Investors Alley

November 2014 Vol. 1 Issue 5

The Turnaround Stock Report

Quickening the Pace of Our Additions

Fellow Investor,

The last thirty days has seen an impressive rally in the market with the exception of several areas. These sectors include energy which has been battered by an over $30 decline in the price per barrel for oil since summer, a move triggered by Saudi actions that few if any analysts saw coming.

In This Issue

Miners and other commodity stocks have also sold off as the U.S. dollar continues to strengthen against major currencies such as the Yen and the Euro. Tepid global demand also is not supportive for the commodity complex right now either.

A good portion of the rise in equities has been concentrated in stocks that have been 2014's winners such as **Apple (NYSE: AAPL), Alibaba (Nasdaq: BABA)** and **Microsoft (Nasdaq: MSFT).** The small biotech sector has also performed well as underperforming fund managers buy high beta plays in an attempt to catch up to their benchmarks by year-end bonus time.

The rally has bypassed most of our turnaround stocks so far which makes logical sense. Turnaround stocks by their very nature have negative sentiment on them when one should purchase them awaiting brighter days. This is the time of the year managers buy the year's winners and dump the year's losers in a ritual known as year-end "window dressing" which inevitably leads to what is called the "January Effect". This is traditionally the month where last year's losers rally from oversold territory and post strong results.

This is one reason we added two new selections in our October newsletter and are adding another two this month after adding only one selection a month when we first launched. Our last newsletter of the year in December will also see two or even three selections to get ahead of what should be much more favorable terrain in January.

The fall in oil prices bears watching closely and not just because of the energy positions within our portfolio but larger macro reasons. Investors hear a lot of positive commentary today on the fall in oil prices helping consumers and manufacturers. This is true, but this sudden plunge in oil also is going to have other impacts some of them very detrimental if oil holds at these levels or declines further.

More than one hedge fund is going to take some major losses or have to shut down holding junk bonds from some of the smaller E&P plays that floated so much debt over the past few years when oil was north of $100 a barrel. This could disrupt the credit markets as well as the equity markets depending on the size of the blow up(s).

We are also going to see a significant slowdown of capex and hiring in the energy space should this continue. The sector has been one of the few adding high paying jobs in what continues to be the weakest post war recovery on record. Even with boosts from energy complex, full time jobs are still two million less than peak levels in 2007 due partly to the rise in part-time jobs as well as decline in labor participation rate. Median income is still down seven percent from 2007's recent peak on an inflation adjusted basis.

The drop in oil punishes some of the bad actors in the world such as Russia, Iran and Venezuela. It also hurts allies like that of Mexico and makes the massive financing to get to huge offshore fields off Brazil online more problematic. Not to mention this could hurt the prospects of Africa, which has one of the best growth stories in recent history going on right now.

Finally, consolidation in the space could accelerate given needs to cut costs. This is the key reason behind the now hostile merger between **Halliburton (NYSE: HAL)** and **Baker Hughes (NYSE: BHI)** and could be the start of a larger consolidation movement. This is a development we will continue to monitor closely. My personal opinion is the market is very close to a bottom and the next major move in oil will be up.

This month we add to two new selections in different sectors to continue to diversify our portfolio. One is a small pharma play that could be one of the weirder winners from the recent mid-term elections. The other is an American manufacturer icon whose impressive turnaround effort since the financial crisis got delayed in 2014 due to a detrimental recall effort. This dirt cheap stock should get back on the road to recovery in 2015 however.

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

A Recovery to Get Back on Track in 2015

General Motors (NYSE: GM) successful journey out of bankruptcy hit a major bump in the road in 2014. This has cut around 25% from the value of the shares since the first of the year. However, this is likely to be a temporary bump in the road and the company and its stock should be back on the road to recovery in the New Year.

Both Chrysler and General Motors were two high profile American icons that were forced into bankruptcy by the financial crisis and its aftermath. Domestic vehicles sales plunged from approximately 17 million annually pre-crisis to under 10 million in 2009. Chrysler was sold for pennies on the dollar to Fiat and the United States government provided billions of dollars in loans and temporary financing to General Motors while guiding the company through an expedited bankruptcy process.

Under bankruptcy, the company was able to shed creditors' claims for pennies on the dollar even if the Federal government had to upend some 200 years of bankruptcy code to do so. General Motors was also able to address its huge legacy costs of pensions and retiree health benefits and even managed to establish a two tier wage system for new UAW members.

