Applied Investment Management (AIM) Program

AIM Class of 2013 Equity Fund Reports
Fall 2012

Date: Friday, September 21, 2012 Time: 1:00 p.m.
Road Show Location: Mason Street Advisors/Northwestern Mutual

Student Presenter	Company Name	Ticker	Price	Page No.
Daniel Tallarico	Synnex	SNX	$35.75	2
Patrick Maag	Select Comfort Corporation	SCSS	$33.58	5
Mark McCanna	Flushing Financial Corporation	FFIC	$15.30	8
Kevin Kroeger	Tenneco Inc.	TEN	$31.78	11
Chris Gwinn	Sun Hydraulics Corporation	SNHY	$26.46	14

Thank you for taking the time today and participating in the AIM 'road show' at Mason Street Advisors. 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. Again, thank you for allowing us the opportunity to present at Mason Street.

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Synnex (SNX)
September 21, 2012

Dan Tallarico — Information Technology

Synnex is a provider of distribution and business process outsourcing (BPO) for resellers, retailers, and original equipment manufacturers (OEMs) worldwide. Synnex has two operating segments; Distribution Services and Global Business Services (GBS).The majority of Synnex's revenues are derived from the Distribution Services segment (98%), which consists mostly of IT system and product distribution services. Additionally, Synnex offers contract assembly services, hard drive imaging for government and healthcare sectors, along with an array of other services. Synnex's GBS Services segment globally offers BPO services ranging from IT outsourcing to logistics services and financing. No customer accounted for more than 10% of the firm's total revenue in fiscal year 2011. Some of SNX's largest customers include CDW Corporation, Iron Bow Technologies, Staples Business Depot, Insight Enterprises, and Systemax. Synnex is a Fortune 500 company that was founded in 1980 and is headquartered in Fremont, California with over 10,000 employees. Synnex operates in over 30 distribution facilities in the United States, Canada, Japan and Mexico.

Price($)	35.75	Beta	1.2		FY:December	2011A	2012E	2013E
Price Target($)	46.04	WACC	10.1%		Revenue(mil)	10,409.84	$10,936.87	$ 11,277.44
52 WK H-L($)	$44.25-$23.19	M-Term Rev. Gr Rate Est:	4.2%		% Growth	20.85%	5.1%	3.1%
Market Cap(mil)	1,315.4M	M-Term EPS. Gr Rate Est	10.0%		Gross Margin	6.06%	6.5%	6.5%
Float(mil)	25.9M	Debt/Equity	14.31%		Operating Margin	2.46%	2.4%	2.5%
Short Interest	13.33%	ROA	5.64%		EPS($)	$ 4.08	$ 4.32	$ 4.44
Avg. Daily Vol	218,810	ROE	13.98%		FCF/Share	$ 4.05	$ 3.11	$ 3.36
Dividend($)	-				P/E	7.19	10.6	10.3
Yield(%)	-				EV/EBITDA	4.92	5.14	5.45

Recommendation

Synnex has seen 100 consecutive quarters of profitability over the past several decades. Additionally, the firm has seen average revenue growth of over 11% for the past 3 years despite the weak global economy. This strength in sales is largely attributed to the efficiency with which Synnex conducts their business. Synnex's efficiency metrics are industry leading, including their ROE, which is currently 14% and about 600 basis points greater than their closest competitor, Ingram Micro, and over 400 basis points better than Tech Data Corporation. The corporation's focus on efficiency has led to significantly higher margins than each of these competitors (Gross Margins and Operating Margins are over 100 basis points higher than each). It has also led to a great increase in cash flows as Synnex has a FCF yield well above its industry peers and competitors at 11.6%**.** Synnex's ability to generate large amounts of cash has allowed the firm to hire more workers **-** and expand and improve upon the quality of their services in a capital intensive and highly competitive industry. They have been able to differentiate themselves through their ability to develop lasting relationships with customers and offer services their competitors cannot match, which include technical support, customer service, renewals management, demand generation, back office support for sales, and marketing and administrative functions. For these reasons and an attractive valuation, it is recommended that SNX be added to the AIM Fund at a target price of $46, representing an upside of 30%. The firm does not pay a dividend.

Investment Thesis

- **Growth Investments.** While most corporations scaled back their investments during the recent economic downturn, Synnex invested in their GBS services segment, cloud services, sales organization and in acquiring businesses. These investments have just begun to pay off, one of which is the 2011 acquisition of Marubeni Infotec. The operation was previously breaking even, but in the past year Synnex has grown its profitability in a relatively stagnant Japanese market. Sales investments have also begun being profitable as Synnex has recently been winning new business contracts across the globe. Over the past 6 months they have more than tripled their run rate from $10 million to $48 million by signing new clients such as Aruba Networks.

- **Margin Expansion/Shift to GBS.** Despite representing only 2% of revenue the GBS segment of Synnex currently represents 7% of operating income. Management projects operating margins for the GBS segment will soon rise into the low to mid-teens vs. the Distribution segment which currently has a 2.3% operating margin. As this segment continues to be a focus of growth for Synnex (management projects it to bring in well over 400 million USD in gross revenue), it will continue to be a major contributor to bottom line growth. The driving force behind this margin expansion can be attributed to more services being wrapped around products Synnex sells and a continued shift of the mix of their business to more technical type products
- **Strategic Partnerships.** Synnex has built lasting relationships with many high profile corporations, including HP and Microsoft. Synnex's primary OEM suppliers include HP, Panasonic, Microsoft, Lenovo, Seagate, Lexmark, Acer, Intel, Xerox, and Symantec. Synnex has begun to expand overseas by forging new deals with corporations such as Huawei, the largest telecommunications equipment maker in the world, in order to expand their geographic footprint. These partnerships will expand SNX's customer base across both industries and geographies. As a result of these relationships SNX has increased their percent of revenues from outside North America by 11% over the past year.

