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**Cash Flow Trends and Their Fundamental Drivers:  
Comprehensive Review (Qtr 2, 2010)  
FREE CASH MARGIN INDEX:**

**2.43%**  
Recession Low (Mar. 2001)

**5.97%**  
Current (June. 2010)

**6.69%**  
Recent High (March, 2010)

For the twelve months ended June 2010, median free cash margin for the 3,807 non-financial firms in our survey declined to 5.97% from 6.69% for the twelve months ended March 2010. Even as free cash margin declined, however, firm fundamentals continued to improve. Revenues increased for the second consecutive reporting period and were accompanied by an improvement in gross margin and a reduction in spending on SG&A. Receivable days and inventory days remained relatively flat, though companies took longer to pay vendors, using increased payables days to boost cash flow. Capital spending measured as a percent of revenue continued to bounce near recent lows. Overall, our data give no obvious signs that companies are beginning to embrace growth. They are shunning new investments in inventory and capital equipment and sheltering resources as protection against uncertainty.

In our sample during the current reporting period, four industry sectors reported improved free cash margin from the same period in 2009, and five sectors saw free cash margin decline. Eleven sectors saw their free cash margin remain relatively stable. Individual companies with interesting free cash margin trends that are examined in this report are Wal-Mart (WMT), Ruddick Corp. (RDK), Lear Corp. (LEA), Ciena Corp. (Ciena), Hertz (HTZ) and Landstar Systems (LSTR).

Data for this research were provided by Cash Flow Analytics, LLC., [www.cashflowanalytics.com](http://www.cashflowanalytics.com).  
Charles Mulford is a principal in Cash Flow Analytics, LLC. September, 2010

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**Georgia Tech Financial Analysis Lab**

The Georgia Tech Financial Analysis Lab conducts research on issues of financial reporting and analysis. Unbiased information is vital to effective investment decision-making. Accordingly, we think that independent research organizations, such as our own, have an important role to play in providing information to market participants.

Because our Lab is housed within a university, all of our research reports have an educational quality, as they are designed to impart knowledge and understanding to those who read them. Our focus is on issues that we believe will be of interest to a large segment of stock market participants. Depending on the issue, we may focus our attention on individual companies, groups of companies, or on large segments of the market at large.

A recurring theme in our work is the identification of reporting practices that give investors a misleading signal, whether positive or negative, of corporate earning power. We define earning power as the ability to generate a sustainable stream of earnings that is backed by cash flow. Accordingly, our research may look into reporting practices that affect either earnings or cash flow, or both. At times, our research may look at stock prices generally, though from a fundamental and not technical point of view.

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## Cash Flow Trends and Their Fundamental Drivers: Comprehensive Industry Review (Qtr 2, 2010)

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## Cash Flow Trends and Their Fundamental Drivers: Comprehensive Industry Review (Qtr 2, 2010)

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### FREE CASH MARGIN INDEX\*:

|                           |                     |                           |
|---------------------------|---------------------|---------------------------|
| <b>2.43</b>               | <b>5.97</b>         | <b>6.69</b>               |
| Recession Low (Mar. 2001) | Current (June 2010) | Recent High (March, 2010) |

The **\*Free Cash Margin Index** is free cash flow measured as a percentage of revenue for the trailing twelve month period.

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### Introduction

This research report is part of a continuing series that examines cash flow trends and the underlying drivers that are causing changes in those trends. In the current study we conduct a review of the cash flow performance of all non-financial companies for a series of rolling twelve-month periods from the first quarter of 2000 through the second quarter of 2010. Additionally, we look at individual industry results and focus our attention on the cash flow performance of several companies in those industries that stood out with improving free cash margin and in those that suffered from significant declines in free cash margin. All companies with a current market cap of \$50 million or more are included, resulting in a total sample of 3,807 companies. Please see pages 6-8 for a list of industries and sub-industries included. That list is followed by a summary of our findings.

Measured as free cash flow divided by revenue, free cash margin is a cash flow profit margin. It indicates what percent of revenue is left for shareholders in the form of free and discretionary cash flow. If the company sells its products or services for a dollar, free cash margin tells us how many cents the shareholders can take home without reducing the company's ability to generate more. Thus, as we look at cash flow trends and their underlying drivers, our particular interest is on how those factors impact free cash margin.

For more detail, our industry spreadsheets that identify trends in free cash margin and its underlying drivers for 20 separate industry sectors and 61 industries for the all available reporting periods through the second quarter of 2010 have been posted. The spreadsheets, which are updated quarterly, can be found on the Lab's website at [www.mgt.gatech.edu/finlab](http://www.mgt.gatech.edu/finlab).

### ***Our Continuing Focus on Cash Flow***

Corporate financial success is dependent not only on a company's ability to generate revenues and earnings, but also cash flow, especially free cash flow. It is free cash flow and growth in free cash flow, that discretionary stream of cash that a company can put to use for acquisitions, debt retirement, dividends and stock buybacks that works with growing earnings to drive firm value higher. Because it is "free," free cash flow comes with no strings attached. It is truly discretionary. Spending it does not impact the company's ability to generate more. A company with revenue growth will eventually lose the favor of investors if it never finds a way to generate earnings. In a similar way, a company with profits that is unable to generate cash will also experience waning investor enthusiasm. It may take a while. Investors are patient with profitable, growing companies. Ultimately, however, a company must show an ability to generate free cash flow.

Companies that consume cash must continually seek new sources of capital – whether debt or equity. At some point, those sources of capital will dry up or become prohibitively expensive if the firm does not show at least some progress toward getting closer to positive cash generation. Worse, if cash flow does not back a company's earnings, ultimately those earnings themselves may become suspect, necessitating write-downs of the resulting non-cash assets. Net losses will likely accompany those write-downs.

When free cash margin is positive, a firm is covering all ongoing claims and is able to pay dividends, reduce debt or simply add to its cash coffers. When free cash margin turns negative, ongoing claims are not being met. Cash and short-term investments can be used to meet the shortfall. However, on-hand cash and short-term investments are not an unlimited source of funds. Firms can borrow money to meet their needs. However, even if this were an option, increasing debt levels add new, unwanted risks. Equity issues provide another avenue, but capital markets can be painfully dilutive when share prices are depressed for firms that are seemingly unable to generate cash.

During periods of growth, firms may have problems generating cash as profits are consumed with growth-related investments in working capital and property, plant and equipment needed to support that growth. During recessions, cash generation can be particularly problematic as revenues and profits decline, draining the economic engine that supports cash generation. Regardless of the economic environment, however, free cash margin serves as an important measure of long-term financial health for individual companies, industries and the economy as a whole. We think that by periodically examining their cash generating ability, we will gain insight into the overall financial health of important segments of U.S. firms. With data dating back to 2000, we will see how the cash-generating performance of these firms presently compares with their performance during previous periods of economic contraction (e.g., 2001 and 2008-2009) and economic expansion.

### **Cash Flow Definitions**

Free cash flow is the cash flow equivalent of the income statement “bottom line.” Like net income, free cash flow is available for shareholders after all prior claims have been satisfied. However, also like net income, which, to facilitate analysis, can be divided into certain sub-measures of performance, like gross profit and operating profit, free cash flow can be similarly divided. Thus, while our primary focus is on free cash flow and free cash margin, or free cash flow as a percentage of revenue, we analyze here the fundamental drivers underlying two distinct, but also closely related, measures of cash flow:

- 1) Operating cash flow and operating cash margin - cash flow from operations after interest charges and income taxes. Operating cash margin is operating cash flow divided by revenue.
  
- 2) Free cash flow and free cash margin - cash flow available for common shareholders that can be used for such discretionary purposes as stock buybacks and dividends without affecting the firm's ability to grow and generate more. This measure is calculated as operating cash flow less preferred dividends and net capital expenditures. Free cash margin is free cash flow divided by revenue.

### **Data and Methodology**

Our data is provided by Cash Flow Analytics, LLC<sup>1</sup>. As noted, each data amount is for a rolling twelve-month period ending with the quarter end in question. For example, cash flow amounts for June 30, 2010 represent amounts for the twelve months (four quarters) ending June 30, 2010.

### **Industries**

The 20 industry sectors and 61 sub-industries are as follows:

- **Energy – 0010**
- Energy Equipment & Services
- Oil, Gas & Consumable Fuels
- **Materials – 0020**
- Chemicals
- Construction Materials
- Containers & Packaging
- Metals & Mining
- Paper & Forest Products
- **Capital Goods – 0030**
- Aerospace & Defense
- Building Products
- Construction & Engineering
- Electrical Equipment

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<sup>1</sup> Cash Flow Analytics, LLC, 1727 Malvern Place, Duluth, Georgia, 30097. [www.cashflowanalytics.com](http://www.cashflowanalytics.com). Charles Mulford is a principal in Cash Flow Analytics, LLC.

- Industrial Conglomerates
- Machinery
- Trading Companies & Distributors
- **Commercial & Professional Services – 0040**
- Commercial Services & Supplies
- Professional Services
- **Transportation – 0050**
- Air Freight & Logistics
- Airlines
- Marine
- Road & Rail
- Transportation Infrastructure
- **Automobiles & Components – 0060**
- Auto Components
- Automobiles
- **Consumer Durables & Apparel – 0070**
- Household Durables
- Leisure Equipment & Products
- Textiles, Apparel & Luxury Goods
- **Consumer Services – 0080**
- Hotels, Restaurants & Leisure
- Diversified Consumer Services
- **Media – 0090**
- Media
- **Retailing – 0100**
- Distributors
- Internet & Catalog Retail
- Multiline Retail
- Specialty Retail
- **Food & Staples Retailing – 0110**
- Food & Staples Retailing
- **Food Beverage & Tobacco – 0120**
- Beverages
- Food Products
- Tobacco
- **Household & Personal Products – 0130**
- Household Products
- Personal Products
- **Health Care Equipment & Services – 0140**
- Health Care Equipment & Supplies
- Health Care Providers & Services
- Health Care Technology
- **Pharmaceuticals, Biotechnology & Life Sciences – 0150**
- Biotechnology
- Pharmaceuticals
- Life Sciences Tools & Services
- **Software & Services – 0160**

- Internet Software & Services
- It Services
- Software
- **Technology Hardware & Equipment - 0170**
- Communications Equipment
- Computers & Peripherals
- Electronic Equipment, Instruments & Components
- Office Electronics
- Semiconductor Equipment & Products
- **Semiconductors & Semiconductor Equipment – 0180**
- Semiconductors & Semiconductor Equipment
- **Telecommunication Services – 0190**
- Diversified Telecommunication Services
- Wireless Telecommunication Services
- **Utilities – 0200**
- Electric Utilities
- Gas Utilities
- Multi-utilities
- Water Utilities
- Independent Power Producers & Energy Traders

## Results

### *Summary*

For the twelve months ending in the second quarter of 2010, median free cash margin declined after five consecutive quarters of increases, falling from 6.69% in the first quarter of 2010 to 5.97%. The metric, however, still remains significantly higher than it was in the twelve months ending June 2009, when it measured 4.76%. Notwithstanding the recent decline in median free cash margin, we continued to observe positive developments in the cash-generating ability of our sample firms.

### **Results for all non-financial companies**

In the exhibits below we present a graph of free cash margin and several of its underlying drivers. These exhibits were constructed with data from our complete sample of companies, including all industries and sub-industries. A total of 3,807 companies are included. These graphs are followed with exhibits that show the trend in free cash margin for each of the 20 industry groups. For more details on each individual industry, please refer to the individual industry spreadsheets reports that are available on our website ([www.mgt.gatech.edu/finlab](http://www.mgt.gatech.edu/finlab)).

