

## Applied Investment Management (AIM) Program

### AIM Class of 2013 Equity Fund Reports Spring 2013

**Date:** February 8<sup>th</sup> | **Time:** 3-5 p.m. | **Location:** AIM Research Room (488)

**Join us in person, or considering joining us live at:**

Connect to the LIVE meeting via [Blackboard](#) web-based conferencing tool

Student Presenter	Company Name	Ticker	Price	Page No.
Peter Lemek	FARO Technologies	FARO	\$33.66	2
Greg Trunk	Antares Pharma	ATRS	\$3.77	5
Brent Adams	Potlatch Corporation	PCH	\$43.77	8
Heinz Schelhammer	Stone Energy Corporation	SGY	\$22.61	11
Elizabeth Buckton	PhotoMedex	PHMD	\$14.55	14
Dan Tallarico	AVG Technologies	AVG	\$13.15	17

These student presentations are an important element of the applied learning experience in the AIM program. The students conduct fundamental equity research and present their recommendations in written and oral format – with the goal of adding their stock to the AIM Equity Fund. Your comments and advice add considerably to their educational experience and is greatly appreciated. Each student will spend about 5-7 minutes presenting their formal recommendation, which is then followed by about 8-10 minutes of Q & A.

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## FARO Technologies (FARO)

February 8, 2013

Peter Lemek

Information Technology

*FARO Technologies (NASDAQ: FARO) designs, develops, manufactures, and supports portable, software driven, 3-D measurement and imaging systems used in a broad range of manufacturing, industrial, building construction, and forensic applications. FARO's measuring devices and their computer-aided manufacturing measurement (CAM2) software systems provide for CAD-based inspection, surveying, and other applications to enhance product quality, improve productivity, and decrease scrap in the manufacturing process. In FY2011, the company derived 38% of sales from the Americas, 39% of sales from Europe/Africa, and 23% of sales from Asia/Pacific. The company currently has 15,000 customers worldwide ranging from small machine shops to large Fortune 500 companies. FARO was founded in 1982, incorporated in Lake Mary, Florida, in 1992, and has 961 employees in more than 30 countries.*

Price (\$): (2/01/2013)	33.66	Beta v. RTY:	1.34	<b>FY</b>	<b>2011A</b>	<b>2012E</b>	<b>2013E</b>
Price Target:	40.75	WACC (%):	13.68	Sales (mil)	254.164	259.875	278.5065
52 week H-L(\$)	59.66-31.10	M-Term Rev Gr Rate Est	9.07%	% Growth	32.53%	2.25%	7.17%
Market Cap (mil):	556.3	M-Term EPS Gr Rate Est	14.74%	Gross Margin(%):	56.53%	55.77%	56.00%
Float (mil):	16.7	Debt/Equity:	0	Operating Margin(%):	12.93%	11.03%	9.78%
Short Interest (%):	4.4	ROA (%):	7.9	EPS	1.39	1.42	1.27
Avg Daily Volume	173,389	ROE (%):	9.6	FCF/Share	0.25	0.83	1.52
Dividend (\$):	0	Line of Credit (mil)	\$30	P/E	24.22	23.77	26.42
Yield (%):	0			EV/EBITDA	15.89	14.86	15.63

### Recommendation

FARO has been profitable every quarter since 2009, and it has been growing at roughly 30% over the past three years. Overall, 2012 sales were slower than expected due to a still depressed macroeconomic environment for their customers. Management estimates that only 5% of the current market for FARO and their main competitor Hexagon's products has been penetrated. FARO has a favorable, diversified customer base with its top 10 customers representing 5.9% of sales, and the company has an estimated 30,000 product installations with their existing customers. Larger customers, such as Airbus, will have up to 70 products in their plants, whereas many companies the firm sells to are only on their first or second product leaving quite a significant amount of room to grow among a growing base of existing customers. With over 158 patents worldwide and 22 registered or pending trademarks in the US, FARO is one of the most innovative companies in the sector, and it continues to file new patents every month. During a tough CY2012, FARO has still managed to add 2,000 new customers to its base. Despite the company losing 43.37% in market value over the past year due to missed earnings in FY12Q2 and FY12Q3 and a management shake-up in the Americas, fundamentals have stayed in place in the company and interest in products has remained very strong. It is recommended that FARO be added to the domestic equity portfolio at a price target of \$40.75, an appreciation of 21.06%. The company pays no dividend.

### Investment Thesis

- Changing Market Segments.** FARO is currently the leader in emerging markets for CAM2 tools. The company is continuing to change its geographic end market mix to further emphasize emerging markets in Asia and the Americas. Since FY 2009, sales in the Americas and Asia grew by 20.97% and 34.87% CAGR respectively. The company's share prices have trended downward with Chinese production numbers over the past year, but recent manufacturing data bodes well for the company as HSBC released a PMI of 52.3 for January in China which is a two year high. Also, the ISM just released a PMI of 53.1 in January for the U.S. displaying significant expanding activity.
- Increase in Corporate IT Spending.** According to Gartner, IT spending is expected to increase 3.8% from 2012 to \$3.7 trillion. This spending is expected to continue to grow to surpass \$4

trillion by 2015. Gartner also predicts that the business process services market will double in size to \$145 billion from 2011 to 2016. In 2012, FARO did not see any deals lost due to budget freezing, but the company sales from new customers drop to 35% from 43% in y/y sales for FY12Q3. With IT spending loosening in the coming quarters, FARO's sales mix should return towards the historical mix of 50/50 sales to new vs. existing customers. Gross margins, decreased due to pricing discounts to obtain new customers, should return to the normal 56-60% range once these purchasing pressures are relaxed for IT departments across corporations, and FARO will be able to sell their products at normalized prices.

### **Valuation**

To find the intrinsic value of FARO, a five-year DCF model was constructed. Sales growth rates were varied across the company's three reportable geographic regions according to management and macroeconomic outlooks. The firm's current WACC of 13.68% was given a 100 bps premium due to uncertainty in economic outlook and future foreign exchange rates. This discount rate of 14.68% was used along with a perpetuity growth rate of 2% to arrive at a value of \$55.39. A sensitivity analysis was conducted varying the discount rate and the terminal growth rate resulting in a High – Low range of \$72.38 - \$30.60. Along with the DCF, an industry average EV/EBITDA 18.79X was determined and used to return a value \$26.12. Using a weighted 50/50 mix of DCF to EV/EBITDA approach yielded an intrinsic value of \$40.75, an upside of 21% with no dividend paid.

