

EQUITY RESEARCH

Monthly Stock Monitor August 5, 2008



HIGHLIGHTS

MARKET COMMENTARY.....	”Fighting the Three-Headed Beast”
A.T. CROSS.....	Good 2Q results
DIGITAL ALLY.....	9 th consecutive quarter of record revenues
DOMINION RESOURCES.....	Improved 2Q08 earnings
DUKE ENERGY.....	Upgraded to OUTPERFORM
MEDIA GENERAL.....	Lowering price target
NISOURCE.....	Downgraded to NEUTRAL
PFIZER.....	Terminated Coverage
SHUTTERFLY.....	Decelerating revenue growth
UNION BANKSHARES.....	Maintains solid balance sheet

MARKET COMMENT ~ “Fighting the Three-Headed Beast”

Volatility in the equity markets continued during the past month as both "bulls" & "bears" argued the direction of the economy, stocks, and the ongoing credit contraction. Many pundits have made various predictions as to when the US economy will improve while debating the interpretation of recent economic reports. Whatever these supposed experts argue one thing can be agreed upon by all; the US economy is battling contracting credit conditions, a slowing real estate market, and higher fuel/food costs, or what we call, "The Three-Headed Beast".

The credit contraction began one year ago as investors reassessed the true value of sub prime mortgages and the investments created from these pools of loans. Investors fled these investments thereby causing a downward spiral of these securities' values. This caused a ripple effect as home prices began to decline over fears of inflated prices and rising housing inventories. In response lenders began to raise credit standards for home purchases thereby increasing the slowing effect on the housing market and accelerating the fall of real estate prices.

According to the S&P/Case-Shiller index, home prices declined 17% during May, versus last year's same period, in 10 of the 20 metropolitan followed by this service. The cascading effect of falling real estate prices created negative equity on home loans causing a large increase of home foreclosures during the past 2 quarters. U.S. consumers, seeing falling real estate values and slowing property sales instinctively began to pullback on their spending habits. Additionally rising food and fuel prices further shrank discretionary spending helping to slow the US economy.

Recent reports have given a mixed picture as to the direction of the economy. U.S. consumers, which account for 70% of the economy, have reduced driving, evidenced by gasoline demand during the past month falling 2.4% compared to July 2007. Retail sales have also suffered as shoppers have opted for lower priced private label food purchases, reduced buying of prescription drugs, and caused the Big Three's auto sales to decline 10%-26%. The employment picture has

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weakened with unemployment increasing during the past quarter from 5.4% to 5.7% as July's report showed a loss of 51,000 jobs. However, despite these negative reports the Gross Domestic Product rose 1.9% during 2Q08, according to the US Commerce Department which was assisted by \$78 billion in federal tax rebate checks and some of the strongest exports business in years. Due to tax rebate checks personal income during the 2Q rose 7.4%. The falling US dollar has helped the export business as American products have become cheaper overseas and helped grow profits for many companies selling goods into Europe and Asia.

Exports, which grew 9.2% during 2Q08 vs. 5.1% in 1Q08, helped sustain earnings of the S&P 500 during the most recent quarter. While there has been earnings weakness from companies with strictly U.S. sales, those with foreign sales have seen increased profits. Overall S&P earnings, during the 2Q08 earnings season, fell 17.9% compared to 2Q07 's profits. The majority of the decline came from auto, financial, home builders, and the negative effects of rising energy costs on corporate profitability. The Wall Street Journal recently argued stripping out financials, home builders, energy, and autos would have produced an 11.3% earnings growth in the S&P 500 during 2Q08.