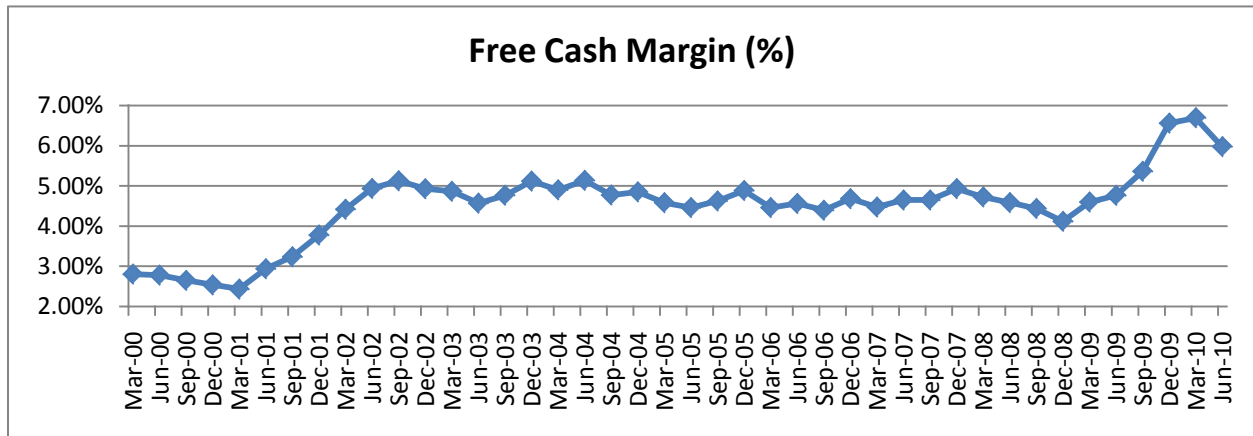
In the twelve months ending with the second quarter of 2010, median free cash margin declined for the first time in five consecutive quarters. On a positive note, however, company fundamentals continued to improve. Median revenues increased for the second consecutive reporting period, growing to \$541,613,000 in the June 2010 period from \$527,873,000 in March 2010 and \$523,395,000 in December 2009. Driven by improvements in gross margin and SG&A%, operating cushion also improved, increasing to 14.96% in the June 2010 reporting



period from 14.84% in March 2010 and 14.63% in June 2009. At 52.78 and 24.61, respectively, receivables days and inventory days remained relatively flat in the June 2010 reporting period when compared with the March numbers. Both measures are up, however, from June 2009, when receivables days and inventory days measured 46.29 and 20.75, respectively. In the June 2010 period, companies used vendor financing to enhance cash flow. Payables days increased to 29.03 in June 2010 from 26.96 in March 2010 and 23.52 in June 2009. Finally, our sample firms showed no significant changes in capital spending. In the June 2010 reporting period, median capital expenditures as a percent of revenue were 2.79%, down slightly from 2.83% in March 2010 and 3.76% in June 2009.

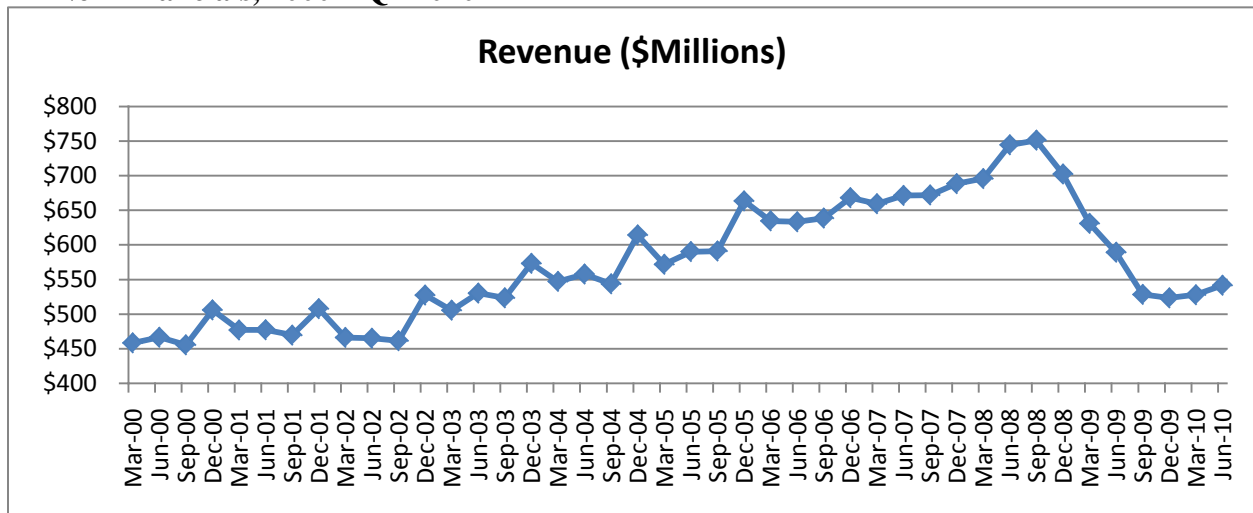
Overall, our sample firms continued to operate in a “hunker down” mode, sheltering resources and shunning new investments in inventory and capital equipment. An increase in revenues notwithstanding, we saw no evidence that firms were beginning to embrace growth or invest for the future. Instead, they appeared to be treading water, protecting their cash resources from future unknowns and waiting for a clearer economic picture to emerge.

**All Non-financials, 2000 – Q2 2010**

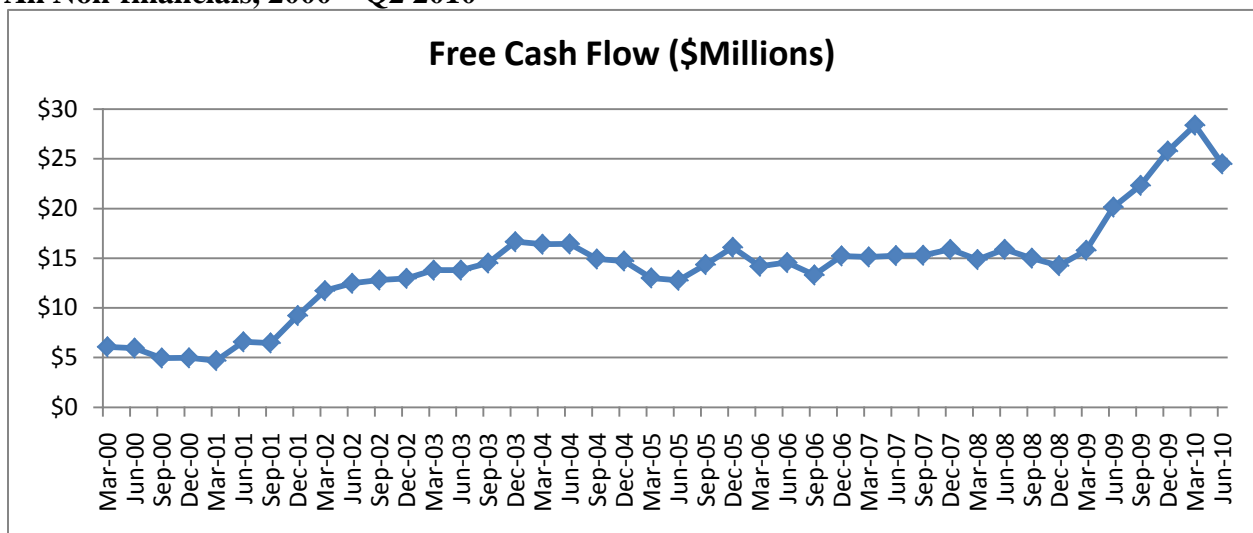


As seen in the chart below, revenues are slowly, but steadily, increasing.

**All Non-financials, 2000 – Q2 2010**

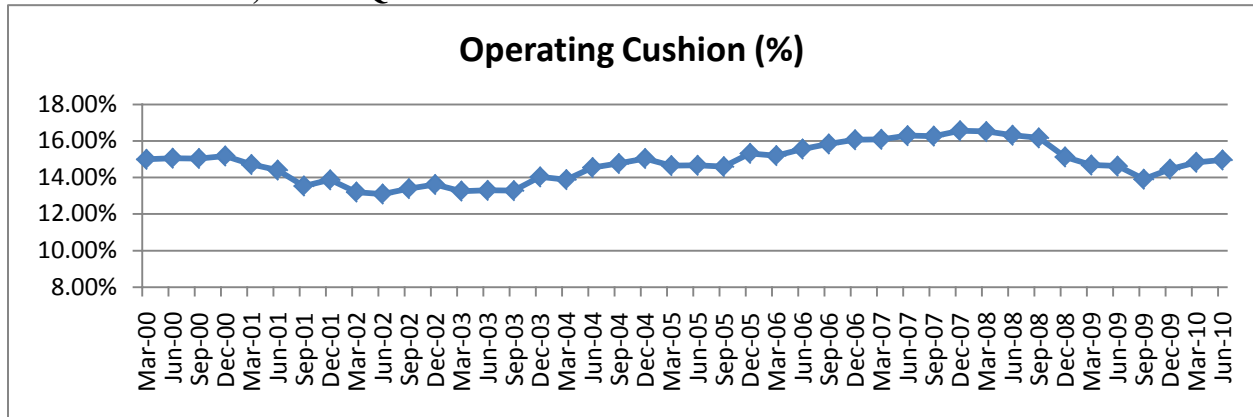


**All Non-financials, 2000 – Q2 2010**

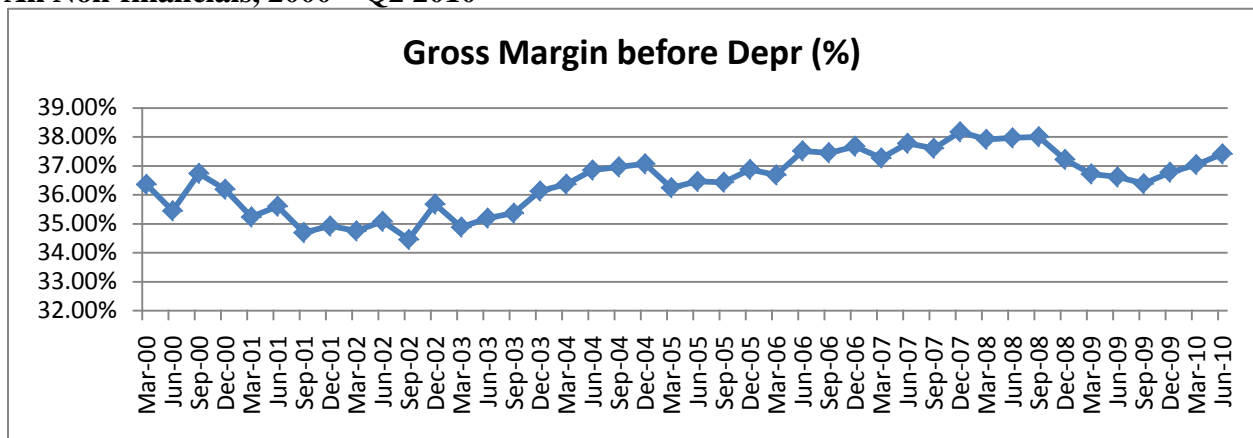


Accompanying the improvement in revenues, operating cushion, or operating profit before depreciation and amortization, also increased, helped by improving gross margin and declining SG&A expenditures as a % of revenue. Managers continue to do an excellent job of controlling costs and improving efficiency.

