Applied Investment Management (AIM) Program

AIM Class of 2011 Equity Fund Reports
Fall 2010

Date: **November 11, 2010** ***Location:*** **AIM Research Room**

Format: **5-6:00 pm Student Presentations**
6:15 pm Introduction of the AIM Class of 2012
6:15-7:15 pm Student Presentations

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Kristin Holzhauer	Vale	VALE	$33.65	17
Luke Darkow	Terremark Worldwide	TMRK	$11.62	20
Mark Rutherford	Shuffle Master	SHFL	$9.65	23

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Fred’s, Inc. (Nasdaq: FRED)
November 11, 2010

Michael Muratore Consumer Services

Fred’s sells general merchandise through retail discount stores and pharmacies in the southeastern United States. FRED’s stores offer pharmaceutical products (33.5% of sales), household goods (23.4%), food and tobacco products (16.2%), apparel and linens (7.9%), and health and beauty aids (7.6%), to primarily low, middle, and fixed-income families. Approximately 83% of Fred’s stores are located in markets with populations of 15,000 or fewer people. Full-service pharmacies are located in about 50% of the company’s stores. The company also sells general merchandise to franchised Fred’s stores (2% of sales). As of April 3, 2010, Fred’s operated 669 general merchandise stores, including 24 franchised stores. Founded in 1947, Fred’s is headquartered in Memphis, TN.

Price ($): (11/8/10)	$ 12.40	Beta:	0.84	FY: Jan	2010A	2011E	2012E
Price Target ($):	$ 15.50	WACC:	9.16%	Revenue (Mil)	1,788,136	1,877,543	1,933,869
52WK H-L ($):	$9.01 - $14.39	LT Rev Growth Rate Est	3%	% Growth	5.00%	3.00%	2.00%
Market Cap (mil)	489	LT EPS Growth Rate Est	9.20%	Gross Margin	27.92%	28.00%	28.00%
Float (mil)	36.27	Debt/Equity:	1.00%	Operating Margin	2.15%	2.26%	2.55%
Short Interest (%):	17	ROA:	4.23%	EPS (Cal)	0.59	0.73	0.90
Avg. Daily Vol (mil)	0.178	ROE:	5.91%	FCF/Share	$ 0.68	$ 0.53	$ 0.59
Dividend ($):	0.16			P/E (Cal)	19.94	19.09	16.76
Yield (%):	1.30						

Recommendation

Fred’s operates stores that cater to the basic needs of small-town Americans in the Southeast region of the U.S. The firm has carved a unique niche in the region, providing discount prices on a wide range of products, giving lower and middle-class families a chance to stretch their dollar in today’s challenging economy. Fred’s revenues have been consistent, growing at an average of 3.1% since 2006, despite the economic downturn. While discount stores are a low operating margin business, FRED has seen solid growth in margins since their low of 0.92% in 2008 to 2.15% in 2010. Management’s forecasted revenue growth is 3-5% in 2010, and conservative growth rates for the next 4 years are about 2% per year. Their latest same stores sales growth of 2.50% in Q2 is significantly better than the peer average of 1.66%. Lastly, Fred’s has a consistent history of paying a dividend to shareholders, with a 5 year dividend growth rate of 13.4%. Their current dividend yield is 1.30%. Because of these reasons and a favorable valuation, it is recommended that FRED be added to the AIM Equity Fund with a target price of $15.70, which offers a potential upside of 27%.

Investment Thesis

- **Distinctive Niche.** FRED’s offers a wide variety of merchandise with a more attractive price-to-value relationship than other drug stores or smaller discount/variety stores - and is more shopper-convenient than a larger discount store like Wal-Mart. Stores are typically located in small to medium sized towns in the southeastern United States, where there are fewer store options for consumers to purchase their basic needs. A good way to think about Fred’s product mix is a combination of Walgreen’s, Big Lots, and Target. Stores have over 12,000 frequently purchased items and maintain low price points and competitive prices. Fred’s stores are usually located in convenient shopping and residential areas, with 43% being freestanding, allowing for easy customer access. Stores are manageable sizes and have centric store layouts that allow for fast customer checkouts.
- **Core Five Program.** Lately, management has focused on what they refer to as the Core Five Program, a strategy to upgrade and remodel stores in order to highlight departments in which Fred’s has a clear and marketable advantage over their small-box competitors. Core Five is designed to build upon Fred’s current strength and competitive differentiation by emphasizing the departments that are strong store trip drivers. These departments are Pharmacy, Celebration

and Party, Pets, Paper and Chemical, and Needs for the Home. This year, management increased capital expenditures in the Core Five departments by $8M and added an additional $3M to the advertising for these departments. Management sees each of the Core Five areas eventually achieving 10% same store sales increases, with a 3.5% increase expected in 2010. Lastly, Fred's has measured that stores with the new layout have 20% better sales per square foot than those with the old layout. As part of the Core Five initiative, Fred's has already remodeled 190 stores and eventually will remodel 300 more stores in the next 2 years.

- **Favorable Macroeconomic Environment for Discount Stores.** With unemployment rates hovering just under 10%, along with 9-month lows in consumer confidence and consumer sentiment, consumers are still being cautious with their spending. Regionally, the Southeast has relatively high unemployment rates (MS - 8.8%, TN - 9.6%, GA - 10.3%). Fred's low prices give shoppers an opportunity to save money through Fred's "Everyday Low Prices" strategy, while buying the essentials. As part of this strategy, Fred's maintains low opening price points and competitive prices on key products across all departments. Management prides themselves on offering customers a good price-to-value relationship. Fred's also offers discounted private label items that are cheaper alternatives to national name brand products.

Valuation

To find the intrinsic value of FRED, a DCF model and Price/Book analysis were conducted giving a 75% weight to the DCF and a 25% weight to the Price/Book. Revenue growth rates were projected out taking into account management projections and historical growth rates which averaged close to 3% annually. Fred's top-line revenue growth rates have been very stable over the past 5 years. FRED is currently trading at a 0.98x Price/Book multiple and the 5 year Price/Book multiple average is 1.29x. This is a discount to their peer average, which is 2.37x on a TTM basis, and a 2.18x 5-year average. The sensitivity analysis accounted for variations in WACC of 9.16% and the terminal growth rate of 3% and yielded a range of values from $13.42 - $17.82. An intrinsic value of $15.50 was obtained using the DCF and Price/Book Multiples analyses. Along with Fred's 1.30% dividend, a price target of $15.70 was obtained, providing a 27% upside.

Risks

- **Seasonality.** An inherent risk to FRED's business is seasonality. Fred's is heavily dependent on sales that occur during the Christmas season (27% of total revenues occur in Q4). An inventory imbalance could definitely result if Christmas sales fall below management's expectations. Additionally, if fourth quarter results were below expectations, profitability and operating results would suffer if unexpected markdowns were needed.
- **Change in Third Party Reimbursements, Including Government Programs.** A large portion of Fred's net sales comes from federal and state governments and private insurance plans, particularly in the pharmacy area (about 33% of net sales). With the current attitude towards healthcare focusing on cost-containment, both governments and insurers may seek to impose lower reimbursements and utilization restrictions. Basically, private insurance bases their reimbursement rates off the government rate, and if there is a drop in reimbursement rates, Fred's revenues would be adversely affected.

Management

Bruce Efird has been CEO since February of 2009. Prior to joining the FRED'S, Mr. Efird was Executive Vice-President-Merchandising at Meijer, Inc. He began his retail career with Food Lion, Inc. in 1984. Mr. Efird brings spent his entire career in the retail industry, with specific experience in the consumable areas of the business.

