The Goldman Guide

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In This Issue

Upside Down

“Innovation distinguishes between a leader and a follower.”

The quote above really sets the tone for this week’s Guide. Can you guess who said it? The answer can be found below.

Anyway, investors must have ended the week scratching their heads. It seems what’s up is down and what is down is up. Last week Microsoft, Intel, IBM, and Hewlett Packard all reported quarterly results. And save perhaps for Microsoft to a degree, the results were strong.

What makes this noteworthy for 3 of the 4 is that PC shipments and the must-haves that go with them (like software and accessories) have been in decline, led by sluggish netbooks, in favor of tablets, and basically anything that fits into one’s hand. Additionally, a bunch of high-growth upstarts have been trying to eat into IBM’s service-business market share.

HP is the real shocker. Some had left it for dead (or at least a slow death due to lack of innovation and a new game plan.)

On the flipside, King Google stumbled badly, missing estimates. Wasn’t Google poised to take over the world?

This phenomenon wasn’t limited to the tech world. Citigroup and JP Morgan, two banks which many investors lauded in the financials space missed forecasts. Meanwhile, the media pariah Bank of America actually made money in the quarter reversing recent trends.

To top it off, GM (General Motors or Government Motors depending upon your political bent) has reclaimed its title of world’s top-selling automobile maker.

I am not providing this information as a recap of news reports. There is a major lesson to be learned here.

To use a sports analogy, the resurgence of the tech bellwethers versus the stumbles of the current king of the heap is akin to the Yankees being overlooked by another team that has shown flash.

It may not be exciting to talk about the Yankees because we are so accustomed to their success and we feel it must be on the decline because others are on the rise. Then you turn around and they are right there.

Companies that have a history of success due largely to innovation will likely survive and succeed, even if they are supplanted by others for periods of time, as long as they continue to change and innovate. Eastman Kodak did not, and they filed for bankruptcy last week.

Leaders remain leaders until they prove they are laggards, regardless of sentiment. And that is where investments should be directed. (More on this below.)

Speaking of Leaders/Laggards

A few months ago we gave predictions of companies we felt would be or could be acquired during 4Q11. These included Yahoo! and Research in Motion (RIM.) Last week, both stocks were given a boost. Rumors swirled that RIM might be bought by Samsung, or at the least license some of their IP (intellectual property) to generate revenue. One of Yahoo's co-founders stepped down, bringing speculation that a deal could be in the cards.

So, we may be right about one or both, albeit a bit late.

In any event, both of these companies were leaders but quickly became laggards. RIM's focus on the business customer and the ignorance of where consumer interest was heading doomed the company that was essentially a "closed" technology company. Yahoo's missteps early on in Internet advertising and its focus on portals, banners, and content instead of search and branding in multiple services and offerings crushed it.

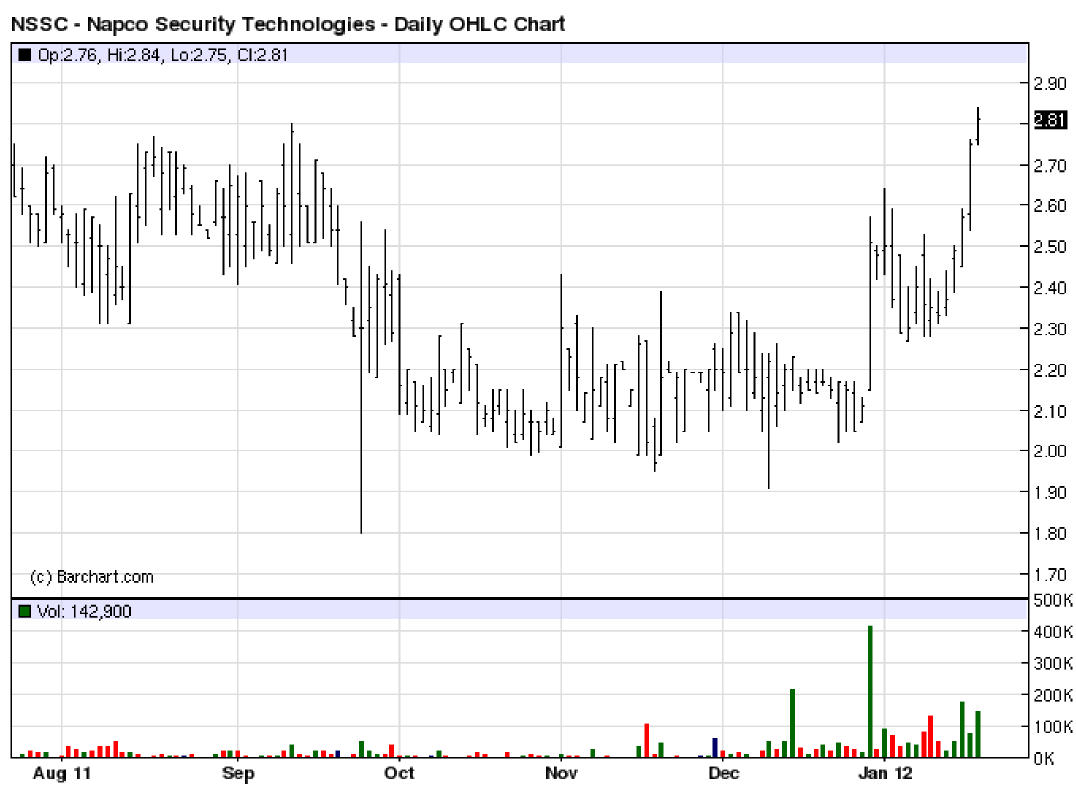
By the way, the quote at the top is attributed to this generation's greatest innovator, Steve Jobs.

