Investors Alley

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The Turnaround Stock Report

Continued Low Oil Prices Present Opportunities and Pain

Fellow Investor,

March has been an interesting month from a market perspective. Equities began the month giving up some of the very strong gains they posted in February and oil went once again below the $45 a barrel level on West Texas Intermediate (WTI) before popping above that level once over the last week. The US dollar continued its recent strength from the first couple of weeks of the month and been on a strong trend higher since last summer.

A week ago the major indices were basically unchanged for the year. This started to change after the Federal Reserve's latest comments on March 18th. The central bank removed its long standing "patient" stand on when it might raise rates but bent over backwards to insist this did not mean it would become "impatient" any time in the near future. The market took that as meaning the ramp up in rates will be slower and more incremental than the previous consensus.

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Markets rejoiced and stage a nice rise for the rest of the week. The rally was widespread as global equities posted their best weekly gain in two years. The dollar reverse itself quickly at one point going from under $1.05 per Euro to a $1.10; a huge move in the currency markets. Commodities started to behave better as the dollar weakened. Oil move up after almost two weeks of daily declines despite continuing concerns about a crude supply glut.

Lower gasoline prices are starting to be felt in different sectors of the economy. It certainly is boosting spending at restaurants. Restaurant holding company **Darden (NYSE: DRI)** reported quarterly results that easily beat both top and bottom line expectations and saw very strong same store sales growth. Even long time laggard Olive Garden managed its second straight quarter of year-over-year gains, something that previously not happened since 2010. **Nike (NYSE: NKE)** also easily beat the consensus as domestic sales were better than expected.

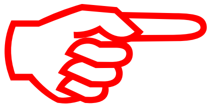
Given it is unlikely that the crude oil price is going to have a big and sustainable rally in the near term given the continue increase of supply worldwide, this tailwind for increased consumer spending should be in place for at least the medium term. Improved job growth over the past year also should continue to be a positive for the consumer discretionary sectors. As such, it is one of the few areas I look to find new additions for our Turnaround Stock Report and we will continue to increase our allocation to these spaces as prudent.

I am also hopeful the housing market will see a strong spring selling season which will help our housing picks. Outside of these and a few other areas, I am seeing less relative bargains in the market at the current time. Low interest rates should remain in place for the foreseeable future as central banks continue to provide a backstop to the markets.

Hopefully once we get beyond the first half of 2015, year-over-year earnings growth will return to equities in the second half. Until then, being prudent and cautious seems the appropriate course of action. In short, I expect the market to continue to be the topsy turvy affair it has been throughout 2015 so far.

I'm always here for you. If you have a question, compliment, complaint, comment or just want to say "hi" you can reach me at bret.jensen@investorsalley.com.

Bret Jensen
Editor
The Turnaround Stock Report



P.S. I'll be a key presenter at the Las Vegas MoneyShow running May 12th through May 14th. I will present on two topics: one on biotech investing and the other on making sense of the energy markets. This is a great opportunity for you to get in-depth information on both subjects and ask questions. At the last show in Orlando the room was almost at capacity and I expect both presentations to fill up quickly this time. If you live in the Las Vegas area or plan to be there or just need an excuse to visit **click here for more information and to register for free.**

ARCP: A REIT Putting 2014 Behind It

Our first Turnaround Stock Report selection for this month's issue is an area where we have not plumbed for value before. This is the real estate investment trust space which is traditionally the reserve of income investors. The sector has been one of the best performers in the market since equities bottomed in the midst of the financial crisis back in March of 2009.

Property values have sharply rebounded since the nadir of the 2008/2009 financial debacle when many of the big and small names were thought to be heading to bankruptcy due to their debt loads and plunging property prices. Asset values have rallied as the economy has slowly gained strength and as the Federal Reserve has pumped extraordinary liquidity into the economy which had lifted all asset values including equity and land holdings.

In addition, interest rates have remained lower and for longer than anyone thought five years ago thus making income streams from buildings, malls, medical facilities, hotels and the assorted other assets REITs typically hold more valuable to investors. This trend should remain in place as the Fed will be hard pressed to raise rates given the recent strength of the dollar and even as central banks in Europe and Japan continue with their quantitative easing programs.