Ownership

% of Shares Held by All Insider and 5% Owners:	7%
% of Shares Held by Institutional & Mutual Fund Owners:	95%

Source: Yahoo! Finance

Top 5 Shareholders

Holder	Shares	% Out
River Road Asset Management, LLC	2,621,028	6.68
Heartland Advisors Inc.	2,303,750	5.87
Dimensional Fund Advisors LP	2,285,168	5.83
T. Rowe Price Associates Inc.	2,117,875	5.40
Vanguard Group, Inc. (The)	1,851,382	4.72

Source: Yahoo! Finance

EnerNOC, Inc. (ENOC)
November 11, 2010

Kyle Boser — Business Services Sector

EnerNOC, Inc. (ENOC) was founded in 2001 and is headquartered in Boston, Massachusetts. ENOC bridges the gap between the supply and demand of electric power. By using their proprietary software (PowerTrak) they provide Demand Response (DR) solutions (96% of revenue) for utilities and grid operators. They receive payments from utilities and grid operating companies for their service and pay a percentage of that revenue to commercial and industrial (C&I) electricity end users such as, supermarkets, factories, and universities, for their participation in energy reduction plans when called upon. During peak energy usage, ENOC is able to reduce power usage by remotely activating power savers such as shutting off sections of lights, shutting down parts of a production line, changing the temperature settings, etc. Using their Carbontrak software they also provide energy management solutions (4% of revenue) for their customers by collecting and analyzing energy usage data and providing cost effective ways to limit energy consumption.

Price ($): (11/5/10)	30.72	Beta:	1.20
Price Target ($):	38	WACC	13.35%
52WK H-L ($):	24-37	L-Term Rev. Gr Rate Est:	15%
Market Cap (mil):	720.1	L-Term EPS Gr Rate Est:	20%
Float (mil):	18.11	Debt/Equity:	0.0%
Short Interest (%):	14.2%	ROA:	-0.64%
Avg. Daily Vol (K):	225,177	ROE:	-0.87%
Dividend ($):	0.00		
Yield (%):	0.0%		

FY: Aug	2009A	2010E	2011E
Revenue ($K)	190,675	285,511	339,959
% Growth	79.69%	19.07%	17.00%
Gross Margin	45.34%	45.23%	45.45%
Operating Margin	-2.65%	3.95%	9.85%
EPS ($Cal)	-0.32	0.30	1.49
FCF/Share	(0.41)	1.09	$0.44
P/S (Cal)	2.97	2.60	2.28
EV/EBITDA	85.63	24.42	12.47

Recommendation

ENOC provides a unique opportunity to obtain exposure to the clean energy movement. ENOC is viewed as the industry leader in DR solutions with 5,000MW under management - their nearest competitor (COMV) has 4,000MW. Their propriety PowerTrack software allows for near real-time collection of data to measure, analyze and forecast energy demand. During a DR event, ENOC is able to remotely activate energy reduction capabilities and monitor performance in real-time. Their software is considered one of the best in the industry and is capable of connecting to hundreds of different devices across all brand name products. Using this technology to stabilize grids during peak levels of energy use, serves as a cost-effective way to provide a clean energy alternative by reducing the number of plants utility companies must use. ENOC's technology is increasing in popularity with both megawatts and revenues increasing more than 3x over that last 3 years. ENOC has not been shy in acquiring companies; in 2009 they acquired two companies - Cogent Energy, an energy efficiency and building control provider and eQuilibrium - a carbon accounting firm. These acquisitions allowed ENOC to provide a more complete product offering to help fend off future competition. The U.S. alone is expected to need an additional 700,000MW (current capacity is 1.1MMW) by 2030, and the infrastructure necessary to produce such capacity would cost $2.4T. Utility companies, therefore, are becoming more dependent on DR solutions to reduce the need for additional investment. ENOC has yet to be profitable for a full year, but management guidance and analyst expectations are for the firm to be profitable in 2010 - and with continued growth potential, they should remain profitable for years to come. It is recommended ENOC be added to the AIM Equity Portfolio with a target price of $38, offering a potential upside of 24%.

Investment Thesis

- **Smart grid solution adoption.** The North American Electric Reliability Corporation estimates demand for electricity to increase 19%, while generation capacity is expected to increase only 12% over the next 10 years. Traditionally, utilities have met peak energy demand by building new power plants which is expensive and becoming more difficult to permit due to 'not in my backyard' (NIMBY) sentiment. Meeting peak demand using traditional supply-side solutions can cost energy suppliers 10x to 100x that of the base load supply. As a result, it is becoming increasingly necessary for utilities and grid operators to find ways to more efficiently use their existing energy sources. Further, the Federal Energy Regulation Commission estimates there was a reduction of 37GW in peak demand due to DR in 2009 and projects this number may reach 188GW (equivalent to 2,000 power plants) by 2019.

- **Leverage customer relationships to sell additional products.** ENOC has the opportunity to see significant growth through add-on sales to current customers. ENOC can leverage their relationship as a trusted partner to their 8,000 customers and sell them additional energy management solutions. Their newest energy management product, SiteSMART, has had recent success with 6 utility companies and they are currently in late stages of negotiations to deploy the product. Energy management products currently represent only 4% of revenue, but with new product offerings and a strong sales channel ENOC should be able to add additional growth through their energy management products. In the most recent quarter energy management products increased 109% yr-yr compared to 55% yr-yr DR growth.
- **Large market growth and international expansion opportunity.** According to Pike research the DR market in the U.S. is expected to grow from $1.4B in 2010 to $8.2B by 2020. As a result, ENOC, as the market leader, has first mover advantage and should be able to capitalize on this growth opportunity. Additionally, ENOC successfully branched into the international market by offering services in the U.K. last year which will provide a base for additional international expansion, specifically in Europe.

Valuation

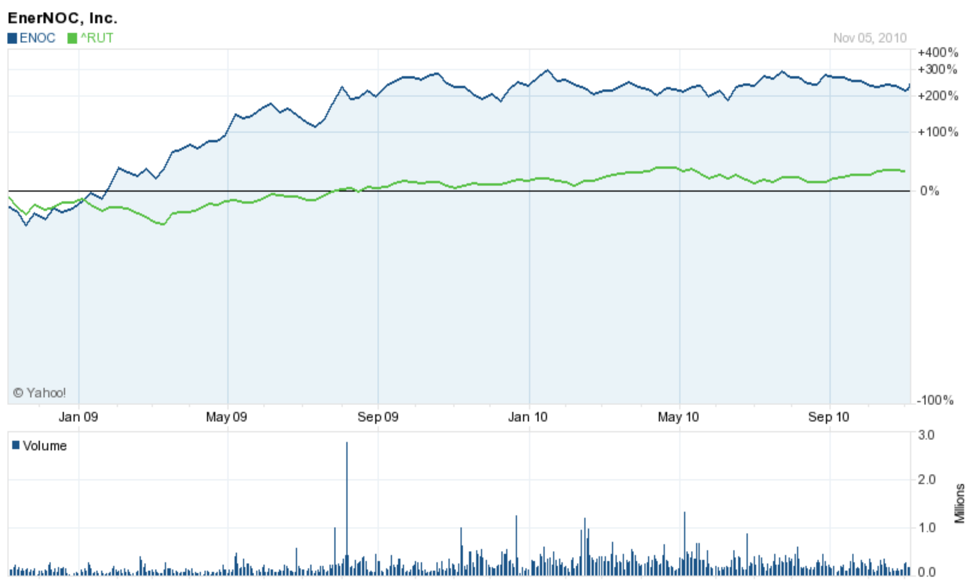
ENOC is currently trading at 3.06x TTM revenue/share of $9.44. Using this 3.06x multiple to a projected NTM revenue/share of $11.40, results in a price target of $35. With their P/S multiple of 3.06x, ENOC is trading at a premium to their peers, which is justified as they are the clear leader in the industry with the best technology and the only firm expected to be profitable in 2010. Based on a 5-year DCF analysis with a computed WACC of 13.3% and a terminal growth rate of 3%, an intrinsic value of $39 was calculated. A sensitivity analysis that adjusts both the long-term growth rate (2-4%) and the WACC (11-15%) generated a price range of $31-42. As a result of the industry's and ENOC's growth potential, a price target of $38 was established. With the stock currently trading at $30.72, a $38 price target provides upside potential of 24%.

Risks

- **Customer concentration.** PJM interconnection, a grid operator that coordinates the movement of wholesale electricity in 13 states, represented 52% of ENOC revenue in 2009. The risk is partially moderated because grid operators represent a pool of different utilities and the contracts are typically extended over 3 to 10 years.
- **Increasing competition.** As DR becomes more popular among utilities and grid operators, more competition is expected to enter the market which will come from typical DR companies like COMV and Advanced Metering Infrastructure (AMI) technology, which could allow supply side operators to manage their own demand response solutions.
- **Lack of diversification.** ENOC receives 96% of revenues from demand response solutions which all come from the C&I space.

