



THE INSTITUTE FOR STUDENT BUSINESS EDUCATION  
FINANCIAL SERVICES GROUP

March 2007

**FSG Directors**

**Matt Dabrowski**  
m-dabrowski@northwestern.edu

**Chad Frontz**  
c-frontz@northwestern.edu

**Jonathan Liu**  
jliu@northwestern.edu

**Visit our blog at:**  
[isbefsg.wordpress.com](http://isbefsg.wordpress.com)

**Email FSG:**  
[isbe.fsg@gmail.com](mailto:isbe.fsg@gmail.com)

## INVESTMENT RESEARCH DIVISION SPRING 2007 PORTFOLIO





## BluePhoenix Solutions Ltd. (BPHX)

<b>Rating</b>	<b>Buy</b>
<b>Target Price</b>	<b>9.27</b>
Last Price	9.10
52 Week Range	4.41 – 10.42
Mkt. Cap. (MM)	139.9
Sector	Financial

<b>Key Statistics</b>	
P/E	28.0x
FCF	9.97M
Current Ratio	1.73
Diluted EPS	0.33

### Investment Research Analysts

Amit Swaroop  
[aswaroop@northwestern.edu](mailto:aswaroop@northwestern.edu)

*This report was written by members of the Financial Services Group, part of The Institute for Student Business Education, Northwestern University's premier, student-run business organization. This is a product of the Investment Research division.*

### Investment Thesis

BluePhoenix Solutions is a company on the rise. It has hit new highs four times in the last two weeks, and its successful completion of a modernization project for Toyota and recent acquisition of a strategic off-shore facility in Russia, suggest that its future prospects look good. It has been competing well with much bigger competitors such as IBM, Microsoft, Oracle, Accenture, and Patni Computer Systems. We therefore issue BluePhoenix Solutions a buy rating. Based on a pricing multiple of 28.1x earnings, derived from the industry average, and a diluted EPS of 0.33, we are setting a target price of 9.27.

### Company Profile

BluePhoenix Solutions is involved in the development of novel information technology (IT) modernization solutions. Its operations are broken up into 13 segments: IT Discovery, LogicMiner, DBSMigrator, PlatformMigrator, Rehosing, LanguageMigrator, DataMigrator, SOA-Ready Enablement, FieldEnabler, StandardsEnabler, EuroEnabler, AppBuilder, and Redevelopment. BluePhoenix Solutions is based in Israel, and its business is conducted world wide. In fact, most of its revenue, about 86%, is generated outside of Israel.

### Industry Overview

By nature, the technological industry is quite volatile. New innovations are always arising, causing companies to constantly enter and exit the industry. This makes the industry very susceptible to increased competition from new companies. To combat this, BluePhoenix Solutions continues to find innovative ways of meeting shareholders expectations. For example, BluePhoenix Solutions' recent acquisition of a company in St. Petersburg, Russia is expected to save more than \$3M a year and increase its overall profitability.

### Competitive Analysis

BluePhoenix Solutions' major competitors include IBM, Microsoft, Oracle, Accenture, and Patni Computer Systems, all of which have much larger market caps. Patni is the smallest of the competitors and therefore the best for comparing to BluePhoenix Solutions. BluePhoenix Solutions' quarterly revenue growth since last year is an impressive 18.4%, slightly higher than that of Patni. BluePhoenix Solutions' P/E is 28.00, which is slightly less than the industry average of 28.09, indicating that BluePhoenix Solutions may be undervalued.

### Historical Performance

In the last two weeks, BluePhoenix Solutions has hit new highs four times. Its price has grown by 76% since 2006 and in the first quarter of 2007, its sales have increased 25% since the first quarter of 2006. On May 2, 2007, it announced the successful completion of a modernization project for Toyota Motor Sales. This will help Toyota respond to recent growing demand for Toyota and Lexus vehicles. On May 9, 2007, BluePhoenix Solutions announced the acquisition of a strategic off-shore facility in St. Petersburg, Russia. We expect similar projects to help bolster BluePhoenix Solutions' stock.

### Financial Stability

Since BluePhoenix Solutions' P/E is lower than that of the industry, it may be undervalued. It generates \$9.97M of free cash flow, much less than its \$39.17M of debt, but that seems to be a trend that is common among its competitors as well. It has a current ratio of 1.73, indicating that it does not have trouble paying back short-term liabilities.





