Applied Investment Management (AIM) Program

Spring 2010
February 19, 2010

Hosted by : MBO Cleary

AIM Class of 2010 Equity Fund Reports

Student Presenter	Company Name	Ticker	Price	Page No.
Ross Michler	Dolan Media Company	DM	$10.37	2
Josué López	Cherokee Incorporated	CHKE	$16.27	5
Ryan Rusch	SVB Financial Group	SIVB	$40.23	8
Matthew Pruyn	NutriSystem, Inc.	NTRI	$20.36	11
Mike Rice	ProAssurance Corporation	PRA	$49.53	14

Thank you for taking the time today and participating in the AIM 'road show' at MBO Cleary. 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 MBO Cleary.

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Dolan Media Company
DM
Price: $10.37 ($4.56-15.00)
Fiscal Year Ends: December 31

February 15, 2010 — Ross Michler
Russell 2000 Index: $610.72 ($342.59-649.15) — Media Sector

Dolan Media Company (DM) is a leading provider of business information and professional services to the legal, financial, and real estate industries in the United States. DM receives 52.4% of revenues from its Professional Services Division, which comprises three subsidiaries: National Default Exchange, which provides mortgage default processing services to law firms, mortgage lenders, and loan servicers on California foreclosure files; DiscoverReady, which offers outsourced discovery management and document review services to major companies and their counsel; and Counsel Press, the nation's largest provider of appellate services to law firms. The remaining 47.6%of revenues is attributable to the firm's Business Information Division, which currently publishes 64 print publications, manages 45 online publication websites, and administers 36 event websites with email notification systems. Headquartered in Minneapolis, Minnesota, Dolan Media was founded in 1992 and has 1,800 employees.

Recommendation

As the second-largest publisher of law periodicals and the third-largest publisher of local business journals in the United States, DM operates within an attractive niche space of the publishing industry. Major competitors for DM include First American Corp, Lender Processing, Gannet Co., and McGraw-Hill. The firm's emphasis on revenue growth (34.9% y/y in 2009) through acquisitions and continued investment in its Business Information Division should allow DM to maintain its competitive position within an industry that is struggling to restructure to compete with online alternatives. Furthermore, management expects to achieve 2% EBITDA margin expansion (from 28% to 30%) as its acquisition of Barrett-NDEx in September 2008 creates synergies within its Professional Services Division. Additionally, DM's substantial geographic footprint in California and Nevada should allow the firm's mortgage business to continue to capitalize upon the continuing turmoil in the housing market. Therefore, due to its unique competitive position, favorable potential for margin expansion, and enhanced mortgage service opportunities, it is recommended that DM be added to the AIM Equity Portfolio with a target price of $16, offering a potential upside of 55%. The firm currently pays no dividend.

Key Statistics	Feb 15, 2010
Market Cap	$309.47M
Shares Outstanding	29.48M
Ave. Volume (3 month)	250,333
Adjusted Beta	1.25
EPS (TTM)	$1.24
2010 Estimated EPS	$1.28
P/E (TTM)	8.36
ROA (TTM)	5.30%
ROE (TTM)	11.45%
Debt/Assets	29.21%
Gross Margin	63.90%
Operating Margin	17.23%
Dividend Yield	N/A
WACC	10.50%
Analyst Coverage	5
Target Price	$16

Source: Bloomberg

Investment Thesis

- **Acquisition growth.** Given the firm's strong history of acquisitions and the CEO's background in investment banking, Dolan Media is expected to expand their professional services segment. Through their acquisitions of Barrett-NDEx ($167.5M) in 2008 and DiscoverReady ($31.9M) in November 2009, DM has made strategic acquisitions to enter new markets for their Professional Services Division as well as drive margin growth. National Default Exchange operates with a 5% stronger gross margin than DM's publishing division (68% versus 63%), thereby contributing to a stronger bottom line as management focuses on the more profitable segment.

- **U.S. Housing.** DM's National Default Exchange provides the specialized, paper-intensive service of mortgage default processing to law firms. As the number of mortgage default filings increase, so will the demand for NDeX's business services. With depressed housing prices and a continued tight lending market, it has become more difficult for borrowers to refinance and the number of mortgage delinquencies continues to rise. Moreover, DM's primary business operates in the state of California, which has one of the highest unemployment rates at 12.4%. With the higher margin NDeX business accounting for 48.4% of DM's total revenue, a higher number of mortgage defaults will not only lead to increased revenues, but will also aid DM's bottom-line.
- **High Renewal Rate and Value.** Despite the economic headwinds from print media, Dolan's local journals add unique and irreplaceable value to its customers, shown by its high subscriber renewal rate at almost 75%. Also, every United States jurisdiction requires that public notices appear only in qualified local newspapers, and DM is qualified in 14 of its 21 U.S. markets. Thus, Dolan's print products benefit from its ability to carry public notice advertising, which are legally required announcements informing the public about government-related actions.

Valuation

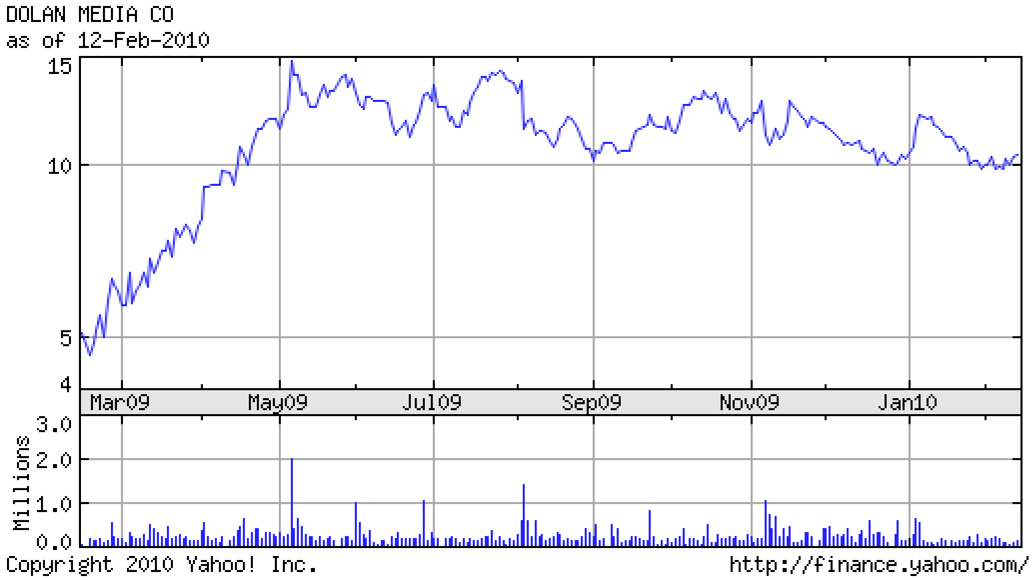
With a TTM P/E of 8.36x, DM currently trades at a discount to the industry average P/E of 16x. Applying a conservative 13x multiple to the estimated 2010 EPS of $1.28 produces a relative valuation of $16.64. A 5-year DCF analysis with a WACC of 10.50% and terminal growth rate of 3.0%, led to an intrinsic value of $16.22. A sensitivity analysis adjusting for best and worst case scenarios led to an intrinsic value range of $12-22. Taking management revenue and EBITDA assumptions and the firm's competitive positioning with appellate services into consideration, a stock price of $16 was established for DM, offering upside potential of 55%.

