

Mossberg's Investor Digest

June 2009

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From the Editor...

June 2009 Issue

Economic recovery...will it be shaped like a V, U, W or L? Most investors I've spoken with recently agree that the economic downturn appears to have reached bottom. However, the consensus calls for us to bounce along the bottom for a while before the economy recovers. Factors affecting consumption, which accounts for 70% of the U.S. economy, clearly support a prolonged downturn.

Home prices have dropped significantly – According to the National Association of Realtors, median sale prices of existing family homes declined 16% in May. The Case-Shiller index was reported this morning and showed an 18% decline in April. As the largest asset of U.S. households, we'll need to see a recovery in home prices before consumers will start spending again.

Unemployment Rates – Unemployment is at 9.6% - the highest level in 26 years.

Thrifty U.S. consumer – U.S. savings jumped to the highest level since 1959.

Availability of Credit – In addition to an already difficult credit market, congress is passing credit a card reform legislation that may make it more difficult for consumers to get credit. Advanta, the 11th-biggest U.S. credit-card issuer, ceased lending on June 10.

A few names profiled in the Digest that may offer some defense for an extended economic downturn are Express Scripts (Nasdaq: ESRX), Western Union (NYSE: WU), Carriage Services (NYSE: CVU), and Texas Pacific Land Trust (NYSE: TPL).

Dave Mossberg

Virtusa (Nasdaq: VRTU) –\$7.26, June 16, 2009, Page 2 – Shares are currently trading just above tangible book value. With \$4.30 per share in cash and no debt, there is a significant margin of safety. The EV/ EBITDA multiple is just 5.2x. The company appears to have made sustainable margin improvements. Combined with the success in adding new clients last year, the company appears to be on track to resume significant revenue and profitability growth. Valuation multiples should expand as growth resumes.

MedQuist (Nasdaq: MEDQ) - \$7.71, June 18, 2009, Page 3 – Shares trade at an EV/ EBITDA multiple of just 4X. Given the company's leadership position in the medical transcription business, potential to improve profitability and returns, shares appear to be a bargain at these levels. Also, with \$1.39 per share in cash and no debt, there is a considerable margin of safety.

GameStop (NYSE: GME) – \$22.17, June 26, 2009, Page 4 – GME's share price is relatively unchanged from where it started the year. In addition to the lackluster top line performance during the first quarter and difficult comparisons in 2Q09, shares are likely feeling pressure from concerns over new entrants into the used video game market and electronic delivery of games. Trading at 4.6x EV/ EBITDA it appears these concerns are already accounted for in the valuation. Based on the CFO's \$1 million purchase between \$22 and \$25 per share, it appears he believes the concerns are overblown.

CPI Corp (NYSE: CPY) - \$16.62, June 30, 2009, Page 5 – The portrait studio business normally requires limited working and fixed capital. Going forward capex requirements should be at the \$5 million mark for several years. Based on first quarter's improved profitability levels and assuming there is not another leg down in the economy, the company should be able to produce \$25 million in free cash flow this year.

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Best Idea Profile

Virtusa Corp. (Nasdaq: VRTU)

DESCRIPTION:

Headquartered in Westborough, MA, Virtusa is a global IT services company. About one third of the business is generated from IT consulting and technology implementation. The remaining two thirds comes from Applications outsourcing. The company services Fortune 1000 customers across three verticals, 1) Financial services (approximately 45% of revenue), 2) Media (25%), 3) Technology (35%). The company has 3,764 employees with offices in the United States Europe and Asia. Most of the company's employees reside in India, or Sri Lanka.

KEY INVESTMENT CONSIDERATIONS:

Growth 2x secular growth trends – To save money, CIOs of large corporations are increasingly looking to move IT work offshore. According to a study by Glomark-Governan, offshore IT outsourcing can reduce overall IT operations costs by 21% to 55%. Due to this savings, offshore IT spending is expected to double between 2008 and 2012, representing 17% annual growth rate for that period (source: IDC). According to NeolT, 75% of the largest 2,000 companies are engaged in offshore outsourcing. Of these firms, the rate of spending on offshore contracts is expected to double from 20% of IT budgets to as much as 40% of budgets in the coming years. Benefiting from these trends, Virtusa has delivered 12 years of sequential growth and 32% CAGR over the past five years. While growth rates have abated recently due to the difficult economic environment, last year the company added 21 new clients to its base of 56 clients, which exceeded its targets.

