BEST IDEAS NEWSLETTER

VOLUME I

2011

# ANALYSIS OF BEST IDEAS NEWSLETTER PORTFOLIO

MAY 2011 – DECEMBER 2014

OUR BEST IDEAS NEWSLETTER

# Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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Valuentum Securities Inc.
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*"Valuentum has hit the ball out of the park during the last month with a few of its picks."*

## About Our Best Ideas Newsletter

*By Brian Nelson, CFA*

Brian Nelson, CFA
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First of all, I wanted to extend a thank you for your continued subscription to Valuentum Securities. We are growing rapidly as a firm, and we think our fresh, unique stock-picking methodology will provide members with a leg up on the market. Our mission with our Best Ideas Newsletter is to provide you with a list of our best ideas constructed in a portfolio that we think will not only beat the market in each annual period, but will also deliver positive returns every year. This is certainly a tall order, and one in which other newsletters do not embrace, but we are up to the challenge and remain dedicated to being your equity research provider.

For those that may not be familiar with us, we strive to stand out from the crowd and deliver you the most compelling investment ideas at the best time to buy. Most investment research firms fall into a few camps, whether it be value, growth, income, momentum,

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Please see *About Our Best Ideas Newsletter* on page 2

## A Strong Start to Outperformance

*By Valuentum Analysts*

Valuentum hit the ball out of the park during the last month with a few of its picks. We continue to be very bullish on the outlook for commercial aerospace, and the addition of three names in the sector to our Best Ideas List June 6 contributed significantly to outperformance. Astronics (ATRO) has increased nearly 32%, while EDAC Tech (EDAC) and Precision Castparts (PCP) advanced 19% and 6%, respectively. We also saw strong performance from Apple Corp. (AAPL), and one of our more controversial ideas, Ancestry.com (ACOM). Our dividend high-yielders didn't perform that well, but we continue to like trash-taker Republic Services (RSG) and cigarette-maker Altria Group (MO)—the latter boasting nearly a 6% annual yield.

In all, our portfolio returned over 6% versus the S&P's decline of 0.2%, outperformance that we're particularly proud of out of the gates.

Please see *A Strong Start to Outperformance* on page 4

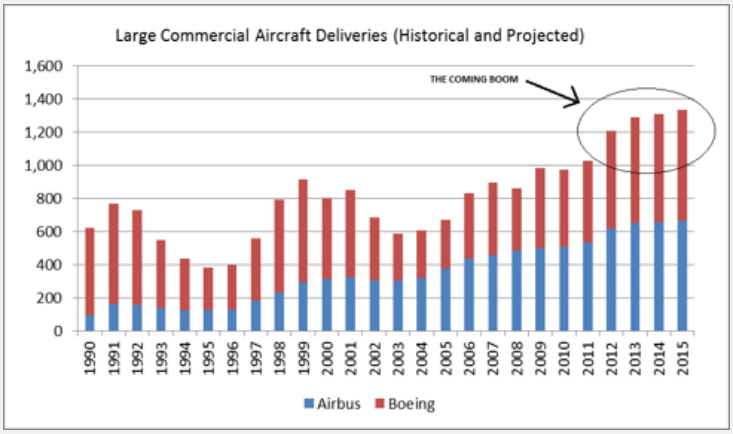
# Why We Like Commercial Aerospace

*By Brian Nelson, CFA*

Expected deliveries of commercial planes are set to advance considerably in coming years. In this article, we dig into the valuation and potential upside of Precision Castparts (PCP), one of the best long-term plays on commercial aerospace demand, in our opinion. We also dive into an interesting small-cap play and a compelling micro-cap opportunity in the aerospace supply chain.

*"Expected deliveries of commercial planes are set to advance considerably in coming years."*

Let's briefly review the trajectory of large commercial aircraft deliveries during the next several years. Aside from the fundamental drivers (replacement planes, emerging-market growth, etc.), Boeing (BA) and Airbus are rapidly increasingly production of their workhorse narrowbody aircraft (737, A320) due to encroaching rivals, while rolling out (747-8, 787) and ramping up deliveries (A380) of brand new builds. Beyond 2015, look for large commercial aircraft (LCA) deliveries to nudge up slightly as a result of the ramp up of A350 deliveries (followed thereafter by a cyclical downswing).




That said, let's move into a discussion on Precision Castparts. The metal-

**Please see *Why We Like Commercial Aerospace* on page 5**

*"We're looking for companies that are undervalued…have strong growth potential, have a solid track record of generating economic profits for shareholders with reasonable risk, are strong cash-flow generators, have manageable financial leverage, and are currently showing bullish technical and momentum indicators."*

*About Our Best Ideas Newsletter* from page 1

chartists or some variant of the aforementioned. We think each in its own right holds merit, but we think the combination of these approaches is even more powerful. After all, stock price movements aren't just driven by investors of the value or growth variety, but by all market participants. Therefore, we look at stocks from a variety of investment perspectives in order to understand and capitalize on opportunities. We want to arm you, our subscriber, with relevant, actionable information.

We're looking for companies that are undervalued—both on a DCF basis and versus peers—have strong growth potential, have a solid track record of generating economic profits for shareholders with reasonable risk, are strong cash-flow generators, have management financial leverage, and are currently showing bullish technical and momentum indicators. We want to deliver these names to you in our Best Ideas Newsletter.

## Our Thesis on Ancestry.com

*By Valuentum Analysts*

It's not every day that investors come across a firm with a cash-rich, subscription-based business model with substantial revenue growth prospects and operating-leverage tailwinds. And certainly one wouldn't expect to find it with a name such as Ancestry.com (ACOM). But whether you're a family history buff or not, this name may be a perfect fit for the aggressive growth portion of your equity portfolio.

Here are five reasons to buy this name at these levels:

1) Ancestry.com's long-term market opportunity is phenomenal.

2) The firm's incremental margins on new subscribers are more than triple that of current reported results, offering a long runway for earnings leverage.

3) Ancestry.com's cash-rich, subscription-based business model benefits from one of the strongest competitive advantages out there -- the network effect.

4) The firm's social-networking endeavors and international efforts are only in the early innings.

5) The firm's valuation presents significant upside potential and little downside risk.

**Please see *Our Thesis on Ancestry.com* on page 6**

*"Ancestry.com's cash-rich, subscription-based business model benefits from one of the strongest competitive advantages out there – the network effect."*

## Sizing Up the Long-term Growth Potential of Buffalo Wild Wings

*By Valuentum Analysts*

A restaurant focused on the concept of wings, beer, and sports seems like nothing special, but Buffalo Wild Wings (BWLD) certainly has carved out a solid presence in this arena. With each restaurant boasting an extensive multi-media system (projection screens, 50 televisions, etc.), a full bar and open layout, "B-Dubs", as it is commonly known, has become the place of choice for many social chicken-wing lovers. Thanks in part to its widespread appeal, the firm has experienced tremendous growth during the past number of years as revenue has more than doubled since 2006. Management also expects to open more than 100 new restaurants in 2011. But how long can this growth continue?

First of all, management is looking at a saturation point of roughly 1,400 restaurants in the U.S., targeting a mix of 40% company-owned and 60% franchised. At the end of last year, the firm owned or franchised 732 restaurants in 44 states. Given the traction this establishment has gained, it's probably hard to argue that the Buffalo-Wild-Wings concept is not transferable across most of the nation. At least, along a similar scale as it has been thus far in its founding state of Ohio.

**Please see *Sizing Up the Long-term Growth of Buffalo Wild Wings* on page 13**

*"...it's probably hard to argue that the Buffalo-Wild-Wings concept is not transferable across most of the nation…along a similar scale as it has been thus far in its founding state of Ohio."*

*A Strong Start to Outperformance* from page 1

Below we outline the constituents of our portfolio and their respective weightings and returns thus far. Each subsequent issue will include Valuentum's discussion of the latest changes to the portfolio, a summary of new names on our watch list, as well as analysis and trends impacting companies on our Best Ideas List.

Our investment process will be 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 List are the cream up the crop based on our stock picking methodology.

*"The goal of our Best Ideas Newsletter is to outperform the S&P 500 Index and to generate positive returns regardless of the broad market environment."*

**OUR BEST IDEAS -- as of July 13, 2011** — **Best Ideas Portfolio Inception Date: May 17, 2011**

| Portfolio Holdings | Symbol | VBI Score* | First Purchase Date | Cost Basis/Share ($) | Total Shares | Total Cost ($) | Current Value/Share ($) | Current Value ($) | Dividends Received | % of Portfolio | % Return |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *Bullish* | | | | | | | | | | | |
| Apple Corp. | AAPL | 10 | 17-Jun-11 | 328.99 | 30 | 9,876.70 | 358.02 | 10,740.60 | 0.00 | 10.1% | 8.7% |
| Altria Group | MO | 8 | 28-Jun-11 | 26.43 | 378 | 9,997.54 | 26.86 | 10,153.08 | 0.00 | 9.5% | 1.6% |
| Ancestry.com | ACOM | 10 | 17-May-11 | 39.00 | 256 | 9,991.00 | 43.70 | 11,187.20 | 0.00 | 10.5% | 12.0% |
| Astronics | ATRO | 10 | 6-Jun-11 | 24.93 | 401 | 10,003.93 | 32.87 | 13,180.87 | 0.00 | 12.4% | 31.8% |
| Buffalo Wild Wings | BWLD | 7 | 13-Jul-11 | 65.42 | 152 | 9,950.84 | 67.83 | 10,310.16 | 0.00 | 9.7% | 3.6% |
| Collective Brands | PSS | 8 | 11-Jul-11 | 15.09 | 662 | 9,996.58 | 14.46 | 9,572.52 | 0.00 | 9.0% | -4.2% |
| EDAC Tech | EDAC | 9 | 6-Jun-11 | 4.08 | 2450 | 10,003.00 | 4.85 | 11,882.50 | 0.00 | 11.2% | 18.8% |
| Precision Castparts | PCP | 8 | 6-Jun-11 | 152.07 | 65 | 9,891.55 | 161.70 | 10,510.50 | 0.00 | 9.9% | 6.3% |
| Republic Services | RSG | 8 | 19-May-11 | 32.95 | 303 | 9,990.85 | 30.27 | 9,171.81 | 60.60 | 8.6% | -7.6% |
| *Bearish* | | | | | | | | | | | |
| AMR Corp. | AMR | 1 | | | --- No Short Position --- | | | | | | |
| *Put Options* | Feb-2012 -- $5 strike | | 13-Jul-11 | 0.73 | 10 | 747.00 | 0.71 | 710.00 | | 0.7% | -5.0% |
| Under Armour | UA | 4 | | | --- No Short Position --- | | | | | | |
| *Put Options* | Jan-2012 -- $77.50 strike | | 13-Jul-11 | 9.20 | 1 | 928.00 | 8.90 | 890.00 | | 0.8% | -4.1% |
| Guggenheim Airline ETF | FAA | n/a | | | --- No Short Position --- | | | | | | |
| *Put Options* | Dec-2011 -- $35 strike | | 13-Jul-11 | 3.70 | 3 | 1,120.00 | 1.95 | 585.00 | | 0.5% | -47.8% |
| Cash | | | | | | 7,503.01 | | 7,563.61 | | 7.1% | 0.8% |
| **Portfolio Value** | | | | | | 100,000.00 | | | 106,457.85 | | **6.5%** |
| SPY | | | 17-May-11 | 132.69 | 754 | 100,000.00 | 131.84 | 99,359.41 | 473.28 | 100.00% | |
| **Benchmark Value** | | | | | | | | | 99,832.69 | | **-0.2%** |
| **Under/Outperformance** | | | | | | | | | | | **6.6%** |

| Watch List | Symbol | VBI Score* | Notes |
|---|---|---|---|
| *Bullish* | | | |
| Big Five Sporting Goods | BGFV | 8 | Big Five is significantly undervalued. We'd initiate a position if it became relatively more attractive than our existing longs. |
| Microsoft | MSFT | 8 | We think Microsoft is worth $35 per share. We're waiting for a technical breakout to initiate a position. |
| Reynolds American | RAI | 7 | We like dividends and view them as an integral part of our strategy. If the new cigarette warning labels pressure Reynolds' stock, we may initiate a position. |
| Rick's Cabaret | RICK | 8 | Rick's is significatly undervalued, and we'd initiate a long position if it became relatively more attractive than our existing long ideas. |
| *Bearish* | | | |
| Churchill Downs | CHDN | 4 | Churchill Downs is saddled with overpayment/selection risk with its acquisition program. We'd layer on a large put position if its equity reached $50 per share. |
| LinkedIn | LNKD | 4 | We think LinkedIn is overvalued and are looking for the opportune time to layer on a put position. We might take a stab if its equity reached $120 per share. |

This portfolio is not a real money portfolio. Data as of July 13. Cost basis includes commissions. Results include dividends, but not interest received on cash balance.

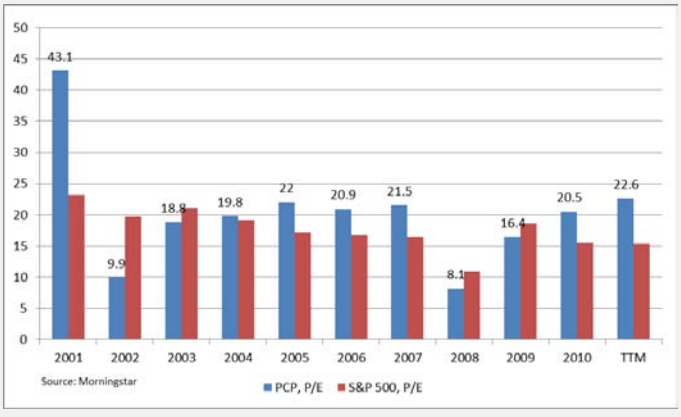
* See page 15 regarding the Valuentum Buying Index (VBI)

**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.

*Why We Like Commercial Aerospace* from page 2

bender has an enviable position on all of the jet-engine programs of the major powerplant manufacturers (GE, Rolls Royce, Pratt & Whitney)--spanning such platforms as the A380 double-decker, 787 Dreamliner, and A350. Plus, the firm has been working with these jet makers for decades and has secured increased dollar-content (revenue per engine) on future programs. Aside from this nice tailwind in its investment cast products segment, the firm will also benefit from the future pace of new aircraft deliveries in its forgings and fasteners segments, which round out its aerospace portfolio.

With that backdrop, let's examine Precision Castparts' potential upside. Commercial OEMs and aircraft suppliers often benefit from the market's short-sidedness, which results in the application of a hefty multiple on future earnings, assuming the near-term picture remains bright at that time. As the commercial aircraft delivery upswing ensues--when the major OEMs achieve near-term targets for 737/A320 production and the first customers of the 787 and 747-8 take delivery--look for the market to eventually place an inflated multiple on future earnings of most participants at some point during this upswing. In Precision Castparts' case, we're already there, with this low-cost metal bender garnering an earnings multiple consistent with historical peaks. Therefore, most equity appreciation for the firm will most likely be driven by earnings expansion during the next several years.




After viewing the chart above, Precision often garners a multiple in the high-teens / low 20s on trailing earnings during strong times in the aerospace sector. Interestingly, during the peak of the previous aerospace delivery cycle (in calendar 2007), the firm garnered roughly a 20x multiple on forward earnings for fiscal 2009 (which turned out to about $7.50). So, with this ballpark 20x multiple in mind (on a forward basis), let's examine Precision's earnings trajectory during the next few years.

Assuming metal price pass-throughs do not generate material gyrations in revenue (a base-case forecast), the firm's top-line should expand roughly in step with large commercial deliveries (with some adjustment for lead time) in coming years-- the aerospace end market generates about 60% of the firm's total revenue with power and general industrial accounting for the balance). Also providing additional tailwinds to revenue expansion are share gains via previous acquisitions and higher dollar content per aircraft. Further, the firm's operating margins should expand in coming years thanks to higher throughput (operating leverage) and continued cost-containment.

| (in millions of USD) | FY2010A | FY2011A | FY2012E | FY2013E | FY2014P | FY2015P |
|---|---|---|---|---|---|---|
| Total Revenue | 5,459 | 6,220 | 6,942 | 8,105 | 8,711 | 9,042 |
| YoY % Growth | -19.4% | 13.9% | 11.6% | 16.8% | 7.5% | 3.8% |
| LCA Units* | 972 | 1,027 | 1,206 | 1,287 | 1,310 | 1,334 |
| YoY % Growth | -0.7% | 5.7% | 17.4% | 6.7% | 1.8% | 1.8% |
| Operating Income | 1,423 | 1,503 | 1,735 | 2,156 | 2,369 | 2,387 |
| Operating Margin | 26.1% | 24.2% | 25.0% | 26.6% | 27.2% | 26.4% |
| YoY % Growth | -10.2% | 5.6% | 15.5% | 24.2% | 9.9% | 0.7% |
| Diluted EPS | $6.49 | $7.04 | $8.12 | $10.06 | $11.05 | $11.13 |
| YoY % Growth | -12.7% | 8.6% | 15.3% | 23.9% | 9.8% | 0.7% |
| Consensus EPS** | | | $8.51 | $9.98 | n/a | n/a |

*Boeing and Aircraft deliveries (historical and projected) -- based on calendar year.
**Source: Yahoo

In fiscal 2013 (ending March 2013), Precision is expected to earn roughly $10 per share, with significant earnings expansion expected in the following year (fiscal 2014). Based on historical market tendencies and the trajectory of the firm's growth, it would not be surprising to see Precision trade up to near $200 per share (20 x 10) within the next couple years.

But how attractive is Precision on a discounted cash-flow basis? Using the same forecasts that resulted in the table above and expanding the horizon to 10 years (an appropriate period given that commercial aerospace cycles last about 7 years from peak to subsequent peak; view the delivery chart above), Precision's shares are

***Why We Like Commercial Aerospace* continued on next page**

worth between $130 to $140 (assuming a discount rate in the high-single-digits), representing little downside risk from today's levels. Importantly, utilizing a discounted cash-flow process is one way to sort out or dismiss claims regarding earnings quality.

In short, Precision's shares have substantial valuation support at the $130 level and could rise to as much as $200 during the coming upswing. Investors should pick an entry point that best suits their given level of risk. We think it belongs on our Best Ideas List at today's levels.

**What About Other Commercial Aerospace Suppliers?**

The aerospace supply chain is littered with public suppliers, and investors should expect a rising-tide-lifts-all-boats phenomenon in coming years, with perhaps the best performers being the ones that are least-followed on the street.

First, a small-cap name we added to our Best Ideas List is Astronics (ATRO), a maker of lighting systems and electrical power systems for the commercial (nearly 60% of revenue) and military and general aviation markets. The company's electronics products provide in-seat power for passengers and power in-flight entertainment systems (IFE) found on commercial jetliners. Astronics is benefiting from a trend of increasing IFE and in-seat power on new generation aircraft and has a decent position on new builds such as the 787, A380, and A350. Though customer concentration is some risk (Panasonic Avionics Corp. accounts for about 27% of sales), the firm should experience strong growth in the years ahead. Based on consensus estimates for next year, the company is trading at less than 13x earnings on sales growth of about 15% (check out the firm's most recent presentation here). With a market cap of less than $300 million, Astronics is not on many investors' radar screens.

We'll close with the mentioning of one micro-cap play whose respective equity can largely be viewed as a call option on future aerospace growth. This firm needs very little to go its way during the coming upswing to really move the needle with respect to operating and share-price performance. This company is EDAC Technology Corp. (EDAC), a $20 million market cap (yes, that's not a typo: it's tiny) supplier of precision components (jet engine parts, special tooling, etc.) to the aerospace sector. United Technologies (UTX) is its largest customer at about 44% of revenue, and EDAC has secured a position on the firm's geared turbofan engine (high pressure compressor hubs, turbine disks, etc.), which is turning into a favorite powerplant among commercial OEMs in the narrowbody arena.

The firm is also a supplier on Boeing's 787 Dreamliner (fan cowl, fan blisk) and the Joint Strike Fighter (compressor integrated blade rotors, compressor fan case, etc.). In fact, less than five years ago, EDAC was producing parts for only one client and a single engine, but now the firm is on over ten major engine programs across a wider range of customers. Growth in backlog has been stunning, and thanks to a new multi-year $42 million agreement to supply additional engine parts to a leading European engine maker (announced this year), backlog now stands at over $171 million from about $140 million at the end of 2010 and just over $20 million in 2005--that's about 2.3x the firm's annual revenue run-rate and over 8x its market cap, revealing nice visibility.

EDAC is profitable and has negligible exposure to raw material cost fluctuations (it has a dollar-for-dollar passthrough to customers). Plus, the firm's first-quarter performance showed improvement over last year, and management indicated on the call that its order pipeline remains active. With daily dollar volume at just $44,000, institutional investors will not be too active in this firm's stock, and retail investors should view EDAC's equity as an interesting call option on future aerospace demand. EDAC could reach its previous highs of $6 per share during the coming upswing, offering 50% upside from today's levels. The firm has performed nicely since we added it to our Best Ideas List.

*Our Thesis on Ancestry.com* from page 3

**Ancestry.com's long-term market opportunity is phenomenal.**

Ancestry.com provides a complete experience for users interested in building out their family trees, learning about their family histories, and uncovering pictures and stories about their family's past. Genealogical research is not new. What is new, however, is how users are performing genealogical research. Many now flock to the convenience of using searchable, digitized databases on the internet to accomplish what was once a snail-mail and painstaking research effort. Perhaps the greatest evidence of the emergence of this structural shift is the growth rates of gross subscriber additions at Ancestry.com during the past few years. Thanks in part to a successful television show, "Who Do You Think You Are?" (WDYTYA), gross subscriber additions have more than doubled to 1.02 million in 2010 from 480k in 2007.

Ancestry.com's subscribers now total 1.6 million at the end of the first quarter of 2011, roughly doubling levels from the end of 2007. Despite this impressive growth during the past few years, the firm's market opportunity remains robust. As Ancestry.com continues to invest in new content on its website, previous users that opted to cancel have started to come back. In fact, according to management on their first-quarter earnings call, about 20% of gross subscriber additions per period are returning customers. As such, the aggregate 2.7 million gross subscriber additions during the past four years is probably the best gauge to use as the current penetration rate of Ancestry.com's addressable market. In other words, it's fair to assume that users that may have stumbled upon the website a number of years ago may now again be interested in the firm's upgraded services.

There are a few ways of sizing up Ancestry.com's potential market opportunity. Management is targeting roughly 16 million subscribers across an estimate of roughly 163 million households. This may be a touch optimistic. According to the US Census Bureau, there are roughly 39.6 million people in the US that are above the 65+ age category, a demographic well-known for pursuing genealogical research. If we restrict Ancestry.com's market opportunity to just the 65+ age bracket, based on the 2.7 million gross subscriber additions during the past 4 years, only 6.8% of this market has recently used Ancestry.com's product offering. Based on Ancestry.com existing subscriber base of 1.6 million, just 4% of this market currently uses its services.

Admittedly, it's unfair to restrict Ancestry.com's market opportunity to just the 65+ age group. The firm's customer base spans all age groups, as we doubt that the 65+ age group is completely responsible for the 1 million downloads of Ancestry.com's mobile app for the iPhone, iPad, and iPod. Nonetheless, such an exercise reveals the firm's vast subscriber growth potential ahead of the company. And with viewership of its television show WDYTYA at many, many times its current subscriber base, a doubling or tripling of subscribers over time should be viewed as a conservative base-case forecast.

**The firm's incremental margins on new subscribers are more than triple that of current reported results, offering a long runway for earnings leverage.**

Ancestry.com generates over $200 in annual revenue per subscriber on customer acquisition costs of about $80 (these metrics were better in the firm's first-quarter results). Incremental margins on each new subscriber are north of 60% and dwarf the firm's reported operating margins of 20% in 2010 and 15.6% in the first quarter of 2011. With subscriber growth thus far, operating margins have already advanced 12 percentage points from the 8% mark in 2008. With such a vast market opportunity in front of it, operating leverage will be substantial, and long-term operating margins are likely to hit over 50% within the next 5 to 7 years.

At the high end of its guidance range for 2011, management is targeting revenue and total subscribers of $400 million and 1.73 million, respectively. Consensus estimates for 2011 and 2012 appear too low, in our opinion.

***Our Thesis on Ancestry.com* continued on next page**

**Ancestry.com's cash-rich, subscription-based business model benefits from one of the strongest competitive advantages out there -- the network effect.**

Ancestry.com's business model is a veritable cash cow, as the firm reaps subscription revenue across a plan duration mix of monthly, quarterly, 6-month, and annual subscriptions. The firm also benefits from product sales at about 7% of revenue, but subscription growth should dwarf its contribution over time. At the end of the first quarter of 2011, about 60% of the firm's subscribers are on an annual plan and 33% are on a monthly plan, with the balance choosing quarterly or a half-year service. Although churn rates are much higher for monthly subscribers, which represent about 60% of gross subscriber additions, Ancestry.com charges a higher fee for providing the convenience of allowing monthly subscribers to move in and out of the service over time.

This customer convenience often results in high reported cancellation rates per quarter, but it's important to note that a meaningful portion of the churn represents satisfied subscribers that expect to return at a later date, pending additional content upgrades. Ancestry.com has invested between 14%-17% of revenue per year in technology and development to keep subscribers coming back for more. For users relatively new to genealogical research, a subscription to Ancestry.com could last years, as discovering 128 great-great-great-great-great grandparents, for example, could take some time.

It's difficult not to be fond of Ancestry.com's competitive position. After all, encountering another subscriber on the firm's website with a common ancestor could save years of time and lots of money, a feature that goes unmatched by competitors. And as more subscribers input their family histories and trees on its website, the more valuable Ancestry.com's product offering becomes to the incremental subscriber – a true network effect. Many subscribers also add stories and pictures to their trees as well, offering new users the rare chance to learn more about their family's past and even view the face of a long-lost ancestor.

**The firm's social-networking endeavors and international efforts are only in the early innings.**

Though a transaction is not to be expected, Ancestry.com's product offering can be viewed as a natural extension or ancillary service to the social-networking behemoth Facebook. Management expects to launch a substantial improvement to its social-networking capabilities within the next quarter or two, and it would not be surprising if Facebook is a large partner in this effort. This is a key positive catalyst for further subscriber acceleration, especially within the younger age demographics.

International growth presents another opportunity for Ancestry.com. Non-US subscription revenue represented roughly 25% of last year's total subscription revenue, with the UK and 'all other countries' expanding nearly 70% during the period. As Ancestry.com acquires additional foreign content during the

*"Management expects to launch a substantial improvement to its social-networking capabilities within the next quarter or two, and it would not be surprising if Facebook is a large partner in this effort."*

*Our Thesis on Ancestry.com* continued on next page

next few years, non-US growth should be expected to accelerate further.

Ancestry.com also has the opportunity to ramp up sales of advertising on its website, a revenue stream that appears to be minimal at this time. With a subscriber base of 1.6 million that likely invests hours of time on its website, it'd be valuable for Ancestry.com to further develop this profitable revenue stream. Other subscription-based business models with similar customer demographics have been successful, and there doesn't appear to be any reason why Ancestry.com couldn't do the same.

**The firm's valuation presents significant upside potential and little downside risk.**

Though investors may shy away given the firm's lofty earnings multiple, it's probably best to look at this high-growth firm through a discounted cash-flow model. With our relatively bullish, yet achievable forecasts for the firm's adjusted EBITDA and enterprise free cash flow, we think Ancestry.com is worth $70 per share. This represents over 60% upside from today's price levels.

If we were to perp 2012 enterprise free cash flow at a growing perpetuity of just 3% and add the $100 million in net cash sitting on Ancestry.com's balance sheet at the end of the first quarter, we'd arrive at an equity value of about $40 per share. It seems very likely that Ancestry.com will achieve free cash flow growth well north of a mere 3% for many years to come, revealing little downside risk at today's prices.

## Apple is Significantly Undervalued

*By Valuentum Analysts*

We often use a discounted cash-flow model as a means to back into the current share price of firms in order to ascertain whether the market is unfairly pricing their stock relative to reasonable long-term growth and profitability assumptions. In Apple's case, it appears that the market is certainly concerned about future growth rates, almost to the tune of merely expecting inflation-like expansion beginning toward the middle of this decade.

Although in the land of technology, competition adapts quickly and a few years from now can be viewed as the distant future, Apple represents a compelling risk-reward opportunity at these levels based on our analysis. Often, evaluating a firm via a discounted cash-flow model and re-engineering its stock price can provide a better picture of a company's investment potential on a risk-reward basis than even the most clearly written prose.

Below, we display our valuation-model summary that generates a fair value for Apple in the $320 to $340 range. Apple would need to hit some major speed-bumps in terms of growth beyond year 4 (fiscal 2014) in order to justify that share price level. And while metrics such as the trailing P/E, PEG ratio, and P/S are valuable to some degree, there's probably no better perspective gained in terms of valuation than viewing a company through its future free cash flow stream. In doing so, investors also get a better understanding of the key drivers behind a firm's business (which factors to pay attention to and which ones to de-emphasize).

The summary on the next page assumes that Apple achieves consensus growth rates for revenue during the next two years (perhaps a conservative outcome given the accelerated traction the iPhone has had against Research in Motion's (RIMM) Blackberry, with expansion then slowing to 3% by year 5 (fiscal 2015). Earnings are expected to hit consensus during the next two years and then slow dramatically in the years beyond, largely due to this declining revenue growth. As it's probably worth

*Apple is Significantly Undervalued* **continued on next page**

repeating, these are the forecasts that would drive Apple's valuation to roughly equal its current stock price. Though maintaining double-digit growth rates for each of the next five years may be difficult for Apple (given the law of large numbers and the burden of constant innovation), we think the market's current expectation for inflation-like top-line expansion at Apple in year 5 (fiscal 2015) and beyond is too conservative.

The box below reveals what fair value we targeted by adjusting our intermediate-term and long-term forecasts for Apple -- $320 to $340 per share ($335 specifically). As mentioned before, the model assumes Apple achieves consensus estimates for both top-line and bottom-line this year and next.

| Apple Inc. | AAPL |
|---|---|
| Fair Value -- the instrinsic value of the firm | 335.00 |
| Upside -- the upside potential based on historical volatility of operating performance | 437.00 |
| Downside -- the downside potential based on historical volatility of operating performance | 233.00 |
| | |
| Phases of the Model | |
| Phase I Present Value -- the value generated between years 1 through 5 | 101,740 |
| Phase II Present Value -- the value generated between years 6 through 20 | 134,000 |
| Phase III Present Value -- the value generated after year 20 | 48,487 |
| Total Firm/Enterprise Value (present value) -- the sum of Phase I-III present values | 284,228 |
| Net Balance Sheet Impact -- cash less debt less other adjustments | 25,620 |
| Total Equity Value -- the residual value belonging to shareholders | 309,848 |

## Republic Services: A Trash Stock Worth Picking Up

*By Valuentum Analysts*

As Benjamin Franklin once said, "nothing is certain but death and taxes." If he had lived during our time, Franklin would probably have added a couple other certainties - and garbage would have been among them.

The US non-hazardous solid-waste services industry generates annual revenue in excess of $50 billion, a staggering number just to keep our streets clean. Public companies (like Waste Management (WM), Republic Services (RSG), Waste Connections (WCN), etc.) dominate this market, generating greater than 60% of industry revenues and controlling an equal percentage of valuable disposal capacity. The top line for the group can be expected to expand at a nominal-GDP rate, with pricing growth in the industry adding an additional tailwind thanks to recent consolidation (Republic Services/Allied Waste), a rational focus on return on invested capital, and cost pressures facing independent mom-and-pop trash companies and municipalities.

There are a couple reasons to be fans of the waste-services industry:

**1) Operators generate strong and predictable cash flow.**

Within the collection line of a waste hauler's business (typically 60-70% of revenue; about 75%-plus in Republic's case), residential services provided to municipalities and individual households are on a service-based model (not-volume based) and can largely be viewed as insulated from economic pressures. Such a constant revenue stream helps to mitigate cyclical pressures in a trash taker's commercial collection and industrial roll-off lines, which also fall into the overall waste-collection category.

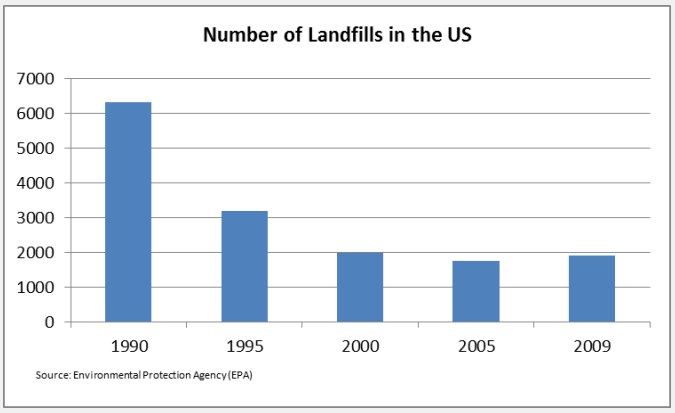
Cell-by-cell landfill build-out provides additional flexibility with respect to capital outlays, as haulers can scale back expenditures during troubled economic times. Waste Management's results speak to the cash-flow stability of this business, and Republic's free cash flow margin will return to double-digit levels this year following its acquisition of Allied Waste a few years ago.

**2) There are huge barriers to entry in the landfill business.**

Transfer and disposal (typically 20%-30% of revenue; about 18% of revenue in Republic's case) is the most lucrative revenue stream in the waste business. Landfill ownership can largely be viewed as the primary competitive advantage for a solid-waste operator. Though anyone that can finance a truck can bid on collection routes (service is undifferentiated), new entrants are at a significant disadvantage for disposal.

For starters, building a landfill is expensive, time-consuming (permits can take 3-7 years to obtain, sometimes longer), and NIMBY (not-in-my-backyard) opposition has only increased with suburban sprawl. Subtitle D of the Resource Conservation and Recovery Act (1991) significantly increased the cost and complexity of landfill ownership (composite liners, leachate collection systems, zoning, etc.). As a result, many landfills in the US have been closed, and disposal airspace should only become more valuable over time.

*Republic Services: A Trash Stock Worth Picking Up*
**continued on next page**




Since collected waste must go somewhere (direct haul is only practical for 40-50 miles), the company that controls the disposal assets in a given "wasteshed" (locality) often dictates pricing. Owning the only dump in town also limits hefty tipping fees paid to other participants. Waste Management and Republic Services internalize--dispose of into their own company-owned landfills--more than 60% of collected waste, bolstering operating margins relative to privately-held, independent operators. Importantly, landfilling still represents the most prominent form of disposal, declining only 3 percentage points (as a percentage of generation) during the last decade. Materials recovery (including recycling) should continue its march upward, but the pace of this trend is far from tragic for the waste-hauling sector.

**Republic's Story**

After its acquisition of Allied Waste, Republic now operates roughly 190-plus solid municipal-waste landfills from under 60 pre-acquisition, second only to Waste Management's 271 sites. These disposal assets represent a long-term strategic benefit that will only become more valuable over time due to an increasingly onerous regulatory environment and continued citizens' group opposition to greenfield sites.

Through long-term exclusive franchise contracts with municipalities, Republic operates as a monopoly in nearly 30% of its markets. Plus, Republic arguably has the most attractive franchise deal in the country, an exclusive contract that runs through 2035 with Las Vegas. Its enormous Apex regional landfill in Clark County, Nevada, is the busiest facility in the country and should enjoy years of strong cash flow generation from one of the fastest-growing areas in the country.

Although Republic has largely captured its targeted synergies related to the Allied transaction, continued execution should drive free cash flow margins to levels even higher than peer Waste Management. Specifically, Republic's guidance for $860 million to $885 million for free cash flow in 2011 seems achievable and breaches the double-digit mark as a percentage of revenue (check out Republic's most recent presentation here).

On an enterprise free cash flow basis, we're looking at annual levels comfortably above the $1 billion mark. Assuming a meager 2% long-term growth rate, a high-single-digit cost of capital (perhaps a conservative assumption given yields on its recent new issues), and accounting for the trash taker's elevated net debt load, a fair value for the firm's equity rests in the high $30 per share, roughly 20% upside from current levels--and a fairly large mispricing for a steady-eddy, defensive firm such as Republic. To sweeten the deal for investors, the trash taker also pays a nice annual dividend yield of 2.5%, the payout of which will likely increase later this year.

## Altria's Yield is Tempting

*By Valuentum Analysts*

*Some readers may be surprised that (Altria) is a top performer for investors in the face of the onslaught of government restrictions and legal actions that have cost the firm tens of billions of dollars and threaten the cigarette manufacturer with bankruptcy.*

*But in the capital markets, bad news for the firm often is transformed into good news for investors. Many shun the stock in the company and fear that its legal liability for producing a dangerous product--cigarettes--will eventually crush the firm. This aversion to the firm pushes down the price of (Altria's) shares and raises the return to investors who stick with the stock.*

*As long as the firm survives and continues to be very profitable, paying out a good fraction of its earnings in the form of dividends, investors will*

*Altria's Yield is Tempting* continued on next page

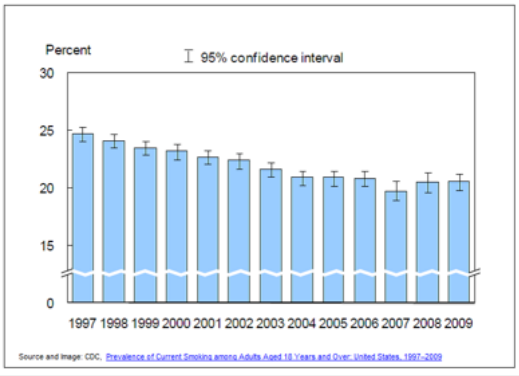
*continue to do extraordinarily well.*

--- "The Future For Investors," Jeremy J. Siegel explaining why Altria (MO) "has been the golden company that beat the market by 9 percent per year over the last half century and left every other firm far behind in the race to be number one (through 2003)."

In Siegel's now somewhat dated book, readers learned of the magnificent returns one could garner by holding a solid dividend-paying company that is continuously pressured with uncertainty through both the ups and downs of its share price. The reinvested dividends during the troughs of a firm's stock price often find a way of propelling the overall return of that stock to meaningful outperformance when the shares ultimately reach new highs during optimistic times. We tend to agree with Siegel on this point and believe Altria Group to be a core position on our Best Ideas list.

The FDA's recently announced that it will require new, larger warning labels on the packaging and advertising of cigarettes come fall of next year, but we don't expect such new labeling to have a material impact on the domestic cigarette-making industry. For one, cigarette smoking in the US has already been in decline for years (see chart below), and the FDA's projections for the number of those that will likely quit as a result of the new, larger warning labels is but a drop in the bucket compared with the 46 million Americans who currently smoke.

**Figure 8.1. Prevalence of current smoking among adults aged 18 years and over: United States, 1997-2009**




Source and image: CDC, Prevalence of Current Smoking among Adults Aged 18 Years and Over: United States, 1997–2009

If Altria's share price begins to face pressure in anticipation of the impact of such new labeling next year, we'd be looking to increase our exposure to the firm. Not only would it then garner a higher yield than today's levels of about 5.7% under that scenario, but any market overreaction would further enhance our total return via reinvested dividends at the bottom should the stock return to new highs. Altria is currently targeting roughly an 80% payout ratio, and with expectations for the firm to earn nearly $2.20 per share by 2012, we could see as much as 15% dividend growth in two years to an annual payout of over $1.70 per share, which represents a projected yield of 6.5% based on its current share price. We also think Altria is undervalued on a discounted cash-flow basis.

Given the uncertain economic climate and the defensive characteristics of the tobacco industry, we have also added Reynolds American (RAI) to our watch list. The firm boasts a similar yield (5.7%) and target payout ratio (80% of earnings), and its innovative capsule technology is driving share increases in Camel's menthol category, a trend perhaps overlooked by the investment community. With expectations for the firm to earn about $2.84 in 2012, the company has a projected yield of just over 6% at current share price levels, slightly below that of Altria. We continue to watch this firm opportunistically.

*Sizing Up the Long-term Growth of Buffalo Wild Wings* from page 3

In 1982, Buffalo Wild Wings built its first location near the Ohio State University. First-quarter same-store-sales of company-owned stores and franchised stores are now experiencing accelerated growth from last year, with the metrics increasing 3.6% and 1.6%, respectively, providing additional market support for more restaurants down the road.

Buffalo Wild Wings' growth opportunity can be sized up in a number of ways, but a population-per-restaurant-per-state ratio may be the most revealing of this franchise's potential. For example, if "B-Dubs" achieves a similar population-per-restaurant per state ratio as that of Ohio, the saturation point could be north of 2,000 units in the U.S. That's roughly 50% greater than management's forecast. And this doesn't include expected growth in Canada (which could reach 50 units in five years). Even a pretty hefty haircut on the 2,000-plus number, to account for more competitive regions (New York) and areas where demographics may not support such a ratio (Florida), growth well in excess of management's expectations seems achievable in the long haul.

| | --- # of Restaurants Open, as of end of 2010 --- | | | | | |
|---|---|---|---|---|---|---|
| | Company-owned | Franchised | Total | Pop. (thous) per Rest.* | Saturation (units)** | Current Penetration*** |
| Alabama | 1 | 9 | 10 | 478 | 35 | 28% |
| Arizona | 4 | 13 | 17 | 376 | 47 | 36% |
| Arkansas | — | 5 | 5 | 583 | 21 | 23% |
| California | 4 | 18 | 22 | 1,693 | 274 | 8% |
| Colorado | 14 | 2 | 16 | 314 | 37 | 43% |
| Connecticut | — | 5 | 5 | 715 | 26 | 19% |
| Delaware | — | 5 | 5 | 180 | 7 | 76% |
| Florida | 2 | 22 | 24 | 783 | 139 | 17% |
| Georgia | 9 | 1 | 10 | 969 | 71 | 14% |
| Hawaii | — | 1 | 1 | 1,360 | 10 | 10% |
| Idaho | — | 3 | 3 | 523 | 12 | 26% |
| Illinois | 12 | 45 | 57 | 225 | 95 | 60% |
| Indiana | 3 | 45 | 48 | 135 | 48 | 100% |
| Iowa | 13 | — | 13 | 234 | 22 | 58% |
| Kansas | 9 | — | 9 | 317 | 21 | 43% |
| Kentucky | 12 | 5 | 17 | 255 | 32 | 53% |
| Louisiana | — | 9 | 9 | 504 | 33 | 27% |
| Maryland | — | 9 | 9 | 642 | 43 | 21% |
| Massachusetts | — | 1 | 1 | 6,548 | 48 | 2% |
| Michigan | — | 41 | 41 | 241 | 73 | 56% |
| Minnesota | 23 | 4 | 27 | 196 | 39 | 69% |
| Mississippi | 2 | 5 | 7 | 424 | 22 | 32% |
| Missouri | 6 | 17 | 23 | 260 | 44 | 52% |
| Montana | — | 3 | 3 | 330 | 7 | 41% |
| Nebraska | 6 | 2 | 8 | 228 | 13 | 59% |
| Nevada | 9 | 1 | 10 | 270 | 20 | 50% |
| New Jersey | — | 2 | 2 | 4,396 | 65 | 3% |
| New Mexico | — | 3 | 3 | 686 | 15 | 20% |
| New York | 9 | 10 | 19 | 1,020 | 143 | 13% |
| North Carolina | 14 | 4 | 18 | 530 | 70 | 26% |
| North Dakota | — | 5 | 5 | 135 | 5 | 101% |
| Ohio | 23 | 62 | 85 | 136 | 85 | 100% |
| Oklahoma | — | 13 | 13 | 289 | 28 | 47% |
| Oregon | — | 5 | 5 | 766 | 28 | 18% |
| Pennsylvania | 4 | 1 | 5 | 2,540 | 94 | 5% |
| South Carolina | 1 | 7 | 8 | 578 | 34 | 23% |
| South Dakota | — | 2 | 2 | 407 | 6 | 33% |
| Tennessee | 17 | — | 17 | 373 | 47 | 36% |
| Texas | 35 | 51 | 86 | 292 | 185 | 46% |
| Virginia | 11 | 19 | 30 | 267 | 59 | 51% |
| Vermont | — | 1 | 1 | 626 | 5 | 22% |
| Washington | — | 1 | 1 | 6,725 | 50 | 2% |
| West Virginia | — | 8 | 8 | 232 | 14 | 59% |
| Wisconsin | 16 | 8 | 24 | 237 | 42 | 57% |
| | 259 | 473 | 732 | 410 | 2213 | 33% |

* State population divided by # of restaurants opened in that state (2010)

** Number of restaurants needed in corresponding state to equal Population/Restaurant ratio of Ohio

*** Current number of restaurants divided by Saturation (units)

Source: Buffalo Wild Wings, United States Census Bureau

***Sizing Up the Long-term Growth of Buffalo Wild Wings* continued on next page**

Right now, Buffalo Wild Wings' earnings and stock price are benefiting significantly from a decline in chicken wing prices (about 20%-25% of cost of sales). This is despite traffic concerns regarding the potential for an abbreviated or canceled NFL season.

In the firm's first quarter, "B-Dubs" paid 36% less for chicken wings than it did in the first quarter a year ago ($1.22/lbs vs. $1.91/lbs). Declining costs drove restaurant cost of sales down an impressive 2.7 percentage points on restaurant sales that expanded nearly 20% from the first quarter of last year.

Chicken wing prices are certainly volatile, and investors can probably expect them to bounce back from first-quarter levels through the course of the year due to seasonal trends. However, should Buffalo Wild Wings' stock take a hit from this expected rebound in wing prices or from additional concerns about the temporary impact the NFL lockout may have on traffic and performance this year, long-term investors could be presented with a nice entry point to capitalize on the growth potential of this franchise. Buffalo Wild Wings should be on every small-cap growth investor's watch list.

Update: We subsequently added Buffalo Wild Wings to our Best Ideas portfolio.

# Our Methodology – The Valuentum Buying Index

*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, 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. 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.

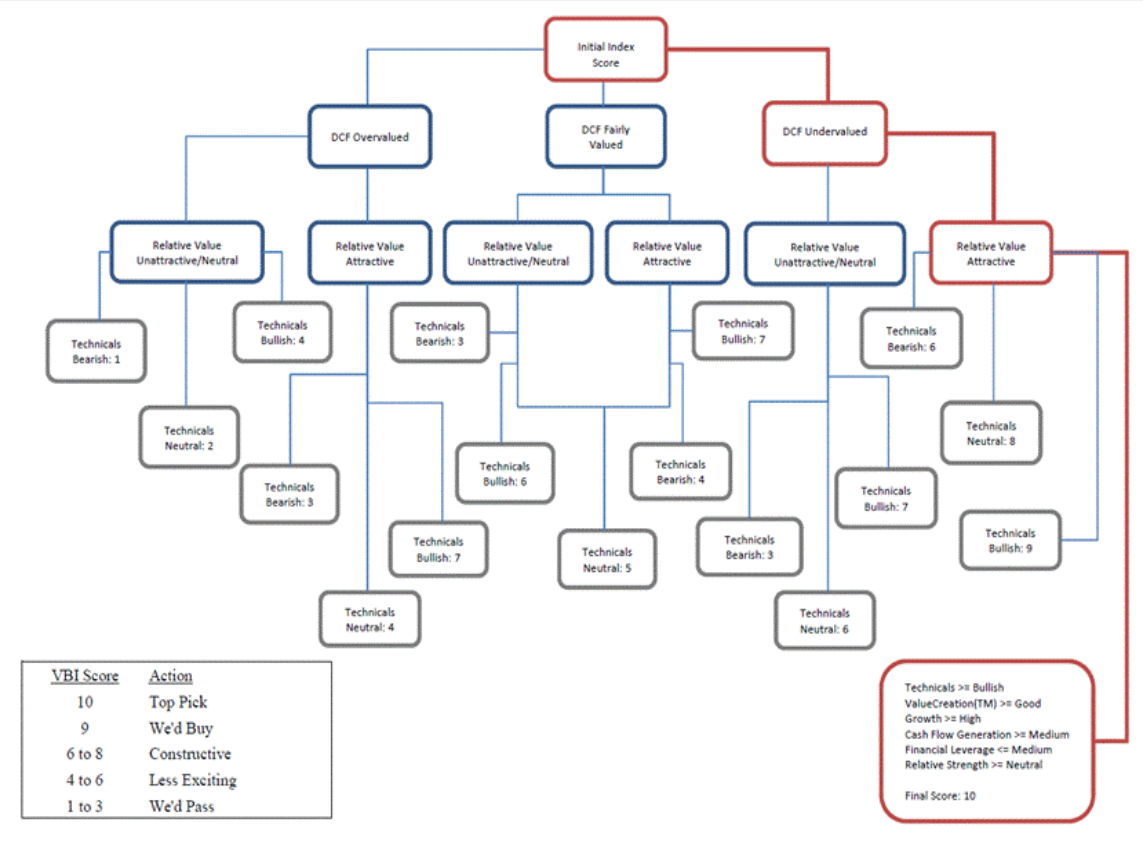
Let's discuss how a firm can score a 10, the best mark on our index (a "Top Pick"). First, the company would need to be 'undervalued' on a DCF basis and 'attractive' on a relative 'value basis. The stock would also have to be exhibiting 'bullish' technicals. The firm would need a ValueCreation rating 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 sell"). 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.