### **Risks**

- **Adverse Macro-Economic Conditions.** Company sales are highly dependent on the overall macro-economy. The company finds it quite difficult to book new customers in tougher economic times therefore forcing the company to discount prices in order to attain an additional customer base. In the aftermath of the financial crises, the company declined 29% in overall sales and 175% in net income. FARO has shown missed earnings in the previous three quarters during a soft 2012 economic environment and further poor conditions would continue to tighten client budgets and negatively affect FARO's sales.
- **Competition.** Several of the company's product lines are highly competitive with other firms. The company particularly competes with Hexagon, a Swedish company with larger financial resources than FARO. If FARO's R&D doesn't continue to keep up with technological innovation in the laser measurement market, the company's product lines are not diversified enough to cover losses from these technological lags.
- **Adverse Acquisitions.** Company management has discussed the possibility of searching for acquisition targets in the future. The company has a significant amount of cash and cash equivalents on hand, \$145 million, and access to another \$30 million through a credit facility. FARO is well positioned to acquire another company, but they have not done so since 2005. Obviously, a poor acquisition choice and integration, particularly in a soft economic environment, could be detrimental to the firm.

### **Management**

Mr. Jay Freeland has served as President and CEO of FARO since December, 2006. Mr. Freeland was previously COO in the company starting in 2004, and he received his BA in Economics from Union College. Mr. Freeland currently is heading the Managing Director for the Americas position after the January 4, 2013, termination of Mr. David Morse. There is no time table as to when a new Managing Director will be hired. Mr. Keith Bair has been the company's Senior VP and CFO since 2006, and he has an MBA in Accounting from Lehigh University.



### Ownership

% of Shares held by All Insider and 5% Owners:	1.63%
% of Shares Held by Institutional & Mutual Fund Owners:	93.38%

Source: Bloomberg

### Top 5 Shareholders

Holder	Shares	% Outstanding
Royce & Associates	1,491,631	8.79
Blackrock	1,335,703	7.87
TCW Group Inc.	1,100,002	6.48
Vanguard Group Inc.	995,282	5.86
Ameriprise Financial Inc.	970,700	5.72

Source: Bloomberg

## Antares Pharma, Inc. (ATRS)

February 8, 2013

Greg Trunk

Healthcare

*ATRS (NASDAQ:ATRS) is a biotech company focused on the development and marketing of self-injection pharmaceutical products and technology in addition to topical gel products. ATRS products include disposable pressure-assisted auto injection systems (Vibex), disposable pen injection systems, reusable needle-free injection systems (Vision), and advanced transdermal delivery. Antares licenses its drug delivery technologies for approved and developmental stage products globally. ATRS also engages in experimental stage development of proprietary medical treatments. Revenue is comprised 62% from the US, 35% Europe, and 3% internationally. ATRS was founded in 1979 and headquartered in Ewing, NJ.*

Price (\$)	3.77	Beta:	0.99	FY: December	2011A	2012E	2013E
Price Target (\$):	5.16	WACC	10.3%	Revenue (Mil)	16.5	23.2	34.6
52WK Range (\$):	2.43-5.58	M-Term Rev. Gr Rate Est:	30.7%	% Growth	28.4%	38.2%	56.3%
Market Cap:	471.79M	M-Term EPS Gr Rate Est:	53.6%	Gross Margin	58.7%	52.2%	53.8%
Float	110.81M	Debt/Equity	0.0%	Operating Margin	-27.0%	-32.6%	-1.7%
Short Interest (%):	9.4%	ROA:	-16.0%	EPS (Cal)	-\$0.05A	-\$0.12E	-\$0.01E
Avg. Daily Vol:	754K	ROE:	-19.7%	FCF/Share	-\$0.02A	-\$0.11E	-\$0.12E
Dividend (\$):	N/A	Cash (\$):	88M	P/E (Cal)	N/A	N/A	N/A
Yield (%):	N/A						

### Recommendation

Injectable drugs are used for managing chronic medical conditions requiring repeated injections over time. The combination of patient preference for autonomy, disposal concerns, and cost considerations is fueling a shift to needle free and/or self-injection drug delivery systems. The highly fragmented market for advanced drug delivery systems is estimated at \$150B and growing at 7.2% annually. ATRS is well positioned for substantial long term earnings growth within this market driven by its already rapidly growing traditional business of licensing drug delivery systems and critical recent expansion into pharmaceutical development. ATRS is the only US based company within the market with comprehensive intellectual property covering all aspects of its proprietary Auto-Injector, Multi-dose Pen and Needle Free Injection Technology Device Platforms. Furthermore, marquee partnerships agreements with leading pharmaceutical companies such as Teva, Pfizer, Watson, and Meda provide financial support for internal pharmaceutical development. Partnership revenue has grown at 3 year CARR of 39% and is projected to grow 30-60% YoY in coming years. The worldwide market for injectable drugs including injection required biologic drugs is estimated to be \$120B and is growing at 5.8% CAGR through 2015. ATRS has committed to launching one new product per year starting in 2013, most notably for rheumatoid arthritis and testosterone replacement therapy. Though a promising business by itself; ATRS is also an attractive buyout candidate in light of its strong intellectual property, partnership agreements, lack of long term debt, and promising product pipeline at \$6-\$7 target price range.

### Investment Thesis

- Oxetrup** - Antares' first proprietary product to be launched, Oxetrup is an easy to operate, single use, once weekly, auto injector formulation of methotrexate (MTX) for rheumatoid arthritis patients. Sales of biologic and other new products to treat the 1.3M sufferers of rheumatoid arthritis are approximately \$6.0B annually. MTX is the most commonly prescribed anti-rheumatic drug, used in an estimated 70% of rheumatoid arthritis patients. Current approaches to treatment suffer from various flaws; orals (5M Rx/year) have poor bioavailability and Gastrointestinal (GI) intolerability; and syringe injectables (400K Rx/year) require administration by physicians or impracticable self-injection by hand-function impaired patients. Oxetrup will likely be the first MTX auto-injector and provides a simpler and less painful method of administration while

offering improved GI tolerability and bioavailability. Antares finished clinical trials faster than expected in 2012 and is set to file NDA sometime early 2013, leaving potential launch starting late 2013/early 2014.

