PORTFOLIO MANAGER'S REVIEW

THE MANUAL OF Ideas
SERIOUS IDEAS FOR SERIOUS INVESTORS™

A Monthly Publication of BeyondProxy LLC ✻ www.manualofideas.com ✻ editor@manualofideas.com ✻ September 29, 2009

When asked how he became so successful, Buffett answered: "we read hundreds and hundreds of annual reports every year."

Edited by the *Manual of Ideas* Research Team

*"If our efforts can further the goals of our members by giving them a discernible edge over other market participants, we have succeeded."*

## Top Three Ideas In This Report



## Also Inside



## About Portfolio Manager's Review

Our goal is to bring you equity investment ideas that are compelling on the basis of value versus price. In our quest for value, we analyze the top holdings of top fund managers. We also use a proprietary screening methodology to identify opportunities that are not yet widely followed by institutional investors.

Our managing editor John Mihaljevic is a fund manager, former banker and analyst. He is a member of Value Investors Club, an exclusive community of top money managers, and has won the Club's prize for best investment idea. John is a trained capital allocator, having studied under Yale chief investment officer David Swensen and served as research assistant to Nobel laureate James Tobin. John holds a BA in Economics, *summa cum laude,* from Yale and is a CFA charterholder. He resides in New York City with his wife and two kids.

# THE "MAGIC FORMULA" ISSUE

► Snapshot of 100 "cheap" and "good" companies
► 30 companies profiled by *MOI* research team
► Proprietary selection of Top 3 candidates for investment
► Plus: Exclusive Interview with Brian Gaines

*"Magic Formula" companies mentioned in this issue include Accenture, Allied Healthcare, Amedisys, American Oriental, America's Car-Mart, AmerisourceBergen, AmSurg, APAC Customer, A-Power Energy, Argan, Bridgepoint Edu., Broadridge Financial, Buckle, Cass Information, Centene, Chart Industries, Chicago Bridge & Iron, China Education, China Sky One, China-Biotics, Coca-Cola Company, Comfort Systems, Continucare, Cornerstone, Corporate Executive Board, CSG Systems, Cytokinetics, Deckers Outdoor, Deluxe Corp., DPL, Dun & Bradstreet, EarthLink, EMCOR Group, Endo Pharma, Energen, ePlus, Fluor, [redacted] Foster Wheeler, GameStop, Gentiva Health, Georgia Power, [redacted] Graham Corp., Great Northern Iron, GT Solar, H&R Block, Hawaiian Holdings, Herbalife, Hewlett-Packard, i2 Technologies, ICO Global Comms, Innophos, ITT Educational, j2 Global Communications, Jackson Hewitt Tax, Joy Global, KBR, [redacted] Laclede Group, Lihua International, Lockheed Martin, Lorillard, Matrixx Initiatives, Maxygen, McGraw-Hill, Metropolitan Health Networks, MIPS Technologies, Mirant, Navarre, Net1 UEPS, Neustar, NutriSystem, Pain Therapeutics, PDL BioPharma, [redacted] [redacted] Pioneer Southwest, Pre-Paid Legal, [redacted] Primoris Services, Progress Software, Questcor Pharma, [redacted] Sabine Royalty Trust, Sepracor, [redacted] Terra Industries, Terra Nitrogen, UGI Corp., United Online, Universal Travel, USA Mobility, Versant, Virgin Mobile USA, Watson Wyatt, Weight Watchers, World Fuel Services, Wright Express, Yum! Brands, and more.*

*(profiled companies are underlined)*

# Table of Contents

## Editor's Commentary

The "magic formula" has been good to us. Last November, we published a report profiling 100 companies that scored high in terms of "cheapness" and "goodness," based on criteria laid out in Joel Greenblatt's *The Little Book That Beats The Market*. We highlighted ten of the 100 profiled companies as particularly attractive in the context of the "magic formula" screening methodology.

Not only have those ten selections trounced the broader market indices and other magic formula stocks, but the reception of the inaugural report set us on an exciting path of growth. Some of the world's top investors now rely on *Portfolio Manager's Review* in their idea generation processes.

**Performance of Top 10 "Magic Formula" Stocks**
**Featured in Inaugural *Portfolio Manager's Review*** *(published on November 20, 2008)**

| Ticker | Company | Price at Publication | Recent Price | Recent MV (mn) | Return | Annualized Return |
|---|---|---|---|---|---|---|
| AEO | American Eagle | $7.11 | $17.06 | $3,540 | **+140%** | +178% |
| ELOS | Syneron | 6.24 | 11.48 | 316 | **+84%** | +104% |
| GRMN | Garmin | 15.22 | 36.85 | 7,390 | **+142%** | +181% |
| KHD | KHD Humboldt | 6.58 | 10.42 | 315 | **+58%** | +71% |
| MSFT | Microsoft | 17.53 | 25.83 | 230,160 | **+47%** | +57% |
| PRXI | Premier Exhibitions | 0.60 | 1.12 | 34 | **+87%** | +108% |
| TPX | Tempur-Pedic | 5.44 | 17.20 | 1,290 | **+216%** | +284% |
| TZOO | Travelzoo | 5.00 | 13.77 | 226 | **+175%** | +227% |
| UEPS | Net1 UEPS | 8.43 | 22.15 | 1,000 | **+163%** | +210% |
| WFR | MEMC Electronic | 10.45 | 16.75 | 3,740 | **+60%** | +74% |

* Stock price returns are based on closing market prices as of September 28, 2009.
Source: *Manual of Ideas* analysis.

In this issue, we profile 30 magic formula stocks—companies whose operating income is high relative to both enterprise value and capital employed in the business. The list of companies scoring high on these dual criteria has changed considerably since late last year, so it's once again time to look for new opportunities.

As we worked our way through the latest screen results, we found, perhaps not surprisingly, that today's magic formula selections as a group are less compelling than stocks passing the magic formula screen in November 2008. Prospective returns from the companies in this issue should be materially lower than the historical returns shown in the table above. Nonetheless, the companies highlighted herein strike us as quite a bit more interesting than the average S&P 500 stock. As a result, magic formula stocks remain a "must-consider" group.