Please view the flow chart on the next page regarding our Valuentum Buying Index.

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

# Our Methodology – The Valuentum Buying Index

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OUR BEST IDEAS NEWSLETTER

# Valuentum Securities

Stock Analysis: From Value through Momentum Investing

August 15, 2011
Volume 1 Issue 2

Valuentum Securities Inc.
www.valuentum.com info@valuentum.com

| Portfolio Return | Benchmark Return | Outperformance |
|---|---|---|
| 1.4% | -10.5% | 11.9% |

Portfolio Inception Date: May 17, 2011

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*"Valuentum had another strong month of relative outperformance, widening the gap relative to the S&P 500 by over 1100 basis points."*

## Stay the Course

*By Brian Nelson, CFA*

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It's incredible to have witnessed the volatility in the markets the past few days. To be honest, not much has changed with respect to fundamentals since a few weeks ago, a time when companies were reporting fantastic second-quarter results (see page 11). In fact, according to this Reuters report, more than 70% of companies in the S&P that have reported have beat earnings estimates on 11% bottom-line growth--and that growth number includes a 27% fall in financial/bank earnings and relatively flat performance from utilities. Recessionary? We don't think so.

And do we think the fact that companies reporting prior to August 2nd have been cautious on providing outlooks due to the ill-timed debt-ceiling deadline? Yes. Does this mean that the third and fourth quarter will be weak, even in the face of record backlogs from industrial giants like General Electric (GE) and solid order growth from the likes of United Technologies (UTX), International Business Machines (IBM) and a host of other companies and resilience in the consumer as witnessed by Apple (AAPL), McDonald's (MCD), and

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**Please see *Stay the Course* on page 2**

## Widening Outperformance to Over 1100 Basis Points

*By Valuentum Analysts*

Valuentum had another strong month of relative outperformance, widening the gap relative to the S&P 500 to over 1100 basis points. We had some great reports out of Apple (AAPL) and EDAC Tech (EDAC) that propelled returns on the long side, and the performance of our put positions has been fantastic – in all three cases (Under Armour, Guggenheim Airline ETF, and AMR), we cashed in on a double (100%+ gain). In doing so, we now have some dry powder to the tune of about 13% cash, which we plan to allocate opportunistically in the weeks ahead, pending opportunities on both the long and short side – we disclose our watch list beginning on page 11.

**Please see *Widening Outperformance to Over 1100 Basis Points* on page 5**

***Stay the Course*** **continued from page 1**

Disney (DIS)? We don't think so. But what about the poor orders indicated in the July ISM data? Did we mention companies took a short-term pause as they waited for Washington to discover reason and raise the debt ceiling toward the end of July?

And what about the downward revision in first-quarter GDP to negligible expansion and the likelihood that second-quarter GDP may also be revised downward from the advance estimate of 1.3%? Umm, did we mention that S&P earnings have advanced 11% in the same quarter the market is expecting a downward revision (including poor performance in financial/bank earnings), and most were driven by higher revenue expansion. What about the speculative short attacks on the French banks—Societe Generale, BNP Paribas, and Credit Agricole—which was prompted by unfounded rumors that a particular credit rating agency may downgrade France's debt rating, despite comments by that particular credit rating agency suggesting that it won't? Rumors, speculative short attacks...yes, no kidding. Are the US banks concerned? Well, if Jamie Dimon, CEO of JPMorgan (JPM), is any indication, he's still enjoying his bus tour in California.

*"It's quite clear that the market is searching for the next crisis and paying little attention to what's actually happening – strong and better-than-expected corporate earnings, continued lower borrowing costs for some time to come, and falling oil prices to buoy consumer spending."*

And what about "The Bernanke" and the Fed's comments about holding rates low through mid-2013? We don't see how this can possibly be bad for consumers or businesses, as money flows into riskier assets -- whether it be longer-dated corporates (further reducing borrowing costs), emerging markets (pushing the dollar lower, helping exports, GDP), or equities (and gold). And has the risk of the United States government defaulting on its debt really increased 50 basis points, as measured by CDS spreads, since 2007 -- as this report suggests? Yes, and again, we're not joking--ridiculous. It's probably worth noting that the US government has debt in dollars and it owns a printing press -- we should expect long-term inflationary pressures, not a US default.

Perhaps the best way to explain all of the volatility in the past several trading sessions is to look at the market's reaction immediately following the FOMC's release -- up, then down 200 on the Dow only to finish 400 points higher in a matter of minutes (a 600-plus point range). The answer is that investors aren't thinking clearly -- they're not only getting misinformation but it is being exacerbated as they are hearing it from people on CNBC with fancy titles. It's quite clear that the market is searching for the next crisis and paying little attention to what's actually happening -- strong and better-than-expected corporate earnings, continued lower borrowing costs for some time to come, and falling oil prices to buoy consumer spending.

It is a shame that we're dealing with speculative attacks on banks again (this time in Europe though) as the sole source of concern and uncertainty. We firmly believe that this is the only unfounded concern that is shaking the global markets. Do investors really believe Europe is not ready to deal with this, or that Bernanke, schooled in Depression economics and with first-hand experience dealing with the events of the US financial crisis just three short years ago, is not ready to act to silence the shorts? Just as we nearly recovered all of the gains lost in the US financial crisis before this recent correction, we will again make new highs in the S&P once this crisis-of-fear and uncertainty passes. And dare we say, even if the economy remains sluggish. Stay the course.

# Company Spotlight: EDAC Tech (EDAC)

*By Brian Nelson, CFA*

It's not every day we come across such a massive mispricing in the market as that of EDAC Tech (EDAC) at these levels, but nonetheless we are amazed at the upside opportunity presented by this stock.

*"Our fair value estimate for EDAC Tech is $10 per share (it's trading at $5-$6 currently)…we make our case for investors interested in picking up a potential double."*

As part of our process, we employ a discounted cash-flow model to arrive at a fair value estimate for every company within our equity coverage universe. In the case of EDAC Tech, a nano-cap aerospace supplier of precision components to jet engine makers, we think the shares are significantly undervalued at today's prices of roughly $5-$6 per share. Based on our DCF process, our fair value estimate for EDAC Tech is $10 per share (assuming a 9.4% weighted average cost of capital), and we reveal our forecasts and valuation summary below to make our case for investors interested in picking up a potential double**.**

**Valuation Summary**

For starters, let's evaluate EDAC Tech's performance through the first six months of this year.

EDAC TECHNOLOGIES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
For the three and six months ended July 2, 2011 and July 3, 2010

| (In thousands except per share amounts) | For the three months ended July 2, 2011 | July 3, 2010 | For the six months ended July 2, 2011 | July 3, 2010 |
|---|---|---|---|---|
| Sales | $ 21,880 | $ 18,841 | $ 42,079 | $ 36,628 |
| Cost of Sales | 18,249 | 16,583 | 35,639 | 32,229 |
| Gross Profit | 3,631 | 2,258 | 6,440 | 4,399 |
| Selling, General and Administrative Expenses | 1,903 | 1,529 | 3,848 | 3,260 |
| Income from Operations | 1,728 | 729 | 2,592 | 1,139 |
| Non-Operating Income (Expense): | | | | |
| Interest Expense | (273) | (226) | (533) | (452) |
| Other | 3 | - | 8 | 360 |
| Income before Provision For Income Taxes | 1,458 | 503 | 2,067 | 1,047 |
| Provision for Income Taxes | 481 | 158 | 682 | 343 |
| Net Income | $ 977 | $ 345 | $ 1,385 | $ 704 |
| Income per share data (Note A): | | | | |
| Basic Income Per Common Share | $ 0.20 | $ 0.07 | $ 0.28 | $ 0.15 |
| Diluted Income Per Common Share | $ 0.19 | $ 0.07 | $ 0.27 | $ 0.14 |

*Source: EDAC Tech's 2Q Form 10-Q.*

As you can see from the performance thus far this year, EDAC is on track to earn roughly $0.54 per share in 2011 (diluted income per common share was $0.27 through the first six months). Importantly, however, the firm's second quarter results are more revealing of the trajectory of the firm's business, in which it earned $0.19 per share. From our second-quarter earnings note:

EDAC's revenue reached record levels, jumping 16%, while net income almost tripled. Sales in all three of its major product lines improved – EDAC Aero, APEX Machine Tool and EDAC Machinery – while the firm's bottom line improved materially thanks to more cost-effective manufacturing and a better product mix (gross margin increased 460 basis points in the period)

*Company Spotlight: EDAC Tech* **continued on page 6**

## Abbott's Shares Look Cheap

*By Valuentum Analysts*

As part of our process, we employ a discounted cash-flow model to arrive at a fair value estimate for every company within our equity coverage universe. In Abbott's (ABT) case, we think the shares look undervalued at today's prices. Our fair value estimate for Abbott is $63 per share, over 25% higher than where it is currently trading. In the spirit of transparency, our DCF model valuation template can be found here. We make this template available to investors, and it can be re-used to value any other operating firm.

*"Our fair value estimate for Abbott is $63 per share, over 25% higher than where it is currently trading."*

**Valuation Summary**

We assume annual average top-line growth will average in the mid-single-digits over the next five years. We also assume that Abbott will grow earnings at a mid-teens pace during our discrete five-year horizon. We expect the firm's excess returns on invested capital will fade to our estimate of its cost of capital (about 9%) by Year 20 in our model.

**Please see *Abbott's Shares Look Cheap* on page 7**

## Buffalo Wild Wings' Growth Story Intact

*By Valuentum Analysts*

Buffalo Wild Wings (BWLD) reported decent second-quarter results that showed impressive top-line expansion but some cost pressures due to its store-expansion plans. We continue to believe in the long-term growth story of "B-Dubs" and would add to our position in our Best Ideas portfolio on any significant weakness in the shares.

Total revenue for the second quarter increased over 26% on the heels of a 5.9% same-store sales increase in company-owned restaurants and a 2.7% jump at franchised restaurants (the firm operated 43 additional company-owned restaurants versus the same period a year ago). Average weekly sales for company-owned restaurants were up nearly 12% in the period, while the measure advanced 4% for franchised locations – both solid increases. The firm's bottom-line expanded about 16%, a little lighter than what we were expecting, but still very strong performance.

*"We continue to believe that management's expectation for the long-term restaurant potential of its chain is conservative."*

The company opened 18 new locations across the US and its first international location in Toronto during the quarter, strong unit-growth momentum. Management expects to open 29 new company-owned restaurants in the US and 3 in Canada during the second half of 2011 (it expects franchisees to open about 37 locations). We continue to believe that management's expectation for the long-term restaurant potential of its chain is conservative.

**Please see *Buffalo Wild Wings' Growth Story Intact* on page 7**

*Widening Outperformance to Over 1100 Basis Points* from page 1

| Portfolio Return | Benchmark Return | Outperformance |
|---|---|---|
| 1.4% | -10.5% | 11.9% |

Portfolio Inception Date: May 17, 2011

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 (see page 11), as well as analysis and trends impacting companies on our Best Ideas List (see pages 3, 4, 9, and 11 in this issue).

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-picking methodology (see page 14 in this issue).

*"The goal of our Best Ideas Newsletter is to outperform the S&P 500 Index and to generate positive returns regardless of the broad market environment."*

**OUR BEST IDEAS -- as of August 12, 2011** — **Best Ideas Portfolio Inception Date: May 17, 2011**

| Portfolio Holdings | Symbol | VBI Score* | First Purchase Date | Cost Basis/Share ($) | Total Shares | Total Cost ($) | Current Value/Share ($) | Current Value ($) | Dividends Received | % of Portfolio | % Return |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *Bullish* | | | | | | | | | | | |
| Apple Corp. | AAPL | 9 | 17-Jun-11 | 328.99 | 30 | 9,876.70 | 376.99 | 11,309.70 | 0.00 | 11.2% | 14.5% |
| Altria Group | MO | 6 | 28-Jun-11 | 26.43 | 378 | 9,997.54 | 25.20 | 9,525.60 | 0.00 | 9.4% | -4.7% |
| Ancestry.com | ACOM | 6 | 17-May-11 | 39.00 | 256 | 9,991.00 | 30.58 | 7,828.48 | 0.00 | 7.7% | -21.6% |
| Astronics | ATRO | 6 | 6-Jun-11 | 24.93 | 401 | 10,003.93 | 26.50 | 10,626.50 | 0.00 | 10.5% | 6.2% |
| Buffalo Wild Wings | BWLD | 7 | 13-Jul-11 | 65.42 | 152 | 9,950.84 | 62.49 | 9,498.48 | 0.00 | 9.4% | -4.5% |
| Collective Brands | PSS | 6 | 11-Jul-11 | 15.09 | 662 | 9,996.58 | 9.75 | 6,454.50 | 0.00 | 6.4% | -35.4% |
| EDAC Tech | EDAC | 9 | 6-Jun-11 | 4.08 | 2450 | 10,003.00 | 6.02 | 14,749.00 | 0.00 | 14.5% | 47.4% |
| Precision Castparts | PCP | 7 | 6-Jun-11 | 152.07 | 65 | 9,891.55 | 152.37 | 9,904.05 | 0.00 | 9.8% | 0.1% |
| Republic Services | RSG | 6 | 19-May-11 | 32.95 | 303 | 9,990.85 | 26.91 | 8,153.73 | 60.60 | 8.0% | -17.8% |
| *Bearish* | | | | | | | | | | | |
| Prior to the publishing of this edition, we notified our subscribers that we closed out our put positions of Under Armour (Jan 2012 -- $77.50 strike) at $20.60 per contract, the Guggeheim Airline ETF (Dec 2011 -- $35 strike) at $7.40 per contract, and AMR, the parent of American Airlines, (Feb 2012, $5 strike) at $1.56 per contract. We received total proceeds of $5,801.50 after transaction costs from these trades. We feel that there are better opportunities out there than holding on to these deep-in-the-money puts at this time. | | | | | | | | | | | |
| We currently do not have any open put positions. Please view our watch list beginning on page 11 for ideas we are tracking. | | | | | | | | | | | |
| Cash | | | | | | 7,503.01 | | 13,365.11 | | 13.2% | |
| **Portfolio Value** | | | | | | 100,000.00 | | | 101,415.15 | | **1.4%** |
| SPY | | | 17-May-11 | 132.69 | 754 | 100,000.00 | 118.12 | 89,019.52 | 473.28 | 100.00% | |
| **Benchmark Value** | | | | | | | | | 89,492.80 | | **-10.5%** |
| **Under/Outperformance** | | | | | | | | | | | **11.9%** |

| Watch List | Symbol | VBI Score* | Notes |
|---|---|---|---|
| *Bullish* | | | |
| Please see our Watch List beginning on page 11. | | | |
| *Bearish* | | | |
| Please see our Watch List beginning on page 11. | | | |

This portfolio is not a real money portfolio. Data as of July 13. Cost basis includes commissions. Results include dividends, but not interest received on cash balance.

* See page 15 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.

*Company Spotlight: EDAC Tech* continued from page 3

... The company's backlog now stands at $168 million, up from $134 million sequentially (that's just three months ago), and represents over 6 times its market cap. We believe this backlog to be of the higher-margin variety, and increased throughput should continue to drive margin improvement.

We think the firm's second quarter performance is more indicative of what investors can expect in the third and fourth quarters, where we are forecasting earnings per share of $0.12 and $0.19, respectively - putting our full-year 2011 earnings per share forecast at $0.58. By extension, EDAC Tech is currently trading at about 8.5 times this year's earnings and less than 7 times next year's earnings (based on our forecasts). These are ridiculous multiples.

Let's dig a bit deeper into the sustainability of this performance. On EDAC Tech's second-quarter conference call, the firm noted that it expects a slight sequential decline in revenue (5-10%) in its third quarter due to seasonality (which explains our relatively lower third-quarter EPS forecast), but noted that revenue should be particularly strong in the fourth quarter of this year as it begins to recognize revenue from a recent large European order.

Regarding sustainable long-term growth, EDAC has secured a nice position on the geared turbo fan engine from United Technologies (UTX) - which represents about 40%-50% of total revenue - and also has a presence on CFM's (GE/Safran) LEAP-X engine, which is an option offered on the best-selling A320neo (new engine option). We expect commercial aircraft deliveries in the next few years to expand considerably, led by increased production rates by Boeing (BA) and Airbus in the narrowbody segment (A320, 737). The recent Paris Air Show and American's (AMR) large order for 460 replacement planes this year speak to the strength of commercial aerospace in coming years.

Importantly, however, EDAC noted that it expects to continue to improve margins in the years ahead, which will be a critical driver behind earnings expansion. Given the operating leverage we've seen out of other jet-engine suppliers like Precision Castparts (PCP) during previous cycles, we're fairly confident in the company's claim regarding margins. We reproduce management's comments from its second-quarter conference call:

Q: I'm just curious about the sustainability of margins at this level ... I mean it's really a remarkable improvement and I was just wondering if you can retain these levels.

EDAC: Our objective is to maintain these levels and by no means be our ceiling. We hope to continue to improve as we work through our development parts that we have done last year and this year. We are very optimistic that we'll able to continue to hold or improve these margins.

With the company's top-line growth trajectory and the prospects for further margin enhancements, we would not be surprised to see the firm earn $0.72 next year - less than 7 times its current price on the heels of about 25% earnings growth. Of note, we don't expect EDAC Tech to achieve the gross margin levels that it achieved in its second quarter (about 16.6%) - the levels management says it can maintain and improve upon - until 2013, meaning our $10 per share fair value could even be conservative. We expect EDAC Tech to expand earnings at a double-digit pace going forward given the expected strength of the commercial aerospace cycle, which we had outlined above.

In all, we think EDAC Tech is significantly undervalued in the $5-$6 per share range. And as it relates to our conviction in the call, the name represents the largest holding in our Best Ideas portfolio at this time.

*Abbott's Shares Look Cheap* continued from page 4

| Abott Laboratories | ABT |
|---|---|
| Fair Value -- the instrinsic value of the firm | 63.00 |
| Upside -- the upside potential based on historical volatility of operating performance | 76.00 |
| Downside -- the downside potential based on historical volatility of operating performance | 50.00 |
| | |
| Phases of the Model | |
| Phase I Present Value -- the value generated between years 1 through 5 | 32,265 |
| Phase II Present Value -- the value generated between years 6 through 20 | 47,348 |
| Phase III Present Value -- the value generated after year 20 | 30,576 |
| Total Firm/Enterprise Value (present value) -- the sum of Phase I-III present values | 110,188 |
| Net Balance Sheet Impact -- cash less debt less other adjustments | (11,594) |
| Total Equity Value -- the residual value belonging to shareholders | 98,594 |

*Source: Valuentum Securities, Inc.*

Our estimated fair value range between $50 per share and $76 per share considers the risks inherent to Abbott's business, as well as the future potential variability in the company's free cash flow stream. We'd consider adding Abbott to our Best Ideas portfolio, if it became relatively more attractive than our existing long ideas.

*Buffalo Wild Wings' Growth Story Intact* continued from page 4

... The firm noted that same-store sales for company-owned and franchised restaurants are increasing at a pace of about 5% and 3%, respectively, so far through the third quarter. Buffalo Wild Wings noted that it should also achieve its net earnings growth goal of 20% for the year, as a result of this continued same-store sales momentum and the NFL season intact. We continue to like the shares.

## Intel's Shares Look Significantly Undervalued

*By Valuentum Analysts*

As of late, Intel (INTC) has been the Microsoft (MSFT) of the chip space. For example, the company beats estimates (in Q1 2011 by a lot), and then maybe moves up or down a percent or two. On its second-quarter earnings call, Intel announced that capital investments will total more than $10 billion for the year, and that PC growth was low double-digits rather than mid-double digits. The shares then experienced a mild sell-off.

However, the company continues to have a near monopoly in a growing sector and produces gobs of free cash flow. On a discounted cash flow valuation, we think Intel shares are worth $26 under a bear-case scenario, but $34 in our estimated scenario. However, given the market's distaste for Intel, we think the shares should fetch a value of at least $26, which implies a P/E multiple of 11x our 2011 forecast.

**The PC is dead...or is it?**

Interestingly enough, a lot of the problems overhanging shares of Microsoft are creating an overhang on Intel. Much has been made about the rise of the tablet and the death of the PC. We think these worries are completely overblown. Although we love Apple (AAPL) and think the tablet has considerable growth left, we don't think it's going to completely cannibalize the PC market. Additionally, according to most tech companies, the US is in the middle of a technology refresh cycle, which could accelerate if and when the macro situation improves.

Even if some companies abandon the Windows platform, Intel still supplies high margin processors to Apple. Admittedly, we'd be even more excited if Apple were using an Intel processor rather than its own A5, but we still think low-double digit PC growth will continue, as will the sales of Macs with Intel insides. In addition to PC growth, the build-out of the cloud will continue to be a tailwind for Intel. Data center processor revenue was up 14% in the second quarter, and the business has nearly doubled

*Intel's Shares Look Significantly Undervalued* continued on next page

since 2009. We think companies building clouds will continue to trust Intel to power these clouds, and we could see data center processors becoming an even bigger part of the company's revenue mix going forward.

**More than just microchips**

We also think the market has been quick to write-off Intel as little more than a parts supplier. With the acquisition of McAffe for $7.68 billion in 2010, Intel also entered the profitable software security and solutions industry. We expect McAffe to capitalize on the proliferation of corporate mobile devices and the downfall of Research in Motion's (RIMM) Blackberry platform. McAffe should contribute at least another $2 billion to Intel's top line in 2011. Clearly, analysts expected the bottom line contribution to be much greater than it was, as EPS growth was only 7.4% versus 21.1% top-line growth in the second quarter.

Though McAffe has stiff competition from free spyware and other security options on the consumer level, we think the enterprise business will continue to grow, and the results should eventually translate to increased profitability. In fact, Intel even forecasted that gross margins should increase by nearly 400 basis points to 64% in Q3. We think some of this can be attributed to the high-margin software business.

**A clean balance sheet, healthy dividend make Intel a low-risk investment**

With very little long-term debt, in fact so little that the company earns positive interest on the loads of cash it's creating, we don't think there's much downside risk in Intel at $23 a share. It's not a huge discount (12%) from our bear-case scenario, but we think the buybacks and healthy dividend (around 3.2%) should support the stock.

Even if the market fails to recognize the earning power and free cash flow of Intel, we think $26 is the lowest price investors should demand for their shares. This implies a trailing P/E multiple of 11 (which it currently trades at), and a dividend yield of 2.8%. However, if the market realizes that PCs aren't dead and that Intel has diversified revenue streams, we think shares are worth as much as $34, giving investors a chance at nearly 50% upside.

## Visa Remains a Growth Story, Shares Have Upside

*By Valuentum Analysts*

If you've been watching Visa (V) and Mastercard (MA) over the last two years, both were highflying stocks with tremendous room for revenue and earnings growth. However, in a seemingly random act, Senator Dick Durbin decided to identify service revenues from the debit card duopoly as detrimental to the consumer.

Since the famed "Durbin Amendment" was added to Dodd-Frank, the shares of Visa have dipped as low as $66 when the Federal Reserve announced an 11 cent processing limit on debit cards, to as high as $90 after news broke that the Federal Reserve doubled the limit to 22 cents.

Although we think the company is more valuable without price ceilings, on a discounted-cash flow basis, shares of Visa are worth over $100 each, in our opinion. This puts our valuation at about 20x 2011 earnings, which is reasonable given that we expect EPS to grow 30% in fiscal year 2011.

**Visa's business model is tremendous**

Unlike competitors American Express (AXP) and Discover (DFS), Visa and Mastercard do not take on the lending risk associated with issuing credit cards. Instead, they rely on companies like JP Morgan Chase (JPM), Citi (C), Bank of America (BAC), Nordstrom (JWN), HSBC (HBC), and Capital One (COF) to take on the lending risk, while they collect payments every time their debit and credit cards are swiped. This broker model was costly, as Visa did not become very profitable until they acquired enough users, both via merchants and consumers, to process enough transactions.

With no lending risk and high barriers to entry, Visa possesses a rare business that throws off tons of cash as long as consumers continue to spend money. Additionally, the company obtains complete data on its users that can be sold to direct marketers.

**One of the most dominant competitive advantages: The Network Effect**

The network effect is easily one of the strongest competitive advantages a company can have,

*Visa Remains a Growth Story* **continued on next page**

and Visa has an impressive network. With around 300 million credit card accounts and around 400 million debit cards in the United States, Visa is easily the biggest player in the transaction processing business. The company processed an impressive $5 trillion in fiscal year 2010, with over 1.8 billion cards worldwide.

Because so many people "go with Visa" (to quote Morgan Freeman), almost every merchant in the United States, big or small, accepts Visa. Though there are still a few cash-only places scattered throughout the United States, new advances in technology, such as iPads that can process credit cards, Visa should be accepted almost everywhere. We measure the strength of Visa's competitive advantages by the sustainability of the gap between return on invested capital and its weighted average cost of capital. This, in conjunction with a rigorous DCF process, represents the core of what we do at Valuentum in arriving at our best ideas.

**Debit downer?**

As we said earlier, we'd prefer to see no restrictive regulation on Visa and Mastercard's debit card business. Debit card business eclipsed credit card business again in 2010, with total transactions processed climbing 18.5% to $2.9 trillion in the US. Though these debit card transactions will no longer be nearly as profitable as credit card transactions, we think a combination of pressures by Visa and its big banking partners like JPMorgan Chase and Bank of America will encourage consumers to substitute back to credit cards. As two of the biggest credit card lenders in the country, they may be far more interested in pushing their clientele into their profitable credit card offerings, rather than the no-longer profitable debit cards.

In response to the Durbin Amendment, we've already seen banks eliminate free checking and debit card rewards, which we suspect could decelerate debit card growth. Regardless, we think the move towards a cashless society will benefit total transaction volume.

**International growth overlooked, PayPal overestimated**

With the way it's been trading lately, it appears investors are focusing on the slower growth U.S. business (up 9%) rather than a robust international business (up 22%). CEO Joe Saunders stated that he thinks continued debit growth in other countries will continue to drive expansion. We think a build-out of the Visa network globally could catch on elsewhere as it has in the U.S., and that it should continue to be a profitable endeavor.

Furthermore, a lot has been made about eBay's (EBAY) PayPal online processing system becoming the future of payments. However, we think the high take rates (about 9%) are unsustainable when both Visa and Mastercard have significantly lower (2-3%) take rates and have far more users and accounts. Additionally, we think the acquisition of CyberSource, a leading online payments solution, will help make Visa one of the next generation payment players.

**Lots of uncertainty surrounds the future**

With the passing of the Durbin Amendment, Visa guided down its revenue growth and EPS growth. However, the new outlook only prompted us to lower our fair value estimate for Visa a few dollars to $107 per share. That still leaves plenty of upside, assuming the less profitable debit card transactions do not impact the business more than we expect.

## Ancestry.com Raises Full Year Guidance

*By Valuentum Analysts*

Best idea, Ancestry.com (ACOM) reported solid second-quarter results that showed nice subscriber growth and impressive EBITDA margins. The firm raised its outlook for revenue and adjusted EBITDA in 2011, but held the line with its previous subscriber guidance, a move we think is conservative given the huge influx of subscribers in its first quarter. We think the firm has tremendous upside and are retaining our current position in our Best Ideas portfolio.

Subscriber growth of 28% from the same period a year ago fueled a 36% increase in the company's top line during the quarter. We were particularly impressed with the level of average monthly revenue per subscriber, which continues to move steadily upward. Churn did increase a bit during the period, but we think the uptick in churn is more a function of the substantial first-quarter subscriber growth than any impact from the economic situation, a view management

*Ancestry.com Raises Full-Year Guidance* **continued on next page**

reiterated on the call. Impressively, the firm's adjusted EBITDA margin hit 37.9% in the quarter compared to 33.9% in the year-ago period. Management did caution, however, that these levels may not be reached again in the back half of the year due to a heightened focus on acquiring new content and ongoing marketing and advertising spend. Free cash flow nearly doubled from the same quarter a year ago, and we believe the firm to be significantly undervalued on the basis of our DCF process.

Ancestry.com has traded off following its second-quarter report, as investors may be confusing management's conservatism with its 2011 subscriber growth forecast for underlying weakness. We maintain, however, that consensus estimates for this year and next are too low and think performance will continue to be strong in the quarters ahead.

## Raising Our Fair Value of McDonald's

*By Valuentum Analysts*

At Valuentum, we focus on the long-term intrinsic value of a company via a discounted cash-flow valuation process. That means building an extensive model for each company, and updating it when material events occur that may change our opinion. McDonald's second quarter results were very impressive, outpacing consensus as well as our estimates. As such, we have revisited our valuation and are raising our fair value estimate. We now forecast stronger top-line growth and better operating margins, the combination of which results in our current $87 per share fair value estimate.

**Top-line and bottom-line surprised us.**

We originally thought forecasting top-line growth in the double-digits might be a little bullish, given lackluster same-store-sales numbers earlier in the quarter. However, in its second quarter, McDonald's posted revenue growth of 16.1% and operating margins of 31.7%, which came in 120 basis points higher than our forecast. This culminated in diluted earnings per share of $1.35, beating our estimates by eight cents. We weren't expecting such large margin expansion (180 basis points over the previous quarter), given the input-cost headwinds that have impacted most companies. However, the advantage of being the largest restaurant-chain in the world allowed them to effectively squeeze suppliers and keep costs in check.

**Several positives to take away.**

We noted incredible sales in China (same store sales up a reported 14%) and continued excellence in supply-chain management as two of the biggest positives in the quarter. CFO Pete Bensen noted that most of the growth in China was driven by new customer traffic. This is meaningful, as getting people inside the store will not only drive new sources of revenue, but it will also build brand loyalty, while allowing customers to explore different and often higher margin options.

Additionally, growth in Europe was spectacular, considering the poor macro-economic situation and uncertainty in several core countries. Same store sales numbers were up 5.9%, and operating income was up 24% (though only 10% in constant currencies). Even Japan performed well, and only 17 stores remain closed due to the earthquake.

Even the US region did well, as same store sales increased to 4.5% in the second quarter, up from 2.9% in the first quarter. We think the company's focus on adding value to customers via inexpensive beverages and new product offerings are really resonating with customers. The reintroduction of the "Daily Double" value meal, priced below $4 in most regions, should be another factor in the firm's third quarter, and continued warm weather may keep driving traffic higher.

**Shares continue to look fairly valued, but a pull-back could create an attractive entry point.**

With shares surging to about $88, we think McDonald's still looks about fairly valued. However, we continue to be fans of the company and have very little, if anything, to say negatively about its last quarter. Although McDonald's tends to be somewhat of a defensive name, we think a pullback could provide a nice entry point, with downside protection offered by its healthy dividend and share buyback program.

## Another Strong Quarter from Apple

*By Valuentum Analysts*

Apple (AAPL) reported its fiscal third-quarter results, and they were fantastic. The firm's top- and bottom-lines exceeded both consensus and our expectations, and we continue to believe that there is further upside to the shares. We added them to our Best Ideas List June 17, a trading session before its near-term bottom at about $310 per share. The stock surged to over $400 per share during after-hours trading following its report, and we will continue to monitor its trading activity in the coming weeks to see if taking a slice of our position off the table may be warranted. We will update our subscribers before we take any action.

Apple posted quarterly revenue of $28.6 billion and earnings per share of $7.79, both well in excess of consensus (which was about $25 billion in revenue and about $5.87 per share on the bottom line). The company's gross margin advanced 2.6 percentage points to 41.7% during the quarter, representing solid improvement and easing some rumors about gross-margin pressure. The company sold over 20.3 million iPhones in the quarter (up 142% from the same period a year ago) and about 9.3 million iPads during the period (nearly triple what it sold in last year's quarter). Unit sales of the iPod declined in the period, but this should be of little concern to investors, as this product is merely being cannibalized by strong sales of the iPhone and iPad, both of which can play music. The iPhone numbers are particularly impressive, given the impending launch later this year of an updated iPhone, which will boast an improved processor and camera. By extension, we view these strong iPhone results as a material negative for Research in Motion (RIMM).

Importantly, the firm's cash hoard, comprising of 'cash and cash equivalents,' 'short-term marketable securities', and 'long-term marketable securites,' advanced to a total of $76.2 billion, or over $80 per share (about 20% of its total market capitalization). We think this cash hoard provides Apple with increasing flexibility to retain its solid position and impressive trend of constant innovation across all of its major growth engines.

Apple's guidance for its fiscal fourth-quarter in terms of revenue and earnings were less than compelling, but Apple has a tendency of setting the market's expectations low, and then delivering significant outperformance, which it did this quarter. In all, we maintain our positive view on Apple's fundamentals.

## Expanding Our Watch List

*By Valuentum Analysts*

With the markets showing signs of high volatility as of late, we've widened our watch list to include names that have reported strong second-quarter earnings (some reporting as recent as a few weeks ago). We think firms with strong earnings potential are ones that could see the biggest bounce when the market recovers, as multiple compression from both a declining price and expanding earnings makes these names particularly interesting for investors that fall into the value camp. Though we fall short of making generalities, we're less enthused about firms that have reported generally weaker second-quarter earnings, despite their share price declines. In other words, we're looking to add best-of-breed names to our Best Ideas portfolio at the most opportune time, and we use a rigorous discounted cash-flow valuation process and a thorough competitive advantage assessment to augment our investment process.

**Kraft Foods (KFT); VBI: 8**

Kraft Foods (KFT) reported solid second-quarter results and indicated that it would split its high-growth global snacks business and its mature, high-margin North American grocery business. The firm also bumped up its 2011 organic net revenue growth and operating earnings per share outlook, to at least 5% (was 4%) and $2.25 (was $2.20), respectively. We were impressed with the firm's second-quarter performance and think its move to create two independent public companies will create value for shareholders over the long haul.

**CBS Corp. (CBS); VBI: 8**

CBS Corp. (CBS) reported strong second-quarter results that showed excellent performance pretty much across the board. Revenue jumped 8% from the same quarter last year thanks to solid performance in content licensing and distribution, while operating income before depreciation and

*Expanding Our Watch List* **continued on next page**

amortization (OIBDA) jumped over 50% thanks to strong growth in every segment and a seven percentage point improvement in its OIBDA margin.

**Roper Industries (ROP); VBI: 7**

Roper Industries (ROP) reported solid second-quarter results that showed significant revenue and earnings expansion. Sales jumped 23% (16% organic) in the period to an all-time high, while net earnings expanded over 40%, despite a higher tax rate. The firm's adjusted EBITDA margin expanded over 280 basis points to 28.5% in the period, a strong showing. Free cash flow jumped 41% from the same period a year ago to $145 million, which represented 21% of the firm's sales in the quarter. This is the strongest free-cash-flow conversion rate the firm has seen in years (at least since 2006), and we expect Roper to continue to achieve free-cash-flow levels in the high-teens and low twenties as a percentage of revenue, on average, going forward.

**Eaton Corp (ETN); VBI: 7**

Eaton Corp. (ETN), a diversified industrial manufacturer, reported excellent second-quarter results that showed strong revenue growth and solid earnings expansion. The firm's top line expanded 21% during the period (14% core), while the company's segment margins at the operating level reached all-time highs of 13.9%. This led to net income expansion of almost 50% from last year's quarter, a fantastic showing. Eaten also bumped up its end-market growth expectations for 2011 by a percentage point to 11%, while it raised the midpoint of its full-year earnings per share guidance by $0.15 to $4.06 per share at the high end.

**CNH Global (CNH); VBI: 7**

CNH Global (CNH), the second-largest maker of farm equipment after Deere (DE), posted fantastic second-quarter results, with net sales increasing 24% and net income more than doubling. The firm experienced substantial strength in agricultural equipment and construction equipment revenue, up 22% and 30%, respectively, and translated this performance into solid profitability improvement. CNH's operating margin increased to 10.7% during the quarter from 8.4% in the same period a year ago.

**Coca-Cola (KO); VBI 7**

Coca-Cola (KO) reported second-quarter results that showed strong worldwide volume growth of 6% led by expansion outside of the US, namely Eurasia and Africa (up 7%), the Pacific, which includes China (up 7%), and Latin America (up 6%). Demand for the firm's brand Coca-Cola was particularly impressive in China (up 24%) and Russia (up 17%). Total revenue increased 47% (due primarily to its acquisition of Coca Cola Enterprises' North American operations), though concentrate sales and currency contributed 6 percentage points of growth, respectively.

**Harley Davidson (HOG); VBI: 6**

Harley-Davison (HOG) reported solid second-quarter results that showed strong retail motorcycle sales and solid earnings improvement. Sales of motorcycles and related products advanced 18% as US dealers sold 7.5% more new Harley-Davidson motorcycles in the period compared to last year's quarter, marking the first year-over-year jump in the metric since the fourth quarter of 2006.

**International Business Machines (IBM); VBI: 7**

International Business Machines (IBM) posted strong second-quarter results. The firm's top-line increased 12% (5% adjusting for currency), while net income advanced 8% from the same period a year ago. The firm indicated that hardware, software and services revenue grew at a double-digit pace, and the company raised its full year 2011 operating earnings per share guidance to at least $13.25 from at least $13.15 previously.

*Expanding Our Watch List* **continued on next page**

**United Technologies (UTX); VBI: 6**

United Technologies (UTX) posted excellent second-quarter results, with sales advancing 9% (6% organic) and net income jumping nearly 20% from the prior-year period. The firm's operating margin for the quarter was 15.9%, 120 basis points higher than last year. Impressively, the firm noted that for the first time since mid-2008, all six of its business segments showed organic growth in the period. Further, order rates at Otis were up 23% thanks to strong demand from Asia and China, while order rates for commercial HVAC new equipment at Carrier jumped 13%.

**Honeywell (HON); VBI: 6**

Honeywell (HON) reported second-quarter results that showed strong sales growth and solid earnings expansion. The firm's top-line expanded 15% in the period (7% organic growth), while earnings per share jumped over 40% from the same quarter a year ago thanks to a 70 basis-point expansion of segment margins to 14.3% in the quarter. Honeywell bumped up its full-year revenue guidance to the range of $36.1-$36.7 billion (up $100 million from its previous range) and its 2011 earnings-per-share estimate to the range of $3.85-$4.00 per share from $3.80-$3.95 per share previously.

Other names on our long-idea watch list:

**Abbott (ABT); VBI: 7 – see page 4**

**Intel (INTC); VBI: 7 – see page 7**

**Visa (V); VBI: 6 – see page 8**

**McDonald's (MCD); VBI: 6 – see page 10**

**Big Five Sporting Goods (BGFV); VBI: 7** – visit www.valuentum.com

**Microsoft (MSFT); VBI: 8** – visit www.valuentum.com

**Reynolds American (RAI); VBI: 6** – visit www.valuentum.com

**Rick's Cabaret (RICK); VBI: 6** – visit www.valuentum.com

**Walt Disney (DIS); VBI: 7** – visit www.valuentum.com

**Xerox (XRX); VBI: 7** – visit www.valuentum.com

**Nike (NKE); VBI: 7** – visit www.valuentum.com

On the short-side, we continue to look to initiate a put position on Churchill Downs (CHDN) at $50 per share and LinkedIn (LNKD) at $120 per share, both of which we think are significantly overvalued – but are waiting for them to be extremely so before acting. We also may re-establish our put positions on Under Armour (UA), the Guggeheim Airline ETF (FAA) and AMR (AMR), the parent of American Airlines, if the opportunity presents itself again at higher prices. You can read our thoughts on these put ideas at our website: www.valuentum.com.

# Our Methodology – The Valuentum Buying Index

*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, 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. 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.

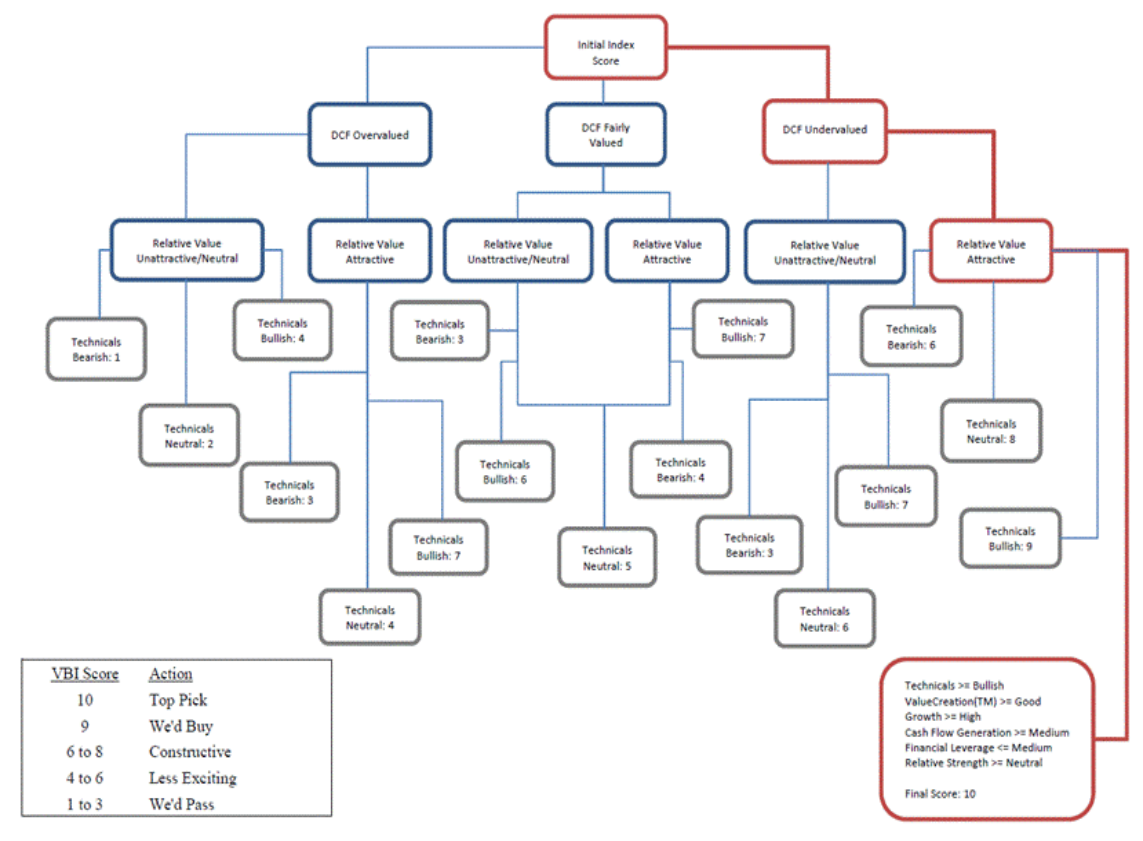
Let's discuss how a firm can score a 10, the best mark on our index (a "Top Pick"). First, the company would need to be 'undervalued' on a DCF basis and 'attractive' on a relative 'value basis. The stock would also have to be exhibiting 'bullish' technicals. The firm would need a ValueCreation rating 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 sell"). 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.

Please view the flow chart on the next page regarding our Valuentum Buying Index.

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

# Our Methodology – The Valuentum Buying Index

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Valuentum Best Ideas Newsletter: Volume 1, Issue 2

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No warranty is made regarding the accuracy of any data or any opinions. The portfolio in the Valuentum Best Ideas Newsletter is hypothetical and does not represent real money. Performance assessment of the Valuentum Buying Index™ is currently ongoing, and we intend to update investors as soon as such results are available. Past performance is not a guarantee of future results.

For general information about Valuentum's products and services, please contact us at info@Valuentum.com.

OUR BEST IDEAS NEWSLETTER

# Valuentum Securities

Stock Analysis: From Value through Momentum Investing

September 15, 2011
Volume 1 Issue 3

Valuentum Securities Inc.
www.valuentum.com info@valuentum.com

| Portfolio Return | Benchmark Return | Outperformance |
|---|---|---|
| 9.9% | -10.8% | 20.7% |

Portfolio Inception Date: May 17, 2011

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*"Our portfolio is now outpacing the S&P 500 by over 2,000 basis points."*

## Keeping Our Eye on the Ball

*By Brian Nelson, CFA*

Brian Nelson, CFA
President, Equity Research
brian@valuentum.com

As followers of Valuentum know, the goal of our Best Ideas portfolio is not only to outperform the market benchmark (the S&P 500 Index), but also to deliver positive returns regardless of the broad market environment. This month we hit a few singles--Collective Brands (PSS) and Apple (AAPL)--and a double with EDAC Tech (EDAC), and our eye continues to remain on the ball as we go to bat for the best investments. Our portfolio is now outpacing our benchmark by over 2,000 basis points (up from about 1100 basis points last month), with a positive return of nearly 10% since inception (May 17, 2011).

EDAC Tech has been the biggest driver of alpha (outperformance) for us thus far, and we decided to trim our position after a nice 90%+ gain (and to prudently reduce our aerospace exposure). We still hold a relatively large position in the company, however, and expect upside to $10 per share based on valuation. We profiled EDAC Tech in the August edition of our Best Ideas Newsletter, which can be found here.

Collective Brands, the owner of Payless ShoeSource…

**Please see *Keeping Our Eye on the Ball* on page 2**

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## Valuentum Begins Publishing 16-page Equity Research Reports

*By Valuentum Editorial Staff*

In case you missed the announcement, we wanted to let you know that we've begun publishing equity research reports on the largest U.S. companies. During the next 12 months, we plan to produce 16-page equity research reports for up to 1,800 companies currently monitored by our analyst team. The reports are available with a subscription to Valuentum.com, our investment Web site.

"We strive to be the champion of the individual investor, and our equity research reports are targeted to meet their needs." said Brian Nelson, president of equity research at Valuentum.

**Please see *Valuentum Begins Publishing…* on page 2**

*Keeping Our Eye on the Ball* continued from page 1

stores, and Apple also posted strong relative outperformance this month. Collective announced that it will pursue "strategic initiatives to unlock shareholder value," which we speculate involves a sale of the company, possibly to a private equity firm. We had expected a strategic re-alignment of the firm, and shares have popped nearly 35% since the last edition of our newsletter. In Apple's case, the firm has handled the announcement of the resignation of already-legendary CEO Steve Jobs quite well, and we continue to expect strong performance from the iPhone-maker in coming periods.

During the month, we also put to work some of the proceeds we received from EDAC Tech and from closing our put positions in the Guggenheim Airline ETF (FAA), AMR Corp. (AMR), the parent of American Airlines, and Under Armour (UA) – all three of which were doubles for us. First, we started a new, small position in Ford (F) – 200 shares -- as we look to capitalize on the realization of pent-up demand for autos in future periods. We also think the market is unfairly beating down the company to a valuation that has now become too difficult to pass up. We also opened up a small position in Intel (INTC) – 100 shares. The firm's 4.3% annual dividend yield coupled with a valuation that speaks to roughly 80% upside has made us pretty excited about the company's total return potential. We expect to add to our positions in Ford and Intel opportunistically in coming periods.

