



Mossberg's Investor Digest

January 2009

Issue #7

From the Editor...

One theme that comes out in this month's issue is the weak economy's affect on crime related companies. Cornell (NYSE: CRN) and Brink's Home Security (NYSE: CFL) could both stand to benefit if crime rates increase, or if there is a perception this will happen. Actually, for anyone who has read Steven Levitt's Freakonomics, it's debatable if crime rates are actually affected by a weak economy.

In his book Levitt argues that a strong or weak economy does not really affect crime. The number of police on the street does affect crime rates, however, and with the decreasing size of the tax base, it will be harder for local government to add to their police forces.

Levitt's book also points out that capital punishment is not really a deterrent on crime. However incarceration is correlated. Seems pretty simple...the more people in prison, the less crime there is.

Thank you for your interest in Mossberg's Investor Digest. I welcome your feedback.

Dave Mossberg

January 2009 Issue

i2 Technologies (Nasdaq: ITWO) - \$6.49

January 9, 2009 Page 2 – Normally, I would not suggest looking at a stock based on valuation alone. After all, cheap stocks can always get cheaper. However, it appears that the market is giving no value to i2's shares. The value of the NOL, intellectual property portfolio and installed base of supply chain management software should clearly be worth more than the \$14 million enterprise value.

Cornell Companies (NYSE: CRN) - \$14.67

January 23, 2009 Page 3 – Headquartered in Houston, TX, Cornell Companies is the nation's third-largest private prison company, which stands to benefit from an imbalance in demand and supply of prison beds. The enterprise value to EBITDA multiple of just 7x is quite an attractive valuation for one of the few companies that appears poised for growth in 2009 and beyond.

Brink's Home Security (Nasdaq: CFL) - \$22.46

January 28, 2009 Page 4 – Brink's Home Security is the second largest provider (next to Tyco's ADT) of monitored security services. Approximately 90% of the company's revenue is from recurring monthly subscribers, which on average, remain customers for over 10 years. With this average customer life, the rate of return on the initial \$1,100 customer acquisition cost is over 20%.

SmartPros (Nasdaq: SPRO) - \$2.65

January 29, 2009 Page 5 – SmartPros provides continuing education and corporate training to professionals in the fields of accounting/finance, engineering, securities, legal, and insurance, all of which have mandatory continuing education requirements.

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Mossberg's Investor Digest Idea Profile

i2 Technologies (Nasdaq: ITWO)

DESCRIPTION:

Dallas-based i2 Technologies is a leading provider of Supply Chain Management (SCM) software. ITWO has approximately 500 customers that span multiple industries. In December, ITWO agreed to terminate a merger agreement with JDA Software, and received a \$20 million breakup fee in consideration. The merger had valued i2 at a price of \$14.86 per share.

KEY INVESTMENT CONSIDERATION:

Large portfolio of Intellectual Property – Over the years, ITWO has spent over \$1 billion in building a large patent portfolio. The company has over 140 U.S. patents and more than 155 pending. In June, ITWO successfully settled a patent infringement law suit with SAP and received \$83.3 million in cash.

VALUATION:

There is more than one way to calculate enterprise value depending on how you look at the value of ITWO's convertible preferred stock.

1) The first way is to assume that someone else will come along and buy ITWO, triggering the conversion and the conversion premium of the preferred stock. Here are the calculation and assumptions.

\$141 million: Market capitalization 21.8 million common shares X \$6.49 stock price

+ **\$86 million:** Face value of long term debt on the balance sheet as of September 30, 2008

+ **\$120 million:** Conversion of preferred stock – Today, the preferred shares are convertible into 4.7 million common shares at a price of \$23.15 per share. This calculation also includes a 10% penalty premium that would need to be paid assuming a change of control.

- **\$228 million:** Cash on the balance sheet as of September 30, 2008

- **\$20 million:** Cash breakup fee paid by JDA Software subsequent to the end of the quarter
= **\$99 million in Enterprise Value**

2) If we assume that the company will continue to operate as a stand alone business past 2014, when the preferred shares automatically convert into common shares, the enterprise value is just \$14 million. Here is the second calculation, assuming the business continues as a standalone entity.

\$141 million: Market capitalization 21.8 million common shares X \$6.49 stock price

+ **\$86 million:** Face value of long term debt on the balance sheet as of September 30, 2008

+ **\$35 million:** Conversion of preferred stock – In 2014, the preferred shares are convertible into 5.4 million shares. (increases from 4.7 million due to in-kind dividend). Here is the value at the current stock price of \$6.49.

