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New Rec: American Reprographics	(ARP: \$32.06)	Oct. 1, 2006
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Position: Sell

Target: \$21

	3Q06e	4Q06e	1Q07e	2Q07e	FY2006e	FY2007e
Rev (\$000s)	151.1	144.0	156.3	165.2	587.4	625.4
EPS (\$)	0.33	0.26	0.36	0.40	1.28	1.38
Y/Y Growth	43.3%	36.8%	12.6%	61.6%	45.5%	8.2%
PE	na	na	na	na	25.0	23.2
PSR	na	na	na	na	2.5	2.3
Consensus	0.34	0.29	0.39	0.44	1.30	1.58

Shares Out: 45.5M

Market Cap: \$1.46B

FYE: Dec

Summary: American Reprographics operates 225 locally branded reprographic service centers. ARP's core services are the printing and reproduction of blueprints, floor plans, drawings, plans, specs, schematics and general documents

for the AEC (Architecture, Engineering and Construction) industry, which accounts for 80% of total revenue. ARP also sells a variety of black and white and color documents to the non-AEC market, including promotional materials, signs, banners, and other marketing presentations. In this report, we will refer to all printed material as “documents”.

ARP’s price has appreciated by nearly 150% since its IPO in Feb. 2005, from \$13 to its latest closing price of \$32.06. This performance has been driven by an acceleration in US private non-residential construction, with y/y construction growth of 5%, 7% and 14% for 2004, 2005 and 1H06 respectively. ARP’s organic growth appears highly correlated, and has followed suit with 5%, 8% and 13% year over year growth for the same time periods.

Understandably, “street” analysts are enthused. They believe that the non-residential construction market will continue to grow steadily over the next few years, acting as a strong tailwind for ARP. Our thesis does not rely on a slowdown in non-residential construction, and we assume sustainable growth in this market thru 2007.

However, it appears that ARP and the reprography industry are in the early stages of a paradigm shift in the manner in which documents are printed and distributed by the AEC industry. As the AEC industry moves towards more digital platforms, such as online plan rooms and online collaboration software that are used to view, share and edit construction documents online, the need to print hard copies of these documents will be greatly diminished.

This is the main problem for ARP, according to our industry surveys. The move towards these digital platforms is gaining momentum, and the associated reduction in printing puts ARP’s traditional print business at risk. Our due diligence includes speaking with multiple industry insiders with diverse backgrounds, including senior executives of reprographic firms, digital software companies, architecture and engineering firms, and contractors. In addition, there are dozens of case studies available that discuss the reduction in print volume and printing costs that occur when firms move to digital, document-sharing solutions.

The desire for greater efficiency and cost savings by the AEC industry is driving it towards digital solutions for its document management. Online planrooms allow a subcontractor to selectively choose which documents it wishes to print rather than receiving the entire set of plans. Subcontractors can alternatively choose to view the documents online and calculate the necessary measurements on their computers without needing to print anything, or subcontractors can download documents directly to a computer to be printed on an

office or on-site printer. All three of these online planroom solutions result in less printing for the reprographer.

Exacerbating the problem for reprographic shops is a more sophisticated solution, online collaboration software, which allows AEC project team members to not just view, but also to edit construction documents online. Project work may be done in a more timely and efficient manner, and a significant amount of printing that occurs in the “design and edit” phase of a project can be eliminated. Online collaboration is also used in the “bid and construct” phase of a project, similar to online planrooms. We note that Autodesk is the leading provider of online collaboration software, with its Buzzsaw and Constructware solutions.

It appears, and industry experts have confirmed this view, that the AEC industry’s move to digitally managing its construction documents is still in the early stages. The large majority of projects are still managed in the traditional, hard copy print manner. More importantly, our contacts widely agree that this digital transition is rapidly gaining momentum. As a result, reprographer’s traditional print revenue will be at risk, and they will be challenged to adapt to a new business model. This leads to a crucial question. Is ARP prepared for this paradigm shift, and can it adjust its business model to offset a decline in its traditional print volume and revenue?

The “street” believes that ARP’s proprietary online planroom, PlanWell, will enable the company to transition successfully to a digital environment. We are skeptical. We doubt that PlanWell will be able to offset the dramatic changes and lost print revenue that we expect. Our industry insiders described four ways in which reprographers and ARP will be challenged to generate revenue in a digital world of online planrooms.

First, reprographers will be paid to print “selected” documents, but this volume will be significantly lower (70%-80% lower, according to a couple of our industry sources) than the traditional “print entire sets of documents and distribute”. Second, pressure is being put on online planrooms to allow “free” downloads of documents. AEC firms believe that more free and open access to documents will increase the ability of subcontractors to bid on projects. More bids produce lower costs and the project’s owner benefits. Third, ARP has licensed its PlanWell to more than 130 reprographers. However, the license fee is primarily paid upfront and is not a large revenue generator (about 0.5% of total revenue in 1H06). Fourth, many AEC firms refuse to pay reprographers an upfront digital management fee for hosting the project on its online planroom. These firms believe that reprographers should receive revenue for the printing of documents and no more.