During the past month equities halted recent declines and rallied after Merrill Lynch (MER-\$26.39) reported quarterly earnings and market pundits proclaimed the worst of the sub prime mess was over for the financial sector. On this rationale, financial stocks rallied and was buffeted by the bail-out package recently passed by Congress. Under this legislation government-sponsored housing agencies, Fannie Mae (FNM-\$11.83) and Freddie Mac (FRE-\$7.52), were rescued as their mortgage obligations effectively become the responsibility of the US Government. Because of the recent rally the performance of the major market averages turned in mixed numbers for the month of July with the Dow Jones higher by 0.43%, the S&P 500 lower by 0.84%, and the NASDAQ rising 0.67%. Many bulls argue a pick-up during 2H08 earnings of the S&P 500 will propel the equity markets higher, while the bears see a lackluster economy going into 2009.

The future direction of the stock is likely to be determined by how the US economy responds to dealing with the "Three-Headed Beast". While many debate how consumers will fare going forward it would seem falling fuel prices would go a long way towards helping the economy. Of late consumers have been paying \$50-\$150 to fill up their gas tanks. High pump prices have caused consumers to decrease spending on dining out, travel plans, home improvements and auto purchases creating a ripple effect which has cascaded throughout the economy. A decline in prices at the gas pump could raise discretionary income, thus potentially increasing consumer spending which could improve the pace of US economic activity. Improved economic activity may place a bottom in the real estate market and relieve pressure on the US financial system. Under this scenario, equity markets could rally led by consumer-sensitive, financials, and home builder stocks. Consult with your Anderson & Strudwick advisor for appropriate strategies to potentially improve investment portfolio returns.

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COMMENTS AND UPDATES

A.T. Cross (ATX-\$8.05) reported a solid 2Q with revenues growing 19% Y-o-Y to \$43.2 million. The Cross Accessory Division was up 8% to \$25.9 million, and the Cross Optical Group grew 38% to \$17.3 million. Gross margin was essentially flat Y-o-Y at 56.4%. Operating income was up more than 70% to \$3.2 million from \$1.9 million in 2Q of last year. Diluted EPS for 2Q was \$0.12, double from \$0.06 2Q '07. Importantly, inventory at the end of the quarter was in good shape, despite the addition of nearly \$1.8 million from the acquisition of Native Eyewear into the Optical Group. We believe Native will complement the existing Costa Del Mar product line well by targeting the premium sunglass market. ATX has four growth strategies: 1) Grow the Cross brand in the Accessory Division by reshaping their approach to the quality writing instrument market and developing new brand extensions. 2) Continue to lower their Accessory Division cost structure by optimizing their manufacturing facility in China and its supply chain. 3) Grow the Optical Group's polarized sunglass business through Costa Del Mar and Native brands and achieve scale and competitive position in this premium sunglass market. 4) Utilize their strong balance sheet and increasing cash flows to execute smart, value-added acquisitions to strengthen each part of their business with new long-term growth opportunities. Despite the extremely weak consumer discretionary environment, they are maintaining their guidance they provided at the beginning of the year. They expect to report revenues for FY08 of \$165-\$170 million and EPS of \$0.49-\$0.51. Also, as stated earlier this year, their three-year financial plan is to grow the ATX businesses to revenues over \$200 million and a 10% operating margin with the majority of this growth to be organic. We rate these shares an OUTPERFORM with a \$14 price target. (STT)

Digital Ally (DGLY-\$7.51) reported its ninth consecutive record revenue quarter of \$8.9 million vs. \$3.8 million a year ago or a 133% increase. Diluted EPS increased 167% to \$0.08 vs. \$0.03 a year ago. However, DGLY "missed" the street consensus revenue and EPS estimates of \$9.1 million and \$0.09 respectively. DGLY reiterated FY '08 guidance with revenues of \$40 million and operating margin about 29%. The company continues to take market share in the in-car video system market. They now have over 2,000 individual municipal customers up from 1,400 from just six months ago. Due to "slightly missing" estimates, DGLY has lost some of its near term momentum. Investors are now likely waiting on more evidence that management can continue to execute. Additionally, there is concern of an erosion in the tax base due to falling real estate prices which would potentially cause municipalities to cut back on law enforcement expenditures. DGLY maintains that a significant amount of their business comes from the federal government and NOT the states. If DGLY can recover the solid sequentially growth in 3Q, the market could reward the shares with a much higher PE multiple. We have an OUTPERFORM rating on DGLY with a \$12 price target. (STT)

