



# MOTLEY FOOL STOCK ADVISOR™

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With  
**David & Tom Gardner**  
Motley Fool  
Co-Founders

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## Did You Know?

### You Control the Content!

We believe in the power of our community — and this is why we're handing you the keys to our new community-driven feature. We even want you to help us name the thing! Flip to page 6 for details, as well as instructions on how to cast your vote.

## Dear Fellow Fools,

Stick with me as I (Tom here) explain why bear markets are good for you. So good for you, in fact, that these are probably the best of times to be with *Stock Advisor*.

As long as you're an investor with a long-term horizon who continues to buy regularly and reinvests dividends, you would much rather see these temporary dips than a flatline period in which the market seems to stall.

Professor Jeremy Siegel really drives the point home in his fine book *The Future for Investors*. His example involves the stock market crash of 1929 and the Great Depression that followed. On Sept. 3, 1929, the Dow Jones Industrial Average hit 381 — and it did not reach that level again until November 1954. That's an incredible peak to trough to peak that pained investors for a full 25 years. Can you imagine if it took until 2032 for the S&P 500 to regain the level it hit last October? That's what investors faced back then.

Let me ask you — if you knew that was going to happen, you would surely be better off dumping your stocks and getting into bonds or treasuries for 25 years, right? Well ... not so fast.

According to Siegel, the average stockholder who reinvested his or her dividends during the Depression actually showed an annual rate of return of more than 6% during that 25-year period! That's about twice the accumulation of bonds and four times better than short-term treasuries.

In fact, Siegel points out that if the Great Depression had never occurred and stock prices had remained flat for those 25 years, things would actually have been far worse for long-term investors. Consider that \$1,000 invested at the beginning of this fictional, stable flat-line period would have turned into only \$2,720 by November 1954, 60% less than what investors actually accumulated in real life.

And that's just those who reinvested dividends. Investors who continued to buy more stocks during those historic lows made out even better. If you're wondering why, it's simply because they were buying more and more shares when prices were depressed, and when stocks moved up again their returns rocketed ahead. Siegel calls the concept a "bear-market protector and return accelerator."

What are the lessons here? Simple. This is not the time to sell off stocks and sit on cash. Keep investing in our stocks with money you don't need for at least five years. Look to our new recommendations each month and our Best Buys Now for our top picks for new money. And remember — barring the impossible scenario of a market that goes straight up and never dips — these are actually the best of times for investors. As Siegel says, "Market cycles, although difficult on investors' psyches, generate wealth for long-term stockholders."

That's you. A long-term stockholder (with a damaged psyche, perhaps) sticking with your plan. We're confident you'll be rewarded well for hanging in there.

Fool on!



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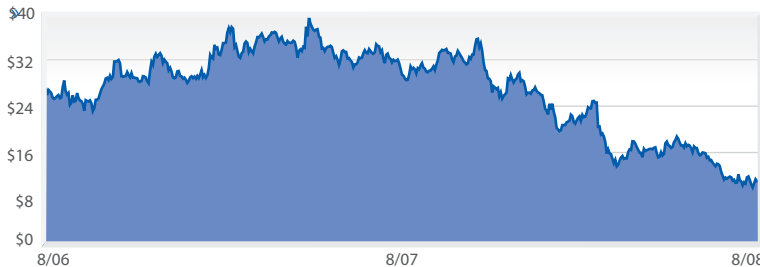
## Titanium Metals (NYSE: TIE)

BY DAVID GARDNER WITH KARL THIEL

Titanium Metals is the largest domestic producer of titanium, a sturdy but lightweight metal used in the aerospace industry and other new applications.

### Why Buy:

- » A record backlog for new aircraft means steady business for years to come.
- » New applications for titanium will reduce aerospace exposure and boost the bottom line.
- » Concerns about Boeing's production delays have shares trading cheap.



Headquarters:	Dallas
Website:	timet.com
Recent Price:	\$11.22
Risk Level:	Medium
Position in Industry:	Stalwart
Market Cap*:	\$2,031
Cash/Debt*:	\$41/\$23
Revenue (TTM/07/06)*:	\$1,187/\$1,279/\$1,183
Earnings (TTM/07/06)*:	\$202/\$268/\$281
Insider Ownership:	53%
Biggest Threat:	More Dreamliner delays

**The Team Says:** **It's time for Timet**

Data as of 8/12/08

\*in millions.

Iron Man was having a bad day at the office. Dressed head to toe in bulky metal armor, he flew up, up to the highest reaches of the sky and ... froze. Returning to the lab, he upgraded his suit to a titanium alloy. Lightweight, strong, and resistant to cold, the new high-tech material allowed him to fly high and save the world, enriching throngs of happy **Marvel** (NYSE: MVL) shareholders along the way.

Supremely corrosion-resistant and sporting the highest strength-to-weight ratio of any metal, titanium isn't just a key component of stratosphere-ready exoskeletons. It's a crucial commodity for the aerospace industry, where it's used to make aircraft frames, engines, and supports. It's also used in cars, prosthetic limbs, and deep-sea oil and gas drilling platforms. But while titanium is the ninth-most abundant element in the earth's crust, it's scattered among rocks and dirt — so finding useful quantities isn't easy. Turning what's collected into pure metal is even more difficult.