- **Vibex QS T** - This product is potentially the first self-administered auto injectable testosterone product for men suffering from testosterone deficiency. US sales of testosterone replacement therapies grossed \$1.6 B in 2011, growing at 20% annually and are projected to exceed \$5B in 2017. Current testosterone replacement therapy including gels (70% market share), are prone to transference risk and insufficient absorption. Long-acting injectable testosterone replacement therapy is already gaining share with injectable Rx growing 45% YoY despite painful intramuscular injections requiring a 2 inch 20 gauge IM injections for 30-45 seconds, and fluctuating testosterone levels for 2-4 week period. The Auto-injector method avoids the transference issues present with gels. Furthermore, in clinical surveys physicians surveyed believe weekly self-injection will improve patient compliance and deliver optimized serum testosterone levels. Vibex QS T will enter the clinic in 2013, with projected mid 2015 NDA filing, and mid 2016 launch.
- **Generic Version of EpiPen** - EpiPen 2011 sales of \$323M represented over 95% of epinephrine auto injector market. Epinephrine is utilized for the treatment of severe allergic reactions. ATRS has a license agreement with Teva for supplying a generic version of Mylan's and Pfizer's EpiPen. ATRS will receive a royalty on net sales (around 10%) plus device sales. Teva is set to launch the Vibex Epi on June 22, 2015 pending court approval of legal settlement and began ordering from ATRS in 2013. Analysts estimate that the EpiPen market could grow to \$750M or more by 2015.

### Valuation

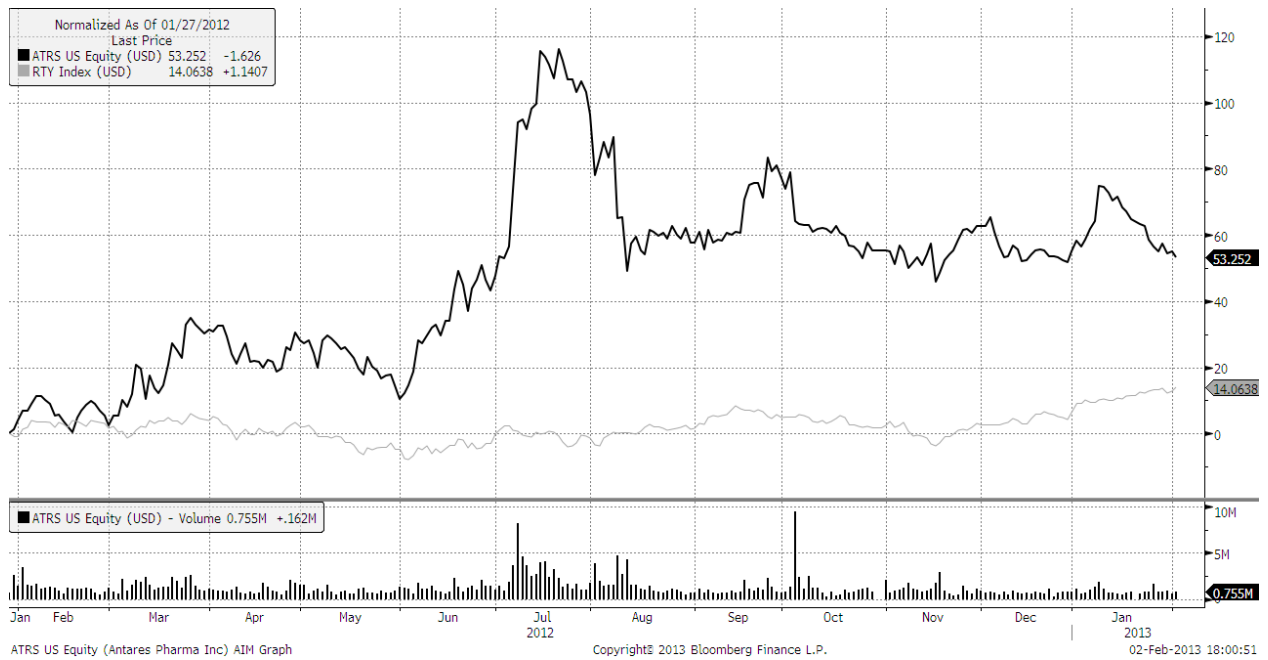
To find the intrinsic value of ATRS, a seven year DCF and market cap to cash balance approach was used. In the DCF approach a 10% WACC, 31.0% growth rate in years 3-7, and an exit multiple of 5X sales was used to find an intrinsic value of \$5.40. A sensitivity analyses was conducted on WACC and exit multiple to find valuation range of \$3.20 to \$6.80. A market capitalization to cash multiple of 6 was used based on ATRS product pipeline and comparable developmental stage biotech companies to find an estimated value of \$4.80. Based upon a 40% DCF and 60% market capitalization to cash approaches an estimated price target of \$5.04 was established, representing a 34% upside.

### Risks

- **Development** - ATRS success is heavily contingent upon approval and introduction of novel medical treatments. The clinical development process is typically highly expensive and may result in delays or regulatory denials. To fund research and development the company recently completed a \$54M secondary offering in early October 2012 after having had an earlier secondary offering of \$21M in May 2011. Last quarter the company announced it had \$33M in cash plus an additional \$54M raised from its secondary offering for a total cash balance of \$88M. Future secondary offerings are unexpected at this time.
- **Partnerships Agreements**- Currently, ATRS is substantially dependent upon royalty revenue and changes in partnership agreements would negatively impact the company. In addition, ATRS is completely reliant upon outside parties for manufacturing of its products. This may be problematic if previous methotrexate shortages occur again.

### Management

Dr. Paul Wotton was appointed President and CEO of Antares in October 2008 after joining as President and COO in July 2008. He previously served as CEO of Topigen Pharmaceuticals Inc. and Head of Global Business Development at SkyePharma PLC. Robert Apple has been CFO since 2006.



### Ownership

% of Shares Held by All Insider and 5% Owners:	20.71%
% of Shares Held by Institutional & Mutual Fund Owners:	34.13%

Source: Bloomberg

### Top 5 Shareholders

<u>Holder</u>	<u>Shares</u>	<u>% Out</u>
Jacques Gonella	8,919,135	7.13%
Deerfield Management	8,161,598	6.52%
Orbimed Advisors	6,333,300	5.06%
Vanguard Group	6,024,864	4.81%
Blackrock	5,445,841	4.35%

Source: Bloomberg

## Potlatch Corporation (PCH)

February 8, 2013

Brent Adams

Financials/REITs

*Potlatch Corporation (PCH) is a real estate investment trust (REIT) which owns approximately 1.42 million acres of timberland in Arkansas, Idaho, Minnesota and Wisconsin. The company grows and harvests timber, as well as manufactures and sells wood products, printing papers, and other pulp-based products. The Resource Management Division manages its timberlands, harvests timber, procures other wood fiber, sells logs and leases land for hunting and other recreational activities. The Real Estate Division develops and sells land parcels, as well as invests in timberlands. The Wood Products Division manufactures lumber, plywood, and particleboard. Resource Management, Real Estate and Wood Products account for 40%, 23% and 37% of net operating income, respectively. Potlatch files as a REIT for federal income tax purposes. Potlatch was founded in 1903 and is headquartered in Spokane, Washington.*

