Investors Alley

January 2015 Vol. 1 Issue 7

The Turnaround Stock Report

Volatility from All Different Directions

Fellow Investor,

Stocks have gotten off to a very rocky start in the New Year. Equities are now down some four percent from their recent highs. Volatility has increased markedly in the opening stanza of the year. The turmoil in the markets could continue for a while as the outlook for global growth remains tepid at best at the moment. Japan is going through a contraction, Europe continues to struggle to post any economic growth even as new Greek elections loom large on January 25th and no one trusts that China is actually growing at seven percent annually.

In This Issue

I have three main concerns for the market right now. First is turmoil in the currency markets as the dollar continues to strengthen against major currencies providing a headwind for domestic earnings growth and exposing the market to greater volatility. The big event last week that rocked the markets was the decision of the Swiss National Bank to uncap the Swiss currency against the Euro as the peg was getting too costly to maintain, especially in light of anticipated (and now announced) quantitative easing measures from the European Central Bank.

The Swiss Franc shot up more than 20% against the Euro as a result, cratering Switzerland's stock market and most likely triggering a recession in the country. The unexpected move also caused currency firm **FXCM Inc. (NASDAQ: FXCM)** to collapse before receiving a last minute cash infusion. Everest, a large hedge fund here in Miami, had its main fund implode as it got caught on the wrong side of the huge appreciation of the Swiss Franc against the Euro.

The market should expect more volatility in the months ahead due to currency moves as various central banks try desperately to avoid deflation and having their economies sink into recession again. I also worry about the ramifications of the steep and sharp plunge in oil prices.

The huge decline of oil is rattling the oil export dependent economies of Russia, Iran, and Venezuela as well as allies Canada and Norway. Capital expenditures are being slashed deeply across the oil and gas sector removing over $100 billion in new investment during 2015. Layoffs are occurring and accelerating across the high paying energy sector.

Valuations are above their historical norms at just under 18 times trailing earnings. The market feels slightly overvalued at these levels given the tepid global growth outlook to begin the New Year. That being said, we continue to find some undervalued gems in some unloved sectors and underappreciated transformation stories. This month we bring into the portfolio an engineering and construction stock that has been cut in half in an overreaction to the slowdown in investment in the energy sector as well as an "off the radar" pick in retailing that has recently transformed its business model.

On a final note, I'll be giving a presentation called "**Building an Optimized Biotech Portfolio for Outsized Returns with Minimal Risk**" where I'll discuss how to add biotech exposure to your portfolio while minimizing the inherent risk with that sector. The presentation is on Thursday, February 5th, at the World MoneyShow in Orlando, Florida. If you live nearby or plan to be in the area please feel free to come by and attend. There's more information on our website, just click here.

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

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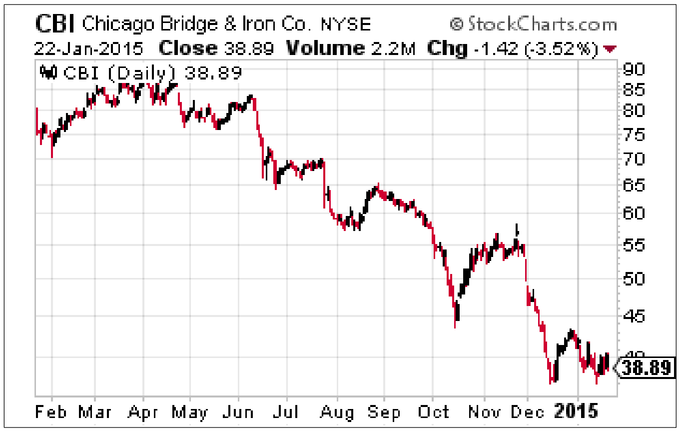
Chicago Bridge & Iron: Our Second Play on a Massive Backlog

Last month we highlighted a railcar manufacturer, **Greenbrier Companies (NYSE: GBX),** whose stock was being unfairly punished due to the recent sharp and steep fall in crude oil prices. We noted that demand for oil tank cars was likely to continue to increase due to upcoming safety regulations and those cars made up only 30% of its new order backlog recently anyhow.

