toshiba. Of course, the shocking loser was Apple (AAPL), which saw shipments fall 6% (considerably lower than the 25%+ drops of competitors), though market share increased 110 basis points to 13.6%. With the entire industry slumping, who's to blame?

Not surprisingly, we're labeling Apple as the major disrupter in the PC market. Since the inception of the iPhone and subsequent iPad releases, computing has shifted more and more toward mobile consumption, with the wireless providers like Verizon (VZ) and AT&T (T) as the primary beneficiaries. Obviously Dell and HP, both in the midst of turnarounds, have struggled mightily. In fact, Dell trades at forward EV/EBITDA multiple of 3, while HP is valued at 4x EV/EBITDA. View companies with low EV/EBITDA multiples and high returns on capital here.

However, we're not interested in buying either of these names at this time. Both are attempting to become more levered to enterprise hardware and software spending, but the space is incredibly competitive, with heavyweights ranging from IBM (IBM) to Oracle (ORCL) to Salesforce.com (CRM). Let's also not discount the huge presence (and stickiness) of Microsoft (MSFT), which has dominant products such as Office, SQL, and Windows.

With the PC makers trading at such cheap multiples, the opportunities in the space look compelling, especially if the PC market bottoms soon and the plans to gain enterprise market share materialize. Yet, we think the PC is heading towards commoditization, so low-margin competitors like Lenovo will continue to gain share, providing downward pressure on the sector's ability to create real value for shareholders. Further, neither of these companies has a viable presence in mobile, or a willingness to compete with Google (GOOG) or Amazon (AMZN) tablets.

Therefore, we think the value in big tech remains in two companies: Apple and Microsoft (we're favorable on Google's value-momentum indicators, too). Oddly enough, the companies took drastically different journeys to their respective market positions, but we think the next generation of computing will be dominated by these two firms.

An investment thesis in Apple requires little more than taking a look at the tremendous growth in usage and popularity of all of its products. We've previously detailed why we think iPhone 5 is already a massive success, and the iPad remains in a class of its own with regards to the premium tablet market. Its traditional computers continue to gain market share, particularly in the US, and particularly with younger consumers. We're not too excited about the prospects of an iPad Mini due to the potential that it cannibalizes iPad sales and weighs negatively on the firm's margin mix, but we also don't ever underestimate Apple's ability to execute. Just a few years ago RIM's (RIMM) BlackBerry was the most popular phones, but Apple completely shattered Research In Motion's market position, so we wouldn't be surprised to see it crush the Kindle and the Nook. Apple's execution will remain top notch, and the firm will continue to take traditional computing market share—possibly encroaching on Microsoft's enterprise stranglehold.

Still, we don't think that means Microsoft is done for. On the contrary, the Apple model provides a clear path to success for the tech giant. In his letter to shareholders released earlier this week, CEO Steve Ballmer outlined his thoughts on Microsoft and its near-term future. Many have labeled it as "trying to be like Apple," to which we say, "great." Though Microsoft deserves some share of criticism for not focusing on a mobile strategy, its partners certainly didn't help. While Apple was making sleek, aluminum-encased

Please see *Why We Continue to Like Apple and Microsoft...*on next page

*Why We Continue to Like Apple and Microsoft...*continued from previous page

computers and phones, OEMs created mediocre, tired styles.

In our view, Windows 8 mobile, for instance, isn't a failure nearly as much as Nokia (NOK) is as a partner. The same goes for tablets, thus far. The Surface is a clear reaction to the failure of its OEM partners to produce suitable competition for Apple or Google. Thus, Microsoft is in the midst of becoming a hardware creator, which may not be a bad thing.

Taking a look at the company's previous hardware adventures, we can point to two very nice devices: the Zune HD and the Xbox 360. Zune HD was a very good MP3 player that simply didn't stand a chance against the iPod or the Apple ecosystem, but it was still a usable, attractive device. The Xbox 360, on the other hand, has become the most popular game console in the United States—so popular that the firm has held off on its next generation console. Microsoft has slowly turned the device from a one dimentional gaming system into a home entertainment hub. However, we'd like to see some hardware improvements—360 isn't known for its reliability.

Critics may point to a preference for iOS or Mountain Lion, but we think the software differences are overrated. Most consumers use computers to access the Internet, write documents, or create spreadsheets, all of which are pretty much the same experience on any operating system. We think the real advantage lies in Apple's huge store network and customer service. There's no worry about going through a third party or having everyone pass the buck when a Mac stops working, which is the exact opposite of a Windows computer or Android phone. Microsoft is already working on creating a store base that we think will house the Surface, the Xbox, and eventually its own computers. Though Apple branding continues to garner a premium, we think vertical integration will help Microsoft become a competitor on all fronts, while the current OEMs become even more commoditized and…dare we say…eventually disappear (if reinvention does not happen).

Ultimately, we're big fans of both companies, and each has acted rationally while focusing on maintaining high margins. Unless Amazon or Google is willing to follow a similar model, we suspect the two firms could come to dominate computing over the next several years. Consumers have shown a willingness to pay a premium for superior Apple devices and services, and we think Microsoft can achieve similar results. People already pay a pretty penny for superior Microsoft products (Office, SQL, Xbox Live), so we don't think it's a stretch that the firm can enter mobile computing and personal computing successfully.

Microsoft looks slightly cheaper on a discounted cash-flow basis, but we continue to hold both it and Apple in our actively managed newsletter portfolios: Microsoft as a dividend-growth idea, and Apple as a constituent of the portfolio in our Best Ideas Newsletter (see page 8).

Oracle's Revenues Fall Short

By RJ Towner

Enterprise computing titan Oracle (ORCL) reported mixed results for its fiscal year 2013 first quarter. Revenue came in meaningfully lower than consensus expectations, down 2% year-over-year to $8.1 billion. Non-GAAP earnings per share grew 11% year-over-year to $0.53, equal to the consensus estimate. Without the negative impact of currency, earnings would have surged 17%. Our fair value estimate remains unchanged.

The main driver of weakness at the tech giant continues to be hardware, as the Sun Microsystems acquisition hasn't been quite as accretive as the firm would have liked. Hardware products revenue fell 24%, while support revenue fell 11%, as businesses remain cautious on making heavy tech infrastructure investments. New software licenses and cloud software grew 11% (ex-currency), with the operating margin increasing to 44%.

Recently, Oracle has focused on acquiring new human resources technology to integrate with its enterprise offerings. We highlighted SelectMinds and think the acquisition of Taleo will also help cement Oracle's dominant enterprise position. Even if hardware remains weak, the company continues to generate enormous amounts of cash, with operating cash flow coming in at $5.7 billion during the period. Free cash flow was an absolutely tremendous $5.1 billion, which led the firm to repurchase over $3 billion of shares (and at a nice price, in our view).

In the current quarter, the firm expects revenue growth between 0-4% (1-5% ex-currency), leading to earnings of $0.59-$0.63 on a non-GAAP basis. Revenue growth expectations came in slightly short of expectations, but earnings growth was roughly in-line with consensus. We were also anxious to hear that CEO Larry Ellison will announce changes to the company's cloud offerings next week.

Oracle's guidance could prove to be conservative if companies execute on fourth-quarter budget dumps. Shares score a 7 on the Valuentum Buying Index (our stock-selection methodology), so we think the firm looks somewhat attractive. Still, we're comfortable with the current tech exposure in the portfolio of our Best Ideas Newsletter, which includes Apple (AAPL) and eBay (EBAY), among others.