Strong recurring revenue – With approximately 90% of revenue from existing clients, the company has stable and visible revenue streams.

Low cost delivery model – VRTU delivers its services with less than 20% of resources (people) on site and the remainder offshore. Compared to a industry average of 25%, VRTU can offer a lower cost solution for customers that still drives better margins for Virtusa.

Margin expansion opportunities – At 6% of sales, FY09 operating margin underperformed the prior two years primarily due to under-utilization of staff. Improved utilization and operational efficiency efforts have driven operating margin improvements in the second half of last fiscal year, which management believes are sustainable.

RISKS:

Customer Concentration – British Telecom accounts for 19% of revenue and 36% of gross profit during last fiscal year. A disruption from this customer could materially affect results. However, it would appear that British Telecom views its relationship with Virtusa as strategic. BT owns 4% stake in the company.

VALUATION:

Shares are currently trading just above tangible book value. With \$4.30 per share in cash and no debt, there is a significant margin of safety. The EV/ EBITDA multiple is just 5.2x. The company appears to have made sustainable margin improvements. Combined with the success in adding new clients last year, the company appears to be on track to resume significant revenue and profitability growth. Valuation multiples should expand as growth resumes.

(Nasdaq: VRTU)

Investment Data (as of 6/16/09)

Recent Price	\$7.26
52-Week Range	4.00 - 10.65
Fiscal Year End	March
Dividend	N/A
Yield	N/A
Shares Outstanding	24.8 MM
Average Trading Volume (3 mos) (NYSE Only)	100,000
Market Capitalization	180 MM
Cash	107 MM
Long Term Debt	N/A
Enterprise Value (EV)	73 MM
LT Debt/ Equity	N/A
Tangible BV/ Share	6.15
TTM Revenue	172 MM
P/ Revenue	1.0 x
TTM EPS (non-GAAP)	0.50
P/ EPS	14.6x
TTM EBITDA	14 MM
EV/ TTM EBITDA	5.2x

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Best Idea Profile

MedQuist (Nasdaq:MEDQ)

DESCRIPTION:

Headquartered in Mount Laurel, NJ, MedQuist provides medical transcription services to hospitals, clinics, physician offices and other medical practices throughout the U.S. With over 5,000 medical transcriptionists, the company is one of the largest Medical Transcription Service Organizations (MTSO) in the world. In August, 2008, CBaySystems Holdings acquired 70% of the company from Phillips for \$287 million (\$11 per share). CBaySystems is a holding company (controlled by S.A.C.) with a portfolio of medical transcription businesses including CBaySystems Pvt. Ltd. (the largest MTSO in India), and Mirrus Systems.

KEY INVESTMENT CONSIDERATIONS:

Litigation issues resolved – As a result of an internal review of billing practices in 2004, the SEC and DOJ opened investigations, which also led to shareholder litigation and class action lawsuits. No evidence emerged to support wrongdoing. The SEC and DOJ have closed their investigations and class action suits have been dismissed (in one case with prejudice), and/or settled. Now that the company has resolved all issues related to the billing review, the company's legal bills should be substantially reduced. In addition, the uncertainty of the outcome of the litigation has been removed, which makes the stock investible to a larger base of prospective shareholders and analyst coverage.

(Nasdaq: MEDQ)

Investment Data (as of 6/18/09)

Recent Price	\$5.17
52-Week Range	0.87 - 8.26
Fiscal Year End	December
Dividend	N/A
Yield	N/A
Shares Outstanding	37.5 MM
Average Trading Volume (3 mos)	28,000
Market Capitalization	194 MM
Cash	52 MM
Long Term Debt	N/A
Enterprise Value (EV)	142 MM
LT Debt/ Equity	N/A
BV/ Share	1.84
TTM Revenue	322 MM
P/ Revenue	0.6x
TTM EPS (non-GAAP)	-1.53
P/ EPS	N/A
TTM adjusted EBITDA	34.5 M
EV/ TTM EBITDA	4.1x

High returns with recurring revenue streams – With retention rates as high as 95%, the medical transcription business creates long-term recurring revenue streams. This business can produce net margins of approximately 10% and the company has limited need to finance working capital or fixed asset expenditures. MEDQ's financial performance over the last several years has been substandard. However, now that litigation issues have been resolved, the company appears to be on track to return to historic profitability levels. During the first quarter of 2009, EBITDA and net margin were 15.3% and 8.6%, respectively. At these levels the company is producing ROIC in the high teens. With continued improvement in profitability this business can produce returns in the low to mid 30's.