Since being selected for The Turnaround Stock Report portfolio the shares have gained about 10% as the company reported solid results, gave encouraging forward guidance and saw its impressive order backlog continue to expand.

This month we are continuing that theme by highlighting another industrial concern that has been taken out to the woodshed on the basis of falling energy prices and in an overreaction to what they mean to the company's long term prospects and growth. The company is **Chicago Bridge & Iron (NYSE: CBI)** which has been cut in half to $40 a share from its recent highs of over $80 a share just last summer.



What has brought the stock down over past six months are two major concerns. The first is that the dramatic drop in oil will freeze most new large investments in the energy infrastructure space, of which Chicago Bridge & Iron is major player building LNG (Liquefied Natural Gas) plants, gasification facilities, refinery expansions and other major engineering orders within the energy industry.

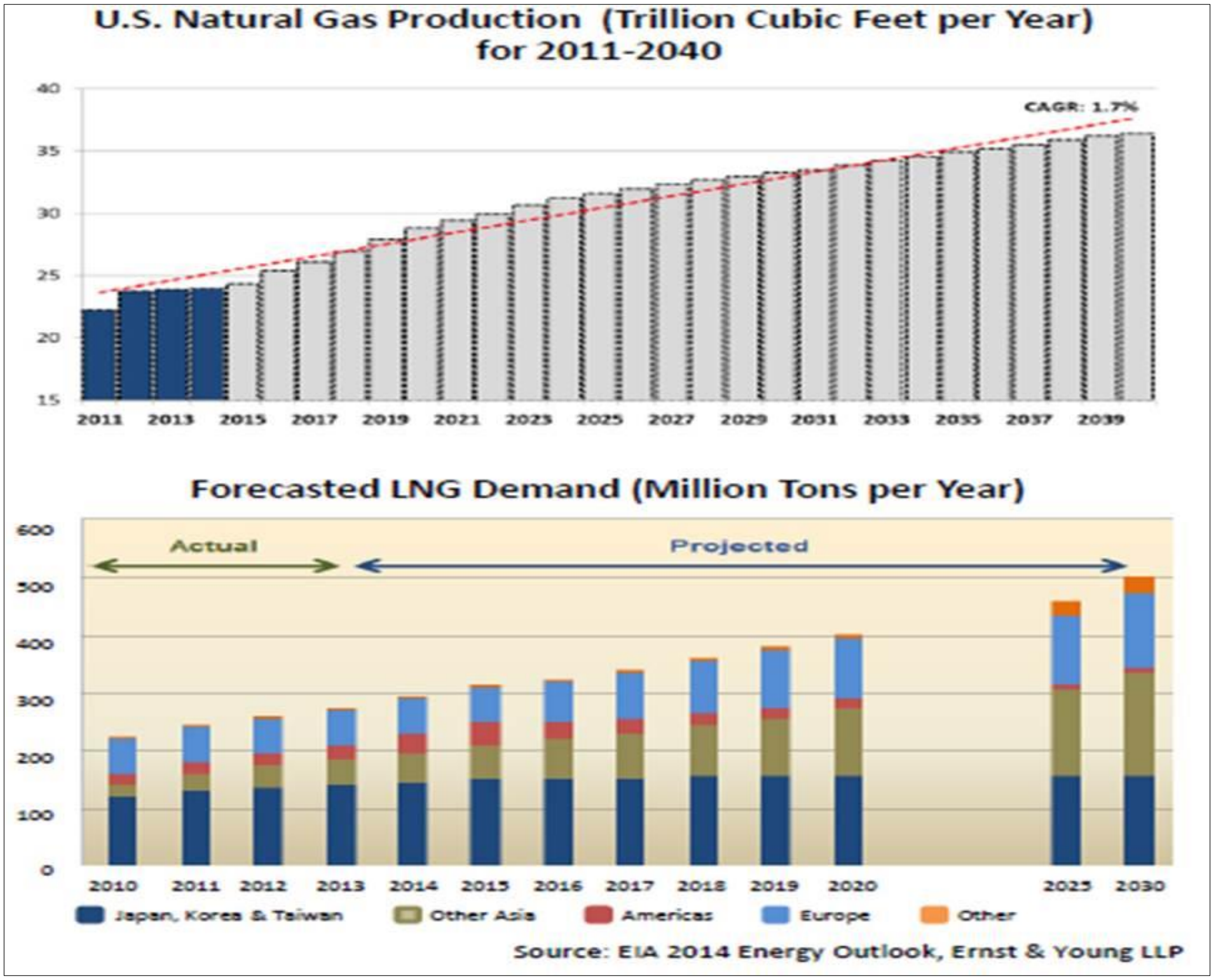
The second major concern is cost overruns at some nuclear plant construction projects when the company bought out Shaw Group two years ago as well as some of the purchase accounting measures it used within that acquisition. Let's take a deeper look at both of these issues.