Investment Considerations	
DCF Valuation	UNDERVALUED
Relative Valuation	NEUTRAL
ValueCreation™	EXCELLENT
ValueRisk™	MEDIUM
ValueTrend™	POSITIVE
Cash Flow Generation	STRONG
Financial Leverage	LOW
Growth	MODEST
Technical Evaluation	BULLISH
Relative Strength	STRONG
Money Flow Index (MFI)	NEUTRAL
Upside/Downside Volume (U/D)	BULLISH
Near-term Technical Support, 10-week MA	28.00

DCF = Discounted Cash Flow; MFI, U/D = Please see glossary. MA = Moving Average

Business Quality — ValueCreation™

ValueRisk™	Very Poor	Poor	Good	Excellent
Low				
Medium				
High				
Very High				

Firms that generate economic profits with little operating variability score near the top right of the matrix.

Relative Valuation	Forward P/E	PEG	Price / FV
Microsoft	9.7	1.0	63.3%
Adobe Systems	12.9	1.4	86.2%
F5 Networks	21.6	1.8	87.3%
Salesforce.com	87.4	NMF	101.9%
Peer Median	17.2	1.4	86.7%
Oracle	**11.5**	**1.6**	**73.3%**

Price / FV = Current Stock Price divided by Estimated Fair Value

Financial Summary	----- Actual -----		Projected
Fiscal Year End:	May-11	May-12	May-13
Revenue	35,622	37,121	38,977
Revenue, YoY%	32.8%	4.2%	5.0%
Operating Income	12,728	14,057	18,910
Operating Margin %	35.7%	37.9%	48.5%
Net Income	8,547	9,981	13,688
Net Income Margin %	24.0%	26.9%	35.1%
Diluted EPS	1.67	1.96	2.69
Diluted EPS, YoY %	37.8%	17.5%	37.1%
Free Cash Flow (CFO-capex)	10,764	13,095	15,462
Free Cash Flow Margin %	30.2%	35.3%	39.7%

In Millions of USD (except for per share items)

AAR Reports Fantastic First Quarter Results

By Valuentum Analysts

Aircraft leasing and maintenance firm AAR (AIR) reported strong first quarter results. Revenue surged 13% year-over-year to $550.5 million, slightly above consensus estimates. Earnings ticked-up nearly 10% to $0.45 per share, better than the consensus estimate that called for earnings to fall.

Due to a favorable product mix driven by acquisitions, gross margins increased 80 basis points year-over-year to 16.4%. SG&A (as a percentage of sales) increased slightly year-over-year to 9.7%; however, last year's expense was irregularly low as 2 aircraft sales were factored into the sales mix. In fact, net of aircraft sales, net revenues actually increased 43% year-over-year. Strength was fairly broad-based, but Structures & Systems, aided by acquisitions, grew revenues 80% and profits 133%. Maintenance, Repair & Overhaul revenues climbed 13% to $105.5 million, leading operating profits to jump 30% to $13 million. This culminated in free cash flow of $22 million, leading the company to repurchase $6.1 million worth of its shares (475,000) and retire $13 million of convertible debt.

Going forward, the firm raised its full-year earnings guidance range to $1.60 to $1.70 from $1.55 to $1.65. We remain very confident in the firm's ability to grow earnings through the course of fiscal year 2013. We continue to like the aerospace supply chain, as we hold Astronics (ATRO), EDAC Technologies (EDAC), and Precision CastParts (PCP) in the portfolio of our Best Ideas Newsletter (see page 8).

Adobe Releases Disappointing Guidance

By Valuentum Analysts

Software maker Adobe (ADBE) reported decent third-quarter results. Revenue grew 7% year-over-year to $1.1 billion, roughly in-line with consensus estimates. Earnings increased just 5% year-over-year, to $0.58 per share (non-GAAP), and came in just a penny shy of consensus expectations. Going forward, the firm issued a disappointing outlook, guiding to earnings per share of $0.53-$0.58 during the fourth quarter, short of the consensus estimate of $0.67 per share. Revenue guidance was also a bit light, as the firm expects revenue of $1.075 billion-$1.125 billion, below the consensus expectation calling for $1.2 billion.

The firm is in the midst of transforming its business model from selling large software packages to its Creative Cloud and Digital Marketing Suite subscription model. Still, gross margins fell 70 basis points year-over-year, to 88.9%, which is still a robust figure but will likely continue to trend lower (as free and lower cost competitors emerge). We're more worried about SG&A expenses, which increased 60 basis points to 61.8% of revenue, as the firm ramped up its marketing spending. We expect marketing costs to continue to increase as the firm focuses on communicating its new products to customers.

Overall, we liked Adobe's quarter, but its outlook was a bit weak. The company reported some nice wins with its Digital Marketing Suite product, which is on pace to exceed $750 million in sales this year. Creative Cloud usage is also growing at a healthy clip, adding 8,000 subscribers weekly during the third quarter--ahead of the firm's internal expectation of 5,000 subscribers. The company also generated over $144 million in free cash flow during the period, and Adobe has plenty of cash on hand to invest in new products. Though the firm scores a 7 on the Valuentum Buying Index (our stock-selection methodology), they are fairly valued. As a result, we aren't interested in adding shares to our actively-managed portfolios at this time.

We continue to prefer Microsoft (MSFT) as our best idea in the software space, though we've yet to add it to our Best Ideas portfolio. However, it is one of the largest positions in our Dividend Growth portfolio.

The Future Looks Even More Dire at Hewlett Packard

By RJ Towner

Computer and hardware maker Hewlett Packard (HPQ) painted a gloomy outlook for its 2013 fiscal year at its analyst day. According to CEO Meg Whitman, the 2013 fiscal year will be a transition year, as the company looks toward reinventing itself and becoming a leaner, more effective company. Though the transition isn't expected to be completed until the end of fiscal year 2014, 2013 will take the brunt of the pain.

Net of restructuring costs, fiscal year 2013 earnings look to be $3.40-$3.60 per share—meaningfully lower than the consensus estimate of $4.18 per share. Further, essentially every division within the company looks like it will be quite weak. HP Enterprise Services expects revenue to fall 11%-13%, with operating margins of 0%-3%. While several competitors have focused on building stockpiles of cash with high-margin services businesses, HP hasn't had a favorable sales mix, leading to several low margin businesses with disappointing returns on invested capital. Long-term, the company expects the segment to grow 3%-5% annually, with 7%-9% operating margins, as it migrates 80% of its services revenue to data center contracts (with the other 20% coming from cloud-related business). We think this is a rather ambitious plan, especially considering the fierce competition in data center—one of the few growth drivers remaining for big tech.

The HP Printing and Personal Services segment looks like it may even be in worse shape. The fall of the PC is well-documented, but slightly exaggerated, in our view. However, we do strongly believe that Apple (AAPL) is the only personal computer maker selling a differentiated product that consumers want, in our view. For most consumers not purchasing a Mac, they are pleased as long as the computer runs Windows (MSFT) on an Intel (INTC). Whether a computer is an HP, Dell (DELL), or Gateway is secondary now that products have become so commoditized. HP also wants to re-enter mobile computing, but we're not sure it will be able to compete with the likes of Apple or Amazon (AMZN). Still, the firm has a strong printing business, which should continue to throw off a good amount of cash, though it, too, is in a secular decline. The company will focus on eliminating unnecessary products to streamline production to aid profits in this segment.

