

TICKER

Safety in Numbers

A BRENTWOOD RESEARCH FIRM WAGES WAR ON WALL STREET FOR THE BENEFIT OF THE SERIOUS INVESTOR BY DREW RUBLE

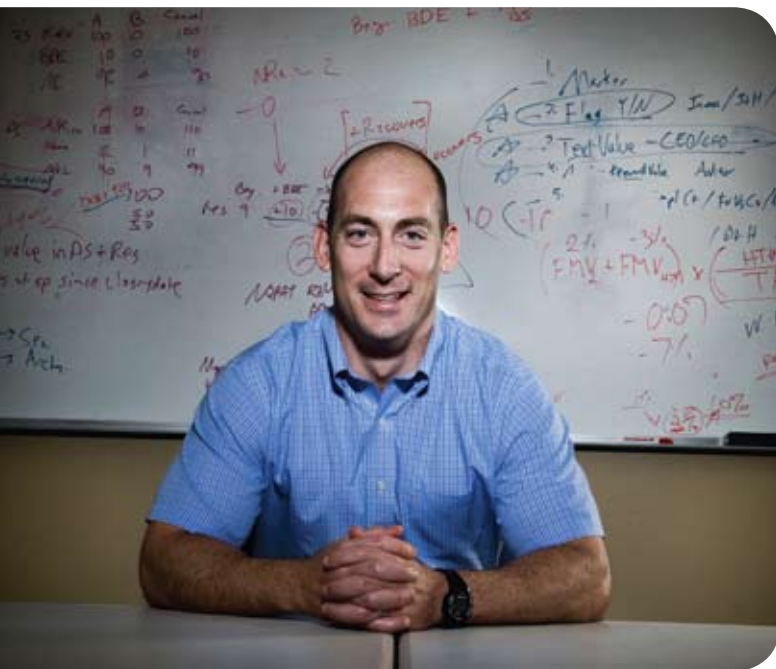


PHOTO BY ERIC ENGLAND

O

ne stock trader E-Trade would have you believe that picking stocks is so easy that even a baby can do it. And for much of the last few decades, with the stock market headed straight up, that might have been true.

Those days are over. Today, it matters what kind of stock picking advice you get.

Enter Brentwood's David Trainer—Wall Street's version of the Little Engine that Could.

New Constructs, the investment research firm Trainer founded in 2003, was recently named the winner in *Barron's* one-year stock-picking contest. This follows the firm's selection by *Institutional Investor* magazine as the No. 1-ranked research firm for stock picking over a prior four-year period (a ranking that included the small independent research firms as well as the Wall Street sell-side firms). No wonder, then, that Erin Burnett, host of CNBC program *Squawk on the Street*, once called Trainer "one of the best stock pickers on the planet."

How does he do it? New Constructs' proprietary research scrubs the reports that companies submit to the Securities and Exchange Commission, plumbing the depths of companies' footnotes to break

down income statements and balance sheets. Eschewing company press releases and Wall Street research reports, most of which tend to focus on accounting earnings, the folks at New Constructs devote their efforts to actually reading the reports that companies submit, parsing all relevant financial data to understand the true profitability of the company. Trainer even holds a patent on his process entitled "System and Method For Reversing Accounting Distortions and Calculating A True Value of a Business."

New Constructs has provided *Nashville Post* with its unique research on 23 Nashville public companies. (This analysis took place in late August.) Company snapshots combine five equally weighted criteria: economic versus reported earnings per share (EPS), return on invested capital ranked by quintile, two-year average free cash flow yield, price-to-economic book value ratio, and the market-implied growth appreciation period (GAP). The results are used to construct a risk/reward investment rating for each company. In this system, companies are ranked "1" through "5" as either "very attractive" (1), "attractive" (2), "neutral" (3), "dangerous" (4) or "very dangerous" (5). Each individual criterion is ranked 1 through 5 against the performance of more than 3,000 companies. These rankings identify disconnects between the market's expectations for future cash flows and current cash flows. A very dangerous company, then, has poor economic profits versus misleading accounting profits that exaggerate earnings, which has the potential to artificially increase stock valuation. A very attractive company, on the other hand, has a cheap valuation with strong economic profits, suggestive of a hidden value the market has failed to recognize.

