



*Celebrating  
100 Years*

**Applied Investment Management (AIM) Program**  
**AIM Class of 2012 Equity Fund Reports**  
**Date: April 29, 2011      Location: Chicago, IL**

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Colleen Osborne <i>Senior Mentor: Peter Stucki</i>	Ebix Inc.	EBIX	\$23.29	8
Harrison Davis <i>Senior Mentors: Shannon Lawton</i>	Exact Science Corporation	EXAS	\$7.60	11
Sajid Bhimani <i>Senior Mentors: Christina Starkey and Ethan Matter</i>	Giant Interactive	GA	\$8.71	14
James Carlson <i>Senior Mentors: Kyle Boser</i>	Nelnet Inc.	NNI	\$22.65	17
Nick Hiller <i>Senior Mentors: Andrew Freedman</i>	Omnivision Technology	OVTI	\$32.55	20
Dan Leibforth <i>Senior Mentors: Kristin Holzhauser and Mark Rutherford</i>	Horsehead Holdings Corp.	ZINC	\$16.35	23

Thank you for taking the time today and participating in the AIM ‘road show’ in Chicago. 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. Today, each student will spend about 5-7 minutes presenting their formal recommendation, which is then followed by about 8-10 minutes of Q & A. Thank you to Jennifer Sloan and the Marquette Team in Chicago for your hospitality.

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## Acacia Research Corporation (ACTG)

April 29, 2011

Tom Kelly

Business Services

*Acacia Research Corporation (NASDAQ: ACTG) is the industry leader in patent licensing and enforcement throughout the United States and the world. Acacia acquires, develops, licenses, and enforces patented technologies. Acacia assists its clients in developing their patent portfolios, protection and enforcement from unauthorized use, and generation of revenues from their patents. Acacia partners with patent owners to reach licensing deals with major corporations or defend their patents through litigation and settlement. Revenue is typically split with their partner on a 50/50 basis. The company's client base consists of individual inventors as well as both small and large companies. Acacia currently controls tens of thousands of patents in over 170 patent portfolios. Acacia is known as a non-practicing entity, which is a patent holder that does not manufacture products or services from the patents they hold. The company is headquartered in Newport Beach, CA and has 48 employees.*

Price (\$): (4/21/11)	38.82	Beta:	1.38	FY: Dec	2010A	2011E	2012E
Price Target (\$):	50.00	WACC	13.07%	Revenue (\$mil)	131.83	168.74	210.93
52WK H-L (\$):	10.82-37.99	Mid-Term Rcv. Gr Rate Est:	23.00%	% Growth	95.77%	28.00%	25.00%
Market Cap (mil):	1,370.00	Mid-Term EPS Gr Rate Est:	30.83%	Operating Margin	54.93%	55.00%	56.00%
Float (mil):	35.19	Debt/Equity:	0.00%	EPS (\$Cal)	0.97	1.79	2.51
Short Interest (%):	3.90%	ROA:	27.46%	FCF/Share	2.26	2.85	3.57
Avg. Daily Vol:	459,257	ROE:	32.51%	P/E (Cal)	39.99	21.68	15.45
Dividend (\$):	N/A			EV/EBITDA	10.51	8.37	6.67
Yield (%):	N/A						

**Recommendation** Acacia had its strongest year ever in 2010 in terms of revenue and earnings. Revenues in 2010 were \$131.8 million; increasing 95% from the previous year. The company reported its first positive earnings in 2010 (\$34 million or \$0.97 EPS) and revenues have increased at a 46% CAGR since 2005. According to the company, Acacia is still in the early stages of revenue generation from its patent base. The company has a very strong cash and investments position, with no debt and \$104 million in working capital. Acacia has \$90 million NOLs that will be carried forward, which allow the company to avoid paying the statutory-rate taxes through 2013. With patent licensing becoming an increasing trend for companies to increase revenues, Acacia is well positioned for future growth. The price target of \$50 represents a potential upside of nearly 30%. Consequently, because of Acacia's strong recent performance and their positioning in a growing industry, it is recommended that ACTG be added to the AIM Equity Fund. Acacia does not currently pay a dividend.

### Investment Thesis

- Industry Leader.** Acacia is the premier player in the patent licensing industry. Intellectual property as an asset class has seen 60% outperformance relative to the S&P 500 over the last four years - and 36% outperformance during the last year. As one of the largest non-practicing entities (NPEs) in the U.S., the company has or controls the rights to over 170 patent portfolios; a number that is rapidly increasing yearly (a CAGR of 35% over the last 5 years). According to PatentFreedom, Acacia represents an estimated 10% of all larger NPEs in North America during the 2005-2010 period. Acacia also has been able to acquire patents in some of the most important and growing technological areas, such as flash memory, digital media, and data storage.
- Large Corporate Clients.** Acacia has great brand awareness with some of the biggest companies worldwide. Exxon Mobile, General Electric, and Microsoft have all made licensing deals with Acacia, showing the company's willingness and ability to serve even the largest businesses. Many of the company's smaller competitors cannot reach these same types of agreements. With

the proven ability to deal with the larger companies, and an increasing number of patents under its control, Acacia will become better suited to service their licensees every need.

- **Increasing Margins.** As the business model for Acacia develops, the company is becoming more efficient in its business. In 2010, Acacia had a degree of operating leverage (DOL) of over 2, showing that an increase in revenue will likely lead to a greater increase in operating income. With positive operating leverage in the future, Acacia should be able to grow its margins since the company is in its early stages of revenue growth. In building such a large base patent portfolio, Acacia hopes to significantly increase their number of revenue producing patents. The company had 91 revenue producing patents in 2010, and the number has been growing at a 50% CAGR since 2005. Acacia has been trying to reach settlements in the enforcement of patents, which allows for a guaranteed result and lower costs.

### Valuation

To find the intrinsic value of ACTG, a five-year DCF analysis, an EV/EBITDA multiple approach, and Price/Sales multiples approach were used. Increasing revenue was the main driver of the future free cash flows. By looking at the past and future expectations, revenue growth was conservatively grown at 28% in 2011 and steadily decreased to 20% in 2015. The WACC was calculated to be 13.07%, a terminal growth rate of 3% was used, and an intrinsic value of \$48.93 was found. A sensitivity analysis accounting for variations in the WACC and terminal growth rate was performed, yielding a price range of \$41.31-\$60.15. A 15x multiple was applied to 2012 EBITDA/share based on trading comparables and yielded an intrinsic value of \$53.50. A 6x price/sales multiple was applied to 2013 sales/share, and yielded an intrinsic value of \$44.37. EV/EBITDA is the best valuation basis for the company considering the NOLs carrying forward. Weighting EV/EBITDA 50%, and both DCF and price/sales 25%, a price target of \$50 was set.

### Risks

- **Volatile Earnings.** One of the biggest troubles in Acacia's business model is the inconsistent earnings. Quarterly results will likely fluctuate greatly do to the timing of settlements. The potential for negative earnings quarters still looms over the company. Management does not give guidance because of the lumpy results, allowing them to avoid getting cornered into making quarterly results. The company has said that no individual patent or patent portfolio is individually significant to their licensing and enforcement business as a whole.
- **Unfavorable Litigation Results.** Several litigation factors could influence Acacia's ability to generate favorable results. Patent reform in the U.S Senate has failed to be enacted for several years; however, support for reform that would hurt patent holders remains. It is believed that Congress will likely support NPEs. Beside the legislative branch of government, the U.S. Patent and Trademark Office plays a large role in the legislation of licensing and enforcement of patents. In court, Acacia also relies on trial judges and juries to understand the complexities of patent enforcement litigation, which is often difficult. Expensive appeals often occur if the decision is unsatisfactory.

### Management

Paul Ryan is the Chairman and CEO of Acacia. He has served as a director since 1995, chairman since 2000, and as CEO since 1997. Ryan also previously served as the company's Executive Vice President and Chief Investment Officer. Ryan was the co-founder of the American Health Care Fund, and held positions at Young & Rubicam, Ogilvy & Mather, and Merrill Lynch. Ryan attended Cornell University for his B.S. degree, and attended the New York University Graduate School of Business.