The following three companies deserve closer attention:

[redacted] (market value of $[redacted] million) is an Asian online gaming company with a strong balance sheet, trading at an attractive 15% trailing EBIT-to-EV yield. While the company has disappointed growth investors' aggressive expectations this year, EPS is projected to increase from $0.40 in 2009 to $0.62 in 2010. With the stock at $5.18 per share, the company is selling at less than 10x earnings (even without adjusting for net cash). The company retains ample growth opportunities and appears well-positioned to exploit monetization platforms such as Everest Poker, a leading global poker site. The shares offer a compelling risk-reward tradeoff, in our view.

[redacted] (market value of $[redacted] million) is a niche player providing database management software to small and medium-sized businesses. The company has a strong balance sheet, with close to one-half of market value in net cash. Insiders own almost 20%, with aggressive share repurchases signaling a high regard for shareholder value. The company landed its biggest deal in history earlier this year and is expected to grow earnings, yet the shares trade at a 14% EBIT-to-EV yield. With ample opportunities for incremental value creation, both operationally and financially, we view [redacted] as meaningfully underpriced.

[redacted] (market value of $[redacted] billion) is one of the leading defense contractors in the country, with revenue diversified across a variety of programs. The shares trade at a 15% EBIT-to-EV yield—quite low for a strong player in a market with high barriers to entry. EPS is estimated to increase from $4.78 in 2009 to $5.06 in 2010, putting the shares at less than ten times earnings. While investors may be worried about the trajectory of the government's defense spending, we continue to live in an uncertain world that should demand considerable military expenditures for a long time to come (unfortunately).

We also draw your attention to the following five other magic formula stocks: [redacted] is a drug maker owned by Bruce Berkowitz. The company has a 2012 patent expiration issue, but the shares may be too cheap to ignore at eight times forward earnings (unadjusted for almost $3 billion of net cash). [redacted] essentially trades at an enterprise value of zero, yet owns a global cement plant engineering business with material normalized earning power. [redacted] may be the cheapest large-cap pharma stock, trading at delevered multiples of eight times 2009E earnings and seven times 2010E earnings. Bruce Berkowitz, David Einhorn and Dan Loeb hold substantial investments in the company. [redacted] is a niche services firm that helps retailers, wholesalers and the government save money by auditing transactions and recovering overpayments. While the company's retail customers may be reluctant to engage *any* service providers, PRG provides high ROI to customers. The shares appear overly cheap at an EBIT-to-EV yield of 22%. [redacted] is one of the leaders in the somewhat insular electronic design automation (EDA) software industry, which serves the global semiconductor sector. Long-term growth opportunities and a relatively wide moat for a technology company make the shares a potential bargain at 11% trailing EBIT-to-EV and 13x forward earnings.

We look forward to your feedback and suggestions, as they help us make *Portfolio Manager's Review* even more useful to you.

Sincerely,

John Mihaljevic

John Mihaljevic, CFA
and *The Manual of Ideas* research team

P.S. For an explanation of the magic formula approach to investing, visit http://tinyurl.com/mfinvesting

# Exclusive Interview with Brian Gaines

We are pleased to bring you this conversation with Brian Gaines, founder of Springhouse Capital Management, which was founded in 2002 with the backing of famed value investor Joel Greenblatt. Since inception in November 2002 through August 2009, Springhouse has generated a compounded annual return of 17.12%, net of fees, versus 4.15% for the S&P 500 Index. The fund is up nearly 24% this year.

**Brian Bares**
Springhouse Capital Management, LP

***MOI:*** **Tell us a little about the genesis of your firm. What goals did you have at the outset, and what operating principles have guided you since then?**

*"Joel Greenblatt sat me down and asked if I wanted to start my own fund, which would be seeded initially with their capital… this was a dream scenario."*

**Brian Gaines:** The way Springhouse started was slightly unusual in that I never sat down and had any grand plans to start a firm. I had worked for Gotham Capital as an intern and then full-time during my second year of business school at Wharton and had plans to join them upon returning to New York in the fall of 2002. Upon arrival, Joel Greenblatt sat me down and asked if I wanted to start my own fund, which would be seeded initially with their capital. I could work out of their offices, use their infrastructure, and focus all my time on company research. For anyone who loves picking stocks as much as I do, this was a dream scenario. Despite the tendency for hedge funds to become larger and more institutionalized over the last several years, I always knew that I wanted to focus on picking stocks and not managing people. As a result, Gotham still manages all of my infrastructure today. This allows me, along with partner Jeff Graf who joined me in 2005, to focus nearly entirely on investing.

In terms of investing principles, I have always believed that you can generate above average returns if you focus most of your time on the downside of investments, wait for situations where you have at least 50% upside to a reasonable outcome, and take oversized positions when those opportunities do arise. My background prior to business school was in high yield and distressed debt, both in banking and for an investment firm. Bond investors focus more on the downside of an investment since there is no equity upside. I think this background helps me maintain a healthy level of skepticism and focus primarily on not getting burned, which is crucial when taking larger positions. I know concentrated investing is out of style today as some high profile investors have had tough times, but it seems more appropriate than ever to wait for great situations and take oversized positions. The key for us is waiting patiently for the right opportunities and making sure we are doing great work on the downside.

caused the change in market price. We are all susceptible to being bullied with those movements. Retail is a good recent example. In March, companies traded at distressed multiples off margins that were at long term lows. Today, margins are at near peak levels due to cost cuts and reduced inventories and multiples are at normal to above normal levels. It is hard for me to believe either situation is reality.

I think individual and institutional investors deal differently with this issue. Individuals are much more likely to not notice the deep loss because they are not watching the market every day and showing returns to investors. On the other hand, they are much less likely to sell when the momentum of the market carries valuations well above what would seem to be reasonable based on the facts. The key is to stay level headed and not let the market tell you that you are wrong or right.

***MOI:* What books have you read in recent years that have stood out as valuable additions to your investment library?**

“I recently read Lords of Finance about central bankers following World War I and through the Great Depression and it was fascinating.”

**Brian Gaines:** I tend to read and re-read more of the business history books as it is always useful to compare and contrast past periods to today’s times. Books like *Barbarians at the Gate*, *The Vulture Investors* or *Merchants of Debt* are consistently great reads. *Market Wizards* also provides some interesting comparisons to today’s markets. I recently read *Lords of Finance* about central bankers following World War I and through the Great Depression and it was fascinating.