There is not nearly the value in the real estate investment trust sector as there was even a few years ago. However, I believe that **American Capital Realty Properties (NYSE: ARCP)** has great value here for patient investors.

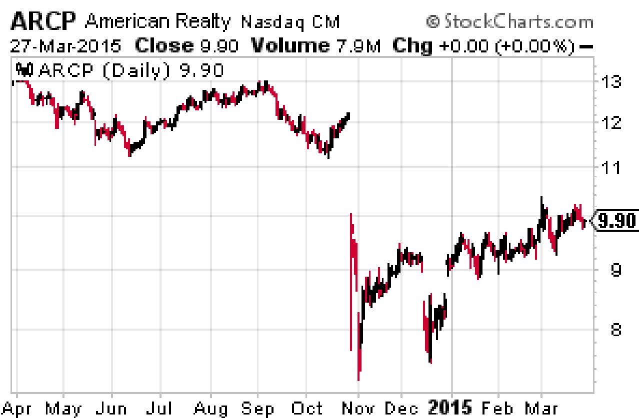
American Capital Realty Properties is the largest single tenant REIT in the country. The stock unfortunately has not participated in the big rally that has swept across just about every other REIT in the market. There are good reasons for this. The company has suffered from poor, overpaid and conflicted management and has had several accounting concerns as well that led to some earnings restatements.

However, things are starting to turn around at this huge REIT. Its previous CEO has left and an activist fund has taken a major stake in the REIT and has been pushing for positive shareholder changes. In addition, the company's assets are woefully undervalued compared to its two biggest competitors. American Capital Realty Properties at these levels could basically sell off properties and use the proceeds to buy back stock and unlock significant shareholder value which is always a nice cushion. I believe the company is in a very early innings of a substantial turnaround that should lead to solid capital appreciation in the years ahead. Investors also get paid a nice fat dividend while awaiting for positive changes to bear fruit.

2014: A Very Challenging Year:

As can be seen from the chart below, the last year has not been kind to the stock price of American Capital Realty Properties. Even while other REITs were showing a very solid gain over the past twelve months, ARCP has had a significant decline despite the favorable tailwinds for the industry overall. It should be noted that the stock has bounced off its recent lows of approximately $8.00 a share. (See chart on next page.)

There are myriad reasons for the stock's poor performance over the previous year. The company had to restate and lower adjusted funds from operations (AFFO) for all of 2011, 2012, 2013 and the first two quarters of 2014. The company also found some improper payments to were made to ARC Properties Advisors, LLC, a management company majority-owned



by Nicholas Schorsch, the long standing CEO of American Realty Capital Partners.

In addition to the improper payments, some of which the company has recovered, Mr. Schorsch was one of the best compensated CEOs in the industry and within the market which consistently raised the ire of investors even as he built American Realty Capital Properties to the biggest single tenant REIT in the country via acquisitions and organic growth.

Change Is Underway:

The underperformance of the shares in the REIT as well as the company's other challenges has recently drawn the focus of activists who saw the underlying value of the company's assets. Corvex Capital has amassed an almost eight percent stake in American Capital Realty Properties and has been one of the key drivers of the ouster of Mr. Schorsch from the company. The company has named an interim CEO and has a search in place for a permanent leader which should buoy the stock once found and named.

Corvex Capital was founded by Keith Meister who learned his trade as one of the key lieutenants to noted value and activist manager Carl Icahn who has unlocked substantial shareholder value at dozens of companies over the past few decades. Corvex is fighting for substantial board representation. Corvex has been joined recently by Twin Securities, another activist with a substantial stake in American Realty Capital Properties. New board membership changes should be welcomed by the market if and when it happens.

Undervalued Assets:

The properties within American Capital Realty Properties' portfolio currently are valued at under book value at the current price of approximate $10.00 a share on this REIT. To put that in perspective the company's two biggest competitors **National Realty Partners (NYSE: NNN)** and **Realty Income Corporation (NYSE: O)** both sell at more than twice book value. There may be some future write-downs on the value of the company's acquisition of Cole Real Estate last year but if and when they occur they will still leave American Capital Realty Properties selling for substantially less from a book value perspective than either of their two biggest competitors.