The auto manufacturer spent the next couple of years under federal government administration and management before returning as a public entity in late 2010. The stock struggled for the next 18 months before starting to ride the recovery in the domestic vehicle market over the next 18 months, a period that saw the stock double from $20 a share in the middle of 2012 to $40 a share to begin 2014.

Then came the company's recall crisis involving ignition parts first made a dozen years ago which may have resulted in approximately 30 deaths over a period where the company produced over 100 million vehicles worldwide. 10 to 15 years ago this would have been resolved months ago. However, in an era of myriad 24/7 news channels and social media in the most litigious developed country on the planet it has become a major fiasco and generated months of negative headlines for the company. The other main driver of the stock's recent problems is the poor results from Europe which have plagued all the major automakers.

General Motors Headquarters, Detroit, Michigan

Even though any liabilities for the deaths associated with the defective switches should have been discharged via bankruptcy, the company has set up a compensation system to pay victims' families. This should cost less than $1 billion dollars which is much less than the company has already spent recalling millions of vehicles over the past year. The company will also probably end up paying a $1 billion to $3 billion dollar fine to the Federal government which seems to have completely missed this problem when it was in charge of administration of the company for several years.

Although this will amount to the largest fine against an automaker in history, it is a relative pittance given General Motor's enterprise value is north of $65 billion. The settlement and compensation payouts will also put a huge overhang on the stock behind the company and allow investors to focus on General Motor's significant core value drivers.

Even though auto sales have approached pre-crisis levels, the average age of a vehicle on the road today in the United States is more than a decade old, very high by historical averages. This bodes well for the replacement cycle as does low interest rates and the best recent spurt of job growth since the late 1990s. In addition, all the negative news around its recall debacle has not dented sales in the United States which should be considered a major positive.

The company has done a solid job in bringing up margins since emerging from bankruptcy. Recent low gas prices could boost that trend if this development holds. Lower gas prices tend to boost the sales mix towards trucks and SUVs which provide automakers with much higher profit margins than cars. This wildcard needs to be watched as it is not yet reflected in earnings estimates.

The other huge value driver around General Motors I believe some investors missed is its huge presence in China, which will be the biggest auto market in the world over the next few decades. Through joint ventures, the company produces almost 300,000 vehicles a month in the Middle Kingdom including around 100,000 Buicks monthly which is a brand that is an afterthought in the U.S. market.

General Motors continued to gain market share in 2014 despite its recall issues in the United States and losses in Europe. I expect this to continue due to the company's partners, product mix and the historical enmity between China and Japan which frequently explodes resulting in sporadic boycotts against Japanese automakers like Toyota. Despite **Ford's (NYSE: F)** stellar growth in 2014, it still sells only one third the vehicles in China that General Motors does.

General Motors should continue to post losses in Europe as will most automakers in 2015. However, the company is taking steps to reduce losses and improve operations on the European continent. With new car registrations near two decade lows and barely off where they were during the financial crisis, it is hard to see how Europe gets any worse. Any surprise in 2015 is likely to be on the upside especially if the Eurozone can unite around the need for United States like quantitative easing and other growth measures.

Other positives for the company and the stock in 2015 include easy comps to what has been a disappointing year for profits due primarily to the costs associated with the recall. In addition, Michigan became a "right to work" state in early 2013 which should undermine the ability of the UAW to disrupt operations to the same extent as they have over previous decades. The state's governor was recently re-elected; this cements that law for the foreseeable future.

Summary:

General Motors recovery from the crisis was temporarily upended in 2014 thanks to a recall that spiraled out of control as well as challenges in Europe. I expect the company to put the recall debacle in its rearview mirror in the first half in 2015. The company's North American business should continue to purr along in the New Year and China will continue to deliver very solid growth in a critical market. It is hard to see Europe getting any worse and any improvement on the continent would reduce losses in GM's European operations and boost the bottom line.

I believe all the bad news originated in the soon to be concluded year is fully priced into the stock of General Motors and then some. The shares are priced at under 7.5 times the consensus earnings estimates in 2015. This is less than half the overall market multiple of just under 16 times forward earnings. The shares also yield almost four percent (3.8%) adding to next year's potential return and also helping put a nice floor under the stock.

If things improve just mildly from 2014 and the company hits its projected earnings estimates in 2015, it is hard to see how this stock is not considerably higher 12 months from now. Putting a conservative 10-11 times the consensus earnings of ~$4.30 a share General Motors is slated to make in 2015 gives us a price target of $43 to $47.50 a share on General Motors in the coming year.