Demand:

Yes, the recent drop in energy prices is going to be felt by those firms whose demand comes from the energy sector. Exploration & Production companies have already slashed their capital budgets significantly for 2015. However, larger players have cut their production budgets less than the small producers whose very survival is questionable if oil stays at these levels over the long term. These larger players comprise a greater percentage of Chicago Bridge & Iron's work orders given the size of the projects it usually takes on.

In addition, most of the pain felt by these declining capital budgets will be felt by more mainstream energy services plays like Halliburton (NYSE: HAL) as producers slash the number of new wells they plan to drill in the New Year. Longer lead time projects around energy infrastructure that have already started will continue to move forward.

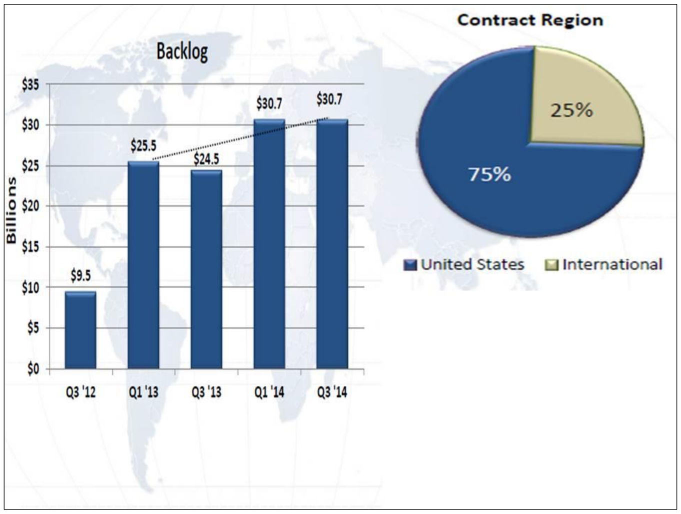
Low natural gas prices in the United States will continue to drive the infrastructure needed to created and export LNG to regions in the world where natural gas prices are much, much higher such as Europe and Asia. The predicted growth of natural gas production in the United States and the expansion of LNG demand over the next couple of decades should provide the company a solid tailwind for years and years to come.



Chemical companies like BASF will also continue to build multi-billion dollar plants along the Gulf Coast of the United States to take advantage of low energy prices which make up a huge part of the costs of producing chemicals needed by industry. Since CBI is a major player in this kind of construction it should continue to win contract awards in these spaces.

As it is the company has a massive order backlog of north of $30 billion currently. The company already has recorded $13 billion in new orders just through Q3 – a record for full year performance. The current backlog represents more than two years of revenues at current annual run rates.

As the chart at right demonstrates, the acquisition of Shaw Group and organic growth over the past 18-24 months have left Chicago Bridge & Iron's backlog at all-time high levels despite concerns a slowdown in capital spending in the energy patch. In addition, three fourths of the company's current order backlog is in the United States making earnings less susceptible to currency swings which have been a major source of turmoil recently in the market.