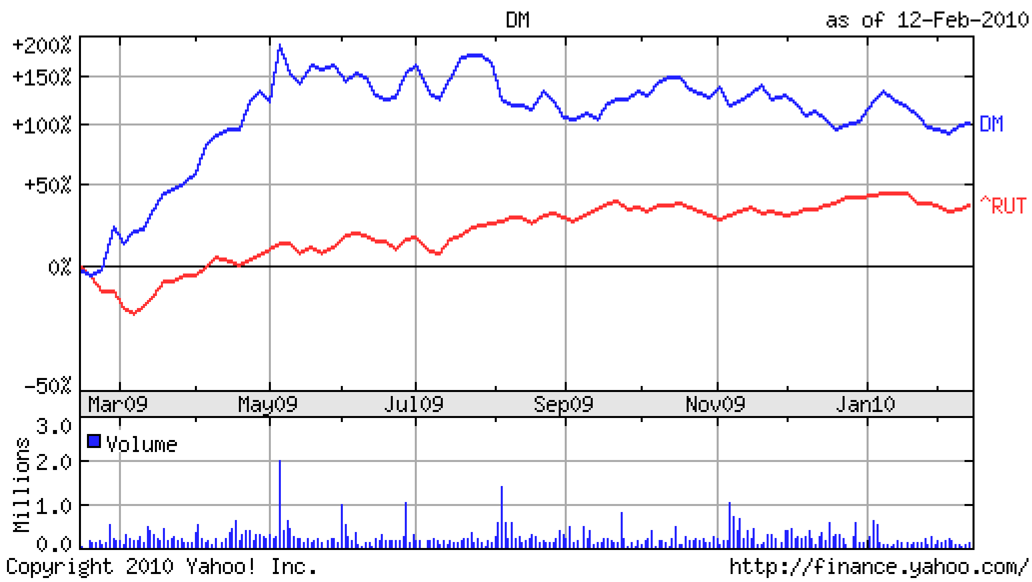
Risks

- **Government Intervention into the Mortgage Market.** NDeX's business revenue is dependent upon mortgage default rates. Over the course of the past two years, the U.S. government has shown unprecedented involvement in the financial services industry and the housing market. Should the government pass regulation limiting the number of natural foreclosures, the number of case files and DM's revenues could decrease significantly.
- **Print Publishing.** DM's Business Information Division is subject to the same headwinds facing all print media and publishing companies. Profits will suffer if the firm is unable to address the long-term threat of its readers migrating to online services. While Dolan Media is beginning to address those issues with their newly created websites, if these are not well received, then their growth strategy will be adversely affected. Furthermore, display and classified advertising would be hurt if their clients move to online and multimedia advertising strategies.
- **Acquisitions.** DM has been aggressive with large scale acquisitions in the past 18 months and has taken on additional debt to fund its acquisitions. There is always the threat of overpaying, and their financial health and flexibility will be hurt if they continue to take on debt to fund these growth opportunities. Furthermore, DiscoverReady presents an entirely new business segment for DM, if management fails to integrate the new business line, profitability and future growth will be hindered.

Management

James Dolan brings years of industry experience to DM, having founded the company in 1992 and currently serving as the company's Chairman, CEO, and President. Previously, Mr. Dolan worked at an investment bank specializing in the media industry and has built the company through a long history of acquisitions. The company's Board of Directors is split into three classes for voting purposes.





Ownership

% of Shares Held by Insiders:	9.00%
% of Shares Held by Institutional & Mutual Fund Owners:	80.00%

Source: Bloomberg

Top 5 Shareholders

Holder Name	Shares Held	Percent of Share Outstanding
T. Rowe Price Associates Inc.	2,912,141	9.68%
William, Blair & Company, LLC	1,808,614	6.01%
Cardinal Capital Management LLC	1,622,505	5.39%
James P Dolan	1,572,455	5.23%
Friess Associates Inc.	1,324,100	4.40%

Source: Bloomberg

Cherokee Incorporated
CHKE
Price: $16.27 ($11.29 – 24.43)
Fiscal Year Ends: January 31

February 15, 2010 Josué López
Russell 2000 Index: $610.72 ($342.59 – 649.15) Industrial Materials Sector

Cherokee Incorporated (CHKE) licenses brand-names and trademarks for apparel, footwear, and accessories to retail clients. While the company owns the brands which it licenses to retailers, the firm does not engage in product design, direct marketing, or production sourcing. Cherokee owns several trademarks, including Cherokee, Sideout, Carole Little, Laila Ali, Chorus Line, All That Jazz, and Molly Malloy. In total, the firm has eighteen licensing agreements in place covering both domestic and international markets. Of these eighteen agreements, eleven pertain to the licensing of the Cherokee brand itself, which promotes a family and casual lifestyle with an emphasis on comfort and quality at an affordable price. In addition to licensing the firm's own brands, Cherokee assists other brands, retailers, and wholesalers in identifying licensees or licensors for their brands or stores. The firm's two major clients include Target Corporation, the second largest American discount retailer, and Tesco plc, the largest British retailer by sales and market share. Revenues from Target totaled $15.2 million (42% of net revenues) and international revenues from Tesco totaled $15.2 million (42% of net revenues). The firm completed an initial public offering in 1984 and is headquartered in Van Nuys, California.