That's where **Titanium Metals** (NYSE: TIE) — Timet, for those in the know — comes in. Together with Russia's VSMPO-Avisma, U.S.-based **RTI International** (NYSE: RTI), and **Allegheny Technologies** (NYSE: ATI), Timet provides most of the world's titanium supply. It is one of the few companies capable of the capital-intensive, decades-old process of turning raw ore into titanium sponge, a form that can be refined into pure metal or alloys.

Unlike other commodity investments, which have been red hot lately, titanium stocks are floundering. But as you'll see, these problems are short-term blips. Thanks to the market's overreaction, we've been given a great opportunity: Timet is cheaper than it's been in nearly three years. You could say this is the commodity that time forgot.

### Unfriendly Skies

In 2007, nearly 60% of Timet's revenue came from the commercial aerospace industry. But top manufacturers like Airbus and **Boeing** (NYSE: BA) have thrown a wrench in things, stalling production for major commercial aircraft. This is partly to blame for Timet's stock drop — it's down more than 60% since October — but I believe the decline is largely because the market is falsely lumping together the aerospace industry with the troubled commercial airlines.

Demand for new aircraft will be strong in the coming years: *The Airline Monitor* estimates that Airbus and Boeing have an order backlog of 6,817 planes (even accounting for production delays). Furthermore, airlines can't afford to let aging fleets sit, and rising energy costs mean greater demand for fuel-efficient planes. That's great news for Timet, as newer planes require a much higher percentage of titanium than older models. There's also been a jump in military spending programs, which require titanium for fighter jets and armor. And titanium is ideal for desalination plants, oil risers, industrial equipment — even as a building material — because it's resistant to environmental effects.

### Lustrous and Free Cash Flow

Timet has a clean balance sheet with little debt. It produced \$88 million in free cash flow over the past 12 months and still had room to sink money back into its business. It also gave back to shareholders, offering a nice 2.7% dividend yield.

Although net margin fell a bit during the past two years, it stood at an enviable 17% over the past 12 months, far better than RTI or Allegheny's levels. Return on equity has also tumbled somewhat, but it still stands at a solid 18%.

Earnings declined slightly in 2007 (and will contract further this year), but not enough to warrant the big stock drop. Timet trades at just 10 times trailing-12-month earnings and about 11 times estimated 2008 earnings — both well below its historical average. This means we could see oversized returns when business picks back up. If the company returns to its three-year average trailing price-to-earnings (P/E) ratio of 21.4, the stock would be worth about \$23.50 right now. Rising earnings and an expanding P/E ratio can be a profitable combination for investors.

Karl and I are not suggesting that this will happen overnight, but this is an industry leader that produces a key commodity and trades at less than 1.7 times trailing sales despite its high operating margin.

### Staying Grounded

Even with a hefty order backlog, Timet will probably continue to trade in step with the aerospace industry for the foreseeable future, so additional production delays from Boeing's 787 Dreamliner or Airbus' A380 will likely depress the share price. And while long-term contracts add stability to future revenue and largely insulate Timet from the fluctuating price of titanium, over the long term, competitors could start to invade Timet's turf. That's particularly the case beyond aerospace and defense, in industries where the U.S. government doesn't protect domestic producers.

Finally, Timet has an excessively complicated management structure. Chairman Harold Simmons, who holds a majority interest in Timet, is also chairman of Contran Corp. Contran controls **Valhi** (NYSE: VHI), which shares CEO Steven Watson with Timet. Valhi in turn owns a majority interest in **Kronos Worldwide** (NYSE: KRO), **CompX International** (NYSE: CIX), and **NL Industries** (NYSE: NL), which share board members and management with the other companies. Only some are involved in the titanium industry. The companies also have an interlocking web of loans, partnerships, and stock ownership that I won't pretend to fully understand. On the plus side, Simmons and Watson have been executives or directors at companies related to Valhi and Contran since 1961 and 1980, respectively. And Simmons and Watson have skin in the game — they've bought more than \$11 million in Timet stock over the past 12 months.

### The Foolish Bottom Line

Timet is America's largest producer of titanium, with industry-leading returns on equity and net margins. But Wall Street is focusing on short-term snags and airline misfortunes, so the stock has plummeted despite the rising demand for this amazingly adaptable metal. With Timet trading at a bargain and titanium here to stay, why settle for anything less than superhero-worthy? 🦸

## Dueling Fools: Looking Polished

**Tom: Timet's management structure is more complicated than the last season of *Lost*. Can we trust these guys?**

**David:** I'll admit that Timet is involved in some bizarre relationships, but I hardly think that the management team is the equivalent of *Lost*'s "Others." Compensation seems reasonable, Chairman Harold Simmons owns a significant stake in the company, and let's not forget that this team has created a significant amount of shareholder value over the years. Until they give me reason otherwise, I'll give Timet's management the benefit of the doubt.

**Tom: The vast majority of the world's titanium is produced outside the U.S., in places like Australia and South Africa. How concerned should we be about foreign competition?**

**David:** Not very. Titanium may be lighter than steel, but it's still a pain to transport across an ocean. Furthermore, the U.S. government imposes a 15% tariff on titanium imports; this is a key competitive advantage for Timet over foreign producers.

