Applied Investment Management (AIM)

AIM Fund Investment Advisory Board Meeting

November 19, 2008
Location: Raynor Library Lower Conference Room Center
Session One: 4:30 – 5:45 PM
Session Two: 5:45 – 7:00 PM

AIM Equity Fund Presentations

Student Presenter	Company Name	Ticker	Price
Andy Parker	Acuity Brands	AYI	$29.94
Kevin Roloff	Comtech Telecommunications Corp.	CMTL	$43.75
Stanley Nunoo	Dril-Quip Inc.	DRQ	$19.27
Connor Lawrie	Koppers Holdings Inc.	KOP	$18.70
Maggie Hughes	**ICON plc**	ICLR	$19.06
Anna Toshach	Lincoln Educational Services Corp.	LINC	$13.84
Andrew Knapp	McGrath Rent Corp.	MGRC	$17.80
Steven Briggs	**CAE Inc.**	CGT	$5.78
Philip Benedict	Energy Conversion Devices	ENER	$27.12
Andy Verchota	Websense Inc.	TLK	$21.24
Tim Kellen	**Diageo PLC**	DEO	$53.68
Katie Wycklendt	**PT Telekomunikasi Indonesia**	TLK	$21.24
David Martin	Senior Housing Properties Trust	SNH	$16.24

International in bold.

Acuity Brands
AYI
Price: $29.94 ($26.23-29.98)
Fiscal Year Ended: August 31

Date: November 14, 2008 — Andy Parker
Russell 2000 Index: 491.23(433.35-799.57) — Industrial Materials Sector

Acuity Brands designs, produces and distributes both indoor and outdoor lighting fixtures. Their products are used in commercial, industrial, infrastructure, and residential applications. AYI sells their products to electrical distributors, lighting showrooms, retail home improvement centers and municipalities. In addition to the distribution centers, the company uses 240 company-employed salespeople and ~160 sales agencies each employing numerous salespeople, to target specific customer and geographic segments. They operate 16 manufacturing facilities, 13 in North America and 3 in Europe. AYI markets their products under a number of brand names including Lithonia Lighting, Holophane, American Electrical Lighting, SpecLight, and SAERIS. Sales in North America accounted for 96% of net sales in FY08. In October 2007, AYI completed a spin-off of Zep Inc., a producer of cleaning supplies. The company is based in Atlanta, GA. Acuity Brands Lighting was founded in 2001 after being spun-off from National Service Industries. AYI employs approximately 6,500 people.

Recommendation

Amidst challenging economic conditions, AYI is well positioned to weather the storm. The company boasts a cash position of $297M, greater than 20% of their total capitalization, giving them plenty of financial flexibility. Management guided a 110bps increase to operating margins (currently 13.6%), making the company more defensible in a down economic cycle. AYI has a market-leading 19% share of the $11.2B North American lighting fixture market, giving them staying power in the industry. Current legislation and higher energy costs make a shift toward more efficient lighting inevitable. An estimated $70B in outdated lighting fixtures need replacement and AYI is poised to take advantage. SAERIS, an AYI subsidiary, provides comprehensive services to companies looking to upgrade lighting fixtures in existing buildings. This business line, which did $70M in FY08, should bolster revenues for AYI at a time when their traditional sales face pressure from lower levels of construction. FCF has exceeded net income in 6 of AYI's last 7 fiscal years. Strong cash flows coupled with a solid balance sheet give AYI a solid foundation in rocky economic conditions. With a target price of $36, it is recommended that AYI be considered for addition to the fund.

Key Statistics	11/14/08
Market Cap	$1.16B
Shares Outstanding	40.37M
Average Volume	603,458
Beta	1.06
EPS (TTM)	$3.56
Debt to Equity (mrq)	63.2%
P/E (TTM)	8.53
Dividend Yield	1.70%
PEG	0.70
WACC	10.7%
ROE	23.83%
ROA	11.39%
Analyst Coverage	6
Gross Margin	40.25%
Operating Margin	13.60%
Target Price	$36.00

Source: Bloomberg

Investment Thesis

- **Strong Financial Condition-** In this uncertain economic environment cash is vital. AYI has $297M of cash and $364M in debt. In February 2009, AYI will pay down $160M of debt lowering their D/E ratio to 35.4%. After delevering, management plans to invest in the company both organically and through acquisitions.
- **Renovation/Relight paradigm shift** – AYI is preparing their sales force to more effectively target potential customers in the $70B relight market. They are trying to sell companies on the benefits of relight like higher profitability, goodwill from "green" image, less maintenance, and payback periods under 2 years. Also, the Energy Policy Act of 2005, which provides tax breaks for improvements to energy systems on commercial buildings, has been extended to 2013- giving companies added incentive to renovate.
- **Cost Cutting Initiatives/Margin Expansion-** Recent headcount reductions (800 employees) and plant closings (2) are an example of AYI's efforts to cut fat from company operations. Streamlining efforts will result in $36M of annual savings when completed in Q409. Q408 operating margins improved 120bps YOY and AYI guided an additional 110bps increase for FY09.

Valuation

Using a terminal growth rate of 3% and a WACC of 11.4%, a DCF model valued AYI's shares at $34.54 in the base case- 15% higher than the current stock price of $29.94. A Price to Earnings valuation returned an intrinsic value of $36.90, using an industry multiple of 11.32. A multiple of 6x 2010 estimated EBITDA valued AYI's shares at $36.84. I have set a target price at $36.

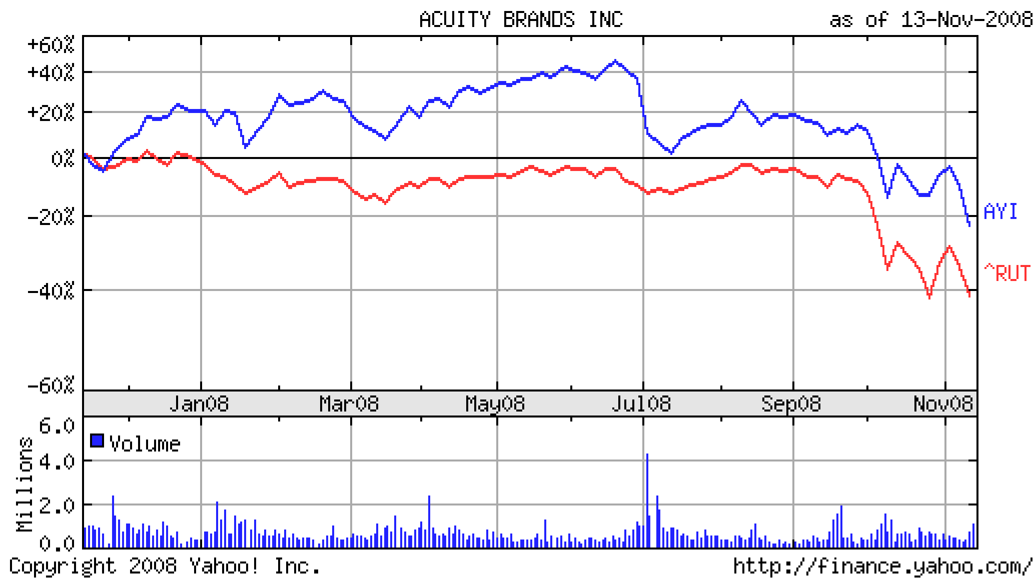
WACC	GROWTH RATE 2.5%	3.0%	3.5%	4.0%	4.5%
11.0%	$ 34.50	$ 36.18	$ 38.08	$ 40.26	$ 42.77
11.5%	$ 32.45	$ 33.91	$ 35.56	$ 37.43	$ 39.57
12.0%	$ 30.61	$ 31.90	$ 33.34	$ 34.97	$ 36.80
12.5%	$ 28.97	$ 30.11	$ 31.37	$ 32.79	$ 34.38
13.0%	$ 27.47	$ 28.49	$ 29.61	$ 30.85	$ 32.24

Risks

- **Lower Construction Starts.** AYI expects 8-12% volume declines in nonresidential construction for FY09, compared to the 6.6% decline in FY08. Management estimates that the lower levels of construction last year resulted in a 3% decline in sales.
- **Cost of Raw Materials.** Management anticipates a 50bps blow to gross margin due to the increased cost of inputs in FY09. Steel costs for AYI rose 40% in Q408, costing the company an additional $5M. AYI reacted with 5-10% price increases on products at the end of the quarter.
- **Concentrated Sales Mix.** Home Depot represented 11% of FY08 sales (15% in '07 and '06). North America accounted for 96% of sales last year.

Management

Chairman of the Board, President, and CEO Vernon Nagel has held his position since 2004. Prior to taking his position as CEO, Mr. Nagel served as the company CFO. He has been with the company since it was founded in 2001. Richard Reece serves as the Executive VP and CFO. Mr. Reece joined Acuity in 2005 after a long career at Belden CDT. The BOD is well diversified with members from a broad array of industries.



Ownership

% of Shares Held by All Insider and 5% Owners:	1.0%
% of Shares Held by Institutional & Mutual Fund Owners:	100.0%

Source: Yahoo! Finance

Top 5 Shareholders

Holder Name	Shares Held	Percent of Share Outstanding
Artisan Partners LP	5,642,365	13.98%
Barclays Global Investors	2,990,291	7.41%
Prudential PLC	2,502,463	6.20%
Keeley Asset Management Corp.	2,172,480	5.38%
Columbia Wanger Asset Management	2,161,300	5.35%

Comtech Telecommunications, Corp.
CMTL
Price: $43.75 ($37.59 – $56.07)
Fiscal Year Ends: July 31

Date: November 12, 2008 — Kevin Roloff
Russell 2000 Index: 482.29 (441.92 – 799.57) — Hardware Sector

Comtech develops, produces, and markets equipment for advanced communication solutions that are sold primarily into the commercial and defense communications markets. Comtech's products include satellite earth station modems, over-the-horizon microwave systems, movement tracking systems, microsatellites, and broadband amplifiers. The company conducts business in three segments. The Telecommunications Transmission segment (39% of fiscal 2008 revenue) provides equipment and systems to enhance satellite transmission efficiency and to enable wireless communications where terrestrial communications are unavailable. The Mobile Data Communications segment (49%) provides integrated solutions for global, satellite-based communications when mobile, real-time, secure transmission is required. The RF Microwave Amplifiers segment (12%) develops broadband amplifiers for the microwave and RF spectrums. Products are sold directly, through value-added resellers, or through a combination of both. Comtech was founded in 1967 and is headquartered in Melville, New York.

Recommendation

By marketing innovative solutions that offer lower operating costs and increased efficiency in comparison to competitive products, Comtech has been able to capitalize on a dramatic increase in market demand, which is due in part to growing bandwidth requirements and a shortage of satellite transponder space. This "bandwidth crunch" has prompted service providers to make significant investments in infrastructure to increase their network efficiency. Comtech's sales have grown at a 24% CAGR over the last four years, and judging by the fact that transponder utilization is expected to increase from 60% today to 84% in 2012, demand for Comtech's products should remain strong. To complement healthy top line growth, the company has expanded its operating margin from 15% to 20% over the last five years, while competitors continue to generate operating margins of no more than 7%. With more than $200M in cash and a current ratio close to four, its balance sheet is just as attractive as its income statement. While the current economic environment will present a challenge, Comtech's record backlog of $201M is evidence that the company is more insulated from consumer spending than most other companies. In the long-term, Comtech's favorable market position and the rapid expansion of its target markets will continue to drive demand. I recommend adding Comtech to the AIM portfolio at a target price of $58.00, which represents an upside of 33%.

Key Statistics	Nov. 2008
Market Cap	$1.078B
Shares Outstanding	24.51M
Average Vol. (3 mo.)	349,389
Beta	0.81
Diluted EPS (TTM)	$2.75
2009 Estimated EPS	$2.89
P/E (TTM)	16.00
PEG (5 yr expected)	0.90
WACC	9.52%
Debt/Equity (qtr end)	23.74%
ROE	19.39%
Operating Margin	20.09%
Profit Margin	14.38%
Dividend Yield	0.00%
No. of Analysts	8
Target Price	$58.00

Source: Bloomberg

Investment Thesis

- **Radyne Acquisition.** The August 1, 2008 acquisition of Radyne was the largest in company history ($232M in cash). The addition of Radyne more than doubled the size of the RF Microwave segment and strengthened the other two divisions. Besides expanding Comtech's addressable markets and customer base, the closing of Radyne's Phoenix, AZ facility and the integration of its operations into Comtech's Tempe, AZ facility will produce cost savings.
- **Developing Countries.** Developing countries are upgrading their communications systems, but many lack the financial capacity to install land-based systems. Satellite and over-the-horizon

microwave technologies offer viable solutions. Comtech is currently working to secure $80M in contracts with an existing North African customer and a contract worth $40M with another foreign government. International sales accounted for 27% of total 2008 sales.

- **Competitive Positioning.** Comtech's products provide customers with greater efficiency and lower operating costs than competitive products. Comtech's newest satellite earth station modem uses Carrier-in-Carrier technology, which increases bandwidth efficiency by 50%. An embedded base of 150,000 legacy modems at wireless and wireline carriers, governments, broadcasters, ISP's, and satellite service providers presents significant upgrade opportunities.
- **Military Demand.** Demand remains strong for satellite-based and over-the-horizon microwave solutions due to a lack of terrestrial-based systems in many areas where militaries operate. The government and military fixed satellite market is expected to grow to $3.6 billion in 2010, a 44% increase from 2008 levels. Comtech's proprietary mobile data communications network that was developed for the DoD and has been maintained for 10 years creates significant barriers to entry.
- **Communications Traffic. S**trong cellular communications growth (especially in emerging markets where the projected subscriber CAGR is 15.7% through 2011) and the popularity of bandwidth-heavy HDTV are putting satellite transponder space at an all-time premium. Cellular backhaul revenue is expected to double by 2013.