Let's see a baby do that.

Note: New Constructs has received funding from Solidus, an investor in NashvillePost parent company, SouthComm Inc.

[ACCORDING TO TRAINER]

Here are a few observations based on a New Constructs' scrub of Middle Tennessee stocks.

By David Trainer

[BUY]

ASGR: America Service Group – ASGR gets our top rating of "Very Attractive" because it has high and rising economic cash flows and a low-risk (i.e. cheap) valuation. The current valuation (\$13.81 per share) of the stock assumes that ASGR's profits will permanently decline by 15% and the company will never grow profits again. After removing certain non-operating expenses, we show the companies economic profits rising by \$2.6 million even though the accounting results show a small decline in earnings during the last fiscal year. Rising profits and a valuation that assumes permanent declines in profits combine to offer investors excellent "Risk/Reward."

[SELL]

CHUX: O'Charley's – CHUX gets a "Dangerous Rating" because the company's valuation is too high and the economics of the business are poor. The current valuation (\$5.68 per share) of the stock implies that CHUX's profits will grow 10% compounded annually for the next 15 years. Over the last five years, revenues have fallen by about 1% and operating profits after tax (NOPAT) have fallen by over 20%. Combing through the financial footnotes for "Red Flags" for CHUX also reveals that the company has had to write off over \$114 million of assets in the last eight years. That means that management has lost 30 cents on every dollar of investment on the current balance sheet. Against that background, we think it is fair to say that the future embedded in CHUX's stock price could be setting investors up for a fall.

AVCA: Advocat – AVCA gets a "Dangerous Rating" for the same general reasons as CHUX: high stock valuation and poor economic earnings. However, the main "Red Flag" we find for AVCA is different: combing through the financial footnotes in the company's annual reports reveals that AVCA has \$260 million of off-balance sheet debt. The company also has \$25 million of debt on its books for a total of about \$290 million of debt. That number is quite large compared to the net assets (\$78 million) and market value (\$31 million) of the company. After factoring the true debt burden of the company into the valuation, our model shows the value of the stock is about -\$10 per share assuming no future profit growth. To justify the current stock price (\$5.45), the company has to grow profits 12% each and every year for 10 years. Just like our rating says –investing in this stock could be "Dangerous."

[NEW CONSTRUCTS RISK/REWARD RATINGS]

1 - is Very Attractive (best score) • 5 - is Very Dangerous (worst score)

	COMPANY NAME	OVERALL RISK/REWARD RATING
HS	HealthSpring	1
ASGR	America Service Group	1
AMSG	AmSurg	3
HWAY	Healthways	3
LPNT	LifePoint Hospitals	3
NHC	National HealthCare	3
CXW	Corrections Corp. of America	3
FAC	First Acceptance	3
HSTM	HealthStream	3
CBRL	Cracker Barrel Old Country Store	3
TNCC	Tennessee Commerce Bancorp	4
TSCO	Tractor Supply	4
CLC	CLARCOR	4
CYH	Community Health Systems	4
GCO	Genesco	4
PNFP	Pinnacle Financial Partners	4
GET	Gaylord Entertainment	4
JAX	J. Alexander's	4
LPX	Louisiana-Pacific	4
AVCA	Advocat	4
CHUX	O'Charley's	4
BMTI	BioMimetic Therapeutics	4
DK	Delek US Holdings	4

New Constructs (NC) does not cover the following two local publicly traded companies. HR—a hybrid REIT, a type of company NC does not cover as a general rule due to lack of disclosure regarding the amount of cash and debt allocated toward its finance versus real estate businesses. DG—not enough 10K filing or stock price history for NC to build a model. (DG only recently went public again.) NC needs at least two years of stock prices and financial history to build a model.