Valuation

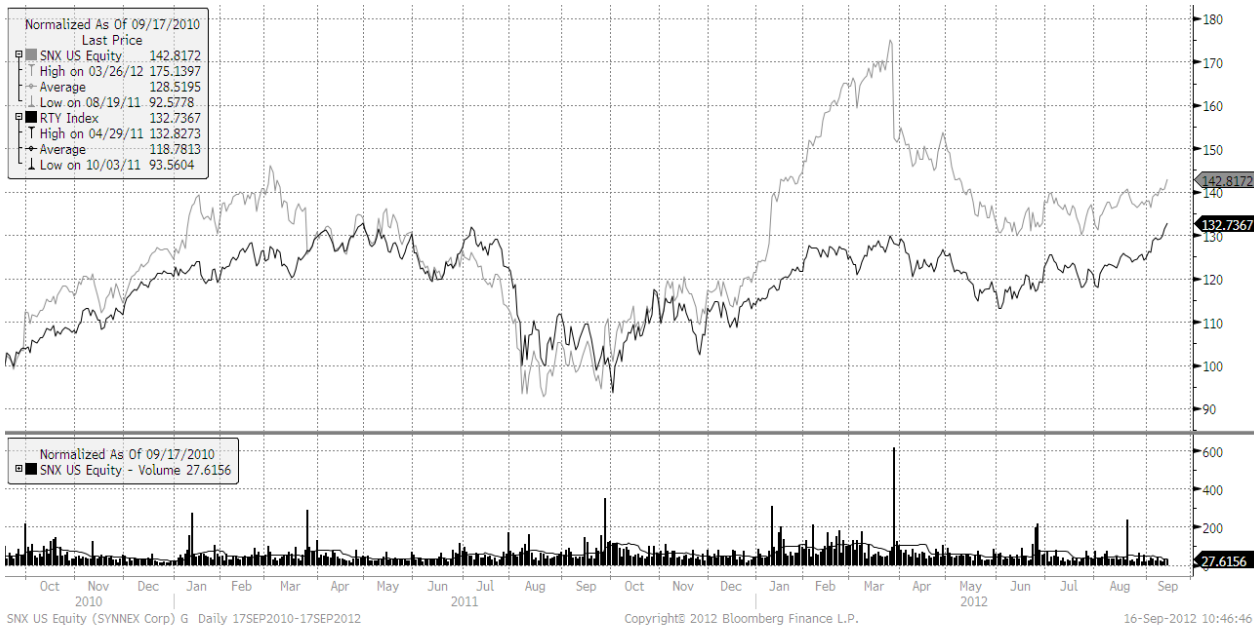
To find the intrinsic value of SNX, a five-year DCF was conducted. Sales growth rates were varied year-to-year to account for both Distribution revenue growth and GBS revenue growth. A sensitivity analysis also was used to account for variations in WACC and the terminal growth rate. A WACC of 10.1% was used and yielded an intrinsic value of $53.70. Blended peer average and historic EV/EBITDA and P/CF multiples approaches were used. With an EV/EBITDA multiple of 5.5x, this method gives an intrinsic value of $43.02 and a P/CF multiple of 9x giving an intrinsic value of $41.42. Taking these into account and equally weighting the DCF and each multiple, a price target of $46 was established representing a 30% upside. The firm currently does not pay a dividend.

Risks

- **Reliance on HP**. Synnex is heavily reliant on its partnerships with HP. In Q2 of 2012 HP products accounted for 36% of SNX's revenue. The sale of HP products and services represented approximately 35%, 38%, and 36% of their revenue for fiscal years 2011, 2010, and 2009, respectively. HP has consistently been a major customer of Synnex throughout the years but any significant financial distress placed upon HP could negatively impact the sales of SNX.
- **Changing Technology.** A major issue with any company working with technological hardware is their ability to manage their purchasing and inventory. This becomes an even more challenging obstacle for SNX as they manage facilities across the globe, since they must continue to stay up to date as to what is relevant in each region.
- **Competitive Industry.** The high amount of competition in the industry has pushed margins to low levels. It has also caused the industry to consolidate, due to the fact that many corporations have been forced out or merged.

Management

CEO Kevin Murai has been with SNX since 2008 and is 48 years of age. He was previously COO of Ingram Micro and worked there for 19 years. COO Dennis Polk has been with SNX since 2002. His previous roles include VP of Corporate Finaance and CFO. He had previosuly been VP of Finance at DoveBid, Inc.



Source: Bloomberg

Ownership

% of Shares Held by All Insider and 5% Owners:	60%
% of Shares Held by Institutional & Mutual Fund Owners:	81%

Source: Yahoo! Finance

Top 5 Shareholders

Holder	Shares	% Out
Silver Star Dev LTD	5,907,796	15.83
Fidelity Management & Research	5,292,998	14.18
Peer Developments	4,282,895	11.48
Dimensional Fund Advisors	2,728,362	7.31
Vanguard Group Inc.	1,613,690	4.32

Source: Bloomberg

Select Comfort Corporation (SCSS)
September 21, 2012

Patrick Maag Consumer Discretionary

Select Comfort Corporation (NASDAQ: SCSS) designs, manufactures and distributes adjustable firmness air-bed mattresses as well as foundations and accessories. SCSS offers 3 series of mattresses under the Sleep Number brand. The mattresses are sold through nationwide retail stores (87.5% of sales), direct marketing operations (8.7%) and wholesale operations (3.8%). The business is vertically integrated with production facilities in Irmo, SC and Salt Lake City, UT. The company operates approximately 400 retail stores, all under Sleep Number marquees. Since 2007, the mattress manufacturer has grown earnings 86% and looks to double 2011 sales by 2015. The company was founded in 1987 in Minneapolis, MN and went public in 1999.