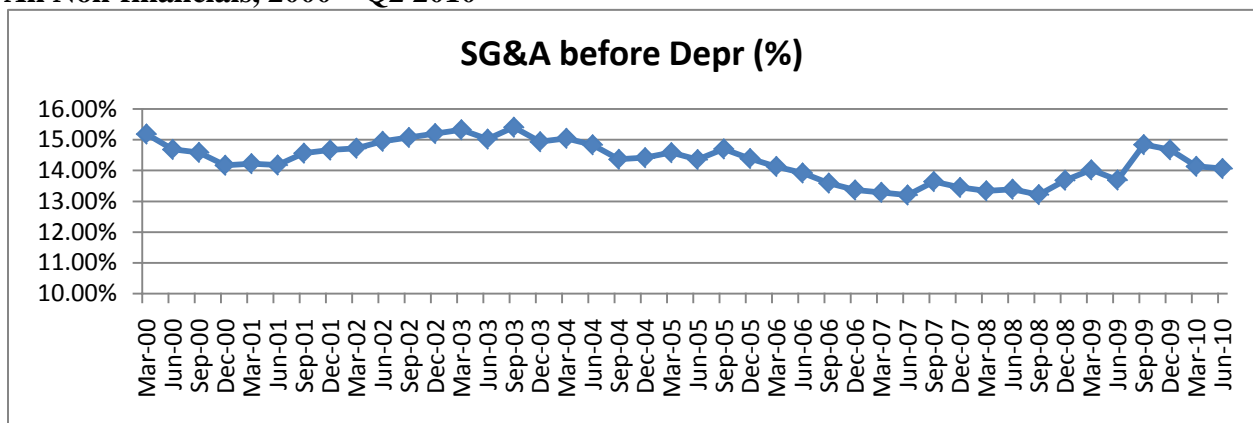
**All Non-financials, 2000 – Q2 2010**



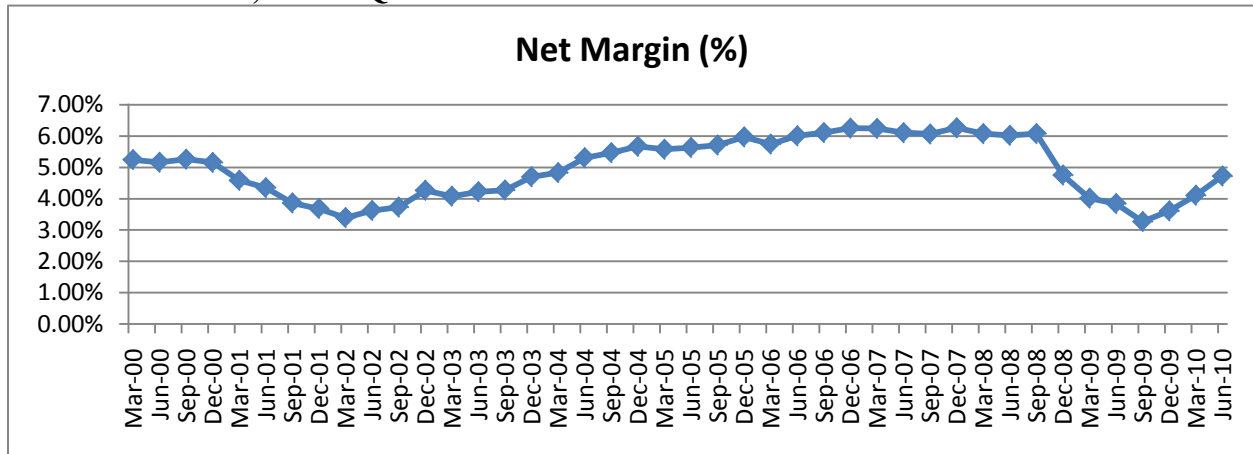
**All Non-financials, 2000 – Q2 2010**



**All Non-financials, 2000 – Q2 2010**

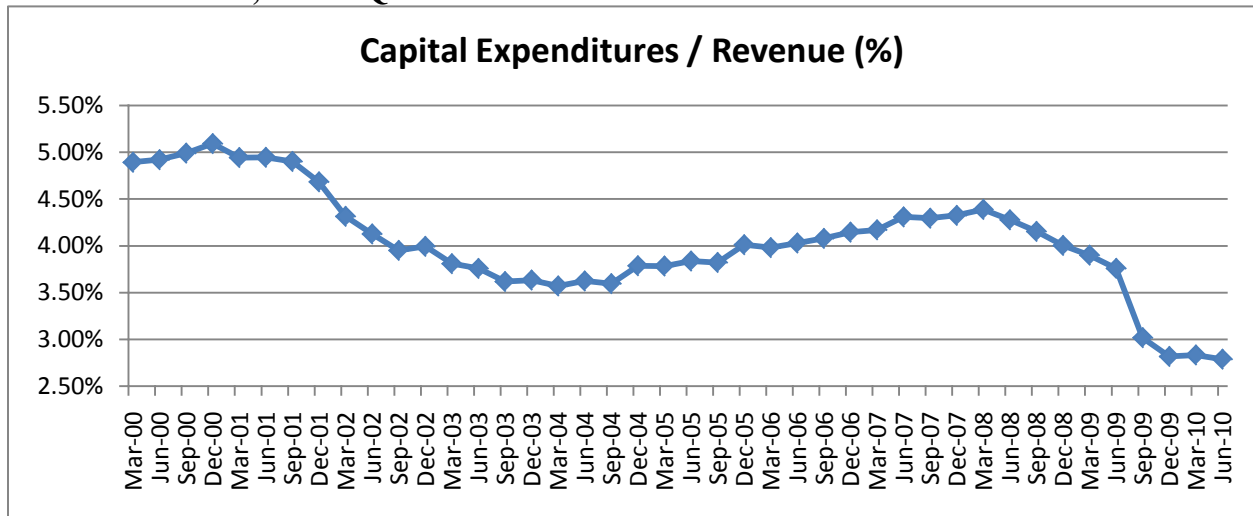


**All Non-financials, 2000 – Q2 2010**



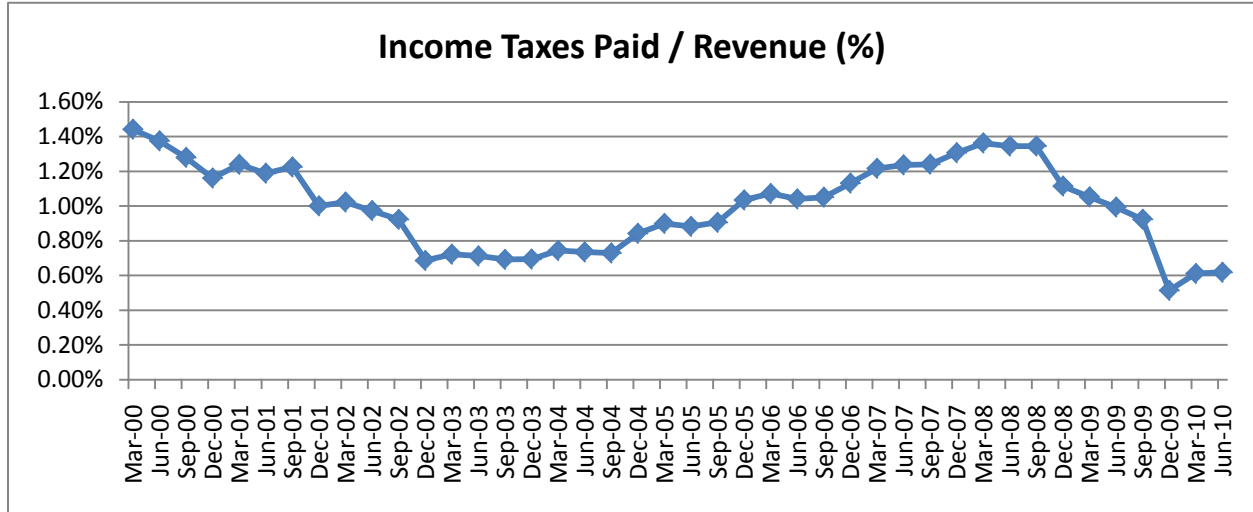
Capital expenditures as a % of revenue remained flat in the twelve months ending June 2010. This metric appears to have bottomed out as companies have reduced capital expenditures as much as possible.

**All Non-financials, 2000 – Q2 2010**



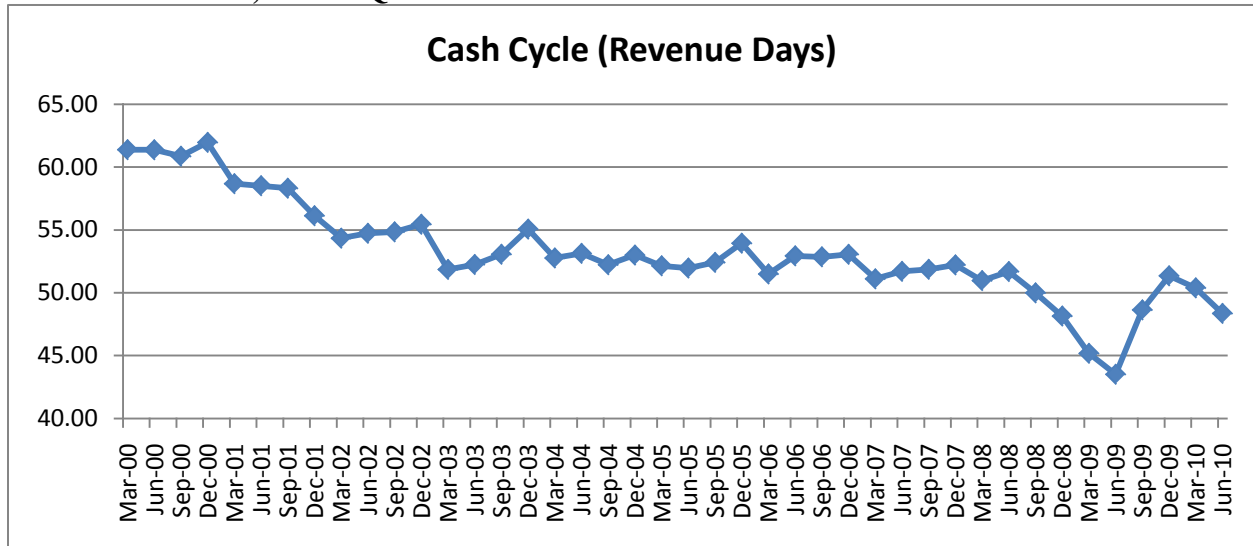
Income taxes paid as a % of revenue stayed flat between the twelve months ending March 2010 and June 2010.

**All Non-financials, 2000 – Q2 2010**

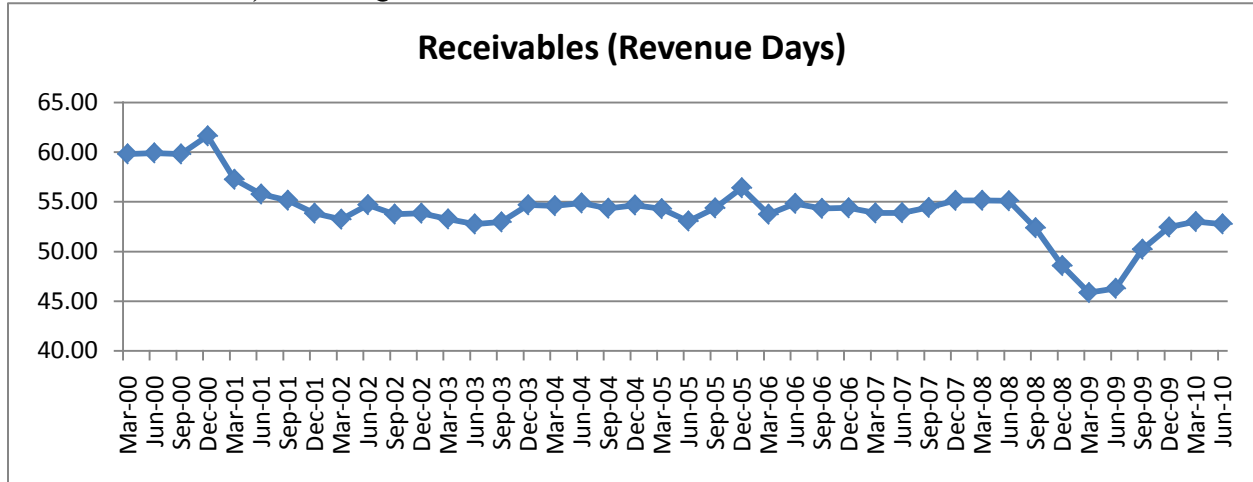


The cash cycle, which measures the proportion of operating cash flow carried in working capital and is measured by receivables days plus inventory days less payables days, continued its decline over the past two periods. Driving the decrease in the cash cycle was an increase in median payables days from 26.96 revenue days in March 2010 to 29.03 revenue days in June.