## Walt Disney Co.

(Dis)

<b>Rating</b>	<b>Buy</b>
<b>Target Price</b>	<b>37.41</b>
Last Price	34.72
52 Week Range	26.75-36.09
Mkt. Cap. (MM)	71,510
Sector	Media

<b>Key Statistics</b>	
Beta	1.00
Operating Cash Flow	6.00B
EBITDA	\$8.4B
Debt/Equity	0.381

### Investment Research Analysts

David Levine  
[david-levine@northwestern.edu](mailto:david-levine@northwestern.edu)

*This report was written by members of the Financial Services Group, part of The Institute for Student Business Education, Northwestern University's premier, student-run business organization. This is a product of the Investment Research division.*

### Investment Thesis

Transferring Monday Night football from ABC to ESPN cut costs a great deal, which helped generate profit. Barring external threats, theme parks are a stable form of profit, and Disney parks/resorts profit should increase with the opening of Hong-Kong Disneyland. Lastly, the new Disney.com website is not only more user friendly, but also offers television, music, and more interactive games than ever before. EPS estimates range from 1.85 to 2.15, but the expansion of both the parks and website, as well as lower costs, should put earnings on the higher end. Its forward P/E/ is 17.4, which is feasible, as it is a more stable option than TWC, which has a forward P/E of 24. With an EPS of 2.15, trading at 17.4x earnings, we have set a price target of \$37.41.

### Company Profile

Revenues are broken up into four segments (descending order): Media Networks, Parks and Resorts, Studio Entertainment, and Consumer Products. Revenues from Media Networks and Parks and Resorts increased 11% and 10% respectively. This is advantageous because ESPN's ratings continue to rise with increased showings of major sports. Better ratings means more advertising revenues. Increased park attendance will continue with the opening of Hong-Kong Disneyland Resort. A weakness may be that studio entertainment revenues are vulnerable, as home entertainment sales have declined.

### Industry Overview

The parks and resorts industry in general is well established, but as of late is improving, as threats of terrorist attacks are not as severe, and more parks are being opened. Attendance increases of about 3% have lifted revenues around 8%. The entertainment industry is a mature industry that has been inconsistent as of late. Time Warner and CBS have struggled the past few years (declines of 5-10%), while Disney has grown about 12%. The entertainment industry is taking a very different direction as watching movies/television on the internet is common.

### Competitive Analysis

The big players are Disney, Time Warner, CBS and News Corp. Disney controls about 46% of the industry, while Time Warner, CBS, and News Corp. control about 17% each. Disney has much more operating cash flow than its closest competitor TWC (\$6.00B vs. \$3.6B.) This extra cash enables the company to invest more speedily instead of having to wait and invest over time. Its greatest advantage is that it is most diverse. It controls sports networks, news, movie production, theme parks, and licensing. This can also be a disadvantage as the company's size makes overseeing the finances sticky.

### Historical Performance

There were two main drivers in earnings last quarter were studio productions and the dropping of Monday Night Football from ABC to ESPN. The release of Pirates of the Caribbean and re-release of Little Mermaid boosted sales. Last quarter earnings estimates were 0.39, while actual earnings were 0.50. Last year, it beat earnings estimates by 0.28, and although this magnitude is unusual, it is not unusual for this company to exceed expectations.

### Financial Stability

The company should have no problem meeting its short and long-term obligations as it has more \$2.4 billion in cash. It has a beta of one, so it is not a huge risk. Its EBITDA is \$8.4 billion but more importantly, it has a low debt/equity ratio of 0.381 compared to some of its largest competitors, which makes it a more financially stable option.



## Johnson & Johnson

(JNJ)

<b>Rating</b>	<b>Buy</b>
<b>Target Price</b>	<b>70.02</b>
Last Price	60.76
52 Week Range	57.32 - 69.41
Mkt. Cap. (MM)	175,820.0
Sector	Healthcare

<b>Key Statistics</b>	
P/E	16.26x
EPS	3.73
Div & Yield	1.50 (2.50%)
Free Cash Flow	11.582B
Oper. Margin	25.71%

### Investment Research Analyst

James Smallwood  
[j-smallwood@northwestern.edu](mailto:j-smallwood@northwestern.edu)

*This report was written by members of the Financial Services Group, part of The Institute for Student Business Education, Northwestern University's premier, student-run business organization. This is a product of the Investment Research division.*

### Investment Thesis

Johnson & Johnson is a company with a solid history and a bright future. High cash flow, numerous drugs in the pipeline anticipated to hit the market over the next year, and a relatively low valuation make this stock an attractive buy. It is increasing its expenditures in research and development which reflects the significant amount of projects in late stage development. A price target of 70.02 has been assigned based on expected earnings of 3.89 EPS and a slightly higher P/E ratio of 18x, approaching the industry average. At its current price, it presents a unique value/growth combination for investors.

