

EQUITY RESEARCH

Monthly Stock Monitor
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HIGHLIGHTS

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MARKET COMMENT ~ “The Bulls are Back in Town”

The month of April saw a return of investor optimism and positive returns in the equity markets as the broad averages rallied due to declining worries over the recent credit contraction. A slew of economic and profit reports were viewed positively causing market pundits to claim the worst was over for the US economy. However, debate continues to rage on Wall Street whether the economy is poised for a pick-up during the 2H08, which ultimately could dictate the direction of the stock market.

Following 5 consecutive months of negative performances, the equity averages turned in positive results for the month of April. During April the Dow Jones Industrial Average rose 4.5%, the S&P 500 increased 4.8%, and the NASDAQ rallied 5.9%. On an interesting note, St. Patrick's Day seems to have been a "lucky" starting point for equities as the stock market has rallied 12% since March 17, following the bail out of Bear Stearns (BSC-\$10.84). The rally in the equity markets was aided by better-than-expected corporate earnings reports and positively viewed economic reports.

The first-quarter earnings season began as a majority of companies reported earnings above Wall Street consensus estimates. One such report was General Motors (GM-\$22.34) whose 1Q earnings release showed the company had not lost as much money as expected by industry analysts, helping to improve investors' appetite for stocks. Additionally, several economic reports reinforced the renewed bullish sentiment causing more investors to move back into the equity markets. 1Q Gross Domestic Production increased by 0.6%, driven by exports and build-ups of US inventories. Another area which performed better than expected was the April Unemployment report showing a jobs decline of only 20,000 versus an expected decrease of 80,000. Investors also reacted favorably to consumer spending figures showing the US consumer increased spending by 0.4%, above consensus expectations. These factors also caused a rally in the US dollar.

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Following a prolonged downturn, the US dollar recently rallied against foreign currencies as traders bought dollars based on better-than-expected corporate earnings and the above-mentioned economic reports. While the US dollar has experienced steep declines, it is hoped by bulls, the greenback has bottomed and will begin to rebound higher in the coming months. This currency rally has also affected commodity prices. An inverse relationship has developed between the US dollar and commodities during the past few years. As the dollar declined, many commodities (trading in foreign dollars) rallied higher pushing up prices for such as items as gold, oil, wheat, corn, rice, and many others reaching recent all time new highs. However, a rising dollar has caused some traders to exit commodities and hopes are this will continue to dampen current inflationary pressures. Declining inflationary pressures could assist the Federal Reserve's attempt to stimulate the US economy, minimize the economic effects of the current credit contraction, and defend the US dollar.

Since the credit meltdown began last summer the Fed has been very pro-active in providing liquidity to the credit markets by establishing term-auction lending, primary-dealer credit, and term-securities lending facilities. Also, the Fed announced a preemptive move aimed at easing the lending squeeze on US consumers by accepting consumer loaned-back securities in exchange for Treasury securities. During April the Federal Reserve lowered interest rates for the seventh time in 8 months. Many feel this may have been the last rate cut for some time as the Fed will focus on boosting emergency reserves and assisting foreign Central Banks now dealing with their own credit contraction.

These moves by the Federal Reserve and better-than-expected 1Q earnings reports increased money flow back into equities as investors are hoping the credit contraction in the US is in the process of easing and the economy improves during the 2H08. Going forward, this latter point is potentially the larger issue for the stock market. Last month we outlined the three types of economic recoveries investors expect during the next 2 years: "V", "U", and "L". The belief of a "V" recovery in the economy is what has driven the recent stock market rally. Under the "V" recovery scenario, it is expected the US economy will improve during 2H08, and along with it will come much higher earnings during the 2H08. Recent earnings and economic reports brought many investors, who had been on the sidelines, back into the stock market with strong buying volumes. Given the recent stampede of investors back into the markets, accompanied by positive statements on the economy/stocks by various market mavens, one could say...."The Bulls Are Back In Town". While many are espousing a "V" recovery is on the horizon, investors may want to see whether this indeed materializes or whether a "U" or "L" recovery is in store for the US. Regarding how to approach these different economic scenarios investors should contact their Anderson & Strudwick representative for appropriate investment strategies.

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COMMENTS AND UPDATES

CMS Energy (CMS-\$14.89) reported 1Q08 earnings of \$0.44/share compared to (\$0.97)/share during 1Q07. Last year's results suffered from (\$1.39)/share charge associated with the sale of international operations. Earnings from continuing operations, non-GAAP, were \$0.44/share compared to \$0.42/share. The electric utility earnings grew to \$0.28/share from \$0.26/share, earnings from the gas utility were flat at \$0.26/share, the loss from the Enterprises/Parent units improved to (\$0.10)/share from (\$0.12)/share. These results at CMS point towards the continued turnaround at this utility with operating earnings improving to \$0.44/share from \$0.42/share. Operations improved on the regulated utility side of CMS's business while operating losses declined at the non-regulated Enterprises unit. Additionally, EBITDA at Consumer's Energy improved to \$1.33 billion from \$1.26 billion while Consolidated's EBITDA rose to \$1.28 billion from \$1.27 billion. During its earnings conference call management stated it would continue to reduce operating expenses, focus on its regulated utility businesses, and use improving cash flow to lower debt. CMS reduced its debt at the Parent level by approximately \$400 million and CMS Enterprises' level by \$80 million. CMS did confirm its 2008 earnings guidance of \$1.20/share. Given the company's improving cash flow/earnings and debt reduction we anticipate the Board of Directors could raise its common stock dividend this year marking the second increase since reinstating the dividend in 2007. A continuation of earnings and dividend growth could increase investor demand for CMS's shares, potentially pushing its stock towards our \$19 target. These shares are rated OUTPERFORM. (SFM)

