Economic Indicators

Economic Indicators: An Update for the 7 Rivers Region reports on a long-term study of regional economic indicators. The research is ongoing and spans a period of time to enable us to understand and report trends. This project is expected to continuously build on a base of economic information and provide decision makers with valuable tools for strategic planning. The information will also provide a basis for comparison with other regions and a measure of our progress.

State Bank Financial sponsors this research project in collaboration with the University of Wisconsin-La Crosse College of Business Administration and the *La Crosse Tribune*. These programs will continuously build on a base of information and provide decision makers like you with valuable tools for strategic planning.

Specific goals of this project are:

- Support business owners in their business decisions by gathering key local economic indicators and trend information.
- Develop specific economic indicators for this region that are not readily available to decision makers.
- Develop tools to assess our progress in economic growth. Prepare baseline measures that will allow comparison with other regions and measure future progress of the region.
- Track the region's participation in the "new economy" and development in the high tech arena.
- Bring professionals together with business owners for discussion about the local economy and related critical issues.
- Create a business recruitment and retention tool by publishing the information.

Core economic indicators cover the following areas:

- Employment
- Income
- Cost of Living
- Consumer Attitude and Behavior
- Real Estate and Housing
- Interest Rates
- Equity Performance

Economic Indicators and Trends

Taggert J. Brooks, Ph.D., UW-La Crosse Department of Economics

Core economic indicators have been tracked since 2001 to have objective measures for our 7 Rivers Region economy. The special focus of the Spring Meeting is what factors help build and encourage a culture of innovation and change within an organization? As we continue our reports on core 7 Rivers Region economic indicators, a panel of three leaders from our region's fast-growth companies will identify what factors have facilitated their competitive advantages. Dr. Brooks begins with some observations on the labor market and moves on to a discussion of the Federal budget.

Please note: Dr. Brooks occasionally writes on the 7 Rivers Region Economics blog, which contains ideas and writings that might or might not be included in this publication provided at the Economic Indicators breakfast meetings. Dr. Brooks will use the blog to track different topics and collect ideas. The Web address is: http://sevenriversecon.blogspot.com/.

The Jobless Recovery

By most accounts, the economy is beginning to recover from the "Great Recession." While the National Bureau of Economic Research (NBER) has yet to call an "official" end to the recession, most economists estimate it occurred around December 2009. That makes the recession 24 months in length and the longest single contraction since the Great Depression.[1] However, as Larry Summers recently pointed out the problem is we are experiencing "a statistical recovery and a human recession."[2]

Chart 1 depicts the unemployment rate, which is still around 9.7%. The top line number hides the deeper problems of the chronically unemployed – those unemployed longer than 26 weeks – which now make up in excess of 41% of the unemployed. Notice that while the overall unemployment rate was as high in the early 80s, the average duration was not nearly as long.

[1] http://www.nber.org/cycles.html
[2] http://blogs.wsj.com/davos/2010/01/30/summers-statistical-recovery-and-human-recession/tab/article/

Chart 1

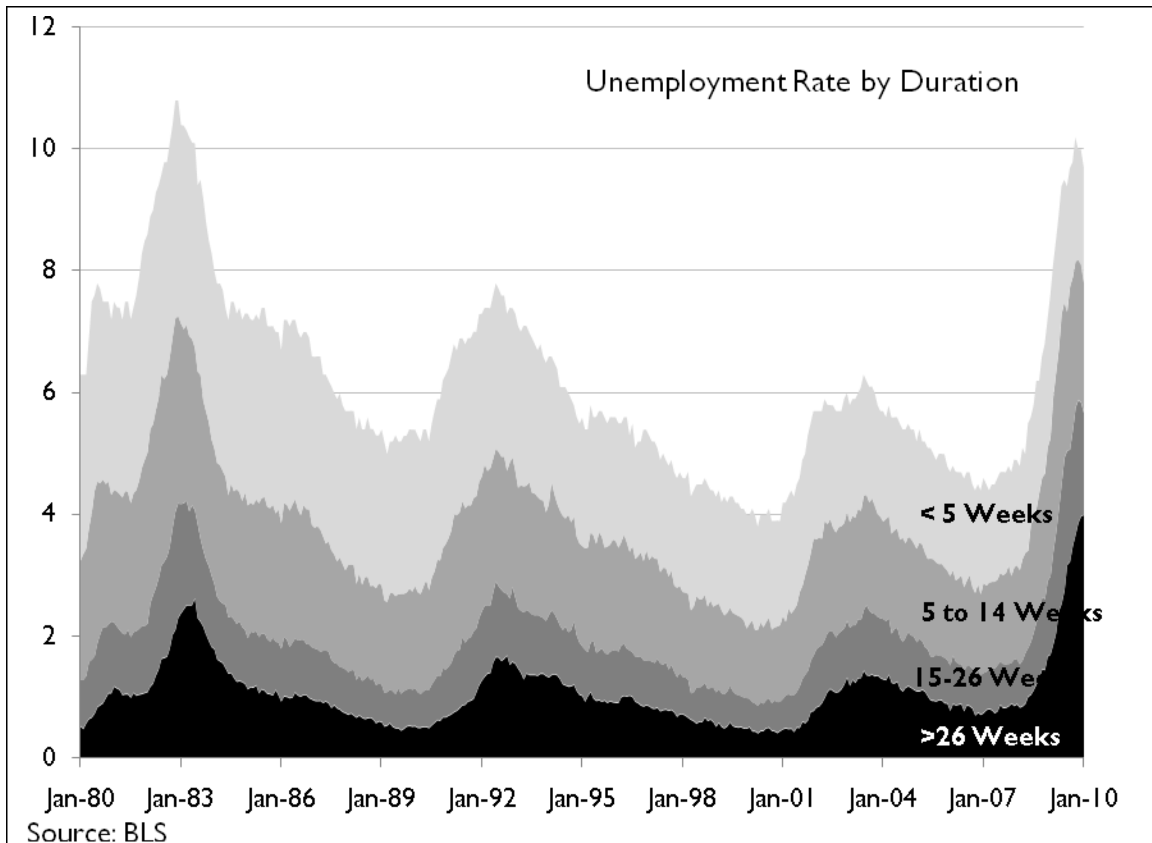
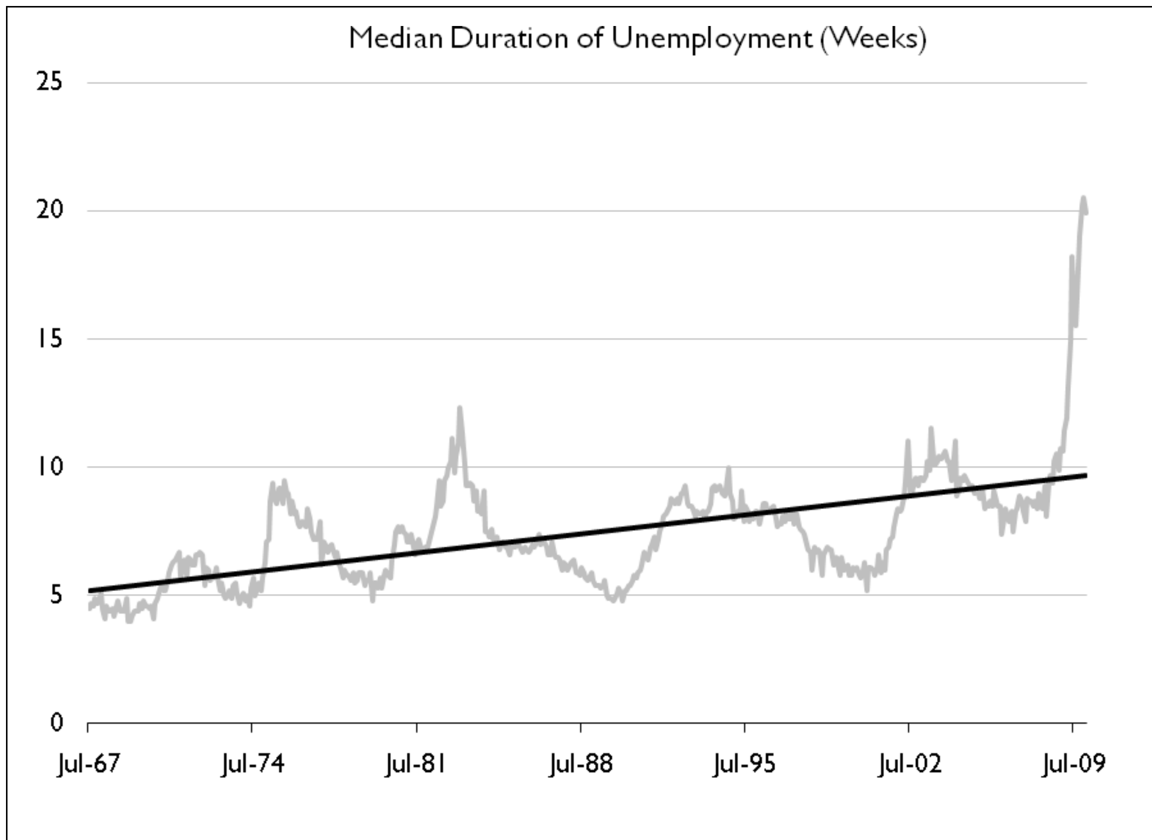


Chart 2 depicts the general increase in the duration of unemployment. During the 60s the median duration was five weeks, while the trend for the median has now risen to ten weeks. The actual median duration during the current recession is twenty weeks. This appears to be a feature of modern recessions; the duration of unemployment is longer, in part because the process of job searching and matching is taking longer. Another reason is that modern recessions appear to involve more permanent structural changes to the economy rather than merely responses to fluctuations in demand. Firms appear to restructure in the face of declining demand by reorganizing and refocusing their employment. They also appear to wait much longer to hire when coming out of a period of declining demand.

Chart 2



The so called "jobless recovery" can be seen when comparing past recessions to modern recessions. Notice how quickly employment rebounds in the recessions immediately post WWII. Workers laid off at the beginning of a recession were often called back to the same job once demand resumed, in part because our economy was relatively more heavily weighted towards manufactured goods than it is today.

The two graphs below update graphs I've produced before. Notice that in 2001 we were in recession for one year, and it took an additional two years for employment to recover to its pre-recession peak. If the same trajectory were to hold true for the current recession, we are looking at another four years before employment recovers to its pre-recession peak in December 2007.

Chart 3

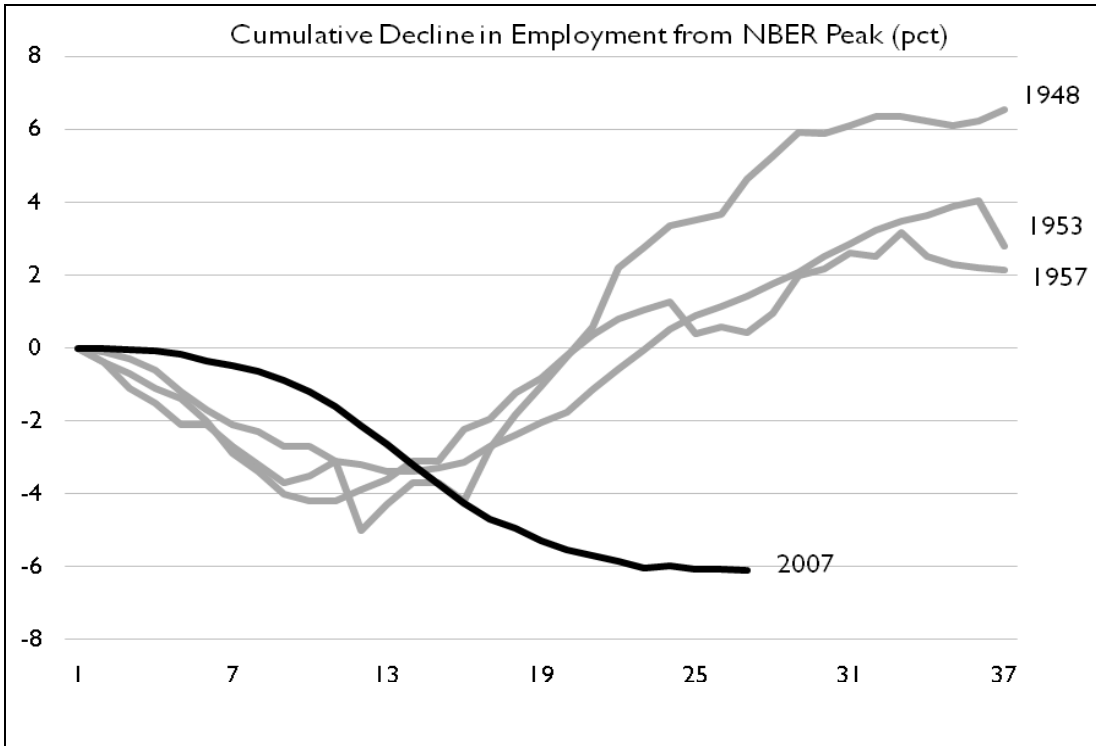


Chart 4

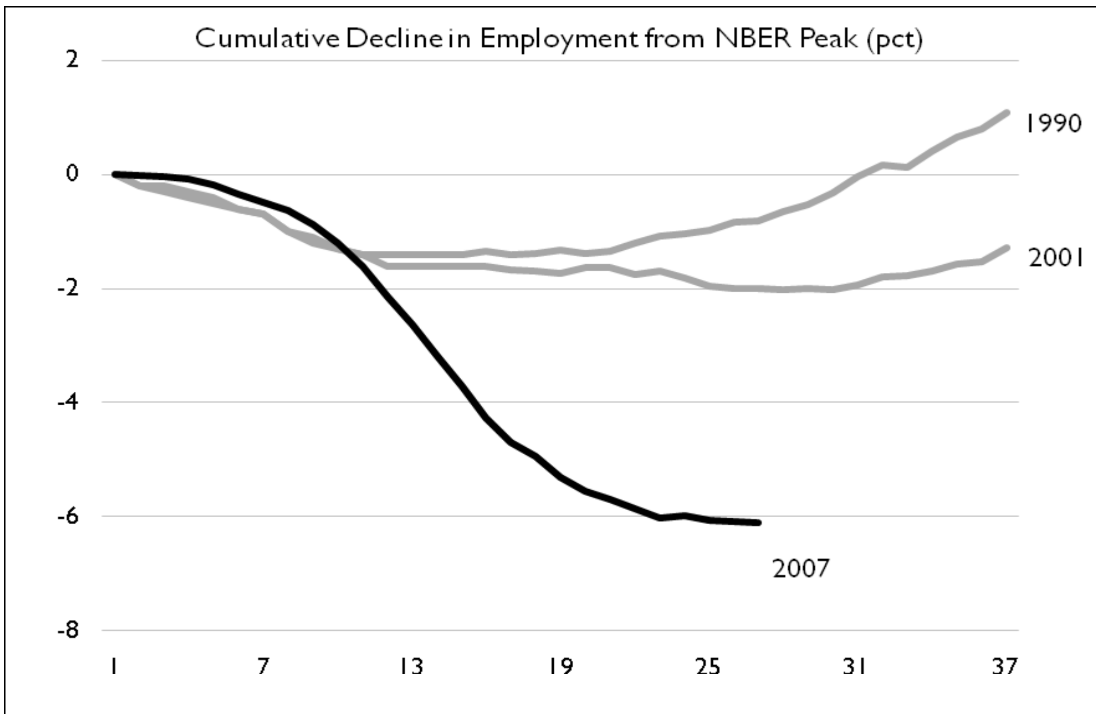


Chart 5 has the current changes in employment by sector since the beginning of the recession. This measures the percentage of total losses for each sector. We can see that manufacturing is the hardest hit in terms of aggregate losses. Since our region is more heavily based in manufacturing employment we can expect this trend to affect us as well. The few bright spots in terms of job losses are those sectors that have seen some employment growth, such as the Heath care and Education sectors, which our region also has a fair amount of exposure to.