### Company Profile

Johnson & Johnson engages in the manufacturing and selling of various healthcare products worldwide. It is organized into three business segments: Consumer, Pharmaceutical and Medical Devices, and Diagnostics. Over the past year, the Consumer segment has seen the largest growth in sales (a 7.5% increase over last year's sales). Strong sales performance was led by Skin Care and Kids Care franchises. This was attributable to sales growth in products such as Aveeno, Johnson's Adult, the newly acquired Groupe Vendôme adult skin care product lines, and success of powder product lines in international markets.

### Industry Overview

Johnson & Johnson operates in an environment that is increasingly hostile to intellectual property rights, is susceptible to inflation rates, and has growing concerns about the rising cost of healthcare. In response to these concerns, Johnson & Johnson prices products responsibly (net price increases in products below the U.S. Consumer Price Index) and strives to maintain its profit margins through cost reduction programs. Barriers to entry are high in the industry and switching costs are practically nonexistent for the consumer. Innovation and product performance are key drivers of success.

### Competitive Analysis

Lead competitors of Johnson & Johnson include Merck, Proctor & Gamble, Novartis, and Pfizer. The pharmaceutical giant, Merck, seems to pose Johnson & Johnson the most competition. While other competitors have been having their drugs delayed, Merck has had notable trial successes with its pipeline. Despite this success, Merck's quarterly revenue growth has not been up to par. Johnson & Johnson has respectable quarterly revenue growth of 8.5%, above most large cap companies in its sector mainly because it is more diversified and doesn't rely solely on its pharmaceutical segment for revenues. Its P/E is much lower than many of its competitors as well, making it an attractive buy.

### Historical Performance

Johnson & Johnson has consistently beat analysts' expectations of earnings over the past year. This past quarter Johnson & Johnson exceeded estimates by 2.5%. A main driver for future earnings is its pharmaceutical business which contributes over 40% to Johnson & Johnson's total revenues. With many new drugs in the pipeline, it is anticipated that these new drugs will spur earnings growth throughout the rest of 2007 once they hit the market.

### Financial Stability

Johnson & Johnson is a financially stable company that generates a healthy amount of cash flow. Although its Quick Ratio is 0.67 due to the recent acquisition of Pfizer's consumer business, I am confident that with annual operating cash flows of \$10-14 billion, Johnson & Johnson should be able to successfully navigate this situation and restore its usual good financial health.



## MetLife Inc.

(MET)

<b>Rating</b>	<b>Neutral</b>
<b>Target Price</b>	<b>\$66</b>
Last Price	\$63.57
52 Week Range	48.10 - 66.25
Mkt. Cap. (MM)	4,785.0
Sector	Financial

### Key Statistics

Current Ratio	5.62
Debt/Equity	0.4x
Price/Earnings	7.9x

### Investment Research Analysts

Alok Parekh  
[a-parekh@northwestern.edu](mailto:a-parekh@northwestern.edu)

Chanhyuk Ro  
[c-ro@northwestern.edu](mailto:c-ro@northwestern.edu)

Amit Swaroop  
[aswaroop@northwestern.edu](mailto:aswaroop@northwestern.edu)

*This report was written by members of the Financial Services Group, part of The Institute for Student Business Education, Northwestern University's premier, student-run business organization. This is a product of the Investment Research division.*

### Investment Thesis

MetLife is an extremely stable company with strong financials. Only 6% of revenue comes from home insurance thus providing it a cushion against a future housing market slump. Its foreign and local forays will help boost its top line revenues as well. However, increased competition from a recovering AIG, as well as a strong Prudential, could prevent large growth in the future. We expect MetLife's price to move along with the S&P500. Its strong financials ensure a safe investment option but we feel that increased competition combined with concerns over maintaining past growth will hinder MetLife's share price in the future. Therefore, we give MetLife a neutral rating and issue a target price of 66.

### Company Profile

MetLife provides insurance services worldwide and is broken up into five segments: Institutional, Individual, Auto and Home, International, and Reinsurance. Its services include providing life, automobile, home, and non-medical health insurance. The Institutional and Individual segments generate the majority of MetLife's revenue, accounting for 42% and 30% of total revenues respectively. MetLife also provides services to Latin America, Europe, and Asia-Pacific regions. MetLife's reinsurance and foreign markets have been seeing double-digit revenue growth over the past few years as well.

### Industry Overview

MetLife's Auto and Home segment accounts for only 6% of total revenue and therefore we feel that future earnings will not be susceptible to a future housing market decline in the US. However, because MetLife offers only non-medical healthcare, it is vulnerable to increased competition from the volatile healthcare industry. Firms in this industry are known to expand and begin providing non-medical healthcare insurance thereby increasing the competitiveness of the market. To combat this issue, MetLife continues to review and update their products.