Given the stock trading around $40 a share to begin 2014 this is not much of a stretch valuation. Add in a roughly four percent yield and this gives up a potential overall return of 40% to 55% over the next 12 months.

Recommendation: Buy GM up to $34 a share and hold until $47.50 a share

Position: Long GM

Zogenix: Catalysts Could Power Major Upside

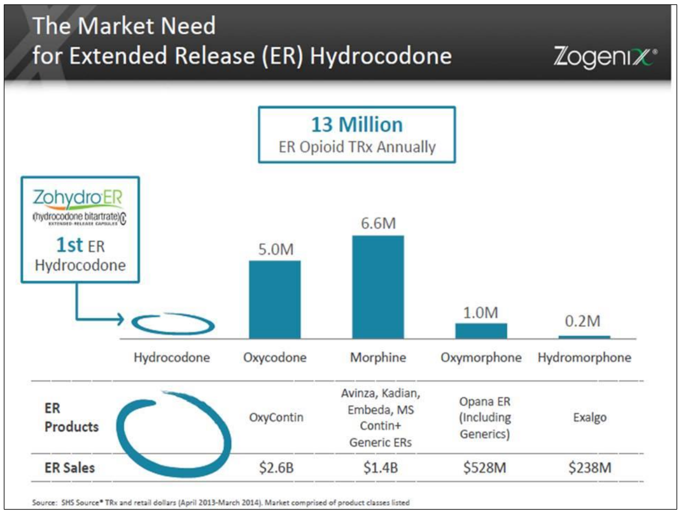
We're adding the second drug play to our Turnaround Stock Report this month. Hopefully it will turn out to deliver the same returns as the two biotech rocket ships that Small Cap Gems advocated over the past couple of months. Today, we look at a small pharma play that has fallen on some temporary hard times but has catalysts in the pipeline that should allow it drift back up to earlier highs. Let's take a look at **Zogenix (Nasdaq: ZGNX).**

Company Overview:

Zogenix came public in 2010 and is focused on developing therapies that address specific clinical needs for people living with CNS (Central Nervous System) and pain-related conditions who need innovative treatment alternatives to help them return to normal daily functioning. The company has a market capitalization of approximately $200 million after a recent steep decline from its highs in the first quarter of this year.

The plight of Zohydro:

Zohydro is a unique product for chronic severe pain sufferers who cannot tolerate the acetaminophen that is used in other extended-release opioid medications such as OxyContin and hydrocodone (Vicodin). This is an important drug as for a growing number of people acetaminophen causes liver damage that can lead to fatalities or even the need for liver transplants in severe cases. Zohydro is a drug that addresses this growing market that is estimated to be 2.5 million patients. It is potentially a huge market opportunity.



The F.D.A. approved this narcotic pain reliever in October of last year after an extended review. The stock soared from under $2 a share at the time of the approval to nearly $5 a share in late February of this year. That is when Zogenix's problems started. Zohyrdo became the cause celebre for some district attorneys and governors who made it the poster child for accidental opioid overdoses which cratered the shares which now go for around $1.25 apiece. See the chart on the next page.

A particular zealot was Massachusetts governor Deval Patrick who tried to get distribution stopped in his state making it the focus of his efforts even though none of the 668 people who died due to accidental opioid overdoses in Massachusetts in 2012 were due to Zohydro which was not even approved yet. Zogenix successfully got an injunction in Federal Court to override the governor's action in April.

The governor then unveiled a $20 million package of proposals to tackle what he described as a crisis of addiction to opioid drugs in the state and called for a summit of all six New England governors to address a broader regional response. With the except of Paul LePage of Maine, all of the other New England governors attended.

Another key political opponent to the distribution of Zohydro is West Virginia senator Joe Manchin, whose daughter happens to be the CEO of **Mylan (NYSE: MYL)** a generic drug firm that has competing products in this space: more than a little conflict of interest in my opinion.

Zogenix might be one of the weirder winners of the mid-term elections. Governor Patrick is no longer in office and the candidate from his party selected to replace him, Martha Coakley, was soundly defeated by Republican Charlie Baker, and Senator Manchin's party is now in the minority in the Senate, thus greatly neutralizing his voice. He will also need to focus on his re-election during the next cycle in increasingly red West Virginia. The recent elections in my opinion removed a huge political headwind for Zogenix which has not been reflected in the stock price yet. This will all be become moot in time as the company is in the middle of the process to get an abuse resistant version of Zohydro approved which should happen sometime in the first half of 2016.