Chart 5

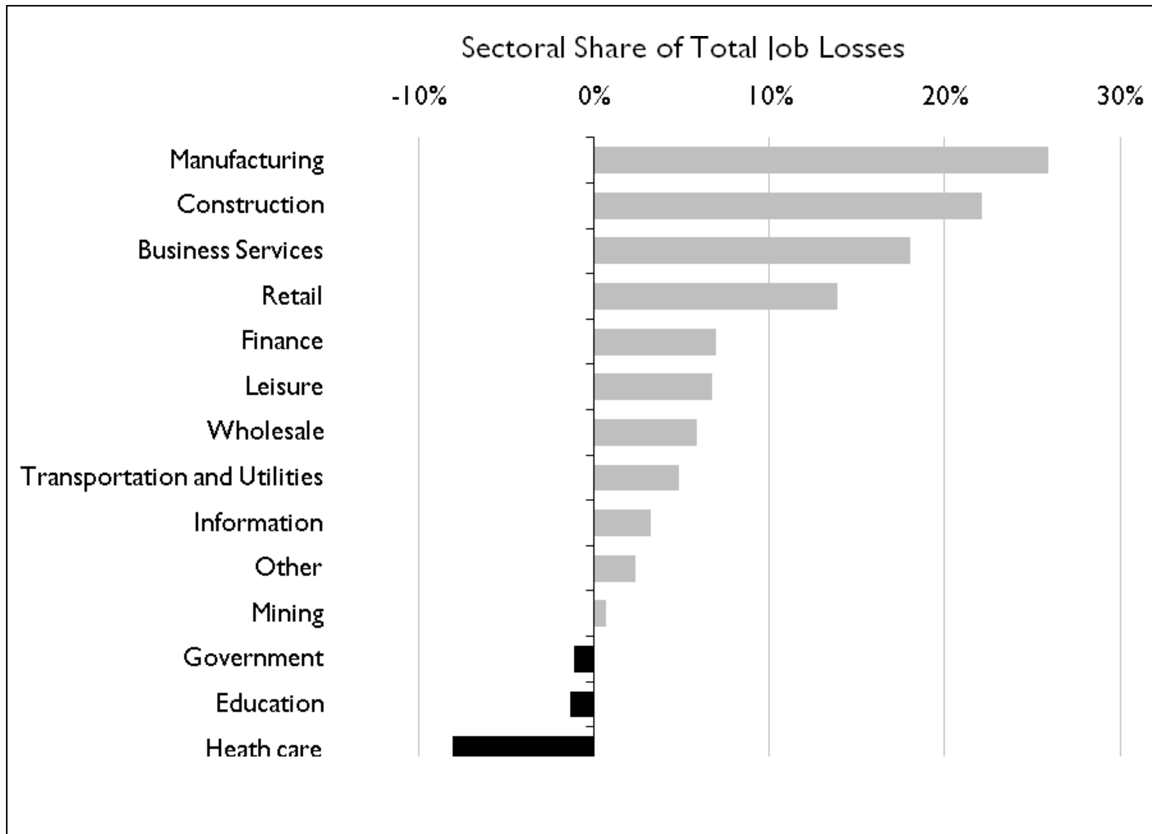


Chart 6

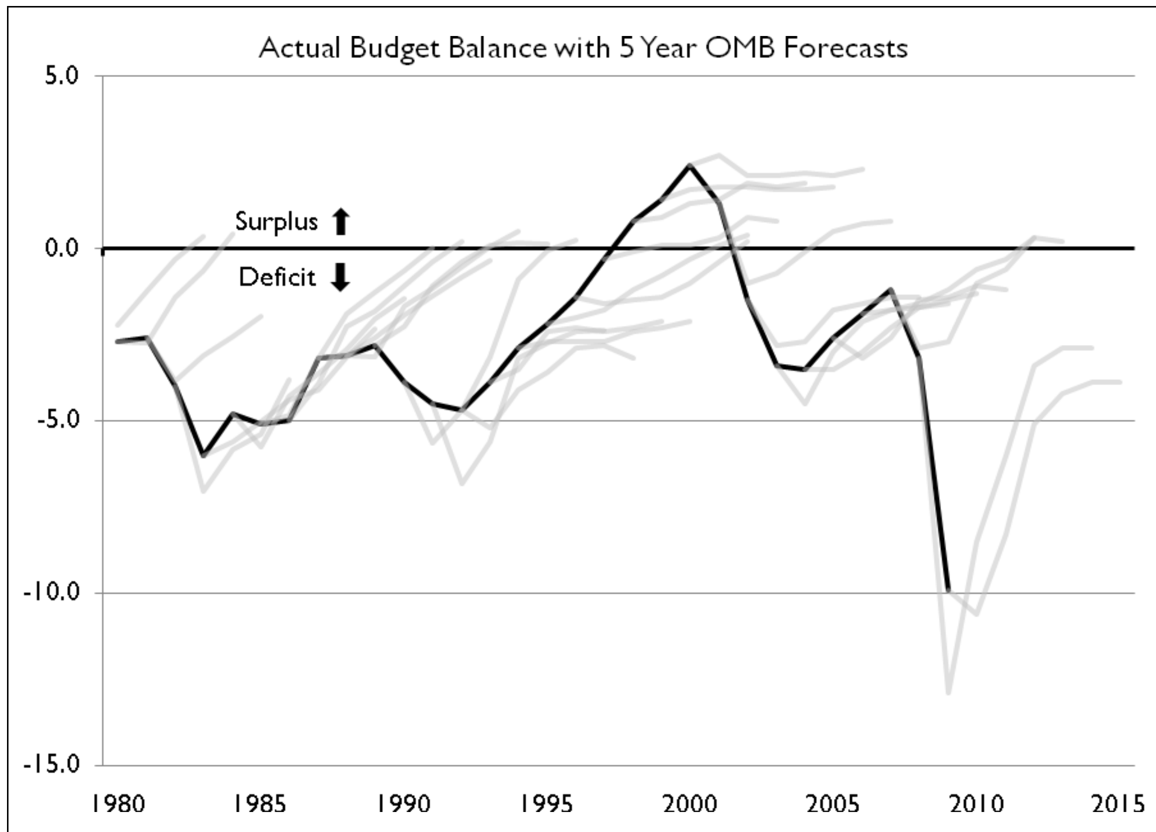
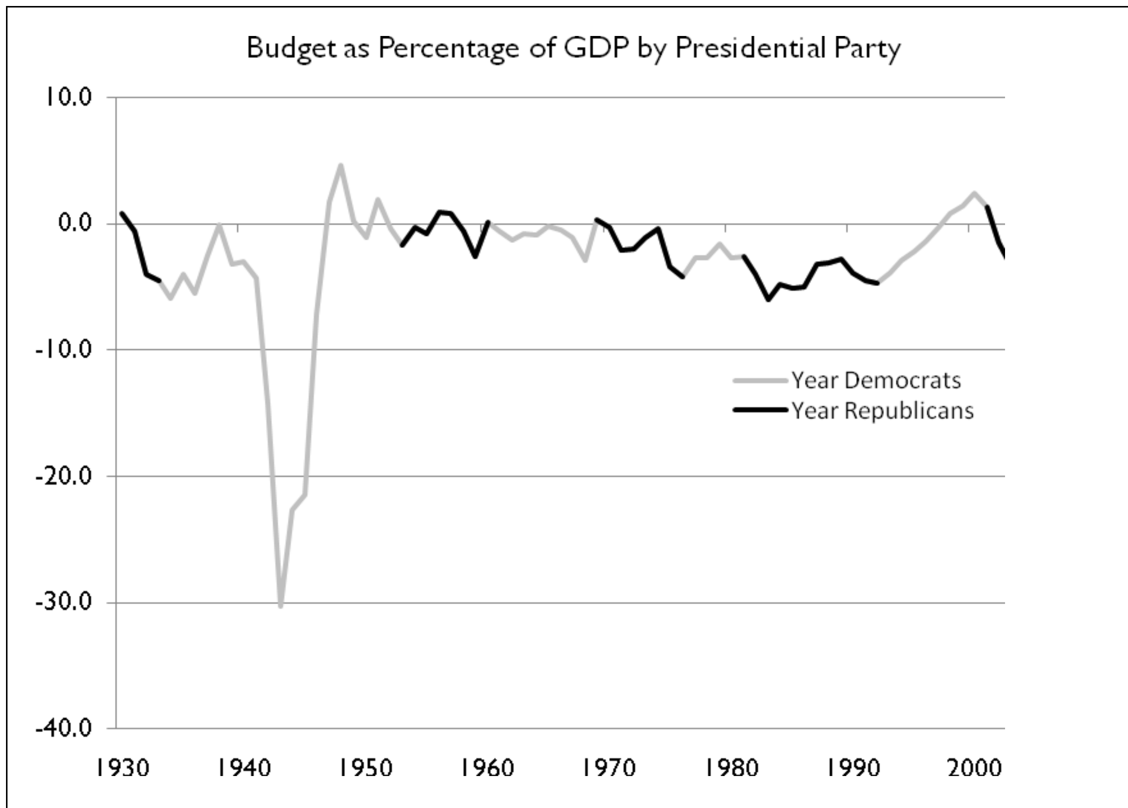


Chart 6 has a plot that is inspired by a recent visualization in the *New York Times.*[3] The graph provides the actual budget balance represented by the black line and the Presidential five year forecasts from the annual proposed budget represented with light grey lines. There are two striking facts. The first is how every, and I mean every, forecast calls for decreasing deficits (depicted by the upward sloping light gray lines) if not in the first or second year, definitely by the third through fifth year, yet that is rarely the case. Forecasts are clearly not rational because the errors are biased. The average forecast error is almost one percent, implying the actual deficit is one percent of GDP above the forecast. Notice the other striking thing, how much of a surprise the boom of the late 1990's was for the public coffer.

Unfortunately, the conversation around the federal debt and deficits has become increasingly partisan. With a few simple graphs I'd like to demonstrate that the issues are, in fact, not partisan but shared by both parties. Neither can claim to be the party of fiscal austerity. But really it matters little who is responsible for the debt; our future budget problems have existed since the 60s and appear to continue to mount independent of the party in power.

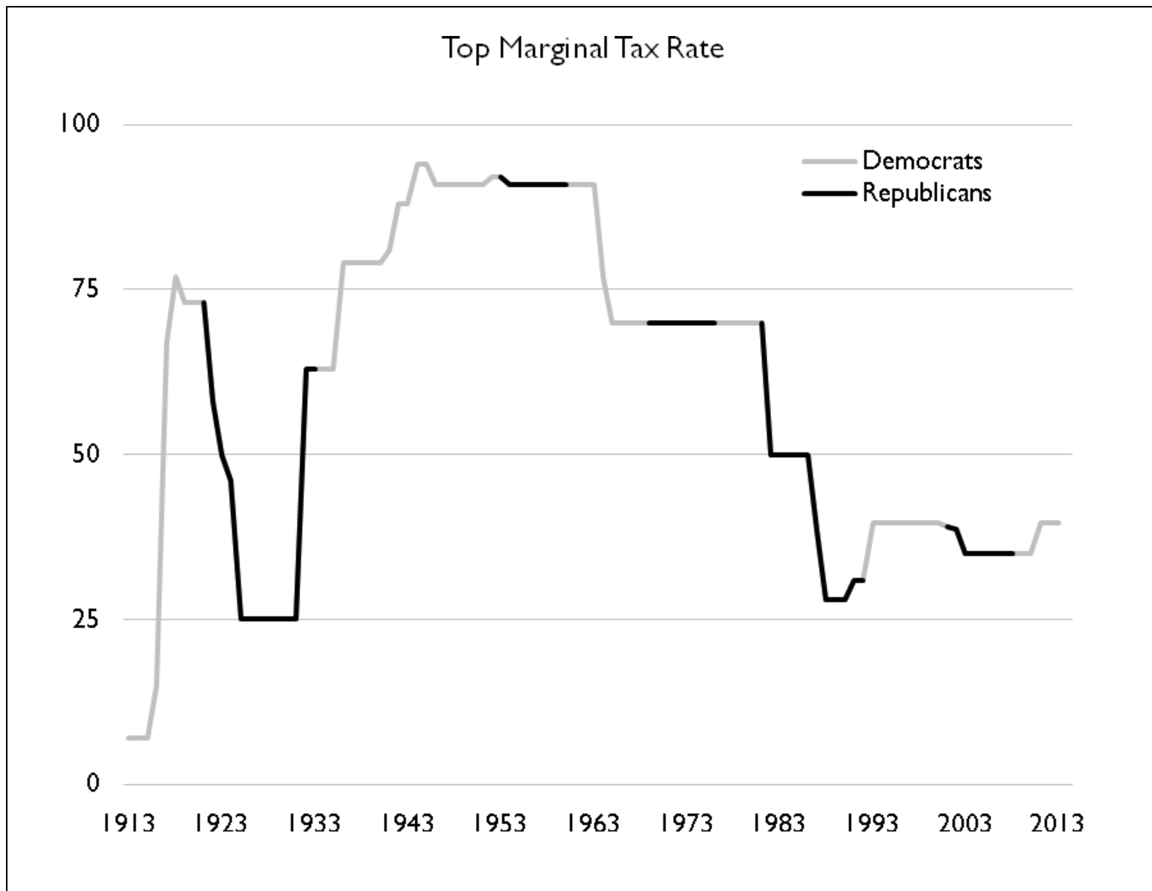
[3] http://www.nytimes.com/interactive/2010/02/02/us/politics/20100201-budget-porcupine-graphic.html

Chart 7



The above graph depicts the budget position as a percentage of GDP, by presidential party. Dark lines represent Republican Presidents, while light grey lines represent Democratic Presidents. The line above zero represents a budget surplus while below zero it represents a deficit. The deficits of WWII swamp the rest of the deficits as a percentage of GDP. Notice that Democrats also are responsible for two of the three surpluses. Also note how small the budget response was to the Great Depression, particularly compared to our current response.

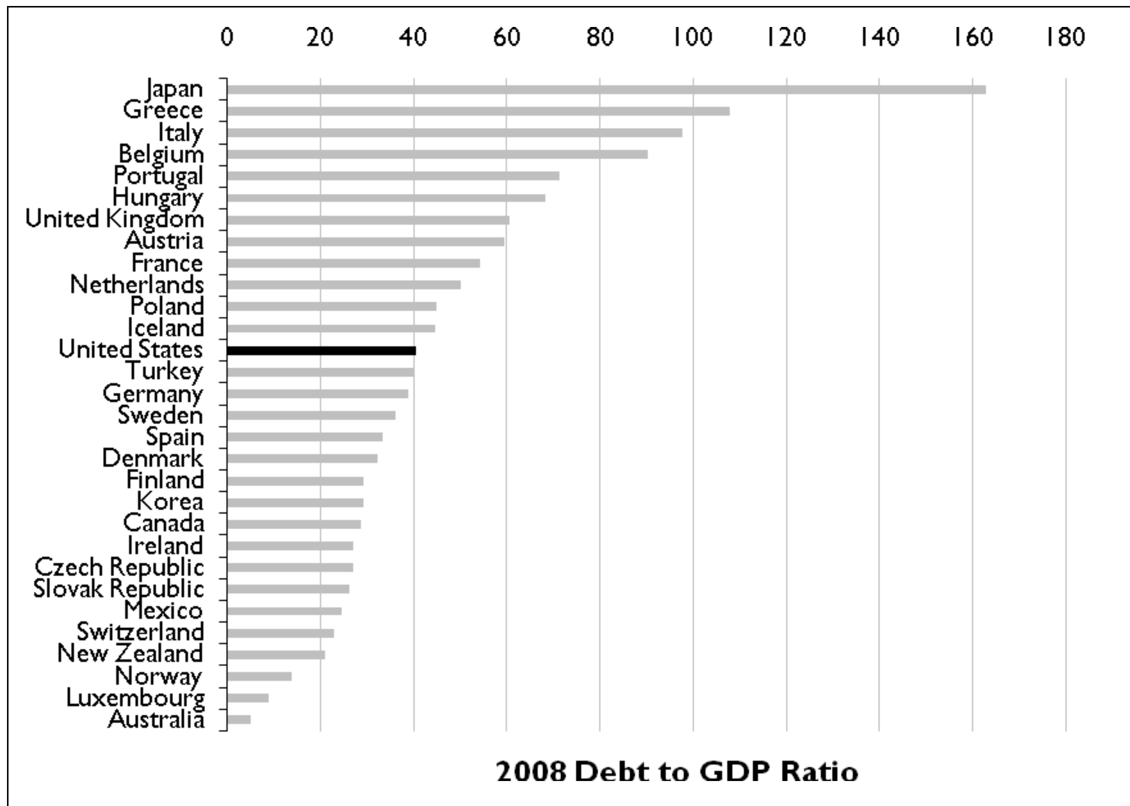
Chart 8



Here we have the top marginal tax rate by presidential party. President Obama was recently attacked for wanting to allow the Bush tax cuts to sunset. I thought it would be useful to see the top marginal rates since the beginning of the income tax. Again, this is broken down by party of the president. Darker lines represent Republican Presidents and lighter. Another word of caution is in order when looking at this graph. It only depicts the top marginal rate, not who is or how many are bound by that marginal rate.