In addition, both National Realty Partners and Realty Income Corporation yield a little north of four percent on an annual basis. American Capital Realty Properties yields right at a bountiful 10% currently. Now given restatements show that AFFO was previously overstated by 20% to 25% in previous quarters and years I expect that dividend to be cut when a new leader is in place. However, the REIT should still yield six to eight percent after the dividend is reduced at the current beaten down stock price. Finally, ARCP sells at approximately seven time trailing revenues, both NNN and O sell for nearly 13 times trailing sales.

Reasons for Hope:

Even with the company's recent travails the underlying business fundamentals of the REIT are solid. Its properties are over 99% leased with its average lease expiration out more than a decade. Its purchase of the Red Lobster properties from **Darden (NYSE: DRI)** looks solid at better than a seven percent capitalization rate especially with restaurant sales picking up nicely recently thanks to lower gasoline prices and a strong jobs market.

The company's debt load is manageable and staggered. The company could easily sell off non-core properties

for more than they are carried on the books to reduce debt if need be given the strong demand for real estate with solid cash flows in the market.

I expect activists to continue to push for changes that should be positive for shareholders and capital appreciation. Most importantly for a new management team that can improve sentiment on the REIT and start to narrow the big valuation discount to its main competitors. Given the recent increase in M&A activity in the real estate space – most recently with **Simon Property Group's (NYSE: SPG)** approximately $17 billion buyout offer for rival mall operator **Macerich (NYSE: MAC)** – a buyout of American Capital Realty Properties or for a substantial portion of its assets cannot be ruled out.

I believe as a new management team gets in place, settles any litigation from AFFO restatements and the company starts to put a difficult 2014 behind it, the valuation discount with peers should start to disappear. I think 30% to 40% appreciation over the next 12-18 months is a likely probability. This would leave ARCP still trading at a significant discount to peers. Combined with what is likely to be a six to eight percent annual dividend yield going forward this is a substantial total return that should easily outperform what the overall market over that same timeframe.

Recommendation: Buy ARCP up to $10.75 a share, hold until $14.00 a share.

New Policy on Taking Profits and Cutting Losses

One thing I have learned over three decades of investing is that it is being a good investor is a journey. One constantly learns new rules and relearns old ones whether they are a novice or an experienced investor. The market has always been and will always be a humbling beast.

Over the years I have developed a philosophy with riding winners while being prudent enough to take some profits. This was sent out to subscribers as interim communication when **Cytori Therapeutics (NASDAQ: CYTX)** doubled soon after being included in the Turnaround Stock Report in the February issue.

The strategy is simply this: I sell 10% of my original stake once it achieves a 50% gain. I then will also sell 20% of the original stake after the stock doubles and 20% more if I am fortunate to hit a triple. The other half of the original stake now rides on the "house's" money unless something drastically changes on the company's prospects. Part of the strategy could also have already been employed on big gainers **Halozyme Therapeutics (NASDAQ: HALO)** and **Dynavax Technologies (NASDAQ: DVAX).**

As important as it is to take some gains while maintaining a stake in stocks that are having big rallies, it is just as critical to abandon stocks that are not living up to expectations and keep losses to manageable amounts. The truth is that not every investment works out, especially in high beta areas like biotech, commodity based stocks and turnaround situations.

This is an area that most investors struggle with and certainly something that I have been challenged with throughout my investing career. Before I make any investment, I do an inordinate amount of research before I commit funds to a particular idea.

Sometimes it is hard to let go of that original decision. However, when the facts on the ground change one's decision must change as well even if that can be a difficult thing to do given human nature. A perfect example of this is the carnage in the energy complex as the price of crude oil has been more than cut in half in a short amount of time. This is the first time this has occurred outside of a global recession since 1998 and it caught almost every analyst and pundit off guard.

Going forward, we are instituting a policy to keep losses more manageable and avoid the big losses that can

occur when an investment goes bad for unforeseen reasons. Starting with our two additions this month, any time a stock reaches a 25% loss we will jettisoned it from the portfolio except in extraordinary circumstances. This should be enough cushion not to hit the "ejection" button too soon but shallow enough to keep losses to a manageable level. We will not buy back into a stock for at least 90 days if ever as this will enforce a discipline of avoiding larger losses. We will also start to publish a stop/loss point for every recommendation going forward.