- **\$228 million:** Cash on the balance sheet as of September 30, 2008.

- **\$20 million:** Cash breakup fee paid by JDA Software subsequent to the end of the quarter

= **\$14 million in Enterprise Value**

While the outlook for spending on ITWO's products /services is not attractive for 2009, the valuation is. Depending on what discount rate you use, the present value of the ITWO's \$1.8 billion net operating loss (NOL) alone, is somewhere between \$75 million to \$100 million to an acquiring company. For a company with a strong base of recurring revenue, and solid cash flow generation to be trading at 3x EV/EBITDA or less, seems like a real bargain. The valuation probably reflects a number of factors including; 1) extreme pessimism about ITWO's prospects; 2) some non-fundamental reason, such as selling by the arbitrage players, forced selling, or anticipation of forced selling by existing holders, and/or 3) difficulty in understanding the capital structure.

(Nasdaq: ITWO)

Investment Data (as of 1/9/09)

Recent Price	\$6.49
52-Week Range	5.50 - 14.60
Fiscal Year End	December
Dividend	N/A
Yield	N/A
Shares Outstanding	21.8 MM
Average Trading Volume (3 mos)	320,000
Market Capitalization	142 MM
Cash	221 MM
Long Term Debt	85 MM
Enterprise Value (EV)	99 MM
LT Debt/ Equity	0.81
Tangible BV/ Share	4.05
TTM Revenue	255 MM
P/ Revenue	0.6x
TTM EPS (non-GAAP)	0.76
P/ EPS	8.5x
TTM EBITDA	32.3 MM
EV/ TTM EBITDA	3.1x

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Best Idea Profile

Cornell Companies (NYSE: CRN)

DESCRIPTION:

Headquartered in Houston, TX, Cornell Companies is the nation's third-largest private prison company, following #1 Corrections Corp (NYSE: CXW) and #2 GEO Group (NYSE: GEO). The company has 20,200 beds in 71 facilities in 15 states. The company operates three divisions; Adult Secure (50% of revenue) provides incarceration and related services, Abraxis Youth and Family Services (30% of revenue) provides juvenile detention and related services, and Adult Community-based (20% of revenue) provides halfway house and other services that help offenders transition back into their home communities. CRN has a 25-year operating history in the prison business and a 35-year history in the other divisions.

KEY INVESTMENT CONSIDERATION:

Imbalance in demand and supply of prison beds

Demand – The demand for prison beds is not dependent on macroeconomic cycle. In fact, the Pew Charitable Trusts expects inmate populations in 10 states to increase by more than 25% from 2006 to 2011. Here are three factors driving demand for prison beds.

1. Crackdown on illegal immigration – There are 11.8 million unauthorized immigrants in the U.S., up from 8.5 million in 2000. Within this population about ½ million are criminal aliens and another ½ million are non-criminals, who have been ordered for deportation, but are still living here. By comparison, there are only 100,000 beds allocated to house illegal aliens.

2. Lengthening of mandatory sentences for certain crimes

3. Overcrowded prisons – The federal prison system operates at 135% of capacity and on average the state systems operate at 105% to 110%. To reduce occupancy to 100% of capacity would require 167,000 new beds.

Supply – Difficulties in credit markets combined with a tax base affected by weak economy and declining property values are likely to affect state, local and federal governments' ability to fund new projects. According to Bank of America equity research, there are approximately 30,000 new beds coming online over the next two years. This won't even come close to meeting the incremental demand of 67,000 new beds and is far less than the 167,000 needed to bring supply and demand into balance.

Private prison industry has a lot of room to grow - Private providers only represent 7.4% of the total \$65 billion corrections market. Because private operators, like Cornell, can consolidate prisoners from multiple areas and house them in facilities that are located where land, building and labor costs are low, outsourcing prisons can reduce cost by as much as 15%. (according to the Reason Foundation). In addition to volume increases, pricing has also been favorable. Pre-2006 prices per bed were approximately \$40...now they're over \$60.

The bottom line should grow much faster than the top – The company breaks even at around 65% of capacity. Due to capacity additions, occupancy at the end of the third quarter was at 90%, significantly below the prior year levels of 99.4%. As occupancy increases in the coming quarters, profitability should grow much faster than the top line.