***MOI:* Brian, thank you very much for taking the time to interview with us.**

## ***Free Cash Flow*** *(sorted by LTM free cash flow yield)*

| Company / Ticker | LTM FCF Yield | Market Value ($mn) | Enterprise Value ($mn) | LTM EBIT / EV | LTM EBIT / Capital | P/E (Est.) This FY | P/E (Est.) Next FY | Ins. Own. | Last Six Months Insider Buys | Last Six Months Insider Sales | Notable Shareholders (superinvestors in bold) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Innophos / IPHS | 47% | 420 | 572 | 48% | 50-99% | 7x | 11x | 17% | - | 9 | Acadian, Corsair, Integrity |
| Matrixx Initiatives / MTXX | 45% | 53 | 31 | nm | nm | nm | 28x | 4% | - | 7 | Gamco, Paradigm, RenTech |
| World Fuel Services / INT | 43% | 1,405 | 1,102 | 16% | 25-50% | 14x | 13x | 6% | 2 | 23 | Acadian, Argyll, Kayne |
| Wright Express / WXS | 33% | 1,156 | 1,333 | 22% | >99% | 15x | 14x | 1% | - | 14 | Keeley, MSD, Times Square |
| Navarre Corp. / NAVR | 32% | 78 | 101 | nm | nm | 9x | na | 8% | 1 | - | LSV, Perkins, Prescott, RenTech |
| i2 Technologies / ITWO | 31% | 370 | 303 | 13% | >99% | 17x | 18x | 26% | - | 2 | Acadian, S.A.C., RenTech |
| Maxygen / MAXY | 30% | 253 | 51 | >99% | >99% | na | na | 21% | - | 1 | Acadian, Conus, GS, RenTech |
| USA Mobility / USMO | 29% | 286 | 207 | 30% | >99% | na | na | 1% | - | 6 | GS, Numeric, RenTech, Royce |
| EarthLink / ELNK | 24% | 893 | 518 | 28% | >99% | 8x | 10x | 9% | - | 12 | Acadian, RenTech, Steel |
| United Online / UNTD | 22% | 671 | 936 | nm | nm | 6x | 6x | 3% | - | 9 | Blair, Keane, LSV, RenTech |
| Jackson Hewitt Tax / JTX | 22% | 136 | 410 | 11% | >99% | 6x | 5x | 1% | 3 | - | Freestone, Polar, Shamrock |
| Deluxe Corp. / DLX | 20% | 870 | 1,670 | 11% | >99% | 7x | 7x | 1% | - | - | LSV, Oppenheimer, Wentworth |
| EMCOR Group / EME | 20% | 1,617 | 1,293 | 25% | >99% | 11x | 13x | 2% | 1 | 3 | Acadian, Artisan, Rothschild |
| Chart Industries / GTLS | 19% | 611 | 649 | 21% | 50-99% | 13x | 19x | 1% | - | 5 | Neuberger, Wentworth |
| PDL BioPharma / PDLI | 19% | 942 | 1,205 | 24% | >99% | 7x | 6x | 1% | 2 | - | Acadian, Iridian, RechTech |
| Hawaiian Holdings / HA | 18% | 423 | 406 | 33% | >99% | 6x | 7x | 5% | 3 | 1 | Acadian, Cadence, RenTech |
| Endo Pharma / ENDP | 17% | 2,594 | 2,509 | 14% | >99% | 8x | 8x | 2% | 1 | - | Aronson, D.E. Shaw, LSV, Royce |
| Questcor Pharma / QCOR | 17% | 344 | 274 | 21% | >99% | 11x | 9x | 7% | - | 4 | Accipiter, Numeric, Thompson |
| GT Solar / SOLR | 17% | 816 | 655 | 23% | >99% | 11x | 9x | 78% | - | 12 | Adage, Oaktree, T. Rowe |
| Amedisys / AMED | 15% | 1,190 | 1,431 | 14% | >99% | 9x | 9x | 2% | - | 11 | Dreman, Times Square |
| UGI Corp. / UGI | 15% | 2,722 | 4,790 | 15% | >99% | 11x | 10x | 1% | 1 | 13 | Ironbridge, Snyder, Wellington |
| Terra Nitrogen / TNH | 15% | 1,944 | 1,865 | 17% | >99% | na | na | 73% | - | - | Merrill Lynch, RenTech |
| Mirant / MIR | 15% | 2,265 | 2,987 | 97% | 50-99% | 5x | 10x | 0% | - | - | LSV, Paulson, SASCO |
| McGraw-Hill / MHP | 15% | 7,451 | 8,183 | 15% | >99% | 11x | 9x | 2% | - | - | Greenlight (short), T. Rowe |
| Great Northern Iron / GNI | 14% | 141 | 136 | 15% | >99% | na | na | 7% | - | - | Bridgeway |
| Pfizer / PFE | 14% | 110,686 | 99,679 | 9% | 0-25% | 8x | 7x | 1% | - | 4 | Fairholme, Greenlight, Third Pt |
| H&R Block / HRB | 14% | 6,022 | 6,154 | 14% | >99% | 11x | 10x | 4% | 1 | - | Breeden, Davis, Jennison |
| Comfort Systems USA / FIX | 14% | 472 | 361 | 20% | 50-99% | 14x | 18x | 2% | - | 4 | Artisan, Barrow, Frontier |
| AmSurg / AMSG | 13% | 651 | 883 | 25% | >99% | 12x | 12x | 2% | - | 6 | Dreman, Fenimore |
| PRG-Schultz / PRGX | 13% | 123 | 112 | 22% | >99% | 10x | 8x | 20% | 3 | - | Blum, JANA, RenTech |
| NutriSystem / NTRI | 13% | 476 | 402 | 13% | 50-99% | 15x | 15x | 3% | - | 1 | Brandywine, Tinicum, Royce |
| Pioneer Southwest / PSE | 13% | 600 | 537 | 17% | 50-99% | 9x | 8x | 69% | - | 1 | Fiduciary, Glickenhaus, Royce |
| AmerisourceBergen / ABC | 12% | 6,394 | 6,672 | 13% | >99% | 13x | 12x | 2% | - | 4 | Analytic, Glenview |
| Forest Labs / FRX | 12% | 8,601 | 5,747 | 17% | 25-50% | 8x | 8x | 1% | - | - | Clearbridge, Fairholme, LSV |
| Pre-Paid Legal / PPD | 12% | 570 | 579 | 17% | >99% | 8x | 8x | 33% | - | - | Smith, Steadfast, RenTech |
| Broadridge Financial / BR | 12% | 2,817 | 2,613 | 13% | >99% | 13x | 12x | 0% | - | 4 | Acadian, Blue Ridge |
| CSG Systems / CSGS | 12% | 558 | 579 | 15% | 50-99% | 10x | 10x | 2% | - | 3 | LSV, RenTech, Rothschild |
| Lockheed Martin / LMT | 12% | 29,937 | 31,070 | 15% | >99% | 11x | 10x | 0% | - | - | Cap Re, Chieftain, State Street |
| Accenture / ACN | 11% | 25,781 | 21,771 | 14% | >99% | 13x | 13x | 2% | - | - | Franklin, Wellington |
| Gentiva Health / GTIV | 11% | 719 | 852 | 25% | >99% | 12x | 12x | 10% | - | 11 | Acadian, Alger, Opus, Royce |
| Net1 UEPS / UEPS | 11% | 966 | 749 | 12% | >99% | 12x | 10x | 16% | - | 10 | Alydar, Gen. Atlantic, Westfield |
| Terra Industries / TRA | 11% | 3,512 | 2,849 | 20% | >99% | 16x | 12x | 1% | - | - | D.E. Shaw, GS, TPG-Axon |
| Sabine Royalty Trust / SBR | 10% | 586 | 582 | 12% | >99% | 15x | 15x | 1% | - | - | Lucas, Sarofim |
| KBR / KBR | 10% | 3,577 | 2,500 | 23% | >99% | 13x | 14x | 1% | - | 3 | Analytic, D.E. Shaw, Cap. World |
| Herbalife / HLF | 10% | 1,967 | 2,100 | 14% | >99% | 11x | 9x | 1% | - | 1 | Aronson, D.E. Shaw, Times Sq. |
| Neustar / NSR | 10% | 1,650 | 1,403 | 7% | 50-99% | 17x | 15x | 1% | - | 1 | Eton Park, Primecap, Times Sq. |
| Allied Healthcare / AHCI | 10% | 122 | 88 | 15% | 50-99% | 12x | 10x | 0% | - | - | Rutabaga, Springhouse |
| Versant / VSNT | 9% | 68 | 41 | 14% | >99% | na | na | 10% | - | - | Murphy, RenTech, Royce |
| Weight Watchers / WTW | 9% | 2,065 | 3,596 | 11% | >99% | 10x | 10x | 57% | - | 1 | Capital World, MS, T. Rowe |
| Raytheon / RTN | 9% | 18,531 | 18,627 | 15% | >99% | 10x | 9x | 0% | - | 10 | Barrow, Capital World, NWQ |