A few things stand out. The Kennedy and Reagan cuts in marginal rates were large even if partially undone by their own party later. Also notice the top marginal rate during the Great Depression. It was initially lowered dramatically before the Great Depression then unfortunately increased from 25 percent to 63 percent during the Great Depression. The administration mistakenly wanted to balance the budget in the middle of a recession, helping to make it the depression that it was. A lesson we have hopefully learned not to repeat. Our current deficits will be quite small relative to the damage we could do by trying to balance the budget today. Of course that is not to say that we don’t have a responsibility in the coming years to address our bigger impending budget issues, Medicare and Medicaid.

Chart 9

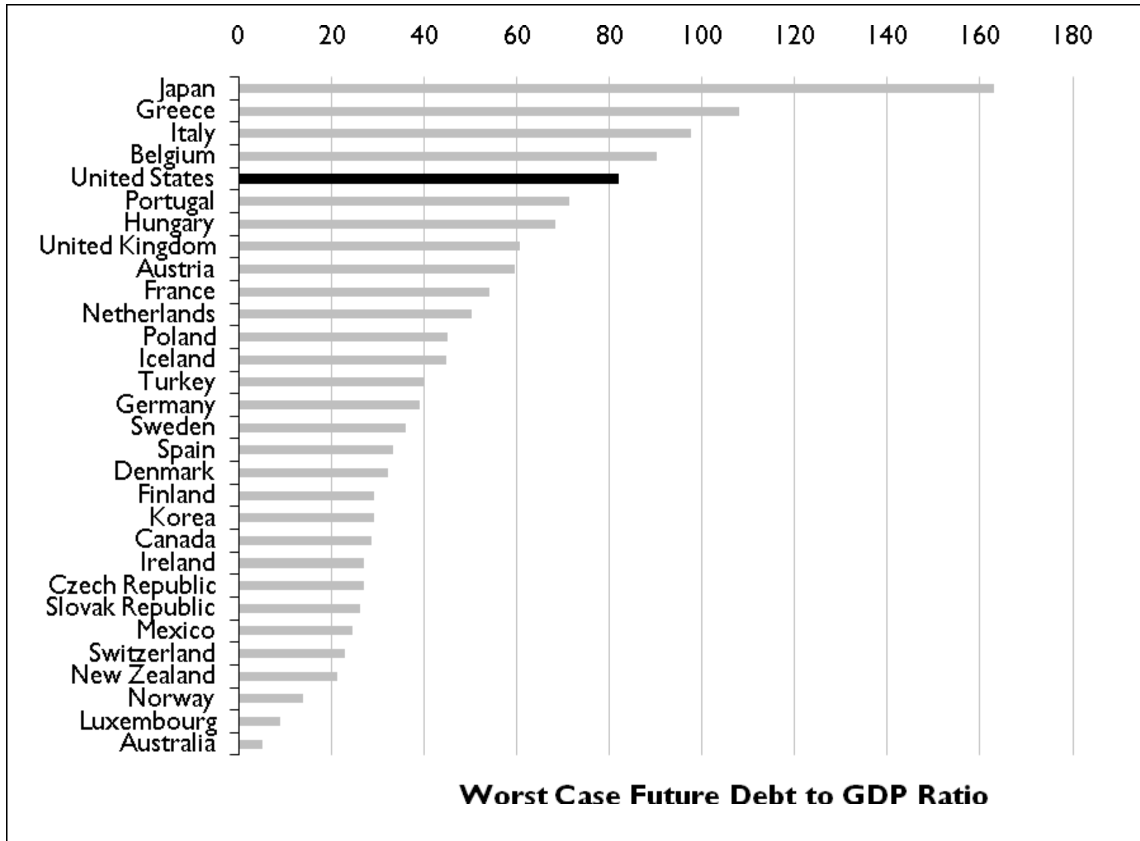


In the graph above, we have the Organisation for Economic Co-operation and Development (OECD) countries ranked by their debt to GDP ratio in 2008. The US is in the middle of the pack, with plenty of countries that have not experienced problems above us. Merely having debt is not necessarily a bad thing. It is the level of debt we believe will inhibit growth in the long run. And for the moment we don't appear to be at a level that will inhibit growth.

Below I've included a worst case scenario for this last year. Had every other country's debt remained the same (though they didn't) and the US increased due to the stimulus, where would we stand? Even then we would still not be at the top. Japan, with its lost decade, accumulated more debt than we have. The question of how debt affects economies is still a bit open. In the footnotes you'll find two good readings.[4, 5] Bruce Bartlett also has a good discussion of the national debt here: http://capitalgainsandgames.com/blog/bruce-bartlett/1553/what-national-debt.

[4] http://www.ft.com/cms/s/2/cf3a3f5e-1f94-11df-8975-00144feab49a.html
[5] http://blogs.ft.com/undercover/2010/03/maybe-debt-doesnt-matter-after-all/

Chart 10



Housing Market

As I've mentioned previously, it is often the case that the first to enter a recession is the first out. Unfortunately in this recession our region appeared to be the last in, and will likely be the last out. One example of this would be the housing market. While other places in the country have started to bottom out, our region has only recently started to decline. The price drop seen in the next graph is at least partially made worse by the tax incentives for first time buyers. The credit helped to bring down the average selling price by increasing the number of sales at the low end of the distribution. It is likely also due to job losses and the slowing regional economy.

Chart 11

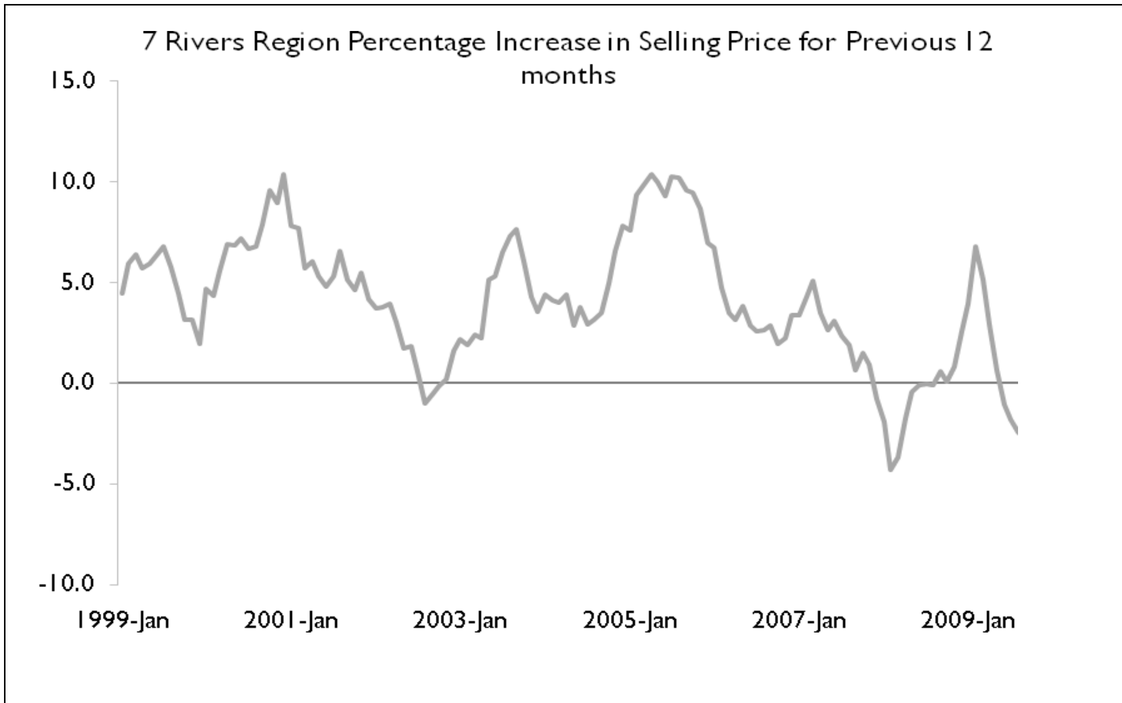


Chart 12

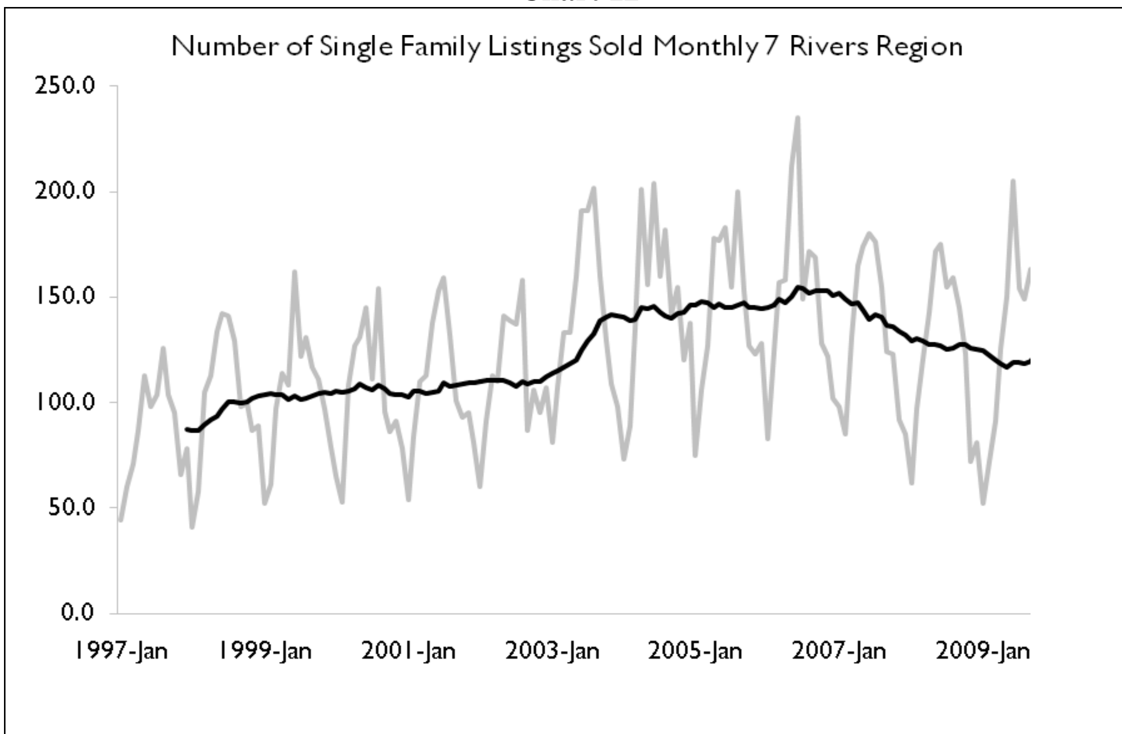


Chart 13

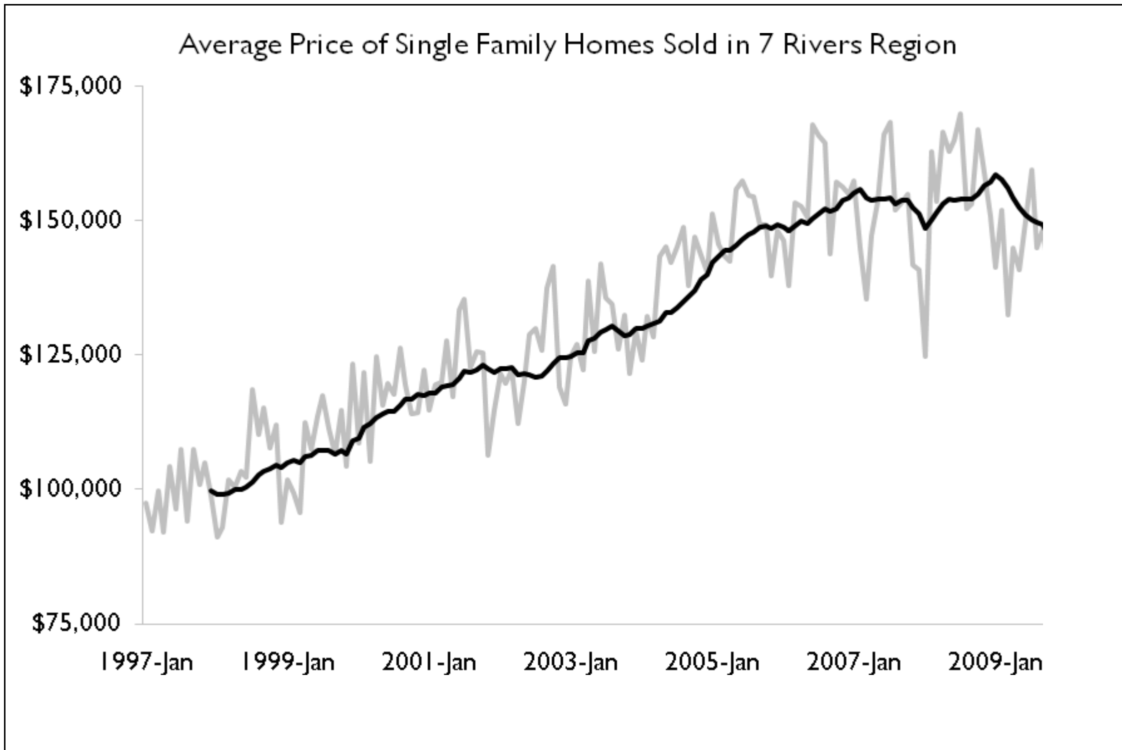
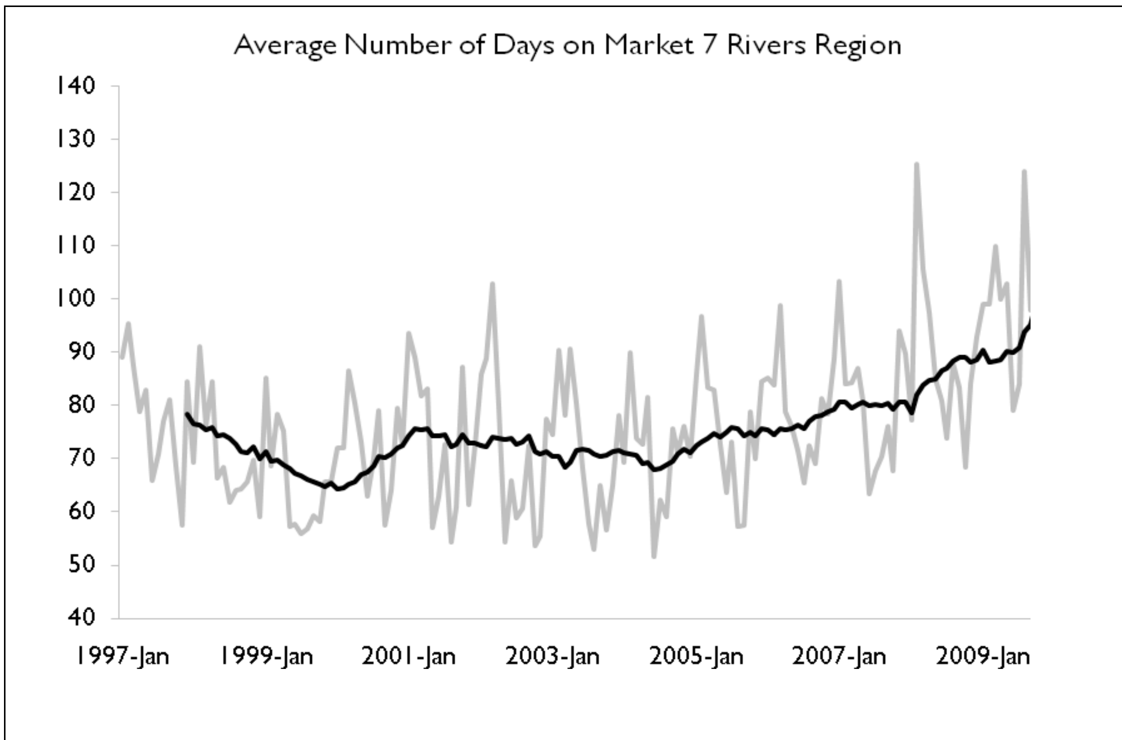