This month we are purging two energy holdings where this policy would have come in very useful: **Emerald Oil (NYSE: EOX)** and **Hercules Offshore (NASDAQ: HERO).** Both were good investments when oil was north of $100 a barrel as it was during when the equities were recommended. They would also have done fine at $75 a barrel. However, with oil at under $50 a barrel with no one sure when and where crude prices will eventually bottom they are no longer worthy of inclusion within the portfolio. We will keep our two remaining energy plays in the portfolio for now as they are more exposed to natural gas prices that could rise as rig counts continue to plunge and have more manageable debt loads. In their place, we are adding two new names in sectors that have better current tailwinds than the energy sector.

KORS: In the Bargain Bin

Our second selection is a retailer that has been placed in the bargain bin as growth has slowed from previous levels. The company still enjoys sales and profit growth that most retailers would kill for but investment sentiment has soured sending this luxury retailing play down near 52 week lows. This decline is offering growth investors a rare attractive entry point on what until recently has been a very hot play in the retailing industry.

The retailer is **Michael Kors (NASDAQ: KORS)** and it is not the typical equity within the Turnaround Stock Report as this is not a broken company that is in need of a new strategy or needs to execute initiatives to turn around its core business fundamentals. The only thing that has changed significantly on the stock in investor sentiment, which is likely to be temporary. Even though it is in a different industry, the predicament on the shares and company reminds me of the fairly similar situation of **Halozyme Therapeutics (NASDAQ: HALO)** when it first went into the portfolio in late 2014. That stock has been one of the star performers in our portfolio and Michael Kors has similar potential.

Company Overview:

Michael Kors is a rapidly growing global luxury lifestyle brand led by a renowned, award-winning designer. Since launching his namesake brand over 30 years ago, Michael Kors has featured distinctive designs, materials and craftsmanship with a jet-set aesthetic that combines stylish elegance and a sporty attitude. The company has a presence in almost 100 countries and just over 500 stores worldwide as well as just under 200 licensed partners. It also supplies goods to just under 4,000 stores globally and two thirds in North America.

The company came public late in 2011 and sports a market capitalization of just under $14 billion. Approximately three quarters of Michael Kors' sales currently come from North America. The rest comes from Europe and Asia, mostly from the former. Goods sales are roughly split between wholesale and retail

with pure licensing revenues making up a much smaller part of overall sales.

A History of Growth:

When the company first came public in 2011 it posted earnings of just over 40 cents a share on revenues just slightly over $800 million. For FY2015 which closes at the end of the month, the retailer should post earnings just north of $4.25 a share on revenues north of $4.2 billion. Both sales and earnings should be up over 30% year-over-year. The company has opened over 100 new owned stores over the past year and has seen retail sales increase over 35% year-over-year in the last completed quarter. Smaller license sales are growing at just under 10% annually.

Growth is slowing but still very robust. In upcoming FY2016, the consensus is both revenue and earnings will increase in the mid-teens. The company is just really getting started establishing its brand in Asia recently opening its flagship store in Tokyo and I expect Asia and emerging markets will constitute a more and more important channel for growth in years ahead.

Recent Challenges:

The stock recently hit 52 week lows at just under $65.00 a share. The stock has bounced back a bit lately to just under $67.00 a share. However, the shares are still down some $30.00 from their recent highs hit in early in summer.

The cause of the recent decline is twofold. The company recently said its same store sales growth in the United States has come down to just 8.6% year-over-year in its fiscal third quarter, down from what has been double digit growth in recent years. The company also stated that FY2015 e-commerce sales should in the range of $1.05 billion to $1.08 billion below the consensus of $1.15 billion.

Part of this is due to damage at its fulfillment center in Ohio. This was caused as the roof collapsed due to weather. The company stated this resulted in three weeks of slowing order fulfillment and should cost the retailer $10 million in sales and a two cent impact to earnings per share.