The Enterprise Group's future looks brighter, as the company has been able to gain share in the enterprise server and data storage businesses. The firm will continue to provide customers with integrated software offerings. However, the enterprise market is one of the last growth engines remaining for big tech, so competition from IBM (IBM), Accenture (ACN), Oracle (ORCL), and Salesforce.com (CRM) will remain fierce. We think HP will have to acquire young software firms at lofty multiples to "keep up with the Joneses."

Ultimately, we aren't very excited about the near-term picture at HP. Though cash flow remains fairly robust, it will be sensitive to both secular declines and macroeconomic headwinds. Turnarounds are notoriously underestimated in both difficulty and duration, so it's possible HP's stock languishes until 2016 or 2017, in our view. If it does work, shareholders could be able to reap massive rewards. Still, after considering the risk and opportunity cost of such an investment, we're not ready to dive in head-first. Therefore, we aren't interested in adding the tech giant to the portfolio of our Best Ideas Newsletter at this time.

Weakness in Rail Traffic: Economic or Secular?

By Valuentum Analysts

Norfolk Southern (NSC), one of the US' largest rail companies, announced that its third quarter results will not be as good as expected. Earnings per share for the period will be in the range of $1.18 to $1.25, significantly lower than the consensus expectation of $1.63. The major reason for the decline appears to be reduced coal shipments, where volume will fall 13%, leading to overall volume declines of 2%. CFO John Rahtbone considers the U.S. grain market as another contributor to weakness. The firm also expects lower fuel surcharge revenues to negatively impact results by $25 million to $30 million due to an unfavorable lag effect (or about $80 million in total from the same period a year ago). Norfolk will report third-quarter results October 23.

Union Pacific's (UNP) CFO Rob Knight also mentioned weakness in coal and industrial production, which is being offset by strength from autos and chemicals. Still, unlike Norfolk Southern, Union Pacific expects shipments to remain elevated on a year-over-year basis. Though it appears industrial production isn't great, we're bearish on the coal sector in general, thanks to the rise of cheaper, cleaner natural gas and the implications of negative political sentiment. We've seen some pretty bullish news out of the homebuilding sector and out of many retailers, so weakness in rails, tech infrastructure spending, and some global bellwethers (FedEx, Intel) aren't causing us to give up on the US economy at this time.

We typically place a greater emphasis on rails as an indicator of economic activity, but if coal is in a secular decline, translating their performance to the broader economy may lose its informative value. Norfolk, for example, is among the most exposed to the fossil fuel (see chart below), but it shouldn't impact Kansas City Southern (KSU) or Canadian National (CN) nearly as much. We also suspect Burlington Northern Santa Fe (BRK.A) could be negatively impacted.

2011 Impact of Coal on Rails

Company	Coal % of Revenue
CSX	23.7%
Kansas City Southern	13.4%
Norfolk Southern	31.0%
Union Pacific	22.1%
Canadian National	7.6%

*UNP includes petroleum coke

Source: Valuentum Securities, Annual Filings

Still, it doesn't look great for CSX (CSX) or Union Pacific either. Massive migration to natural gas could have a long-lasting impact on the industry, but we think the transportation firms will figure out new ways to replace the lost volume. Natural gas can also be shipped via rail, and we think demand for it will increase given recent price declines (but not as much to offset the coal declines). Housing should also benefit the rails, as lumber and other large construction materials are often transported via rail.

Regardless, we aren't fans of any name in the rail space at current levels. We continue to wait to see if investors overly punish the sector in the coming weeks, providing us with an attractive investment opportunity in the portfolio of our Best Ideas Newsletter.

BlackBerry 10 and 2 Million New Subscribers

By RJ Towner

CEO Thorstein Heins is optimistic about the future of BlackBerry maker Research In Motion (RIMM). At the RIM developer's conference, he mentioned that BlackBerry has the opportunity to become the third largest smartphone ecosystem in the world and that RIM added 2 million new subscribers in recent months. The stock also trades at a significant discount to book value, and its enterprise value of $1.5 billion is significantly lower than its market capitalization of $3.5 billion. Without question, RIM is priced for a considerable decline; if not...bankruptcy.

From a product perspective, RIM is in a tough spot. BlackBerry 10 has been delayed several times, and we think the new operating system will likely be less popular than iOS 6 (AAPL) or Android (GOOG). Further, even when new BlackBerry phones are released, the excitement generated by iPhone 5 will probably leave RIM, and most other hardware makers, in the dust. As we saw from Nokia (NOK), Apple has a tendency to make the product launches of competitors look immaterial. Additionally, with many iPhone 4 and 4S subscribers renewing contracts in the next several months, it will be tough for any hardware maker, let alone a less popular one like RIM, to gain market share in the US.

If the iPhone 5 upgrade cycle lasts for the next year, which is likely in our view, BlackBerry 10 will be a failure. Had it been released in March or April of 2012 before excitement over iPhone 5 was so overwhelming, then perhaps it would have had a chance. Still, the goal of becoming the number three ecosystem probably isn't too much to ask for. Android and iOS are in a battle for market share—we're ready to throw in the towel with regards to Nokia's iteration of Windows 8 (MSFT) at this point. There's room for BlackBerry, but unfortunately, we think the room is on the low-end of the market, resulting in lower ARPU (average revenue per user) customers and a decline in brand perception.

Yet, BlackBerry 10 seems to be focused on the high-end and enterprise markets—two arenas where the firm's existing clients seem less interested in its products. These areas offer high ARPU customers, as well as stickiness, but if the clients don't want RIM products, it might be value-destructive for RIM to try to re-establish a presence in the market. However, the low-end market isn't incredibly attractive for RIM either because it simply doesn't have the manufacturing scale. We've also heard rumors about a merger with Nokia or an acquisition with Microsoft, but neither seems likely.

Perhaps the most unlikely, but best idea could be a merger of all three parties. RIM and Nokia merge, while Microsoft creates the software. RIM provides the security infrastructure, as well as brand, while Nokia brings the manufacturing scale and excellence, and Microsoft provides the new phones with high quality software. But again, this idea is purely speculative and highly unlikely. Plus, success would not be guaranteed under this scenario either.

Financially, RIM's balance sheet remains strong, and the company's $2 billion cash hoard also gives the firm a natural floor in its stock price (assuming there is no cash-flow burn). We think the company still has a compelling opportunity to make a dent in the low-end market in the US, and as a somewhat premium product internationally. However, we remain firmly on the sidelines as competition from Apple appears near-insurmountable at this time, and the firm's score on the Valuentum Buying Index (our stock selection methodology) remains middle-of-the-road.

KB Home's Results: Another Positive for Housing

By Valuentum Analysts

Homebuilder KB Home (KBH) reported strong third quarter results. Earnings exceeded consensus expectations by a whopping $0.20 as the firm earned $0.04 per share, compared to a loss of $0.13 during the same period last year. The earnings increase was due almost entirely to a positive income tax benefit of $10.7 million, but the firm's operating loss still improved by $2 million. Revenue grew 16% year-over-year to $425 million, slightly below consensus estimates but strong nonetheless.