Digital Ally, Inc. (DGLY-\$9.23) reported 1Q08 of \$0.10/share vs. \$0.01/share, its eighth consecutive record revenue quarter. For the three months ended March 30, 2008, revenue increased 150% to approximately \$8.6 million, when compared with revenue of approximately \$3.4 million in the 1Q07. Sales during the 1Q08 increased 22% when compared with approximately \$7.0 million in the fourth quarter of 2007. Gross profits improved 178% in the quarter and pretax income rose 1,456% in the quarter compared to the 1Q07. Basic earnings per share increased 1,100% to \$0.12 in the quarter ended March 30, 2008 compared with \$0.01 per share in the prior-year period. DGLY continues to get follow-on orders with larger quantities from existing customers, while winning a high percentage of new opportunities. DGLY just also announced a new product for mass transit with more on the way for school buses and military applications. We believe that DGLY still has much larger potential since they have only about a 10%-15% penetration rate of the law enforcement market and should continue its high growth for the next year or two. These shares are rated OUTPERFORM with a \$12 price target. (STT)

Dominion Resources (D-\$44.80) reported 1Q08 GAAP earnings of \$1.18/share vs. \$0.65/share during 1Q07. On an operating basis, D reported earnings of \$1.00/share vs. \$0.74/share as operating earnings rose to \$578 million from \$518 million. The improvement was driven primarily by higher results from the generation businesses and certain tax benefits. These positives offset the negatives from warmer-than-normal weather and expenses related to service restoration following severe storms in the electric utility area. Additionally, the current quarter benefited from the absence of unrecovered Virginia fuel expenses, realized gains from D's remaining exploration & production (E&P) operations, lower interest expense, and accretion from lower outstanding common shares. On a quarter-to-quarter basis, Dominion Virginia Power added \$0.01/share, Dominion Energy improved \$0.12/share, and Dominion Generation was higher by \$0.38/share. Total operating revenues, on a GAAP basis, were \$4.38 billion compared to \$4.66 billion. The decline is primarily attributable to the absence of D's E&P operation which were sold in 2007. D's 1Q08 results of \$1.00/share exceeded Wall Street expectations of \$0.88/share. However, D management appears to be conservative by maintaining its earnings guidance of \$3.05-\$3.15/share for 2008, despite higher 1Q08 results. Earnings guidance for 2Q08 is \$0.47-\$0.52/share. Should D generate earnings, during the next 2 quarters, above expectations then management may raise overall 2008 earnings guidance sometime this summer. Earnings growth could allow the Board of Directors to increase D's annual dividend according to their business model, thus providing shareholders the potential of a growing income stream in tandem with growing corporate profits. These shares are rated NEUTRAL. (SFM)

GlobalSCAPE (GSB-\$2.39) reported 1Q08 earnings in line with expectations. Revenues for this quarter were \$4.05 million compared to \$3.62 million for the same quarter in 2007, which is an 11% increase in 1Q08. Net income was \$175,411, or \$0.01 per fully diluted share, compared to net income of \$473,214 in 1Q07, or \$0.03/share on a GAAP basis. Non-GAAP net income for 1Q08 was \$499,275, or \$0.03 per fully diluted share compared to \$620,623 or \$0.03 per share in 1Q07. GSB expects the next two quarters to be flat with sequential growth reaccelerating in Q4. GSB, and its competitors, are also experiencing a slowdown enterprise IT spending but recent insider buying is an encouraging sign. These shares are rated OUTPERFORM with an \$8 price target. (STT)

Massey Energy (MEE-\$58.20) reported 1Q08 earnings of \$0.52/share vs. \$0.40/share during 1Q07. The 28.5% increase was due to increased produced coal revenues and higher operating cash margins per ton. Increased produced coal revenues rose 4.5% to \$543.2 million as some below-market priced contracts expired and higher exports of steam and metallurgical coal. Average utility coal prices/ton realizations rose to \$47.89 from \$45.01 and metallurgical coal prices/ton averages improved to \$80.63 from \$73.68. The average cash cost/ton was \$45.62, versus \$42.36, and operating cash margins per ton rose 8.5% to \$56.36/ton as higher produced coal revenue per ton offset cost increases. The recent rising tide of commodity prices, and higher earnings, has increased investor's bullishness for coal companies like MEE. Coal prices have been rising during the past year as large amounts of investor money has been rotating into the commodity markets following declining returns in the equity markets. These higher coal prices, in conjunction with MEE's cost-cutting efforts have produced improved earnings. Management's guidance for 2008 & 2009 have raised investor enthusiasm for MEE shares with expectations of 2008 coal shipments of 41.5 million - 43.0 million tons and 46.0 million - 48.0 million tons in 2009. Additionally, guidance was given of average produced coal prices of \$61-63/ton in 2008 and \$65-\$74/ton in 2009. Since August of 2007 MEE's shares have more than tripled in value from rising commodity prices and a large migration of investor money into coal stocks. Going forward, a continued upward move of MEE's shares have two risks: declining coal prices and a sudden migration of investor money out of coal stocks. MEE is rated NEUTRAL. (SFM)

