

June 5, 2007

Volume 2, Issue 12

# Monthly Update



An investment publication with a focus on Telecommunications, Technology, Industrial and Small Cap stocks.

By Ted Moreau, CFA

## Welcome!

Welcome to our investor newsletter focusing on Telecommunications, Technology, Industrial and Small-capitalization stocks.

## In this issue, we highlight:

- May 2007 Capital Goods Road show notes. (see below).
- Quantitative screen highlights (left column pages 1-2).

On May 22nd and 23rd, The Cardinal Group, in association with WJB Capital Group of New York, met with the management teams of several capital goods companies in the Milwaukee area. Included in the field trip were (in order of attendance) Brady Corporation (BRC), Manpower International (MAN), Badger Meter (BMI), Actuant (ATU), Ladish (LDSH), Manitowoc Company (MTW), Oshkosh Truck (OSK), and Bucyrus International (BUCY). BRC and ATU highlighted their active M&A strategies, growing EPS through operating leverage and both noting elevated prices due to recent private equity deals, which they are trying to avoid. MAN emphasized their heavy exposure to European markets (and France in particular), while MTW and BUCY remain excited about the potential energy consumption expansion in emerging markets. BMI emphasized recent cost reduction activity and that water conservation efforts in the U.S. could expand their market opportunity. The MRAP (mine resisted ambush protected) opportunity for OSK is enormous for defense business and acquisition of JLG in non-residential construction is ahead of plan. OSK and MTW remain "Buys" in our coverage universe and we are upgrading BRC, BUCY, and ATU to "Buys" as a result of our field trip. MAN and LDSH are not rated.

## Brady (BRC - Upgraded to Buy from Neutral): (\$37.56)

- Brady has had exceptional results and improved shareholder value since new management team was in place at the end of 2003. Brady's goal is to be number one or two in its niche markets, which drives its acquisition program.
- Brady has established a strategy of 10%+ annual sales growth, split fairly evenly between organic and growth via acquisitions. But with only 3.7% organic sales growth through the first three quarter of fiscal 2007, Brady's fiscal 2007 sales growth will largely come via acquisitions.
- Brady has been, and will continue to be, very active on the M&A front averaging about one acquisition per month. Brady has an internal M&A team consisting of about seven individuals that targets opportunities at about 8x EBITDA, but has noted the recent surge in private equity activity has pushed valuations to about 10x EBITDA. Brady noted their pipeline is full, targeting small, private companies that aren't likely to be impacted by bidding wars from private equity groups keeping valuations modest.
- Approximately 2/3 of Brady's business comes from their MRO (Maintenance Repair and Operations) customers, which grows at about nominal GDP.
- Approximately 1/3 of Brady's business comes from their OEM customers which includes mobile handsets, hard disk drives for PC's, and printed circuit boards for consumer electronics (labels). The mobile handset business has experienced softness of late, which may be tied to a buildup of Motorola RAZR inventory in the market. While Brady acknowledges the issue, management believes the inventory overhang has not flowed through to Brady. We estimate sales from Motorola to be at most 5% of total Brady sales. Additional mobile handset customers include Nokia (#1 in the world), Samsung, and Ericsson.
- As the world focuses on lowering the costs of mobile phones (average life of a handset now under 12 months) to make them more affordable, particularly to emerging market

## Quantitative Smallcap Rankings as of 5/30/07

### Top 20 Smallcap Screens (All Industries)

1. Manitowoc (MTW)
2. Reliance Steel (RS)
3. General Cable (BGC)
4. CommScope (CTV)
5. BE Aerospace (BEAV)
6. Ceradyne (CRDN)
7. Chatterm (CHTT)
8. Chemed (CHE)
9. Frontier Oil (FTO)
10. Steel Dyn. (STLD)
11. Plat. Undw. (PTP)
12. Varian Semi (VSEA)
13. J2 Glbl. (JCOM)
14. Gardner Denver (GDI)
15. Comm. Metals (CMC)
16. Superior Energ. (SPN)
17. Cleveland-Clf (CLF)
18. Aeropostale (ARO)
19. Sotheby's (BID)
20. Trimble (TRMB)

### Quantitative Technology Rankings as of 5/30/07

#### Top 20 Technology (All Capitalization)

1. Immersion (IMMR)
2. CommScope (CTV)
3. Flir Systems (FLIR)
4. Garmin (GRMN)
5. Jack Henry (JKHY)
6. Varian Semi. (VSEA)
7. Oracle (ORCL)
8. McAfee (MFE)
9. Trimble (TRMB)
10. Nvidia (NVDA)
11. Emulex (ELX)
12. Premiere Gbl. (PGI)
13. Lam Res. (LRCX)
14. KLA-Tencor (KLAC)
15. Novatel (NVTL)
16. Interdigital (IDCC)
17. Radiant Syst. (RADS)
18. Vishay Intertech (VSH)
19. SPSS Inc. (SPSS)
20. Actuate (ACTU)

regions, we do not believe Brady will be targeted. Brady contributes an estimated \$0.75 of the overall \$125 cost to create a handset, hardly significant enough to aggressively lower the handset's cost.

