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Agenda

- I. Quick Background**
- II. Value Proposition and Examples**
- III. Stock-Picking Proof**
- IV. Appendix**

Part I

Quick Background

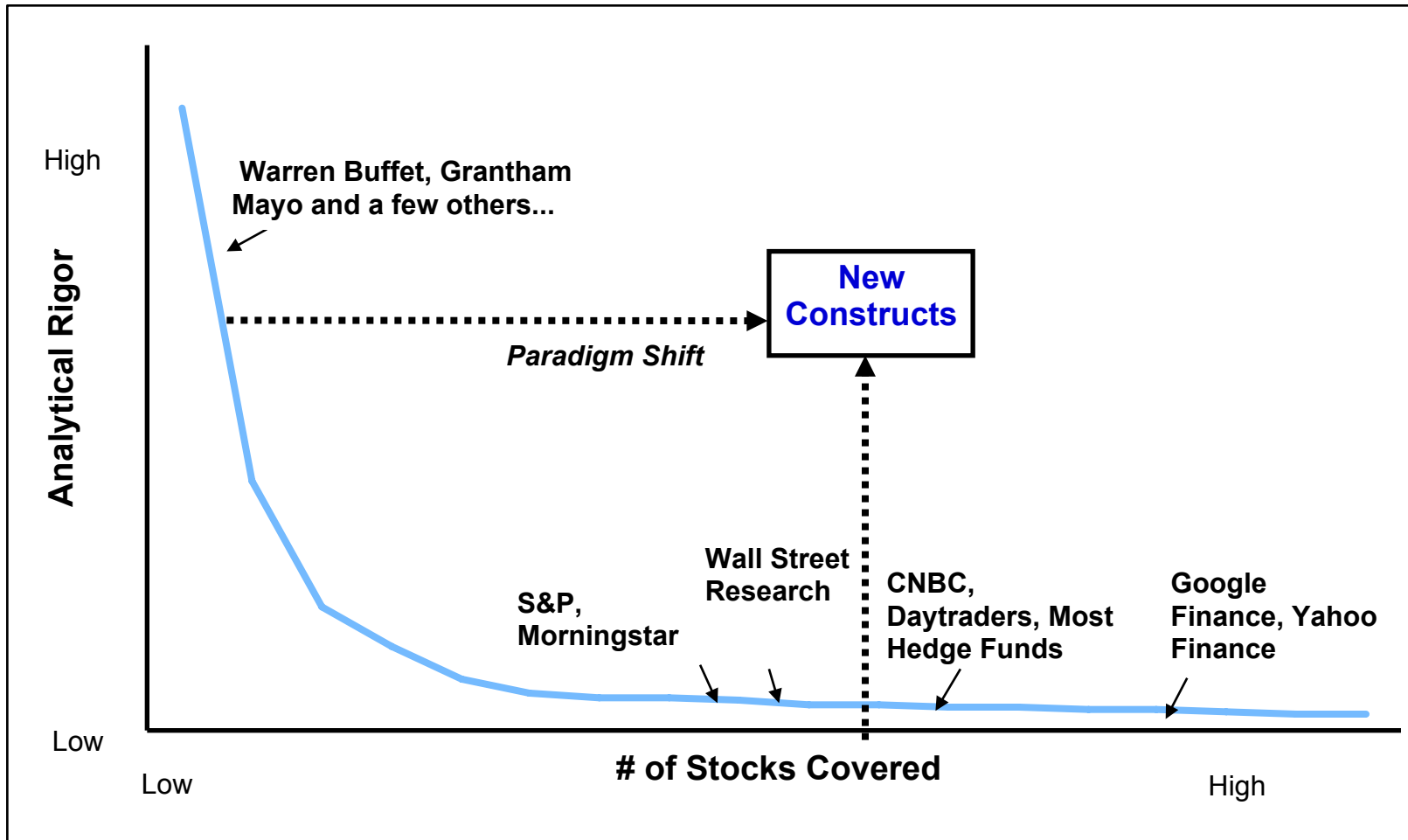
Overview

Independent Proprietary research

- Founded July 2002
- Top Ranked Model Portfolio by Barrons for 3 years
- Fundamental focus
- Patented research platform covers 3000+ stocks
- Products
 - Newsletters: Most Attractive and Most Dangerous Stocks
 - Forensic Accounting reports and studies
 - Company Reports
 - Valuation models (web-based)
 - Database for screening and downloading data