Chart 14

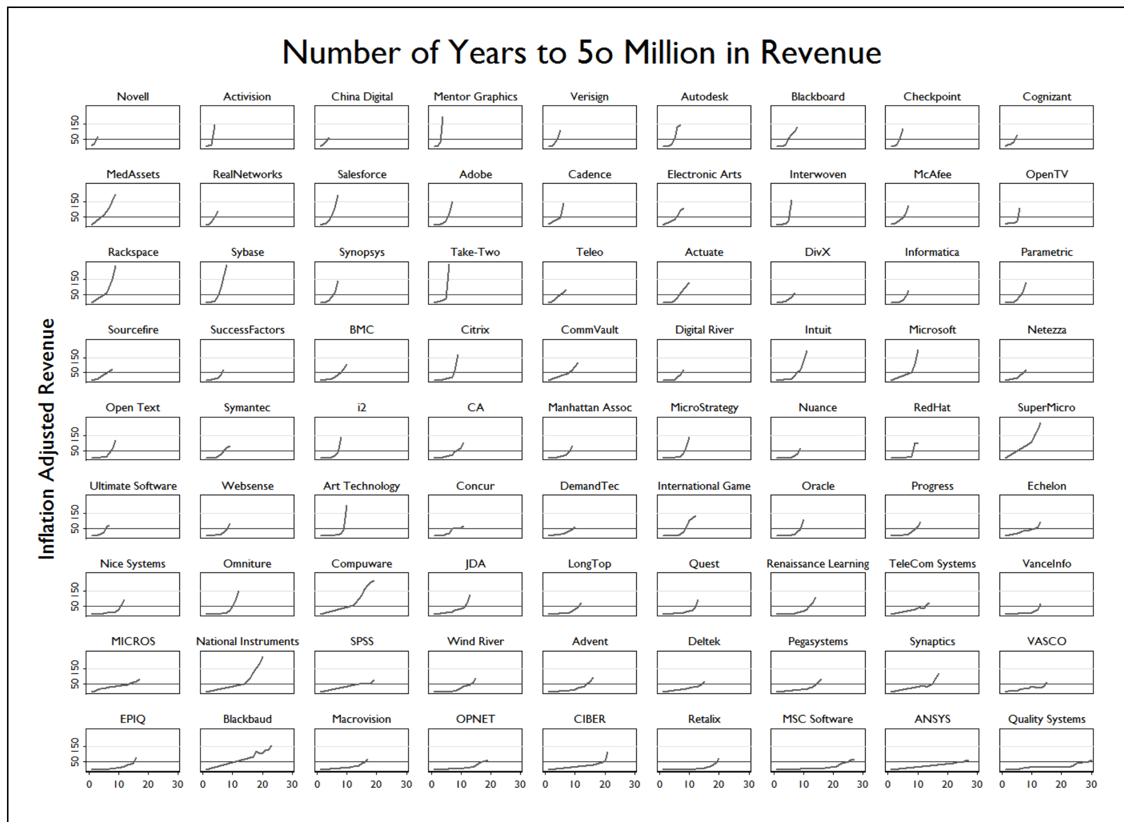


Innovation and Economic Growth

Economists know little about what encourages economic growth, or what spurs entrepreneurial activity. We do know data, and sometimes that data can suggest the answer is not very simple. Below I have data on the top 81 publicly traded software companies measured by market capitalization. The data come from the WSJ/Techcrunch.[6]

A few things stand out but first a note. These are the companies that have survived. They are not a sample of all software companies ever started. Analyzing them too closely falls afoul of the survivorship bias inherent when analyzing data from successful outcomes. But it is instructive to realize how varied even their paths have been. The small multiples graph orders the firms based on the number of years it took the firm to reach $50 million in annual revenue (where the annual revenue has been adjusted for inflation in terms of 2008 dollars). The fastest 25 percent did it in six years, the median firm took nine years, and the mean number of years was ten. However, fully 25 percent of the top publicly traded software firms took thirteen or more years to reach $50 million in revenue, with some taking as long as 26 years.

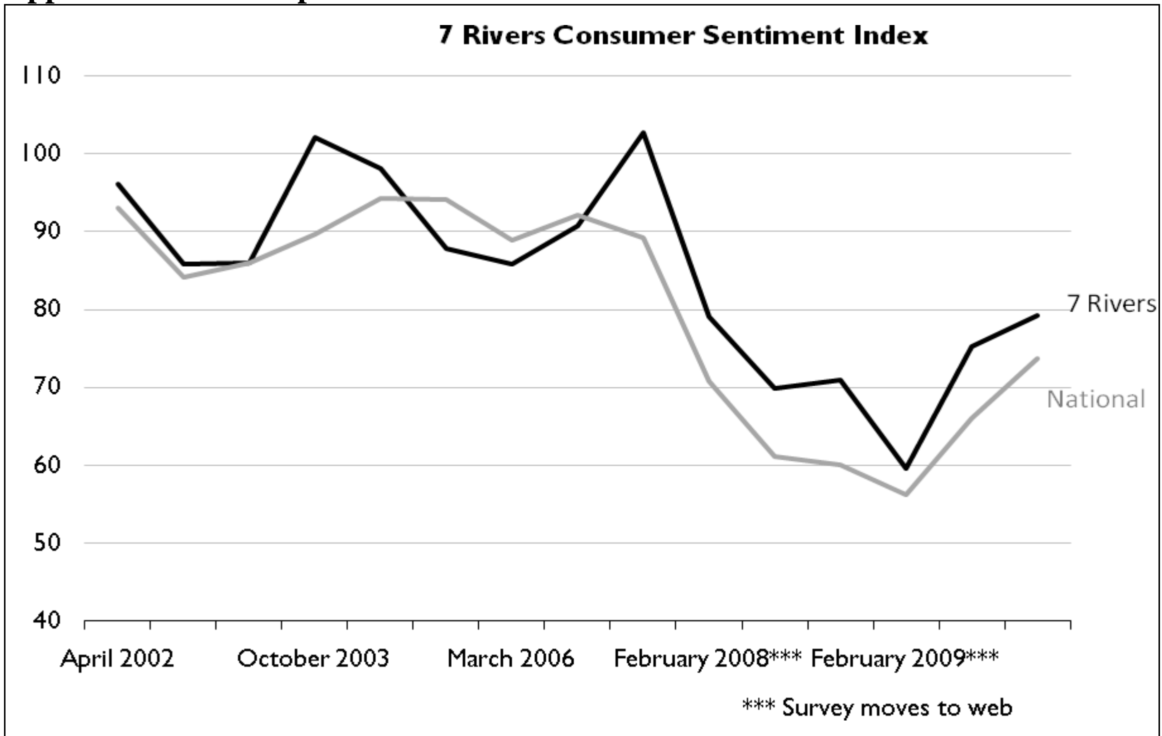
Chart 15

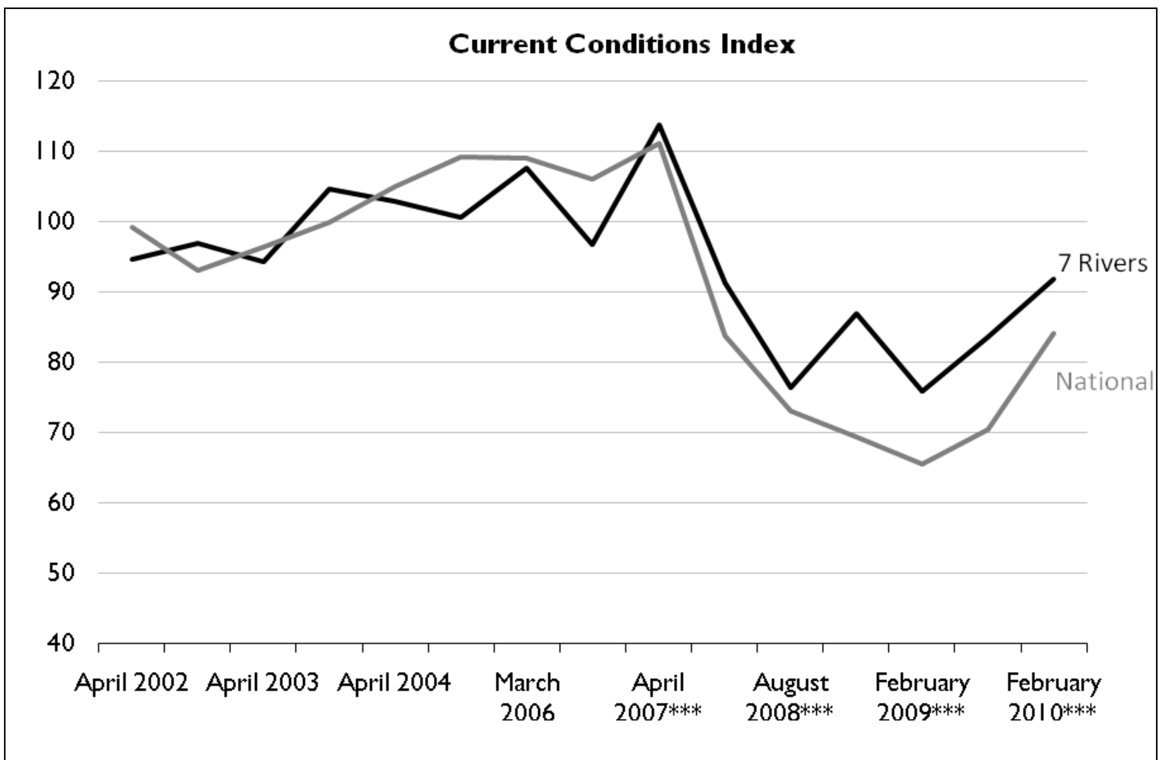


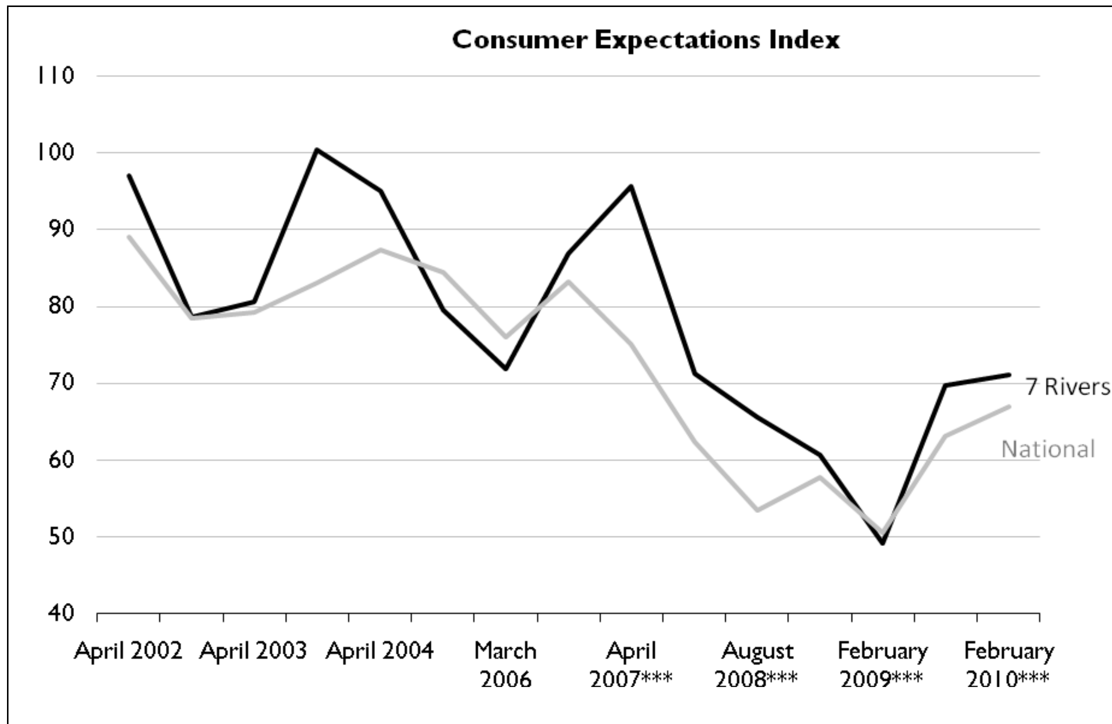
---

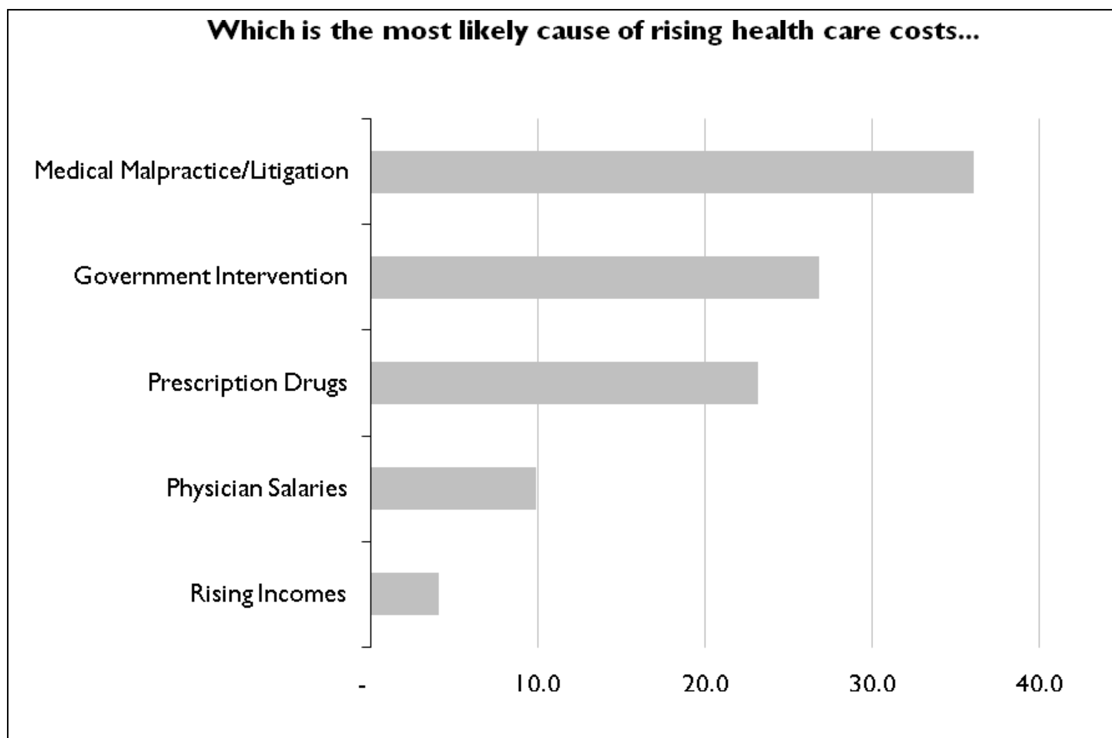
[6] http://www.ipo-dashboards.com/wordpress/2009/09/the-slow-death-of-venture-capital/