### Financial Services/REITs

Price (\$): 2/1/13	43.77	Beta (vs. Russell 2000):	0.77	FY: Dec	2012A	2013E	2014E
Price Target (\$):	52	WACC (%):	7.4	Revenue (mil):	525.1	551.1	587.0
52WK H-L (\$):	44.51-28.02	Debt/Equity:	257.9	% Growth:	5.57	4.95	6.50
Market Cap (mil):	1,751.80	ROA:	5.81	Gross Margin (%):	25.6	28.33	31.86
Float (mil):	39.91	ROE:	30.34	Operating Margin (%):	16.19	19.25	23.34
Short Interest (%):	2.18	P/B:	11.4	FCF/Share (\$):	1.26	1.53	1.90
Avg Daily Vol (000s):	267.28	Dividend (TTM) (\$):	1.24	EPS (Cal):	1.06	1.29	1.56
		Yield (%):	3.17	Dividend (\$):	1.24	1.24	1.40

### Recommendation

There are many different ways to invest in the U.S. housing recovery, such as through homebuilders, lumber and appliance companies, construction firms and REITs. PCH provides an opportunity to invest in the housing recovery as a timber REIT. After peaking in July 2007, the inventory of U.S. existing homes has declined 47% and are approaching a more normalized level. Homebuilders will likely continue to have increased demand for new construction as potential buyers have a smaller selection of houses from which to purchase. The firm has been intelligent to date when deferring portions of its harvest as it did during the bottoming out of the domestic housing market in 2008. U.S. lumber demand jumped 6% in 2012 versus 2011 and is expected to increase another 10% in 2013 – and the spot price of lumber has also risen. As a result, PCH is modestly increasing its harvest level in 2013 and it is believed that sawlog prices will be higher in the years ahead as demand continues to improve. Since its sales are so closely tied to regional economies, the firm is able to keep harvesting cycles in sync with the local demand. Over the long-term, PCH is poised to directly benefit from the housing recovery. Because of these reasons and a favorable valuation, it is recommended that PCH be added to the AIM Equity Fund with a target price of \$52, which offers a potential upside of nearly 20%. In addition to the potential share price appreciation, PCH pays a yearly dividend of \$1.24, representing a 3.17% dividend yield.

### Investment Thesis

- **Domestic Housing Recovery.** Signs point to a bottoming of U.S. housing slump and an emerging recovery that began in the second half of 2012. U.S. housing starts increased 37% YoY, to an annual rate of 954,000, the highest reading since June 2008. Similarly, building permits increased 29% YoY to an annual rate of 903,000 in December, the highest level since July 2008. Additionally, home ownership has become a favorable alternative to renting. Apartment rents have increased by 21% since March 2010, driven by lower vacancy rates and lack of new supply. The average rent of \$1,213 is more than \$260 a month higher than a mortgage payment for a



median-priced home. Overall housing payments are down 37% from 2007 due to price declines and record-low mortgage rates.

- **Rising Local Property Values.** Timber REITs can usually grab up large parcels of land for very low prices in the vicinity of \$800-\$1500 per acre. At the time of purchase these areas tend to have low value and are not economically viable for any other purposes. Over the course of decades, however, things change and areas which used to be underutilized are now in greater demand. For example, the explosive growth of the Bakken Shale region has taken low cost land and raised its value significantly.
- **Natural Resources.** As new technology has developed for harvesting the earth's natural resources, areas which were previously considered barren may become unlocked and attractive to new developments. In addition, horizontal drilling may provide access to undiscovered natural gas or oil deposits.
- **Double-Dipping.** Double-dipping occurs when a company needs to build a connecting structure through an intermediary stretch of land owned by PCH. Examples of the structures include railroads, pipelines, power lines and communication cables. PCH can either sell or rent a small portion of the land for use, but the land around the sold or rented portion can still be farmed for timber, hence double-dipping. As each of the potential structures takes up a minimal amount of space, the amount of timberland lost is minuscule compared to the potential selling or rental rates.

### Valuation

To find the intrinsic value of PCH, a five-year Dividend Discount Model was constructed. A blended growth rate of 11.97% was applied to account for historical growth, fundamental calculations and analysts' predictions. A conservative cost of equity of 8.40% was used and yielded an intrinsic value of \$44.75. A P/FCF multiples approach was also used taking PCH's historical average of 34.78 and a peer average of 38.84x. Applying the calculated P/FCF multiple of 36.81 to a projected 2013 FCF per share of \$1.53, yielded an intrinsic value of \$56.32. An EV/EBITDA multiples approach was also used taking PCH's historical average of 18.37x and a peer average of 18.80x. Applying the calculated EV/EBITDA multiple of 18.59x to a projected 2013 EBITDA per share of \$2.99, yielded an intrinsic value of 55.58. Weighting the DDM, P/FCF and EV/EBITDA valuations evenly, a price target of \$52 was derived. The firm also pays a yearly dividend of \$1.24, yielding 3.17%.

### Risks

- **Mortgage Lending.** Strict mortgage lending may slow the housing recovery. Would-be homebuyers are finding it is still a challenge to obtain mortgage financing. Banks have tightened credit requirements given that lax lending standards were a root cause of the financial crisis. As a result, even credit-worthy applicants have had difficulty obtaining a mortgage, which may slow the pace of the housing recovery.
- **Newsprint and Paper.** Measured in metric tons, U.S. newsprint consumption has fallen from 8 million metric tons in 2007 to just 4 million in 2011, while other U.S. paper consumption has fallen from 80 million metric tons to 65 million. Digital circulation of newspapers has increased drastically with digital subscriptions for the New York Times and Wall Street Journal increasing 135% and 48% YoY, respectively.
- **Commodity Prices.** Lumber prices can be volatile, which increases short-term fluctuations in the company's stock price.

### Management

Mr. Michael J. Covey was elected president and chief executive officer of Potlatch in 2006 and has served as chairman of the board since 2007. Before joining PCH, Mr. Covey was executive vice president at Plum Creek Timber Company Inc., where he worked for 23 years. Mr. Eric J. Cremers has served as chief financial officer since 2007 and executive vice president of finance since March 2012.