### Competitive Analysis

MetLife's (47.83B) biggest competitor is AIG (174.90B), the largest firm in the industry, which is making a huge comeback. During the last 5 years, AIG has been hit with accounting scandals and the exposure of an inefficient management. Under its new CEO the company has registered a 38% jump in net income to \$11.6 billion (2006) and is expecting stronger results in 2007. MetLife's revenue is 48.40B as compared to Prudential at 32.49B. Prudential has been making significant investments in real estate in booming foreign markets such as India and has signed a number of big deals.

### Historical Performance

Actual EPS rose from 1.24 to 1.36 in the 4th quarter of 2006 (exceeding analyst estimates by \$0.18). This increase in EPS could be attributed to its sale of New York apartment complexes to Tishman Speyer and the real estate arm of BlackRock. Its net gain from the sale was roughly \$3 BB. Despite the current quarter's growth being - 3.8%, analysts estimate 11.7% growth next year. Its future growth could be partly attributed to its current joint venture for the \$1.1BB "12th and Midtown Project", which includes 1.2 MM sq. ft. of office space, 500 hotel rooms, 600 residences and 150,000 sq. ft. of retail space.

### Financial Stability

A cause for concern may be inefficient utilization of its asset base shown by a high current ratio of 5.62, much higher than the industry average. Its financials are less leveraged as compared to competitors with a debt-equity ratio of 0.46. Its cash reserves of over \$10B are less than 1/3<sup>rd</sup> of Prudential, but we feel that this may not be cause for concern due to its small debt load.



## Merck & Co. Inc.

(MRK)

<b>Rating</b>	<b>Buy</b>
<b>Target Price</b>	<b>50.20</b>
Last Price	45.37
52 Week Range	46.55 - 32.75
Mkt. Cap. (MM)	98,294
Sector	Healthcare

<b>Key Statistics</b>	
Forward P/E	17.37x
PEG	2.18
P/B	5.6
EBITDA	10.72B
EPS	2.89

### Investment Research Analysts

Megan Adolph  
[madolph@northwestern.edu](mailto:madolph@northwestern.edu)

Maansi Johri  
[m-johri@northwestern.edu](mailto:m-johri@northwestern.edu)

*This report was written by members of the Financial Services Group, part of The Institute for Student Business Education, Northwestern University's premier, student-run business organization. This is a product of the Investment Research division.*

### Investment Thesis

Recently Merck has been expanding its operations in countries located in Latin America, the Middle East, Africa, Eastern Europe and Asia Pacific where changes in government policies and economic conditions are making it possible for the company to earn fair returns. In terms of profitability, Merck has posted results that are some of its industry's best in terms of high returns on assets over the past five years. With its plans for growth, we expect this company to trade at a higher price in the future. We give Merck a target price of 50.20 based on a projected P/E ratio of 17.37x and analyst EPS estimate of 2.89.

### Company Profile

Merck is a global, research-driven pharmaceutical company that discovers, develops, manufactures, and markets a wide range of products to improve human and animal health. A majority of the revenue comes from two main segments: 90% from pharmaceuticals and 7.5% from vaccines. The focus of these two segments is in human health services. The pharmaceutical profits generate about fifteen times that the profits of the vaccine segment. About 61% of revenues are in the United States, 22% in Europe, Middle East, and Africa, and 6.5% in Japan.

### Industry Overview

The drugs industry has been growing at a steady rate with, but slightly below, the S&P 500. The TTM revenue growth % for the stock is 2.8 while the industry is at 5.56. Because the products of this industry are susceptible to FDA approval, time is an important factor that is sometimes out of their control. The company's worldwide business is subject to risks of currency fluctuations, governmental actions and other government proceedings abroad. The company is also dependent on patent rights as there is a lot of competition from generic brands once their patent expires.

### Competitive Analysis

Merck is in an industry with a relatively large number of competitors. Merck is a medium-sized player with the fifth highest market cap with about 99B. Main competitors include Bristol-Meyers Squibb, Pfizer, and Johnson & Johnson with 56.2B, 183.1B, and 178.13B market caps respectively. Merck has a PEG of 2.18, which is the second highest for the industry with an average of 1.86. For P/E, the industry average is 18.34 and Merck is 22.47. For the entire industry, the operating margins are around -3.85% and the P/B is 5.5x. Merck is higher in both operating margins and P/B, with values of 26.2% and 5.6x, respectively. Merck has about 5% global market share which is among the top ten in the industry.

### Historical Performance

Merck has had consistent growth since 2005. Analyst expectations for this stock's earnings have been fairly stable and earnings have met or slightly exceeded expectations. Current EPS estimate for this year is 2.65 and presently Merck is at 2.89. This stock has seen steady revenue growth of .1 over the past three years.

### Financial Stability

EBITDA is 10.72B. Merck has a long-term debt/equity ratio of .389 which is seventh in the industry. Compared to Bristol-Meyers Squibb and Pfizer with quick ratios of 1.12 and 1.76 respectively, Merck has a quick ratio of .95 and can sustain itself and meet current liability obligations.