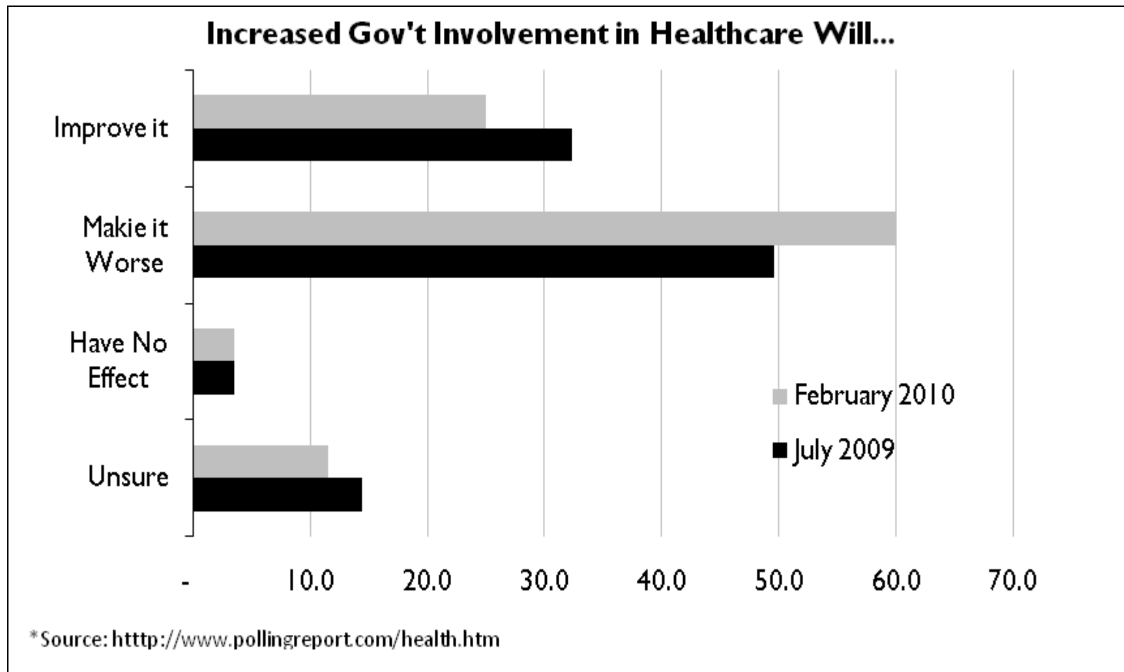
Appendix: Extra Graphs

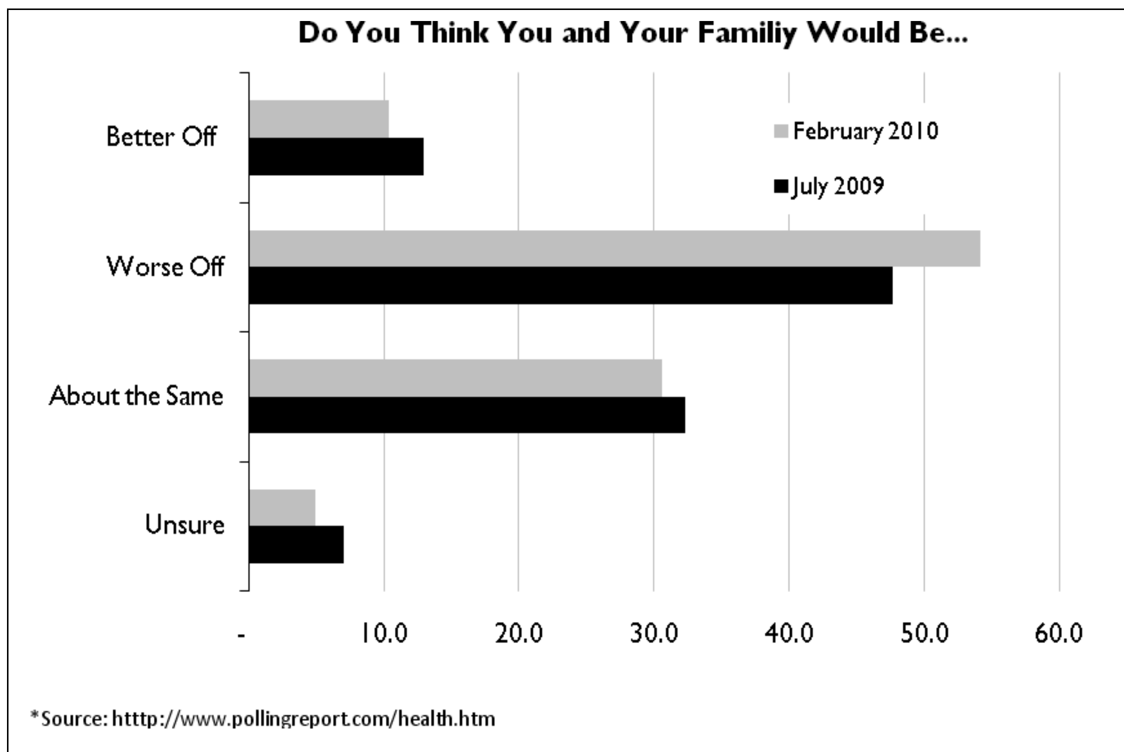


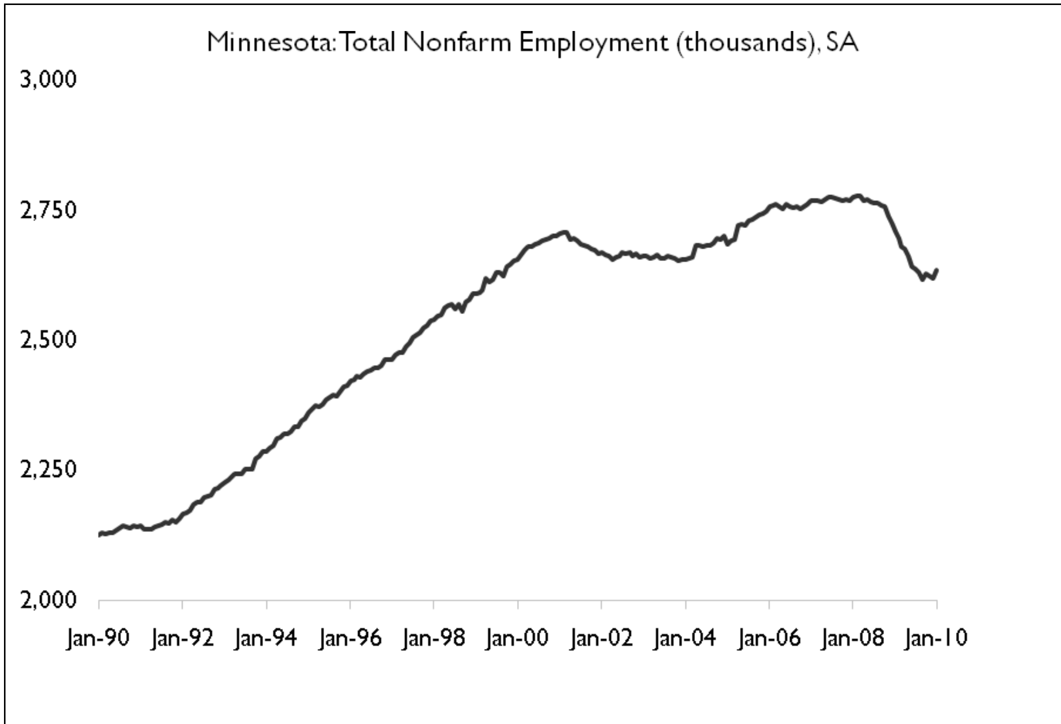


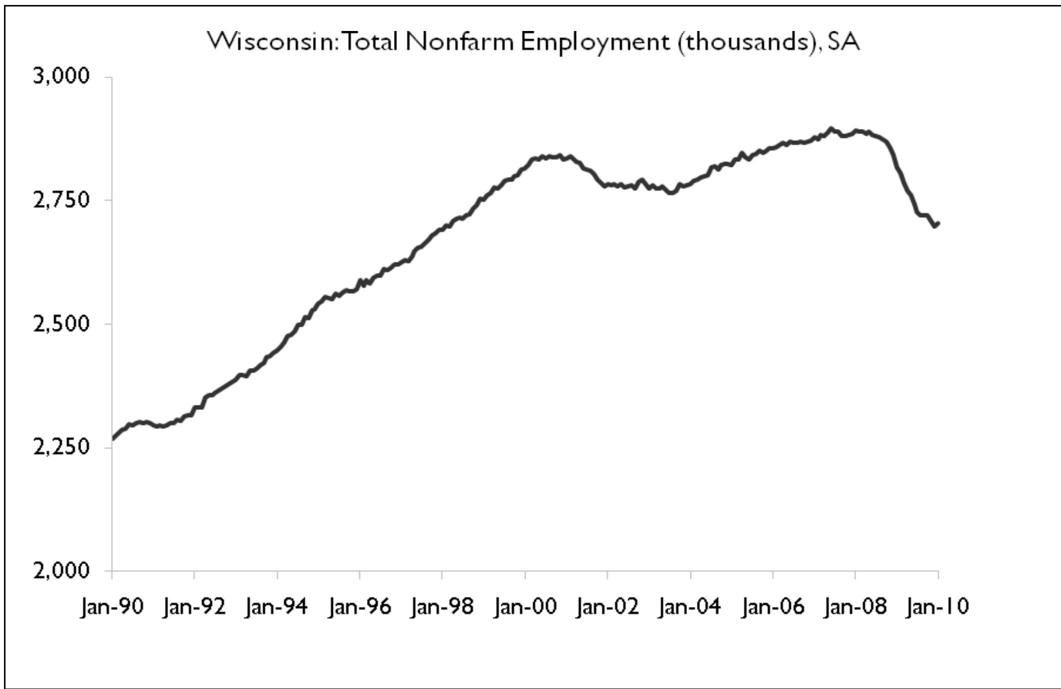

Consumer Expectations Index
110
100
90
80
70
60
50
40
April 2002
April 2003
April 2004
March 2006
April 2007***
August 2008***
February 2009***
February 2010***
7 Rivers
National

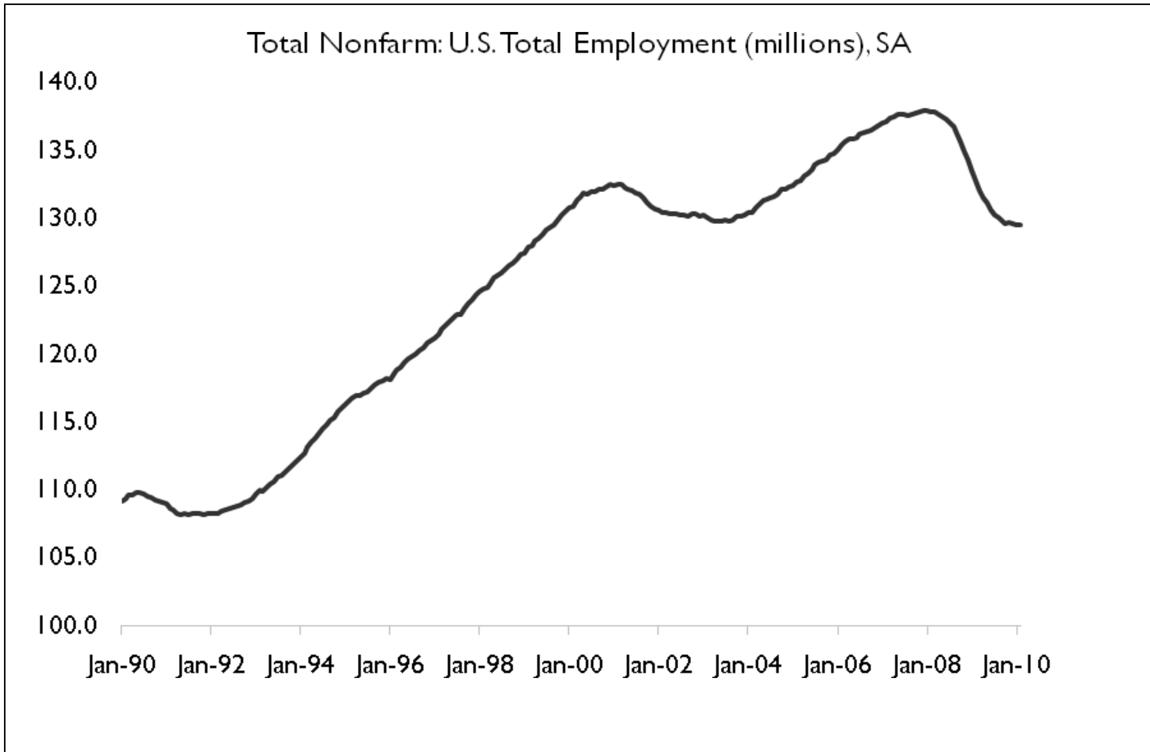

Which is the most likely cause of rising health care costs...
Medical Malpractice/Litigation
Government Intervention
Prescription Drugs
Physician Salaries
Rising Incomes
-
10.0
20.0
30.0
40.0

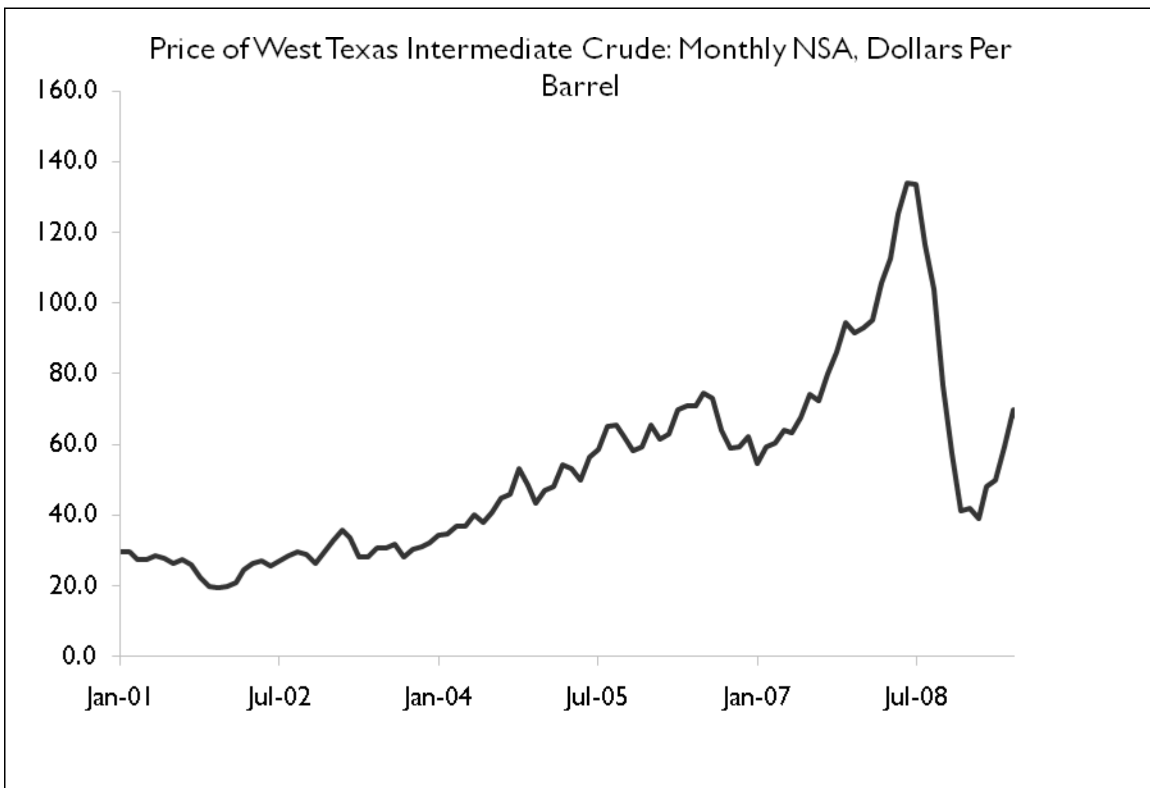

Increased Gov't Involvement in Healthcare Will...
Improve it
Makie it Worse
Have No Effect
Unsure
February 2010
July 2009
-
10.0
20.0
30.0
40.0
50.0
60.0
70.0
*Source: htttp://www.pollingreport.com/health.htm