**Tom: I've noticed a few baseball players, including many Red Sox guys, have started sporting titanium necklaces. Please tell me this wasn't a major component of your investment thesis.**

**David:** Those necklaces allegedly help "stabilize energy flow" and reduce recovery time. Judging by the Red Sox' performance in recent years, they seem to do the trick! When I mentioned promising new applications for titanium, I was thinking more along the lines of armor plating, pollution control equipment, chemical and power plants, and architectural applications, but Timet does supply the sporting goods industry, too.

**Tom: My pick this month, Precision Castparts (NYSE: PCP), is Timet's single largest customer. Will Timet be OK if Precision decides to take its business elsewhere?**

**David:** Taking your ball and going home, huh? It's like Little League all over again. It's true that Precision is Timet's largest customer, but Precision only contributed 11% of revenue in 2007. Timet has signed binding, long-term production arrangements with many of its major clients, including Boeing, Rolls-Royce, and, yes, Precision, so we'd be just fine. 🦸

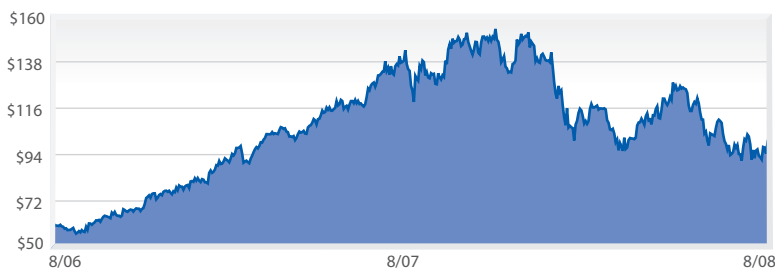
## Precision Castparts (NYSE: PCP)

BY TOM GARDNER WITH ANDY CROSS

Precision specializes in designing and manufacturing high-end mechanical products for use in jet engines, gas turbines, and industrial machinery.

### Why Buy:

- » It's the best-in-breed manufacturer of complex component parts.
- » Jet engine manufacturers and power plant operators are increasingly seeking more fuel efficient systems.
- » The stock is down 30% in '08 due to concerns over costs and the economy.



Headquarters:	Portland, Ore.
Website:	precast.com
Recent Price:	\$96.80
Risk Level:	Medium-High
Position in Industry:	Juggernaut
Market Cap*:	\$13,500
Cash/Debt*:	\$414/\$325
Revenue (TTM/07/06)*:	\$7,037/\$5,319/\$3,480
Earnings (TTM/07/05)*:	\$1,037/\$633/\$351
Insider Ownership:	0.35%
Biggest Threat:	Metal costs skyrocket

**The Team Says:** **A cheap high-flyer**

Data as of 8/12/08

\*in millions.

I've spent my fair share of time on airplanes — heading to investor meetings, family gatherings, national sporting events, and some overseas holidays. So I'm the first to appreciate a company that's dedicated to making air travel a bit ... better.

While it can't control the size of the seats, the quality of the snacks, or the cleanliness of the lavatories, **Precision Castparts** (NYSE: PCP) — a leading supplier of specialized high-end engineering parts to jet engine manufacturers and other industrial clients — is committed to making jet engines faster, stronger, and more efficient, all in an effort to make our flights shorter and subsequently more enjoyable.

Much like David's pick (Titanium Metals), my recommendation this month is set to benefit from the growth in global travel, especially as plane makers build more fuel- and cost-efficient aircraft (like Boeing's new 787 Dreamliner). The long-term excitement around this stock is tempered by near-term concerns over rising gas prices, recurring airline bankruptcies, and a run-up in raw material costs. I'll let the market fuss over the short term — and I'll urge you to take advantage of the discounted stock price and pick up shares in what I believe will be a long-term winner.

### All the Moving Parts

Precision Castparts is all about ... precision. The company thrives on it. That's because its core business is supplying complex, critical metal components for jet engines and industrial gas turbines that simply cannot fail. The consequences are too dire. Precision is one of the largest and most efficient makers of these castings, fasteners, and forged products.

Just picture all of the moving parts of an airplane — from the massive blades on its jet engines to the smaller, complex

components of its compressors, combustors, and turbines. Chances are these products come from Precision's casting division (where molten metals are poured into a mold) or its forging division (where metal is shaped under great pressure). In addition to supplying similar products to power companies, Precision develops high-end fasteners (think heavy duty screws and bolts), tools, metal alloys, and special waxes for thousands of clients (including itself) in the aerospace, auto, farming, paper, and waste disposal industries. It operates a nearly fully integrated supply chain, mitigating some of the raw material costs and providing multiple revenue streams.

### Lots of Pennies in Precision

As the low-cost producer of these parts, Precision generates some of the highest operating margins in the industry (north of 20%). And while the concentrated nature of its aerospace client base (GE makes up more than 10% of total revenue, with Pratt & Whitney and Rolls-Royce close behind) prevents any great pricing power, Precision's technical competitive advantage keeps a floor on its margins. Additionally, switching costs are pretty hefty for its largest clients. GE, Pratt, and Rolls have been clients for decades.

Revenue has grown nearly 30% annually for the past five years, while the efficient operating model has boosted operating profits 40% per year. At the start of the last economic downturn in 2001, long-term debt stood at more than \$800 million and there was just \$40 million in cash on the balance sheet. Today Precision carries more than \$400 million in cash against just \$325 million in total debt. A very strong balance sheet and efficient operating model should sustain decent returns on capital over the next five years.



