

# SHADOW STOCK ROOKIES:

## NEWCOMERS TO THE 2001 LISTING

By Kenneth J. Michal

Sales growth rate is often used to confirm the strength of growth in earnings per share. The median sales growth rate of 14.9% for the Shadow Stock Rookies is noticeably above the 13.3% median for the complete Shadow Stock group.

A total of 47 new companies filtered their way through the *AAII Journal's* annual screen for Shadow Stocks. Every year at this time we screen for companies that meet the Shadow Stock requirements and can be added to the list. The complete list of Shadow Stocks and a description of the criteria for inclusion can be found in the article starting on page 15.

The initial screen for Shadow Stocks is only a starting point for further screening and analysis. The listings on the following pages present a brief financial profile of stocks new to the Shadow Stock group.

### EXAMINING THE FIGURES

The price-earnings ratio, also referred to as the earnings multiple, provides a quick feel for the market's valuation of a firm. It is computed by dividing the stock price by the firm's earnings per share for the most recent 12-month period. Stocks trading with high price-earnings ratios are generally trading with high expectations of future earnings growth. An earnings drop perceived as temporary by the market may also lead to extreme values. Lantronix's price-earnings ratio of 637.5 is a good example of high expectations. Lantronix's earnings per share estimate for the next fiscal year is \$0.25. This high price-earnings ratio also reflects the stock's low earnings per share of one cent.

Stocks with low price-earnings ratios generally have lower expectations of earnings growth or are perceived to possess higher risk. Value investors often seek good-quality firms trading with low price-earnings ratios with the belief that the market may be overreacting to company or industry events and is incorrectly valuing the stock's future.

When examining a firm's price-earnings ratio, some insight can be gained by comparing it against benchmarks, such as the price-earnings ratio for the market, for the company's industry, and even the company's own historical levels. The price-earnings ratio can be found in financial papers such as the *Wall Street Journal* and *Barron's*. Industry ratios are a little bit harder to come by but can be found in publications like *Value Line Investment Survey* or in software programs such as *AAII's Stock Investor*.

Earnings per share growth is one of the main benchmarks used for measuring company performance. The range of annual earnings growth rates over the last five-year period for this group of 47 firms swings from -31.9% for poultry producer WLR Foods to 156.0% for Qualstar, a manufacturer of magnetic tape libraries for storing data. Extremely high growth rates may not be meaningful; for example, high rates may occur because earnings in the base year used in the calculation were at an extremely low level or near zero. Qualstar is a perfect example here since the company's earnings per share figure in the base year of the calculation was \$0.01. Beyond an overall growth rate, individual investors should look at year-to-year trends as well—for long-

*(continued on page 24)*

*A complete explanation of the Shadow Stock series, along with a list of all Shadow Stocks, appears on page 15 of this issue; new members receive explanations in the new member packet.*

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## SHADOW STOCKS 2001: THE ROOKIES