Overhang from Shaw acquisition:

One of the stranger causes of the stock's recent decline were allegations of some funny purchase accounting methods used to account for the acquisition of Shaw Group. These came from an obscure quasi – research firm with an iffy long term record in these matters at best. However these allegations did coincide with the beginning of the shares' decline – as did the drop in oil prices.

The company has refuted these missives and they have not shown up in subsequent quarterly reports either and I personally think they should be dismissed at this point. More importantly, Chicago Bridge & Iron inherited a couple of nuclear plant build outs when it bought Shaw. These have some unresolved cost overruns that have acted as a relevant headwind to the company and the stock.

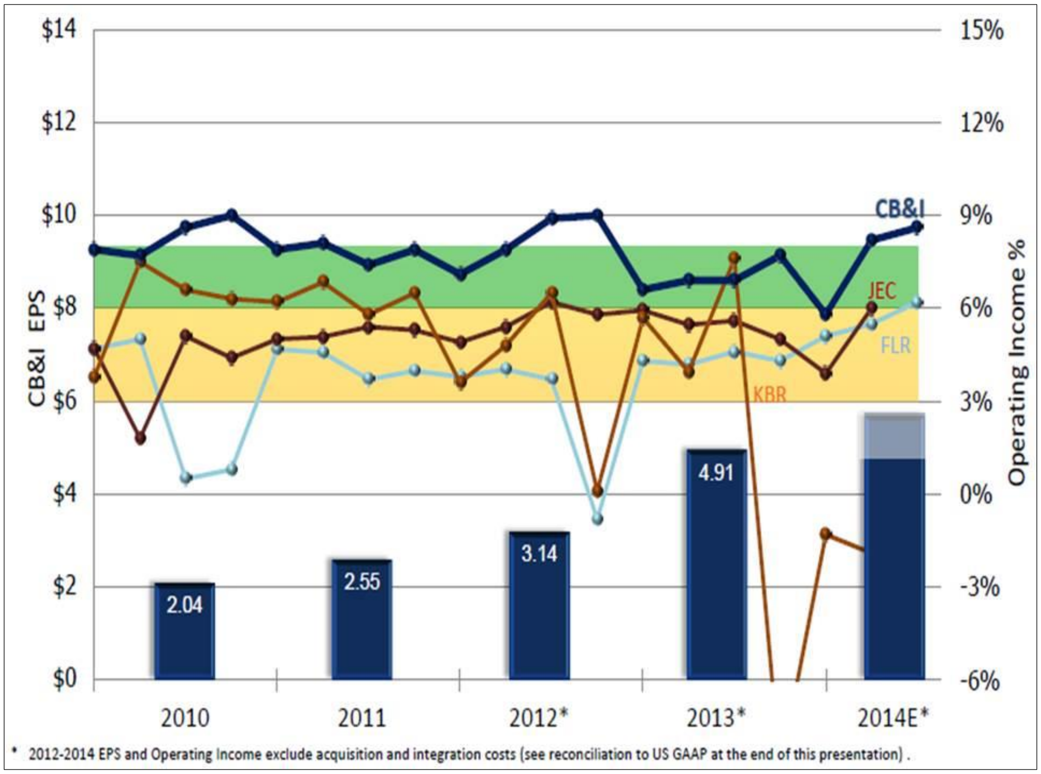
I expect this issue to be resolved sometime in 2015 removing an overhang from the stock. Cash liability is currently reserved at $500 million. It is important to remember that Toshiba through its Westinghouse subsidiary is responsible for the design and delivery of the plants in question. CBI is just the fabricator and constructor of the facilities. The current argument is who should pay for design changes after construction commenced. I think all parties should reach some sort of accommodation in the near future and CBI has already reserved against any likely losses.