### Ownership

% of Shares Held by All Insider and 5% Owners:	4%
% of Shares Held by Institutional & Mutual Fund Owners:	71%

Source: Yahoo! Finance

### Top 5 Shareholders

<u>Holder</u>	<u>Shares</u>	<u>% Out</u>
Kingdon Capital Management LLC	2,000,000	5.41
Columbia Partners, LLC, I \ Vestment Management	1,965,636	5.31
Apex Capital, LLC.	1,925,000	5.20
Vanguard Group, INC. (The)	1,468,232	3.97
Thompson, Siegel & Walmsley, INC.	1,227,564	3.32

Source: Yahoo! Finance

## Bank of Marin Bancorp (BMRC)

April 29, 2011

Jeffrey Hoffmeyer

Financial Services

*Bank of Marin Bancorp (BMRC) is a bank holding company which operates through its lone subsidiary, Bank of Marin. The bank operates through its 17 offices in Sonoma, Napa and Marin counties, just north of San Francisco, California. The bank also has loan offices in San Francisco and Santa Rosa. The bank provides various commercial and retail banking products to these areas. Bank of Marin's business banking focuses mostly on small to midsize companies and non-profit organizations, which makes up approximately 60% of its total deposits. The remaining 40% comes from individuals, and about 87% of total deposits come from Marin and Sonoma Counties. Interest and fees on loans make up around 84% of total revenue. The company was founded in 1989, and is headquartered in Novato, California. In 2007 the bank was reorganized so that Bank of Marin Bancorp was created as the holding company for Bank of Marin.*

Price (\$): (4/21/11)	37.01	Beta:	0.86	FY: Dec.	2010A	2011E	2012E
Price Target (\$):	46.14	WACC	7.15%	Revenue (Mil)	61.36	65.91	69.78
52WK H-L (\$):	39-30	M-Term Rev. Gr Rate Est:	4%	% Growth	2.72%	7.42%	5.87%
Market Cap (mil):	199.88	M-Term EPS Gr Rate Est:	4%	Net Interest Margin	5.18%	5.63%	6.00%
Float (mil):	5.11	Financial Leverage	10x	Pretax Margin	35.95%	38.27%	40.67%
Short Interest (%):	12.7%	ROA:	1.2%	EPS (Cal)	2.55	3.09	3.48
Avg. Daily Vol:	10,160	ROE:	11.7%	P/E (Cal)	14.49	11.98	10.64
Dividend (\$):	0.64	Tier 1 Capital Ratio	10%	BVPS	\$23	\$25	\$28
Yield (%):	1.7%	Credit Provisions/Loans	0.58%	P/B	1.61	1.47	1.34

### Recommendation

Bank of Marin Bancorp has had consistent earnings over the past five years, ranging from \$11.88 million in 2006 to \$13.55 million in 2010, experiencing only a 1.4% decrease in 2008 during the Great Recession. Loan and fee revenues have steadily increased since 2007 from \$53.4 million to \$56.2 million and could rise more rapidly if interest rates increase. Bank of Marin continues to expand in the central California area, recently adding and consolidating 2 branches in Napa Valley through the acquisition Charter Oak Bank and they plan to soon open another office in Sonoma County. As a result of the firm's growth in San Francisco, Santa Rosa, and Napa Valley areas, the company's deposits increased by 7.17% in 2010 reaching \$1 billion. Because of the firm's continued expansion and stability, it is recommended that Bank of Marin Bancorp be added the AIM Equity Fund with a target price of \$46.14, representing a 24% upside.

### Investment Thesis

- Continuous organic growth in affluent counties.** Bank of Marin is headquartered in Marin County, California, which is one of the wealthiest counties in the United States. The per capita income in Marin is \$53,284, compared to the \$29,020 in California and \$27,041 across the U.S. The firm has recently expanded into the San Francisco area and is planning to open another office in Sonoma County where the per capita income is \$44,373 and \$32,939 respectively. Earlier this year, the Bank of Marin also acquired a new branch in Napa County, where the per capita income is \$34,995. These stronger income areas represent a higher potential for deposits as new offices are opened and as interest rates increase. As a result the firm will be able to acquire more interest earning assets and increase their revenues.
- Increasing loans and decreasing loan losses.** In 2010 Bank of Marin increased its total loans by \$23.7 million to \$941.4 million, a 2.6% increase. The firm's uncollectable loans decreased in 2010 from \$4.8 million to \$3.6 million. These charge-offs represented .38% of average loans, compared to a .53% charge off figure in 2010. In addition to this, non-accrual loans totaled \$12.9

million in 2010, representing only 1.37% of the bank's loan portfolio. These losses on loans are likely to decrease as the economy continues to improve.

- **Strong relationship with local community.** The Bank of Marin has built a strong reputation with their local community which has allowed them to gain market share and become the leading community bank in deposits among Marin County. For Marin County businesses, the Bank of Marin now holds a 24% market share. The firm has been able to increase its deposits to \$1 billion for the first time in 2010, largely thanks to its high stability and distrust that exists with larger banks due to the recession.

### **Valuation**

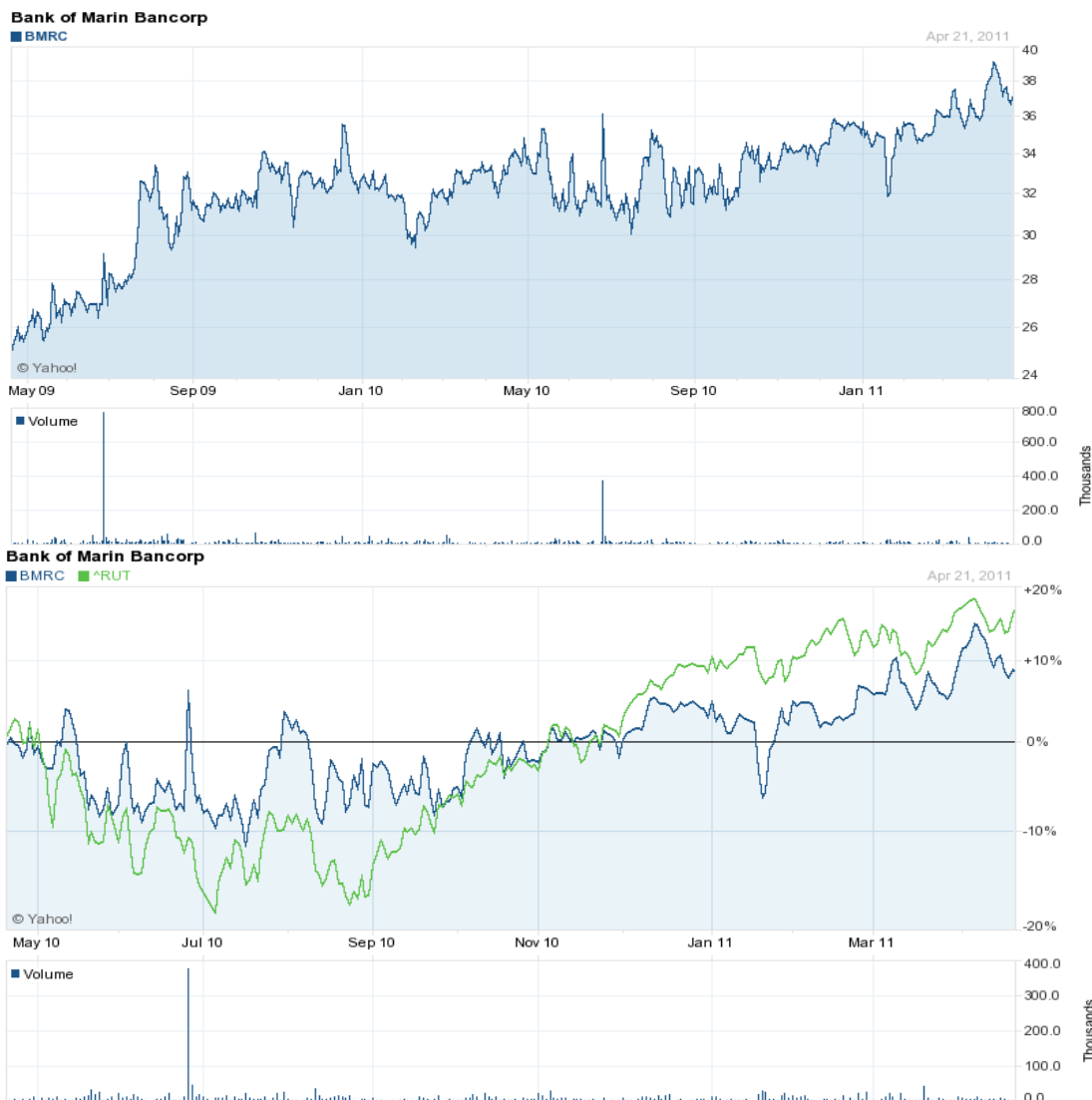
To value the Bank of Marin, a 16x P/E multiple was used against its 2011 estimated EPS of \$3.09, to get an intrinsic value of \$49.44. The 16x multiple was chosen based on what other companies in the industry were trading at, considering location, dividend, sales growth, EPS growth, stability and size. An excess equity model was also used, with a cost of equity of 9.09% to arrive at an intrinsic value of \$42.84. The two approaches were equally weighted to arrive at an intrinsic stock price of \$46.14, representing a 24% upside. The firm also pays a \$.64 dividend, which it has steadily been increasing, resulting in a dividend yield of 1.7%.