Price ($): (9/14/12)	33.58
Price Target ($):	37.63
52WK H-L ($):	35.60-11.97
Market Cap (mil):	1,889.30
Float (mil)	53.7
Short Interest (%):	7.66%
Avg. Daily Vol (mil):	24.89
Dividend ($):	0.00
Yield (%):	0.0%

Beta:	1.43
WACC:	13.7%
5yr Avg. Rev. Gr Rate Est:	17.4%
5yr Avg. EPS Gr Rate Est:	32.9%
L-Term Rev. Gr. Rate Est:	3.5%
Debt/Equity:	0.0%
2011 ROA:	28.8%
2011 ROE:	55.7%

FY: Dec	2011A	2012E	2013E
Revenue (Mil)	743.2	943.9	1109.0
% Growth	22.7%	27.0%	17.5%
Gross Margin	63.3%	63.3%	63.8%
Operating Margin	12.2%	13.5%	14.7%
EPS (Cal)	$1.07	$1.43	$1.83
FCF/Share	$1.23	$1.16	$1.82
P/E (Cal)	31.24	23.45	18.37
EV/EBITDA	10.35	6.89	4.89

Recommendation

Since the financial collapse at the end of 2008, SCSS has carried out a successful growth strategy, managing to stay debt free while posting rapid growth. From 2009-2011 the company has grown sales by 36.5% and EPS by 40%. A new company strategy implemented in 2009 has created a strong operating platform and can be seen in the 61% growth in sales/ft^2 in company controlled retail stores. The transition has also seen the vertically integrated business expand operating margins every year from 3.92% in 2009 to 12.2% in 2011. SCSS has turned improved cash flows into infrastructure investments to meet a 2015 operating margin goal of 15+%. In 2011 SCSS met its long term store count growth goal of 5-8% with a 5% increase. While 93% of all stores made over $1M in sales, 33% comparable stores sales growth has generated more growth opportunities for the mattress manufacturer. These growth numbers have led the company to beat earnings estimates 14 times consecutively. The company has also recognized a growth opportunity in a younger target demographic with 4x the population base. Because of this sustainable growth and a strong valuation, it is recommended that SCSS be added to the AIM Equity Fund with a price target of $37.63, representing a 12% upside.

Investment Thesis

- **Financial strength and business model.** SCSS finished 2011 with $146M in cash, equivalents and a current ratio of 1.61. This strong capital base without debt provides sufficient operating liquidity and capital expenditure funding for the foreseeable future. A unique business model allows for lean inventory levels using just-in-time manufacturing and made to order, modular assembly. With little capital tied up in operations, the company is free to grow brand awareness, expand store locations and fund innovation. This also allows SCSS to achieve inventory turnover rate of 13.19x while Sealy and Tempur-Pedic posted rates of 11.5x and 7.27x respectively in most recent filings.
- **Target Demographic.** The aging population in the United States will need products that can adapt to their health concerns. A 2010 Bureau of Labor Statistics survey reported that Americans over 74 years of age spend an average of over 9 hours per day sleeping. As the most time consuming portion of the elderly population's day, selecting a proper mattress is important. The Sleep Number beds allow customers to adjust mattress to customer specific needs. Clinical trials

at Stanford, Duke and Harvard have validated that Sleep Number mattresses provide better sleep quality and greater back pain relief than traditional mattress product such as innerspring mattresses. The company has also selected a new target demographic. Upper middle-class 30-54 year-olds represent a 4x larger audience than the former target of 45-65 year-olds. Positioning the brand in a more premium position will help reach this new customer base.

- **Differentiated product and customer experience.** The Sleep Number bed eliminates the industry notion of "one-size fits all" and offers personalized comfort allowing couples to adjust mattress firmness to optimal levels. The company's selling model includes sales, delivery and post sales service to reinforce sales at all points. The many customer contact points allow the immediate feedback to be directly fed into the R&D processes. Relationship driven sales and in store demonstrations allow customers to see how the technology works and experience the benefits of the innovative product. In 2009 the company ended relationships mattress retailers and closed 72 stores to focus on driving traffic through company controlled sales channels. The results have been good with improved profitability and control over customer purchasing experience.

Valuation

To find the intrinsic value of SCSS, a 5 year DCF was conducted and weighted 50% of the final value. Revenue growth started at 27% in 2012 and trended down to 10% in year 5. The DCF used a calculated WACC of 13.67. This DCF yielded an intrinsic value of $37.18. A sensitivity analysis of year 1 FCF was performed with a WACC ranging from 11% to 15% and FCF of $65M ± 5%. Another sensitivity analysis of year 5 FCF used the same WACC range but varied the FCF of $290M by ± 20%. Each was weighted 25% and yielded values of $38.14 and $38.03 respectively. The combination of the three methods came to intrinsic value of $37.39. The company does not pay a dividend.