Valuation:

During its recent investor day in early November the company provided solid guidance. For FY2014, which will end when the company reports Q4 earnings towards the end of February, revenues are expected to be in the range of $12.6 billion to $13.2 billion. Earnings per share are expected to land in the $4.80 to $5.65 range for the entire fiscal year. Revenues for FY2015 are projected to be in the $14.8 billion to $15.2 billion range with earnings per share of $5.75 to $6.05. Another nice year for revenue and earnings growth seems to be in store.

Taking the low end of the earnings range provided for FY2015 (which is right where the consensus earnings of $5.70 a share currently are as well), and Chicago Bridge & Iron trades at approximately seven times forward earnings. This is a deep discount to the overall market multiple that currently stands at around 16 times forward earnings.

Competitors **Flour (NYSE: FLR)** and **Jacobs Engineering Group (NYSE: JEC)** go for 11.5 and 10.3 times forward earnings, respectively. As can be seen from the chart below, Chicago Bridge & Iron has produced better operating margins recently than either of these companies.



Outlook:

Now that tax loss selling for 2014 is over, I expect Chicago Bridge & Iron to have a much brighter year for its shareholders in 2015. Although the company is more tied to the expansion of natural gas as a fuel source than the price of oil in the projects it builds a bottom in the oil price would greatly improve sentiment on the stock as well as on those of its competitors. That may take some time to establish but it would not be surprising if looking back at the end of the year that this takes place some of the first quarter of this year.

I also expect the company to put to bed the issues surrounding its acquisition of Shaw Group that made it a major player in the energy infrastructure space sometime in the New Year as well. At the very least this should allow the stock to trade in line with the low expectations around its peers at this point in time.

This gives me a price target of just over $60 a share on tepid valuation expectations. This is more than 50% above the stock's current price and would represent a retracement of half of the shares recent decline. This is also right in line with the $60.50 a share median price target the 14 analysts that cover the company have on the stock. When the shares near these levels, we will reevaluate the current status of the company's prospects to determine whether to raise our price target or take profits.

Recommendation: Buy CBI up to $45 a share and hold to at least $60 a share.

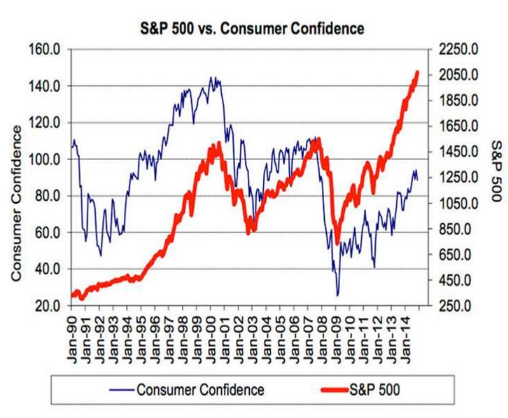
Position: Long CBI

Sequential Brands: Major Catalysts Should Power Unique Retailer Higher

For the past month or two I have been looking for a retailing play to add to The Turnaround Stock Report portfolio. With gasoline prices plunging, the consumer should have significant more income to put toward consumer discretionary plays like retailers. This new found bounty has not found its way so far to boosting retail sales but this should happen once consumers get comfortable with the fact that lower gasoline prices are here to stay for a while.

In addition, falling gasoline prices are a key driver behind consumer confidence being at ten year highs. Although I am sanguine on the market as a whole, rising consumer confidence historically has been correlated to strong gains in the market.