*"(Intel's) 4.3% annual dividend yield coupled with a valuation that speaks to roughly 80% upside has made us pretty excited about the company's total return potential."*

September has been a busy month for us, as we also added to the position of one of our more controversial ideas, Ancestry.com (ACOM) – 40 shares. We think the market is severely underestimating the long-term growth potential of the online family history provider and expect a substantial move upward toward the back half of this year and into next as the market begins to anticipate the release of the 1940 US Federal Census (which will be made public April 2012), a huge catalyst for genealogical research. We profiled Ancestry.com in the July edition of our Best Ideas Newsletter, which can be found here.

**Please see *Keeping Our Eye* on the Ball on page 5**

*Valuentum Begins Publishing…* continued from page 1

"The proliferation of untrustworthy financial opinions on the web and the poor performance of once-trusted independent equity research providers have left the individual investor underserved in today's difficult market environment. Individual investors can count on Valuentum to provide an unbiased, systematic valuation and technical process that culminates in an easily-understood equity research methodology, which ranks stocks on their relative investment merit. Our ranking system, the Valuentum Buying Index™, is fresh, unique and has already shown that it can identify outperforming stocks as revealed by the performance of our Best Ideas Newsletter."

Valuentum analysts perform rigorous discounted cash-flow analysis, assess underlying risks of the investment, and evaluate technical and momentum indicators of a stock in order to pinpoint the best time to buy the most attractive equity investments. For more about our methodology, please see page 17.

# Company Spotlight: Ford Motor (F)

*By Valuentum Analysts*

Famous investor and manager of the Fidelity Magellan Fund Peter Lynch is best known for his "buy what you know" strategy. Though Lynch did a lot more than just go to malls and buy stock in the most popular stores, occasionally the best investment opportunities are right in front of you. We think investors will have a chance to replicate Lynch's famous auto trade of the 1980's today with shares of Ford inexplicably tumbling towards the single digits.

*"Shares of the leaner, meaner Ford have been beaten down. Under $10 per share, Ford is trading at an insanely cheap forward P/E ratio just north of 5 times."*

On a discounted cash-flow basis, we think Ford is worth $20 if we double dip into a second recession, $34 under the continued low-growth scenario, and $48—more than a five bagger—if the economy can make a significant recovery.

CEO Alan Mullaly is one of the best executives in America. He famously took every step necessary to avoid a bailout, by leveraging the company to the fullest extent. Over the past few years, Mullaly has reinvigorated a dying company into the leanest US automaker.

Shares of the leaner, meaner Ford have been beaten down. Under $10 per share, Ford is trading at an insanely cheap forward P/E ratio just north of 5 times. In spite of macro-economic uncertainty, we think it's pretty unbelievable that a company firing on all cylinders is trending downward as if it's selling typewriters. We see several catalysts looming that will help shares appreciate to fair-value levels.

**Lower gas prices (in the near term)**

At first sight, this seems like a dream. No, the industry fundamentals do not match-up long-term at all. Currently, demand outpaces supply globally, and there's a good chance it will be like this for a long time. However, gasoline switches to a cheaper blend in the fall, which will in itself cause prices at the pump to fall. Additionally, we think fears of inflation in China could provide a near-term catalyst to decrease the global demand for oil.

Regardless, if gas prices do remain low for even a short amount of time, it could be a great catalyst for strong Q3 and Q4 sales. A drop in gas prices could also spur demand for less-fuel efficient, but more profitable vehicles like the Ford F-Series, 500, and Expedition.

**Ford steals market share**

Without question, we think this is already well-under way and trending positively. Ford's market share fell from 23.2% in 2000, until it bottomed in 2008 at 14.2%. Since then, Ford, while divesting non-core units, has continued to add additional market share, with 16.7% so far in 2011.

The major driver, contrary to some ideas, is not the lack of a bailout. Certainly that may sway fans of small government, but we don't think it really factors into the minds of many outside of the financial and political realm.

So what's the real driver? People want Fords. It's as simple as that. The company continues to impress with better vehicle offerings year after year.

*Company Spotlight: Ford Motor* continued on page 6

# Collective Brands Beats Estimates, Shares Soar

*By Valuentum Analysts*

Collective Brands (PSS), one of our best ideas, reported second-quarter earnings that beat most analysts' estimates and announced a plan to unlock shareholder value. Sales were up nearly 5%, and net of a large goodwill impairment, earnings came in at $0.16 a share.

The numbers weren't the big news. Collective announced that it will pursue "strategic initiatives to unlock shareholder value" which we speculate involves a sale of the company, possibly to a private equity firm, or a spin-off of the successful PLG group. We've thought that a sum of the parts evaluation shows the true value of Collective, but we underestimated management's willingness to deliver, and are very pleasantly surprised. We are maintaining our fair value estimate of $24, but will be creating a sum of the parts valuation to provide an alternative valuation.

*"It's also important to note that (Collective Brands') stock price action (up ~20% following earnings) was probably dually fueled by takeover speculators and a short squeeze, since nearly 30% of the float was short."*

It's also important to note that the stock's price action (up ~20% following earnings) was probably dually fueled by takeover speculators and a short squeeze, since nearly 30% of the float was short. Collective announced a shareholders' rights plan to protect them in the face of a takeover.

**Please see *Collective Brands...* on page 7**

# Watch List Addition: Rush Enterprises

*By Valuentum Analysts*

We've added Rush Enterprises (RUSHA), a full-service, integrated retailer of commercial vehicles and related services, to our watch list. Through its network of Rush Truck Centers, the company provides one-stop services for the needs of its commercial vehicle customers, including retail sales of new and used vehicles, aftermarket parts sales, service/repair stations, and financing/leasing-related products.

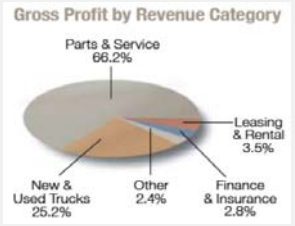



Image Source: 2010 Annual Report

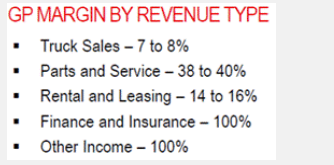



Image Source: Investor Presentation

**Strong high-margin, recurring parts and services revenue stream**

The firm's parts and services segment generates roughly 60% to 70% of total gross profit. This is a higher margin and recurring revenue stream -- more lucrative than truck sales and its rental and leasing business lines. The breakdown of gross profit and gross profit margin are shown in the top two pictures in the right column. The company's parts and services revenue continues to grow rapidly, despite the poor economic environment.

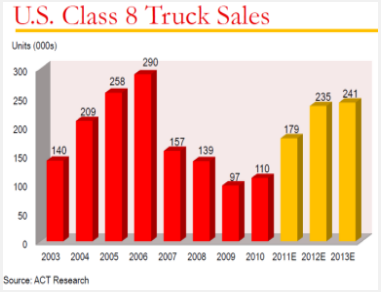



Image Source: Investor Presentation

**What's the opportunity for investors?**

The age of the truck population is the oldest in some time, and we're nowhere near peak levels of truck orders witnessed in 2006 (see the bottom picture in the right column). Plus, we think the replacement cycle is now accelerating for Rush. From its 2Q press release: "The second quarter marked our first meaningful increase in Class 8 and medium-duty truck sales since Class 8 industry orders began increasing in November 2010."

**Please see *Watch List Addition: Rush Enterprises...* on page 7**

| Portfolio Return | Benchmark Return | Outperformance |
|---|---|---|
| 9.9% | -10.8% | 20.7% |

Portfolio Inception Date: May 17, 2011

***Keeping our Eye on the Ball*** **continued from page 2**

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 11), as well as analysis and trends impacting companies on our Best Ideas List.

Our investment process is completely transparent and easy to implement in your own portfolio. As we mentioned earlier, 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-picking methodology.

*"Firms added to our Best Ideas portfolio are the cream of the crop based on our stock-picking methodology."*

**OUR BEST IDEAS -- as of September 13, 2011** — **Best Ideas Portfolio Inception Date: May 17, 2011**

| Portfolio Holdings | Symbol | VBI Score* | First Purchase Date | Cost Basis/Share ($) | Total Shares | Total Cost ($) | Current Value/Share ($) | Current Value ($) | Dividends Received | % of Portfolio | % Return |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *Bullish* | | | | | | | | | | | |
| Apple Corp. | AAPL | 7 | 17-Jun-11 | 328.99 | 30 | 9,876.70 | 384.62 | 11,538.60 | 0.00 | 10.5% | 16.8% |
| Altria Group | MO | 6 | 28-Jun-11 | 26.43 | 378 | 9,997.54 | 26.18 | 9,896.04 | 0.00 | 9.0% | -1.0% |
| Ancestry.com | ACOM | 5 | 17-May-11 | 39.00 | 256 | 9,991.00 | 28.28 | 7,239.68 | 0.00 | 6.6% | -27.5% |
| **NEW: We bought 40 shares of ACOM on 9/12/2011 at $30.46.** | | | | **30.46** | **40** | **1,225.40** | **28.28** | **1,131.20** | **0.00** | **1.0%** | **-7.7%** |
| Astronics | ATRO | 6 | 6-Jun-11 | 24.93 | 401 | 10,003.93 | 27.95 | 11,207.95 | 0.00 | 10.2% | 12.0% |
| Buffalo Wild Wings | BWLD | 7 | 13-Jul-11 | 65.42 | 152 | 9,950.84 | 60.29 | 9,164.08 | 0.00 | 8.3% | -7.9% |
| Collective Brands | PSS | 6 | 11-Jul-11 | 15.09 | 662 | 9,996.58 | 13.03 | 8,625.86 | 0.00 | 7.9% | -13.7% |
| EDAC Tech | EDAC | 6 | 6-Jun-11 | 4.08 | 1225 | 5,005.00 | 8.00 | 9,800.00 | 0.00 | 8.9% | 95.8% |
| **NEW: We sold 1225 shares of EDAC on 8/30/2011 at $7.93 for a 90%+ gain.** | | | | | | | | | | | |
| **NEW: Ford Motor** | **F** | **7** | **12-Sep-11** | **9.94** | **200** | **1,995.00** | **10.17** | **2,034.00** | **0.00** | **1.9%** | **2.0%** |
| **NEW: Intel** | **INTC** | **6** | **12-Sep-11** | **19.89** | **100** | **1,996.00** | **20.76** | **2,076.00** | **0.00** | **1.9%** | **4.0%** |
| Precision Castparts | PCP | 7 | 6-Jun-11 | 152.07 | 65 | 9,891.55 | 163.94 | 10,656.10 | 1.95 | 9.7% | 7.7% |
| Republic Services | RSG | 6 | 19-May-11 | 32.95 | 303 | 9,990.85 | 28.51 | 8,638.53 | 60.60 | 7.9% | -12.9% |
| Cash | | | | | | | | | | 16.3% | |
| *Bearish* | | | | | | | | | | | |
| We currently do not have any open put positions. Please view our watch list beginning on page 14 for ideas we are tracking. | | | | | | | | | | | |
| **Best Ideas Portfolio Value** | | | | | | 100,000.00 | | | **109,865.95** | | **9.9%** |
| SPY | | | 17-May-11 | 132.69 | 754 | 100,000.00 | 117.74 | 88,733.14 | 473.28 | 100.00% | |
| **Benchmark Value** | | | | | | | | | **89,206.42** | | **-10.8%** |
| **Under/Outperformance** | | | | | | | | | | | **20.7%** |

This portfolio is not a real money portfolio. Data as of September 13. Cost basis includes commissions. Results include dividends, but not interest received on cash balance.

* 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.

*Company Spotlight: Ford Motor* continued from page 3

Sales of the Fiesta, a new value and fuel-efficient offering, were up 58% in July, and the new line-up of crossovers and fuel efficient vehicles have helped boost sales across the board. Year-to-date, sales of Ford brand vehicles are up nearly 18% in the United States.

Furthermore, Ford continues to provide customers with the highest selling light-truck offerings (Ford F-series has already sold over 300,000 vehicles to date) and SUVs (Escape up nearly 30%, Explorer up over 100% after a remodel). After eliminating the faltering Mercury brand and divesting Mazda, Jaguar, and Volvo, we think the leaner Ford can approach market share upwards of 17% within the next few years.

**Credit upgrade**

S&P recently downgraded the United States credit, but the same will not be said about Ford. Given its ability to generate free cash flow and consistent commitment to pay down automotive debt, we think Ford stands a chance to be upgraded, lowering its cost of borrowing, which automatically creates value for shareholders.

Additionally, Mullaly has suggested that once investment grade status is reached, Ford will resume paying a dividend. A dividend will likely cause multiple expansion in itself, especially if it is enough to generate some decent income at a sustainable rate.

**Pent-up demand surfaces**

We think this scenario is inevitable and is being completely ignored and neglected by the market. Over the past thirty years, Americans have purchased less than 11 million cars just three times, all during recessions. In fact, the median number of cars purchased over the last thirty years is over 15 million units. This leaves a huge amount of growth from 11.7 million cars in 2010, and a projected 12.5-13 million units in 2011. Additionally, the huge drop-off in cars in 2008-2011 leaves the United States with an aged fleet due for replacement.

We doubt, short of a financial catastrophe, that Americans will buy fewer than 13-14 million cars in 2012-13, simply because older cars are beginning to falter and become far too expensive to repair. The sweet spot of car purchases between 1999 and 2002, which resulted in nearly 70 million units moved, is becoming increasingly obsolete and a good majority of these cars will need to be replaced.

Furthermore, we think a demographic shift from the northern states to the south and west also benefits vehicle sales. Almost no southern or western cities have sufficient infrastructure to transport its influx of northerners tired of the cold and immigrants coming from Latin America. According to the US census, population has boomed nearly 14% in the South over the past decade, while the Mid-West and Northeast have grown at less than 4%. People living in Arizona and Texas literally have to drive more than people in New York and Chicago.

If job growth accelerates, we wouldn't be surprised by auto sales that top 16 or 17 million units. Even if it doesn't, we are very confident Ford, as well as the entire industry, will be selling more cars than they are now.

Update: We added Ford to our Best Ideas portfolio.

*Collective Brands...* continued from page 4

**Payless Domestic continues to struggle**

Much like the last eight quarters or so, Payless Domestic posted weak results; however, management seems committed to finally turning things around. Former CEO Matt Rubel came from a fairly high fashion background, leading both Tommy Hilfiger and Nike's (NKE) Cole Haan unit. In retrospect, his idea to make Payless more fashion forward, but at a higher price-point, clearly didn't resonate with customers. As a result, management laid forth a plan to undo the damage.

Payless plans to lower price-points, shutter unproductive stores (approximately 475 over the next three years), and is conducting extensive market research in an effort to reconnect with its former core customers.

Management briefly touched on how hard its consumer has been hit, supporting our thesis that the lower-end hasn't really recovered from the Great Recession yet. Unemployment for less-educated Americans continues to significantly outpace that of the more-educated population. High fuel and wage stagnation aren't making things any better, but that also means that things, aside from rampant deflation, cannot get much worse for Payless' key demographics.

For the time being, refocusing on a value proposition is a strong move for Payless Domestic and should help the company stall its negative same store sales trend.

**PLG enjoying product success**

PLG, which consists of heavy hitters like Saucony and Sperry, performed tremendously well, with wholesale revenues up 25% and retail up over 8%. Though the firm didn't share much specifically, we know from our own research that the Sperry brand is absolutely on fire, expanding via new product offerings and distribution channels. Management did provide some information on Saucony, which they continue to say is doing well both internationally and domestically. We were glad to hear new developments are surfacing in lightweight running and training, which is almost entirely dominated by Nike Free.

Overall, we liked management's candid tone, and admission of previous inventory blunders. Although a good portion of the problem is likely out of their control, they seem to be taking proactive steps in boosting long and short term profitability. The company continues to pay off long-term debt and gobble up shares that were trading cheaply, though they've already bought back the maximum amount authorized. We continue to hold Collective Brands in our Best Ideas portfolio.

*Watch List Addition: Rush Enterprises* continued from page 4

Rush Enterprises' revenue is already on track this year to outpace previous peak results witnessed in 2006, and relatively leaner operations should drive earnings above the previous cyclical peak in coming years (thanks primarily to increases in its higher-margin parts and services revenue stream, an acceleration in commercial truck sales to satisfy pent-up demand, and a larger product suite via Navistar). Investors should expect peak earnings during this commercial truck cycle of greater than $2.50 per share for Rush (2013) and normalized earnings of about $1.50-$2 per share.

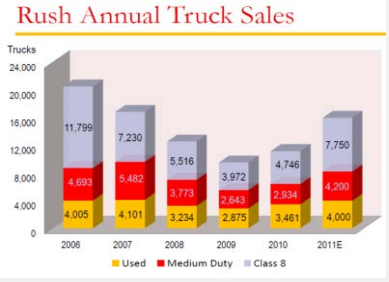



Image Source: Investor Presentation

This is well above its five-year earnings range of $0.64 and $1.46. Assuming a forward market multiple of about 13x, Rush's shares have upside to about $30 in the most optimistic of valuations and downside valuation risk to the high teens based the lower end of a normalized earnings estimate and applying 13x multiple to such estimate. On a DCF basis, we think the firm is worth about $21 per share. With the stock trading around $17 per share, we'll be keeping a close eye for any dip into the mid-teens.

## Target Posts Best Comps in Four Years

*By Valuentum Analysts*

Target Corp (TGT) reported strong second-quarter results that showed accelerating same-store sales growth (its best showing in four years), but modest operating-income and net-earnings expansion that still beat expectations. Total sales increased about 5% thanks to a 3.9% jump in comps, while segment EBIT expanded 4.6% from the same period a year ago. The firm's earnings per share leapt 11.5% during the quarter (mostly driven by share buybacks), and the company issued full-year 2011 diluted EPS in the range of 4.15 to $4.30, a range we think is achievable.

The firm's average transaction amount increased 3.5% from the same period a year ago, thanks to a 1.8% jump in units per transaction and a 1.7% increase in the average selling price per unit. Management also indicated that every region across the country experienced a healthy increase in comparable store sales, broad-based strength.

Target also noted a continuation of the trends we've been witnessing in retail as of late (higher-income versus lower-end). We reproduce management's comments from the second-quarter call below:

"As we've continued to study consumer shopping patterns, we're seeing clear contrasts between higher income consumers and more moderate income households. While optimism at all income levels has improved since the recession, wealthy households continue to be the most optimistic. Across all of retail, the 20% of households with the highest incomes are shopping more often and spending more, while the other 80% have been cutting trips and spending less."

In all, we think Target's performance was better than Wal-Mart's (WMT), particularly as it relates to comparable store sales, but still feel investors should remain on the sidelines at this time. Though moderately underpriced, Target's valuation is not that compelling, and we're fairly comfortable with our retail exposure in our Best Ideas portfolio at this time.

## Home Depot Outshines Lowes

*By Valuentum Analysts*

Home Depot (HD) reported solid second-quarter results that revealed a strong rebound in its seasonal business and strength in its core categories (hardware, building materials, and electrical), despite the sluggish housing recovery. We like the name better than peer Lowe's (LOW), but don't feel diving head first into a housing market play is best at this point in the economic recovery.

Home Depot's sales jumped over 4% from the same quarter a year ago on a similar percentage jump in global comps, while earnings per diluted share expanded nearly 20%, a very impressive growth number. Operating income increased 12% and net earnings increased over 14%, so we were quite pleased with Home Depot's ability to leverage sales expansion in solid performance on the core operating and net lines. The number of customer transactions bumped up 1.1%, while the average ticket increased about 3% during the period—meaningful improvement even from the first quarter of this year. Given this strong showing, the company now expects earnings from continuing operations to jump 16% for the full year, to $2.34 per share (was $2.24).

We think most of this strength is coming at the expense of rival Lowe's (LOW), which in contrast cut its full-year outlook and revealed negative comps in the same calendar quarter, and the firm's strategic focus on distribution and customer service. According to the company's independent third-party tracking of consumer activity, Home Depot gained unit share in 5 of 13 departments during the second quarter: flooring, plumbing, electrical, lighting, and kitchens. Home Depot also noted that all but three of its top 40 markets experienced positive same-store sales in the quarter (with particular strength in its Midwest and South Atlantic regions) and said that comps into August are performing nicely, something that reinforces our view that we are not heading into another painful recession.

That said, the firm did stress that the housing

*Home Depot Outshines Lowes* continued on next page

market remains under pressure and that private fixed residential investment as a percentage of GDP continues to set 60-plus year lows near 2%. We'd wait for further confirmation that the housing sector has stabilized—the firm doesn't expect any meaningful improvement in the housing market in the back half of 2011--before diving into Home Depot's shares.

## Wal-Mart Raises Full Year Guidance

*By Valuentum Analysts*

Wal-Mart (WMT) issued fiscal 2012 second-quarter results that showed resiliency in the face of a difficult consumer spending environment. Net sales advanced 5.5% from the same period a year ago, while diluted earnings per share rose over 12% from last year's quarter. Total US comps were flat during the period, as continued strong performance at Sam's Club largely offset declines at Wal-Mart US, which, despite lower comps, posted its best quarterly performance since the third quarter of fiscal 2010. Impressively, Wal-Mart International increased net sales by over 16% in the quarter, a nice showing.

The retailer narrowed and raised its full-year guidance to the range of $4.41 to $4.51 per share, which implies about 8% earnings growth at the high end. We think this range is achievable, and we're encouraged by the confidence management continues to exude in its business in the back half of this year, despite the uncertain direction of the health of the economy. Specifically, we expect continued strength in Sam's Club and its grocery, health and wellness business (about two-thirds of sales), which may propel Wal-Mart US comps to positive territory this quarter.

All told, Wal-Mart put up a great fiscal 2012 second quarter, and its outlook for the back half of the year should reassure investors. Though we view Wal-Mart as a fantastic company, we think the firm looks fairly valued at this time. We're also paying particularly close attention to stiff competition from the likes of Family Dollar (FDO) and Dollar General (DG), the former scooped up recently by Berkshire Hathaway (BRK-B).

## Steer Clear of Airline Stocks

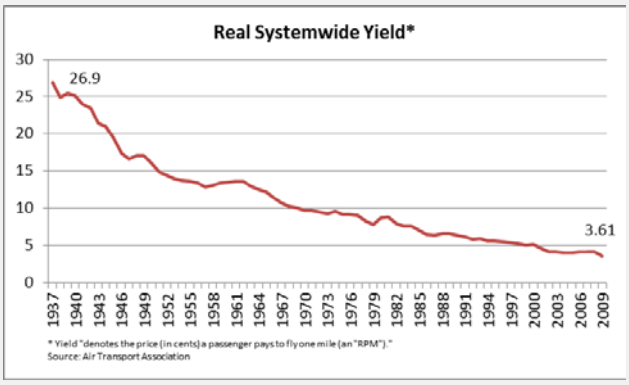
*By Valuentum Analysts*

Whenever we see a bullish article on airlines such as this one, we are compelled to remind individual investors that airline stocks are merely speculative bets on changes in the direction of crude oil prices and the economy. As we outline in our airline industry primer:

"As many airline executives may attest, both unit revenue and unit cost are largely out of their control. For one, air travel service is largely commodified and suffers from substantial and intense fare competition driven by severe price transparency and the unavoidable concept of perishable inventory -- when a flight takes off, empty seats cannot be filled. Such a combination is the weight that keeps real pricing (yield) growth from being sufficient to meaningfully alter the long-term economics of the industry. To this day, network airlines are still forced to match fares offered by low-cost carriers or suffer even greater revenue declines. Fare increases can only be sustained if they are matched permanently by low-cost peers [like Southwest (LUV) or JetBlue (JBLU), for example].

Further, with barriers to entry primarily limited to capital costs (any U.S. carrier deemed fit by the Department of Transportation can operate passenger service in the U.S.), it's safe to assume that we haven't seen the last domestic start-up, even after the most recent failure of upstart Skybus. The mere existence of interested, economically-tied parties (like Boeing, for example) seem to suggest that new entrants will always pose a threat to dump unwanted capacity on otherwise healthy routes. Perhaps unsurprisingly, one can even tap Boeing's expertise in launching an airline. The poor performance of systemwide -- domestic and international -- real yields (pricing) across U.S. airlines is displayed in the chart on the next page, a trend that is very unlikely to change anytime soon:

*Steer Clear of Airline Stocks* **continued on next page**




As an airline's unit revenue is pressured by intense pricing competition, its unit cost is significantly impacted by the price and volatility of jet fuel. According to the Air Transport Association, jet fuel now represents more than a quarter of industry operating costs, surpassing labor expenses as the largest cost item. Although airlines may hedge fuel to some extent, such a strategic move is financial and should not be viewed as an operational boost or any sort of sustainable competitive advantage. And due to the presence of low-cost providers, network carriers have traditionally found it difficult to hike fares or charge additional fees sufficient enough to pass along these rising energy costs.

Though we've made some money trading put options in the Guggenheim Airline ETF (FAA) and AMR (AMR), the parent of American Airlines, in our Best Ideas Newsletter, we maintain that airline stocks are not long-term investments, regardless of what sell-side analysts or respected journals may posit.

The stories about shedding capacity, rightsizing route structures, pursuing ancillary revenue streams (checked baggage, etc.) are not new news. These modest and relatively inconsequential improvements in industry dynamics have been around for years, and perhaps Barron's has best summed it best up by revealing the performance of such stocks since then:

"AMR, parent of American Airlines, is down 57% this year to about 3.50, not much above its 2009 low. Delta (DAL) is off 40% to 7.50; United Continental (UAL) has fallen 25%, to 18; Southwest (LUV) has dropped 37%, to 8.25; and JetBlue (JBLU) is off 37%, to 4.15."

As subscribers to Valuentum know, we were ahead of the move on AMR, and we continue to believe that the firm's shares are practically worthless, as we wrote in this May 17 article (we have since closed our put position, however). As for the other domestic carriers, we maintain that investors should steer clear of the group.

# Our Watch "Shopping" List

*By Valuentum Analysts*

**Rush Enterprises (RUSHA); VBI: 7**

Please see page 4 for a discussion on Rush.

**Pfizer (PFE); VBI: 6**

Please see page 14 regarding Pfizer.

**Kraft Foods (KFT); VBI: 6**

Kraft Foods (KFT) reported solid second-quarter results and indicated that it would split its high-growth global snacks business and its mature, high-margin North American grocery business. The firm also bumped up its 2011 organic net revenue growth and operating earnings per share outlook, to at least 5% (was 4%) and $2.25 (was $2.20), respectively. We were impressed with the firm's second-quarter performance and think its move to create two independent public companies will create value for shareholders over the long haul.

**CBS Corp. (CBS); VBI: 6**

CBS Corp. (CBS) reported strong second-quarter results that showed excellent performance pretty much across the board. Revenue jumped 8% from the same quarter last year thanks to solid performance in content licensing and distribution, while operating income before depreciation and amortization (OIBDA) jumped over 50% thanks to strong growth in every segment and a seven percentage point improvement in its OIBDA margin.

**Roper Industries (ROP); VBI: 5**

Roper Industries (ROP) reported solid second-quarter results that showed significant revenue and earnings expansion. Sales jumped 23% (16% organic) in the period to an all-time high, while net earnings expanded over 40%, despite a higher tax rate. The firm's adjusted EBITDA margin expanded over 280 basis points to 28.5% in the period, a strong showing. Free cash flow jumped 41% from the same period a year ago to $145 million, which represented 21% of the firm's sales in the quarter. This is the strongest free-cash-flow conversion rate the firm has seen in years (at least since 2006), and we expect Roper to continue to achieve free-cash-flow levels in the high-teens and low twenties as a percentage of revenue, on average, going forward.

**Eaton Corp (ETN); VBI: 5**

Eaton Corp. (ETN), a diversified industrial manufacturer, reported excellent second-quarter results that showed strong revenue growth and solid earnings expansion. The firm's top line expanded 21% during the period (14% core), while the company's segment margins at the operating level reached all-time highs of 13.9%. This led to net income expansion of almost 50% from last year's quarter, a fantastic showing. Eaten also bumped up its end-market growth expectations for 2011 by a percentage point to 11%, while it raised the midpoint of its full-year earnings per share guidance by $0.15 to $4.06 per share at the high end.

**CNH Global (CNH); VBI: 3**

CNH Global (CNH), the second-largest maker of farm equipment after Deere (DE), posted fantastic second-quarter results, with net sales increasing 24% and net income more than doubling. The firm experienced substantial strength in agricultural equipment and construction equipment revenue, up 22% and 30%, respectively, and translated this performance into solid profitability improvement. CNH's operating margin increased to 10.7% during the quarter from 8.4% in the same period a year ago.

*Our Watch "Shopping" List* continued on next page

**Coca-Cola (KO); VBI 6**

Coca-Cola (KO) reported second-quarter results that showed strong worldwide volume growth of 6% led by expansion outside of the US, namely Eurasia and Africa (up 7%), the Pacific, which includes China (up 7%), and Latin America (up 6%). Demand for the firm's brand Coca-Cola was particularly impressive in China (up 24%) and Russia (up 17%). Total revenue increased 47% (due primarily to its acquisition of Coca Cola Enterprises' North American operations), though concentrate sales and currency contributed 6 percentage points of growth, respectively.

**Harley Davidson (HOG); VBI: 5**

Harley-Davison (HOG) reported solid second-quarter results that showed strong retail motorcycle sales and solid earnings improvement. Sales of motorcycles and related products advanced 18% as US dealers sold 7.5% more new Harley-Davidson motorcycles in the period compared to last year's quarter, marking the first year-over-year jump in the metric since the fourth quarter of 2006.

**International Business Machines (IBM); VBI: 3**

International Business Machines (IBM) posted strong second-quarter results. The firm's top-line increased 12% (5% adjusting for currency), while net income advanced 8% from the same period a year ago. The firm indicated that hardware, software and services revenue grew at a double-digit pace, and the company raised its full year 2011 operating earnings per share guidance to at least $13.25 from at least $13.15 previously.

**United Technologies (UTX); VBI: 3**

United Technologies (UTX) posted excellent second-quarter results, with sales advancing 9% (6% organic) and net income jumping nearly 20% from the prior-year period. The firm's operating margin for the quarter was 15.9%, 120 basis points higher than last year. Impressively, the firm noted that for the first time since mid-2008, all six of its business segments showed organic growth in the period. Further, order rates at Otis were up 23% thanks to strong demand from Asia and China, while order rates for commercial HVAC new equipment at Carrier jumped 13%.

**Honeywell (HON); VBI: 6**

Honeywell (HON) reported second-quarter results that showed strong sales growth and solid earnings expansion. The firm's top-line expanded 15% in the period (7% organic growth), while earnings per share jumped over 40% from the same quarter a year ago thanks to a 70 basis-point expansion of segment margins to 14.3% in the quarter. Honeywell bumped up its full-year revenue guidance to the range of $36.1-$36.7 billion (up $100 million from its previous range) and its 2011 earnings-per-share estimate to the range of $3.85-$4.00 per share from $3.80-$3.95 per share previously.

**Visa (V); VBI: 6**

Please view the August edition of our newsletter here.

**McDonald's (MCD); VBI: 6**

Please view the August edition of our newsletter here.

*Our Watch "Shopping" List* **continued on next page**

Other names on our long-idea watch list:

**Big Five Sporting Goods (BGFV); VBI: 4** – visit www.valuentum.com

**Microsoft (MSFT); VBI: 6** – visit www.valuentum.com

**Reynolds American (RAI); VBI: 5** – visit www.valuentum.com

**Rick's Cabaret (RICK); VBI: 4** – visit www.valuentum.com

**Walt Disney (DIS); VBI: 5** – visit www.valuentum.com

**Xerox (XRX); VBI: 6** – visit www.valuentum.com

**Nike (NKE); VBI: 5** – visit www.valuentum.com

On the short-side, we continue to look to initiate a put position on Churchill Downs (CHDN) at $50 per share and LinkedIn (LNKD) at $120 per share, both of which we think are significantly overvalued – but are waiting for them to be extremely so before acting. We also may re-establish our put positions on Under Armour (UA), the Guggeheim Airline ETF (FAA) and AMR (AMR), the parent of American Airlines, if the opportunity presents itself again at higher prices. You can read our thoughts on these put ideas at our website: www.valuentum.com.

Valuentum Retail Equity Research | Visit us at www.valuentum.com | (10=best) | Data as of 9-Sep-2011

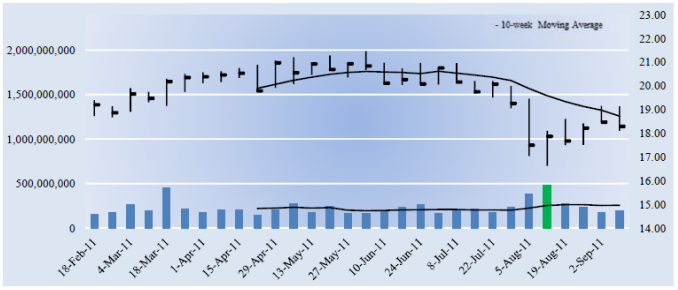
## Pfizer PFE UNDERVALUED 25.8%

Valuentum Buying Index™ 6 | Valuentum Value Rating ✓

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $18.28 | $30.00 | $23.00 - $38.00 | LARGE-CAP VALUE | Health Care | Pharmaceuticals |

**The market appears to have put Pfizer '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 buying, or accumulation (green bar).

### Company Vitals

| | |
|---|---|
| Market Cap (USD) | $147,593 |
| Avg Weekly Vol (30 wks) | 227,672 |
| 30-week Range (USD) | 16.63 - 21.45 |
| Valuentum Sector | Health Care |
| 5-week Return | 6.8% |
| 13-week Return | -9.0% |
| 30-week Return | -2.9% |
| Dividend Yield % | 3.9% |
| Dividends per Share | 0.72 |
| Forward Dividend Payout Ratio | 31.8% |
| Est. Normal Diluted EPS | 2.13 |
| P/E on Est. Normal Diluted EPS | 8.6 |
| Est. Normal EBITDA | 30,117 |
| Forward EV/EBITDA | 5.3 |
| EV/Est. Normal EBITDA | 5.4 |
| Forward Revenue Growth (5-yr) | -1.9% |
| Forward EPS Growth (5-yr) | 13.6% |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | 11.4% |
| Return on Assets | 5.5% |
| ROIC, with goodwill | 18.0% |
| ROIC, without goodwill | 27.5% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 44,033 |
| Net Debt | 16,021 |
| Total Debt/EBITDA | 1.7 |
| Net Debt/EBITDA | 0.6 |
| EBITDA/Interest | 14.2 |
| Current Ratio | 2.1 |
| Quick Ratio | 1.5 |

NMF = Not Meaningful

### Investment Highlights

• Pfizer 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 27.5% during the past three years.

• Pfizer '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.

• Pfizer 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 39.9% in coming years. Total debt-to-EBITDA was 1.7 last year, while debt-to-book capitalization stood at 33.4%.

• 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 sports a very nice dividend yield of 3.9%. We expect the firm to pay out about 32% of next year's earnings to shareholders as dividends.

### Investment Considerations

| | |
|---|---|
| DCF Valuation | UNDERVALUED |
| Relative Valuation | ATTRACTIVE |
| ValueCreation™ | EXCELLENT |
| ValueRisk™ | MEDIUM |
| ValueTrend™ | NEGATIVE |
| Cash Flow Generation | STRONG |
| Financial Leverage | MEDIUM |
| Growth | DECLINING |
| Technical Evaluation | BEARISH |
| Relative Strength | NEUTRAL |
| Money Flow Index (MFI) | NEUTRAL |
| Upside/Downside Volume (U/D) | BEARISH |
| Near-term Technical Resistance, 10-wk MA | 19.00 |

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 |
|---|---|---|---|
| Abbott Laboratories | 10.8 | 1.4 | 74.2% |
| Bristol-Myers Squibb | 12.8 | 3.5 | 145.8% |
| Eli Lilly | 8.3 | NMF | 86.0% |
| Merck | 8.5 | 1.8 | 62.4% |
| Peer Median | 9.7 | 1.8 | 80.1% |
| **Pfizer** | **8.1** | **1.3** | **60.9%** |

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

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Dec-09 | Dec-10 | Dec-11 |
| Revenue | 50,009 | 67,809 | 67,199 |
| Revenue, YoY% | 3.5% | 35.6% | -0.9% |
| Operating Income | 15,524 | 17,099 | 22,578 |
| Operating Margin % | 31.0% | 25.2% | 33.6% |
| Net Income | 8,621 | 8,266 | 18,622 |
| Net Income Margin % | 17.2% | 12.2% | 27.7% |
| Diluted EPS | 1.22 | 1.02 | 2.26 |
| Diluted EPS, YoY % | 2.9% | -16.3% | 120.9% |
| Free Cash Flow (CFO-capex) | 15,368 | 9,950 | 26,386 |
| Free Cash Flow Margin % | 30.7% | 14.7% | 39.3% |

In Millions of USD (except for per share items)

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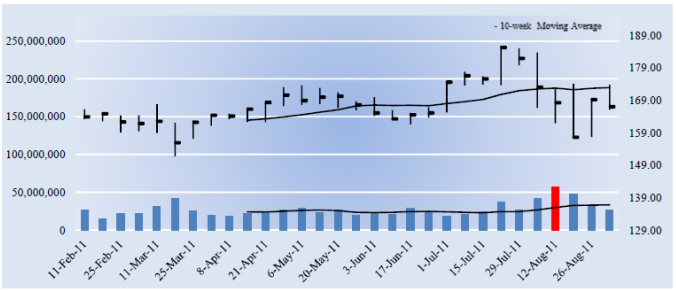
## IBM IBM FAIRLY VALUED

Buying Index™ 3 | Value Rating

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $166.98 | $188.00 | $150.00 - $226.00 | MEGA-CAP VALUE | Information Technology | Computers & Peripherals - hardware |

**Despite IBM's strong cash flow generation, we think the shares are fairly valued at this time.**

### 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 | FAIRLY VALUED |
| Relative Valuation | UNATTRACTIVE |
| ValueCreation™ | EXCELLENT |
| ValueRisk™ | LOW |
| ValueTrend™ | POSITIVE |
| Cash Flow Generation | STRONG |
| Financial Leverage | LOW |
| Growth | MODEST |
| Technical Evaluation | BEARISH |
| Relative Strength | STRONG |
| Money Flow Index (MFI) | NEUTRAL |
| Upside/Downside Volume (U/D) | BEARISH |
| Near-term Technical Resistance, 10-wk MA | 173.00 |

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

### Business Quality

| ValueRisk™ \ ValueCreation™ | 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) | $214,963 |
| Avg Weekly Vol (30 wks) | 27,272 |
| 30-week Range (USD) | 151.71 - 185.63 |
| Valuentum Sector | Information Technology |
| 5-week Return | -8.6% |
| 13-week Return | 1.3% |
| 30-week Return | 1.8% |
| Dividend Yield % | 1.5% |
| Dividends per Share | 2.50 |
| Forward Dividend Payout Ratio | 18.6% |
| Est. Normal Diluted EPS | 15.34 |
| P/E on Est. Normal Diluted EPS | 10.9 |
| Est. Normal EBITDA | 30,772 |
| Forward EV/EBITDA | 8.2 |
| EV/Est. Normal EBITDA | 7.5 |
| Forward Revenue Growth (5-yr) | 4.9% |
| Forward EPS Growth (5-yr) | 7.6% |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | 66.0% |
| Return on Assets | 12.1% |
| ROIC, with goodwill | 28.7% |
| ROIC, without goodwill | 50.6% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 28,624 |
| Net Debt | 16,973 |
| Total Debt/EBITDA | 1.2 |
| Net Debt/EBITDA | 0.7 |
| EBITDA/Interest | 62.5 |
| Current Ratio | 1.2 |
| Quick Ratio | 1.0 |

NMF = Not Meaningful

### Investment Highlights

• IBM'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 company looks fairly valued at this time. We expect the firm to trade within our fair value estimate range for the time being. If the firm's share price fell below $150, we'd take a closer look.

• IBM has an excellent combination of strong free cash flow generation and low financial leverage. We expect the firm's free cash flow margin to average about 15.1% in coming years. Total debt-to-EBITDA was 1.2 last year, while debt-to-book capitalization stood at 55.4%.

• Although we think there may be a better time to dabble in the firm's shares based on our DCF process, the firm's stock has outperformed the market benchmark during the past quarter, indicating increased investor interest in the company.

• The firm experienced a revenue CAGR of about 0.4% during the past 3 years. We expect its revenue growth to be better than its peer median during the next five years.

### Relative Valuation

| | Forward P/E | PEG | Price / FV |
|---|---|---|---|
| Apple | 13.2 | 1.2 | 70.4% |
| Dell | 7.2 | 1.9 | 61.9% |
| Hewlett-Packard | 5.1 | 1.7 | 55.3% |
| Research in Motion | 6.0 | NMF | 77.2% |
| Peer Median | 6.6 | 1.7 | 66.2% |
| **IBM** | **12.4** | **1.9** | **88.8%** |

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

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Dec-09 | Dec-10 | Dec-11 |
| Revenue | 95,758 | 99,871 | 108,760 |
| Revenue, YoY% | -7.6% | 4.3% | 8.9% |
| Operating Income | 17,013 | 18,151 | 22,919 |
| Operating Margin % | 17.8% | 18.2% | 21.1% |
| Net Income | 13,425 | 14,833 | 16,960 |
| Net Income Margin % | 14.0% | 14.9% | 15.6% |
| Diluted EPS | 10.01 | 11.52 | 13.44 |
| Diluted EPS, YoY % | 12.6% | 15.1% | 16.7% |
| Free Cash Flow (CFO-capex) | 16,696 | 14,795 | 15,842 |
| Free Cash Flow Margin % | 17.4% | 14.8% | 14.6% |

In Millions of USD (except for per share items)

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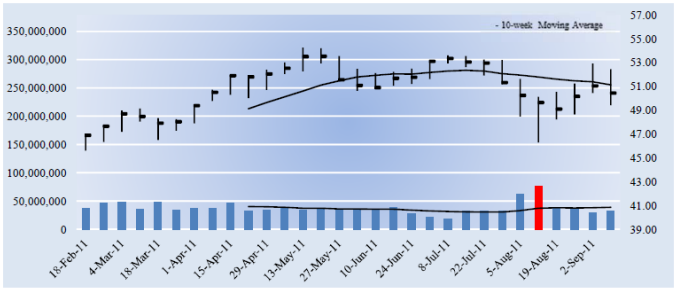
## Abbott Laboratories ABT UNDERVALUED 1.1%

Buying Index™ 3 | Value Rating ✓

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $50.43 | $68.00 | $51.00 - $85.00 | LARGE-CAP VALUE | Health Care | Pharmaceuticals |

**Abbott Laboratories's shares look cheap based on our discounted cash flow process.**

### 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 | NEUTRAL |
| ValueCreation™ | EXCELLENT |
| ValueRisk™ | MEDIUM |
| ValueTrend™ | NEGATIVE |
| Cash Flow Generation | STRONG |
| Financial Leverage | MEDIUM |
| Growth | MODEST |
| Technical Evaluation | BEARISH |
| Relative Strength | STRONG |
| Money Flow Index (MFI) | NEUTRAL |
| Upside/Downside Volume (U/D) | BEARISH |
| Near-term Technical Resistance, 10-wk MA | 51.00 |

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

### Company Vitals

| | |
|---|---|
| Market Cap (USD) | $78,470 |
| Avg Weekly Vol (30 wks) | 37,241 |
| 30-week Range (USD) | 45.6 - 54.24 |
| Valuentum Sector | Health Care |
| 5-week Return | 2.3% |
| 13-week Return | -1.6% |
| 30-week Return | 10.3% |
| Dividend Yield % | 3.4% |
| Dividends per Share | 1.72 |
| Forward Dividend Payout Ratio | 36.9% |
| Est. Normal Diluted EPS | 5.10 |
| P/E on Est. Normal Diluted EPS | 9.9 |
| Est. Normal EBITDA | 13,405 |
| Forward EV/EBITDA | 7.3 |
| EV/Est. Normal EBITDA | 6.7 |
| Forward Revenue Growth (5-yr) | 5.4% |
| Forward EPS Growth (5-yr) | 12.5% |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | 25.3% |
| Return on Assets | 10.6% |
| ROIC, with goodwill | 17.1% |
| ROIC, without goodwill | 27.4% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 18,918 |
| Net Debt | 11,594 |
| Total Debt/EBITDA | 2.1 |
| Net Debt/EBITDA | 1.3 |
| EBITDA/Interest | 16.3 |
| Current Ratio | 1.3 |
| Quick Ratio | 0.8 |

NMF = Not Meaningful

### Investment Highlights

• Abbott Laboratories 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 27.4% during the past three years.

• Although we think the firm's DCF valuation indicates a potential attractive investment opportunity, we'd be more comfortable investing in the firm if it was more attractively priced on a relative basis versus peers as well.

• Abbott Laboratories 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 22.5% in coming years. Total debt-to-EBITDA was 2.1 last year, while debt-to-book capitalization stood at 45.8%.

• 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.

• The firm sports a very nice dividend yield of 3.4%. We expect the firm to pay out about 37% of next year's earnings to shareholders as dividends.

### Business Quality

| ValueRisk™ \ ValueCreation™ | 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 |
|---|---|---|---|
| Bristol-Myers Squibb | 12.8 | 3.5 | 145.8% |
| Eli Lilly | 8.3 | NMF | 86.0% |
| Merck | 8.5 | 1.8 | 62.4% |
| Pfizer | 8.1 | 1.3 | 60.9% |
| Peer Median | 8.4 | 1.8 | 74.2% |
| **Abbott Laboratories** | **10.8** | **1.4** | **74.2%** |

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

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Dec-09 | Dec-10 | Dec-11 |
| Revenue | 30,765 | 35,167 | 39,035 |
| Revenue, YoY% | 4.2% | 14.3% | 11.0% |
| Operating Income | 6,406 | 6,401 | 9,401 |
| Operating Margin % | 20.8% | 18.2% | 24.1% |
| Net Income | 5,746 | 4,626 | 7,250 |
| Net Income Margin % | 18.7% | 13.2% | 18.6% |
| Diluted EPS | 3.69 | 2.97 | 4.66 |
| Diluted EPS, YoY % | 20.6% | -19.5% | 56.8% |
| Free Cash Flow (CFO-capex) | 6,186 | 7,721 | 8,621 |
| Free Cash Flow Margin % | 20.1% | 22.0% | 22.1% |

In Millions of USD (except for per share items)

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# Our Methodology – The Valuentum Buying Index

*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, 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. 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.