Management

Both Co-Founders Tim Healy and David Brewster are actively involved in the daily operations of the company. Tim Healy is the sitting CEO, before starting ENOC he worked for Northern Power Systems, Merrill Lynch, International Fuel Cells and was also the founder of Student Advantage. David Brewster is currently the President and is responsible for overseeing marketing and regulatory affairs.



Ownership

% of Shares Held by All Insider and 5% Owners:	26%
% of Shares Held by Institutional & Mutual Fund Owners:	68%

Source: Bloomberg

Top 5 Shareholders

Holder	Shares	% Out
Price (T.Rowe) Associates Inc.	1,425,376	5.74
David B. Brewster	1,390,654	5.60
Waddell & Reed Financial Inc.	1,245,700	5.02
Deutsche Bank Aktiengesell Inc.	934,287	3.76
Granahan Investment Management Inc.	745,680	3.00

Source: Bloomberg

Endo Pharmaceutical (ENDP)

November 11, 2010

Herwin Yip Domestic Healthcare Sector

Endo Pharmaceuticals (ENDP) a pharmaceutical holding company, located in Chadds Ford PA, engages in the research, development, manufacturing, marketing, and sale of branded and generic prescription pharmaceuticals used primarily to treat and manage pain, overactive bladder, prostate and bladder cancer, and the early onset of puberty in children or central precocious puberty. As of December 31 2009, ENDP had a portfolio of branded products that included brand names such as, Lidoderm(R), Opana(R)ER and Opana(R), Percocet(R), Frova(R), Voltaren(R)Gel, Sanctura XR(R), Sanctura(R), Vantas(R), Valstar(R), and Supprelin(R)LA. The firms.'s non-branded generic portfolio consists of products primarily focused in pain management.

Price ($): (11/02/10)	35.88	Beta:	0.89	FY: Dec	2010E	2011E	2012E
Price Target ($):	43	WACC	8.65%	Revenue (Mil)	1661.03	2235.6288	2463.6139
52WK H-L ($):	19-38	L-Term Rev. Gr Rate Est:	8.00%	% Growth	14.24%	35.59%	10.20%
Market Cap (mil):	4,140.00	L-Term EPS Gr Rate Est:	3.00%	Gross Margin	75.44%	70.00%	68.00%
Float (mil):	57.94	Debt/Equity:	18.2%	Operating Margin	34.00%	28.00%	26.00%
Short Interest (%):	8.7%	ROA:	11.93%	EPS (Cal)	$3.00	$3.51	$3.49
Avg. Daily Vol (mil):	0.536	ROE:	21.12%	FCF/Share	3.41	3.54	3.49
Dividend ($):	0.00			P/E (Cal)	11.96	10.22	10.28
Yield (%):	0.0%			EV/EBITDA	6.34x	5.89	5.97

Recommendation

ENDP is a specialty pharmaceutical company that focuses on the areas of pain management, oncology and urology. The firm currently has a myriad of drugs in its portfolio including: *Lidoderm* (48% of revenue), *Opana* (17%) and *Voltaren* (7%); all being pain management drugs for various purposes. Branded drugs constitute 88% of the firm's revenue with the remainder obtained from medical devices. The firm has been aggressive in its efforts to diversify beyond pain management and has recently acquired Qualitest Pharmaceuticals, Penwest Pharmaceuticals and Healthtronics to strength their generic drug manufacturing (6% of revenue), drug delivery platform and medical devices segment (12%). ENDP is a play on the aging demographic and generic drug trend with *Voltaren* being used primarily for people with osteoarthritis, and the Qualitest acquisition as a toehold on the generic drug space. In summary, Endo's stable business model along with a diverse drug portfolio and stable pipeline presents the firm to be an attractive investment opportunity. With that, it is recommended that ENDP be added to the AIM Equity Fund with a target price of $43, an upside potential of 22%.

Investment Thesis

- **Deep pain management drug portfolio.** ENDP deals primarily in the pain management market via *Lidoderm, Opana, Percocet, Voltaren* and *Frova*. The U.S. market for pain management pharmaceuticals continues to exhibit strength, growing at a 5-year CAGR of 6% to a value of $21.4 billion in 2009. The aging demographic trend in the US is highly supportive of ENDP's pain management drug portfolio. The U.S. Census Bureau indicated that from 2000 to 2010, the population aged 65 and older reached 40 million, growing 14% over a 10 year period. Currently, osteoarthritis affects 21 million people in the U.S. *Voltaren*, a topical gel which treats osteoarthritis pain; stand to benefit most from an aging population. The gel-like application of *Voltaren* is superior to the traditional oral application as it by places the gastro intestinal tract, thereby reducing the risk of stomach ulcers, kidney or liver problems. Introduced in 2008, *Volatren* grew 38% from 09Q3 is expected to grow at a 2 year CAGR of 104% and management indicated that in the process of considering selling *Volatren* beyond the U.S. borders.

- **Promising pipeline.** Phase III testing of *Aveed*, a long acting injectable treatment for male hypogonadism, was recently completed and is expected to be approved by the FDA from 2011-2103. Male hypogonadism affects 5 million men in the U.S. and has a prevalence rate of 10 -39% in men over 50 but only 5-10% of patients receiving treatment. Hypogonadism, however, accounts for 18% of global male's health market and has a market size of about $725 million with a growth rate of 20%. *Aveed*, being the is the first injectable long acting treatment, is expected to have more efficient delivery system than the traditional oral and topical hypogonadism treatments.
- **Strategic acquisition**. ENDP recently acquired Qualitest Pharmaceuticals, the 6th largest generic pharmaceutical, for $1.2 billion to beef up its generic manufacturing capabilities. The Qualitest acquisition extends ENDP's portfolio by 175 products, of which 32 are listed among the top 250 generic drugs by volume. The acquisition will expand ENDP's presence in pain treatment and urology, and is expected to add at least $400 million to ENDP's topline, $30 million in cost synergies and a combine generic revenue growth of 15%. EDP also acquired Penwest Pharmaceuticals for $144 million in August. The acquisition provides ENDP with an enhanced platform in drug delivery and efficacy, and is expected to be immediately accretive, adding $0.05/share to EPS.

Valuation

Based on a 5-year DCF analysis with a computed WACC of 8.31% and a terminal growth rate of 2%, an intrinsic value of $47 was obtained. An average sales growth rate of 6.3% was used on 2012, tapering down to about 4% in 2013 and 2014 respectively. Gross and operation margins were assumed to decline from 75% to 65% and 34% to 22.5% respectively as ENDP diversifies its business line and increase its presence in generic drug manufacturing. A sensitivity analysis that adjusts both the long-term growth rate (1-3%) and the WACC (7.65% – 9.65%) generates a price range of $35.40 to $61.21. An equally weighted relative valuation was performed using 13x forward P/E for 2013 normalized EPS of $3.18 and 8x EV/EBITDA multiple yield a price target of $40. Giving an equal weighting to both my DCF and multiple models, a $44 price target is obtained. With the stock currently trading at $35.70, the $44 price target would yield a 25% return. The firm pays no dividend.

Risks

- **Generic competition.** Lidoderm, a pain management drug that targets pain associated with herpectic neuralgia, consist 44% of ENDP's revenue. ENDP has sole claim on Lidoderm's patent till 2015. Watson Labs recently challenge grounds on of patent non infringement with the production of generic Lidoerm. Approval for generic production can began at the earliest in Aug 2012. Generic competition risk can be mitigated by ENDP's to produce the generic version of Lidoderm due to its in house generic manufacturing capabilities
- **Concentrated customer profile.** The top 3 customers of ENDP; Cardinal Health (33%), Mckesson (29%) and AmerisourceBergen (15%), account for 80% of ENDP's revenue. Any loss in one of the three major customers will be a negative for ENDP. The risk of losing a major client is mitigated by ENP's distribution and marketing partnership with Teva and Novartis.
- **Uncertainty in healthcare reform.** The effects on pharmaceuticals are still unknown. The increase in pharmaceutical tax might offset any benefits from the closing of the "donut hole". With the Republican Party winning the House, the future of the healthcare bill remains in flux.

Management

Mr. David Holveck is the President, CEO and Director of Endo Pharmaceuticals. Prior to joining ENDP in April 2008, he was the president of J&J Development Corp. Mr. Holveck has experience as a CEO in Centocor, a biotech firm that focus in immunology and oncology. He is paid 70% in stock and long term options, with the rest in cash.