S&P 500 vs. Consumer Confidence



**Source: Marketwatch*

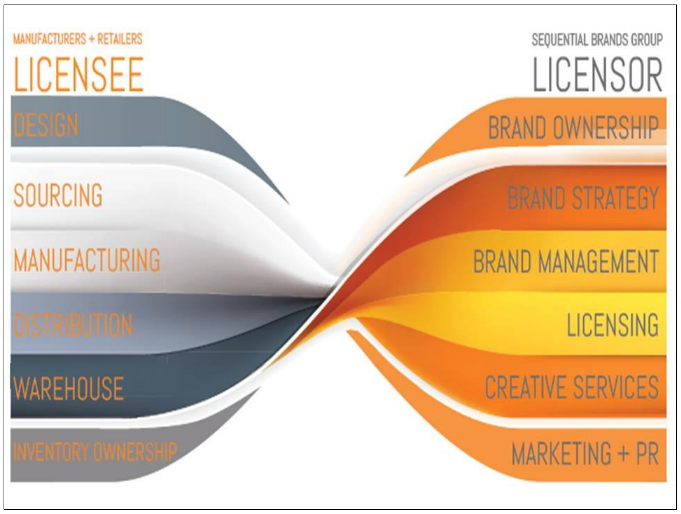
The trick is finding a retailing play that has not already had a huge boost in the market already and is still undervalued. I believe I have finally found one that has a unique and transformational business model that should bode well for many years of outperformance in the market. The name of this niche retailing play is called **Sequential Brands Group (NASDAQ: SQBG)**.

Company Overview:

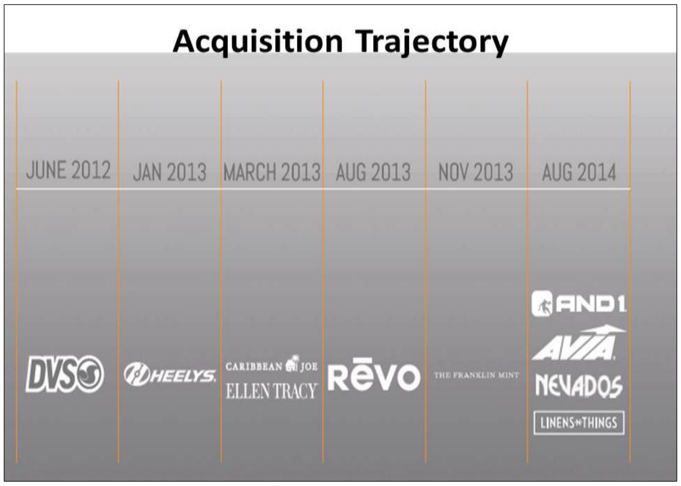
Sequential Brands Group is a brand manager that owns the rights to a dozen niche global brands with some $2 billion in worldwide revenue. Most of these brands have been acquired over the past two years. Their goal is to expand this portfolio and license a large-scale and diversified portfolio of consumer brands across multiple industries.

Sequential is fairly unique in the industry as it is purely a brand manager that gains by purchasing brands and revitalizing their sales. Manufacturers and retailers buy up the rights to produce the goods under these brands and guarantee a minimum level of royalties. This mitigates risk for Sequential dramatically.

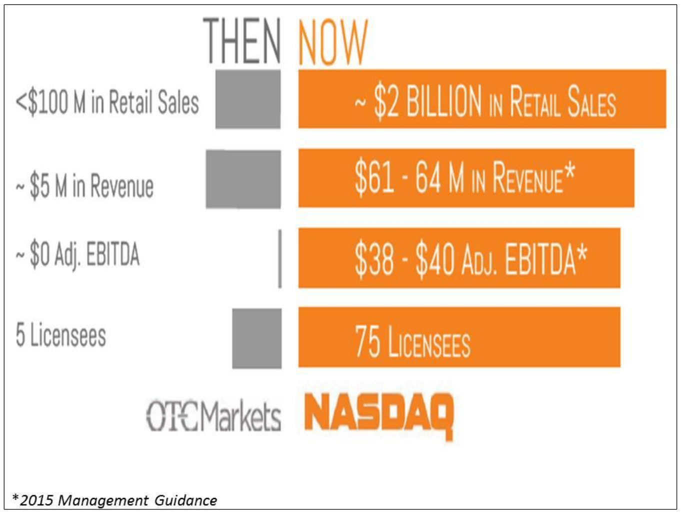
In its licensing arrangements, Sequential's partners are responsible for designing, manufacturing and distributing the company's licensed products, which means Sequential can essentially focus only on brand image and marketing aspects. Sequential's "asset-light" model has a variety of benefits. They do not have to manage inventory, invest in working capital, deal with manufacturing or logistics, and this is a very high margin business with high returns on capital. They manage a fairly substantial global portfolio with fewer than 50 overall employees.