Recommendation

During 3Q of fiscal year 2010, total U.S. based sales of Cherokee merchandise were down 13.1% YoY. The decline can be attributed to a 21.1% decline of Cherokee branded items at Target Stores – not unexpected given the difficult retail environment brought upon by the global recession. In total, royalty revenues were flat at $8.0M during the quarter compared to $8.0M one year earlier. Royalty revenues from both Target and Tesco were down $0.3M and $0.05M from $3.7M and $2.95M, respectively, from 3Q of fiscal 2009. Offsetting these declines was a royalty revenue increase to $458,000 compared to $376,000 from the large Canadian department store, Zellers. CHKE runs very lean operations employing only 20 associates, carries no debt, and has $9.3M of cash on its balance sheet. The firm has generated positive free cash flow for five years with an average FCF margin of 46%. The firm has paid a quarterly dividend for over five years totaling over $137M that currently yields 9.30%. It is recommended that CHKE be added to the AIM Equity Fund with a target price of $19.

Key Statistics	Feb. 15, 2010
Market Cap	$143.40M
Shares Outstanding	8.81M
Avg. Volume (3 Mo.)	73,266
Beta	1.02
Diluted EPS (ttm)	$1.34
P/E (ttm)	12.11
Enterprise Value	$134.14M
WACC	9.55%
Total Debt/Equity	N/A
Total Debt/Assets	N/A
ROE (ttm)	53.67%
ROA (ttm)	38.30%
Gross Margin	100.00%
Operating Margin	61.08%
Dividend Yield	9.30%
Analyst Coverage	2
Target Price	$19

Source: Yahoo! Finance

Investment Thesis

- **International Licensing Expansion.** The retail direct licensing agreement that Cherokee entered with Tesco allowed the introduction of the Cherokee brand oversees in the United Kingdom and Ireland. Since then, the agreement has been expanded to include China, South Korea, Thailand, Slovakia, and Poland. Given the weakness in the global retail environment, there is uncertainty regarding when Tesco will start selling Cherokee branded products in these countries. Sales in these countries would boost royalty revenue from the Tesco agreement. Furthermore, the firm has continued to develop opportunities in North America through the penetration of the Canadian and

Mexican markets via Zeller's and Comerical Mexicana, respectively. Moreover, in 2008, the firm entered a four year agreement with Grupo Eroski for the Cherokee brand in Spain.

- **Excellent Financial Health.** Cherokee benefits from a very strong balance sheet with $9.3M in cash and no debt on the balance sheet. The company generates positive cash flow from operations which it uses to fund its day to day activities. Cherokee pays out excess cash as dividends (which currently yields more than 9%) to its shareholders. Compared to its competition, CHKE far exceeds most industry effectiveness ratios. The firm's return on equity of 53.67% is well above the industry average of 9.53%. The firm's return on assets of 38.30% also exceeds the industry average of 4.06%. Cherokee's return on invested capital of 67.22% dwarfs the industry average of 4.06%.
- **Light Business Model.** Cherokee's operations are lean and the firm's business model requires little capital investment combined with few costs of business. CHKE fully owns the Cherokee, Sideout, and other brands in its portfolio, which it licenses to selected retailers. The firm operates precisely as brand licensor, so it escapes the costs of producing apparel and clothing design. The expenses the firm incurs are a largely a result of employee salaries and maintaining and marketing the brand trademarks to clients in various countries**.**

Valuation

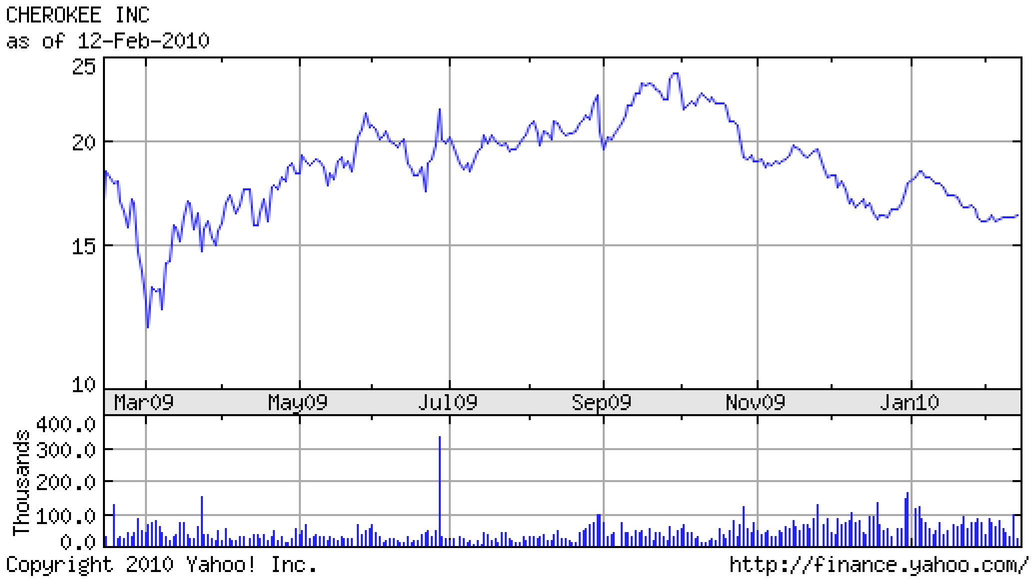
CHKE is currently trading at 12.11x EPS (ttm) of $1.34 compared to the industry average of 16.80x. Based on a 10 year DCF analysis with a WACC of 9.55% and a terminal growth rate of 3%, an intrinsic value of $21.84 was established for CHKE. A sensitivity analysis varying both the terminal value (1.5-4.5%) and the WACC (8.50-11%) yielded a price range of $17.91-28.92. Considering these measures of intrinsic value, a conservative price target of $19.00 was estimated. With CHKE currently trading at $16.27, the $19 price target presents a potential return of 16.78%, in addition to the firm's 9.30% dividend yield.

