MARQUETTE
UNIVERSITY

Applied Investment Management (AIM) Program

AIM Fund Investment Advisory Board Meeting

December 6, 2005

AIM Fund Potential Portfolio Recommendations (Additional Analyses)

Student Presenter	Company Name	Ticker	Recommended Portfolio Weighting	Recommended Investment	Share Price 12_2_05	# of Shares to be Purchased	Initial Market Value
Jaclyn Jensen	Matria Healthcare Inc.	MATR			$34.50		
Tim Wojs	American Reprographics Company	ARP			$21.75		
Scott Kennedy	California Water Service Corp.	CWT			$35.86		
Ray Auth	Buffalo Wild Wings Inc.	BWLD			$27.85		
Greg Rawls	Nuance Communications	NUAN			$6.35		
Mike Hepp	Compass Minerals International, Inc.	CMP			$25.00		
Jason Toellner	Shenandoah Telecommunications Company	SHEN			$43.01		
Paul Zandt	Gray Television	GTN			$9.21		
Ryan Berg	TETRA Technologies Inc.	TTI			$30.15		
Chris Cunningham	Synaptics	SYNA			$26.19		

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Matria Healthcare Inc.
MATR
Price: $33.76 ($20.85 - $39.61)
Fiscal Year Ends: December 31, 2005

November 29, 2005 — Jaclyn Jensen
Russell 2000 Index: 674.53 (570.03 – 688.51) — Health Care Sector

Matria Healthcare Inc. provides disease management services and related products to self-insured employers, private and government sponsored health plans, pharmaceutical companies, and individual patients. The company operates in North and South America, Europe, and Asia, with 25% of sales generated in the United States. MATR consists of two operating segments: Health Enhancement and Women's and Children's Health. The company offers disease management services for diabetes, cardiovascular disease, respiratory disorders, cancer, obesity, depression, chronic pain, a variety of maternity related problems, and other chronic conditions. MATR also offers a line of diabetes products and provides an online health and wellness site.

Key Statistics	29 Nov 2005
Market Cap	$700.190M
Shares Outstanding	20.520M
Average Volume	262,650
Beta	0.75
2004 Actual EPS	$0.70
2005 Estimated EPS	$1.09
P/E (TTM)	35.97
Cash Flow/Share	$3.72
FCF/share	$3.28
Debt/Assets	1.33%
ROE	19.11%
Gross Margin	42.34%
LT Growth Estimate	20.00%
WACC	8.20%

Recommendation

Matria's goal of becoming a one-stop shop for disease management services, as well as its strategy of targeting the high-margin self-insured employer segment of its customer base has proven to be a successful growth strategy. Third quarter EPS was in line with analyst estimates, however revenue came out about 5% below estimates. The revenue shortfall, combined with contract implementation delays, lead to a sharp sell-off and a lowering of fourth quarter estimates. The company gained a record 40 new and expanded contracts in 2005, some of which requested additional services to be added to their contracts. Management cited the late add-ons as a reason for the delays. Since the contracts were delayed, not lost, and the long-term fundamentals of the company and industry remain strong, the market may have overreacted to the news creating a buying opportunity. Based upon the company's fundamentals and growth potential it should be fairly valued at $41.00. I am recommending an additional 1% weighting in the AIM Fund.

Investment Thesis

- **Diversified revenue base and strong growth.** MATR's revenue is generated from multiple business activities and various geographic regions. Its domestic disease management segment is expected to grow at a rate of 40% for at least the next two years, and the Women's and Children's Health division is on the rebound and has added to the company's revenue growth for the past three quarters.
- **Pressure to control employee health care costs fuels growth in the disease management business.** MATR focuses primarily on Fortune 1000 self-insured employers, a market group that has grown in both size and disease management interest

level recently. This customer group tends to offer higher margins than those negotiated through health plans. Furthermore, Matria's focus on this group helps to isolate them from the competitive pressures of the industry's larger players whose primary customer targets are large health plans.

- **Proprietary TRAX technology.** MATR uses its TRAX technology to operate more effectively and to provide quality of care improvement. The company believes that its technology is superior to that used by its competitors.
- **Growth through acquisitions of smaller, single-focus disease management companies.** Matria is working towards its goal of being a one-stop shop for disease management needs. MATR compounds the growth gained from new services offered by acquired companies by cross-selling its current programs to the acquired company's customers.

Valuation

Based on my discounted cash flow model, Matria should be valued at $40.99. MATR is currently trading at a P/E of 35.97, which indicates that the company is undervalued relative to its peers which are trading at an average of 37.785 times earnings. Based on a relative P/E valuation using 2005 earnings, MATR should be trading at $41.18. The average valuation of the analysts providing a price target for MATR is $39.75, with actual price targets ranging from $34 to $44, and ratings including nine buys, two holds, and one sell. I believe that a target valuation of $41.00 is reasonable for the stock.

Risks

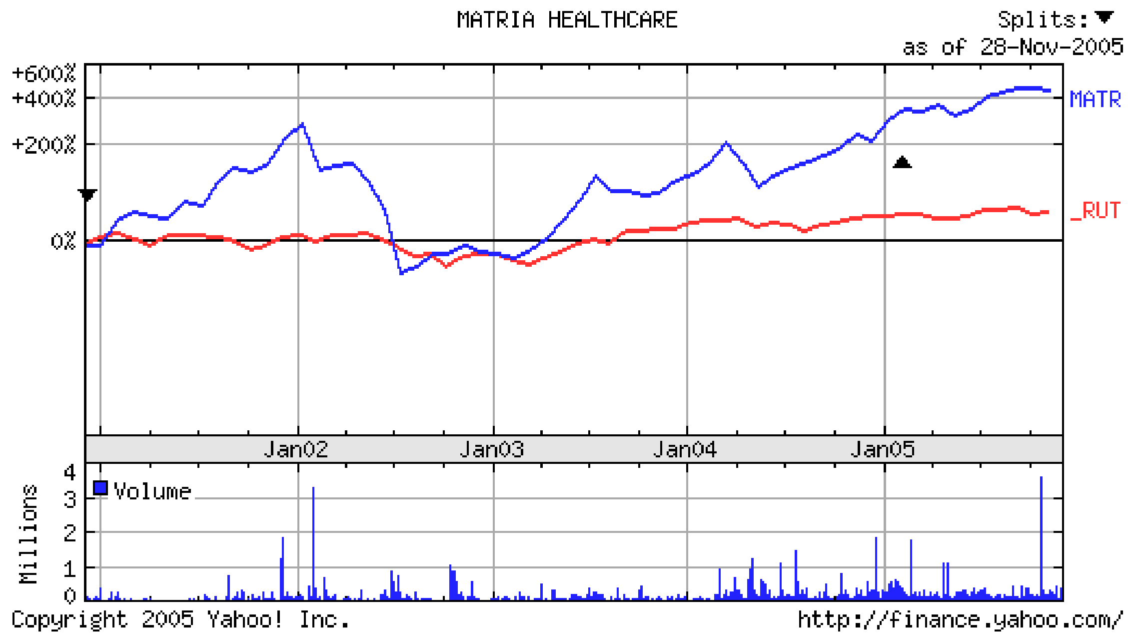
- **Uncertainty surrounding future of the Facet division.** The Facet subsidiary, which offers a line of diabetes related products, does not fit with the direction of MATR and is expected to be spun off in the near term. While the division is profitable, its growth rate has been on a steady decline and in the third quarter posted a negative 10% quarterly growth. Uncertainty surrounding potential disposition charges, the sale price, and use of the proceeds could have a negative impact on share price.
- **Exchange Rate Risk.** Approximately 22% of 2004 sales were denominated in a foreign currency. The company does not expect to be adversely affected by exchange rate fluctuations and therefore does not currently hedge its foreign currency risk.
- **Competition.** Matria is the fifth largest competitor in the disease management industry with only 6% of total industry revenues. While its program offerings meet or exceed that of the larger players in the industry, the company may have a hard time gaining additional market share.

Management

Parker "Pete" Petit, the Chairman and CEO of MATR, was the founder of Healthdyne which merged with Tokos Medical Corp in 1996 to form Matria. The executives of the company currently hold approximately 4.7% of the shares outstanding. Overall the corporate governance of the company seems shareholder friendly.

Other Notable Information

- Matria recently cleaned up its balance sheet by redeeming $85 million in convertible debt, leaving the company with $22 million in cash and only $2 million in long-term debt.



Top 5 Shareholders

Holder	Shares Held	Percent of Shares Outstanding
Wellington Management	1,435,000	6.922%
Earnest Partners	1,029,000	4.962%
Parker Petit (CEO)	900,308	4.342%
RS Investment Management	893,807	4.311%
Next Century	605,943	2.922%

American Reprographics Company
ARP
Last Price: $20.84 (13.00 – 21.99)
Year End: December

Russell 2000: 673.69 (570.03 – 688.51) Tim Wojs

American Reprographics Company (ARP) is the largest nationwide provider of reprographic services to the architectural, engineering, and construction (AEC) industry. Reprographics is the management and reproduction of construction documents (mainly blueprints) and its related materials. ARP specializes in business-to-business document management services, document distribution and logistics, and print-on-demand. The company also provides services to non-AEC industry companies, most of which include the reproduction of large or small color marketing and point of sale materials. ARP operates about 190 facilities, located in 141 cities throughout 30 states. American Reprographics Company became a public company in early February 2005.

