

SHADOW STOCK ROOKIES:

WHAT THE NEWCOMERS LOOK LIKE

By Wayne A. Thorp

The price-earnings ratios for the Shadow Stock rookies range from 3.2 for freight carrier and tanker operator B&H Ocean Carriers Ltd., to 102.6 for OYO Geospace Corp. OYO's current price-earnings ratio has more than doubled from last year's level of 49.8.

Our annual screen for Shadow Stocks uncovered 44 new companies that did not appear in last year's listing. In screening for new Shadow Stocks, we look for non-financial firms whose: market capitalization (shares outstanding multiplied by market price per share) is between \$20 million and \$250 million; institutional ownership is no more than 15% of outstanding shares; earnings are positive for the last trailing four quarters (12 months) and the last two fiscal years; and that have at least three fiscal years of financial data. New companies meeting these criteria are called Shadow Stock "rookies," and it is interesting to take a closer look at the investment characteristics of these newcomers. [For a complete list of the 2003 Shadow Stocks, refer to the article that begins on page 17 of this issue.]

It is important to remember that the Shadow Stocks as a group represent only a starting point to further research and analysis. This listing presents only a brief financial profile of the new Shadow Stocks and should not be considered a recommended list.

BEHIND THE NUMBERS

This year's rookies are grouped by sector; sectors are listed in descending order by industry code as defined by Market Guide (see page 25). Market Guide—the primary data provider for AAI's *Stock Investor* program, which is used to screen for the Shadow Stocks—uses 12 broad sector classifications.

When examining the companies in a given sector, as well as sector data, keep in mind that sectors are a broad classification as compared to the more narrow industry classifications. This means that you will find companies with a wider variety of operations in each sector than you would when comparing companies in the same industry. For example, the services sector contains companies ranging from an operator of time-share resorts to a retailer of lumber and building materials (see page 21 of this issue for a list of the sector and industry classifications used by Market Guide).

In the table on page 25, you will see that each sector row contains values for some of the data columns. These values represent the median values for all stocks in that particular sector. A median in a group is the midpoint, where exactly half of the values are higher and half are lower. Median values hold a distinct advantage over averages, as a few "outliers"—values well outside the "normal" range—can skew group averages. The end of the rookies listing also provides the median values of selected data elements for the 44 new Shadow Stocks, the entire group of 159 Shadow Stocks, and all listed companies—the universe from which the Shadow Stocks are taken.

PRICE-EARNINGS RATIO

The first data column is the price-earnings ratio, also referred to as the earnings multiple. Computed by dividing the latest market price by earnings per share for the last 12 months (trailing four quarters), it provides a feel for

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how the market is valuing the stocks' future earnings potential and risk. Stocks with high price-earnings ratios generally have higher expectations attached to them in terms of future earnings growth.

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

When examining a firm's price-earnings ratio, common approaches are to compare the value against certain benchmarks, such as the market or industry price-earnings ratio or even the company's own historical levels. Price-earnings ratios can be found in financial publications such as the *Wall Street Journal* and *Barron's*. Industry ratios are a bit more difficult to find, although they are available in publications such as the *Value Line Investment Survey* or in software packages such as *AII's Stock Investor*.

The range of current price-earnings ratios for the list of rookies varies from 3.2 for freight carrier and tanker operator B&H Ocean Carriers Limited (BHO) to 102.6 for OYO Geospace Corporation (OYOG). OYO's price-earnings ratio overwhelms its sector median (24.0 for the technology sector) as well as the median values for the new Shadow Stocks (18.1), all Shadow Stocks (16.1), and all exchange-listed companies (16.9). OYO's current price-earnings ratio has more than doubled from last year's level of 49.8. The company's current earnings per share of \$0.21 is just above the \$0.20 it reported for its last fiscal year. However, even with the stock's price doubling in value from its level one year ago, the company's current stock price stands at only 51% of its 52-week high (last data column).

EARNINGS GROWTH

Earnings per share growth is one of the main benchmarks for measuring company performance. The growth rates in this group range from -34.5% for OYO Geospace Corporation to 146.5% for Amedisys, Inc. (AMED), a health care services company. Growth rates at these extreme levels are not typically meaningful; high rates may occur, for example, because base years used in the calculations were at extremely low levels. Amedisys achieved its growth rate by increasing earnings from \$0.01 to \$0.91 in the last fiscal year. Beyond the overall growth rates, investors should look at the year-to-year trend; doing so can unmask the variability and risk of the underlying figures.