Outsourcing trends will drive secular growth – Only 40% of the \$12 billion medical transcription market is outsourced to transcription companies. The remaining 60% is done in-house by the hospitals, clinics and physicians offices. Outsourcing this function saves money and can improve productivity, two value propositions that are clearly in demand for healthcare providers.

Larger players will gain share in highly fragmented market – There are several thousand companies that provide medical transcription services, most of which have less than \$1 million in revenue. There are only a handful of other players (TRCR, NUAN, Webmedx) with a revenue base greater than \$20 million. With efficiency of scale and scope and greater ability to consistently delivery high quality, larger players, like MedQuist, are in better position to gain market share.

KEY RISK:

A small group of investors, CBaySystems, along with two large institutional holders, control about 80% of the stock. The concentrated ownership could be a turnoff to prospective holders. In addition, the interests of CBay might not always align with that of all shareholders.

VALUATION:

Shares trade at an EV/ EBITDA multiple of just 4X. Given the company's leadership position in the medical transcription business, potential to improve profitability and returns, shares appear to be a bargain at these levels. Also, with \$1.39 per share in cash and no debt, there is a considerable margin of safety.

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Best Idea Profile

GameStop (NYSE: GME)

DESCRIPTION:

Headquartered in Grapevine, TX, GameStop is the world's largest video game retailer. GME has approximately 6,200 stores located in the U.S. (4,300 stores), Canada (325 stores), Europe (1,200 stores), and Australia/New Zealand (350 stores). In its stores and on its e-commerce sites, GameStop.com and ebgames.com, GME sells and trades new and used video game software, hardware and other related accessories and merchandise. GME also publishes *Game Informer* magazine the largest video game magazine in N. America...five times larger than its closest competitor. *Game Informer* is the 12th largest consumer publication in the U.S. with 3.5 million paid subscriptions.

KEY INVESTMENT CONSIDERATIONS:

Used video games are the key to GameStop's competitive moat – As the largest retailer of used video games, GameStop has a substantial competitive advantage over other video game retailers, one that would be very difficult to duplicate.

- **Large selection of games for older platforms** – GME is the only large retailer that carries a large selection of used games. GME offers approx. 3,000 SKUs of used video game titles for use on current and previous generation gaming platforms. The base of used platforms is large and growing. Based NPD Group reports, only 43% of the 185 million units of handheld and console video game systems in the US are current generation platforms. According to GME's estimates, the installed base of video game software units in the US currently exceeds 1.5 billion units.
- **Proprietary inventory system** – Building a system to manage 3,000 SKU's isn't easy. GME's proprietary system is 13 years in the making.
- **Refurb center** – GME refurbished 14 million discs and 1 million hardware units in 2008 at its in-house refurb center. No other retailer has this in-house capability.
- **Trading in used video games becomes currency for new sales** – Customers can trade in used video games in exchange for credit for new purchases. This is a service that is generally unavailable at most mass merchants, toy stores and electronics retailers.
- **Used business is heavily regulated with significant compliance burdens** – GME has invested in training, systems and personnel to be compliant with regulations of trading used games. In addition to regulations designed to prevent sale of stolen merchandise and limits on purchases from minors, there are many specialized local requirements. Approx. 50% of GME's stores require some type of license to buy and sell used goods, about 25% have fingerprinting requirements.

Used video games are recession resistant and produce higher margin – With an average price of \$18, compared to the average price of \$41 for new video games, it's easy to see the value proposition of used games for consumers with tighter budgets. This was evident in 1Q results...during the first quarter used video game sales increased 32% versus a 3% decline for new games. Used video games also generate significantly higher gross margin, 48% to 50%, versus the company's overall margin of 26% (fiscal 2008). During fiscal 2008, used video games accounted for 23% of revenue and 43% of gross profit. While new game and console sales may be under pressure due to the difficult economic environment, the mix shift that includes higher margin used games should allow the company to meet its annual guidance.

VALUATION:

The current share price is relatively unchanged from where it started the year. In addition to the lackluster top line performance during the first quarter and difficult comparisons in 2Q09, shares are likely feeling pressure from concerns over new entrants into the used video game market and electronic delivery of games. Trading at 4.6x EV/ EBITDA it appears these concerns are already accounted for in the valuation. Based on the CFO's \$1 million purchase between \$22 and \$25 per share, it appears he believes the concerns are overblown.