The other big overhang on the stock was competitor Perdue Pharma received an expedited review for a similar tamper resistant product in the space in June. However, at the end of October Zogenix and Purdue Pharma exchanged waivers of regulatory exclusivity for extended-release hydrocodone products which reduced the potential impact of this development dramatically.

Growth and Pipeline:

Despite the obstacles thrown in front of Zohydro, sales are growing impressively. In its recently completed quarter its sales grew 47% year-over-year. Physicians that can prescribe Zohydro increased to 4,000 from 2,800 just in the quarter and the company has had 31,000 prescriptions written for Zohydro since launch.

The company currently has Relday in phase II trials. This compound is a propriety once-monthly subcutaneous formulation of risperidone for the treatment of schizophrenia, another potential large market. Trial results should be available sometime in the third quarter of 2015.

The company recently acquired a potential treatment for Dravet syndrome for some $24 million recently. The company plans to start Phase III trials for this compound in the second quarter of 2015.

Zogenix has funded development and its recent purchase by selling its migraine treatment Sumavel DosePro for some $90 million with possible additional payments of $20 million to a larger pharmaceutical firm in the second quarter of 2014 which bolster its balance sheet substantially. The company has some $50 million in cash on its balance sheet and anticipates no need to raise additional capital in 2015.

Summary:

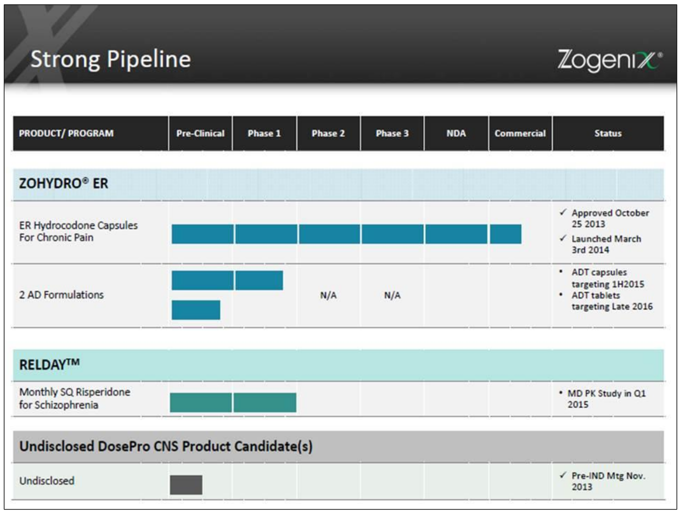
Zogenix reminds me of **Avanir Pharmaceuticals (Nasdaq: AVNR)** which has been a huge winner within the Small Cap Gems portfolio since placed in the inaugural edition with a gain better than 150% since then. Like Avanir, sales for its main product are growing some 50% annually. Also like Avanir, the stock is being held back because of some temporary legal issues. In addition, the company has other drugs in the pipeline or "shots on goal" and net cash on the balance sheet. Finally, both companies make sense as buyout targets for larger players.

A better analogy might be **Lannett Company (NYSE: LCI)** whose generic oxycodone had similar issues at one time. I identified and purchased this stock in November 2012 when the stock traded at $4.50 a share. Less than a year later I sold the entire position at $10 a share. The stock now trades near $50 a share. It is one of the few quick doubles I have made in my investment career that makes me nauseous every time I think of it.

The five analysts who cover the stock have a median price target of $3 a share on ZGNX, more than twice the current price of the stock.

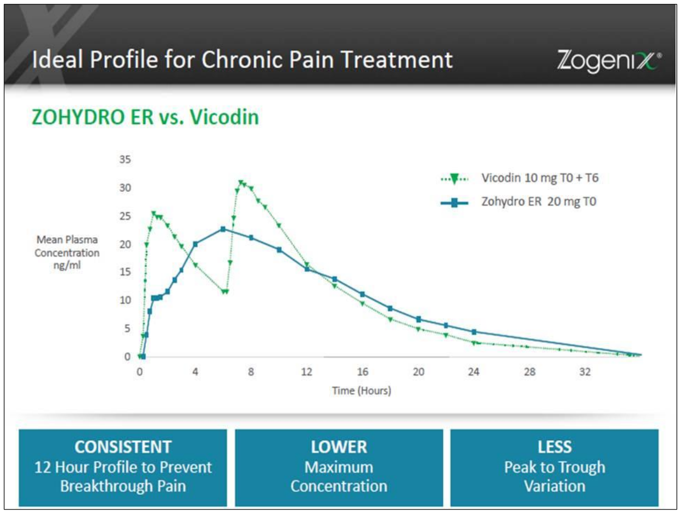
If Zogenix turns out to have similar appreciation to Lannett or Avanir I plan to recommend investors take half profits when the stock reaches $4.00 a share, above 20% below previous highs this year and more than a double from a current price of $1.25 a share. The rest we will let ride.