In addition to overcoming these challenges, ARP must contend with greater competition from alternative online planrooms and digital solutions. The consensus among our industry contacts is that the online control of project documents is likely to move away from reprographers. Reprographers, including ARP, have benefited by being the early providers of online planrooms in the industry. But AEC firms now have a significant amount of choices, including third parties such as McGraw Hill's Dodge, builders' associations such as the Association for General Contractors and the Golden State Builders' Exchanges, architecture groups such as the AIA, American Institute of Architects. Additionally, AEC firms may use independent software to host their own online planrooms, such as Fluor and Centex, or purchase online collaboration software, led by Autodesk.

ARP's revenue growth should be adversely affected by a significant move towards digital document management and a paperless industry. Whereas ARP's organic growth has been very closely correlated to the US private non-residential construction market over the past few years, we now expect ARP's organic revenue growth to lag this market over the next five years. We estimate that ARP's revenue will grow organically at an annual rate that is at least 5% less than the US private non-residential construction market over the next five years. We estimate 3% organic revenue growth for ARP in 2007, 5% below FMI's forecast of 8% growth in private non-residential construction for 2007 and 2008. FMI is the construction consultant used by ARP.

The "street" models 8% organic revenue growth in 2007 based on a growing construction market but does not appear to factor in the negative effects of the paradigm shift that we project. We expect the current enthusiasm, which is priced into the stock, to be replaced by concern regarding the serious challenges and uncertainty facing ARP and its traditional business model.

Our total revenue growth estimate, including the benefit from acquisitions already made by ARP, equals 17% in 2H06 and 6.5% in 2007. This compares to the "street" expectations for approximately 19.5% and 11.5%, respectively. We model operating margins to be 30 bps above the "street" in 2H06 and 40 bps below the "street" in 2007. Our bottom line EPS estimate is \$1.28 for the full year 2006 and \$1.38 for 2007. Comparatively, the "street" consensus is \$1.30 and \$1.58, respectively.

ARP's balance sheet is weak, with \$285M of intangible assets, and \$145M of shareholder equity, tangible net worth is negative -\$140M at the end

of Q2. Long term debt is \$250M, and cash is \$23M. If our scenario plays out, write-downs of intangibles could be a problem.

Our price target of \$21 is based on a 15x multiple of our 2007 EPS estimate of \$1.38.

Background:

American Reprographics Co., based in Glendale, CA, is a reprographics company with 225 locally branded service centers (branches).

The company began operations in 1960 under the name Ford Graphics. In 1989, ARP's current senior management team purchased the reprographer, and in 1997 it recapitalized the company with the help of outside investors, and changed its corporate name to American Reprographics. In 2000, Code, Hennessey & Simmons LLC (CHS), a private equity firm, acquired a 50% stake in ARP from the previous outside investors. The company went public in Feb. 2005 at a price of \$13 per share. A 6.1M share secondary offering for selling shareholders, including CHS and senior management, was priced at \$34.50 in April, 2006.

ARP has grown its number of branches primarily through acquisitions. Since 1997, the company has acquired more than 100 reprography companies, generally retaining the acquired companies' management as well as maintaining the local brand name. ARP's largest local brands are listed in Table 1 and its most concentrated states, in terms of number of branches, are listed in Table 2.

Table 1

ARP's largest brand names

	# of branches
Ridgway's	47
Ford Graphics	20
OCB	14
Mercury/LDO	10
San Jose Blue	9
Consolidated Repro	9
Engineering Repro	9
Total	225

Table 2

ARP's most concentrated states

	# of branches
California	80
Texas	13
Florida	13
Pennsylvania	8
Washington	8
Virginia	7
Michigan	7
Arizona	7
Total	225

Source: Company website

While California accounts for about 36% of its total branches, ARP states in its latest 10-K that the company derives approximately 50% of its total revenues from California.

ARP's customer base of about 73,000 is very diverse, as no single customer accounted for more than 2% of total revenue in 2005. Yet, the company does receive 90% of its total sales from just 30% of its customers.

The AEC (Architecture, Engineering and Construction) industry accounts for 80% of ARP's total sales, of which 65% is non-residential and 15% is residential, according to management. This AEC business primarily consists of printing construction blueprints, plans and specs. The 20% of sales that is non-AEC covers a wide variety of print activities including black & white documents, color prints, promotional documents and large format marketing materials such as posters, displays, banners and signs. The non-AEC business is affected by general economic conditions and should trend similarly to GDP, according to ARP.

ARP breaks its revenues into 3 business lines: Reprographic Services (75.7% of revenue in 2Q06), Facilities Management (16.3%) and Equipment and Supplies Sales (8.0%). Reprographic Services are performed in an ARP local branch and consist of managing, printing, finishing, binding and distribution of AEC and non-AEC documents, as described above. Facilities Management offers similar print services but they are performed on-site at ARP customer locations. ARP will often own and service the equipment, provide for materials and, for larger clients, provide an employee to run the operation. Both business lines charge customers per square foot of printed material. Through its Equipment and Supplies Sales business, ARP sells printers, paper, ink and other materials.