PEG RATIO

The ratio of price-earnings to earnings per share growth—also called the PEG ratio—is a common valuation technique. As a general rule, firms with a ratio around 1.0 are considered to be fairly valued, those with ratios less than 0.5 are undervalued, and those with ratios above 1.5 are overvalued. The median value for the new Shadow Stocks was 1.1 and for the whole Shadow Stocks group it was 0.9, compared to a median of 1.1 for all exchange-listed companies. [Note: The PEG ratios calculated in the table use growth rates based on earnings per share from continuing operations.]

SALES

While market capitalization is most commonly used as a measure for company size, another proxy is sales. Using this figure to measure company size has its advantages because it does not rely on the market's valuation of a company (stock price), as does market capitalization. Keep in mind, however, that the level of sales will vary from

sector to sector and from industry to industry, so it is best to compare firms in similar lines of business. The median level for the group of new Shadow Stocks is \$62.4 million in sales, below the median value of \$81.4 million for the entire group of Shadow Stocks.

Sales growth is often used to confirm the strength, or lack thereof, of growth in earnings per share. Sales are less susceptible than earnings to management manipulation and often point to changes in overall company trends before they become apparent in earnings. Revenue growth directly affects the bottom line and the effects will be magnified if management is able to contain costs.

Beyond examining the overall growth in sales, be sure also to look at the year-to-year numbers, just as with earnings—look for consistency in the growth. The greater the variability in the year-to-year values, the greater the risk.

The median sales growth rate for the new Shadow Stocks is just slightly lower than the median earnings growth rate—9.5% versus 10.4%—whereas the median sales growth rate for all exchange-traded securities far outpaces that of earnings growth: 11.3% to 0.3%.

RELATIVE STRENGTH

Generally, relative strength indicates how well a stock's price has performed compared to some benchmark or industry index. The relative strength figure presented in the Shadow Stock rookie list compares the stock's performance to that of the Standard & Poor's 500 stock index over the last 52 weeks. This value is reported with a base level of zero, which represents stock performance equal to that of the S&P 500 over that time period. Numbers greater than zero reflect performance above the index, while negative values portray below-market performance.