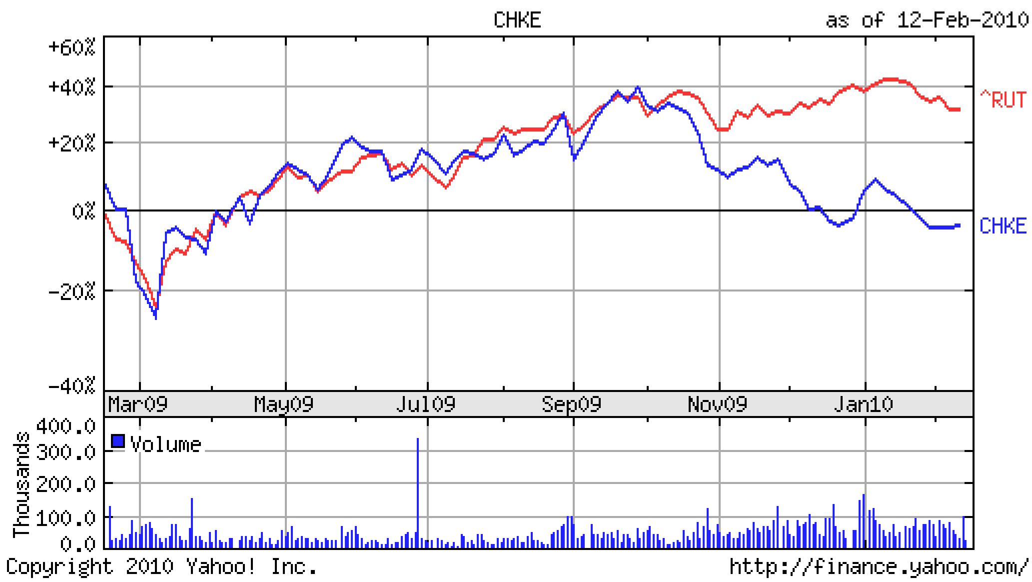
Risks

- **Intense Competition.** With regards to the Cherokee brand, the firm faces competition from independent and private label brands including Levi Strauss, The Gap, Old Navy, Iconix Brand Group, Faded Glory, Arizona, and Route 66. Companies with greater financial resources entering the established trademarks/branding space could negatively affect Cherokee's bottom line.
- **Reliance on Two Major Clients.** Target and Tesco each generate 42% of the firm's royalty revenue. The termination of either contract would have an adverse effect on Cherokee's revenue should the firm be unable to quickly replace these royalty streams.
- **Dependence on Management.** CHKE's success is contingent on the performance and services of key executives, including Robert Margolis, Chairman and Chief Executive Officer; Howard Siegel, President; and Russell J. Riopelle, Chief Financial Officer.

Management

After a brief resignation of his posts as Co-Chairman of the Board, President, and Chief Executive Officer in 1993, Robert Margolis returned to Cherokee as Chairman of the Board and Chief Executive Officer on May 5, 1995. He co-founded the firm's Apparel Division in 1981 and was instrumental in transforming the firm's business model to what he termed a "retail direct licensing strategy."





Ownership

% of Shares Held by Insiders:	9.38%
% of Shares Held by Institutional & Mutual Fund Owners:	46.00%

Source: Yahoo! Finance

Top 5 Shareholders

Holder Name	Shares Held	Percent of Share Outstanding
Eagle Asset Management, Inc.	874,537	9.92%
Robert Margolis	743,037	8.43%
Barclays Global Investors UK Holdings Ltd	718,195	8.15%
Kayne Anderson Rudnick Investment Mgmt	698,388	7.92%
Renaissance Technologies	434,400	4.93%

Source: Yahoo! Finance

SVB Financial Group
SIVB
Price: $40.23 ($11.58-47.97)
Fiscal Year Ends: December 31

February 19, 2010 — Ryan Rusch
Russell 2000: $594.30 ($342.57-649.15) — Financial Services Sector

SVB Financial Group (SIVB) has been the holding company for Silicon Valley Bank since November of 2000. Headquartered in Santa Clara, CA, Silicon Valley Bank focuses on offering diversified financial and complementary services to entrepreneurs in the technology, life sciences, venture capital, private equity, and premium wine industries-primarily in the San Francisco Bay area, for over 25 years. Banking services are provided to clients of all sizes within a wide variety of points along their operating life cycles. With 27 offices located in the United States and five international locations, SVIB also offers Fund Management Services (SVB Capital) and Private Client Services (SVB Global and SVB Analytics).

Recommendation

Operating under the management of Ken Wilcox, the Ernst and Young 2009 Entrepreneur of the Year, Silicon Valley Bank begins 2010 ranked fifth on the Forbes Best Bank List. Through a fortified balance sheet, strong capital ratios, and a loan-to-deposit ratio of 44%, SIVB has positioned itself to capitalize, compared to its peers, from a higher interest rate environment and an improved U.S. economy. With 60% of its deposits being noninterest bearing, SIVB should be able to leverage an increase in the Federal Funds rate into an improved Net Interest Margin (NIM) and EPS expansion. For a 100 bps increase in rates, SIVB will experience NIM expansion of 25bps and an estimated annual EPS contribution of $0.43. Possessing the ability to expand their loan portfolio and funding flexibility, SIVB has emerged as the industry leader in technology and venture capital lending. Further, as business spending on technology will likely increase as a share of U.S. GDP in 2010, venture capital investments should begin to rebound from the $17.7B it raised in 2009 back to levels upwards of $20B, as seen in 2008. Therefore, due to SIVB's prominent experience with technology and venture capital lending and its opportunity to expand its balance sheet and loan portfolio, it is recommended that SIVB be added to the AIM Equity Portfolio with a price target of $51, offering an upside potential of 26%.

Key Statistics	Feb. 19, 2010
Market Cap	$1,692M
Shares Outstanding	41.33M
Ave. Volume (3 month)	748,203
Adjusted Beta	1.43
EPS (TTM)	$1.22
2011 Estimated EPS	$2.36
Price/Earnings (TTM)	33.28
Price/Book	1.48
Price/Tangible Book	1.53
ROA	0.42%
ROE	4.54%
ROC	0.50%
Net Interest Margin	4.51%
Tier 1 Capital Ratio	15.45%
Analyst Coverage	12
Target Price	$51

Source: Bloomberg

Investment Thesis

- **Economic Improvement Leverage.** SIVB's asset sensitivity (60% of deposits are noninterest bearing and 70% of the total loan portfolio is floating) provides it with the opportunity to expand EPS once the Fed begins to raise the Fed Funds rate to a more normalized level. SIVB made the decision not to reduce their prime rate below 4% once the Fed lowered rates began making initial rate cuts. This decision will have a delayed effect on NIM once the Fed begins increasing rates. However, after a 75bps increase in rates, SIVB will experience NIM expansion of 16bps and an added $0.27 to annual EPS. As the Fed Funds rate continues increasing, NIM and annual EPS will increase 25bps and $0.43 respectively with a rate increase of 100bps.