Recommendation

Although American Reprographics Company is a relatively new public company, they have established themselves as the nationwide leader in the reprographics industry. With the largest national network and technology that is quickly becoming the industry standard, ARP is best poised to take advantage of the substantial growth recovery in the non-residential AEC industry. With FMI's revised construction growth estimate raised from 6-8%, I believe that ARP will be able to grow top-line by 8-10% and bottom-line by 15-20% annually. I believe that the AIM fund should consider investing in this company should one of the current business services companies reach their price target or experience a substantial change to current fundamentals.

Key Statistics	November 2005
Portfolio Weighting	0%
Market Cap	892.93 mil
Shares Outstanding	44.2 mil
Debt/Capital	66%
Q3 EPS vs. Cons.	$0.23 vs. $0.21
Est. EPS '05	$0.85
Est. EPS '06	$1.08
P/E TTM	19.8x
Forward P/E	15.5x
Revenue	477.08 mil
Dividend Payout	0%
Morningstar Sector	Bus. Serv.

Investment Thesis

- **Largest national network enables scale.** ARP currently operates approximately 190 facilities in 141 cities throughout 30 states, Toronto, and Mexico City. This network is eight times larger (city-wise) and 5 time larger (facilities-wise) then their closest competitor. They are the only national provider of reprographic services, which is attractive to larger AEC and non-AEC firms who wish to do business with only one reprographics firm. ARP uses a hub and satellite system, where the facilities are broken up into 40 divisions, each of which has at least one large full-service facility that has high production capacity and sophisticated equipment. These full-service facilities are supplemented by smaller satellite shops that are closer to the customers and specialize in quick turnaround capabilities and responsive service. The company has a central administrative function and allows the individual divisions to control pricing, marketing, and sales functions.

- **Proprietary software.** ARP believes that the next growth opportunity in the reprographics industry is through the continued digitalization of documents and related services. In order to capitalize on this trend, ARP has developed PlanWell, an online planning room that allows customers to digitally view documents and plans and send online orders to local service facilities. The PlanWell software package is viewed as industry standard. The company currently does not charge customers for this service, but

with increased usage of the software, this may be a vital growth opportunity for ARP if they are able to charge customers on a per-click-and-view basis.

- **Currently in the midst of a non-residential construction recovery.** The non-residential portion of the AEC industry is currently experiencing a recovery. The industry experienced a slump from 2000-2003, but construction activity in 2004 and 2005 has rebounded significantly. FMI, a leading consultant to the construction industry, forecasts increases in activity to continue at an 8% annual rate through 2009.

Valuation

Using a discounted cash flow model, I estimate that shares of ARP should be valued at $24. This includes using a 20% growth rate in earnings and a 5% terminal growth rate. However, a discounted cash flow model is somewhat ineffective for ARP because of its short life as a public company. With the lack of similar companies for comparison, computing an accurate beta is difficult. In relative terms, using a P/E of 20 and estimated EPS ’05 of $0.85, I compute the value of ARP shares to be $23.50.

Risks

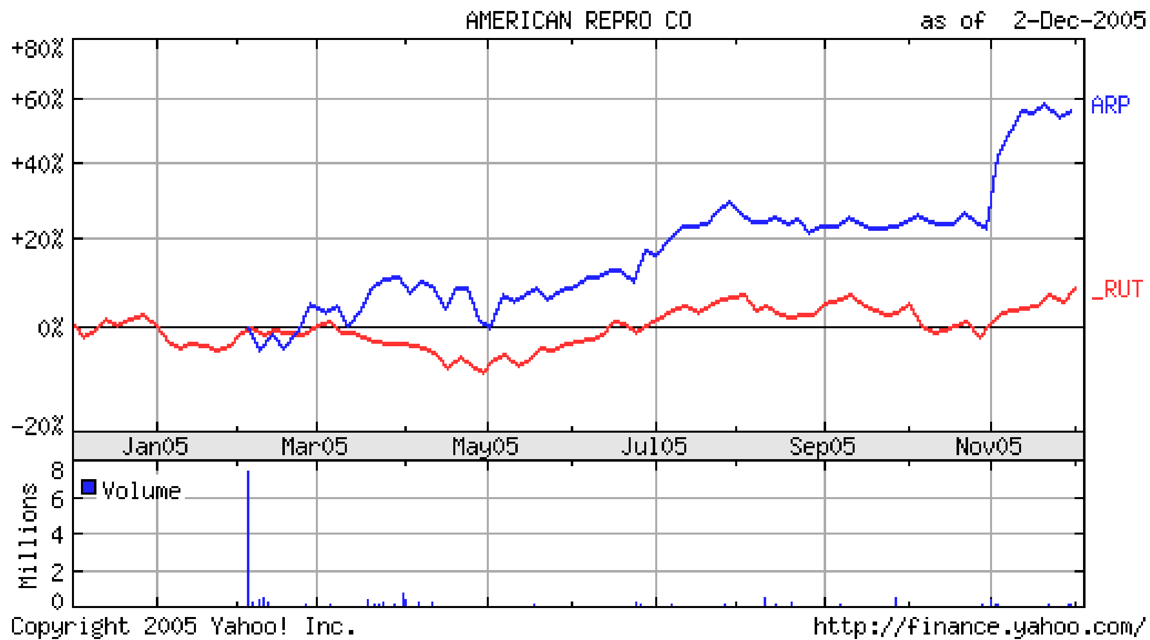
- **Dependent on cyclical industry.** ARP is extremely dependent on the AEC industry, as 80% of its revenues stem from this industry. Although FMI forecasts non-residential construction activity to grow at about 8% annually through 2009, unforeseen macroeconomic factors such as substantial changes in GDP or unemployment rates could significantly harm the AEC industry, and therefore, ARP.
- **Inability to stay technologically superior.** PlanWell has become the industry standard for online plan rooms for the AEC industry. Management believes that online plan rooms are the next growth opportunity for the reprographics industry. The inability to keep PlanWell as the industry standard for online plan rooms could hamper the company’s competitive position.
- **Customer rejection of usage prices for PlanWell in the future.** As the use of PlanWell by the AEC industry increases, management believes that reprographic orders will become more selective, as some users may only need a couple sheets of material instead of the entire blueprint. In the future, ARP would like to charge users on a per-click-and-view basis if print volumes decrease. If the prices fail to gain traction, revenues could be affected.

Management

The management of ARP is considerably experienced in the reprographics industry, with most executives having over 10 years of experience. S. (Mohan) Chandramohan has been the company’s CEO and president since 1991.

Outlook

- For Q3’05, ARP surpassed consensus earnings estimates by $0.02 ($0.23 vs. $0.21).
- Guidance for FY’05 was raised, both top and bottom line, to reflect increasing growth in the non-residential portion of the AEC industry. Revenue guidance was raised to $485-$490 million, as earnings guidance was raised to $0.83-$0.85
- FMI, a leading consultant to the construction industry, recently raised growth expectations for the non-residential portions of the industry (both buildings and other structures) from 6% to 8% through 2009.
- Management has emphasized their commitment to increasing their facilities management services at the expense of growth in equipment and supply sales. FM services currently provide double the margins that equipment and supply sales do.



TOP SHAREHOLDERS

Holder	Shares	% Out	Value
DELAWARE MANAGEMENT BUSINESS TRUST	2,559,594	7.38	$43,769,057
WELLINGTON MANAGEMENT COMPANY, LLP	2,346,900	6.77	$40,131,990
EMINENCE CAPITAL, L.L.C.	1,833,500	5.29	$31,352,850
WEATHERBIE, M.A. & CO, INC.	1,560,330	4.50	$26,681,643
TIMES SQUARE CAPITAL MANAGEMENT	1,465,214	4.22	$25,055,159
AXA	1,211,000	3.49	$20,708,100
JANUS CAPITAL MANAGEMENT, LLC	738,940	2.13	$12,635,874
SYSTEMATIC FINANCIAL MANAGEMENT, L.P.	708,355	2.04	$12,112,870
EAGLE ASSET MANAGEMENT, INC.	548,260	1.58	$9,375,246

EQ ADVISORS TRUST-EQ/ALLIANCE SMALL CAP GROWTH PORTFOLIO	922,900	2.66	$14,849,461
JANUS VENTURE FUND	687,310	1.98	$11,753,001
DELAWARE GROUP EQUITY FDS III-TREND FUND	425,900	1.23	$6,852,731

California Water Service Corp.
CWT
Price: $35.22 (31.17 – 42.11)
Fiscal Year Ends: December

November 28, 2005 Scott Kennedy
Russell 2000: 671.50

California Water Services Group is a holding company that is involved in the supply and distribution of water. It has five operating subsidiaries: Cal Water, Utility Services, New Mexico Water, Washington Water, and Hawaii Water. As a whole, the group provides regulated and non-regulated services to over 2 million people in 100 communities. Cal Water was formed in 1926, and is the second largest investor-owned utility in America with its headquarters in San Jose, California.

Recommendation

I believe CWT will be able to achieve high single-digit earnings growth in the long-term due to its favorable regulatory environment and because it offers good margins within a utility sub-sector that should continue exhibiting positive results. The water utility industry has favorable long-term growth prospects and CWT is going to be able to distance itself from the competition. The stock should be valued at $39.50.