### **Risks**

- **High competition.** The Bank of Marin faces significant competition from other banks, credit unions and other financial institutions for its customers. Non-bank competitors do not face the same regulations as banks, allowing them to be more flexible in competing for customers. Recent laws on regulation could also affect the Bank of Marin's flexibility. Some of the competition is much larger and is able to exercise economies of scale. Larger commercial banks also have much higher lending limits, which allows them to offer certain services that the Bank of Marin is unable to provide. These things could affect the firm's profit margins or its ability to remain competitive in the future.
- **Interest rate risk.** The income for the firm is largely dependent on interest rates. Revenues are made up mostly by interest earned on loans, and likewise a significant portion of costs is interest paid on deposits and borrowed funds. Changes in interest rates can also affect the demand for loans and deposits as well as change the fair value of their assets and liabilities. The firm tries to minimize their interest rate exposure, but says that sustained low interest rates could hurt Bank of Marin's financial condition.

### **Management**

Russell Colombo has been president, CEO and director since 2006 after joining Bank of Marin in 2004. He worked for 15 years at the San Francisco office of Comerica Bank as Senior Vice President and Group Manager. He also worked for 19 years at Union Bank of California. Joel Sklar, MD, is the Chairman of the Board and is one of the founding directors of Bank of Marin. He has served on the Board since its inception in 1989. Dr. Sklar is currently the Chief Medical Officer at Marin General Hospital and is a director of Marin Hospitalist Medical Group and Marin Medical Practice Concepts. He also serves as a director of the California Film institute.



### Ownership

% of Shares Held by All Insider and 5% Owners:	3%
% of Shares Held by Institutional & Mutual Fund Owners:	43%

Source: Yahoo! Finance

### Top 5 Shareholders

Holder	Shares	% Out
BANC FUNDS COMPANY, L.L.C. (THE)	462,311	8.71
WADDELL & REED FINANCIAL INC.	190,400	3.59
BlackRock Institutional Trust Company, N.A.	178,346	3.36
WELLINGTON MANAGEMENT COMPANY, LLP	158,920	3.00
BlackRock Fund Advisors	135,945	2.56

Source: Yahoo! Finance

## Ebix, Inc. (EBIX)

April 29, 2011

Colleen Osborne

Software

*Ebix, Inc. (NASDAQ: EBIX) is a leading international supplier of on-demand software and e-commerce services to the insurance industry. Ebix develops and markets software solutions including infrastructure exchanges (71% of 2010 revenue), carrier systems (7%), broker systems (10%), business process outsourcing (BPO) services (12%), and custom platforms for all entities involved in insurance sourcing. With offices across Brazil, Singapore, Australia, United States, New Zealand, India, China, Japan and Canada, Ebix powers multiple exchanges across the world in the fields of life, annuity, health, and property & casualty insurance, while conducting over \$100 billion in insurance premiums on its platforms. Through its Software as a Service (SaaS) model, the company employs 1,157 insurance and technology professionals that provide products, support, and consultancy to over 300,000 users on six continents. Recent acquisitions have expanded the exchange channel to include end-to-end health and employee benefit software services. Ebix was founded in 1976 as Delphi Systems, Inc., a California company. In December 2003, the company changed its name to Ebix, Inc. and is currently headquartered in Atlanta, Georgia.*

Price (\$ 4/21/11)	23.29	Beta:	1.27	FY: December	2010A	2011E	2012E
Price Target (\$):	31.03	WACC	11.95%	Revenue (Mil)	132.19	171.85	225.12
52WK Range (\$):	6.25-30.35	Mid Term Rev. Gr Rate Est:	10.0%	% Growth	35.32%	30.00%	31.00%
Market Cap:	893.05M	Mid Term EPS Gr Rate Est:	15.0%	Gross Margin	77.61%	78.00%	79.00%
Float	32.06M	Debt/Equity	15.4%	Operating Margin	39.72%	39.00%	40.00%
Short Interest (%):	17.6%	ROA:	20.9%	EPS (Cal)	\$1.49A	\$1.66E	\$1.86E
Avg. Daily Vol:	573,908	ROE:	29.4%	FCF/Share	\$1.28	\$1.52	\$1.78
Dividend (\$):	0.00			P/E (Cal)	15.63	14.03	12.52
Yield (%):	0.0%			EV/EBITDA	14.7x	12.4x	10.3x

### Recommendation

Ebix's easily adaptable platform is marketable to insurance businesses of all sizes and has influenced its position as a first-mover in the insurance software space. On February 7, 2011, Ebix completed the acquisition of Atlanta-based A.D.A.M, a leading provider of health information and benefits technology. The \$66M acquisition helps Ebix further strengthen its exchange channel in the health information and services areas for employers, benefit brokers, hospitals, media, and healthcare organizations. Management predicts the acquisition to be immediately accretive, generating \$0.15 of additional diluted EPS in 2011, indicating strong bottom line growth and few alterations to the cost structure. The merger anticipates a combined company recurring revenue stream of 75% and various cross-selling opportunities to clients of both entities. Increased bookings with named accounts, including CUNA Mutual, Guardian, Fidelity, New York Life, and MetLife, among others, are expected to drive FY 2011 revenue as well. Due to its niche positioning, Ebix leads the business software space in terms of TTM gross and operating margins of 77.6% and 38.6%, beating industry averages of 51.9% and 8.41%, respectively. With a strong business model and favorable valuation, it is recommended that Ebix be added to the AIM Domestic Equity portfolio with a target price of \$31, representing a potential upside of approximately 30%.

### Investment Thesis

- **Need for Efficiency in the Insurance Industry.** Increased transaction expediency and reduced operating costs motivate the longstanding insurance industry to automate systems and regulate processes. It is estimated that American insurance companies currently spend \$60B yearly on IT infrastructure and maintenance, which proves crucial for Ebix in maintenance of its client base. Gartner predicts a 16% YoY increase in the enterprise SaaS market during 2011, supporting the increased desire for paperless processing, a trend that improves both back-end and consumer-facing global insurance operations.
- **Expansion through Acquisition.** Management's strategic acquisitions expand the product breadth, geographic reach, and client roster of Ebix. Favorable returns on capital investments



have driven ROIC to its current level of nearly 20%. Through its acquisitions, Ebix has been able to expand product suite options and market them as add-on features to current clients. Ten seamless acquisitions during FY 2008 through FY 2010 provided cost synergies that contributed to 77% YoY revenue growth in 2009 and 35% YoY in 2010. A March 2011 agreement with Bank of America expands the company's credit facility by \$25M. This increased borrowing capacity, paired with cash holdings of \$23.4M and strong operating cash flows, position Ebix for future acquisitions.

- **Incomparable Client Retention Rates.** Visibility for Ebix is indicated through 99.5% customer retention rates during 2010. Insurance industry participants who do business with Ebix clients are exposed to the flexibility of their exchange platform. In turn, Ebix benefits from this "network effect" through low client-acquisition costs. A large clientele base diversifies its revenues, as no single client accounted for more than 4% of total revenue in FY 2010. Accordingly, during the past 7 years, Ebix has not lost a customer that accounts for more than 0.5% of annual revenue.

### Valuation

A ten-year DCF and EV/Sales multiples approach were used to value Ebix and weighted 75% and 25%, respectively. A WACC of 11.95% was calculated, and a 50 bps premium was added to account for frequent acquisitions that drive the firm's top line growth. A final discount rate of 12.45% and terminal growth rate of 3.00% were used to discount future cash flows for the firm, yielding an intrinsic value of \$32.00. A sensitivity analysis adjusting the terminal growth rate between 2 and 4% and conservative WACC, net of premium, between 11.5 and 13.5%, yielded a price range of \$29.51 to \$40.16. A 6.5x EV/Sales multiple was calculated to yield an intrinsic value of \$28.00. Taking both methods into account, a \$31.00 price target was established, representing 30% upside potential. The firm does not pay a dividend.

### Risks

- **Government Regulation and Litigation.** The newness of online commerce to the consumer insurance market makes future regulations hard to predict. FTC regulations have the potential to expose brokers and carriers to legal penalties as insurance transactions become more automated. Similarly, healthcare reform and the implementation of the Affordable Care Act could place pressure on demand for software by third-party insurance benefit providers.
- **Alterations to Foreign Obligations.** With nearly 25% of revenue coming from abroad, Ebix faces a reduced effective tax rate due to a blend of rates in foreign nations where income is earned. International product development and intellectual property ownership centralization in India and Singapore have led to decreased tax rates, which are likely to increase if income is moved back to the U.S. in future years. Currency fluctuations and foreign government regulation have the ability to influence EBIX as well.
- **Need for Complete System Switchover.** High costs of tearing out legacy IT systems and retraining employees often deter firms from adopting new technology. Insurance carriers with in-house capacity for agency and brokerage functions are less likely to adopt an internet-based platform if they can utilize internal storage.