Risks

- **Sluggish consumer spending.** Currently, the company is highly dependent on mall traffic and popularity of malls as shopping destinations. In 2009 SCSS started an initiative to use independent buildings under the company's name to mitigate the risk of slowing mall traffic. Recent economic uncertainty has also caused consumers to more carefully allocate disposable income. This sluggish spending could not only reduce mall traffic and adversely affect sales.
- **Competitors' resources and innovation.** Some of the company's competitors have access to greater resources in the development of new mattress products. These resources include better brand recognition and greater market share through more points of sale. If Select Comfort Corp. fails to create new innovative products as well as maintaining a significant marketing budget, industry competitors will seize market share.
- **Inventory levels.** The lean inventory levels of just-in-time manufacturing do not allow SCSS a significant buffer in reacting to supply shocks. With only two manufacturing facilities SCSS faces the risk of order delays, which could adversely affect customer satisfaction and profitability. Many components used in manufacturing are provided on a sole source basis which streamlines the production process, but disruption in these relationships could adversely affect sales.

Management

The CEO Shelly R. Ibach has been with SCSS since 2007, starting as Vice President of sales in Company Owned Channels. Ibach was promoted to Chief Operating Officer in June 2011 before becoming CEO and President in June 2012. Kathryn Roedel, Executive Vice President and Chief Services and Fulfillment Officer, joined the company in April 2005 after working as Vice President of Global Supply Chain for GE Medical Systems.

Ownership

% of Shares Held by All Insider and 5% Owners:	8%
% of Shares Held by Institutional & Mutual Fund Owners:	87%

Source: Yahoo! Finance

Top 5 Shareholders

Holder	Shares	% Out
Disciplined Growth Investors	3,746,909	6.66
Alliancebernstein LP	3,662,511	6.51
Vanguard Group, Inc.	3,118,549	5.54
State Street Corp	2,885,059	5.13
BlackRock Fund Advisors	2,392,846	4.25

Source: Yahoo! Finance

Flushing Financial Corporation (FFIC)
September 21, 2012

Mark McCanna Financial Institutions

Flushing Financial Corporation (NASDAQ: FFIC) is a savings bank headquartered in Lake Success, NY. Savings banks, also known as "thrift" banks, are community-based institutions that typically focus on growing deposits and originating home mortgages. 43% of FFIC's loans are multi-family residential, 22% are one-to-four family, 18% are commercial real estate, and the remainder being mostly commercial business loans. From 2010 to 2011, FFIC had solid loan growth of 4.4% YoY, with non-interest bearing deposits growing 17.7%, and interest bearing deposits decreasing 1.23%. The savings bank operates through 16 full-service banking offices, nine in Queens County, two in Nassau County, four in Brooklyn, and one in Manhattan. The bank also has an internet branch, "iGObanking.com," which offers checking, saving, and certificate of deposit accounts in order to raise capital from beyond the extremely competitive New York banking market.

					FY: September	2011A	2012E	2013E
Price($): (9/13/12)	$15.30		Beta:	0.71	Interest Revenue (thousands)	$224,500	$237,355	$251,186
Price Target ($):	$18.94		WACC	4.20%	% Growth	5.32%	2.52%	5.83%
52 WK H-L ($):	$17.01-10.00		M-Term Rev. Gr Rate Est:	5.00%	Net Interest Margin	3.64%	3.66%	3.69%
Market Cap (mil):	$474.80		M-Term EPS Gr Rate Est:	4.00%				
Float (mil):	28.42		Financial Leverage	10.30	EPS	$1.28	$1.35	$1.40
Short Interest:	4.04%		ROA:	0.71	P/E	13.69	14.76	15.53
Avg. Daily Vol:	66,053		ROE:	8.15	BVPS	$15.40	$16.74	$18.14
Dividend:	$0.52		Tier 1 Capital Ratio	13.71%	P/B	1.07	1.20	1.25
Yield:	3.40%		Credit Provisions/Revenue (%):	13.50%				

Recommendation

Flushing Financial Corporation is a well-capitalized thrift bank in the New York City Metropolitan area with its Tier 1 core capital ratio and risk-based capital levels in excess of regulatory requirements by at least 4% of assets. As is typical of thrift banks, most of FFIC's loan portfolio consists of various types of mortgages. New York City suffered from the real estate bubble, but not as much as other cities, and the continued population growth of NYC will be a driver in the growth of real estate investments. Averages obtained by comparing the price to book ratios of ten peer thrift banks to various metrics of their performance, FFIC's net interest margin is undervalued by 20%, its dividend yield by 30%, its liquidity by 3%, its earnings per share by 40%, , and its ROE by 12%. FFIC plans to expand through acquisitions and opening more banking centers. Based on their growth prospects and FFIC's relatively low price, it is recommended to be added to the AIM Equity portfolio with a price target of $18.94, representing a 25.5% upside. The bank also pays a 3.4% dividend yield.

Investment Thesis

- **Higher Lending Standards.** FFIC has reconsidered its underwriting standards in adapting to the post 2007 real estate market. For multi-family residential properties, a borrower must now provide evidence that they have improved the property value of the underlying asset to refinance an existing mortgage. A review of delinquent multi-family loans showed that a majority of them had fewer residential units, so FFIC is shifting their loan portfolio towards larger properties. There have also been a number of changes for one-to-four family residential property mortgage loans; previously they originated home equity lines of credit without verifying a borrower's income, but now income verification is required. Furthermore, they no longer offer loans to self-employed individuals based on income. These increased underwriting standards will lead to improved loan loss reserves and higher income for the bank. Non-performing assets as a percent of total loans decreased 8.4% from 2010 to 2011.