## Time to Fly (and Buy)

Andy and I have watched Precision for a few months, but the stock price was just too rich for our blood. Until now. After peaking at \$150 a share in the fall, the stock has fallen 30% — and its earnings multiples have collapsed with it. Now at just about 13 times owner earnings (compared with well north of 20 in the past few years) — and with analysts expecting earnings growth of more than 15% per year — we see this as our chance to buy into one of the premier high-tech industrial manufacturers at a bargain price.

By 2013, with Boeing's fuel-efficient Dreamliner flying the friendly skies, power companies preparing to refit their industrial gas turbines, and fasteners benefiting from increased demand across industries and international markets, I think Precision will be a \$25 billion to \$30 billion company. That translates to annualized returns of about 17% from here.

## Travel Advisory

The biggest risk with fallen growth stocks is that they keep falling. But because Precision is so specialized and management has done an admirable job over the years building a profitable operating model, I believe patient investors will be rewarded through the cycles. And yes, there will be cycles.

Additional delays in the Dreamliner launch or the slow ramp-up for the Airbus A380 could affect growth. So far, Precision hasn't seen much revenue hit its books from these programs, as most of its supply contracts with the two major jet manufacturers involve other planes. Precision will certainly see a nice boost once these newer jumbo jets hit the market.

Line outages are always a risk for specialized manufacturers. Last quarter, an overheated furnace caused some problems in one of Precision's primary heat presses. The company estimated at the time that it would take approximately six weeks to get the press back up and running and replace damaged parts. Events like that translate to lost opportunities for shareholders.

## The Foolish Bottom Line

In the next decade, we'll see massive technology investments that will benefit Precision Castparts: fuel-efficient jet engines, gas turbines to generate electricity, fabricated metals to manufacture stronger, lighter industrial parts. With Precision's stock price off nearly 30% year to date, we're getting all that enormous potential at a bargain price. Buy today and then we'll watch this stock take off. 🦋

## Dueling Fools: Precision Pick

**David: Let's turn the tables on a question you asked me. My pick this month, Titanium Metals, depends on Precision for about 11% of its sales. What happens to Precision if Timet moves on?**

**Tom:** Timet supplies Precision with no more than \$150 million in products, or less than 3% of Precision's costs of goods sold. Plus, given the slack in the aerospace industry right now, there should be plenty of titanium to go around. That said, Timet is one of the largest suppliers of titanium, a key ingredient to Precision's end product, so I'm betting the two continue to play nicely together.

**David: Does Precision enjoy the long-tenured relationships and high insider ownership you covet?**

**Tom:** To pseudo-quote Meatloaf, "one out of two ain't bad." Insiders don't own much stock, but the team is rich in talent. CEO Mark Donegan is a 23-year veteran of the company and once worked at the rich training grounds of GE. He owns more than \$21 million in stock, which isn't bad for a \$14 billion company.

**David: Could you touch a little more on the competition? What keeps Precision up at night?**

**Tom:** There aren't many companies out there that do what Precision does. It's the No. 1 or No. 2 supplier in its key markets. **Alcoa** (NYSE: AA) is probably the biggest threat. Its Howmet division goes head to head with Precision in the casting business. **Allegheny Technologies** (NYSE: ATI) and **Carpenter Tech** (NYSE: CRS) are two tough competitors when it comes to alloys, and incidentally, they're companies I looked at as possible recommendations this month.

**David: We're big believers in diversification, yet here you are following your big brother's footsteps by recommending a company dependent on the aerospace biz. Can subscribers buy both stocks?**

**Tom:** Timet and Precision depend on a healthy mix of aerospace customers (Boeing, GE, etc.). This shouldn't prevent anyone from buying both of our recommendations, but for added diversification they should own at least a dozen other stocks. Our Best Buys Now are a great source for additional ideas. 🦋

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**1. Buy Businesses, Not Tickers.** We buy into a company's prospects, future, and management. We put our money in a company we believe will generate shareholder value over the long term.

**2. Be a Lifetime Investor.** We don't just buy our stocks and forget about them. We keep tabs on them, follow the news, study the earnings reports, and strive to learn more about the industries.

**3. Diversify.** We believe in building a diversified portfolio that protects us from the inevitable blips.

**4. Fish Where Others Aren't.** We're not interested in following the crowds. We're interested in thinking for ourselves, doing our own research, and making our own decisions.

**5. Check Emotions at the Door.** We recognize that stocks will move up or down — often daily. We don't let our emotions affect our decisions.

**6. Keep Score.** We believe in accountability and have tracked our positions from the get-go. You can find the performance of all of our picks on our online scorecard.

## 7. Be Foolish and Have Fun.

We believe that you can manage your money and plan your retirement better than your broker —and we think you should have fun along the way.

*This month we bid adieu to our Master the Market section and introduce a new feature in which you, as part of our Stock Advisor community, tell us what you want to read about. The first topics up for a vote are listed to the right, so check them out, log on, and cast your vote.*

If ever there were a “last but not least” category, this is it. We're wrapping up our Master the Market series this month with something that really sets The Motley Fool apart: having fun. All while giving you the world's greatest investing advice, of course!

If you think about any of the activities and work you've been involved with over your lifetime, you probably excelled at the stuff you really enjoyed doing. The same is true in the financial world: You'll be a much better investor if you enjoy the process.