Dominion Resources (D-\$42.33) reported 2Q08 operating earnings of \$0.50/share vs. \$0.44/share during 2Q08. The improvement came from increased profits at the Dominion Generation and Dominion Energy units, the absence of un-recovered fuel expenses in Virginia due to fuel expense deferral allowances, lower interest expense, and accretion of earnings due to the company's recent share repurchase program. Dominion Generation produced profits of \$0.36/share vs. \$0.12/share, on a quarter-to-quarter basis, benefiting from higher operating margins. Dominion Energy's contributed \$0.12/share vs. \$0.09/share, as the remaining exploration/production reported higher volumes and realized profits. The re-formulated D continues to chug along following last year's sale of the exploration/production business. This sale allowed D to gear its operating model towards a more conservative nature by reducing its risk in unregulated ventures. Going forward, D raised 2008 earnings guidance from \$3.05-\$3.15/share to \$3.10-\$3.15/share and 2009 guidance from \$3.25-\$3.40/share to \$3.30-\$3.45/share. Under this earnings scenario, D could continue to increase its annual dividend which was recently stated as one of their operational strategies. The stock looks fairly valued trading at 2.7x book value and paying a 3.4% dividend yield. D shares are rated NEUTRAL. (SFM)

Upgraded our rating on **Duke Energy (DUK-\$17.37)** to Outperform from Neutral. We are raising our rating on DUK due to a low valuation, its business model, and a current dividend yield of 5.4%. After reaching a high in December 2007 of \$20.78/share, DUK has declined approximately 20% due to recent volatility in the equity markets. However, with its shares near its 52-week low, DUK shares are trading at 1x book value, below its industry peers. The company's goal to grow earnings 5%-7% over the next few years appears achievable given its conservative to moderate business plan. DUK sees profit growth coming from its regulated unit and the Commercial Power and DEI businesses potentially growing adjusted earnings before interest/taxes at a compounded rate of 8%-12% through 2012. We have little expectations for profit contributions from the Crescent Resources unit until there is improvement in the US real estate market. The quarterly common stock dividend was

increased to \$0.23/share from \$0.22/share. Additionally, DUK management anticipates raising its common stock dividend in the future based on earnings growth. Based on a current 5.4% dividend yield, with prospects of future dividend increases based on 5%-7% annual earnings growth, and trading at an attractive valuation of 1x book value, we raised our rating on DUK to OUTPERFORM from NEUTRAL. Our price target is \$22/share, or 1.3x book value. (SFM)

Media General (MEG-\$12.76) reported 2Q08 earnings of (\$0.06)/share, which included a \$0.14/share severance charge, vs. \$0.19/share during 2Q08. Absent the 2Q08 severance charge, MEG would have reported \$0.08/share in earnings. Profits at the Publishing unit declined to \$6.8 million from \$22.6 million as total revenues were lower by 14.7% and newspaper ad revenues fell 17.1%. Profits at the Broadcast unit fell to \$14.9 million from \$18 million due to weak National and Local time sales partially offset by a \$2.8 million increase in Political revenues. The Interactive Media Unit produced a \$665,000 loss versus a \$359,000 profit. When comparing quarters, free cash flow (after-tax cash flow less cap ex) improved to \$13.2 million from \$5 million following a \$13.8 million decline in cap ex spending. This is important since it is the free cash flow which allows MEG to maintain its high dividend payout equating to a 7% yield. It appears this high dividend yield is providing support for MEG's shares at these levels and should continue to do so as long as the current payout is maintained. MEG announced it is in the process of "impairment testing primarily of goodwill and other intangible assets" on its balance sheet given the current economic slowdown and investors declining valuations of the media industry's assets. Potentially, this could lead to a reduction of MEG's book value. These shares offer upside when a perceived economic bottom has been reached in the US economy. Any positive economic news could create a rally in MEG shares pushing the stock towards \$16-\$19/share. MEG is rated OUTPERFORM. However, we lowered our price target to \$19/share reflecting negative sentiment presently surrounding media stocks and on the assumption of an asset impairment charge reducing MEG's current book value of \$38/share. (SFM)