Key Statistics	Nov. 28, 2005
Portfolio Weight	1%
Market Cap.	647.66M
Dividend Yield	3.20%
ROA	3.64%
ROE	8.52%
P/E	25.97
EPS '05 est.	$1.42
EPS '06 est.	$1.71
Sector	Utility

Investment Thesis

- **Favorable water regulatory rate environment and company policy of water conservation.** The water utility company applied in August for revenue rate hikes that if granted would raise the ROE for 8 of their districts, or 25 percent of their operating area, to 12.23%. Two new commissioners have been added to the California Public Utilities Commission and they should be pleased with CWT's efforts to decouple revenue from customer usage by encouraging conservation and protecting the customer from price fluctuations. One way that CWT works for its customers and adds to its own business capabilities is by teaming up with the California Foundation for Environment and Economy, which allows them to consult with experts to find ways to make their company more eco-friendly while also becoming more efficient and increasing margins. Furthermore, CWT belongs to the California Water Association that just opened its San Francisco office across the street from the CPUC in order to increase its lobbying presence.
- **Repeal of the Public Utility Holding Company Act.** The 2005 Energy Bill included a provision that repealed the outdated PUHCA legislation and opened the door for consolidation within the utility industry. The group's position as industry giant may be enticing to utilities or non-utilities that in the past few years have strengthened their balance sheet cash reserves and are looking at expansion. For instance, it is possible that SJW Corporation may want to expand its 6% stake. GE Investments, which owns 26%, and has begun to recognize the growth potential of water, may decide to add to the conglomerate's stake in the firm, but even if that did not happen, GE is still a very reputable source of technology and resources.
- **Dividend growth.** CWT has a 60-year history of paying a dividend, which is currently $1.14, or 3.2%.

Valuation
California Water Corp. should achieve approximately 9 percent annual earnings growth over the next several years due to successful lobbying of rate hikes and integrating new customers into their operations. This growth rate would exceed the industry pace of around 7 percent. Earnings per share projections are $1.42 for 2005 and $1.71 for 2006. I have valued the company's shares at $39.50.

Risks

- **Expenditures linked to environmental regulations.** Cal Water must comply with several environmental and water quality requirements, and as such will continue to utilize expenditures to cover those costs. Work is currently being done to comply with the arsenic standards that take affect in 2006.
- **Future rate hikes are not guaranteed.** While CWT and its interest groups such as the California Water Association lobby for rate hikes that will cover any increases in expenditures, the California regulatory commission has in the past been less inclined to fully meet those demands. In the past couple of years they have been accommodating, but that trend is unpredictable since it relates to public costs.
- **Adverse weather conditions.** Dry conditions as well as excess waterfall would have an effect on CWT's operations. Droughts would lead to water conservation and a decrease in demand, while excess rainfall may hinder their operations or projects being undertaken to improve infrastructure.

Management
Peter Nelson, 57, is the President and CEO of California Water and its subsidiaries. He has been a director since 1996.

Outlook and Growth Assumptions

- Water acquisition expense was 41.9% of total operating expenses, a 6.7% decrease
- Margins went up 8% from less of a need to purchase water
- CWT filed a rate case in August for 8 of its districts, a decision should come early in '06
- Project costs associated with water conservation efforts should solidify rate increases
- Consolidation within the utility industry has been focused on water companies
- Having operations in multiple states will spread the impact of state specific events/risks
- EPA projected that $277 billion will be needed over the next 20 years to upgrade and maintain US water infrastructure systems.

Major Shareholdings

Shares Outstanding	18.00 Mil
Institutional Ownership (%)	27.40
Top 10 Institutions (%)	16.60
Mutual Fund Ownership (%)	8.97

Top Institutional Holders

Holder	Shares	%	Value
Barclays Global Investors Intl	530,811	2.9	$21,869,413
Fisher Investments	392,725	2.2	$16,180,270
Vanguard Group	356,513	2.0	$14,688,335

Buffalo Wild Wings Inc.
BWLD
Price: $28.54 ($25.16-41.70)
Fiscal Year End: December 31

November 30, 2005
Russell 2000: 679.29 (570.03-688.51) Ray Auth

Buffalo Wild Wings Inc. owns and operates 116 company-owned restaurants and franchises an additional 234 Buffalo Wild Wings Grill & Bar Restaurants in 34 different states as of September 25, 2005. Of the 350 total restaurants, 23% are located in Ohio. BWLD creates a quick and casual dining atmosphere which is part of a rapidly growing industry. The grill and bar segment philosophy is considered to be the fastest growing sub-segment of the casual dining industry. Primarily known as a place for chicken wings, BWLD continues to diversify their menu to attract a variety of consumers. The inviting atmosphere of BWLD consists of multimedia systems, open bars, a spacious layout, and an appeal to sports fans and families.

Recommendation

Buffalo Wild Wings Inc. is beginning to establish itself as the 'place for wings'. With twelve signature sauces, BWLD is considered one of the top places in America to indulge in chicken wings. However, not only are the chicken wings appealing, BWLD is beginning to branch out to attract a larger number of customers. BWLD is entering into a massive growth phase across the United States which should boost earnings and revenues. BWLD should maintain revenue growth of 20% coupled with 22% earnings growth. Over the next ten years, Buffalo Wild Wings has announced that they will increase their restaurant total to between 1,000 and 1,400 stores. The increase to this number of stores equates to around a 20% growth in restaurants per year. Management provided better than expected guidance for 2006 as they announced 20 new company opened stores along with 50-55 new franchised restaurants. This was about four more stores than the consensus estimates. BWLD expects the increased restaurant count to be a huge boost to the bottom line and allow BWLD to be a dominant player in the bar and grill segment of the restaurant industry.

Key Statistics: Nov. 2005

Weighting:	2%
Revenue:	$199M
Gross Margin:	69.89%
Op. Margin:	6.56%
Forward P/E:	26.30
EPS Growth:	22%
OCF:	$13M
Debt/EBITDA	0.00%
Debt/Capital	0.00%

Investment Thesis

- **Massive Growth Phase:** Over the next decade, BWLD is entering into an enormous growth phase. They are expecting to increase their stores from the 350 they currently manage to over 1,000 stores by 2015. This dramatic increase in stores should not only boost revenues, but tight cost structures will create an incredible boost to the bottom line. Management continues to stress the importance of improving their margins which is imperative as they enter the next phase of operations.
- **Menu Diversification:** BWLD also realizes that not everyone in the world enjoys chicken wings. This is crucial as they are beginning to roll out new menu options other than chicken wings. As the growth continues, they are expected to increase options even more to attract a wide array of consumers. Currently, BWLD serves burgers, salads, and

a variety of other entrees in addition to chicken wings. BWLD needs to have other products available on their menu to sustain their growth.

Valuation

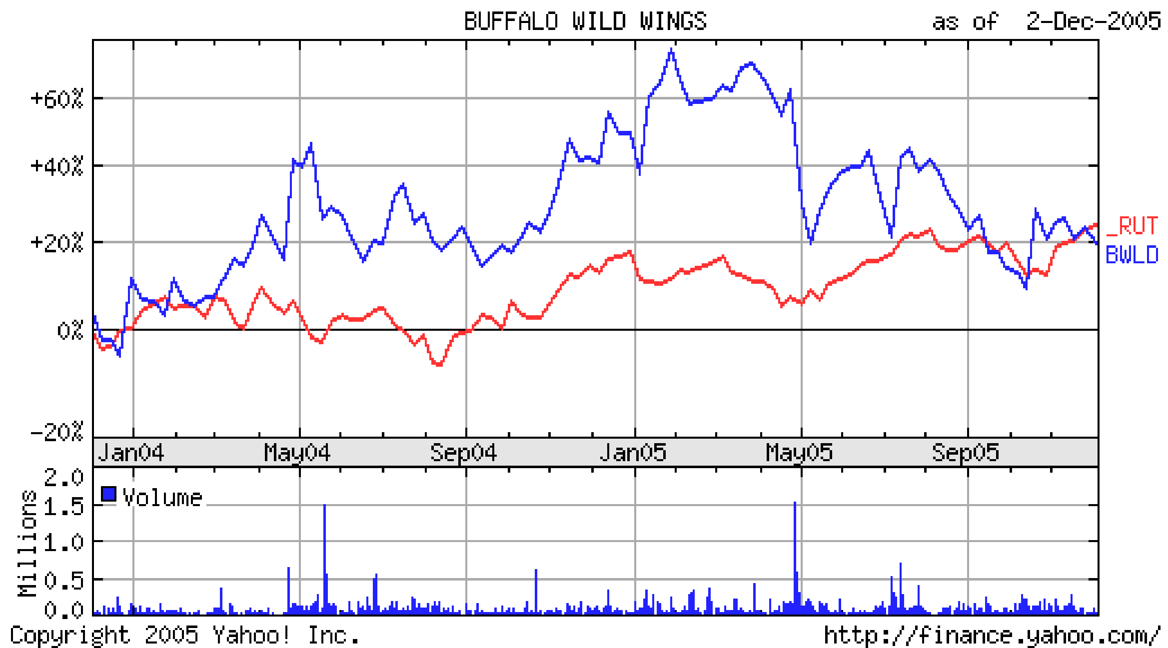
BWLD should experience annual revenue and earnings growth of 20% and 22% respectively over the next several years. This is based on continued restaurant growth and improving brand awareness. Earnings estimates for 2005 are $1.06, $1.39 for 2006, and $1.50 for 2007. Based on these predictions, the discounted cash flow model reveals a fair value price of $46.83, an undervaluation of approximately 64%. BWLD's P/E is 26.30 compared to the industry average of 47.08. Their PEG is 1.08. There are currently eight analysts who cover the company. Five have buy recommendations while three have hold recommendations. RBC Capital Markets assesses a fair value of $47.00. Merriman Curhan Ford reveals a fair value of $45.00.