### Staying Steps Ahead of the Crowd

I'm guessing most of you reading this are having at least *some* fun as an investor. You may not be able to tear apart financial statements like Thornton Oglove or size up a company in 20 minutes like Warren Buffett, but that's OK — not many people can. As long as you can maintain a curiosity about companies, products, and services and how the entire business world fits together, you'll be several steps ahead of the crowd.

Our mission as Fools is to educate, amuse, and enrich. We take the amuse part seriously (get it?), so we'll do our part to help keep things fun for you.

We're eager to please, like the employee who was leaving work one day and saw his boss standing in front of the paper shredder, perplexed. “I have an extremely important and sensitive document here,” said the boss, “but my secretary's gone and I can't make this thing work ... can you help me?” Seeing a chance to impress, the employee said, “Absolutely!” and turned the machine on and sent the document into the shredder. “Oh, good,” said the relieved boss. “I only need one copy.”

### Seeking Your Help

Now that we're on a roll, are you ready to have some more fun? Good, because that's the premise of a new feature that will appear each month on this page. In it, we will cover the topics that you, our community, ask for. That's right: You're in the driver's seat of *Stock Advisor*.

**How it works:** Each month (beginning today), we'll present you three topics that we're considering covering in the next issue. Based on your votes each month, we'll deliver coverage of the topic that receives the most votes. It's that simple!

### Let Your Voice Be Heard

Now that you're feeling inspired to vote, here's the scoop on how to go about it:


1. Log on to [stockadvisor.fool.com](http://stockadvisor.fool.com) and look for voting details in the Ballot Box feature on the home page.
2. From the Ballot Box, click over to the SA Community Page discussion board and look for the post titled “August 2008 Vote.”
3. Cast your vote! (And if you have any suggestions for what to name our new feature, post them there, too.)

### Without Further Ado, This Month's Choices

**Candidate No. 1:** The *Stock Advisor* team takes a closer look at which of our companies have made the biggest moves (down or up) in CAPS during the past three months.

**Candidate No. 2:** The *Stock Advisor* team slices and dices the scorecard to see which companies rank highest in terms of insider ownership.

**Candidate No. 3:** David chooses which of Tom's stocks he likes the most today — and Tom returns the favor by choosing his favorite from David's side of things.

We're looking forward to learning what you want to read more about. Every vote counts, so log on today! 

### David's List

Company	Recent Share Price
Marvel (MVL)	\$33.74
Apple (AAPL)	\$176.73
Canadian Ntl. (CNI)	\$51.34
Nvidia (NVDA)	\$11.07
Starbucks (SBUX)	\$16.36

After the market's tepid reaction to **Marvel's** (NYSE: MVL) superhero-like earnings, we decided to promote the three-time recommendation to the top spot. Marvel's earnings blew away analyst estimates in the second quarter, and its high-margin licensing operations continue to net the company hordes of cash. Plus, the newest numbers don't yet include the colossal profits Marvel is set to receive from its *Iron Man* and *Incredible Hulk* movies! You can't beat this top stock for new money.

Reentering our list this month after a long absence is **Nvidia** (Nasdaq: NVDA). The first half of 2008 was a forgettable one for the graphics chip maker: Lower margins, product delays, and elevated competition distorted what was once a flawless picture. While the stock remains a long-term winner on our scorecard, its shares are off a brutal 70% from their annual high. That said, we like Nvidia's position as the premier player in graphic technology. Its cutting-edge products usually have competitors playing catch up, and recent advances into parallel programming could enhance Nvidia's market share. The company sports a crystal clear balance sheet with more than \$1.6 billion in cash and no debt.

Fools should take advantage of a two-year low and buy some shares today. 🐻

### Tom's List

Company	Recent Share Price
LinearTech. (LLTC)	\$33.99
Cemex (CX)	\$22.02
MSC Industrial (MSM)	\$49.51
Berkshire Hath. (BRK-B)	\$3,838
UnitedHealth (UNH)	\$31.48

He's baaaaack! Warren Buffett and his **Berkshire Hathaway** (NYSE: BRK-B) holding company are among the safest bets around, and with the stock down about 20% recently we think this is a good time to add more. To be clear, though, there are no sure things in investing:

Berkshire's stock lost more than 45% in the late 1990s, after all. But if you don't yet have any exposure to the world's greatest investor, now's the time to, um, expose yourself.

**UnitedHealth's** (NYSE: UNH) stock price is showing signs of life after hitting a multi-year low. All health-care providers are facing rising costs and the possibility of unfavorable health-care legislation in an election year. We think this bad news is baked into United's price, and we consider this is a strong buy, especially for Fools interested in the health-care industry.

**Cemex** (NYSE: CX) is certainly not a titillating company, but the cement maker should excite the value investor in you. Like all things construction related, its price has suffered. Unlike many, however, Cemex should emerge even stronger on the flip side — and with a price that will have shareholders all shook up (in a good way, of course). 🐻

*The Motley Fool owns shares of Berkshire Hathaway, Cemex, and Starbucks.*

## Sidelined Stocks: BIIB, CCRT, VALU

*These stocks from our scorecard offer the least compelling opportunities for new money this month. We are not selling our positions, but we do not recommend starting or adding to these companies today.*

» We've been keeping an eye on **Biogen Idec** (Nasdaq: BIIB) for some time now because of the waning strength of its drug pipeline. Unfortunately, there's reason to believe that Biogen's pipeline may get considerably weaker. New evidence of a rare brain disease among patients taking the company's fast-growing Tysabri drug ignited concerns that the FDA may restrict or halt future sales. Nothing official has been concluded, but we just don't think there's enough visibility right now to recommend buying the stock.