[MFI100 ● PMR_Profile_Valuation_Sentenc● PMR Profile valuation sentence.xls● issues/pmr/200904/PMR Profile valuation sentence macro.xls, PMRprofile1, then PMRprofile 2]

## Free Cash Flow *(sorted by LTM free cash flow yield) (continued)*

| Company / Ticker | LTM FCF Yield | Market Value ($mn) | Enterpr. Value ($mn) | LTM EBIT / EV | LTM EBIT / Capital | P/E (Est.) This FY | P/E (Est.) Next FY | Ins. Own. | Last Six Months Insider Buys | Last Six Months Insider Sales | Notable Shareholders (superinvestors in bold) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| China Education / CEU | 9% | 129 | 101 | 14% | >99% | na | na | 58% | - | - | Marxe Austin |
| Sepracor / SEPR | 9% | 2,543 | 2,326 | 11% | >99% | 8x | 8x | 1% | - | 2 | Aletheia, NWQ, Times Square |
| Dun & Bradstreet / DNB | 9% | 3,899 | 4,541 | 11% | >99% | 14x | 13x | 1% | - | 1 | Davis, MFS |
| Watson Wyatt / WW | 9% | 1,880 | 1,670 | 13% | 50-99% | 13x | 12x | 2% | - | - | Findlay, Marathon, Royce |
| ePlus / PLUS | 9% | 127 | 99 | 25% | >99% | na | na | 44% | - | 25 | Heartland, Hovde, LSV |
| Hewlett-Packard / HPQ | 8% | 111,488 | 115,081 | 8% | >99% | 12x | 11x | 1% | 1 | 25 | Dodge, Lone Pine, Third Point |
| j2 Global Comms / JCOM | 8% | 1,029 | 837 | 11% | >99% | 12x | 12x | 4% | - | 15 | Cardinal, RenTech, Times Sq. |
| Continucare / CNU | 8% | 187 | 173 | 14% | >99% | 12x | 11x | 46% | - | - | T. Rowe |
| Cornerstone / CRTX | 8% | 169 | 156 | 13% | >99% | 12x | 18x | 88% | - | 19 | BBT, RenTech |
| Bridgepoint Edu. / BPI | 8% | 843 | 722 | 1% | >99% | 16x | 11x | 69% | 3 | 10 | Alydar, Arbor, Vinik |
| Virgin Mobile USA / VM | 8% | 334 | 564 | 14% | >99% | 12x | 10x | 4% | - | 3 | Jennison, T. Rowe |
| Joy Global / JOYG | 8% | 4,738 | 5,019 | 14% | 50-99% | 11x | 19x | 1% | - | 2 | Capital World, RenTech |
| Synopsys / SNPS | 8% | 3,289 | 2,207 | 11% | >99% | 13x | 13x | 1% | - | 10 | Ameriprise, Argyll, Dodge & Cox |
| GameStop / GME | 7% | 4,288 | 4,586 | 14% | 50-99% | 10x | 9x | 5% | 2 | 4 | Calamos, Rainier, Robeco |
| American Oriental / AOB | 7% | 378 | 403 | 16% | 50-99% | 7x | 6x | 21% | - | - | Oppenheimer, Wellspring |
| MIPS Technologies / MIPS | 7% | 169 | 137 | 15% | >99% | 13x | 9x | 1% | - | 1 | Cardinal, RenTech, Thrivent |
| Cass Information / CASS | 7% | 283 | 204 | 19% | >99% | 15x | 12x | 7% | - | 6 | River Road, Riverbridge |
| Primoris Services / PRIM | 7% | 236 | 194 | 20% | >99% | na | na | 66% | 5 | - | Michael Price, Millennium |
| APAC Customer / APAC | 6% | 315 | 305 | 9% | 50-99% | 10x | 9x | 39% | - | 55 | Acadian, Bridgeway, RenTech |
| Lorillard / LO | 6% | 12,025 | 11,217 | 14% | >99% | 12x | 11x | 1% | - | 2 | Franklin, GS, RenTech |
| Universal Travel / UTA | 6% | 164 | 142 | 15% | >99% | na | na | 29% | - | 17 | Driehaus, Pope |
| Pervasive Software / PVSW | 6% | 91 | 47 | 14% | 25-50% | 16x | 13x | 14% | - | 9 | Dialectic, RenTech, Royce |
| Centene / CNC | 6% | 859 | 703 | 18% | >99% | 10x | 9x | 2% | - | - | Eagle, Jennison, RenTech |