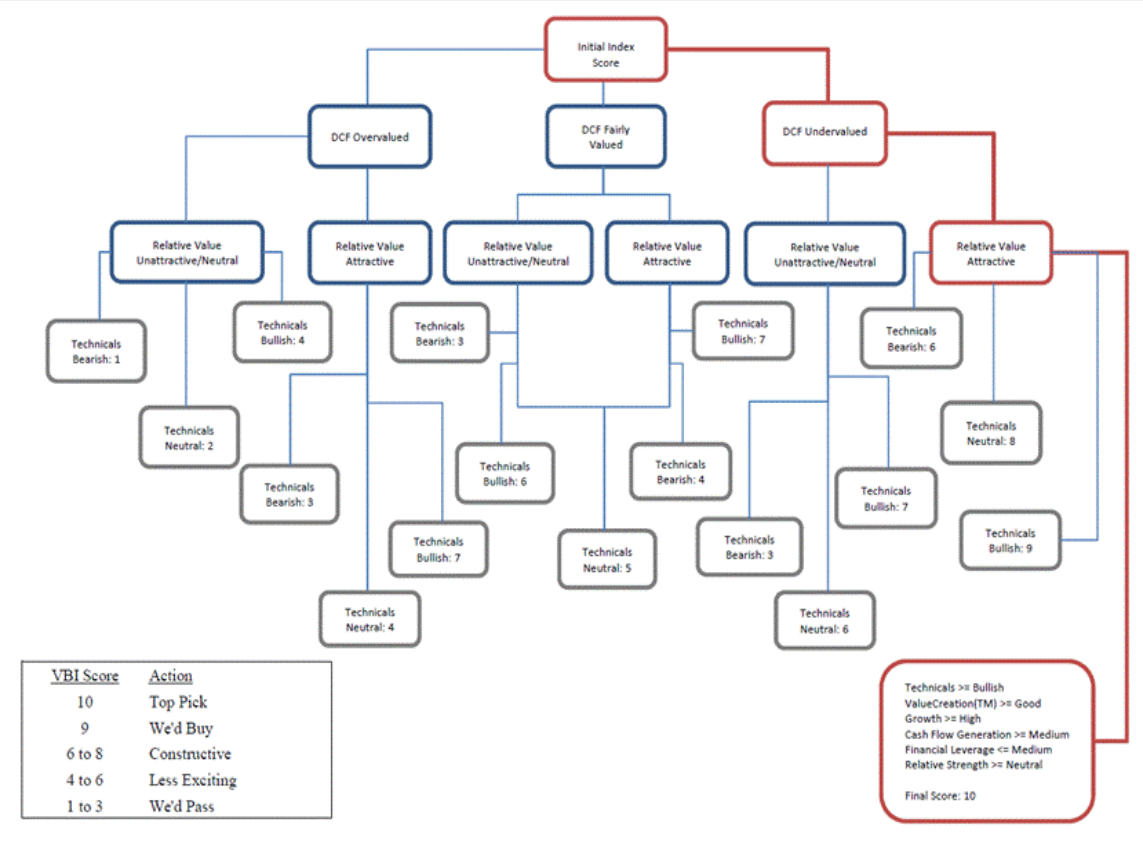
Let's discuss how a firm can score a 10, the best mark on our index (a "Top Pick"). First, the company would need to be 'undervalued' on a DCF basis and 'attractive' on a relative 'value basis. The stock would also have to be exhibiting 'bullish' technicals. The firm would need a ValueCreation rating 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 sell"). 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.

Please view the flow chart on the next page regarding our Valuentum Buying Index.

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

# Our Methodology – The Valuentum Buying Index

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OUR BEST IDEAS NEWSLETTER

# Valuentum Securities

Stock Analysis: From Value through Momentum Investing

October 15, 2011
Volume 1 Issue 4

Valuentum Securities Inc.
www.valuentum.com info@valuentum.com

| Portfolio Return | Benchmark Return | Outperformance |
|---|---|---|
| 12.3% | -8.8% | 21.1% |

Portfolio Inception Date: May 17, 2011

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*"Our total return jumped 2.4 percentage points, while our relative performance versus our benchmark widened by 40 basis points from last month."*

## No Recession in Sight

*By Brian Nelson, CFA*

Brian Nelson, CFA
President, Equity Research
brian@valuentum.com

As you've probably read or heard recently, many pundits claim that the US may fall into a double-dip recession in coming quarters. Based on our independent view of the domestic economy, we don't think so. We believe the equity markets are poised to move higher and that our portfolio is well-positioned for continued outperformance relative to the S&P 500.

First, let's evaluate the health of the consumer. According to this report, September retail same-store sales were nothing short of fantastic. Firms like Nordstrom (JWN), Limited (LTD), Zumeiz (ZUMZ), and Buckle (BKE) all blew by expectations and revealed double-digit expansion. Bigger players like Target (TGT), Kohl's (KSS), Saks (SKS) and Costco (COST) also had a nice showing in the month. Although the Street continues to be cautious on retail in coming periods, we think this conservatism sets the table for further same-store sales outperformance from the group during the holiday season. The recent fall in prices at the pump, and the Fed's "Operation Twist" -- designed to...

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Please see *No Recession in Sight* on page 2

## Higher Returns, More Outperformance

*By Valuentum Analysts*

Valuentum had another month of strong performance. Our total return jumped 2.4 percentage points, while our relative performance versus our benchmark (the S&P 500 Index) widened by 40 basis points from last month. We continue to outpace the index by over 20 percentage points.

We've made a number of transactions since the time of the publication of our September newsletter. First, we added to one of our favorite firms, Republic Services (RSG). We think the trash-taker is worth $37 per share (nearly 40% upside), and its annual dividend yield of 3%+ is very attractive. We also added to Ancestry.com (ACOM) on a pullback, and the firm has rebounded roughly 15% since then – a nice move.

We also took the opportunity to rebalance our long/short (put) exposure

Please see *Higher Returns, More Outperformance...* on page 7

*No Recession in Sight* continued from page 1

push long-term borrowing rates lower while keeping short-term rates relatively unchanged -- should help, too. And how can we talk about the consumer without mentioning the most recent fundamental data point on Apple (AAPL) – the electronics giant sold over one million copies of its new iPhone 4S in a 24-hour period last week! This shattered company records and marked nearly a 70% increase over sales of the now-legacy iPhone 4.

Let's move on to auto sales. According to this article, the Detroit automakers had an excellent September. Auto sales at General Motors (GM) were up 20%, while Ford (F) saw nearly a 10% jump. Even Chrysler experienced a sales increase of 27%. In all, US auto sales for the month jumped 9.9%, and that includes weakness from Toyota and Honda, both of which were still working through problems related to the March earthquake in Japan. The annualized sales rate hit over 13 million units – the best showing since April. We should note that before the industry downturn, annualized sales of autos were 17 million, representing more than 30% upside from the current demand pace. Sales of higher-margin trucks and SUVs were particularly strong. At GM, sales of trucks and SUVs increased a whopping 34% (at Ford, they were up 24%)! Trade in activity to upgrade aging vehicles was the primary driver, and we expect this trend to continue for some time. Our thesis on Ford remains firmly intact.

*"The annualized (auto) sales rate hit over 13 million units (in September) – the best showing since April. We should note that before the industry downturn, annualized sales of autos were 17 million, representing more than 30% upside from the current demand pace…Our thesis on Ford remains intact."*

Let's move on to manufacturing activity. The September ISM Manufacturing Survey increased one percentage point to 51.6% -- nothing to get too excited about, but far from recessionary, nonetheless. Though the new order index suggested slight contraction, we point to the massive backlogs at Boeing (BA), Airbus (EADSY.PK), General Electric (GE), and the strong growth in orders at United Technologies (UTX) and a host of other industrial firms in the second quarter. Boeing and Airbus have nearly eight years of orders at current production rates (and will be ramping up deliveries significantly in coming periods), while GE's industrial backlog set an all-time high of nearly $190 billion in the second quarter! And while Alcoa's (AA) third-quarter earnings, released Tuesday, were well below expectations, the aluminum giant revealed substantial year-over-year top-line expansion across the board. Revenue from commercial transportation increased 44%, automotive jumped 26%, while packaging and aerospace expanded over 20%, respectively. We think the US economy is not headed for recession anytime soon.

But what about jobs? Not Steve Jobs, the Apple-icon that passed away a few weeks ago, but employment. Well, 9.1% is an unacceptable unemployment rate and nowhere near what we'd consider to be "normal" structural levels. But we did get a bright spot last Friday. According to this report, the US added 103,000 new jobs in September – that was better than what economists were expecting. Professional and business services led the charge, adding 48,000 new positions, while healthcare and information also saw increases. Construction and government jobs (led by the US Postal Service) continue to decline, as expected. We withhold judgment on Obama's proposed jobs plan, but wouldn't be surprised to see some political action in coming months to get the headline unemployment rate to fall. No incumbent President has ever been elected with a 7% unemployment rate –

Please see *No Recession in Sight on next page*

*No Recession in Sight* continued from previous page

let alone one above 9%. Obama is well aware of this.

Though very little points to an impending double-dip recession, we do, however, expect weakness in housing-related firms for some time to come. Ingersoll-Rand's (IR) recent pre-announcement late September was particularly discouraging. The culprits were its consumer-related businesses (residential HVAC, golf and residential security) and poor commercial security activity. Though it noted that transport, industrial and commercial HVAC revenues remained strong, we wouldn't be surprised to hear more earnings warnings from other industrial firms levered to housing in coming weeks. We'd steer clear of those companies and point to aerospace as the bright spot within industrial-land (our portfolio is overweight aerospace).

We also wouldn't read too much into Fedex (FDX) recent outlook revision. After spooking the markets a few weeks ago by paring the package-shipper's fiscal 2012 outlook due to weakness in Asia, CEO Fred Smith made it clear at recent conferences that he expects continued economic growth – not contraction. We think the revision was more of a case of management overpromising than any change in the trajectory of economic activity.

*"Though erratic at times, the Baltic Dry Index – a measure of commodity shipping costs and, by extension, economic activity – also reached the highest levels in 2011 last week! The index has surged roughly 50% since the beginning of August, with recent gains driven by China's insatiable thirst for thermal coal. China appears healthy."*

Plus, we think growth in China and Asia remains strong. For example, same-store sales in China at Yum Brands (YUM) jumped nearly 20% in its third quarter, released earlier in October. The firm expects to place a total of 600 stores (KFC, Pizza Hut) in China during 2011 and is not looking back. And perhaps overshadowed by the earnings miss, Alcoa raised its expectations for aluminum demand in China during 2011 by 2 percentage points, to 17%. Though erratic at times, the Baltic Dry Index – a measure of commodity shipping costs and, by extension, economic activity – also reached the highest levels in 2011 last week! The index has surged roughly 50% since the beginning of August, with recent gains driven by China's insatiable thirst for thermal coal. China appears healthy.

But what about Europe? This has been the major source of concern for the markets. However, we maintain that a recapitalization of the European banks should be expected, and the US banks are now among the strongest in the world (save the Canadian and Australian banks) thanks to Treasury Secretary Geithner's stress tests during the Great Recession. Granted, we're dealing with some sovereign debt issues, to say the very least (and perhaps an oversimplification), but we're not dealing with impossible-to-value synthetic derivatives on mortgage instruments here. Holders of European bank equities should expect substantial equity dilution in coming periods (due to expected losses on sovereign bonds), but we do not expect the European financial system to collapse – which is the only thing that would damage our thesis (and only temporarily). Sovereign debt from weak issuers has a price – a low one – but nonetheless, exposure can be measured and dealt with – unlike the uncertainty and liquidity crisis that triggered the Lehman failure. That said, we're maintaining our 0% bank exposure in our portfolio, but only because we see plenty of better risk/reward opportunities elsewhere.

**Please see *No Recession in Sight on next page***

*No Recession in Sight* continued from previous page

*"We maintain the US will avoid a double-dip recession and believe our portfolio is well-positioned for continued outperformance."*

Overall, we expect to see companies that miss earnings estimates this quarter blame Europe for the shortfall, but such disappointments will be temporary – as was the liquidity crisis that shook the US banks. Investors should remember that we're well above March 2009 levels – "the bottom" – and that markets are resilient and do recover. Plus, while Europe may slow, there will still be pockets of strength in the region -- aerospace, of course, but even technology. For example, Oracle noted in its recent quarterly results, released in late September, that Applications revenue was particularly strong in Europe, up an impressive 60%. We maintain the US will avoid a double-dip recession and believe our portfolio is well-positioned for continued outperformance.

## Is First Solar Really That Bad?

*By Valuentum Analysts*

After the failure of the federally-supported company, Solyndra, shares of First Solar (FSLR) have been beaten down harshly. By now, you've probably heard that Solyndra received over half a billion dollars in federal loans, and thereafter went bankrupt. It looks possible that First Solar, which is scheduled to possibly receive government loan assistance for its next major projects, could have their funding stripped away by a reactionary Congress. Management has noted this would "materially affect earnings."

So why is the market so negative on the solar industry? It hasn't been a sudden change, but only recently has the trend come about. There are a few things to like about the solar industry. For one, it's growing rapidly. According to the Solar Energies Industry Association, US demand alone has grown 69% year to date and will likely achieve a growth rate of nearly 100%. Although the numbers are unclear, China is also growing at a tepid pace. The rest of the emerging world also shows a healthy appetite for this clean energy, and global pollution mandates will create more demand for solar energy, regardless if the market really wants it.

Additionally, a company like First Solar receives low-cost government backed loans to keep costs low. With the most advanced technology, First Solar is the lowest cost American producer at $0.99/watt (common industry metric). It is also the largest, with facilities in Australia, Europe, North America and Asia.

However, the industry has plenty of downside, the biggest being the heavy government investment and subsidies involved. During good macroeconomic conditions, the US government is willing to invest more in "green energies" to meet pollution target mandates and create jobs. However, the US, Italy, and to a lesser extent, Germany, are concerned with global economic conditions, with Italy specifically, and likely the United States, pursuing austerity measures that will cut subsidies to industries like solar energy. Additionally, this austerity in the developed world could put a drag on developing economies' growth, which could lead to lower fossil fuel prices. This could harm the incentive to install solar energy.

Please see *Is First Solar...* on page 8

# Company Spotlight: Collective Brands (PSS)

*By Valuentum Analysts*

As followers of Valuentum know, Collective Brands (PSS) was one of the first positions in our best ideas portfolio. Unfortunately, the timing could not have been worse, as the market collapsed upon itself, sending down Collective shares by over 30%. Since bottoming out at around $9, Collective has rallied nearly 50%, with the shares now approaching our cost basis. Given the announcement of "strategic initiatives" and its tremendous short-term outperformance (it has been a material source of alpha for us during the past several weeks), we revisited our position and think that with or without a buyout, Collective remains one of our top picks.

*"Under our full range of possibilities, we think Collective Brands is worth between $17 and $31 per share. Our base case scenario leaves us with a fair value of $24, which implies 32x our 2011 earnings forecast and 17x our 2012 estimate."*

**DCF Valuation: $24 per share**

At Valuentum, we ultimately think a crucial part of the investment process is applying a discounted cash flow model to arrive at a fair value estimate. This gives a sense of the intrinsic value of a business and allows us to determine the true value of a company without the often incorrect price the market may assign to it.

Under our full range of possibilities, we think Collective Brands is worth between $17 and $31 per share. Our base case scenario leaves us with a fair value of $24, which implies 32x our 2011 earnings forecast and 17x our 2012 estimate.

Although the company is struggling with its core, low-end Payless Shoes customer, most stores remain cash-flow positive. Furthermore, PLG wholesale, which includes, Keds, Sperry, and Saucony, is generating plenty of cash from its growing revenues and an 11% operating margin.

**However, it appears the sum of the parts is greater than the whole.**

Although Valuentum is not an investment bank by any means, we've simplified our sum-of-the-parts analysis to illustrate what an acquirer may pay for the business, which is more valuable broken into two than as one.

First, we honestly don't see any strategic fits in the public arena. VF Corp (VFC), which has looked to expand their footwear offerings, recently acquired Timberland. The deal cost them $2.3 billion, at a 16x 2010 EBIT multiple. Though they were able to finance the deal via 3.5% short dated notes, we don't expect management to start piling up debt on an acquisition spree.

How about Deckers (DECK)? Though UGG is on its way to becoming an iconic American brand, it seems odd that they would try to enter running via Saucony. However, we think the Sperry and Keds brand do make a lot of sense, and that the company could leverage some of its fashion know-how into continued growth. That said, we're not sure if management really wants to make any acquisitions or if they want to tap into their growing cash position given the uncertain macroeconomic conditions.

Nike? Not a chance. They acquired Converse several years ago, but the deal was dirt cheap and paid for itself almost immediately. Given its past acquisitions, including Starter, Bauer, Cole Haan, and Umbro, we think

*Company Spotlight: Collective Brands* continued on page 8

# Nike Just Does it Again; Raising Our Fair Value

*By Valuentum Analysts*

Nike (NKE) reported an absolutely spectacular first quarter that beat what we thought were aggressive estimates. Due to increased expectations, we've upped our fair value estimate to $97 per share (was $95 previously).

**North American results: a huge upside surprise**

Nike posted wonderful North American results. Apparel was up 23%, reinforcing our thesis that sports apparel is a tailwind industry. This "mature" industry was up 15% currency neutral, which was even greater than 9% currency neutral growth in China. As CEO Mark Parker said at Nike's Analyst Day, "Nike is a growth company."

Though commentary was limited, Nike also seems very excited about its upcoming NFL license. With ratings and fantasy football participation reaching all-time highs, we think riding football and NFL success could be a key trend for Nike in the back end of 2012 and early 2013.

Even gross margins were flat sequentially, in a quarter in which input costs could have easily pressured the bottom line. With higher price-points and lower costs for fuel and cotton in the second half of the year, gross margins may even have a chance to expand.

**Please see *Nike Just Does it Again...* on page 9**

*"Nike (NKE) reported an absolutely spectacular first quarter that beat what we thought were aggressive estimates. Due to increased expectations, we've upped our fair value estimate to $97 per share."*

# Sprint: A Bet on Clearwire and Lightsquared as Much as the Actual Company

*By Valuentum Analysts*

Sprint (S) shareholders have been on an absolute rollercoaster this year. For a brief period of time, a strong first quarter propelled shares to over $6, but the broader market sell-off and a lack of profitability brought shares down to the $3 range where they hover now.

There was a small pop when the rumor broke that they would begin carrying Apple's (AAPL) iPhone 5 in mid-October, but shares came tumbling back down. Ultimately, Sprint is the smallest of the three major national carriers, both by number of customers and actual service coverage. With the ATT (T) – T-Mobile deal still in limbo, Sprint could end up being the only low-cost provider of nationwide service. Or, they won't be.

Either way, we think the real future of Sprint doesn't lie in its brand itself. Technically speaking, the exclusive HTC Evo line is one of the best on the market, though it pales in comparison to the iPhone. And with the iPhone likely coming to Sprint, we think Sprint is poised to steal market share. It appears the Sprint iPhone will be the only one with an unlimited data plan, which will steal customers tired of paying for data by quantity consumed.

The company also added over 1 million subscribers in the second quarter without the iPhone. Though the subsidy and acquisition costs will be high, we are confident it will end up being accretive to revenue and long-term profitability. Furthermore, Sprint was named number one in customer service for all mobile carriers in 2010; things are moving in the right direction…operationally.

**Please see *Sprint...* on page 9**

| Portfolio Return | Benchmark Return | Outperformance |
|---|---|---|
| 12.3% | -8.8% | 21.1% |

Portfolio Inception Date: May 17, 2011

## *Higher Returns, More Outperformance* continued from page 1

with the addition of a put position in Chipotle (Jan 2012, $300 strike). The stock has moved against us somewhat as the market surged off its bear-market lows earlier this month, but we continue to expect a slide in the firm's stock in coming months. Plus, we view the put exposure as equally important from a portfolio construction standpoint (it is our only put holding at this time) as we do our assessment of the company's over-valuation. During the month, we also jumped at the opportunity to add eBay (EBAY) to our portfolio (100 shares at $29.13). The operator of PayPal scored a 10 on our Valuentum Buying Index, and its stock has rocketed since.

*"During the month, we also jumped at the opportunity to add eBay (EBAY) to our portfolio (100 shares at $29.13). The operator of PayPal scored a 10 on our Valuentum Buying Index, and its stock has rocketed since."*

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 12), as well as analysis and trends impacting companies on our Best Ideas List. We currently have over 8% of our portfolio in cash, and we plan to deploy it opportunistically in coming weeks.

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-picking methodology.

**OUR BEST IDEAS -- as of October 11, 2011** — **Best Ideas Portfolio Inception Date: May 17, 2011**

| Portfolio Holdings | Symbol | VBI Score* | First Purchase Date | Cost Basis/Share ($) | Total Shares | Total Cost ($) | Current Value/Share ($) | Current Value ($) | Dividends Received | % of Portfolio | % Return |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *Bullish* | | | | | | | | | | | |
| Apple Corp. | AAPL | 7 | 17-Jun-11 | 328.99 | 20 | 6,586.80 | 400.29 | 8,005.80 | 0.00 | 7.1% | 21.5% |
| **NEW: We sold 10 shares of AAPL on 10/3/2011 at $379.44.** | | | | | | | | | | | |
| Altria Group | MO | 7 | 28-Jun-11 | 26.43 | 378 | 9,997.54 | 27.80 | 10,508.40 | 154.98 | 9.4% | 6.7% |
| Ancestry.com | ACOM | 3 | 17-May-11 | 37.89 | 296 | 11,216.40 | 24.85 | 7,355.60 | 0.00 | 6.6% | -34.4% |
| **NEW: We bought 150 shares of ACOM on 9/23/2011 at $21.60.** | | | | **21.60** | **150** | **3,247.00** | **24.85** | **3,727.50** | **0.00** | **3.3%** | **14.8%** |
| Astronics | ATRO | 3 | 6-Jun-11 | 24.93 | 401 | 10,003.93 | 32.30 | 12,952.30 | 0.00 | 11.5% | 29.5% |
| Buffalo Wild Wings | BWLD | 6 | 13-Jul-11 | 65.42 | 152 | 9,950.84 | 59.68 | 9,071.36 | 0.00 | 8.1% | -8.8% |
| Collective Brands | PSS | 6 | 11-Jul-11 | 15.09 | 662 | 9,996.58 | 14.71 | 9,738.02 | 0.00 | 8.7% | -2.6% |
| **NEW: eBay** | **EBAY** | **10** | **3-Oct-11** | **29.13** | **100** | **2,920.00** | **32.83** | **3,283.00** | **0.00** | **2.9%** | **12.4%** |
| EDAC Tech | EDAC | 6 | 6-Jun-11 | 4.08 | 1225 | 5,005.00 | 7.28 | 8,918.00 | 0.00 | 7.9% | 78.2% |
| Ford Motor | F | 7 | 12-Sep-11 | 9.94 | 200 | 1,995.00 | 11.24 | 2,248.00 | 0.00 | 2.0% | 12.7% |
| Intel | INTC | 6 | 12-Sep-11 | 19.89 | 100 | 1,996.00 | 22.99 | 2,299.00 | 0.00 | 2.0% | 15.2% |
| Precision Castparts | PCP | 3 | 6-Jun-11 | 152.07 | 65 | 9,891.55 | 163.89 | 10,652.85 | 1.95 | 9.5% | 7.7% |
| Republic Services | RSG | 3 | 19-May-11 | 32.95 | 303 | 9,990.85 | 28.35 | 8,590.05 | 121.20 | 7.7% | -12.8% |
| **NEW: We bought 100 shares of RSG on 9/22/2011 at $26.65.** | | | | **26.65** | **100** | **2,672.00** | **28.35** | **2,835.00** | **0.00** | **2.5%** | **6.1%** |
| Cash | | | | | | | | 9,640.14 | | 8.6% | 0.0% |
| *Bearish* | | | | | | | | | | | |
| **NEW: Chipote Mexican** | **CMG** | **4** | **3-Oct-11** | **33.70** | **1 Contract** | **3,378.25** | **24.60** | **2,460.00** | **0.00** | **2.2%** | **-27.2%** |
| **---> Jan 2012, $300 strike** | | | | | | | | | | | |
| **Best Ideas Portfolio Value** | | | | | | 100,000.00 | | 112,285.02 | | | 12.3% |
| SPY | | | 17-May-11 | 132.69 | 754 | 100,000.00 | 119.7 | 90,210.26 | 944.31 | 100.00% | |
| **Benchmark Value** | | | | | | | | **91,154.57** | | | **-8.8%** |
| **Under/Outperformance** | | | | | | | | | | | **21.1%** |

This portfolio is not a real money portfolio. Data as of October 11. Cost basis includes commissions. Results include dividends, but not interest received on cash balance.

* 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.

*Company Spotlight: Collective Brands* continued from page 5

Nike would prefer a beaten down iconic brand rather than paying up for growth and some overlap (Nike/Saucony; Cole Haan/Sperry).

Regardless, we think this wholesale business is extremely valuable, and could be acquired by a private equity firm. Based on EBIT multiples, we think there's several ways the business may be valued.

We looked at recent consumer cyclical private equity deals, and noticed that most companies fetched EBIT multiples between 8 and 15. Based on a 12x our 2011 EBIT estimate, the wholesale business is worth over $800 million, or about $14 per share. Collective Brands closed just above this price, so at these levels, investors are potentially getting $2 billion in sales, $128 million in 2010 operating profit and Payless International for under a dollar! Even in a weighted average of outcomes, Collective Brands net of PLG whole sale still only costs fifty cents. We think that's a pretty great deal for investors.

**What if the bankers don't break it up?**

Even if the bankers decide not to break-up the company, Collective will still receive a premium to its current share price.

Based on commonly used M&A metrics like EBITA and book value, given the current market landscape, the company could fetch a bid between $17 and $32 per share. This is noticeably similar to our fair value estimate, so we find these numbers realistic. The company still looks undervalued at current levels, and we will continue to hold the company in our portfolio.

*Is First Solar...* continued from page 4

Furthermore, these massive subsidies vary by nation, and thus far appear to give Chinese companies a low-cost advantage, in spite of having lower quality technology. The Department of Energy blames these massive subsidies for the United States transitioning from the world's largest solar supplier in the 1990's to only producing 7% of the global supply today.

The effects on First Solar could be absolutely devastating. In the second quarter, we saw gross margins fall by 1,200 basis points year-over-year and over 900 basis points sequentially. SG&A also swelled to over 16% of sales. With substantial political risks in the United States and Europe, we think earnings will be significiantly lower than what the company guided. We wouldn't be surprised to see revenues underperform expectations and earnings per share actually fall for the year.

In our scenarios, we see shares of First Solar worth about $53 per share on the high end of our fair value range at this time. Even with increasing revenues for the fourth quarter expected to double, we don't think they will be able to maintain their excess gross margins and high returns on invested capital. Ultimately, given the substantial risks involved that are completely out of the company's control, we think investors may be best served looking at cheap out of the money put options or avoiding the stock altogether. Even if it is the best in the industry, it doesn't look like the biggest consumers of solar energy will be increasing spending any time soon, and that the Chinese have a labor-cost advantage that could take decades to erode.

All that said, the company still has a cash hoard of over $300 million, is the technological innovator in the industry, and management seems very confident in future prospects. Ultimately, down the road, and after some industry consolidation allows for better pricing, First Solar could be an interesting investment. However, we're looking at it as a put-option candidate in our portfolio.

* Please see page 14 for a discussion of other put-option candidates we are considering.

*Nike Just Does it Again...* continued from page 6

**Some Issues in China**

Although emerging market revenues were up 24% in the first quarter, China was only up 9%, with apparel down 8%. Management cited a new selling strategy that will take a few quarters to officially roll out. Adidas had similar issues not long ago, and we don't expect this one blemish to last long.

**BasketBull Market**

Even though Nike will always be associated with Michael Jordan and the game of basketball, the company is extremely excited about growth in this large business going forward. The signature lines, led by superstars like LeBron James and Kobe Bryant, have some excellent product refreshes coming out in this quarter, which should help grow the basketball shoe and apparel business -- whether or not the NBA manages to play basketball this season. We think basketball is the new soccer; accessible to everyone and becoming one of the only truly global sports.

As long as Nike continues to hoard top NBA talent, we think kids across the United States, China, Brazil, and everyone in between will continue to covet the shoes their heroes play in. Nike will then continue to make the shoes a generational status symbol that only helps build brand loyalty when these younger players start to branch out into running, lifestyle apparel, and other sports.

Nike is building great momentum, and we think the current risks are macro issues. The company itself remains the best-in-class of apparel companies, and its long-term growth story looks to have several more years ahead of it. Future orders were up 13%, indicating that we just might see a strong holiday season after all.

*Sprint...* continued from page 6

**Clearwire: An unmitigated disaster**

Unfortunately, the operations are just one part of the equation. On the other hand, the balance sheet is a mess. Sprint has a tremendous amount of debt, though none coming due until 2012. However, since they've been cash flow positive for the last six quarters, we aren't really worried about debt at this time.

We are extremely worried, however, about Clearwire (CLWR). Clearwire is a publically traded company, but Sprint is the owner of 54% of its shares. While Clearwire attempts to build up its own—and also Sprint's—4G network, it has struggled to take much of the mobile Internet market share and is burning through cash (already over $1.7 billion year to date). The success of this 4G network will determine the fate of Clearwire, and possibly even Sprint's share price.

Unfortunately, the company doesn't seem too convinced that Clearwire will work out. In late July, they inked a deal with start-up Lightsquared for over $13 billion for access to their satellite 4G and LTE network. Lightsquared has received the majority of its publicity due hedge fund manager Phil Falcone's enormous investment, but it is unclear whether or not the company is viable and that its technology doesn't interfere with other satellites.

So it comes down to this: Sprint is facing stiff competition from much larger competitors who offer more phones and have better profit margins. The future of its next generation technology depends largely on two start-ups with poor results. As much as we like what CEO Dan Hesse and his management has done operationally, especially in the pre-paid business, we think Clearwire and Lightsquared could prove to be just as bad investments as Nextel was a few years ago. With a fair value range of $3 to $5, we think Sprint is fairly valued and represents a risky investment we'd prefer to stay out of.

## Walgreens' Strong 4Q Report Overshadowed By Fall Out with Express Scripts

*By Valuentum Analysts*

Walgreens (WAG) reported strong fiscal fourth-quarter that showed solid revenue and earnings expansion. However, the lack of progress on key contract negotiations with pharmacy benefit manager Express Scripts (ESRX) left us a bit disappointed overall, to say the least. Nonetheless, our $34 fair value estimate for Walgreens remains unchanged at this time.

Walgreens' fourth-quarter sales advanced 6.5% thanks to a 4.4% increase in comps (stores open for more than a year), while earnings per share increased over 16%, excluding an after-tax gain associated with the sale of its pharmacy benefits management business (adjusted net earnings increased 10.1% during the period). Prescription sales (nearly two thirds of revenue) jumped 5.7% during the quarter, as the number of prescriptions filled advanced 4% (3.4% on an apples-to-apples basis). Walgreens also revealed nice share gains through the course of 2011 and now accounts for 20% of the retail prescription market.

Though the quarterly results were strong, Walgreens indicated that contract negotiations with Express Scripts had fallen through, and the company will likely not be a part of the pharmacy benefit manager's network beginning next calendar year. The existing deal with Express Scripts is not small potatoes and likely contributes $5 to $6 billion in revenue per year, or about 7% of Walgreen's business (Express Scripts reimburses Walgreens for prescriptions). We think the lack of a definitive agreement will continue to be the source of concern for Walgreen's stock -- not only because of the pressure on this year's (fiscal 2012) earnings but also because of the uncertainty regarding further loss of business with Medco (MHS). Express Scripts is seeking to merge with Medco to create the largest pharmacy benefits manager, and the latter may play hardball with Walgreens as well.

We remain on the sidelines with respect to Walgreens' stock and would only become interested if the shares fell below $27 (the low end of our fair value range).

## Ingersoll Rand's Warning Just the Beginning for Industrial Names; Stick With Aerospace

*By Valuentum Analysts*

Ingersoll Rand (IR) cut its third-quarter revenue and earnings-per-share outlook to the range of $3.9 billion to $3.95 billion (was $4.05 billion to $4.15 billion) and $0.77 to $0.80 (was $0.85 to $0.95), respectively. Perhaps unsurprisingly, the cause was due to its consumer-related business (residential HVAC, golf and residential security) and poor commercial security activity. Though it noted that transport, industrial and commercial HVAC revenues remained strong, such strength offers little consolation to investors, given the magnitude of the outlook revision.

Further, Ingersoll noted that third-quarter operating income was hurt by the lower volumes and an unfavorable product mix in the residential and security segments. And topping things off, the firm indicated the strengthening of the dollar against the Euro will likely hurt performance in its fourth quarter. We don't think such performance bodes well for most of the industrial sector and Honeywell (HON) and United Technologies' (UTX) residential building divisions (air conditioners, control systems), though we expect outperformance from these respective companies' aerospace divisions to offset any weakness. Aerospace continues to be one of the bright spots in the global economy as both Boeing (BA) and Airbus (EADSY.PK) plan to ramp up production of their narrowbody aircraft in coming years -- driven by a competitive response to thwart new entrants from China and Russia and less so from immediate demand.

All told, we wouldn't be surprised to hear more earnings warnings from the industrial space in coming weeks, and we are maintaining our fair value estimates for Honeywell and United Technologies. We do not cover Ingersoll Rand and believe aerospace is the best place to be within industrial-land, with Precision Castparts (PCP), Astronics (ATRO), and Edac Tech (EDAC) as our top three aerospace picks.

## Best Idea Ford Looks Set to Sign a Win-Win Labor Deal

*By Valuentum Analysts*

Ford Motor (F) has rallied considerably since we added it to our portfolio. Ultimately we think the price spike can be attributed to a few different factors, but most importantly, it looks like Ford and the UAW has struck up a deal that should be beneficial to both employees and shareholders. Although the UAW still must ratify the deal, initial terms of the deal indicate a fair agreement for employees, and a tremendous sign of confidence for the United States economy in the mid-term.

**Lower entry-level pay, more variable pay**

As expected with the precedent set with the GM deal a few weeks earlier, the new labor contract creates an entry level wage of $15.78, with a guaranteed raise to $19.28 in year four of the agreement. Additionally, the contract opts for profit sharing initiatives rather than annual raises. This aligns the compensation of employees even more with the interests of shareholders, which tends to be a net-positive. Current employees will receive a $6,000 signing bonus to compensate for frozen cost of living adjustments since 2007.

On top of achieving a lower fixed cost structure, Ford pledged to add 5,570 new factory jobs in the United States –on top of the over 6,000 jobs management promised earlier this year. We think this signals that the company is pretty optimistic about automotive sales over the next three to five years, and applaud any company that's able to create more jobs in a difficult economic situation.

The deal also allows Ford to buy out up to 20% of the aged workforce for $50,000 or $100,000, depending on skill level. This paves the way for lower fixed labor costs, but accelerated pension usage. We think this will still provide a net cost savings.

As S&P stated a few weeks ago in a note to clients, they plan on upgrading Ford's credit rating to BB+, the highest junk debt rating, assuming this labor contract doesn't put them at a disadvantage. Since it's a very similar deal to the one the UAW struck up with GM, we would call the deal relatively neutral. A credit upgrade should follow, paving the way for Ford to return more cash to shareholders via a dividend.

## Oracle's Fiscal First-Quarter Results Reveal Strength in Software Sales, Europe

*By Valuentum Analysts*

Oracle (ORCL) posted strong fiscal first-quarter results that showed significant growth in new software licenses and product support (about two thirds of revenue) and some weakness in hardware systems products revenues (about 20% of its top line). Services revenue, accounting for the balance, increased nicely and remained steady at about 14% of sales. We are maintaining our $38 fair value estimate.

Oracle's top-line advanced at a low double-digit pace, while the firm's GAAP operating income increased an impressive 40%, translating to a 36% increase in net income and a 46% jump in operating cash flow. The significant profitability expansion was driven by a refocus on its high-end server business – Exadata, Exalogic, and SPARC M-Series – while it shed lower margin commodity hardware revenue, driving roughly a 6 percentage point increase in hardware gross margins. We're encouraged by Oracle's new line-up of products, particularly the SPARC T4 microprocessor (which will replace the T3 microprocessor) and the SPARC SuperCluster, a new high-end server. Oracle claims the T4 is five times faster than the T3, and we think customers will be generally pleased by this performance improvement. Cash flow was bolstered by the jump in net income, a decline in trade receivables, and an increase in deferred revenues -- offset in part by a reduction in accounts payable. With operating cash flow ($5.4 billion) at nearly 3 times net income (about $1.8 billion), we're fans of Oracle's earnings quality during the period.

Overall, we were pleased with the firm's fiscal first-quarter, which also provides some insight into the health of the tech sector through July and August. Oracle noted "broad-based geographic and product momentum," and interestingly, noted that Applications revenue was particularly strong in Europe (up 60%), contradicting much of the media reports regarding the supposed corporate crisis there. The company indicated that it expects new software license revenue to expand from 6% to 16%

**Please see *Oracle...*on next page**

*Oracle...* continued from page 11

(a large range) in its fiscal second-quarter, while hardware product revenue should continue to fall by, at most, a 5% pace.

We like the outlook for software licenses and are less concerned about the declines in hardware, given management's focus on moving away from low-margin commodity servers. We also think the firm's second-quarter GAAP revenue-growth guidance for 5% to 9% growth and its earnings-per-share range of $0.56 to $0.58 are achievable. We are strongly considering adding Oracle to our portfolio on a pullback.

# Ideas for Your Radar

*By Valuentum Analysts*

In the chart to the right, we show 10 significantly undervalued stocks based on our DCF process (ranked by price/fair value). Below, we show our watch list and reveal each respective company's score on our Valuentum Buying Index.

| Company Name | Ticker | Sector | P/FV |
|---|---|---|---|
| Ancestry.com | ACOM | Information Technology | 0.45 |
| Office Depot | ODP | Consumer Discretionary | 0.46 |
| Terex | TEX | Industrials | 0.53 |
| Intel | INTC | Information Technology | 0.55 |
| Hewlett-Packard | HPQ | Information Technology | 0.55 |
| Xerox | XRX | Industrials | 0.57 |
| Century Aluminum | CENX | Materials | 0.58 |
| R.R. Donnelley | RRD | Industrials | 0.60 |
| Astronics | ATRO | Industrials | 0.60 |
| Pfizer | PFE | Health Care | 0.61 |

A snapshot of our institutional data feed.

**Kraft Foods (KFT); VBI: 3**

Kraft Foods (KFT) reported solid second-quarter results and indicated that it would split its high-growth global snacks business and its mature, high-margin North American grocery business. The firm also bumped up its 2011 organic net revenue growth and operating earnings per share outlook, to at least 5% (was 4%) and $2.25 (was $2.20), respectively. We were impressed with the firm's second-quarter performance and think its move to create two independent public companies will create value for shareholders over the long haul.

**CBS Corp. (CBS); VBI: 6**

CBS Corp. (CBS) reported strong second-quarter results that showed excellent performance pretty much across the board. Revenue jumped 8% from the same quarter last year thanks to solid performance in content licensing and distribution, while operating income before depreciation and amortization (OIBDA) jumped over 50% thanks to strong growth in every segment and a seven percentage point improvement in its OIBDA margin.

**Roper Industries (ROP); VBI: 5**

Roper Industries (ROP) reported solid second-quarter results that showed significant revenue and earnings expansion. Sales jumped 23% (16% organic) in the period to an all-time high, while net earnings expanded over 40%, despite a higher tax rate. The firm's adjusted EBITDA margin expanded over 280 basis points to 28.5% in the period, a strong showing. Free cash flow jumped 41% from the same period a year ago to $145 million, which represented 21% of the firm's sales in the quarter. This is the strongest free-cash-flow conversion rate the firm has seen in years (at least since 2006), and we expect Roper to continue to achieve free-cash-flow levels in the high-teens and low twenties as a percentage of revenue, on average, going forward.

**Eaton Corp (ETN); VBI: 5**

Eaton Corp. (ETN), a diversified industrial manufacturer, reported excellent second-quarter results that showed strong revenue growth and solid earnings expansion. The firm's top line expanded 21% during the period (14% core), while the company's segment margins at the operating level reached all-time highs of 13.9%. This led to net income expansion of almost 50% from last year's quarter, a fantastic showing. Eaten also bumped up its end-market growth expectations for 2011 by a percentage point to 11%, while it raised the midpoint of its full-year earnings per share guidance by $0.15 to $4.06 per share at the high end.

*Ideas...* continued on next page

**Oracle (ORCL); VBI: 6**

We're encouraged by Oracle's new line-up of products, particularly the SPARC T4 microprocessor (which will replace the T3 microprocessor) and the SPARC SuperCluster, a new high-end server. Oracle claims the T4 is five times faster than the T3, and we think customers will be generally pleased by this performance improvement. We are considering adding the firm to our portfolio on improvement in its VBI score.

**CNH Global (CNH); VBI: 3**

CNH Global (CNH), the second-largest maker of farm equipment after Deere (DE), posted fantastic second-quarter results, with net sales increasing 24% and net income more than doubling. The firm experienced substantial strength in agricultural equipment and construction equipment revenue, up 22% and 30%, respectively, and translated this performance into solid profitability improvement. CNH's operating margin increased to 10.7% during the quarter from 8.4% in the same period a year ago.

**Coca-Cola (KO); VBI 6**

Coca-Cola (KO) reported second-quarter results that showed strong worldwide volume growth of 6% led by expansion outside of the US, namely Eurasia and Africa (up 7%), the Pacific, which includes China (up 7%), and Latin America (up 6%). Demand for the firm's brand Coca-Cola was particularly impressive in China (up 24%) and Russia (up 17%). Total revenue increased 47% (due primarily to its acquisition of Coca Cola Enterprises' North American operations), though concentrate sales and currency contributed 6 percentage points of growth, respectively.

**Harley Davidson (HOG); VBI: 5**

Harley-Davison (HOG) reported solid second-quarter results that showed strong retail motorcycle sales and solid earnings improvement. Sales of motorcycles and related products advanced 18% as US dealers sold 7.5% more new Harley-Davidson motorcycles in the period compared to last year's quarter, marking the first year-over-year jump in the metric since the fourth quarter of 2006.

**International Business Machines (IBM); VBI: 3**

International Business Machines (IBM) posted strong second-quarter results. The firm's top-line increased 12% (5% adjusting for currency), while net income advanced 8% from the same period a year ago. The firm indicated that hardware, software and services revenue grew at a double-digit pace, and the company raised its full year 2011 operating earnings per share guidance to at least $13.25 from at least $13.15 previously.

**United Technologies (UTX); VBI: 3**

United Technologies (UTX) posted excellent second-quarter results, with sales advancing 9% (6% organic) and net income jumping nearly 20% from the prior-year period. The firm's operating margin for the quarter was 15.9%, 120 basis points higher than last year. Impressively, the firm noted that for the first time since mid-2008, all six of its business segments showed organic growth in the period. Further, order rates at Otis were up 23% thanks to strong demand from Asia and China, while order rates for commercial HVAC new equipment at Carrier jumped 13%.

**Honeywell (HON); VBI: 6**

Honeywell (HON) reported second-quarter results that showed strong sales growth and solid earnings expansion. The firm's top-line expanded 15% in the period (7% organic growth), while earnings per share jumped over 40% from the same quarter a year ago thanks to a 70 basis-point expansion of segment margins to 14.3% in the quarter. Honeywell bumped up its full-year revenue guidance to the range of $36.1-$36.7 billion (up $100 million from its previous range) and its 2011 earnings-per-share estimate to the range of $3.85-$4.00 per share from $3.80-$3.95 per share previously.

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

Other names on our long-idea watch list:

**McDonald's (MCD); VBI: 7 -** Please view the August edition of our newsletter here.

**Visa (V); VBI: 6 -** Please view the August edition of our newsletter here.

**Rush Enterprises (RUSHA); VBI: 7 -** visit www.valuentum.com

**Pfizer (PFE); VBI: 6 -** visit www.valuentum.com

**Big Five Sporting Goods (BGFV); VBI: 4** – visit www.valuentum.com

**Microsoft (MSFT); VBI: 3** – visit www.valuentum.com

**Reynolds American (RAI); VBI: 6** – visit www.valuentum.com

**Rick's Cabaret (RICK); VBI: 4** – visit www.valuentum.com

**Walt Disney (DIS); VBI: 3** – visit www.valuentum.com

**Xerox (XRX); VBI: 6** – visit www.valuentum.com

**Nike (NKE); VBI: 5** – visit www.valuentum.com

On the short-side, we continue to look to initiate a put position on Churchill Downs (CHDN) at $50 per share and LinkedIn (LNKD) at $120 per share, both of which we think are significantly overvalued – but are waiting for them to be extremely so before acting. We also may re-establish our put positions on Under Armour (UA), the Guggeheim Airline ETF (FAA) and AMR (AMR), the parent of American Airlines, if the opportunity presents itself again at higher prices – we had doubled our money on these positions in the past. We've also added First Solar (FSLR) to our list of short candidates. You can read our thoughts on these put ideas at our website: www.valuentum.com.

Valuentum Retail Equity Research | Visit us at www.valuentum.com | (10=best) | Data as of 30-Sep-2011

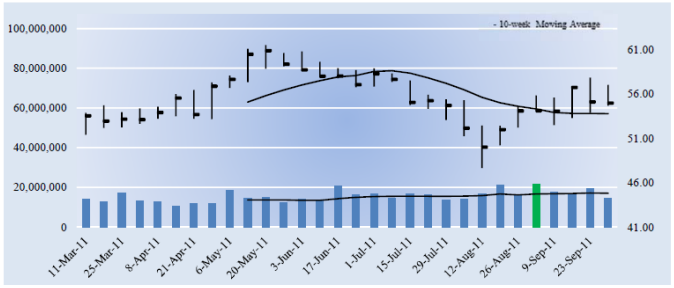
## Amgen AMGN UNDERVALUED 5.5%

Buying Index™ 7 | Value Rating ✓

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $54.96 | $83.00 | $58.00 - $108.00 | LARGE-CAP VALUE | Health Care | Biotechnology |

**Amgen 's shares look cheap based on our discounted cash flow process.**

### Stock Chart (weekly)




The week with the highest trading volume out of the last 13 weeks was a week of heavy buying, or accumulation (green bar).

### Investment Considerations

| | |
|---|---|
| DCF Valuation | UNDERVALUED |
| Relative Valuation | NEUTRAL |
| ValueCreation™ | EXCELLENT |
| ValueRisk™ | MEDIUM |
| ValueTrend™ | POSITIVE |
| Cash Flow Generation | STRONG |
| Financial Leverage | MEDIUM |
| Growth | MODEST |
| Technical Evaluation | BULLISH |
| Relative Strength | STRONG |
| Money Flow Index (MFI) | NEUTRAL |
| Upside/Downside Volume (U/D) | BEARISH |
| Near-term Technical Support, 10-week MA | 54.00 |

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) | $53,036 |
| Avg Weekly Vol (30 wks) | 15,379 |
| 30-week Range (USD) | 47.66 - 61.53 |
| Valuentum Sector | Health Care |
| 5-week Return | 1.1% |
| 13-week Return | -5.5% |
| 30-week Return | 4.6% |
| Dividend Yield % | 0.0% |
| Dividends per Share | 0.00 |
| Forward Dividend Payout Ratio | 0.0% |
| Est. Normal Diluted EPS | 5.97 |
| P/E on Est. Normal Diluted EPS | 9.2 |
| Est. Normal EBITDA | 7,696 |
| Forward EV/EBITDA | 6.8 |
| EV/Est. Normal EBITDA | 6.4 |
| Forward Revenue Growth (5-yr) | 2.7% |
| Forward EPS Growth (5-yr) | 6.2% |

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

### Investment Highlights

• Amgen 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. We expect the firm's return on invested capital (excluding goodwill) to expand to 65.7% from 56.3% during the next two years.

• Although we think the firm's DCF valuation indicates a potential attractive investment opportunity, we'd be more comfortable investing in the firm if it was more attractively priced on a relative basis versus peers as well.

• Amgen 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 36.4% in coming years. Total debt-to-EBITDA was 2 last year, while debt-to-book capitalization stood at 35.8%.

• 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.

• The firm experienced a revenue CAGR of about 0.6% during the past 3 years. We expect its revenue growth to be below that of its peer median during the next five years.