» Tired of waiting for signs of improvement in the credit markets, **CompuCredit** (Nasdaq: CCRT) management has shifted the company into survival mode by reducing marketing expenditures, shutting down new business initiatives, eliminating staff, and even subleasing excess office space. With no guarantee that financing will be available for the foreseeable future, we applaud management's painful but prudent move. We still believe this one will recover, but we don't recommend buying shares just yet.

» Until CEO Jean Bernhard Buttner either leaves the company or comes up with a better vision for **Value Line** (Nasdaq: VALU), we recommend you look for value elsewhere. 🐻



### Earnings Hits

**Axsys Technologies'** (Nasdaq: AXYS) specialty cameras, lenses, and surveillance gear helped the company record picture-perfect results in the second quarter. Sales jumped 40% and earnings topped analysts' estimates. Security needs from private and government customers will continue to drive strong demand for Axsys' Surveillance Systems Group. We anticipate some serious growth for the company — and its share price.

**Dolby's** (NYSE: DLB) second quarter was music to our ears. The company posted 29% sales growth, soaring margins, and a 56% jump in net income — beating analysts' estimates for the 12th consecutive quarter. Dolby has had a great run, but with price reductions in Blu-ray Disc players, the ongoing transition to digital TV, and exciting new opportunities in high-end mobile applications, we believe this stock is just getting started.

**Medco Health Solutions'** (NYSE: MHS) second quarter was just what the doctor ordered. Thanks to a record dispensing rate for higher-margin generic drugs and a sharp reduction in share count, our favorite pharmacy benefits manager increased earnings per share more than 30% year over year. Medco has a strong competitive position, solid free cash flow, and great growth prospects as big-name blockbuster drugs become available in generic form. Shares aren't cheap, but this is a low-risk health-care play that is largely immune to an ailing economy.

The hits keep coming for **Netflix** (Nasdaq: NFLX). Our online DVD dynamo ended its second quarter with 8.4 million members, a 25% jump from last year's levels. And those members came cheap, as the company posted its lowest ever subscriber acquisition costs. The new Roku box is selling well, and we're excited about the upcoming Xbox and LG Electronics partnerships. At today's prices, Netflix is a streaming buy.

It was quite a quarter for **Quality Systems** (Nasdaq: QSII). Our medical records software provider posted record revenue and operating income and boosted its dividend by 20%. In addition to Quality's great balance sheet and strong free cash flow, it's poised to benefit from the inevitable wave of medical documentation upgrades. We believe Quality has quite a bright future ahead, and only the ongoing boardroom battles have prevented this company from reaching Best Buy Now status.

### Earnings Misses

The challenging economic climate has not been kind to **Corporate Executive Board** (Nasdaq: EXBD). Although

the company posted surprisingly solid second-quarter results, investors focused on declining growth in contract value (a leading indicator of future revenue) and a low cross-sell ratio. Shares fell to a five-year low. Corporate Executive may never recapture the mega-growth of years past, but this is a good price to pay for a firm with a wide moat, solid financials, and stellar client retention rates.

**Costco** (Nasdaq: COST) shares went on sale after the company warned that fourth-quarter results will fall "well below" analysts' expectations due to inflationary pressures and higher energy costs. The membership warehouse has postponed raising its prices as long as possible in order to capture market share from competitors. While this tactic will certainly build goodwill with Costco members, it likely won't have the same cache with shareholders. Costco remains a great business, so we recommend taking advantage of the wholesale discount in today's shares.

**Garmin** (Nasdaq: GRMN) navigated its way through a tough consumer environment to post 23% sales growth and a 19% increase in net income during the second quarter. But a delay in the launch of the company's Nuvi cell phone, along with concerns about competition from new GPS-enabled mobile devices from Apple and Nokia, pushed shares to a two-year low. The competitive concerns are quite real, but Garmin has a great balance sheet, a strong management team, and a stock price that is now 70% off its 52-week high. For the aggressive investor, Garmin is a buy.

It's easy to diagnose what the market disliked about **Lab Corp.'s** (NYSE: LH) second quarter. The company lowered full-year guidance, then admitted that it had to boost its allowance for doubtful accounts because of difficulty in collecting cash from customers. These short-term setbacks are certainly frustrating, but we still love Lab Corp.'s long-term prospects. Demand for its specialty diagnostic services should only increase, and it remains a cash flow-generating machine.

**Whole Foods'** (Nasdaq: WFMI) fiscal third quarter profits plunged a painful 30% thanks to consumer weakness and higher-than-expected costs of integrating the Wild Oats stores. Whole Foods cut sales and earnings expectations, curtailed new store openings, and eliminated the quarterly dividend. This is bad news no matter how you serve it up, but we think management's drastic moves are necessary. At a valuation on par with slower-growing grocery chains like Safeway and Kroger, Whole Foods should appeal to patient, long-term investors. 🐾



## Fool's Tools: What the Income Statement Shows Us

By MATTHEW ARGERSINGER

Cash is king — but is your favorite company using that green wisely? That's the bottom line ... literally.