Valuation

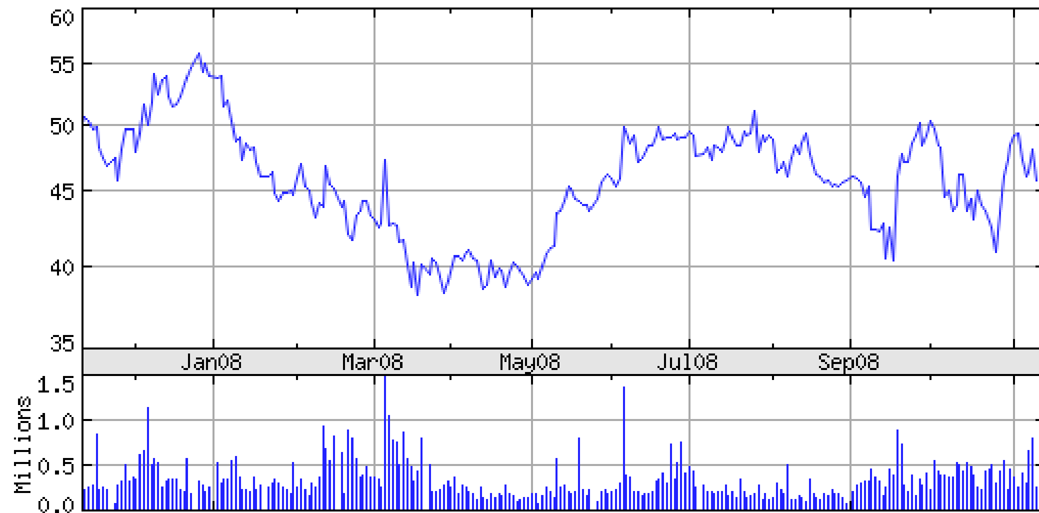
Assuming a WACC of 9.5%, a sales growth rate of 39% in year one (to account for the Radyne acquisition), a sales growth rate of 12% in year two, and a terminal growth rate of 3.0%, a DCF model yielded a value of $56.71. Comparing Comtech's forecasted 2009 earnings to a 5-year industry P/E and to CMTL's 5-year P/E, values of $60.75 and $67.13 were obtained, respectively. After considering both valuation methods, a target price of $58.00 was established, which represents a 33% upside.

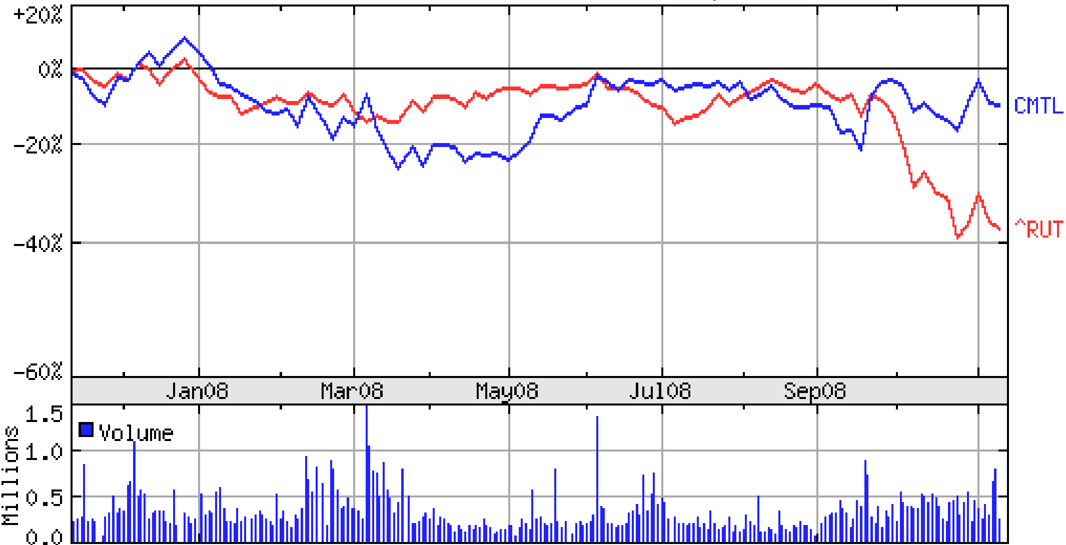
Risks

- **Customer Concentration.** The U.S. government accounted for 66%, 61%, and 47% of total sales in 2008, 2007, and 2006, respectively. At fiscal year-end, 72% of the company's backlog consisted of U.S. government contracts. This subjects Comtech to unpredictability of order placements, reductions in government spending, cost audits, and strict regulation. Furthermore, government contracts are awarded through a competitive bidding process.
- **Contract cancellations.** Nearly all of Comtech's contracts may be cancelled at the customers' will. Historically, the company has not experienced any material terminations.
- **Acquisition risk.** There is no certainty that current or future acquisitions will be successful. Radyne has a history of inconsistent operating results and missing expectations. This poses operational and administrative challenges for management. Comtech must also manage the company's substantial increase in scale due to the Radyne acquisition.
- **Corporate Governance.** The president and CEO of Comtech is also the Chairman of the Board. Two of the remaining five directors have been affiliated with the company in some capacity. In addition, executive compensation is borderline excessive.
- **Export Regulations.** Because of the nature of Comtech's products, certain products may require licenses from the U.S. government for export, and some products are not allowed to be exported. Comtech is currently involved in an export dispute with U.S. Customs regarding items that were purchased by a Brazilian customer.

Management

Fred Kornberg has been President and CEO of Comtech since 1976 and has been with the company since 1971. Michael Porcelain has been Senior Vice President and CFO since 2006. Prior to joining Comtech in 2002, Mr. Porcelain was a Director of Corporate Profit and Business Planning for Symbol Technologies, which is a mobile wireless information solutions company.





Ownership

% of Shares Held by All Insider and 5% Owners:	1%
% of Shares Held by Institutional & Mutual Fund Owners:	99%

Source: MSN Money

Top 5 Shareholders

Holder Name	Shares Held	Percent of Shares Outstanding
FMR LLC	1,876,186	7.66%
Variable Insurance Products	1,509,904	6.16%
Paradigm Capital Management	1,436,926	5.86%
Barclays Global Investors UK Holdings	1,330,689	5.43%
Friess Associates Inc.	1,227,927	5.01%

Source: Yahoo! Finance

Dril-Quip Inc.
DRQ
Price: $19.27 (18.03 – 65.36)
Fiscal Year Ended: December 31

Date: November 14, 2008 — Stanley Nunoo
Russell 2000 Index 491.23 (441.92 – 799.57) — Energy Sector

Dril-Quip (DRQ) is a leading global manufacturer of offshore drilling and production equipment. The products offered by DRQ are primarily used by large independent and foreign oil and gas companies that operate in deepwater and harsh-environment drilling conditions. The Company's main products include subsea and surface wellheads, subsea and surface production trees, and subsea control systems. DRQ's services include providing advisory assistance, reconditioning services and the rental of installation tools. The Houston Texas-based firm was founded in 1981 and has operations globally with offices in nearly every major offshore drilling region.

Recommendation

Despite the current volatility in the energy markets, DRQ is strategically positioned to capitalize on the growing expansion into offshore drilling by E&P companies worldwide. The company recently completed an in-country wellhead system in Brazil and is on pace to hire 40 machinists in 2008 in this region to accommodate the growing demand for their services. Major offshore discoveries in the U.S., Brazil and West Africa have increased demand for DRQ's products and services leading to a y-o-y 3Q revenue growth of 10.0% in the Western Hemisphere region and a 30.0% increase in the Asian-Pacific region. DRQ competes in the subsea production market against larger, more capitalized firms such as FMC Technologies and Vetco Offshore. The company's ability to manufacture lower costing products that are more flexible to the changing needs of its customers has helped it obtain a 10% market share of the subsea drilling market. The firm's strong relationship with Brazilian E&P provider Petrobras has enabled them to obtain a formidable position in the growing Brazilian energy market. Brazil currently has 12.2 billion barrels of proven oil reserves and 693 active subsea wells. Petrobras has a 95% ownership of the market share in this area. DRQ is responsible for supplying 50% of this market with subsea wellheads. DRQ's ongoing global capacity expansion has been the main driver of top-line growth leading to 12.0% y-o-y growth in revenue and 19.0% growth in net income during 2007. It is recommended that DRQ be added to the AIM equity portfolio with a price target of $30.00.

Key Statistics	11/14/2008
Market Cap	752.0M
Shares Outstanding	39.0M
Average Volume	697,693
Beta	1.27
EPS (TTM)	2.77
2009 Consensus EPS	3.22
P/E (TTM)	6.96
Gross Margin	42.43%
WACC	12.50%
ROE	20.37%
ROA	16.67%
ROIC	20.29%
Debt/Assets	0.31%
Operating Margin	28.0%
Analyst Coverage	10
Target Price	$30.00

*Source: Bloomberg

Investment Thesis

- **Global footprint.** DRQ currently generates 70% of its revenues outside the U.S. With manufacturing centers in Brazil, Singapore, and Scotland. DRQ is positioned to capitalize on the growing attraction toward deepwater drilling. Over the next four years, the global offshore drilling industry is on pace to grow by 50%, primarily in areas that focus on deeper and more challenging drilling environments. Since the company's business model is mainly focused on the subsea production area of offshore drilling, it is less dependent on the construction of new rigs and has the ability to outperform during the later segments of the drilling life cycle.
- **Slow Production Insulation.** Given recent concerns involving delayed construction of new offshore rigs, DRQ is well insulated because only 20% of their business is driven by one-time sales related to new construction activities. DRQ's products are significantly weighted toward products that are considered consumable goods and are driven by working rigs.
- **Vertical Integration.** DRQ is known for having a consistent track record of top-quality product innovation and development. All of the manufacturing operations and services provided by DRQ are made through the company's onsite forging and machine fabrication assembly process. This vertical integration process gives DRQ the ability to be a low cost manufacturer and allows the firm to have better control over product quality and lead times while providing lower upfront capital expenditures to their customers. The firm's focus on specialized equipment production has helped it become one of the top two sellers in three different product groups: subsea wellhead systems, pipe connecters, and mudline suspension systems.

Valuation

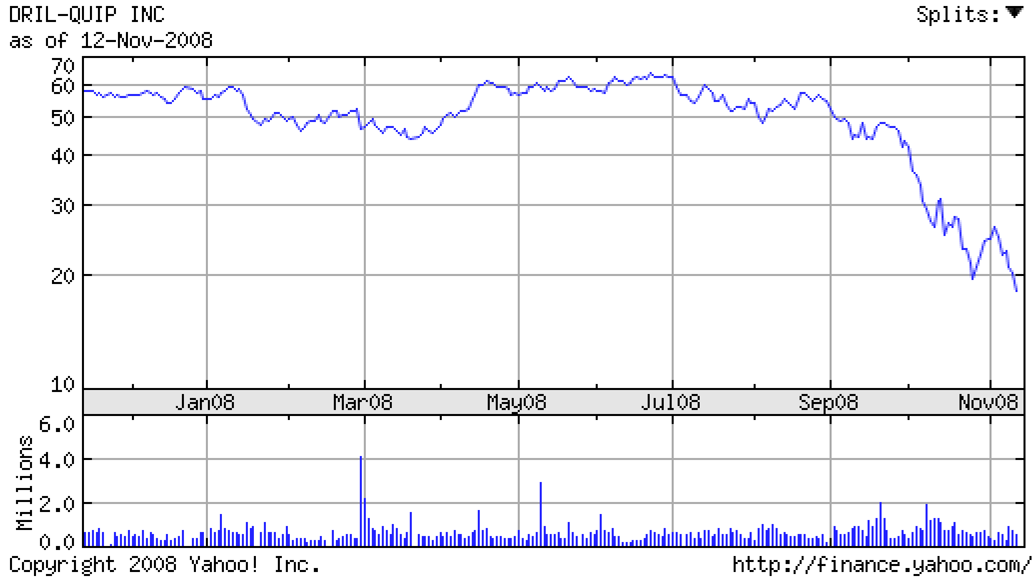
A 5 year DCF valuation for DRQ with a calculated WACC of 12.50%, an average revenue growth rate of 7.5% and a terminal growth rate of 3.0% leads to an intrinsic share price of $29.46, versus the current price of $19.27. Adjusting for best and worst case scenarios yields a price range of $19.50 - $40.41. Based on an industry average 2009 EV/EBITDA multiple of 4.27x for oil and gas service firms of a similar size, a price of $31.36 was obtained. A P/E multiple of 10x 2009 EPS estimates yields an intrinsic value of $31.93. After accounting for these valuations, the target price has been set at $30.00 with an upside potential of 56%.

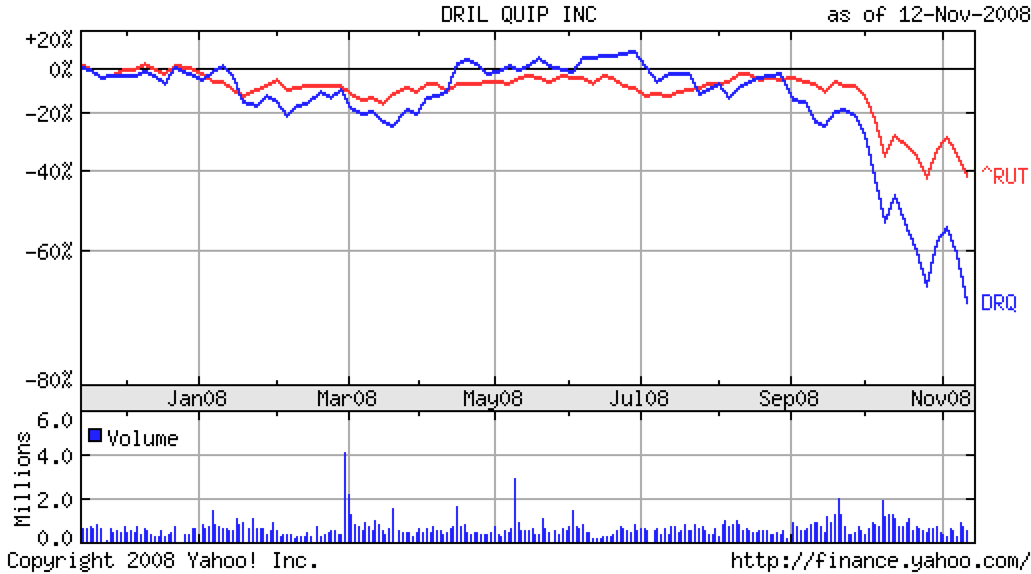
Risks

- **E&P Drilling Dependency.** DRQ's profitability is heavily dependent on drilling activity. Prolonged periods of depressed oil and gas prices could lead to a material decline in drilling activity and the need for the products and services that are offered by DRQ. Also the possibility of the US making a definitive shift toward renewable energy under the Obama Administration could negatively affect DRQ's ability to maintain domestic profitability.
- **Market Competition.** The majority of DRQ's competitors are larger multi-national companies who have a greater capacity of operations. If DRQ is unable to continue to produce top quality products that meet customer's specific needs it would negatively affect the company's ability to win contracts against their larger competitors.