### Relative Valuation

| | Forward P/E | PEG | Price / FV |
|---|---|---|---|
| Biogen | 15.4 | 2.6 | 119.4% |
| Celgene | 17.4 | 1.8 | 99.9% |
| Gilead Sciences | 9.9 | 1.2 | 69.3% |
| Human Genome | -6.9 | NMF | 141.0% |
| Peer Median | 12.7 | 1.8 | 109.6% |
| **Amgen** | **10.2** | **1.9** | **66.2%** |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | 21.1% |
| Return on Assets | 11.7% |
| ROIC, with goodwill | 24.4% |
| ROIC, without goodwill | 51.6% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 13,362 |
| Net Debt | -4,060 |
| Total Debt/EBITDA | 2.0 |
| Net Debt/EBITDA | NMF |
| EBITDA/Interest | 11.1 |
| Current Ratio | 3.5 |
| Quick Ratio | 3.0 |

NMF = Not Meaningful

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Dec-09 | Dec-10 | Dec-11 |
| Revenue | 14,642 | 15,053 | 15,414 |
| Revenue, YoY% | -2.4% | 2.8% | 2.4% |
| Operating Income | 5,573 | 5,662 | 6,188 |
| Operating Margin % | 38.1% | 37.6% | 40.1% |
| Net Income | 4,605 | 4,627 | 5,075 |
| Net Income Margin % | 31.5% | 30.7% | 32.9% |
| Diluted EPS | 4.51 | 4.79 | 5.37 |
| Diluted EPS, YoY % | 15.6% | 6.3% | 11.9% |
| Free Cash Flow (CFO-capex) | 5,806 | 5,207 | 5,739 |
| Free Cash Flow Margin % | 39.7% | 34.6% | 37.2% |

In Millions of USD (except for per share items)

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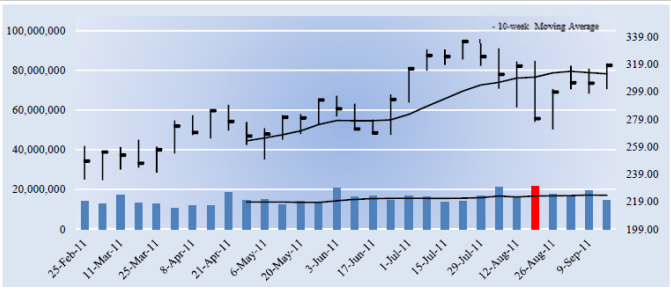
## Chipotle CMG OVERVALUED 12.9%

Buying Index™ 4 | Value Rating ✖

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $318.06 | $213.00 | $149.00 - $277.00 | LARGE-CAP GROWTH | Consumer Discretionary | Restaurants |

**Chipotle's technicals look very bullish. Traders could be eyeing the stock.**

### 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).

### Company Vitals

| | |
|---|---|
| Market Cap (USD) | $10,094 |
| Avg Weekly Vol (30 wks) | 15,379 |
| 30-week Range (USD) | 234.48 - 337.32 |
| Valuentum Sector | Consumer Discretionary |
| 5-week Return | -0.6% |
| 13-week Return | 18.7% |
| 30-week Return | 23.5% |
| Dividend Yield % | 0.0% |
| Dividends per Share | 0.00 |
| Forward Dividend Payout Ratio | 0.0% |
| Est. Normal Diluted EPS | 10.15 |
| P/E on Est. Normal Diluted EPS | 31.3 |
| Est. Normal EBITDA | 615 |
| Forward EV/EBITDA | 22.5 |
| EV/Est. Normal EBITDA | 15.8 |
| Forward Revenue Growth (5-yr) | 17.6% |
| Forward EPS Growth (5-yr) | 18.4% |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | 18.7% |
| Return on Assets | 13.8% |
| ROIC, with goodwill | 26.3% |
| ROIC, without goodwill | 27.2% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 4 |
| Net Debt | -346 |
| Total Debt/EBITDA | 0.0 |
| Net Debt/EBITDA | NMF |
| EBITDA/Interest | Excellent |
| Current Ratio | 3.3 |
| Quick Ratio | 3.1 |

NMF = Not Meaningful

### Investment Highlights

• Chipotle 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. We expect the firm's return on invested capital (excluding goodwill) to expand to 43.3% from 33.3% during the next two years.

• Although we don't think the firm's valuation indicates an attractive investment opportunity at this time, we'd take a closer look if the firm's share price fell below $149. The market seems to be pricing greater long-term revenue growth and profit expansion than we think is achievable.

• Chipotle has an excellent combination of strong free cash flow generation and low financial leverage. We expect the firm's free cash flow margin to average about 8.6% in coming years. Total debt-to-EBITDA was 0 last year, while debt-to-book capitalization stood at 0.5%.

• Although we think there may be a better time to dabble in the firm's shares based on our DCF process, the firm's stock has outperformed the market benchmark during the past quarter, indicating increased investor interest in the company.

• 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.

### Investment Considerations

| | |
|---|---|
| DCF Valuation | OVERVALUED |
| Relative Valuation | UNATTRACTIVE |
| ValueCreation™ | EXCELLENT |
| ValueRisk™ | MEDIUM |
| ValueTrend™ | POSITIVE |
| Cash Flow Generation | STRONG |
| Financial Leverage | LOW |
| Growth | AGGRESSIVE |
| Technical Evaluation | VERY BULLISH |
| Relative Strength | STRONG |
| Money Flow Index (MFI) | NEUTRAL |
| Upside/Downside Volume (U/D) | BULLISH |
| Near-term Technical Support, 10-week MA | 312.00 |

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 |
|---|---|---|---|
| Darden Restaurants | 12.0 | 1.6 | 91.2% |
| McDonald's | 16.2 | 2.1 | 101.5% |
| Starbucks | 25.5 | 3.0 | 122.5% |
| Yum! Brands | 18.4 | 2.2 | 122.4% |
| Peer Median | 17.3 | 2.1 | 111.9% |
| **Chipotle** | **46.1** | **3.1** | **149.3%** |

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

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Dec-09 | Dec-10 | Dec-11 |
| Revenue | 1,518 | 1,836 | 2,277 |
| Revenue, YoY% | 14.0% | 20.9% | 24.0% |
| Operating Income | 210 | 294 | 347 |
| Operating Margin % | 13.8% | 16.0% | 15.3% |
| Net Income | 127 | 179 | 216 |
| Net Income Margin % | 8.4% | 9.7% | 9.5% |
| Diluted EPS | 3.95 | 5.64 | 6.90 |
| Diluted EPS, YoY % | 67.5% | 42.7% | 22.3% |
| Free Cash Flow (CFO-capex) | 143 | 176 | 202 |
| Free Cash Flow Margin % | 9.4% | 9.6% | 8.9% |

In Millions of USD (except for per share items)

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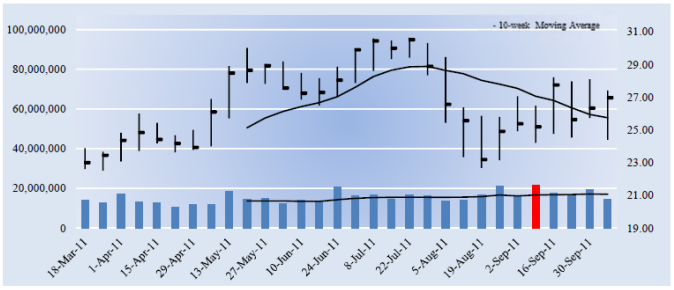
## Macy's M UNDERVALUED 0.2%

Buying Index™ 9 | Value Rating ✓

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $26.95 | $42.00 | $27.00 - $57.00 | LARGE-CAP VALUE | Consumer Discretionary | Multiline Retail |

**Macy's 's valuation and techicals are attractive. We'd take a closer look at the firm's shares.**

### 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).

### Company Vitals

| | |
|---|---|
| Market Cap (USD) | $11,516 |
| Avg Weekly Vol (30 wks) | 15,379 |
| 30-week Range (USD) | 22.5 - 30.62 |
| Valuentum Sector | Consumer Discretionary |
| 5-week Return | 10.3% |
| 13-week Return | -9.7% |
| 30-week Return | 14.5% |
| Dividend Yield % | 0.7% |
| Dividends per Share | 0.20 |
| Forward Dividend Payout Ratio | 7.4% |
| Est. Normal Diluted EPS | 3.02 |
| P/E on Est. Normal Diluted EPS | 8.9 |
| Est. Normal EBITDA | 3,709 |
| Forward EV/EBITDA | 5.0 |
| EV/Est. Normal EBITDA | 4.7 |
| Forward Revenue Growth (5-yr) | 2.6% |
| Forward EPS Growth (5-yr) | 9.9% |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | -14.0% |
| Return on Assets | -4.5% |
| ROIC, with goodwill | 17.7% |
| ROIC, without goodwill | 25.5% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 7,425 |
| Net Debt | 5,961 |
| Total Debt/EBITDA | 2.4 |
| Net Debt/EBITDA | 2.0 |
| EBITDA/Interest | 5.3 |
| Current Ratio | 1.4 |
| Quick Ratio | 0.4 |

NMF = Not Meaningful

### Investment Highlights

• Macy's 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 25.5% during the past three years.

• Macy's '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.

• Macy's '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.

• 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.

### Investment Considerations

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

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 |
|---|---|---|---|
| J.C. Penney | 28.0 | 4.3 | 173.9% |
| Kohl's | 11.0 | 1.4 | 76.0% |
| Nordstrom | 15.5 | 1.9 | 95.5% |
| Sears Holdings | -42.1 | NMF | 172.6% |
| Peer Median | 13.2 | 1.9 | 134.0% |
| **Macy's** | **10.0** | **1.4** | **64.2%** |

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

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Jan-10 | Jan-11 | Jan-12 |
| Revenue | 23,489 | 25,003 | 26,253 |
| Revenue, YoY% | -5.6% | 6.4% | 5.0% |
| Operating Income | 1,454 | 1,919 | 2,338 |
| Operating Margin % | 6.2% | 7.7% | 8.9% |
| Net Income | 350 | 847 | 1,132 |
| Net Income Margin % | 1.5% | 3.4% | 4.3% |
| Diluted EPS | 0.83 | 1.98 | 2.70 |
| Diluted EPS, YoY % | -107.2% | 139.7% | 36.0% |
| Free Cash Flow (CFO-capex) | 1,290 | 1,001 | 1,359 |
| Free Cash Flow Margin % | 5.5% | 4.0% | 5.2% |

In Millions of USD (except for per share items)

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Valuentum Retail Equity Research | Visit us at www.valuentum.com | (10=best) | Data as of 23-Sep-2011

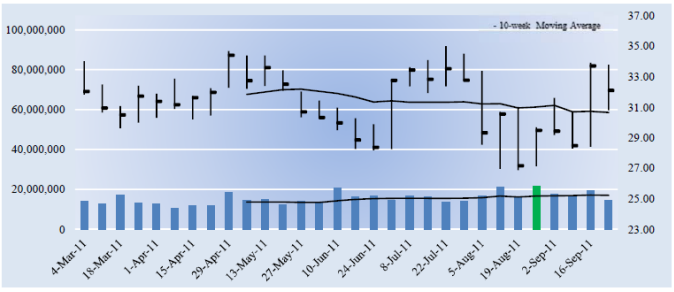
## eBay EBAY UNDERVALUED 9.1%

Buying Index™ 10 | Value Rating ✓

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $32.08 | $47.00 | $35.00 - $59.00 | LARGE-CAP BLEND | Consumer Discretionary | Internet & Catalog Retail |

**eBay 's strong cash flow generation and attractive valuation represent a compelling combination. We'd take a closer look at picking up the firm's shares.**

### Stock Chart (weekly)




The week with the highest trading volume out of the last 13 weeks was a week of heavy buying, or accumulation (green bar).

### Company Vitals

| | |
|---|---|
| Market Cap (USD) | $42,584 |
| Avg Weekly Vol (30 wks) | 15,379 |
| 30-week Range (USD) | 26.86 - 34.99 |
| Valuentum Sector | Consumer Discretionary |
| 5-week Return | 15.6% |
| 13-week Return | 13.6% |
| 30-week Return | -4.8% |
| Dividend Yield % | 0.0% |
| Dividends per Share | 0.00 |
| Forward Dividend Payout Ratio | 0.0% |
| Est. Normal Diluted EPS | 2.71 |
| P/E on Est. Normal Diluted EPS | 11.8 |
| Est. Normal EBITDA | 5,376 |
| Forward EV/EBITDA | 9.2 |
| EV/Est. Normal EBITDA | 7.0 |
| Forward Revenue Growth (5-yr) | 15.7% |
| Forward EPS Growth (5-yr) | 19.8% |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | 15.7% |
| Return on Assets | 11.5% |
| ROIC, with goodwill | 23.6% |
| ROIC, without goodwill | 106.5% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 1,794 |
| Net Debt | -4,829 |
| Total Debt/EBITDA | 0.6 |
| Net Debt/EBITDA | NMF |
| EBITDA/Interest | Excellent |
| Current Ratio | 2.4 |
| Quick Ratio | 2.3 |

NMF = Not Meaningful

### Investment Highlights

• eBay 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. We expect the firm's return on invested capital (excluding goodwill) to expand to 154.5% from 116% during the next two years.

• eBay '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.

• eBay has an excellent combination of strong free cash flow generation and low financial leverage. We expect the firm's free cash flow margin to average about 25.7% in coming years. Total debt-to-EBITDA was 0.6 last year, while debt-to-book capitalization stood at 10.5%.

• 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.

• 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.

### Investment Considerations

| | |
|---|---|
| DCF Valuation | UNDERVALUED |
| Relative Valuation | ATTRACTIVE |
| ValueCreation™ | EXCELLENT |
| ValueRisk™ | MEDIUM |
| ValueTrend™ | POSITIVE |
| Cash Flow Generation | STRONG |
| Financial Leverage | LOW |
| Growth | AGGRESSIVE |
| Technical Evaluation | VERY BULLISH |
| Relative Strength | STRONG |
| Money Flow Index (MFI) | NEUTRAL |
| Upside/Downside Volume (U/D) | IMPROVING |
| Near-term Technical Support, 10-week MA | 31.00 |

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 |
|---|---|---|---|
| Amazon.com | 111.3 | 2.4 | 95.6% |
| Expedia | 13.7 | 1.3 | 87.6% |
| Liberty Interactive | 19.6 | NMF | 106.5% |
| Priceline.com | 22.3 | 1.7 | 88.1% |
| Peer Median | 20.9 | 1.7 | 91.8% |
| **eBay** | **15.7** | **1.2** | **68.3%** |

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

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Dec-09 | Dec-10 | Dec-11 |
| Revenue | 8,727 | 9,156 | 11,445 |
| Revenue, YoY% | 2.2% | 4.9% | 25.0% |
| Operating Income | 1,495 | 2,075 | 3,163 |
| Operating Margin % | 17.1% | 22.7% | 27.6% |
| Net Income | 2,389 | 1,801 | 2,677 |
| Net Income Margin % | 27.4% | 19.7% | 23.4% |
| Diluted EPS | 1.83 | 1.36 | 2.04 |
| Diluted EPS, YoY % | 35.0% | -25.9% | 50.4% |
| Free Cash Flow (CFO-capex) | 2,341 | 2,022 | 3,191 |
| Free Cash Flow Margin % | 26.8% | 22.1% | 27.9% |

In Millions of USD (except for per share items)

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# Our Methodology – The Valuentum Buying Index

*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, 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. 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.

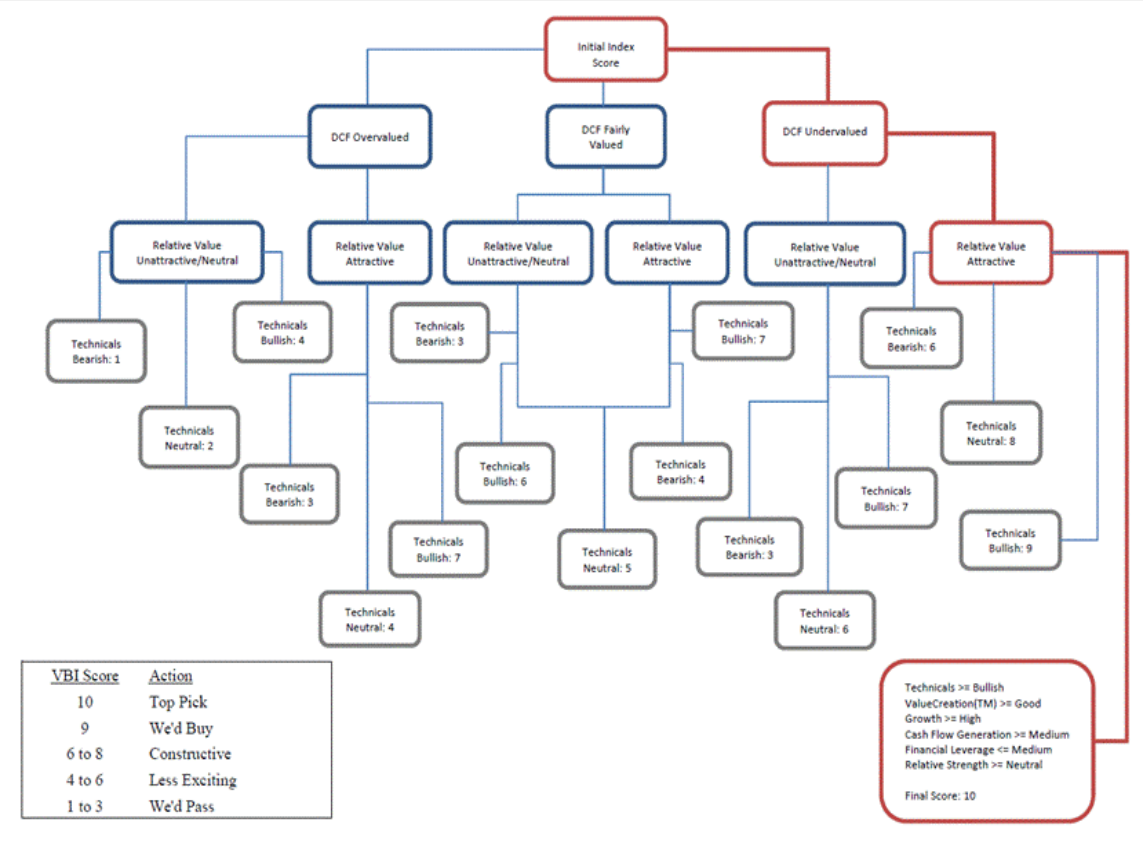
Let's discuss how a firm can score a 10, the best mark on our index (a "Top Pick"). First, the company would need to be 'undervalued' on a DCF basis and 'attractive' on a relative 'value basis. The stock would also have to be exhibiting 'bullish' technicals. The firm would need a ValueCreation rating 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 sell"). 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.

Please view the flow chart on the next page regarding our Valuentum Buying Index.

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

# Our Methodology – The Valuentum Buying Index

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Valuentum Best Ideas Newsletter: Volume 1, Issue 4

Valuentum's Best Ideas Newsletter is published monthly. To receive this newsletter on a monthly basis, please subscribe to Valuentum by visiting our website at www.valuentum.com. Or contact us at info@valuentum.com.

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OUR BEST IDEAS NEWSLETTER

# Valuentum Securities

Stock Analysis: From Value through Momentum Investing

November 15, 2011
Volume 1 Issue 5

Valuentum Securities Inc.
www.valuentum.com info@valuentum.com

| Portfolio Return | Benchmark Return | Outperformance |
|---|---|---|
| 12.6% | -3.6% | 16.2% |

Portfolio Inception Date: May 17, 2011

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## Third-Quarter Earnings Strong Despite Eurozone Fears

*By Brian Nelson, CFA*

Brian Nelson, CFA
President, Equity Research
brian@valuentum.com

As investors continue to deal with widespread global macroeconomic uncertainty, we thought it important to provide a perspective on the trajectory of what drives long-term stock prices: earnings (cash flow). We encourage investors to stay focused on corporate performance, as once the Eurozone fears are resolved, the markets will inevitably come back to setting valuations based on firm-specific performance.

Last week, I sat down for an interview to discuss third-quarter earnings and what we're watching in Europe, and I wanted to share the transcript with you here in our Best Ideas Newsletter. I have included it below:

Interviewer: Good morning. I'm here with Brian Nelson, president of equity research at Valuentum Securities. And today we're going to talk about third quarter earnings. Brian, thanks for coming.

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**Please see *Third-Quarter Earnings...*on page 2**

## Navigating Through Uncertainty

*By Valuentum Analysts*

The previous month can best be described as a period where we digested some of our huge gains so far this year. EDAC Tech (EDAC) set another new high above $10 per share (our cost basis is just over $4 per share), and we trimmed our position in the firm yet again to raise cash for more opportunistic ideas. Apple (AAPL) registered a new high in the period before coming in on concerns about supply issues related to its iPad. Though we think such concerns may reduce the likelihood of an outsize earnings beat this quarter, Apple remains considerably undervalued based on our DCF process, and we're holding strong in our portfolio (it has an astounding $80 billion+ in cash on hand). The recent additions to our portfolio have also performed nicely, with Ford (F), eBay (EBAY) and Intel (INTC) all now meaningfully above our cost basis (we added to Ford

**Please see *Navigating Through Uncertainty...* on page 7**

*Third-Quarter Earnings...*continued from page 1

B. Nelson: It's good to be here.

Interviewer: So with third-quarter earnings season just about wrapped up, how have the reports been overall?

B. Nelson: I think the reports have actually been very good. On a trailing four-quarter basis, with the companies that have reported on the S&P so far and estimating those that haven't, we're looking at all-time highs again on a trailing four-quarter basis. We have now surpassed the levels seen prior to the Great Recession. I think corporations are now seeing very strong earnings growth. In fact, roughly 75% of companies in the S&P 500 that have reported earnings thus far have actually beat expectations, and we're seeing bottom-line expansion of about 15%, so these are very strong results.

*"In fact, roughly 75% of companies in the S&P 500 that have reported earnings thus far have actually beat expectations, and we're seeing bottom-line expansion of about 15%, so these are very strong results."*

Interviewer: Very interesting. Where did these better than expected results come from?

B. Nelson: I think most of the earnings expansion has come from cost-cutting measures as well as efficiency initiatives, but a lot of the companies have also posted very strong top-line expansion. In fact, over 60% of the companies that have reported so far in the third quarter have beaten consensus sales forecast expectations, and even companies that missed on the bottom line had fantastic results, two examples being Apple as well as Amazon (AMZN). And the top line growth isn't shabby. In fact, we're seeing double digit top-line expansion in the third quarter.

Interviewer: What were some of the strongest reports, in your opinion?

B. Nelson: I think one of the stronger consumer reports that we've seen, which was actually more recently, is Walt Disney (DIS), which reported a very strong quarter with media networks revenue up 9% and revenue from its resorts and parks up 11%. This is on higher ticket prices as well as increased attendance. And, in fact, Walt Disney for the first time in a while saw earnings expansion, income expansion, from all five of its business segments. So people are going on vacation, they are spending money, and they're also buying premium coffee. Starbucks (SBUX) had a very strong quarter. US comps were up 10%, global comps were up 9%, partially due to strong loyalty programs as well as some unique fall offerings, but nonetheless people have continued to buy Starbucks coffee.

Within the airline space, Priceline.com (PCLN) for example saw its highest quarterly airline ticketing revenue in the last seven quarters. That's also been very strong. Then of course what you may already know with smartphone adoption, Qualcomm (QCOM) had a very strong quarter, and so did Apple. Though it did miss on the bottom line, the growth was very strong, and we think the 4S adoption will continue to be a key driver for Apple later this year.

I think also when you look at the online consumer, Amazon posted very solid

**Please see *Third-Quarter Earnings...*on next page**

*Third-Quarter Earnings...*continued from previous page

top line expansion, and eBay (EBAY) for example had its highest quarterly revenue growth in the last six years, and we hold that one in our Best Ideas portfolio. We think that name is a bargain at these levels and we think, to a large extent, you are getting PayPal for free. So, despite all the worries you may see in the media with respect to Europe and also concerns with the domestic economy, third-quarter results were actually very strong, and this may come as a surprise to many.

Interviewer: What about industrials?

B. Nelson: I think you're right. The industrials are a key driver to assessing the global macroeconomic environment, but we've seen some strength out of the industrials sector as well, and one thing we continue to look at at Valuentum are the order books at Boeing (BA) and Airbus (EADSY.PK). Boeing and Airbus have roughly 7 years of backlog waiting to be delivered. These are unfulfilled deliveries of commercial aircraft, and we think this is very positive for the commercial supply chain and should mitigate any cyclicality over the next several years if we enter into a weak period in Europe or a slowdown domestically.

*"But while we've been positive on aerospace for a while, we also saw a very strong report out of Caterpillar (CAT). In fact, Caterpillar had a record backlog; again, unfulfilled orders. In its third quarter it also had the highest sales, highest operating margins, as well as the best operating cash flow in its history."*

But while we've been positive on aerospace for a while, we also saw a very strong report out of Caterpillar (CAT). In fact, Caterpillar had a record backlog; again, unfulfilled orders in its third quarter. It also had the highest sales, highest operating margins, as well as the best operating cash flow in its history. So these are bellwether industrials that are putting up strong numbers. Honeywell (HON) and General Electric (GE) had very similar stories with very solid organic sales expansion of 8% in their respective quarters. In fact, GE's industrial backlog increased sequentially to $191 billion. So you have these bellwethers suggesting that we aren't entering into a global recession.

In fact economic growth is still very resilient. I think probably the most telling assessment within the domestic economy for the third quarter has been rail volumes, actually assessing what is moving about within the US on rail gives a good idea of how the economy is tracking. Union Pacific (UNP) had very strong freight revenues for the quarter. In fact all six of its end markets expanded, with industrial products up 24% in Union Pacific's quarter. So, goods are moving around the country, industrial names continue to see order growth and backlog expansion, and we firmly believe that economic activity is not contracting. And as we outlined in our Best Ideas newsletter (October edition), we think a recession in the US is nowhere in sight.

Interviewer: What about some of the weak reports?

B. Nelson: Obviously there are going to be some winners and some losers in any earnings season. Outside of some of the high beta names like Green

**Please see *Third-Quarter Earnings...*on next page**

*Third-Quarter Earnings...*continued from previous page

*"The third quarter is now behind us, so we're looking ahead to the fourth quarter and 2012… for the most part we think the US economy is on track. Corporate America is reporting strong results, and we're seeing that not only out of bellwethers, but also out of names in our Best Ideas portfolio. "*

Mountain Coffee Roasters (GMCR) or Netflix (NFLX), looking at some of the bigger names like Kellogg (K)--we think the firm had a very poor quarter, because it cut very deep within its supply chain during the Great Recession to boost margins. This is coming back to haunt them as they have to reinvest in their supply chain to shore it up to get things going again. Commodity prices were also the headwind for some companies, such as Clorox (CLX), which is a name that continues to face higher commodity prices and can't push prices to offset that. This is in stark contrast to a solid name like Kraft (KFT) that's able to raise prices. In fact in the third quarter it had seven percentage points of pricing expansion to offset these commodity costs.

This was a very controversial quarter in terms of the assessment for 3M (MMM). It indicated that it was seeing weakness in terms of orders from its customers. We think this is relatively isolated to one specific segment, the LCD film segment, which we thought heading into the quarter was going to be weak. And when we look at 3M's performance, five of the six segments did perform very well, with the LCD film segment being the sole weakness. Finally, Alcoa (AA), which kicked off earnings season, had poor results due to lower metal prices, but when you look at the end market expansion of Alcoa in its third quarter, it is absolutely phenomenal. Commercial transportation, automotive, and aerospace end markets were up huge for Alcoa.

Interviewer: So kind of a mixed bag to some extent?

B. Nelson: Yeah. I think it's fair to say we had some winners and we had some losers in the third quarter. But I'd say the reports were much more positive than they were negative. But the markets are always forward-looking. The third quarter is now behind us, so we're looking ahead to the fourth quarter and 2012. The companies that did come out with guidance, a good majority of them lowered their guidance relative to those that raised it. So we're still very cautious, we're still evaluating the global macro environment. We're not taking the Eurozone problems lightly. We continue to analyze the debt situations of Italy, Spain, of regions that are facing very serious debt situations (Greece), but for the most part we think the US economy is on track. Corporate America is reporting strong results, and we're seeing that not only out of the bellwethers, but also out of names in our Best Ideas portfolio. We think our Best Ideas portfolio is very well positioned to capitalize on the strength that we're seeing.

Interviewer: Thanks Brian.

B. Nelson: Thank you.

# Company Spotlight: Eastman Chemical

*By Valuentum Analysts*

While the primary legacy of George Eastman, Eastman Kodak, looks headed for bankruptcy, we think its former subsidiary, Eastman Chemical (EMN), is cheap. With a dividend yield of almost 2.7% and an upside of 35% (our fair value is in the mid-$50s), we think Eastman Chemical provides an interesting investment opportunity.

*"With a dividend yield of almost 2.7% and an upside of 35% (our fair value is in the mid-$50s), we think Eastman Chemical provides an interesting investment opportunity."*

**Business background**

Though the company can trace its origins to the 1920's, Eastman Chemical was spun-off of its parent company, Eastman Kodak over 15 years ago. Since its independence began, Eastman has paid a dividend in all but one quarter, with it recently being increased in 2010, and again in Q2 2011.

A lot of language exclusive to the chemical industry makes Eastman Chemical sound like an extremely complicated business. From acetate tow to non-phthalate plasticizers, it's no wonder the market has yet to fully appreciate the company's earnings power.

However technical the language may be, Eastman's business is not nearly as complicated. As a chemical, plastics, and fibers producer, Eastman creates products with end uses running the gambit from Nalgene bottles (copolyester resin) to cigarette filters (acetate tow). That being said, odds are there are dozens of products you use on a daily basis with derivatives directly from Eastman Chemical.

Eastman generates over half of its revenues in the United States and Canada, with around $2.9 billion in sales in 2010, up 31% in 2009. However, with nearly an equal amount of sales outside of North America, the company is a proxy for global growth.

**Global expansion**

The demand for acetate tow and acetate yarn in 2010 was strong enough that the company acquired a manufacturing facility in Korea to meet growing demand. Due to the increased capacity and utilization, Eastman grew revenues an impressive 21% in Q2 2011. This additional incremental revenue should accrue to increased operating earnings in the fibers segment.

Additionally, Eastman recently opened a new hydrocarbon resin facility in the Netherlands to meet demand for its low-cost resins. Unlike competitor Dow Chemical (DOW), Eastman uses coal instead of oil in its hydrocarbon resins, which are a key component in its plastics.

Eastman's Asian business increased sales by 36%, with 18% of that attributable to volume increases. We think a new contract with China Tobacco to produce acetate tow for its cigarette filters will lead to higher revenues and increased profitability. However, management did warn of some softening in Asian demand in the summer months, which we do not view as a significant long-term concern.

*Company Spotlight: Eastman Chemical* continued on page 8

# New Highs for Apple: Delayed Not Canceled; Fiscal Fourth Quarter Merely a Timing Miss

*By Valuentum Analysts*

Perhaps the most valuable thing investors can learn is that stock prices are determined by future (not past) expectations of a firm's business fundamentals, and by extension, its future free cash flow stream. The uncertainty of the future--and not the certainty of the past--is what drives stock prices and their volatility (after all, if the future were known with certainty, stocks would trade at precisely their known fair values).

This consideration is important as we evaluate Apple's (AAPL) fiscal fourth-quarter results, which came in lighter than what the Street had been expecting. Despite the miss, the iPhone-maker guided its fiscal first-quarter above consensus estimates, which should and always will trump any earnings miss as interpreted by the market in the previous quarter. Importantly, the last quarter (Apple's fiscal fourth quarter) is now behind us, and all that matters is what's ahead in the future for Apple. And, in Apple's case, the future is bright. We're maintaining our $531 fair value estimate.

The iPhone-maker posted quarterly revenue of $28.3 billion and…

**Please see *New Highs for Apple…* on page 9**

*"Despite the miss, the iPhone-maker guided its fiscal first-quarter above consensus estimates, which should and always will trump any earnings miss as interpreted by the market in the previous quarter. Importantly, the last quarter (Apple's fiscal fourth quarter) is now behind us, and all that matters is what's ahead in the future for Apple."*

# Best-Idea Astronics Posts Record Third-Quarter Revenue, Earnings, and Bookings

*By Valuentum Analysts*

Best-idea Astronics (ATRO) posted excellent third-quarter results that showed both strong sales and earnings expansion. We are maintaining our above-market $47 fair value estimate, which represents about 15.6 times earnings if we annualize this quarter's ($0.52 per share). We will be retaining our outsize position in our Best Ideas Newsletter.

Astronics' top line reached a record, advancing 13%, while diluted earnings per share jumped 41%. Commercial transport revenue jumped 23%, while sales from its business jet segment increased 20%. The firm's gross margin ticked down about 0.5 percentage points, which directly impacted the operating line, as SG&A as a percentage of revenue held relatively steady at 11.3% of sales. The firm's operating margin was 14% in the third quarter and, on a year-to-date basis, advanced 1.5 percentage points from the same period last year. Astronics noted that net income was a record, at 12% of sales, thanks in part to lower interest expense and a lower tax rate.

Importantly, however, the firm achieved record quarterly bookings of nearly $65 million—up 6% year-over-year and 12% sequentially. We view the bookings number as particularly positive, as it is greater than quarterly revenue ($56.4), but also in that it signals that our thesis on the aerospace industry remains spot on. We continue to believe that commercial aircraft build rates by Boeing (BA) and Airbus (EADSY.PK) will remain strong for the next few years, and Astronics—with its electrical content (cabin electronics, aircraft lighting, and airframe power)—will be nicely positioned to reap the benefits of this growth curve. Astronics' aerospace backlog was $101.4 million at the end of the third quarter (up from $102 million at the end of the second quarter), as order momentum continues.

| Portfolio Return | Benchmark Return | Outperformance |
|---|---|---|
| 12.6% | -3.6% | 16.2% |

Portfolio Inception Date: May 17, 2011

***Navigating Through Uncertainty*** **continued from page 1**

and eBay during the period as well). Though our total return jumped 0.3 percentage points, our relative performance narrowed a bit compared to our benchmark (the S&P 500 Index) from last month. However, our outperformance still remains best-in-class, and we continue to outpace the index by over 16 percentage points.

Perhaps the biggest headwind in the period was the performance of our put position in Chipotle (Jan 2012, $300 strike). The stock continues to move against us, but we maintain the burrito-maker is significantly overpriced based on our DCF process (it also guided 2012 comps lower, which we think will take some time for the Street to reflect in its stock price). If this position does not work out for us, we may initiate another put option with a longer duration and higher strike (given its price run-up). Plus, our put exposure should be viewed as a hedge against downside beta-risk given our portfolio's overweight on the long side. Our recent addition of a put option on LinkedIn (LNKD) should be viewed similarly.

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 13), as well as analysis and trends impacting companies on our Best Ideas List. We currently have about 3% of our portfolio in cash, a level we are comfortable with at this time.

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-picking methodology.

| OUR BEST IDEAS -- as of November 11, 2011 | | | | | | | | | Best Ideas Portfolio Inception Date: May 17, 2011 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Portfolio Holdings** | Symbol | VBI Score* | First Purchase Date | Cost Basis/Share ($) | Total Shares | Total Cost ($) | Current Value/Share ($) | Current Value ($) | Dividends Received | % of Portfolio | % Return |
| *Bullish* | | | | | | | | | | | |
| Apple Corp. | AAPL | 7 | 17-Jun-11 | 328.99 | 20 | 6,586.80 | 384.62 | 7,692.40 | 0.00 | 6.8% | 16.8% |
| Altria Group | MO | 7 | 28-Jun-11 | 26.43 | 378 | 9,997.54 | 27.78 | 10,500.84 | 154.98 | 9.3% | 6.6% |
| Ancestry.com | ACOM | 6 | 17-May-11 | 32.43 | 446 | 14,463.40 | 24.11 | 10,753.06 | 0.00 | 9.5% | -25.7% |
| Astronics | ATRO | 3 | 6-Jun-11 | 24.93 | 401 | 10,003.93 | 31.92 | 12,799.92 | 0.00 | 11.4% | 27.9% |
| Buffalo Wild Wings | BWLD | 6 | 13-Jul-11 | 65.42 | 152 | 9,950.84 | 63.99 | 9,726.48 | 0.00 | 8.6% | -2.3% |
| Collective Brands | PSS | 6 | 11-Jul-11 | 15.09 | 662 | 9,996.58 | 14.53 | 9,618.86 | 0.00 | 8.5% | -3.8% |
| eBay | EBAY | 10 | 3-Oct-11 | 29.13 | 100 | 2,920.00 | 31.76 | 3,176.00 | 0.00 | 2.8% | 8.8% |
| **NEW: We bought 100 shares of EBAY on 11/8/2011 at $32.80.** | | | | **32.80** | **100** | **3,287.00** | **31.76** | **3,176.00** | **0.00** | **2.8%** | **-3.4%** |
| EDAC Tech | EDAC | 6 | 6-Jun-11 | 4.08 | 1100 | 4,495.00 | 9.07 | 9,977.00 | 0.00 | 8.9% | 122.0% |
| **NEW: We sold 125 shares of EDAC on 11/8/2011 at $9.84.** | | | | | | | | | | | |
| Ford Motor | F | 7 | 12-Sep-11 | 9.94 | 200 | 1,995.00 | 11.14 | 2,228.00 | 0.00 | 2.0% | 11.7% |
| **NEW: We bought 250 shares of Ford on 11/8/2011 at $11.53.** | | | | **11.53** | **250** | **2,889.50** | **11.14** | **2,785.00** | **0.00** | **2.5%** | **-3.6%** |
| Intel | INTC | 6 | 12-Sep-11 | 19.89 | 100 | 1,996.00 | 24.85 | 2,485.00 | 21.00 | 2.2% | 25.6% |
| Precision Castparts | PCP | 3 | 6-Jun-11 | 152.07 | 65 | 9,891.55 | 167.34 | 10,877.10 | 1.95 | 9.7% | 10.0% |
| Republic Services | RSG | 3 | 19-May-11 | 31.42 | 403 | 12,662.85 | 27.72 | 11,171.16 | 161.20 | 9.9% | -10.5% |
| Cash | | | | | | | | 3,659.39 | | 3.2% | 0.0% |
| *Bearish* | | | | | | | | | | | |
| Chipote Mexican | CMG | 4 | 3-Oct-11 | 33.70 | 1 Contract | 3,378.25 | 10.40 | 1,040.00 | 0.00 | 0.9% | -69.2% |
| ---> Jan 2012, $300 strike | | | | | | | | | | | |
| **NEW: LinkedIn** | **LNKD** | **1** | **8-Nov-11** | **10.40** | **1 Contract** | **1,048.25** | **9.80** | **980.00** | **0.00** | **0.9%** | **-6.5%** |
| **---> Aug 2012, $55 strike** | | | | | | | | | | | |
| **Best Ideas Portfolio Value** | | | | | | 100,000.00 | | 112,646.21 | | | 12.6% |
| SPY | | | 17-May-11 | 132.69 | 754 | 100,000.00 | 126.66 | 95,455.57 | 944.31 | 100.00% | |
| **Benchmark Value** | | | | | | | | **96,399.88** | | | **-3.6%** |
| **Under/Outperformance** | | | | | | | | | | | **16.2%** |

This portfolio is not a real money portfolio. Data as of November 11. Cost basis includes commissions. Results include dividends, but not interest received on cash balance.

* 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.

*Company Spotlight: Eastman Chemical* continued from page 5

Since management prefers to invest in the business rather than buy back shares or really boost the dividend, we would not be surprised to see the company acquire complimentary production facilities in Latin America or Asia if profitable opportunities are present.

**Major risks are macro**

Not unlike other cyclical companies, Eastman's future growth lies in emerging markets, thus meaning another global recession could cause sales and profits to deteriorate quickly. However, in 2009, which we consider worse than anything going forward, revenues fell 34%, but the company managed to post $1.05 in earnings from continuing operations and remain cash-flow positive without cutting their dividend. Two years later, after retiring debt with higher interest burdens and stockpiling over $600 million in cash, the company should easily withstand difficult economic conditions.

Regardless, Valuentum believes the US and Canada, which account for over 50% of Eastman's business, are not headed for a recession, so the risk from these two countries is minor. Europe remains the biggest risk, as the majority of revenue increases in the region in 2010 were due to volume increases rather than pricing.

Another risk we see for shareholders is in the form of a takeover. The board of directors recently eliminated the supermajority voting rights provision, possibly indicating their desire to be acquired. We will wait until they announce more specific details, but given the fairly simple nature of the business, as well as its strong market positions and operating leverage, we think the firm could be an excellent buyout candidate. We would like to see a buyout in excess of our fair value, which is less likely given where the current share price sits.

We think that Eastman trading at about 7.5x our 2011 earnings forecast looks like a great bet, especially for investors who are bullish on the global economy. However, a recession would considerably affect profits and the company's ability to invest in organic growth. We don't think the chance of a global recession is very high, but Europe remains a dangerous wild card for cyclical multinationals.

## Cisco Reports Fiscal First-Quarter Results; Restructuring Efforts Bearing Fruit

*By Valuentum Analysts*

Cisco (CSCO) reported fiscal first-quarter results that came in better than consensus expectations. We're comfortable with our long-term projections for Cisco and are maintaining our above-market $22 fair value estimate.

Cisco's total revenue advanced 4.7% from the same period a year ago (slightly lower than the firm's long-term expected pace), as both product and service sales expanded. Cisco's widely-watched gross margin fell 160 basis points, to 61.2%, in the quarter, which was about in line with what we were expecting for the period. Though gross profit expanded and research and development investment slowed, the firm's results were weighed down by over $200 million in restructuring and other charges during the period as Cisco tries to get its operations back on track.

As a result, operating income fell about 6% from last year's quarter, while net income also tumbled by almost 8%. Diluted earnings per share came in at $0.33, down only a penny from last year, as share buybacks stemmed the decline. Non-GAAP net income, however, nudged up slightly from the same period a year ago and came in better than consensus forecasts. Cash flow from operations was excellent, increasing roughly $600 million from last year's quarter. Total cash still stands at an astounding $44 billion.

Looking forward, Cisco indicated that it has completed the majority of its restructuring efforts, which, if true, should set the stage for the stock to continue to converge to our fair value estimate. For the current fiscal quarter, the firm expects revenue to advance as much as 8%, and earnings per share to reach $0.44. This outlook was above consensus forecasts.

*New Highs for Apple...* continued from page 6

quarterly net profit of $6.6 billion, or $7.05 per diluted share. Compared with last year's quarter, these numbers represent significant growth in the firm's top and bottom line. During the period, Apple sold over 17 million iPhones (21% growth), 11.12 million iPads (166% growth), and 4.89 million Macs (26% growth). Much of the disappointment in Apple's performance was due to a shortfall in iPhone sales which caused roughly a $0.25 bottom-line miss--the Street had been expecting several million more iPhones in terms of unit sales. However, the leak of the launch of the features behind the iPhone 4S ultimately swayed consumers to wait for the upgraded phone. And with Apple selling over 4 million units of the iPhone 4S in a three-to-four day period after the closing of the recently reported quarter, we're far from concerned about any slowdown in this key profit driver.

Apple's cash flow generation continues to be robust, and the firm now holds more than $81 billion in cash on its balance sheet. As mentioned above, Apple's guidance for the first quarter of fiscal 2012 also came in better than expectations, with revenue anticipated at $37 billion and diluted earnings per share of about $9.30. We fully expect Apple to deliver on its guidance for next quarter, but we are watching developments at smartphone makers powered by Google's Android, as well as developments in the tablet market, which witnessed the release of Amazon's (AMZN) new Kindle Fire in mid-November.

## Jefferies Cuts Europe Exposure; Why This Is More Than a Headline

*By Valuentum Analysts*

Investment-bank Jefferies (JEF) has come under scrutiny in the past few weeks following a downgrade of its credit rating by an independent rating firm, which cited large gross exposure to European debt, the focal point of the market's nervousness in the past few months. In response, Jefferies pretty much opened its sovereign books to the public (detailing both its long and short positions and its net exposure per country), and then announced that it had reduced its gross exposure to Europe by half. We are quite impressed with this unprecedented transparency, but that's not why we're encouraged by this development.

We've reproduced one of Jefferies' press releases that it used to combat worries about its capital position:

*Jefferies announced today that its trading positions in the sovereign securities of the nations of Portugal, Italy, Ireland, Greece, and Spain have been reduced by an aggregate of approximately $1.1 billion long and $1.1 billion short. This represents a 49.5% reduction in Jefferies' gross holdings of these securities since the close of business Friday and resulted in no meaningful profit or loss on today's trading activity or our remaining positions, which continue to be substantially matched by country and maturity. Jefferies' current net exposure to these sovereign securities is currently $59 million, or 1.7% of shareholder equity, with negligible market or credit risk.*

*"We undertook this reduction in our holdings solely to demonstrate the liquid nature of this market-making trading book," said Richard Handler, Chairman and CEO, and Brian Friedman, Chairman of the Executive Committee of Jefferies, in a joint statement. "We will now resume our normal market-making activities and serve our clients around the world."*

As Jefferies outlined above, the European sovereign markets remain incredibly liquid and organized. If a firm like Jefferies can move in and out at will (despite facing capital concerns), then there is little doubt that the other larger US investment banks can do as well. As we outlined in the October edition of our Best Ideas Newsletter, we maintain that, if we encounter any problems with Europe, it will merely be transitory and the health of the US economy will continue to be strong. We've seen no information since the publication of our newsletter to disconfirm this thesis.

## LinkedIn Valuation: Completely Absurd, Significantly Overvalued

*By Valuentum Analysts*

A number of months ago, we wrote about Netflix (NFLX) and how we thought the shares were absurdly overvalued -- *Netflix Valuation: Completely Absurd, Significantly Overvalued*. The stock was trading around $250 per share at that time, and now it's trading for less than $100 per share. We're now making a similar valuation call on LinkedIn (LNKD).

LinkedIn posted third-quarter results recently. When a company is growing as fast as LinkedIn, the year-over-year comparisons become relatively meaningless, and at the end of the day, we think earnings (and by extension cash flow) is what drives long-term equity prices. Our view is that the firm's stock price will continue to hum along, until the Street grows impatient with the name (that is, the syndicate backs away upon lockup expiration), setting the table for the beginnings of a tumble. Our significantly below-market $55 fair value estimate remains unchanged.

LinkedIn grew revenue 126% in the quarter (as members advanced 63%) led by a more-than-doubling of revenue from hiring solutions and marketing solutions, while non-GAAP earnings per share reached $0.06—again, not that impressive for a firm that is trading above $80 per share. Interestingly, non-GAAP net income only increased $600,000 (yes, that's $0.6 million) from the same period a year ago—far from material expansion (how LinkedIn—or perhaps more appropriate, the sell side—has convinced the market of its current price-to-earnings multiple is beyond us). Adjusted EBITDA margins held steady at 18%, revealing little operating leverage in the business, at least currently.

The firm also issued a shelf registration for $100 million Thursday, the beginning of substantial dilution that holders of this stock should expect, as LinkedIn continues to be in need of cash (a shelf is the subsequent sale of additional shares). This is a huge red flag. LinkedIn could have easily raised more money at its initial public offering just a few months ago, but it decided to keep the float small to drive a huge spike when its shares first began trading. What happens when LinkedIn actually releases as many shares as it needs to drive its desired growth? Well, that's when the bubble begins to deflate, and we believe the beginning of the decline is near.

Looking forward, the professional social-networking provider expects revenue this year to reach as much as $512 million on the high end (up from $485 million). We expect continued substantial growth, but LinkedIn would have to maintain an unbelievable trajectory for a very long time to justify its current share price. Remember, this is the identical thesis we had on Netflix before its dramatic price decline. We remain on the sidelines and are currently evaluating opening a put option in the portfolio of our Best Ideas Newsletter, with timing and the premium paid for volatility the only outstanding considerations.

*Update* We've subsequently initiated a put position on LinkedIn on November 8.

## Starbucks Posts Fantastic Fiscal Fourth Quarter; 2012 and 2013 are Looking Even Better

*By Valuentum Analysts*

Starbucks (SBUX) reported strong fiscal fourth-quarter results that showed excellent same-store sales expansion and an improved business outlook, despite higher coffee costs. We're sticking with our $32 per share fair value estimate, as we had expected the strong results.

Total revenues, on a comparable 13-week basis, jumped about 15%, while earnings per share increased 16% to a record $0.37, excluding non-recurring items (above expectations). Global comps jumped 9% on a comparable 13-week basis thanks to a 6% jump in traffic and a 3% increase in ticket prices (US comps increased 10%, while international comps advanced 6%). Such growth accelerated from previous periods, as for the full fiscal year 2011, global comps increased 8% and came in better than peer Dunkin Brands' (DNKN)

**Please see *Starbucks...* on next page**

*Starbucks...*continued from previous page

6% comp for its respective quarter. US consumers seemingly can't get enough of Starbucks' brew thanks to growth of its loyalty program (My Starbucks Rewards program) and fall promotions (Pumpkin Spice Latte, etc.), while international growth continues to gain traction.