## Mizuho Financial Group (MFG)

<b>Rating</b>	<b>Neutral</b>
<b>Target Price</b>	\$12.61 (+/-) 0.01
Last Price	\$12.61
52 Week Range	11.99 - 15.35
Mkt. Cap. (MM)	152.05
Sector	Financial

<b>Key Statistics</b>	
Price/Earnings	0.03x
ROE	17%
EPS	\$257.00

### Investment Research Analyst

Alok Parekh

[a-parekh@northwestern.edu](mailto:a-parekh@northwestern.edu)

*This report was written by members of the Financial Services Group, part of The Institute for Student Business Education, Northwestern University's premier, student-run business organization. This is a product of the Investment Research division.*

### Investment Thesis

We will give a neutral rating to Mizuho. While Japan's banking industry has been suffering due to the high amount of non-performing loans, Mizuho maintains high ROE and is also hedged strongly in their foreign investments. Its consolidated net income has risen 16% in the past year and remains Japan's 2<sup>nd</sup> largest bank in assets. While Mizuho's liabilities exceed its cash reserves, its foreign prospects provide a positive outlook on its future. Based on external factors and competitor prices, the target price will be consistent with the current price (up down variance of 1%).

### Company Profile

Mizuho Financial Group is headquartered in Tokyo, Japan, with three primary banking subsidiaries: Mizuho Bank (retail), Mizuho Corporate Bank, and Mizuho Trust and Banking, which focuses mainly on trust services. In 2005, Mizuho launched a strategic plan to realign business operations into a Global Corporate, Global Retail, and Global Asset and Wealth Management Group. It is Japan's second-largest bank in assets and has a strong domestic clientele of 30 million accounts and 17,000 corporate customers. It holds JPY150 trillion in assets, JPY82.4 trillion in deposits, and its total loans are at JPY 65.4 trillion.

### Industry Overview

The Japanese banking industry has been suffering from the high volume of NPL's. Banks have relied heavily on loans and bad debt has led to a significant decrease in stock prices and profitability. However, recent positive signals such as the upgrade of Japanese banks by Moody's Investor Services has influenced investors to buy back banking stocks. This was followed by Mitsubishi UFJ and Sumitomo Mitsui jumping 2.3 and 2.8 respectively on the Topix, even though they have been experiencing major profit declines with the rest of the industry.

### Competitive Analysis

Mizuho's major competitors in the banking industry are Mitsubishi UFJ, Sumitomo Mitsui, and Citigroup. As of December 31, 2006, it holds net income of \$4.83 billion, which is dwarfed by Citigroup's \$20.64 billion. However, Mizuho's quarterly revenue growth of 182.90% is promising as it lies 146.3% over the industry average. Its operating margin of 55.01% is also higher than the industry average as well as Citigroup's 47.98%. Over the past year, Mizuho's stock has fallen 24% while Mitsubishi UFJ declined 28%. When the Topix Banks Index experienced a jump of 1.9% on May 8, 2007, Mizuho led the gains with 2.9% while MUFJ and Sumitomo Mitsui followed the trend.

### Historical Performance

Due to the increase in problem loans and stock portfolio losses, Mizuho slashed its consolidated net profit forecast by 25% for the FY2007. However, relative to its primary competitors, this performance is not necessarily under-par. In the past year, MUFJ's stock prices declined more than Mizuho while Sumitomo Mitsui suffered a 36% decline in full-year profit. On February 15, 2007, MUFJ was prohibited from making new loans after violating internal rules; this has allowed Mizuho to build its market share and gain a competitive edge. Earnings per share (EPS) in the first half of FY 2006 have steadily increased to \$257, and the return on equity (ROE) remains at a high level of 17.1%.

### Financial Stability

Mizuho's P/E ratio of 0.03 compared to the industry average of 14.81 suggests that it may be undervalued. Less deposits, it has liabilities of \$595 billion and \$17 billion in cash. Its recent debt-for-equity swap with Orient will result in a \$2.4 billion loss. However, its global expansion and investment in overseas offices aim to cover these liabilities and losses.