As can be seen from the graphic below the company has acquired a variety of global niche brands which will power its growth in coming years. Sequential concentrates on improving the image of the brands it acquires. The company also adds value and boosts sales growth by adding e-commerce channels to established brands, opening distribution in new countries, as well making logical brand extensions that can increase sales in tertiary categories.



Since Sequential decided to fully commit to this business model in 2012 and move from the OTC markets to the NASDAQ the results have been dramatic and the company is in the early innings of its growth trajectory.



Positive Catalysts Mounting:

Sequential made a potentially game-changing transaction in June 2014 by acquiring Galaxy Brand Holdings from Carlyle and Blackstone for $100 million in cash, 13.75 million shares of its common stock and some additional warrants. This transaction positioned Sequential as one of the largest pure-play brand licensing companies in the world. It also gave it a couple of strategic partners in two of the largest private equity firms in the world.

This could be a critical partnership going forward. Carlyle and Blackstone have good insight to major retailers looking to spin off underperforming or no longer strategic brands. Both firms now have a vested interest through its share holdings of seeing Sequential succeed given its stake in the company and could be an important source of financing for accretive deals in the future.

There have been recent reports about Sequential being interested in a potential buyout of Perry Ellis. Perry Ellis has a portfolio of dozens of men's fashion brands, including Callaway Golf, Original Penguin, and Jantzen, which can nicely integrate into SQBG's growing brand portfolio.

The company announced this week that it has entered into a long-term partnership with leading entertainment and lifestyle retailer HSN to present a selection of the best branded collectible and memorabilia products that The Franklin Mint will be offering to consumers. This deal should boost sales in one of Sequential's core brands significantly.

The company's progress, accretive brand acquisitions, and impressive sales growth are getting some favorable mentions by analysts. Canaccord Genuity reiterated its "Buy" rating once month ago. The analyst firm has a whopping $20 a share price target on the brand manager noting "SQBG's resilient brand management model plays exceptionally well to this need as its licensing partnerships can serve to distinguish a retailer from the competition while creating a consistent and predictable revenue stream." It also sees Sequential "likely exceeding its 2016 goal of $100M in royalty revenue and $70M in EBITDA. SQBG is our top small cap pick in the retailing space."

Brean Capital reiterated their "Buy" rating on Sequential and has a $17 a share price target on the stock. Brean's analyst noted about the firm's view on Sequential "We continue to believe the licensing model is a compelling business model given that it is asset light, has guaranteed minimum revenue, is scalable and works across various consumer segments."

Valuation:

The company has gone from just over $5 million in revenues in FY2012 to what is likely to be over $40 million in revenues in FY2014. Analysts have a consensus estimate of over $60 million in FY2015 not counting any additional potential acquisitions in 2015. Given the company's asset light model, private equity partners and amount of potential targets I believe further purchases are in the cards this year. The company's own guidance is for $100 million in revenues in FY2016.

The company also guided to $70 million in EBITDA by FY2016 which analysts have stated recently is not only achievable but probably conservative. The company has less than a $500 million market capitalization which gives it a valuation of around seven times the EBITDA it expects to achieve in FY2016.

Bigger brand manager competitor **Iconix (NASDAQ: ICON)** sells at just under 11 times EBITDA even though it is growing sales at a much slower pace. Sequential's CEO was the COO of Iconix at the tender age of 29 and is very well respected in the industry. The company has a strong management team that has a strong understanding of retail market trends and positions and manages its brand portfolio accordingly.