- **Shift from Thrift to Commercial.** FFIC has long been a thrift bank, but in recent years they have begun to explore opportunities for the bank to shift to a more commercial bank. FFIC has taken advantage of more extensive banking regulation and financial industry downsizing by recruiting bankers that were downsized from larger firms. These new employees bring significant commercial banking relationships to FFIC. Commercial banking can result in lower interest bearing deposits, which put upward pressure on net interest margin and a correspondingly higher level of return on equity and price to book ratio. The ten closest commercial banks to FFIC by market capitalization have an average P/B ratio of 1.3x and return on equity of 13.33%, which FFIC should achieve as they commercialize.
- **Focus on Asian Communities.** FFIC's branches are particularly concentrated in the NYC borough of Queens. This area has a particularly high level of ethnic diversity and the bank is particularly focused on the Asian community, which comprises 23% of the borough's population and 50% of NYC's total Asian population. Since 2000, the percent of Asian immigrants has risen from 20% to the current 35% level. Asian populations are noted for having high levels of savings, education, and entrepreneurship. This customer base can help FFIC realize their goal of becoming a more commercial bank. Furthermore, the bank's employees collectively speak 30 languages, which means they are well positioned to take advantage of Queen's ethnic diversity. Immigrants tend to be attracted to areas with similar demographic backgrounds, and since banking is so responsive to trust, FFIC can take advantage of any increase in immigration.

Valuation

The discount dividend model and price to book ratio approaches were used to find the intrinsic value of FFIC. The WACC for the company was computed to be 4.2%. The discounted dividend model used the most recent and historically relevant yearly dividend payouts of $0.52. The intrinsic value of this approach was weighted by 20% in the total valuation and the remaining 80% was allocated to the price to book multiple of 1.25, which is consistent with other banks with similar business plans and market value. The multiple yielded an intrinsic value of $18.47, while the dividend model yielded $20.80. Blended together, FFIC has an estimated intrinsic value of $18.94; an upside of nearly 30%.

Risks

- **High Competition.** The market area of FFIC has an extremely high density of financial institutions. Many of these institutions have greater financial resources, name recognition, and market presence. Individuals may perceive these institutions as more stable than FFIC, and therefore direct their deposits and borrowings from them. Since 2007, the banking industry has consolidated and interstate banking restrictions have been lifted; this makes it more difficult for community banks to compete. This is why FFIC's internet banking platform is so important; it allows the bank to take deposits beyond their geographic footprint.
- **Regulation.** In 2010 President Obama signed the Reform Act into law with the intention to address perceived weaknesses in the U.S. financial regulatory system and prevent further economic crises. The full impact of the regulation will not be known until the new regulations are actually implemented; however the Reform Act has already eliminated the banks previous regulator, the Office of Thrift Supervisions, and replaced it with two regulators, the Office of the Comptroller of the Currency, and the Federal Reserve. Reporting to two offices, rather than one, may increase regulatory costs.

Management

John R. Buran has served as Executive Vice President and Chief Operating Officer from 2001 to 2005, when he was promoted to President and Chief Executive of the company. FFIC has 19 executives, much more than the average of 6 at peer companies; this can promote specialization, and market insight, but also make collaboration more difficult. The board has 12 members, one more than the average peer, but the average tenure of the board members is almost twice the peer average of 10 years.

Ownership

% of Shares Helf by All Insiders and 5% Owners:	5.00%
% of Shares Helf by Institutional and Mutual Fund Owners:	83.00%

Top 5 Shareholders

Holder	Shares	% Out
Wellington Management Company, LLP	3,000,438	9.69%
Dimensional Fund Advisors, LP	1,620,951	5.24%
Vanguard Group	1,546,927	5.00%
Goldman Sachs Group Inc	1,153,907	3.73%
JP Morgan Chase & Company	1,077,630	3.48%

Tenneco Inc. (TEN)
September 21, 2012

Kevin Kroeger Consumer Cyclical

Tenneco Inc. (TEN) is a producer of emission control (66% of sales) and ride control (34%) products and systems for light, commercial and specialty vehicle applications. The company serves original equipment vehicle manufacturers (82% of sales) and the repair and replacement markets, or aftermarket, worldwide (18%). The firm offers emission control systems, such as catalytic converters and diesel oxidation catalysts to reduce harmful gaseous emissions; diesel particulate filters to eliminate particulate matter emitted from diesel engines; burner systems, which combust fuel and air inside the exhaust system; and hydrocarbon vaporizers and injectors. It also provides lean nitrogen oxide traps, selective catalytic reduction (SCR) systems, and alternative nitrogen oxide (NOx) reduction technologies that reduce NOx emissions from diesel power trains. Ride control products enhance the safety and comfort of a vehicle by ensuring an equal distribution of loads on tires and reducing noise, vibration, and harshness. Examples of these products include: shock absorbers, struts, mufflers, vibration control components, and advanced suspension systems (all under the leading Walker and Monroe brands). The company is headquartered in Lake Forest, IL.