| Metropolitan Health / MDF | 6% | 99 | 70 | 32% | >99% | 9x | 9x | 13% | - | 26 | Levy, Nicusa, RenTech |
| Progress Software / PRGS | 6% | 933 | 747 | 5% | >99% | 13x | 11x | 1% | - | - | Artisan, Cardinal, Kalmar |
| Energen / EGN | 6% | 3,035 | 3,666 | 14% | >99% | 12x | 10x | 1% | - | 7 | Parnassus, Royce, Wedge |
| Buckle / BKE | 5% | 1,551 | 1,388 | 13% | >99% | 13x | 13x | 43% | - | 7 | Acadian, Royce, Turner |
| ITT Educational / ESI | 5% | 3,996 | 3,861 | 10% | >99% | 14x | 11x | 0% | - | 1 | Blum, Colum. Wanger, RenTech |
| Coca-Cola Company / KO | 5% | 122,755 | 126,258 | 6% | 50-99% | 17x | 16x | 5% | - | - | BRK, Lone Pine, Markel, TCI |
| Foster Wheeler / FWLT | 5% | 3,940 | 3,301 | 15% | >99% | 11x | 12x | 0% | - | 1 | H Partners, T. Rowe, Westfield |
| America's Car-Mart / CRMT | 5% | 275 | 305 | 11% | >99% | 12x | 10x | 16% | - | 17 | Alydar, Rutabaga |
| Deckers Outdoor / DECK | 5% | 1,096 | 921 | 14% | 50-99% | 11x | 11x | 3% | - | - | Apex, Mazama, Perry, RenTech |
| DPL / DPL | 4% | 3,042 | 4,526 | 9% | >99% | 12x | 10x | 1% | 1 | - | Gabelli, Luminus, Westwood |
| Fluor / FLR | 4% | 9,150 | 7,180 | 16% | 50-99% | 13x | 14x | 0% | - | 12 | Capital Guardian, Clearbridge |
| Yum! Brands / YUM | 3% | 15,163 | 18,427 | 8% | 25-50% | 15x | 14x | 1% | - | 30 | Cap Re, Southeastern, T. Rowe |
| China-Biotics / CHBT | 3% | 283 | 225 | 11% | >99% | 13x | 10x | 49% | - | 1 | Heartland, Pope |
| Lihua International / LIWA | 3% | 219 | 208 | 13% | >99% | na | na | 90% | 2 | - | Vision Opportunity China |
| Pain Therapeutics / PTIE | 3% | 208 | 26 | 31% | 25-50% | nm | nm | 14% | 2 | 30 | Eastbourne, RenTech, Visium |
| China Sky One / CSKI | 2% | 218 | 170 | 25% | >99% | 6x | 5x | 36% | - | - | Kleinheinz, Pope |
| Corporate Executive / EXBD | 2% | 874 | 828 | 7% | >99% | 19x | 19x | 0% | 2 | - | Capital World, Kornitzer, MS |
| Graham Corp. / GHM | 2% | 138 | 92 | 25% | 25-50% | 27x | 24x | 3% | 1 | 3 | RenTech, Royce, Wyper |
| GigaMedia / GIGM | 0% | 282 | 200 | 15% | >99% | 13x | 8x | 21% | - | 4 | Criterion, Palo Alto, Toscafund |
| Cytokinetics / CYTK | -1% | 303 | 184 | 10% | >99% | 12x | nm | 24% | 1 | 24 | Orbimed, QVT, Wellington |
| A-Power Energy / APWR | -3% | 350 | 253 | 10% | 50-99% | 12x | 8x | 35% | - | - | Essex, Two Sigma, Weiss |
| Chicago Bridge / CBI | -5% | 1,743 | 1,787 | 17% | >99% | 10x | 12x | 2% | - | - | Jennison, Keeley, Neuberger |
| Laclede Group / LG | -9% | 715 | 1,148 | 11% | >99% | 11x | 13x | 7% | 3 | 1 | GS, O'Shaughnessy, RenTech |
| KHD Humboldt Wedag / KHD | -11% | 311 | (38) | nm | >99% | nm | 28x | 22% | - | - | Luxor, Paradigm, RenTech |
| Argan / AGX | -27% | 179 | 130 | 15% | >99% | na | na | 29% | 2 | 42 | Ashford, Brown |
| ICO Global Comms / ICOG | -36% | 162 | 169 | >99% | >99% | na | na | 45% | - | - | Eton Park, Highland, Kleinheinz |
| Georgia Power / GPW | -288% | 234 | 8,566 | 18% | >99% | na | na | 2% | - | - | -- |

[MFI100 ● PMR_Profile_Valuation_Sentenc ● PMR Profile valuation sentence.xls ● issues/pmr/200904/PMR Profile valuation sentence macro.xls, PMRprofile1, then PMRprofile 2]