The median relative strength for the Shadow Stock rookies is 33%,

SHADOW STOCKS 2003: THE ROOKIES

Company (Exchange:Ticker)	P/E Ratio		Earnings per Share		P/E to EPS Grth (%)	Sales		52-Wk Rel Strgth (%)	Price as % of 52-Wk High (%)	Description
	Current (X)	Yr Ago (X)	12 Mo (\$)	Grth 5 Yr (%)		12 Mo (\$ Mil)	Grth 5 Yr (%)			
01 - Basic Materials	17.4	16.0	—	-11.8	1.2	390.9	4.2	17	67	
Alcide Corporation (M: ALCD)	27.0	43.6	0.57	-9.8	na	21.6	13.3	-21	60	Chemical compounds
Great Northern Iron Ore (N: GNI)	13.1	11.2	4.99	-0.7	na	9.4	-0.2	11	87	Minn mineral interests
Novamerican Steel Inc. (M: TONS)	4.3	6.6	1.69	-5.6	na	449.6	10.3	49	72	Steel & aluminum prods
02 - Capital Goods	15.1	14.4	—	-4.3	0.8	190.5	7.3	7	63	
Aero Systems Engineering, (M: AERS)	12.8	na	0.39	16.0	0.8	38.9	5.9	125	63	Propulsion test sys
Baran Group Ltd. (M: BRAN)	6.7	na	0.92	na	na	204.5	na	na	66	Engineering & contracting
HEICO Corporation (N: HEI)	18.3	12.3	0.62	2.7	0.7	172.6	37.7	-17	61	Aerospace prods & servs
Lancer Corporation (A: LAN)	22.7	50.0	0.25	-25.6	na	135.9	3.7	125	98	Beverage machines
Masisa S.A. (ADR) (N: MYS)	16.9	11.0	0.44	14.9	1.1	219.5	15.4	-25	60	Fiberboard & particle board
Minuteman Int'l Inc. (M: MMAN)	10.2	10.6	0.86	1.9	5.4	75.7	9.5	26	78	Vacuums
Nobility Homes, Inc. (M: NOBH)	12.0	15.5	0.75	3.8	2.9	34.4	-3.7	26	86	Manufactured homes
Noland Company (M: NOLD)	12.6	15.1	2.45	4.2	3.2	484.8	0.5	33	100	Mechanical equip & supp
Pfeiffer Vacuum Technology (N: PV)	13.3	12.9	1.56	25.7	0.5	157.6	5.9	-24	55	Vacuum pumps & sys
U.S. Home Systems, Inc. (M: USHS)	39.2	13.6	0.15	na	na	45.7	na	39	89	Home improvement prods
United Park City Mines Co. (N: UPK)	20.3	162.0	0.90	18.3	1.1	10.0	-0.7	12	71	Utah real estate co
04 - Consumer Cyclical	14.5	14.6	—	-8.1	0.9	241.6	5.4	14	64	
Emerson Radio Corp. (A: MSN)	8.7	4.8	0.71	24.7	0.4	332.0	12.3	351	93	Consumer electronics
Hooker Furniture Corp. (M: HOFI)	8.3	na	2.13	na	na	237.1	na	na	91	Residential furniture
05 - Consumer Non-Cyclical	16.7	18.7	—	3.4	1.4	282.5	5.5	18	73	
Bridgford Foods Corp. (M: BRID)	29.4	17.4	0.36	3.4	8.6	143.8	5.7	13	69	Snack food products
Calavo Growers, Inc. (M: CVGW)	12.9	na	0.56	na	na	243.8	na	na	85	Avocado products
Perdigao S.A. (ADR) (N: PDA)	5.0	10.5	1.55	na	na	769.2	na	-24	54	Poultry & pork
Seneca Foods Corporation (M: SENE)	25.7	na	1.04	-33.1	na	648.7	2.3	43	100	Canned & frozen vegetables
06 - Energy	20.5	10.3	—	4.6	1.3	171.0	14.8	14	71	
CREDO Petroleum Corp. (M: CRED)	26.1	11.0	0.40	51.6	0.5	5.4	20.3	95	90	Mid-continent petroleum co
PrimeEnergy Corporation (M: PNRG)	23.7	5.9	0.38	48.9	0.5	35.1	12.8	26	89	Crude oil & natual gas
08 - Health Care	19.2	30.1	—	10.1	0.9	33.2	15.9	-28	47	
Amedisys, Inc. (M: AMED)	5.1	7.7	1.22	146.5	0.2	129.0	26.9	0	46	Health care servs
Bio-Reference Labs, Inc. (M: BRLI)	18.1	46.3	0.42	19.1	1.0	92.3	18.1	33	61	Chemical diagnostic tests
Lannett Company, Inc. (A: LCI)	27.8	25.0	0.67	na	na	30.1	na	555	80	Pharmaceutical prods
MedAmicus, Inc. (M: MEDM)	14.2	22.6	0.60	49.8	0.4	17.8	19.0	-37	41	Pressure measurement sys
Synovis Life Technologies (M: SYNO)	29.2	43.6	0.27	28.2	3.0	40.0	23.1	44	93	Medical prods
Virbac Corporation (M: VBAC)	51.9	42.0	0.11	18.7	2.8	62.4	28.2	27	77	Animal health care prods
09 - Services	17.0	18.9	—	-3.9	1.0	188.8	15.2	-5	57	
Cache, Inc. (M: CACH)	18.0	18.8	0.81	10.4	1.7	193.1	6.9	279	77	Specialty retailer
ILX Resorts Incorporated (A: ILX)	8.1	11.9	0.99	10.3	0.8	54.7	8.9	38	92	Time-share resorts
Interlott Technologies (A: ILI)	20.5	15.8	0.28	7.4	2.8	45.6	18.1	57	75	Lottery & phone card vending
Medifast, Inc. (A: MED)	21.5	1.6	0.36	2.7	6.9	9.0	-21.2	2,067	91	Health & diet prods
Napco Security Systems (M: NSSC)	21.5	na	0.50	1.0	43.0	57.4	0.9	115	97	Security alarm prods
Nevada Gold & Casinos (A: UWN)	17.3	16.6	0.35	25.0	0.6	2.4	55.2	97	89	Casino, real estate & rest'n'ts
VSE Corporation (M: VSEC)	27.9	18.0	0.34	-13.2	na	130.8	-1.5	64	82	Engineering & testing servs
Wolohan Lumber Co. (M: WLHN)	14.5	21.2	1.50	12.6	1.2	209.1	-11.0	21	75	Lumber & building materials
10 - Technology	24.0	28.6	—	-17.4	1.2	46.1	10.6	-39	38	
Netsmart Technologies Inc. (M: NTST)	37.3	9.8	0.17	15.1	2.5	20.5	22.7	135	80	Management info sys
OYO Geospace Corporation (M: OYOG)	102.6	49.8	0.21	-34.5	na	65.0	9.7	-17	51	Seismic data instr & equip
ParthusCeva, Inc. (M: PCVA)	15.6	na	0.33	na	na	21.0	na	na	71	Intellectual property licensor
11 - Transportation	17.9	16.6	—	-7.0	0.9	496.8	10.8	14.5	70	
B&H Ocean Carriers Ltd. (A: BHO)	3.2	na	2.64	21.6	0.2	67.7	26.4	42	88	Bulk carriers & tankers
Nordic American Tanker (A: NAT)	23.2	4.6	0.60	120.4	0.2	14.9	na	22	84	Oil tankers
12 - Utilities	15.1	13.5	—	2.7	1.7	1,593.4	11.9	20	84	
Connecticut Water Service (M: CTWS)	23.6	25.5	1.11	2.5	9.4	45.5	3.3	5	84	Water utility holding co
Delta Natural Gas Company (M: DGAS)	16.1	12.7	1.37	14.1	1.1	55.9	5.8	38	97	Kentucky gas co
Middlesex Water Company (M: MSEX)	23.3	26.9	0.95	1.9	12.3	62.4	9.4	20	82	Retail water supplier
Median of New Shadow Stocks	18.1	15.3	—	10.4	1.1	62.4	9.5	33	81	
Median of All Shadow Stocks	16.1	16.7	—	15.2	0.9	81.4	12.2	23	78	
Median of Exchange-Listed Companies	16.9	17.4	—	0.3	1.1	161.8	11.3	8	69	