Risks

- Chicken wing fluctuations remain the single greatest threat to BWLD. As a measure, it is estimated that for every $0.01/lb annual change in chicken wing prices, EPS could change by approximately $0.01. Chicken wing volatility has settled down to normal levels following the two Hurricanes in September.
- The Avian Bird Flu is a new threat to BWLD as the world is trying to control it.
- Competition is always in issue in the restaurant industry. Consumers have such a wide variety of restaurants to choose from that loyalty is really never achieved. BWLD must continue to deliver superior food choices along with excellent dining experiences to keep ahead of their competitors.
- The opening of new restaurants must be closely monitored by management for flaws in the cost structure in order to maintain proper revenue and earnings growth.
- Management must continue to find prime locations for the opening of new restaurants. If restaurants are placed too close together, cannibalism of sales could occur.

Outlook

- BWLD continues to manage impressive margins for the restaurant industry. They have a gross margin of 69.89% compared to the industry average of 48.60%. In addition, they have an operating margin of 6.56% compared to the industry operating at negative margins.
- The restaurant growth is going to be supported by operating cash flow and not debt.
- With 20% restaurant growth each year, a boost to the bottom line is imminent due to their excellent margins and lack of debt.



Major Shareholders

Name	Shares Held	% Outstanding
Fidelity Management	1.26 Million	14.87%
Carefree Capital	641,110	7.56%
STRS Ohio	500,880	5.91%
Deutsche Bank AK	472,925	5.58%
TCW Group Inc.	379,603	4.48%

Nuance Communications
NUAN
Price $6.17 (3.42 - 6.30)
Fiscal Year End: Sept

November 28, 2005 Greg Rawls
Russell 2000: 671.50

Scan Soft recently grew when the Massachusetts based company purchased Nuance on September 15, 2005 for $221 million. ScanSoft soon changed their name to Nuance Communications. Nuance is a leading provider of speech and imaging solutions for businesses. Nuances speech products are sold globally and have the ability to support over 45 languages with 99% accuracy. Nuance also offers imaging solutions that enable automatic reproduction of documents.

Recommendation

Nuance will experience strong growth for years to come as the voice solutions market continues to become more widely adopted. Nuance Communications recently changed its name from ScanSoft after acquiring fellow voice recognition leader Nuance. The merger will help Nuance by improving their technology. It will also give them a more dominate market leadership position. Nuance will be able to maintain its leadership position because of the company's 400 plus patents and patents pending. Nuance will grow as there is an increasing use of voice recognition technology and as companies are able to develop further uses of voice recognition.

Key Statistics	November 28, 2005
Portfolio weight	2%
Market Cap	$692 million
LT Debt/Total Cap.	8.4%
Dividend Yield	0
ROE	0
LTG Rate (7 yr)	25%
Thomson Consensus Rating (1=Buy 5=Sell)	1.8
P/E Fiscal '05E	31.10
P/E Fiscal '06E	21.75
Morningstar Sector	Hardware
EPS 2005	$.20
EPS 2006	$.29

Investment Thesis

- **There continues to be increasing applications for voice recognition.** Some of the more promising areas of growth include financial services, healthcare, government and telecommunications. Some of the areas making use of network and embedded speech include automated call centers, directory assistance, consumer devices and automobiles. The dictation business, which includes Nuance's Dragon Naturally Speaking product, is growing in popularity in the medical industry. Also, several individuals and corporations are using the software to become more productive. Nuance's imaging products are used by Canon, Hewlett-Packard and Xerox in digital copiers, printers and scanners.
- **The voice recognition market will grow for years to come**. The voice recognition market is expected to reach $3.1 billion by 2008 according to Business Insights. Business Insights stated that "Speech recognition and text-to-speech engines will account for the lion's share of revenues within this segment." Datamonitor expects the number of speech recognition systems worldwide to grow from 99,000 in 2004 to 226,000 by 2009.
- **Nuance technology is, and will remain, the leading technology in the voice recognition market.** Nuance has over 400 patents and patents pending. It was also noted by an industry analyst that programming for voice recognition is quite different compared to standard programming. Therefore, it would be more challenging for a company to enter into the voice recognition market and compete against Nuance.
- **ScanSoft's (Nuance) recent acquisition of Nuance will result in several positive synergies for the newly created company.** In combining these two leaders in voice recognition,

synergies should occur. These include improved technology, improved customer satisfaction and the opportunity to improve on existing relationships with industry leaders.

- **Nuance has had good relationships with several leading technology companies.** Nuance has existing relationships with several leading technology companies including Avaya, Cisco, IBM, Microsoft and Nortel.

Valuation

Nuance is currently undervalued at $6.17 and should be trading at $7.38. The seven year growth rate for NUAN is 25%. The growth rate during the transitional time period for the company is 6.6%. The EPS for Nuance was $.10 in 2004 and analysts estimate an EPS of $.20 in 2005 and $.29 in 2006. Currently two analysts have a strong buy recommendation, two have a moderate buy recommendation and one has a hold recommendation for Nuance.

Risks

- **Increased competition.** If a competitor emerges with voice recognition technology that is superior to Nuance's, the company would greatly suffer.
- **Adoption of voice recognition technology.** If voice recognition is not widely accepted into the market in coming years, the consequences for Nuance will be drastic. Nuance's success will be largely related to the acceptance of voice recognition worldwide.
- **Currency risk.** Nuance currently does not hedge its exposure to foreign markets. As the company continues to expand globally, it will become more exposed to this risk.
- **Ownership.** Over 10% of NUAN is owned by Warburg Pincus. Warburg Pincus is a Private Equity company with $21 billion under management. Pincus has a long term investment strategy with the average investment period being six years.

Management

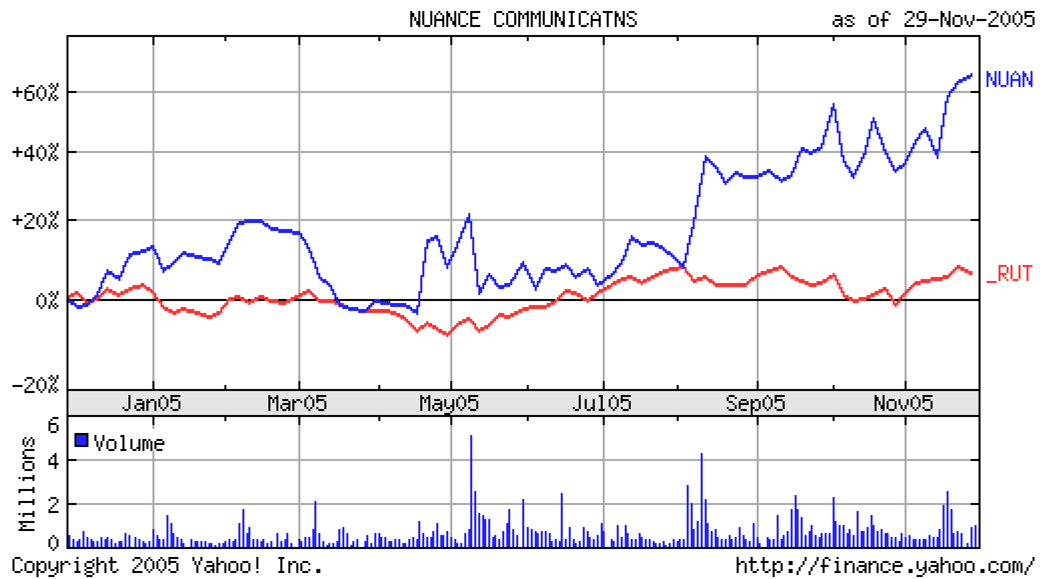
Paul Ricci has served as the CEO for Nuance since 2000. As CEO he has lead Nuance through several strategic acquisitions. Mr. Ricci's past experience includes working as president of the desktop systems department at Xerox for ten years. Jeanne McCann is the president of R&D at Nuance. She joined the company in 2001 when Nuance acquired Lernout & Hauspie and where she was the head of R&D.

Outlook and Growth Assumptions

- EPS for the 2004 was $(.09).
- EPS guidance for the first quarter is $.04.
- The average analyst estimates EPS for fiscal 2005 to be $.20.

Long-term financial goals:

- The seven year growth rate average is 25% and the growth rate for the ten transitional years is 6.7%.
- Nuances trailing twelve month operating margin is -.63%.