- **Resumption of Loan Growth in 2010.** Currently, SIVB has a loan/deposit ratio of 44% and a TCE ratio near 9%. With 57% of SIVB's loan portfolio concentrated in technology and the remainder concentrated in private equity and venture capital, the capacity exists to expand upon their portfolio. Over the past five years, SIVB's loan portfolio has grown at a CAGR of 12.6%, and deposits have increased at a CAGR of 24.4%. With increased business spending expected during 1H10, larger IT budget allocations will benefit the small and mid-cap technological firms. Government stimulus spending with also help the life sciences companies which SIVB focuses on in their loan portfolio.
- **Concentrated Industry Performance.** During the two previous recession and recovery periods in the U.S., private equity funds have experienced average returns of 35% and 36% from 1991 to 1993 and 2001 to 2003 respectively. Entering 2010, performance growth is expected by venture capitalist to be derived largely from early/seed stage companies which have a 10-year average return nearing 37%. With strong early/seed stage company performance, SIVB's benefit will be experienced not only in their technology loan portfolio (70% of loans allocated in early/seed stage companies), but also in through SVB Capital's fund management.
- **Synergistic Business Model.** With locations and relationships throughout the U.S., SIVB's market share has gradually expanded to include the banking responsibilities of more than 400 of the top 800 venture capital firms. Recently established offices in London, Israel, China, and India will assist in SIVB's ability to continue the expansion of their cross-selling business model to emerging technology, venture capital, and private equity firms across the globe. Currently, foreign assets comprise less than 1% of SIVB's total assets.

Valuation

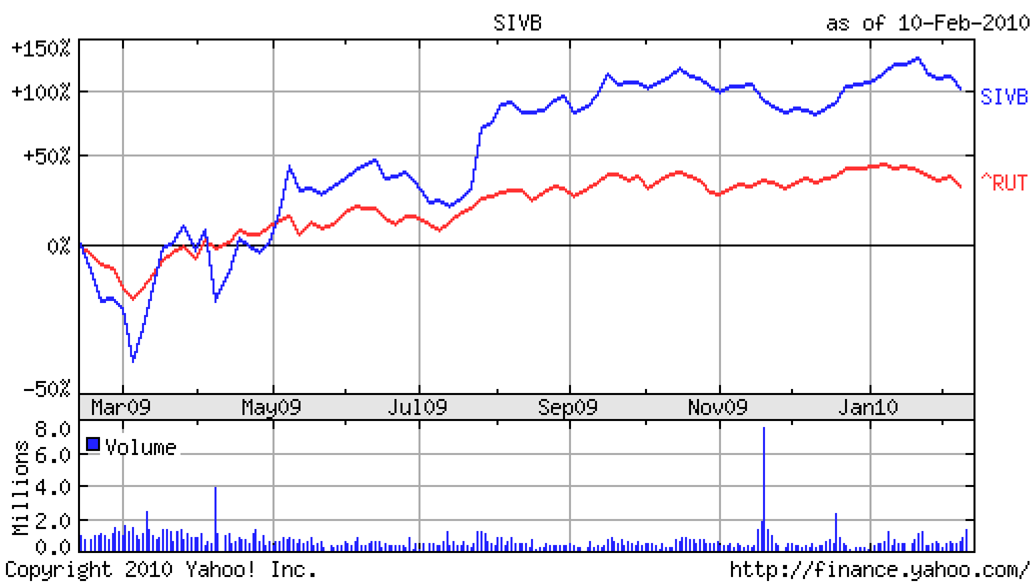
Applying a 1.7x multiple to a calculated 2010 Tangible Book Value per share of $31.34 yields an intrinsic value of $52.58. A bear case scenario that accounts for 2x the amount of net charge offs experienced in 2009 yielded a TBV/share of $23.74. Applying a P/TBV multiple of 1.7x to this bear case produces an intrinsic value of $40.36. A bull case scenario considering only a 10% increase in net charge offs for 2010 yielded a TBV/share price of $28.78. With the application of the same P/TBV multiple of 1.7x an intrinsic value of $53.28 was calculated. Furthermore, after normalizing EPS over the previous 10 years, the application of a 20x multiple to 2011calculated EPS realized a price target of $46. With SIVB currently trading at $40.50 and not paying a dividend, a price target of $51would yield a 26% return.

Risks

- **Delayed Growth in Technology Industry.** The loan portfolio of SIVB is comprised with a 57% concentration in the technology and life sciences industry. Delayed business spending within these industries would postpone SIVB's technology and life sciences loan growth potential.
- **Delayed Liquidity Events.** The venture capital and private equity industry is currently in the process of recovering from a depressed liquidity event market. Total venture-backed IPOs reached a six year low in 2008 with only six IPOs. Initial reports have shown that in 2009 the environment experienced a slight recovery with 13 venture-backed IPOs.
- **Extension of Low Interest Rates.** Prolonged delays of the rising of the Federal Funds rate would halt a potential for SIVB to expand its NIM. With a majority of SIVB's deposits being noninterest bearing any increase in the Feds Funds rate would contribute directly to revenue.

Management

Ken Wilcox, President and CEO since 2000, has spent numerous years specializing in technology lending and venture capital investing. Wilcox is also a member of the Board of Directors of the Federal Reserve, the Asia Society, and the Silicon Valley Education Foundation. Marc Verissimo, Chief Strategy and Risk Officer, has extensive bank lending experience through numerous commercial banking leadership positions with Bank of America and Comerica Bank.



Ownership

% of Shares Held by Insiders:	0.97%
% of Shares Held by Institutional & Mutual Fund Owners:	87.0%

Source: Bloomberg

Top 5 Shareholders

Holder Name	Shares Held	Percent of Share Outstanding
Blackrock Institutional Trust Company, N.A.	3,588,000	8.7%
Fidelity Management & Research	3,015,112	7.4%
T. Rowe Price Associates, Inc.	2,168,700	5.3%
American Funds SMALLCAP World Fund	1,789,000	4.4%
Thornburg Investment Management	1,739,712	4.2%

Source: Bloomberg

NutriSystem, Inc.
NTRI
Price: \$20.36 (\$10.28-\$33.54)
Fiscal Year Ends: December 31

February 11, 2010
Russell 2000: 605.46 (342.59-649.15)

Matthew Pruyn
Business Services Sector

NutriSystem (NTRI) is a leading provider of weight management products and services. NTRI sells prepared foods and grocery items delivered to customers' homes in the U.S. and Canada. NutriSystem typically offers a monthly supply of meals, which are composed of foods with a low glycemic index. The majority of NTRI's orders are placed online (93% of FY08 revenues); however, NutriSystem also offers its products through partnerships with retail stores, including Costco and Wal-Mart. Its weight loss programs are also sold through television home network shopping channel QVC (6% of FY 08 revenues). NutriSystem was founded in 1972 and is headquartered in Horsham, Pennsylvania.