Deep Fundamental Research With Scale

8yrs Perfecting the Research Process (Patented)



Part II

Value Proposition and Examples

Better Diligence → Better Results

Untapped Expertise

Investment Landscape Is Changing

- Need for new, untapped source(s) of alpha
- Channel checking = sucked dry
- Expert networks offer declining additional insight
- Financial expertise at a cyclical low
- Market is more challenging than ever
- Diligence will matter more again

Why Diligence Is Needed

Core Problem: GAAP is exploitable.

Only Solution: Read the Footnotes and MD&A.

Traditional P&L	Economic P&L
Revenues	Revenues
- operating expenses	- operating expenses
	- Hidden Charges
= pretax earnings	= pretax earnings
- taxes	- taxes
= Reported Profit	= Profit
	- capital charge/hidden liabilities and assets
	= Economic Profit

We Do the Dirty Work So You Don't Have To

Scouring the Footnotes and MD&A

- Hidden Expenses/Income
- Unrecorded Goodwill
- Impairments
- Unconsolidated Subsidiaries
- Minority Interests
- Unrealized Gains/Losses
- Changes in Accounting Rules
- Derivatives Exposure
- Customer Concentration
- Employee Stock Options
- Operating Leases
- Loan Loss/LIFO Reserves
- Pension Assumptions
- Excess Cash
- Pension Over/Under Funding
- Auditor's Opinions
- Carrying Value vs Fair Value
- Mid-year acquisitions

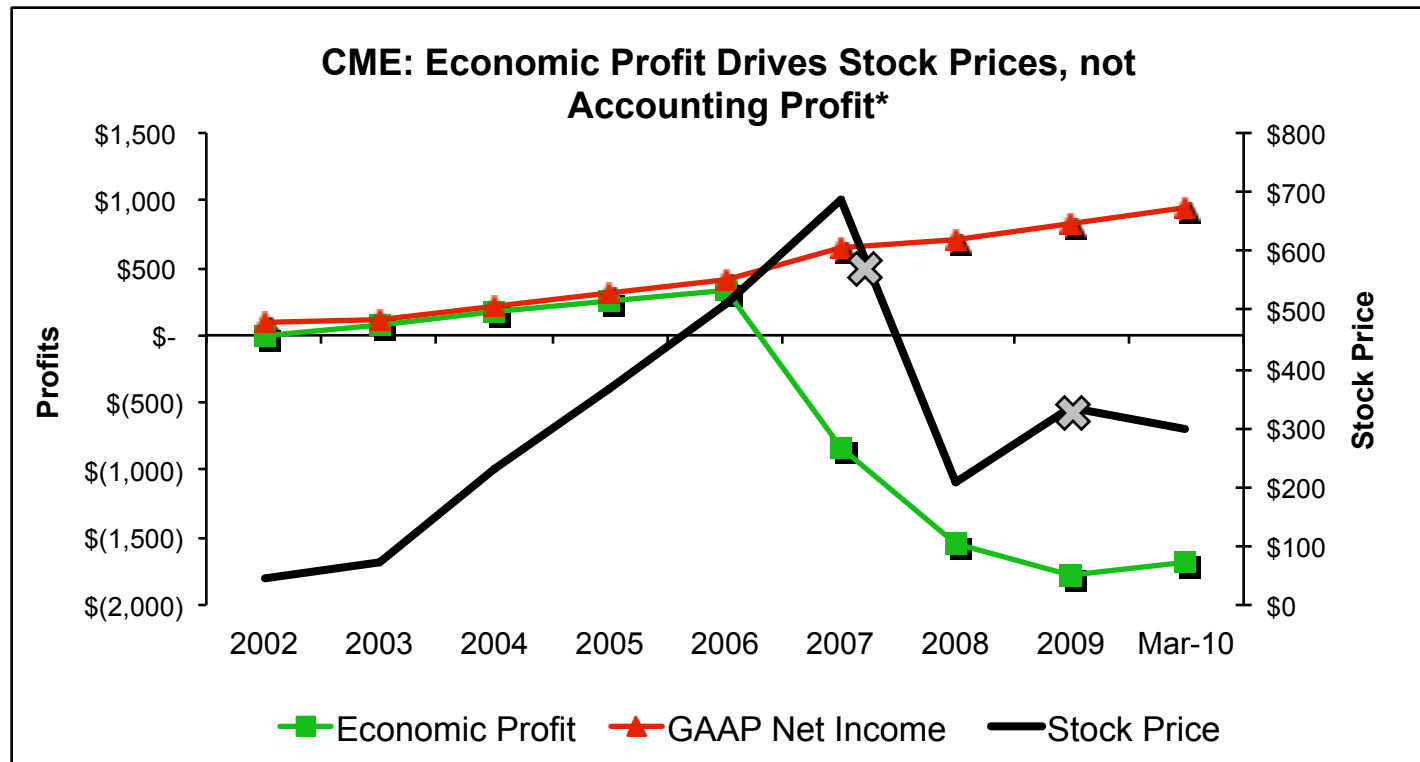
No one else covers all the bases as well as we do.