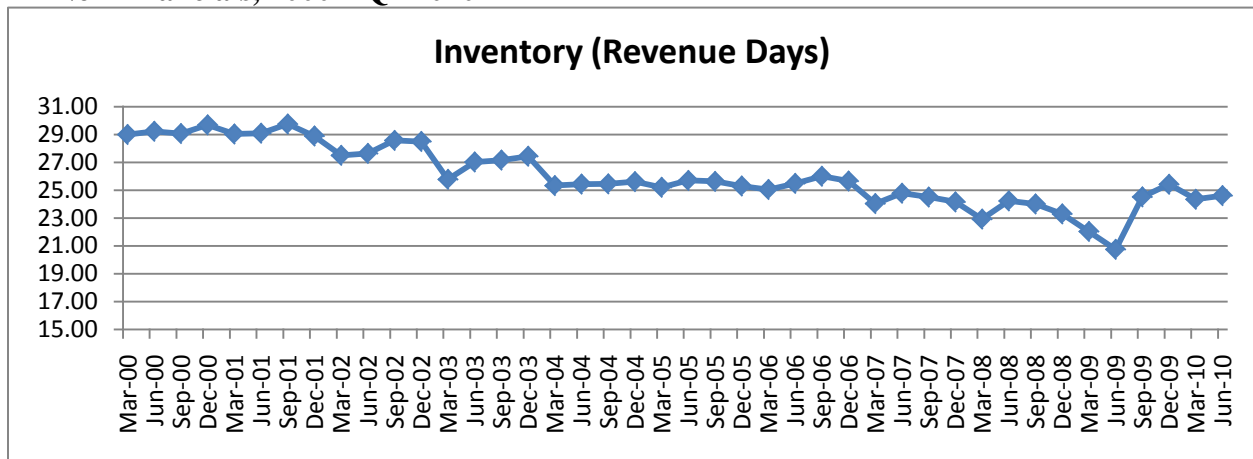
**All Non-financials, 2000 – Q2 2010**



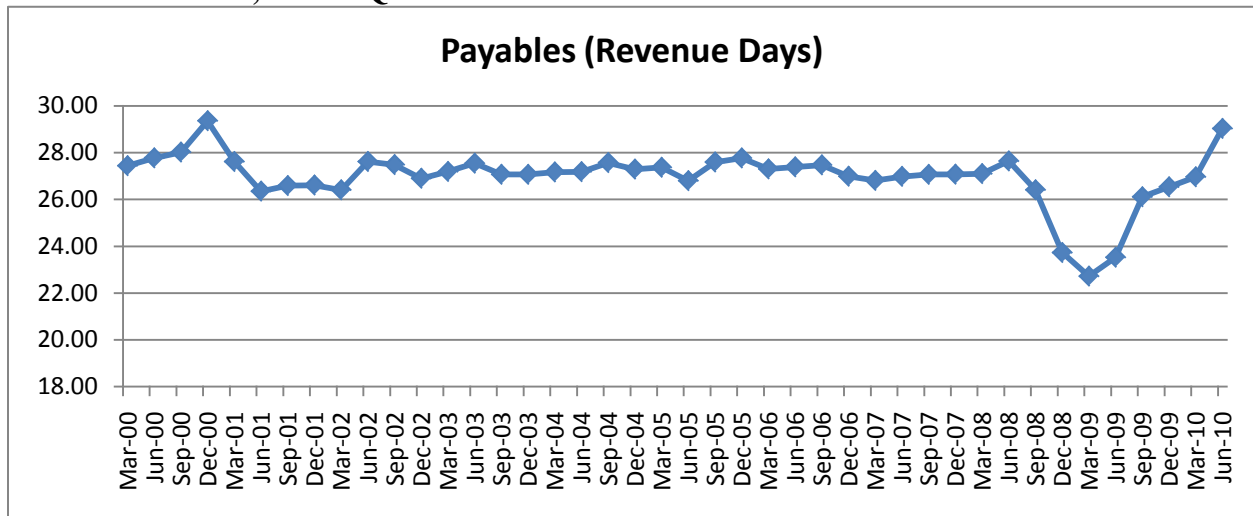
**All Non-financials, 2000 – Q2 2010**



**All Non-financials, 2000 – Q2 2010**



**All Non-financials, 2000 – Q2 2010**



### Individual Industry Results

Of the 20 industry sectors studied, during the twelve months ended June 2010 when compared with the twelve months ended June 2009, we saw moderate to substantial improvement in free cash margin in four industries, relatively stable free cash margin in eleven industries, and five industries with declining free cash margin.

#### **Industry sectors with improving free cash margin:**

- Commercial and Professional Services
- Automobiles and Components
- Food and Staples Retailing
- Healthcare Equipment and Services

#### **Industry sectors with stable free cash margin:**

- Energy
- Capital Goods
- Consumer Services
- Media
- Retailing
- Food, Beverage and Tobacco
- Pharmaceuticals, Biotechnology and Life Sciences
- Software and Services
- Semiconductors and Semiconductor Equipment
- Telecommunications Services
- Utilities

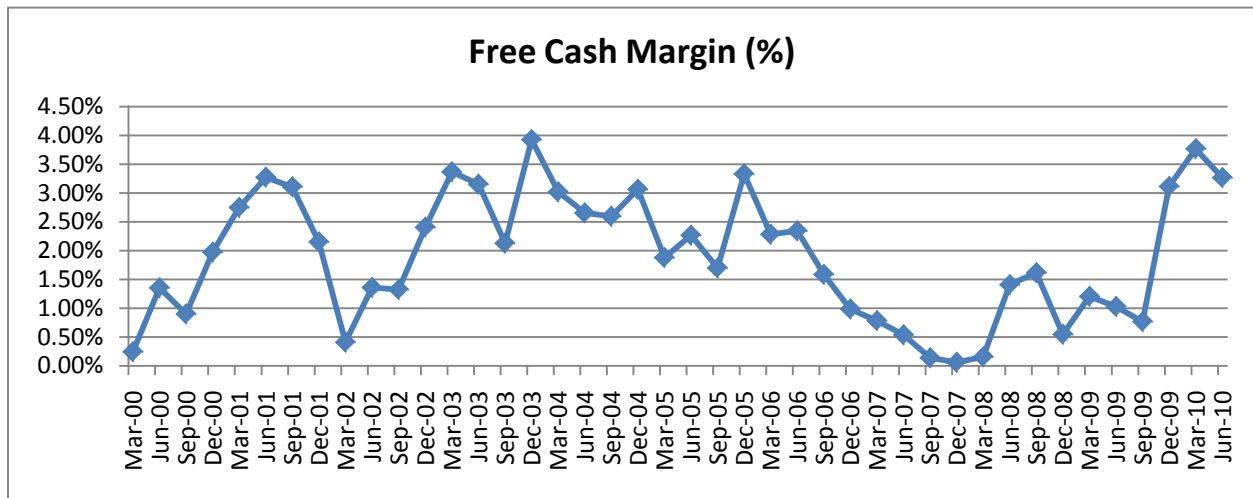
#### **Industry sectors with declining free cash margin:**

- Materials
- Transportation
- Consumer Durables and Apparel
- Household and Personal Products
- Technology Hardware and Equipment

Please refer to the individual industry spreadsheets, available on our website, for further detail on the industries discussed in this report.

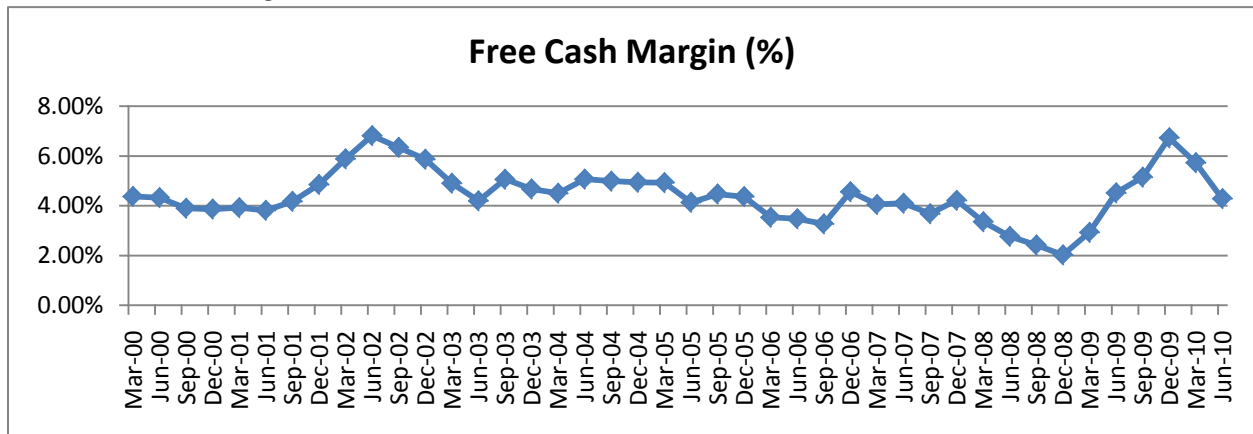
Our results show the following trends in free cash margin:

**Energy: 2000 – Q2 2010**



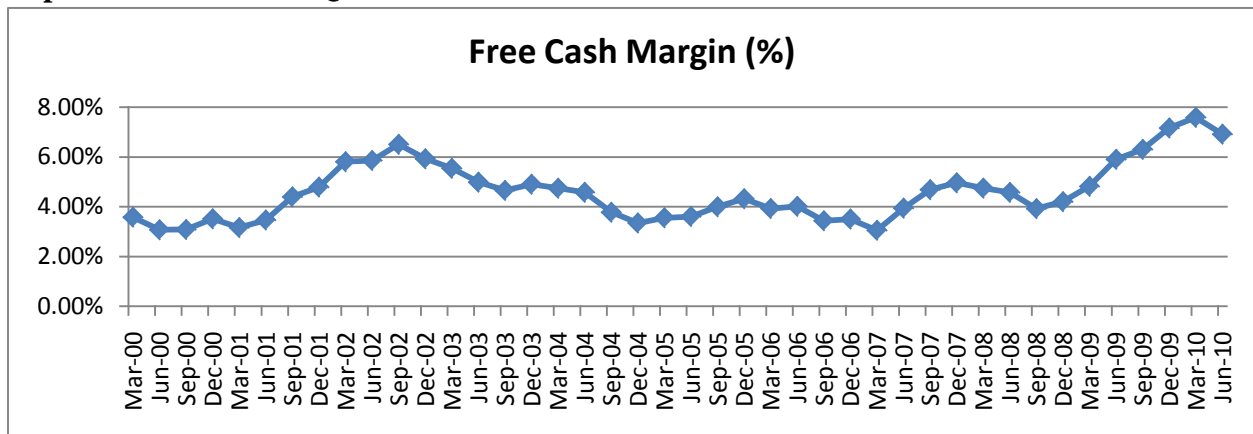
See industry specific spreadsheet for details.

**Materials: 2000 – Q2 2010**



See industry specific spreadsheet for details.

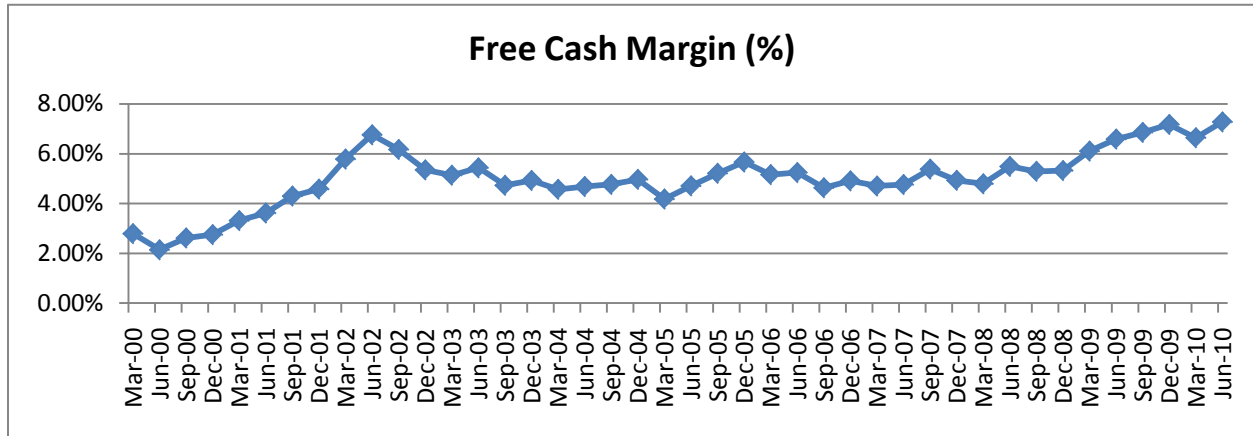
**Capital Goods: 2000 – Q2 2010**



See industry specific spreadsheet for details.