### Ownership

% of Shares Held by All Insider and 5% Owners:	24%
% of Shares Held by Institutional & Mutual Fund Owners:	94%

Source: Bloomberg

### Top 5 Shareholders

Holder	Shares	% Out
BlackRock	3,677,874	9.11
Perkins Investment Management, LLC	3,293,514	8.16
Vanguard Group Inc.	2,057,000	5.09
T. Rowe Price Associates	1,888,740	4.68
Bank of New York Mellon Corp.	1,433,863	3.55

Source: Bloomberg

**Stone Energy Corp. (SGY)**  
February 8, 2013

Heinz Schelhammer

Domestic Energy

*Stone Energy Corp. (NYSE: SGY) is an independent oil and natural gas company engaged in the acquisition, exploration, exploitation, development, and operation of oil and gas properties, mostly in the Gulf of Mexico and Appalachia regions. As of the end of 2012 it had estimated proved oil and natural gas reserves of approximately 129 million barrel equivalents (773 billion cubic feet of gas equivalent). SGY operates in the Gulf Coast Basin (onshore and offshore), the Appalachia region, the Rocky Mountains, and in the Eagle Ford Shale. The company was founded in 1993 and is headquartered in Lafayette, Louisiana, with additional offices in New Orleans Louisiana, Houston, Texas, and Morgantown, West Virginia.*

Price (\$): (2/1/2013)	\$ 22.61	Beta:	1.539	FY: Dec. 31	2011 A	2012 E	2013 E
Price Target (\$):	\$ 28.95	WACC:	10.24%	Revenue (\$mil)	\$ 864.56	\$922.34	\$ 916.26
52 WK L-H (\$):	19.27-35.47	M-Term Rev Gr. Rate Est:	8.18%	% Growth	30.96%	6.68%	-0.66%
Market Cap. (mil):	\$ 1,119.3	M-Term EPS Gr. Rate Est:	6.57%	Gross Margin	45.77%	41.10%	42.00%
Float (mil):	47.70	Debt/Equity:	92.84%	Operating Margin	35.97%	31.62%	31.60%
Short Interest (%):	7.52%	ROA:	10.11%	EPS (Cal)	4.05	3.22	3.25
Avg. Daily Vol. (K):	814,179	ROE:	35.39%	CF/Share	11.90	10.93	10.50
Dividend (\$):	\$ -	ROIC:	15.08%	P/E (Cal)	5.59	7.02	6.95
Yield (%):	0.00%			EV/EBITDA	3.44	3.34	3.46

### Recommendation

As a growing exploration and production (E&P) company, Stone Energy has the potential to become a multiple of its current size in the next few years as they grow their reserve base in many key areas of the United States. Another positive for the company has been its movement towards higher priced crude oil, and natural gas that is heavy with liquids, proving a beneficial impact in this low natural gas price environment. Alongside the growth potential in production, SGY's prospects also look good as JP Morgan expects natural gas prices, currently at \$3.30/MMBtu, to rise to an average of \$4.25/MMBtu for 2013, which should fall straight to their bottom line, and Brent Crude to average around \$115/bbl, which is around its current level. Gulf of Mexico (GOM) oil is priced around Brent levels, which is at a premium of \$18 to that of WTI Crude. In the JP Morgan report about their outlook for the commodity market in 2013, their main thesis for a rise in natural gas prices is the continued shift away from coal for power generation and lower rig counts, as some other developments are a couple years away, such as LNG exportation and the possibility for use in vehicles. The company has also made a shift from 100% of reserves based in deep shelf GOM, to currently split a third each between the deep shelf GOM, deepwater, and the Marcellus Shale. In the recently released *Short-Term Energy Outlook*, the U.S. Energy Information Administration lays out its forecast over the next few years, and it expects total U.S. crude oil production to increase to 7.3 million bbl/d in 2013, and 7.9 million bbl/d in 2014, which would be the highest annual average level of production since 1988. This increased production follows along the International Energy Agency's views that the U.S. will surpass Saudi Arabia in oil production by 2020. Given these positive developments, it is recommended that SGY be added to the AIM Equity Fund with a target price of \$28.95, which offers a potential upside of 28.05%. The firm does not currently pay a dividend.

### Investment Thesis

- **Shifting Focus towards Oil/NGLs** As the commodity market for natural gas has been unfavorable over the past few years, the company has been reevaluating its prospects and even delaying natural gas opportunities in some regions until the pricing environment is more favorable. In the meantime, the company has grown its exposure to the deepwater GOM region to

increase the production of crude oil and towards natural gas projects that have more natural gas liquids, as both of these commodities have maintained a more favorable pricing market.

- **Reserve Growth** At the beginning of the year, SGY announced its year-end 2012 proved reserves increased 28% from the previous year, with production replacement of 288%. This continues the firm's strong reserve growth over the past few years, which has grown at a 20% CAGR from 2009 to 2011. A strategy of the company has been to limit reinvestment into their legacy assets and to use this high level of cash flow to fund growth in the production of crude oil and natural gas that is in price-advantaged basins.
- **Portfolio Diversification** With additional exploration over the past few years, SGY has reduced its reserves concentration from the conventional GOM Shelf, and increased its exposure to the Marcellus Shale and Deepwater GOM. By having more operations spread across the US, the company can shift around its resources to the areas that may be more heavily favored at any moment. This can be seen at the moment as the company looks to slow the growth of its dry natural gas production assets as the commodity pricing is unfavorable, and to focus on more profitable wet gas regions and into crude oil production.

### Valuation

To find the intrinsic value of SGY, a ten-year DCF was conducted, and a price target of \$29.08 was obtained. A sensitivity analysis was also conducted, with the discount rate varying from 9.75% to 10.75%, and the projected 2022 P/E multiple varying from 9 to 11, to give a range of \$26.29 – \$32.06. A P/E multiple was used with 9 comparable competitors to arrive at an average multiple of 12, and applying this to the 2013 EPS estimate of \$3.25 yielded a value of \$39.05. Lastly, the \$22.00 per share present valuation of SGY's reserves after debt were included into the valuation process. Weighting the DCF, P/E, and reserve valuation methods by 50%, 20%, and 30%, respectively, established an intrinsic price target of \$28.95, representing a 28.05% upside.

### Risks

- **Fracking Regulation in Marcellus Shale** If new regulations came about regarding the process of hydraulic fracturing, or "fracking," in Pennsylvania or West Virginia, where SGY operates, this would severely impact future production, as SGY uses this technique on all of their wells drilled in the Marcellus Shale.
- **Inability to Recover Proved Reserves** If the company runs into difficulties in extracting their reserves, or the costs of extraction significantly increase, this could negatively effect the company's operations as a large amount of their production would be adversely effected. This could lead to unexpected higher costs, or the need to purchase other properties to continue their growth.
- **Concentration of Major Customers** Over the past few years, four companies have made up 10% or more of sales, including Shell Trading (US) Company and Conoco, Inc., which made up 46% and 28%, respectively, of 2011 sales. While the loss of any one of these customers would be a negative issue, it would probably only be a short term issue given the nature of the business, and that the products SGY is dealing with are commodities, which have a readily open market.