Ownership

% of Shares Held by All Insider and 5% Owners:	0.04%
% of Shares Held by Institutional & Mutual Fund Owners:	>90%

Source: Yahoo! Finance

Top 5 Shareholders

Holder	Shares	% Out
Capital Research Global Investors	8,405,700	7.28
Shaw De & Co.	7,289,497	6.32
FMR LLC	6,442,639	5.58
Royce & Associates	6,350,300	5.50
LSV Asset Management	6,038,673	5.23

Source: Yahoo! Finance

Telecom Argentina (TEO)
November 11, 2010

Christina Starkey — International Telecommunications

Telecom Argentina S.A., (NYSE: TEO) and its subsidiaries, provides telephone services to residential and corporate customers in northern Argentina (95% of revenues) and Paraguay (5%). It operates in two major segments: Voice, Data, & Internet Services and Wireless Telecommunication Services. The Voice, Data, and Internet Services segment, which represents 34.34% of revenues, provides fixed telecom services, international telecom service, data transmission, and internet services. The Wireless Telecom Services segment (65.65% of revenues), offers wireless telephone services via cellular and PCS networks, and is operated by Telecom Argentina's service provider, Personal. The segment also engages in the sale of wireless handsets to customers, agents, and various third-party distributors. The company was founded in 1990 and is based in Buenos Aires, Argentina.

Price ($): (11/2/10)	24.51	Beta:	1.09
Price Target ($):	32.00	WACC	17.00%
52WK H-L ($):	14.79-27.15	L-Term Rev. Gr Rate Est:	8.66%
Market Cap (bil$):	4.83	L-Term EPS Gr Rate Est:	4.57%
Float (mil):	48.1	Debt/Equity:	16.54%
Short Interest (%):	0.40%	ROA:	17.51%
Avg. Daily Vol (thou):	691.1	ROE:	31.47%
Dividend ($):	0.86		
Yield (%):	3.60%		

FY: Dec	2009	2010E	2011E
Revenue (Bil)	3.33	3.69	4.06
% Growth	15.25%	11.00%	10.00%
Gross Margin	22.34%	22.00%	22.00%
Operating Margin	11.88%	11.00%	10.00%
EPS (Cal)	$2.01	$2.16	$2.27
FCF/Share	$0.57	$0.63	$0.67
P/E (Cal)	12.47	13.00	13.25
EV/EBITDA	4.38x	4.25x	4.11x

Recommendation

TEO has established itself as one the market leaders in Argentina in the areas of fixed line service and wireless subscribers with market shares of 30.8% and 36.4%, respectively. TEO is able to achieve its dominant market share through management's vision to broaden its revenue stream while continuing to produce innovative products and services. Also, TEO has been and will continue to leverage its strong balance sheet to capitalize on the growing digital convergence trend. The company has $301million in cash assets ($1.53 cash per share) and a total Debt/Equity of 16.54%, which is much lower than the industry average and the company's direct competitors. Given the firms stronghold on the market and the trend in wireless revenue growth, it is recommended that TEO be added to the International AIM Equity Fund with a target price of $32.00, which offers a potential upside of 26%. The firm also pays a 3.6% dividend.

Investment Thesis

- **Growth Opportunities in South America.** As telecommunications technologies in South America begin to catch up with other developed nations (U.S. and Europe), as well as more technologically-advanced countries in Asia, TEO is poised to bridge the gap between standard fixed lines and basic voice services to an expanding market for 3G and 4G. The penetration rate in Argentina for wireless phones is 117.7%, and the opportunity that exists to convert many of these users to higher-technology data end-users is immense. As Argentina, Paraguay, and other South American countries continue to realize strong economic growth, incomes across these countries will increase, and there will be a rising middle class to demand for these higher technologies. Considering the TTMGDP rates for Argentina (6.8%) and Paraguay (5.3%), these market opportunities should increase TEO's revenues.

- **Changing Consumer Trends.** Due to the increasing shift in smartphone usage in Argentina and the improving Average Revenue per User (ARPU), an opportunity exists for TEO to continue increasing their margins. The company's ARPU is predicted to increase from $13.34 to about $18.24 over the next two years, due to the increased data transmission and 3G penetration in the Argentine population. TEO already maintains solid gross (22.34%) and operating margins (11.18%), with their operating margins being nearly twice that of its nearest competitor (6.60%).

- **Network Technology Expansion.** While continuously developing its 3G capabilities, TEO has also initiated a joint venture with Sony Ericsson to create the first experience of research and development of 4G in Argentina. The deployment of this advanced technology platform is critical for TEO's operations and ability to retain a competitive edge. The company has the financial capacity to focus on future opportunities driven by R&D and CAPEX because of its strong balance sheet. TEO has a 16.54% Debt/Equity Ratio, which leaves more flexibility to implement its growth and R&D initiatives through debt financing. Since the telecommunications industry is a highly capital-intensive business, having the resources to maintain and improve the network is vital.

Valuation

TEO is currently trading at 12.45x TTM EPS of $2.01. Applying a conservative historical 13.2x multiple to the estimated 2010 EPS of $2.16 produces a relative valuation of $28.51. Based on a 5-year DCF analysis with a computed WACC of 17% (including country risk) and a terminal growth rate of 3.0%, an intrinsic value of $33.42 was obtained for CHT. A sensitivity analysis that adjusts both the long-term growth rate from 2% to 4% and the WACC from 15% to 19% generates a feasible price range of $18.97-$41.23. Therefore, a target price was set at $32.00. With the stock currently trading around $24.51, the $33.00 price target would yield a nearly 26% return and a 3.6% dividend yield.

Risks

- **Government Policies.** South American political environments have generally been less stable than more developed nations throughout the past couple decades, especially in Argentina. Any change in governmental policy regarding regulation in the telecommunications industry or overall economy, could place higher restriction on business in the region.
- **Inflation Risk.** In the past, Argentina has experienced periods of high levels of inflation, which has negatively affected the economy. As the world begins its economic recovery, any significant rises in inflation could negatively affect TEO's costs and margins.
- **ADR based on class B shares.** Management has made a continuous commitment to shareholders in both classes, which is reflected in the 3.6% dividend on class B shares; however, the risk still exists in any shareholder structure that class A shares could be given a higher priority.

Management

Franco Bertone, TEO's CEO since early 2009, comes from an electrical engineering background and has experience as Director of Operations, as well as Director of Shareholder Relations at Telecom Italia in Argentina. He also has held director-level positions at various telecommunications companies throughout South America. Adrian Calaza, CFO, also worked at Telecom Italia group, and was CFO of Entel Bolivia prior to joining TEO as CFO in 2009.

Ownership

% of Shares Held by All Insider and 5% Owners:	15%
% of Shares Held by Institutional & Mutual Fund Owners:	85%

Source: Yahoo! Finance

Top 5 Shareholders

Holder	Shares	% Out
Consolidar AFJP	4,137,148	4.69
Brandes Investment	3,949,684	4.48
MET AFJP	2,476,878	2.81
Renaissance Technologies Group	2,215,600	2.51
Acadian Asset Management	1,946,374	2.21

Source: Yahoo! Finance

Echo Global Logistics, Inc. (ECHO)

November 11, 2010

David Zakutansky Domestic Business Services

Echo Global Logistics (ECHO) provides transportation and logistics services for client transportation needs globally. Services include: carrier management, rate negotiation, freight bill audit and payment, routing compliance, and shipment execution and tracking. ECHO serves roughly 16,000 clients globally and uses its network of over 24,000 transportation providers to serve its client base. The company operates on an "asset light" business model, providing it with a high degree of operating leverage. ECHO serves both enterprise clients (40% of revenues) who sign multi-year contracts and transactional clients (60% of revenues) who use ECHO services on a transaction-by-transaction basis. The company focuses on truckload (TL), less than truckload (LTL), and small parcel delivery, in addition to offering an intermodal option. In June 2009, ECHO acquired Raytrans Distribution Services to expand its U.S. presence. The company went public in 2009 and is headquartered in Chicago, IL.