The third quarter's metrics were pretty strong across the board, as average selling prices increased 8% year-over-year to $245,100 and home deliveries increased 7% to 1,720. Pricing was particularly strong in the West and Southwest regions, growing 14% and 13%, respectively. We think both regions will continue to outperform much of the nation due to the collective shift from the Midwest to the Sunbelt, and the economic growth taking place in California, particularly around Silicon Valley. Gross margins were 60 basis points better than a year ago at 17.5%, but we were more impressed by the firm's ability to keep SG&A expenses in check.

However, order growth wasn't incredibly strong, increasing just 3% year-over-year. The company did face a tough comparison, but the firm's backlog remained strong, up 33% year-over-year to $744.7 million. We'll wait to see how other firms perform, but we think it is possible KB may be lagging the competition, including D.R. Horton (DHI), Toll Brothers (TOL), Pulte (PHM) and Lennar (LEN). Nevertheless, the firm was able to generate $14 million in operating cash flow, allowing it to bolster its balance sheet. KB Home spent $8.3 million to extinguish high-yielding debt.

Though we like housing at the moment, we do not find any of the homebuilding stocks very attractive at this time. KB Home, specifically, trades at the high end of our fair value range, so we're not looking to add the name to the portfolio of our Best Ideas Newsletter.

Strength in New Housing Continues at Lennar

By Valuentum Analysts

Homebuilder Lennar (LEN) reported fantastic third-quarter results. Revenue at the homebuilder surged 34% year-over-year to $1.1 billion, meaningfully better than the consensus expectation. Earnings grew well over 3-fold to $0.40 share, more than ten cents better than consensus estimates.

Like KB Home (KBH), Lennar saw improving metrics across the board. Average selling prices increased 4% to $258,000, and deliveries surged 28% year-over-year to 3,617 units. Gross margins also expanded by 220 basis points as input costs had a minimal impact on the bottom line. SG&A fell 230 basis points as a percentage of sales, indicating the firm's ability to leverage fixed costs. Lennar's backlog also grew considerably, up 79% on a unit basis and 95% on a value basis, suggesting the firm will have plenty of growth ahead. The company also saw new orders surge 44% with a cancelation rate of just 17%.

We're very positive on Lennar's market position going forward. One of the major issues negatively impacting smaller homebuilders is access to capital, a problem the firm doesn't have. It raised $400 million in debt via a private placement transaction during the third quarter. Though the deal mostly retires more expensive debt, we think the firm has ample liquidity to ramp production if the housing market substantially accelerates. Management also noted that it sees the housing recovery as being well underway and that it isn't facing input cost increases that will severally impact profitability.

Even though we like the trends we are seeing in the domestic housing market, we believe shares of the homebuilders are fairly valued at current levels. Lennar has been incredibly strong, technically, scoring a 7 on the Valuentum Buying Index (our stock-selection methodology), but we continue to prefer diversified exposure to banking ETF's to gain exposure to the strengthening domestic housing market (XLF, KBE). Though we don't think Lennar's share price offers a margin of safety wide enough for us to include it in the portfolio of our Best Ideas Newsletter, we expect further upside from current levels ($40 represents the high end of our fair value range).

Ideas for Your Radar

By Valuentum Analysts

Our Valuentum Buying Index (VBI), which places a considerable emphasis on a firm's valuation, is the primary driver behind names included in our best ideas portfolio. However, the size of our coverage universe lends itself to a plethora of new ideas beyond the ones we seek to capitalize on. Below, we provide a unique screen that sorts companies we feel are undervalued on both a DCF and relative value basis (the first two pillars of our VBI; the third is a technical assessment). We update this screen monthly and deliver it to you in our newsletter (for your added convenience, we also post it on our site). You'll see we hold a number of these firms in our portfolio (EDAC, RSG, RIO, INTC), and we continue to monitor the remainder for the most opportune time to add them. The names on this list are the cream of the crop for the value investor and can supplement your "shopping list" of new ideas.

Name	Symbol	DCF Valuation	Relative Valuation	Price/Fair Value
Huntsman	HUN	UNDERVALUED	ATTRACTIVE	0.53
KEMET Corp	KEM	UNDERVALUED	ATTRACTIVE	0.53
Jabil Circuit	JBL	UNDERVALUED	ATTRACTIVE	0.56
EDAC Tech	EDAC	UNDERVALUED	ATTRACTIVE	0.58
Endo Pharma	ENDP	UNDERVALUED	ATTRACTIVE	0.59
Superior Energy	SPN	UNDERVALUED	ATTRACTIVE	0.59
Coinstar	CSTR	UNDERVALUED	ATTRACTIVE	0.59
Revlon	REV	UNDERVALUED	ATTRACTIVE	0.59
Rio Tinto	RIO	UNDERVALUED	ATTRACTIVE	0.59
Foster Wheeler	FWLT	UNDERVALUED	ATTRACTIVE	0.60
Mylan	MYL	UNDERVALUED	ATTRACTIVE	0.60
Tenneco	TEN	UNDERVALUED	ATTRACTIVE	0.62
Tempur Pedic	TPX	UNDERVALUED	ATTRACTIVE	0.63
Hewlett-Packard	HPQ	UNDERVALUED	ATTRACTIVE	0.63
Teva Pharma	TEVA	UNDERVALUED	ATTRACTIVE	0.64
Synaptics	SYNA	UNDERVALUED	ATTRACTIVE	0.65
General Cable	BGC	UNDERVALUED	ATTRACTIVE	0.65
Weatherford Intl	WFT	UNDERVALUED	ATTRACTIVE	0.66
Nabors Industries	NBR	UNDERVALUED	ATTRACTIVE	0.66
Caterpillar	CAT	UNDERVALUED	ATTRACTIVE	0.67
Chicago Bridge & Iron	CBI	UNDERVALUED	ATTRACTIVE	0.67
Helen of Troy	HELE	UNDERVALUED	ATTRACTIVE	0.68
Microsoft	MSFT	UNDERVALUED	ATTRACTIVE	0.68
Cisco	CSCO	UNDERVALUED	ATTRACTIVE	0.68
FTI Consulting	FCN	UNDERVALUED	ATTRACTIVE	0.68
Jarden	JAH	UNDERVALUED	ATTRACTIVE	0.69
Koppers	KOP	UNDERVALUED	ATTRACTIVE	0.69
Total	TOT	UNDERVALUED	ATTRACTIVE	0.70
Google	GOOG	UNDERVALUED	ATTRACTIVE	0.70
Tyson Foods	TSN	UNDERVALUED	ATTRACTIVE	0.70
Broadcom	BRCM	UNDERVALUED	ATTRACTIVE	0.71
AAR Corp	AIR	UNDERVALUED	ATTRACTIVE	0.71
Insperity	NSP	UNDERVALUED	ATTRACTIVE	0.72
Western Union	WU	UNDERVALUED	ATTRACTIVE	0.73
Pfizer	PFE	UNDERVALUED	ATTRACTIVE	0.73
Verint	VRNT	UNDERVALUED	ATTRACTIVE	0.73
Aeropostale	ARO	UNDERVALUED	ATTRACTIVE	0.74
Harman Intl	HAR	UNDERVALUED	ATTRACTIVE	0.75
Johnson & Johnson	JNJ	UNDERVALUED	ATTRACTIVE	0.75
Intel	INTC	UNDERVALUED	ATTRACTIVE	0.75
Omega Healthcare	OHI	UNDERVALUED	ATTRACTIVE	0.76
Republic Services	RSG	UNDERVALUED	ATTRACTIVE	0.77
Zimmer	ZMH	UNDERVALUED	ATTRACTIVE	0.77
Waste Management	WM	UNDERVALUED	ATTRACTIVE	0.79
Quality Systems	QSII	UNDERVALUED	ATTRACTIVE	0.80

Ideas... **continued on next page**

Ideas... continued from previous page

The initial table below showcases firms that fit the bill of the Valuentum investor, with each posting a 9 or a 10 on our index. These are names that we may swap into our portfolio on the long side (if not already held) should their upside potential become greater than our current holdings.