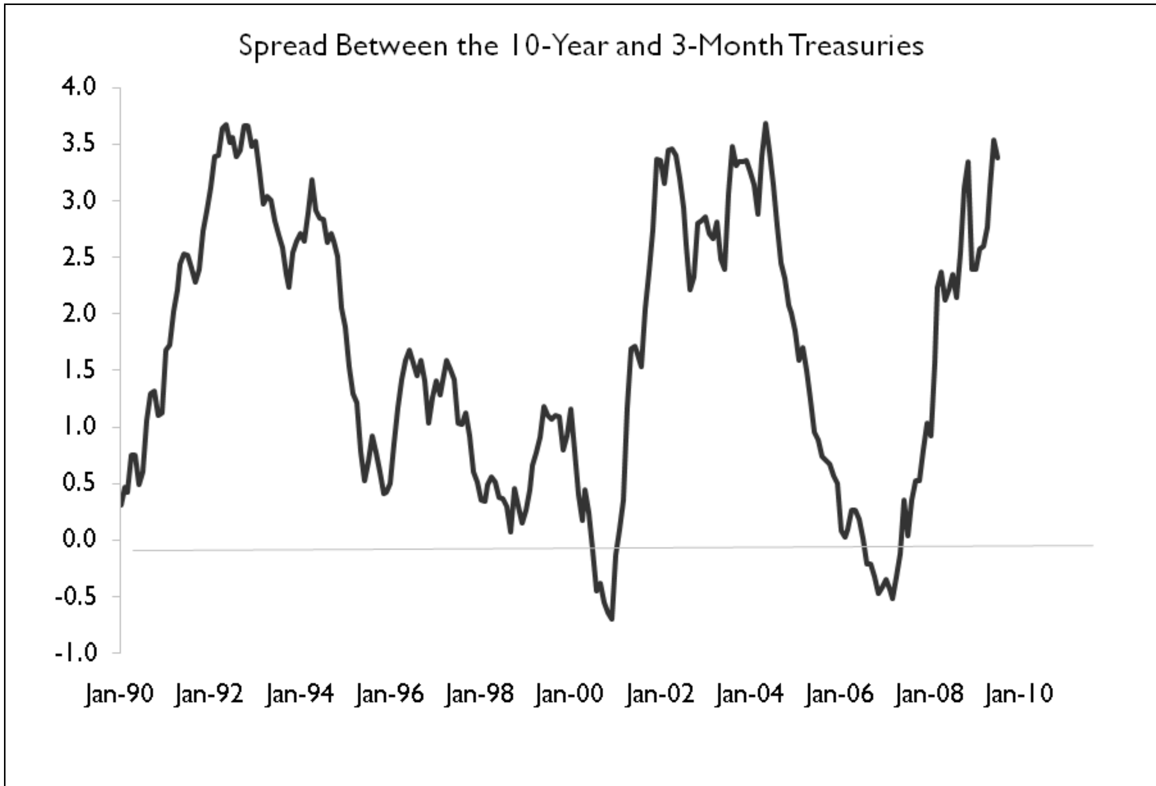

Do You Think You and Your Familiy Would Be...
Better Off
Worse Off
About the Same
Unsure
February 2010
July 2009
-
10.0
20.0
30.0
40.0
50.0
60.0
*Source: htttp://www.pollingreport.com/health.htm

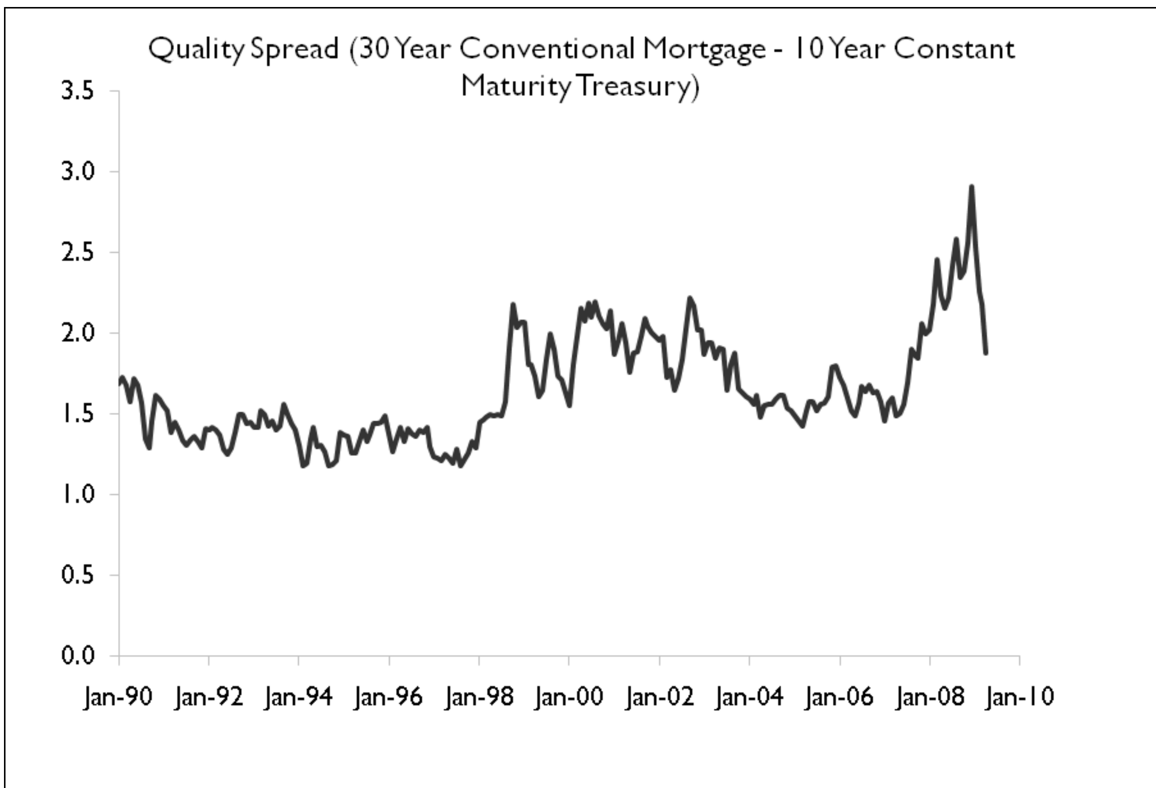

Minnesota: Total Nonfarm Employment (thousands), SA
3,000
2,750
2,500
2,250
2,000
Jan-90
Jan-92
Jan-94
Jan-96
Jan-98
Jan-00
Jan-02
Jan-04
Jan-06
Jan-08
Jan-10

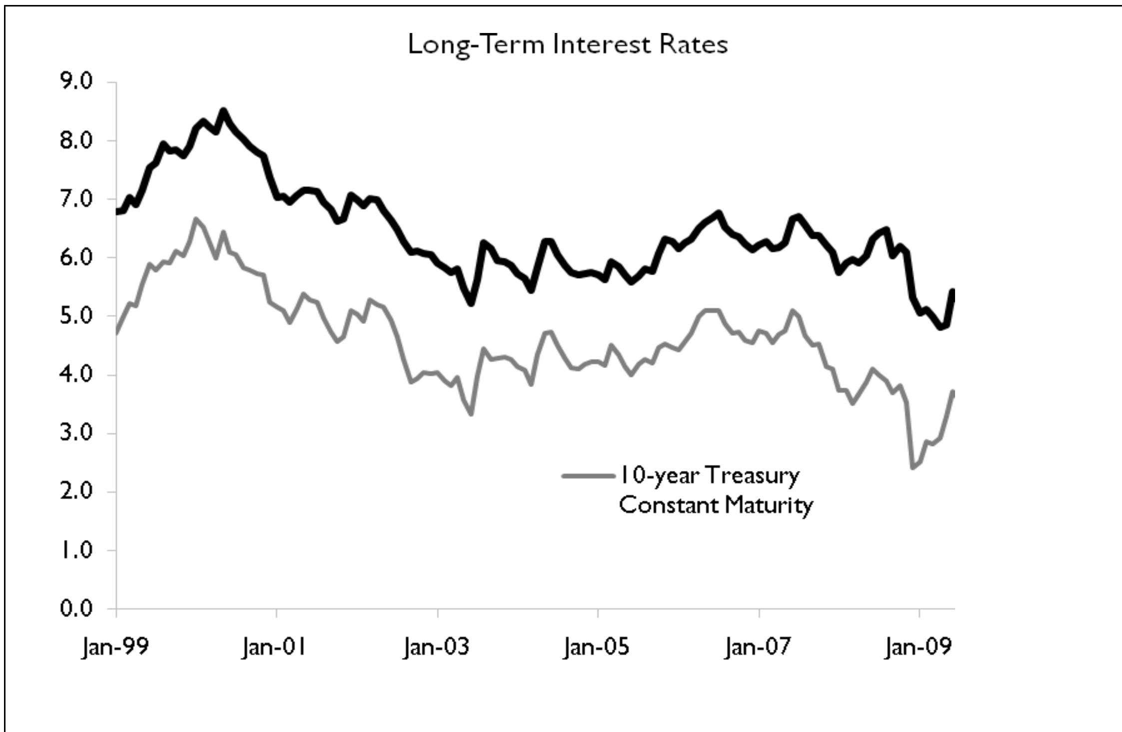

Wisconsin: Total Nonfarm Employment (thousands), SA
3,000
2,750
2,500
2,250
2,000
Jan-90
Jan-92
Jan-94
Jan-96
Jan-98
Jan-00
Jan-02
Jan-04
Jan-06
Jan-08
Jan-10

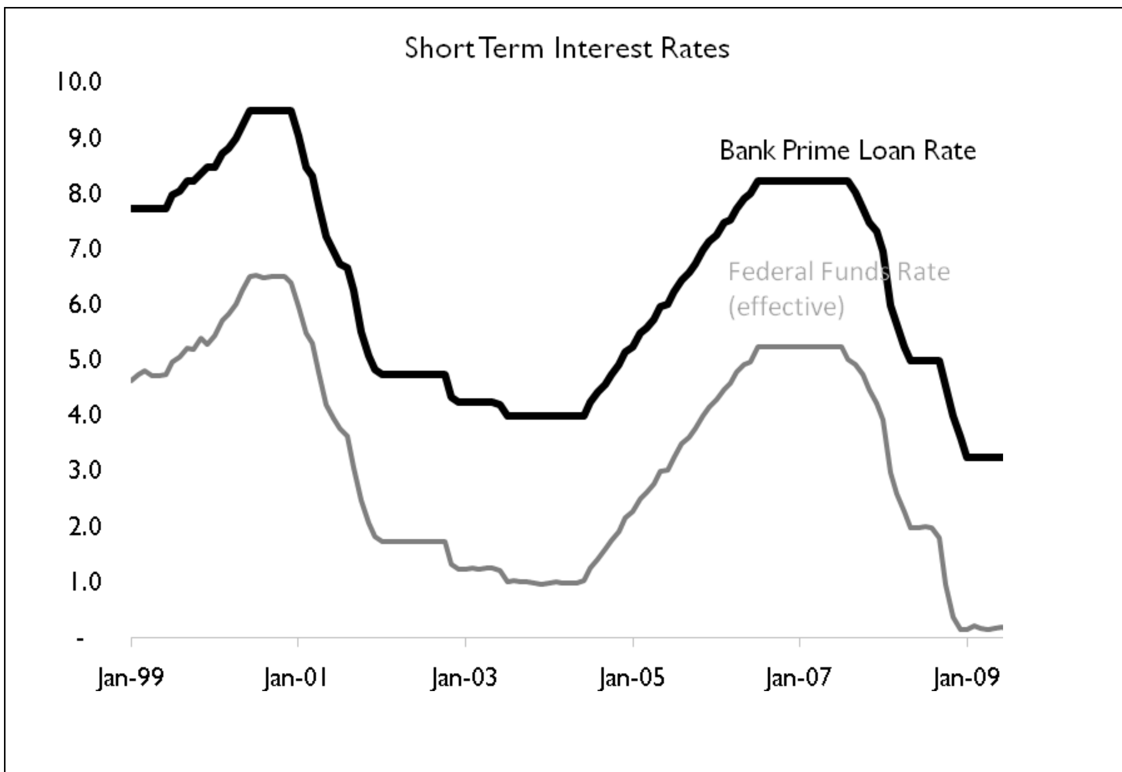

Total Nonfarm: U.S. Total Employment (millions), SA
140.0
135.0
130.0
125.0
120.0
115.0
110.0
105.0
100.0
Jan-90
Jan-92
Jan-94
Jan-96
Jan-98
Jan-00
Jan-02
Jan-04
Jan-06
Jan-08
Jan-10

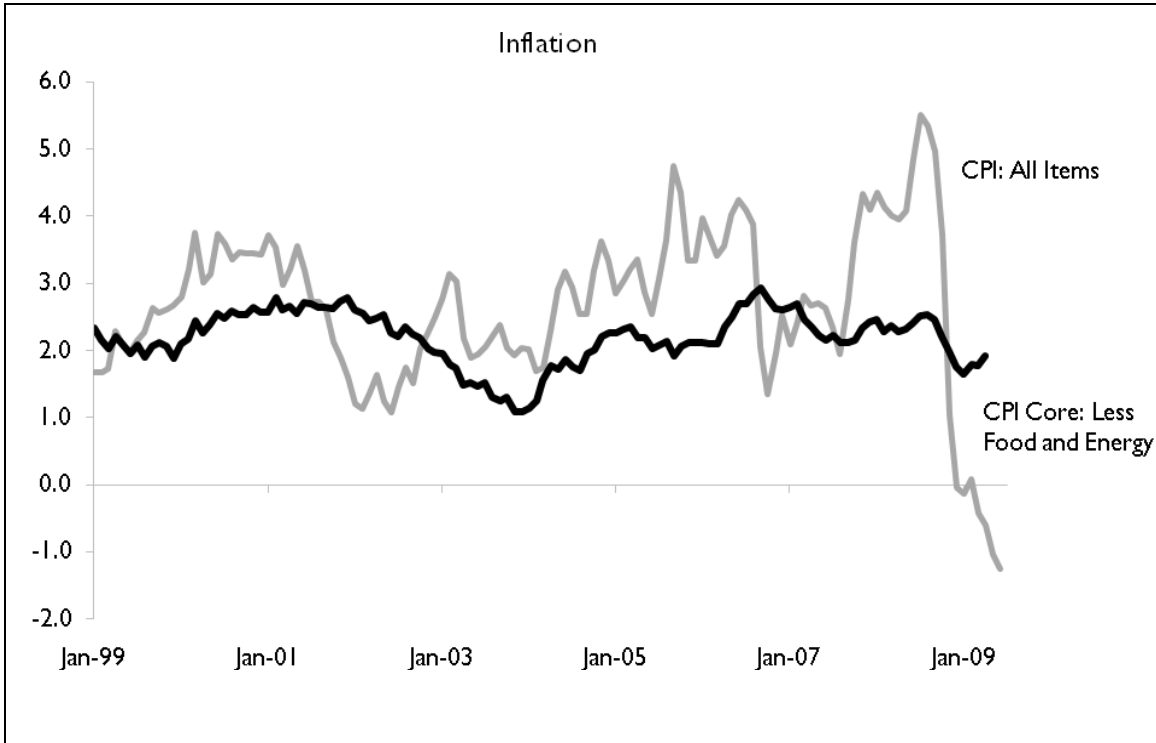

Price of West Texas Intermediate Crude: Monthly NSA, Dollars Per Barrel
160.0
140.0
120.0
100.0
80.0
60.0
40.0
20.0
0.0
Jan-01
Jul-02
Jan-04
Jul-05
Jan-07
Jul-08