Management

Dril-Quip is lead by a three-way co-CEO management structure with Larry Reinert, Gary Smith, and Mike Walker. All three co-CEOs formerly worked at Vetco Offshore and have over 100 years of combined experience in the oilfield equipment industry. They have been instrumental in growing the firm into a global leader in the oil and gas service industry.





Ownership

% of Shares Held by All Insider and 5% Owners:	23%
% of Shares Held by Institutional & Mutual Fund Owners:	87%

Source: Yahoo! Finance

Top 5 Shareholders

Holder Name	Shares Held	Percent of Share Outstanding
Barclays Global Investors UK Holdings	1,593,103	4.02%
Bank of New York Mellon Corporation	1,470,968	3.71%
Wellington Management Company, LLP	1,143,440	2.88%
Vanguard Group, Inc.	1,012,694	2.55%
FMR LLC	973,000	2.45%

Koppers Holdings Inc.
KOP
Price: $18.70 ($16.41-$51.95)
Fiscal Year Ends: December 31

November 14, 2008 — Connor Lawrie
Russell 2000 Index: $482.29 ($441.92-$799.57) — Industrial Materials

Koppers Holdings Incorporated (KOP) is a global provider of carbon compounds and commercial wood treatment products. Its carbon materials and chemicals segment (64% of 2007 revenue) is the largest distiller of coal tar in North America, Australia, the United Kingdom and Scandinavia. The coal tar is distilled into a variety of products including carbon pitch, creosote, and phthalic anhydride, which are critical intermediate materials in the production of aluminum, the pressure treatment of wood and the production of plasticizers and specialty chemicals, respectively. Its railroad and utility products segment (36% of 2007 revenue) treats and distributes railroad crossties and other utility poles. This segment operates 15 wood treatment plants and 13 pole distribution yards in the US and Australia. Both segments sell directly to customers through long-term contracts. Koppers Holdings was formed in 1988 as an MBO of certain assets of Beazer East, Inc. In 1997, Koppers recapitalized its business with the assistance of Saratoga Partners, LP who became the majority equity holder.

Recommendation

The company has positioned itself well as the leading producer or only producer of distilled coal tar products in the markets it serves. Recently, the company has expanded capacity to better serve China and Middle Eastern aluminum smelters which should offset flat to negative domestic and European demand for carbon pitch. Koppers' coal tar distillation capacity will be about 2.4 million tons after the added capacity of 400,000 tons comes online. Koppers provides most of its carbon compounds on long-term contracts with an average length of 5 years. Koppers' Railroad segment is a defensive business as a result of government mandated service and replacements of railroad ties. This industry has grown by ~3% from 2004-08 and should see steady growth of 2%-3% for 2009. Due to the favorable longer-term demand prospects, near-term defensive growth in the railroad segment, strong position in the carbon compound market, and ability to generate free cash flow, it is recommended that Koppers be added to the AIM portfolio with a target price of $26.52.

Key Statistics	11/14/08
Market Cap	$380.99M
Shares Outstanding	20.37M
Average Volume (3mo)	278,000
Beta (3yr weekly)	1.56
2008 Est. EPS	$3.44
2009 Est. EPS	$3.79
P/E (TTM)	5.53
P/S (TTM)	0.27
EV/EBITDA (TTM)	4.39
WACC	12.09%
Debt/Assets (TTM)	65.84%
EBIT/Interest Expense	2.83
Gross Margin	17.73%
Operating Margin	9.86%
Dividend Yield	4.20%
Analyst Coverage	5
Target Price	$26.52

Source: Bloomberg

Investment Thesis

- **Defensive-** The Railway Tie Association has indicated wood crosstie insertion levels will increase 3% in 2009. Management expects its volumes to be 2-3 times those industry projections as a result of lower orders for 2008 from a weak lumber market caused by

Hurricane Ike. This segment is driven on maintenance rather than new lines of the domestic railway systems. The US government mandates a certain annual amount of maintenance each year. In addition to wood crosstie production, Koppers has a 50% equity ownership in KSA, LP which manufactures concrete crossties.

- ***Solid Capital Position-*** *The after-tax proceeds from the sale of KOP's Monessen Coke plant of $90 million were used to pay down approximately $50 million in debt and repurchase $17.5 million of stock (~2% float). KOP replaced its current credit facility with a 4 year $300 million revolver at LIBOR + 250 bps. With a consistent free cash flow yield of 11% and a manageable Debt/EBITDA of 1.9, Koppers is well positioned financially to withstand even further challenges in the marketplace.*
- ***Increased Carbon Pitch Capacity-*** *By 2009, Koppers will have expanded distillation capacity of 400,000 metric tons of coal tar in its plant in* Tangshan, China adding to its current capacity of 2 million metric tons. *The primary focus of this added capacity is to be able to supply new aluminum smelters coming online in the Middle East, China, and India.* Koppers is strategically positioned with eight distillation plants around the world to provide sufficient access to coal tar and for the effective distribution of its products.

Valuation

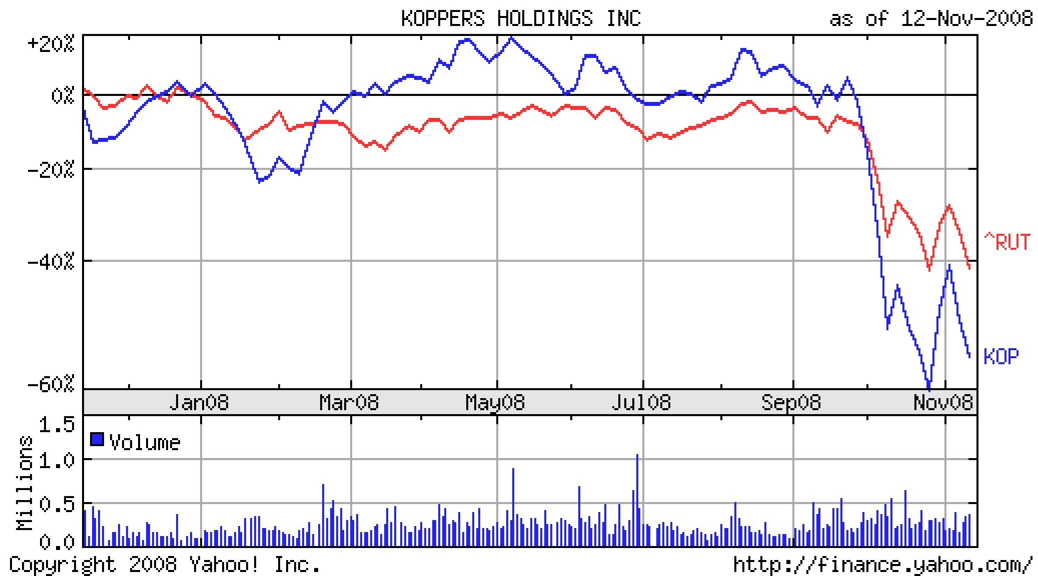
A 5 year DCF valuation for KOP indicates an intrinsic value of $23.46 using a WACC of 12.09% and a terminal growth rate of 3.0% compared to the current price of $18.70. Adjusting for WACC and terminal growth assumptions leads to a price range of $16.76-$35.10 A P/E model was utilized applying the low, mean, and high 2009 EPS estimations, which yielded an average value of $26.11. An EV/EBITDA multiple was calculated using a peer group multiple of 5.0x and estimated 2009 EBIDTA which yielded a value of $30.00. Taking into account all valuations, a target price of $26.52 was found. The firm pays a dividend yield of 4.20%.

Risks

- **Aluminum Demand-** After distilling coal tar, 50% of the three by-products is carbon pitch. In total, 90% of the carbon pitch is sold to aluminum smelters for production. Thus, about 30% of revenue is derived from aluminum smelters. Currently, 7% of global aluminum capacity is in idle status. Management expects its new markets from the added capacity to mitigate soft demand in the domestic and European markets.
- **Currency Risk-** For 2007, approximately 49% of Koppers' revenues were denominated in currencies other than the US Dollar (15% Europe, 16% Australia and the Pacific, and 9% other countries). KOP has not historically and does not currently hedge for currency translations.
- **Coal Tar Supply-** Coal tar is a by-product generated through the processing of coal into coke for use in steel and iron manufacturing. Koppers purchases coal tar from a number of global resources including United States Steel Corp. and Mittal Steel USA. With lower production rates of steel, Koppers may face shortages in supply of coal tar.

Management

Mr. Walter W. Turner has been president, CEO and a director of Koppers since, February 1998. He has been with the company through its various names and changes since 1969. Brian H. McCurrie has been vice president and CFO since November 2004. Prior to his 11 years with the company he worked in the global rail transportation market.



Ownership

% of Shares Held by All Insider and 5% Owners:	13.00%
% of Shares Held by Institutional & Mutual Fund Owners:	87.00%

Source: Yahoo! Finance

Top 5 Shareholders

Holder Name	Shares Held	Percent of Share Outstanding
Price (T. Rowe) Associates Inc.	2,029,400	9.89%
Keeley Asset Management Corp.	1,441,030	7.02%
SouthernSun Asset Management, Inc.	1,202,420	5.86%
Goldman Sachs Group Inc.	1,075 ,994	5.25%
Turner Investment Partners, Inc.	768,115	3.74%

Source: Yahoo! Finance

ICON plc
ICLR
Price: $19.06 ($18.67-44.78)
Fiscal Year Ends: December 31

November 14, 2008 Maggie Hughes
iShares MSCI EAFE Index: $43.71 (37.50-84.67) International Healthcare Sector

ICON plc is a leading Clinical Research Organization (CRO) that provides global research and development services to pharmaceutical, biotechnology and medical device companies. ICLR operates in two segments: Clinical Research (92% of net revenue) and Central Laboratory (8% of net revenue). The Clinical Research segment focuses on the planning, management and execution of all phases of the clinical trial process, while the Central Lab segment boasts an extensive array of tests and advanced technology to standardize the analysis of trial results. Unlike their competitors, ICLR employs study-specific teams that improve result quality and accuracy. ICLR was founded in 1990 and is headquartered in Dublin Ireland; they operate 71 locations in 38 countries, but mainly the United States, Ireland and the rest of Europe (42%, 16%, and 32% of net revenue, respectively).

Recommendation

ICLR is one of only a select few competitors with adequate scale and experience to compete as a global player in the $17.8 billion CRO market. Major competitors include Covance Inc., Pharmaceutical Development Inc. and PARAEXEL. ICLR's extensive test menu, dedicated project teams and comprehensive, web-based database have made it a leader in this rapidly growing market, 15-20% CAGR. Their success is evident both in record backlog ($1.7 billion, +54% yoy) and client mix (contracts with the 20 largest pharmaceutical companies in 2006). In addition, ICLR has experienced 40% net revenue growth in 2006 and 2007 coupled with improved gross (43%) and operating (12%) margins. The recent industry sell-off was a market overreaction based on macroeconomic speculation rather than company fundamentals. Therefore, because of ICLR's prominent position in the fragmented global CRO market and strong long-term industry fundamentals, I am recommending the addition of ICLR to the International AIM Equity Portfolio with a target price of $30. 1 ADR represents 1 ordinary share of ICLR.

Key Statistics	Nov. 13, 2008
Market Cap	$1,209.86M
Shares Outstanding	58.504M
Ave. Volume (3 month)	576,580
Adjusted Beta	.709
EPS (TTM)	$1.21
2009 Estimated EPS	$1.61
P/E (TTM)	16.03
PEG Ratio	.68
WACC	10.34%
Debt/Assets	0.10
ROE	14.89%
ROA	9.10%
Gross Margin	43.26%
Operating Margin	12.03%
Analyst Coverage	14
Target Price	$30.00

Source: Bloomberg

Investment Thesis

- **High Quality, Global CRO.** The CRO industry is extremely fragmented with only a handful of global competitors due to the extensive infrastructure and organizational requirements necessary to manage international clinical trials. ICLR is the fourth largest competitor effectively obtaining 6% of the market (top five competitors have 41% market share). Customers choose ICLR because of their global diversification, team-specific approach and remote data management services. ICLR has reported strong new business wins and a 3Q08 book-to-bill ratio of 1.6:1.
- **Expansion of CRO Industry**. The CRO industry has seen rapid expansion in recent years, as companies looked to effectively manage costs and ensure accurate clinical tests. The CRO market grew from a $3.6 billion industry in 1997 to $17.8 billion in 2007. Although the market will not maintain the growth rate, industry fundamentals remain intact. Each 5% increase in

research outsourcing catalyzes a 15% growth in the CRO industry. ICLR is capitalizing on this market expansion by maintaining their quality service, while increasing their geographic presence in Eastern Europe, India and Asia, previously unsaturated markets that offer cost advantages.

- **Competitive Needs of Pharmaceutical Companies.** The growth of large pharmaceutical and drug companies is dependent upon the consistent introduction of new products into the market. As companies look to compete with generic providers, CROs will become a more cost-effective and timely way to perform research. Furthermore, large pharmaceutical companies are slowly evolving to a more strategic outsourcing approach in which these companies partner with one CRO to provide all of their research and development needs. ICLR will capitalize on this shift because of their global capabilities and respected industry track record.
- **Cost Containment Pressures.** With continued margin pressure from generic drug pricing and patent expirations, companies are looking to more efficiently conduct trials. They are trying to streamline their research and utilize competitive advantage by being the first to introduce new products to the market. CROs conduct trials 30% faster than in-house research (4-5 months), which expedites the time-to-market and can translate to $120-150 million in increased revenue potential, as cited by the Association of Clinical Research Organizations.