We also show firms that register a 1 or 2 on our VBI. These names represent put-option candidates. We provide the respective lists below, and each firm's report can be found on our website at the following link:

http://www.valuentum.com/articles/20120111

Name	Symbol	Industry	VBI
Google	GOOG	Internet Software & Svcs	10
AAR Corp	AIR	A&D Suppliers	9
Broadcom	BRCM	Integrated Circuits	9
Cisco	CSCO	Networking Equipment	9
EDAC Tech	EDAC	A&D Suppliers	9
FTI Consulting	FCN	Management Services	9
General Cable	BGC	Electrical Equipment - industrial	9
Goldman Sachs	GS	Banks & Money Centers	9
Helen of Troy	HELE	Household Products	9
Huntsman	HUN	Chemicals - broad	9
Intel	INTC	Broad Line Semiconductors	9
Jarden	JAH	Household Durables	9
Johnson & Johnson	JNJ	Household Products	9
Microsoft	MSFT	Software	9
Mylan	MYL	Pharmaceuticals	9
Nabors Industries	NBR	Energy Equipment	9
Omega Healthcare	OHI	REIT - Healthcare	9
Pfizer	PFE	Pharmaceuticals	9
Republic Services	RSG	Environmental Services	9
Superior Energy	SPN	Energy Equipment	9
Synaptics	SYNA	Computers & Peripherals	9
Tenneco	TEN	Auto Parts Suppliers	9
Total	TOT	Major Oil & Gas	9
Zimmer	ZMH	Medical Devices	9

Name	Symbol	Industry	VBI
Badger Meter	BMI	Electrical Equipment	1
Cepheid	CPHD	Medical Devices	1
Cerner	CERN	Medical Srvc Providers	1
Commvault Systems Inc	CVLT	Software	1
Fred's Inc	FRED	Multiline Retail - discount	1
Hyatt	H	Hotels	1
Petsmart	PETM	Specialty Retailers	1
Teradata	TDC	Computer Hardware	1
Ulta Salon	ULTA	Personal Services	1
Fifth Third	FITB	Banks & Money Centers	2
Healthcare Realty Trust	HR	REIT - Healthcare	2
Hershey Foods	HSY	Food Products - Large	2
Lumber Liquidators	LL	Specialty Retailers	2
Rackspace	RAX	Business Services	2
Urban Outfitters	URBN	Specialty Retail - apparel	2
Wisconsin Energy	WEC	Utilities	2

Valuentum Retail Equity Research | Visit us at www.valuentum.com | (10=best) | Data as of 28-Sep-2012

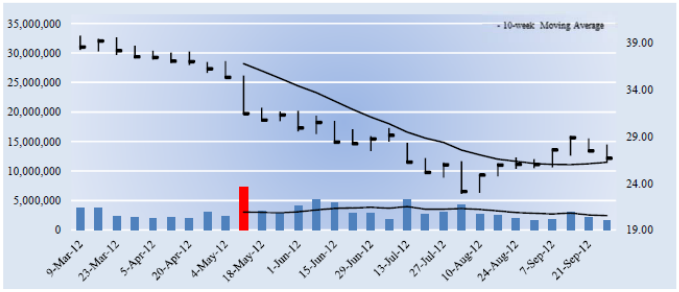
FTI Consulting FCN UNDERVALUED 8.7%

Buying Index™ 9 | Value Rating ✓

Last Close	Estimated Fair Value	Fair Value Range	Investment Style	Sector	Industry
$26.68	$39.00	$29.00 - $49.00	SMALL-CAP VALUE	Information Technology	Management Services

FTI Consulting appears undervalued on the basis of both our DCF process and relative value assessment versus peers.

Stock Chart (weekly)



The week with the highest trading volume out of the last 13 weeks was a week of heavy selling, or distribution (red bar).

Investment Considerations

DCF Valuation	UNDERVALUED
Relative Valuation	ATTRACTIVE
ValueCreation™	EXCELLENT
ValueRisk™	MEDIUM
ValueTrend™	NEGATIVE
Cash Flow Generation	STRONG
Financial Leverage	MEDIUM
Growth	MODEST
Technical Evaluation	BULLISH
Relative Strength	WEAK
Money Flow Index (MFI)	NEUTRAL
Upside/Downside Volume (U/D)	IMPROVING
Near-term Technical Support, 10-week MA	26.00

DCF = Discounted Cash Flow; MFI, U/D = Please see glossary. MA = Moving Average

Company Vitals

Market Cap (USD)	$1,160
Avg Weekly Vol (30 wks)	3,014
30-week Range (USD)	22.88 - 39.8
Valuentum Sector	Information Technology
5-week Return	2.1%
13-week Return	-7.4%
30-week Return	-32.0%
Dividend Yield %	0.0%
Dividends per Share	0.00
Forward Dividend Payout Ratio	0.0%
Est. Normal Diluted EPS	2.61
P/E on Est. Normal Diluted EPS	10.2
Est. Normal EBITDA	285
Forward EV/EBITDA	6.4
EV/Est. Normal EBITDA	5.9
Forward Revenue Growth (5-yr)	2.6%
Forward EPS Growth (5-yr)	3.5%

NMF = Not Meaningful; Est. = Estimated; FY = Fiscal Year

Returns Summary

	3-year Historical Average
Return on Equity	9.4%
Return on Assets	4.8%
ROIC, with goodwill	12.6%
ROIC, without goodwill	56.6%

ROIC = Return on Invested Capital; NMF = Not Meaningful

Leverage, Coverage, and Liquidity

In Millions of USD

Total Debt	797
Net Debt	522
Total Debt/EBITDA	3.0
Net Debt/EBITDA	2.0
EBITDA/Interest	4.5
Current Ratio	1.5
Quick Ratio	1.5

NMF = Not Meaningful

Investment Highlights

• FTI Consulting earns a ValueCreation™ rating of EXCELLENT, the highest possible mark on our scale. The firm has been generating economic value for shareholders for the past few years, a track record we view very positively. Return on invested capital (excluding goodwill) has averaged 56.6% during the past three years.

• FTI Consulting's valuation is compelling at this time. The firm is trading at a nice discount to our estimate of its fair value, even after considering an appropriate margin of safety. The firm's forward earnings multiple and PEG ratio also look attractive versus peers.

• FTI Consulting has a good combination of strong free cash flow generation and manageable financial leverage. We expect the firm's free cash flow margin to average about 7.8% in coming years. Total debt-to-EBITDA was 3 last year, while debt-to-book capitalization stood at 41.9%.