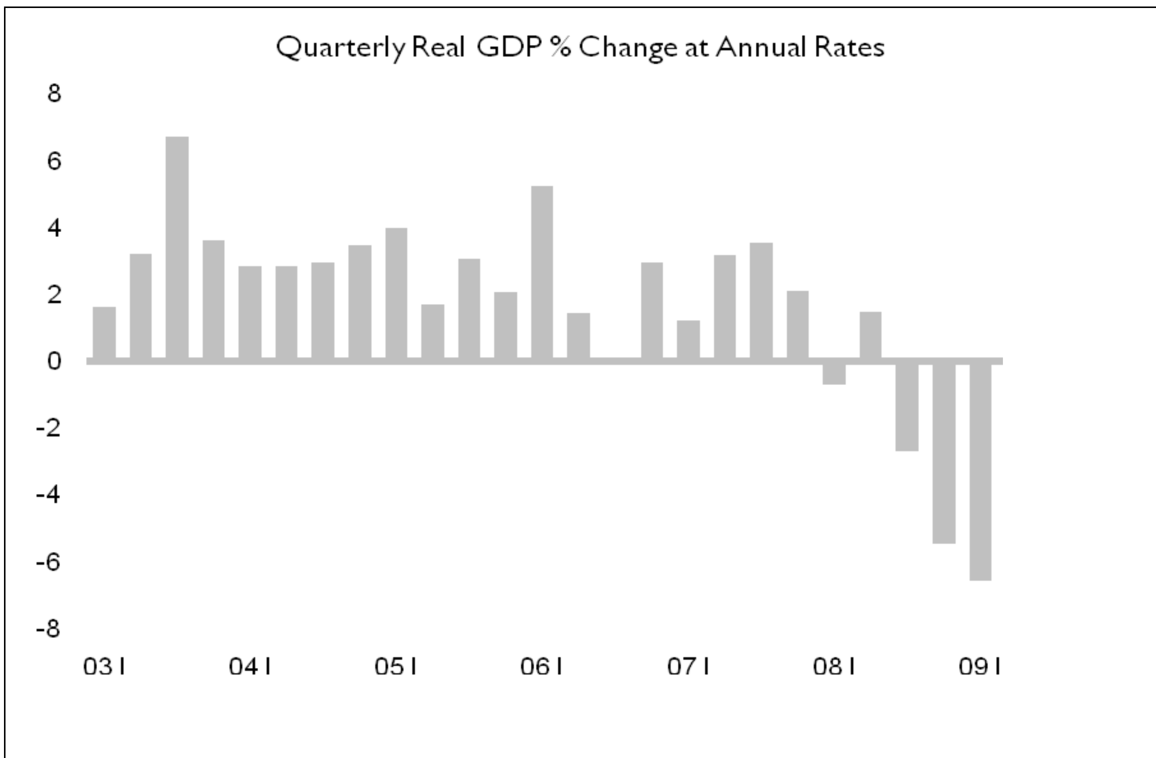

Spread Between the 10-Year and 3-Month Treasuries
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
-0.5
-1.0
Jan-90 Jan-92 Jan-94 Jan-96 Jan-98 Jan-00 Jan-02 Jan-04 Jan-06 Jan-08 Jan-10


Quality Spread (30 Year Conventional Mortgage - 10 Year Constant Maturity Treasury)
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
Jan-90 Jan-92 Jan-94 Jan-96 Jan-98 Jan-00 Jan-02 Jan-04 Jan-06 Jan-08 Jan-10


Long-Term Interest Rates
9.0
8.0
7.0
6.0
5.0
4.0
3.0
2.0
1.0
0.0
Jan-99
Jan-01
Jan-03
Jan-05
Jan-07
Jan-09
10-year Treasury Constant Maturity


Short Term Interest Rates
10.0
9.0
8.0
7.0
6.0
5.0
4.0
3.0
2.0
1.0
-
Jan-99
Jan-01
Jan-03
Jan-05
Jan-07
Jan-09
Bank Prime Loan Rate
Federal Funds Rate (effective)


Inflation
6.0
5.0
4.0
3.0
2.0
1.0
0.0
-1.0
-2.0
Jan-99
Jan-01
Jan-03
Jan-05
Jan-07
Jan-09
CPI: All Items
CPI Core: Less Food and Energy


Quarterly Real GDP % Change at Annual Rates
8
6
4
2
0
-2
-4
-6
-8
03 I
04 I
05 I
06 I
07 I
08 I
09 I

The 7 Rivers Equity Index: The First Decade of the 21st Century

Thomas M. Krueger, D.B.A., Professor of Finance, UW-La Crosse Department of Finance

I. The 7 Rivers Equity Index

This report covers the share price performance and provides a fundamental financial analysis of companies headquartered in the 7 Rivers Region over the seven-month period from August 2009 through February 2010. This period includes December 2010, when the 7 Rivers Equity Index celebrated its ten year anniversary. Hence, it is befitting in this report to spend some time looking at the performance of the individual members, past and present, over the first decade of the 21st Century. The remainder of this report provides insight to the cause for the varying performance of local companies by examining managerial performance at local companies based on nine financial ratios. Three popular ratios are taken from each of their most recent income statements, balance sheets, and statements of cash flows. (For the most recent analysis of security prices and local firm return forecasts, refer to the September 2009 edition of *7 Rivers Region: An Economic Update*.)

Two criteria must be met for inclusion in the 7 Rivers Equity Index. One, the firm must be publicly held with share price data available from the financial press or Internet sources. Two, the company's headquarters must be within 100 miles of La Crosse, which includes the 7 Rivers Region. A listing of such companies is generated with the assistance of *ReferenceUSA*, a data service allowing one to screen public corporations on the basis of distance from a given point, which in this case is downtown La Crosse. The fifteen companies currently in the 7 Rivers Equity Index set are identified in Table 1.

The last decade has been anything but smooth for national and local stocks. In an article titled "Wealth Creators vs. Wealth Destroyers: Looking at Firm Stumbles Since 2000," Sam Mamudi reports that large-cap growth funds lost $107.6 billion for investors over the period. Meanwhile, tech funds erased $62.8 billion of investor wealth (*Wall Street Journal*, March 3, 2010, p. C15). Results are greatly influenced by what happened at the start of the decade, when investors rushed to dot.com and growth stocks and then they crashed. On one hand there are the American Fund and Vanguard families of mutual funds that created an average of $190 billion in wealth, while on the other hand there is the Janus Capital Group, which lost a staggering $58 billion.

Similar results can be noted in Table 1, where stock price changes (taken from *Yahoo!Finance*) of local returns for the decade are presented on the middle column. Among those companies currently meeting the "local" and "public" criteria, Fastenal, National Presto, and Rochester Medical's share prices rose by over 200 percent! The share prices of Marten Transportation and Hormel double, a very respectable showing. At the other extreme, share prices of three financial institutions dropped by over 60

percent. The average return of the current 7 Rivers Region companies was 41% over the period.

Table 1. 7 Rivers Equity Index

The headquarters of each of these public firms is within 100 miles of La Crosse

State / Company/ City/ Industry	1999-2009 Price Change	2008-2009 Price Change
Wisconsin		
Baraboo Bancorporation (BAOB)	-65%	-76%
Baraboo; Retail banking		
Citizens Community Bank (CZWI)	-46%	-61%
Eau Claire; Retail banking		
Energy Composites Corporation (ENCC)	-6%	-6%
Wisconsin Rapids; Fiberglass-based manufacturing		
Marten Transportation (MRTN)	109%	29%
Mondovi; Trucking		
Mid-Wisconsin Financial Services	-71%	-67%
Medford; Retail banking		
National Presto (NPK)	208%	107%
Eau Claire; Cookware		
Renaissance Learning (RLRN)	2%	-19%
Wisconsin Rapids; Educational software		
Wausau-Mosinee Paper (WPP)	-1%	29%
Mosinee; Paper products		
Minnesota		
Fastenal (FAST)	277%	4%
Winona; Threaded fasteners		
HMN Financial (HMNF)	-63%	-83%
Spring Valley; Savings & loan		
Hormel (HRL)	100%	-5%
Austin; Pork and turkey processing		
Merchants Financial Group (MFGI)	-27%	-20%
Winona; Retail banking		
Rochester Medical (ROCM)	216%	0%
Stewartville; Urinary treatment products		
Iowa		
Flexsteel Industries (F LXS)	-23%	-15%
Dubuque; Home furnishings		
Heartland Financial USA (HTLF)	1%	-23%
Dubuque; Retail banking		

Firms included in the 7 Rivers Equity Index that are no longer publically held	Price Change While in 7 Rivers Equity Index
Ag Services of America – acquired by Rabobank (1/2004)	-43%
Bone Care International – acquired by Genzyme Corporation (6/2005)	161%
Featherlite – acquired by Universal Trailer Holdings (10/06)	16%
First Federal Capital Corporation – acquired by Associated Banc-Corp (10/04)	127%

Table 1. 7 Rivers Equity Index – Continued

La Crosse Footwear – relocated to Oregon (3/2001)	-49%
Land's End – acquired by Sears (6/2002)	78%
Northland Cranberries – privatized (11/2005)	-97%
Pemstar – acquired by Benchmark Electronics (1/07)	-76%
Sheldahl – bankrupt (4/2002)	-100%
State Bank La Crosse – privatized (2/2003)	- 8%
TenderCare International – acquired by Hain Celestial (12/07)	100%

In the bottom portion of Table 1 is a listing of the eleven companies that at some point during the past decade were in the 7 Rivers Region index, but no longer qualify for identified reasons. Among these companies, Bone Care International earned a return of 161 percent and First Federal Capital Corporation experienced a price run-up of 127 percent. At the other extreme, Northland Cranberries and Sheldahl went bankrupt. The average rate of return for these eleven companies was 10 percent over the period.

II. Comparative Performance over the First Decade of the 21 Century

If we take a weighted average of the twenty-six companies, we end up with the 27.5 percent gain in the value of the 7 Rivers Equity Index, which is presented in the December 2009 row of the first column of Table 2. Table 2 presents the value of a $100 investment in the companies in the 7 Rivers Equity Index, Dow Jones Industrial Average, and Standard & Poor's 500 Indexes. Scanning down the first column, we can see that the value of local shares rose in six of the years in the decade being studied. The greatest rise occurred in 2004, when 7 Rivers Equity Index rose 18.4 percent. The largest single drop occurred in 2008, when the decline was 9.8 percent. Overall, the 7 Rivers Equity Index rose to 127.5 and then to 134.5 over the first two months of 2010, taking the terminal value of the 7 Rivers Equity Index up $34.50.

The middle set of columns in Table 2 present the performance of the Dow Jones Industrial Average (DJIA). The DJIA rose in five years, with the best year being the 25.3 percent gain in 2003. A $100 investment in the DJIA on December 31, 1999 would be worth $90.70 at the end of the decade, with a slight decline in early 2010.

Insight to the performance of a $100 investment in the S&P 500 is presented in the right column of Table 2. After a selloff over the first two years, the S&P 500 spent the next five years trying to get back to $100. The 38.5 percent loss in 2008, the worst single annual percentage change in Table 2, stymied this attempt and the S&P 500 ended 2009 at 76, or down $24.

Looking across the three indexes, as illustrated in Table 1, several similarities and differences are apparent. One similarity is that all firms experienced their best gains in the 2003/2004 period and their greatest one-year loss in 2008. The most significant difference appears to be that local stocks are not as sensitive to systematic market events, such as the dot.com bust which was followed by the 9/11 terrorist attacks. While the 7 Rivers Equity Index was down only 80 cents at the end of 2002, the DJIA and S&P 500 had dropped $27.40 and $40.10, respectively, from their initial $100 levels.

Table 2. Comparative Index Performance

Since 12/31/1999 Index Value of 100
(Year-to-Year Change in Parentheses Through 12/2008)
[Change since 12/2008 in Brackets]

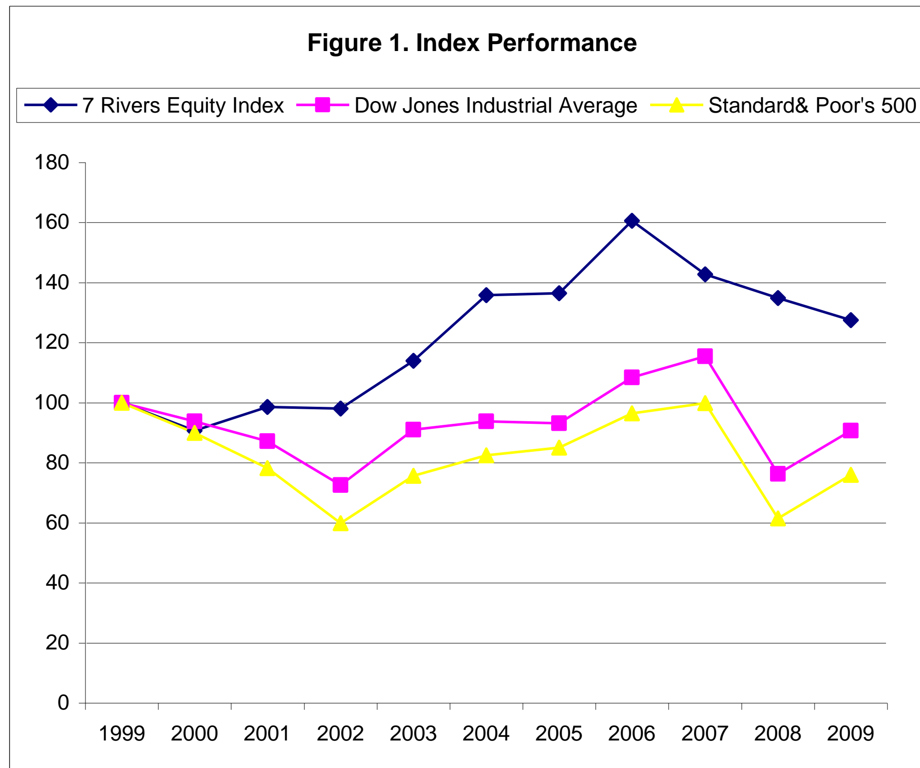
	7 Rivers Equity Index		Dow Jones Industrial Average		Standard & Poor's 500	
12/1999	100.0	(n/a)	100.0	(n/a)	100.0	(n/a)
12/2000	91.2	(-8.8%)	93.8	(-6.2%)	89.9	(-10.1%)
12/2001	99.3	(+8.7%)	87.2	(-7.0%)	78.2	(-13.0%)
12/2002	99.2	(-0.1%)	72.6	(-16.7%)	59.9	(-23.4%)
12/2003	115.4	(+16.3%)	91.0	(+25.3%)	75.7	(+26.4%)
12/2004	136.7	(+18.4%)	93.8	(+3.1%)	82.5	(+9.0%)
12/2005	137.9	(0.9%)	93.2	(-0.8%)	85.0	(+3.0%)
12/2006	158.7	(15.1%)	108.4	(16.3%)	96.5	(+13.5%)
12/2007	145.8	(-8.1%)	115.4	(6.5%)	99.9	(+3.3%)
12/2008	131.5	(-9.8%)	76.3	(-33.8%)	61.5	(-38.5%)
January 2009	119.0	[-9.5%]	69.6	[-8.8%]	56.2	[-8.6%]
February 2009	112.9	[-14.1%]	61.4	[-19.5%]	50.0	[-18.6%]
March 2009	115.1	[-12.5%]	66.1	[-13.3%]	54.3	[-11.7%]
April 2009	124.1	[-5.6%]	71.0	[-6.9%]	59.4	[-3.3%]
May 2009	126.4	[3.9%]	73.9	[-3.1%]	62.6	[1.7%]
June 2009	124.2	[-5.6%]	73.4	[-3.7%]	62.6	[1.9%]
July 2009	125.7	[-4.1%]	79.1	[3.6%]	66.7	[8.4%]
August 2009	123.6	[-6.1%]	82.6	[8.3%]	69.5	[13.1%]
September 2009	124.7	[-5.2%]	84.5	[10.7%]	72.0	[17.1%]
October 2009	120.0	[-8.7%]	84.5	[10.7%]	70.5	[14.6%]
November 2009	121.9	[-7.3%]	90.0	[18.0%]	74.6	[21.3%]
December 2009	127.5	[-3.0%]	90.7	[18.9%]	76.0	[23.6%]
January 2010	129.6	[-1.4%]	87.6	[14.8%]	73.1	[18.9%]
February 2010	134.5	[2.3%]	89.8	[17.7%]	75.2	[22.3%]

The financial markets meltdown in 2008 also had much less of an impact on local stocks. However, this lack of a fall might be one cause for the lack of a recovery in 2009. Across the December 2007 to December 2009 period, the DJIA and S&P 500 gave up about 23 percent of their value. Despite its lack of a recovery in 2009, the 7 Rivers Equity Index only dropped 13 percent over the two-year period.

To provide more insight to the performance across the last two years, performance of individual companies in the 7 Rivers Equity Index is presented in the second column of Table 1. In those two years, all six of the financial companies in the index dropped, with an average decline of 55 percent. The 83 percent loss of HMN Financial was almost enough to overwhelm the superb 107 percent gain of National Presto, as consumers bought cooking appliances and viewed eating home as a cheap alternative to restaurant prices.