Price ($): (11/05/10)	11.9	Beta:	0.80
Price Target ($):	16.25	WACC	11.32%
52WK H-L ($):	10-16	L-Term Rev. Gr Rate Est:	5%
Market Cap (mil):	259.92	L-Term EPS Gr Rate Est:	5%
Float (mil):	12.69	Debt/Equity:	0.0%
Short Interest (%):	12.1%	ROA:	5.5%
Avg. Daily Vol (mil):	79,123	ROE:	13.3%
Dividend ($):	0.00		
Yield (%):	0.0%		

FY: Dec	2009A	2010E	2011E
Revenue ($mil)	259.81	384.52	634.46
% Growth	28.11%	48.00%	65.00%
Gross Margin	19.60%	18.20%	18.70%
Operating Margin	2.35%	2.70%	3.00%
EPS ($Cal)	0.36A	0.29E	0.54E
FCF/Share	$0.16	$0.42	$0.80
P/E (Cal)	32	30	20
EV/EBITDA	23.31x	17.55x	11.23x

Recommendation

Echo boasts a strong platform and is strategically positioned to take advantage of the growing number of companies and institutions looking to outsource their logistics needs. Echo's strong network of over 24,000 logistics/transportation providers and its web-based proprietary service affords clients a more effective logistic experience and helps the firm turn transactional clients into enterprise clients. With Internet sales and technological advances, including on-truck communication, Echo stands to benefit from the projected 32% increase in outsourcing of logistics needs. Furthermore, Echo and its dedicated management and operation teams are in a prime position for expansion and growth. Echo posted a revenue CAGR of 42% for the last 3 years and is in position to leverage its platform and scalable business model. Gross and operating margins are 19.6% and 2.35%, respectively, and have been consistent over the last 3 years. The margin consistency can be attributed to Echo's movement into more programs to facilitate the logistics experience for clients, the development of a business environment more accepting of outsourcing (i.e. increased supply chain management), and the reality that outsourcing logistics to a company like Echo can decrease an organization's costs between 5% and 15%. Therefore, because of its strong platform and growth prospects, it is recommended that ECHO be added to the Domestic AIM Equity Fund with a $16.25 target price and a 36% potential upside.

Investment Thesis

- **Swift Organic Growth with Margin Improvement Opportunity.** Echo clearly stands out as one of the fastest growing companies in the technology-enabled transportation service/logistics space. Revenues have grown from $7.3 million in 2005 to $260 million in 2009. From 1996 to 2008, the outsourced third-party logistics market has grown at a CAGR of 12.5%. The transportation logistics market reached a size of $1.3 trillion in 2008. Roughly 10% of this vast and growing market is outsourced, thereby placing Echo in prime position to continue to seize opportunities in this substantially sized market.
- **Technology Driven.** Echo technology is the driving force behind the business model employed at the firm. Echo has brought significant proprietary technology to a space that has historically been

slow to adopt updated techniques of communication, capacity identification, scalability, and transaction of business. The software Echo has developed tracks and updates real-time price data for 24,000 transportation and logistics providers. With this technology, Echo is able to save customers between 5 to 15% on logistics expenses. The web-based proprietary system employed at the firm helps clients stay connected with real-time updates as well as the potential to automate a significant number of shipping transactions.

- **Growth in Client Base.** Echo's client base is the company's most important asset and presents the firm's largest opportunity for growth. As the company establishes its ability to efficiently execute shipments with competitive pricing, Echo is expected to expand its transactional client base by 67%. Full integration into clients' logistic and shipping departments will encourage more transactional clients to evolve into enterprise clients. In 2009, 35 of the 116 enterprise clients at Echo had begun as transactional clients. Accelerating client expansion, especially in the transactional space, will propel the company to growth levels witnessed in the recent past.

Valuation

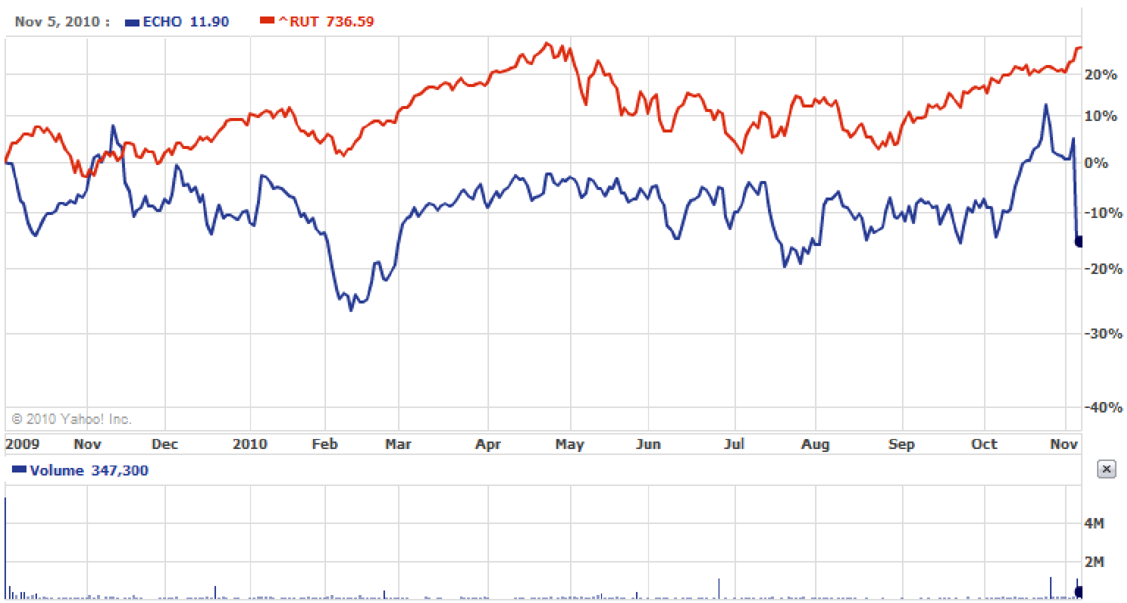
ECHO is currently trading at 32x TTM EPS of $0.37. Applying a 30x multiple on my 2011 EPS estimate of $0.29 and a 20x multiple on my 2012 EPS estimate of $0.54 yields an intrinsic value of $15.58. Based on a 5-year DCF analysis with a computed WACC of 11.32% and a terminal growth rate of 2.5%, an intrinsic value of $16.92 was obtained for ECHO. A sensitivity analysis that adjusts both the long-term growth rate (2-3%) and the WACC (10.82-11.82%) generates a price range of $15.15-18.75. Due to the immediate near-term positive trends in the industry, a conservative price target of $16.25 was established. With the stock currently trading at $11.90, a $16.25 price target would yield a 36% return.

Risks

- **Ownership Concentration.** Eric Lefkofsky, Richard Heise, and Bradley Keywell, the company's founders, directly or indirectly, control 61% of Echo's outstanding common stock. These individuals realistically have control over all matters requiring action by shareholders. A change of control within the company would not be passed without their agreement. To account for this risk, a stockowner concentration premium of 2% was added to ECHO's WACC.
- **U.S. and Customer Concentration.** Echo customer concentration is just over 90% within the United States. In addition, 19% of revenues were derived from the company's five largest clients, and 27% of revenues were derived from the top ten clients in 2009. The loss of one or more of the company's major clients could adversely affect operation results.
- **Highly Competitive Industry.** The "asset light" space in the business is dominated by such competitors as C.H. Robinson Worldwide, Freightquote.com, and Transplace. Asset-based competitors include Ryder Systems, Schneider National, UPS, FedEx, and YRCW Worldwide. In addition, the company also competes with large business process outsourcing companies, including IBM and Accenture, as they offer similar logistics services to the same types of clients served by Echo. Each of these large-name competitors, as well as client's internal sales forces and shipping departments, pose threats to Echo's significant growth expectations.

Management

Douglas Waggoner, the current CEO, has served at ECHO since December 2006 and has been a board member since February 2008. Mr. Waggoner is a 29-year veteran in the transportation industry and has served as CEO and held other executive positions at SelecTrans, LLC, which was eventually acquired by Echo in April 2007. Echo's management team has converted from an entrepreneurial start-up to a successful corporation and added several other experienced industry experts, including Chairman, Samual Skinner; COO, Orazio Buzza; and CFO, David Menzel.