Diligence Pays: Economic Earnings Matter

CME Group (CME): Most Dangerous List: Mar-Apr 08; Jan-Mar 10

Red Flags from Footnotes and MD&A or DCF and Economic Earnings Analysis

1. \$426mm off-balance sheet debt and write-offs (2% of assets)
2. \$7,646mm in deferred tax liabilities (96% of assets)
3. DCF - very high expectations embedded in stock price: 10% profit growth for 25 yrs



*This graph was created based on information collected and analyzed by New Constructs, LLC. New Constructs regularly gathers information from over 3,000 companies' 10Ks, including the Notes to the Financial Statements and MD&A.

Samples: Why the Footnotes Matter

Change in Useful Life

Ticker	Year	Note
TWTC	2009	The change in the useful life assumptions increased net income by 70% (\$0.13 per share).

Customer Concentration

Over 600 companies in the Russell 3000 have customers that make up more than 10% of sales

TICKER	YEAR	Concentration of Revenues
CACI	2010	94.8% of Revenues comes from U.S. Government

Carrying Value Vs. Fair Value

Year	# of Documents where Carrying Value > Fair Value
2010	89

Examples:

Ticker	Year	Notes
RF	2010	The fair value of loans is 90% of the carrying value.
BPOP	2010	The fair value of loans is 88% of the carrying value.

Auditors Opinion

Year	# of Documents with Unaudited Internal Controls
2010	132
2009	129
2008	99
Year	# of Documents with an Adverse Opinion of Internal Controls
2010	36
2009	22
2008	12

Samples: Why the Footnotes Matter

Pensions Status

YEAR	# Of Compa	\$ of Total Under Funded Pensions
2010	1126	\$575 Billion

Examples

Ticker	Year	Under-funded amount
AMR	2010	\$8.1 billion, which is 3.6 times their current market cap.
EK	2010	\$2.6 billion, which is 2.9 times their current market cap.