VALUATION:

Shares are currently trading near their 52 week low and at just 18% above their tangible book value. The enterprise value to EBITDA multiple of just 7x is quite an attractive valuation for one of the few companies that appears poised for growth in 2009 and beyond.

(NYSE: CRN)

Investment Data (as of 1/23/09)

Recent Price	\$14.67
52-Week Range	13.46 - 28.45
Fiscal Year End	December
Dividend	N/A
Yield	N/A
Shares Outstanding	14.8 MM
Average Trading Volume (3 mos)	120,000
Market Capitalization	217 MM
Cash	1.8 MM
Long Term Debt	318 MM
Enterprise Value (EV)	533 MM
LT Debt/ Equity	1.5
Tangible BV/ Share	12.34
TTM Revenue	337 MM
P/ Revenue	0.6x
TTM EPS (non-GAAP)	1.38
P/ EPS	10.6x
TTM EBITDA	74 MM
EV/ TTM EBITDA	7.2x

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Idea Profile

Brink's Home Security (NYSE: CFL)

DESCRIPTION:

Founded in 1983, Brink's Home Security is the second largest provider (next to Tyco's ADT) of monitored security services. CFL has approximately 1.3 million residential (95% of revenue) and commercial (5% of revenue) customers in the U.S. and Canada. The company was spun off of The Brinks Company (NYSE: BCO) on October 31, 2008.

KEY INVESTMENT CONSIDERATIONS:

Security monitoring market is highly fragmented...The big will get bigger. The top five players comprise just under 40% of the market. As in any fragmented market, larger players typically take share from smaller ones due to competitive advantage created by economies of scale and scope. CFL has already proven its ability to take share, growing its top line at a pace that is 50% greater than the overall market (12% CAGR past 5 years).

Entry into the commercial market provides significant opportunity – According to Barnes & Associates, the security monitoring market is a \$14 billion annual market (\$8 billion commercial and \$6 billion residential). With only 5% of revenue derived from commercial customers, CFL has plenty of room to grow in the commercial market. The company has indicated an appetite for acquisitions and the depressed economy may be creating a buyers market in which CFL could more easily pick up attractive commercial monitoring companies at bargain prices.

Customer retention is among the highest in the industry and key to driving returns – The average net cost to acquire a new customer is approximately \$1,100, which includes the costs of the equipment, installation, commissions and the pro-rata portion of marketing and other costs, less installation fees collected. With average monthly cash flow (revenue minus operating expenses) of about \$22 per subscriber, it takes about 48 months to have a nominal payback per subscriber. Therefore, it is imperative that the company retain its customer base. CFL's customer attrition rates have averaged between 6.5% to 7.5% over the past several years. By comparison, ADT, the largest securing monitoring company, reported attrition of 13% for the fiscal year ended in September. Apparently there are some difference in the way this number is calculated. Nevertheless, CFL's attrition has been consistently 200 to 300 basis points lower than the industry on an apples-to-apples comparison.

Good business with long term recurring revenue streams and returns in excess of 20% - Approximately 90% of the company's revenue is from recurring monthly subscribers, which on average, remain customers for over 10 years. With this average customer life, the rate of return on the initial \$1,100 customer acquisition cost is over 20%.

RISK:

Over a period of 3 years, beginning in mid-2009, the company will make a brand transition, eliminating the Brinks name. While changing the brand is unlikely to affect the current customer base, establishing a new brand may increase the costs of acquiring new customers and have a negative effect on returns. To help offset these costs, rebranding the company will also eliminate the 1.25% royalty payment that is currently being paid to Brink's (NYSE: BCO).

VALUATION:

CFL was spun off from its parent in strong financial condition. Adding to the \$4 million in cash and no debt at the end of the September quarter, the company received \$50 million in cash at the time of its separation from its former parent. The current valuation of 4.4x EV/EBITDA appears attractive for a market leader, with strong recurring revenue, and solid returns.