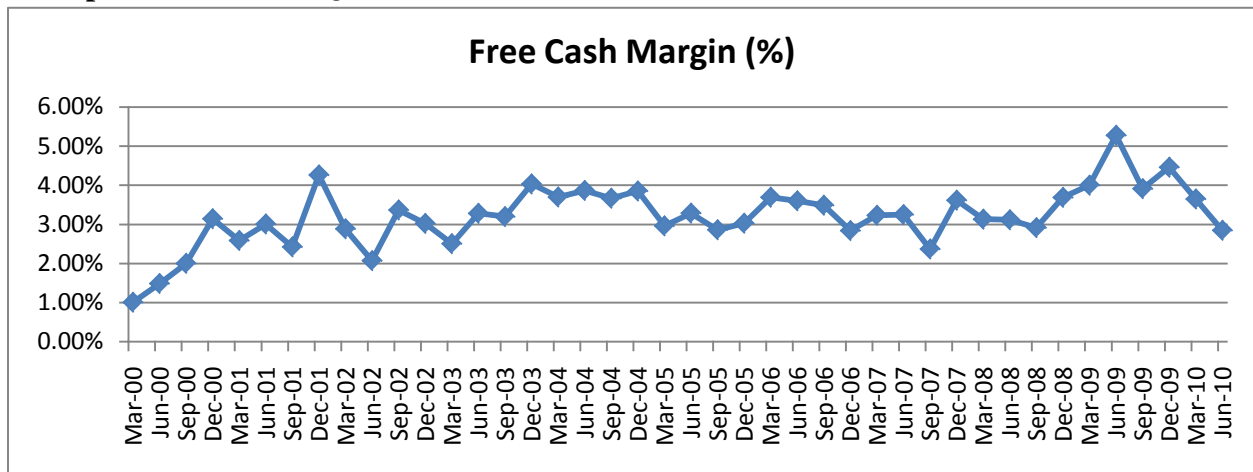


**Commercial and Professional Services: 2000 – Q2 2010**



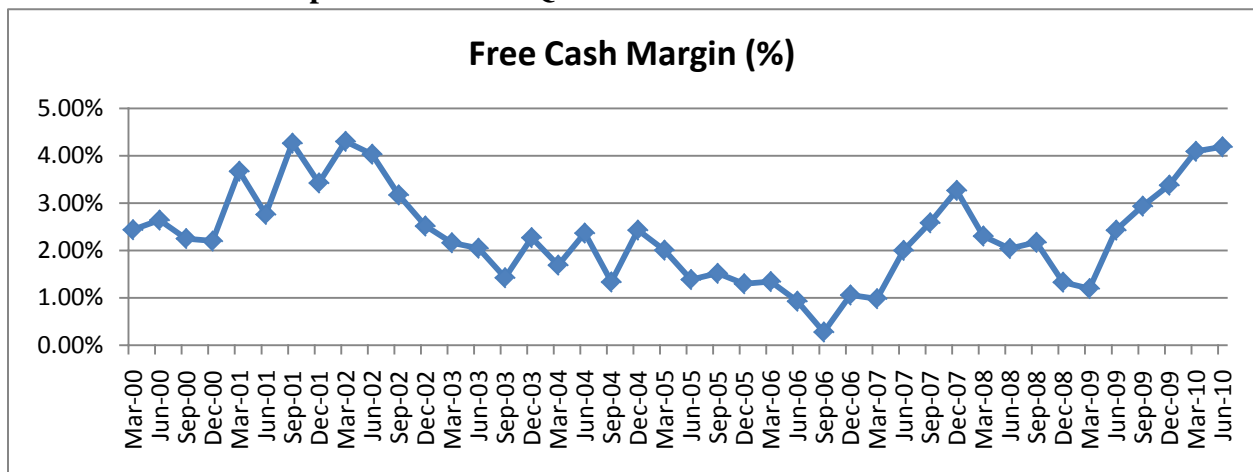
See industry specific spreadsheet for details.

**Transportation: 2000 – Q2 2010**



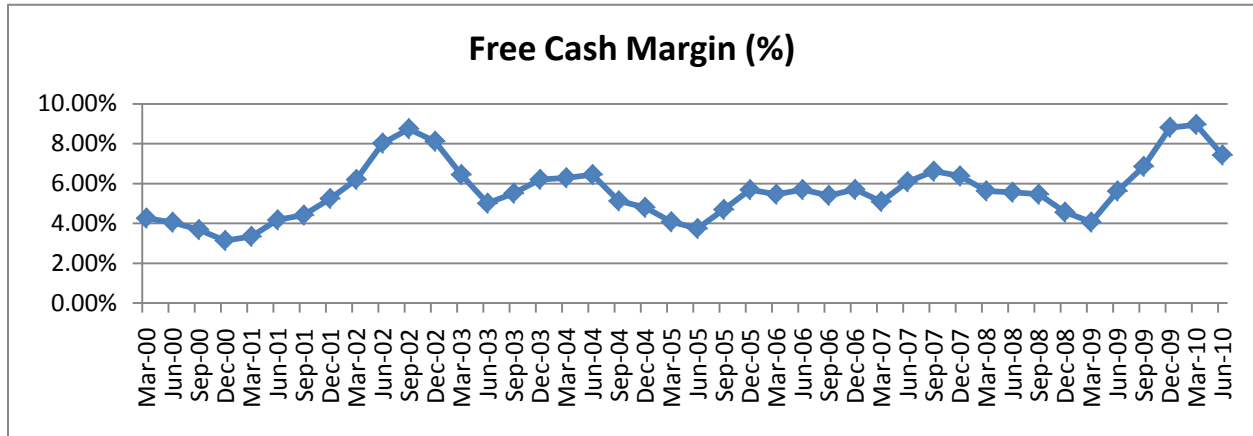
See industry specific spreadsheet for details.

**Automobiles and Components: 2000 – Q2 2010**



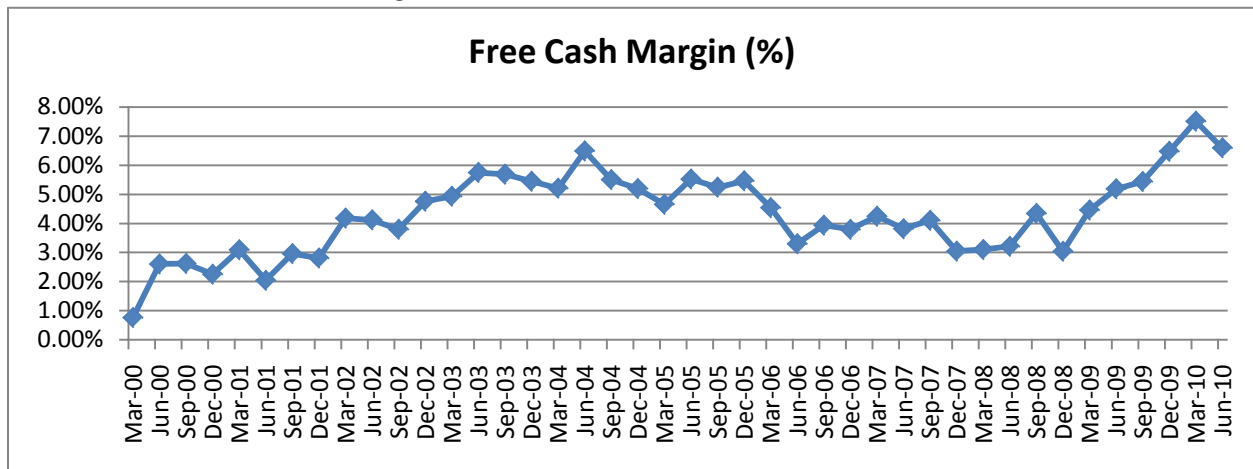
See industry specific spreadsheet for details.

**Consumer Durables and Apparel: 2000 – Q2 2010**



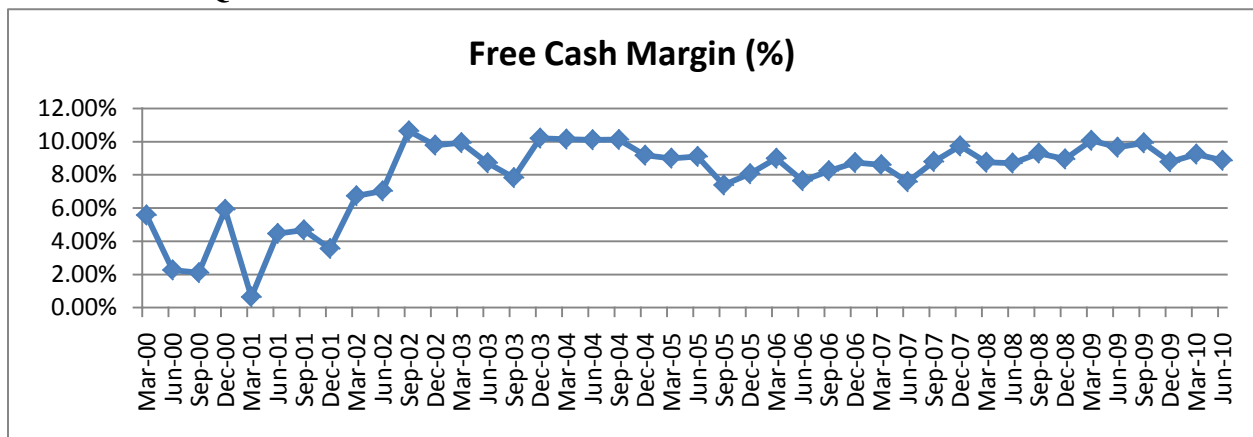
See industry specific spreadsheet for details.

**Consumer Services: 2000 – Q2 2010**



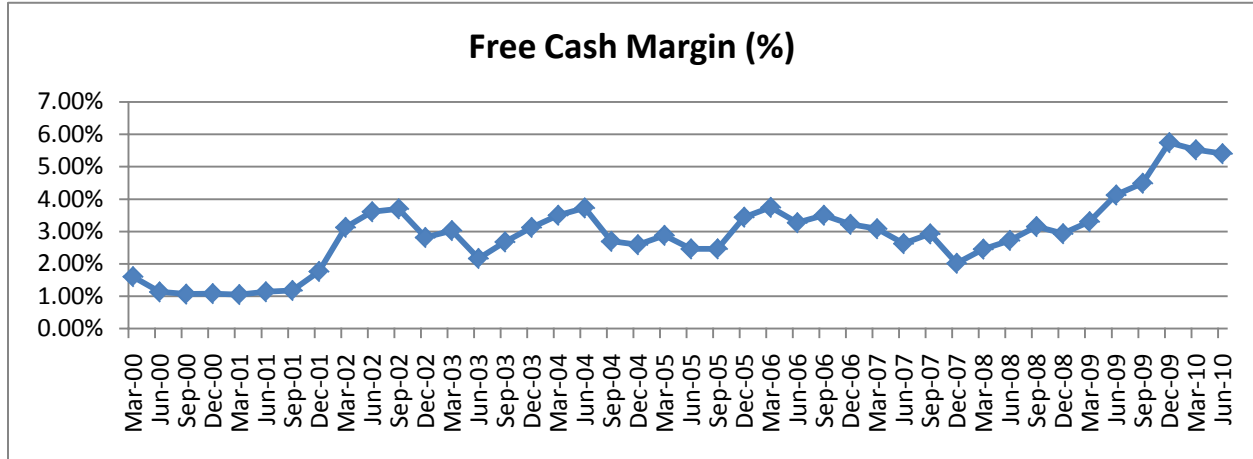
See industry specific spreadsheet for details.

**Media: 2000 – Q2 2010**



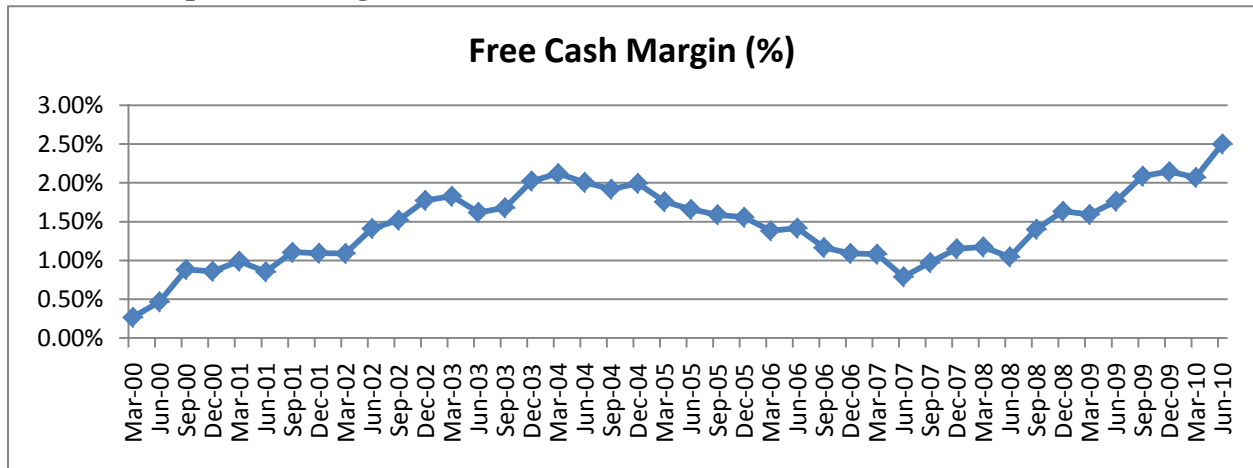
See industry specific spreadsheet for details.

