



From the Editor...

August 2008 Issue

Interesting Investment Theme:

State and local governments are in desperate financial condition

– This is a theme that has come up in two of the ideas recently published in the Digest. The housing bubble and credit crises have led to increased interest payments on municipal debt and lowered tax revenues for many city and state governments. One of the highest profile cases is in Jefferson County, Alabama. In a mess created by the U.S. credit crises, Alabama's largest county appears headed for the biggest municipal bankruptcy in U.S. history. The county is likely to default on \$4 billion debt, dwarfing previous record of \$1.7 billion set by Orange County, California. In May, the City of Vallejo, CA decided to declare bankruptcy after experiencing a decline in tax revenue linked to a large number of home foreclosures.

No matter who wins the next presidential election, it's likely that federal taxes will increase. Increased federal taxes, lower property tax revenue, and increased interest payments will all force state and local governments to find creative ways to raise tax revenues and/or cut spending.

NIC (Nasdaq: EGOV), published July 28, 2008, has a compelling value proposition for government customers that lowers costs and enhances revenue, while producing impressive returns for the company's shareholders.

Legalized gambling revenues also offer an increasingly acceptable way for governments to raise tax revenue.

Penn National Gaming (Nasdaq: PENN), published August 5, 2008, offers an interesting way to play this trend.

Penn National Gaming (Nasdaq: PENN):

August 5, 2008 Page 2 – After its terminated takeover, PENN is now flush with liquidity and in excellent position to acquire properties at fire-sale prices. The company states that the \$1.3 billion (after tax) in cash proceeds can be re-deployed to purchase \$430 million to \$650 million in incremental EBITDA, nearly 2x what it has produced in the past 12 months.

Helix Energy Solutions (NYSE: HLX):

August 5, 2008 Page 3 – HLX focuses on squeezing more production out of existing fields. Instead of hunting for new oil fields, which typically carries a significant amount of risk, Helix focuses on applying technology to increase the amount of oil that can be recovered from an existing proven field.

Jacada (Nasdaq: JCDA):

August 10, 2008 Page 4 – JCDA's products have demonstrated ability to produce significant return on investment, enabling customers to reduce call times (and headcount) by 15% to 20%. Valuation multiples should expand significantly as the company begins to generate profits and investors realize the story has migrated from deep value play to a growth story.

HearUSA (AMEX: EAR):

August 18, 2008 Page 5 – This leading provider of hearing aids and diagnostic services recently signed a deal with AARP that puts the company in the driver's seat to benefit from increased awareness and use of hearing aids.

Kana Software (OTCBB: KANA.OB):

August 24, 2008 Page 6 – After several years of underperformance, Kana has posted 4 quarters of improving results. As performance continues to improve and stabilize, investors should recognize the value in the stock.



Mossberg's Investor Digest

Idea Profile

Penn National Gaming (Nasdaq: PENN)

DESCRIPTION:

Penn National Gaming owns and operates 19 casinos and other gaming facilities in 15 of the 16 legalized gambling jurisdictions (all but Las Vegas) in the United States.

KEY INVESTMENT CONSIDERATIONS:

After its terminated takeover, PENN is now flush with liquidity and in excellent position to acquire properties at fire sale prices.

Terminated deal – In June '07, just prior to the credit crises last year, PENN agreed to be purchased for \$67 per share. At the beginning of July, PENN reached an agreement to terminate the acquisition and accept \$1.475 billion in cash proceeds for issuing \$1.25 billion in non-interest bearing 7-year redeemable preferred equity and accepting the \$225 million cash termination fee.

The preferred equity is unique and may be causing some confusion – PENN pays no interest or coupon on the instrument. It is redeemable in 2015, only by the company, for stock with a floor price of \$45 and a ceiling of \$67 (18.7M to 27.8M shares). It will be reported as equity on the balance sheet and the diluted share count will increase by 27.8 million shares (as long as the stock trades under \$45). Effectively, the company has issued \$1.25 billion in stock at a price that is 1.7x to 2.5x greater than current levels.