Owner	Percent of Ownership
Warburg Pincus	10%
Chilton Investment Co.	7%
SRI International	6.5%
Cisco Systems	5.3%
Sandra Bergeron	3.5%
Charles Berger	1.8%
All directors and executives (17 people)	9.35%

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Compass Minerals International, Inc.
CMP
Price: $23.99 (21.58 – 26.83)
Fiscal Year Ends: December 31

November 28, 2005 Michael Hepp
Russell 2000 Index: 671.50 (570.03 – 688.51)

Compass Minerals International is the second-leading salt producer in North America and the largest in the United Kingdom. The Company operates 11 production facilities, including the largest rock salt mine in the world in Goderich, Ontario. The Company's product lines include salt for highway deicing, consumer deicing, water conditioning, consumer and industrial food preparation, agriculture and industrial applications. In addition, Compass Minerals is North America's leading producer of sulfate of potash (SOP), which is used in the production of specialty fertilizers for high-value crops and turf.

Recommendation

With stable demand and steady price increases year after year, Compass Minerals will likely see healthy cash flows well into the future. Although the Company mines and refines one of the simplest chemicals, it maintains a healthy advantage over its rivals through size and flexible production. The Company's continued focus on increasing dividends should make it a very favorable investment. With an intrinsic value of $32, Compass Minerals International is a buy recommendation.

Key Statistics	Nov. '05
Portfolio Weighting	2%
S&P Rating	B+
Market Cap	$760.89M
LT Debt/Equity	6.59
Dividend Yield	4.60%
ROA LTM	12.31%
P/E Fiscal '05E	20.34
P/E Fiscal '06E	15.61
Morningstar Sector	Ind. Materials

Investment Thesis

- **Cost advantage –** The Company operates the largest salt mine in North America at its Goderich, Ontario location. The mine has a port on Lake Huron, which allows for the material to be put directly into the Company's main transportation network. Nearly 50% of the Company's production capacity comes from this mine, which has reserves that will last well into the foreseeable future. Sodium of potash, which comprises of 13% of the Company's net revenues, is extracted through solar evaporation. This method is also used in the production of high-grade salt and it requires very little energy.
- **Stable demand –** Rock salt is the most preferred method used to deice roads in the winter. The Great Lakes regions of the U.S. and Canada generally see consistent snow fall every winter. This region is Compass Mineral's primary market and its waterways provide inexpensive means to transport large quantities of salt.
- **Growth through SOP -** Sodium of potash (SOP) is gaining popularity as a fertilizer used in agriculture and in professional landscaping. The sodium of potash market should maintain mid single-digit growth. Prior to the 2003 acquisition of a SOP producer in Ogden, Utah, Compass Minerals did not have any means to extract minerals through solar evaporation. This large facility on the Great Salt Lake is capable of producing both SOP and salt at a very low cost.

Valuation

The dividend discount model gives Compass Minerals an intrinsic value of $31 per share. This model was built of the assumption of a 9.5% weighted average cost of capital and a 4% long-term dividend growth rate. Since the extent to which the Company will expand its dividends is unknown, I employed a discounted free cash-flow model to better estimate the intrinsic value. Assuming a 4% cash flow growth rate at maturity, a 9.5% cost of capital and capital expenditures gradually falling to 100% of depreciation, the intrinsic value of Compass Minerals is $33. Reconciliation of the two methods provides a target price of $32 per share.

Risks

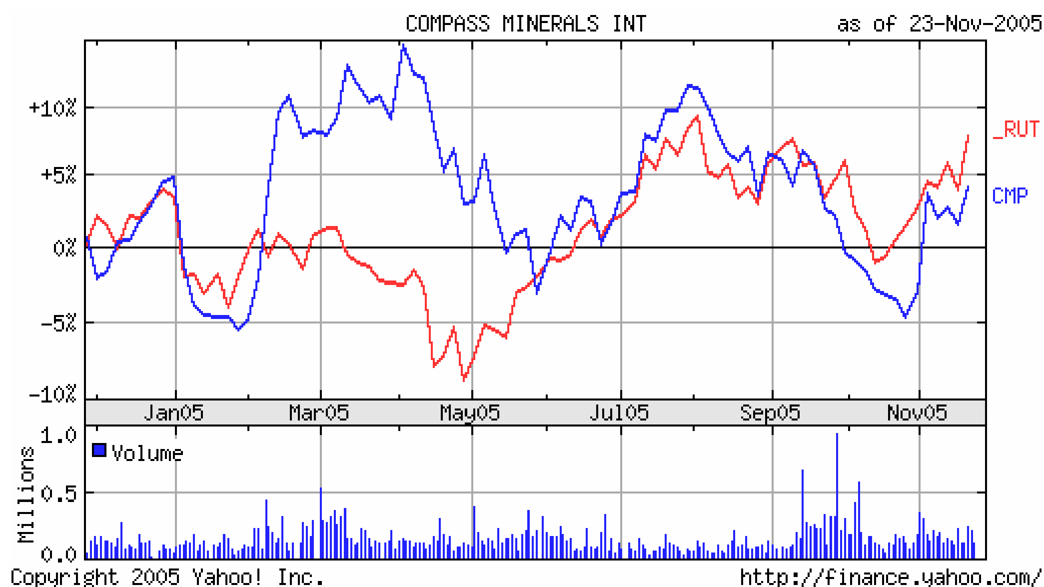
- **Debt -** Compass Minerals is highly leveraged with a long-term debt to equity ratio of 6.59. Earnings before interest and taxes only cover interest on debt 2.5 times. With steady cash flows from operations, it is unlikely that the company will default on debt payments.
- **Transportation costs -** If the company is unable to pass along higher transportation costs to its customers, margins will be substantially reduced. In 2005, the Company raised prices 8% to cover higher transportation costs. Historically the average cost to deliver one ton of salt was $16. Today, the average cost is $30 per ton.
- **Weather patterns –** The severity of winter varies greatly every year. The performance of the Company is highly impacted by the severity of winter weather and the amount of salt used for deicing.
- **Energy prices –** The Company uses mechanical evaporation in the production of general trade salts. This method requires the natural gas or coal as its main energy sources. High energy costs greatly affect margins.

Management

CEO and President Michael Ducey worked for Borden Chemicals for 30 years prior to joining Compass Minerals in 2002. He owns 1.8% of the Company's stock and receives an annual compensation package of about $1 million. On November 4, 2005, Compass Minerals announced that Ducey will retire at the end of 2006. He will remain on the Board of Directors and serve as a consultant. The Company is currently searching for a replacement.

Outlook and Growth Assumptions

- Compass Minerals participates in a relatively slow growing industry. The average volume of road salt sold in the U.S. has historically grown at a rate of one percent per year. General trade salt grows at a slightly faster rate at 2% per year. Sales growth for Compass Minerals comes mostly from price increases and gaining new customers.
- SOP sales are expected to grow at a rate of 5-6% per year.
- The long-term annual growth rate for Compass Minerals is projected to be 4%.



Major Holdings

% of Shares Held by All Insiders:	2%
% of Shares Held by Institutional & Mutual Fund Owners:	98%
Number of Institutions Holding Shares:	107

Top Institutional Holders

Holder	Shares	%	Value
AMERICAN EXPRESS FINANCAIL CORP	1,381,582	4.36	$31,776,386
WELLINGTON MANAGEMENT COMPANY, LLP	1,209,200	3.81	$27,811,600
CITIGROUP INC.	1,158,819	3.65	$26,652,837
REED, CONNER & BIRDWELL, INC.	1,141,254	3.60	$26,248,842

Shenandoah Telecommunications Company
SHEN
Price: $42.81 ($25.28-$52.66)
Fiscal Year Ends: December

November 28, 2005 Jason Toellner
Russell 2000: 671.50 (570.03-688.51)

The Group's principal activities are to provide regulated and unregulated telecommunication services through its nine wholly owned subsidiaries. The services provided by the Group include: telephone service and wireless personal communications service under the brand name 'Sprint', cellular telephone, cable television, unregulated communications equipment sales and services, Internet access and paging services. The Group provides integrated telecommunication products and services in the Northern Shenandoah Valley and surrounding areas. The Group operates in the Northern Shenandoah Valley as well as in parts of West Virginia, Maryland, and Pennsylvania. The Group also leases towers and operates and maintains an interstate fiber optic network. The company is located Edinburg, Virginia and was founded in 1902.

Recommendation

Shenandoah Telecommunications will be able to achieve solid earnings and revenue growth for the next several years. SHEN is a strong affiliate with Sprint and the majority of its revenues consist of wireless operations which is a growing market within the United States. SHEN has been around for a hundred plus years and has an efficient business model that generates strong margins and pays a firm dividend yield. SHEN has an intrinsic value of $57.75 and is the top prospective holding within the Telecommunications sector for the portfolio.

Key Statistics	November '05
Weighting	0
Market Cap	347.08M
LT Debt/Capital	24%
Dividend Yield	1%
ROE	8.43%
Operating Margin	14.06%
Current P/E	34.88
EPS 05E	$1.33
Rev 05E	$143M
Free Cash Flow	$1.9M
Morningstar Category	Telecommunications

Investment Thesis

- **Continuation of wireless growth in United States.** U.S. subscriber growth annually for the next several years is still expected to be between 5-8% versus the 10-15% global wireless growth. SHEN is well positioned as it is currently an affiliate with Sprint and is well spread out throughout the Southern and Eastern states. The recent merger of Sprint and Nextel will allow SHEN subscribers to have more markets in which their service will have access. The current nationwide trend to move from landline to wireless in the next several years will only benefit SHEN.