- Brady also highlighted its cost reduction efforts targeting the Die cut business, which are anticipated to realize approximately \$10 million in annual savings. Initial savings should be recognized in F1Q08.
- Brady expects double digit R&D growth in fiscal 2008.
- Fiscal 2007 sales guidance is \$1.35 - \$1.37b with EPS of \$2.06 - \$2.15. Brady achieved a net income margin of 8.4% in the most recent quarter and targets 12% by 2010.

### Manpower, Inc. (MAN - Not Rated): (\$92.23)

- In the first quarter of 2007, Manpower experienced strong revenue growth in Europe with France up 10%, Italy up 15%, and EMEA up 17%, all on a y/y basis. In fact, approximately 88% of Manpower's revenue is international, while the stock tends to react to US released numbers, at least in the short term, which is generally a buying opportunity. The European strength (34% of revenue from France, 37% from EMEA) is due to loosening labor laws while the US appears to be trending towards more restrictive laws (although the US remains far ahead in the free labor law race). Manpower management wouldn't speculate on the impact of the recent French presidential elections, although the pro-US presidential (relative to Chirac) would seem to suggest a more competitive market. In Asia, India appears poised to grow while the opportunity in China remains out in the future.
- Management believes it can expand its operating profit margin to 4%, up from the mid-3% area in 2006 and 2.3% in the seasonally weak March quarter. Manpower is likely to experience gross margin improvement due to geographic mix, improved margins in the more competitive US region, and SG&A cost improvement throughout the course of 2007.
- Manpower showed a five-year chart of estimated market growth in many of its emerging international markets, which are well above that of the US where its market share is the lowest. Summary of the Manpower growth opportunity:

Market	5-Yr Market Growth	MAN Market Share
Italy	13-16%	16%
Nordic	10-13%	23%
Germany	13-16%	5%
Japan	10-13%	3%
US	7-10%	4%
France	7-10%	23%
UK	7-10%	4%

### Badger Meter (BMI - Neutral): (\$26.34)

- High barriers to entry on meter side with 4 major players and BMI only pure investment play. Lower barriers to entry on the technology side.
- Percent of market converted to Automated Meter Reading is in 20% - 25% area vs. 12% six years ago. Slow moving, but significant opportunity.
- Earnings are driven by unit volume and product mix, with higher margins on residential AMR products and proprietary products. Badger has been selling its own proprietary AMR systems (Orion) since 2002, which recently surpassed sales of primary competitor Itron's products. As an example of technology upgrades, the Orion product line, while intended as a walk-by/drive-by system, has the ability to connect with a variety of other technologies, such as power line carrier, broadband over power line, municipal WI-FI and radio frequency systems to allow for remote reading of the data. Another proprietary product, The Galaxy® fixed network AMR system, was introduced in late 2005 and has had limited sales to date on plenty of hype.

- Copper (used in Bronze, a major meter component) is always a big question mark and accounts for approximately 80% of the raw material of a water meter. Price increases continue to be implemented gradually to offset the continuing increase in copper prices. Some meters can be quite heavy, but components are on a level playing field with other manufacturers. Plastic meters are just as durable, but have not been adopted widely likely due more to psychological reasons. BMI is moving labor progressively from Milwaukee to lower cost regions, mostly Mexico, although Badger has been there for 30 years already. Productivity improvements are expected in 2007 from Mexico.
- Badger's Q4 is generally seasonally weaker with Q2 and Q3 stronger, but results tend to be impacted by lumpy utility adoption and order activity.
- Smaller relative contribution of industrial sales likely not part of the strategy, but domestic opportunity remains significant as meter readers have low penetration and many municipalities have a flat-fee utility rate. Over 40% of the homes in the U.S. do not have water meters and water conservation initiatives could lead to significantly higher penetration.