# Deckers Outdoor (DECK) – Owned By Perry

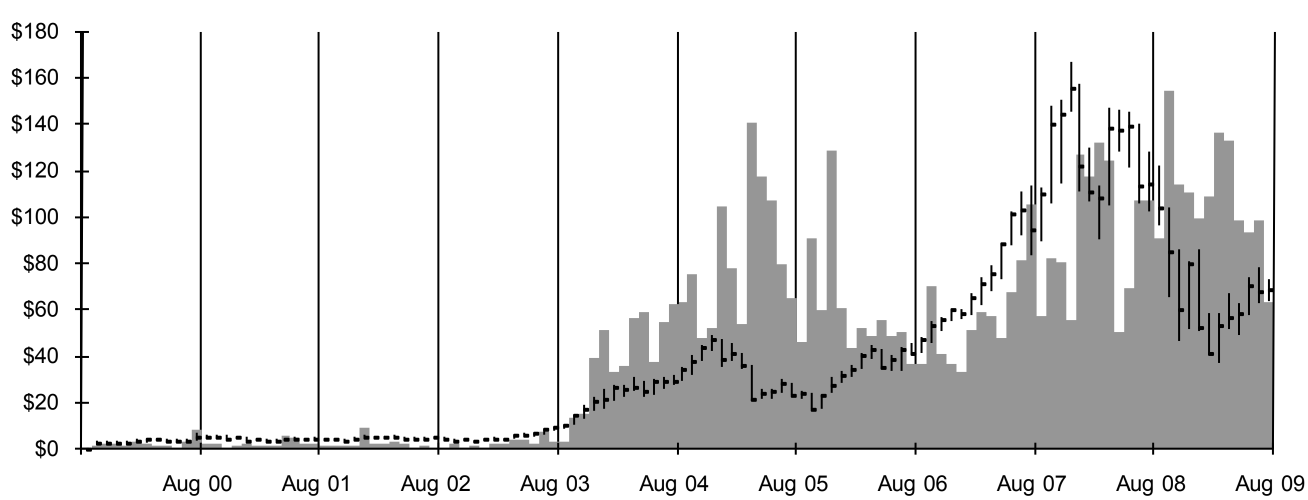
Goleta, CA, 805-967-7611
http://www.deckers.com

Consumer Cyclical: Footwear, Member of S&P SmallCap 600

| Trading Data | Consensus EPS Estimates | | | | Valuation | |
|---|---|---|---|---|---|---|
| Price: $83.44 (as of 9/25/09) | | | Month | # of | P/E FYE 12/31/08 | 15x |
| 52-week range: $37.24 - $110.12 | | Latest | Ago | Ests | P/E FYE 12/31/09 | 11x |
| Market value: $1.1 billion | This quarter | $2.25 | $2.24 | 9 | P/E FYE 12/31/10 | 11x |
| Enterprise value: $921 million | Next quarter | 3.90 | 3.90 | 9 | P/E FYE 12/31/11 | 9x |
| Shares out: 13.1 million | FYE 12/31/09 | 7.34 | 7.33 | 9 | EV / LTM revenue | 1.2x |
| **Ownership Data** | FYE 12/31/10 | 7.74 | 7.76 | 9 | EV / LTM EBITDA | n/m |
| Insider ownership: 3% | FYE 12/31/11 | 9.03 | 9.03 | 2 | EV / LTM EBIT | 7x |
| Insider buys (last six months): 0 | LT EPS growth | 21.7% | 21.7% | 5 | P / tangible book | 2.9x |
| Insider sales (last six months): 0 | **Latest Quarterly EPS Surprise** | | | | **Greenblatt Criteria** | |
| Institutional ownership: 95% | Date | Actual | Estimate | | LTM EBIT yield | 14% |
| # of institutional owners: 488 | 7/23/09 | $0.26 | -$0.09 | | LTM pre-tax ROC | 78% |

| Operating Performance and Financial Position | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| *($ millions, except* | Fiscal Years Ended | | | | | | | LTME | FQE | FQE |
| *per share data)* | 12/31/02 | 12/31/03 | 12/31/04 | 12/31/05 | 12/31/06 | 12/31/07 | 12/31/08 | 6/30/09 | 6/30/08 | 6/30/09 |
| Revenue | 99 | 121 | 215 | 265 | 304 | 449 | 689 | 738 | 91 | 103 |
| Gross profit | 41 | 51 | 90 | 111 | 141 | 207 | 305 | 323 | 36 | 41 |
| EBIT | 3 | 19 | 42 | 52 | 51 | 106 | 117 | 129 | (7) | 3 |
| Net income | (8) | 9 | 25 | 31 | 31 | 66 | 74 | 82 | (4) | 3 |
| Diluted EPS | 0.13 | 0.73 | 2.05 | 2.42 | 2.38 | 5.06 | 5.60 | 6.19 | (0.29) | 0.22 |
| Cash from ops | 8 | 18 | 12 | 30 | 49 | 61 | 53 | 71 | (49) | (49) |
| Capex | 2 | 1 | 1 | 4 | 6 | 6 | 22 | 19 | 4 | 4 |
| Free cash flow | 7 | 17 | 11 | 26 | 43 | 55 | 31 | 52 | (52) | (54) |
| Cash & investments | 4 | 7 | 26 | 53 | 99 | 168 | 195 | 175 | 125 | 175 |
| Total current assets | 45 | 46 | 101 | 134 | 187 | 302 | 413 | 403 | 308 | 403 |
| Intangible assets | 71 | 71 | 70 | 70 | 54 | 54 | 24 | 25 | 45 | 25 |
| Total assets | 122 | 121 | 175 | 209 | 250 | 370 | 484 | 478 | 378 | 478 |
| Short-term debt | 4 | 4 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total current liabilities | 22 | 23 | 31 | 30 | 40 | 71 | 95 | 68 | 63 | 68 |
| Long-term debt | 35 | 27 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total liabilities | 57 | 51 | 34 | 34 | 40 | 71 | 99 | 74 | 65 | 74 |
| Preferred stock | 6 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Common equity | 60 | 71 | 141 | 175 | 210 | 299 | 384 | 405 | 312 | 405 |
| EBIT/capital employed | 12% | 78% | >100% | >100% | 91% | >100% | >100% | 78% | n/m | n/m |

## Ten-Year Stock Price Performance and Trading Volume Dynamics



## BUSINESS OVERVIEW

Deckers produces and markets footwear under owned brands UGG, Teva, Simple, TSUBO, Ahnu, and Deckers.