Many attractive properties may be up for sale – At a time when the whole gaming industry is on its rear, many casino operators have expended all of their dry powder with slackening demand and significantly diminished access to capital. PENN, now flush with liquidity is in a position to act like a vulture over the next few years and pick up some attractive properties at fire sale prices. The company states that the \$1.3 billion (after tax) in cash proceeds can be re-deployed to purchase \$430 million to \$650 million in incremental EBITDA, nearly 2x what it has produced in the past 12 months.

Strong Insider Ownership – About 10% of the stock is owned by the CEO, who thinks like an owner and has made investments in the right areas in the past.

Secular growth in gaming industry is likely in the coming years – State and Local governments are in desperate financial condition and revenue from legalized gambling makes an attractive alternative to raising taxes. No matter who wins the next presidential election, it's likely that federal taxes will increase. With increased tax payments at the federal level, combined with the weak economy and difficulties in the credit market, it is likely that state and local government entities will have fiscal difficulties and/or have a difficult time funding new projects. The recent vote of the City of Vallejo, CA to declare bankruptcy and the looming bankruptcy of Jefferson County, AL, which could be the largest in U.S. history, illustrate the point.

KEY RISKS:

Property Concentration – Approximately 40% to 50% of PENN's revenue and net income is derived from two properties. A disruption at one of these properties could have a significant adverse affect on the company's earnings.

VALUATION:

With an enterprise value of \$4.8 billion (calculated conservatively by converting the preferred at the lower end of the conversion rate), the current EV to EBITDA valuation is approximately 7.6x. This is an attractive value, considering PENN's TTM ROE was 13% and it has the potential to double its EBITDA by redeploying its excess liquidity in the next couple of years.

(Nasdaq: PENN)	
Investment Data (as of 8/5/08)	
Recent Price	\$29.74
52-Week Range	21.72 - 62.30
Fiscal Year End	Dec
Dividend	NA
Yield	NA
Shares Outstanding	86.9 MM
Average Trading Volume (3 mos)	1.6 MM
Market Capitalization	2.6 B
Cash	167.9 MM
Long Term Debt	3.0 B
Enterprise Value (EV)	5.5 B
LT Debt/ Equity	2.6
Tangible BV/ Share	N/A
TTM Revenue	2.4 B
P/ Revenue	1.1x
TTM EPS	1.76
P/ EPS	16.9x
TTM EBITDA	631.3 MM
EV/ TTM EBITDA	8.7x

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Mossberg's Investor Digest Idea Profile

Helix Energy Solutions Group, Inc. (NYSE: HLX)

DESCRIPTION:

Helix Energy Solutions Group is an offshore oil and gas company. Contracting services such as deepwater pipe-laying, well operations, robotics and reservoir services comprise approximately 30% of revenue. Another 40% of revenue is generated by its 59% interest in Cal-Dive (NYSE:DVR), a provider of dive-related shallow-water construction services. The final 30% of revenue comes from its oil and gas production business, which focuses on marginal, mature and smaller fields. The company is headquartered in Houston, TX and conducts operations primarily in the Gulf of Mexico, North Sea, Asia Pacific and Middle East regions.

KEY INVESTMENT CONSIDERATIONS:

Unique business model adds stability in a cyclical industry – During peak demand periods, Helix deploys its internal service operations in the open market, and then during off-cycles, the company uses these assets on its own properties. According to the company, this approach reduces the effects of industry cyclicality, hedges risk, and smoothes earnings and cash flows to achieve better returns than typically seen in the service sector alone.

Strong backlog on the service side - As of June 30, 2008, HLX's contracting services operations had backlog of approximately \$1.3 billion. The \$700 million of backlog that is expected to be recognized in the remainder of 2008, represents a 12% sequential increase from the first half, which does not including revenue that will book and ship within the period.

HLX focuses on squeezing more production out of existing fields – The average recovery rate for an oil field is just 30% to 35%. Instead of hunting for new oil fields, which typically carries a significant amount of risk, Helix focuses on applying technology to increase the amount of oil that can be recovered from an existing proven field.

Hedge against Hurricanes - The Company's service operations, which represent 70% of the company's revenue, offer a hedge against hurricanes, as service business activity can pick up significantly to repair hurricane damage.