Starbucks' operating margin also advanced 60 basis points, to 13.8%, on a non-GAAP basis, which excludes non-recurring gains. Starbucks was able to capitalize on sales leverage to mitigate higher commodity costs (coffee), which negatively impacted operating margins by 290 basis points. On top of the strong performance, management upped its dividend by 31% and announced an authorization to purchase as many as 20 million shares more of the company's stock. We're not thrilled with the buyback at these levels.

Looking ahead, the company plans to open 800 net new stores globally during 2012, with half opening in the Americas, 300 in China and Asia, and the balance in EMEA (Europe, Middle East, Russia, and Africa). In fact, the firm expects to have 1,500 stores open in mainland China by 2015, a rapid pace of expansion (it currently has about 500 stores open in China). Starbucks is looking for 10% top-line growth next year driven by mid-single-digit comparable store sales growth, levels we think are achievable. Commodity costs are expected to continue to weigh on results, though the firm still expects operating margin improvement over the just-completed fiscal 2011. We'll continue to monitor coffee prices closely.

On the bottom line for fiscal 2012, Starbucks indicated that it expects earnings per share to reach $1.82 on the high end, representing as much as 20% growth over fiscal 2011. We're at $1.84, so we think the firm will beat the high end of its provided range. However, most of this growth is expected to come during the back half of the fiscal year, so there is some forecasting risk, in our opinion, particularly with respect to currency.

That said, 2013 may be better still, as the firm has locked in lower coffee costs and Starbucks K-Cups (which will be available in US retail stores next year) will likely become a more material earnings driver. Its partnership with Green Mountain (GMCR) will help propel results, as well.

Starbucks also seems quite positive on its Starbucks Blonde Roast (a premium light roast coffee), which will be available in retail stores in January, and estimates the market opportunity to be about $1 billion. We're somewhat skeptical that the market opportunity is this large, and any success will likely cannibalize some existing retail coffee sales as consumers switch to the new brew.

All things considered, we're big fans of Starbucks but its shares are a bit expensive. We'd be looking to add the firm to the portfolio in our Best Ideas Newsletter on a meaningful pullback.

## Qualcomm Reports Strong Fiscal Fourth Quarter on Proliferation of Smartphones

*By Valuentum Analysts*

Qualcomm (QCOM) posted solid fiscal fourth-quarter results that showed record revenues, earnings, and MSM (Mobile Station Modem) chipset shipments. We are maintaining our $53 fair value estimate.

The firm's revenue performance was particularly impressive. Its top line jumped 39% on a year-over-year basis and 14% sequentially thanks to strong growth in CDMA-based (code division multiple access based) MSM shipments. Qualcomm continues to reap the benefits of sales of smartphones (like Apple's iPhone and devices using Google's Android software), which use its chips, and adoption of 3G technology, which depends on the firm's patents for CDMA technology. Growth of 3G in emerging markets continues to be strong, and according to Wireless Intelligence, emerging-market 3G connections increased nearly 40% in the quarter. The company has over 200 royalty-bearing 3G licenses and 13 single-mode OFDM licenses around the world, an impressive product suite.

Qualcomm's non-GAAP operating income increased 44% from the same period a year ago, while non-GAAP net income jumped 24% (diluted earnings per share advanced 18%). Qualcomm also noted that the integration process regarding its largest acquisition to date, Atheros, has gone very well, and the earnings trajectory reflects this. Free cash flow was very strong, coming in at 41% of revenues, up 52% from last year's quarter. We expect the firm to...

**Please see *Qualcomm...*on next page**

*Qualcomm...* continued from page 11

continue to return cash to shareholders via a dividend and share buybacks.

Looking ahead, Qualcomm provided a rosy outlook for the first quarter of fiscal 2012. Management expects revenue to advance by as much as 42% on a year-over-year basis, while non-GAAP diluted earnings per share is anticipated to increase by 12% on the high end, to $0.92. Backing these growth numbers are expectations for as many as 154 million MSM shipments, a 31% increase.

For all of fiscal year 2012, the company, on the high end of its guidance ranges, expects revenue to jump 27% and non-GAAP earnings per share to increase 13%, above consensus estimates. Qualcomm seems very excited about the upcoming commercial launch of its Snapdragon multimode LTE solution, and the company continues to invest in Microsoft's (MSFT) Window's computing platform to go beyond cellular into mobile. In fact, the firm expects Windows 8 to be a significant driver beyond fiscal 2012, which speaks to the sustainability of its current growth trajectory. We continue to like the optimism the company exudes.

## Kraft Shows Off Pricing Power in Third Quarter

*By Valuentum Analysts*

Kraft (KFT) reported excellent third-quarter results that showed significant pricing expansion. The firm raised its outlook for 2011, and we are maintaining our above-market fair value estimate.

The firm's top-line advanced 11.5% led almost exclusively by organic expansion, which was 8.4% in the quarter. We loved that 7 percentage points of the growth was pricing, which signals to us the strength of Kraft's competitive advantages and pricing power. Volume and mix contributed the balance of the growth. The company noted that momentum is accelerating in North America, that operating results in Europe remain strong, and that it is seeing double-digit growth in developing markets—all positive news.

Kraft's adjusted operating income jumped over 12% thanks to pricing growth, productivity enhancements, and favorable foreign currency. The firm's adjusted operating margin edged up 10 basis points. We think Kraft's pricing power and ability to hold the line with margins in the face of higher commodity costs is among the best among peers. While we liked operating performance, we were blown away at the company's bottom-line expansion. Earnings per share jumped a whopping 23.4%, to $0.58 in the quarter (above consensus estimates).

Looking ahead, Kraft raised its organic revenue guidance for 2011 to at least 6% from 5% previously and increased its earnings-per-share outlook for this year to at least $2.27 from $2.25 previously. The company's decision to split the firm into two remains on plan (read our second-quarter note for more detail on this development). We are strongly considering adding the firm to our Best Ideas portfolio on the basis of its pricing power and undervaluation.

## Amgen Announces $5 Billion Buyback; Move Reinforces Our 'Undervalued" Thesis

*By Valuentum Analysts*

Biotech-firm Amgen (AMGN) announced recently that it would pursue a large $5 billion share buyback (under its $10 billion stock repurchase program) to scoop up its undervalued stock. We think this move is fantastic and reinforces our view that Amgen is significantly undervalued. We are maintaining our above-market $83 fair value estimate and are encouraged by management's actions that clearly are in favor of shareholders (over bondholders).

The company will lever up its balance sheet by issuing senior notes to fund the repurchase (at

Please see *Amgen...*on next page

*Amgen...* continued from previous page

attractive yields). We're not concerned about Amgen's investment-grade balance sheet, given its robust cash-flow generation, and think this move is decidedly value-creative. The company will pay a price not greater than $60 nor less than $54, which pretty much bounds the lower end of our fair value estimate range, at $58 per share. The tender offer began November 8. The firm noted that if the offer is fully-subscribed, Amgen will retire roughly 10% of its outstanding common stock.

The move comes shortly after Amgen raised its 2011 guidance for total revenue and adjusted EPS to $15.6 billion (was $15.5 billion) and $5.30 (was $5.20), respectively, on the high end of its provided ranges. Plus, we're excited about the firm, as it continues to support late stage clinical programs including AMG 386 in ovarian cancer, ganitumab (AMG 479) in pancreatic cancer, talimogene laherparepvec—the firm's oncolytic virus therapy--and AMG 145 through research and development expenses. Amgen also continues to speak highly of rilotumumab (AMG 102) in gastric cancer, though the antibody remains in Phase II studies.

We would not participate in the modified Dutch auction, as we think Amgen's shares have further room to increase based on valuation. But the move is a resounding signal to us that management thinks its equity is cheap, and undoubtedly a positive for investors.

# 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). You'll see we hold a number of these firms in our portfolio (EBAY, ACOM, 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.

| Company Name | Ticker | Market Cap | Valuentum Buying Index | DCF Assessment | Relative Value | Price / Fair Value | Stock Price | Fair Value |
|---|---|---|---|---|---|---|---|---|
| eBay | EBAY | 42,583.5 | 10 | UNDERVALUED | ATTRACTIVE | 0.68 | 32.08 | 47.00 |
| Alpha Natural | ANR | 3,233.9 | 9 | UNDERVALUED | ATTRACTIVE | 0.62 | 26.56 | 43.00 |
| Macy's | M | 11,515.7 | 9 | UNDERVALUED | ATTRACTIVE | 0.64 | 26.95 | 42.00 |
| Owens-Illinois | OI | 3,217.9 | 9 | UNDERVALUED | ATTRACTIVE | 0.69 | 19.26 | 28.00 |
| Wyndham | WYN | 6,406.6 | 9 | UNDERVALUED | ATTRACTIVE | 0.71 | 34.63 | 49.00 |
| Cisco | CSCO | 88,006.7 | 9 | UNDERVALUED | ATTRACTIVE | 0.72 | 15.82 | 22.00 |
| Pfizer | PFE | 158,734.8 | 9 | UNDERVALUED | ATTRACTIVE | 0.73 | 19.66 | 27.00 |
| Valero Energy | VLO | 10,099.0 | 6 | UNDERVALUED | ATTRACTIVE | 0.39 | 17.78 | 46.00 |
| Ancestry.com | ACOM | 1,367.1 | 6 | UNDERVALUED | ATTRACTIVE | 0.45 | 28.06 | 62.00 |
| Intel | INTC | 111,869.4 | 6 | UNDERVALUED | ATTRACTIVE | 0.55 | 19.64 | 36.00 |
| Hewlett-Packard | HPQ | 57,734.5 | 6 | UNDERVALUED | ATTRACTIVE | 0.55 | 24.34 | 44.00 |
| Xerox | XRX | 10,832.8 | 6 | UNDERVALUED | ATTRACTIVE | 0.57 | 8.02 | 14.00 |
| Tenneco | TEN | 1,562.2 | 6 | UNDERVALUED | ATTRACTIVE | 0.58 | 25.61 | 44.00 |
| Sealed Air | SEE | 3,064.0 | 6 | UNDERVALUED | ATTRACTIVE | 0.60 | 17.34 | 29.00 |
| R.R. Donnelley | RRD | 3,135.0 | 6 | UNDERVALUED | ATTRACTIVE | 0.60 | 14.95 | 25.00 |
| WESCO | WCC | 1,641.2 | 6 | UNDERVALUED | ATTRACTIVE | 0.61 | 35.59 | 58.00 |
| Eastman Chemical | EMN | 5,634.1 | 6 | UNDERVALUED | ATTRACTIVE | 0.65 | 76.24 | 118.00 |
| ITT Corp | ITT | 7,927.1 | 6 | UNDERVALUED | ATTRACTIVE | 0.67 | 42.78 | 64.00 |
| Gilead Sciences | GILD | 33,887.8 | 6 | UNDERVALUED | ATTRACTIVE | 0.67 | 38.80 | 58.00 |
| Oracle | ORCL | 133,328.0 | 6 | UNDERVALUED | ATTRACTIVE | 0.68 | 26.00 | 38.00 |
| Anixter | AXE | 1,752.6 | 6 | UNDERVALUED | ATTRACTIVE | 0.70 | 49.37 | 71.00 |
| Adobe Systems | ADBE | 12,956.3 | 6 | UNDERVALUED | ATTRACTIVE | 0.70 | 24.64 | 35.00 |

Eastman Chemical has been updated on our site post-publication and now registers a 9 on our VBI. For all firms, 'Stock Price' reflects the price as of the publication date of the report (ex EMN).

The table above can supplement your "shopping list" of new ideas. On our website, we provide a 16-page equity research report that supports our valuation assessment for each. The reports can be found here.

*Ideas...* continued on next page

***Ideas...*** **continued from previous page**

The following table 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 should their upside potential become greater than our current holdings. We also show firms that register a 1 on our VBI. These names represent put-option candidates (we may also consider firms that register a 2, 3 or 4 on our index as put-option candidates). We provide the respective lists below, and each firm's report can be found on our website here.

The Good:

| Company Name | Ticker | Market Cap | Valuentum Buying Index™ | Price / Fair Value | Stock Price | Fair Value | Forward PE | PEG |
|---|---|---|---|---|---|---|---|---|
| eBay | EBAY | 42,583.5 | 10 | 0.68 | 32.08 | 47.00 | 15.73 | 1.19 |
| Alpha Natural | ANR | 3,233.9 | 9 | 0.62 | 26.56 | 43.00 | 15.03 | 1.14 |
| Macy's | M | 11,515.7 | 9 | 0.64 | 26.95 | 42.00 | 9.99 | 1.38 |
| Owens-Illinois | OI | 3,217.9 | 9 | 0.69 | 19.26 | 28.00 | 8.53 | 0.87 |
| Wyndham | WYN | 6,406.6 | 9 | 0.71 | 34.63 | 49.00 | 14.42 | 2.28 |
| Cisco | CSCO | 88,006.7 | 9 | 0.72 | 15.82 | 22.00 | 9.21 | 1.13 |
| Pfizer | PFE | 158,734.8 | 9 | 0.73 | 19.66 | 27.00 | 8.61 | 1.38 |

*Update* Profiled-company Eastman Chemical (EMN) has been updated post-publication and now registers a score of 9 on our Valuentum Buying Index.

The ("Really") Bad:

| Company Name | Ticker | Market Cap | Valuentum Buying Index™ | Price / Fair Value | Stock Price | Fair Value | Forward PE | PEG |
|---|---|---|---|---|---|---|---|---|
| Clean Harbors | CLH | 2,692.8 | 1 | 1.34 | 50.87 | 38.00 | 26.62 | 2.17 |
| Churchill Downs | CHDN | 611.4 | 1 | 1.39 | 39.03 | 28.00 | 16.50 | 1.88 |

We're also watching the airline group for opportunities to re-layer on some of the put options that were big winners for us in the past months (AMR, FAA). Under Armour (UA) and First Solar (FSLR) also make our list of stocks we may bet on for a fall.

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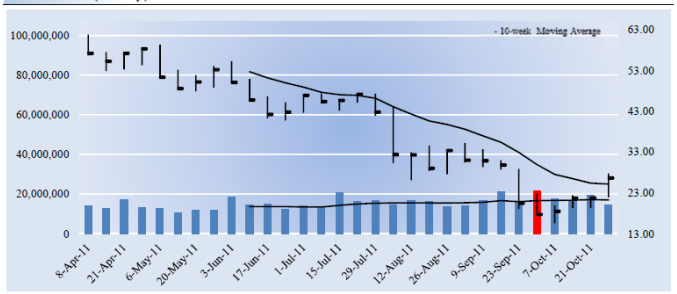
## Alpha Natural ANR UNDERVALUED 5.4%

Buying Index™ 9 | Value Rating ✓

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $26.56 | $43.00 | $28.00 - $58.00 | MID-CAP BLEND | Energy | Industrial Minerals |

**Alpha Natural's valuation and techicals are attractive. We'd take a closer look at the firm's shares.**

### 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).

### Company Vitals

| | |
|---|---|
| Market Cap (USD) | $3,234 |
| Avg Weekly Vol (30 wks) | 15,379 |
| 30-week Range (USD) | 15.49 - 61.66 |
| Valuentum Sector | Energy |
| 5-week Return | 28.2% |
| 13-week Return | -39.7% |
| 30-week Return | -56.3% |
| Dividend Yield % | 0.0% |
| Dividends per Share | 0.00 |
| Forward Dividend Payout Ratio | 0.0% |
| Est. Normal Diluted EPS | 2.41 |
| P/E on Est. Normal Diluted EPS | 11.0 |
| Est. Normal EBITDA | 2,347 |
| Forward EV/EBITDA | 2.0 |
| EV/Est. Normal EBITDA | 1.5 |
| Forward Revenue Growth (5-yr) | 25.1% |
| Forward EPS Growth (5-yr) | 29.1% |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | 12.3% |
| Return on Assets | 4.9% |
| ROIC, with goodwill | 19.0% |
| ROIC, without goodwill | 20.0% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 754 |
| Net Debt | 199 |
| Total Debt/EBITDA | 0.7 |
| Net Debt/EBITDA | 0.2 |
| EBITDA/Interest | 13.8 |
| Current Ratio | 3.1 |
| Quick Ratio | 1.9 |

NMF = Not Meaningful

### Investment Highlights

• Alpha Natural 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 20% during the past three years.

• Alpha Natural'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.

• Alpha Natural has an excellent combination of strong free cash flow generation and low financial leverage. We expect the firm's free cash flow margin to average about 3.5% in coming years. Total debt-to-EBITDA was 0.7 last year, while debt-to-book capitalization stood at 22.1%.

• The firm posts a VBI score of 9. We like the firm's prospects as an investment candidate on this basis. In fact, very few firms score above an 8 on our scale.

• 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.

### Investment Considerations

| | |
|---|---|
| DCF Valuation | UNDERVALUED |
| Relative Valuation | ATTRACTIVE |
| ValueCreation™ | EXCELLENT |
| ValueRisk™ | HIGH |
| ValueTrend™ | NEGATIVE |
| Cash Flow Generation | STRONG |
| Financial Leverage | LOW |
| Growth | AGGRESSIVE |
| Technical Evaluation | VERY BULLISH |
| Relative Strength | WEAK |
| Money Flow Index (MFI) | NEUTRAL |
| Upside/Downside Volume (U/D) | BEARISH |
| Near-term Technical Support, 10-week MA | 25.00 |

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 |
|---|---|---|---|
| Arch Coal | 16.1 | 1.2 | 106.4% |
| CONSOL Energy | 16.2 | 1.7 | 129.9% |
| James River Coal | 22.7 | NMF | 104.0% |
| Peabody Energy | 11.6 | 1.1 | 74.3% |
| Peer Median | 16.2 | 1.2 | 105.2% |
| **Alpha Natural** | **15.0** | **1.1** | **61.8%** |

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

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Dec-09 | Dec-10 | Dec-11 |
| Revenue | 2,496 | 3,917 | 6,933 |
| Revenue, YoY% | -2.3% | 57.0% | 77.0% |
| Operating Income | 117 | 174 | 408 |
| Operating Margin % | 4.7% | 4.4% | 5.9% |
| Net Income | 67 | 97 | 220 |
| Net Income Margin % | 2.7% | 2.5% | 3.2% |
| Diluted EPS | 0.73 | 0.80 | 1.77 |
| Diluted EPS, YoY % | -68.3% | 9.6% | 121.4% |
| Free Cash Flow (CFO-capex) | 306 | 577 | 279 |
| Free Cash Flow Margin % | 12.2% | 14.7% | 4.0% |

In Millions of USD (except for per share items)

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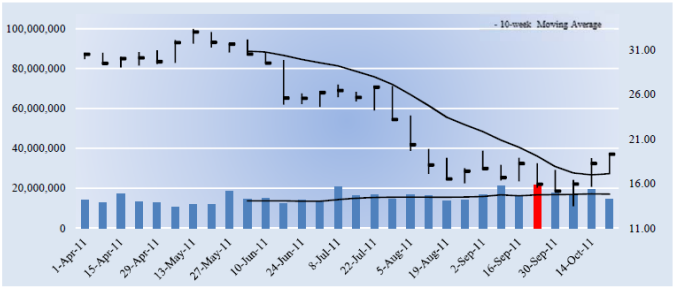
## Owens-Illinois OI UNDERVALUED 3.8%

Buying Index™ 9 | Value Rating ✓

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $19.26 | $28.00 | $20.00 - $36.00 | MID-CAP VALUE | Materials | Containers & Packaging |

**Owens-Illinois 's valuation and techicals are attractive. We'd take a closer look at the firm's shares.**

### 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).

### Company Vitals

| | |
|---|---|
| Market Cap (USD) | $3,218 |
| Avg Weekly Vol (30 wks) | 15,379 |
| 30-week Range (USD) | 13.43 - 33.32 |
| Valuentum Sector | Materials |
| 5-week Return | 8.4% |
| 13-week Return | -27.4% |
| 30-week Return | -36.7% |
| Dividend Yield % | 0.0% |
| Dividends per Share | 0.00 |
| Forward Dividend Payout Ratio | 0.0% |
| Est. Normal Diluted EPS | 2.74 |
| P/E on Est. Normal Diluted EPS | 7.0 |
| Est. Normal EBITDA | 1,453 |
| Forward EV/EBITDA | 5.4 |
| EV/Est. Normal EBITDA | 4.8 |
| Forward Revenue Growth (5-yr) | 4.1% |
| Forward EPS Growth (5-yr) | 14.5% |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | 18.7% |
| Return on Assets | 3.1% |
| ROIC, with goodwill | 13.5% |
| ROIC, without goodwill | 23.3% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 4,448 |
| Net Debt | 3,808 |
| Total Debt/EBITDA | 3.7 |
| Net Debt/EBITDA | 3.2 |
| EBITDA/Interest | 4.8 |
| Current Ratio | 1.3 |
| Quick Ratio | 0.8 |

NMF = Not Meaningful

### Investment Highlights

• Owens-Illinois 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 23.3% during the past three years.

• Owens-Illinois '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.

• Owens-Illinois '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 posts a VBI score of 9. We like the firm's prospects as an investment candidate on this basis. In fact, very few firms score above an 8 on our scale.

• 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.

### Investment Considerations

| | |
|---|---|
| DCF Valuation | UNDERVALUED |
| Relative Valuation | ATTRACTIVE |
| ValueCreation™ | EXCELLENT |
| ValueRisk™ | HIGH |
| ValueTrend™ | POSITIVE |
| Cash Flow Generation | STRONG |
| Financial Leverage | HIGH |
| Growth | MODEST |
| Technical Evaluation | VERY BULLISH |
| Relative Strength | WEAK |
| Money Flow Index (MFI) | NEUTRAL |
| Upside/Downside Volume (U/D) | IMPROVING |
| Near-term Technical Support, 10-week MA | 17.00 |

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 |
|---|---|---|---|
| Aptar | 17.6 | 3.0 | 124.3% |
| Ball Corp | 12.8 | NMF | 102.4% |
| Bemis | 15.1 | 3.4 | 117.0% |
| Sealed Air | 10.0 | 0.8 | 59.8% |
| Peer Median | 14.0 | 3.0 | 109.7% |
| **Owens-Illinois** | **8.5** | **0.9** | **68.8%** |

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

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Dec-09 | Dec-10 | Dec-11 |
| Revenue | 7,067 | 6,633 | 7,429 |
| Revenue, YoY% | -10.4% | -6.1% | 12.0% |
| Operating Income | 919 | 796 | 845 |
| Operating Margin % | 13.0% | 12.0% | 11.4% |
| Net Income | 162 | 253 | 377 |
| Net Income Margin % | 2.3% | 3.8% | 5.1% |
| Diluted EPS | 0.95 | 1.51 | 2.26 |
| Diluted EPS, YoY % | -36.0% | 59.6% | 49.1% |
| Free Cash Flow (CFO-capex) | 372 | 389 | 267 |
| Free Cash Flow Margin % | 5.3% | 5.9% | 3.6% |

In Millions of USD (except for per share items)

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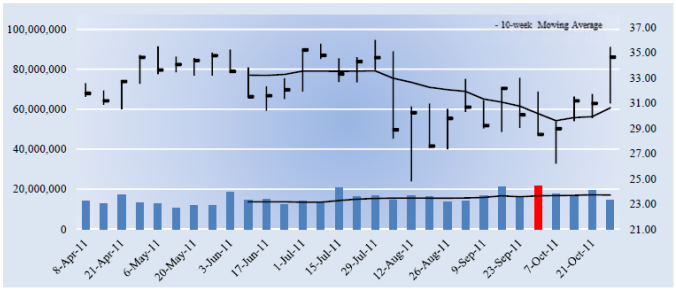
## Wyndham WYN UNDERVALUED 1.1%

Buying Index™ 9 | Value Rating ✓

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $34.63 | $49.00 | $35.00 - $63.00 | MID-CAP VALUE | Consumer Discretionary | Hotels |

**Wyndham 's strong cash flow generation and attractive valuation represent a compelling combination. We'd take a closer look at picking up the firm's shares.**

### 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 | STRONG |
| Money Flow Index (MFI) | NEUTRAL |
| Upside/Downside Volume (U/D) | BULLISH |
| Near-term Technical Support, 10-week MA | 31.00 |

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

### Business Quality

| ValueRisk™ \ ValueCreation™ | 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) | $6,407 |
| Avg Weekly Vol (30 wks) | 15,379 |
| 30-week Range (USD) | 24.76 - 36 |
| Valuentum Sector | Consumer Discretionary |
| 5-week Return | 13.6% |
| 13-week Return | -0.8% |
| 30-week Return | 6.8% |
| Dividend Yield % | 1.4% |
| Dividends per Share | 0.48 |
| Forward Dividend Payout Ratio | 20.0% |
| Est. Normal Diluted EPS | 2.77 |
| P/E on Est. Normal Diluted EPS | 12.5 |
| Est. Normal EBITDA | 1,137 |
| Forward EV/EBITDA | 8.2 |
| EV/Est. Normal EBITDA | 7.3 |
| Forward Revenue Growth (5-yr) | 4.8% |
| Forward EPS Growth (5-yr) | 7.4% |

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

### Investment Highlights

• Wyndham 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 68.3% during the past three years.

• Wyndham '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.

• Wyndham 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 14.8% in coming years. Total debt-to-EBITDA was 2.3 last year, while debt-to-book capitalization stood at 41.8%.

• 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.

• The firm experienced a net income CAGR of about -2% during the past 3 years. We expect its net income growth to be better than its peer median during the next five years.

### Relative Valuation

| | Forward P/E | PEG | Price / FV |
|---|---|---|---|
| Choice Hotels | 20.2 | 3.0 | 145.6% |
| Marriott Intl | 23.9 | 6.3 | 192.8% |
| Starwood | 29.5 | 2.9 | 140.5% |
| Wynn Resorts | 26.2 | 2.8 | 134.0% |
| Peer Median | 25.1 | 3.0 | 143.1% |
| **Wyndham** | **14.4** | **2.3** | **70.7%** |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | -3.8% |
| Return on Assets | -1.2% |
| ROIC, with goodwill | 37.5% |
| ROIC, without goodwill | 68.3% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 2,094 |
| Net Debt | 1,938 |
| Total Debt/EBITDA | 2.3 |
| Net Debt/EBITDA | 2.1 |
| EBITDA/Interest | 5.4 |
| Current Ratio | 1.1 |
| Quick Ratio | 0.6 |

NMF = Not Meaningful

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Dec-09 | Dec-10 | Dec-11 |
| Revenue | 3,750 | 3,851 | 4,236 |
| Revenue, YoY% | -12.4% | 2.7% | 10.0% |
| Operating Income | 656 | 731 | 824 |
| Operating Margin % | 17.5% | 19.0% | 19.5% |
| Net Income | 293 | 379 | 446 |
| Net Income Margin % | 7.8% | 9.8% | 10.5% |
| Diluted EPS | 1.61 | 2.05 | 2.40 |
| Diluted EPS, YoY % | -126.7% | 27.3% | 17.2% |
| Free Cash Flow (CFO-capex) | 554 | 468 | 575 |
| Free Cash Flow Margin % | 14.8% | 12.2% | 13.6% |

In Millions of USD (except for per share items)

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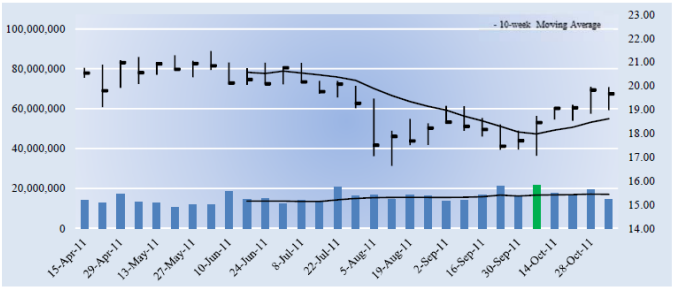
## Pfizer PFE UNDERVALUED 1.7%

Buying Index™ 9 | Value Rating ✓

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $19.66 | $27.00 | $20.00 - $34.00 | LARGE-CAP VALUE | Health Care | Pharmaceuticals |

**Pfizer 's strong cash flow generation and attractive valuation represent a compelling combination. We'd take a closer look at picking up the firm's shares.**

### Stock Chart (weekly)




The week with the highest trading volume out of the last 13 weeks was a week of heavy buying, or accumulation (green bar).

### Company Vitals

| | |
|---|---|
| Market Cap (USD) | $158,735 |
| Avg Weekly Vol (30 wks) | 15,379 |
| 30-week Range (USD) | 16.63 - 21.45 |
| Valuentum Sector | Health Care |
| 5-week Return | 11.1% |
| 13-week Return | 14.9% |
| 30-week Return | -4.3% |
| Dividend Yield % | 4.1% |
| Dividends per Share | 0.80 |
| Forward Dividend Payout Ratio | 35.0% |
| Est. Normal Diluted EPS | 2.16 |
| P/E on Est. Normal Diluted EPS | 9.1 |
| Est. Normal EBITDA | 30,402 |
| Forward EV/EBITDA | 5.6 |
| EV/Est. Normal EBITDA | 5.7 |
| Forward Revenue Growth (5-yr) | -1.8% |
| Forward EPS Growth (5-yr) | 14.0% |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | 11.7% |
| Return on Assets | 5.7% |
| ROIC, with goodwill | 17.0% |
| ROIC, without goodwill | 25.6% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 44,033 |
| Net Debt | 16,021 |
| Total Debt/EBITDA | 1.7 |
| Net Debt/EBITDA | 0.6 |
| EBITDA/Interest | 14.2 |
| Current Ratio | 2.1 |
| Quick Ratio | 1.5 |

NMF = Not Meaningful

### Investment Highlights

• Pfizer 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 25.6% during the past three years.

• Pfizer '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.

• Pfizer 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 35.4% in coming years. Total debt-to-EBITDA was 1.7 last year, while debt-to-book capitalization stood at 33.4%.

• relative stock price performance, undervaluation, and dividend yield of4.1% may make it attractive to a variety of investors. Having more types of investors interested in its shares increases the potential for future stock price appreciation, in our opinion.

• The firm sports a very nice dividend yield of 4.1%. We expect the firm to pay out about 35% of next year's earnings to shareholders as dividends.

### Investment Considerations

| | |
|---|---|
| DCF Valuation | UNDERVALUED |
| Relative Valuation | ATTRACTIVE |
| ValueCreation™ | EXCELLENT |
| ValueRisk™ | MEDIUM |
| ValueTrend™ | NEGATIVE |
| Cash Flow Generation | STRONG |
| Financial Leverage | MEDIUM |
| Growth | DECLINING |
| Technical Evaluation | BULLISH |
| Relative Strength | STRONG |
| Money Flow Index (MFI) | NEUTRAL |
| Upside/Downside Volume (U/D) | BULLISH |
| Near-term Technical Support, 10-week MA | 19.00 |

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 |
|---|---|---|---|
| Abbott Laboratories | 11.4 | 1.6 | 80.8% |
| Bristol-Myers Squibb | 13.7 | 3.4 | 142.5% |
| Eli Lilly | 8.7 | NMF | 90.3% |
| Merck | 9.0 | 1.9 | 74.0% |
| Peer Median | 10.2 | 1.9 | 85.6% |
| **Pfizer** | **8.6** | **1.4** | **72.8%** |

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

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Dec-09 | Dec-10 | Dec-11 |
| Revenue | 50,009 | 67,809 | 67,131 |
| Revenue, YoY% | 3.5% | 35.6% | -1.0% |
| Operating Income | 15,456 | 17,099 | 22,778 |
| Operating Margin % | 30.9% | 25.2% | 33.9% |
| Net Income | 8,621 | 8,266 | 18,798 |
| Net Income Margin % | 17.2% | 12.2% | 28.0% |
| Diluted EPS | 1.22 | 1.02 | 2.28 |
| Diluted EPS, YoY % | -4.6% | -16.3% | 123.0% |
| Free Cash Flow (CFO-capex) | 15,368 | 9,950 | 29,233 |
| Free Cash Flow Margin % | 30.7% | 14.7% | 43.5% |

In Millions of USD (except for per share items)

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VALUENTUM

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VALUENTUM

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Please select the following link to view the full 16-page report:

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

# Our Methodology – The Valuentum Buying Index

*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, 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. 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.

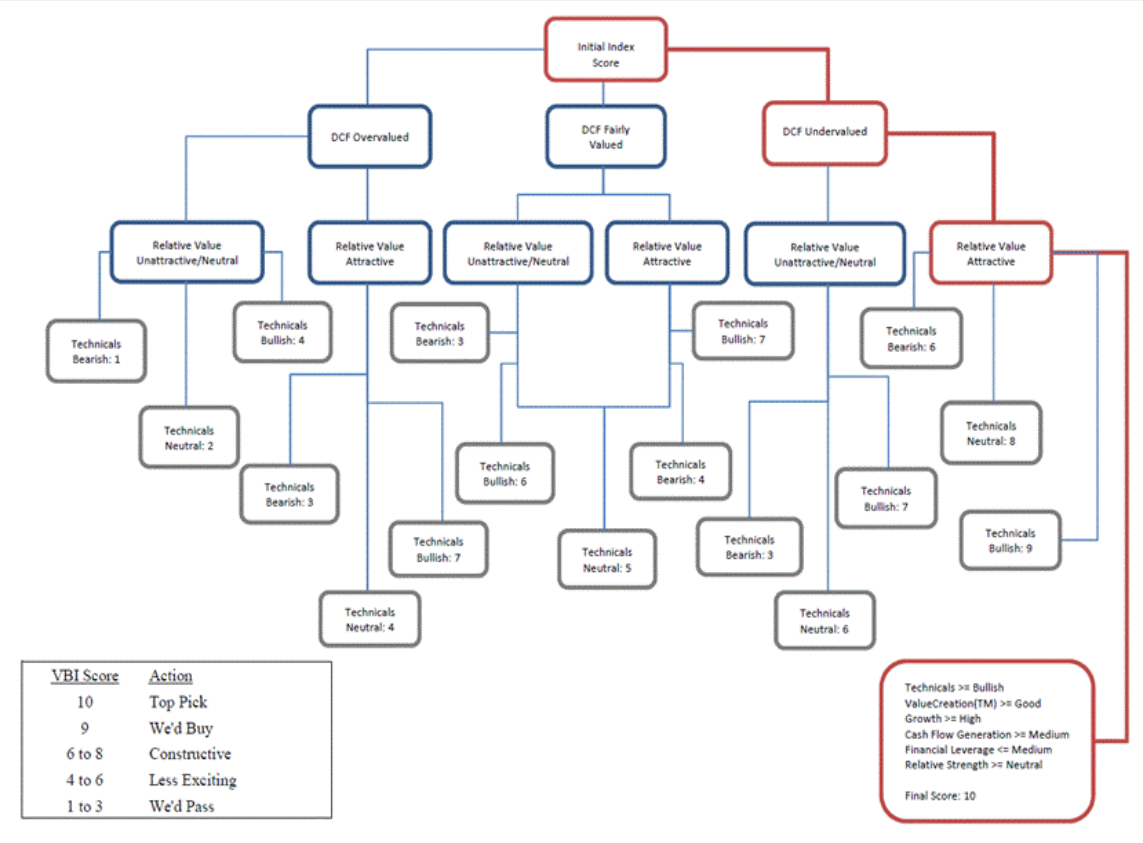
Let's discuss how a firm can score a 10, the best mark on our index (a "Top Pick"). First, the company would need to be 'undervalued' on a DCF basis and 'attractive' on a relative 'value basis. The stock would also have to be exhibiting 'bullish' technicals. The firm would need a ValueCreation rating 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 sell"). 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.

Please view the flow chart on the next page regarding our Valuentum Buying Index.

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

# Our Methodology – The Valuentum Buying Index

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Valuentum Best Ideas Newsletter: Volume 1, Issue 5

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*OUR BEST IDEAS NEWSLETTER*

# Valuentum Securities

Stock Analysis: From Value through Momentum Investing

December 15, 2011
Volume 1 Issue 6

Valuentum Securities Inc.
www.valuentum.com info@valuentum.com

| Portfolio Return | Benchmark Return | Outperformance |
|---|---|---|
| 11.6% | -6.3% | 17.9% |

Portfolio Inception Date: May 17, 2011

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## Investing in Pockets of Strength

*By Brian Nelson, CFA*

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Recent data points from earnings releases in the past couple weeks have created a cloud of uncertainty over our outlook on fourth-quarter earnings season. But we believe our portfolio is well-positioned within pockets of strength in the global economy and littered with paid-to-wait dividend-yield opportunities that will benefit once short-term, temporary issues inevitably pass.

First, let's talk about trends impacting our aerospace exposure, which remains our largest industry weighting in the portfolio by far. Just this week, Southwest Airlines (LUV) announced one of the largest orders for planes in aerospace history, tying up a $19 billion deal (at list prices) with Boeing (BA) for delivery of over 208 narrowbody aircraft, including 200 of Boeing's upgraded 737, the MAX. This order comes just a few weeks after private Indonesian carrier, Lion Air,

**Please see *Investing in Pockets of Strength...*on page 2**

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## More Relative Outperformance

*By Valuentum Analysts*

We had another great month of relative outperformance, with our portfolio widening the gap relative to the S&P 500 by approximately 170 basis points during the period, despite headwinds from declining values of our put-option positions in Chipotle (CMG) and LinkedIn (LNKD). EDAC Tech (EDAC) continues to roar ahead, and despite the firm now falling within our fair value estimate range, we are content with letting this winner run to the upper bound of our valuation in the mid-teens. Astronics (ATRO) put together a very nice month of outperformance, and while we took some profits, we think the stock has upside to almost $50 per share. Altria (MO) continues to migrate to our mid-$30s fair value estimate, despite paying out a hefty dividend, and Apple moved higher in the face of a weak overall market. Collective Brands (PSS) lost little

**Please see *More Relative Outperformance...* on page 7**

*Investing in Pockets of Strength...*continued from page 1

ordered 230 planes from Boeing, including 201 orders for the upgraded 737.

Since Boeing announced that it would re-engine its workhorse 737 earlier this year, the jet maker has landed nearly 950 commitments for the upgraded plane, and management thinks this number could rise to 1,500 by the end of next year. Orders for Airbus' (EADSY.PK) competing A320neo are even better, as airlines across the globe look to expand or replace gas-guzzling jetliners with more fuel-efficient aircraft.

Both of these commercial aircraft makers have roughly 7 years' worth of orders in backlog (unfulfilled deliveries) and are aggressively ramping up production, suggesting to us that the aerospace cycle will continue to thrive regardless of impending Euro-zone weakness or an economic slowdown in China, two factors that continue to weigh on investor confidence (China's GDP growth in its third-quarter was still a very strong 9.1%, which is down only slightly from the 9.7% peak pace achieved earlier this year). Aerospace suppliers Precision Castparts (PCP), Astronics, and EDAC Tech remain our best ideas in the aerospace industry to capitalize on this area of strength, and we're comfortable with a large percentage of our portfolio exposed to the prolonged upswing in cyclical demand in aerospace. In fact, Astronics and EDAC Tech have been the top two performers for us thus far, with the latter more than doubling since we added it to our portfolio last June.

Next let's talk about the consumer. Cyber Monday, the online version of Black Friday, was nothing short of fantastic. According to ComScore, which measures digital sales, online purchases made on Cyber Monday increased by over 20%, surpassing the $1 billion mark achieved last year. ComScore also indicated that from the beginning of November through December 9, retail e-commerce sales jumped 15% from the same period last year, suggesting such strength was not isolated to just one shopping day. The firm noted that as many as six individual days during the holiday season have surpassed the $1 billion online sales number thus far. And not bad, considering a domestic unemployment rate of 8.6% (down 0.4 percentage points from October) and an even higher under-employment rate.

*"We think the payment infrastructures of eBay (EBAY), which owns PayPal, and Visa (V), two firms we hold in our portfolio, are well-positioned to capitalize on the secular trend toward online purchases."*

We think the payment infrastructures of eBay (EBAY), which owns PayPal, and Visa (V), two firms we hold in our portfolio, are well-positioned to capitalize on the secular trend toward online purchases. Interestingly, eBay, for example, said that its Cyber Monday special on a white Apple (AAPL) iPad 2 Wi-Fi 16GB, sold out in less than two hours that day (less than two hours!). And consistent with our theme of investing in pockets of strength in the economy, Apple also remains one of the larger positions in our portfolio, and we expect continued strength from its iPad and iPhone (4S) platforms through the course of next year.

**Please see *Investing in Pockets of Strength...*on next page**

*Investing in Pockets of Strength...*continued from previous page

Though we seek to capitalize on the secular trend toward online and credit-card purchases, the US Department of Commerce's report for overall November retail sales was meager (even after considering a nearly 7% jump in Black Friday sales from last year). The report showed the twenty-fifth straight month of gains, but the magnitude of the increase (0.2%) came in below most economists' expectations -- expansion was 0.6 percentage points in October and 1.3 percentage points in September. Importantly, the slowdown surfaced in spite of significant promotional activity by retailers to lure in holiday shoppers. Just this week, for example, Best Buy (BBY) put up disappointing quarterly earnings due to declines in gross margins caused by heavy discounting during the period, despite the documented strength in electronics and appliance sales showcased in the Commerce Department's report. However, the world's largest electronics retailer noted that sales in its online channel burgeoned 20%, reinforcing our long thesis on payment processors levered to e-commerce growth.

*"Ford has significant valuation upside (north of $20 per share), in our opinion, and we prefer the company to General Motors (GM), which continues to battle perceptions regarding a government overhang."*

However, besides electronics and appliance stores, another bright spot in the November sales report were auto sales (up a relatively nice 0.7%). With the reinstatement of Ford's (F) dividend last week (it will pay its first dividend in five years in March), we are now being paid to wait (roughly a 2% annual dividend yield) for further acceleration in replacement demand for America's aging automobile fleet. Ford has significant valuation upside (north of $20 per share), in our opinion, and we prefer the company to General Motors (GM), which continues to battle perceptions regarding a government overhang.

*"We think Intel is worth $37 per share, and there are very few firms on the market today that present such total return potential."*

And in the theme of getting paid to wait for our thesis to play out, Intel (INTC) revised its fourth-quarter revenue outlook due to hard disk drive supply shortages from the recent flooding in Thailand, but its hefty dividend yield (~3.5%) makes the company very attractive to hold in anticipation of a rebuild of microprocessor inventories toward the middle of next year. We think Intel is worth $37 per share, and there are very few firms on the market today that present such total return potential. We're content with waiting for economic activity to resume its pace in Thailand (which makes 50% of the world's HDD capacity), as flooding, while unfortunate, is but a temporary issue.

Though our conviction in Intel's upside remains strong, other chipmakers like Texas Instruments (TXN), Altera (ALTR) and Lattice Semi (LSCC) cut their respective fourth-quarter revenue outlooks in past weeks, and we think this muddies the waters for how fourth-quarter earnings season may evolve. Plus, Dow-component DuPont (DD), whose products are found in a plethora of consumer goods, lowered its full-year 2011 outlook late last week, suggesting to us that we may see some downside earnings surprises during

**Please see *Investing in Pockets of Strength...*on next page**

*Investing in Pockets of Strength...*continued from previous page

*"Though we think our portfolio is well-positioned for continued outperformance, we're growing more cautious that the fear of a global recession—rather than a global recession itself—is causing corporations to tighten their budgets and become more conservative with cash/inventory purchases."*

fourth quarter earnings season. Importantly, DuPont just raised its earnings guidance in October, so the abrupt change could represent a red flag for the economic environment during the months of November and December. And just this week, we received some very concerning comments from mining-equipment maker Joy Global (JOY) regarding the outlook for commodities and mining equipment demand (both original equipment and aftermarket).

Though we think our portfolio is well-positioned for continued outperformance, we're growing more cautious that the fear of a global recession—rather than a global recession itself—is causing corporations to tighten their budgets and become more conservative with cash/inventory purchases. Over-coverage by the media of the Euro-zone debt crisis and domestic political uncertainty regarding the extension of the payroll tax cut and extended unemployment benefits is likely jeopardizing economic momentum through the first half of next year, in our opinion. However, despite recent instances where European Central Bank (ECB) President Mario Draghi has disappointed the equity markets given his more conservative stance, we believe both he and Federal Reserve Chairman Bernanke remain poised to act to stem any global financial crisis before it unravels.

Overall, we maintain the US economy is not headed toward recession anytime soon and are content with investing in technically-attractive, undervalued companies levered to pockets of growth or in companies that offer us tremendous valuation upside with a nice dividend-kicker. However, given recent data points that suggest increasing uncertainty is starting to impact corporate results, we may use any strength in the equity markets in coming days and weeks to trim the weightings of some of our long positions whose VBI scores have lagged since original purchase.

## AMR Files For Bankruptcy, as Expected

*By Valuentum Analysts*

As expected, AMR Corp (AMR), the parent of American Airlines filed for bankruptcy protection. We had been expecting the demise of the carrier as we outlined to our subscribers previously on our website. We encourage investors to not dabble in the firm's shares after the filing, as it is extremely likely that the shares will be cancelled (meaning current holders get nothing).

It turns out we got an answer to our rhetorical question, "Is AMR's Equity Practically Worthless," sooner than we had expected. The firm flashed a 1 on our Valuentum Buying Index in May – July, which is the lowest possible ranking on our stock-picking scale. During bankruptcy, AMR will renegotiate with its unions to capture cost savings, optimize its fleet by breaking free of leases, and force haircuts on its debt load. Plus, the filing today helps to protect AMR's current cash load, which would have diminished further if it pushed off the filing.

**Please see *AMR Files For Bankruptcy...*on page 9**

# Home Depot Reports Strong Third-Quarter Results on Storm-Related Demand, Raises Dividend

*By Valuentum Analysts*

*"We continue to feel that Home Depot is better positioned that peer Lowe's (LOW) and are maintaining our $35 fair value estimate on the home-improvement retailer."*

Home Depot (HD) reported solid third-quarter results, increased its 2011 guidance, and lifted its dividend 16%. We continue to feel that Home Depot is better positioned that peer Lowe's (LOW) and are maintaining our $35 fair value estimate on the home-improvement retailer.

The firm's revenue jumped 4.4% from the third quarter led by comparable store sales of 4.2% (total transactions were up 1.2%, while average ticket price accounted for the balance of the increase). Comp sales for US stores were also strong at 3.8%. Storm-related sales—Hurricane Irene—bolstered results, and the firm noted positive comps in all but 5 of its top 40 markets (New Jersey and South Atlantic regions were particularly strong). Though these two regions benefited from storm-related demand (generators, pumps, extension cords, etc.), management noted that its strongest division was actually its western one, which was not impacted by Hurricane Irene, suggesting its core categories remain on track. Home Depot noted that tools, electrical, indoor garden, building materials and plumbing were outperformers, while lumber, outdoor garden, bath and millwork were weak during the period. This solid same-store-sales performance came in better than Lowe's for the same period, a streak that now has continued for ten consecutive quarters.

The company's gross margin expanded slightly due to supply chain improvements offset in part by the mix of products and services sold. The firm's operating margin also expanded during the period thanks to positive expense leverage (expenses are increasing at about 20% of the sales growth rate). Such strong gross-margin performance fell to the bottom line, as earnings per share jumped about 18% from the same period last year, to $0.60 (consensus was at $0.59).

Looked ahead, the company maintained its fiscal 2011 sales guidance of up approximately 2.5%, but raised its bottom-line yearly outlook to 18% growth, or $2.38 per diluted share (was $2.34). And while Home Depot will face tough year-over-year comparisons due to the expiration of an energy-efficient tax credit in the US and strong performance from its gift centers, the home-improvement retailer expects positive comps for the period. We also share below what management had to say about the US housing market and economy on its conference call:

"In the U.S., we still don't see and we don't expect to see in the near term any meaningful tailwind from the housing market. Inventories remain high, pricing is under pressure and credit is still difficult. Private fixed residential investment, PFRI, as a percent of GDP, is still at a historic low."

*Home Depot Reports Strong Third-Quarter...* **continued on page 8**

# Wal-Mart's Third-Quarter Earnings Decline, But US Comps Reverse; Low-End Consumers Increase Spending

*By Valuentum Analysts*

Wal-Mart (WMT) announced mixed third-quarter fiscal 2012 results that came in roughly in line with the mid-point of its previously-issued earnings guidance. Though we were disappointed by weak traffic trends in the quarter, we're holding the line with our fair value estimate for Wal-Mart.