(NYSE: CFL)

Investment Data (as of 1/28/09)

Recent Price	\$22.46
52-Week Range	13.15 - 25.00
Fiscal Year End	December
Dividend	N/A
Yield	N/A
Shares Outstanding	45.8 MM
Average Trading Volume (3 mos)	450,000
Market Capitalization	1.0 B
Cash	\$50 MM - estimate
Long Term Debt	0
Enterprise Value (EV)	0.95 B
LT Debt/ Equity	N/A
BV/ Share	9.78
TTM Revenue	523 MM
P/ Revenue	1.9x
TTM EPS (non-GAAP)	1.19
P/ EPS	18.9x
TTM EBITDA	214 MM
EV/ TTM EBITDA	4.4x

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Best Idea Profile

SmartPros (Nasdaq: SPRO)

DESCRIPTION:

Founded in 1981, SmartPros provides continuing education and corporate training to professionals in the fields of accounting/finance, engineering, securities, legal, and insurance, all of which have mandatory continuing education requirements. The company also provides governance, ethics, and compliance training for corporate customers. Courseware is offered in off-the-shelf and custom-designed programs and delivered in a variety of media types including online, video, CD-Rom, and live Webcasting. The company publishes a monthly newsletter and web portal <http://accouting.smartpros.com> for accounting and finance professionals. The site serves a user base of 350,000 profiled members. Approximately 35% to 40% of sales are derived online.

KEY INVESTMENT CONSIDERATION:

Strong cash flow generation – Most of the company's revenue is derived from subscriptions, which are billed on an annual basis and payable in advance. This generates a significant deferred revenue balance...\$5.2 million at the end of the third quarter. In addition to giving the company added visibility, payment terms allow the company to grow without the need to finance significant working capital (there is little A/R and no inventory).

Strong Balance Sheet – The company has \$6.2 million in cash and no long term debt. Recently the company authorized a \$750,000 share repurchase program.

Growth Through Acquisition – Since there is little need to finance working capital and Capex is minimal (\$100k per quarter on average), excess cash can be reinvested by acquiring new businesses. This is the most efficient way to reach the critical mass that can provide efficiencies of scale and scope. Since March of 2007, the company has made four acquisitions, totaling \$5.5 million in aggregate value. The company has indicated an appetite for acquisitions and the depressed economy may be creating a buyers market in which SPRO could more easily pick up attractive companies at bargain prices.

Strong Insider Ownership – About 35% of the stock is owned by the insiders. They have reasonable compensation and the CEO and two directors bought stock in the open market last year.

RISK:

Weakness in the economy may curtail spending on continuing education. The company reported during the third quarter that its clients had recently been taking longer to renew subscriptions. While spending in all areas is likely to decline during tough economic times, workers are likely to pursue education programs in order to add new skills that can increase their attractiveness to potential employers or improve their compensation. Also, it's important to keep in mind that continuing education is mandatory in most of the professions that are served by SmartPros courseware.

VALUATION:

Over the past two years, the company has delivered operating margin in the 6% to 7% range. While operating margin fell to 3% during the trailing 12 months, it's important to note that this was due to incremental costs associated with acquisitions and investments in new product development. Product development costs are expensed and not capitalized, which is a much more conservative accounting approach. Assuming that these costs were more one time in nature, margins should return to recent levels soon (they were 12% during 3Q08) and drive improved profitability and returns. Even so, SPRO's enterprise value is just 5x that of the depressed TTM EBITDA.

(Nasdaq: SPRO)	
Investment Data (as of 1/29/09)	
Recent Price	\$2.65
52-Week Range	2.20 - 5.80
Fiscal Year End	December
Dividend	N/A
Yield	N/A
Shares Outstanding	4.9 MM
Average Trading Volume (3 mos)	60,000
Market Capitalization	13.3 MM
Cash	6.2 MM
Long Term Debt	0
Enterprise Value (EV)	7.1 MM
LT Debt/ Equity	N/A
BV/ Share	2.35
TTM Revenue	16.9 MM
P/ Revenue	0.8x
TTM EPS (non-GAAP)	0.23
P/ EPS	11.7x
TTM EBITDA	1.4 MM
EV/ TTM EBITDA	5.1x

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The value proposition of the digest is essentially an "Idea Generator". During the course of my 13-year career in capital markets, I've had the chance to meet and work closely with some very smart professional investors who have consistent track records of outperforming the market indexes. Some of these investors, which include mutual fund managers, hedge fund managers, and other professional investors, are kind enough to share their best ideas with me. I conduct my own analysis of their ideas and publish summaries of those ideas I think represent timely investment opportunities. Over time, I trust the majority of these ideas will pan out and help subscribers generate index-beating returns.

The goal of the Best Idea Profiles in this newsletter is to describe all of relevant investment merits and risks of a company in one page. It is not intended to be an exhaustive report including every detail of a company. With limited space available, I am forced to include only those data points that I feel are most important for subscribers to know before they begin their own due diligence. Thank you for your interest in Mossberg's Investor Digest.

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