## INVESTMENT HIGHLIGHTS

- **Owns UGG and Teva brands,** which accounted for 84% and 13% of 2008 sales. The sheepskin UGG boots and other footwear emphasize luxury and comfort. Teva targets active outdoor customers. Deckers outsources manufacturing, with most products made at six contractor factories in China.
- **Wholesale distribution was 84% of sales in 2008.** Online and direct retail sales (14 stores) represent less than 20% of sales. Average wholesale price per pair increased 16% to $31 in 1H09, due to higher UGG sales. Volume rose 6% to 6.6 million pairs.
- **Guiding for 2009 EPS to be "flat to up slightly"** from $7.27 in 2008. Sales should rise 9-10%, with gross and SG&A margins of 44.5% and 24.5%.
- **Chairman and CEO Angel Martinez** worked at Reebok and Keen before joining Deckers in 2005.
- **Strong balance sheet**, with $108 million of cash, $67 million of short-term investments and no debt.
- **Repurchased 150,000 shares for $10 million in 3Q09 ($67 per share).** Deckers approved a $50 million stock repurchase program in June 2009.
- **Shares trade at 14% trailing EBIT-to-EV yield.**

## INVESTMENT RISKS & CONCERNS

- **Dependence on UGG brand for majority of sales.** The UGG brand has grown in sales from $24 million in 2002 to $582 million in 2008. Changing fashion styles are a big risk.
- **Highly competitive industry with low barriers to entry**. Footwear competitors include established companies as well as thousands of start-up brands.
- **Universal strapping system patent used in Teva sandals expired in 2007.** While this could lead to increased competition from companies copying Teva's designs, Deckers is generally at risk of knock-off products selling at lower price points.
- **Increased authorized number of shares** from 20 million to 50 million at AGM in May.

## COMPARABLE PUBLIC COMPANY ANALYSIS

| | MV ($mn) | EV ($mn) | EV / Rev. | P / T. Book | This FY P/E | Next FY P/E |
|---|---|---|---|---|---|---|
| COLM | 1,420 | 1,100 | .9x | 1.6x | 28x | 23x |
| WWW | 1,220 | 1,180 | 1.0x | 3.2x | 15x | 13x |
| TBL | 790 | 610 | .5x | 1.7x | 21x | 20x |
| **DECK** | **1,050** | **870** | **1.2x** | **2.8x** | **11x** | **10x** |

## SELECTED OPERATING DATA [1]

| FYE December 31 | 2004 | 2005 | 2006 | 2007 | 2008 | 1H09 |
|---|---|---|---|---|---|---|
| Net sales ($mn) | 215 | 265 | 304 | 449 | 689 | 237 |
| Change (y-y) | 77% | 23% | 15% | 47% | 54% | 26% |
| *% of net sales by segment:* | | | | | | |
| UGG wholesale | 47% | 57% | 60% | 65% | 70% | 55% |
| Teva wholesale | 39% | 30% | 25% | 18% | 12% | 23% |
| Simple wholesale | 4% | 3% | 4% | 2% | 2% | 3% |
| Other wholesale [2] | 0% | 0% | 0% | 0% | 1% | 2% |
| eCommerce [3] | 9% | 10% | 9% | 10% | 10% | 9% |
| Retail stores [3] | 0% | 0% | 2% | 4% | 6% | 8% |
| *Net sales growth by segment:* | | | | | | |
| UGG wholesale | 195% | 48% | 21% | 60% | 66% | 44% |
| Teva wholesale | 15% | -4% | -6% | 9% | -1% | -8% |
| eCommerce | 206% | 30% | 11% | 57% | 51% | -3% |
| Retail stores | n/m | n/m | 511% | 163% | 109% | 139% |
| *EBIT margin by segment:* [4] | | | | | | |
| UGG wholesale | 31% | 32% | 40% | 41% | 39% | 39% |
| Teva wholesale | 30% | 28% | 25% | 26% | 17% | 22% |
| eCommerce | 28% | 27% | 30% | 32% | 33% | 26% |
| Retail stores | n/m | 0% | 17% | 17% | 17% | 0% |
| Overhead costs | -9% | -9% | -11% | -11% | -11% | -15% |
| Total EBIT margin | 20% | 20% | 22% | 24% | 22% | 10% |
| *Net sales by geography:* | | | | | | |
| U.S. | 82% | 87% | 87% | 86% | 84% | 67% |
| International | 18% | 13% | 13% | 14% | 16% | 33% |
| *Selected items as % of revenue:* | | | | | | |
| Gross profit | 42% | 42% | 46% | 46% | 44% | 42% |
| SG&A | 22% | 22% | 24% | 23% | 22% | 32% |
| Net income | 12% | 12% | 10% | 15% | 11% | 6% |
| D&A | 1% | 1% | 1% | 1% | 1% | 2% |
| Capex | 1% | 2% | 2% | 1% | 3% | 3% |
| Return on tang. equity [5] | 75% | 36% | 23% | 33% | 24% | n/m |
| Tang. equity to assets [5] | 44% | 71% | 78% | 78% | 78% | 82% |
| Avg wholesale price/pair | $26 | $28 | $30 | $35 | $42 | $31 |
| Change (y-y) | 13% | 8% | 8% | 14% | 23% | 16% |
| # of pairs sold (mn) | 8 | 9 | 9 | 12 | 15 | 7 |
| Change (y-y) | 52% | 14% | 6% | 27% | 25% | 6% |
| Δ shares out (avg) | 15% | 12% | 1% | 3% | 2% | 1% |

Source: Company filings, *Manual of Ideas* analysis.

[1] Deckers' business is seasonal, primarily owing to higher UGG sales in the fall. 44% and 29% of 2008 net sales occurred in the fourth and third quarters, respectively, while the first and second quarter each represented about 14%.