Media General (MEG-\$14.17) reported 1Q08 earnings of (\$0.91)/share vs. (\$0.27)/share during 1Q07. The just completed quarter includes a (\$0.47)/charge related to plans to sell five TV stations. Revenues declined to \$194.4 million from \$218.3 million. These declining results were due to a weakening economy and lower advertising revenues as the Publishing Division suffered primarily from the real estate market slowdown in Florida negatively affecting MEG's Tampa operations. Revenues in Florida declined 29.5% for the quarter compared to last year's quarter while Virginia's fell 11.1%, North Carolina was lower by 7.3%, and Alabama/South Carolina both fell 4.6%. While debate rages whether a recession has hit the US it appears the effects of an economic slowdown have affected US media companies like MEG. Examining MEG's three operating units produces growing evidence that decreased consumer spending is generating lower advertising revenues. Given tough operating fundamentals, management is moving to reduce expenses and debt. A continuation of cost-cutting will be needed by MEG, and all newspaper/media companies, until the US economy recovers thus producing increased ad revenues. MEG's shares appear to have already priced in a recession with the stock sitting at a 15-year low. However, patient investors will be rewarded with a 5.9% dividend which appears secure given a 3.3x EBITDA-to-dividend coverage ratio. Newspaper/media stocks are early cyclicals which led the equity markets lower last year in anticipation of an economic slowdown and could lead the markets higher when the US emerges from its current economic doldrums. These shares are rated OUTPERFORM and could be used for short-term trading and long-term investing by aggressive/speculative accounts. (SFM)

Shutterfly Inc. (SFLY-\$13.03) reported 1Q08 revenues of \$34.3, million an increase of 29%, but was at the low-end of guidance. Adjusted EBITDA of (\$728,000) was better than expected and a GAAP loss of \$0.15/share was in line. Full year guidance was reduced with revenue cut by 6%, but EBITDA was unchanged at about \$38 million. SFLY continues to see strong holiday related growth but non-holiday demand is suffering due to the economic slowdown. As a result, the company's ability to achieve 2008 targets is highly dependent on 4Q holiday-related demand. While some investors may perceive the less robust revenue outlook as a sign that competitive pricing is cutting into Shutterfly's business, we tend to agree with management's assessment that that is not the case. Strong growth around key holidays, third-party measurement data, accelerating growth in consumer engagement metrics, and their internal competitive tracking all support the theory that the macro environment is driving a slowdown in demand. We expect that the shares will remain depressed pending better visibility on the crucial fourth quarter. SFLY remains a strong leader in a category with substantial growth potential and light penetration. With \$3.60/share in cash, the shares are very attractive at current levels. These shares are rated OUTPERFORM with a \$35 price target. (STT)

Union Bankshares (UBSH-\$19.25) reported 1Q08 earnings of \$0.29/share vs. \$0.41/share during 1Q07. Lower profits were due to increased loan loss provisions, costs associated with new branch openings and a de novo office, and costs from merging affiliated banks. UBSH, on a quarter-to-quarter comparison, saw higher service income on deposit accounts and increased non-interest income. The provision for loan losses grew by \$2.3 million due to a reduction of an estimated loan loss exposure and an increase of \$1.6 million in loan losses. These increases came from loan growth, net charge-offs, and uncertainty regarding a slowing economy and credit risk factors. While examining comparable periods shows no improvement in many categories, on a sequential quarterly basis there has been progress in some areas. For example, while 1Q08's ROA declined compared to 1Q07, these results were flat when compared to 4Q07. Similarly,

1Q08 ROE's was lower vs. 1Q07, but higher when compared to 4Q07. Net interest margins may improve going forward into 2H08 following a steepening of the yield curve and assuming competition for deposits does not raise funding costs. Moreover, the credit quality of UBSH's loan portfolio appears solid, despite the recent \$1.6 million increase in loan loss provisions, net charge-offs were 0.11% of loans. Non-performing assets totaled \$10.8 million of which \$7.2 million is from a single credit relationship. While management has seen softening in its markets, loan growth has been good driven by the commercial sector. UBSH's 4% dividend appears secure and offers patient investors an attractive high yield while awaiting rebound in the financial sector. These shares look attractive trading at 1.2x book and offering a 4% dividend yield. Our target price is \$31/share based on an eventual pick-up in the economy, stabilization of the US financial system, UBSH's credit quality remains strong, and the dividend is maintained. UBSH is rated OUTPERFORM. (SFM)

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