**Retailing: 2000 – Q2 2010**



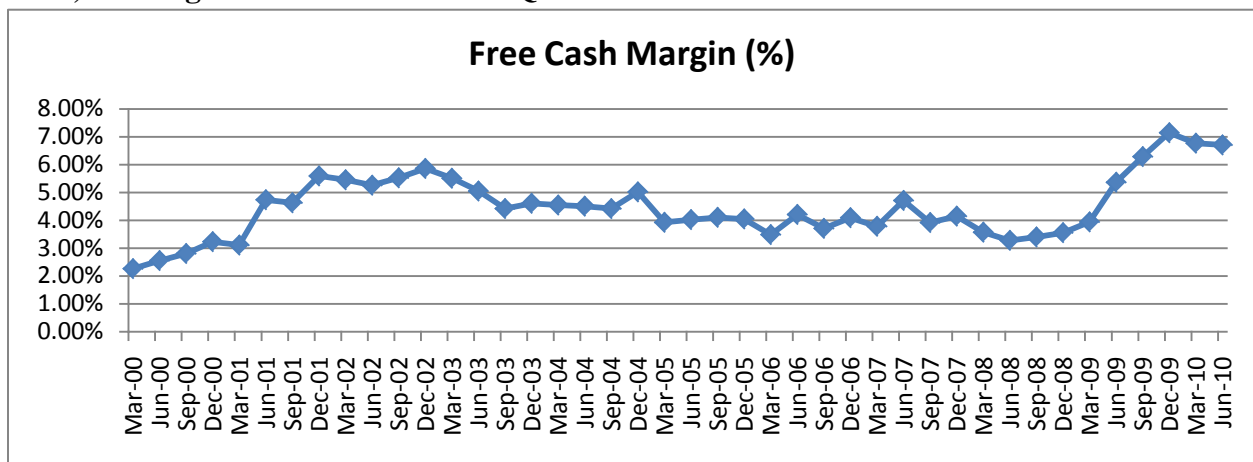
See industry specific spreadsheet for details.

**Food and Staples Retailing: 2000 – Q2 2010**



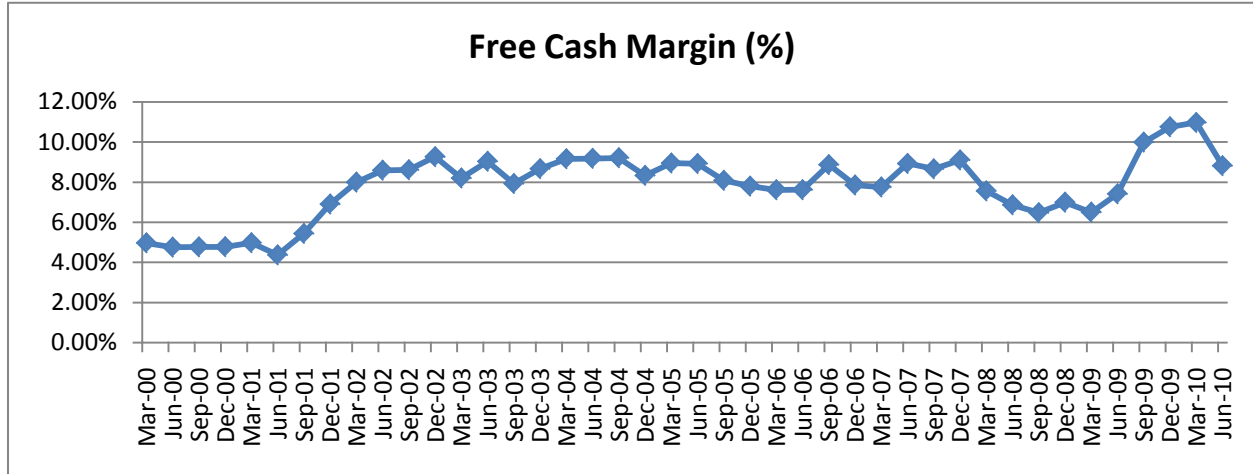
See industry specific spreadsheet for details.

**Food, Beverage and Tobacco: 2000 – Q2 2010**



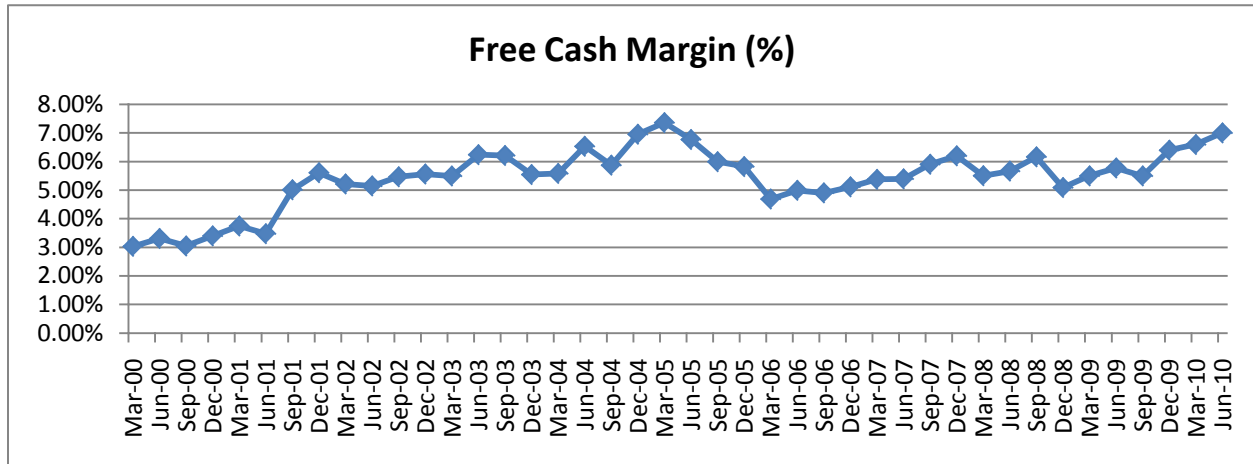
See industry specific spreadsheet for details.

**Household and Personal Products: 2000 – Q2 2010**



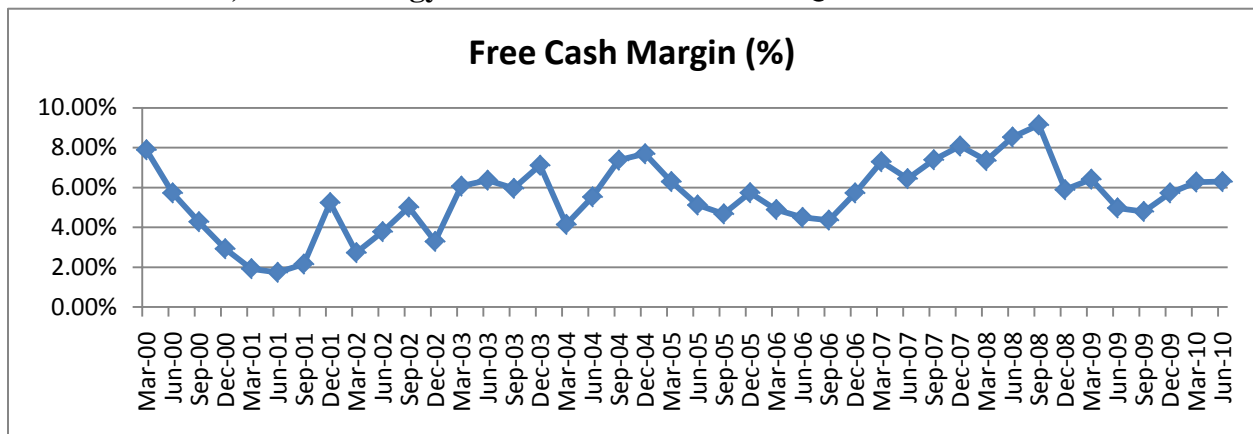
See industry specific spreadsheet for details.

**Healthcare Equipment and Services: 2000 – Q2 2010**



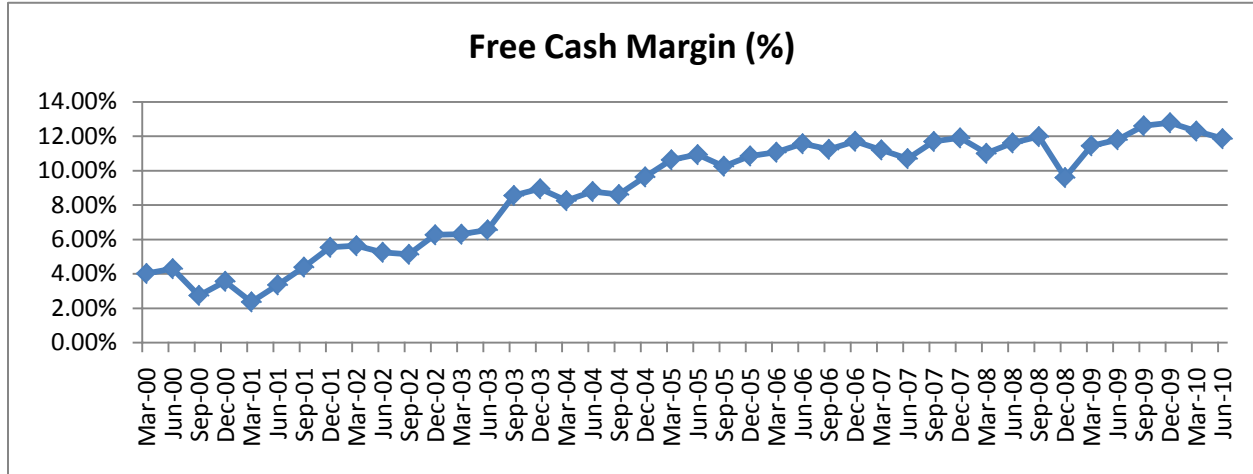
See industry specific spreadsheet for details.

**Pharmaceuticals, Biotechnology and Life Sciences: 2000 – Q2 2010**



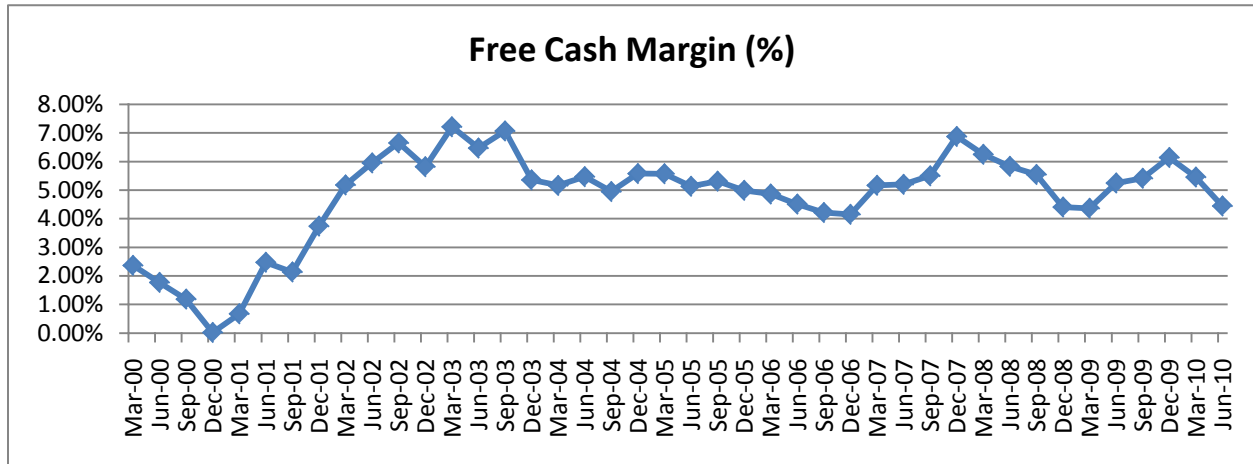
See industry specific spreadsheet for details.

**Software and Services: 2000 – Q2 2010**



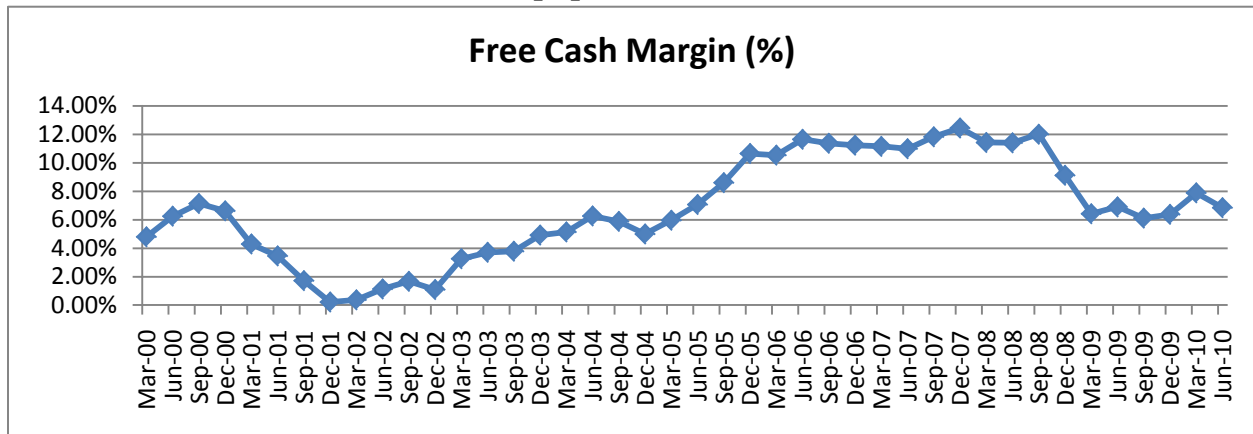
See industry specific spreadsheet for details.