Hidden One-Time Items

Hidden One-Time Income

Year	# of Hidden One-Time Income Issues		
2010	504		
2009	469		
TICKER	YEAR	Hidden One-Time Income	% of Operating Revenue
TRMS	2010	18,700,000	69.99%
KS	2009	163,998,000	25.93%

Hidden One-Time Expenses

Year	# of Hidden One-Time Expenses		
2010	1566		
2009	1584		
TICKER	YEAR	Hidden One-Time Expense	% of Operating Revenue
HL	2010	193,200,000	46%
EGY	2009	33,373,000	29%

Samples: Why the Footnotes Matter

Options Liabilities

Year	# of Companies with Outstanding ESO Liabilites	
2010	2616	
TICKER	YEAR	Notes
ARUN	2010	ESO liability = 17 % of Equity Market Value & WABSO = WADSO

Net Periodic Benefit Income (Income Is deducted from NOPAT)

Year	# of Companies with Net Periodic Benefit Income	
2010	49	
TICKER	YEAR	Pension Income as % of Revenue
EK	2010	2.2%, driven by expected return on assets assumption of 8.73%, higher than 85% of all companies we cover. Median is 7.5%.

Major Mid-Year Acquisitions

Year	# of Companies with Material Mid-year Acquisitions			
2010	276			
TICKER	YEAR	Acquisition Date	ROIC Unadjusted	ROIC Adjusted for Acquisition
DAR	2010	12/17/10	4.50%	12.70%

More samples in reports on our website: Asset-write offs, Hidden Items, Off-Balance Sheet Debt and more.

Part III

Stock-Picking Proof

From Barron's & more, details on our blog

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FEATURE | SATURDAY, JANUARY 29, 2011

Market Beaters

By VITO J. RACANELLI

For our fourth consecutive contest, the average broker's stock-focus list topped the S&P 500. Winners: BofA Merrill, Wedbush, McAdams Wright, Morgan Keegan.

Propelled by a powerful bull market that has lasted almost two years, Wall Street's brokers continue to flex their muscles in the *Barron's*-Zack's semiannual stock-picking competition.

For the fourth contest in a row, stretching back to the end of 2008, the average return of the brokerage focus lists—or best-stock-ideas list—has trounced that of the S&P 500 over six months, one year, three years and five years.

Yes, there has been a monster rally since the March 2009 lows. But our winners brought more to the investment table than mere beta.



Beta is the generally salutary effect that advancing markets have on individual stock prices—basically, the rising-tide-lifts-all-boats phenomenon. However, in 2010, when small-capitalization stocks were much in favor among investors globally, **Bank of America Merrill Lynch** (ticker: BAC) still took the gold for the six months through Dec. 31, with a 31.6% return, even though its U.S. 1 List, as its focus list is dubbed, was stuffed with lots of large-caps.

Nipping closely at BofA ML's heels over that stretch was **Raymond James Financial** (RJF), which turned in a 30.9% gain. The Tampa-based brokerage outfit, whose focus list had been a laggard in earlier contests, seems to be on the comeback trail.

Some other brokers took advantage of the market's three big dips last year—in February, July and August—to produce stellar one-year numbers. Several traded around the same stock names, seeking to sell them near highs and to buy them back near lows.

For all of 2010, Los Angeles-based Wedbush Securities finished first, up from third place last time, with a 36% return. It was followed by **New Constructs, which advanced almost 27%. The small Tennessee-based research outfit has often been at or near the top of our polls. (For more on the company's views on stocks, see *ETF Focus*.)**

Over three years, Seattle-based McAdams Wright Ragen topped the pack, with a nearly 15% return, improving from second place last time.

MORGAN KEEGAN, a regional broker that has been a perennial powerhouse in our contest, took second in the three-year competition and again won the five-year race, going away, with a 33% return. The Memphis-based regional broker has effectively owned that prestigious piece of real estate since late 2008.

What is it about Tennessee and good performance?

Goldman Sachs (GS), which also sports an impressive long-term record, was runner-up over five years, with a nearly 23% return.

The cellar dwellers in the respective periods measured were **Credit Suisse** (CS), **Wells Fargo Advisors**, (WFC) **Morgan Stanley** (MS) and **Raymond James** (RJF).

Every six months, *Barron's* ranks the top stock picks of a number of U.S. brokers. This time, a dozen participated in our rankings.