Company (Exchange: Ticker)	P/E Ratio Current (X)	Earnings per Share		P/E to EPS Growth (X)	Sales		52-Week Price		52-Week Relative Strength Rank		Description
		Last 12 Mos. (\$)	5-Yr. Ann'l Growth (%)		Last 12 Mos. (\$ Mil.)	5-Yr. Ann'l Growth (%)	High (\$)	Low (\$)	Firm (%)	Industry (%)	
ARCADIS (M: ARCAF)	8.7	0.88	na	na	503.9	na	8.06	6.13	72	76	Consulting, engin'g & contracting serv
Boyd Gaming Corporation (N: BYD)	2.8	1.24	-0.6	na	1155.5	8.4	6.13	3.25	38	71	Casinos in Las Vegas
Camtek LTD. (M: CAMT)	16.4	0.46	na	na	45.0	na	11.50	4.50	na	70	Systems to inspect circuit boards
Catalyst Semiconductor (M: CATS)	3.1	1.61	18.9	0.2	86.8	0.3	13.63	3.31	74	39	Semiconductor memory prods
Crystal Systems Solutions (M: CRYS)	21.3	0.35	142.0	0.2	48.8	107.3	19.63	5.44	30	2	Software tools for mainframe sys
Dave & Buster's, Inc. (N: DAB)	13.6	0.81	5.9	0.7	305.4	38.0	12.25	6.00	83	54	Restaurant/entertainment complexes
Donna Karan International (N: DK)	15.3	0.61	-13.8	na	673.6	9.5	9.38	4.25	84	36	Brand name clothing & accessories
Dynacq International Inc. (M: DYII)	12.4	0.86	46.3	0.3	26.0	30.4	15.00	6.00	73	38	Healthcare delivery system
ECTel Ltd. (M: ECTX)	26.6	0.46	59.5	0.5	54.9	29.2	41.25	9.63	40	5	Telecommun serv monitoring prods
Exploration Company of DE (M: TXCO)	13.4	0.22	16.9	0.8	13.8	67.0	3.88	1.78	88	98	Oil & natural gas properties
E-Z-EM, Inc. (A: EZMA)	9.7	0.61	28.7	0.6	112.3	4.8	10.63	5.56	48	62	Medical diagnostic products
Fletcher Challenge Forest (N: FFS)	3.0	0.43	na	na	276.4	na	4.31	0.88	24	39	Forest mgmt & processing plants
FTI Consulting, Inc. (A: FCN)	10.9	0.91	13.1	0.5	121.5	33.0	11.63	4.75	95	22	Litigation support consulting services
Grupo Radio Centro, S.A. (N: RC)	7.6	1.04	10.1	0.8	92.5	14.3	14.88	5.13	62	16	Radio stations in Mexico City
Herbalife International (M: HERBA)	5.0	1.64	5.8	1.1	982.5	15.4	16.38	6.88	35	3	Weight-control & personal care prods
Hungry Minds, Inc. (M: HMIN)	7.8	0.82	7.5	1.0	243.3	27.4	16.75	3.00	36	71	Consumer & how-to book publisher
Image Entertainment, Inc. (M: DISK)	9.0	0.37	-28.5	na	97.0	-0.4	7.00	2.75	38	8	Distrib DVD & optical disc programming
Innodata Corporation (M: INOD)	50.0	0.25	41.9	1.3	39.3	14.0	11.25	2.56	98	0	On-line data conversion & mgmt servs
Instrumentarium Corp. (M: INMY)	5.1	2.16	4.6	na	784.0	18.4	18.50	8.75	42	62	Medical technology
Interphase Corporation (M: INPH)	18.8	0.61	0.0	3.8	58.4	9.2	49.00	6.13	29	10	Computer network & storage prods
Knape/Vogt Manufacturing (M: KNAP)	7.2	1.83	7.1	0.8	151.1	-2.3	16.36	11.88	68	45	Shelving, drawers, closets, & cabinets
Lantronix, Inc. (M: LTRX)	637.5	0.01	5.9	na	46.0	5.8	12.38	3.88	na	10	On-line reprogram'g of electronic devices
Media Arts Group, Inc. (N: MDA)	3.7	1.20	21.0	0.2	142.0	32.7	9.25	3.13	80	22	Art home decor, collect & gift prods
NationsRent, Inc. (N: NRI)	5.4	0.37	70.1	na	668.2	103.0	6.19	1.06	21	53	Equipment rental co.
North Coast Energy, Inc. (M: NCEB)	11.0	0.45	23.2	0.5	31.0	1.5	5.00	2.03	92	98	Natural gas & oil in Appalachians
PEC Solutions, Inc. (M: PECS)	28.0	0.36	na	na	64.5	na	12.00	4.38	na	0	Internet technology servs to govt
Pemco Aviation Group Inc. (M: PAGI)	7.1	1.86	-10.5	na	171.4	2.7	18.94	7.56	80	68	Aircraft mainten; target & guidance sys
Penn Octane Corporation (M: POCC)	71.4	0.09	17.4	4.2	121.0	46.1	10.94	2.25	54	98	Liquid petroleum gas
Qualstar Corporation (M: QBAK)	8.3	1.01	156.0	na	51.9	42.5	16.00	5.13	na	19	Automated magnetic tape to store data
Ravenswood Winery, Inc. (M: RVWD)	10.2	1.23	34.7	0.3	34.4	33.3	15.38	10.38	74	80	California wines
Richton International (A: RHT)	7.7	3.04	47.7	0.2	260.1	34.1	22.50	13.69	86	54	Sprinklers, outdoor light, fountain equip
Saes Getters S.p.A. (M: SAESY)	9.0	0.97	na	na	148.1	na	10.75	5.25	86	50	Technology for vacuum & gas environ
Schawk, Inc. (N: SGK)	16.8	0.52	-3.0	na	209.4	12.2	9.69	7.50	67	54	Digital imaging prepress serv
Seneca Foods Corporation (M: SENE)	19.3	1.11	23.5	1.5	647.0	20.9	14.88	10.75	78	80	Canned & frozen vegetable prods
Shenandoah Telecommunic. (M: SHET)	10.0	3.22	5.8	1.7	57.1	15.9	55.00	27.00	62	5	Telecommunication services
Spartan Stores, Inc. (M: SPTN)	3.7	1.64	18.2	0.2	3157.4	4.0	11.81	5.00	na	58	Distrib groceries to retail stores
St. Joseph Light & Power (N: SAJ)	23.1	1.00	-11.7	na	108.5	5.9	24.69	17.44	76	94	Electricity in NW Missouri
Sunburst Hospitality Corp (N: SNB)	17.3	0.40	-17.5	0.2	211.7	12.9	7.38	4.13	81	89	Full & limited serv hotels
Sunrise Telecom, Inc. (M: SRTI)	9.8	0.41	na	na	104.9	na	62.31	3.03	na	70	Network & telecom diagnostic equip
Syntel, Inc. (M: SYNT)	27.4	0.21	56.3	0.4	164.8	19.3	20.94	5.00	26	0	Emerging technologies integration