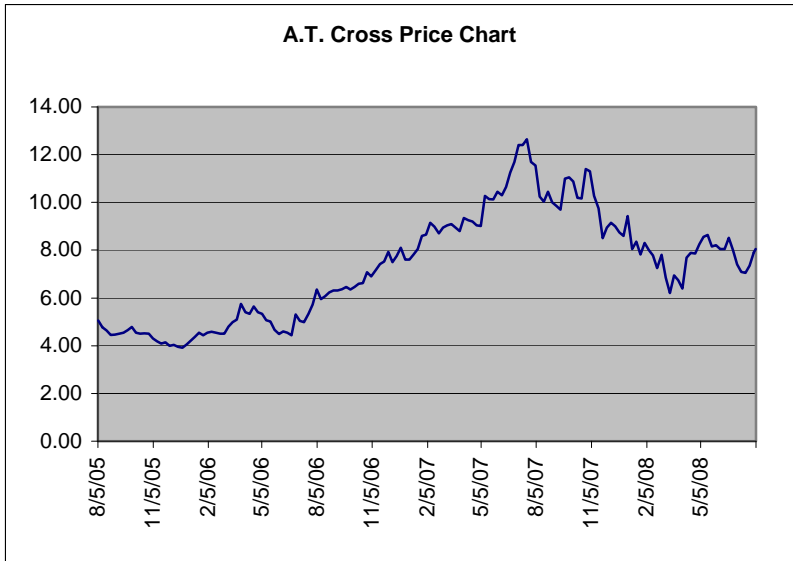
We downgraded our rating on **NiSource (NI-\$16.72)** to Neutral from Outperform. Our original thesis for giving NI an Outperform rating as a growth-income story was based on three parts: earnings growth, merger/consolidation candidate, and high dividend yield. Given recent quarterly reports it appears NI earnings will exhibit little growth as operating expenses have been trending higher during the past year. Going forward earnings will need to improve in order to handle potential rising operating and capital expenditure costs. Additionally, management's recent earnings guidance of \$1.25-\$1.35/share through 2008-2010 points towards flat profits at best during the next couple of years. The prospects of a merger/consolidation for NI also appears to have dwindled due to the current credit contraction in the US. Additionally, NI has various rate cases pending with regulators adding uncertainty to the company's future cash flow which could make it difficult to assess the value of any assets which the company may want to sell over the near term. NI continues to pay a dividend yield of 5.4% which may be attractive to income investors. However, while offering a high dividend yield, NI lacks an earnings growth component and the prospect of mergers/consolidations in the gas/electric utility sector are low at this time. Thus, with two parts of our investment thesis no longer in place, we reduced our rating to NEUTRAL from OUTPERFORM. (SFM)

We terminated coverage of **Pfizer Inc. (PFE-\$18.98)**. Pfizer Inc. is a major pharmaceuticals, hospital/consumer products, and animal health lines. Headquartered in New York City, the company's primary pharmaceutical product lines include Zoloft, Lipitor, Norvasc, Zithromax, Aricept, Cardura, Diflucan, Zyrtec, Celebrex, and Viagra. (SFM)