KEY RISKS:

Operational Risk – Marine construction and offshore oil and gas rig operations involved a high degree of operational risk.

Acquisition Integration - Helix has made several acquisitions over the past few years and states that acquisitions are part of the growth strategy going forward. Integrating operations, employees, and cultures is difficult and could cause significant disruption.

VALUATION:

Because HLX is a complicated story with many parts, there may be some hidden value that is not being realized. At current levels the company trades at just 8.6x 2008 EPS guidance of \$3.46, and has an enterprise valuation of just 5.0x 2008 EBITDA guidance of \$940 million. These are attractive multiples given the company's TTM ROE of 20%.

(NYSE: HLX) Investment Data (as of 8/5/08)	
Recent Price	\$29.15
52-Week Range	28.26 - 47.35
Fiscal Year End	Dec
Dividend	NA
Yield	NA
Shares Outstanding	90.5 MM
Average Trading Volume (3 mos)	2.0 MM
Market Capitalization	2.6 B
Cash	23.2 MM
Long Term Debt	1.9 B
Enterprise Value (EV)	4.4 B
LT Debt/ Equity	0.9
Tangible BV/ Share	\$10.4
TTM Revenue	2.0 B
P/ Revenue	1.3x
TTM EPS	3.87
P/ EPS	7.5x
TTM EBITDA	751.0 MM
EV/ TTM EBITDA	5.9x

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Idea Profile

Jacada (Nasdaq: JCDA)

DESCRIPTION:

With an 18 year operating history, Jacada provides contact center software designed to bridge disconnected systems and simplify and automate customer service processes. Essentially, the company's software allows contact center agents to be more efficient and lowers the average call times. In turn, lower call times reduces headcount requirement and ultimately leads to significant cost savings. The company has 1,200 customers including Vodafone, Qwest, UBS and 20 of the Fortune 100. Headquartered in Israel with global operations, Jacada's principal markets are in North America (40% of 2007 sales) and Europe (56%).

KEY INVESTMENT CONSIDERATIONS:

Divesting legacy business repositions JCDA as a pure-play high growth company, which should lead to higher valuations – In January 2008, Jacada sold a legacy business for \$26 million in cash. While selling the legacy business takes away approximately 30% of revenue and lowers profitability, removing the mature business increases the company's growth rate from a blended 20% to 60%.

Tough economic times means customers focus on IT investments with a high impact high return projects – JCDA's products have demonstrated ability to produce significant return on investment, enabling customers to reduce call times (and headcount) by 15% to 20%.

Solid value proposition leads to new customer growth – With its solid value proposition, 1Q08 backlog was up 50% and new customers have accounted for 70% of revenue in recent quarters. On August 5th the company announced a new material contract with a major telecom service provider, the fourth major contract win since June.

\$2.68 per share in cash, no debt, and positive operating cash flows, should offer limited downside risk – The company has announced an authorization to buy back as much as \$10 million (13% of stock outstanding at current levels) worth of its own shares, which should offer downside support should shares fall from current levels.

Increased activity from channel partners – 2007 investments in establishing sales and service channels have begun to pay off in 2008. During the 1Q08, channel partners, which include Accenture and IBM, represented 20% of revenue. These channel partners extend the company's market reach and validate the value proposition of its products.

KEY RISKS:

Competition – Microsoft and other large players have competing offerings. While competitors don't appear to be enjoying as much success as JCDA in this market, a change in focus by competitors could lead to increased pressure.

Customer concentration – In 2007, two customers represented 41% of total revenue and in 2006 three represented 57% of revenue. A failure to secure new customers and retain existing customers could severely impact financial results. In addition, the large nature of these contracts can cause significant fluctuations in quarterly performance.

VALUATION:

With revenue expectations of \$20 million to \$22 million for 2008, JCDA trades at an enterprise value of just 0.8x to 0.9x revenue, a compelling valuation for a software company with a 60% growth rate. If management is able to execute on its growth plans over the next year, valuation multiples could expand significantly as the company begins to generate profits and investors realize the story has migrated from deep value play to a growth story.