### **Actuant (ATU - Upgraded to Buy from Neutral): (\$56.65)**

- Actuant targets consistent 4-5% annual organic sales growth combined with approximately \$150 - \$200 million in annual tuck in acquisitions. The organic / acquisition growth model supports approximately 15-20% EPS growth due to operating leverage, cost control, de-leveraging, and free cash flow. ATU targets greater than 20% return on invested capital.
- Actuant seeks growth opportunities through a balanced approach between organic and inorganic investments based on a free cash flow model (\$110m FCF projected this year on a low capex intensive business). Acquisitions tend to be bolt-on vs. company transformations on the belief that these smaller deals provide more favorable ROI. Big fish in a small pond mentality.
- Released guidance figures for 2007 do not assume incremental acquisitions, which are likely during the year.
- On the M&A front, recent pricing environment inflated likely due to private equity.
- Inclusion of organic growth targets in management's bonus compensation.
- Q2 typically seasonally weaker with stronger earnings due to higher margins in the 2H, more of an impact from higher margin industrial business segment. Top line growth of 10% targeted, evenly balanced between organic and acquisition growth.
- Seeks to boost margins through increased Asian sourcing and lean manufacturing. China sourcing was \$50m in 2005, \$90m in 2006 and \$175m expected for 2008 and could go higher. (Management believes sourcing from China could increase significantly over the next 3-5 years).
- Negatively impacted by 2007 Diesel emission standard changes, but expect actuation systems related to diesel emissions to reach \$100m business by 2010 due to increased content per vehicle and selling prices 2X for 2009 what seeing today. The Gits business (diesel engine actuation and turbochargers) could potentially double over the next five years, spurred by the more severe 2010 standards. Gits' technology could become part of several engine manufacturers' new diesel emission solutions. Also beginning to benefit from China truck growth, but from a low base.
- Demand from Hydratight's oil & gas and power generation markets remains robust and continued growth can come from a combination of more service technicians and more equipment rental sales, as well as an increase in traditional equipment sales. Not necessarily related to volatile crude prices, rather more on the fact that many North Sea oil rigs are older and need more maintenance.
- Convertible hardtop business remains interesting with increased presence in North America, a vehicle option that has been available in Europe for some time.

## **Manitowoc (MTW - Buy): (\$77.13)**

- MTW is a pure play on global infrastructure with crane business driven by strong end markets. Management believes North America remains in the middle innings or so and even earlier in the rest of the world including emerging markets. World construction markets for MTW show sustainable growth through 2015. All of MTW's end markets for cranes are strong with the exception of residential construction (19% of sales, mostly in Europe). 12-24 month lag to general construction industry. Company maintains healthy market share position likely due to continued emphasis on R&D with 17 new cranes planned for 2007.
- End markets include: Commercial Construction (22% of 2006 sales), Industrial & Petrochemical (20%), Road & Highway (14%), Power Plants (14%), Utilities (7%), and Manufacturing (4%).
- MTW appeared most optimistic about the energy markets, especially in emerging markets such as China, where substantial construction of energy facilities will require crane equipment. For example China has 30 nuclear plants under construction and another 200 planned. They also have a substantial amount of coal plants planned for construction into the next decade.
- Management appeared apprehensive on where the company stands in capacity and whether it will become a constraint in the coming months. Investors tend to focus on backlog growth, which could potentially be hampered by the loss of contracts from lack of capacity. Management expects 2007 capital expenditures to exceed \$80m vs. \$70m previously expected and \$68m spent in 2006. Capital spending is more focused on manufacturing efficiencies vs. a significant increase in fixed costs. MTW generates \$300 million in annual operating cash flow, easily financing potential expansion activity.
- We have some concern with the fact that management has previously underestimated demand for crane product in anticipation for a peak in the cycle, which appears a ways off and differs from cycles of the past drastically. Undoubtedly they aren't alone, but we do have some concerns whether spending will be sufficient for upcoming demand. As an example, management did say that they have already reached sales run rate goal in China for 2007. In addition, MTW originally estimated crane revenue growth of 20% in 2007, but now estimates 30% growth.
- Current backlog figures are being addressed by management, which may provide more of a constant appearance of backlog growth and may appear tempered to investors going forward. We believe a slower backlog growth or the appearance of slower backlog growth from capacity constraints would impact the stock.
- In response to a variable cost model, the company participates in a fair amount of outsourcing in cranes and has recently bulked up outsourcing in Eastern Europe of late.
- Aftermarket service of installed base in cranes is above 50%, but clearly has room to grow, which would provide a margin boost as aftermarket parts and service are higher margin than OEM. Company is committed to developing aftermarket support.
- Management remains committed to all three businesses and notably has divested businesses in the past, so not emotional. Marine will not be a grower, but Cranes will lead the pack and Foodservice is poised for global growth. All brands maintain solid market positions.
- Foodservice in China has a long way to grow and management believes could migrate to more of a U.S. type market, but MTW has not moved inland in China at this point.
- Marine is 50% government and 50% commercial with commercial backlog stretching out to 2009 and could provide a nice boost as has dragged down corporate margins in the past.