Recommendation

NutriSystem's new retail agreements should help reignite sales growth (FY10 \$627M, 20% YOY increase). Since its products are now sold at over 10,000 major retail stores, NTRI's brand awareness should continue to increase substantially. Specifically, the agreements with retail stores should help NTRI expand its customer base and capitalize on new segments within the weight management industry. NTRI's direct channel distribution method provides the firm with a competitive advantage. The majority of NTRI's sales are placed through the Internet and phone (direct channel), which eliminates the high fixed costs associated with a diet center. Management noted that new customer starts increased by over 20% from Q2 to Q3, which can be attributed to the initial success of its NutriSystem D. Since new customer starts tend to trail off as the season progresses, this increase is a strong indicator of future performance. Also, the implementation of NTRI's cost cutting initiatives and improved customer reactivation levels should translate into increased profitability. As a result, operating margins are forecasted to improve by nearly 400 bps at 13%. In addition, NTRI pays a substantial annual dividend of \$.70 (3.40% yield). Furthermore, NTRI generates strong free cash flow and has no long-term outstanding debt (\$3.25/share in cash). Therefore, it is recommended that NTRI be added to the AIM Fund with a target price of \$30, which represents a potential gain of 40%.

Key Statistics	Feb. 11, 2010
Market Cap	\$655.8M
Shares Outstanding	30.95M
Ave. Volume (3 month)	984,782
Adjusted Beta	.71
EPS (TTM)	\$0.77
2010 Estimated EPS	\$1.56
P/E (TTM)	27.63
PEG Ratio	1.33
Dividend Yield	3.40%
WACC	9.51%
Forward P/E	13.67
ROE	17.67%
ROA	17.69%
Gross Margin	53.3%
Operating Margin	9.0%
Analyst Coverage	6
Target Price	\$30

Source: Bloomberg

Investment Thesis

- **Retail Expansion.** In December, NutriSystem announced key deals with Sam's Club (600 locations) and Walgreen's (approx. 7,000 locations) to sell it its weight loss systems. As a result, NTRI's national expansion should be a catalyst for future growth. NTRI's products are now available at major retail chains, which will increase their national presence and help attract new customers. Specifically, management expects retail sales to account for approximately 15% of FY10 revenues (versus <2% FY 09).

- **Penetration of Diabetes Market.** NutriSystem has developed a new weight loss program, NutriSystem D, for people afflicted with Type II diabetes. This product provides NTRI with a unique opportunity to capitalize on a growing segment of the weight loss market. Specifically, the potential U.S. market consists of 24 million people diagnosed with diabetes and another 57 million who are pre-diabetic. NutriSystem has partnered with the American Diabetes Association (ADA) to co-market NutriSystem D. In addition, NutriSystem D will now be available in the diet and diabetes section of nearly 7,000 Walgreen's stores.
- **Attractive Pricing.** NTRI's products tend to be more affordable than competing products with an average cost per meal at approximately $3. Specifically, a study conducted by the National Business Research Institute indicated that NutriSystem is hundreds of dollars cheaper on an annual basis than other weight loss programs. Both *Smart Money Magazine* and *CBS Money Watch* have accredited NTRI's programs for having the "best bang for the buck." As a result, NTRI's affordability should help attract new customers away from more expensive alternatives.

Valuation

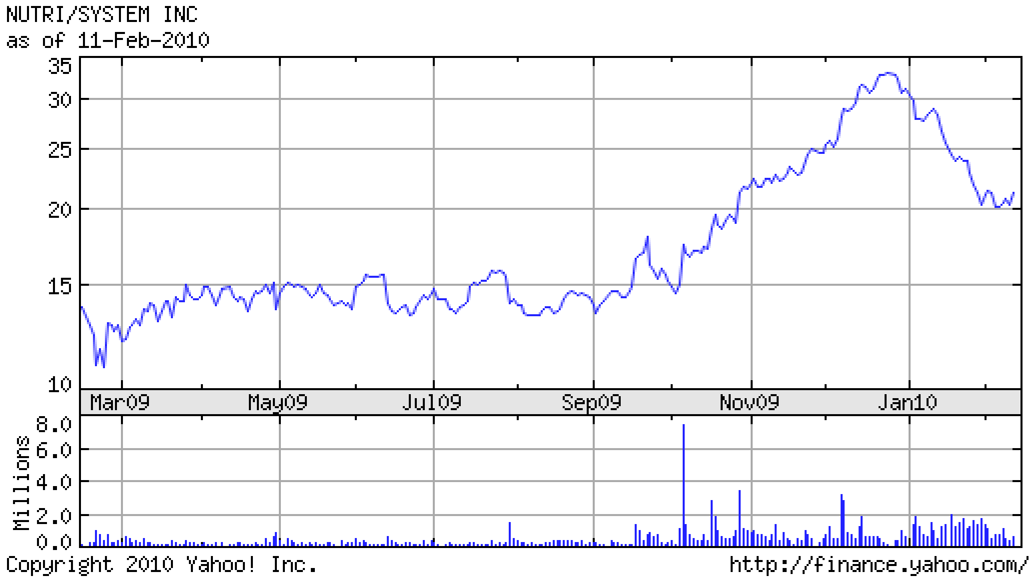
Based on a 10 year DCF model with a computed WACC of 9.51% and a terminal growth rate of 3%, the model yielded an intrinsic value of $32. Adjusting for WACC and terminal growth assumptions, a sensitivity analysis yielded a price range of $27.45 -$35.65. Additionally, NTRI is currently trading at 27.69xTTM EPS of $0.77. A conservative historical P/E ratio of 20 times the 2010 EPS estimate of $1.56 results in a $31.20 fair value price. With all metrics taken into account, a target price of $30 has been established, implying a 40% upside.