(Nadaq: JCDA) Investment Data (as of 8/9/08)	
Recent Price	\$3.68
52-Week Range	2.76 - 4.34
Fiscal Year End	Dec
Dividend	NA
Yield	NA
Shares Outstanding	20.6 MM
Average Trading Volume (3 mos)	40,000
Market Capitalization	75.9 MM
Cash & Investments	55.4 MM
Long Term Debt	NA
Enterprise Value (EV)	17.9 MM
LT Debt/ Equity	N/A
Tangible BV/ Share	\$2.95
TTM Revenue	16.2 MM
EV/ Revenue	1.1x
*TTM EPS	(0.45)
P/ EPS	NA
*TTM EBITDA	(11.1 MM)
EV/ TTM EBITDA	NA
* Adjusted for \$20.6 million extraordinary gain	

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Idea Profile

HearUSA (AMEX: EAR)

DESCRIPTION:

Headquartered in West Palm Beach, Florida, HearUSA provides hearing aids and diagnostic services through 195 company-owned hearing care centers and online via www.hearingshop.com. In addition, the company is recognized as the market leader of managed hearing care. EAR sponsors a network of approximately 1,900 credentialed audiology providers that participate in selected hearing benefit programs contracted by the company with more than 400+ payors, including agreements with 8 of the top 10 of U.S. health insurers.

KEY INVESTMENT CONSIDERATIONS:

Opportunity to be the clear leader in a highly fragmented industry – The top 5 players only compromise 44% of the overall market. The remaining 56% is made up of 9,000 independent practitioners. EAR has an active acquisition program to aggregate these practitioners; gaining operating efficiencies and economies of scale in the process. Since the beginning of the program in 2005, the company has acquired 79 centers, representing \$38.3 million in annual revenue.

Favorable demographic trends – As the Baby Boomer population ages (now 44 to 62 years old), the size of the hearing aid market should increase. In fact, 94% of hearing aids are sold to people over 50 years of age. However, it appears the Boomers haven't been in a hurry to get the assistance they need. According to the Better Hearing Institute, 1 in 10 Americans (31 million) has significant hearing loss and could benefit from using a hearing aid. Of that population, only about 20% to 25% utilizes hearing aids. While it may be a challenge for the industry to change the perception of hearing aids as less of an optional luxury item to more of a medical necessity, it also represents a significant growth opportunity for the industry. One way to help encourage the use of hearing aids is a proposed \$500 tax credit, which is currently being contemplated by Congress.

Strategic financing from Siemens – The company enjoys an attractive form of vendor financing from Siemens. Siemens provides HearUSA with a \$50 million line of credit for use in making acquisitions and working capital financing. Provided that HearUSA's hearing aids sold are more than 90% Siemens, principal and interest payments are forgiven. Since 2002, more than \$25 million of principal and interest has been forgiven.

KEY RISKS:

Acquisitive growth - Integrating operations, employees, and cultures is difficult and could cause significant disruption.

Limited trading volume – Limited float and low daily trading make the stock susceptible to price fluctuations.

CATALYST:

New relationship with AARP could be "Watershed opportunity" – Last week, EAR signed an agreement to provide discounts on hearing aids and related services to members of AARP, one of the most influential advocates for the senior population. Of the U.S. population 50 years and older, 42%, or 39 million people, belong to AARP. To put the agreement into some perspective, 6 million AARP members admitted to having hearing loss. EAR sold just 60,000 hearing aids last year.

The agreement will call for EAR to pay a \$7.4 million annual license fee and direct a portion of its existing marketing efforts to promote the relationship. Also, in a unique arrangement, the company will work with other manufacturers and other competing distributors as part of the agreement. While management works out the economic details, they have suspended earnings guidance. An update is expected when EAR releases third quarter results.

VALUATION:

The company trades at approximately 9.0x the lone analysts 2009 EPS estimate of \$0.17. Even assuming conversion of a portion of Siemens debt to equity, as is provided in their agreement, the strategic financing provides significant boost to EAR's return on equity. As the company turns profitable and begins producing even low single digit net margins, ROE should expand significantly. In turn, valuation multiples should reflect the higher returns and high growth expectations.