Ownership

% of Shares Held by All Insider and 5% Owners:	67%
% of Shares Held by Institutional & Mutual Fund Owners:	40%

Source: Yahoo Finance

Top 5 Shareholders

Holder	Shares	% Out
Lefkofsky, Eric P.	2,961,810	13.56
New Enterprise Associates	2,420,219	11.08
Old Willow Partners	2,229,310	10.21
Keywell, Bradley A.	1,855,001	8.49
Goldman Sachs Group, Inc.	1,142,317	5.24

Source: Bloomberg

VALE (NYSE: VALE)
November 11, 2010

Kristin Holzhauer International Industrial Materials

Vale is a major diversified mining and logistics company and is the world's largest producer of iron ore and pellets (61% FY09 sales). The company expanded into nickel and copper (20%) with the acquisition of Inco in 2006, and maintains large aluminum (9%) and logistics (5%) holdings. Vale also produces copper, coal, potash, cobalt, and platinum group metals. Over 50% of their gross revenues come from Asia, followed by Europe and South America at 22% and 20%, respectively. VALE is engaged in mineral exploration efforts in twenty-one countries and is headquartered in Rio de Janeiro, Brazil. Vale's integrated railroads and ports transport two-thirds of Brazil's domestic rail cargo.

Price: (11/4/10)	$ 33.65	Beta:	1.51		FY: Dec	2009A	2010E	2011E
Price Target:	$ 42.93	WACC:	7.31%		Revenue (Mil)	23,311	42,575	62,782
52WK H-L ($):	24-35	Y3-5 Rev. Gr Rate Est:	23.74%		% Growth	-38.00%	82.64%	47.46%
Market Cap (bil):	177.69	Y3-5 EPS Gr Rate Est:	50.78%		Gross Margin	41.60%	58.80%	59.30%
Float (bil):	3.54	Debt/Equity:	39.81%		Operating Margin	30.40%	45.50%	50.20%
Short Interest (%):	1.60	ROA:	9.71%		EPS (Cal)	$ 0.99	$ 3.16	$ 4.85
Avg. Daily Vol (mil):	13,131	ROE:	21.67%		FCF/Share	$ (1.16)	$ (0.20)	$ 2.57
Dividend ($):	0.46				P/E (Cal)	29.0	10.7	7.6
Yield (%):	2.37%				EV/EBITDA	9.4x	7.1x	4.7x

Recommendation

Given its close correlation with Vale's businesses, the continuing recovery in global industrial production is a positive sign for shareholders. The global manufacturing PMI has been over the 50 reading for sixteen straight months and demand has pushed the LME index of prices to two-year highs. Rising iron ore prices, coupled with global steel demand, are expected to grow 10.7% in FY10 and 5.2% in FY11, which positions Vale favorably over the near-term. The company has over 8 billion tons of proven iron ore reserves under its control.

Management's confidence in operations is underscored by the nearly $6 billion approved distribution to shareholders through buybacks and dividend payments through FY11. These efforts to maximize shareholder wealth are in step with Vale's strategy of adding growth through organic projects rather than large acquisitions. Additionally, Vale has planned to double FY11 capex to $24 billion partially to achieve higher market share in the crop fertilizer space, which will reduce dependence on the highly cyclical minerals market. By diversifying its revenue and profit sources, Vale should realize 59.3% and 50.2% gross and operating margins in FY11, respectively. Additionally, although the company maintains $25 billion of debt on its balance sheet, that figure is quite manageable in light of the $12 billion of annual cash flow. Because of these reasons and a favorable valuation, it is recommended that Vale be added to the AIM International Equity Fund with a target price of $42.93, offering an upside of 27%.

Investment Thesis

- **Iron Ore Demand Going Higher.** Regardless of global macro uncertainties, the demand for high quality iron ore—which consumes less energy and sells at a premium—remains elevated. Specifically, energy rationing measures in China are likely to increase demand of VALE's high quality ore and reduce consumption of low quality Indian and Chinese products. Iron ore prices rose 39% in 3Q10, reaching $128.2/ton, including a $13.0/ton quality premium. Notably, prices fell 31% y/y in 2Q09, but Vale still generated an impressive 50% EBITDA margin. During 1H10, Vale acquired Corumba mining operations from Rio Tinto for $750 million in cash, and mines at Simandou, two sites of underdeveloped high quality ore deposits that will help increase output 32.3% by 2012. The Ferrous Minerals segment accounts for 71.8% of Vale's revenues.

- **Chinese Steel Consumption.** Vale expects to gain from the rapid industrialization and urbanization of China, the world's largest consumer of minerals and metals. China accounts for 68% of the global demand for iron ore, and 46% of Vale's output. At an urbanization rate of 47% - and continuing to grow, China's demand for steel is likely to increase rapidly over the medium term. Historically, steel demand in China has traded at 1.6x GDP growth rate; assuming FY11 GDP is 9.0%, an additional 450 million tons of iron ore—well over Vale's 300M ton capacity—will be required. Currently, Australia is China's top source of imported iron ore, but a proposed 30% tax on Australian mining profits beginning in FY12 could dramatically increase costs and shift Chinese interests towards more competitive suppliers.
- **102.8% Increase in FY11 Capex.** The operational performance of all minerals and metals produced by Vale, represented by the company's output index, is expected to grow at an annual average rate of 16.3% during FY11-15, well above the pace of 9.8% per year during FY03-08. Vale's FY11 capex budget has increased 102.8% to $24.0 billion to boost output of key products amid soaring demand from emerging markets. Logistics projects, accounting for 20% of the increase, will expand rail capacity and add twenty vessels to the existing fleet, enhancing Vale's competitiveness and minimizing exposure to spot freight prices. Vale's railroads and ports transport 67% of Brazilian rail cargo.

Valuation

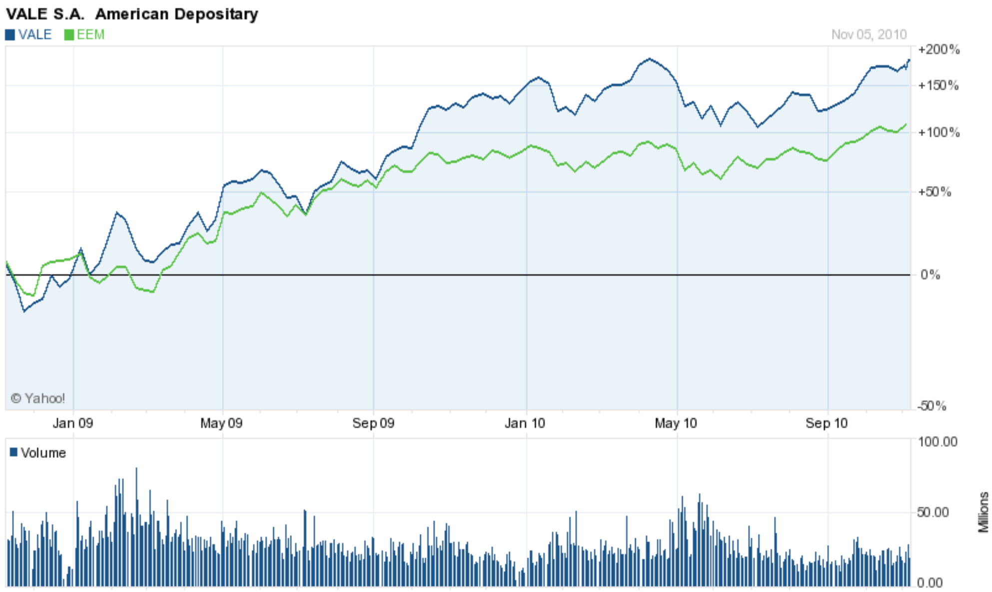
To find the intrinsic value of Vale, a five-year DCF was conducted. Revenue and COGS growth rates were varied year-to-year to account for changing iron ore and copper prices, and logistics improvements, respectively. A WACC of 7.31% was used that included a 1.60% country premium for Brazil embedded in Vale's 7.60% market risk premium. Sensitivity analysis—varying WACC and the 3.00% perpetuity growth rate by 0.25%—yields an intrinsic value of $43.19. A multiples approach was also used that took into account Vale's P/E of 13.1 and EV/EBITDA of 7.1. Applying a 10.4x multiple to the 2010 EPS estimate of $3.92/ADR yields an intrinsic value of $42.67. Weighting the DCF and multiples approaches equally establishes a $42.93 target, a 27% upside on the current price of $33.65.