In 2000, the company launched PlanWell, its proprietary online planroom. This planroom, along with a suite of additional software products, allows for the online management of construction documents, and enables the online purchase of selected documents for print. ARP also operates a wholly owned trade organization PEiR (Profit and Education in Reprographics). As of 2Q06, there were 129 members that are required to license PlanWell, pay membership fees and who may purchase equipment and supplies at discounted prices. Revenue from PEiR is less than 1% of total sales.

According to the International Reprographics Association (IRgA), as mentioned in ARP's 10-K, the US reprographics industry is \$5B and consists of about 3,000 firms with average annual sales of approximately \$1.5M. Most of the competition is from small, local firms. Some medium-sized firms, Service Point (16 branches), Thomas Reprographics (34), ABC Imaging (25), provide regional

competition. There are also a couple nationwide reprographic networks that connect and unite independent firms, such as US Reprographics, which has more than 250 locations in the US and 400 worldwide, and ReproMax, that has almost 300 print locations in North America. It appears that this industry data does not include FedEx Kinko's, which has 1,500 locations and generated more than \$2B of revenue in 2005. We discuss this competitor in more detail below.

Discussion:

1. ARP's revenues are tied heavily to the construction industry. As growth in non-residential construction has accelerated over the past year, ARP's financial results and stock price have benefited. However, we think that the relationship between reprographers and the AEC industry is in the early stages of a paradigm shift, and that the current business model of reprographers will be severely challenged.

The services performed by reprographers vary from firm to firm, with some concentrating on color marketing materials, some on AEC plans and documents, and some offering a mix. Those firms with an AEC focus, such as ARP, are directly affected by the growth or decline in the construction industry. As explained to us by our industry contacts, traditionally, a construction project requires a certain amount of printed plans and documents throughout the process. The more construction projects being built in the US, the more plans and documents are needed and printed, and reprographers experience an increase in print volumes and revenue. This seems intuitively correct. Table 3 shows the correlation between ARP's organic growth and the growth (decline) in the US private non-residential construction market.

Table 3
Correlation of ARP organic growth to US construction (y/y)

	2002	2003	2004	2005	1H06
ARP organic revenue growth	-8.5%	-5.1%	4.5%	7.6%	12.6%
US construction growth*	-13.1%	-4.8%	5.3%	7.4%	14.4%

* US private non-residential construction
Source: US Census, Company Info, OWS estimates

The movement towards a digitally-connected AEC industry is expected to significantly reduce the need to print construction documents. This would reduce print volumes and print revenue for reprographers.

2. Driven by the desire for greater efficiency and cost savings, the AEC industry is moving towards digital platforms, such as online planrooms. These solutions

allow everyone, from the architects to the subcontractors, to view specs and plans online and to eliminate the costs and time associated with printing and shipping construction documents.

Traditionally, the “bid and construct” phase of a project has been paper intensive. Subcontractors, who perform 90% of a project’s work (according to an Autodesk white paper), are initially asked to bid for the job. The number of subcontractors can range from just a few to a few hundred. As explained to us by a reprographics CEO, an entire set of a project’s drawings are sent to all bidders so that they may view the plans, calculate take-offs and make educated bids. Take-offs are measurements necessary to understand a projects scope, such as square feet for a flooring contractor. As an illustration, a construction project might have 100 drawings in a set, and those sets are printed in their entirety and then distributed to 100 subcontractors that are interested in bidding. The problem is that this process is inefficient in terms of time and cost. Additional inefficiencies are apparent during the actual construction, when changes and addenda to the project’s plan are made, and new sets of drawings must be printed and distributed to the necessary parties.

Online planrooms eliminate much of these time and cost inefficiencies. Online planrooms allow project members to view documents via the internet, anywhere, anytime, with immediate real-time access to updated information and addenda. There is no waiting for printing, distribution and shipping. Additionally, there are three dynamics by which online planrooms reduce printing and distribution costs.

First, online planrooms give subcontractors the ability to view documents solely on their computers rather than by hard copy. A primary task of the subcontractor is to calculate take-offs in order to know a quantitative measure such as square feet, length of plumbing pipes, number of doors, etc. This information allows the subcontractor to submit an educated bid. It doesn’t matter whether the information is obtained via an online plan or hard copy, as long as it is accurate. On-screen, digital take-off software is growing in acceptance in the industry. As a result, subcontractors can avoid the time delay and the frequently required financial deposit for hard copy documents.

Second, online planrooms give subcontractors the ability to select a limited number of documents to print, rather than receive an entire set. If a subcontractor does want a hard copy to view, he/she may choose specific documents that are meaningful. For instance, an electrical subcontractor may only need the electrical schematic and would select that one document to be printed. According to a couple of our contacts, approximately 70%-80% of documents in a set are never

looked at. It is unnecessary, inefficient and costly to send an entire set of documents to a subcontractor that only needs a fraction of them.