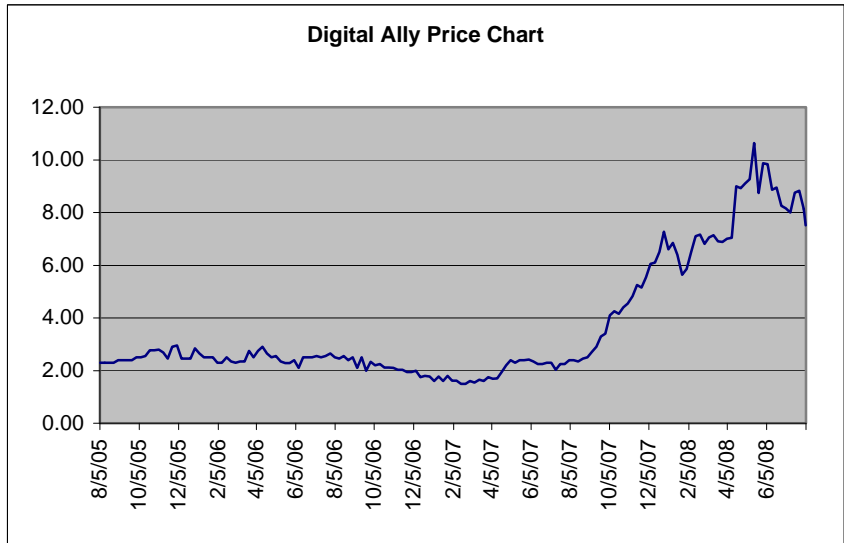
Shutterfly (SFLY-\$8.84) reported 2Q results that can be characterized by decelerating growth in revenue. Revenues were \$35.8 million up 19% Y-o-Y, but at the low end of the guidance range of \$35 million -\$38 million. Adjusted EBITDA of \$0.4 million was in-line with expectations due to tighter costs controls. SFLY maintained full-year revenue guidance of \$225 million -\$240 million. Gross margin outlook was raised by 100 basis points and capital expenditure outlook was reduced from 16.5% to 15%. 3Q guidance for revenues of \$33 million -\$36 million is below consensus of \$39 million, and as a result, the year is even more 4Q loaded, as holiday-related growth is expected to remain robust while non-holiday related spending continues to soften. While the economic environment and especially the consumer discretionary sector continues to be challenging, we continue to view SFLY as the leader in its category and a very strong franchise. Customer engagement metrics (i.e., unique visitors, avg. stay in minutes, order size, # orders/day, etc.) appear to still be healthy. However, the stock remains depressed as the market is apparently dismissing 4Q as being overly aggressive on the part of management. A potential catalyst would be if crude oil continues to fall thus giving consumers more discretionary income. Under this scenario, shares could rally as the market would possibly feel more comfortable that the management could deliver

on the very important 4Q holiday season. Considering MSFT bought AQNT (also a category leader in its space) 14 months ago at about a 20X forward EV/EBITDA multiple, SFLY appears attractive at 4X forward EV/EBITDA. We rate SFLY OUTPERFORM with a target price of \$35. (SFM)