It should be noted that the company has seen a 73% jump in sales from its U.S. e-commerce site (self-hosted) over the retailer's previous outsourced site. If the U.S. e-commerce tally were included in the comp total, Michael Kors would have put up over 10% same store year-over-year growth domestically in Q3.

In addition, the strong dollar has soured the sentiment on some of the luxury retailers. The company recently lowered guidance for the seasonally weak post holidays first quarter to 89 to 92 cents a share which was a bit lower than the existing 94 cents a share consensus primarily due to currency concerns. It should be noted that the company has very high margins and is seeing same store sales growth of over 25% in Europe and Asia. Overall sales are growing at over 60% year-over-year on a combination of new store openings and organic same store growth which should mitigate to a large degree weak currencies overseas.

Long Term Opportunities:

The company has a well thought strategy it is executing to continue its impressive sales and earnings growth of recent years. The plan has several simple and sound parts.

1. Increase brand awareness. This will be key to growing presence in both developed and emerging markets like China which are increasingly embracing luxury brands.
2. Expand the number of stores in North America and Europe.
3. Increase size and frequency of purchases from high end consumers.
4. Align brand with up-market department stores and expand shop-in-shop footprint. This has great promise as more and higher end department stores are embracing this model and it has proved quite effective.
5. Drive retail and wholesale business through continued leverage of existing operations.

Michael Kors has a solid strategy to grow sales over the medium and long term. It has been very effective in taking market share from **Coach (NYSE: COH)** in the handbag segment in recent years and a key factor in that once highflying brand's challenging times over the past 12 – 18 months. Growing brand presence in key emerging markets like China and India will be key to future growth as this is where high end consumers are being created in the highest numbers in recent years.

Valuation and Summary:

The pullback in the shares of Michael Kors shares presents us with a very solid buying opportunity. The decline has been a significant overreaction as growth may be down from the unsustainable levels in recent years but is still very heady for a retailer.

In the last reported quarter the company reported quarterly earnings of $1.48 a share, 15 cents a share above the consensus. Revenues came in $10 million above expectations at $1.31 billion which was up nearly 30% year-over-year.

Despite this growth, the shares are selling at just over 14 times FY2016 (which starts on April 1st) profit projections. This compares to a market that is going for over 16 times forward earnings. In addition, the average S&P 500 company is not seeing either the revenue or earnings growth that Michael Kors is experiencing. The retailer also has a strong balance sheet with approximately $1 billion in net cash on the books. I expect the company will use its accelerating free cash flow to buy back more and more stock in coming years.

A more rational valuation range would be 18 – 21 forward earnings which would still be under the historical PE valuation this stock has sold for but we will be conservative since growth has slowed from very high levels. With earnings per share expected to be approximately $4.80 a share in FY2016. That gives us a price target range of $86 to $100 a share.

Recommendation: Buy KORS up to $75 a share, hold until $100 a share.

Portfolio Update

It has been a very solid month for the Turnaround Stock Report portfolio overall although the carnage in the energy sector continues to push down most stocks in the oil & gas sectors. This was balanced by outstanding performance from some of our recent selections including a small biotech stock that has roughly doubled since it made its debut in the February edition of the newsletter.

Here are some of the highlights within the portfolio over the past month. **General Motors (NYSE: GM)** continues to deliver strong performance as it has been throughout 2015. Bending to activists, the company recently approved an additional $5 billion stock buyback that was applauded by the market. The company will also shut down its St. Petersburg manufacturing facility which seems prudent given the turmoil in Russia.

Chicago Bridge & Iron (NYSE: CBI) had a strong month despite some continued cost overruns at a nuclear facility it is a prime sub-contractor on and is now trading for solidly over the $45.00 a share level. Our other pick that has been oversold with the plunge in oil, **Greenbrier Companies (NYSE: GBX)**; largely spent the time from our last update consolidating its gains in February.

AEGON (NYSE: AEG), our pick for a lower euro, had a strong month and hopefully is now poised to break out from undervalued levels (the shares trade for roughly 60% of book value). **Sequential Brands Group (NYSE: SQBG)** was down slightly for the month. Revenue was up 75% year-over-year when the company last reported quarterly results in late February. Two directors picked up more than $800,000 in new shares in early March which is encouraging.