Winning Ways

Some of the leaders on these lists focused on sectors, such as industrials, energy, materials and consumer discretionary, prospered by trading in and out of certain stocks as they rose and fell. And some benefited by making big bets on a few

Six months	% Change	One Year	% Change	Three Years	% Change
BofA Merrill Lynch	31.55	Wedbush Securities	36.09	McAdams Wright	14.64
Raymond James	30.87	New Constructs	26.38	Morgan Keegan	12.77
Goldman Sachs	28.85	BofA Merrill Lynch	23.05	New Constructs	10.53
McAdams Wright	27.86	Charles Schwab	20.08	Edward Jones	-2.41
Charles Schwab	27.76	Morgan Keegan	19.95	Charles Schwab	-3.18
New Constructs	26.86	McAdams Wright	19.31	BofA Merrill Lynch**	-6.42
Morgan Keegan	24.72	Raymond James	16.01	Credit Suisse	-6.05
Wells Fargo Advisors	24.69	Goldman Sachs***	13.14	Wells Fargo Advisors	-7.17
Morgan Stanley*	23.59	Morgan Stanley	12.07	Goldman Sachs	-8.78
Wedbush Securities	21.68	Edward Jones	10.54	Raymond James	-8.97
Edward Jones	21.33	Credit Suisse	9.46	Wedbush Securities	-10.89
Credit Suisse	19.28	Wells Fargo Advisors	8.05	Morgan Stanley	-11.28
Average	25.76		17.81		-12.18
S&P 500 Index	23.27		15.06		-2.98
			21.91		7.51

View Full Image

*Average performance of all focus lists. **BofA Merrill Lynch. ***BofA Merrill Lynch. % change in focus list returns in March 2010.

Some of the contestants, such as **Charles Schwab** (SCHW), are well-known to the average investor. But others, such as McAdams Wright, aren't. Chicago-based Zacks Investment Research does the math for us, by compiling the data and then keeping a running tally of each focus list, or best stock ideas, for various periods over the past five years. (For a more detailed description of the methodology, see [related story](#).)

Certain sectors particularly helped or hindered the performance of the focus lists. Last year, it paid to have big dollops of industrials, materials, energy stocks and consumer-discretionary issues, like those linked to retailing. Energy shares aided Raymond James and Goldman Sachs, while health-care stocks, with some exceptions, took a bite out of the performance of the brokerages that finished near the bottom, according to Zacks analyst Tracey Ryniec.

A lack of utilities companies, a laggard group last year, contributed to the winners' runs. And, as noted, with the small-cap Russell 2000 index returning 25% in 2010, versus 14% for the S&P 500, it paid handsomely to have smaller companies on a focus list.

That makes Bank of America Merrill Lynch's victory especially notable. Steve Fleishman, chairman of the committee running its US 1 List, notes that the typically 25-to-30-name list was more large-stock-weighted last year. Its average member's stock-market value was a hefty \$40 billion.

BofA Merrill's top five performers in the second half were auto maker Ford (F), heavy-equipment producer **Terex** (TEX), wireless-communication specialist **Qualcomm** (QCOM; for more on the company, see [Tech Trader](#)), software giant **Oracle** (ORCL) and one little guy, **Dick's Sporting Goods** (DKS). Ford, whose earnings disappointed investors Friday, is off the list now.

The list profited, Fleishman adds, partly from the rising earnings at industrial and consumer-discretionary companies. One of the investment firm's newest picks is **CSX** (CSX), which it says has the lowest valuation of any major U.S. railroad and the potential to substantially boost its operating margin.

IN THE ONE-YEAR GAME, Wedbush's head of equities, Sheri Kaiserman, says that its 15-to-25-stock Best Ideas list benefited from stocks that doubled. Among them: **OmniVision Technology** (OVTI)—a supplier to **Apple** (AAPL)—and **Coinstar** (CSTR), whose coin-counting and redbox DVD-rental kiosks are in malls and supermarkets around the country. OmniVision is now off the Best Ideas list.