Exchange Key: N = New York Stock Exchange  
A = American Stock Exchange  
M = Nasdaq

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		Last 12 Mos. (\$)	5-Yr. Ann'l Growth (%)		Last 12 Mos. (\$ Mil.)	5-Yr. Ann'l Growth (%)	High (\$)	Low (\$)	Firm (%)	Industry (%)	
Thermo Fibertek, Inc. (A: TFT)	11.9	0.29	10.0	1.2	240.6	7.0	8.25	2.81	33	62	Processing machinery for paper indus
Tremont Advisers Inc. (M: TMAV)	24.4	0.52	na	na	20.9	na	15.00	6.40	83	14	Investment consulting & management
TRICOM S.A. (N: TDR)	13.4	0.59	5.5	2.4	212.1	43.0	28.50	6.55	26	5	Telecommun in Dominican Republic
Trinity Biotech plc (M: TRIB)	11.3	0.20	15.7	0.7	28.6	38.6	7.59	1.66	82	83	diagnostic test kits for labs
Tutogen Medical, Inc. (A: TTG)	21.7	0.24	15.2	1.4	16.7	8.2	8.06	2.63	89	62	tissue process'g; distrib of surgical prods
United Capital Corp. (A: AFP)	4.3	3.47	41.1	0.1	63.3	-5.0	18.75	11.75	50	10	Real estate & antenna systems
WLR Foods, Inc. (M: WLRF)	67.0	0.21	-31.9	na	842.6	-1.3	14.13	3.38	97	80	Turkey & chicken prods
<b>Median of New Shadow Stocks</b>	<b>11.0</b>	<b>—</b>	<b>14.2</b>	<b>0.7</b>	<b>121.0</b>	<b>14.9</b>	<b>—</b>	<b>—</b>	<b>72</b>	<b>—</b>	
<b>Median of All Shadow Stocks</b>	<b>12.4</b>	<b>—</b>	<b>16.9</b>	<b>0.7</b>	<b>100.1</b>	<b>16.9</b>	<b>—</b>	<b>—</b>	<b>58</b>	<b>—</b>	
<b>Median of All Companies</b>	<b>13.5</b>	<b>—</b>	<b>7.6</b>	<b>0.9</b>	<b>88.6</b>	<b>13.3</b>	<b>—</b>	<b>—</b>	<b>49</b>	<b>—</b>	