Valuation

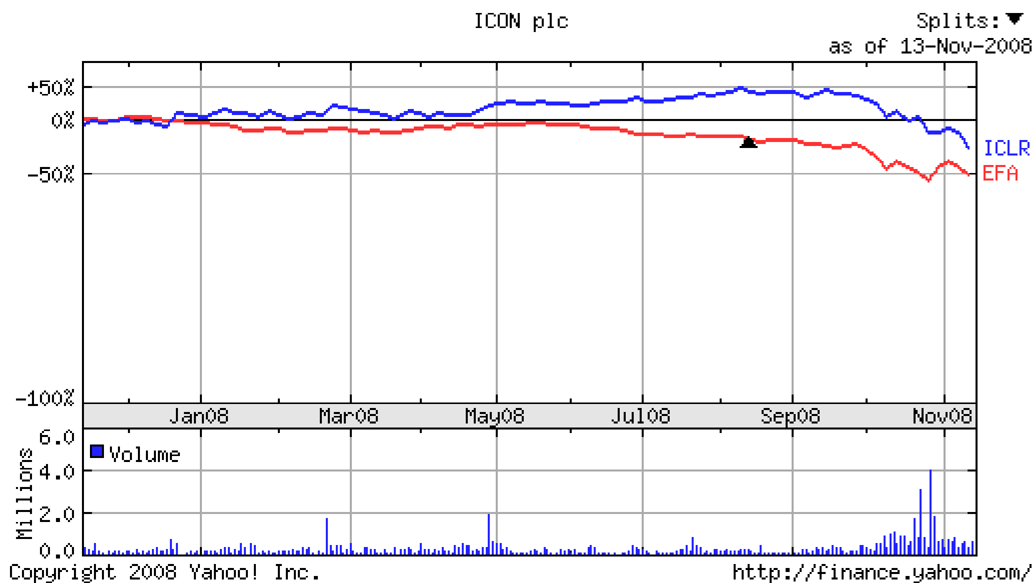
ICLR is currently trading at 15.7x TTM EPS of $1.21. A conservative historical P/E average of 20x my 2009 EPS estimate of $1.56 yields a $31.25 price target. Based on a 10 year DCF analysis with a computed WACC of 10.34% (2% currency risk included) and a terminal growth rate of 3%, an intrinsic value of $37.50 was obtained for ICLR. A sensitivity analysis that adjusts both the long-term growth rate (2-4%) and the WACC (9.34-10.34%) generates a price range of $32.37-44.92. This DCF assumes continued strong net revenue growth (+20% for five years) until the market returns to a more normalized growth rate in the mid-teens for the remaining five years of valuation. Due to the immediate near-term headwinds, I set my price target at a conservative $30. With the stock currently trading around $20, the $30 price target would yield a 50% return.

Risks

- **Credit Availability.** As the credit crunch continues, it is becoming more difficult for small biotechnology and pharmaceutical companies to obtain adequate funding; therefore, some companies are decreasing or postponing their discretionary research spending.
- **Dependence on Large Clients.** ICLR derives a large portion of their net revenues from a small number of clients. In 2007, 30% and 47% of net revenues were attributed to their largest five and ten clients, respectively (no one client contributed more than 10% to net revenue). The termination of one of these contracts would be detrimental to ICLR's profitability.
- **Exchange Rate Fluctuation.** 50% of net revenue comes from outside the United States; the majority of this revenue is denominated in Euros. Changes in the exchange rates between these currencies affect financial results that are reported in US Dollars. A strengthening US Dollar will have a negative impact on revenues, but will improve margins because of natural hedging used to match the currency between revenue and cost streams.
- **Industry Reform.** Many governments are trying to pass legislation that would reduce healthcare costs. If these efforts were successful, companies may react by cutting their research spending. The popularization of managed care organizations could prove detrimental to research spending, as they work to minimize healthcare expenditures.

Management

Dr. John Climax, co-founder of ICLR, has served as Chairman of the Board since the company's inception and boasts over 20 years of global CRO experience. Peter Gray, current CEO, has been a director since 1997, serving prior roles as both COO and CFO. Under Gray's leadership, ICLR has more than quadrupled its net revenue.



Ownership

% of Shares Held by Insiders:	17%
% of Shares Held by Institutional & Mutual Fund Owners:	86%

Source: Yahoo! Finance

Top 5 Shareholders

Holder Name	Shares Held	Percent of Share Outstanding
Neuberger Berman, LLC	4,399,328	7.52%
AXA	2,154,100	3.68%
William Blair & Co, LLC	1,939,676	3.32%
Eagle Asset Management, Inc.	1,687,438	2.89%
Wells Fargo & Co.	1,367,108	2.34%

Source: Yahoo! Finance

Lincoln Educational Services Corporation
LINC
Price: $13.84($15.95-$9.85)
Fiscal Year Ends: December 31

Date: November 13, 2008 — Anna Toshach, Consumer Services
Russell 2000 Index: 491.23 (433.35 - 799.57)

Headquartered in West Orange, New Jersey, Lincoln Educational Services Corporation is a small, for-profit, post-secondary educational services firm in the United States. It currently offers career-oriented degree and diploma programs in five principal areas of study: automotive technology, health sciences, skilled trades, business and information technology, and spa and culinary. The company operates 34 campuses in 17 states all of which are either nationally or regionally accredited. As of December 31, 2007, there were over 18,000 students enrolled in its programs. Lincoln Educational Services Corporation operates under the brand names of Lincoln Technical Institute, Lincoln College of Technology, Nashville Auto-Diesel College, Southwestern College, and Euphoria Institute of Beauty Arts and Sciences. The company was founded in 1946 as Lincoln Technical Institute, Inc. and changed its name to Lincoln Educational Services Corporation in 2003.

Recommendation

Key Statistics	Nov. 2008
Market Cap	$352.35M
Shares Outstanding	25.46M
Average Volume	25,298
Beta	0.78
EPS (TTM)	$0.67
2008 Estimated EPS	$0.71
Div Yield	NA
P/E (TTM)	25.50x
PEG	1.00
WACC	9.19%
ROE	10.75%
Gross Margin	57.44%
Operating Margin	7.80%
Analyst Coverage	8
Target Price	$18
**Source: Bloomberg*	

While large universities, both public and private, concentrate on developing upper-level graduate programs and research facilities, their focus on bachelor, masters, and graduate degree programs ignores a substantial portion of the post-secondary education market. Over the past 40 years, enrollments in post-secondary institutions have increased at an average rate of 11% every five years. Within that overall number, students enrolled in accredited, non-degree granting, Title IV eligible post-secondary institutions have grown from >1% in 1990 to 2.9%, or 430,000 students, in 2005. (NECS). Additionally, 160,000 associates degrees were awarded in 2005, a 28% increase since 1995. From 1990 to 2005, the difference between the salaries of an adult with a bachelors degree and one with a high school diploma increased from $14,500 $17,500 per year. Within the career-oriented post-secondary education market, Lincoln Educational Service Corp. is a growing player, with enrollments up 20% since 2006 compared to only 3% growth in the overall education industry. The company offers its students over thirty career programs which award technical certificates, associates degrees, or bachelor degrees upon completion. These programs were attained through both acquisitions and organic development by the company. Although the majority of its students are enrolled in automotive technology and health sciences (39% and 30%, respectively), business and information technology programs are a growing share of the business (up on average 66% for each of the first three quarters in 2008). Additionally, the company has recently begun offering degree-granting programs online, and plans to continue developing its online offerings. It is recommended that LINC be added to the AIM small-cap equity portfolio with a price target of $18.

Investment Thesis

- **Steady Growth in Market for Post-Secondary Education.** From 1990 to 2005, the wage gap between the salaries of an adult with a bachelors degree vs. only a high school diploma increased from $14,500 $17,500 per year. This increasing disparity has been a key driver for consistent growth in enrollments at post-secondary educational institutes Also, with the U.S. slowly transitioning to a more service-based economy, pressure on adults to obtain college degrees or diplomas in order to be competitive in the job market continues to grow.
- **Expanded Degree Offerings.** Over the past five years, Lincoln has developed and grown its program offerings, acquiring six education institutes since 2003 and expanding from 28 to 38 programs since 2005. With an increasing number of students enrolling in health care services and business and information technology programs, the company plans on focusing on these areas as it continues to expand its program offerings. In 3Q2008, Lincoln was accredited for two additional bachelors and two additional associates

degrees, bringing their total to 22 associates programs and four bachelors programs. Also the company plans to start a graphic design program in 4Q2008. Additionally, in October 2008 the company entered into an agreement to acquire Briarwood College, the first regionally-accredited college in Lincoln's portfolio. Briarwood will add two additional bachelors and 31 associates programs to Lincoln's offerings.

- **Online Degree Initiative.** Many of the larger players in the for-profit post-secondary education business offer convenient online programs for working adult students. Online courses are a significant competitive advantage in the industry as they attract working adults as well as providing upside to operating margins due to less overhead costs for online students. In April 2008, the company began offering courses online as part of a hybrid degree-granting program, and received approval to offer three bachelor's degree programs online. Currently, about 500 students are utilizing this program as a compliment to their campus-based classes. By the end of 2009, Lincoln plans on having a fully operational, independent online degree program.
- **Solid Fundamental Business Model**
  Through organic development and strategic acquisitions, Lincoln has obtained 34 campuses in 17 states; offering 32 certificate programs, 22 associate degree programs and four bachelor degree programs. A main focus now is to increase enrollment and persistence growth. In 2008 management began to increase online advertising, translating to an enrollment lead volume increase of 11.5% on a 5.6% increase in spending for the 3Q2008. On their latest call, management spoke to a 85% employment rate for graduates beginning to translate to higher referral starts (historically 20%), as well as a better recruitment strategy leading to a 5% increase in high school starts. With these developments, coupled with macro-trends driving adult learners back to school ("media" starts were up 17.5% y/y as of Q3), Lincoln is ready to recognize operating margin expansion from the current 8% through lower marketing costs per start, higher utilization rates, and increased online enrollment.

Valuation

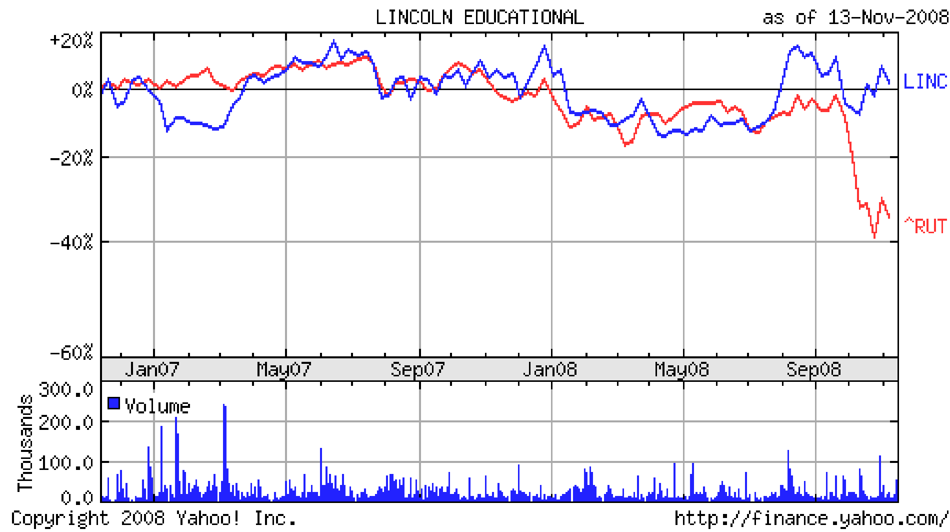
A five year discounted cash flow model yields an intrinsic value of $17 /share, with best/worst case ranging from $11-$20. Utilizing a conservative P/E valuation of 20x, compared to an average industry P/E of 36x, an intrinsic value for LINC of $18/share was derived. Finally, with a P/S valuation using a multiple of 1.5x compared to the industry average of 3.9x, a value of $19/share. Averaging these valuation metrics, the target price derived for Lincoln is $18, which represents 38% of upside potential to the current stock price.

Risks

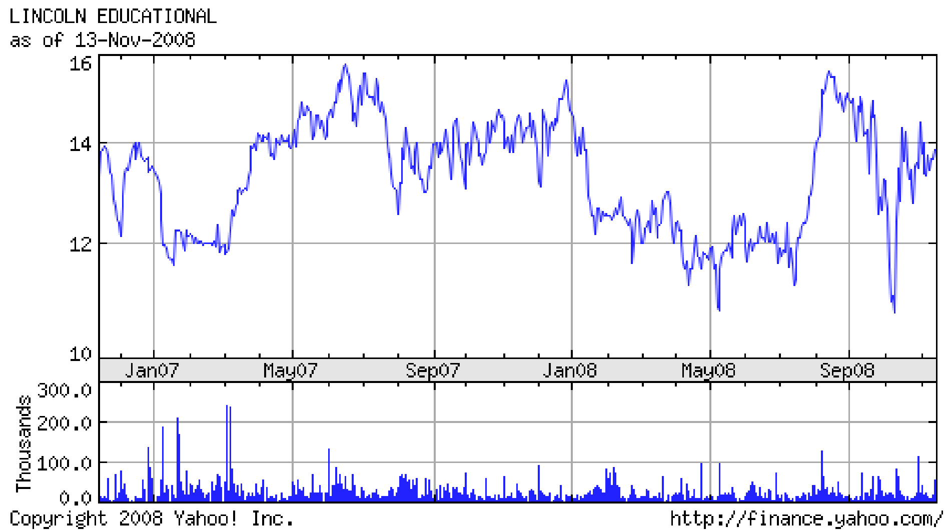
- **Regulatory Environment**
  As with any Title IV institution, Lincoln is subject to regulatory pressures and regulations from both the state and federal governments. Specifically Lincoln has to continually ensure that all of its colleges are properly aligned with federal and state requirements for Title IV students in order to receive favorable conditions for the disbursement of Title IV funds. If any of the Lincoln schools fail to comply with regulations, they may be required to post letters of credit or surety bonds as collateral for Title IV funds. Also, if Lincoln overall fails to comply with the 90/10 rule, it could lose Title IV eligibility, which would severely impact the business.
- **Expansion**
  In their last conference call, management alluded to a 62% average utilization rate for its facilities. As a general trend, the industry has utilization rates closer to 80%. While increased enrollment would increase the utilization rate and provide margin leverage, the company may have to re-evaluate the profitability of some if its campuses if utilization rates decline.
- **Goodwill**
  The company currently holds $82,714,000 in goodwill on its balance sheet, which will increase with the acquisition of Briarwood. This represents 33% of the company's assets. Although goodwill is continually tested for impairment, there would be a significant impact to EPS if a large portion of goodwill was found to be impaired.