Overall we saw strong performance from our biotech & biopharma selections. **Dynavax Technologies (NASDAQ: DVAX)** gained some **25%** over the month and I expect momentum to continue to be strong into the release of the company's large hepatitis B vaccine trials sometime

in the second half of the year. The company also got a nice upgrade from JP Morgan who sees the shares hitting $36.00.

Zogenix (NASDAQ: ZGNX) sold off on the announcement it will sell is Zohydro franchise. I added to my stake at approximately $1.20 a share. The company is getting $100 million in upfront payments and could earn more than $250 million in additional regulatory and sales milestone payments in coming years. To put this in perspective, the company has only a market capitalization of approximately $210 million. It has also has two promising drugs about to start Phase III trials and now has enough cash to fund operations through 2017. The stock has risen since the initial sell-off and I expect the share price to continue to rise.

Halozyme Therapeutics (NASDAQ: HALO) spent the month consolidating its huge recent gains **but sold off a bit on March 25th in a swoon that hit the biotech sector that day. Cytori Therapeutics (NASDAQ: CYTX)** was the definite star of the show in March as the shares have roughly doubled since inclusion into the portfolio in last month's edition as the company was allowed to expand the population in a key trial and also received Orphan Drug designation in Europe.

Finally, the other addition in February's edition, **Felcor Lodging (NYSE: FCH)** acquitted itself well in its first month within the portfolio. The company sold another non-core property in Texas and continues to execute well against its turnaround strategy.

This month we add another two selections into the portfolio while booting out two of our energy laggards, **Emerald Oil (NYSE: EOX)** and **Hercules Offshore (NASDAQ: HERO)**.

Current Portfolio

Company	Entry Date	Entry Price	Recent Price	Buy Up To	Target Price	Returns
Michael Kors (KORS)	03/26/16	$66.97	$66.97	$75.00	$100.00	N/A
American Cap. Realty (ARCP)	03/26/15	$9.90	$9.90	$10.75	$14.00	N/A
FelCor Lodging Trust (FCH)	02/20/15	$10.78	$11.46	$11.50		6.3%
Cytori Therapeutics (CYTX)	02/20/15	$0.55	$1.18	$0.75		114.5%
Sequential Brands (SQBG)	01/21/15	$11.09	$10.23	$12.00	$17.00	-7.8%
Chicago Bridge & Iron (CBI)	01/21/15	$40.31	$48.10	$45.00	$60.00	19.3%
Greenbrier Cos. (GBX)	12/17/14	$46.51	$56.34	$50.00	$80.00	21.1%
Halozyme Thera. (HALO)	12/17/14	$8.65	$13.31	$10.00	$18.00	53.9%
Zogenix (ZGNX)	11/18/14	$1.24	$1.31	$1.75	$4.00	5.6%
General Motors (GM)	11/18/14	$32.27	$37.35	$34.00	$47.50	15.7%
Warren Resources (WRES)	10/15/14	$3.37	$1.03	$4.50	$7.00	-69.7%
Dynavax Technologies (DVAX)*	10/15/14	$14.30	$22.37	$17.50	$30.00	56.4%
Chesapeake Energy (CHK)	09/15/14	$25.05	$14.22	$27.00	$33.00	-43.2%
AEGON N. V. (AEG)	08/14/14	$7.74	$7.95	$9.00	$15.00	2.7%

Closed Positions

Company	Entry Date	Entry Price	Close Price	Close Date	Returns
Hercules Offshore (HERO)	07/18/14	$4.01	$0.45	03/26/15	-88.6%
Emerald Oil (EOX)	07/18/14	$7.56	$0.86	03/26/15	-84.8%

Notes:

Entry price is determined by the last "Close" price at the closing of the market on the day before publication.

Recent price is determined by the last "Close" price at the closing of the market on the day before publication; most recent update: 03/26/15. Returns data represents share price appreciation or depreciation between entry price and recent price.

* Dynavax did a 1/10 split on 11/05/14 thus the original entry price of $1.43 has been adjusted to $14.30 to reflect current pricing level comparisons.

This is not real-time data and should not be interpreted as such.

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