Data Source: AAI's Stock Investor/Market Guide, Inc. Statistics are as of January 3, 2003.

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

just slightly above the median value for all Shadow Stocks of 23%.

Among the newcomers, Medifast, Inc. (MED) had a relative strength of 2,067% that outpaced all others. MedAmicus, Inc. (MEDM) had the lowest relative strength for the rookies at -37%, meaning that its stock price underperformed the S&P 500 by 37% over the period.

Investors seeking stocks with positive price momentum often look for stocks with strong, improving relative strength values. The best way to do this is to check both a short-term relative strength figure and the performance over a longer time frame. A high 52-week relative strength value coupled with a lower figure for a more recent time period—say 13 weeks—points to a condition of deteriorating price strength.

PRICE RELATIVE TO HIGH

Another figure that investors can use to gauge the momentum of a company's stock price is the stock's current price as a percentage of its 52-week high. Used in conjunction with relative strength values, price as a percentage of 52-week high helps to indicate whether a company is still maintaining its price strength. Figures near 100% mean that the current price is close to its 52-week high—an indication of price strength—while a lower percentage indicates that the stock price has come down from its high.

For the stocks that were at opposite ends for 52-week relative strength, Medifast, Inc., with a relative strength value of 2,067%, has a current price that is 91% of its 52-week high, while MedAmicus,

with a relative strength of -37%, has, not surprisingly, a current stock price that is only 41% of its 52-week high.

SHADOW STOCK SPREADSHEET

From the descriptions provided on the list of Shadow Stock rookies, you can see that it is a diverse collection of companies. The profiles presented here illustrate some useful preliminary screens in the stock selection process.

To provide more detailed financial data for all 159 Shadow Stocks, AAI has compiled a spreadsheet, which is available for download from the AAI Web site. To access this spreadsheet, log onto AAI.com, go to the Download Library under Community on the left side, and choose the category Files From AAI. ♦

P/E Ratio—Current (X): Market price per share divided by the most recent 12 months' earnings per share. A measure of the market's expectations regarding the firm's earnings growth potential and risk. Firms with very high price-earnings ratios are being valued by the market on the basis of high expected growth potential.

P/E Ratio—Yr. Ago (X): Firm's price-earnings ratio one year ago. Provides a measure of comparison for judging the current price-earnings ratio.

Earnings per Share—12 Mo (\$): Net income after preferred stock dividends for the last 12 months divided by the average shares outstanding during the year.

Earnings per Share—Growth 5 Yr (%): Annual percentage growth in earnings per share over the last five fiscal years. A measure of how successful the company has been in generating the bottom line, net profit.

P/E to EPS Growth (%): The price-earnings ratio of a stock divided by its annual growth rate in fully diluted earnings per share from continuing operations over the last five years. Also

referred to as the PEG ratio. Measures market valuation relative to historical earnings growth. A ratio below 1.0 is reason for further analysis.

Sales—12 Mo (\$ Mil): Net sales in millions of dollars for the last 12 months. An alternative measure of firm size that does not rely on the market valuation of a company.

Sales—Growth 5 Yr (%): Annual percentage growth in sales over the last five fiscal years. Provides a confirmation of the quality of the historical earnings per share growth rate.

52-Week Relative Strength (%): The price performance of a stock relative to the S&P 500 stock index, expressed as a percentage, where the index or base value is zero. Provides a measure of how well a stock has performed as compared to the market. Values greater than zero indicate the stock has outperformed the index over the given time period, while a negative value indicates underperformance relative to the index.

Price as % of 52-Week High (%): Current market price per share divided by the highest market price per share over the last 52 weeks. An indication of current price strength.