Third, many online planrooms give subcontractors the ability to download and print documents at their own computer. According to several sources, wide-format digital printers are increasingly being sold to subcontractors for placement in their office or on-site location. This proliferation is due mainly to the introduction of low cost systems. In fact, H-P currently sells digital wide-format printers for blueprints for less than \$1,000. According to one reprographics newsletter: “the trend of general contractors and construction planners placing large-format digital engineering systems directly on the job site is growing at a tremendous rate”. The ability to print selected documents in-office and on-site is another step towards time and cost efficiency and another step away from reprographers.

It is important to note that our industry contacts widely agreed that the AEC industry is only in the early stages of its move towards online planrooms and that the trend is gaining momentum. The more rapidly the transition takes place, the sooner reprographers will face declining print volumes.

3. Another digital solution gaining momentum in the AEC industry is online collaboration software. This is a more sophisticated solution than online planrooms, that allows architects, engineers and contractors who are working on a common project to not just view, but also to edit, share, track and archive construction documents online. This functionality allows for fewer documents to be printed during the “design and edit” phase of the project, in addition to providing the same benefits and reduced printing costs in the “bid and construct” phase as online planrooms.

Autodesk is the leader in collaboration software with its Buzzsaw and Constructware solutions. According to Autodesk, the benefits of online collaboration include increased control of documentation and communications, reduced claims and litigation due to better accountability, improved communication between team members, improved productivity by shortening edit and RFI (request for information) cycle times, and the elimination of costs associated with printing, copying and shipping hard copy documents. More simply put, collaboration software allows for better communication with real-time information, which leads to greater efficiency and cost savings.

Online collaboration reduces the need to print construction documents, adversely affecting reprographers’ business. There are numerous case studies that support this position.

For instance, according to an Autodesk Barnes & Noble case study, “Previously, the chain worked with a reprography company that sent out everything on paper. The retailer’s printing costs and FedEx and Airborne expenses were high”. Barnes & Nobles’ manager of store design was quoted: “the most overriding issue for us in moving to an online system was cost savings. We wanted to get the printing costs from our architects and our blueprinting costs down as much as possible. Each time an architect sent a roll of drawings to us, we had to make copies and then send them out to our different vendors. With 20 vendors per job, we were spending a lot of money and time doing it all manually”.

Barnes & Nobles now uses Autodesk’s online collaboration solution, Buzzsaw, to “manage the dissemination of drawings and design data to its consultants, contractors and subcontractor. Under the previous manual system, if a change were made, the chain had to issue a new set of drawings and send them out. With Buzzsaw, the change is made electronically and the project managers who need to see the change have instant access to it”. “It has reduced our printing costs significantly”, said the store design manager.

We have read more than a dozen additional case studies, mostly from Autodesk, that similarly discuss the reduction in printing volume and costs due to online collaboration software. Here are a few quotes. Regarding Woolworth’s, “the chain no longer has to print the drawings and send them from office to office. Instead, it posts them on its Buzzsaw site, where they can be immediately accessed by whoever needs to see them”. Petco’s chief store designer was quoted, “we no longer have to mail hard copies of floor plans to our field personnel. Now we can just send them electronically”. Lastly, a case study for Houston’s water line construction project states: “by posting and sharing design drawings in Constructware, printing and drawing delivery charges have been significantly reduced”.

Like online planrooms, online collaboration software is in an early adoption stage, but is gaining momentum. We expect Autodesk to maintain its leadership in the online collaboration market, as it benefits from the extensive reach and market share of its AutoCAD design product for architects and engineers. We note that AutoCAD has 4M users worldwide. While Autodesk is reluctant to provide user numbers and growth for Buzzsaw and Constructware, we know that as of 12/31/05 Constructware had about 28,000 users and the product experienced a 250% increase in new business in 2005 versus 2004. This information comes from a press release issued by Constructware before being acquired by Autodesk in 2006.

4. Is ARP prepared for this paradigm shift in the reprographics industry, and will it be able to adjust its business model enough to offset a decline in its traditional print volume and revenue? The “street” believes ARP is well positioned to manage any potential movement towards a more digital environment, due primarily to the belief that ARP’s own online plan room, PlanWell, will make up for any decline in its traditional printing revenue. We are skeptical. While ARP has attempted to position itself as best it can in preparation for a shift to a digital environment, we do not think it will be enough to overcome the dramatic changes that we expect to occur in the industry.

We think that there are four possible ways for ARP to generate revenue with its PlanWell online planroom: A. charge for printing selected documents, B. charge for downloading selected documents, C. license PlanWell to independent reprographers, D. get paid to control and manage the project’s documents. We think ARP will be challenged on all four of these potential revenue generators, and, as a result will be unable to offset the lost revenue from its traditional print business.

A. Charge for printing: The move towards digital solutions in the AEC industry will lead to a reduction in print volumes and revenues for reprographers. ARP’s ownership of PlanWell should have no bearing on this paradigm shift. We expect fewer print orders regardless of whether a reprographer has an online planroom. ARP will be able to charge for the selected print orders that come through PlanWell, but we expect the volume of these orders to be far less than it has been under its traditional print business model. We note that PlanWell print orders are priced at the same rate as traditional orders, according to our contacts.