### Management

David H. Welch, 64, is the Chairman, President, and CEO of SGY, and has been with the company since mid-2004. Before SGY, he held many executive positions with Amoco and later BP. Kenneth H. Beer, 55, has been the Executive Vice President and Chief Financial Officer since 2011 and 2005, respectively, after serving as a director of research and a senior energy analyst at the investment banking firm of Johnson Rice & Company. Keith A. Seilhan was recently promoted to Vice President – Deep Water, and before working at SGY was with Amoco/BP for 21 years, primarily in the deep water of GOM, and filled the role as BP's Incident Commander on the Deepwater Horizon Incident in 2010 in his final year at BP.



### Ownership

% of Shares Held by All Insider and 5% Owners	7%
% of Shares Held by Institutional & Mutual Fund Owners:	93%

Source: Yahoo! Finance

### Top 5 Shareholders

Holder	Shares	% Out
BlackRock	4,002,637	8.09%
FMR LLC	3,367,100	6.80%
Vanguard Group Inc	3,250,825	6.57%
Heartland Advisors Incorporated	2,650,990	5.36%
LSV Asset Management	2,420,500	4.89%

Source: Bloomberg

## PhotoMedex Inc. (PHMD)

February 8, 2012

Elizabeth Buckton

Healthcare

*PhotoMedex, Inc. manufactures proprietary products and services that address skin diseases and dermatological conditions such as psoriasis, vitiligo, atopic dermatitis and leukoderma. PHMD offers products and service on contract to dermatologists, professional aestheticians and consumers. Their experience in the physician market provides the platform to expand their skin health solutions to spa markets, as well as traditional retail, online and infomercial outlets for home-use products like the no!no! Hair remover. PhotoMedex was founded in 1998 and is headquartered in Montgomeryville, Pennsylvania.*

Price (\$ (2/1/13))	14.55	Beta:	1.3	FY: December	2011A	2012E	2013E
Price Target (\$):	22.15	WACC	13.7%	Revenue (Mil)	132	218	262
52WK Range (\$):	9.85-19.18	M-Term Rev. Gr Rate Est:	9.0%	% Growth	88.50%	65.00%	20.00%
Market Cap:	\$312M	M-Term EPS Gr Rate Est:	13.0%	Gross Margin	80.09%	80.00%	80.00%
Float	11.8M	Debt/Equity	0.0%	Operating Margin	-2.01%	12.73%	20.00%
Short Interest (%):	3.7%	ROA:	-0.5%	EPS (Cal)	-\$0.51A	\$0.88E	\$1.37E
Avg. Daily Vol:	2.2M	ROE:	-0.8%	FCF/Share	-0.46	1.06	1.85
Dividend (\$):	N/A			P/E (Cal)	(28.59)	16.51	10.63
Yield (%):	N/A						

### Recommendation

The 2011 reverse merger gave PhotoMedex the face-lift that it desperately needed. The sales channel and product line synergies enabled these two companies to reach earnings and growth potential that neither would have been able to achieve independently. Radiancy's core competencies include marketing and sales in a direct-to-customer channel. PHMD hopes to continue utilizing this channel for products that were only available in physician offices, previously. This new business model has allowed PHMD to tap into high margin products like NEOVA and XTRAC, which can realize margins up to 70%. PHMD's success with XTRAC is especially pertinent because it treats psoriasis, which is the most prevalent autoimmune disease in the U.S. affecting 125M people globally. Currently there is no cure for psoriasis and the total direct and indirect healthcare costs for patients are calculated at \$11.25B annually. The XTRAC has been shown to improve and clear up psoriasis in as little as 3-5 treatments. PHMD's technologies are clinically supported, are cleared by the FDA, and have a large addressable market opportunity. It is therefore recommended that PhotoMedex, Inc. be added to the AIM Equity portfolio with a price target of \$22.15 representing a 52% upside.

### Investment Thesis

**no!no! Hair Products.** These devices have experienced widespread retail success. To date, over 300K and 4M have been sold domestically and internationally, respectively. No!no! currently holds a 53% market share in Japan. The product continues to break on-day sales records on home shopping networks, and this product is believed to hold the largest market share (26% penetration) of any home-use aesthetic device. PHMD hopes to continue to robust sales growth of this product through increased advertising expenses. They manage these expenses through the media efficiency ratio (MER), and this spending discipline will ensure that the advertising dollars are spent effectively.

**Advanced Consumer Sales Engine.** Accompanied by creative marketing programs, Radiancy brought successful direct-to-consumer marketing strategies and a retail network to PHMD. PhotoMedex has capitalized on Radiancy's marketing base to increase patient awareness of XTRAC Excimer Laser and NEOVA topical skin care products, which were traditionally only marketed to physicians and aesthetic professionals. This is notable because PHMD is gearing the business toward high margin treatment revenues (38% YoY growth in treatment revenues), which relies on marketing and physician recommendations.

**Expansion into Medical Aesthetics.** Specialized medical professionals like dermatologists have expanded their practices into medical aesthetics in order to increase profitability. The global aesthetic market is valued at around \$34B annually, which includes direct-to-customer sales as well as revenue derived from physicians. Since more individuals are working at home or unemployed infomercials and e-commerce have become the primary sales channel for these products. In November 2012, 42K units were sold on a U.S. home shopping network, generating \$10.5 retail sales in one day. PHMD's developed sales channel is well positioned for this continued trend.

### **Valuation**

Using a 10-year DCF with a computed WACC of 13.7% and a LT growth rate of 2.5%, an intrinsic value of \$21.71 was determined for PHMD. The DCF grew revenues in the near term at an average 9% per year and maintained operating margins at around 20%. A 16x P/E multiple was applied to the 2013 EPS forecast of \$1.37 and yielded an intrinsic value of \$22.59. Weighing the DCF, P/E evenly, a \$22.15 price target was established, representing a 52% upside. The firm does not pay a dividend.