• The firm's shares have underperformed the market benchmark during the past quarter. Although FTI Consulting's valuation appears attractive, the company is currently exhibiting characteristics of a potential value trap, and we'd still be cautious at these levels. There may be a better entry point yet.

• FTI Consulting is an advisory firm that helps organizations with corporate finance/restructuring and forensic/litigation consulting, among other areas. The company remains heavily exposed to M&A activity and changes in regulatory trends.

Business Quality

ValueCreation™

ValueRisk™	Very Poor	Poor	Good	Excellent
Low				
Medium				■
High				
Very High				

Firms that generate economic profits with little operating variability score near the top right of the matrix.

Relative Valuation

	Forward P/E	PEG	Price / FV
Booz Allen	8.5	NMF	76.9%
Corrections Corp	21.2	4.0	167.3%
CRA Intl	19.9	NMF	82.3%
Huron Consulting	15.0	1.4	74.1%
Peer Median	17.4	2.7	79.6%
FTI Consulting	**11.8**	**1.9**	**68.4%**

Price / FV = Current Stock Price divided by Estimated Fair Value

Financial Summary

	----- Actual -----		Projected
Fiscal Year End:	Dec-10	Dec-11	Dec-12
Revenue	1,401	1,567	1,582
Revenue, YoY%	0.1%	11.8%	1.0%
Operating Income	220	214	211
Operating Margin %	15.7%	13.7%	13.3%
Net Income	72	104	97
Net Income Margin %	5.1%	6.6%	6.2%
Diluted EPS	1.51	2.39	2.26
Diluted EPS, YoY %	-43.8%	57.8%	-5.3%
Free Cash Flow (CFO-capex)	172	143	127
Free Cash Flow Margin %	12.3%	9.1%	8.0%

In Millions of USD (except for per share items)

Structure of the Management Services Industry — GOOD

The management services industry primarily comprises of advisory and consulting firms. The reputation and performance track record of constituents is necessary to drive a high level of repeat/referral business and attract/retain top professionals. Most industry constituents produce consistent cash flows and require very little capital spending to maintain operations. Still, firms remain exposed to capital market changes, including M&A activity and legal/regulatory requirements, which may impact demand for their business and utilization of professionals. We generally like the structure of the group.

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http://www.valuentum.com/categories/20110609

Valuentum Retail Equity Research | Visit us at www.valuentum.com | (10=best) | Data as of 6-Jul-2012

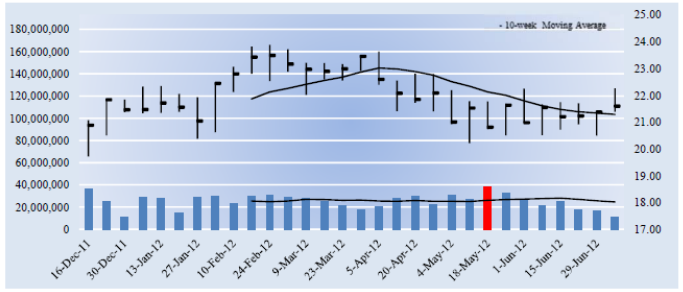
Mylan MYL UNDERVALUED 34.3%

Buying Index™ 9 | Value Rating ✓

Last Close	Estimated Fair Value	Fair Value Range	Investment Style	Sector	Industry
$21.59	$36.00	$29.00 - $43.00	MID-CAP VALUE	Health Care	Pharmaceuticals

The market appears to have put Mylan's shares on sale. We'd take a closer look.

Stock Chart (weekly)



The week with the highest trading volume out of the last 13 weeks was a week of heavy selling, or distribution (red bar).

Investment Considerations

DCF Valuation	UNDERVALUED
Relative Valuation	ATTRACTIVE
ValueCreation™	EXCELLENT
ValueRisk™	LOW
ValueTrend™	NEGATIVE
Cash Flow Generation	STRONG
Financial Leverage	HIGH
Growth	MODEST
Technical Evaluation	VERY BULLISH
Relative Strength	NEUTRAL
Money Flow Index (MFI)	NEUTRAL
Upside/Downside Volume (U/D)	BEARISH
Near-term Technical Support, 10-week MA	21.00

DCF = Discounted Cash Flow; MFI, U/D = Please see glossary. MA = Moving Average

Business Quality

ValueCreation™

ValueRisk™	Very Poor	Poor	Good	Excellent
Low				
Medium				
High				
Very High				

Firms that generate economic profits with little operating variability score near the top right of the matrix.

Company Vitals

Market Cap (USD)	$9,473
Avg Weekly Vol (30 wks)	25,080
30-week Range (USD)	19.71 - 23.88
Valuentum Sector	Health Care
5-week Return	2.8%
13-week Return	-2.7%
30-week Return	9.4%
Dividend Yield %	0.0%
Dividends per Share	0.00
Forward Dividend Payout Ratio	0.0%
Est. Normal Diluted EPS	2.65
P/E on Est. Normal Diluted EPS	8.1
Est. Normal EBITDA	2,876
Forward EV/EBITDA	5.5
EV/Est. Normal EBITDA	5.0
Forward Revenue Growth (5-yr)	6.1%
Forward EPS Growth (5-yr)	16.1%

NMF = Not Meaningful; Est. = Estimated; FY = Fiscal Year

Investment Highlights

• Mylan's business quality (an evaluation of our ValueCreation™ and ValueRisk™ ratings) ranks among the best of the firms in our coverage universe. The firm has been generating economic value for shareholders with relatively stable operating results for the past few years, a combination we view very positively.

• The firm's shares are trading at an attractive level at this time. Given the company's track record of solid business performance, we'd take a closer look at picking up some of the firm's shares.

• Mylan's cash flow generation is robust, but its financial leverage could potentially be concerning down the road. If cash flows begin to weaken, we'd become more cautious on the firm's overall financial health.

• The firm's share price performance has been roughly in line with that of the market during the past quarter. We'd expect the firm's stock price to converge to our fair value estimate within the next three years, if our forecasts prove accurate.

• The firm's technicals look very attractive. If current prices hold, the firm's moving averages could create a golden cross, a very bullish technical pattern.

Relative Valuation

	Forward P/E	PEG	Price / FV
Abbott Laboratories	12.7	1.5	84.1%
Eli Lilly	12.9	1.4	85.3%
Merck	10.8	2.3	109.2%
Pfizer	10.1	1.4	72.7%
Peer Median	11.8	1.4	84.7%
Mylan	**8.7**	**1.1**	**60.0%**

Price / FV = Current Stock Price divided by Estimated Fair Value

Returns Summary

	3-year Historical Average
Return on Equity	11.3%
Return on Assets	3.4%
ROIC, with goodwill	10.3%
ROIC, without goodwill	17.3%

ROIC = Return on Invested Capital; NMF = Not Meaningful

Financial Summary

	----- Actual -----		Projected
Fiscal Year End:	Dec-10	Dec-11	Dec-12
Revenue	5,451	6,130	6,927
Revenue, YoY%	7.0%	12.5%	13.0%
Operating Income	849	1,054	2,057
Operating Margin %	15.6%	17.2%	29.7%
Net Income	345	537	1,117
Net Income Margin %	6.3%	8.8%	16.1%
Diluted EPS	1.05	1.22	2.49
Diluted EPS, YoY %	38.4%	16.6%	103.9%
Free Cash Flow (CFO-capex)	739	441	1,005
Free Cash Flow Margin %	13.6%	7.2%	14.5%

