



# the investigative investor

REAL-TIME REPORTING FROM BLUE HERON RESEARCH PARTNERS

## The Slow-Go Stimulus Bill

COMPANIES HOPING FOR MONEY ARE GOING TO HAVE TO WAIT AWHILE

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### ABOUT BLUE HERON RESEARCH PARTNERS

Blue Heron Research Partners is an independent firm that provides fundamental analysis to institutional investors on an exclusive, real-time basis. Our focus is on issues that drive performance, ranging from the strategic and execution skills of a management team to trends taking shape at the sales and operational levels. Our methodology combines investigative journalism and classic value investing tools.

The \$787 billion stimulus bill was passed and signed with great fanfare in February. For many companies involved in infrastructure work, the bill represented manna from Washington—at least in theory. It would be a shot in the arm, pumping in much-needed revenues from new projects that would make up for the devastating decline in the economy.

But as anyone who has dealt with government agencies knows, the time required for authorization, approval, and disbursement of funds can stretch for seeming eons. Companies are lining up for the so-called “shovel ready” lists that all governors and mayors have kept in their back pocket. **But shovels can't go into the ground until the cash is in hand.** That's still a long way off.

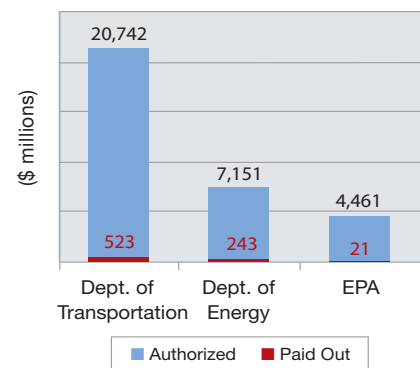
We have followed companies in the infrastructure sector and regularly talk to sources who can verify whether money is getting out into the field. To check on the progress of funding, we talked in late June to municipal officials, distributors, and contractors.

**THEIR REPORT:** no money is flowing yet. And at best, they said it would not start to show up until late this year.

Most of those interviewed had submitted projects to their appropriate state or federal agency. **Eleven of the 12 said they had not gotten any approvals yet for improvements.** The sole “yes” came from a water treatment plant superintendent in Ohio, who won authorization for an \$800,000 repainting of two water towers. Even so, that project won't be bid out until August, with work slated to start in October.

### Just a Trickle

These three agencies have the most to spend on capital projects. Actual funds paid out to date, compared to funds authorized, is minuscule.



Source: Agency Reports, 7/3/09

In general, conditions remain grim in hard-hit states. A sampling of comments:

- ▶ “Here in California business is getting worse every month. There has been no municipal spending coming out of the stimulus bill. And now the state is cutting their funding, so everything is only going to get worse.” —sales manager for a water products distributor in San Bernardino, CA
- ▶ “As yet none of the contractors in our area have received any money/work from the stimulus bill. There has been quite a lull in activity and nothing is moving.” —manager for an aggregates supplier in Salem, MA
- ▶ “Somewhere down the road, maybe in six months, we are hoping to see projects that are being funded by the stimulus bill. We

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## STIMULUS FUNDS *(continued from page 1)*

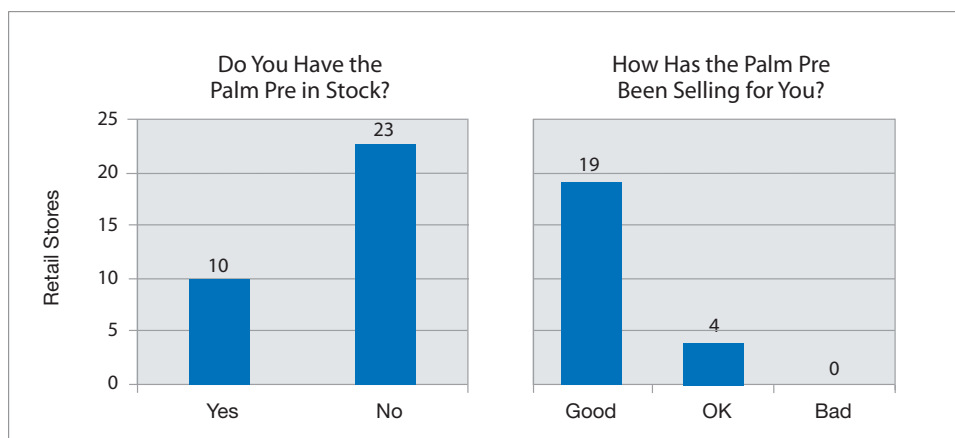
aren't seeing any yet. Business has been really weak for the past six months." —*project manager for paving company in western Maryland*