Risks

- **Higher Energy Costs.** Energy costs accounted for 15.6% of Vale's total COGS in 2009, with 9.4% from fuel and 6.2% from electricity. Past shortages of electricity have occurred in Brazil and could reoccur in the future, adversely impacting the cost and supply of electricity for Vale's operations. There is no assurance that the Brazilian government's policies will be able to encourage enough power generation growth to meet future consumption.
- **Currency Risk.** In 2008 Vale had currency losses of US$1.0 billion, followed by currency gains of US$665 million in 2009. The price volatility of the Brazilian *Real* (64% FY09 COGS), Canadian dollar (16% FY09 COGS), and other currencies against the U.S. dollar affect results may drastically alter Vale's financial income, expense, and cash flow generation, both positively and negatively.

Management

Roger Agnelli has served as CEO and President of Vale since 2001, after a brief stint as Chairman of the Board from 2000-2001. Mr. Agnelli was a special advisor to the President of Brazil on the country's Economic and Social Development Council from 2003-2007 and sits on the boards of Anadarko and ABB Ltd. Prior to his appointment to CFO in 2002, Fabio de Oliveira Barbosa spent four years as the Brazilian National Treasury Secretary and four years as an advisor to the Executive Board of the World Bank. Vale has seen its stock appreciate 1394% since Mr. Agnelli and Mr. Barbosa began working together.



Ownership

No insider filings have been reported.

Source: ThomsonONE Banker

Top 5 Shareholders

Holder	Shares	% Out
BlackRock Fund Advisors	40,809,936	0.77
Lazard Asset Management, LLC	33,737,716	0.64
T. Rowe Price Associates, Inc.	21,967,820	0.42
Capital World Investors	19,367,300	0.37
JP Morgan Chase & Company	17,400,367	0.33

Source: Yahoo! Finance

Terremark Worldwide Inc. (TMRK)
November 11, 2010

Luke Darkow Telecommunications

Terremark Worldwide (TMRK) is a global provider of managed IT services with strategically located data centers in the United States, Europe and Latin America which cost effectively house critical customer IT infrastructure. TMRK offers a comprehensive portfolio of IT solutions operating in three main segments providing neutral collocation services (38% of revenue), managed hosting services (56%), and exchange point services (6%) to a diversified customer base of approximately 1,300 worldwide across a broad range of sectors. Founded in 1982, TMRK has extensive experience in the growing data center services industry boasting an operational and sales team assembled from several of the world's leading communication service providers. TMRK is headquartered in Miami Florida with 887 employees.

				FY: Aug	2009A	2010E	2011E
Price ($): (11/03/10)	11.62	Beta:	1.62	Revenue (Mil)	111.17	155.16	196.66
Price Target ($):	15	WACC	13%	% Growth	34.41%	39.57%	26.75%
52WK H-L ($):	6-11.16	L-Term Rev. Gr Est:	15%	Gross Margin	45.41%	46.00%	47.00%
Market Cap (mil):	779.21	L-Term EBITDA Gr Est:	26%	EBITDA Margin	23.67%	23.00%	27.50%
Float (mil):	50.16	Debt/Equity:	554.2%	EPS (Cal)	(0.51)	(0.31)	0.07
Short Interest (%):	15.3%	ROA:	-4.3%	EV/EBITDA	20.99x	17.95x	12.12x
Avg. Daily Vol (mil):	0.95	ROE:	-39.9%				
Dividend ($):	0.00						
Yield (%):	0.0%						

Recommendation

Cisco Systems estimates that global IP traffic grew 45% in 2009 and will quadruple from 2009 to 2014, which represents a CAGR of 34%. In turn, this has created the need for more advanced network equipment, higher power and cooling requirements, increased contingency planning and redundancy systems, and disaster recovery services. TMRK has been able to capitalize on these strong sector tailwinds with revenue growing at a CAGR of 38% and EBITDA growing at a CAGR of 66% since 2007. TMRK recently reported Q2 FY 2011 earnings in which the company raised guidance for the second half of its fiscal year. Additionally, cash flow is expected to remain strong with EBITDA growing at a CAGR of 25% through 2015. Investor skepticism over balance sheet pressures is currently muting TMRK's strong growth story. This investor skepticism is evidenced by a 15% short interest and a negative skew of options on the stock representing investors paying up for downside protection. TMRK's business has a high amount of forecasting visibility due to customer contracts ranging from 2-3 years. Cash flows from customers locked into long-term contracts can be reasonably predicted mitigating the risk of servicing high amounts of debt. Additionally, customer churn at TMRK is 2%, which is an industry best, and further increases the visibility in predicting cash flows. In light of TMRK's highly attractive growth story and misunderstood balance sheet, it is recommended that TMRK be added to the AIM Equity Fund at a price target of $15, representing a potential upside of 29%.

Investment Thesis

- **Federal Government Exposure a Differentiator.** TMRK is a leader in serving the U.S. government with customized space built to accommodate the high level of security requirements necessary for housing their IT infrastructure. This allows TMRK to be considered as one of the few select data center providers to receive Sensitive Compartmented Information Facilities (SCIF) certification. The certification process takes at least two years serving as a strong barrier to entry to other data center service providers. Additionally, TMRK has achieved 0% churn in its government business which represents 24% of revenue. Management has guided churn to remain consistent throughout 2011 and 2012.

- **Favorable Cyclical and Secular Trends in Managed Hosting.** As a result of the recession, broad sector growth rates in managed hosting dropped 530 bps from 18.3% in 2007 to 13% in 2009. With signs that the macroeconomic outlook is slightly improving, TMRK will benefit from a cyclical bounce in managed hosting revenue growth at CAGR of 15%. In addition to this cyclical reacceleration of managed hosting revenue, an increased attention on cost efficiencies and a growing acceptance of the managed hosting value proposition represents a positive secular trend for TMRK.
- **Growth in Cloud Business Provides Long Term Opportunity.** TMRK's cloud business has grown from $2.5m in 1Q FY'10 to **$**26m in 1Q FY'11 representing YoY cloud run rate growth of 940%. Management continues to see strong demand for its enterprise cloud offering and it has become a key component of recent high profile contract wins with Verizon Wireless who will use 25,000 sq. ft. of collocation space at TMRK's NCR sight to serve government clients but also to utilize TMRK cloud technology in serving business clients. This deal represents approximately $21m in incremental run rate revenue (total contracted unearned revenue) based on TMRK's revenue per sq. ft. of $800-900 per year. TMRK has put an emphasis on further penetration within Fortune 100 companies led by the company's growing and differentiated cloud platform.

Valuation

To derive an intrinsic value for TMRK, a variety of valuation techniques were utilized. A discounted cash flow analysis was performed, which yielded a base case intrinsic value of $14.95 with a computed WACC of 12.50% and a terminal growth rate of 3%. A relative valuation technique was utilized as well, taking a weighted average of TMRK's peer average EV/EBITDA of 12.16x and the Street's consensus EV/EBITDA estimate of 12.00x. Applying the calculated EV/EBITDA of 12.08x to a projected FY2012 EBITDA of $119.78m, yielded an intrinsic value of $14.87. Taking both valuation techniques into consideration a target price of $15 has been established for TMRK. The firm does not pay a dividend.

Risks

- **High Financial Leverage and Debt.** Currently TMRK is levered at approximately 6x EBITDA and has a debt to equity ratio ~550%. Coverage ratios based on EBITDA rather than EBIT due to high amounts of depreciation has averaged ~1.4x the past three years. TMRK exhibits strong EBITDA growth at a CAGR of 66% the past 3 years, but in order to significantly de-lever it will be imperative for the company to drive EBITDA growth on its current capital base.
- **High Revenue Concentration.** TMRK's largest customer is the United States Government at 24%. Although the Federal Government is a highly attractive customer, these government contracts are subject to oversight audits, profit and cost control limits, and provisions permitting modification and termination with little prior notice. All these factors have the potential to negatively affect profitability for TMRK.
- **Dependence on Key Facilities.** The flagship data center for TMRK is located in Miami Florida and accounts for 38% of total revenue. Miami is a city with high risks related to tropical weather. While TMRK's Miami facility was built to withstand a category 5 hurricane, any disruption of service at this facility would represent a major negative impact on company revenues and projections.