## Nautilus Inc.

(NLS)

<b>Rating</b>	<b>Buy</b>
<b>Target Price</b>	<b>16.95</b>
Last Price	13.98
52 Week Range	11.10-19.05
Mkt. Cap. (MM)	444.15
Sector	Consumer Goods

<b>Key Statistics</b>	
Forward P/E	12.46x
Current Ratio	1.7
Quick Ratio	0.96
EPS	0.82
Div & Yield	0.40(2.80%)

### Investment Research Analysts

James Smallwood  
[j-smallwood@northwestern.edu](mailto:j-smallwood@northwestern.edu)

*This report was written by members of the Financial Services Group, part of The Institute for Student Business Education, Northwestern University's premier, student-run business organization. This is a product of the Investment Research division.*

### Investment Thesis

For a small cap company early in its growth, we feel that Nautilus is an attractive buy, but not without risk. For the past five years Nautilus has seen stable income growth and has positioned itself on the frontier of its industry, making the company known for its innovation and commitment to producing top tier fitness products. Its policy to improve gross margins should allow the company to plow back more money for research and development. Assuming Nautilus meets earnings next year of 1.13, we assign it a price target of 16.95 based on a P/E of 15x, slightly above its forward P/E as we see no reason to value this company much lower than its current P/E (trailing 12 months).

### Company Profile

Nautilus is a leading designer, developer, manufacturer and marketer of fitness and apparel products. It offers strength equipment (weights and benches), cardio equipment (including treadmills, ellipticals, and exercise bicycles, steppers and stepmills), home gyms, dumbbells, and various accessories. The company distributes its products through direct, retail, commercial, Internet, catalog, and international channels to health clubs, government agencies, hotels, corporate fitness centers, colleges, universities, and assisted living facilities. Nautilus operates in the United States, Switzerland, the United Kingdom, Germany, Italy, and China.

### Industry Overview

Nautilus operates in an industry where economic moats do not exist. There are relatively few barriers to entry and product performance and customer liability is of utmost importance to attain stable growth for a company. The industry has been experiencing solid revenue growth of 13% and we expect this to continue with the trends of becoming a more health-conscious American.

### Competitive Analysis

Nautilus recently won the Global Innovation Award at the renowned FIBO 2007 international trade show for health and fitness with the TreadClimber TC916, their biggest innovation. For the second time in three years Nautilus has received the top innovation honor. Management of Nautilus still considers Nautilus to be in its early stages of growth and anticipates the company to remain on the frontier of its industry. The chief competitor of Nautilus is Cybex International Inc. Cybex is the industry leader of ROE, but Nautilus is by far showing the largest earnings growth of 592.6%, well above the competition.

### Historical Performance

Earnings last quarter were down from the previous year due to sluggish trends in the North American market for home fitness equipment. Nautilus is expected to achieve stronger net sales through new innovation and new promotions as the next fitness cycle begins. Gross margin-improving activities that began in the end of the 2005 year period were evident however this quarter. Improvements in efficiency put Nautilus in an excellent position to improve bottom line results once sales start to pick back up.

### Financial Stability

Nautilus can sustain itself financially with a current ratio of 1.70. Although its quick ratio has dipped below 1 at .96 currently, Nautilus has high growth potential and with growing efficiency and outlook for a greater free cash flow, Nautilus should regain its financial stability within the near future.



## Starbucks

(SBUX)

<b>Rating</b>	<b>Buy</b>
<b>Target Price</b>	<b>38.02</b>
Last Price	31.66
52 Week Range	40.01 - 28.72
Mkt. Cap. (MM)	23,775.X
Sector	Consumer Services

<b>Key Statistics</b>	
P/E	42.2x
Forward P/E	35.6x
P/S	2.9x
ROA	13.1%
Total Revenue	8.21B

### Investment Research Analysts

Veda Kilaru  
[v-kilaru@northwestern.edu](mailto:v-kilaru@northwestern.edu)

*This report was written by members of the Financial Services Group, part of The Institute for Student Business Education, Northwestern University's premier, student-run business organization. This is a product of the Investment Research division.*

### Investment Thesis

Starbucks receives a buy rating. Its revenue growth continues to be driven by the opening of new retail stores, and the company has substantial opportunities in the U.S. and internationally. It has plans to strengthen its position, aiming for 2,400 openings in fiscal 2007 and long-term expansion in China. Increased use of drive-thrus and new breakfast/lunch offerings should lead to higher returns on invested capital. However, the price of Starbucks stock reflects high market expectations for its future operating results. Failure to meet this outlook could cause the stock to plummet. Therefore, a target price of 38.02 is recommended.

### Company Profile

Starbucks sells coffee, espresso, tea, cold blended drinks, food items, coffee-related merchandise, whole bean coffee, and a line of compact discs. The United States and International segments both include Company-operated retail stores (85% of revenue) and certain specialty operations (15% of revenue) within the United States including licensed retail stores, foodservice accounts, grocery stores, warehouse clubs, etc. International specialty operations primarily include retail store licensing operations in more than 25 countries and foodservice accounts in Canada and the United Kingdom.