Summary:

Sequential has been on a roll recently and is up some 15% since I made my initial purchase last week. The shares now go for $11.50 a share with a 52 week high of just over $14 a share. The shares are undervalued based on EBITDA compared to its primary competitors and have a long visible growth ramp. With low gas prices bolstering the global consumer, it seems like a good time to pick up this niche retailing play with a unique and highly profitable business model. Given the run up in the shares in the last week, I would accumulate a stake incrementally as the stock could temporarily give up some of its recent gains especially in light of increased market volatility so far in 2015.

Recommendation: Buy SQBQ up to $12 a share, hold until median price target of $17 a share that analysts currently hold on the stock. We will reassess when shares hit price target.

Position: Long SQBG

Portfolio Update

As noted at the beginning of this month's issue, it has been a volatile time in the markets since our last update. Despite this, some of the recent additions to The Turnaround Stock Report have performed quite well over the past month.

Industrial concerns that were added in the past couple of months, those being **General Motors (NYSE: GM)** and **Greenbrier Companies (NYSE: GBX)**, and both have performed well for the portfolio. Automakers are being buoyed by falling gas prices which have boosted the sales mix going to higher margin trucks and SUVs in the past few months which in turn bodes well for earnings. Greenbrier delivered a stellar quarterly earnings report since our last update which included robust forward guidance and an ever expanding order backlog. Both stocks have further capital appreciation ahead of them even in this tepid global growth environment.

Biotech play **DynaVax Technologies (NASDAQ: DVAX)** had a nice month. Jefferies reiterated a "Buy" rating and their price target of $30 a share on this small biotech concern. The company also initiated a Phase II trial for a treatment for asthma with pharma giant **AstraZeneca (NYSE: AZN)** that could net DynaVax $100 million in milestone payments as well as a royalty stream if all goes well. **Zogenix (NASDAQ: ZGNX)** put in a nice performance over the past thirty days albeit on little news flow.

Halozyme Therapeutics (NYSE: HALO) is by far the biggest star in the portfolio this month as the shares have soared some 75% since our last update. The company needed a game changing licensing agreement with the biotech unit of **Johnson & Johnson (NYSE: JNJ).** PEGPH20 received Orphan Drug designation in Europe and MLV & Company also raised its price target on Halozyme earlier this month. The biotech even got a shout out from Jim Cramer who had the company's CEO on Mad Money in January.

Our energy picks continue to be challenged, to put it mildly, by the continuing plunge in crude. Oil prices had their first up week in two months last week so hopefully a bottom is starting to form in the energy complex. **Chesapeake Energy (NYSE: CHK)** did okay despite the fall in oil over the past month and it is increasingly being viewed as a survivor in the sector even at $50 oil.

Current Portfolio

Company	Entry Date	Entry Price	Recent Price	Buy Up To	Target Price	Returns
Sequential Brands (SQBG)	01/21/14	$11.09	$11.09	$12.00	$17.00	N/A
Chicago Bridge & Iron (CBI)	01/21/14	$40.31	$40.31	$45.00	$60.00	N/A
Greenbrier Cos. (GBX)	12/17/14	$46.51	$51.68	$50.00	$80.00	11.1%
Halozyme Thera. (HALO)	12/17/14	$8.65	$14.04	$10.00	$18.00	62.3%
Zogenix (ZGNX)	11/18/14	$1.24	$1.33	$1.75	$4.00	7.3%
General Motors (GM)	11/18/14	$32.27	$33.89	$34.00	$47.50	5.0%
Warren Resources (WRES)	10/15/14	$3.37	$1.27	$4.50	$7.00	-62.6%
Dynavax Technologies (DVAX)*	10/15/14	$14.30	$18.03	$17.50	$30.00	26.1%
Chesapeake Energy (CHK)	09/15/14	$25.05	$19.87	$27.00	$33.00	-20.7%
AEGON N. V. (AEG)	08/14/14	$7.74	$7.18	$9.00	$15.00	-7.2%
Hercules Offshore (HERO)	07/18/14	$4.01	$0.85	$4.25	$6.00	-78.8%
Emerald Oil (EOX)	07/18/14	$7.56	$0.81	$8.00	$12.00	-89.3%

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: 01/21/15. 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.