Revenue from ARP’s facilities management business line is equally at risk to this expected decline in print volume, in our opinion. The reason is that facilities management print orders are no different than standard reprographics print orders, other than their location. Facilities management revenue is based on the amount of printing (usually by square foot) that occurs at a customer’s in-office location, which is serviced and managed by ARP. These customers are primarily AEC firms.

B. Charge for downloading: According to one industry contact, more than 50% of currently existing online planrooms offer the capability to download a document and print it in-house. For those that do allow downloads, there is a debate as to whether these downloads should be free or charged for. We think that a large majority of online planrooms will provide document downloads for free.

Those parties wishing to charge for downloads are primarily reprographers that own and/or operate an online planroom. This stance makes sense, as reprographers surely recognize that a downloaded document that is printed in-house is lost revenue, and they seek to counter this loss with a fee. The problem is that those parties responsible for the project, the architects, engineers and general contractors, believe it is in their best interest, and in the best interest of the project's owner, to provide documents via free downloads. As several insiders explained to us, open and free access to documents allows more subcontractors the opportunity to bid on the project, especially those that may be financially strapped. The more bids there are, the better the pricing, and, ultimately, the total cost of the project is lower.

ARP's PlanWell does not currently offer downloads. But given the insistence of the project participants with whom we spoke, we expect that ARP will soon be forced into providing free downloads along with the entire industry. If ARP chooses to charge for downloads, we think many of its customers will consider alternative solutions that do provide free downloads.

"Project owners are the winners", according to one industry insider. Who are the losers? It appears to us to be the reprographers.

C. Licensing: ARP licenses PlanWell to its 129 PEiR members and to 6 additional independent reprographers. ARP typically receives an upfront fee for the license, and an ongoing annual maintenance fee for managing the PlanWell server, but there is little potential for upside revenue if usage of the licensed PlanWell grows. Management acknowledges that these licenses are not large revenue generators but are issued with the intent to make PlanWell an industry standard. As such, we do not expect ARP to benefit materially from these licenses. In 1H06, ARP received just \$1.2M in license fees, about 0.5% of total sales.

D. Digital management fee: Currently, when an AEC firm decides to place a project on PlanWell, ARP will charge a digital management fee for managing and hosting the online project. But, according to a few of our industry contacts, many AEC firms refuse to pay such a fee.

Some AEC firms believe that reprographers should receive revenue for the printing of documents and no more. "General contractors will not pay", stated one industry executive. We note that this opinion was not unanimous and that there are some firms willing to pay an upfront fee. Even if some fee can be charged, as one exec explained, "blueprints are a commodity" and as more competitive solutions become available for online management, pricing pressure on fees is likely to grow.

The “street” points out that “digital service” revenues have grown to be 5% of ARP’s total revenue, as of 2Q06. Due to a lack of disclosure, it is difficult to know exactly how fast this revenue is growing, but we’ve seen one “street” analyst estimate 80%-90% y/y growth. According to ARP’s 10-K, “digital services include digital document management tasks, scanning and archiving digital documents, posting documents to the web and other related work performed on a computer”. The problem is that these appear to be low-value-added services, which we think will be subject to pricing pressures and/or will be brought in-house as AEC firms become more digitally proficient.

5. Competition from alternative online planrooms and digital solutions is increasing rapidly. The consensus amongst our industry contacts is that the online control of project documents is likely to move away from reprographers. This is primarily due to the simple fact that there will be a greater number of online planroom choices for the AEC industry than before. Additionally, several contacts think that the control and management of project documents is best in the hands of the architects and engineers who actually create and have contractual responsibility for the documents. As a result, we think that it is likely that ARP will lose market share of the online planroom marketplace to many of the new alternatives.

ARP’s PlanWell is widely considered one of the leading online planrooms based on its reach and the number of projects it has hosted. According to our contacts, this is attributed to ARP’s early entrance into the market in 2000, its already existing relationships with the AEC industry, and the lack of alternative online solutions. However, with competition increasing we expect ARP’s early-entrance advantage to disappear.

Competition is coming from multiple sources: third party organizations are using independent planroom software, builder and architect associations are offering planrooms, general contractors place their own planrooms on their websites, and online collaboration software allows architects and engineers to run their own planrooms as well.

Some examples are: McGraw Hill offers plans through its Dodge service; the Association of General Contractors (AGC) has partnered with iSQFT to provide online planrooms for its regional chapters and members; the City of Kansas City and the Kansas City Builders’ Association have partnered to create an online planroom with free access to documents related to the city’s projects; AEPlans, a developer of online planroom software, has been working with regional chapters of the American Institute of Architects (AIA) to set up online planrooms for its members; the Golden State Builders’ Exchanges (GSBE) covering

California offers free online plan rooms to public contracting agencies, private owners, architects, and engineers.

The primary motivation for these mostly non-profit organizations to offer online planrooms is to provide value-added services to its members. For instance, according to the GSBE, its free online planrooms are offered to its members “to help them receive the best responsible bids for their construction projects”. Additionally, some organizations are using online planrooms to generate revenue, by charging a fee for each project posted.