Price ($) (09/14/12):	$31.78	Beta:	1.50	FY: December	**2011A**	**2012E**	**2013E**
Price Target ($):	$ 45.44	WACC	11.25%	Revenue ($Mil)	7,205.00	7,738.23	8,205.32
52WK H-L ($):	22.47 - 40.69	MT Rev. Gr Rate Est (3-5 yr):	8.70%	% Growth	21.4%	7.4%	6.0%
Market Cap (mil):	1919.4M	MT EPS Gr Rate Est (3-5 yr):	29.00%	Gross Margin	16.2%	16.6%	16.0%
Float (mil):	58.8M	LT Debt/Total Assets	34.7%	Operating Margin	5.3%	6.1%	6.2%
Short Interest (%):	6.4%	Credit Rating	BB, Ba3	EPS ($Cal)	$2.91	$4.02	$4.71
Avg. Vol (10 day)	786,612	EBITDA 1-yr Growth	28.2%	FCF/Share	$ 0.52	$ (0.38)	$ 1.49
Current Ratio	1.31	2011A ROA:	4.8%	P/E (Cal)	10.93	7.90	6.75
Dividend Yield	0.0%	2011A ROIC:	21.5%	EV/EBITDA	5.3	4.8	4.6

Recommendation

The YTD underperformance in stocks linked to the global production of light, commercial, and specialty vehicles offers the AIM student-managers a compelling entry point into Tenneco, a company with visible mid-term catalysts, leading market share in core competencies, and exposure to long term secular themes in the industrials space. TEN is the leader in North America for emission control products (2nd in Europe and China), and also commands leading share in ride control products in both North America and Europe. While pricing is always a concern for component suppliers tied to the major auto-OEM's, TEN's tenured status as a tier-1 supplier and the more stringent diesel-emissions standards going live over the next 2-5 years makes a margin squeeze unlikely. In addition, the company's rapidly expanding presence in commercial/specialty vehicles (including partnerships with Navistar, Caterpillar, Deere, Harley, Tata, MAN SE) highlights the level of innovation and technical proficiency within the organization. On the macro front, geographic diversity (47% of sales North America, Europe 26%, China 9%, South America 8%, India 7%, and Australia 2%) should enable TEN to continue to move forward with product introductions despite the embedded economic slowdowns in Europe, China, and Australia. If worldwide production volumes were to drop materially below IHS forecasts, the company's relatively high exposure (15-18%) to the North American and European aftermarkets provides an attractive hedge. For these reasons, along with favorable timing and valuation, it is recommended TEN be added to the AIM equity portfolio with a target price of $45.44, which is 43% higher than its current price.

Investment Thesis

- **Looming emission-reduction regulation solidifies earnings power.** Management cites 17 different pieces of legislation touching TEN's geographies over the next two years. Sovereigns implement emission-reduction controls in tiers, with successive tiers becoming more stringent. For example, the Euro-6 standard (2013) requires all vehicles equipped with a diesel engine to reduce NOx emissions by 50% from the Euro-5 standard. On top of shifting focus to commercial vehicles, the company has customized its 5-year technology roadmap towards these regulations.

- **Commercial/Specialty vehicle opportunity.** In addition to being margin accretive, the considerable runway TEN has to increase CV penetration gives TEN a clear path for growth. Despite lowering 2012 guidance for CV sales, management still expects 30% of 2016 sales to come from this segment, implying a 5-year CAGR of 40%. The company's growth in this end-market also serves to diversify away from its consumer-discretionary oriented customer base. GM and Ford accounted for 19% and 15% of 2011 sales. New contracts with MAN, a European CV OEM, and Tata Motors, an Indian OEM, are an initial step into the potential for future deals involving natural gas vehicles (NGV's) and vessels.
- **Aftermarket helps smooth production cycles.** While not perfectly uncorrelated, soft new car sales moves average age of existing vehicles higher (currently 11 years in U.S), adding wear, and driving consumers into auto parts retailers such as Advanced Auto Parts (1.1% of sales), O'Reilly Automotive (.9%), and Monro Muffler (.8%). As N.A light vehicle production fell at a 9.3% CAGR from 2005-2009, stock prices for these three retailers appreciated 4x the market. Auto-retail is not as developed in Europe, but similar phenomenon is likely to occur in the region as vehicle production wanes, offering TEN some downside protection.

Valuation

Given the mid-term nature of the investment thesis, a 5 year DCF was used to value TEN's shares. Revenues were projected by geographic end market, where both management commentary and IHS production estimates determined growth. A calculated WACC of 11.25% and a terminal growth of 2.50% were applied to free cash flow estimates, producing a price of $41.59. Stressing the WACC and terminal growth rate 1% and .50% respectively in both directions yielded a price range of $42.40-$30.07. Additionally, an adjusted peer EV/EBITDA multiple of 4.57 was applied to 2013E EBITDA, yielding an intrinsic value of $51.22. A weighted average of both the DCF (60%) and EV/EBITDA (40%) approaches generates a price target of $45.44, which is 43% higher than its current market price of $31.78.

Risks

- **Debt.** Like most auto suppliers, a heavy portion of TEN's costs are fixed. While the company has a history of swiftly eliminating variable components of its cost structure through layoffs and plant closures, a global downturn of similar magnitude to the most recent recession could damage the company's ability to retire maturing debt in 2015, 2016, and 2020.
- **Preference for alternative emissions-reduction technology from competition.** TEN's secret sauce within the emissions control business is its SCR technology. Some larger competitors offer similar reduction-products utilizing engine gas recirculation (EGR) technology, which aims to reduce the conditions under which NOx is formed. SCR is exclusively an after treatment solution. While TEN has several products to complement EGR, an increase in the demand for this technology would adversely affect core SCR sales.
- **Regulation Enforcement in China.** While management is comfortable confirming the regulation timeline in Europe and the U.S, they are less certain China's government will go through with its plans to implement Euro-4 for commercial vehicles in July of 2013.