- **Strong business initiative in established market.** SHEN is focusing on its wireless operations as its key driver of growth for the next several years. The combination of the wireless broadband initiative which will focus on the adaptation to new technologies and the strong nationwide brand awareness it receives as being an affiliate with Sprint will support SHEN's growth. SHEN recently made an acquisition of NTC Communications to further diversify its services to enable that growth can occur through other avenues of its business.

- **Solid and efficient business model.** SHEN is a well established company that still maintains to produce strong margins and pays a dividend yield of 1%. SHEN also generates a solid balance sheet as it has been paying down its debt substantially in the last few years. SHEN has an efficient business model that will enable the company to produce strong revenue and EPS numbers in the future.

Valuation

Using the dividend discount model and intrinsic value of $57.75 was computed using a short term dividend growth rate of 7.088% and then flattening out towards a 4.5% long term dividend growth rate. This indicates that the stock is currently undervalued by 34.90% compared to its computed intrinsic value.

Risks

- **Relationship with Sprint.** It is very essential to SHEN that maintains its relationship with Sprint as SHEN does not own any licenses to operate a wireless network. Therefore, SHEN highly depends on the continuity and fairness of key affiliate agreements with Sprint. Sprint has substantial power over these agreements and any change in the agreements could have an adverse affect on the value of SHEN.

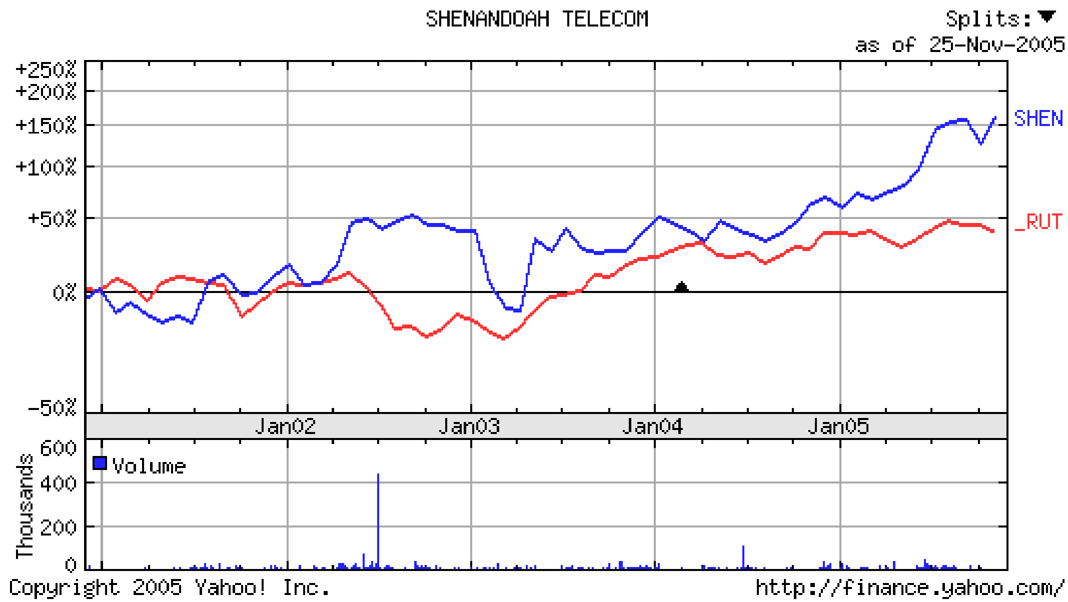
- **Lack of liquidity and guidance.** SHEN is a relatively illiquid stock as it typically trades less than 10000 shares per day and therefore increases the risk of ownership for the investor. As well, SHEN does not provide formal guidance and this leads to a lack of visibility for future operations which can lead to high volatility if the results vary from expectations.

Management

The management team at SHEN is regarded as highly efficient and of high quality. The current CEO, Christopher French, has been in the position since 1988 and has been a key innovator within the company to adapt and initiate the new technologies within the industry.

Outlook and Growth Assumptions

Revenue is expected to grow between 5-8% and EPS is expected to grow between 8-10% for the next several years. Current estimates for 2005 include revenues of $143M and EPS of $1.44. With strong margins and a dividend yield of 1%, SHEN is the top prospective holding within the Telecommunications sector.



Breakdown of Ownership	
% of Shares Held by All Insider and 5% Owners:	10%
% of Shares Held by Institutional & Mutual Fund Owners:	10%
% of Float Held by Institutional & Mutual Fund Owners:	11%
Number of Institutions Holding Shares:	37

Top Institutional Holders

Holder	Shares	% Out	Value
Wachovia Corporation	380,000	4.95	$15,652,200
Barclays Bank PLC	164,862	2.15	$6,790,665
State Street Corporation	118,547	1.55	$4,882,950
Advisory Research, Inc.	64,610	0.84	$2,661,285
Vanguard Group, Inc.	55,753	0.73	$2,296,466

Gray Television
GTN
Price: $8.95 ($8.74-15.74)
Fiscal Year Ends: December

November 28, 2005 Paul Zandt
Russell 2000: 676.10

Gray Television, Inc. owns 31 television stations in 27 cities, most of which are mid-sized markets. The company also presently owns five daily newspapers and a wireless paging company, but these holdings are in the process of being spun off into a separately traded public company named Triple Crown Media, Inc. The spin-off, which is expected to be consummated by December 31, 2005, will make Gray Television, Inc. a pure player in the broadcast television industry. Of the company's television station holdings, 16 are CBS-affiliated stations, eight are NBC stations, and seven are ABC stations. In addition, the company has recently announced plans to purchase NBC affiliates in South Bend, Indiana and Charleston, West Virginia.

Recommendation

Gray Television, Inc. has a sound strategy that focuses on mid-sized markets with strong growth potential, often cities with major colleges or universities. In most of the markets it serves, Gray television stations are news leaders and are highly involved in their respective communities. 23 out of the 31 stations Gray owns are #1 in local news viewership and 22 stations are #1 in overall viewership. Such a strategy will help Gray Television remain stable and profitable in an increasingly cluttered media landscape. In addition, the company has been very effective in generating free cash flow. The planned spin-off has resulted in Gray's stock price to decline nearly 30% in the past several months. That trend, along with the company's solid business strategy in broadcast television, makes Gray Television, Inc. an attractive purchase opportunity.

Key Statistics	Dec. 2005
Portfolio weighting	1%
Credit Rating	B+
Market Cap.	$437.9 million
Cash flow margin	15.0%
Dividend yield	1.30%
ROE	7.6%
ROA	2.4%
LT Debt to Total Capital	49.7%
Price to book ratio	1.16
Trailing P/E	18.3
Forward P/E 12/06	19.1
Estimated 2006 EPS	0.53
Morningstar Sector	Media

Investment Thesis

- **Gray television stations have a strong local presence.** Strong local news content and locally-generated programming is an effective way to deal with the increasing competitive pressure from cable and digital television, as well as from the Internet and other forms. Gray Television acquires television stations that are local news leaders and stresses strong local programming content and high community involvement. As a result, the overwhelming majority of Gray stations are #1 in their markets. This local dominance acts as an "economic moat" in each market, in that it is much easier to maintain leadership in local news and programming than it is to establish such a position. This is particularly true in small and mid-sized markets were local news audiences tend to be "less fickle" in the viewing habits.

- **Potentially favorable earnings environment in 2006 with Olympic programming and off-year elections.** Broadcast television companies have experienced depressed earnings in

2005, compared to 2004 – a year which featured both the Olympics and a presidential election. This has had a negative impact on the stock prices of many of those companies. While earnings and revenues in 2006 likely will not return to 2004 levels, the return of Winter Olympic programming will be a positive factor for NBC affiliates (Gray Television presently has eight and is purchasing two more). In addition, the return of political advertising for the 2006 Congressional elections may also enhance revenues.

- **Consistently strong positive free cash flow margins.** Gray television has consistently generated increasingly positive free cash flows during the past five years. In 2004, the company generated an impressive cash flow margin of 15%, which was one of the highest among the small cap media companies analyzed.

Risks

- **Lingering negative effects from spin-off.** When Gray Television announced in August that it intended to spin off its newspaper publishing and wireless paging businesses, the company's stock fell nearly 30% over the following few months. This decline may have been fueled by a report and sell recommendation from a prominent analyst who that believed the company should have sold those businesses outright to create greater shareholder value. Lingering effects from this recommendation may prevent near-term appreciation in Gray's stock price.

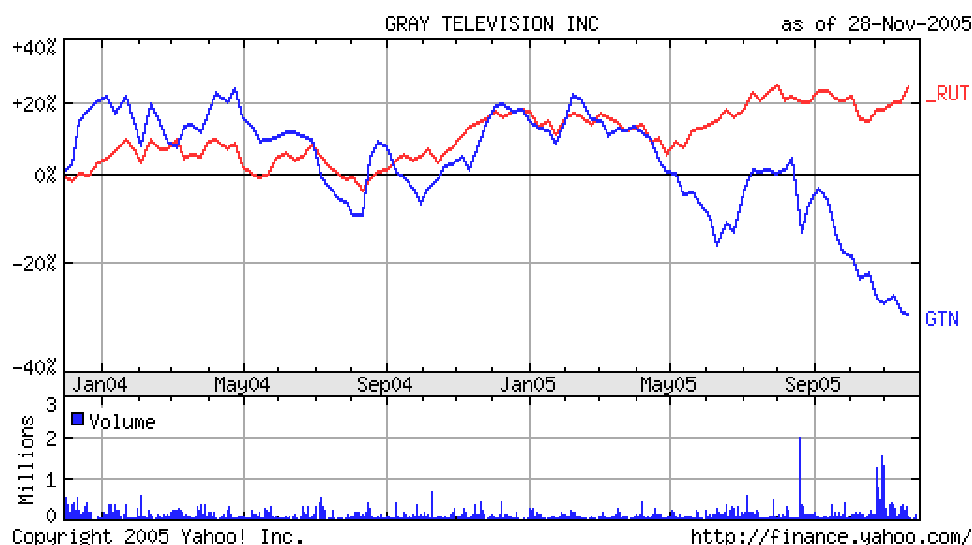
- **Continued slump in the media sector.** For the past several years, investors generally have been reticent to own media stocks, particularly the stocks of "older" media companies involved in broadcast radio, television and publishing. If this bearish sentiment continues, it may continue to have a drag on the stock price of Gray Television and other media companies.