In Millions of USD (except for per share items)

Leverage, Coverage, and Liquidity

In Millions of USD

Total Debt	5,299
Net Debt	4,884
Total Debt/EBITDA	3.4
Net Debt/EBITDA	3.1
EBITDA/Interest	4.7
Current Ratio	1.4
Quick Ratio	0.7

NMF = Not Meaningful

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Valuentum Retail Equity Research | Visit us at www.valuentum.com | (10=best) | Data as of 31-Aug-2012

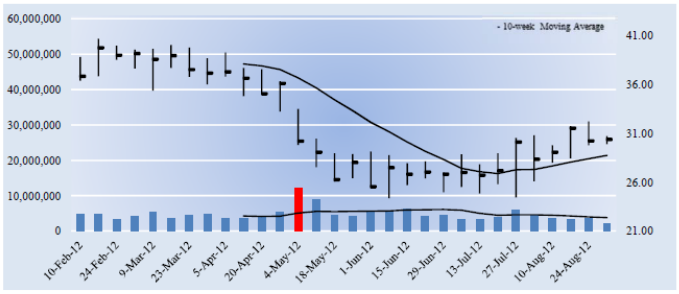
Tenneco TEN UNDERVALUED 5.4%

Buying Index™ 9 | Value Rating ✓

Last Close	Estimated Fair Value	Fair Value Range	Investment Style	Sector	Industry
$30.37	$49.00	$32.00 - $66.00	SMALL-CAP VALUE	Consumer Discretionary	Auto Parts Suppliers

Tenneco appears undervalued on the basis of both our DCF process and relative value assessment versus peers.

Stock Chart (weekly)



The week with the highest trading volume out of the last 13 weeks was a week of heavy selling, or distribution (red bar).

Investment Considerations

DCF Valuation	UNDERVALUED
Relative Valuation	ATTRACTIVE
ValueCreation™	GOOD
ValueRisk™	HIGH
ValueTrend™	POSITIVE
Cash Flow Generation	MEDIUM
Financial Leverage	MEDIUM
Growth	MODEST
Technical Evaluation	BULLISH
Relative Strength	STRONG
Money Flow Index (MFI)	NEUTRAL
Upside/Downside Volume (U/D)	BULLISH
Near-term Technical Support, 10-week MA	29.00

DCF = Discounted Cash Flow; MFI, U/D = Please see glossary. MA = Moving Average

Company Vitals

Market Cap (USD)	$1,868
Avg Weekly Vol (30 wks)	4,686
30-week Range (USD)	24.35 - 40.68
Valuentum Sector	Consumer Discretionary
5-week Return	0.3%
13-week Return	18.4%
30-week Return	-19.7%
Dividend Yield %	0.0%
Dividends per Share	0.00
Forward Dividend Payout Ratio	0.0%
Est. Normal Diluted EPS	4.00
P/E on Est. Normal Diluted EPS	7.6
Est. Normal EBITDA	802
Forward EV/EBITDA	4.2
EV/Est. Normal EBITDA	3.6
Forward Revenue Growth (5-yr)	6.2%
Forward EPS Growth (5-yr)	10.1%

NMF = Not Meaningful; Est. = Estimated; FY = Fiscal Year

Returns Summary

	3-year Historical Average
Return on Equity	-3204.8%
Return on Assets	1.9%
ROIC, with goodwill	11.6%
ROIC, without goodwill	12.3%

ROIC = Return on Invested Capital; NMF = Not Meaningful

Leverage, Coverage, and Liquidity

In Millions of USD

Total Debt	1,224
Net Debt	1,010
Total Debt/EBITDA	2.0
Net Debt/EBITDA	1.7
EBITDA/Interest	5.6
Current Ratio	1.3
Quick Ratio	0.8

NMF = Not Meaningful

Investment Highlights

• Although Tenneco has put up decent economic profits during the past few years, these returns have not come without volatility. Such business performance indicates heightened risk with respect to the firm's ability to continue to put up strong results.

• Tenneco's valuation is compelling at this time. The firm is trading at a nice discount to our estimate of its fair value, even after considering an appropriate margin of safety. The firm's forward earnings multiple and PEG ratio also look attractive versus peers.

• Tenneco's cash flow generation and financial leverage are at decent levels, in our opinion. The firm's free cash flow margin and debt-to-EBITDA metrics are about what we'd expect from an average firm in our coverage universe.

• The company's stock price has outperformed the benchmark during the last quarter, and its valuation still looks interesting at these levels. Investors could be accumulating shares, as the stock continues to trade at bargain-basement levels.

• Tenneco sells emission control and ride control systems and products for vehicle applications. Highly cyclical demand for its products and material operating leverage, exacerbated by input cost swings, are key concerns.

Business Quality

ValueCreation™

ValueRisk™	Very Poor	Poor	Good	Excellent
Low				
Medium				
High			■	
Very High				

Firms that generate economic profits with little operating variability score near the top right of the matrix.

Relative Valuation

	Forward P/E	PEG	Price / FV
Cooper Tire & Rubber	7.9	NMF	76.9%
Magna Intl	8.4	2.8	77.3%
BorgWarner	12.5	1.7	92.9%
Johnson Controls	10.7	2.3	97.2%
Peer Median	9.6	2.3	85.1%
Tenneco	**9.1**	**1.2**	**62.0%**

Price / FV = Current Stock Price divided by Estimated Fair Value

Financial Summary

	----- Actual -----		Projected
Fiscal Year End:	Dec-10	Dec-11	Dec-12
Revenue	5,937	7,205	7,421
Revenue, YoY%	27.7%	21.4%	3.0%
Operating Income	287	400	469
Operating Margin %	4.8%	5.6%	6.3%
Net Income	39	157	209
Net Income Margin %	0.7%	2.2%	2.8%
Diluted EPS	0.64	2.55	3.32
Diluted EPS, YoY %	-142.5%	299.2%	30.2%
Free Cash Flow (CFO-capex)	81	17	176
Free Cash Flow Margin %	1.4%	0.2%	2.4%

In Millions of USD (except for per share items)

Structure of the Auto Parts Supplier Industry — POOR

The highly-cyclical auto supplier industry depends on economic conditions and consumer confidence. Volatile gas prices impact a supplier's input costs and the types of vehicles demanded by consumers. OEMs have considerable bargaining power over suppliers in negotiating terms on largely-commoditized parts. The industry is regulated by environmental and safety laws, providing both challenges and opportunities. Suppliers have considerable operating leverage and remain extremely competitive, which prevents outsize economic returns over the long haul. In general, we don't like the group.

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Our Methodology – The Valuentum Buying Index (VBI)

By Valuentum Analysts

But how, you will ask, does one decide what [stocks are] "attractive"? Most analysts feel they must choose between two approaches customarily thought to be in opposition: "value" and "growth,"...We view that as fuzzy thinking...Growth is always a component of value [and] the very term "value investing" is redundant.

-- Warren Buffett, Berkshire Hathaway annual report, 1993

At Valuentum, we take Buffett's thoughts one step further. We think the best opportunities arise from a complete understanding of all investing disciplines in order to identify the most attractive stocks at any given time. Valuentum therefore analyzes each stock across a wide spectrum of philosophies, from deep value through momentum investing. We think companies that are attractive from a number of investment perspectives--whether it be growth, value, income, momentum, etc.--have the greatest probability of capital appreciation and relative outperformance. The more investors that are interested in the stock for reasons based on their respective investment mandates, the more likely it will move higher.