**Technology Hardware and Equipment: 2000 – Q2 2010**



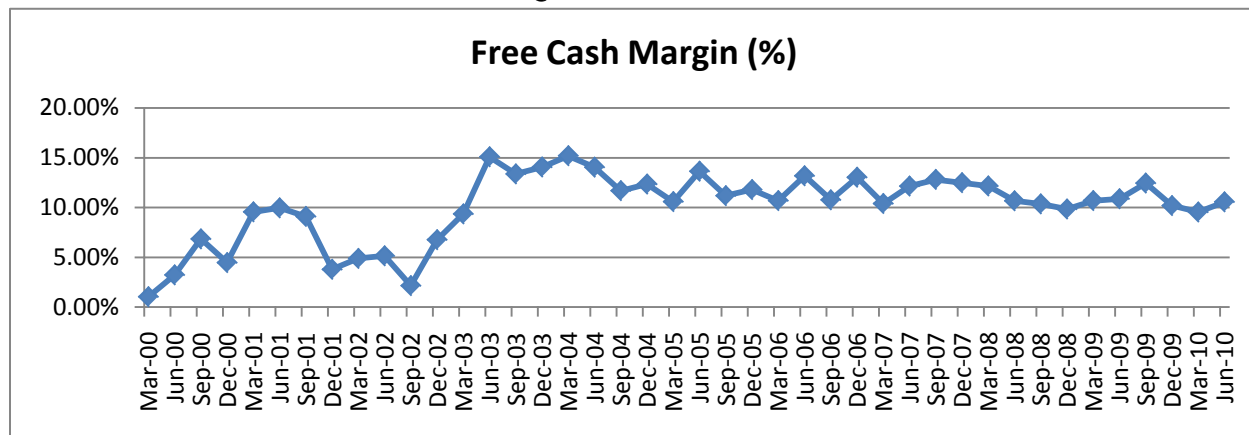
See industry specific spreadsheet for details.

**Semiconductors and Semiconductor Equipment: 2000 – Q2 2010**



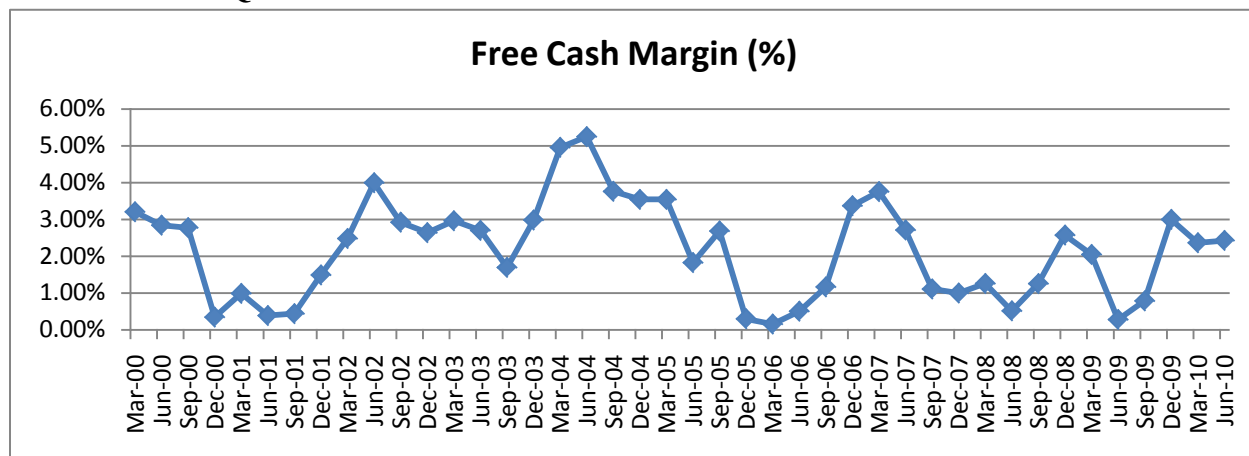
See industry specific spreadsheet for details.

**Telecommunications Services: 2000 – Q2 2010**



See industry specific spreadsheet for details.

**Utilities: 2000 – Q2 2010**



See industry specific spreadsheet for details.

**The Standouts: A Closer Look**

The drivers of improvements or declines in free cash margin consist of factors that impact profitability and efficiency. On the profitability front, operating cushion measures operating profit, exclusive of the non-cash expenses, depreciation and amortization. Factors impacting operating cushion consist of gross margin (excluding depreciation and amortization), and SG&A% (excluding depreciation and amortization). Also impacting profitability and a firm’s ability to generate free cash flow, but excluded from operating cushion, is income taxes paid, which we measure as a percent of revenue. Capital expenditures do not impact profitability directly, but through depreciation. However, these expenditures are subtracted in computing free cash flow. It is also important to look at capital expenditures because these are investments in fixed assets that will likely improve a company’s ability to generate revenue, and subsequent profit, in the future. Like operating expenses and taxes, we measure capital expenditures as a percent of revenue.

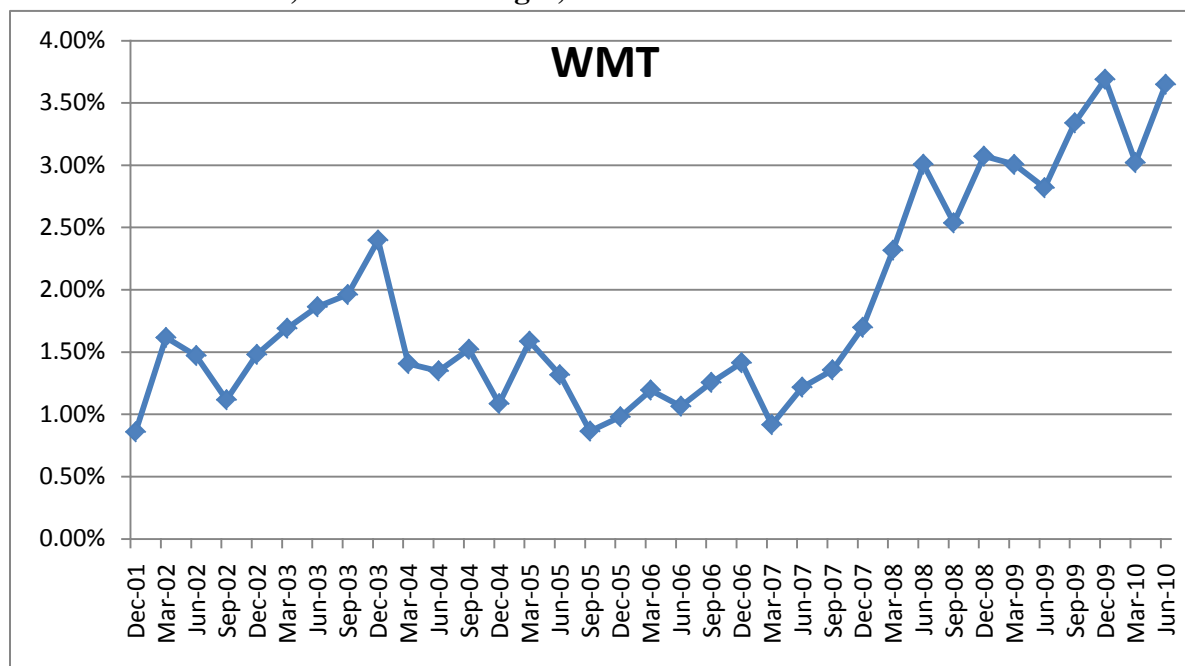
On the efficiency front, increases in receivables and inventory consume free cash flow. Increases in accounts payable provide free cash flow. The combination of receivables days plus inventory days less payables days is a firm's cash cycle. Reductions in the cash cycle provide free cash flow, while increases in the cash cycle consume free cash flow. We give consideration to all of these factors when analyzing changes in free cash margin for the standout firms discussed in this section.

### ***Improving free cash margin***

Among the industry sectors with improving free cash margin, the two groups that looked interesting were the Food and Staples Retailing industry and the Automobiles and Components industry. For the Food and Staples Retailing industry, free cash margin improved to 2.50% for the twelve months ended June 2010, from 1.76 % in June 2009. The Automobiles and Components industry saw free cash margin rise to 4.19% in June 2010 from 2.43% in June 2009. We will take a closer look at Walmart, Ruddick Corp, and Lear Corp.

Graphs of free cash margin for these companies across the period studied are provided below. With each graph we also provide a short summary of the primary drivers or factors that we think were behind the observed changes in free cash margin for the selected firms. For more details regarding the industries, please refer to the separate industry spreadsheets found on our website.

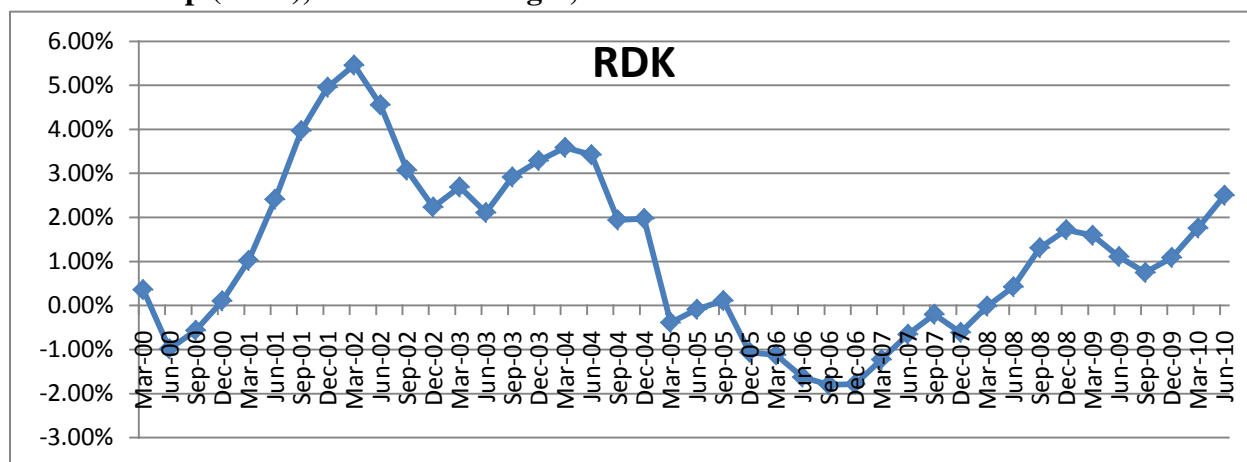
### **Wal-Mart Stores Inc, Free Cash Margin, March 2001 – June 2010**



Wal-mart Stores Inc. (WMT). Walmart's free cash margin rose from 2.82% for the twelve months ended June 2009 to 3.65% for the twelve months ended June 2010. There are two main drivers behind this significant increase in free cash margin over this time period. One driver is

the company's operating cushion, which rose from 6.73% in June 2009 to 7.89% in June 2010. The other driver of free cash margin is a decrease in the cash cycle from 7.98 revenue days in June 2009 to 4.7 revenue days in June 2010. The decrease in cash cycle was almost entirely due to an increase in payable days, which we do not consider to be a sustainable way to increase free cash margin. Receivable days and inventory days essentially stayed the same between the two periods. Also, capital expenditures to revenue fell slightly from 2.94% for the twelve months ending June 2009 to 2.68%.