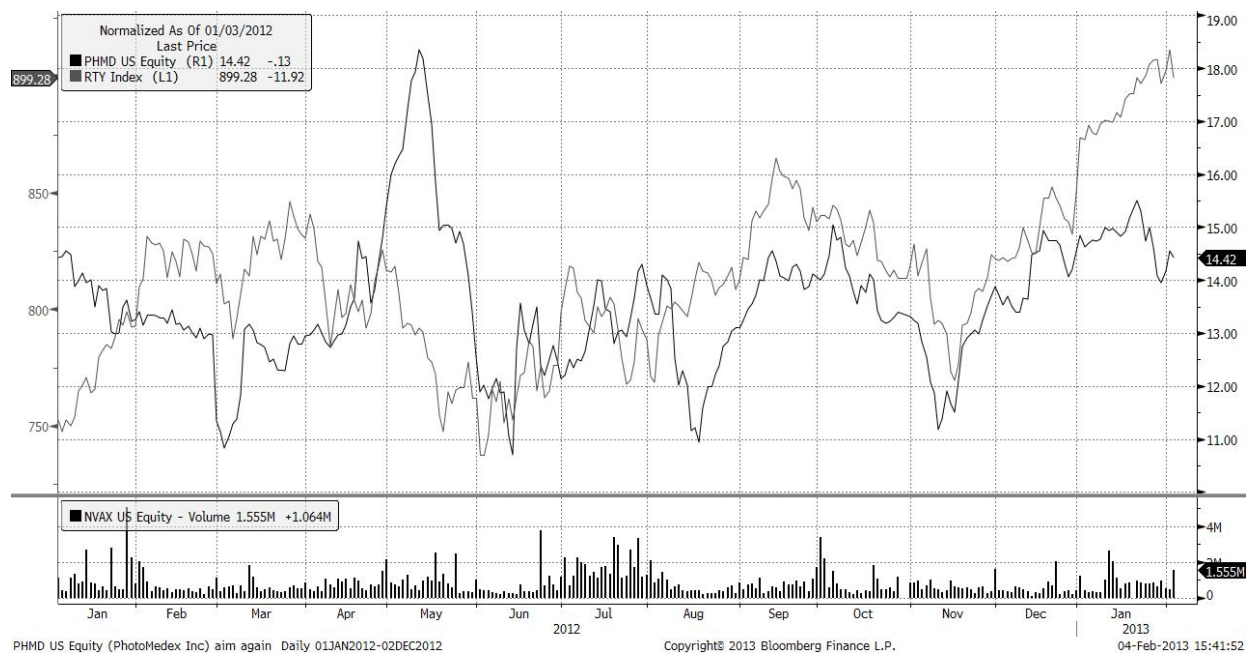
### **Risk Factors**

**Exposed to Customer Credit Risk.** Most of PHMD's sales related to its no!no! line of products is on an open credit basis. PhotoMedex's exposure to these credit risks may increase due to the current economic slowdown. Future credit losses, if incurred, could harm its business and have material adverse effects on its operational and financial position.

**Inability to Raise Necessary Capital.** The cosmetic industry is subject to continuous technological development and product innovation. And although the company does not currently need additional equity or debt financing, they may have trouble getting the financing in the future for future innovation needs.

### **Management**

Dolev Rafaeli was appointed to CEO and director in 2011. Dr. Rafaeli joined Radiancy in 2006 as president and DEO and has over 22 years of experience managing international operations. After the merger with Radiancy, Dennis McGrath reassumed his role of CFO in addition to president and director of PhotoMedex. He has held many other senior-level positions with companies that specialize in business solutions and integration. Nahum Melumad was appointed to the Board of Directors in 2011. Prior to joining PHMD he served in many notable roles including consultant and advisor to organizations like Bristol-Myers Squibb Co., General Electric, and Morgan Stanley.



### Ownership

% of Shares Held by All Insider and 5% Owners:	33%
% of Shares Held by Institutional & Mutual Fund Owners:	37%

Source: Bloomberg

### Top 5 Shareholders

<u>Holder</u>	<u>Shares</u>	<u>% Out</u>
Rafaeli Dolev	2,373,132	11%
Pell Lewis	1,775,319	8%
Oneda Katsumi	1,525,164	7%
Ben-Dror Yoav	1,308,921	6%
Eastnet Investments Ltd.	1,153,858	5%

Source: Bloomberg



## AVG Technologies (AVG)

February 8, 2013

Dan Tallarico

Information Technology

*AVG Technologies (NYSE:AVG) is a computer security software company. AVG Technologies is best known for their Anti-Virus program which is the base of their home security line of products. The product is offered in both paid and free forms. Additionally for home security, AVG offers a PC tune-up product, a premium security product and online safety tools. AVG also targets business users and mobile users through their file server protection, business security, e-mail security, and antivirus for Android devices. AVG has approximately 143 million active users and derives their revenue from these users through their subscription based products and through their ad based products. These ad based products verify the security of websites that may appear during an internet search for users so that they may feel secure when clicking on potential links or ads. AVG generates their revenue across the globe with a wide geographic base, the Americas represent 57% of total revenue, EMEA contributes 38% and Asia-Pacific 5%. AVG was founded in 1991 in the Czech Republic, had their IPO in February of 2012 and is headquartered in the Netherlands.*

Price(\$)	13.15	Beta	1.1		FY:September	2011A	2012E	2013E
Price Target(\$)	17.80	WACC	10.8%		Revenue(mil)	272.39	\$ 357.50	\$ 419.35
52 WK H-L(\$)	\$9.42-\$16.39	M-Term Rev. Gr Rate Est:	12.7%		% Growth	25.40%	31.2%	17.3%
Market Cap(mil)	705.3	M-Term EPS. Gr Rate Est	15.1%		Gross Margin	88.54%	84.0%	85.0%
Float(mil)	14.5	Total Debt	152.90M		Operating Margin	25.15%	24.0%	25.0%
Short Interest	2.07%	ROA	16.03%		EPS(\$)	\$ 1.69	\$ 1.17	\$ 1.46
Avg. Daily Vol	363,956	ROIC	11.18%		FCF/Share	\$ 1.96	\$ 1.15	\$ 1.38
Dividend(\$)	-				P/E	16.55	9.01	7.64
Yield(%)	-							

### Recommendation

AVG has proven the ability to monetize their customer base since ramping up their growth investments the past three years. What started as a play to gain customers through free offerings has translated itself into paying customers and a diverse revenue base. In 2000 AVG first introduced its free services and by 2008, the company had 83 million users with AVG monetizing 8% of these customers. Through Q3 of 2012, 44% of the 143 million customer base has been monetized. AVG has been able to differentiate itself through high quality products, despite operating in a highly competitive landscape. AVG's highly regarded products have afforded the company large margins and high efficiency ratios despite being smaller than some of their competitors, such as Symantec. AVG's gross margin currently is about 84% while they maintain a robust operating margin of over 30%. These margins have translated themselves into a wealth of free cash flow. AVG's FCF yield is 12.25% well ahead of that of Symantec (8.55%). With a TTM FCF of over \$84 million, AVG will look to continue the growth of its customer base through cross selling and an expansion of their business lines. High efficiency metrics and a solid business model will continue to pave the way for AVG in growing industries. It is recommended AVG be added to the AIM domestic equity portfolio at a target price of \$17.70 representing a 35% upside.