[2] Other wholesale includes mainly TSUBO and Ahnu brands, which were acquired in May 2008 and March 2009, respectively.

[3] The eCommerce and retail store segments are managed separately because they are direct to consumer sales, while the brand segments are wholesale sales. >95% of eCommerce and retail store sales relate to UGG and Teva.

[4] EBIT figures exclude impairment losses.

[5] Ratios are based on average tangible equity and average tangible assets.

## MAJOR HOLDERS

Insiders 3% | Barclays 7% | Apex 5% | Turner 5% | Vanguard 5% | Buckingham 4% | Perry 3% | RenTech 3% | FMR 3%

## RATINGS

| | |
|---|---|
| **VALUE** Intrinsic value materially higher than market value? | ☆☆☆ |
| **MANAGEMENT** Capable and properly incentivized? | ☆☆☆ |
| **FINANCIAL STRENGTH** Solid balance sheet? | ☆☆☆☆☆ |
| **MOAT** Able to sustain high returns on invested capital? | ☆☆ |
| **EARNINGS MOMENTUM** Fundamentals improving? | ☆☆☆ |
| **MACRO** Poised to benefit from economic and secular trends? | ☆☆☆ |
| **EXPLOSIVENESS** 5%+ probability of 5x upside in one year? | ☆☆☆ |

## THE BOTTOM LINE

With a 21% trailing EBIT-to-EV yield and high historic returns on capital, it is no surprise Deckers is a magic formula stock. While we cannot divine the future prospects of the UGG brand, we are skeptical Deckers can continue reinvesting capital at exceptional returns. As the footwear industry is notoriously fickle, we prefer not to jump on this "one-trick pony."

## About *Portfolio Manager's Review*



*Portfolio Manager's Review* is published monthly by BeyondProxy. Subscribers may download content to their computer and store and print materials for their individual use only. Any other reproduction, transmission, display or editing of the content by any means, mechanical or electronic, without the prior written permission of BeyondProxy is strictly prohibited.

**Terms of use:** Use of this newsletter and its content is governed by the Terms of Use described in detail at www.manualofideas.com. See a summary of key terms below.

**Contact information:** For all customer service, subscription or other inquiries, please visit www.manualofideas.com, or contact us at BeyondProxy, 235 East 95th Street, Suite 14J, New York, NY 10128; telephone: 415-412-8059.

**Editor-in-chief:** John Mihaljevic, CFA.

**Annual subscription price:** $999.

**To subscribe,** visit www.manualofideas.com/pmr.html

### General Publication Information and Terms of Use

*Portfolio Manager's Review* is published by BeyondProxy. Use of this newsletter and its content is governed by the Terms of Use described in detail at www.manualofideas.com/terms.html. For your convenience, a summary of certain key policies, disclosures and disclaimers is reproduced below. This summary is meant in no way to limit or otherwise circumscribe the full scope and effect of the complete Terms of Use.

**No Investment Advice**
This newsletter is not an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. This newsletter is distributed for informational purposes only and should not be construed as investment advice or a recommendation to sell or buy any security or other investment, or undertake any investment strategy. It does not constitute a general or personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual investors. The price and value of securities referred to in this newsletter will fluctuate. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of all of the original capital invested in a security discussed in this newsletter may occur. Certain transactions, including those involving futures, options, and other derivatives, give rise to substantial risk and are not suitable for all investors.

**Disclaimers**
There are no warranties, expressed or implied, as to the accuracy, completeness, or results obtained from any information set forth in this newsletter. BeyondProxy will not be liable to you or anyone else for any loss or injury resulting directly or indirectly from the use of the information contained in this newsletter, caused in whole or in part by its negligence in compiling, interpreting, reporting or delivering the content in this newsletter.

**Related Persons**
BeyondProxy's officers, directors, employees and/or principals (collectively "Related Persons") may have positions in and may, from time to time, make purchases or sales of the securities or other investments discussed or evaluated in this newsletter.

John Mihaljevic, Chairman of BeyondProxy, is also a principal of Mihaljevic Capital Management LLC ("MCM"), which serves as the general partner of a private investment partnership. MCM may purchase or sell securities and financial instruments discussed in this newsletter on behalf of the investment partnership or other accounts it manages.

It is the policy of MCM and all Related Persons to allow a full trading day to elapse after the publication of this newsletter before purchases or sales of any securities or financial instruments discussed herein are made.

**Compensation**
BeyondProxy receives compensation in connection with the publication of this newsletter only in the form of subscription fees charged to subscribers and reproduction or re-dissemination fees charged to subscribers or others interested in the newsletter content.

THE MANUAL OF **Ideas**
SERIOUS IDEAS FOR SERIOUS INVESTORS™

# Pay-By-Check Subscription Form

**Publisher: BeyondProxy LLC**

**For faster enrollment, subscribe online at www.manualofideas.com**

## To Do:

Please print this form and fill in the following information legibly and completely.

Mail the completed form and payment to:

**John Mihaljevic**
**Editor, The Manual of Ideas**
**235 E 95th Street, 14J**
**New York, NY 10128**

## Your Information:

Name: ______________________________

Firm: ______________________________

Mailing Address: ______________________________

City: ______________________ State (if applicable): ____________

ZIP / Postal Code: ____________ Country: ______________________

Email: ______________________________

## Your Subscriptions:

| | | |
|---|---|---|
| ***PORTFOLIO MANAGER'S REVIEW:*** | ☐ one year, $999 (12 issues) | ☐ two years, $1,898 (24 issues) |
| ***EQUITIES AND TOBIN'S Q:*** | ☐ one year, $399 (4 issues) | ☐ two years, $698 (8 issues) |
| ***DOWNSIDE PROTECTION REPORT:*** | ☐ one year, $149 (12 issues) | ☐ two years, $288 (24 issues) |
| ***10X45 BARGAIN HUNTER:*** | ☐ one year, $99 (26 issues) | ☐ two years, $188 (52 issues) |

## Payment Information:

☑ Check enclosed (make payable to "BeyondProxy LLC")

## Confirmation:

We will confirm by email the receipt of your request and welcome you to *The Manual of Ideas.* Thanks!

**Questions about your order?** Email us at subscribe@manualofideas.com or call 415-412-8059.