- ▶ "None of the water projects we submitted were accepted. If some money was to show up at this point we would be pleasantly surprised, but we are not expecting any." —*superintendent of water, Colorado Springs utility*

**OUR TAKEAWAY:** *any company counting on stimulus funding to carry it through a weak second half of 2009 is likely to be disappointed.* At Blue Heron, we have an extensive database of sources related to infrastructure spending. We would be happy to develop an in-depth report for clients who want to know how a company might fare in this not-yet-stimulating environment. ■

## IN THE NEWS: THE PALM PRE

# Has Palm Overplayed Its Hand?



## STORE LOCATIONS

We called Sprint, Best Buy, and RadioShack stores in these cities:

Boston  
 New York  
 Philadelphia  
 Cleveland  
 Atlanta  
 Dallas  
 Kansas City  
 Salt Lake City  
 Seattle  
 San Francisco  
 Los Angeles

**THE BUZZ:** Palm's new Pre is flying off the shelves.

**THE REALITY CHECK:** The much-heralded Palm Pre was launched in early June. An early leader in PDAs and smartphones, Palm has lagged badly behind Apple, RIMM, and others for years. Now, with a new CEO at the helm (imported from Apple), and a next-generation phone on the market, **believers say Palm is back in the race.** The company noted that initial Pre sales were "exceeding expectations," and most analysts chimed in with favorable reviews and predictions of strong sales in the next quarter. In turn, Palm stock has soared from less than \$2 to \$16.

Amid the huzzahs, a few caveats should be noted. **The Pre rollout was a "soft" launch, with many retailers not getting phones.** We called the largest retail outlets—Sprint, Best Buy, and RadioShack—in late June to check on sales. Two-thirds did not have the Pre in stock, mostly because they had yet to get their phones. Sprint store managers reported they were getting regular shipments, but others would have to wait until late July or August.

Once the channel is fully stocked, will the enthusiasm hold up? In Palm's favor, the store managers who had the Pre said it was selling well. But that's typical for a hot new product with a waiting list of fans. **The real test will be when the ordinary user has to be tempted to pay up.** We'll check back in later this summer to see what store managers are saying then. Meanwhile, be careful: Palm never explicitly said what its sales targets were for the Pre. It's rather easy to beat undisclosed expectations. ■

## RESEARCH BRIEFS

## Grinding Out Profits and Fixing Up Businesses

CAPSULE EXCERPTS FROM OUR FIELDWORK ON A TRIO OF COMPANIES

## TECHNOLOGY

## Don't Hang Up Yet

There's nothing like a fugitive former CEO and massive accounting issues to make investors wary of a company. Throw in the punk economy, and most investors would throw in the towel. Such is life for **Comverse Technology** (CMVT.PK), which says it will file its long-delayed financials by February 2010. The company could be worth a look before then. It's deeply entrenched with major phone carriers, and it has growth opportunities in areas like China, India, Africa, and Latin America. A number of industry executives say that Comverse offers a solid product lineup for mobile operators, especially as they roll out 4G systems. "Telecom is a conservative business. Sales cycles are long," says one manager. "Mobile operators are going to be going back to basics. They'll be looking for voicemail and SMS services. This is something Comverse has, and they've had it for a long time."

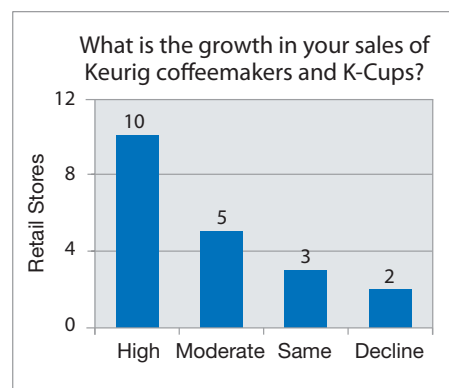
## RETAIL

## Perking Up

We were asked by a client a year ago to look at **Green Mountain Coffee Roasters** (GMCR). With the economy starting to slow down, the client was concerned that the company—which sells individual coffee servings through its Keurig line, the so-called K-Cups—could be vulnerable. Our research team inter-

viewed 33 sources, including retailers, former employees, distributors, and customers. Their findings: the GMCR razor/blade model was likely to hold up, even in a tough environment. Its Keurig line enjoyed great name recognition and a well-entrenched lead ahead of rivals like Flavia (Mars) and Tassimo (Starbucks). The company was lauded for innovation and was getting favorable in-store placements and promotion. And its value as an employee perk seemed to be a low-cost benefit that managers would not easily drop. Keurig offers employees fresh, quickly brewed single servings, with a wide variety of choices—an upgrade over the stale single pot in the office pantry.