Two Great Charts

Since the theme has been leaders, we have unearthed two stocks that have made a bit of a run lately but have great looking charts and could be worth a quick 10-20%.

First up is Napco Security Systems (NASDAQ – NSSC - $2.81.) Napco has been in business for over 40 years and has been publicly traded *since 1972*. Napco produces intrusion and fire alarms, access control, and other related security systems. If you look at the financials, you might yawn. The Company is a slow top-line grower, to the tune of 6-12% annually, in its best years. But it continues to innovate!

Plus, if you lift up the hood, you will see that in its most recent quarters, the Company has pared down debt, increased operating margin, and revenue. Moreover, Napco has been introducing higher profit margin products and services which carry recurring revenue streams and meet demand in an area a little outside of the traditional Napco sweet spot. The Company has been doing some investor relations engagements which have also helped the stock.



Volume has been on the rise and the stock looks like it wants to bust through its 52-week high of $3.02, which is just 7% higher than Friday's close.

Next up is a "fun" company. The Female Health Company (NASDAQ – FHCO -$5.17) manufactures and markets the *FC2 Female Condom®* (FC2), which is available in the U.S. and in about 120 other countries globally. The *FC2 Female Condom®* is the only available FDA-approved product controlled by a woman that offers dual protection against sexually transmitted diseases, including HIV/AIDS, and unintended pregnancy. The World Health Organization (WHO) has cleared FC2 for purchase by U.N. agencies.

For the 2011 fiscal year ended in September, revenue and EPS were down, hurting the stock. However, much of the decline was a result of delays in major shipments, including a 20 million unit order to the United Nations Population Fund (UNFPA), on behalf of Brazil. The UNFPA is a major provider of FHCO's flagship product to emerging nations around the world, in a large-scale effort to reduce HIV/AIDS proliferation.

In addition to this large order, trends are very favorable for The Female Health Company. These include: the feminization of HIV/AIDS, the complexity of developing easy-to-use alternative prevention methods, and the emergence of drug resistant strains of sexually transmitted infections.

We should note that for FY11, revenue was $18.6M with EPS of $0.19. This compares with FY10 revenue of $22.2M and EPS of $0.24. If the Company were to just return to its FY10 revenue and EPS levels, the stock would likely approach $6.00, which is a 33% return from current levels. With a 4.4% dividend to boot, FHCO is a great story for savvy investors seeking a stock that helps provide an innovative solution to a global health problem.

This stock also looks like it wishes to approach or break-through its 52-week high of $5.69, as evidenced by the chart below.

Until next week...

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Rob Goldman has over 20 years of investment and company research experience as a senior research analyst and as a portfolio and mutual fund manager. During his tenure as a sell-side analyst, Rob was a senior member of Piper Jaffray's Technology and Communications teams. Prior to joining Piper, Rob led Josephthal & Co.'s Washington-based Emerging Growth Research Group. In addition to his sell-side experience Rob served as Chief Investment Officer of a boutique investment management firm and Blue and White Investment Management, where he managed Small Cap Growth portfolios and *The Blue and White Fund*.

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