(In our previous one-year contest, Wedbush also got a big boost from sizable bets on a number of stocks that doubled.)

Wedbush's performance, even as it backed off a bit in the second half, was still boosted by its focus on favored sectors, such as retailing, technology and industrials. Though health-care stocks generally lagged behind many other groups last year, the California broker made the most of picks like **ZOLL Medical** (ZOLL), a maker of devices like defibrillators, which jumped 39% in 2010.

Recently, Kaiserman added **Boeing** (BA) to the list, as she says fundamentals in the commercial airline sector are improving and the jet maker should begin delivering its long-delayed Dreamliner by July or August.

Two contestants, McAdams Wright Ragen and **New Constructs**, nimbly traded in and out of the same stocks regularly to help performance. Says **David Trainer**, president of New Constructs: "We live in a

Winning Ways

Some of the leaders on these lists focused on sectors, such as industrials, energy, materials and consumer discretionary, that fared well in 2010. Others prospered by trading in and out of certain stocks as they rose and fell. And some benefitted by making big bets on a few stocks that had spectacular gains.

Six months	% Change	One Year	% Change	Three Years	% Change	Five Years	% Change
BofA Merrill Lynch	31.55	Wedbush Securities	36.09	McAdams Wright	14.64	Morgan Keegan	33.45
Raymond James	30.87	New Constructs	26.98	Morgan Keegan	12.77	Goldman Sachs	22.58
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Average	25.76		17.81		-2.18		14.96
S&P 500 Index	23.27		15.06		-2.86		2.29
S&P 500 Equal Weight	26.24		21.91		7.51		26.40

*Smith Barney and Morgan Stanley have merged their brokerage operations and now appear as one entity. **BofA Merrill Lynch changed its focus-list strategy in March 2007. ***Goldman Sachs changed its focus-list strategy at the end of the third quarter 2008. NA= Not applicable because broker is a relatively recent entrant. Source: Zacks Investment Research

market [where] stocks are pushed around all the time on non-fundamentals." Both brokers took advantage of that.

PAUL LATTA, the director of research at McAdams, adds that his 20-to-25-name list—which won the 2008-2010 contest, covering both a bear and bull market—picked up much of its power in 2009, with a "phenomenal run" from its consumer picks, ironically stocks that had hurt it in 2008.

Over the three years, the list has profited from selections such as **Starbucks** (SBUX), still on it, and **Nordstrom** (JWN) and **Whole Foods** (WFMI), both now removed. The list finished big in 2010 with stocks like **Beckman Coulter** (BEC), a medical and scientific instrument and test maker that was the subject of takeover interest.

Latta expects the stock market to benefit again this year from the lack of returns from alternative assets like bonds.

Elkan Scheidt, chairman of the Morgan Keegan focus list committee, says his portfolio has benefited from a multicapitalization approach, with big names like Apple and **Union Pacific** (UNP) and mid-caps like **Global Payments** (GPN), a provider of electronic transaction-processing services and the list's newest addition.

In its quarter that ended Nov. 30, profits at Global Payments, which relies on consumer spending, dropped 15%. But Scheidt expects its margins to improve, along with the global economy, and says that analysts' earnings estimates for the company eventually could prove to be too low. He's overweight industrials and technology, and underweight utilities, consumer staples and telecoms, but is looking to add energy names.

In six months, we'll tell you how this worked out.