(AMEX: EAR)	
Investment Data (as of 8/17/08)	
Recent Price	\$1.54
52-Week Range	1.04 - 1.82
Fiscal Year End	Dec
Dividend	NA
Yield	NA
Shares Outstanding	38.0 MM
Average Trading Volume (3 mos)	83,500
Market Capitalization	58.5 MM
Cash	3.5 MM
Long Term Debt	51.1 MM
Enterprise Value (EV)	106.1 MM
LT Debt/ Equity	1.5
Tangible BV/ Share	N/A
TTM Revenue	107.9 MM
EV/ Revenue	1.0x
TTM EPS	-0.09
P/ EPS	NA
TTM EBITDA	9.5 MM
EV/ TTM EBITDA	11.2x

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KANA Software Inc. (OTCBB: KANA.OB)

DESCRIPTION:

Kana provides multi-channel customer relationship management (CRM) software and services to large customers, which include Dell, Verizon, Target, and 600 others. Essentially, the company's software helps customers deliver customer service via chat, email, call centers and web self-service. The company is headquartered in the San Francisco Bay area, and does business in North America (75% of total), Europe and Asia (25% of total).

KEY INVESTMENT CONSIDERATIONS:

Recurring maintenance base provides support for the downside – More than 35% of Kana's revenue comes from maintenance services. This revenue will continue to recur each year, assuming the installed base of customers continue to use Kana's software.

IBM relationship allows Kana to compete for large deals – Kana has 600 customers worldwide including half of the Global 100. It's 7-year-old relationship with IBM, gives customers confidence in dealing with the relatively small company and gives Kana the ability to compete for large deals. According to the company, 40% of Kana's new license transactions are over \$1 million and a similar amount of deals in the pipeline are led by IBM.

In tough economic times customers focus on IT investments with a high impact, high return projects – Kana's products allow customers to get the right answers to customer service personnel, quickly and easily. This lowers costs by increasing first-call resolution rates and can also increase customer satisfaction and provide competitive differentiation. In the current economic environment, customers focus more on applications, such as CRM that can provide cost savings and rapid paybacks. License revenue growth of 36% in the 1H08 and a positive outlook for the remainder of the year provide evidence that Kana's products continue to be valuable despite tough economic times.

KEY RISKS:

Reliance on IBM – With approximately 40% of the large deals in the pipeline dependent on one channel partner, a change by IBM would have significant adverse affect on the company.

Competition – Oracle and other large players have competing offerings.

VALUATION:

The company appears to be turning the corner operationally. They have delivered 32% top line growth in the first half of 2008 and three quarters of year-over-year improvement in profitability. The stock trades at just 13x the 2009 consensus EPS estimate of \$0.13. Earnings multiples should expand as the company continues to deliver more stable financial performance.

Buy the maintenance revenue, get the license revenue for free – While Kana does not break out the exact mix of maintenance revenue, it does say that the largest component of service revenue comes from its maintenance services. If we apply a 3x to 4x multiple on a conservative estimate of annual maintenance revenue of \$24 million (35% x TTM revenue of \$69 million), the valuation would be \$72 million to \$96 million. Given the current enterprise value of \$70 million, essentially the market is placing no value on the company's licensing business. This seems like a bargain, considering licensing revenue grew 36% during the first half of the year.

(OTCBB: KANA.OB)

Investment Data (as of 8/25/08)

Recent Price	\$1.65
52-Week Range	1.07 - 3.64
Fiscal Year End	Dec
Dividend	NA
Yield	NA
Shares Outstanding	41.2 MM
Average Trading Volume (3 mos)	334,000
Market Capitalization	68.0 MM
Cash	3.9 MM
Long Term Debt	2.3 MM
Enterprise Value (EV)	66.4 MM
LT Debt/ Equity	0.77
Tangible BV/ Share	N/A
TTM Revenue	69.3 MM
EV/ Revenue	1.0x
TTM EPS	-0.02
P/ EPS	NA
TTM EBITDA	1.7 MM
EV/ TTM EBITDA	39.1x

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