### Investment Thesis

- **Mobile Device Position.** According to Gartner, mobile installed based CAGR is estimated to be 30% and tablet installed CAGR is estimated to be 65% until about 2015. AVG is a prime position to take advantage of these trends as one of the only brand name security providers in this frontier market. AVG has been a leader in the mobile security space through its offering of both free and subscription based security products. AVG's mobile customer count as of the end of September was 20 million up 33% from their customer count at the end of Q2 2012. Their products include family safety products, a safe browser, system and battery optimization products, geolocate lock and wipe apps, as well as anti-spam and security products for android, Mac and Windows

smartphones and tablets. The corporation's current strategy is to penetrate the market and once they do so they will look to monetize these customers as they did with the PC security business.

- **Revenue Diversification/Cross Selling.** In addition to the mobile and PC security industries AVG has expanded its product breadth and partnerships. Over the past 12 months AVG has spent about \$50 million in R&D developing new products over 2.5x what they spend in 2008. Over the past few months AVG added Yahoo! as a new search partner to go along with Google after having negotiated a non-exclusivity contract with Google. AVG is also looking to get into markets such as anti-piracy and privacy. Their "Do Not Track functionality" is an optional component contained within their security products that has 15 million users. This is believed to be the largest privacy community in the world. The final product AVG has launched is their cloud based SMB solution. In early October, they launched CloudCare, the industry's first free cloud-based centralized IT management platform. Going forward cross-selling these products will be a major driver in the company's continued growth.
- **Strong Search Growth and Partnerships.** AVG has been able to consistently maintain good relationships with its search ad partners such as Google and Yahoo!. After having recently reached new deals with each of these partners AVG should be able to continually monetize their customer base. The search market currently is estimated to be worth about \$14 billion and is expected to continue its growth. In addition to the aforementioned partnerships, AVG has also partnered with the likes of Vodafone, Samsung, HTC, and most recently Facebook.

### Valuation

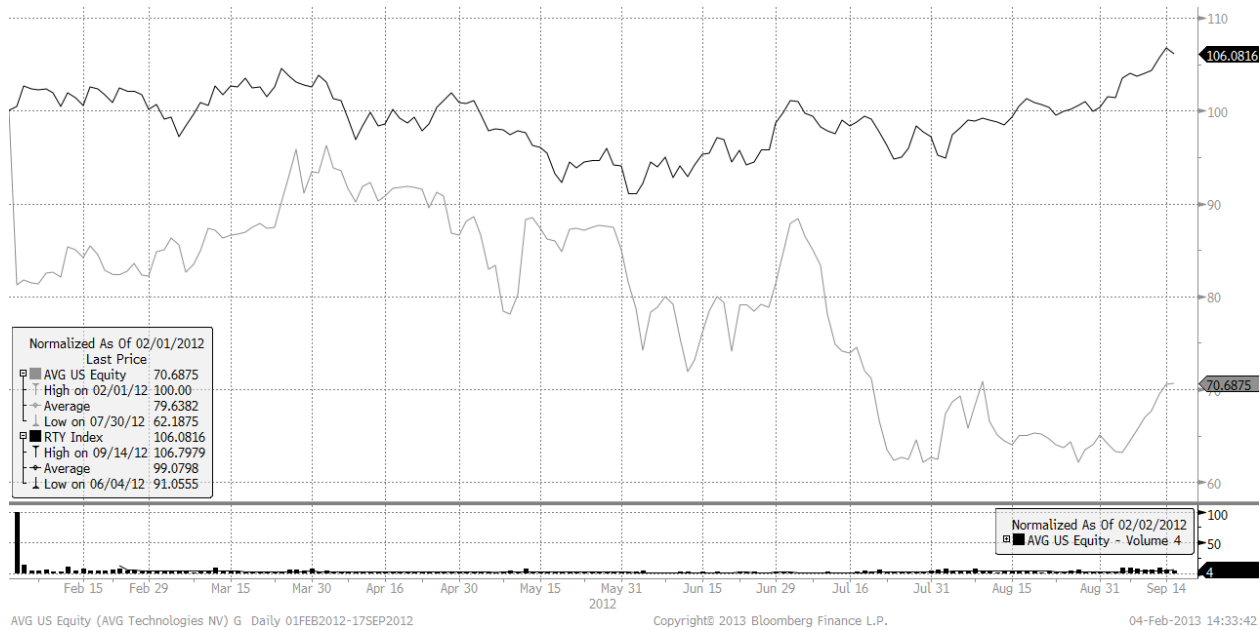
To find the intrinsic value of AVG, a five-year DCF was conducted. Customer growth rates and revenue were varied year-to-year. A sensitivity analysis also was used to account for variations in WACC and the terminal growth rate. A WACC of 9.8% was calculated and a premium of 100 basis points was added. This process yielded an intrinsic value of \$21.53. Blended peer average EV/EBITDA and P/FCF multiples approaches were used. With an EV/EBITDA multiple of 8.5x, this method yields an intrinsic value of \$12.56 and a P/CF multiple of 11.3x yielding an intrinsic value of \$19.32. Taking these into account and equally weighting the DCF and each multiple, a price target of \$17.70 was established representing a 35% upside. The firm does not pay a dividend.

### Risks

- **Competition.** Personal security is a highly competitive industry. With large competitors like Symantec, McAfee, Google and Microsoft amongst others it is of the utmost importance AVG constantly improve and stay ahead of emerging technologies.
- **Breaches of Security.** Any breaches of security could severely affect the reputation and brand name of AVG. if AVG were to lose the ability to keep customers information safe they could lose many of their customers and their business.

### Management

AVG's management team has extensive experience in the tech industry. J.R. Smith has served as the chief executive officer since 2007 and as a managing director of their management board since 2008. Prior to joining AVG, Mr. Smith served as chief executive officer of United Kingdom-based Dot Mobile Limited. John Giamatteo has served as the Chief Operating Officer since 2011. Prior to joining AVG, Mr. Giamatteo served from 2010 to 2011 as Chief Operating Officer of Solera Networks, a network security company, from 2005 to 2010 as Chief Operating Officer of RealNetworks, an Internet media software company.



% of Shares Held by All Insider and 5% Owners:	N/A
% of Shares Held by Institutional & Mutual Fund Owners:	N/A

Ownership

Source: Bloomberg

Top 5 Shareholders

Holder	Shares	% Out
TA Associates, Inc.	12,736,384	23.42%
Intel Corporation	3,289,027	6.05
Ranger Investment Management, LP	1,187,220	2.18
DFA Asia Pacific Small Company Series	2,437,348	1.84
BMO Financial Corp	977,238	1.80

Source: Bloomberg