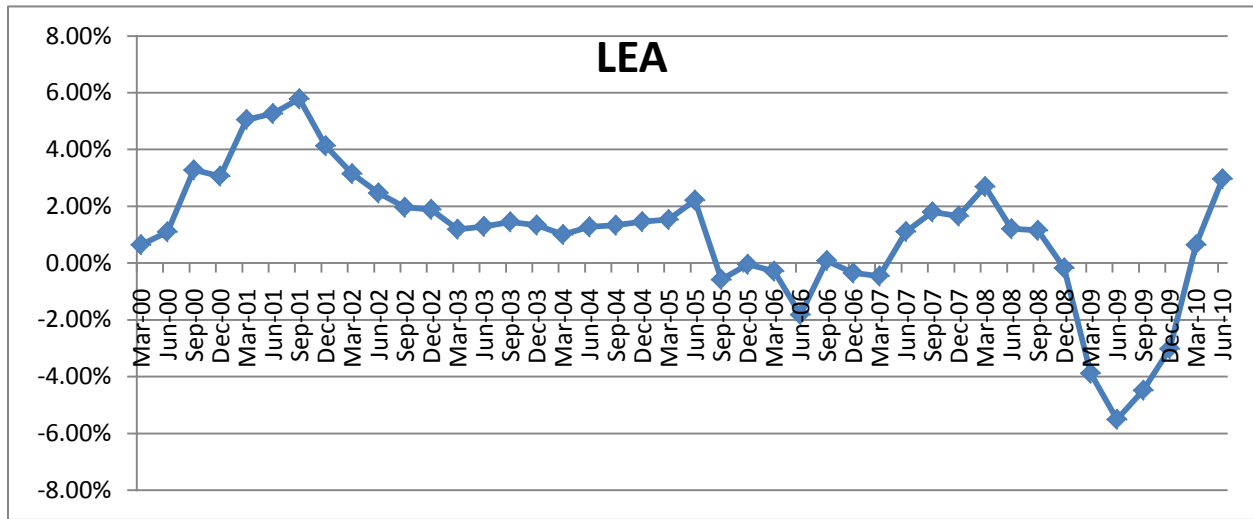
### Ruddick Corp (RDK), Free Cash Margin, March 2000 – June 2010



Ruddick Corp (RDK). From examining the graph above, Ruddick Corp has had a fairly steady increase in free cash margin since it hit its low in late 2006. Despite an increase in the cash cycle from 15.66 revenue days in June 2009 to 18.28 revenue days, which consumed cash, RDK has improved its free cash margin from 1.11% for the twelve months ending June 2009 to 2.5% for the twelve months ending June 2010. A decrease in capital expenditures appears to be the main metric pushing free cash margin higher over these reporting periods. Capital expenditures to revenue are down to 2.55% in June 2010 from 5.08% in June 2009. Operating cushion stayed flat over these periods.



**Lear Corp. (LEA), Free Cash Margin, March 2000 – June 2010**

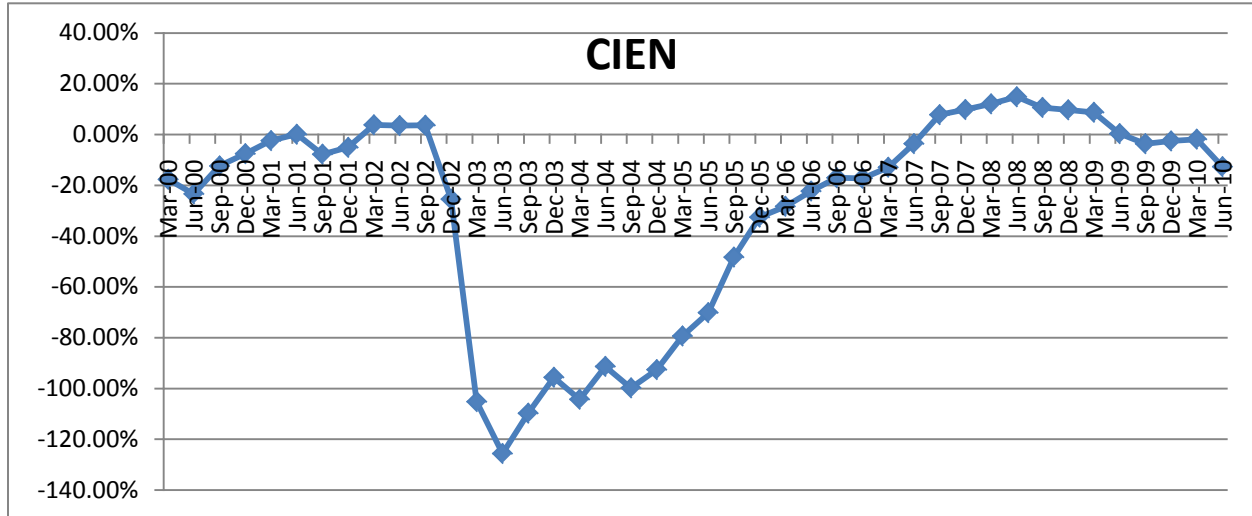


Lear Corp. (LEA). For the twelve months ended June 2009, Lear Corp hit its free cash margin low of -5.51%. For the twelve months ended June 2010, Lear Corp has significantly improved free cash margin to 3.0%. This increase was fueled by an increase in profitability. LEA’s operating cushion improved from 2.0% in June 2009 to 7.41% in June 2010. The other key metrics that affect free cash margin (capital expenditures as percent of revenue, income taxes paid as percent of revenue, and cash cycle) stayed relatively flat over the reporting periods in question. Capital expenditures as a % of revenue in June 2009 was 1.12% and in June 2010 was 1.36%. The cash cycle in June 2009 was 19.03 revenue days and in June 2010 was 19.41 revenue days. Finally, income taxes as a % of revenue were 0.76% in June 2009 and 0.66% in June 2010.

**Declining free cash margin**

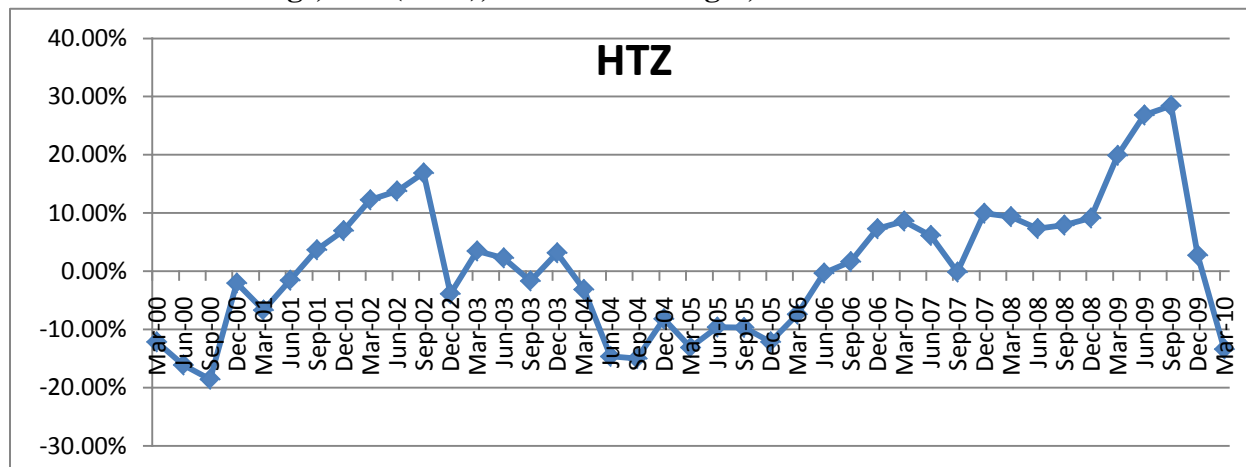
We will take a closer look at a few companies in the Technology, Hardware, and Equipment industry and the Transportation industry, both of which exhibited a drop in free cash margin. Free cash margin for the Telecommunications industry fell in the June 2010 reporting period to 4.45% from 5.25% in June 2009. The transportation industry declined from 5.28% in June 2009 to 2.85% in June 2010. In these industries we will examine Ciena Corp, Hertz, and Landstar Systems.

**Ciena Corp (CIEN), Free Cash Margin, March 2000 – June 2010**



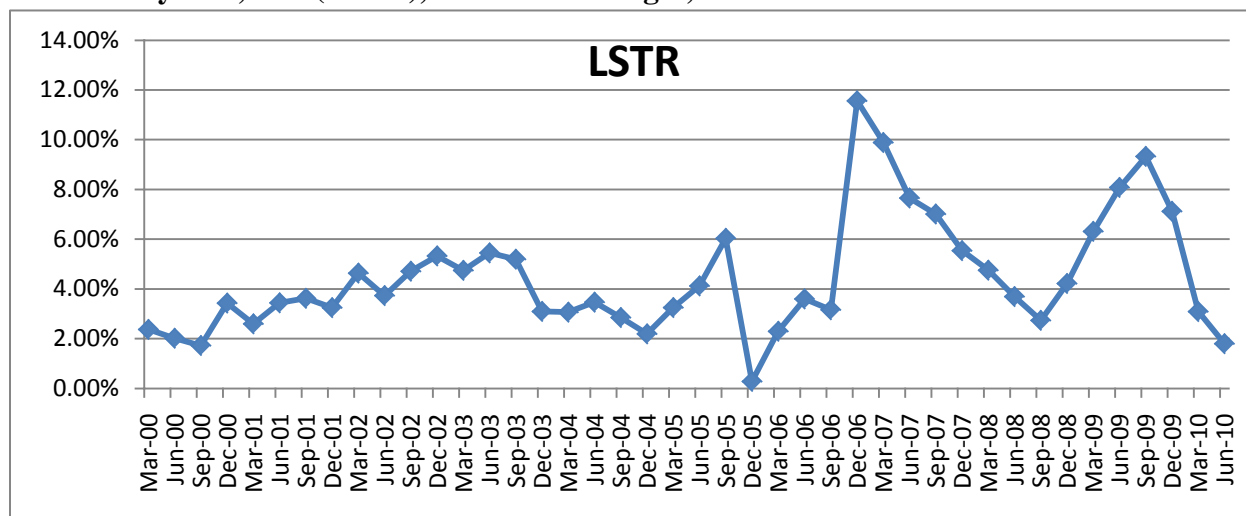
Ciena Corp. (CIEN). CIEN’s free cash margin fell from 0.35% for the twelve months ended June 2009 to -12.66% for the twelve months ended June 2010. Driving the decline in free cash margin was a reduction in operating cushion, which fell to -1.35% in June 2010 from 1.19% in June 2009. The company’s cash cycle also increased, including increases in receivables days and inventory days. However, an acquisition, which closed recently and is unrelated to an operations increase in the cash cycle and which added to receivables and inventory balances, also appears to have pushed the cash cycle higher. Capital expenditures to revenue remained relatively flat over these reporting periods.

**Hertz Global Holdings, Inc. (HTZ), Free Cash Margin, March 2000 – June 2010**



Hertz Global Holdings, Inc (HTZ). Hertz has seen a decline in its free cash margin to -15.89% for the twelve months ending June 2010 from 26.82% for the twelve months ending June 2009. The operating cushion remained relatively unchanged at around 38 to 40% for the last 10 years, so the decline in free cash margin is not due to a decline in profitability. The company appears to be increasing its capital spending. Capital expenditures as a % of revenue increased to 44.94% in June 2010 from -14.11% in June 2009 (negative due to asset sales). As HTZ begins to lighten its capital spending, free cash margin should improve.

**Landstar System, Inc. (LSTR), Free Cash Margin, March 2000 – June 2010**



Landstar System, Inc. (LSTR). LSTR showed a decline in its free cash margin from 8.08% for the twelve months ending June 2009 to 1.80% for the twelve months ending June 2010. There is no one single large factor that contributed to this decline, rather many smaller factors all contributed. Operating cushion fell from 7.72% in June 2009 to 7.0% in June 2010. Capital expenditures as a % of revenue rose to 1.10% for the twelve months ending June 2010 from

0.25% for the twelve months ending June 2009. Finally, the cash cycle rose from 25.15 revenue days in June 2009 to 32.85 revenue days in June 2010.

### ***Conclusions***

In the twelve months ending in June 2010, median free cash margin declined for the first time in five consecutive quarters. On a positive note, however, company fundamentals continued to improve. Median revenues increased for the second consecutive reporting period, growing to \$541,613,000 in the June 2010 period from \$527,873,000 in March 2010 and \$523,395,000 in December 2009. Driven by improvements in gross margin and SG&A%, operating cushion also improved, increasing to 14.96% in the June 2010 reporting period from 14.84% in March 2010 and 14.63% in June 2009. At 52.78 and 24.61, respectively, receivables days and inventory days remained relatively flat in the June 2010 reporting period when compared with the March numbers. Both measures are up, however, from June 2009, when receivables days and inventory days measured 46.29 and 20.75, respectively. In the June 2010 period, companies used vendor financing to enhance cash flow. Payables days increased to 29.03 in June 2010 from 26.96 in March 2010 and 23.52 in June 2009. Finally, our sample firms showed no significant changes in capital spending. In the June 2010 reporting period, median capital expenditures as a percent of revenue were 2.79%, down slightly from 2.83% in March 2010 and 3.76% in June 2009.

Overall, our sample firms continued to operate in a “hunker down” mode, sheltering resources and shunning new investments in inventory and capital equipment. An increase in revenues notwithstanding, we saw no evidence that firms were beginning to embrace growth or invest for the future. Instead, they appeared to be treading water, protecting their cash resources from future unknowns and waiting for a clearer economic picture to emerge.