Management:
In 2005 the company hired a new chief operating officer, Shaun McAlmont, who also became president of Online in 2006. David Carney, the CEO, has been with the company for almost 10 years. The most recent shift in management was the departure of Lawrence Brown, Vice Chairman, who had been with the company for 30 years. The remainder of upper management has an average of 10 years with the company.

Performance Chart Relative to Russell 2000



2 Year Price Chart



Ownership

% of Shares Held by All Insider and 5% Owners:	83%
% of Shares Held by Institutional & Mutual Fund Owners:	16%

Top Institutional Shareholders

Holder Name	Shares Held	Percent of Shares Outstanding
ROYCE & ASSOCIATES, INC	1,666,098	6.55%
DIMENSIONAL FUND ADVISORS, INC	445,039	1.75%
FIRST INVESTORS MANAGEMENT COMPANY, INC	325,200	1.28%
WELLS FARGO & COMPANY	300,611	1.18%
Murphy, Michael R.	179,310	.71%

McGrath RentCorp
MGRC
Price: $17.80 ($17.65-$20.25)
Fiscal Year Ends: December 31

November 16, 2008 — Andrew Knapp
Russell 2000 Index: 456.52 (433.35-799.57) — Consumer Services Sector

McGrath RentCorp. engages in the rental and sale of relocatable modular buildings and electronic test equipment primarily in the United States. It operates in three segments: Mobile Modular Management Corporation (Mobile Modular), TRS-RenTelco, and Enviroplex, Inc. (Enviroplex). The Mobile Modular segment rents and sells modular buildings and accessories to public and private schools, colleges, and universities for temporary and permanent space needs in California, Texas, Florida, North Carolina, and Georgia. The TRS-RenTelco segment rents and sells electronic test equipment. The Enviroplex segment manufactures and sells portable classrooms to public school districts and other educational institutions in California. McGrath RentCorp. was founded in 1979 and is based in Livermore, California.

Recommendation

McGrath obtains the majority of its profits through its Mobile Modular business, accounting for 71% of pretax income. This segment should see increased activity as classroom rentals are expected to increase throughout 2009-2010 due to an increasing student population, class size reduction programs, and insufficient funding for new construction. Segment growth will also be driven by institutions seeking units for use as temporary offices, restroom buildings, and health care clinics. This demand will be stimulated by an overall domestic reduction in infrastructure expenditures and the need for low cost, temporary alternatives. The other major segment of McGrath's business, TRS-RenTelco, makes up 28% of pretax income and has produced Q3 top-line growth of 17% YoY. The demand for this rental, including general purpose electronic equipment and communications test equipment, should remain consistent as the equipment is generally used in short terms and is considered a cheap alternative to an outright purchase. Overall, McGrath's ability to produce consistent returns in a difficult economic environment makes it a relatively attractive investment. Taking into account economic conditions and company guidance, a DCF and relative valuation have contributed to a per share target price of $26.00. With a potential upside of 46%, it is recommended that McGrath Rentcorp be added to the AIM portfolio.

Key Statistics	Nov. 2008
Market Cap	421.30M
Shares Outstanding	23.66M
Average Volume	106,000
Beta	1.24
Dividend Yield	4.50%
EPS (TTM)	$1.79
Debt Ratio	32.37%
P/E (TTM)	9.83
P/B	1.73
WACC	8.16%
ROE	18.39%
ROA	8.06%
PEG	1.15
Operating Margin	28.52%
Analyst Coverage	4
Target Price	$26.00

Source: Bloomberg

Investment Thesis

- **Economic Resilience.** Current economic conditions are expected to restrict educational construction expenditures throughout 2009-2010 as state and local governments are

unable to establish funding for projects. Also, the student population is expected to steadily grow; a 7% increase in overall enrollment is anticipated by 2016. With these two variables holding true, low-cost modular rentals will be an increasingly attractive alternative for educational institutions seeking additional capacity.

- **Strong Business Model.** McGrath invests its capital in rental assets and are able to recover the investment in a relatively short amount of time. Generally, modular assets return the initial investment 20% into their asset lives; electronic assets take slightly longer at 35%. This contributes to a strong level of asset utilization and helps to generate high operating cash flows which are used to expand the company's asset base.
- **Reputation and Background.** McGrath's 29 years of experience have helped establish itself as a leader in the rental industry. The company's level of expertise in modular and electronic products, its product quality, and its customer service allow it to remain competitive with larger companies.

Valuation

The valuation for McGrath RentCorp was performed using a DCF model and EV/EBITDA multiples analysis. The ten year DCF indicates an implied intrinsic value of $25.02 and after adjusting for WACC and terminal growth assumptions, a sensitivity analysis reveals a price range of $17.16-$39.33. Additionally, a relative EV/EBITDA analysis found an industry average multiple of 6.65x, yielding an intrinsic value of $28.93. Taking each method and its result into account, a target price of $26.00 was established, implying a 46% upside.

Terminal Growth Rate

WACC	2.00%	2.50%	3.00%	3.50%	4.00%
6%	$38.52	$43.68	$50.48	$59.84	$73.54
7%	$27.96	$30.93	$34.63	$39.33	$45.52
8%	$20.92	$22.79	$25.02	$27.73	$31.10
9%	$15.92	$17.16	$18.61	$20.32	$22.36
10%	$12.20	$13.07	$14.06	$15.19	$16.52

Risks

- **Credit Risk.** McGrath executes a substantial amount of their business through receivable agreements with 30 day terms. The company performs credit analyses and requires a deposit on each transaction, however an economic slowdown could have a significant effect on the level of uncollectable sales.
- **Competition.** There is a high level of competition within modular rental and sale. Some of McGrath's larger competitors are in more favorable financial positions and could pose a threat to the future growth of the company. Continual improvement to the company's product quality is necessary to maintain its position in industry.
- **Supplier Risk.** McGrath depends on third party manufacturers to support their operations. The inability to negotiate and maintain arrangements with these suppliers could cause variability in costs and have a negative effect on profitability.

Management

Founder Robert McGrath has been a director since the company's formation in 1979 and has served as Chairman since 1988. McGrath served as the company' CEO from 1979-2003 and CFO from 1979-1993. Dennis Kakures has served as a director and the company's CEO since McGrath's resignation in 2003 and has been with the company since 1989.

Ownership

% of Shares Held by All Insider and 5% Owners:	7%
% of Shares Held by Institutional & Mutual Fund Owners:	85%

Top 5 Shareholders

Holder Name	Shares Held	Percent of Share Outstanding
T. Rowe Price Associates	3,072,400	12.98%
Columbia Wanger Asset Management	2,590,000	10.94%
Kayne Anderson Investments	1,736,536	7.34%
Granahan Investment Management Inc.	1,102,624	4.66%
Vanguard Group Inc.	962,400	4.07%

Source: Bloomberg

CAE Inc.
CGT
Price: $5.78 ($4.35-$13.77)
Fiscal Year Ends: March 31

Date: November 13, 2008
MSCI Canada Index: 18.40 (15.59-36.22)

Steven Briggs
International Hardware

CAE, Inc., together with its subsidiaries, designs, manufactures, and supplies simulation equipment and services to the civil aviation industry, commercial airlines, business aircraft operators, aircraft manufacturers, military organizations, and defense forces. It operates through four segments: Simulation Products/Civil, Training and Services/Civil, Simulation Products/Military, and Training and Services/Military. The company also provides integrated training services for pilots, and cabin crew and maintenance workers. CAE, Inc. was founded in 1947 and is headquartered in Montreal, Canada.

**Bloomberg*

Recommendation

The current fundamentals are intact for CAE and the stock is trading at levels seen in the middle of the last aerospace slump (14x in 2003). There are several reasons to believe that a looming downturn won't be nearly as bad for CAE as the downturn earlier this decade, such as a much stronger balance sheet and increased backlog ($200M more in military than in FY2004). Furthermore, even though the market was concerned about the end markets during the last downturn, it was just as worried about the company's financial health. Today, the company's balance sheet is not a concern. For example, net debt to capital is now about 20% compared to 57% in FY2002. Also, one should note the weakened Canadian dollar. A weaker Canadian dollar is a huge positive for CAE and its operating earnings. A one cent decrease in the Canadian dollar relative to the U.S. dollar results in a higher operating earnings, after the impact of hedging, of $0.8 million dollars. Based on strong orders in civil simulator, training and services, and military segments, CAE has diversified strength in multiple segments to maintain a consistent earnings stream during a trough and excel on the way out. The worst case scenario for CAE is being price in. Once one takes into consideration the superb balance sheet, there is a very interesting position to be had.

Key Statistics	April 2008
Market Cap	$1.47B
Shares Outstanding*	254.86M
Average Volume*	81,000
Beta*	1.04
EPS (TTM)	$.52
2008 Estimated EPS*	$.59
P/E (TTM)	11.1x
Forward P/E	9.5x
EV/EBITDA	5.29x
P/B	1.58x
Debt/Equity	37.0%
ROE	17.17%
EBITDA Margin	23.6%
Operating Margin	18.17%
Dividend Yield	1.5%
Analyst Coverage	3.0
Target Price	$9.75

Investment Thesis

- **Civil Sim Product Strength.** The Civil Simulation segment has many reasons to believe it won't be as bad as 2003, when Airbus and Boeing deliveries bottomed with a 40% reduction. OEM backlog are much higher than in the last downturn, and backlogs are currently about 8 years, compared to 3-4 years in 2003. Not only is CAE's production more efficient, but also keep in mind that the last downturn involved many consecutive

bad events (9/11, Afghanistan and Iraq wars, SARS crisis). All these factors, along with an 85% market share in Civil Sim, lead one to believe the segment will hold up well.

- **Training & Services Poised for Growth & Margin Expansion.** There are many reasons to be bullish on CAE's training and services. First, airline training activity should not drop as sharply as some believe, which is believed to be down in the mid to upper single digits (training dropped about 10% in 2004). Also, in the last downturn, CAE had little exposure to higher growth markets. These markets are not invulnerable to slowdown, but should bounce back rather quickly. Finally, CAE has a larger percentage of higher margin business jet simulators (EBIT margin of 22%).
- **Strong Balance Sheet and Long-term Fundamentals.** In 2002, when the downturn was beginning, CAE had net debt of about $840 million, and a net debt to capital ratio of 57%. Today, the net debt is only $255 million and the net debt to capital ratio is only 20%. In the last downturn, the market was worried about CAE's end markets as well as financial health. Financial health should not be an issue today (ample cash and minimal ST Debt due in the near term). In spite of the anticipated softness in the short-term, the long-term pilot training demand is still expected to exceed supply.

Valuation

A DCF was applied to CGT, with a five-tiered weighting. Discounting the company back at 11% and a heavy weighting on the base case, a valuation of $9.75 was calculated. Also, a P/E multiple of 11.1x was calculated, compared to the stock's 5-year average P/E of 23.8x and the industry average P/E of 19.5x. While although a P/E about 20% may not be as realistic in the 12-18 months, a high teen is. These factors indicate that CGT is significantly undervalued (about 35-45%) and there is a very attractive upside to initiating a long position.

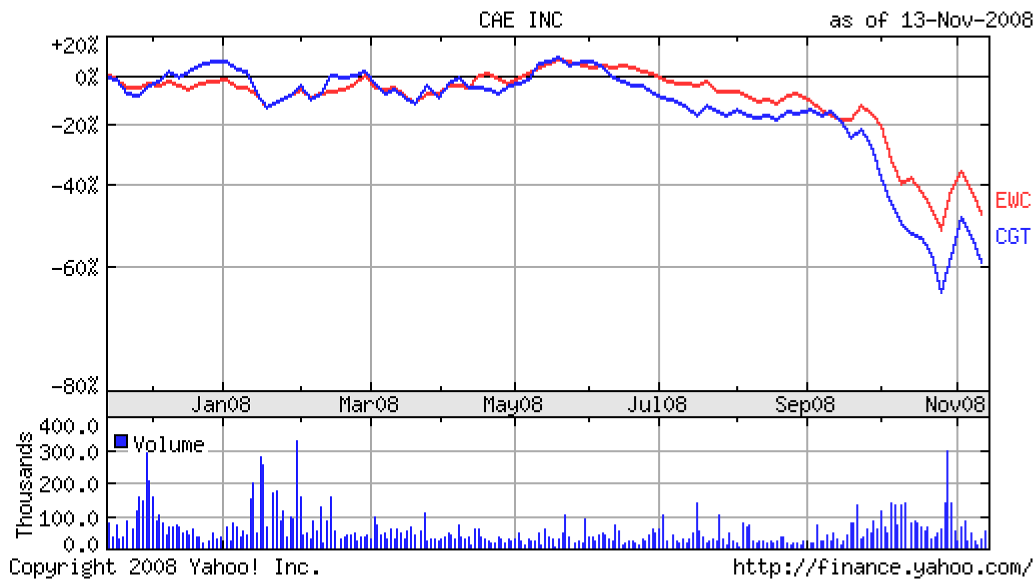
Risks

- **Currency Risk.** In FY08, CAE realized 90% of its revenue from sources outside of Canada. Roughly, a one cent increase in the Canadian dollar relative to the U.S. dollar results in a lower operating earnings, after the impact of hedging, of $0.8 million dollars. The same concept relative to the Euro, results in a negative impact of $0.2 million. The recent fall of the C$ in the last two months should bear solid operating income in the future.
- **Technological Advances.** Both CAE's products and services are technologically advanced, which require a large amount of research and development in order to compete. Significant changes in the technology and in spending could make CAE's products less attractive to the customer.
- **Uneven Government Revenue Streams.** CAE receives various types of government support on a relatively consistent basis. As always with government spending, it is difficult to determine future availability of support and the potential downside this could have on future profits. The most recent large deals have been through France, Germany, and Italy's militaries. U.S. military spending is not expected to decline in the near term.