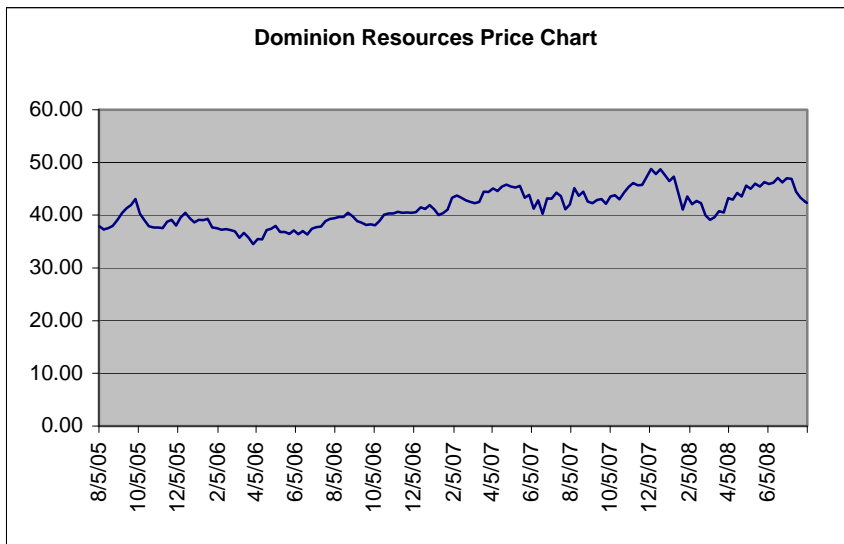
Union Bankshares (UBSH-\$21.94) reported 2Q08 earnings of \$0.32/share vs. \$0.42/share during 2Q07. The decline was due to increased loan loss provisions, costs from the purchases of six bank branches and the opening of a de novo office, and non-recurring expenses related to merging affiliate banks. These were partially offset by higher profitability in the mortgage segment and higher service charges. The mortgage segment generated a profit of \$88,000 vs. a loss of \$163,000 on a quarter-to-quarter basis. During the quarter the provision for loan losses increased \$1.5 million from continued loan growth, net charge-offs, and due to the recent economic slowdown. While the quarter-to-quarter results produced negative comparisons, UBSH's business appears to be improving on a sequential quarterly basis while the credit quality of its portfolio appears sound. On a sequential quarterly basis, UBSH's earnings improved to \$0.32/share versus \$0.27/share from lower funding costs, higher non-interest income, and minimal growth in non-interest expense. More importantly, the loan portfolio's credit quality appears sound as loan delinquencies, according to management, are within normal historical norms, and have not increased above 1Q08's levels. Although loan loss provisions grew by \$1.5 million due to continued loan growth, net charge-offs, and due to the economic slowdown, non-performing loans remained at the same levels as 1Q08. While there has been a slowdown in residential/real estate loan activity, UBSH's service territory remains stable and the bank has not seen significant deterioration in the quality of its loan portfolio. UBSH's portfolio has no exposure to the sub prime market. UBSH offers appreciation potential based on an improvement in the economy, a stabilization of the real estate markets, and the prospects of earnings growth as the US financial system finds firm footing. Trading at 1.3x book value these shares are rated OUTPERFORM. Our price target is \$31/share. (SFM)



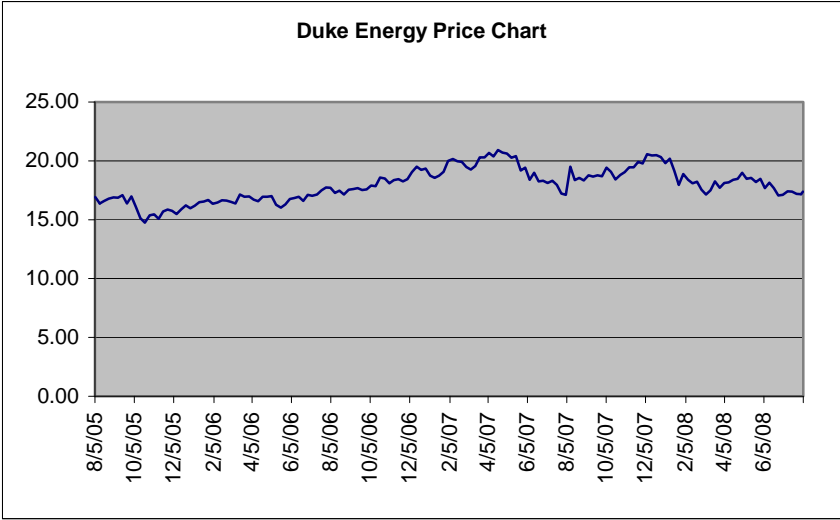
8/21/07 \$9.62 Initiate OUTPERFORM TP: \$14