### Industry Overview

Competition in the specialty coffee retail market is currently fragmented but is on the rise, especially from competitors in the restaurant sector who are focusing on growing the specialty coffee beverage part of their businesses. Furthermore, intense competition exists in the major metropolitan areas where there are local/regional competitors with substantial collective market presence. Increases in labor, occupancy, coffee, and dairy costs will adversely affect profits for firms in this industry. Brand name loyalty and the marketing of an entire experience are what drive most firms' profits in the specialty coffee market.

### Competitive Analysis

Starbucks has the leading share of the domestic specialty coffee retail market. Close competitors of Starbucks are Caribou Coffee (#2 in the market); McDonald's and other fast-food chains which have started marketing premium roast coffee, and Dunkin' Donuts and Tim Hortons which are expanding aggressively. Panera is also rapidly growing and is competing for Starbucks' market share by emulating a similar store environment/ambiance to lure Starbucks customers away. Industry averages for P/E, Forward P/E, P/S, and ROA are 27.2, 23.3, 2.2, and 11.0% respectively.

### Historical Performance

The company had annual sales of \$7.8 billion in 2006, and is projecting 20% growth for this fiscal year. In February, the company said its fiscal first-quarter profit rose 18%, attributing the growth to the 700-plus stores it opened in the quarter, and a 6% jump in sales at stores open at least a year. Since 2001, Starbucks has had 24% compound annual revenue growth, mainly driven by expansion of company operated and licensed stores. However, current shares are now 20% lower than a year ago, potentially due to expansion causing the watering-down of the "Starbucks Experience" detailed by Chairman Schultz.

### Financial Stability

Starbucks can easily sustain itself, with a profit margin of 7.25% and an improved operating margin of 11.5%. Total cash is 436.7M, total debt is 367.51M, and its EBITDA is 1.36B. Operating cash flow is 1.2B, and the company has generated free cash flow for the past seven years. Starbucks produced 8.21B in total revenue as of last quarter.



## Trimeris, Inc.

(TRMS)

<b>Rating</b>	<b>Neutral (Short)</b>
<b>Target Price</b>	<b>3.84</b>
Last Price	6.59
52 Week Range	13.85 - 6.46
Mkt. Cap. (MM)	146
Sector	Healthcare

<b>Key Statistics</b>	
P/E	22.7x
Forward P/E	11.8x
Revenue (MM)	36.98
EBITDA	15.59M
P/S	6.1

### Investment Research Analysts

Veda Kilaru  
[v-kilaru@northwestern.edu](mailto:v-kilaru@northwestern.edu)

*This report was written by members of the Financial Services Group, part of The Institute for Student Business Education, Northwestern University's premier, student-run business organization. This is a product of the Investment Research division.*

### Investment Thesis

Trimeris is a neutral (or short) position mainly for its high risk and poor past performance. Trimeris' value is based solely on Fuzeon sales, which is currently the only drug candidate for which FDA approval has been obtained and if it does not maintain/increase its market acceptance, Trimeris will be materially harmed. Profitability based on past performance is likely to be low, and additional financing will be needed to continue research and production of the drug to stay competitive within the industry. An upcoming management shift could potentially harm profitability as well. Based on P/E and Forward P/E and allowing 12% growth in earnings, I estimate a price target of about 3.84.

### Company Profile

Trimeris is a biopharmaceutical company primarily engaged in the discovery, development and commercialization of new antiviral drug treatments for viral infections such as HIV. The company's only drug, Fuzeon, is the first in a new type of drugs called fusion inhibitors, which work to block the entry of HIV into healthy immune cells. Currently, its revenues come solely from the production and distribution of and royalties on Fuzeon as the main focus at Trimeris is research and development. However the company claims that it is working toward making Fuzeon more profitable in the future.

### Industry Overview

A large portion of resources and revenue must be devoted to R&D in order to stay competitive within the biopharmaceuticals industry. Companies have to follow strict government regulations that can take years to meet before any profitability from products is realized. Further, the diseases that are currently curable by firms' products could develop a resistance and adversely affect demand for those drug candidates; the pharmaceuticals may also cause unknown/unexpected side effects in the future. Companies must rely heavily on the selling of their drug for revenue as very little else will contribute to earnings.

### Competitive Analysis

Trimeris has 3 main competitors: Panacos, Gilead, and Merck – all of whom are also developing new classes of drugs that target novel steps in the HIV cycle. Of these, Merck's compound (MRK-0518) is the most advanced and widely believed it will be submitted to the FDA for approval in the next year. Many of the competitors have significantly greater financial, technical and human resources than Trimeris and may be better able to develop, manufacture, market and distribute products. These competitors also operate large, well-funded R&D programs. Further, smaller companies may prove to be significant competitors, through collaborative arrangements with large pharmaceutical and biotechnology companies. Additionally, an inconvenient dosing regimen severely limits Fuzeon's market potential and puts its sales at risk each time a new product comes out. Industry P/E is 37.5 and Forward P/E is 27.4 while P/S is 10.9.