Valuation

In conducting my valuation, I first discounted future revenue streams beyond 2005 by 20%, which was the average percentage of consolidated revenue generated by the newspaper and wireless paging operations over the previous five years. I assumed a conservative annual revenue growth rate of 5% over the next five years, a terminal revenue growth rate of 3% and an annual average free cash flow margin of 8.9% (which was Gray's four-year cash flow margin excluding the company's exceptional year in 2004). Based on those assumptions, my target price is $14.03. Given the current market price of $8.99, Gray Television, Inc. appears to be undervalued and is an attractive purchase opportunity for the AIM fund.

Announcement of Spin-off

On August 3, 2005, Gray Television announced its intention to spin off its newspaper publishing and wireless services, resulting in a newly created and separately traded public company called Triple Crown Media, Inc. According to Gray Television, the spin-off is expected to be consummated by December 31, 2005. Upon completion, each common shareholder of Gray will receive as a dividend one share of common stock of Triple Crown Media for every 10 shares of Gray class A common stock. In addition, on the date of the spin-off Triple Crown Media will distribute $40 million to Gray Television, which the company says it will use to reduce its outstanding debt.



TOP INSTITUTIONAL HOLDERS

Holder	Shares	% Out	Value*	Reported
GAMCO INVESTORS INC	4,182,862	9.74	$44,296,508	30-Sep-05
DIMENSIONAL FUND ADVISORS INC	3,585,800	8.35	$37,973,622	30-Sep-05
EAGLE ASSET MANAGEMENT, INC.	3,208,262	7.47	$33,975,494	30-Sep-05
COLUMBIA WANGER ASSET MANAGEMENT, L.P.	2,167,000	5.04	$26,134,020	30-Jun-05
BAMCO INC.	2,109,000	4.91	$22,334,310	30-Sep-05
OLSTEIN & ASSOCIATES L.P.	1,953,400	4.55	$20,686,506	30-Sep-05
BABSON CAPITAL MANAGEMENT LLC	1,946,050	4.53	$20,608,669	30-Sep-05
BARCLAYS BANK PLC	1,931,166	4.50	$20,451,047	30-Sep-05
GABELLI FUNDS, LLC	1,346,000	3.13	$16,232,760	30-Jun-05

Ownership Information

SHARES OUTSTANDING	49.00 MIL
INSTITUTIONAL OWNERSHIP	80.70%
MUTUAL FUND OWNERSHIP	15.64%
5%/INSIDER OWNERSHIP	11.11%

TETRA Technologies Inc.
TTI

Price: $28.89 ($16.33-$32.25) | Ryan Berg
Russell 2000 Index: 671.5 (558.36-688.51) | Energy Sector

TETRA is a leading small-cap company specializing in three distinct niches of the oilfield service market: completion fluids, well testing, and well abandonment and decommissioning. The company maintains a leading position in each of its services and is focused on continued growth, through both internal expansion and acquisitions. TETRA was incorporated in 1981 and has grown rapidly through small acquisitions and recent property acquisitions by its Maritech Resources subsidiary. The company generated $353 million of revenue in 2004, of which approximately 88% were from the United States. TETRA is based near Houston and employs approximately 1500 people.

Key Statistics	30 Nov. 2005
Market Cap	$1.00B
Shares Outstanding	34.699M
Average Volume	400,872
Beta vs. S&P 500	1.46
EPS(ttm)	$0.95
2005 Estimated EPS	$1.07
Forward P/E	15.62
ROIC	6.45
04' Operating Margin	7.81%

Recommendation

With its recent string of strategic acquisitions, improving market conditions, and a balanced portfolio of businesses, TETRA is well positioned to outperform its peers over the next several years. TETRA has a portfolio of businesses which spans the well life, providing more balanced financial performance than its peers. During 2004, TETRA made two strategic acquisitions, which provided valuable geographic diversification and allowed access to the wellhead compression business. Furthermore, while hurricane season had a significant negative impact on third quarter results, the storms will likely result in increased demand for well abandonment and decommissioning services over the next few years. Due to all of these factors, TETRA is poised for a strong run over the next few years and represents a relatively attractive investment opportunity in the small cap energy space.

Investment Thesis

- **Balanced and Diverse Product Offerings:** TETRA offers niche products and services at targeted points that span the well life. This diversity gives TETRA more balanced financial performance than its peers. Through its fluids and well testing businesses, TETRA capitalizes on cyclical upturns in the oil and gas drilling cycle. Its newly acquired well compression business is oriented toward the less cyclical mid- to late-life production stage and has a large leasing component, which produces a steady revenue stream independent of drilling activity. During cyclical downturns, increased activity in the well abandonment and decommissioning (WA&D) segment helps to balance the negative effects of declines in drilling activity felt in the fluids and well testing divisions.

- **Synergistic Acquisitions Will Fuel Growth:** Since the beginning of 2004, TETRA has made two significant acquisitions. Moreover, these acquisitions were both completed by mid-2004, which was before the major run-up in energy prices, which would suggest that TETRA was able to make these acquisitions at a reasonable price. In September of 2004, TETRA purchased Kemira, a calcium chloride business in Helsinki, Finland. This acquisition was synergistic because it added much needed capacity to TETRA's fluids business, and provided a valuable source of international diversification. Following this acquisition, TETRA will be the largest manufacturer and marketer of calcium chloride in the world, allowing TETRA to more economically serve the North Sea markets. Also, TETRA acquired Compressco, a

wellhead compression services company, in mid-2004. This acquisition is synergistic because it also will provide geographic diversification, and it will add meaningfully to the bottom line with the high margins inherent in the business.

- **Leading Market Positions in Each Division:** TETRA has the leading market share in their completion fluids division. Also, they are the only company to backward integrate into the manufacture of all primary fluids. This assures supply and competitive pricing. TETRA also boasts the largest onshore production testing company in the Western Hemisphere and a leading position in wellhead compression with their recent acquisition of Compressco. Finally, TETRA is the largest, most comprehensive WA&D service provider in the world.

- **Likely Post-Hurricane Surge in WA&D Demand:** 113 platforms were destroyed by the two recent hurricanes in the Gulf and an additional 53 were significantly damaged. The majority of these are expected to be decommissioned and their wells abandoned. Thus, it is expected that there will be a surge in demand for TETRA's WA&D services in the Gulf of Mexico for the rest of this year and through 2006. The total Gulf of Mexico WA&D market was expected to be about $450 million this year and reach $500-600 million in 2006 before the storms. Now, the market is projected to reach $1 billion for 2006.

- **A Relatively Safe Small Cap Energy Play:** When investing in small-cap energy, there is no such thing as a safe play, as all stocks are highly tied to energy prices. However, TETRA represents a relatively safe play in the space because of its diversified portfolio of businesses. They are able to capitalize on cyclical upturns like all other oil and gas companies, and their WA&D division, which peaks during cyclical downturns, provides a hedge against the cyclical downturns.

Valuation

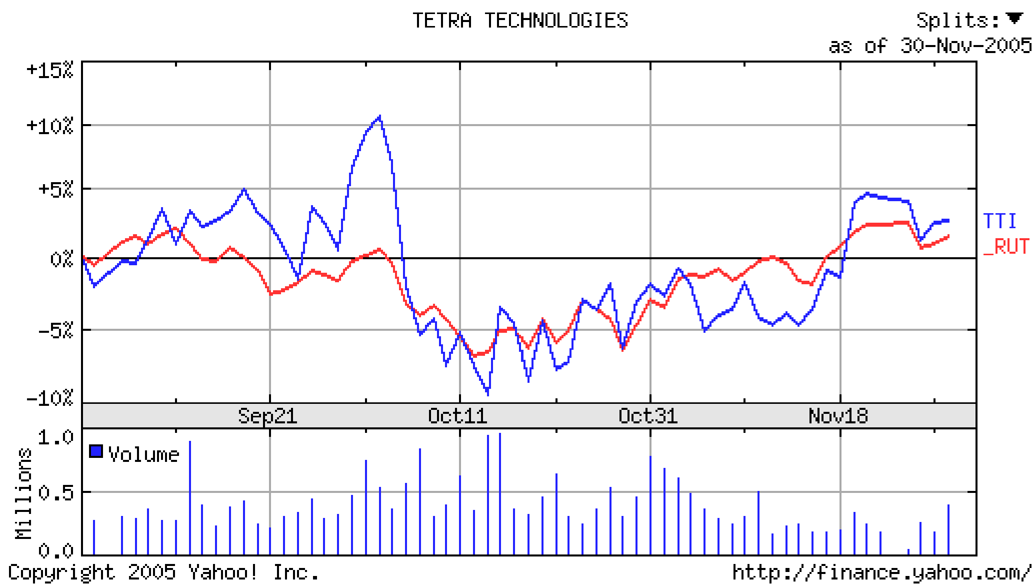
TETRA is valued at a premium to its peers on both an EV/EBITDA basis as well as a P/E basis. However, this premium is warranted given TETRA's strong growth organic growth prospects due to its recent acquisitions, and due to its leading market positions in all of its businesses. Seven analysts cover this stock, and all seven have a buy rating, with 5 rating it a strong buy. The average analyst price target is $35.82.