These examples do not include the AEC firms that are adapting and managing their own online planrooms using independent software from firms such as iSQFT, AEPlans, NextPlans, Pantellos, Integrated Imaging, Barryhund, Avatech and many more. Additionally, as we discussed above, online collaboration software offers a more sophisticated version of online planrooms to the AEC industry. Autodesk is the leader in this category, and rapid growth is expected by industry analysts in the coming years.

Due to the paucity of viable options, AEC firms wishing to post a project online have historically done so using online planrooms hosted by a reprographer, such as ARP. However, the increasing availability of competitive options will negatively affect PlanWell’s status as a leading solution, in our opinion. It is important to note that in our research of the various online planrooms, we did not discover anything proprietary or especially value-added about PlanWell’s solution versus the competitors. In fact, several of our contacts thought PlanWell technology was not the leading technology, and was outdated.

6. The slowdown in the US residential construction market could be a slight drag on ARP’s revenue growth. Management has previously mentioned that residential construction accounts for about 15% of total revenues. Given that housing starts are forecasted to decline about –10% in 2006 and 2007, according to the Mortgage Banking Association, it seems logical to us that ARP’s total revenue growth could be negatively effected by about –1.5%. Management stated that it did not see an impact in the bullish housing market and has not seen a slowdown in 2006.

7. FedEx Kinko’s is a significant competitor to ARP in its traditional print business, generating more than \$2B in revenue in 2005. With 1,500 retail locations and the opening of its World Production Center this year, FedEx Kinko’s is “one more threat to the traditional reprographics industry that has printed and delivered construction documentation or generations”, according to one reprographics exec. The World Production Center is located in Memphis

and allows for large orders to be printed and shipped overnight directly from the FedEx hub.

We have also learned that FedEx Kinko's has recently purchased 400 new wide-format digital printers to replace older models. According to our contact, the company was going to sell the used models, but, instead, decided to place them into smaller FedEx Kinko's locations that did not previously have a wide-format printer. This greatly expands the company's ability to print construction documents.

We note that the FedEx Kinko's location in Harvard Square, Cambridge, MA, where a large number of architectural firms reside, and which is also home to Off Wall Street, offers wide-format digital printing for construction documents and blueprints. Architects can upload the digital documents onto the FedEx website for printing, and, if necessary, shipping. FedEx Kinko's is planning to open about 200 new locations in the US in 2007.

8. ARP is quite cyclical, due to its correlation with the construction industry. In fact, ARP's organic revenues declined -8.5% and -5.1% in 2002 and 2003, respectively, when private non-residential construction also declined (Table 3). Additionally, 50% of the company's revenues are generated in California and therefore are tied significantly to the economic fortunes and new construction in that state. This should be additional reason for a discount in the share price.

9. While the "street" mentions the AEC industry's move towards digital solutions, it does not adequately recognize the challenges that ARP will face, in our opinion. The "street" models, which are based on a growing construction market, do not appear to reflect this paradigm shift in its financial forecasts. Whereas ARP's organic growth has been very closely correlated to the US private non-residential construction market over the past few years (as shown above in Table 3), we expect ARP's organic revenue growth to lag this market over the next five years. Consequently, we expect ARP's financial results to disappoint relative to the "street's" expectations.

It is difficult to know exactly how quickly the AEC industry will adapt digital platforms, such as online planrooms and online collaboration software. However, our industry contacts widely agreed that it is just in the early stages of the digital movement and that the trend is gaining momentum. One contact thought the industry is currently 15% of the way towards a being fully digital and will be at 95% in just two years. Another contact viewed it somewhat differently, and postulated that 80% of today's printing volume would be

disappear in 10 years. Lastly, one engineer is quoted, “in less than five years, most projects’ blueprints will reside in virtual planrooms on the internet”.

We model ARP’s revenues to grow organically at annual rate that is 5% less than the US private non-residential construction market over the next five years. This would mean that in five years 25% of ARP’s print volume per project would be eliminated. We have used the comments and expectations of our industry contacts to generate our estimate. This estimate could prove to be conservative, if the more aggressive opinions of the contacts that we quoted in the above paragraph prove to be correct.

Using a simplified sensitivity test, and assuming that the construction market did not grow for five years, and that ARP was not able to offset the decline in printing with digital management revenue, we estimate that ARP’s revenue would decline 25% from \$587M in 2006 to \$440M in 2011. The 60% of its costs that are fixed would remain at \$283M. Its variable costs would be reduced by 25% to \$141M. The result is an operating profit of just \$16M in 2011. While we recognize that this is a very simplified model, it does point to the potential financial problems ARP could face. If ARP were to lose 50% of its print volume in five years, which is a more aggressive forecast, the company’s financial situation could turn dire. A similar sensitivity test using a 50% print volume loss generates an operating loss of -\$83M in 2011.

FMI, the construction consultant used by ARP, forecasts 8% growth in non-residential construction for 2007 and 2008. It appears that the “street” is using a similar forecast, as its organic revenue growth rate for ARP is 8% in 2007.