### Historical Performance

Historically, Trimeris has always underperformed and has had net operating losses since being founded in 1993 (with the exception of the 2006 fiscal year). As of December 2006, its accumulated deficit was approximately \$371.1 million. Trimeris had a net income of \$7.4 million in 2006 and net losses of approximately \$8.1 million in 2005 and approximately \$40.1 million in 2004. As always, since the company's focus was on R&D, earnings were driven solely by sales of Fuzeon which were minimal. Last year's fourth quarter estimates met analyst expectations however, when operating income increased more than 100% and Fuzeon royalties/income increased 57%.

### Financial Stability

Trimeris' net income in 2006 was \$7.4 Million, and currently has an operating cash flow of \$12.18 Million. Costs are kept low since Fuzeon production is outsourced to partner company Roche. Its profit and operating margins are 19.97% and 25.4% respectively. Current EBITDA is 15.59 Million. If Fuzeon sales do not remain at current levels, then Trimeris will probably face losses in the future once again.





## Wachovia Corp.

(WB)

<b>Rating</b>	<b>Buy</b>
<b>Target Price</b>	<b>57.51</b>
Last Price	55.84
52 Week Range	51.27 - 60.04
Mkt. Cap. (MM)	106,820.0
Sector	Financial

<b>Key Statistics</b>	
P/E	11.8x
PEG	1.3x
FCF	7.01B
EPS	4.74
Forward P/E	10.4x

### Investment Research Analysts

Alok Parekh

[a-parekh@northwestern.edu](mailto:a-parekh@northwestern.edu)

Chanhyuk Ro

[c-ro@northwestern.edu](mailto:c-ro@northwestern.edu)

Amit Swaroop

[aswaroop@northwestern.edu](mailto:aswaroop@northwestern.edu)

*This report was written by members of the Financial Services Group, part of The Institute for Student Business Education, Northwestern University's premier, student-run business organization. This is a product of the Investment Research division.*

### Investment Thesis

Wachovia is a stable company and seems to be a secure investment. Wachovia continues to exceed client expectations and was even named the top bank in consumer satisfaction in February 2007. We expect its recent acquisition of Westcorp and WFS Financial to result in an increase of revenues. We feel that Wachovia may be undervalued and as a result its stock will rise. Therefore, we issue Wachovia a buy rating. Based on a P/E multiple of 12.1x, and an EPS of 4.74, we are setting a target price of \$57.51.

### Company Profile

Wachovia is registered as a bank holding company. It provides a wide range of commercial and retail bank services throughout the United States. It also has branches all over the world including cities such as London, Shanghai, and Tokyo. Its activities are broken up into: General Bank, Corporate and Investment Bank, Capital Management, and Wealth Management. The majority of revenues, 52%, are generated through General Bank activities. Most of Wachovia's operations are done on the East Coast of the United States.

### Industry Overview

Wachovia is susceptible to fierce competition from both banking and non-banking institutions. Competition can range from small community banking institutions to large multi-national service providers. Due to its heavy dependence on money generated through the housing market, the housing slump may negatively affect revenues. However, in 2006, Wachovia's earnings were within 1% of expectations from the Fall of 2005, while its competitors missed their targets by more.

### Competitive Analysis

Major competitors in the banking industry are Bank of America and Citigroup who hold larger market cap compared to Wachovia. However, Bank of America's earnings for the period, 5.26 billion, damaged by the challenging loan environment and flat yield curve, were not satisfactory to investors. Its losses in loans and leases grew 73.6% to 2.57 billion. On the other hand, Citigroup is beating expectations with revenue of 25.5 billion, which is a 15% rise from a year ago. Citigroup's performance was affected by the elimination of 17,000 jobs in the company.

### Historical Performance

Wachovia's stock peaked in February 2007 when it was named the top bank for customer satisfaction. In April 2007 it was ranked first in risk management and has been climbing publicly within the industry. Its EPS has consistently exceeded analyst estimates since June 2006. In March 2006, the company acquired Westcorp and WFS Financial in a \$3.91 BB transaction which added about 8,500 automobile dealer clients, approximately 920,000 individual customers and 19 retail banking offices in Southern California. With a forward P/E of 10.35, earnings are expected to grow as the merger is put into use.

### Financial Stability

Wachovia has a P/E ratio of 11.79, lower than the industry average of 13.85, suggesting that Wachovia may be undervalued. Its PEG of 1.30, which is also below the industry average of 1.46, indicates this as well. Its \$7B in cash reserves are much less than its total debt of \$189.48B, but similar imbalances between cash reserves and total debt exist among its main competitors too.