As such, the Valuentum Buying Index (VBI) combines rigorous financial and valuation analysis with an evaluation of a firm's technicals and momentum indicators to derive a score between 1 and 10 for each company (10=best). The VBI places considerable emphasis on a firm's DCF valuation, its relative valuation versus peers (both forward PE and PEG ratios), as well as its technicals in order to help investors pick the best entry and exit points on the most interesting stocks. We believe our methodology helps identify the most attractive stocks at the best time to buy, helping to avoid value traps and lagging performance due to the opportunity cost of holding a stock with great potential but at an inopportune time.

A Rigorous, Discounted Cash Flow Valuation Assessment

Our methodology starts with in-depth financial statement analysis, where we derive our ValueCreation, ValueRisk, and ValueTrend ratings, which together provide a quantitative assessment of the strength of a firm's competitive advantages. After evaluating historical trends, we then make full annual forecasts for each item on a company's income statement and balance sheet to arrive at a firm's future free cash flows. We derive a company-specific cost of equity (using a fundamental beta based on the expected uncertainty of key valuation drivers) and a cost of debt (considering the firm's capital structure and synthetic credit spread over the risk-free rate), culminating in our estimate of a company's weighted average cost of capital (WACC). We don't use a market price-derived beta, as we embrace market volatility, which provides investors with opportunities to buy attractive stocks at bargain-basement levels.

We assess each company within our complete three-stage free cash flow to the firm (enterprise cash flow) valuation model, which generates an estimate of a company's equity value per share based on its discounted future free cash flows and the company's net balance sheet impact, including other adjustments to equity value (namely pension and OPEB adjustments). Our ValueRisk rating, which considers the underlying uncertainty of the capacity of the firm to continue to generate value for shareholders, sets the margin of safety bands around this fair value estimate. For firms that are trading below the lower bound of our margin of safety band, we consider these companies undervalued based on our DCF process. For firms that are trading above the higher bound of our margin of safety band, we consider these companies overvalued based on our DCF process.

A Forward-Looking Relative Value Assessment

Our discounted cash-flow process allows us to arrive at an absolute view of the firm's intrinsic value. However, we also understand the critical importance of assessing firms on a relative value basis,

Our Methodology – The Valuentum Buying Index **continued on next page**

Our Methodology – The Valuentum Buying Index continued from previous page

versus both their industry and peers. Many institutional money-managers--those that drive stock prices—pay attention to a company's price-to-earnings (PE) ratio and price-earning-to-growth (PEG) ratio in determining whether entities are undervalued. With this in mind, we have included a forward-looking relative value assessment in our process to further augment our rigorous discounted cash-flow process. If a company is undervalued on both a price-to-earnings ratio and a price-earnings-to-growth (PEG) ratio versus industry peers, we would consider the firm to be attractive from a relative value standpoint.

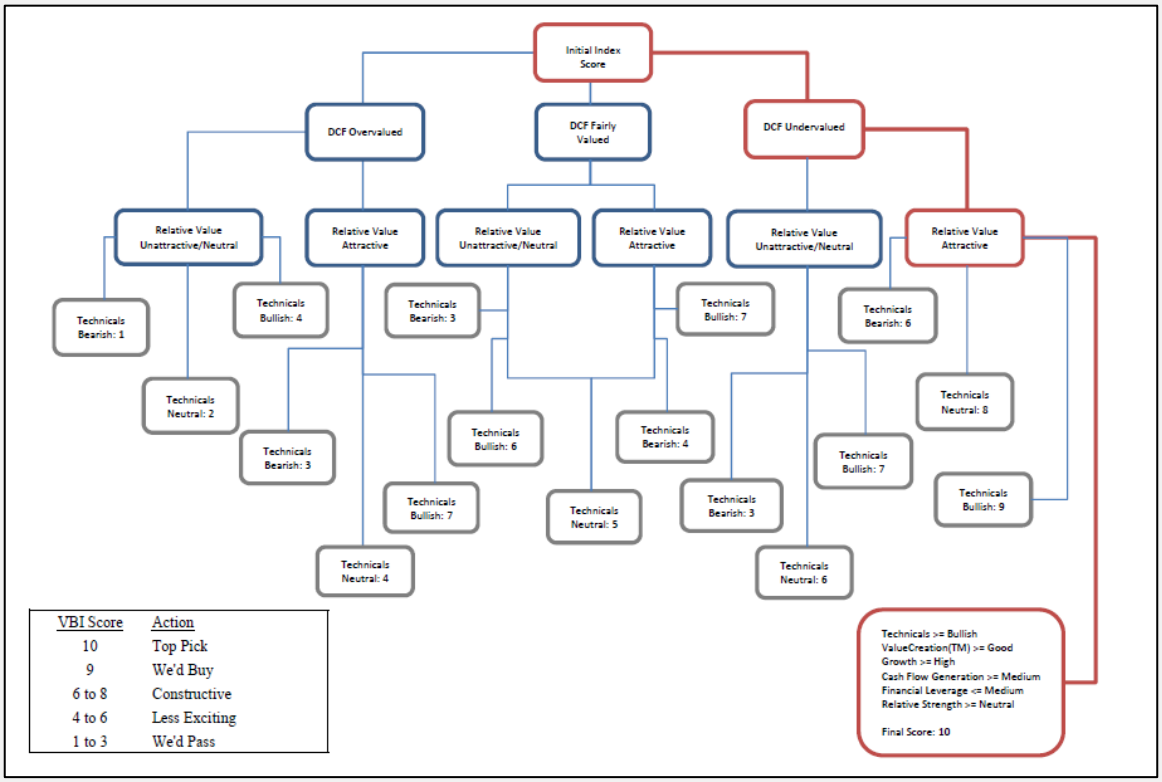
Avoiding Value Traps and Opportunity Cost

Once we have estimated a firm's intrinsic value on the basis of our discounted cash-flow process, determined if it is undervalued according to its firm-specific margin of safety bands, and assessed its relative value versus industry peers, we then evaluate the company's technical and momentum indicators to pin-point the best entry and exit points on the stock. An evaluation of its moving averages, relative strength, upside-downside volume, and money flow index are but a few considerations we look at with respect to our technical and momentum assessment of a company's stock.

Putting It All Together - the Valuentum Buying Index

Let's follow the red line on the flow chart below to see how a firm can score a 10, the best mark on our index (a "Top Pick"). First, the company would need to be 'UNDERVALUED' on a DCF basis and 'ATTRACTIVE' on a relative value basis. The stock would also have to be exhibiting 'BULLISH' technicals. The firm would need a ValueCreation rating of 'GOOD' or 'EXCELLENT', exhibit 'HIGH' or 'AGGRESSIVE' growth prospects, and generate at least a 'MEDIUM' or 'NEUTRAL' assessment for cash flow generation, financial leverage, and relative price strength.

This is a tall order for any company, but we're looking to deliver the very best of ideas to our clients and subscribers. Firms that don't make the cut for a 10 are ranked accordingly, with the least attractive stocks garnering a score of 1 ("We'd Pass"). Most of our coverage universe falls between 3 and 7, but at any given time there could be large number of companies garnering either high or low scores, especially at market lows or tops, respectively.



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