Risks

- Investing in the small cap energy space is inherently risky, as stock prices fluctuate greatly due to sensitivity to oil and natural gas prices.

- Weather conditions represent a risk for TETRA, as a hurricane in the Gulf of Mexico can shut-in significant amounts of production. This was observable during the last quarter.

- Competition also represents a risk for TETRA, as it competes with companies much larger than itself. While TETRA is the market leader in many of these cases, it does not have the same degree of financial flexibility as its larger counterparts.



Key Holders

Percent of Shares Held by Insiders: 2%

Percent of Shares Held by Institutions: 96%

Synaptics
SYNA
Price $25.00 ($17.50 – $35.00)
Fiscal Year Ends: June

December 6, 2005 — Christopher Cunningham
Russell 2000: 689.48

Synaptics designs and ships the touch sensitive software on laptop computers, and similar handheld products such as portable digital music players, mobile phones, and other devices, that allows the user to maneuver on the media screen. Other software and applications provided by the company enable the proper functioning of some mice, keyboards, monitors, and other peripherals of standing PC's. The company was founded in 1986 and began shipping its first products in 1995. SYNA derives 98% of revenues from international markets, namely Asia and Europe.

Recommendation

I believe Synaptics can achieve 10% - 12% annual earnings growth for the next two years. As the world becomes more mobile, consumers continue to embrace such products as laptops, ever-advancing cellular phones, palm pilots, and portable digital music players. Because the software that Synaptics provides facilitates the use of these products, companies like Synaptics have a great opportunity to capitalize on sales growth in these products. I am particularly impressed with the company's gross margin, currently over 46%, and additionally that it has been increasing over the past several years. Based on a discounted cash flow model I have determined the fair market value of SYNA at $32 per share.

Key Statistics	December 6th
Weighting	2%
Beta	1.72
Market Cap.	$485 million
LT Debt/Total Cap.	28%
Dividend Yield	0%
ROE	28.8%
P/E Fiscal '06E	24.11
P/E Fiscal '07E	21.18
S&P Sector Category	Software

Investment Thesis

- **Positive growth opportunities in the Information Technology Services Sector.** The product groups Synaptics designs software for are poised to realize impressive gains this year and in future years due to consumption preferences and the utility of these products. The 'notebook' (laptop computer) market alone, 100% of which could employ software provided by Synaptics, is predicted to grow at a 16.3% compound annual rate from now until 2008. The hard-disk drive (HDD) segment of the market, which predicted to grow at a compound annual rate of over 30% until 2008. Since the HDD sector is currently only 41% of Synaptics' revenues, and the company has given guidance to indicate that future revenues there are less clearly predictable, I predict an approximate growth rate of 18% - 22% for revenues this fiscal year.

- **Impressive margins make this an attractive investment.** With gross margins at 46% and net margins over 24%, this company is very profitable. In this high margin sector SYNA manages to outperform its major competitors and the industry average. Management continues to push better efficiency and lower cost development with a strong focus on R&D to create better products. Margins are expected to continue to

increase, even as the company provides its customers with more and more complex software.

- **Intellectual Property is key.** This company has a strong hold in this area, which is imperative in the software industry. Currently Synaptics holds 76 U.S. patents and has 32 pending. As seen in the superior technology produced within the company, this is a software company that has a slight competitive advantage over its competitors

Valuation

For the last three fiscal years, Synaptics has reported 36% average annual revenue growth, and 106% average annual earnings growth. A good portion of the earnings growth came from a stock buyback in fiscal year 2004, so this figure is not entirely realistic. Using a discounted cash flow model and a WACC of 10.4, I determined the fair value of the stock at $32 per share.

Risks

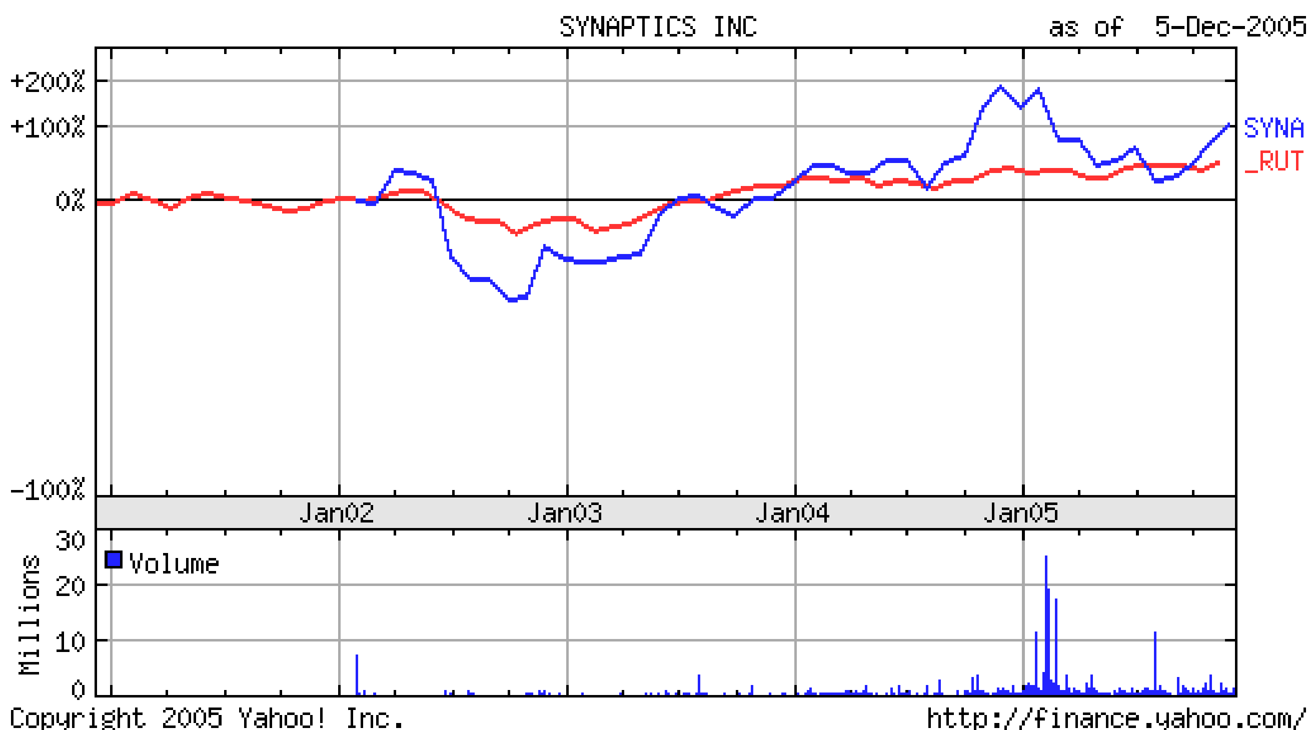
- **Earnings growth estimates this year are negative.** Earnings estimates predict an average of $0.88 in earnings for FY '06. The large increase last year came mostly from an acquisition and I believe this year's numbers are much more realistic and already diluted to incorporate the information whereas last years were not.
- **The company has just taken out a substantial amount of debt.** In December last year Synaptics took out $125 million in long term debt at .075% interest for 10 years. Increasing leverage from almost nothing to 1.5x is significant.
- **Lost the Ipod nano deal.** Though previously Synaptics created the software to run the scrolling programs in all of Apple's Ipods, the project was awarded to another firm for the Ipod Nano. This was a serious let-down for the company and could be the reason for management's apprehension about future growth in the HDD sector.

Management

Most executives have been in the company for 5+ years, almost all of them have been in the industry for significantly longer. This group knows the sector well, and has done an excellent job expanding a great idea into a profitable business.

Outlook and Growth Assumptions:

- The Board authorized a buyback plan of $40 million in stock that is good until April of next year. Over $18 million in common stock was bought back already this calendar year with no further plans to buy back more in the near future.
- Revenue grew over 56% last year; earnings grew close to 40%.
- The company can sustain its own cash growth, but recently has chosen to spend quite freely and take out considerable debt.



Major Shareholder	%
PRICE (T.ROWE) ASSOCIATES	5.76%
GRANAHAN INVESTMENT MANAGEMENT INC.	4.12%
KESTREL INVESTMENT MANAGEMENT CORPORATION	4.11%
BARCLAYS BANK PLC	3.87%
VANGUARD GROUP, INC. (THE)	3.36%

Major Holdings

- % of Shares Held by All Insiders and 5% Owners: 13%
- % of Shares Held by Institutional & Mutual Fund Owners: 76%

Number of Institutions Holding Shares: 143