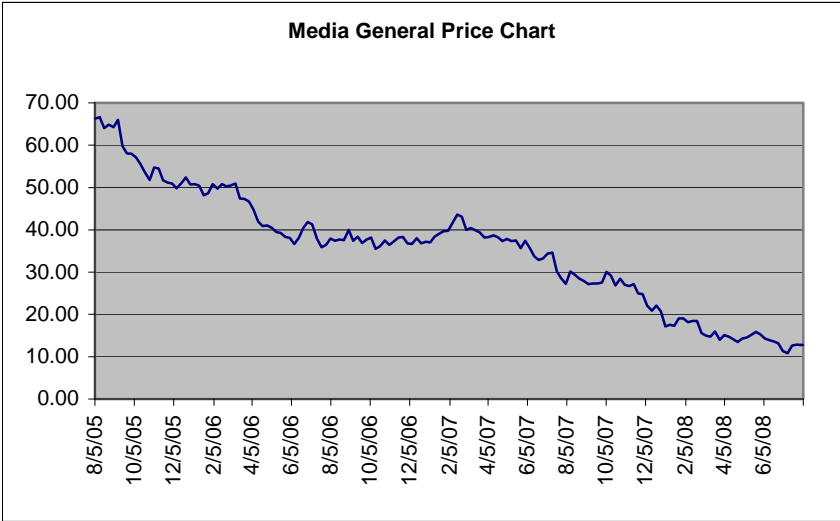
12/18/07 \$6.17 Initiate OUTPERFORM TP: \$9
05/01/08 \$9.27 Raised TP: \$12



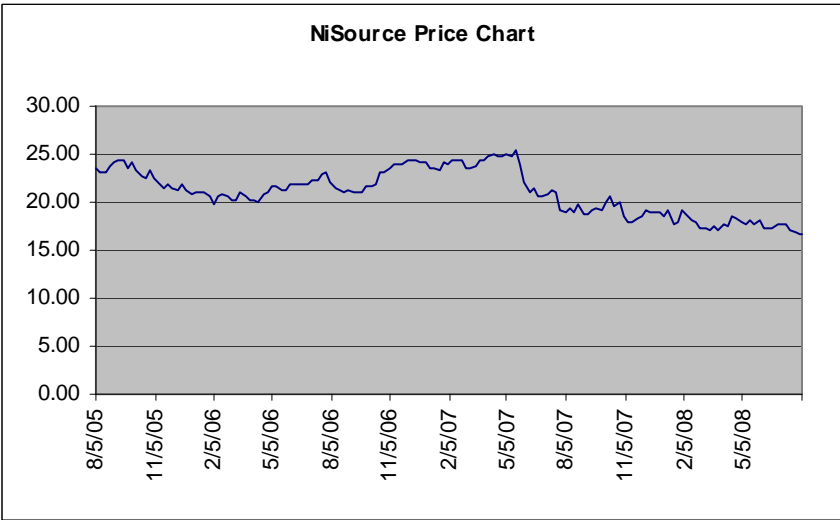
D has been rated NEUTRAL for the entire 3 year period



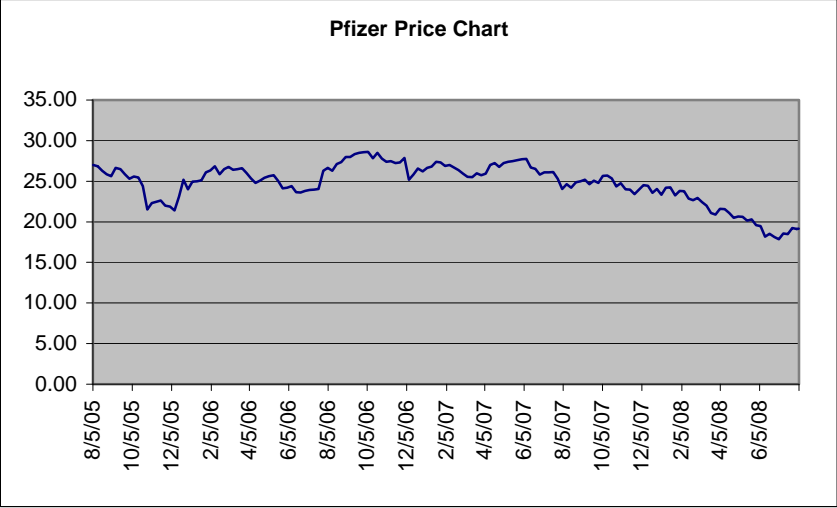
Duke Energy had been rated NEUTRAL for the entire three-year period
 7/17/08 Upgraded to OUTPERFORM @ \$17.08 TP: \$22