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Part IV Appendix

Economic Statements

Measuring Key Results

- **NOPAT** ➡ core operating earnings after-tax
- **Invested Capital** ➡ all cash invested in the business
- **WACC** ➡ rent management must pay for use of capital

Return on Invested Capital = NOPAT/Invested Capital

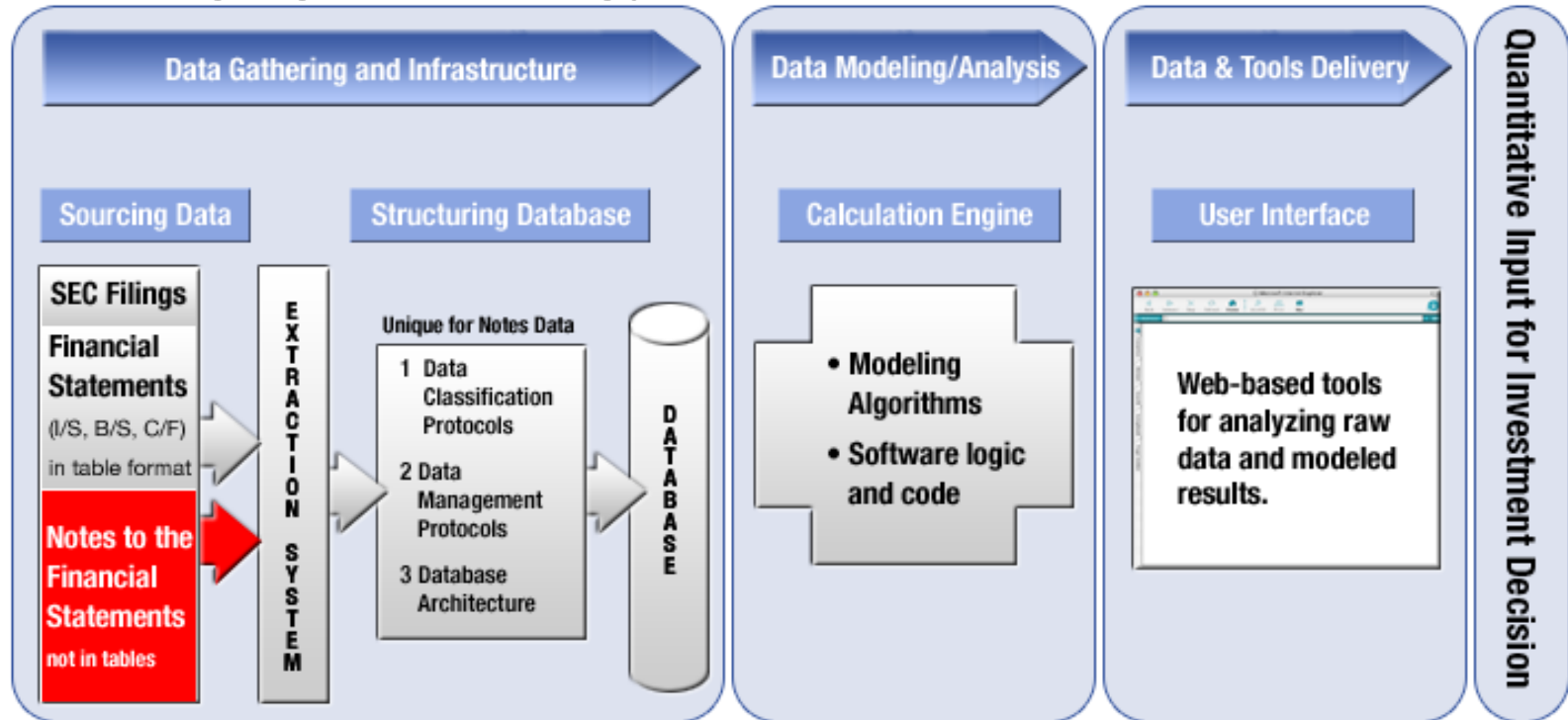
Economic Profit = (ROIC – WACC) * Invested Capital

Free Cash Flow = NOPAT – change in Invested Capital

Economic Profit Margin = ROIC - WACC

Research Platform: Data Parsing to Valuation

Leveraging Technology To Cover 3000+ Stocks



Source: Novo Capital Management, LLC

Gathering and analyzing data from the *Notes to the Financial Statements* is key to better analysis and understanding of:

1. **Profitability and**
2. **Valuation.**

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