### Management

Robin Raina serves as the Company's President, CEO, and Chairman of the Board. He joined Ebix in October 1997 and was elected as a director of the firm in February of 2000. Prior to joining Ebix, Raina held various senior management positions at Mindware/BPR, a technology consulting firm, from 1990 through 1997. CFO Robert F. Kerris joined Ebix in 1997 as well, after serving as CFO at Aelera Corporation and holding senior positions at Equifax Inc, Interland, AT&T, BellSouth, and Northern Telecom.



Source: Yahoo! Finance



Source: Yahoo! Finance

**Ownership**

% of Shares Held by All Insider and 5% Owners:	24%
% of Shares Held by Institutional & Mutual Fund Owners:	68%

Source: Bloomberg

**Top 5 Shareholders**

Holder	Shares	% Out
Robin Raina	3,922,087	9.88%
Rennes Foundation	3,474,093	8.75%
Fidelity Management & Research LLC	3,351,305	8.44%
Epic Asset Management, Ltd	2,000,007	5.04%
Vanguard Group, Inc	1,805,634	4.55%

Source: Bloomberg

## Exact Sciences Corporation (EXAS)

April 29, 2011

Harrison Davis

Healthcare

*Exact Sciences Corporation (NASDAQ: EXAS) is a molecular diagnostics company focused on the early detection and prevention of colorectal cancer. It has exclusive intellectual property protecting its non-invasive, molecular screening technology for the detection of colorectal cancer. EXAS's focus is on the commercial development of its stool-based deoxyribonucleic acid (sDNA), colorectal cancer screening product, which is seeking United States Food and Drug Administration (FDA) clearance and approval. Its non-invasive sDNA screening technology includes proprietary and patented methods that isolate and analyze human deoxyribonucleic acid (DNA) present in stool to screen for the presence of colorectal pre-cancer and cancer in each of the four stages of colorectal cancer. Its sDNA screening test can detect pre-cancerous and cancerous lesions early in their development stage. By detecting pre-cancers and cancers early with the sDNA-based test, affected patients can be referred to a colonoscopy or other treatment, during which the polyp or lesion can be removed. EXAS has a strategic alliance with LabCorp; a collaboration, license, and purchase agreement with Genzyme Corporation; and a licensing and research agreement with the MAYO Foundation for Medical Education and Research. The company was founded in 1995 and is headquartered in Madison, Wisconsin.*

Price (\$) (4/21/11)	7.60	Beta:	1.22	FY: Mar	2010A	2011E	2012E
Price Target (\$):	13.00	WACC	12.7%	Revenue (Mil)	5,344	4,986	4,986
52WK Range (\$):	3.15-9.24	M-Term Rev. Gr Rate Est:	50.0%	% Growth	4.00%	-6.70%	0.00%
Market Cap:	383.6M	M-Term EPS Gr Rate Est:	60.0%	Gross Margin	99.55%	100.00%	100.00%
Float	48.38M	Debt/Equity	1.0%	Operating Margin	-221.29%	-530.00%	-700.00%
Short Interest (%):	12.5%	ROA:	-12.1%	EPS (Cal)	-\$0.29A	-\$0.51E	-\$0.66E
Avg. Daily Vol:	0.647M	ROE:	-26.9%	FCF/Share	-0.35	-0.56	-0.72
Dividend (\$):	N/A			P/E (Cal)	N/A	N/A	N/A
Yield (%):	N/A			EV/EBITDA	N/A	N/A	N/A

### Recommendation

EXAS's patent protected sDNA-based colorectal cancer screening product has tremendous growth opportunities due to the increase in the average age in the U.S. and the inconvenience and discomfort that characterize alternative forms of colorectal cancer screening. EXAS targets individuals between the ages of 50-75 who should be screened for colorectal cancer. Currently, roughly 80 million Americans fall within in the age range; however, only 25% are screened for colorectal cancer citing the preparation and pain that is involved in the screening tests of a colonoscopy. EXAS has produced Cologuard, a non-invasive, patient-friendly stool-based colorectal cancer test that resolves the criticisms associated with a colonoscopy and other forms of screening. FDA approval for Cologuard is expected in late 2012 and analyst estimates predict an initial commercial launch of 150,000 sDNA tests, which would account for revenue of \$22.4M in Cologuard's inaugural year in 2013. The U.S. market opportunity for EXAS's stool-based colorectal cancer screening is estimated to be \$3-5 billion by 2020. Given the exceptional growth prospects and market penetration opportunities, it is recommended EXAS be added to the AIM Equity Fund with a with a target price \$12.91, which offers an upside potential of 70%.

### Investment Thesis

- Superior, Patent-Protected Technology.** Strong patent protection will help EXAS generate higher revenues and margins in the intensely competitive biotechnology market. EXAS's product portfolio includes 14 U.S. patents and 51 foreign patents with each having a term of 20 years. The company's primary patent, Cologuard, has addressed the lack of compliance of individuals in regards to colorectal cancer screening by allowing patients to be screened without the discomforts and inconveniences of other screening methods. In October 2010, Cologuard

detected 85% of colorectal cancers; greatly surpassing the 30-40% detection rate of its competitors.

- **Significant Market Potential for Colorectal Cancer Screening.** Colorectal cancer is the second-deadliest cancer in the U.S. causing almost 50,000 deaths per year. While it is very fatal, it is estimated that one-third of colorectal cancer-related deaths could be saved if more individuals underwent regular screening. Of the 80 million individuals in the U.S. recommended for colorectal screening (ages 50-75), only 25% are regularly screened, which clearly portrays the ineffectiveness and the public's aversion to currently available screening techniques. ESAX's non-invasive sDNA test could significantly increase screening due to its affordability, patient-friendly characteristics, and high sensitivity rates (85% cancer-detection and 64% pre-cancer detection). EXAS has estimated an initial market penetration of 150,000 screenings in 2013, which would account for roughly \$22.4MM of revenue.
- **Changing Demographics.** The rise in the average age of the population in the United States ensures an inflow of individuals ridden with diseases, such as colorectal cancer. According to the U.S. Census Bureau, there will be 72.1 million people above the age of sixty-five in 2030 compared to forty million currently. This increase in population of individuals aged above 65 is more prone to diseases and signals pent up demand for medical care, which could present significant market potential for EXAS.

### Valuation

Using a 10-year DCF with a computed WACC of 12.7% and a terminal growth rate of 3%, an intrinsic value of \$13.01 was determined for EXAS. The DCF model had negative revenue growth in the first two years followed by extreme growth in 2013 and 2014 (350%, 250%) due to the expected commercial launch of Cologuard. The following years' revenues were estimated to grow around 50%. Additionally, an industry average P/E multiple of 25x was applied to the 2017 EPS estimate of \$1.05. Discounting the multiple approach back six years, an intrinsic value of \$12.81 was obtained. Blending these two approaches a price target of \$12.91 was determined, which represents an approximate 70% return.

### Risks

- **FDA Approval and Government Regulation.** The marketing and sale of sDNA colorectal screening services is subject to various state, foreign, and extensive federal regulation, most notably FDA approval. Failure to comply with any of these regulations could delay the commercial launch of Cologuard which could significantly impact EXAS's revenues and cash flows in the upcoming years. Any delays in their launch could inhibit the company from achieving their estimated earnings and cash flow generation. In the most extreme circumstance, should the FDA decide not to give EXAS's Cologuard approval, (final FDA approval is expected to be granted in late 2012) expected revenue from the U.S. market would not occur, resulting in substantial net losses.
- **Competition.** The biotechnology industry is characterized by intense competition. Though the large diagnostics companies do not pose a large threat on EXAS, it faces competition from procedure-based detection technologies such as flexible sigmoidoscopy and the traditional colonoscopy, as well as existing and possibly improved traditional screening tests such as fecal occult blood tests (FOBT) and improvements to the colonoscopy.

### Management

Kevin Conroy is the President and CEO of EXAS since 2009. Prior to joining the company, Mr. Conroy was the President and CEO of Third Wave. He has additional healthcare and management experiences serving as the Intellectual Property counsel at GE Healthcare and as Chief Operating Officer at two venture-backed technology companies in Northern California. Patrick Zenner has been the Chairman of the Board of EXAS since 2008 and a Director since March 2003.