Recommendation: Buy ZGNX up to $1.75 a share. Sell half at $4.00 a share and let the rest ride.



Possible Appreciation Paths:

I think recent events should boost sentiment on the stock in the near future. Sales growth for Zohydro is just at its beginning in a potentially very large addressable market as it has some superior pain relief characteristics against competitors such as Vicodin. I expect the company to continue to see impressive growth rates from Zohydro over the foreseeable future.



Zogenix has a solid pipeline and shareholders should get some important results in the New Year. I also think Zogenix would make an attractive buyout target as a pharma firm with a much bigger sales force which could pump up sales exponentially.

Portfolio Update

As mentioned in the market commentary for this month, the market had a solid month as fund managers rode the winners in 2014 to power the rally. Our turnaround portfolio is still waiting for sentiment to start to turn on some of the currently out of favor names within it. I expect we might have one more tough month but then expect the portfolio to start to outperform in the New Year where one year's losers often become among the best performers the following year.

Falling oil prices certainly have not helped the energy names in our portfolio. However, $75 a barrel feels like it is close to a floor as mid-majors like **Denbury Resources (NYSE: DNR)** have announced they plan to cut next year's capital budget in half which will slow production increases. I also expect some of the marginal players within OPEC to cry uncle soon to actions by Saudi Arabia and cut production as well. The bodes well for a bounce in oil prices in the New Year even though we may have a bit more pain to endure before some sunnier skies appear.

Winter does seem to be descending upon the nation with major snowfall in such places as Maine and even Charleston, South Carolina pointing to a colder than normal winter which should boost natural gas prices in the months ahead. This would benefit **Warren Resources (Nasdaq: WRES)** and **Chesapeake Energy (NYSE: CHK)**. I have added a few shares to each of these positions within my portfolio over the past month. Chesapeake also recently sold some non-core assets that represented about eight percent of overall production for over $5 billion. Proceeds will be used to substantially cut the company's leverage. I expect the debt of Chesapeake to garner numerous credit rating upgrades in the months ahead. This will lower interest costs on the remaining debt and should be a positive catalyst for the stock as well.

In other news, **Dynavax (Nasdaq: DVAX)** initiated a reverse 10 for 1 stock split. This has no impact to the company's market capitalization or its prospects which should still be driven by phase III trials of its hepatitis B vaccine whose results should be published by the second half of 2015.

Finally **AEGON N.V. (NYSE: AEG)** posted earnings that were light due to some actuarial assumption changes but the company showed strong revenue growth year-over-year which was encouraging. The stock still sells way under book value, will continue to benefit from weakening Euro and if sentiment improves on Europe in 2015 it could be a big winner in the year ahead

Investors Alley
November 2014 Vol. 1 Issue 5
The Turnaround Stock Report

Current Portfolio

Company	Entry Date	Entry Price	Recent Price	Buy Up To	Target Price	Returns	Russell 2000 Comp. Rtn.
Zogenix (ZGNX)	11/18/14	$1.24	$1.24	$1.75	$4.00	N/A	N/A
General Motors (GM)	11/18/14	$32.27	$32.27	$34.00	$47.50	N/A	N/A
Warren Resources (WRES)	10/15/14	$3.37	$2.99	$4.50	$7.00	-12.1%	10.2%
Dynavax Technologies (DVAX)*	10/15/14	$14.30	$14.67	$17.50	$30.00	2.6%	10.2%
Chesapeake Energy (CHK)	09/15/14	$25.05	$23.06	$27.00	$33.00	-7.9%	2.1%
AEGON N. V. (AEG)	08/14/14	$7.74	$7.80	$9.00	$15.00	0.8%	2.4%
Hercules Offshore (HERO)	07/18/14	$4.01	$1.51	$4.25	$6.00	-62.3%	1.6%
Emerald Oil (EOX)	07/18/14	$7.56	$2.65	$8.00	$12.00	-64.9%	1.6%

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: 11/18/14.

Returns data represents share price appreciation or depreciation between entry price and recent price.

Russell 2000 Comp. Rtn. represents the returns on the Russell 2000 Index from the point of entry of a stock listed above through the recent price and is meant to provide a comparison to the overall small cap stock market as comprises that index.

* 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.