The bottom line is the culmination of this month's star attraction: the income statement. This synopsis of sales and profits helps us dissect expenses, size up rivals, and see how tightly a company is run. As you'll see, consumer products innovator and *Stock Advisor* Best Buys Now darling **Apple** (Nasdaq: AAPL) is one of the best operators in the biz.

### iPhoning in the Profits

Unlike the balance sheet, which we toured last month, the income statement isn't a snapshot in time. It covers a *period* of time — a quarter, half, or full year. As we move down the table below, costs get taken out of sales (the top line) until we're left with earnings per share (the bottom line).

Apple	June 2008	June 2007	June 2006
Sales	\$30,801	\$22,626	\$18,156
Cost of Sales	\$20,305	\$15,150	\$12,935
<b>Gross Profit</b>	<b>\$10,496</b>	<b>\$7,476</b>	<b>\$5,221</b>
SG&A Expense	\$3,585	\$2,765	\$2,279
R&D Expense	\$1,018	\$754	\$680
<b>Operating Profit</b>	<b>\$5,893</b>	<b>\$3,957</b>	<b>\$2,262</b>
Interest Income	\$647	\$120	\$339
Other Income	\$3	\$422	(\$27)
Income Expense	\$1,941	\$1,365	\$699
<b>Net Income</b>	<b>\$4,602</b>	<b>\$3,134</b>	<b>\$1,875</b>
Diluted Shares	899.7	885.1	874.7
<b>Earnings Per Share</b>	<b>\$5.12</b>	<b>\$3.54</b>	<b>\$2.14</b>

All data, except earnings per share, in millions for the trailing 12 months ended in specified month.

Here are some highlights:

**Sales (or revenue):** These are the proceeds from everything sold over a period of time. For the trailing 12 months (TTM) that ended June 29, Apple rang up \$30.8 billion.

**Cost of sales:** This is the cost of materials and labor; Apple spent \$20.3 billion producing its iPhones, iPods, and Macs.

**Gross profit:** Subtract cost of sales from sales. For the TTM, Apple was left with about \$10.5 billion.

**Operating profit:** Take the gross profit and subtract selling, general, and administrative (SG&A) and research and development (R&D) expenses. Over the TTM, Apple's operating profit was about \$5.9 billion.

SG&A includes salaries, marketing, and rent — about \$3.6 billion for Apple. When revenue grows faster than SG&A expenses, costs are under control and employees are well-oiled machines. For the TTM, Apple's sales increased more than 36%, but SG&A expenses grew less than 30%.

R&D covers developing and improving products and services. If R&D is a slower grower than revenue, it shows that a company may be sacrificing advancement for short-term profits. Apple spends a lot on innovation, but the TTM's 35% jump was still right in line with revenue growth.

**Net income:** Subtract interest payments, other expenses, and income taxes from operating profit. Apple's net income was a hefty \$4.6 billion thanks largely to its lack of debt.

**Earnings per share (EPS):** Divide net income by shares outstanding. Stay conservative by using earnings per *fully diluted* shares to account for employee stock options or other arrangements that can inflate the share count.

### Breaking It All Down

Got all that? Now let's take it a step further. The ratios below allow us to compare Apple with other companies and with itself over time.

**Gross margin:** Divide gross profit by sales. For the TTM, Apple's was about 34%. Compare that with rival **Dell** (Nasdaq: DELL), whose gross margin for the TTM was only 19%. Yep, it's confirmed: Apple scores a nice markup on all that shiny iStuff.

**Operating margin:** Same as gross margin, but take out SG&A and R&D expenses. A higher number means more efficient operations. Operating margins vary, so focus on trends over time. For Apple, the operating margin jumped from 17.5% to 19% year over year. Things are humming along.

**Net margin:** This is net income divided by sales, and it shows how profitable a company is. Apple's profit margin was 14.9% for the TTM; for comparison, Dell's TTM profit margin was a lowly 4.9%.

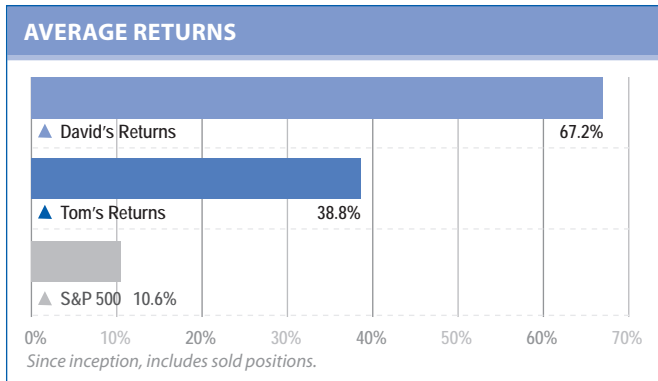
**Price-to-earnings (P/E) ratio:** Divide the current stock price by EPS. Many analysts focus on the P/E ratio, but it has serious shortcomings. Shares fluctuate thanks to offerings and buybacks, and management has lots of wiggle room when reporting earnings. Check out next month's cash flow lesson for better ways to determine valuation.