**Exact Sciences Corporation**

■ EXAS



**Exact Sciences Corporation**

■ EXAS ■ ^RUT



**Ownership**

% of Shares Held by All Insider and 5% Owners:	6%
% of Shares Held by Institutional & Mutual Fund Owners:	51%

Source: Yahoo! Finance

**Top 5 Shareholders**

<u>Holder</u>	<u>Shares</u>	<u>% Out</u>
Wasatch Advisors Inc.	3,385,054	6.49
Shaw D.E. & Co., Inc.	2,644,084	5.07
Mason Street Advisors, LLC	1,705,950	3.27
Perceptive Advisors, LLC	1,269,822	2.43
BlackRock Institutional Trust Co.	1,216,153	2.33

Source: Yahoo! Finance

## Giant Interactive Group Inc. (GA)

April 29, 2011

Sajid Bhimani

International Consumer Goods

*Giant Interactive Group Incorporated (NYSE: GA) is a leading online game developer that focuses primarily on massively multiplayer online (MMO) games. MMO games allow tens of thousands of players to interact and play on one interface. GA presently has 9 operating MMO games out in the market, and has 4 new games in their pipeline to be released this year. In the past year, 96.7% of revenues came from its online gaming segment, while overseas licensing accounted for 3.2% of total operating revenues. GA's primary demographic target is anyone from the ages of 18 to 40. The company IPOed in 2006 and is headquartered out of Shanghai, China, but is incorporated in the Cayman Islands.*

Price (\$ (9/10/10):	\$8.71	Beta:	0.47	FY: December	2010A	2011E	2012E
Price Target (\$):	\$ 12.05	WACC	8.79%	Revenue (\$Mil)	201.94	252.4	302.9
52WK H-L (\$):	\$6.03-\$8.83	M-Rev. Gr Rate Est (4-6 yr):	10.0%	% Growth	5.72%	25.0%	20.0%
Market Cap (mil):	1947.40M	M-EPS Gr Rate Est (4-6 yr):	10.0%	Gross Margin	85.06%	85.00%	85.00%
Float (mil):	222.30M	Debt/Equity:	0.0%	Operating Margin	55.71%	65.00%	65.00%
Short Interest (%):	0.679%	ROA:	11.4%	EPS (\$Cal)	\$0.53	\$0.68	\$0.82
Avg. Vol (3 Mo.):	380.083M	ROE:	12.7%	FCF/Share	(0.60)	0.43	0.39
Dividend (2011E):	0.17			P/E (Cal)	14.00	12.81	10.68
Div. Yield (2011E):	2.52%			EV/EBITDA	8.45	5.74	4.78

### Recommendation

The rapidly growing Chinese online MMO gaming industry grasps 2.5 hours per day, per average active consumer. GA's MMO's collectively had Active Paying Accounts (APA) of 1,693,000 in 4Q10, an increase of 13.1% from the third quarter of 2010 and an increase of 48.8% from the fourth quarter of 2009. Average Concurrent Users (ACU) was 584,000, an increase of 8.5%, and 20.3% from 3Q10, and 4Q09, respectively. Peak Concurrent Users was 1,713,000, which represented a 17%, and 23.2% increase in 3Q10 and 4Q09, respectively. Giant's distribution network is composed of more than 290 non-exclusive regional distributors and extends across almost all provinces in China. This network enables them to reach over 116,500 retail outlets, including Internet cafés covering all of the large cities, and many of the medium and smaller-sized cities in China. GDP and consumer discretionary spending growth is expected to be 8.2% and 9%, respectively in 2011, which will aid in GA's expansion this year. Due to the aforementioned reasons alongside the following valuation, it is recommended that GA be added to the AIM International Equity Fund, with a target price of \$12, which offers a potential upside of 37.14%.

### Investment Thesis

- **Distribution and customer expansion.** GA's distribution network is located primarily in China's largest cities similar to their competitors. GA acknowledged this in their 20-F, and has future plans to expand into smaller and mid-sized cities. Smaller and mid-sized cities are home to 1/3 of the Chinese population. To enhance customer expansion, GA has licensed their largest gaming platform, ZT Online, to Lagger Network Technology. This move will expose them to a larger customer base that extends over Hong Kong, Macau, Taiwan, Malaysia and Singapore. They have also licensed their gaming platform out to other companies to extend their user base into Vietnam, and Russia. GA is also expanding their distribution and licensing platform to countries like South Korea and Japan. The company may undertake this expansion by late 2011. Overseas licensing increased 311% YoY and accounted for approximately 3.2% of total revenue in 2010.
- **Strong new release pipeline.** 4 additional games will be released during 2011. Dragon Soul, one of the very first 3-D online MMOs in all of China, is scheduled to release in Q2 2011. ZT Online 2 is the sequel to the entire ZT Online Series. The game currently is in the closed beta testing phase and has exceeded 200k PCUs. It is expected that ZT Online 2 will account for 7% of total

revenues in 2011 (\$17.7M), in addition to the dominant original ZT Online Series. The additional generated revenues will help to increase margins and exceed growth expectations. GA acquired exclusive rights to operate Allods Online from Mail.Ru. Inc. It is currently operated in Russian speaking markets, but has closed Beta testing in Europe and the U.S. GA expects a commercial launch of Allods online in Q3 2011. Lastly, Eldsworld was acquired from KOG and is scheduled to launch in 2011. It was added to encourage new customers to get involved with MMOs, alongside product diversification. These new additions to GA's portfolio will drive revenue growth and help to expand margins.

- **Strong cash generation and dividend yield.** Over the past 5 years, cash generated from sales has accounted for approximately 78% of total assets. GA ended 2010 with \$913.88M in cash (\$3.91 per share), up \$196M from 2009. With this cash, management could expand its product portfolio, as well as extend efforts to expand overseas. Management has reiterated GA's commitment to an \$0.18 per share dividend to be paid out 2Q11. The \$0.18 dividend constitutes a 35% payout ratio, which is unseen amongst competitors of GA.

### Valuation

To value GA, a ten-year DCF was conducted. Sales growth rates changed year-to-year to account for recent acquisitions and new game releases. A cost of equity of 7.75% was calculated with an additional 1.05% country risk premium yielding a WACC of approximately 8.8%. The DCF yielded an intrinsic value of \$12.56. In addition, a historical P/E Multiple of 14x and a peer-based adjusted P/E multiple of 22.11x were applied to 2011 EPS of \$.68. These approaches yielded a price target of \$9.52 and \$15.03, respectively. A historical EV/EBITDA multiple of 9x yielded an intrinsic value of \$6.94. After conducting a sensitivity analysis comparing the WACC and the terminal growth rate, and their affect on intrinsic value, a price range of \$11.33 to \$16.00 was obtained. After applying a 75% weight on my DCF and 25% weight on an equal average of intrinsic values that were a result of the relative and historical multiple approaches, I calculated an approximate intrinsic value of \$12.00, presenting a 37.14% upside.

### Risks

- **Dependency on ZT online series.** Since inception, the ZT online series has constituted nearly all of GA's historical net revenues. The ZT Online series is comprised of: ZT Online, ZT Online Classic Edition, ZT Online PTP, ZT Online Green, and the newest ZT online 2, which has not been released yet. Management has guided investors by saying that although the ZT Online series is projected to be a substantial part of shorter term revenue, they strongly believe that the new games that are going to be released in 2011 will slowly start to grab a fair amount of market share and will constitute an increasing portion of revenue in the forthcoming years.
- **Competition.** The highly competitive MMO gaming industry in China has caused GA to lose 6% market share over the past 3 years. GA's largest competitors are, but are not limited to Netease.com, Blizzard Entertainment, Changyou.com Limited, Tencent Incorporated, and Shanda Interactive Entertainment Limited. Most of these larger competitors leverage their brand name recognition, larger international player base, greater game development resources, and greater financial and marketing abilities to their advantage, which forces a lot of the smaller MMO gaming companies out of the market. GA has addressed this in their 20-F, and has given guidance that their new games and growth efforts will help them to regain that market share and expand it further. As inflation in China continues to rise, GA hopes that people will begin buying Internet access which will positively affect revenues

### Management

Mr. Yuzhu Shi is the Chairman of the Board of Directors and the CEO of Giant. Mr. Shi serves on Boards for 5 other companies throughout China, one of which is 51 Network Development. Mr. Shi currently owns 57.55% (131,228,540 shares) of the Series B Class shares in GA. This is broken up into a 44.73% share in Union sky holding group and a 12.82% interest in Vogel Holding Group Ltd.