Management

Gregg Sherrill, 59 years old, has served as CEO since 2007. Previously, Sherrill was Corporate VP and President of Power Solutions with Johnson Controls Inc. from 2004 to 2007 and held various engineering and manufacturing positions during 22 years at Ford Motor Company. He is a director on the board of Snap-On Inc.

Ownership

% of Shares Held by All Insider and 5% Owners:	1.00%
% of Shares Held by Institutional & Mutual Fund Owners:	>90.0%

Source: Yahoo! Finance

Top 5 Shareholders

Holder	Shares	% Out
FMR LLC	5,688,019	9.46%
WELLINGTON MANAGEMENT COMPANY, LLP	5,400,315	8.98%
VANGUARD GROUP, INC. (THE)	3,547,595	5.90%
IRIDIAN ASSET MANAGEMENT LLC	3,030,064	5.04%
BESSEMER GROUP, INCORPORATED	3,005,200	5.00%

Source: Yahoo! Finance

Sun Hydraulics Corporation (SNHY)
September 21, 2012

Chris Gwinn — Industrials

Sun Hydraulics Corporation (SNHY) is the market-leading manufacturer of high-performance, screw-in hydraulic cartridge valves and manifolds which control force, speed, and motion as integral components in fluid power systems. In 2011, geographic sales were derived from the Americas (47%), EMA (32%), and Asia (21%). The company's products provide an important control function within a hydraulic system; they control the direction and rates of fluid flow by regulating the control pressures. Common uses of SNHY's hydraulic cartridges consist of steering and braking activities in construction, agricultural, and marine equipment. Hydraulic cartridges are also used to raise, hold, and clamp machinery, work platforms, and ladders for construction, fire, and rescue equipment. Additionally, SNHY sells these products worldwide through independent distributors. Since its IPO in 1997 the company has consistently paid a dividend, with their current dividend yielding 1.46%. SNHY was founded in 1970 and is currently headquartered in Sarasota, Florida.

Price ($) (10/06/11):	$ 26.46		Beta:	1.59		FY: December	**2011A**	**2012E**	**2013E**
Price Target ($):	$ 32.00		WACC	15.54%		Revenue ($Mil)	204.17	215.66	228.67
52WK H-L ($):	33.65 - 18.74		LT Rev. Gr Rate Est (3-5 yr):	12.32%		% Growth	35.49%	5.6%	6.0%
Market Cap (mil):	687.62M		LT EPS Gr Rate Est (3-5 yr):	9.54%		Gross Margin	38.80%	40.05%	40.70%
Float (mil):	20.74M		Debt/Equity:	0.0%		Operating Margin	27.07%	28.08%	29.70%
Short Interest (%):	7.9%		LT Debt/Total Assets	0.0%		EPS ($Cal)	$1.47	$1.59	$1.75
Avg. Vol (10 day)	41,443		EBITDA 1-yr Growth	63.51%		FCF/Share	$1.53	$2.46	$1.62
Inventory Turnover:	15.91		2011A ROA:	22.49%		P/E (Cal)	18.04	16.69	15.11
Cash Ratio:	361.4%		2011A ROE:	25.93%		EV/EBITDA	7.92	6.88	5.50

Recommendation

Amidst a competitive landscape, SNHY has established itself as a leader within the niche market for screw-in hydraulic cartridge valves and manifolds. Their achievements are supported by strong fundamentals including a 2002-2008 revenue CAGR of 21% and a Q2 2012 ROIC of 23.96% (industry average of 14.74%). Furthermore, SNHY's strong liquidity (TTM Q2 2012 cash $53MM; TTM Q2 2012 FCF of $39.2MM) provides flexibility to continually execute its initiatives that will drive growth, profitability, and shareholder returns. SNHY currently has plans to expand its capacity by an adding another factory in Sarasota, FL (estimated $6MM capital expenditure), financed entirely through their substantial cash balance. Management's effectiveness can be seen in its operating margin (Q2 2012 of 28.9%) and profit margin (Q2 2012 of 19.7%), both of which have outperformed their closest competitors in the respective quarter, Parker-Hannifin (operating margin 11.9% and profit margin: 8.9%) and Omega Flex (operating margin 5.2% and profit margin: 3.3%). Because of these reasons, it is recommended that SNHY be added to the AIM Fund with a target price of $32, offering a potential upside of 20%, and a dividend yield of 1.46%.

Investment Thesis

- **Chinese Growth Opportunities.** China (21% of 2011 sales) recently approved a $157B infrastructure spending that will green light 60 infrastructure projects worth more than $150B. Among the approved projects is an expansion of 107 miles of rail track, subway projects in 18 cities, utility improvements, and road construction. Chinese government officials estimate the average construction time for these projects is approximately four years. With the establishment of Sun Hydraulics China Co. Ltd (a representative office in Shanghai built in January 2011), Sun is well positioned to benefit from the Chinese infrastructure investment plans.
- **Increasing Market Share.** With a market share of 33%, SNHY has become a leading market player in the hydraulic valve and manifold space. Despite SNHY's focus to operate more

efficiently and drive sales through offering superior products, SNHY has continued to gain traction on the $2.5B global hydraulic valve market. Due to the diversification of SNHY's product offering, the company has outperformed its end markets by 10% from 2004-2007.

- **Robust Balance Sheet.** Due to SNHY's conservative capital structure, the company is well positioned to experience robust growth as the economy continues the recover. SNHY has an extremely strong liquidity position, as the company has zero debt and a strong cash balance. Furthermore, the company demonstrates industrial efficiency with its healthy gross profit and profit margins of 39.2% and 18.6% in TTM 2012, respectively. In addition, SNHY experienced significant top line growth of 35.5% and 54.7% in 2011 and 2010, respectively. The company has been profitable every year since 1972.