Net sales increased 8.2% (6.8% constant currency) from the same period a year ago, as comparable sales in the US and Sam's Club jumped 1.3% and 5.7%, respectively – the latter excluding fuel. This compares to a negative US comp and 2.4% for Sam's Club in last year's quarter. The major driver behind the positive reversal in US comps (they had been negative for the previous nine quarters) was an increase in the average ticket, not from improved traffic—something we view negatively for Wal-Mart in light of encroaching competition from discount dollar stores—Dollar Tree (DLTR), Dollar General (DG)—and online retailers like Amazon (AMZN). However, we view the general increase as a positive datapoint, as the low-end consumer, weighed down by high unemployment, is spending more. Though US traffic performance was somewhat of a disappointment, Wal-Mart International had a nice showing led by China, Mexico and Argentina, with revenue jumping 20% (15.3% constant currency) from last year's quarter.

**Please see *Wal-Mart's Third-Quarter Earnings...* on page 9**

# Intel Reduces Fourth-Quarter Revenue Forecast on Supply Chain Disruptions

*By Valuentum Analysts*

Intel (INTC) followed the path of other chipmakers like Texas Instruments (TXN), Altera (ALTR), and Lattice Semi (LSCC) and lowered its fourth-quarter revenue and gross margin outlook, blaming hard disk drive supply shortages from the recent flooding in Thailand. We are maintaining our fair value estimate for Intel (INTC), as our estimate of its intrinsic value is based on the company's long-term cash-flow projections, which we think are still readily achievable. Plus, flooding in Thailand should only be a temporary supply chain issue, and we believe the rebuilding of inventories after the first quarter of next year will be a positive catalyst for Intel's shares.

Intel said it now expects fourth-quarter revenue to be about $13.7 billion (+/- $300 million) versus its previous expectation of $14.7 billion (+/- $500 million). Intel also indicated that it now expects non-GAAP gross margin to be 65.5% (+/- a couple percentage points) in the fourth quarter, modestly lower than its previous expectation of 66% (+/- a couple percentage points). And while Intel noted that sales of personal computers are expected to be up sequentially in the fourth quarter, it mentioned that the worldwide PC supply chain continues to reduce inventories and microprocessor purchases due to ongoing hard disk drive supply shortages, a trend it expects to last through the first quarter of next year. The chipmaker, however, is optimistic that a rebuilding of microprocessor inventories will recover during the first half of 2012, and we agree.

Though we weren't pleased with the news, it wasn't totally unexpected given recent moves by its chipmaker peers in recent days and the well-documented flooding in Thailand and its potential impact on Intel's operations. Though this represents yet another data point—in addition to DuPont (DD) and other chipmakers—that fourth-quarter earnings season may disappoint, we'll be looking to capitalize on any price weakness from Intel in coming trading sessions and add to our relatively small position in the portfolio of our Best Ideas Newsletter.

| Portfolio Return | Benchmark Return | Outperformance |
|---|---|---|
| 11.6% | -6.3% | 17.9% |

Portfolio Inception Date: May 17, 2011

***More Relative Outperformance*** **continued from page 1**

ground given its poor quarterly results, and Ancestry.com continues to form a nice bottom after a very sharp pullback in recent months. We think that the online genealogy provider is setting up for a nice 2012, and we're anxiously awaiting its fourth-quarter results and outlook. During the period, we also opened up what can be considered our only financials exposure in Visa (V), and we anticipate valuation upside to almost $130 per share in this name.

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 16), as well as analysis and trends impacting companies on our Best Ideas List. We currently have about 5% of our portfolio in cash, a level we plan to increase in coming days and weeks.

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 December 12, 2011** — **Best Ideas Portfolio Inception Date: May 17, 2011**

| Portfolio Holdings | Symbol | VBI Score* | First Purchase Date | Cost Basis/Share ($) | Total Shares | Total Cost ($) | Current Value/Share ($) | Current Value ($) | Dividends Received | % of Portfolio | % Return |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *Bullish* | | | | | | | | | | | |
| Apple Corp. | AAPL | 3 | 17-Jun-11 | 328.99 | 20 | 6,586.80 | 388.81 | 7,776.20 | 0.00 | 7.0% | 18.1% |
| Altria Group | MO | 7 | 28-Jun-11 | 26.43 | 378 | 9,997.54 | 28.99 | 10,958.22 | 154.98 | 9.8% | 11.2% |
| Ancestry.com | ACOM | 6 | 17-May-11 | 32.43 | 446 | 14,463.40 | 22.99 | 10,253.54 | 0.00 | 9.2% | -29.1% |
| Astronics | ATRO | 6 | 6-Jun-11 | 24.93 | 281 | 7,012.33 | 35.03 | 9,843.43 | 0.00 | 8.8% | 40.4% |
| **NEW: We sold 120 shares of ATRO on 11/30/2011 at $35.65.** | | | | | | | | | | | |
| Buffalo Wild Wings | BWLD | 6 | 13-Jul-11 | 65.42 | 152 | 9,950.84 | 60.50 | 9,196.00 | 0.00 | 8.2% | -7.6% |
| Collective Brands | PSS | 6 | 11-Jul-11 | 15.09 | 662 | 9,996.58 | 13.64 | 9,029.68 | 0.00 | 8.1% | -9.7% |
| eBay | EBAY | 10 | 3-Oct-11 | 31.04 | 200 | 6,207.00 | 30.84 | 6,168.00 | 0.00 | 5.5% | -0.6% |
| EDAC Tech | EDAC | 6 | 6-Jun-11 | 4.08 | 1100 | 4,495.00 | 10.29 | 11,319.00 | 0.00 | 10.1% | 151.8% |
| Ford Motor | F | 6 | 12-Sep-11 | 10.85 | 450 | 4,884.50 | 10.48 | 4,716.00 | 0.00 | 4.2% | -3.4% |
| Intel | INTC | 9 | 12-Sep-11 | 19.89 | 100 | 1,996.00 | 23.56 | 2,356.00 | 21.00 | 2.1% | 19.1% |
| Precision Castparts | PCP | 3 | 6-Jun-11 | 152.07 | 65 | 9,891.55 | 155.00 | 10,075.00 | 3.90 | 9.0% | 1.9% |
| Republic Services | RSG | 6 | 19-May-11 | 31.42 | 403 | 12,662.85 | 26.93 | 10,852.79 | 161.20 | 9.7% | -13.0% |
| **NEW: Visa** | **V** | **7** | **30-Nov-11** | **95.78** | **30** | **2,880.40** | **95.91** | **2,877.30** | **0.00** | **2.6%** | -0.1% |
| Cash | | | | | | | | 5,051.94 | | 4.5% | 0.0% |
| *Bearish* | | | | | | | | | | | |
| Chipote Mexican | CMG | 4 | 3-Oct-11 | 33.70 | 1 Contract | 3,378.25 | 4.30 | 430.00 | 0.00 | 0.4% | -87.3% |
| ---> Jan 2012, $300 strike | | | | | | | | | | | |
| LinkedIn | LNKD | 3 | 8-Nov-11 | 10.40 | 1 Contract | 1,048.25 | 7.00 | 700.00 | 0.00 | 0.6% | -33.2% |
| ---> Aug 2012, $55 strike | | | | | | | | | | | |
| **Best Ideas Portfolio Value** | | | | | | 100,000.00 | | 111,603.10 | | | 11.6% |
| SPY | | | 17-May-11 | 132.69 | 754 | 100,000.00 | 123.05 | 92,734.95 | 944.31 | 100.00% | |
| **Benchmark Value** | | | | | | | | **93,679.25** | | | **-6.3%** |
| **Under/Outperformance** | | | | | | | | | | | **17.9%** |

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

* 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.

*Home Depot Reports Strong Third Quarter...*

continued from page 5

With this relatively bearish outlook for housing, execution in the form of customer service and supply chain improvements will be critical to the home retailer's success in coming periods. As it relates to capital allocation, Home Depot also upped its quarterly dividend by 16%, to 29 cents per share, a move we applaud for income investors. The firm raised its targeted dividend payout ratio to 50% (from 40%), a level we think is manageable. Home Depot will continue to buy back shares and complete the remaining $6.8 billion of share repurchases that have been authorized through 2014.

## Best Buy's Fiscal 3Q Results Disappoint; Excessive Promotions and Weakness in Europe to Blame

*By Valuentum Analysts*

Best Buy (BBY) reported poor fiscal third-quarter results that showed modest comparable store sales growth but material operating-income deterioration. Though results of the world's largest electronics chain came in lower than our expectations during the quarter, Best Buy reaffirmed its adjusted diluted earnings per share guidance range of $3.35 to $3.65 for the year. Nevertheless, we have placed our fair value estimate for Best Buy under review while we re-evaluate the implications of its aggressive pricing actions on long-term profitability. We expect to lower our fair value estimate for the retailer materially.

Best Buy's total revenue increased 1.7% during the period thanks to modest domestic same store sales expansion led by its online channel, offset by international performance at small box stores in Europe open for at least a year. This performance is in stark contrast to the results of the same period a year ago, which witnessed significant comp declines domestically and solid expansion internationally.

Best Buy noted particular strength in mobile computing (including tablets), appliances, eReaders, mobile phones and movies, but weakness in digital imaging and gaming. We suspect most of the sales growth was driven by increased promotional activity to drive increased traffic, as gross profit dollars declined 2% from the prior-year period. We view this trend as particularly worrisome, given the firm's fixed square-footage overhead (brick-and-mortar locations) and the stiff competition it faces from Amazon (AMZN), Wal-Mart (WMT) and Target (TGT).

Overall, adjusted operating income fell 15% led by a nearly 30% fall off in the firm's domestic operations, while adjusted diluted earnings per share dropped 13% in the quarter, to $0.47 (we had been expecting earnings north of $0.50). Free cash flow, however, was robust, and the company's dividend and buyback program remain intact.

Looking at full fiscal 2012 guidance, Best Buy expects comparable store sales in the range of flat to a 3% decline. Gross margins are expected to fall, while overhead is anticipated to increase 2%, leading to expectations of adjusted operating income dollars to be in the range of a 5% decline to 2% growth. All things considered, we were not impressed with Best Buy's performance and don't think this bodes well for smaller electronics retailers like hhgregg (HGG) and RadioShack (RSH), or fourth-quarter earnings season, in general.

*AMR Files For Bankruptcy...* continued from page 4

We expect AMR to emerge as a stronger and leaner carrier once restructuring is complete. In the near term, we view this as a positive for its legacy competitors: US Airways (LCC), Delta (DAL), United Continental (UAL), and Southwest (LUV). AMR likely will cut capacity—unprofitable routes—during the Chapter 11 process, and this will be a meaningful positive on industry yields (at least in the near term and assuming the bankruptcy process is not prolonged and ticket fares aren't slashed while under creditor protection to generate cash flow). However, AMR will become a stronger airline once it emerges, with a lower cost structure--so over the long haul, the filing is a negative for its network peers from a competitive standpoint. US Airways, Delta, United Continental, and Southwest would have preferred AMR to remain outside of the bankruptcy process, as the move today is the only answer for AMR to become a competitive threat.

We don't expect a wave of bankruptcy filings by airlines following AMR's, though we highlight US Airways as the weakest link. US Airways, a proponent of consolidation, has largely missed out on its attempt to merge with a larger carrier in previous years (and its US-heavy exposure is somewhat concerning)--it did tie the knot with America West a number of years ago, however. Interestingly, we could see US Airways become active in AMR's bankruptcy process, scooping up some debt and forcing a merger between it and American during Chapter 11 proceedings.

Merging during Chapter 11 is the best way to tie-up in the airline industry, in our opinion. Combining operations while one carrier is under bankruptcy protection allows for significant flexibility, as both entities (in this potential case US Airways and AMR) could optimize their route networks and fleets, while ensuring that the lowest cost structure can be achieved. Plus, it would allow for the reduction of overhead and redundant expenses. We would be an advocate of AMR tying the knot with another carrier during its bankruptcy. We continue to monitor developments on this front and, as a general rule, encourage investors to continue to steer clear of the airline space.

*Wal-Mart's Third-Quarter Earnings...* continued from page 6

Wal-Mart's segment operating income advanced 5.1% in its US stores, 6.3% at Sam's Club, and 14.2% at Wal-Mart International. However, excluding fuel and adjusting for currency, the operating-income growth at Sam's Club and Wal-Mart International was more subdued. All-in, consolidated operating income increased 4.8%, which includes a currency tailwind (excluding currency, the growth came in at 3.9%). Income from continuing operations fell 2.5% due to a higher tax rate, but on a diluted basis, it came in at $0.97, which roughly hit the mid-point of the guided range of $0.95 to $1.00 for the period. Wal-Mart was able to hit its target due in part to its aggressive share repurchase program. During the third quarter, the firm returned $2.7 billion to shareholders through dividends ($1.3 billion) and stock buybacks ($1.4 billion).

Looking ahead to the holiday quarter, Wal-Mart guided fourth-quarter fiscal 2012 to the range of $1.42 to $1.48 (consensus was at $1.45), which is roughly $0.08 better than what it achieved in the same period a year ago (excluding a $0.07 tax benefit). Management also suggested that US comps would remain positive and hit the range of flat to up 2% (this compares to a fall of 1.8% last year), and we suspect most of this will come from the firm's price investment strategy. Comparable sales, ex fuel, at Sam's Club are expected to rise as much as 6% in the holiday quarter, which compares to a 2.7% jump last year. We think Wal-Mart is fairly valued at current levels.

# Do Not Take DuPont's Downward Revision Lightly; Signals 4Q Earnings Season May Disappoint

*By Valuentum Analysts*

DuPont (DD) recently lowered its 2011 full-year earnings outlook, noting slower growth in certain segments during the fourth quarter as a result of global economic uncertainty. Since our fair value estimates are based on a firm's long-term projections to arrive at its intrinsic value, we are sticking with our fair value estimate for DuPont at this time. In short, we think DuPont still remains on track to achieve our long-term projections, despite the downward revision to this year's earnings today.

In DuPont's release, management indicated the earnings slowdown reflects:

"destocking across polymers and certain industrial supply chains than accelerated during the fourth quarter. Consumer electronics demand has further softened, and housing and construction markets remain weak."

We're taking this news, in light of weakness out of Texas Instruments (TXN) and other chipmakers, as evidence that the widespread global macroeconomic uncertainty coupled with the European debt crisis is starting to creep into the growth rates of domestic multi-nationals. Importantly, DuPont just raised its earnings guidance in October, so reducing it today is a huge red flag for the economic environment during November and December.

That said, global macroeconomic uncertainty seems to be only impacting the pace of growth--not causing a significant drop in earnings. For example, DuPont's (DD) revised earnings for this year still represent as much as a 20% increase from 2010, so this is still nice growth. However, we're growing more cautious that the fear of a global recession—rather than a global recession itself--is causing corporations to tighten their budgets and become more conservative with cash/inventory purchases (similar to what we witnessed out of corporations during the debt ceiling debate). Both the chipmakers and DuPont have noted that consumer inventories remain light. But we don't view this as a permanent condition, and a rebuilding of inventories should be expected as global economic uncertainty inevitably passes—the only contingency being timing.

DuPont's cautious position on consumer electronics runs counter to what we've seen out of the burgeoning smartphone market (even the chipmakers are seeing strength here), but yet is consistent with what 3M (MMM) mentioned in its most recently-reported quarter regarding its LCD film segment. We think there are winners and losers in the consumer electronics market (rather than across-the-board strength), and 3M and DuPont, for example, are levered to the latter. On a bright note, DuPont did mention that other markets—outside of consumer electronics and housing—remain strong, namely the agricultural and food businesses.

All things considered, we're getting some good data points through the month of November that Europe's debt problems and the proliferation of such concerns about a domestic slowdown are actually starting to impact corporate results—what we remain focused on. Further, we think chemical companies like DuPont are good bellwethers to assess the global economy, as their products are used in a plethora of consumer goods. We maintain the US is not headed for a recession anytime soon, but the latest reports are starting to build a case that performance during the fourth quarter will not be as robust as management teams originally had forecasted.

# Company Spotlight: Fusion-iO (FIO) May Have the Technology of the Future But Expectations Are Incredible

*By Valuentum Analysts*

Fusion-iO (FIO) just went public a few months ago, without much fanfare. The company isn't a sexy social media darling a la LinkedIn (LNKD) or Facebook, but it does help fuel the profitability behind them. When cloud computing as a sector heated up, the stock rallied to over $40. However, after the end of its lock-up period and another secondary offering, shares have fallen back below $30.

While we like the technology behind the company, we think the stock is priced for perfection. There's a great possibility that tremendous profitability lies ahead, especially with a growth in the amount of data received and used in analytics that will continue for years, if not decades to come. Nevertheless, given the risks associated with this stock, we think its best investors wait for a more attractive entry point.

**Company background**

Fusion-iO was founded back in 2005, focusing on the new data issues facing enterprises. The company creates both hardware and software data solutions. On the hardware side, the company utilizes non-volatile storage technology, which is also known as NAND flash. For years, flash has only been used in compact storage, a la iPhones, where memory must be accessed quickly and the device cannot be cooled like a traditional PC or mainframe. However, as the technology becomes cheaper, flash, which tends to be more time and energy efficient than traditional dynamic random access memory (DRAM), becomes a more plausible in mass enterprise usage.

Software-wise, Fusion-iO provides enterprises with its directCache solution. According to the annual report, this technology is designed to intelligently cache frequently used memory so datasets can be accessed quicker and more efficiently.

In its recent acquisition of ioTurbine, the company acquired software that's able to optimize the performance of virtual machines and servers. With the ever increasing needs of businesses to increase productivity, virtual machines and servers should play a key role in worker productivity gains. With a virtual machine, an employee is able to process workloads on multiple computers with just one desktop. Additionally, these virtual machines work far quicker than regular computers, meaning employees are able to process massive amounts of data in shorter time intervals.

**Great technology, but so what?**

Though a lot of the technical terms make things difficult to understand, the business model is not. With the likes of Google (GOOG), Amazon (AMZN), Facebook and Apple (AAPL) processing ever increasing amounts of data, Fusion-iO wants to help them store and monetize it (Facebook and Apple are two of its largest customers). It's similar to how we think aerospace suppliers will benefit from the secular strength in the aerospace refresh cycle.

In 2009, the company did just $10 million in sales, but that figure increased in fiscal year 2010 to over $36 million, and in fiscal year 2011, to over $197 million. That growth is absolutely staggering, and we think revenues can grow another 65% this year, based on an increased customer base and upgrades from previous customers. It's nearly impossible to find this kind of growth anywhere, and if the company is successful, it could compound at over 30% annually.

Yet, the profitability is just not there yet. Gross margins have increased by over 200 basis points a year, but SG&A has also ballooned more than three-fold. The company only earned just $0.06 per share in its most recent fiscal year, but we expect revenue growth to be astounding, implying a great deal of incremental profitability. If such leverage continues, Fusion-iO should be wildly profitable, making its current valuation more reasonable (as reasonable as 112x earnings can be).

**Please see *Fusion-iO* on next page**

*Fusion-iO...* **continued from previous page**

**Lots of risks from technology and competition**

Even though they do have a few patents, Fusion-iO faces substantial risks from competition. On one hand, there are several other companies attempting to ride flash technology to high profits. Some OEM's like HP buy Fusion-iO's technology for its own datacenter build-out, but competitors like Intel and EMC (EMC) can create similar hardware and software. Further, these companies already have large installed clientele bases. Fusion-iO also faces competition from smaller players like NetApp (NTAP), and possibly Oracle (ORCL) and IBM (IBM). Many of these are fine companies with much stronger balance sheets.

Additionally, flash is still a premium price-point technology. Seagate Technologies (STX) and Western Digital (WDC) supply companies with traditional HDD storage which is cheaper, though it requires more cooling and higher energy costs. With some companies still hesitant to spend on IT, some less sophisticated and cash-strapped companies could opt to stick with traditional data centers.

Either way, the importance of data and data processing is not a trend that will stop anytime soon. With the wild amounts of uncertainty, we'd be willing to consider a position if shares fell below $14. At its current share price, the risk/reward is only worth it if you think the company can crush the competition. Also remember, the company established provisions to prevent being acquired, so it's unlikely the company gets gobbled up by any well-capitalized competitor anytime soon.

# Ford Reinstates a Quarterly Dividend

*By Valuentum Analysts*

It came as no surprise last week when one of our best ideas, Ford (F) reinstated its quarterly dividend. Though the dividend payable is only 5 cents a share, it amounts to a yield just shy of 2%. In total, the dividend should cost about $800 million in 2012, with plenty of room to grow in the future. However, the dividend does not affect our fair value estimate of the company, which we still assume to be at least $20 per share.

A 2% dividend yield isn't necessarily a reason to jump into any stock, but in the case of Ford, a 2% yield is great income for a stock that we think is worth almost double. Given the company's inconsistent cash-flow generation over the past several years, it seems logical that Ford might struggle to pay it. However, with our forecast predicting the company to generate billions in free cash flow over the next 5 years, the firm registers a relatively high score on the Valuentum Dividend Cushion. This implies sufficient operating success over the next several years, but more importantly, that the dividend is relatively safe.

Due to the credit upgrade and implementation of a dividend, shares have held up relatively well. The dividend should provide a near-term floor for the stock that wasn't there before. We think downside is capped, unless there's another cataclysmic event in Europe, which we can't ever rule out.

Auto sales have picked up steadily in October and November, and we are optimistic US domestic sales will exceed 14 million units next year. 14 million still isn't enough to replace the current aging fleet, and the next several years should result in windfall profits for auto makers and their suppliers, in our opinion.

# Salesforce.com Posts Mixed Third-Quarter Results; We're Not Impressed with Profitless Growth

*By Valuentum Analysts*

Salesforce.com reported mixed third-quarter fiscal 2012 results that showed excellent top-line expansion but very weak levels of profitability. We are maintaining our $120 fair value estimate.

The firm achieved record quarterly revenue in the period, up 36% on a year-over-year basis. Deferred revenue growth, or sales to be recognized in the future, was a bit lower than top-line expansion in the period and came in at 32%. This suggests that revenue growth in the future may slow a bit from the current pace. Salesforce.com's subscription and support revenues jumped 36%, while professional services and other revenues advanced 34%.

On the bottom line, the results were less than impressive. On a GAAP basis, Salesforce.com registered a third-quarter net loss of $0.03 for the period. On a non-GAAP basis, net earnings came in at $0.34. The market continues to place an elevated earnings multiple on the firm's meager earnings stream in setting its valuation. Cash from operations, however, jumped 74% on a year-over-year basis, which provides the basis for our estimate of Salesforce.com's intrinsic value (we use a DCF process to arrive at an intrinsic value for all companies we cover).

Looking ahead, the firm initiated guidance for the fourth quarter, with revenue expected to come in as much as $624 million in the period, above expectations. Salesforce.com expects to report a GAAP loss again, though on a non-GAAP basis, it indicated earnings could reach as high as $0.40 in its fiscal fourth quarter, matching expectations. Management also initiated guidance for fiscal 2013, with revenue expected to reach $2.92 billion at the high end of its range, topping estimates. We're not expecting much on the bottom line for Salesforce.com for fiscal 2013, and management withheld bottom-line guidance for the year, a move we view negatively.

In all, we continue to focus on the earnings and cash-flow stream at Salesforce.com (as opposed to profitless top-line expansion). Oracle's (ORCL) move into the space with the acquisition of RightNow has also dampened our enthusiasm on the stock. We demand a large margin of safety before considering this high-flyer and would not touch Salesforce.com's equity until it fell below $80 per share, the lower end of our fair value range, on improving technicals. In fact, we may consider a put position in Salesforce.com on unjustified price strength.

*How to Find Hidden Investment Gems...* on next page

# How to Find Hidden Investment Gems

*By Valuentum Analysts*

Valuentum's stock picking methodology, the Valuentum Buying Index™ looks at many factors before arriving at a rating, including technicals and the discounted cash flow model to name a few. Our focus on different approaches left us very intrigued by a recent Harvard Business Review article. In the October 2011 issue there was an interview with Michael J. Mauboussin (Chief Investment Strategist at Legg Mason Capital Management) on his views regarding complexity. This is what he had to say:

"If you're an investor and you're only looking at your Bloomberg terminal and reading Forbes and Fortune and the Wall Street Journal, it's unlikely you're going to get a lot of really interesting ideas. You need to read and think more broadly. Great investors most definitely do that already."

Investors and even analysts can become overly focused on one variable or one approach, leading to neutral or even poor results compared to the market. When markets are working efficiently changes in a company's performance or dividend may already be reflected in the stock price. Because of this the well-known, tried and true companies may provide stability and certainty, but they may not provide the most incentive to investors. On the other hand, a small or unknown company may provide all risk and no reward. What is an investor to do?

In this complex and intertwined world, investment ideas come from many sources, and looking outside the box – outside the investment world – is a must. We highlight some of our best ideas below that came from looking beyond traditional news and employing our fresh, unique investment process.

**EDAC Tech (EDAC)**

Why it piqued our interest: We first became interested in going long EDAC Tech a number of months ago when we wrote our June 6 article on Seeking Alpha on some of the best ideas in the commercial aerospace supply chain. We knew the aerospace cycle during the next few years would be robust, and we were surprised to see EDAC Tech trading so cheaply from a valuation standpoint. The firm had a huge and growing backlog, and from our experience in the aerospace supply chain, EDAC Tech would experience substantial operating leverage as throughput increased. The company's market cap was roughly $20 million, so it didn't fall on many investors' radar screens. But that didn't stop us from profiting. We highlighted the company as a best idea to our subscribers, and the firm has subsequently doubled in price.

**AMR Corp (AMR)**

Why it piqued our interest: We first became interested in going short AMR Corp, the parent of American Airlines, a number of months ago when we wrote our May 19 article on Seeking Alpha on why we thought the firm's equity was practically worthless. At the time, many sell-side analysts and independent research shops were still bullish or neutral on the airline space. We were surprised, to say the least. However, our fresh thinking led us to believe that a significant decline in AMR would be in the cards, as its current free cash flow stream was nowhere close to being sufficient to create any value for shareholders over the long haul. Though American Airlines is a firm that many investors have heard of, our process and view on the poor industry dynamics of the airline industry led us to develop an iron-clad thesis on the firm's valuation. As a result, we highlighted to our subscribers the firm's impending decline, and AMR has subsequently declared bankruptcy (shares are trading for pennies) from about $7 per share at the time of the printing of that article.

**Please see *How to Find Hidden Investment Gems...* on next page**

*How to Find Hidden Investment Gems...* continued from previous page

**Netflix (NFLX)**

Why it piqued our interest: This is a firm that many, many investors know very well after the well-documented missteps by management. However, before the significant share price fall, we were one of the only firms pounding the table that a massive decline was coming. In fact, we challenged the investment community in our July article on Seeking Alpha when the shares were trading at about $250 each to arrive a valuation that was anywhere near Netflix's current share price. Simply put, our research advantage with respect to valuation analysis allowed us to uncover this short-idea gem, as other firms remained enamored with its potential growth prospects. Our differentiated investment process allowed our subscribers to steer clear of this land mine and avoid a massive sell-off that has left Netflix's shares wounded well under $100.

**Apple (AAPL)**

Why it piqued our interest: Okay, yes, this is a name that probably has found its way into everyone's portfolio at some time or another -- so it is not hidden. But what is hidden is the best entry and exit points in this behemoth of a stock. Our process allowed us to pinpoint a near-term bottom in Apple's share price as we noted in our June 17 article on Seeking Alpha that the iPad-maker was reflecting nothing more than inflation-like expansion beyond years 2 or 3. We thought this was conservative, and our technical-analysis process flashed a bullish signal that prompted us to add the firm to our Best Ideas portfolio. Our subscribers were well-rewarded as Apple had run up to over $400 before pulling back recently.

**LinkedIn (LNKD)**

Why it piqued our interest: You don't have to look far for someone to tell you that LinkedIn is significantly overvalued. Or do you? Even today, sell-side analysts still peg a price target at about $90 per share. But this didn't sway us from our independent thinking and objective valuation process. We initiated coverage on LinkedIn in our May 22 article on Seeking Alpha stating that its fair value was in the mid-$40s. If you had heeded our warning, it would have saved you from a massive slide in the stock from about $110 to under $70 today. We are just as confident in our call on LinkedIn (LNKD) as we were on our call on Netflix (NFLX), and we continue to expect the professional social-networker's share price to decline.

# 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. On the next page, 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 (EBAY, ACOM, 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.

*Ideas...* continued on next page

***Ideas…*** **continued from previous page**

| Company Name | Ticker | Industry | Market Cap | Valuentum Buying Index | DCF Assessment | Relative Value | Price/Fair Value | Stock Price | Fair Value | Forward PE | PEG |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Helmerich & Payne | HP | Energy Equipment | 6,334 | 10 | UNDERVALUED | ATTRACTIVE | 0.73 | 58.31 | 80.00 | 11.90 | 1.33 |
| eBay | EBAY | Internet & Catalog Retail | 42,584 | 10 | UNDERVALUED | ATTRACTIVE | 0.68 | 32.08 | 47.00 | 15.73 | 1.19 |
| NeuStar | NSR | Wireless Telecom Services | 2,611 | 10 | UNDERVALUED | ATTRACTIVE | 0.73 | 34.33 | 47.00 | 18.68 | 1.20 |
| Eastman Chemical | EMN | Chemicals - broad | 5,885 | 9 | UNDERVALUED | ATTRACTIVE | 0.69 | 39.82 | 58.00 | 8.50 | 1.06 |
| Dell | DELL | Computers & Peripherals - hardware | 30,009 | 9 | UNDERVALUED | ATTRACTIVE | 0.59 | 15.35 | 26.00 | 7.24 | 1.51 |
| Synaptics | SYNA | Computers & Peripherals | 1,142 | 9 | UNDERVALUED | ATTRACTIVE | 0.77 | 32.21 | 42.00 | 12.81 | 1.58 |
| Owens-Illinois | OI | Containers & Packaging | 3,218 | 9 | UNDERVALUED | ATTRACTIVE | 0.69 | 19.26 | 28.00 | 8.53 | 0.87 |
| Jabil Circuit | JBL | Electronic Component Suppliers | 4,615 | 9 | UNDERVALUED | ATTRACTIVE | 0.65 | 20.91 | 32.00 | 8.02 | 1.18 |
| Nabors Industries | NBR | Energy Equipment | 5,081 | 9 | UNDERVALUED | ATTRACTIVE | 0.58 | 17.52 | 30.00 | 11.80 | 0.92 |
| Precision Drilling | PDS | Energy Equipment | 3,312 | 9 | UNDERVALUED | ATTRACTIVE | 0.65 | 11.62 | 18.00 | 11.98 | 1.04 |
| Wyndham | WYN | Hotels | 6,407 | 9 | UNDERVALUED | ATTRACTIVE | 0.71 | 34.63 | 49.00 | 14.42 | 2.28 |
| Cracker Barrel | CBRL | Restaurants | 1,151 | 9 | UNDERVALUED | ATTRACTIVE | 0.73 | 48.70 | 67.00 | 11.29 | 2.06 |
| Western Union | WU | Financial Tech Services | 11,572 | 9 | UNDERVALUED | ATTRACTIVE | 0.72 | 17.30 | 24.00 | 10.91 | 1.15 |
| Macy's | M | Multiline Retail | 11,516 | 9 | UNDERVALUED | ATTRACTIVE | 0.64 | 26.95 | 42.00 | 9.99 | 1.38 |
| Alpha Natural | ANR | Industrial Minerals | 3,234 | 9 | UNDERVALUED | ATTRACTIVE | 0.62 | 26.56 | 43.00 | 15.03 | 1.14 |
| Pfizer | PFE | Pharmaceuticals | 158,735 | 9 | UNDERVALUED | ATTRACTIVE | 0.73 | 19.66 | 27.00 | 8.61 | 1.38 |
| Intel | INTC | Broad Line Semiconductors | 129,470 | 9 | UNDERVALUED | ATTRACTIVE | 0.61 | 22.73 | 37.00 | 9.19 | 2.07 |
| Tenneco | TEN | Auto Parts Suppliers | 1,562 | 6 | UNDERVALUED | ATTRACTIVE | 0.58 | 25.61 | 44.00 | 9.41 | 1.00 |
| Gilead Sciences | GILD | Biotechnology | 33,888 | 6 | UNDERVALUED | ATTRACTIVE | 0.67 | 38.80 | 58.00 | 9.56 | 1.10 |
| R.R. Donnelley | RRD | Commercial Services & Supplies | 3,135 | 6 | UNDERVALUED | ATTRACTIVE | 0.60 | 14.95 | 25.00 | 8.62 | 0.97 |
| Xerox | XRX | Commercial Services & Supplies | 10,833 | 6 | UNDERVALUED | ATTRACTIVE | 0.57 | 8.02 | 14.00 | 7.21 | 0.84 |
| Republic Services | RSG | Environmental Services | 10,313 | 6 | UNDERVALUED | ATTRACTIVE | 0.69 | 26.78 | 39.00 | 14.10 | 2.39 |
| Sealed Air | SEE | Containers & Packaging | 3,064 | 6 | UNDERVALUED | ATTRACTIVE | 0.60 | 17.34 | 29.00 | 10.01 | 0.84 |
| Ancestry.com | ACOM | Internet Software & Services | 1,367 | 6 | UNDERVALUED | ATTRACTIVE | 0.45 | 28.06 | 62.00 | 22.51 | 0.90 |
| Valero Energy | VLO | Refiners | 10,099 | 6 | UNDERVALUED | ATTRACTIVE | 0.39 | 17.78 | 46.00 | 4.07 | 0.49 |
| AnnTaylor | ANN | Specialty Retail - clothes | 1,263 | 6 | UNDERVALUED | ATTRACTIVE | 0.66 | 21.74 | 33.00 | 11.10 | 1.47 |
| Avon Products | AVP | Luxury Goods | 7,191 | 6 | UNDERVALUED | ATTRACTIVE | 0.64 | 16.67 | 26.00 | 9.27 | 1.95 |
| Anixter | AXE | Distributors | 1,753 | 6 | UNDERVALUED | ATTRACTIVE | 0.70 | 49.37 | 71.00 | 8.62 | 0.79 |
| WESCO | WCC | Distributors | 1,641 | 6 | UNDERVALUED | ATTRACTIVE | 0.61 | 35.59 | 58.00 | 9.50 | 0.85 |

The table above can supplement your "shopping list" of new ideas. On our website, we provide a 16-page equity research report that supports our valuation assessment for each. The reports can be found here.

The 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 should their upside potential become greater than our current holdings. We also show firms that register a 1 on our VBI. These names represent put-option candidates (we may also consider firms that register a 2, 3 or 4 on our index as put-option candidates). We provide the respective lists below, and each firm's report can be found on our website here.

## The Good:

| Company Name | Ticker | Industry | Market Cap | Valuentum Buying Index | Price/Fair Value | Stock Price | Fair Value | Forward PE | PEG |
|---|---|---|---|---|---|---|---|---|---|
| Helmerich & Payne | HP | Energy Equipment | 6,334 | 10 | 0.73 | 58.31 | 80.00 | 11.90 | 1.33 |
| eBay | EBAY | Internet & Catalog Retail | 42,584 | 10 | 0.68 | 32.08 | 47.00 | 15.73 | 1.19 |
| NeuStar | NSR | Wireless Telecom Services | 2,611 | 10 | 0.73 | 34.33 | 47.00 | 18.68 | 1.20 |
| Eastman Chemical | EMN | Chemicals - broad | 5,885 | 9 | 0.69 | 39.82 | 58.00 | 8.50 | 1.06 |
| Dell | DELL | Computers & Peripherals - hardware | 30,009 | 9 | 0.59 | 15.35 | 26.00 | 7.24 | 1.51 |
| Synaptics | SYNA | Computers & Peripherals | 1,142 | 9 | 0.77 | 32.21 | 42.00 | 12.81 | 1.58 |
| Owens-Illinois | OI | Containers & Packaging | 3,218 | 9 | 0.69 | 19.26 | 28.00 | 8.53 | 0.87 |
| Jabil Circuit | JBL | Electronic Component Suppliers | 4,615 | 9 | 0.65 | 20.91 | 32.00 | 8.02 | 1.18 |
| Nabors Industries | NBR | Energy Equipment | 5,081 | 9 | 0.58 | 17.52 | 30.00 | 11.80 | 0.92 |
| Precision Drilling | PDS | Energy Equipment | 3,312 | 9 | 0.65 | 11.62 | 18.00 | 11.98 | 1.04 |
| Wyndham | WYN | Hotels | 6,407 | 9 | 0.71 | 34.63 | 49.00 | 14.42 | 2.28 |
| Cracker Barrel | CBRL | Restaurants | 1,151 | 9 | 0.73 | 48.70 | 67.00 | 11.29 | 2.06 |
| Western Union | WU | Financial Tech Services | 11,572 | 9 | 0.72 | 17.30 | 24.00 | 10.91 | 1.15 |
| Macy's | M | Multiline Retail | 11,516 | 9 | 0.64 | 26.95 | 42.00 | 9.99 | 1.38 |
| Alpha Natural | ANR | Industrial Minerals | 3,234 | 9 | 0.62 | 26.56 | 43.00 | 15.03 | 1.14 |
| Pfizer | PFE | Pharmaceuticals | 158,735 | 9 | 0.73 | 19.66 | 27.00 | 8.61 | 1.38 |
| Intel | INTC | Broad Line Semiconductors | 129,470 | 9 | 0.61 | 22.73 | 37.00 | 9.19 | 2.07 |

## The ("Really") Bad:

| Company Name | Ticker | Industry | Market Cap | Valuentum Buying Index | Price/Fair Value | Stock Price | Fair Value | Forward PE | PEG |
|---|---|---|---|---|---|---|---|---|---|
| Aruba Networks | ARUN | Networking Equipment | 2,500 | 1 | 1.33 | 21.35 | 16.00 | 34.09 | 6.37 |
| Churchill Downs | CHDN | Gaming | 611 | 1 | 1.39 | 39.03 | 28.00 | 16.50 | 1.88 |

We're also watching the airline group for opportunities to re-layer on some of the put options that were big winners for us in the past months. Under Armour (UA), First Solar (FSLR), Clean Harbors (CLH), Salesforce.com (CRM) also make our list of stocks we may bet on for a fall.

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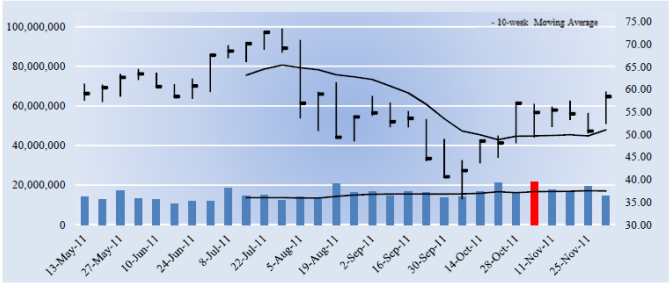
## Helmerich & Payne HP UNDERVALUED 2.9%

Buying Index™ 10 | Value Rating ✓

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $58.31 | $80.00 | $60.00 - $100.00 | MID-CAP BLEND | Energy | Energy Equipment |

**Helmerich & Payne 's strong cash flow generation and attractive valuation represent a compelling combination. We'd take a closer look at picking up the firm's shares.**

### 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™ | MEDIUM |
| ValueTrend™ | POSITIVE |
| Cash Flow Generation | STRONG |
| Financial Leverage | LOW |
| Growth | HIGH |
| Technical Evaluation | BULLISH |
| Relative Strength | NEUTRAL |
| Money Flow Index (MFI) | NEUTRAL |
| Upside/Downside Volume (U/D) | DETERIORATING |
| Near-term Technical Support, 10-week MA | 51.00 |

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

### Business Quality

| ValueRisk™ \ ValueCreation™ | 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) | $6,334 |
| Avg Weekly Vol (30 wks) | 15,379 |
| 30-week Range (USD) | 35.58 - 73.4 |
| Valuentum Sector | Energy |
| 5-week Return | 5.1% |
| 13-week Return | 11.5% |
| 30-week Return | -0.3% |
| Dividend Yield % | 0.5% |
| Dividends per Share | 0.28 |
| Forward Dividend Payout Ratio | 5.7% |
| Est. Normal Diluted EPS | 5.97 |
| P/E on Est. Normal Diluted EPS | 9.8 |
| Est. Normal EBITDA | 1,543 |
| Forward EV/EBITDA | 5.0 |
| EV/Est. Normal EBITDA | 4.0 |
| Forward Revenue Growth (5-yr) | 10.9% |
| Forward EPS Growth (5-yr) | 11.0% |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | 13.0% |
| Return on Assets | 8.4% |
| ROIC, with goodwill | 11.4% |
| ROIC, without goodwill | 11.4% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 235 |
| Net Debt | -129 |
| Total Debt/EBITDA | 0.2 |
| Net Debt/EBITDA | NMF |
| EBITDA/Interest | 57.8 |
| Current Ratio | 2.3 |
| Quick Ratio | 0.9 |

NMF = Not Meaningful

### Investment Highlights

• Helmerich & Payne 's scores fairly well on our business quality matrix. The firm has put up solid economic returns for shareholders during the past few years with relatively low volatility in its operating results. Return on invested capital (excluding goodwill) has averaged 11.4% during the past three years.

• Helmerich & Payne '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.

• Helmerich & Payne has an excellent combination of strong free cash flow generation and low financial leverage. We expect the firm's free cash flow margin to average about 14.7% in coming years. Total debt-to-EBITDA was 0.2 last year, while debt-to-book capitalization stood at 6.7%.

• 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 experienced a revenue CAGR of about 7.7% during the past 3 years. We expect its revenue growth to be below that of its peer median during the next five years.

### Relative Valuation

| | Forward P/E | PEG | Price / FV |
|---|---|---|---|
| Baker Hughes | 12.2 | 1.0 | 81.2% |
| Cameron International | 19.7 | 1.7 | 94.4% |
| Halliburton | 10.8 | 1.0 | 70.3% |
| Schlumberger | 20.2 | 1.8 | 107.2% |
| Peer Median | 15.9 | 1.3 | 87.8% |
| **Helmerich & Payne** | **11.9** | **1.3** | **72.9%** |

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

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Sep-10 | Sep-11 | Sep-12 |
| Revenue | 1,875 | 2,544 | 3,027 |
| Revenue, YoY% | -1.0% | 35.7% | 19.0% |
| Operating Income | 447 | 689 | 870 |
| Operating Margin % | 23.8% | 27.1% | 28.7% |
| Net Income | 286 | 435 | 538 |
| Net Income Margin % | 15.3% | 17.1% | 17.8% |
| Diluted EPS | 2.66 | 4.00 | 4.90 |
| Diluted EPS, YoY % | -19.7% | 50.2% | 22.4% |
| Free Cash Flow (CFO-capex) | 262 | 284 | 361 |
| Free Cash Flow Margin % | 14.0% | 11.2% | 11.9% |

In Millions of USD (except for per share items)

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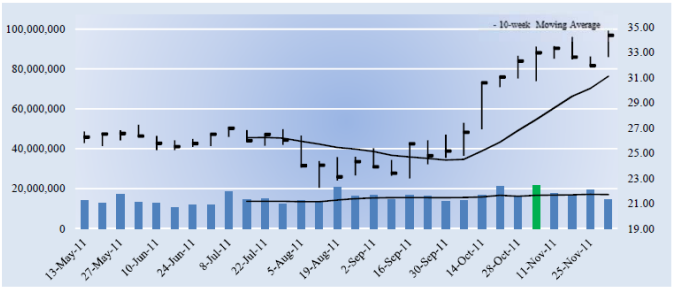
## NeuStar NSR UNDERVALUED 2%

Buying Index™ 10 | Value Rating ✓

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $34.33 | $47.00 | $35.00 - $59.00 | MID-CAP BLEND | Telecom Services | Wireless Telecom Service |

**NeuStar's strong cash flow generation and attractive valuation represent a compelling combination. We'd take a closer look at picking up the firm's shares.**

### Stock Chart (weekly)




The week with the highest trading volume out of the last 13 weeks was a week of heavy buying, or accumulation (green bar).

### Company Vitals

| | |
|---|---|
| Market Cap (USD) | $2,611 |
| Avg Weekly Vol (30 wks) | 15,379 |
| 30-week Range (USD) | 22.24 - 34.73 |
| Valuentum Sector | Telecom Services |
| 5-week Return | 7.9% |
| 13-week Return | 47.8% |
| 30-week Return | 32.4% |
| Dividend Yield % | 0.0% |
| Dividends per Share | 0.00 |
| Forward Dividend Payout Ratio | 0.0% |
| Est. Normal Diluted EPS | 2.87 |
| P/E on Est. Normal Diluted EPS | 12.0 |
| Est. Normal EBITDA | 442 |
| Forward EV/EBITDA | 8.2 |
| EV/Est. Normal EBITDA | 5.1 |
| Forward Revenue Growth (5-yr) | 17.8% |
| Forward EPS Growth (5-yr) | 20.5% |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | 14.3% |
| Return on Assets | 11.2% |
| ROIC, with goodwill | 71.9% |
| ROIC, without goodwill | 175.3% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 10 |
| Net Debt | -336 |
| Total Debt/EBITDA | 0.0 |
| Net Debt/EBITDA | NMF |
| EBITDA/Interest | 28.3 |
| Current Ratio | 4.0 |
| Quick Ratio | 3.8 |

NMF = Not Meaningful

### Investment Highlights

• NeuStar 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 175.3% during the past three years.

• NeuStar'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.

• NeuStar has an excellent combination of strong free cash flow generation and low financial leverage. We expect the firm's free cash flow margin to average about 25% in coming years. Total debt-to-EBITDA was 0 last year, while debt-to-book capitalization stood at 1.7%.

• 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.

• The firm experienced a revenue CAGR of about 7.1% during the past 3 years. We expect its revenue growth to be better than its peer median during the next five years.