**Giant Interactive Group Inc Ame**



**Giant Interactive Group Inc Ame**



**Ownership**

% of Shares Held by All Insider and 5% Owners:	2%
% of Shares Held by Institutional & Mutual Fund Owners:	5%

Source: Yahoo! Finance

**Top 5 Shareholders**

Holder	Shares	% Out
Capital International Inc.	1,818,300	.80
Renaissance Technologies LLC.	1,170,661	.51
Owl Creek Asset Management	1,021,923	.45
Citadel Advisors LLC	681,167	.30
Guggenheim Capital, LLC	613,665	.27

Source: Yahoo! Finance



## Nelnet, Inc. (NNI)

April 29, 2011

James Carlson

Financial Services

*Nelnet, Inc. (NNI) is one of the leading education planning and financing companies in the United States. Nelnet offers a comprehensive array of services and products to individuals and families seeking higher education. While most of its revenue is from the fee-based operating segments, Nelnet also sells loan processing software, provides college planning services to students and families, services loans and manages tuition payment plans. Over the past few years Nelnet has been able to diversify their revenue streams and has become extremely successful in creating sustainable revenue sources. Nelnet's fee-based operating segments now account for 58% of total annual revenue. Their fee revenue has grown from \$306 million in 2009 to \$359 million in 2010 and they have almost doubled the number of student loan accounts they service in 2010. Nelnet's asset generation and management services account for 33% of their revenue, while student loan and guaranty servicing accounts for 22%. The remainder of revenue is obtained from enrollment services, floor income, and tuition payment processing, which are 19%, 18%, and 8% of revenue, respectively. These developments have allowed Nelnet to generate a net income of \$255 million, which is over nine times the \$28 million it made the year it went public in 2003. Nelnet has grown from a small student lender in Lincoln, Nebraska, to one of the most diversified and successful student lenders in the country.*

Price (\$): (4/21/11)	22.65	Beta:	1.36	FY: Aug	2010A	2011E	2012E
Price Target (\$):	27.26	WACC	13%	Revenue (Mil)	189.03	218.41	267.16
52WK H-L (\$):	24.47-17.06	L-Term Rev.	3%	% Growth	35.87%	15.54%	22.32%
Market Cap (mil):	1,090.00	Debt/Capital	1x	Net Operating Mar	36.74%	36.74%	36.74%
Float (mil):	18.76	ROA:	0.73%	Pretax Margin	28.49%	28.49%	28.49%
Short Interest (%):	4.4%	ROE:	22.4%	EPS (Cal)	3.91A	4.51E	5.52E
Avg. Daily Vol:	113,408	Provisions/L	22.70	BVPS	18.75	18.75	18.75
Dividend (\$):	0.28	Interest Cov.	1.8x	P/B	1.14	1.14	1.14
Yield (%):	1.3%						

### Recommendation

Since the beginning of the Great Recession the U.S. has seen a jump in college enrollment, and subsequently, a larger customer base for student lending organizations. While all student lending organizations have been taking advantage of this expansion, Nelnet also focused on diversifying its revenues. A diversified revenue stream and a strong customer base can drive a firm to obtain long term profitability by offsetting the impact of the cyclical downturns in the lending industry with sustainable revenues. Currently, 58% of Nelnet's revenue comes from fee-based operating segments of the company. The total breakdown of revenue is 33% from asset generation and management, 22% from student loan and guaranty services, 19% from enrollment services, 18% from floor income, and 8% from tuition payment processing. Nelnet's success in taking advantage of an expanding customer base, diversifying revenue sources, and creating new products over the past five years and has positioned them to achieve long term profitability. That is why it is recommended to add Nelnet to the AIM equity portfolio at a target price of \$27.26, with a 20.4% potential upside. The company's dividend yield is 1.3%

### Investment Thesis

- Aggressively Diversifying Revenue Sources.** Unlike many lending agencies, Nelnet has been diversifying their revenue streams to become less cyclical in order to maintain their profit margin (28.5% pretax). Total revenue from fees increased 17% from 2009 and the total number of families being serviced increased 10%. Nelnet's revenue structure, as mentioned above, has

allowed their long term profitability to no longer hinge solely on interest income. These revenue diversifications will allow Nelnet to hedge against the cyclical nature of the student lending industry and gives Nelnet an economic moat against its competitors

- **Engaging in Long Term Profitability Projects.** In 2010 Nelnet consolidated its core servicing centers to Denver and Lincoln. Nelnet also became the first servicer approved to begin servicing loans for the Department of Education's direct lending program. Between 2009 and 2010 Nelnet was able to almost double the number of student loans it services, adding over 2 million borrowers to service on behalf of the Department of Education. These initiatives have allowed for Nelnet to improve its margins as well as created an opportunity to secure a government customer that will continue to support Nelnet's sustainable revenues.
- **Reducing Debt and Strengthening Cash Position.** In the past two years, Nelnet has been able to put itself in a position to pay off \$1B in debt. Their \$750 million line of credit, as of February 2011, has been paid down to \$125 million while maintaining an interest coverage ratio of 1.8x. Even while paying down debt Nelnet has been able to grow their capital from \$785 million to \$907 million, with a current debt to capital ratio of 1x. This will allow the company to use more resources to effectively diversify capital, pay down debt and continue to expand.

### Valuation

To find the intrinsic value of Nelnet, an excess equity evaluation was conducted. A computed 24.09% ROE and 92.54% retention rate was applied to a beta of 1.36. Using the risk free rate of 4.5% and a risk premium of 8%, to stay conservative, earnings were calculated using 5 years of high growth at the current ROE. The stable growth years thereafter use a ROE of 15%, a calculated retention rate of 80% and growth rate at GDP (3%). This yielded a result of a present value of excess return at \$411.07 million and an intrinsic value of \$27.26, revealing an approximate 20.4% potential upside.

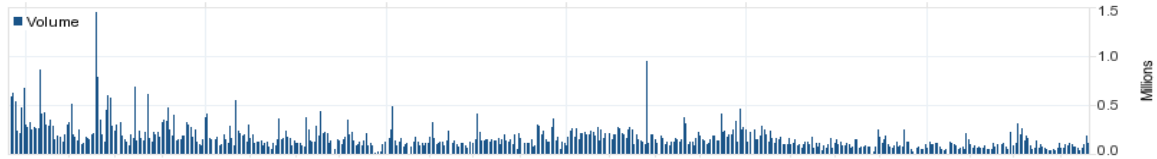
### Risks

- **Possible Loan Defaults.** Nelnet has a slightly higher probability of default than its competitors. This is because they have a higher proportion of loans from schools with traditionally higher default rates. Nelnet was one of only two student loan originators during the credit crisis, which exposed them to riskier loans. During this time Nelnet offered loans to students attending any school for the '08-'09 and '09-'10 school years. Higher defaults could jeopardize the current servicing contract with the Department of Education's direct lending arm, which would have a significant negative impact on sustainable, fee-based revenues.
- **Prepayment Risk.** While the majority of Nelnet's income is not reliant on interest generated from loans, all of its revenue is based on a loan in some manner. Pursuant to the Higher Education Act, students (or any borrower) may prepay any amount of their loan made under the FFEL without any penalty. As a result, if prepayment rates unexpectedly rise, Nelnet's interest and fee-based revenues will suffer.
- **Use of Hedging Derivatives.** Nelnet utilizes derivative instruments to limit exposure to interest rate sensitivity. Although the derivatives employed by Nelnet are intended for economic hedging purposes only, they do not qualify for hedge accounting. Subsequently, Nelnet must use a "mark-to-market" accounting system that allows changes in the fair value of the underlying derivative instrument to affect their financial position. More specifically, changes or shifts in the forward yield curve can negatively impact Nelnet's cash flows and overall profitability.

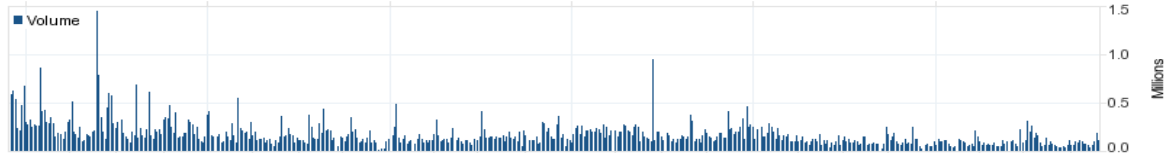
### Management

Michael S. Dunlap is the chairman, CEO and an original founder of Nelnet. He is an integral part of establishing and implementing the strategic direction the company takes. Dunlap has been focusing the majority of Nelnet's resources in diversifying revenue streams, and achieving the best possible economies of scale in all aspects of the company, while achieving superior quality of earnings.