Valuation

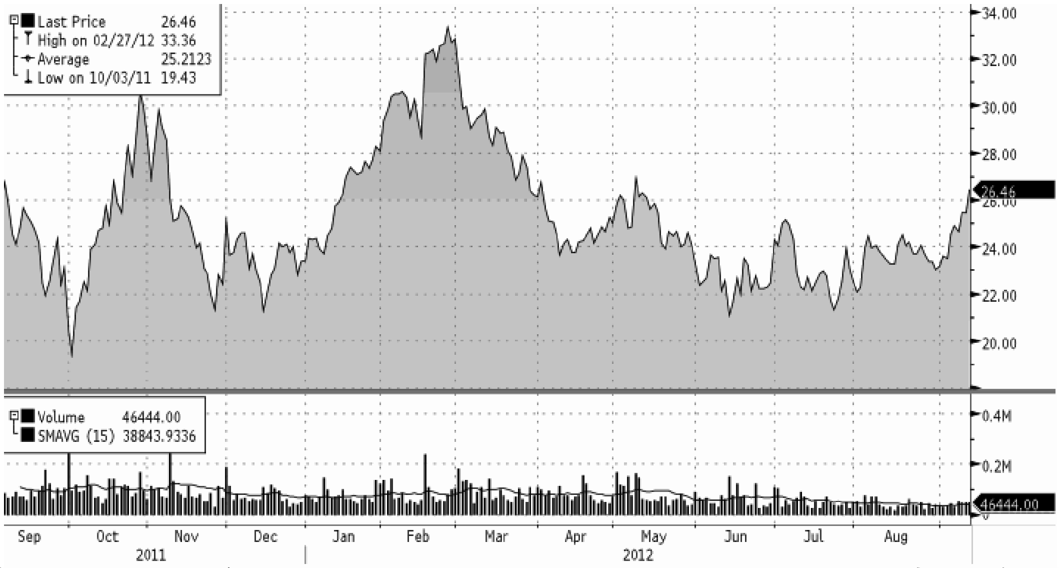
A five-year DCF was conducted to find the intrinsic value of SNHY. Sales growth rates were forecasted through management's expectations in 2012 as well as from economic forecasts. Due to greater than anticipated seasonality in 2H 2012, management expects a seasonal decline of 11% in sales during 2H 2012 (typical seasonality of 5-6% decline); however, revenue is still expected to grow 5.6% for FY2012. This growth accounts from the benefit of the materialized Chinese revenue and North American demand. Due to its continued market expansion, SNHY is expected to generate a long-term growth rate of 12.3%. A WACC of 15.5% and a terminal growth rate of 2.5% was used and yielded an intrinsic value of $31. Additionally, a thorough sensitivity analysis was applied, with a varying WACC, terminal growth rate, operating margin, EBITDA margin, and revenue growth yielding an average intrinsic value of $33. A P/E multiple approach was also applied. With a current P/E multiple of 17.4x and expected 2013 EPS of $1.97, this method provided an intrinsic value of $34.28. Taking all four valuations into account and weighting the intrinsic values appropriately, a price target of $32 was established offering an upside of 20%. SNHY currently pays a 1.36% dividend.

Risks

- **Sluggish Macroeconomic Data.** With generating over 50% of its revenue from international markets, SNHY's business model is contingent upon sustained global economic growth in these markets. SNHY relies heavily upon the macroeconomic indicators such as PMI, GDP, and Consumer Sentiment to gauge consumer demand for their products. Because of a potential European recession and declining Chinese GDP growth (52% of 2011 sales derived from Europe and China) as well as PMI below 50 (August United States, China, Germany PMI: 49.6, 49.2, and 44.7, respectively), there remains the caveat of a near term slowdown in these economies.
- **Currency and Commodity Markets.** The strengthening of the USD has negatively affected SNHY. As a result, net foreign currency transaction loss was $0.1MM in 2010 versus $0.3MM in 2009. In terms of the commodity markets, aluminum prices are expected to rise 3.8% in 2012, while steel is expected to 3.5%; however, aluminum and steel companies are expecting 2012 demand to rise by 6.4% and 5.3%, respectively. Due to these conditions, the currency and commodity markets may have an adverse effect on SNHY's operations. The company does not use financial instruments to hedge foreign currency exchange rates.

Management

Allen Carlson has served as the President, CEO, and Director of Sun Hydraulics since May 2000, after having served as Vice President from January 2000 until May 2000. Prior to his employment with Sun, Mr. Carlson held various engineering, marketing, and management positions for Vickers Inc. Tricia Fulton is the CFO of Sun Hydraulics. Mrs. Fulton has over 20 years of public accounting, operations, and finance experience.



Ownership

% of Shares Held by All Insider and 5% Owners:	20%
% of Shares Held by Institutional & Mutual Fund Owners:	64%

Source: Bloomberg

Top 5 Shareholders

Holder	Shares	% Out
PRICE (T.ROWE) ASSOCIATES INC	2,155,120	8.29
ROYCE & ASSOCIATES, LLC	1,662,284	6.40
VANGUARD GROUP, INC. (THE)	1,108,232	4.26
CONESTOGA CAPITAL ADVISORS, LLC	1,038,078	3.99
MCKEE (C.S.) L.P.	946,198	3.64

Source: Bloomberg