10. Using this industry forecast, we model a deceleration in organic growth in 2H06 of 8.5% (down from 12.5% in 1H06) and model 3% organic growth in 2007.

After accounting for acquisitions already closed by ARP, we estimate total revenue growth of 17% in 2H06 and 6.5% in 2007. This compares to the “street” expectations for about 19.5% and 11.5% growth in 2H06 and 2007, respectively. Our gross margin estimates of 41.2% in 2H06 and 42.4% in 2007 compares to the “street’s” 41.4% and 42.7% estimates, respectively. We estimate an operating margin of 18.3% in 2H06 versus 18% for the “street”. For 2007, our operating margin is modeled at 20% versus approximately 20.4% for the “street”.

Our bottom line EPS estimate is \$1.28 for the full year 2006 and \$1.38 for 2007. This compares to a “street” consensus of \$1.30 and \$1.58 respectively.

Due to the gradual transition from owning equipment (primarily printers) to operating leases, ARP’s capital expenditures have been consistently below its depreciation expense for the past several years. We expect this to continue. In H1 06, free cash flow after business acquisitions was \$22M, equal to net income for the same period.

For the years after 2007, we expect that ARP will continue to be challenged by industry fundamentals and for its growth to continue to lag that of the private non-residential construction market. Any cyclical downturn in non-residential construction or acceleration in the adoption of digital technologies by the AEC industry could lead to a significant decline in revenue and earnings.

11. We initiate with a price target of \$21. If our thesis is proven correct, we expect that the enthusiasm over ARP’s future, which is currently priced into the stock, will be replaced by the reality of a paradigm shift in the industry, with serious challenges and uncertainty surrounding ARP’s business model. If this occurs, we expect ARP to trade at a slight discount to the market. The \$21 price target is based on a 15x multiple on our 2007 EPS estimate of \$1.38.

As of 6/30/06, ARP had \$23M in cash, \$268M in debt and a tangible book value of -\$140M. Intangibles were at \$285M.

12. Three risks to our thesis:

First, ARP is currently benefiting from the tailwind of the private non-residential construction market. Traditionally, as the construction market grows and more projects are built, more construction documents are required. If this market grows at a faster rate than is expected, ARP will likely benefit, and revenues could exceed our expectations.

Second, ARP has been able to grow by acquisition in the fragmented reprographics industry. The company has made over 100 acquisitions since 1997. The ability to purchase reprographers at a price that is favorable relative to its cost of capital could benefit the company’s long-term growth.

Third, if the AEC industry’s transition to digital platforms, such as online planrooms and online collaboration software, is more gradual than we expect, the

negative affect on ARP's financials may be spread out over a longer period of time, and any near-term effect may be less significant than we currently expect and model.

13. Model

Income Statement (000s)	FY2005	FY2006e	FY2007e
Total Revenue	494,204	587,419	625,398
Cost of Goods Sold	289,580	339,483	360,025
SG&A	112,679	131,980	140,584
Amort. Of Intangibles	2,120	3,352	3,400
Total Operating Expense	404,379	471,463	500,609
Operating Profit	89,825	115,956	124,789
Other Income, Net	381	1,201	800
Interest Expense	-26,722	-18,583	-18,800
Net Income Before Taxes	54,140	96,922	106,789
Provision for Income Taxes	-6,336	38,769	42,715
Net Income	60,476	58,153	64,073
Basic Weighted Average Shares	42,264	44,994	45,810
Basic EPS	1.43	1.29	1.40
Diluted Weighted Average Shares	43,178	45,579	46,410
Diluted EPS	1.40	1.28	1.38

% Change	FY2005	FY2006e	FY2007e
Total Revenue	11.3%	18.9%	6.5%
Cost of Goods Sold	9.8%	17.2%	6.1%
SG&A	6.5%	17.1%	6.5%
Amort. Of Intangibles	25.1%	58.1%	1.4%
Total Operating Expense	8.5%	16.6%	6.2%
Operating Profit	26.1%	29.1%	7.6%
Other Income, Net	-9.3%	215.2%	-33.4%
Interest Expense	-20.4%	-30.5%	0.0%
Net Income Before Taxes	42.2%	79.0%	10.2%
Provision for Income Taxes	-174.4%	-711.9%	10.2%
Net Income	104.7%	-3.8%	10.2%
Basic Weighted Average Shares	19.1%	6.5%	1.8%
Basic EPS	72.3%	-9.6%	8.2%
Diluted Weighted Average Shares	15.3%	5.6%	1.8%
Diluted EPS	77.2%	-8.8%	8.2%

% of Revenue	FY2005	FY2006e	FY2007e
Total Revenue	100.0%	100.0%	100.0%
Cost of Goods Sold	58.6%	57.8%	57.6%
SG&A	22.8%	22.5%	22.5%
Amort. Of Intangibles	0.4%	0.6%	0.5%
Total Operating Expense	81.8%	80.3%	80.0%
Operating Profit	18.2%	19.7%	20.0%
Other Income, Net	0.1%	0.2%	0.1%
Interest Expense	-5.4%	-3.2%	-3.0%
Net Income Before Taxes	11.0%	16.5%	17.1%
Provision for Income Taxes	-1.3%	6.6%	6.8%
Net Income	12.2%	9.9%	10.2%