### The Foolish Bottom Line

Income statements can vary — banks, for example, generate revenue from interest, not product sales. But the game is the same: They show how revenue and expenses are changing over time and how much profit a company is raking in. That's a great way to size up a stock's bottom line. 🦋

# SCORECARD

Details on all recommendations available at [stockadvisor.fool.com](http://stockadvisor.fool.com)



### MOST RECENT RECOMMENDATIONS

Issue	DAVID'S Company	Ticker	TOM'S Company	Ticker
▶ 9/08	<b>Titanium Metals</b>	TIE	& <b>Precision Castparts</b>	PCP
▶ 8/08	<b>Illumina</b>	ILMN	& <b>Linear Technology</b>	LLTC
▶ 7/08	<b>Apple</b>	AAPL	& <b>SEI Investments</b>	SEIC
▶ 6/08	<b>Medco</b>	MHS	& <b>Morningstar</b>	MORN
▶ 5/08	<b>Axsys Technologies</b>	AXYS	& <b>MSC Industrial</b>	MSM
▶ 4/08	<b>Canadian National</b>	CNI	& <b>Sherwin-Williams</b>	SHW

### BAGGERS & LAGGERS

TOP 5 PERFORMERS	BOTTOM 5 PERFORMERS
▲ <b>871.4%</b> <b>Marvel (MVL)*</b> Issue 7/02 — David	▼ <b>(82.2%)</b> <b>CompuCredit (CCRT)</b> Issue 2/07 — Tom
▲ <b>866.8%</b> <b>Activision Blizzard (ATVI)*</b> Issue 3/03 — David	▼ <b>(69.7%)</b> <b>Whole Foods (WFMI)*</b> Issue 9/05 — David
▲ <b>695.4%</b> <b>Quality Systems (QSII)*</b> Issue 4/03 — Tom	▼ <b>(67.3%)</b> <b>Pacific Sunwear (PSUN)</b> Issue 1/06 — Tom
▲ <b>469.9%</b> <b>Amazon.com (AMZN)</b> Issue 10/02 — David	▼ <b>(54.0%)</b> <b>Starbucks (SBUX)**</b> Issue 3/06 — David
▲ <b>453.7%</b> <b>GameStop (GME)*</b> Issue 10/04 — David	▼ <b>(46.4%)</b> <b>Vasco Data (VDSI)</b> Issue 1/08 — Tom

*Excluding sold positions. \*QSII was also recommended in the 3/03 and the 12/05 issues; GME was also recommended in the 1/06 issue; MVL was also recommended in the 12/02 and 9/04 issues; ATVI was also recommended in the 9/02 issue; WFMI was also recommended in the 3/08 issue. This is not an endorsement to buy any of these stocks. It is simply a snapshot of our companies' performance to date. \*\* The Motley Fool owns shares.*

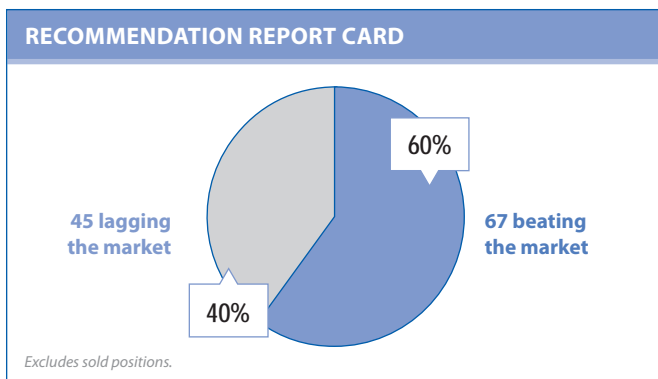
### BEST BUYS NOW

DAVID'S Company	Ticker	Recent Share Price
<b>1. Marvel*</b>	MVL	<b>\$33.74</b>
<b>2. Apple*</b>	AAPL	<b>\$176.73</b>
<b>3. Canadian National</b>	CNI	<b>\$51.34</b>
<b>4. Nvidia</b>	NVDA	<b>\$11.07</b>
<b>3. Starbucks†</b>	SBUX	<b>\$16.36</b>

TOM'S Company	Ticker	Recent Share Price
<b>1. Linear Technologies</b>	LLTC	<b>\$33.99</b>
<b>2. Cemex**</b>	CX	<b>\$22.02</b>
<b>3. MSC Industrial</b>	MSM	<b>\$49.51</b>
<b>4. Berkshire Hathaway**</b>	BRK-B	<b>\$3,838.00</b>
<b>5. UnitedHealth</b>	UNH	<b>\$31.48</b>

*The recommendations in our current issue represent our two best investment ideas this month. But to give you a broader range of options, we've also ranked the best opportunities for new money from among all our past selections. \* David owns shares. \*\* The Motley Fool owns shares. † David and The Motley Fool own shares.*



### TWO STOCKS TO SELL: AMED AND BRL

David pulled the plug on **Amedisys** (Nasdaq: AMED) earlier this week in a special update after the health-care provider's accounting practices were called into question.

Meanwhile, Tom chose to lock in the gains and sell **Barr Pharmaceuticals** (NYSE: BRL), which agreed to be bought by Teva Pharmaceuticals for \$39.90 in cash and .6272 shares of Teva (about \$68 per Barr share).

For David and Tom's top ideas for new money, turn to this month's newest recommendations and Best Buys Now.

All scorecard data as of market close 8/12/08