Statistics are based on figures as of December 28, 2000.

Data Source: AAIL's Stock Investor/Market Guide, Inc.

Exchange Key: N = New York Stock Exchange

A = American Stock Exchange

M = Nasdaq

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term growth rates can mask the variability and risk of the underlying figures.

The ratio of the price-earnings ratio to the earnings growth rate (PEG ratio) provides an indication of how the market values the firm relative to its historical earnings growth rate. When a firm's price-earnings ratio is high relative to historical earnings growth, high expectations are built into the price relative to what the firm has been able to produce in earnings growth historically. An example is Penn Octane, with a price-earnings ratio of 71.4 and a historical growth rate of 17.4% which leads to a high 4.2 PEG ratio.

At the opposite end of the spectrum—when this PEG ratio is low—an investor is able to purchase historical growth at a relatively low price. As a general rule of thumb, firms with PEG ratios near 1.0 are viewed as being fairly valued, those with ratios less than 0.5 are considered to be undervalued, and those with ratios above 1.5 are viewed as being overvalued.

ECTel, FTI Consulting, and North Coast Energy all possess 0.5 ratios for price-earnings to earnings growth—ratios that indicate these stocks may be priced low relative to

historical growth. Alternatively, how-to book publisher Hungry Minds, the company that publishes the popular "For Dummies" series, may have a fair valuation with a ratio of 1.0.

We use market capitalization, computed by multiplying the last price by the average number of shares of common stock outstanding, to measure company size when identifying Shadow Stocks. The total level of sales provides an alternative measure that does not rely on market valuation to judge a firm's size. But keep in mind that sales levels vary by industry, so it is best to compare firms within the same industry.

The sales growth rate is often used to confirm the strength of growth in earnings per share. Sales are less susceptible to accounting choices than reported earnings and often point to a change in overall company trends before it becomes apparent in earnings figures. Revenue growth directly impacts the bottom line and the effect will be magnified if costs can be contained.

Beyond examining the overall sales growth rate, be sure to also look at the year-to-year numbers to find consistency in the growth—the greater the variability, the greater the risk. The five-year sales growth

rates for the new Shadow Stocks range from -5.0% to 107.3%. The median sales growth rate of 14.9% for the new Shadow Stocks group is noticeably above the 13.3% median for the complete Shadow Stocks group.

Examining the high and low prices over the most recent 52-week period gives an indication of a company's stock price volatility over the past year. With the market's bearish turning point last Spring, it is not surprising to see the downside price descent of several small-cap Shadow Stocks.

Technology company Crystal Systems Solutions, a developer of software tools used in implementing conversion projects for computer mainframe systems, provides a good example of the bearish mood that overcame the markets and cut down the Nasdaq in the year 2000. Crystal Systems Solutions started the year with a price near \$16 and hit a high of \$18.375 twice, once in late January and again in late February. By April's close, however, the stock had dipped to \$9.875. The stock continued to slide further down, bottoming out at \$5.625 at the end of October 2000. Crystal Systems Solutions' stock rebounded slightly, closing out the year at a price of \$7.25. The final total: the stock lost

over 50% of its value for the year.

The relative strength rank figure included in the Shadow Stock Rookies listing indicates how a company's stock price has performed relative to all other stocks. A rank of 50% indicates that the stock's performance was better than 50% of all stocks. A rank of 75% reflects performance better than 75% of all stocks—or performance that places the stock within the top 25% of the universe. The 84% relative strength rank for fashion designer Donna Karan International illustrates strong relative strength—among the top 16%.