### **Oshkosh Truck (OSK - Buy): (\$62.76)**

- High confidence in management, which has historically been a good manager of its core business along with successful acquisitions. Potential for upside in a number of areas. Expect relatively quick de-leveraging. With the recent JLG acquisition, management is on its 15th acquisition since mid-90s and has used similar leverage ratios before, although nothing close on a pure dollars basis. OSK has also divested businesses.
- Access (JLG) and Defense businesses appear strong (over 60% of total revenue) with potential upside on any incremental MRAP (mine resisted ambush protected) defense contract. Certainly not a slam dunk, but well positioned in capacity to take a piece and program size continues to increase. Stock may begin to reflect expectation with incremental awards imminent (expected in June).
- Irrespective of the MRAP potential OSK is in the process of taking defense production up about 35% on new vehicles shortly for strong 2H. OSK expects multiple suppliers to be announced for MRAP, which compares to one or two suppliers receiving contracts historically. Therefore, OSK has excellent chance to participate in this program, which now approaches \$25 billion on 22,000 MRAP vehicles by 2009.
- JLG showing recent strength above expectations. Mix in U.S. more favorable towards higher margin AWP's (Aerial Work Platform) with Telehandlers softer due to residential construction. Europe robust which appears likely into 2008. Telehandler sales represent 20% – 30% going into the residential markets and that is less than 50% of U.S. sales. Stronger non residential in the U.S. than expected and residential is weaker. Cash flow and deleveraging of JLG is greater than anticipated.
- JLG synergies can help close the gap in margins vs. competition, which can be 5% - 8% higher. Mgt. expects \$75m in net synergies within three years. The first about a quarter of that would be realized in the first year, primarily from G&A cuts and the other three quarters is from procurement.
- Commercial segment mostly affected by recent emission standards changes, which pulled sales from 2007 into 2006 with OSK experiencing a strong 20% - 40% pre buy and the industry down about 50% as a result. 2010 is a more stringent standard than the 2007 change, so pre-buy may be more apparent, benefiting 2H08 and 2009. The standards are believed to add \$7k - \$12k in costs per truck. The Commercial segment will primarily be impacted, while Fire and Emergency is somewhat impacted, but a more stable market. JLG is also affected, but cost differential is generally \$250 to \$500/unit. Defense is usually exempt from changes in engine emission standards for at least 10 years.
- The OSK (JLG) / CAT alliance is making an impact, but notably is a lower margin business at current pricing. OSK announced in November that the first 12 months of the alliance should add \$300m - \$325m to JLG sales. Now on track and believe can exceed over time and possibility leverage to other products. OSK/JLG is label manufacturing the Caterpillar Telehandler, which includes design, manufacture and then distribution through the CAT dealer network worldwide of about 300 large dealers.
- OSK's fire truck business, Pierce, provides a very stable, consistent growth business of about 5% annually.

### **Bucyrus (BUCY - Upgraded to Buy from Neutral): (\$70.35)**

- Strong position in high barrier to entry global mining "super cycle", particularly coal. The world is clearly awash in coal, with large reserves in two of the largest consumers, China and the U.S. 71 countries have coal deposits vs. only 10 with oil, which is one of the main reasons China is building an enormous \$30b coal liquefaction plant.
- Environmental issues with coal remain, but coal is and will remain a significant contributor to world power generation and progress is being made towards more environmentally friendly technologies including advances in carbon sequestration.
- While coal is the major driver for sales, BUCY is now seeing orders for non-traditional uses such as uranium and gold.
- The DBT acquisition provides strategic fit in products and geographies and particularly increases presence for BUCY in China and Russia. Similarly, DBT will realize geographic benefits from BUCY in India and Brazil. Key DBT management staying on

board.