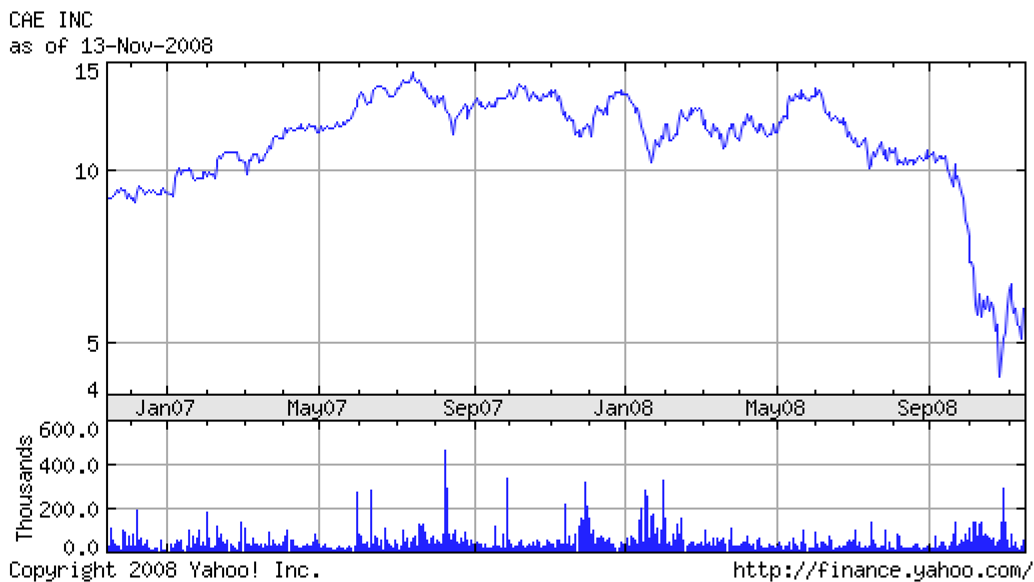
Management

Robert Ellis Brown is President as well as Chief Executive Officer and Alain Raquepas is Vice-president as well as Chief Financial Officer. Brown serves with eleven other members on the twelve person Board of Directors.

1 Year Performance Chart Relative to TSX



2 Year Price Chart



Ownership

% of Shares Held by All Insider and 5% Owners:	21.7%
% of Shares Held by Institutional & Mutual Fund Owners:	56.8%

Source: Yahoo! Finance

Top 5 Shareholders

Holder Name	Shares Held	Percent of Share Outstanding
Jarislowsky Fraser Limited	20,976,783	8.23%
Fidelity Management & Research	16,554,100	6.49%
Harris Financial Corp	15,419,802	6.05%
TD Asset Management	6,179,352	2.42%
RBC Asset Management	5,011,148	1.97%

Source: Bloomberg

Energy Conversion Devices, Inc.
ENER (NYSE)
Price: 27.12 (22.03-81.07)
Fiscal Year Ends June 30

November 14, 2008 Philip Benedict
Russell 2000 Index: 491.23 (448.40-797.03)
Energy Sector

Energy Conversion Devices is the leading manufacturer of thin-film flexible laminates for the building integrated (BIPV) solar market. The company's UNI-SOLAR panels, constructed from paper-thin stainless steel sheets and amorphous silicon, offer a unique value proposition because they are lightweight, flexible and removable. Not only do ECD panels generate greater yield than traditional glass-based PV systems, they are priced lower and require no rooftop penetration. This reduces customer costs by 10-20%, resulting in a faster payback and greater ROI. ECD operates in markets with the highest feed-in tariffs and tax incentive structures for rooftop and building integrated solar products. The company generates 70% of revenues in Europe (Germany, Italy, France, and Spain), 20% in the U.S. and 10% in the rest of the world (primarily South Korea). ECD generates 4% of revenues from their Cobasys JV which manufactures Nickel Metal Hydride (NIMH) batteries for GM and from licensing their IP portfolio. ECD was established in 1960 and is headquartered in Rochester Hills, MI.

Recommendation
ECD is a play on the building-integrated solar market and would give the AIM portfolio international exposure to the alternative energy space. The new management team has transformed ECD from a technology development firm into a commercial manufacturer with a focus on profitability and operational excellence. Under CEO Mark Morelli, ECD attained profitability for the first time in Q3FY08, reduced ramp up times for new capacity from three years to eight months, and is expanding capacity to 1GW by 2012. ECD has a strong balance sheet with $467MM in cash, intends to cover the majority of future R&D expenses through U.S. Air Force and Solar America Initiative program grants, and does not anticipate paying taxes in FY09 due to $300MM of NOL carry-forwards. Due to ECD's position in the BIPV market and strong growth prospects, it is recommended establishing a position with a target price of $60.

Key Statistics	11/14/2008
Market Cap	$1,452MM
Shares Outstanding	45.70MM
Short Interest	10.0MM
3 Mo. Volume	3.42MM
Beta	1.37
FY08 EPS	0.09
FY09E EPS	1.61
FY10E EPS	3.13
P/E TTM	36.13
P/E Forward	19.74
P/S TTM	4.27
WACC	12.82%
ROE	4.10%
ROA	2.90%
Gross Margin	34.06%
Operating Margin	14.64%
Net Margin	13.22%
Analyst Coverage	16
Target Price	$60

Investment Thesis

- **Strong Sales Pipeline.** ECD has a sales pipeline of $1.8Bn and has sold over 90% of FY09 and 60% of FY10 capacity. Contracts are dollar-denominated and increasingly take-or-pay

contracts with associated pricing and minimum purchase requirements. Approximately 50% of sales are through multi-year agreements with building materials distributors and OEMs worldwide.

- **Margin Expansion.** Gross margins were 17.6% in FY07, 27.0% in FY08, and 33.4% in Q109. Long-term gross margins are expected to be in excess of 40% by 2011 due to increased operating efficiencies and cost management. Material cost savings were $3.7MM in Q1FY09.
- **Building Integrated PV (BIPV) Trend.** The PV market consists of ground mount, building applied and building integrated systems. By 2012 management estimates 70% of the total market will consist of rooftop and integrated applications. The commercial rooftop market is projected to constitute 10 GW alone, 50% of which represents prime customers.
- **Capacity Growth.** ECD increased capacity 108% in FY08 to 118MW and is adding an additional 60MW in 2HFY09 as part of a plan to achieve 300MW capacity by 2010 and 1GW by 2012. ECD opened two new lines in September and intends to build a new manufacturing facility in Tianjin, China. Management plans to fund this expansion with operating cash flow and the net proceeds of approximately $405MM from the issuance of debt and equity completed this June.

Valuation

The 5-year DCF model with a pro forma WACC of 20% and terminal growth rate of 3% yielded a valuation range of $58.39-$87.12. An industry average P/E multiple of 29.45x yielded a value of $47.41. Based upon these calculations a price target of $60 was determined, representing potential upside of 121%.

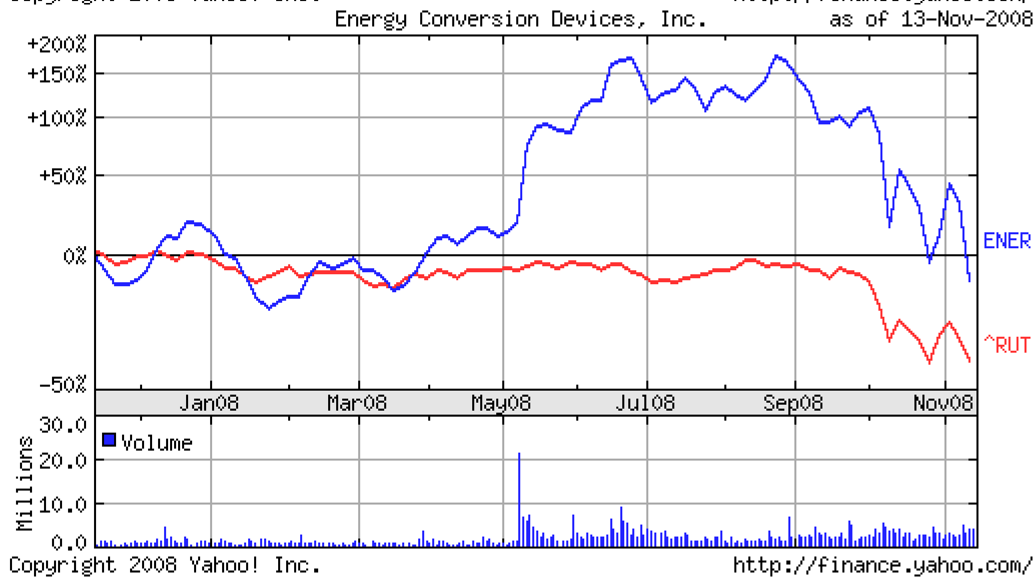
Risks

- **Auction Rate Certificates.** ECD holds $34.30MM of Auction Rate Certificates (ARCs) as LT investments due to illiquid market conditions. These ARCs are AAA-rated Student Loan Asset-Backed Securities issued under the Federal Family Education Loan Program, the principal and interest payments of which are guaranteed by the U.S. Department of Education. ECD has written-off $2.85MM to reflect current market conditions for this paper.
- **Solar Subsidies.** Demand for PV systems is highly dependent upon government tax incentives. Subsidies in Europe and the U.S. have been recently renewed, but future reduction, alteration or elimination of the current subsidy structures could significantly affect demand for ECD's products.
- **Cobasys Arbitration.** ECD and Chevron are involved in litigation regarding the funding of their Cobasys JV. Arbitration has been suspended since February 15, 2008 in an interim settlement agreement until November 17, 2008 to pursue the potential sale of Cobasys to GM. If the sale is not completed or the settlement agreement not extended, arbitration could resume which could result in a non-favorable, material ruling against ECD.
- **Solar Trends.** Many firms are entering the solar space and prices for crystalline modules are decreasing. While ECD's product is differentiated, it is not immune to these industry forces.

Management

CEO Mark Morelli was an executive at United Technologies Corp. and has a strong track record of improving profitability, leading reorganization efforts and expanding business on a global

scale. He received his MBA from MIT and served as an Attack Helicopter Company Commander in the U.S. Army. CFO Harry Zike was formerly the CFO for Siemens Automotive.



Ownership

% of Shares Held by Insiders and 5% Owners:	12%
% of Shares Held by Institutional and Mutual Fund Owners:	98%

Top 5 Shareholders

Holder Name	Shares	Percent Outstanding
Fidelity	5,271,852	11.54
Barclays Global Investors UK Holdings	2,069,837	4.53
American Century Companies, Inc.	1,516,447	3.32
Renaissance Technologies Corp.	1,466,204	3.21
Vanguard Group, Inc.	1,416,059	3.10

Websense Inc.
WBSN
Price: $16.43 (15.43-24.60)
Fiscal Year Ends: December 31

Date: November 14, 2008 — Andy Verchota
Russell 2000 Index: 456.52 (441.92-799.57) — Software Sector

Participating in the internet solution industry, Websense offers a dominant web security product while working to expand their offerings in messaging security and data loss prevention (DLP). Websense sells their solutions to governmental, educational, and corporate institutions. Their products offer functions seeking to protect companies against malware, spyware, phishing, and database infiltration. Websense competes in markets including the United States, Europe, Latin America, Middle East, Africa, and Asia Pacific. Competitors include niche players such as Secure Computing and Blue Coat as well as larger organizations Symantec and McAfee. Headquartered in San Diego, California, Websense was founded in 1994 and currently employs 1,180 people.

Recommendation

In conjunction with an increasingly global workplace the threat and cost of malicious viral attacks has grown substantially. WBSN's recent acquisition of SurfControl expanded market share and improved their footprint in the SMB market. A subscription based revenue model provides transparent cash flows, allowing investors to accurately predict the present and future business environment. Continued penetration of existing customers and conversion of the acquired customer base will drive organic growth. Their dominant position in the web filtering vertical (64%) supported by expansion into messaging security and DLP provides growth potential for WBSN. At current valuation, WBSN offers an attractive entry point for addition to the AIM portfolio.

Key Statistics	Nov. 14, 2008
Market Cap	$803M
Shares Outstanding	45.0M
Average Volume	.695M
Beta	0.76
EPS (TTM)	$1.34
F2009 Estimated EPS	$1.43
P/E (forward)	12.48
P/B	4.09
P/S (TTM)	2.72
WACC	9.1623%
ROE	33.8%
Gross Margin	89.7%
Operating Margin	30.3%
Analysts Coverage	14
Target Price	$22.00

Source: FactSet

Investment Thesis

- **SurfControl Integration.** In 2007, WBSN acquired their second largest competitor in the web filtering vertical. Purchased for $400M ($200M cash / $200M debt) at 4X EV/S, SurfControl increased WBSN market share from 49% to 64%. In addition, conversion of the existing SurfControl customer base provides increased ASP's of 10-30%, focused in the low-end SMB market. In 3Q08, one-third of SurfControl customers up for renewal renewed contracts with WBSN. The acquisition added significantly to company expenses, resulting in GAAP net losses expected through 2008. Thus far, only 5-6% have upgraded to WBSN products. Q4 will present a significant opportunity to increase conversion of SurfControl's 10M users.