(NYSE: GME)

Investment Data (as of 6/26/09)

Recent Price	\$22.17
52-Week Range	16.91 - 47.69
Fiscal Year End	January
Dividend	N/A
Yield	N/A
Shares Outstanding	165 MM
Average Trading Volume (3 mos)	5 MM
Market Capitalization	3.7 B
Cash	230 MM
Long Term Debt	495 MM
Enterprise Value (EV)	3.9 B
LT Debt/ Equity	0.20
BV/ Share	14.71
TTM Revenue	9.0 B
P/ Revenue	0.4x
TTM EPS (non-GAAP)	2.42
P/ EPS	9.2x
TTM EBITDA	848 MM
EV/ TTM EBITDA	4.6x

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Best Idea Profile

CPI Corp. (NYSE: CPY)

DESCRIPTION:

Headquartered in St. Louis, Missouri, CPI Corp. has 3,000 locations in the U.S., Canada and Mexico. With 45% market share in the mass retailer category (about 7% of the \$6.8 billion professional portrait industry), CPI Corp. operates the largest number of portrait studios in North America. The company is the sole operator of portrait studios inside Sears...1,000 stores with the Sears Portrait Studio brand. During 2007, the company acquired the PictureMe business out of bankruptcy and became the sole operator of portrait studios inside Wal-Mart stores. (2,000 studios under the PictureMe Portrait Studio brand).

KEY INVESTMENT CONSIDERATIONS:

Cash flow generation and returns should improve significantly despite tough economic conditions –

The portrait studio business normally requires limited working and fixed capital. Because of the cash or credit nature of the sale, the company typically receives cash on a sale before it is required to pay its vendors. In addition, there is limited inventory requirements...gross margin (excluding D&A) was 91% during 2009. In the past two years, the company has spent \$83 million acquiring PictureMe and approximately \$40 million upgrading its studios to digital technology. Going forward capex requirements should be at the \$5 million mark for several years. The company also has a \$17 million NOL, which should give it no cash tax outlays until the end of 2010. Based on first quarter's improved profitability levels and assuming there is not another leg down in the economy, the company should be able to produce \$25 million in free cash flow this year.

RISK:

Obviously the biggest risk is the exposure the company has to Wal-Mart and Sears. In the case of Sears, the company has enjoyed a relationship for 50 years and in December 2008 renewed its license agreement through 2014. In the case of Wal-Mart, the company has lease agreements that are on two-year renewals in the U.S. and have various terms in Canada and Mexico.

The company is currently in a proxy contest with a 23% shareholder, the results of which will be known at the annual meeting scheduled for July 8. It appears that the shareholder is on the losing side of the contest. If they lose, the shareholder may decide to liquidate their position creating excess supply of stock, limiting near-term upside potential, and potentially putting downward pressure on shares.

POTENTIAL CATALYSTS:

The company has several growth initiatives designed to improve top line performance and increase utilization of its existing assets and productivity of its employees. The company is testing a mobile portrait initiative near its headquarters location in which studio personnel shoot photos at a customer's home and/or an event. In addition, the company has indicated it may use excess manufacturing capacity to provide fulfillment services for smaller portrait studios, thus improving the utilization of its five central processing plants.

VALUATION:

Shares trade at an attractive 4.5x EV/ EBITDA. While top line will likely continue to struggle this year, EBITDA levels should increase significantly, which should help drive valuation. In addition, improving cash flows should garner increased investor attention including the possibility of more sell side sponsorship (there is currently one analyst following the company). The company also pays an attractive 3.4% dividend yield, which appears very sustainable due to expected improvements in cash flows.

(NYSE: CPY)

Investment Data (as of 6/29/09)

Recent Price	\$16.62
52-Week Range	1.00 - 22.20
Fiscal Year End	January
Dividend	0.64
Yield	3.8%
Shares Outstanding	7.0 MM
Average Trading Volume (3 mos)	104,000
Market Capitalization	116 MM
Cash	27 MM
Long Term Debt	102 MM
Enterprise Value (EV)	191 MM
LT Debt/ Equity	N/A
BV/ Share	0.48
TTM Revenue	453 MM
P/ Revenue	0.3x
TTM EPS (non-GAAP)	-0.77
P/ EPS	N/A
TTM EBITDA	42 MM
EV/ TTM EBITDA	4.5x

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