- Capacity expansion underway and we believe an impressive operation with the opportunity to design a more efficient assembly process than used in the older facility.
- BUCY standalone booked at 2/3 of 2008 expanded capacity (24 shovel capacity from 16 in 2007 and 8 before).
- Opportunity for margin expansion going forward with increased sales on generically strong end markets, but more importantly potential for intensified effort to service a huge installed base. DBT has historically captured minimal amounts of aftermarket revenue on its own products. BUCY has done a better job with room to continue and has increased spare parts market share from an estimated 41% in 2002 to an estimated 63% in 2006. Seems like low hanging fruit as customers desire to work with OEMs. DBT has huge potential for improvement and has a reputation of under pricing and giving service business away. Management is aiming to become more selective in service and much more aggressive in pricing as market demand is there. We believe this will be a significant factor to achieve the 3 year EBITDA margin goal of 20%.
- Both BUCY and Joy Global remain huge beneficiaries of Canadian Oil Sands projects, which will provide steady demand going forward. The Oil Sands is the world's second largest oil reserve behind Saudi Arabia, but maintains costly/complex investments by companies such as Shell, Suncor, ExxonMobil, which actually may improve volatility by limiting order surges. BUCY estimates 10% of U.S. consumed oil comes from the tar sands, which might likely increase going forward, but is constrained by infrastructure in the region.
- Enormous dragline potential in the coming years, but very difficult to predict timing and not in guidance, although Street likely anxiously anticipating. Industry likely 1 or 2 per year and BUCY only viable company to receive significant order flow with 88% market share. JOYG other only reasonable choice, but isn't committed to the dragline market. Notably, newer draglines are significantly larger (2x) than older models, which means demand extrapolation from previous major cycle in 1970s is a tough compare, but remains significant. These machines tend to last about 40 years with the bulk of machines an aging fleet.



758 N. Broadway • Suite 1224  
Milwaukee, WI 53202

Phone: (414) 228-4630

Email:

tmoreau@cardinalgroupllc.com  
cmoreau@cardinalgroupllc.com  
tm@cardinalgroupllc.com

Please visit our website:

[www.cardinalgroupllc.com](http://www.cardinalgroupllc.com)

## Biography

### Theodore J. Moreau, CFA-Principal

Ted Moreau was previously Robert W. Baird's Senior Analyst covering Network Technology (1985-2005). Ted has been nationally recognized by the Wall Street Journal and Institutional Investor Magazine. Ted was named to the Wall Street Journal "All-Star Analysts Team" in 1994, 1996, and 1997. He was honored by Institutional Investor Magazine as a "Home Run Hitter" in 1994. Ted was also named to the Institutional Investor's regional "All-American Team" in 1997. He received a BBA and an MBA from the University of Wisconsin-Madison.

### Charles R. Moreau, Associate

Charles Moreau has over three years experience in the securities industry and is a candidate in the CFA program. He started his career at Robert W. Baird & Co. as part of the Equity Capital Markets Group. Charles has a degree in Finance from the W.P. Carey School of Business at Arizona State University.

### Ted J. Moreau, Jr., Associate

Ted Moreau has over six years experience in the telecom industry. He started his career at Artesyn Technologies, later acquired by Emerson, as a telecom equipment market analyst. Ted has a degree in Finance from the University of Wisconsin-Madison.

## Disclosure

*The Cardinal Group LLC is an independent research, investor relations, and institutional portfolio consulting and re-search company providing a suite of services designed to enhance value of under-followed smaller capitalization companies for shareholders and portfolio managers.*

*Cardinal Research LLC is an independent research and institutional investment consulting company specializing in several key industries and focusing primarily on medium, small and micro capitalization companies. Cardinal Research provides a variety of services, including a number of research initiatives. Essentially, Cardinal Research includes any re-search originally emanating from its affiliate The Cardinal Group LLC including research on its corporate investor relations and independent research clients. Additionally, Cardinal Research provides industry research and consulting, primarily for corporate entities in the telecommunications industry.*

*The senior research analyst certifies that the views expressed in this research report and/or financial model accurately reflect such senior analyst's views about the subject securities or issuers and that no part of his compensation was, is, or will be directly or indirectly related to the specific recommendation or views contained in the research report. The Cardinal Group, LLC may be compensated for its research by individual companies mentioned and in some cases recommended in this report. The Cardinal Group LLC may have a position in and/or may act as an investment banker or advisor to such. This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.*

*This material and any information from its use is provided for informational purposes only and should not be regarded as a solicitation of an offer to buy the securities mentioned in it. No representation is made that any returns will be achieved. Past performance is not necessarily indicative of future results. This information is subject to change without notice. The securities mentioned may not be eligible for sale in some states or countries, nor suitable for all types of investors. The Cardinal Group LLC does not warrant the accuracy, completeness, reliability, fitness for a particular purpose or merchantability of this information. The Cardinal Group LLC shall have no liability for the use, misuse, or distribution of this information to unauthorized recipients. This material is strictly for specified recipients only and may not be reproduced, distributed or forwarded in any manner without the permission of The Cardinal Group, LLC.*

©2007 The Cardinal Group LLC. All rights reserved.