- **Product Offering Expansion**. Introduction of the upgraded Web Security Gateway (WSG) product integrates WBSN into growth regions of the web security industry. The WSG offering saw immediate traction, providing $2 million of billings in late Q3. This web filtering solution offers more comprehensive coverage of messaging security. WSG drives 30% upside to average selling price per seat due to premium pricing charged for added capabilities. An estimated 43 million seats under subscription would be natural upgrades to this solution for its added protection from next-generation web threats.
- **100% Subscription Model.** The WBSN revenue model provides strong visibility to investors. Around 90% of quarterly revenues come straight from deferred revenue on the balance sheet. Historical renewal rates have ranged from 85-90%, suggesting the necessity of these products in an increasingly web-based workplace. This steady cash flow characteristics has provided strong visibility leading to 31 consecutive quarters of meeting or beating EPS expectations..
- **Data Loss Prevention.** The January 2007 acquisition of PortAuthority provided WBSN a footprint in the DLP business. An increasing regulatory environment has provided sustained need for software capable of protecting sensitive customer information. DLP sector stands to grow at an 82% CAGR through 2012, becoming a $2.4B business. In 2Q08 DLP comprised ~3% of WBSN total billings.

Valuation

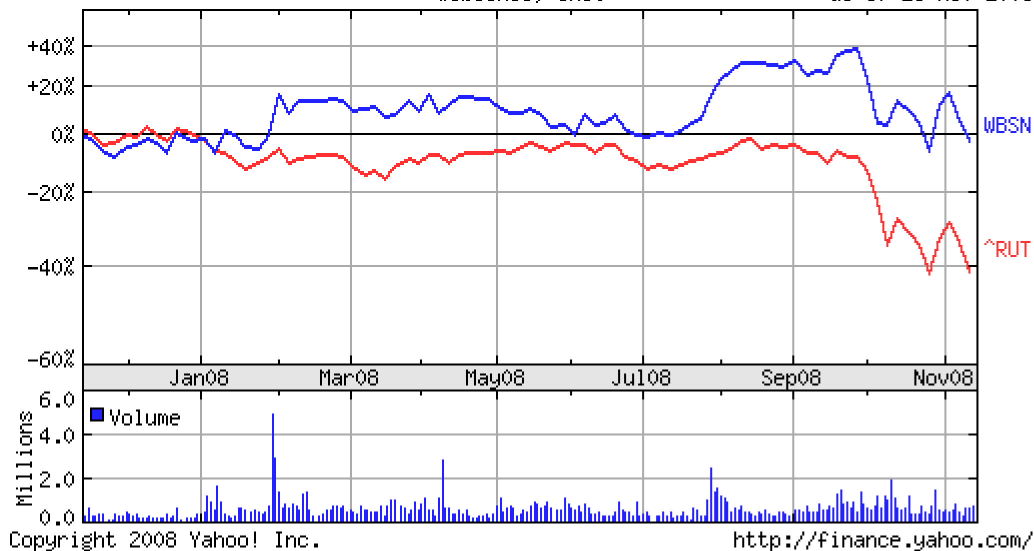
A DCF model offered a range of $16-25 using different earning growth assumptions. Shares currently trade at 12.3X 2009 earnings. Based on their disruptive business model resulting in underlying billings growth, a valuation of 15X was applied to result in a $22 price target. Consistent valuation expectations can be derived from the regularity of cash flows resulting from their subscription model.

Risks

- **Decreased Contract Length**. A decrease in yoy average contract length reflects negative macro trends. At 22.1 month in 3Q08, the average contract has decreased from 23.1 in 3Q07. WBSN products are offered on contract lengths of 12, 24, and 36 months. Twelve month contracts comprise 55% of the total number outstanding. A trend towards shorter duration contracts threatens historical renewal rates between 85-90% and increases the opportunity for larger players (Symantec) to steal market share.
- **Negative FX Effect**. In their Q3 conference call WBSN tightened their billings forecast for 2008 to $345-$350 from $345-$355. This reflects a $4-5M of negative FX effect in relation to the USD. Since September 23rd the Pound (-16%) and Euro (-15%) have seen significant weakening. The United Kingdom provides the second largest source of revenue, at 11% in 3Q. Non-USD denominated countries comprise 41% of the company's annual revenues. In 3Q08 WBSN saw an adverse effect of $1.8M resulting from currency fluctuation.

Management

CEO of WBSN, Gene Hodges, joined the company in January 2006, after serving as President of McAfee from 2001-2006. Hodges's experience with large competitor stands as an advantage for WBSN to establish a footprint in security software. Douglas Wride (President) and Dudley Mendenhall (CFO) both joined the firm since Hodges's arrival, having served previously at in accounting and other executive roles.



Ownership

% of Shares Held by Insiders:	10%
% of Shares Held by Institutional & Mutual Fund Owners:	90%

Source: Yahoo! Finance

Top 5 Institutional Shareholders

Holder Name	Shares Held	Percent of Share Outstanding
Osterweis Capital Management	4,363,843	9.69%
AXA	3,079,110	6.83%
Barclays Global Investors UK Holdings	3,079,110	5.04%
Lord Abbett & Co	2,203,096	4.89%
T. Rowe Price Associates	1,899,500	4.22%

Source: Yahoo! Finance

Diageo PLC
Price: $53.68 ($51.77-$92.45)
Fiscal Year Ends: June 30

November 13, 2008 — Tim Kellen
S&P ADR Index: $1076.97 (936.96-2085.17) — International Consumer Goods

Created in 1997 after the merger of Grand Metropolitan PLC and Guinness PLC, Diageo PLC has become a global leader in the branded beverage alcohol industry. In 2008, the company generated £8 billion in net sales and net income exceeding £1.5 billion. Diageo is led by its eight major brands, which include Smirnoff, Johnnie Walker, Captain Morgan, Baileys, and Guinness and accounted for 59% of total volume in fiscal 2008. The company sells its products in 180 markets worldwide and focuses on four main regions, North America (38% of '08 operating profit), Europe (30%), International (25%), and Asia Pacific (11.1%). Diageo PLC is incorporated in England and Wales and is headquartered in London. The company's shares are traded in London, Paris, and New York.

Recommendation

With its leading global market share of 28% in the premium spirits industry, Diageo PLC is well positioned to generate shareholder return in the coming years, which is demonstrated by its average ROE of 39.1% over the last five years. Diageo holds eight of the world's top brands, with six of the eight holding top market share in their specific categories and the remaining two positioned in the top three. Diageo's tilt towards premium products will provide for expanded margins in the coming years, and its economies of scale will allow it to continue to effectively market its world-class brands. In a time when the financial markets remain in turmoil, the company's management has maintained an A- credit rating, leaving the firm in a position to be opportunistic and take advantage of challenging times. Finally, the company has generated free cash flows greater than 15% over the past three years, which have allowed it to buyback shares and maintain dividend growth. Currently, Diageo's dividend is yielding 5.2% and with a current market price of $53.68, the target price provides an upside of $9.32 or 17.4%. In the consumer goods sector, where opportunities are limited given current market conditions, Diageo provides a solid long-term investment and is recommended for addition to the International AIM portfolio.

Key Statistics	11/13/08
Market Cap	$35.2 BN
Shares Outstanding	626.1 MN
Average Volume	1,407,480
Beta	.682
WACC	7.46%
EPS (ttm)	£.58
P/E (ttm)	15.45x
Debt/Assets	44.68%
Debt/ Equity	2.1x
Dividend Yield	5.2%
ROA	10.2%
ROE	40.7%
Gross Margin	59.0%
Operating Margin	22.9%
Target Price	$63.00
Analyst Coverage	27

Source: Bloomberg

Investment Thesis

- **Leading Global Market Share-** In 2008, Diageo had 28% global market share in premium spirits compared to its competitors Pernod Ricard and Bacardi at 16% and 11% respectively. In addition, Diageo holds eight of the world's top 20 brands and maintains

strong economies of scale giving it significant advantages over the competition in marketing its products.

- **Margin Growth Opportunities.** Diageo's focus on its premium beverage products and strong brands will provide long-term opportunities for margin improvement. As the consumer trend away from value brands and towards premium brands continues, Diageo's product mix will continue to move towards its more profitable products.
- **Strong Discretionary Free Cash Flows.** Over the past three years Diageo has generated free cash flows exceeding £1.2 billion, which Diageo has used to return value to investors. In fiscal 2008, the company returned £1.9 billion to shareholders through share buybacks (£.86B) and dividends (£1.0B), and in 2009, the company is planning to buyback another £.75 billion.
- **Global Diversification.** With no region contributing more that 40% of operating profits, Diageo benefits from global diversification, generating growth in emerging markets, while maintaining market share in developed ones. This diversification provides a slight buffer for the company, given the current macro environment.

Valuation

Based on a 5 year discounted cash flow model with conservative revenue assumptions, a WACC of 7.46%, and a 3.00% terminal growth rate, an intrinsic value of $64.34 is reached. In addition, based upon a weighted average of Diageo's historic multiples and peer multiples, an estimate of $62.39 is obtained. Taking both results into consideration, a target price of $63.00 is obtained.

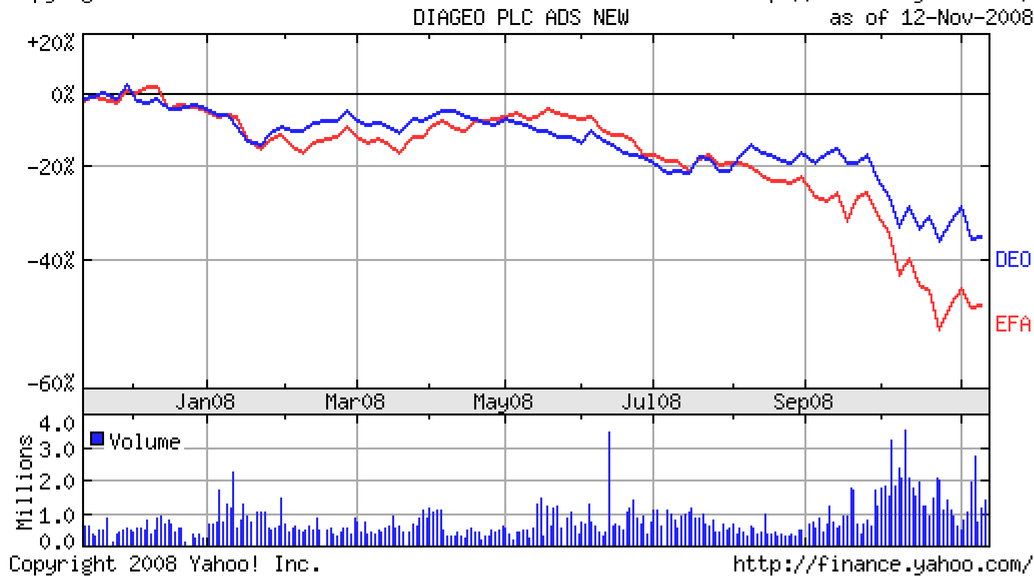
		Equity Value Per Share				
		Terminal Growth Rate				
	65.02	2.50%	2.75%	3.00%	3.25%	3.50%
WACC	8.00%	50.82	53.36	56.15	59.24	62.67
	7.75%	54.08	56.91	60.03	63.50	67.38
	7.50%	57.67	60.83	**64.34**	68.27	72.68
	7.25%	61.64	65.19	69.16	73.63	78.69
	7.00%	66.06	70.07	74.59	79.72	85.57

Risks

- **Prolonged Economic Downturn.** It is clear that there is a global recession, but its extent is unknown. Due to Diageo's tilt towards premium brands, the company could experience some near-term negative effects in the form of lower sales growth and, in the event of a prolonged downturn, a less favorable pricing mix.
- **Regulatory Risk.** As a producer of alcoholic spirits, Diageo is exposed to significant regulation in the form of import and excise duties and limitations related to advertising, distribution, and labeling. Any adverse change in the regulatory environment of its primary markets will negatively impact Diageo.
- **Access to the Debt Markets.** In light of recent events in the financial markets, the cost of accessing the debt markets has increased. Although Diageo maintains a single A-credit rating, the inability to roll over existing debt and market new issues could be detrimental to the company.

Management

Diageo PLC is led by Chairman Dr. Franz Humer and CEO Paul Walsh. Humer replaced former chairman Lord Blyth in July but has been a director since 2005. Walsh has been CEO since 2000 and has been with the company since 1982, formerly serving as the CEO of Pilsbury.



Ownership

% of Shares Held by All Insider and 5% Owners:	0.00%
% of Shares Held by Institutional & Mutual Fund Owners:	16.00 %

Source: Yahoo! Finance

Top 5 Shareholders

Holder Name	Shares Held	Percent of Share Outstanding
Barrow, Hanley Mewhinney & Strauss, Inc.	11,779,497	1.88%
Vanguard Group Inc.	7,768,500	1.24%
Harris Associates L.P.	7,291,101	1.16%
Davis Selected Advisers, LP	5,572,517	.89%
Keybank National Association	3,654,825	.58%

Source: Bloomberg

PT Telekomunikasi Indonesia
TLK
Price: $21.24 ($18.23 - $49.91)
Fiscal Year Ends: December 31

Date: 13 November 2008 Katie Wycklendt
S&P ADR Index: 1,103.73 International Telecom Sector

PT Telekomunikasi Indonesia (TLK) is a leading provider of fixed and mobile information and telecommunications services. The company's operations are concentrated in Indonesia, where it is the largest full-service network provider and has the largest market capitalization of any domestic company. Among services offered are fixed wire line and wireless telephone, mobile cellular, data and internet, and interconnection. Through these services and the company's strategic initiative plan, management seeks to become the region's leading telecommunications company. Government-founded in 1961, the TLK is headquartered in Bandung, Indonesia. Its American Depository Shares have been traded on the NYSE and LSE since initial public offering in 1995.

Recommendation

PT Telecom, the largest player in the emerging Indonesian telecommunications market, is well-positioned for growth. As the world economy heads into a period of stagnation, the domestic service sector is slated for outperformance, led by a boom in mobile and data services. TLK's customer base, at over 75% mobile subscribers, will allow them to take advantage of this environment. Additionally, even at 63.0 million subscribers, TLK's base continues to expand, growing nearly 30.0% in 2007. Such strong growth is expected to continue due to the low level of mobile penetration (21.1%) in the Indonesian market.