Investors seeking stocks showing positive price momentum often look for stocks with strong and improving relative strength ranks. The best way to do this is to check both a short-term relative strength figure and the performance over a long-term period. A high 52-week rank coupled with a low figure for a more recent period—say a low 13-week rank—points to a company whose price strength is weakening.

The final piece of information included in this Rookies listing is a relative strength rank figure for the industry of the new Shadow Stock. Not only do you want to look at the relative strength numbers of the underlying company against the entire universe, but you also want to consider the performance of its industry. Here you can compare how well the industry is doing against

other industries and determine if the industry is a leader or laggard.

For example, look at Sunburst Hospitality, owner and operator of an extensive roster of hotel chains including Comfort, Clarion, and EconoLodge. Sunburst Hospitality has a 52-week relative strength rank of 81%, while its industry—hotels and motels—boasts an even stronger 89% percentile rank figure. In this example, Sunburst Hospitality shows strong performance versus all stocks. Likewise, the hotels & motels industry is performing well against all other industries. Many investors seek out hot industries and concentrate on the leaders among the group.

One industry that is not so hot right now is the computer services industry. Some interesting relative strength rank data, not to be ignored or dismissed, comes from Shadow Stock rookie Innodata and its corresponding industry. Innodata, an on-line data conversion and management services firm, has a 52-week relative strength rank of 98%. However, its industry, computer services, has suffered a serious beating versus all other industries. The industry posted a zero relative strength percentile rank figure—reflecting the lowest price performance in a group of over 100 industries.

What does this reveal about Innodata as a company? First of all, the 98% figure versus that of the

market benchmark clearly shows solid performance. However, it is interesting that the industry figure remains at a rock bottom level. This tells a lot about Innodata's price strength and its ability to rise above an industry locked in an extended period of poor performance. It may also indicate that Innodata is providing a unique service within the industry—a leader within a broad industry, the somewhat vague computer services industry. Or, Innodata may be incorrectly categorized within the computer services industry—another fact that might explain the large discrepancy between the Innodata number and the zero percentile rank for the industry. The Innodata example is an interesting one, a prospect that clearly requires further research into its business model and industry.

For any company's industry group number, please see the complete Shadow Stock listing starting on page 15.

This list of rookie Shadow Stocks is a diverse group of companies. The profiles presented here illustrate some useful preliminary screens in the stock selection process. We have prepared an Excel spreadsheet that contains detailed financials for all 209 Shadow Stocks. The file can be downloaded from the AAIL.com Web site; simply log onto the site, go to the Download Library, and look under the section entitled Files from AAIL. ♦

### Definitions of Screens and Terms

**Price-Earnings Ratio-Current:** Market price per share divided by the most recent 12 months' earnings per share.

**Earnings per Share-Last 12 Months:** Net income after all expenses and preferred stock dividends divided by the average shares outstanding during the year.

**Earnings per Share-5-Year Growth:** Annual percentage growth in earnings per share over the last five fiscal years.

**P/E to EPS Growth:** The price-earnings ratio of a stock divided by its annual earnings per share growth rate over the last five years. Market valuation relative to historical earnings growth. A ratio below 1.0 is reason for further analysis.

**Sales-Last 12 Months:** Net sales in millions of dollars for the last 12 months.

**Sales-5-Year Growth:** Annual percentage growth in sales over the last five fiscal years.

**52-Week Price-High and Low:** The highest and lowest prices reached by the stock over the last 52 weeks.

**52-Week Relative Strength Rank-Firm:** The price performance of a stock relative to the performance of all stocks, expressed as a percentile rank.

**52-Week Relative Strength Rank-Industry:** The price performance of the firm's industry relative to the performance of all industries expressed as a percentile rank. The higher the rank, the better the relative performance.