"It is very hard to go back once you have their hardware in place," said the vp of a major food distributor. "Employees will revolt." Despite heavy short interest, GMCR stock held its ground throughout 2008, then took off in 2009, as its topline revenues surged by more than 50% each quarter. The stock is no doubt expensive, but our



research revealed considerable support for the company's rapid growth.

## MANAGEMENT

## Brand Repairman

With the exception of school kids sticking old gum under desks, we never thought there was a connection between chewing gum and furniture. Yet that seems to be just the case at **Furniture Brands International** (FBN), where the former head of operations at Wrigley is attempting to resurrect the struggling home furnishings manufacturer. Despite knowing almost nothing about the furniture business when he joined the company last year, sources tell us that CEO Ralph Scozzafava is "a master at building a high-performance team and executing on a strategy." We hear that he has introduced serious market research to FBN for the first time to better understand how to position its brands (Thomasville, Drexel Heritage, Lane) and has "invested a lot of money and time and resources in pre-testing and soliciting consumer input before they ever bring a product to market."

The jury is still out on the restructuring, and there has been a fair amount of internal grumbling. Though Scozzafava was known at Wrigley as "Mr. Deliver the Numbers" for his short-term focus, he has displayed patience at FBN. Investors, however, have been less patient during the housing bust, sending shares down from \$15 to about \$3. ■

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## VIEWPOINT

## The Settlement is Over. Now What?

WHY INDEPENDENT RESEARCH IS MORE VALUABLE THAN EVER



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No matter the side of the Street they worked, most analysts were better at calculations than comprehension, and they seemed preoccupied with not offending managements they followed.

Welcome to the re-designed Investigative Investor. Beginning with this issue, we'll offer regular insight on topics that matter to investors, ranging from sector snapshots and trends to bottom-up reporting, all based on our proprietary research.

This month marks another milestone as well—one that, in many ways, paved the way for the launch of Blue Heron in 2005. It was six years ago that New York's then-attorney general, Eliot Spitzer, and the SEC reached a \$1.4 billion settlement with the leading investment banks. The 2003 agreement, you will recall, involved claims that the banks had issued deliberately misleading research to investors. Though successful investors have long viewed sell-side research skeptically, the settlement reminded everyone of the inherent conflicts at firms that use research to support banking, trading, and other activities.

There's been a fair amount of complaining recently about the effects the settlement had on financial markets. A common criticism is that it has led to reduced coverage. Where the big brokerages once pumped out massive volumes of charts and earnings forecasts for even the most obscure companies, today more than 1,400 U.S. public companies are no longer covered by the sell side. By some estimates, 50% of companies are covered by two or fewer analysts. The underlying concern is that dropped coverage leads to a reduction in liquidity that, in turn, increases price volatility.

My take is that what's happening is healthy and will eventually benefit investors who truly do their research. What gives me the expertise to have an opinion on this issue? Before running Blue Heron, I was a senior writer with *Fortune*. In 2002 and 2003, my job was to write about the research scandals, from Grubman to Blodget. At the same time, my job entailed developing an annual report on the best sell-side research. The perch enabled me to peer into the research processes of both buy-side and sell-side firms.

I wasn't that impressed. No matter the side of the Street they worked, most analysts were better at calculations than comprehension, and they seemed preoccupied with not offending managements they followed. I recall the time one analyst discussed his favorite stock pick during an interview, but then called back late in the day pleading for me to mention a second company. Why? He was afraid that omitting the mention would upset the CEO, even as he conceded that firm was nowhere near the caliber of the first one.

It's no wonder that scores of analysts piled into AOL/Time Warner, WorldCom, Enron, and dozens of other favorite stocks, following the herd instinct (and at times their firm's relationships), rather than doing independent analysis.

In the wake of the settlement, a new generation of research firms has emerged. We are one of those firms. In our case, we seek to take a fresh approach to fundamental research—one that combines hard-nosed investigative journalism, intense interviewing, a rich Rolodex of sources, industry expertise, and essential value investing techniques. At the core of our work is a philosophy that our job is to help investors solve problems by becoming an extension of their eyes and ears. We get to sources they can't reach for lack of time, experience, or in-house resources. We listen for nuance and insights that ordinary third-party data would miss. And we deliver our actionable information in close to real time.

One other note on the research settlement: the sell-side firms had to buy and supply independent research to their clients for five years. They spent \$460 million on such research—an obligation that expires at the end of July. (Blue Heron was not a recipient of any such funding.) Although we expect an overall decline in independent research as a result, we believe it remains a superior model. In the coming months, we'll continue to give you a snapshot of what we can do. Until then, good luck and invest with intelligence. ■