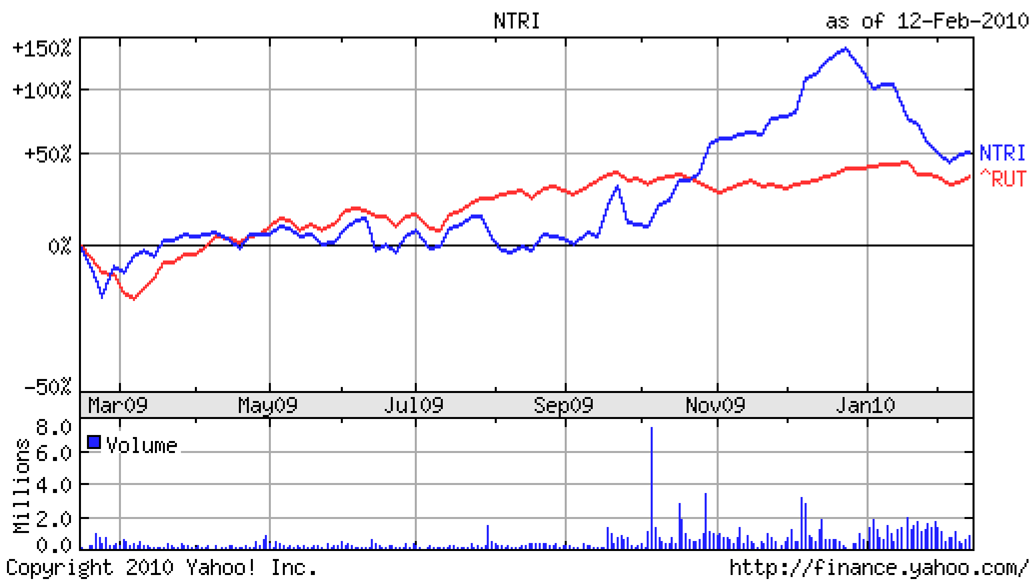
Risks

- **Reliance upon Key Suppliers.** NTRI relies solely upon third-party manufacturers to supply all of its food products. In addition, two suppliers account for a substantial portion of NTRI's inventory purchases (34% combined). Also, NTRI has supply arrangements with these vendors that require NTRI to make certain minimum purchases. As a result, failure to maintain a relationship its suppliers could adversely impact operations.
- **Highly Competitive Industry.** NTRI operates in an extremely competitive industry, which consists of a diverse array of competitors. In addition to its close substitutes, NTRI also competes with pharmaceutical products and other nutritional supplements. As a result, NTRI must continue to innovate and market its product line in order to sustain its competitive advantage.
- **Consumer Spending.** Although NTRI's products are reasonably priced, weak consumer spending could harness growth opportunities. For instance, a consumer may not have the ability to afford a weight loss program during times of economic distress. Consequentially, NTRI is subject to the overall health of the general economy and consumer confidence levels.

Management

Joe Redling has been CEO and Chairman of the BOD of NutriSystem since joining the company in September 2007. Prior to joining NTRI, Redling spent the previous years in senior management positions at AOL. NutriSystem added Redling to the firm due to his expertise in international expansion and worldwide brand and marketing management. Scott Falcolner is the Executive VP-Customer Management and Product Development. Falcolner first joined in 2008; where he previously served as Executive VP at AOL.





Ownership

% of Shares Held by Insiders:	33%
% of Shares Held by Institutional & Mutual Fund Owners:	75%

Source: Bloomberg

Top 5 Shareholders

Holder Name	Shares Held	Percent of Share Outstanding
Royce & Associates, LLC	2,901,187	9.37%
Barclays Global Investors UK Holdings	2,437,876	7.88%
Invesco Ltd.	1,656, 609	5.35%
Vanguard Group, Inc.	1,308,179	4.23%
Tinicum Lantern II, L.L.C.	1,300,000	4.20%

Source: Bloomberg

ProAssurance Corporation
PRA
Price: $49.53 ($40.31-55.16)
Fiscal Year Ends: December 31

February 19, 2010
Russell 2000 Index: $595.82 (342.59-649.15)

Mike Rice
Financial Services Sector

ProAssurance Corporation (PRA) is a property and casualty insurance company that provides professional medical liability insurance. PRA's insurance policies are issued through two subsidiaries; ProAssurance Indemnity and ProAssurance Casualty Company. Their policies primarily cover liabilities regarding the death or injury of a patient because of negligence or misconduct by a medical practitioner. PRA's products are offered in 49 states with a strong concentration in the Midwest. Currently, Alabama, Ohio, Indiana, Wisconsin and Michigan premiums represent over 56% of the revenues. They are recognized as the fifth largest underwriter of medical liability insurance, with approximately 4.9% of the market share in 2008 and 55,000 policyholders. PRA has been recognized in the top 50 performing P&C insurance companies by The Ward Group for the past three years and was also recently upgraded to "A – excellent" by A.M. Best. PRA is headquartered in Birmingham, Alabama and currently employs about 550 people.

Recommendation

ProAssurance Corporation provides an attractive investment opportunity because of the limited downside risk, as well as a strong acquisition and organic growth outlook. After the completion of three successful acquisitions during 2009, which added about $20M to PRA's premiums and has the potential to add up to $100M, management continues to pursue opportunities to expand their offerings within their niche market. Furthermore, the regulatory environment will work in PRA's favor moving forward, with any healthcare reform boosting PRA's top line, while tort reform would minimize large claims. PRA's current financial position will only become stronger as management continues to focus on increasing book value, which has increased at an 18% CAGR over the last five years, and continuing to develop and strengthen PRA's $500M in excess reserves. Finally, because of PRA's appetite for growth, ability to capitalize on health care reform, and protection from large claims through tort reform, it is recommended that PRA be added to the AIM Equity fund with a target price of $63, which represents upside of about 24%.