III. Fundamental Characteristics of Local Firms

Forecasting whether the 7 River firms will continue their downward slide, which is quite evident when one views the trend of the 7 Rivers Equity Index line in Figure 1 from 2006 through 2009, is difficult. To gain insight, the remainder of this report studies the local firms' financial health. Following past precedent, this spring report studies fundamental financial characteristics of firms in the 7 Rivers Equity Index. Morningstar.com was the primary sources of the financial ratios. In most instances the 2009 information covers all of 2009. In the few instances where information was not available for the entire year, Morningstar provides trailing twelve month data, which was used as the estimate for all of 2009. The 2004-2008 averages reported in the following tables are based on an average of five individual calendar years in the 2004-2008 period. Due to their unique nature, financial companies and averages thereof are presented separately and Morningstar does not present cash flow statement ratios for these firms. An improvement in this year's presentation is the reporting of median values, instead of averages, when studying aggregates of financial and non-financial firms (the bottom lines in each panel of Table 3 through Table 5). Usage of medians is more appropriate when the number of firms is small and abnormal performance by a single firm could greatly impact the reported average of all firms.



Income Statement Insights

Gross profit margins (Gross profit/Sales) represent the percentage of revenues not consumed by the cost of producing products and services. As shown in the first 2009 column of Table 3, the median gross profit margin of non-financial local companies is 32 percent, which implies that 68 cents of every dollar of revenue is used to produce the goods being sold. At the high extreme, the gross profit margin of Renaissance Learning is 76 percent, implying only 24 percent of sales are used in production. Wausau-Mosinee Paper's gross profit margin is only 13%, leaving little room to pay sales and administrative expenses. However, Wausau-Mosinee Paper's gross profit margin is almost double the 8 percent average for the 2004-2008 period. The other noticeable change is Marten Transportation's 11 percent gain in gross profit margin from the prior five-year average.

The comparable ratio for financial concerns is sales net of sales, general, and administrative (SG&A) expenses. As one can see in the first column of the bottom panel, sales net of SG&A are generally higher than those of non-financial firms, with a median of 62 percent. However, there is a large gap across financial firms, with the Heartland Financial's sales net of SG&A being almost two and one-half times that of Citizens Community Bank.

Net profit margins (Net income/Sales) represent the percentage of revenue remaining after paying all expenses, including interest and taxes. As shown on the Non-financial firms median line on Table 3's 2004-08 Average column, 6 percent (or 6 cents per dollar) of revenue is normally available for retained earnings and dividend payment. However, in 2009, this value dropped to only 2 percent, or 2 cents per dollar! The largest losses were incurred at Energy Composites and Renaissance Learning, which had negative profit margins of 44 percent and 30 percent, respectively. Only Wausau-Mosinee Paper had a higher net profit margin in 2009 than its 2004-2008 average. However, this positive observation has to be tempered with the observation that the firm's net profit margin was only 2 percent.

Table 3. Analysis of Income Statements Information

Non-financial Firms	Gross Profit Margin (% of sales)		Net Profit Margin (% of total revenue)		Return on Equity (% of equity)	
	2009	2004-08 Average	2009	2004-08 Average	2009	2004–08 Average
Energy Composites	17%	na	-44%	na	-79%	na
Fastenal	49%	43%	10%	11%	16%	21%
Flexsteel	19%	19%	-1%	2%	-1%	6%
Hormel	17%	22%	5%	5%	17%	16%
Marten Transportation	46%	35%	3%	4%	7%	10%
National Presto	18%	18%	9%	9%	15%	9%
Renaissance Learning	76%	80%	-30%	15%	-59%	21%
Rochester Medical	48%	41%	0%	7%	0%	4%
Wausau-Mosinee Paper	13%	8%	2%	1%	9%	0%
Non-financial median	32%	28%	2%	6%	8%	10%

Financial Firms	Sales Net of SG & A (% of Sales)		Net Profit Margin (% of total revenue)		Return on Equity (% of equity)	
	2009	2004-08 Average	2009	2004-08 Average	2009	2004–08 Average
Baraboo Bancorp	na	68%	na	26%	na	12%
Citizens Community	30%	48%	-29%	8%	-5%	3%
HMN Financial	62%	71%	-35%	14%	-18%	7%
Heartland Financial	74%	61%	4%	16%	3%	11%
Merchants Financial	76%	na	12%	na	7%	na
Mid-WI Financial	58%	60%	-9%	14%	-5%	7%
Financial firm median	62%	61%	-9%	14%	-5%	7%

Paralleling national news about the financial problems in the finance industry, perhaps 2009's biggest news was the incredible drop in profit margins among local financial companies! The median profit margin was a 9 percent loss, which is down by 23 percent from the prior five years. Putting it another way, the typical firm was now losing 9 cents per dollar of revenue, versus gaining 14 cents earlier. The biggest single decline was at HMN Financial, which saw its profit margin drop from +14 percent, on average, to -35 percent. Not too far behind was Citizens Community Bank, which lost 29 cents per dollar of revenue.

Return on equity (Net income/Total stockholders equity) reflects the amount of return earned per dollar invested by shareholders. As shown in the right 2009 column of Table 3, there was a relatively small decline in this median value from 10 percent to 8 percent. Consistent with the net profit margin information, Energy Composites and Renaissance Learning had profit margins that were dismal. Applying the concept of "wealth destroyers" from the article written by Mamudi, which was cited earlier, Energy Composites destroyed 79 percent of shareholder wealth in 2009. More dramatic might be the change at Renaissance Learning, which swung from adding 21 cents per dollar of shareholder investment to taking 59 cents per dollar invested. By comparison, Wausau-Mosinee Paper added 9 percent to shareholder wealth.

With such low profit margins, it is not surprising that local financial companies also tended to be destroying wealth (i.e., investment) in 2009. From all local financial firms having positive returns on equity over the 2004-2008 period, most consumed wealth in 2009. However, the worst situation was not as bad as that found among non-financial firms, with the sector low being HMN Financial's negative 18 percent profit margin.

Balance Sheet Insights

Current ratios (Current assets/Current liabilities) provide insight to firm liquidity. As shown in the first set of columns in Table 4, the median current ratio during 2009 was only slightly lower than it was over the prior five years. The most significant change was the decline at Renaissance Learning, where the current ratio was only half of its normal value. Also, with a value less than 1.0, the measure indicates that the firm's short-term obligations exceeded its current assets.

The comparable figure among financial firms is financial leverage, which compares a bank's total assets to equity. As with non-financial firms, local financial firms have experienced only a small change in this ratio during 2009. A higher value is not necessarily good, in this instance. For example, the total assets per dollar of equity rose dramatically at Citizens Community Bank, from $7.60/$1.00 to $10.3/$1. If the assets are unproductive, Citizens Community Bank could face bankruptcy. Hence, it is not surprising that in a period where financial leverage grew, Community Bank's share price dropped 61 percent.

Long-term debt ratios (Long-term debt/Total assets) indicate the amount of long-term borrowing used to acquire assets. Perhaps in anticipation of a looming recession, and aware of the challenges arising from paying interest expense when revenues are shrinking, all local non-financial firms shrunk their long-term debt ratio back in 2008. Continuing the reduction, the median long-term debt ratio dropped from 4.0 to 1.0 percent from the 2008 report to this report. In fact, at the end of 2009, Fastenal, Flexsteel, and Marten Transportation were operating without any long-term debt. Though seemingly safer, such conservative capital structures eliminate the ability to leverage up returns, enhancing return on equity versus return on assets.

In contrast, local financial companies actually increased their financial risk, with the median debt being 170 percent of equity versus 150 percent over the preceding five years. Eighty percent of the financial institutions increased the amount of debt financing relative to equity. In good or even normal periods this would be good news. However, the ratio probably grew as local banks wrote off bad loans, and thereby decreased equity. Heartland Financial, for instance, saw its debt financing rise from $1.10 to $1.80 per dollar of equity. Looking at the financial statements themselves, we can see that Heartland Financial astutely moves about half of its short-term liabilities, due within the coming 12 months, into long term debt in 2008. It thereby spread out the risk of the 2008 financial meltdown in mortgage markets. That is why Heartland Financial's equity rose relative to the total assets (with a financial leverage ratio dropping from 14.1 to 11.9 times) and its long-term debt rate was able to rise even more quickly than equity. This effective management of its capital structure is likely to be one reason that Heartland Financial's stock price dropped only one third as much as the other financial companies in the 7 Rivers Region.

Careful management of assets has helped local firms maintain their asset turnover ratios despite the recession. Aided by increased sales the asset turnover ratio increased by 62 percent in 2009 at National Presto, following an 85 percent surge in 2008. Although five companies reported a total asset turnover that was less than their 2004-2008 average, the only local company with sales lower than total assets (hence a total asset turnover less than 1.0) was Rochester Medical.

Because many of the financial firms' assets can be withdrawn or paid off at a moment's notice, the comparative measure among financial firms is the fixed asset turnover. Think of this as the bank's revenues relative to the money it has invested in headquarters and branch locations. Local bank fixed asset turnover in 2009 was similar to that of the benchmark 2004-2008 period. The lone exception to that consistency was Citizens Community Bank, where fixed asset turnover was less than half of what it had been over the prior five years.

Table 4. Analysis of Balance Sheet Information

Non-financial Firms	Current Ratio (Times Current Liabilities)		Long-term Debt Ratio (% of Total Assets)		Total Asset Turnover (Revenue/Total Assets)	
	2009	2004-08 Average	2009	2004-08 Average	2009	2004–08 Average
Energy Composites	1.8	na	38	na	1.6	na
Fastenal	8.2	6.9	0	1	1.5	1.7
Flexsteel	3.1	2.9	0	13	2.0	2.3
Hormel	2.3	1.8	10	21	1.8	1.9
Marten Transportation	1.4	1.6	0	25	1.3	1.4
National Presto	5.8	4.9	1	4	1.3	0.8
Renaissance Learning	0.7	1.5	16	3	1.4	1.2
Rochester Medical	9.0	8.7	1	9	0.5	0.7
Wausau-Mosinee Paper	1.7	2.0	45	40	1.5	1.4
Non-financial Median	2.3	2.4	1	11	1.5	1.4
Financial Firms	Financial Leverage (Total Assets/Equity)		Long-Term Debt (Debt/ Equity)		Fixed Asset Turnover (Revenue/Fixed Assets)	
	2009	2004-08 Average	2009	2004-08 Average	2009	2004–08 Average
Baraboo Bancorp	11.0	11.4	0.1	0.3	2.5	2.4
Citizens Community	10.3	7.6	1.8	1.6	1.6	3.4
HMN Financial	10.3	10.9	1.7	1.5	3.2	3.4
Heartland Financial	11.9	14.1	1.8	1.1	1.5	1.3
Merchants Financial	na	na	na	na	na	na
Mid-WI Financial	11.1	12.8	1.6	1.5	2.4	2.3
Financial firms median	11.0	11.4	1.7	1.5	2.4	2.4

Cash Flow Statement Insights

Cash is the monetary lubricant that permits a business to operate. Cash is also required to pay dividends and expand operations. Consequently, the statement of cash flows is another important financial statement. These statements describe the change in a firm's cash account arising from its operations and capital expenditures. Finally, bringing together the income statement's operating income and tax rate and balance sheet changes in assets and financing accounts (and of course, these changes are the key inputs to the cash flow statement), one is able to compute free cash flow, or cash inflow adjusted for net investment in assets. Each of these cash flow measures are being presented this year

for the first time in a new format in Table 5. Though it may seem ironic given that the management of cash is the key service provided by financial companies, cash flow statement ratios are not reported by Morningstar for banks due to the nature of their business. (For instance, if cash flows are the nature of a firm's operation, measurement of operating cash flows is problematic.)

Operating cash flows are now being presented in terms of year-to-year changes, which Morningstar.com picks out as a key insight arising from the cash flow statement. As can be seen in the bottom row of the first column of Table 5, the median operating cash flow grew by 9 percent in 2009. This growth rate is 2 percent higher than the typical growth rate during the prior five years. On one side of the median, we see that the operating cash flow growth rate at Flexsteel and Hormel were about 100 percent higher in 2009 than in the prior year. On the negative side, operating cash flows dropped by 30 percent in 2009 at Rochester Medical.

Table 5. Analysis of Cash Flow Statements Information

Non-financial Firms	Operating Cash Flow Growth Rate (Year-over-Year %)		Capital Expenditures (As % of Sales)		Free Cash Flows (As % of Sales)	
	2009	2004-08 Average	2009	2004-08 Average	2009	2004–08 Average
Fastenal	18	24	3	4	13	4
Flexsteel	98	5	0	1	5	1
Hormel	103	6	2	2	7	4
Marten Transportation	24	10	11	22	1	-8
National Presto	-7	8	1	6	7	2
Renaissance Learning	-4	-14	1	2	20	24
Rochester Medical	-30	15	3	5	2	23
Wausau-Mosinee Paper	0	6	4	3	6	0
Non-financial Median	9	7	2	4	6	3

Due to their financial nature, Morningstar.com does not provide cash flow ratios for financial firms. Cash flow information for Energy Composites also was not available.

Local, non-financial firms have been slow to expand coming out of the recent recession. Median capital expenditures, as a percentage of sales, are half of that found during the prior five years. Although Marten Transportation spent 11 percent of sales on trucks, this is only half of the amount spent in the typical year. All other local firms spent less than 5 percent of sales on capital expenditures.

Free cash flows are defined as operating income (i.e., EBIT) adjusted for taxes, less adjustment for increases in net operating capital. Net operating capital includes changes in operating assets (i.e., excluding marketable securities), adjusted for changes in short-term debt. You can think about free cash flows as the money left over after investment, and it can be used to pay dividends, buy back stock, or pay down debt. In the bottom row of Table 5's two right columns, one can see that the median free cash flow, as a percentage of sales, doubled in 2009. Three-fourths of the local non-financial companies experienced a rise in free cash flow in 2009. Fastenal leads this group with a free cash flow that is 13 percent of sales and 9 percent above the 2004-2008 average. The worst single situation in 2009 appears to have existed at Rochester Medical, where free cash flows had fallen from 23 to 2 percent of sales.

IV. Summary

Twenty-six companies have appeared in the 7 Rivers Equity Index over the 2000–2009 period. As of February 2010, there are fifteen publicly-held firms in the 7 Rivers Region. Although the value of national equity indexes is 10 to 25 percent below where they began the 21st Century, investment in 7 Rivers firms rose by about 35 percent. However, the 7 Rivers Equity Index has fallen each year since reaching its highest year-end close at the end of 2006.

The relatively good performance has come despite the bankruptcy of two local companies. Fastenal, with a price increase of 277 percent leads local companies, followed closely by Rochester Medical at 216 percent. By contrast, three local banks have seen share price decreases of exceeding 66 percent, which though bad is better than their loss over the past two years of more than 75 percent.

Insights to the performance of local companies were based on their income statements, balance sheets, and statements of cash flows. Median gross profit margins, net profit margins, and returns on equity were lower for local non-financial firms than they had been over the 2004-2008 period. Both the median gross and net profit margins dropped 4 percent. The one glimmer of hope from income statements was the higher amounts banks had for net of sales, general, and administrative cost. However, after accounting for the losses on their portfolio, local banks had negative median net profit margins and returns on equity. The large 83 percent drop in stock prices at HMN Financial over the past two years is not surprising given the fact that in 2009 the firm destroyed $0.18 per dollar invested by shareholders.

Overall, the financial health of local companies, as measured by their balance sheet, was quite strong in 2009. Median asset turnover was on par with that of the prior year. The largest disparity between non-financial and financial companies existed in the area of long-term debt financing. Non-financial firms continued to limit their exposure to

financial leverage. Financial firms, after writing off bad loans, saw their equity (as a percentage of long-term debt) fall by about 13 percent.

Operating cash flows, cash flows before considering and investment or financing activities, were slightly ahead in 2009. Capital expenditures were only about half of what they were in prior years. As a consequence, free cash flows were up in 2009. Individual companies reported a variety of levels in 2009, as reported and relative to the average annual levels over the 2004-2008 period. The greatest concern might be the recent decline in capital expenditures. Fewer productive assets reduce the ability of the 7 Rivers Region to compete and benefit from an economic recovery.