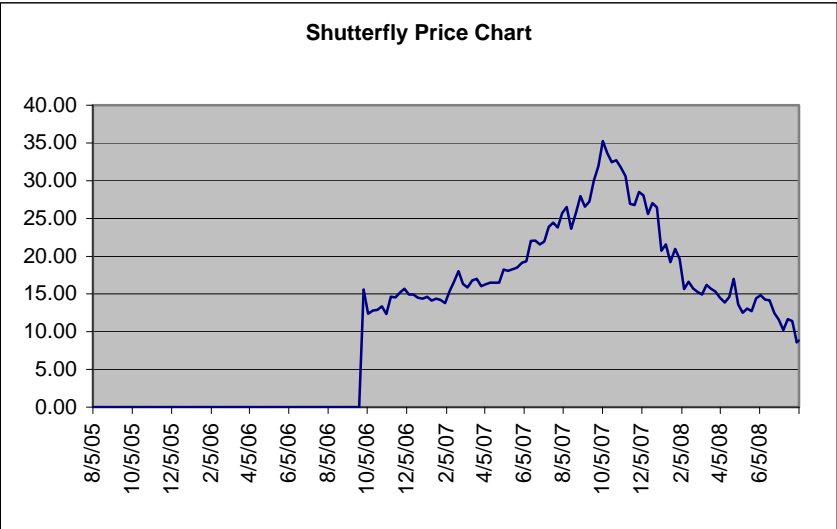
08/07/07 \$28.17 Initiate OUTPERFORM TP: \$39.25
 02/06/07 \$20.08 TP: \$38.
 07/31/08 \$13.24 TP: \$19



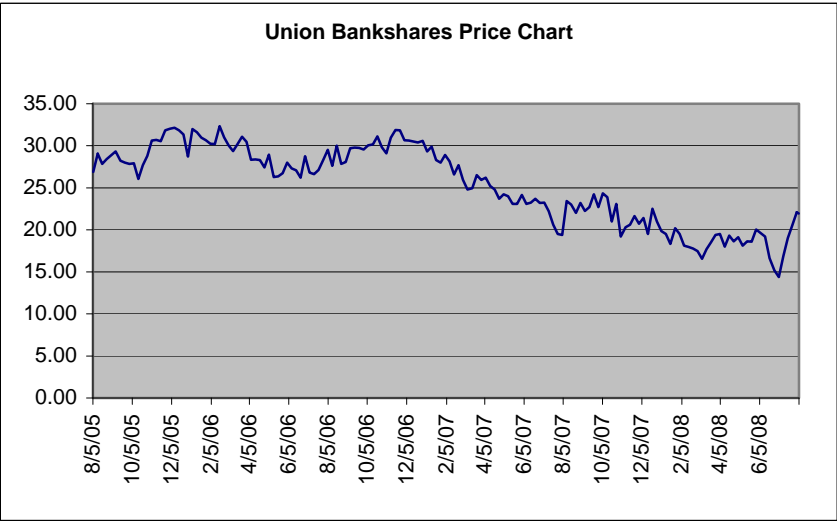
Initiated "Outperform" 05/27/03 CP: \$19.93, TP: \$24
 Updated 01/5/06 "Outperform" TP: \$27
 Downgrade to NEUTRAL 7/17/08 @ 17.09



7/17/08 @ \$18.26: Terminating Coverage



11/15/07 \$26.70 Initiate OUTPERFORM TP: \$35



12/09/04 \$24.34 OUTPERFORM TP: \$40
 08/09/05 \$27.59 TP: \$43
 02/21/06 \$30.77 TP: \$48
 10/27/06 \$29.46 TP: \$44

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- (2) Neutral — The stock's total return including dividends is expected to be in line with the industry or market average of +/- 10% over the next twelve months.
- (3) Underperform — The Stock's total return including dividends is expected to be below the industry or market average by 10% or more over the next twelve months.

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