Key Statistics	Feb 19, 2010
Market Cap	$1.61B
Shares Outstanding	32.41M
Ave. Volume (3 month)	117,841
Beta	.72
2009 Estimated EPS	$5.31
2010 Estimated EPS	$4.94
PEG Ratio	1.06
P/E (TTM)	7.90
Pretax Margin	43.92%
Operating Margin	45.03%
ROE	14.33%
ROA	4.27%
Dividend Yield	N/A
Analyst Coverage	8
Target Price	$63

Source: Bloomberg

Investment Thesis

- **Acquisition Environment.** PRA has successfully completed three acquisitions in the past two years with the goal of diversifying risk and developing a national focus. The 2009 acquisitions included PICA, which held 70% of the podiatry insurance market and Mid-Continent which has a strong ancillary healthcare business. With little debt (acquired $25M of 53M total debt in 2008 acquisition) and significant experience, PRA's management team will continue to look for attractive opportunities that have emerged from difficult market conditions. Opportunities will most likely be in niche markets within the medical malpractice industry.

- **Health Care Reform.** In general, the proposed health care bills should lead to an increase in the number of claims because new patients will be added into the system, thus increasing the likelihood of error by a doctor. Consequently, medical malpractice rates will be forced to increase. PRA has successfully defended many claims in the past which will help minimize losses, while the rate increases will significantly impact gross premiums written.
- **Tort Reform.** Tort reform should minimize potential losses on a case by case and state by state basis. Many of the states that PRA currently operates in have already passed reform or are currently in the legislative process. Tort reform allows states to set limits on the amount of money that can be awarded as damages, which will ultimately help minimize large claims against PRA.
- **Price Stabilization and Competition.** PRA operates in a niche P&C insurance market that is estimated to be about $11.1B. Because they are not impacted by commercial markets, they are at a different area of the pricing cycle and likewise pricing competition is low among the few competitors. Similarly, there is very little threat of new or existing insurance companies entering the medical malpractice area.

Valuation

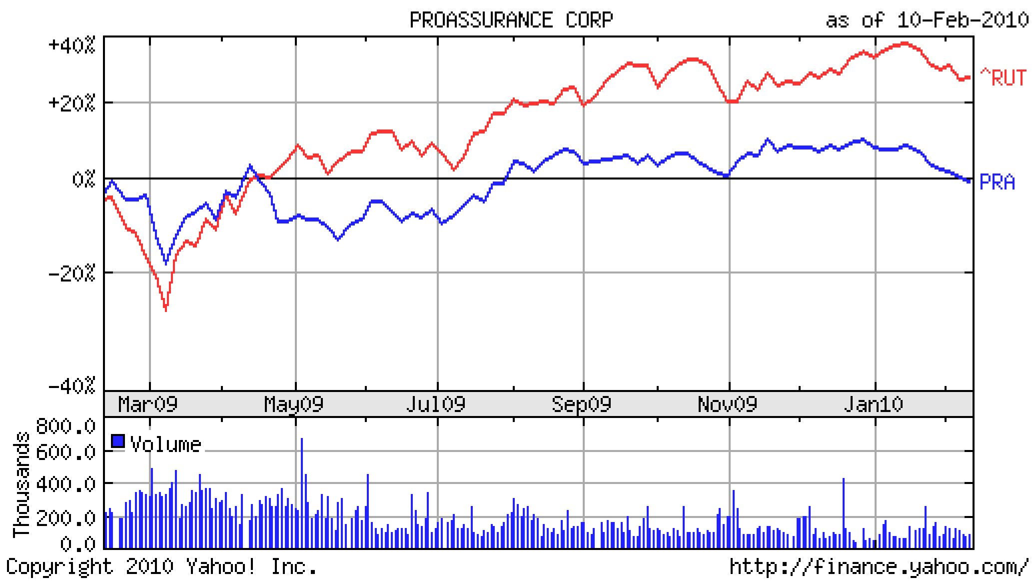
PRA is currently trading at 7.8x EPS, which is well under the peer average of 10.67x. After projecting 2009 and 2010 EPS at $5.31 and $4.94, respectively, and applying the peer average to 2009 EPS an intrinsic value of $56.65 was found. PRA historically trades around 15x and applying that value to 2009 EPS yields a value of $79.56. This model assumes that PRA will be earning 89-90% of gross premiums written. A P/B model that assumes book value growth of 10% in 2009 and 2010 was also used. PRA's one, five and ten year book value CAGR is 10%, 18% and 12%, respectively. With a strong focus on increasing book value, management is expecting this growth to continue. A book value of $51.65 was projected for 2010 and using a 1.25x multiple, which is below the five year average of 1.5, yields an intrinsic value of $64.57. A sensitivity analysis adjusting book value growth from 6% to 14% produced a range of $54.75-$69.59. Based on these assumptions a price target was set at $63, representing a return of about 24%. The company does not pay a dividend.

Risks

- **Health Care and Tort Reform Reversal.** Tort reform decreases the severity of claims and a reversal could lead to large claims in the future. PRA currently sets prices and reserves as if no reform exists and will only change when the results reflect otherwise. Currently, PRA's operations and finances while be able to handle the outcome if reforms were to be stopped in their operating areas, but it will cause market conditions to significantly change.
- **Investment Portfolio.** A market correction could significantly affect the overall investment portfolio despite their conservative investment approach. Currently, the portfolio is managed by New England Asset Management and an immaterial amount of the portfolio is managed internally.
- **Competition.** Despite PRA's national footprint and growing premium base, they compete on a national level with larger firms, such as Berkshire Hathaway and AIG, who currently hold 6.7% and 5.4% of the market share. These firms have more resources and are able to steal clients based on pricing tactics that PRA feels are too aggressive and will not lead to long term profitability.

Management

PRA was founded by Dr. A. Derril Crowe, who retired from the CEO position in 2007. The current management team has an average of 21 years of experience in the industry. Currently, W. Stancil Starnes serves as the CEO and has been employed by PRA since 1979. Victor T. Adamo is currently the President, COO, and Vice-Chairman and has been with PRA since a 2002 merger. Howard Friedman is co-President of PRA and has held this position since 2005. He also serves as the Chief Underwriting Officer. This executive management team has extensive M&A experience, during and prior to their service at PRA and this experience will be valuable to PRA as they continue to pursue acquisitions.



Ownership

% of Shares Held by Insiders:	7.37%
% of Shares Held by Institutional & Mutual Fund Owners:	82.19%

Source: Bloomberg

Top 5 Shareholders

Holder Name	Shares Held	Percent of Share Outstanding
Barclays Global Investors	2,375,277	7.33%
Price (T. Rowe) Associates Inc.	2,368,394	7.31%
Royce & Associates, LLC	1,971,603	6.08%
Crowe A. Derrill	1,875,875	5.79%
Munder Capital Management	1,441,695	4.45%

Source: Bloomberg