Management

Manuel D. Medina has served as Chairman of the Board, President and Chief Executive Officer since April 2000. Prior to serving as Chairman and CEO Medina also served in various positions at TMRK since it's founding in 1982. Mr. Medina, a certified public accountant, worked with Price Waterhouse prior to joining TMRK.

Ownership

% of Shares Held by All Insider and 5% Owners:	25%
% of Shares Held by Institutional & Mutual Fund Owners:	57%

Top 5 Shareholders

Holder	Shares	% Out
FMR LLC	2,648,900	4.03
Ashford Capital Management.	2,299,650	3.50
Vanguard Group Inc.	1,992,337	3.03
Alkeon Capital Management	1,888,364	2.87
Dimensional Fund Advisors	1,560,040	2.37

Shuffle Master (SHFL)
November 11, 2010

Mark Rutherford | Industrial Materials

Shuffle Master (Nasdaq: SHFL) is a gaming company which supplies casino products that enhances profitability, productivity and security. Shuffle Master derives revenue from four product segments: Utility (40.0%), Proprietary Table Games (21.6%), Electronic Table Systems (12.5%) and Electronic Gaming Machines (26.0%). SHFL products include: card shufflers, roulette chip sorters, intelligent table modules, traditional slot machines and wireless gaming solutions allow casinos to improve efficiency. SHFL provides products and services around the globe as it renders 57.0% of revenue from North America, 31.6% from Australia, 5.7% from Asia 4.3% in Europe and 1.3% from other nations. SHFL was founded in 1992 and is headquartered in Las Vegas, Nevada.

Price ($):	9.65	Beta	1.45
Price Target ($):	12.00	WACC	10.0%
52 Wk H-L ($):	10.19-7.16	L-Term Rev. Gr Rate Est:	10.0%
Market Cap (mil):	525.0	L-Term EPS Gr Rate Est:	10.0%
Float (mil):	52.6	Debt/Equity	54.7%
Short Interest:	4.0%	ROA	7.8%
Avg. Daily Vol (mil):	0.291	ROE	14.3%
Dividend	0.0		
Yield	0.0%		

FY: Dec	2009A	2010E	2011E
Revenue ($mil)	$185	$207	$227
% Growth	-0.7%	11.6%	10.0%
Gross Margin	58.9%	62.6%	62.1%
Operating Margin	17.8%	21.4%	21.1%
EPS (Cal)	0.37	0.50	0.53
FCF/Sh	0.80	0.78	0.85
P/E (Cal)	25.9x	19.4x	18.1x
EV/EBITDA	9.7x	8.5x	7.9x

Recommendation

We are in the midst of a cyclical upturn in the gaming sector. Historically this sector has shown remarkable strength in economic downturns as gaming revenues in Las Vegas had never declined until 2008. Over the past two years casino operators have deleveraged and have underinvested in capital expenditures. From 2002 to 2008, MGM, LVS, WYNN and PENN collectively invested anywhere from 10-50% of their revenue in capex with an average of 27% over the period. In the last four quarters capex as a percentage of sales seems to have bottomed out at 15%. As capex begins to increase, firms like SHFL stand to benefit. A recent report showed that Las Vegas is improving as Q3 'strip' revenue to date was up 14% yoy. Casino room rates are also rising steadily. As of October 25, boarder strip room rates were up 37% yoy, premium rates up 56%, mid-level rates up 18% and value down 8%.

Management has posted impressive results over the past five years with a top line CAGR of 13.8% and on a trailing twelve month basis revenues have increased for the last five quarters from $178M to $197M. In FY2009 operating margins improved to 17.8% from 12.2% in FY2008 and this trend has continued into 2010 (23.7% TTM). Management has also deleveraged the company over the past four years. As of Q2 debt-to-equity was 54.7% compared to 61.6% in 2009 and 83.7% in 2008. With lower debt levels management has begun to aggressively reinvest money back into the company. For the last twelve months they have spent $25M (13% of sales) on capex, which is much higher than the five-year average of 8%. As a leader with global exposure to a growing industry, it is recommended that SHFL be added to the AIM Domestic Equity Fund with a price target of $12.00, providing a 24.3% upside.

Investment Thesis

- **New i-Table Product is Adopted Rapidly.**
  Shuffle Master recently launched a brand new product called the i-Table which utilizes six touch-screen player stations embedded in a standard blackjack table. The i-Table automates the betting process which reduces chip theft and dealer errors. Results show that the i-Table increased the

number of rounds per hour by 30%. Finally, this product has great versatility allowing casino's to efficiently switch to other games such as baccarat, three card poker and Texas holdem.

- **Slot Machines Ramp up in 2011.** According to a recent survey of a casino operator in Las Vegas most casinos are only replacing 3-5% of their slot machines this year, just as they did in 2009. This is abnormally low for the highly-competitive gaming industry which thrives on new and exciting games to bring people into casinos. Historically the survey indicated that replacement rates are over 10% per year. After two years of underinvestment, capex should ramp up next year closer to normalized levels driving revenue higher for the Electronic Gaming Machines segment.

- **Exposure to Australia and Asia.** Bolstered by an expanding resources sector and hungry Asian trading partners, Australia's GDP is expected to grow at 3.75% in 2010. SHFL has 32% of revenues in Australia and another 5% in Macau and Singapore, which have been bright spots in the global economy. In October Macau's casino revenues increased by almost 50% yoy to $2.37B. Penetrating the Australia/Asian market is a huge revenue opportunity for SHFL.

Valuation

SHFL is trading at 18.1x 2011 EPS estimates of $0.53. Historically SHFL trades at 20.9x TTM earnings. Applying a 20.0x multiple to 2011 EPS estimates of $0.53 yields a price target of $10.69. From 2003 to 2009 SHFL has traded at 15.4x TTM EV/EBITDA and it is currently trading at 8.5x. Applying a 10.0x EV/EBITDA multiple to TTM EBITDA of $71.7M generates a price of $11.98 per share. Using an industry average 15x P/FCF multiple produces a value of $12.72 per share. Based on a five-year DCF analysis with a computed WACC of 10.0% and a terminal growth rate of 3.0%, an intrinsic value of $12.59 was obtained. A sensitivity analysis that adjusts both the long-term growth rate (2-4%) and the WACC (9-11%) generates a price range of $9.80-17.61. After equally weighting the relative multiples and the DCF analysis, a target price of $12.00 was established offering an upside of 24.5%.

Risks

- **New CEO Still to Be Named.** Earlier this year SHFL unfortunately lost former CEO Tim Parrot due to his unsuccessful battle with cancer. The board of directors has hired Korn/Ferry International to help find a new CEO. David Lopez who is the Chief Operating Officer is presently serving as the interim CEO.
- **Legal Proceedings.** SHFL sells products with proprietary patented and unpatented technologies and they have been forced to go sue several firms for patent infringement. If SHFL is unable to protect intellectual property that could adversely affect the company going forward.
- **Currency Risk.** With roughly 50% of revenues coming from outside the U.S., SHFL is exposed to currency risk, especially with the Australian dollar. Management does not use derivatives to hedge currency risk.

Management

As mentioned above, David Lopez, who is Chief Operating Officer, is serving as interim CEO until the company can find a suitable replacement. Mr. Lopez has been with the company since 1998 and has worked overseen various product rollouts and has ample experience from a marketing perspective. Linster Fox recently joined SHFL as CFO in August of 2009 and brings nine years of CFO experience from both private and public technology companies. Prior to SHFL, Mr. Fox was CFO at Cherokee International LLC and also spent 18 years with Anacomp Inc. On average the management team has 6.8 years of experience with SHFL compared to the peer average of 7.0 years.

Ownership

% of Shares Held by All Insiders:	2.43%
% of Shares Held by Institutional & Mutual Fund Owners:	85.38%

Source: Yahoo! Finance

Top 5 Shareholders

Holder	Shares	% Out
Wells Capital Management	4,230,545	7.9
BlackRock Institutional Trust Company N.A.	4,195,218	7.8
Oppenheimer Funds, Inc.	3,939,360	7.3
Eagle Asset Management	3,497,728	6.5
Fidelity Management & Research	2,674,028	5.0

Source: Yahoo! Finance