**Nelnet, Inc. Common Stock**



**Nelnet, Inc. Common Stock**



Source: Yahoo! Finance

**Ownership**

% of Shares Held by All Insider and 5% Owners:	19.20%
% of Shares Held by Institutional & Mutual Fund Owners:	43.80%

Source: Morningstar Direct

**Top 5 Shareholders**

<u>Holder</u>	<u>Shares</u>	<u>% Out</u>
General American Investors	1,095,363	1.22
Vanguard Strategic Equity Inv	939,772	1.10
Vanguard Small Cap Index Inv	937,697	0.94
DFA U.S. Small Cap Value II	877,535	0.97
iShares Russell 2000 (AU)	699,124	0.73

Source: Morningstar Direct

## Omnivision Technologies, Inc. (OVTI)

April 29, 2011

Nick Hiller

Hardware

*Omnivision Technologies, Inc. (NASDAQ: OVTI) designs, develops, and markets single-chip complementary-metal-oxide semiconductor (CMOS) camera modules used in the consumer electronics, automotive, security, and medical end markets. The firm operates a fabless model, relying on Taiwan Semiconductor (TSM) and several joint ventures to source wafers and other materials, allowing OVTI to focus specifically on CMOS module design. OVTI is the world's largest company in the CMOS market as measured by shipments with over 30% market share. The majority of OVTI's shipments are legacy VGA sensors; however, the company has seen rapid growth in 5 and 8 megapixel offerings due to the booming smartphone market. OVTI has capitalized on the growing smartphone market with its proprietary Backside Illumination (BSI) and CameraCube solutions. BSI modules perform better in lower-light situations than frontside illumination (FSI), and have overall higher picture quality. CameraCube is a system-on-a-chip solution and is the industry's smallest footprint CMOS sensor. Primary competitors in the CMOS market include ST Microelectronics as well as newer entrants Samsung, Sony, and Toshiba. OVTI was founded in 1995, went public in 2000, and is headquartered in Santa Clara, California.*

Price (\$): (4/22/11)	32.55	Beta:	1.74	FY: Aug	2010A	2011E	2012E
Price Target (\$):	42.82	WACC	12.69%	Revenue (Mil)	602.99	966.17	1,279.38
52WK H-L (\$):	5.11-37.05	M-Term Rev. Gr Rate Est	20%	% Growth	18.90%	60.23%	32.42%
Market Cap (mil):	1,874.00	M-Term EPS Gr Rate Est	39%	Gross Margin	24.60%	29.00%	28.90%
Float (mil):	57.22	Debt/Equity:	9.3%	Operating Margin	5.00%	15.40%	16.40%
Short Interest (%):	9.7%	ROA:	3.9%	EPS (Cal)	0.59	2.49	3.22
Avg. Daily Vol (mil):	2.343	ROE:	5.9%	FCF/Share	\$0.65	\$2.55	\$3.29
Dividend (\$):	0.00			P/E (Cal)	55.2	13.1	10.1
Yield (%):	0.0%			EV/EBITDA	26.1	8.2	6.0

### Recommendation

Shipments in the CMOS market are projected to grow at a 15% CAGR and to double by 2015. Much of this growth is being driven by higher megapixel and higher average selling price (ASP) sensors shipped to the mobile phone market. Global smartphone shipments are forecasted to increase by 40% in 2011 to approximately 400 million units, while tablet shipments are forecast by Geitner to increase to 54.8 million in 2011 and 103.4 million in 2012. Due to this rapid end market growth and industry leading technology, OVTI is trading at an attractive entry point (10x 2011 EPS ex. cash). Nearly 60% of OVTI revenues come from shipments of legacy VGA sensors. As smartphones increase in market penetration, OVTI's product mix will continue to shift towards higher megapixel solutions. Higher megapixel CMOS sensors sell at significantly higher ASPs, which will increase OVTI's blended ASP and allow the firm to maintain its high gross margins. OVTI also outsources most manufacturing to joint ventures with TSM, enabling them to minimize operating expenses and time to market. Due to a favorable valuation and an attractive business model, it is recommended that OVTI be added to the AIM Fund with a 30% upside potential.

### Investment Thesis

- Technology Leadership.** OVTI has developed industry leading proprietary technology. The company was the first to commercialize BSI technology and plans to ramp production of BSI-2 chips during fiscal Q2 and Q3. OVTI has also developed the industry's smallest footprint SoC camera module, CameraCube. The company's solutions are featured in a variety of premium consumer electronic devices, including the iPhone 4, and OVTI has an estimated 50% market share in the smartphone market. This market leading technology should enable OVTI to defend its market share from new entrants like Sony and Samsung.
- Favorable Shift in Product Mix.** As the smartphone penetration increases demand will shift from lower megapixel offerings to higher megapixel offerings. OVTI management expects 8MP

chips to become standard for smartphones this year. The company currently derives approximately 60% of revenues from legacy VGA modules. According to OVTI management a 1MP module fetches an ASP twice that of a VGA module, a 2MP module's ASP is 3x that of VGA, and so on. CMOS modules sold into the automotive market can yield an ASP greater than 10x that of a VGA module. This shift has driven gross margins to the high twenty percent range and has driven blended ASPs up on a year-over-year basis in 2010.

- **Apple Speculation and Capacity Constraint Fears Overblown.** Commentary on OVTI became negative after Sony's CEO announced that the company had won sockets in the iPhone 5, in addition to OVTI, which is being shipped this fall. OVTI will still supply sensors to the iPhone 5, although it is unknown what the split between Sony and OVTI will be. Fears of the potential negative effects on OVTI have been overblown as the company continues to secure other design wins in the rapidly growing smartphone market. The company is also working to diversify its end-market exposure by expanding its presence in the automotive, tablet, medical, and security markets. Management expects revenues from the automotive market to be material by 2013. OVTI has also recently announced that it will begin sourcing wafers from Power Chip in addition to TSM, which should alleviate any danger of imminent capacity constraints.
- **Significant Cash Balance.** OVTI has \$450M of cash on the balance sheet - more than \$8/share. This significant cash balance should enable the OVTI to acquire any new disruptive technologies that may emerge. This cash also enables the firm to initiate a share buyback if wanted.

### Valuation

A five-year DCF was constructed to find the intrinsic value of OVTI. ASPs were modeled up slightly in FY'12 due to the effect of a shifting product mix, and were then modeled to stabilize and eventually decrease due to competition. Shipments were modeled up in FY'12 due to new product ramps, and then were modeled to grow slightly slower than the overall market due to new entrants. A WACC of 12.69% was calculated based on a 12.96% cost of equity and a 4.19% cost of debt. The DCF model yielded an intrinsic value of \$41.23. OVTI was also valued using EV/Sales, EV/EBITDA, and Cash adjusted P/E Ratios. Valuing OVTI at 2x 2012 revenues yield a target price of \$45.55, while using a 12x cash adjusted P/E multiple implies a price target of \$46.75. At 10x 2012 EBIT, OVTI shares are worth \$40.94. Averaging the DCF target price of \$41.23 with the average multiple target price of \$44.41 yields an intrinsic value of \$42.82, representing approximately 30% upside. OVTI doesn't pay any dividend.

### Risks

- **Entrance of Large Competitors to CMOS Market.** Sony, Samsung, and Toshiba have all recently entered the CMOS market. All of these companies are significantly larger than OVTI and have substantially larger capital resources available to compete with. Large share gains by these competitors at OVTI's expense would negatively affect intrinsic value.
- **Concentrated Customer Base.** Foxconn and World Peace Industrial Group have consistently contributed more than 10% each over the last 3 years. OVTI's other customers are also large distributors or OEMs. This customer concentration could negatively affect OVTI.
- **Failure to secure design wins.** The company must constantly secure new design wins at large consumer electronics companies, and competition over these sockets is very intense. A failure by OVTI to secure new sockets would negatively affect sales.

### Management

Shaw Hong has served as a director and the CEO since the company's founding in 1995. Mr. Hong is also chairman of the company's board of directors. Mr. Hong graduated from Jiao Tong University in China with a B.S. degree in electrical engineering and also holds an M.S. in electrical engineering from Oregon State University.