### Investment Considerations

| | |
|---|---|
| DCF Valuation | UNDERVALUED |
| Relative Valuation | ATTRACTIVE |
| ValueCreation™ | EXCELLENT |
| ValueRisk™ | MEDIUM |
| ValueTrend™ | NEGATIVE |
| Cash Flow Generation | STRONG |
| Financial Leverage | LOW |
| Growth | AGGRESSIVE |
| Technical Evaluation | BULLISH |
| Relative Strength | STRONG |
| Money Flow Index (MFI) | NEUTRAL |
| Upside/Downside Volume (U/D) | BULLISH |
| Near-term Technical Support, 10-week MA | 31.00 |

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 |
|---|---|---|---|
| American Tower | 69.6 | 2.3 | 173.8% |
| Crown Castle | 83.2 | NMF | 174.8% |
| Level 3 Comm | -3.6 | NMF | 113.6% |
| SBA Comm | -38.3 | NMF | 196.9% |
| Peer Median | 33.0 | 2.3 | 174.3% |
| **NeuStar** | **18.7** | **1.2** | **73.0%** |

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

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Dec-09 | Dec-10 | Dec-11 |
| Revenue | 480 | 527 | 606 |
| Revenue, YoY% | -1.7% | 9.7% | 15.0% |
| Operating Income | 174 | 191 | 233 |
| Operating Margin % | 36.1% | 36.3% | 38.4% |
| Net Income | 101 | 106 | 141 |
| Net Income Margin % | 21.1% | 20.2% | 23.3% |
| Diluted EPS | 1.34 | 1.40 | 1.84 |
| Diluted EPS, YoY % | 2271.5% | 4.2% | 31.6% |
| Free Cash Flow (CFO-capex) | 150 | 107 | 148 |
| Free Cash Flow Margin % | 31.2% | 20.3% | 24.4% |

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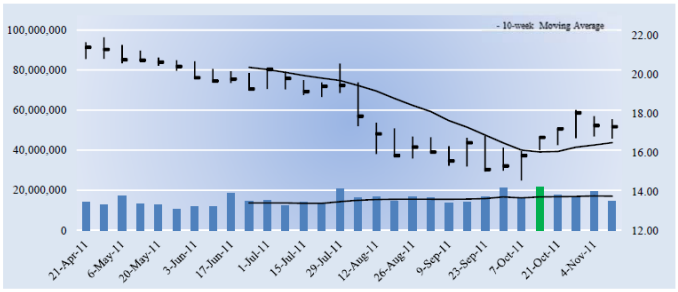
## Western Union WU UNDERVALUED 4%

Buying Index™ 9 | Value Rating ✓

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $17.30 | $24.00 | $18.00 - $30.00 | LARGE-CAP VALUE | Information Technology | Financial Tech Services |

**Western Union 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 buying, or accumulation (green bar).

### Company Vitals

| | |
|---|---|
| Market Cap (USD) | $11,572 |
| Avg Weekly Vol (30 wks) | 15,379 |
| 30-week Range (USD) | 14.55 - 21.88 |
| Valuentum Sector | Information Technology |
| 5-week Return | 7.1% |
| 13-week Return | 1.5% |
| 30-week Return | -17.1% |
| Dividend Yield % | 1.8% |
| Dividends per Share | 0.32 |
| Forward Dividend Payout Ratio | 20.2% |
| Est. Normal Diluted EPS | 1.93 |
| P/E on Est. Normal Diluted EPS | 8.9 |
| Est. Normal EBITDA | 1,840 |
| Forward EV/EBITDA | 7.6 |
| EV/Est. Normal EBITDA | 6.9 |
| Forward Revenue Growth (5-yr) | 5.1% |
| Forward EPS Growth (5-yr) | 11.1% |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | 1666.8% |
| Return on Assets | 13.7% |
| ROIC, with goodwill | 28.2% |
| ROIC, without goodwill | 58.1% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 3,290 |
| Net Debt | 1,133 |
| Total Debt/EBITDA | 2.2 |
| Net Debt/EBITDA | 0.8 |
| EBITDA/Interest | 8.7 |
| Current Ratio | 1.4 |
| Quick Ratio | 0.6 |

NMF = Not Meaningful

### Investment Highlights

Western Union scores fairly well on our Business Quality matrix. The firm has posted solid returns on invested capital with relatively manageable financial risk. Overall, we think Western Union's historical economic returns are nothing to sneeze at, and its risk profile appears reasonable.

• Western Union'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.

• Western Union 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 17.7% in coming years. Total debt-to-EBITDA was 2.2 last year, while debt-to-book capitalization stood at 85%.

• The firm's shares have underperformed the market benchmark during the past quarter. Although Western Union'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.

• The firm experienced a revenue CAGR of about 2% during the past 3 years. We expect its revenue growth to be below that of its peer median during the next five years.

### 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 | 16.00 |

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 |
|---|---|---|---|
| Bottomline Tech | 21.1 | NMF | 91.4% |
| Fiserv | 12.6 | 1.5 | 92.3% |
| Mastercard | 19.7 | 2.1 | 107.6% |
| Visa | 16.1 | 1.7 | 75.5% |
| Peer Median | 17.9 | 1.7 | 91.9% |
| **Western Union** | **10.9** | **1.1** | **72.1%** |

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

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Dec-09 | Dec-10 | Dec-11 |
| Revenue | 5,084 | 5,193 | 5,478 |
| Revenue, YoY% | -3.8% | 2.1% | 5.5% |
| Operating Income | 1,283 | 1,300 | 1,495 |
| Operating Margin % | 25.2% | 25.0% | 27.3% |
| Net Income | 849 | 910 | 1,012 |
| Net Income Margin % | 16.7% | 17.5% | 18.5% |
| Diluted EPS | 1.21 | 1.36 | 1.59 |
| Diluted EPS, YoY % | -2.7% | 12.3% | 16.6% |
| Free Cash Flow (CFO-capex) | 1,147 | 916 | 1,006 |
| Free Cash Flow Margin % | 22.6% | 17.6% | 18.4% |

In Millions of USD (except for per share items)

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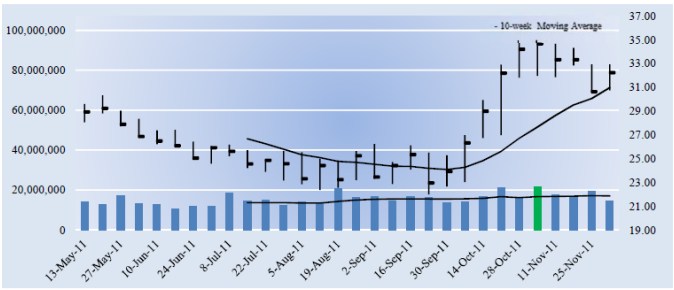
## Synaptics SYNA UNDERVALUED 5.6%

Buying Index™ 9 | Value Rating ✓

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $32.21 | $42.00 | $34.00 - $50.00 | SMALL-CAP VALUE | Information Technology | Computers & Peripherals |

**Synaptics hits the trifecta. The firm receives the highest marks for business quality, valuation, and near-term relative price strength. We'd look for an entry point.**

### Stock Chart (weekly)




The week with the highest trading volume out of the last 13 weeks was a week of heavy buying, or accumulation (green bar).

### Company Vitals

| | |
|---|---|
| Market Cap (USD) | $1,142 |
| Avg Weekly Vol (30 wks) | 15,379 |
| 30-week Range (USD) | 21.97 - 34.94 |
| Valuentum Sector | Information Technology |
| 5-week Return | -3.7% |
| 13-week Return | 39.9% |
| 30-week Return | 13.7% |
| Dividend Yield % | 0.0% |
| Dividends per Share | 0.00 |
| Forward Dividend Payout Ratio | 0.0% |
| Est. Normal Diluted EPS | 2.91 |
| P/E on Est. Normal Diluted EPS | 11.1 |
| Est. Normal EBITDA | 132 |
| Forward EV/EBITDA | 7.9 |
| EV/Est. Normal EBITDA | 6.8 |
| Forward Revenue Growth (5-yr) | 4.5% |
| Forward EPS Growth (5-yr) | 11.3% |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | 24.5% |
| Return on Assets | 14.7% |
| ROIC, with goodwill | 153.3% |
| ROIC, without goodwill | 158.5% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 2 |
| Net Debt | -245 |
| Total Debt/EBITDA | 0.0 |
| Net Debt/EBITDA | NMF |
| EBITDA/Interest | Excellent |
| Current Ratio | 4.0 |
| Quick Ratio | 3.7 |

NMF = Not Meaningful

### Investment Highlights

• Synaptics'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.

• Synaptics has an excellent combination of strong free cash flow generation and low financial leverage. We expect the firm's free cash flow margin to average about 16.3% in coming years. Total debt-to-EBITDA was 0 last year, while debt-to-book capitalization stood at 0.7%.

• 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.

• The firm experienced a free cash flow CAGR of about 15.8% during the past 3 years. We expect its free cash flow growth to be better than its peer median during the next five years.

### Investment Considerations

| | |
|---|---|
| DCF Valuation | UNDERVALUED |
| Relative Valuation | ATTRACTIVE |
| ValueCreation™ | EXCELLENT |
| ValueRisk™ | LOW |
| 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 | 31.00 |

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 |
|---|---|---|---|
| EMC Corp | 15.5 | 1.8 | 101.1% |
| NetApp | 15.1 | 2.1 | 76.1% |
| SanDisk | 10.9 | NMF | 78.6% |
| Western Digital | 16.4 | 0.4 | 98.3% |
| Peer Median | 15.3 | 1.8 | 88.4% |
| **Synaptics** | **12.8** | **1.6** | **76.7%** |

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

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Jun-10 | Jun-11 | Jun-12 |
| Revenue | 515 | 599 | 581 |
| Revenue, YoY% | 8.8% | 16.2% | -3.0% |
| Operating Income | 62 | 73 | 103 |
| Operating Margin % | 12.1% | 12.1% | 17.8% |
| Net Income | 53 | 64 | 89 |
| Net Income Margin % | 10.3% | 10.7% | 15.4% |
| Diluted EPS | 1.50 | 1.80 | 2.51 |
| Diluted EPS, YoY % | -2.1% | 20.3% | 39.8% |
| Free Cash Flow (CFO-capex) | 105 | 78 | 99 |
| Free Cash Flow Margin % | 20.4% | 13.1% | 17.0% |

In Millions of USD (except for per share items)

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Valuentum Retail Equity Research | Visit us at www.valuentum.com | (10=best) | Data as of 2-Dec-2011

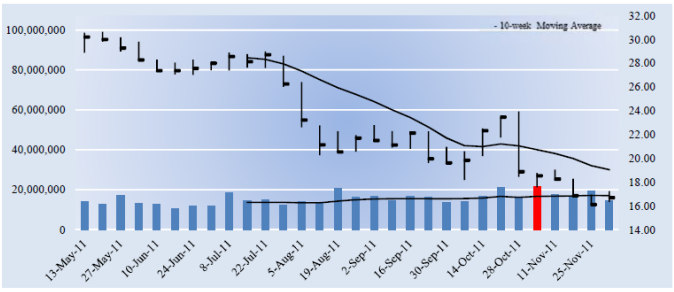
## Avon Products AVP UNDERVALUED 20%

Buying Index™ 6 | Value Rating ✓

| Last Close | Estimated Fair Value | Fair Value Range | Investment Style | Sector | Industry |
|---|---|---|---|---|---|
| $16.67 | $26.00 | $20.00 - $33.00 | MID-CAP VALUE | Consumer Discretionary | Luxury Goods |

**Avon Products 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).

### Company Vitals

| | |
|---|---|
| Market Cap (USD) | $7,191 |
| Avg Weekly Vol (30 wks) | 15,379 |
| 30-week Range (USD) | 16.09 - 30.63 |
| Valuentum Sector | Consumer Discretionary |
| 5-week Return | -10.2% |
| 13-week Return | -20.1% |
| 30-week Return | -42.7% |
| Dividend Yield % | 5.5% |
| Dividends per Share | 0.92 |
| Forward Dividend Payout Ratio | 51.2% |
| Est. Normal Diluted EPS | 1.84 |
| P/E on Est. Normal Diluted EPS | 9.0 |
| Est. Normal EBITDA | 1,497 |
| Forward EV/EBITDA | 6.4 |
| EV/Est. Normal EBITDA | 6.2 |
| Forward Revenue Growth (5-yr) | 2.2% |
| Forward EPS Growth (5-yr) | 6.2% |

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

### Returns Summary

| | 3-year Historical Average |
|---|---|
| Return on Equity | 77.2% |
| Return on Assets | 10.9% |
| ROIC, with goodwill | 41.2% |
| ROIC, without goodwill | 45.5% |

ROIC = Return on Invested Capital; NMF = Not Meaningful

### Leverage, Coverage, and Liquidity

In Millions of USD

| | |
|---|---|
| Total Debt | 3,265 |
| Net Debt | 2,085 |
| Total Debt/EBITDA | 2.6 |
| Net Debt/EBITDA | 1.6 |
| EBITDA/Interest | 14.6 |
| Current Ratio | 1.4 |
| Quick Ratio | 0.7 |

NMF = Not Meaningful

### Investment Highlights

• Avon Products 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 45.5% during the past three years.

• Avon Products'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.

• Avon Products'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 firm's shares have underperformed the market benchmark during the past quarter. Although Avon Products'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.

• The firm sports a very nice dividend yield of 5.5%. We expect the firm to pay out about 51% of next year's earnings to shareholders as dividends.

### Investment Considerations

| | |
|---|---|
| DCF Valuation | UNDERVALUED |
| Relative Valuation | ATTRACTIVE |
| ValueCreation™ | EXCELLENT |
| ValueRisk™ | MEDIUM |
| ValueTrend™ | NEGATIVE |
| Cash Flow Generation | MEDIUM |
| Financial Leverage | MEDIUM |
| Growth | MODEST |
| Technical Evaluation | BEARISH |
| Relative Strength | WEAK |
| Money Flow Index (MFI) | NEUTRAL |
| Upside/Downside Volume (U/D) | IMPROVING |
| Near-term Technical Resistance, 10-wk MA | 19.00 |

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 |
|---|---|---|---|
| Coach | 17.9 | 1.8 | 111.1% |
| Estee Lauder | 25.4 | 3.3 | 133.4% |
| NIKE | 19.1 | 2.4 | 99.2% |
| VF Corp | 16.7 | 1.8 | 106.6% |
| Peer Median | 18.5 | 2.1 | 108.8% |
| **Avon Products** | **9.3** | **1.9** | **64.1%** |

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

### Financial Summary

| | ----- Actual ----- | | Projected |
|---|---|---|---|
| Fiscal Year End: | Dec-09 | Dec-10 | Dec-11 |
| Revenue | 10,383 | 10,863 | 11,406 |
| Revenue, YoY% | -2.9% | 4.6% | 5.0% |
| Operating Income | 1,018 | 1,073 | 1,240 |
| Operating Margin % | 9.8% | 9.9% | 10.9% |
| Net Income | 626 | 592 | 781 |
| Net Income Margin % | 6.0% | 5.5% | 6.8% |
| Diluted EPS | 1.46 | 1.37 | 1.80 |
| Diluted EPS, YoY % | -28.3% | -6.0% | 30.9% |
| Free Cash Flow (CFO-capex) | 485 | 357 | 863 |
| Free Cash Flow Margin % | 4.7% | 3.3% | 7.6% |

In Millions of USD (except for per share items)

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# Our Methodology – The Valuentum Buying Index

*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, 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. 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.

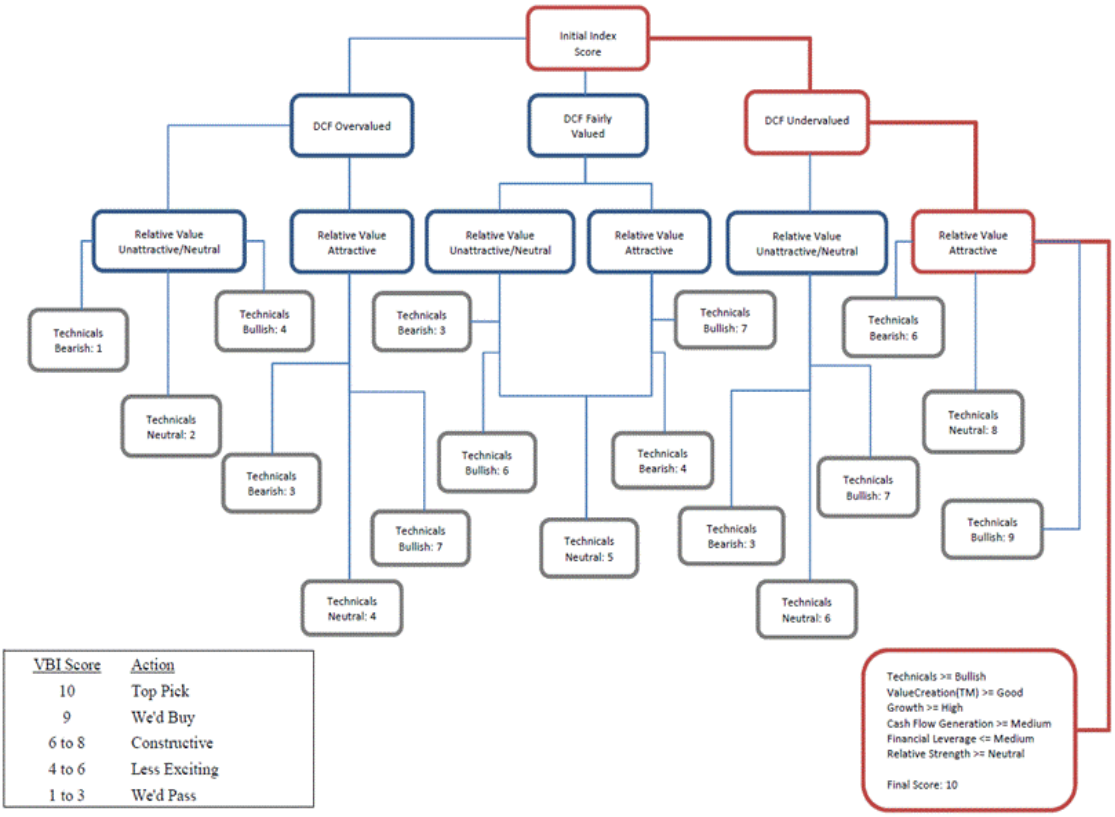
Let's discuss how a firm can score a 10, the best mark on our index (a "Top Pick"). First, the company would need to be 'undervalued' on a DCF basis and 'attractive' on a relative 'value basis. The stock would also have to be exhibiting 'bullish' technicals. The firm would need a ValueCreation rating 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 sell"). 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.

Please view the flow chart on the next page regarding our Valuentum Buying Index.

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

# Our Methodology – The Valuentum Buying Index




| VBI Score | Action |
|---|---|
| 10 | Top Pick |
| 9 | We'd Buy |
| 6 to 8 | Constructive |
| 4 to 6 | Less Exciting |
| 1 to 3 | We'd Pass |

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Valuentum Best Ideas Newsletter: Volume 1, Issue 6

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No warranty is made regarding the accuracy of any data or any opinions. The portfolio in the Valuentum Best Ideas Newsletter is hypothetical and does not represent real money. Performance assessment of the Valuentum Buying Index™ is currently ongoing, and we intend to update investors as soon as such results are available. Past performance is not a guarantee of future results.

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# Analysis: The Best Ideas Portfolio

*The Best Ideas Newsletter portfolio is one of the most followed newsletter portfolios among our membership. In the spirit of transparency, let's examine the portfolio's returns from a variety of different perspectives.*

## Internal Assessment

Cumulative Relative Performance: B+

Adjusted "Fully-Invested" Cumulative Relative Performance: A

The Performance of Each Individual Idea: A

Annual Performance and Risk Metrics: B

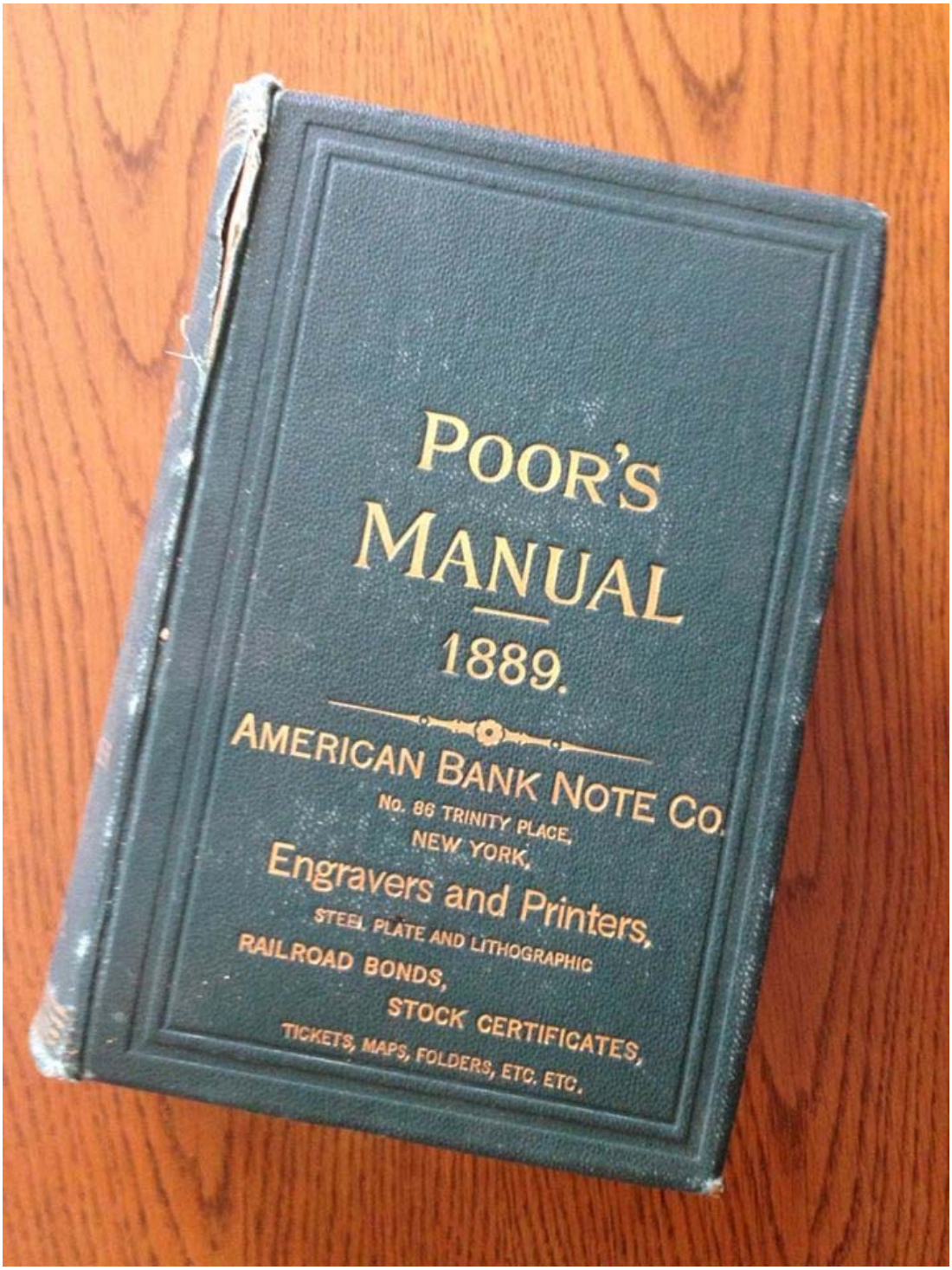

**VALUENTUM SECURITIES**

April 16, 2015

Authored by:
Brian Nelson, CFA

# Analysis: The Best Ideas Portfolio

**The Best Ideas Newsletter portfolio is one of the most followed newsletter portfolios among our membership. In the spirit of transparency, let's examine the portfolio's returns from a variety of different perspectives.**



## Understanding Returns

Stock market research may be as old as the stock market itself, but modern-day historians point to Henry Varnum Poor, born in 1812, as perhaps the true pioneer behind what has commonly become known as equity analysis. Henry Poor founded H.W. Poor Co., which grew out of his 1849 purchase of the *American Railroad Journal*, and the publishing firm he built merged in 1941 with Standard Statistics to become what we know now as Standard & Poor's, or S&P.

In the context of history, even some of the relatively modern research outfits founded in the 1970s, 1980s, and 1990s, or this century can be considered "new" to the game and unproven. Entrepreneurs that paved new ground in the latter part of last century can point to Henry Poor as the true revolutionary behind the creation of this industry. One of Mr. Poor's early manuals of railroad analysis is pictured on the previous page.

Why did we bring up such a history? Well, to a large extent, investors are infatuated with historical returns and track records, both over the near term and over the long term (and everything between). One might say that even a 20-year track record is not long enough – after all, investors are investing for 40, 50, 60 years or longer. From our perspective, it's very difficult to pass judgement on any portfolio manager or stock research firm, especially if for example, the portfolio manager or stock research firm hasn't been in the game as long as others.

Case in point, we wouldn't ding mutual fund company, Morningstar, because it doesn't have a track record during the oil crisis in the 1970s, nor would we say Warren Buffett is an amateur because we don't have his documented and independently-audited performance from the 1930s, following the Great Depression. Mr. Buffett would have been a toddler at that time. Investors should also be aware of the fine print that's on the disclaimer of every investable instrument out there: past results are *not* indicative of future performance. Still, the infatuation with the past continues.

Instead of concerning ourselves with what returns might have been in the 1970s or during the Great Depression, what we think is more important is portfolio transparency, and evaluating portfolios from a variety of different perspectives in order to understand the strengths and weaknesses of both a methodology and the portfolio management team. There is no perfect measurement yardstick, and even annual measurement periods are somewhat arbitrary.

For one, it often takes a number of years for stocks to converge to intrinsic value (or for a thesis to "work out"), and outperformance can be incredibly lumpy at times. Even the Oracle of Omaha, arguably considered one of the best investors in history, had many a year where he trailed the S&P 500. For example, after exceeding the broad market return in 1965, his first reporting year at Berkshire

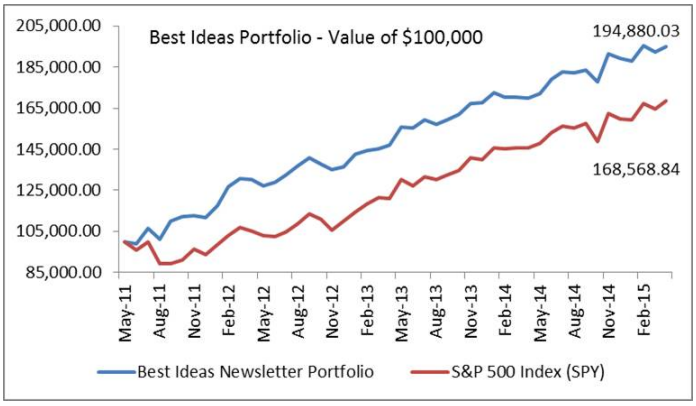
Hathaway, and 1966 in an up-market and down-market, respectively, he trailed the S&P 500 by more than 17 percentage points in 1967 before having a great year in 1968 and 1969, only to fall behind the market yet again in 1970. Out of the first 6 years, he trailed 33% of the time. In 1974, Berkshire Hathaway lost *almost half of its value*![1] That's an incredible amount of volatility for a portfolio manager considered to be among the best in history, no?

In this particular thought piece, let's evaluate Valuentum's Best Ideas Newsletter portfolio from a variety of perspectives with the primary goal of providing as much transparency to our readership as possible. This paper, however, is not a marketing instrument and should not be construed as such. For each parameter, we will offer our own self-assessment and grade ourselves on a simple scale (A = excellent; F = very poor).

- The raw cumulative relative performance
- The adjusted "fully-invested" cumulative relative performance
- The performance of each individual idea in the portfolio
- The annual performance and risk metrics

Please be sure to let us know of the grades you assign to each parameter as well. We always appreciate your feedback!

## Background: Valuentum's Best Ideas Portfolio




The Best Ideas Newsletter portfolio can be considered Valuentum's flagship product, in the spirit of Mr. Poor's *American Railroad Journal*. Founded in 2011, Valuentum now provides research and analysis on thousands of stocks, dividends, and ETFs, and publishes a variety of publications including the Ideas100 and the Dividend100, among other periodicals and data screeners. The firm adds new features to the website every day.

One particular goal of the Best Ideas Newsletter portfolio is to generate a positive return each year and to exceed the performance of a broad market benchmark. We

[1] http://www.berkshirehathaway.com/2014ar/2014ar.pdf

may or may not be successful in achieving these goals. The Best Ideas portfolio seeks to find firms that have good value and good momentum characteristics and typically holds each idea from a Valuentum Buying Index rating of a 9 or 10 (consider buying) to a rating of a 1 or 2 (consider selling). An explanation of the Valuentum Buying Index and how it is used within the Best Ideas Newsletter portfolio is beyond the scope of this paper. However, this information can be found within each edition of the Best Ideas Newsletter and in several places on www.valuentum.com[2].

The Best Ideas Newsletter portfolio is unfunded and *not* an investable portfolio, meaning that the returns of the portfolio cannot be duplicated precisely, given both timing and measurement considerations. To maintain a strict adherence to objectivity and independence, we do not plan to fund the portfolio in the future. The Best Ideas Newsletter portfolio should only be used for informational purposes, and in no way should it or any material on our website be considered a solicitation to buy or sell any security, to pursue any strategy, or to adopt any methodology.

Though our best efforts are applied at all times, Valuentum is not responsible for any errors or omissions or for the results obtained from the use of the Best Ideas Newsletter, no matter how good or how poor they are. Consistent with other financial information publishers, we accept no liability for how readers may choose to utilize the content in any of our products, including the Best Ideas Newsletter. Where appropriate, please always seek help from an experienced financial advisor that knows your individual risk tolerances and goals.

The foundation of Valuentum's Best Ideas Newsletter portfolio was formed through a publishing relationship with Seeking Alpha. Though outside the scope of this paper, a comprehensive study of Valuentum's work published on Seeking Alpha shows material outperformance across a number of time periods across a wide variety of stocks[3]. Recent case studies of the Valuentum Buying Index have also revealed significant outperformance of high VBI-rated stocks (6-10) relative to low-VBI-rated ones (1-5)[4].

Valuentum published its first article on Seeking Alpha covering the investment prospects of Ancestry.com (ACOM)[5] on May 16, 2011. Subsequent articles included targeted topics on aerospace[6]--Precision Castparts (PCP), EDAC Tech (EDAC) and Astronics (ATRO)--and airlines[7] as well as on Apple (AAPL)[8], Altria (MO)[9], Buffalo

[2] http://www.valuentum.com/articles/20110622
[3] http://www.valuentum.com/articles/20141009
[4] http://www.valuentum.com/articles/20141003_1
[5] http://seekingalpha.com/article/270120-5-reasons-to-buy-ancestry-com
[6] http://seekingalpha.com/article/273424-sorting-through-the-aerospace-supply-chain
[7] http://seekingalpha.com/article/270531-why-airline-stocks-are-not-long-term-investments; thesis for put options on FAA and AMR, July 13, 2011.
[8] http://seekingalpha.com/article/275395-apple-priced-for-significantly-slower-growth

Wild Wings (BWLD)[10], Collective Brands (PSS)[11], Republic Services (RSG)[12], Under Armour (UA)[13], and AMR[14], among other topics.

The portfolio and its returns were published in the inaugural edition of the Best Ideas Newsletter, released to members July 15, 2011. Understanding the importance of having an independently-verifiable track record at this time, the portfolio was documented on a third-party website[15], "A Look at How Our Picks Outperformed the Market."

Each subsequent change to the Best Ideas portfolio has been documented via retrievable email transaction alerts sent to members. The newsletter is published on the 15th of each month, and returns are calculated accordingly.

## Cumulative Relative Performance: B+

Please find below the performance of the Best Ideas Newsletter portfolio on a monthly basis relative to the SPDR S&P 500 ETF (SPY), a proxy for the broader market. The data spans the date of portfolio inception, or when the first position (Ancestry.com) was added to the Best Ideas Newsletter portfolio, May 17, 2011, through December, 15, 2014, the latest portfolio return data point in 2014 (the Best Ideas Newsletter is released on the 15th of each month).

### 2011

| | 5/17/2011 | 6/15/2011 | 7/13/2011 | 8/12/2011 | 9/13/2011 | 10/11/2011 | 11/11/2011 | 12/12/2011 |
|---|---|---|---|---|---|---|---|---|
| Best Ideas Newsletter Portfolio | 100,000.00 | 99,013.62 | 106,457.85 | 101,415.15 | 109,865.95 | 112,285.02 | 112,646.21 | 111,608.10 |
| S&P 500 Index (SPY) | 100,000.00 | 95,773.08 | 99,832.69 | 89,492.80 | 89,206.42 | 91,154.57 | 96,399.88 | 93,679.25 |
| Outperformance | 0.00 | 3,240.54 | 6,625.16 | 11,922.35 | 20,659.53 | 21,130.45 | 16,246.33 | 17,928.85 |
| | | -0.99% | 7.52% | -4.74% | 8.33% | 2.20% | 0.32% | -0.92% |
| | | -4.23% | 4.24% | -10.36% | -0.32% | 2.18% | 5.75% | -2.82% |
| Long Percentage (%) | 10.0 | 49.7 | 90.9 | 86.8 | 83.7 | 89.2 | 95.0 | 94.5 |
| Cash & Short Percentage (%) | 90.0 | 50.3 | 9.1 | 13.2 | 16.3 | 10.8 | 5.0 | 5.5 |

### 2012

| | 1/13/2012 | 2/12/2012 | 3/14/2012 | 4/13/2012 | 5/14/2012 | 6/15/2012 | 7/15/2012 | 8/15/2012 | 9/15/2012 | 10/15/2012 | 11/15/2012 | 12/15/2012 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Best Ideas Newsletter Portfolio | 117,311.19 | 126,944.51 | 130,603.74 | 130,093.74 | 127,128.46 | 128,735.06 | 132,379.23 | 136,873.96 | 140,652.17 | 137,758.07 | 135,141.62 | 136,542.31 |
| S&P 500 Index (SPY) | 98,623.11 | 102,783.18 | 106,965.86 | 105,341.02 | 103,057.16 | 102,575.18 | 104,811.97 | 108,610.29 | 113,471.25 | 110,780.01 | 105,534.70 | 110,192.18 |
| Outperformance | 18,688.08 | 24,161.33 | 23,637.88 | 24,752.72 | 24,071.30 | 26,159.88 | 27,567.26 | 28,263.67 | 27,180.92 | 26,978.06 | 29,606.92 | 26,350.13 |
| | 5.11% | 8.21% | 2.88% | -0.39% | -2.28% | 1.26% | 2.83% | 3.40% | 2.76% | -2.06% | -1.90% | 1.04% |
| | 5.28% | 4.22% | 4.07% | -1.52% | -2.17% | -0.47% | 2.18% | 3.62% | 4.48% | -2.37% | -4.73% | 4.41% |
| Long Percentage (%) | 86.4 | 82.8 | 83.3 | 83.2 | 68.3 | 82.9 | 83.3 | 73.8 | 74.3 | 73.7 | 69.7 | 70.0 |
| Cash & Short Percentage (%) | 13.6 | 17.2 | 16.7 | 16.8 | 31.7 | 17.1 | 16.7 | 26.2 | 25.7 | 26.3 | 30.3 | 30.0 |

[9] http://seekingalpha.com/article/276799-altria-looks-attractive-boasts-strong-yield
[10] http://seekingalpha.com/article/271459-sizing-up-the-long-term-growth-potential-for-buffalo-wild-wings; added BWLD on July 13, 2011.
[11] http://seekingalpha.com/article/278772-collective-brands-turnaround-candidate-not-value-trap
[12] http://seekingalpha.com/article/270758-republic-services-a-trash-stock-worth-picking-up
[13] http://seekingalpha.com/article/277905-under-armour-solid-company-but-shares-are-significantly-overvalued; thesis for put options, July 13, 2011.
[14] http://seekingalpha.com/article/270933-is-amrs-equity-practically-worthless
[15] http://seekingalpha.com/article/279686-a-look-at-how-our-picks-outperformed-the-market

## 2013

| | 1/15/2013 | 2/15/2013 | 3/15/2013 | 4/15/2013 | 5/15/2013 | 6/15/2013 | 7/15/2013 | 8/15/2013 | 9/15/2013 | 10/15/2013 | 11/15/2013 | 12/15/2013 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Best Ideas Newsletter Portfolio | 142,531.57 | 144,286.31 | 145,325.55 | 146,855.48 | 155,929.07 | 155,361.69 | 159,472.41 | 157,198.99 | 159,465.60 | 162,154.18 | 167,122.01 | 167,606.69 |
| S&P 500 Index (SPY) | 114,625.07 | 118,498.76 | 121,339.97 | 120,804.88 | 130,190.67 | 127,364.53 | 131,742.41 | 130,408.47 | 132,631.70 | 134,476.60 | 140,754.39 | 139,880.17 |
| Outperformance | 27,906.50 | 25,787.55 | 23,985.58 | 26,050.60 | 25,738.40 | 27,997.16 | 27,730.00 | 26,790.52 | 26,833.90 | 27,677.58 | 26,367.62 | 27,726.52 |
| | 4.39% | 1.23% | 0.72% | 1.05% | 6.18% | -0.36% | 2.65% | -1.43% | 1.44% | 1.69% | 3.06% | 0.29% |
| | 4.02% | 3.38% | 2.40% | -0.44% | 7.77% | -2.17% | 3.44% | -1.01% | 1.70% | 1.39% | 4.67% | -0.62% |
| Long Percentage (%) | 71.1 | 71.4 | 71.5 | 65.7 | 67.6 | 59.9 | 61.1 | 68.5 | 69.0 | 68.2 | 74.4 | 74.4 |
| Cash & Short Percentage (%) | 28.9 | 28.6 | 28.5 | 34.3 | 32.4 | 40.1 | 38.9 | 31.5 | 31.0 | 31.8 | 25.6 | 25.6 |

## 2014

| | 1/15/2014 | 2/15/2014 | 3/15/2014 | 4/15/2014 | 5/15/2014 | 6/15/2014 | 7/15/2014 | 8/15/2014 | 9/15/2014 | 10/15/2014 | 11/15/2014 | 12/15/2014 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Best Ideas Newsletter Portfolio | 172,380.59 | 170,288.27 | 170,496.07 | 169,997.47 | 172,044.17 | 179,056.20 | 182,719.00 | 181,963.20 | 183,484.41 | 177,981.72 | 191,284.26 | 189,283.20 |
| S&P 500 Index (SPY) | 145,555.05 | 145,072.73 | 145,555.05 | 145,830.13 | 147,782.05 | 153,313.74 | 156,356.17 | 155,218.18 | 157,599.67 | 148,924.56 | 162,346.82 | 159,874.90 |
| Outperformance | 26,825.54 | 25,215.54 | 24,941.02 | 24,167.34 | 24,262.12 | 25,742.46 | 26,362.83 | 26,745.02 | 25,884.74 | 29,057.16 | 28,937.44 | 29,408.30 |
| | 2.85% | -1.21% | 0.12% | -0.29% | 1.20% | 4.08% | 2.05% | -0.41% | 0.84% | -3.00% | 7.47% | -1.05% |
| | 4.06% | -0.33% | 0.33% | 0.19% | 1.34% | 3.74% | 1.98% | -0.73% | 1.53% | -5.50% | 9.01% | -1.52% |
| Long Percentage (%) | 75.0 | 74.5 | 74.4 | 78.7 | 77.4 | 75.6 | 76.0 | 73.3 | 73.4 | 61.2 | 69.0 | 68.7 |
| Cash & Short Percentage (%) | 25.0 | 25.5 | 25.6 | 21.3 | 22.6 | 24.4 | 24.0 | 26.7 | 26.6 | 38.8 | 31.0 | 31.3 |

The cumulative outperformance generated by the Best Ideas Newsletter portfolio relative to the SPDR S&P 500 ETF was over 29 percentage points during this measurement period. A discussion, however, is necessary to better understand why the returns of the Best Ideas Newsletter portfolio are more heavily-weighted to 2011 and 2012, rather than more recently.

From inception through the end of 2012, the Best Ideas Newsletter portfolio benefited tremendously, not only from stock selection but also from the view that the broader market valuation was attractive. Therefore, the newsletter portfolio was near fully-invested over most of this time. However, toward the end of 2012, the Best Ideas Newsletter portfolio began to increase its weighting in cash (and put options) to hedge against loftier and loftier market valuations. As it would turn out, however, 2013 and 2014 were very strong years for the equity markets, as shown in the image below.

Though we believe our conservative stance toward lofty valuations in the face of a rising interest rate environment will be well-rewarded in 2015 and 2016, the ability of the Best Ideas Newsletter portfolio to continue to distance the outperformance relative to the broad market benchmark during the strong markets of 2013 and 2014 was hindered by its material cash position (and opportunistic put option ideas, where a number of them expired worthless).

From our perspective, however, the jury is still out as to whether raising cash was the right move. Though it appears we were early in doing so, nobody could have predicted the fantastic returns of the past two years (the vast majority of fund managers underperformed during this time), and we still participated very nicely in the broad market advance, despite the hefty cash headwind. We certainly could have done better, and in this light, we're assigning a B+ for this parameter. From a cumulative standpoint, the Best Ideas Newsletter portfolio ended 2014 up ~89% relative to a ~60% advance in the benchmark.

## Adjusted "Fully-Invested" Cumulative Relative Performance: A

The decision to take a more conservative stance in the wake of ever-rising equity prices mitigated the outperformance that could have been had by the Best Ideas Newsletter portfolio during the measurement period. Though the magnitude of unadjusted outperformance remains very large by most measures, evaluating the Best Ideas Newsletter portfolio on an adjusted "fully-invested" basis may be even more informative of the underlying stock-selection ability of the methodology. Doing so, for one, would correct for the asset allocation "miscue" (the decision to raise cash) that was created through the active-management process.

To make this adjustment, we have grossed up reported returns such that the cash coffers of the portfolio would theoretically be empty during the measurement period. With the average cash balance in the Best Ideas Newsletter portfolio during the measurement period approximating 26.6% (~29% since the beginning of 2013), grossing up cumulative performance to simulate "full" exposure to the portfolio returns would result in an estimate of cumulative relative outperformance of 50-60 percentage points during the time period measured.

Though this back-of-the-envelope calculation is rough at best, we think such outperformance is more reflective of the efficacy of the Valuentum strategy as it explains away the increased cash position and put-option losses, two primary reasons why portfolio outperformance gains trailed off in 2013 and 2014. As it relates to funds with mandates to be fully-invested, we think this "fully-invested" adjustment to the performance of the Best Ideas Newsletter portfolio also allows for a better apples-to-apples comparison, as increased flexibility in the newsletter portfolio actually mitigated outperformance during the past two years. We continue to believe flexibility is important in managing overall portfolio risk, however.

On a "fully-invested" basis, even if the Best Ideas Newsletter portfolio's cash were deployed within the SPDR S&P 500 ETF itself (and did not mirror the portfolio's returns), annual performance would have experienced a very nice boost relative to reported results during the strong years of 2013 and 2014. Such a tactical move to "position for the future" is simply difficult to portray in the context of historical comparisons, and the large cash position may come in handy during 2015 and 2016.

All things considered, we think assigning an A for this parameter is appropriate.

## The Performance of Each Individual Idea: A

| Longs | First Purchase | Incremental Purchase | Incremental Purchase | Last Sale | Last Price | Return from First Purchase |
|---|---|---|---|---|---|---|
| Alibaba | 92.70 | 93.20 | | | NEW | NMF |
| Altria | 26.43 | 36.25 | | | 52.05 | 96.9% |
| Ancestry.com | 39.00 | 21.60 | | 31.54 | | -19.1% |
| Apple | 47.00 | 63.17 | | | 126.17 | 168.5% |
| Astronics | 24.93 | | | 39.19 | | 57.2% |
| Baidu | 133.60 | | | 221.49 | | 65.8% |
| Buffalo Wild Wings | 65.42 | | | 136.05 | | 108.0% |
| Cisco | 26.15 | | | | NEW | NMF |
| Collective Brands | 15.09 | | | 20.80 | | 37.8% |
| DirecTV | 55.02 | | | 84.15 | | 52.9% |
| eBay | 29.13 | 32.80 | | | 57.04 | 95.8% |
| EDAC Tech | 4.08 | | | 17.75 | | 335.0% |
| Financial Select SPDR | 13.46 | | | | 24.46 | 81.7% |
| Ford | 9.94 | 11.53 | 10.33 | 14.82 | | 49.1% |
| General Electric | 26.18 | 25.25 | | | 27.28 | 4.2% |
| Gilead Sciences | 107.89 | 105.62 | | | NEW | NMF |
| Google | 341.75 | 596.48 | | | 533.8 | 56.2% |
| Health Care ETF | 36.60 | | | | 73.93 | 102.0% |
| Intel | 19.89 | 21.67 | | | 32.87 | 65.3% |
| Intuitive Surgical | 532.13 | 382.97 | | 365.87 | | -31.2% |
| Precision Castparts | 152.07 | | | 238.02 | | 56.5% |
| Priceline | 1248.97 | | | | NEW | NMF |
| Republic Services | 32.95 | 26.65 | | | 40.17 | 21.9% |
| Rio Tinto | 46.40 | | | | 42.45 | -8.5% |
| SPDR S&P Bank ETF | 21.07 | | | | 34.16 | 62.1% |
| Teva Pharma | 41.22 | | | | 63.49 | 54.0% |
| Union Pacific | 79.67 | | | | 108.35 | 36.0% |
| Utilities Select SPDR | 41.12 | | | | 44.26 | 7.6% |
| Visa | 23.95 | 29.78 | | | 65.65 | 174.2% |

The table above includes companies that, at one time, have been held in the Best Ideas Newsletter portfolio, including current holdings. The table shows the initial

purchase price of a company and the price of any incremental additions to its position, as well as the last sale price or the last closing price of the firm, as of the date of this writing. The right column shows the performance of each holding from its first purchase price to the last sale price or last closing price of the firm, whichever is relevant. The return measure does not include dividends received, which is considerable for some and a conservative way to present the data.

Out of the 25 holdings that we consider relevant to this analysis, 22 of them generated a positive return. Alibaba (BABA), Cisco (CSCO), Gilead (GILD), and Priceline (PCLN) are too recent of additions to the newsletter portfolio to be included in such analysis. Out of the three positions that did not generate a positive return, Ancestry.com (ACOM) and Intuitive Surgical (ISRG) are no longer included in the portfolio (however, through dollar-cost averaging, roughly break-even was achieved with the former). Rio Tinto (RIO) remains a holding in the Best Ideas Newsletter portfolio, and all things considered, has fared relatively well in the context of collapsing iron ore prices.

Warren Buffett's quote rings true here: "Rule No. 1: Never lose money. Rule No. 2: Never forget rule No. 1." With nearly all of the ideas in the Best Ideas Newsletter portfolio having generated a positive return and the vast majority of returns exceeding that of the broad market over their respective holding periods, we don't think an A is out of the question for this parameter. The next update of this report will compare each position to the return of the broader market over the corresponding holding period.

The mapping of option activity in the portfolio is shown below[16] and reveals the instances where outperformance was eroded away through tactical decisions. Within the context of the portfolio of the Best Ideas Newsletter, the vast majority of the option activity should be viewed as the execution of a hedging strategy. Options have not been a core driver behind the portfolio's overall returns, and we don't expect this to change in the future.

| Puts | First Purchase | Last Sale |
|---|---|---|
| AMR | 0.73 | 1.56 |
| Under Armour | 9.2 | 20.6 |
| FAA | 3.7 | 7.4 |
| Chipotle | 33.7 | Expired |
| LinkedIn | 10.4 | Expired |
| Urban Outfitters | 0.95 | Expired |
| PetSmart | 1.9 | Expired |
| SPDR S&P 500 | 6.36 | Expired |
| Facebook | 1.9 | Expired |
| SPDR S&P 500 | 2.95 | 5.43 |

[16] Facebook was entered as a call position.

## The Annual Performance and Risk Metrics

The Best Ideas Newsletter is released on the 15th of each month, so calendar year comparisons are not apples-to-apples. The annual performance is shown below, with 2011 results representing the time period (5/17/2011-12/12/2011), for example, and each subsequent year representing the time period (12/12/2011-12/15/2012), for example.

The performance of the Best Ideas Newsletter includes dividends received but not the return generated on the cash balance (which may be material), while the benchmark ETF return includes dividends but not the reinvestment of them. On the basis of its existing cash balance, which posed an unfortunate headwind in 2013 and 2014, we would expect the Best Ideas Newsletter portfolio to demonstrate significant relative outperformance in the face of any market weakness.

| | Annual % Change | |
|---|---|---|
| Year | BIP | S&P 500 |
| 2011 | 11.6 | -6.3 |
| 2012 | 22.3 | 17.6 |
| 2013 | 22.8 | 26.9 |
| 2014 | 12.9 | 14.3 |

The Best Ideas Newsletter portfolio has fared considerably well following the excess outperformance in 2011 and 2012 and hefty cash headwind in 2013 and 2014. Grossing up annualized returns to simulate a “fully-invested” portfolio showcases the recurring yearly outperformance potential of the Valuentum strategy. Under a scenario where a “fully-invested” strategy had been pursued in 2013 and 2014, relative outperformance would have been achieved.

Furthermore, the strong and steady performance of portfolio constituents coupled with a more conservative cash position has resulted in a significantly less volatile portfolio. From inception through the last newsletter of 2014, the monthly standard deviation of the Best Ideas Newsletter portfolio was 70 basis points less than that of the SPDR S&P 500, while the average monthly rate of return was nearly 40 basis points more.

Said differently, the Best Ideas Newsletter portfolio packs significantly more return per unit of risk. In this light, we’d be hard-pressed to give the portfolio anything less than a B on this parameter. Future updates to this report will include a reconciliation of the portfolio’s reported returns to calendar year results.

If you have any questions regarding this analysis, or if you’d like to learn more, please contact us at info@valuentum.com.

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