Key Statistics	Nov. 13, 2008
Market Cap	$9,871.55M
DSO	397.88M
Average Volume	0.45M
Beta	1.073
Diluted EPS (TTM)	$2.16
2009 Estimated EPS	$2.45
P/E (TTM)	9.16
P/S (TTM)	1.79
PEG Ratio (5 yr exp.)	3.45
WACC	16.64%
Debt/Assets	0.32
ROE (TTM)	33.23%
Gross Margin	76.67%
Operating Margin	37.37%
Number of Analysts	One
Target Price	$35.00

Source: Bloomberg

Based on valuations derived from a discounted cash flow and a multiples analysis using similar companies from the region, a target price of $35.00 is reached. Given the current market price of $20.47 and the underweighting of the sector and region in the portfolio, it is recommended that TLK be added to the AIM International Fund.

Investment Thesis

- **Robust domestic growth.** Despite global conditions, Indonesia's economic growth remains strong, with 2009 GDP estimated at 6.2% (Asia Development Bank). With the services sector providing support for the economy, the telecom is a leading driver of this resiliency. Most notably, rising discretionary income has resulted in 40% to 50% annual growth in mobile and internet services. Such services represent over 80% of TLK's revenues.

- **Indonesian market dominance.** As the largest company in Indonesia, TLK exercises dominance over the economy generally and the telecom sector specifically. Economies of scale increase margins, with operating profit at over 10 percentage points higher than the closest competitor. Access to capital enables TLK to make opportune acquisitions. The company was granted a $1.25 billion loan as recently as July (Reuters).
- **Strong acquisition integration.** TLK continues to acquire majority and minority interests in smaller companies in the region, demonstrating a superior ability to select and integrate targets. In February, the company acquired Sigma, a Malaysian software development and network system integration firm.
- **Movement toward liberalization.** Holding its first democratic elections in 1999, Indonesia has historically placed heavy regulation on its economy. The government broke its monopoly on the telecom sector in 1995 and began passing legislation to deregulate it in 1999.

Valuation

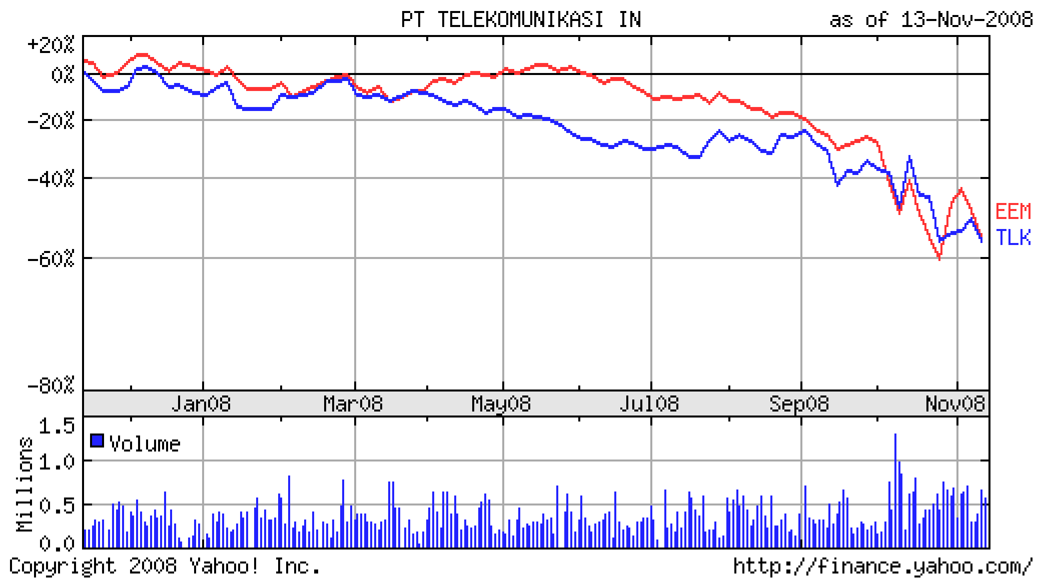
Discounted cash flow, P/E multiple, and EV/EBITA multiple methodologies were all used to value TLK. Based upon projected 2009 EPS of $2.45, the exchange rate of 11,900 IDR/USD and an industry P/E multiple of 15.32, a value of $37.54 per ADR (at 40 shares per ADR) is reached. Additionally, using projected 2009 EBITDA of $3,961.0 million and an industry EV/EBITDA multiple of 4.40 derives a target price of $31.97 per ADR. Finally, a WACC of 16.64% and terminal growth rate of 3.0% applied to a 10-year discounted cash flow model results in a value of $39.44 per share. Adjusting assumptions leads to a price range of $34.45 – $45.85. Accounting for all three valuation techniques gives a target price of $35.00.

Risks

- **Controlling state interest.** The Indonesian government maintains a 51.82% interest in TLK. Included in this interest is the company's single Dwiwarna share, which gives the state veto power over the appointment of any board member.
- **Regulatory environment.** The state continues to impose price ceilings on the industry in an effort to ensure affordability of telecommunications services. While they have been successful in raising these ceilings to pace the market, they remain a threat to margins.
- **Augmented competition.** The privatization and deregulation of the sector has opened it to new entrants, increasing the level of rivalry in the market. At present, these competitive forces, rather than government price controls, are limiting the growth of revenue on a per subscriber basis.
- **Slowing or difficult market penetration.** While much of Indonesia is still open for telecom penetration, the marginal cost of adding subscribers may be increased as growth moves from urban to rural areas.

Management

President Commissioner Tanri Abeng, age 66, is a graduate of Hasanudin University in Makassar. He received an MBA from New York University. Bobby Nazief and Mahmuddin Yasin also serve as commissioners, while P. Sartono and Arif Arryman act as independent commissioners. Any commissioner's appointment is subject to veto by the Indonesian government.



Ownership

% of Shares Held by Insiders:	<0.40%
% of Shares Held by Institutional & Mutual Fund Owners:	3.94%

Source: Bloomberg

Top 5 Shareholders

Holder Name	Shares Held	Percent of Share Outstanding
Lazard Asset Management LLC	12,022,949	2.39%
Dodge & Cox	7,523,959	1.49%
Deutsche Bank AG	3,185,764	0.63%
JPMorgan Chase & Co	2,925,027	0.58%
Wellington Management Co LLP	1,998,965	0.40%

Source: Bloomberg

Senior Housing Properties Trust
SNH
Price: $14.69 ($13.25-$25.21)
Fiscal Year Ends: December 31

November 14, 2008 — David Martin
Russell 2000 Index: $456.52 (433.35-799.57) — Financial Services Sector

Senior Housing Properties Trust is a real estate investment trust (REIT) which owns senior housing properties throughout the United States. The trust invests in hospitals, nursing homes, senior apartments, independent living properties, and assisted living properties. SNH derives a profit by purchasing properties and leasing them at higher rates than their cost of capital and by structuring leases that provide for periodic rental increases. The company focuses on upscale senior living properties that are valued at $2.6B in 34 states as of September 30, 2008. The majority of the properties are located in the northeast and southeast, which are specifically concentrated in Florida, Georgia, Virginia, and Tennessee. As a REIT, SNH is exempt from federal and state income taxes since it distributes at least 90% of its REIT taxable income to shareholders. SNH was founded in 1998 and is currently based in Newton, Massachusetts.

Recommendation

The aging population will increase demand for various forms of senior communities. It is expected that 70 million Americans will reach the age of seventy in 2020. Research from the National Association of Home Builders Council on Senior Housing explains that 44% of the baby boomers plan to move from their current homes during retirement. Senior Housing Properties Trust has a diversified portfolio of facilities to accommodate these demand fundamentals. Residents can choose from different property types that range from independent living facilities to long term care homes. The wide variety of properties limits SNH's exposure to only specific areas of senior housing, and accounts for specific resident's needs and preferences. About 87% of rental revenue came from the residents' private resources from 3Q07-3Q08, thereby helping to reduce the trust's exposure to changes in Medicare and Medicaid reimbursements. SNH's properties are triple net leased, which allows the trust to charge lower rents while obtaining expense reimbursements. Although the AIM fund already has a healthcare REIT (MPW) that invests mainly in hospitals, SNH focuses more on apartment properties catered to senior citizens. It is recommended that SNH be added to the portfolio with a target price of $20 because of the non-cyclical demand and favorable demographic trends associated with senior housing.

Key Statistics	Nov. 2008
Market Cap	$1.86B
Shares Outstanding	114.53M
Average Volume	2.13M
Beta	1.02
EPS (TTM)	$1.07
2009 Estimated EPS	$1.23
P/E (TTM)	14.12
P/E (2009 Estimated)	13.23
Price/Book	0.97
WACC	11.72%
Debt/Assets	25.08%
ROE	7.52%
Dividend Yield	9.61%
Analyst Coverage	9
Target Price	$20.00
*Source: Bloomberg	

Investment Thesis

- **Defensive Sector.** The healthcare sub-sector is recession-resistant when compared to other real estate types. The sub-sector had the highest three year return of 34% and had

the second best year-to-date return of -10.9% within REITs. SNH serves as a defensive stock within an industry that can sustain volatile economic cycles.

- **Acquisition Growth.** While most REITs have been deleveraging and suffering from margin calls, SNH has been expanding its property base. Recent transactions include: 48 medical offices from HRPT Properties Trust for $565 million in May 2008, four wellness centers from an unaffiliated party for $100 million in August 2008, and a senior living apartment complex from an unaffiliated party for $29 million in November 2008. Without any transaction activity from 1Q07 to 3Q07, SNH was well capitalized to acquire these properties due to its sufficient cash on hand and revolving credit facility.
- **Balance Sheet Stability.** Despite its recent acquisitions, the debt-to-market cap ratio was 17% at the end of 3Q08, compared to 16% at 2Q08. SNH has accumulated over $568 million of total debt, but currently has $11M cash on hand and $457 under its credit facility. As the credit markets continue to struggle, SNH is in a position to create opportunities for future growth by acquiring new properties.

Valuation

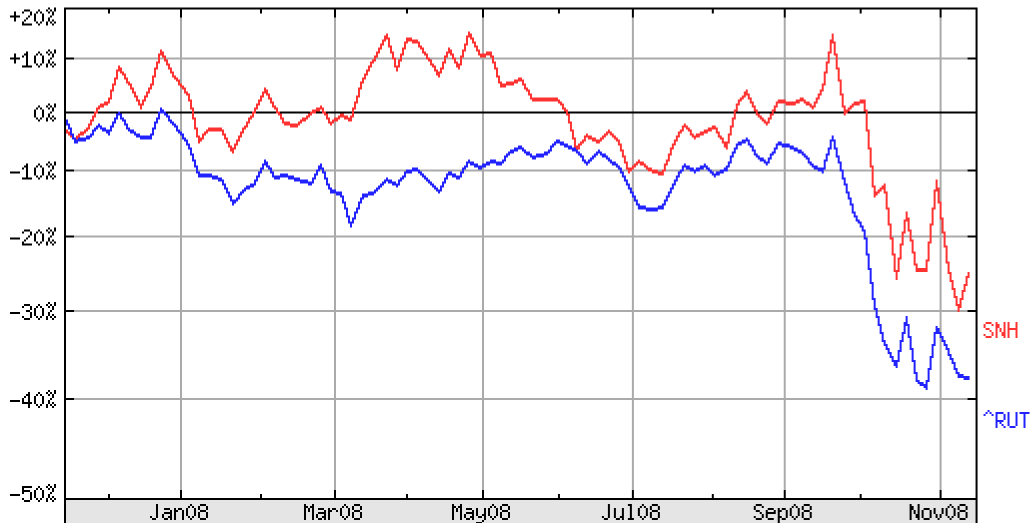
Two valuation methods were used for SNH. The 10 year discounted cash flow valuation for SNH with an estimated WACC of 11.72% and a terminal growth rate of 3.0% leads to an intrinsic value of $20.34, compared to the current price of $14.69. Adjusting for WACC assumptions between 10.00%-12.00% and terminal growth rate assumptions between 2.00%-4.00%, leads to a price range of $19.02-$25.62. In addition, a net asset valuation yields an intrinsic value of $18.44, based on a cap rate of 8.2%. Taking into account all metrics, a conservative target price of $20.00 is reasonable.

Risks

- **Tenant Concentration.** About 70% of SNH's aggregate rents came from Five Star Quality Care in 2007. This high tenant concentration hurts the company's risk profile, as one loss from a customer can be significant. Another risk is SNH's recent decision to lease its four newly acquired wellness centers to Life Time Fitness, Inc. Both tenants have the potential to default on their monthly obligations which poses a risk for SNH's future cash flows.
- **Acquiring versus Developing.** SNH focuses on acquiring properties versus developing its own. This is costly as it forces the company to buy assets from outside firms. It forces SNH to rely on existing structures rather than building properties that surpass resident's expectations and incorporate new trends.
- **Interest Rate Risks.** SNH's acquisitions will be negatively impacted by a rise in interest rates. If interest rates increase, other income generating securities with fewer risk factors become more attractive than REITs. Rising interest rates will not bode well for a sector that has such a heavy reliance upon the capital markets to fund growth.

Management

Senior Housing Properties Trust is managed by REIT Management & Research LLC (RMR). RMR is a private company which was founded to manage REITs and is owned by two Managing Trustees of SNH (Barry Portnoy and Adam Portnoy). This could pose a risk to SNH's shareholders because management may want to increase SNH's size instead of its shareholder value. However, RMR currently oversees one of the largest portfolios of publicly owned real estate in the U.S with over 1,300 properties in 45 states. RMR also allows SNH to have a competitive advantage, offering lower corporate expenses and access to the capital markets.



Ownership

% of Shares Held by All Insider and 5% Owners:	0%
% of Shares Held by Institutional & Mutual Fund Owners:	85%

Source: Yahoo! Finance

Top 5 Shareholders

Holder Name	Shares Held	Percent of Share Outstanding
Deutsche Bank Aktiengesellschaft	10,693,638	9.34%
Morgan Stanley	10,497,042	9.17%
Vanguard Group, Inc.	8,504,740	7.43%
Barclays Global Investors UK Holdings Ltd	6,804,321	5.94%
Cohen & Steers Capital Management, Inc.	5,861,218	5.12%

Source: Yahoo! Finance