### Ownership

% of Shares Held by All Insider and 5% Owners:	1%
% of Shares Held by Institutional & Mutual Fund Owners:	89%

Source: Yahoo! Finance

### Top 5 Shareholders

Holder	Shares	% Out
Wellington Management Company, LLP	5,173,629	8.99
Fisher Investments, Inc.	3,123,728	5.43
Bank of New York Mellon Corporation	2,535,422	4.40
The Vanguard Group, Inc.	2,335,974	4.06
Friess Associates, Inc.	2,199,934	3.82

Source: Yahoo! Finance

## Horsehead Holdings Corp. (ZINC)

April 29, 2011

Dan Leibforth

Industrial Materials

*Horsehead Holdings Corp. (ZINC) is the largest recycler of EPA listed-hazardous waste in the U.S. and the leading environmental services provider to the U.S. steel industry. ZINC operates with three different products: zinc metal, value-added zinc product, and nickel based product. Based on capacity, Horsehead is the largest zinc producer in the U.S. in both the zinc metal (17% increase in 2010 YOY) and value-added zinc product segments. ZINC is the largest producer of zinc oxide made from 100% recycled materials in North America. In addition, they are the leading recycler of EAF dust—a zinc by-product containing EPA-listed hazardous waste generated by North American steel mini-mills. ZINC recycles more than 50% of all EAF dust generated in the U.S. The firm acquired INMETCO in 2009, and became the largest recycler of nickel-bearing waste products generated by stainless and specialty steel producers, as well as one of the leading recyclers of nickel cadmium batteries. In 2010, the nickel based products from INMETCO accounted for 14.2% of revenue, while zinc products accounted for 75.5% and EAF dust held the remaining 10.3%. Horsehead was formed in 2003, went public in 2007, and is headquartered in Pittsburgh, Pennsylvania. They have production and recycling operations at seven facilities in five states.*

Price (\$): (4/21/11)	16.35	Beta:	1.32	FY: Dec	2010A	2011E	2012E
Price Target (\$):	21.80	WACC	13.12%	Revenue (Mil)	382.36	462.66	536.68
52WK H-L (\$):	17.98 - 7.11	Mid-Term Rev. Gr Rate Est:	14.5%	% Growth	76.59%	21.00%	16.00%
Market Cap (mil):	672.25	Mid-Term EPS Gr Rate Est:	15.0%	Gross Margin	15.06%	19.00%	19.50%
Float (mil):	43.19	Debt/Equity:	0.07%	Operating Margin	5.31%	9.50%	10.00%
Short Interest (%):	5.4%	ROA:	5.3%	EPS (Cal)	0.57	0.81	0.94
Avg. Daily Vol:	325,251	ROE:	7.0%	FCF/Share	-\$0.18	\$0.70	\$1.10
Dividend (\$):	0.00			P/E (Cal)	22.10	14.09	9.85
Yield (%):	0.0%			EV/EBITDA	11.87	9.44	11.39

### Recommendation

Over the last year, the basic materials sector has grown 26.4% and, more specifically, the industrial metals & minerals industry has grown by 15.3% over that same time span. ZINC has been able to successfully enter the market and outperform the industry averages in several areas. Horsehead has returned a 7.0% ROE ttm (industry average of 5.7%) and ZINC's ttm net margin is at 6.5% (industry average of 5.5%). Furthermore, ZINC's P/E ratio is 27.9x (industry average is 41.0x), the P/CF is 12.1x (industry at 21.2x), and they support an attractive PEG ratio of 0.7; all of which suggest Horsehead could be undervalued relative to its peers. ZINC has used their unique refining and reproduction systems to create an economic moat that has yet to be challenged by its competition. They have been able to accomplish this because of their advanced technology, wide variety of products, and low production costs due to recycling and the refining of used metals into sellable products. With rising commodity prices and low cost production, ZINC should be able to expand their operating margins to 8.5% and 9%, respectively, for the next two years - and maintain strong revenue growth of 20% and 16% over the same time period. Due to these factors and a favorable valuation, it is recommended that ZINC be added to the AIM Equity Fund with a price target of \$21.80, which offers a potential upside of 33.34%. The firm does not presently pay a dividend.

### Investment Thesis

- **Low-Cost Feedstock Sources.** Horsehead is the only zinc smelter in North America with the proven ability to produce zinc metal and zinc oxide using 100% recycled zinc feedstocks. The use of recycled feedstock reduces exposure to increases in zinc prices and supports operating margins

during periods of high prices. Also, EAF dust recycling operations provide a reliable, cost-effective source of recycled zinc without relying on third-party sellers.

- **Advanced, Proven Technology.** Horsehead's zinc smelters and refineries are unique in their ability to refine zinc using almost any form of zinc-bearing feedstock. This flexibility allows ZINC to modify their feedstock mix based on cost and availability, as well as to use 100% recycled zinc feedstock generated by EAF dust recycling operations. No competitor has this technology which increases their peers' risk to price fluctuations and availability that could hurt profits. Additionally, INMETCO's process technology for the recycling of a broad range of nickel-bearing waste products, providing 14.2% of ZINC's total revenue in 2010, has been successfully licensed with exclusive rights to ZINC, further widening their economic moat.
- **Growing EAF Dust Recycling Industry and Increasing Capacity.** Due to high productivity and operating cost efficiencies, the mini-mill share of the U.S. steel market has doubled in the last ten years and is expected to account for over 70% of U.S. steel produced by 2017, according to the Steel Manufacturers Association. Steel mini-mill operators have increasingly relied on recyclers rather than landfills to manage this increased output. To prepare for this increase in demand, during the past two years ZINC has constructed three new kilns that increased capacity by a combined 260,000 tons annually (34% increase). In 2010, EAF dust receipts grew by 10% YOY. ZINC also entered a long term contract with a leading steel mini-mill producer and acquired the contracts held by EnviroSAFE Services of Ohio, Inc. to manage their EAF recycling.

### Valuation

To find the intrinsic value of ZINC, a five year DCF analysis was conducted. Revenue growth rates were estimated based on management guidance, historical growth and industry growth. A WACC of 13.12% was used, which included a 1.0% risk premium for commodity price fluctuation. A sensitivity analysis was also conducted based on variations in WACC and long term growth. This yielded an intrinsic value of \$22.71. An EV/EBITDA multiple of 12x was also used based on historical levels, which yielded an intrinsic value of \$19.08. With the DCF weighted at 75% and EV/EBITDA at 25%, a price target of \$21.80 was established, providing a potential upside of 33.34%.

### Risks

- **Highly Cyclical Metals Industry.** Negative industry cycles reflect changes in macroeconomic conditions, levels of industry capacity, and availability of usable raw materials. The overall levels of demand for products containing zinc or nickel reflect fluctuations in levels of end-user demand, which depend on general macroeconomic conditions. If any of these situations arise, ZINC would experience negative growth especially due to their niche business model.
- **Fluctuation in Prices of Zinc and Nickel.** Horsehead derives most of their revenue from the sale of zinc and nickel -based products. Changes in the market price of zinc and nickel impact the selling prices of their products, and therefore their profitability is significantly affected by decreased zinc and nickel prices. Market prices of these metals are dependent upon supply and demand and a variety of factors over which they have no control.

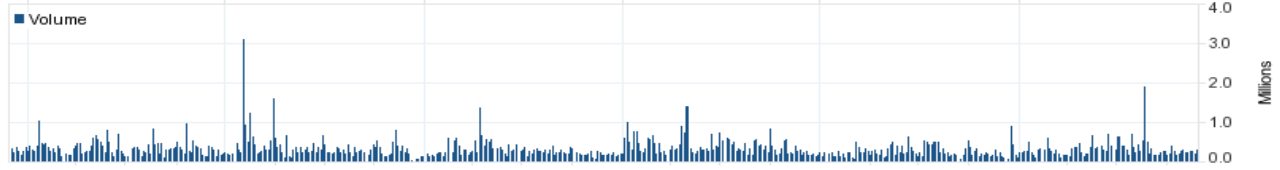
### Management

James M. Hensler, 55, has served as Chairman of the Board, President and Chief Executive Officer since 2004, and has over 31 year experience in the metals industry. From 1999 to 2003, Hensler was Vice President of Global Operations of the Huntington Alloys Business Unit for Special Metals Corp. Robert Scherich has been Chief Financial Officer since 2004. Prior to ZINC, he served as Chief Financial Officer of Valley National Gases Inc. from May 1996 to June 2004.



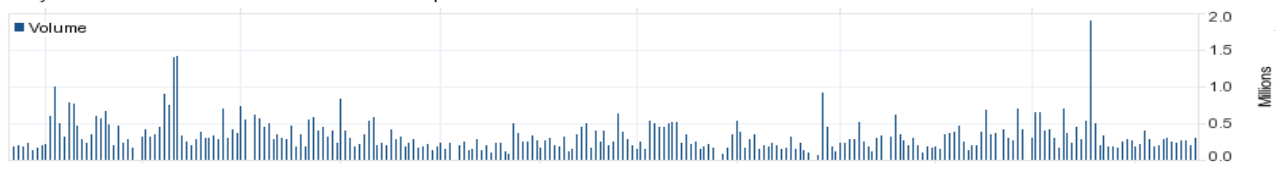
**Horsehead Holding Corp.**

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<b>Ownership</b>		
% of Shares Held by All Insider and 5% Owners		1.6%
% of Shares Held by Institutional and Mutual Fund Owners		98.4%
<b>Top 5 Shareholders</b>		
Shareholder	Shares	% Out
Royce and Associates Inc.	5,363,804	12.29
Fidelity Management & Research	2,750,000	6.30
Vanguard Group Inc.	2,065,887	4.73
Allianz Global Inv of America LP	2,044,952	4.68
William Blair & Company LLC	1,936,099	4.44