Income Statement								
(000s)	1Q06a	2Q06a	3Q06e	4Q06e	1Q07e	2Q07e	3Q07e	4Q07e
Total Revenue	140,802	151,527	151,072	144,018	156,290	165,164	155,604	148,339
Cost of Goods Sold	80,443	85,713	87,924	85,403	89,085	93,318	90,250	87,371
SG&A	31,486	33,112	33,538	33,844	35,009	36,171	34,544	34,860
Amort. Of Intangibles	785	867	850	850	850	850	850	850
Total Op Expense	112,714	118,825	121,462	119,247	124,094	129,489	124,795	122,231
Operating Profit	28,088	32,702	29,610	24,771	32,196	35,676	30,810	26,108
Other Income, Net	329	472	200	200	200	200	200	200
Interest Expense	-4,459	-4,724	-4,700	-4,700	-4,700	-4,700	-4,700	-4,700
Net Inc Before Taxes	23,958	27,583	25,110	20,271	27,696	31,176	26,310	21,608
Provision for Inc Taxes	9,583	11,033	10,044	8,108	11,078	12,470	10,524	8,643
Net Income	14,375	16,550	15,066	12,163	16,617	18,705	15,786	12,965
Basic Wtd Ave Shares	44,625	44,933	45,110	45,310	45,510	45,710	45,910	46,110
Basic EPS	0.32	0.26	0.33	0.27	0.37	0.41	0.34	0.28
Dil Wtd Ave Shares	45,186	45,510	45,710	45,910	46,110	46,310	46,510	46,710
Diluted EPS	0.32	0.25	0.33	0.26	0.36	0.40	0.34	0.28
% Change	1Q06a	2Q06a	3Q06e	4Q06e	1Q07e	2Q07e	3Q07e	4Q07e
Total Revenue	20.9%	20.7%	18.5%	15.5%	11.0%	9.0%	3.0%	3.0%
Cost of Goods Sold	18.1%	19.2%	17.3%	14.5%	10.7%	8.9%	2.6%	2.3%
SG&A	17.1%	17.7%	18.4%	15.3%	11.2%	9.2%	3.0%	3.0%
Amort. Of Intangibles	104.4%	101.2%	41.0%	21.1%	8.3%	-2.0%	0.0%	0.0%
Total Op Expense	18.1%	18.3%	16.9%	4.6%	10.1%	9.0%	2.7%	2.5%
Operating Profit	33.4%	30.4%	25.4%	130.8%	14.6%	9.1%	4.1%	5.4%
Other Income, Net	178.8%	345.3%	217.5%	112.8%	-39.2%	-57.6%	0.0%	0.0%
Interest Expense	-46.4%	-23.7%	-23.3%	-22.6%	5.4%	-0.5%	0.0%	0.0%
Net Inc Before Taxes	86.4%	45.2%	43.2%	326.3%	15.6%	13.0%	4.8%	6.6%
Prov for Income Taxes	-142.2%	44.9%	43.1%	365.2%	15.6%	13.0%	4.8%	6.6%
Net Income	-59.6%	45.4%	43.2%	303.8%	15.6%	13.0%	4.8%	6.6%
Basic Wtd Ave Shares	9.5%	2.3%	2.1%	1.6%	2.0%	1.7%	1.8%	1.8%
Basic EPS	-63.2%	0.0%	39.2%	283.5%	14.1%	57.4%	3.0%	4.7%
Dil Wtd Ave Shares	7.8%	1.4%	1.5%	1.1%	2.0%	1.8%	1.8%	1.7%
Diluted EPS	-62.4%	0.0%	43.3%	278.5%	12.6%	61.6%	3.0%	4.8%
% of Revenue	1Q06a	2Q06a	3Q06e	4Q06e	1Q07e	2Q07e	3Q07e	4Q07e
Total Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of Goods Sold	57.1%	56.6%	58.2%	59.3%	57.0%	56.5%	58.0%	58.9%
SG&A	22.4%	21.9%	22.2%	23.5%	22.4%	21.9%	22.2%	23.5%
Amort. Of Intangibles	0.6%	0.6%	0.6%	0.6%	0.5%	0.5%	0.5%	0.6%
Total Op Expense	80.1%	78.4%	80.4%	82.8%	79.4%	78.4%	80.2%	82.4%
Operating Profit	19.9%	21.6%	19.6%	17.2%	20.6%	21.6%	19.8%	17.6%
Other Income, Net	0.2%	0.3%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Interest Expense	-3.2%	-3.1%	-3.1%	-3.3%	-3.0%	-2.8%	-3.0%	-3.2%
Net Inc Before Taxes	17.0%	18.2%	16.6%	14.1%	17.7%	18.9%	16.9%	14.6%
Prov for Income Taxes	6.8%	7.3%	6.6%	5.6%	7.1%	7.6%	6.8%	5.8%
Net Income	10.2%	10.9%	10.0%	8.4%	10.6%	11.3%	10.1%	8.7%