Investors Alley

April 2015 Vol. 1 Issue 10

The Turnaround Stock Report

Our Turnaround Stocks Faring Well Despite the Volatile Market

In This Issue

Fellow Investor,

The markets are pretty much where they were a month ago after Friday's big drop and renewed concerned around Greece exiting the European Union as well as some unexpected regulatory changes around the Chinese stock markets.

Oil has staged a nice rebound from six year lows recently but I am skeptical whether crude can rally further in the near term due to the continuing strengthening dollar, a supply glut, and no indications Saudi Arabia is done flooding the market with product to discipline marginal producers and maintain its position as the market's swing producer. The recent rise in oil prices was kind to couple of stocks in our portfolio that were being unfairly punished by the steep drop in crude since last summer.

However, I don't think anyone has a good handle on where crude will be six months from now. Black Gold has more two percent or better moves in 2015 so far than it did annually in 2012, 2013, 2014. I think this volatility will go on for at least a few more months. By yearend 2015, crude could just as easily be at $80 a barrel as it could be $30 a barrel although I think a range of $40 to $60 on the West Texas Intermediate benchmark is probably more likely for the time being.

I think Friday's downward action was triggered partly by the acknowledgement that quarterly results are showing very tepid earnings and revenue growth. S&P 500 profits are projected to be down year-over-year this quarter and early reports seem to confirm that. This "profit recession" should continue into the second quarter; the first time this has happened since the dark days of 2009. The markets seem increasingly vulnerable here to at least a decent pullback given equities trade north of 18 times trailing earnings; above historical norms.

I would not be surprised to see at least a three to five percent pullback before summer is out. I am actually looking forward to getting some lower entry points in the months ahead and am comfortable with our current portfolio as sentiment on most of the stocks contain within is already bearish, otherwise they would not be "turnaround" stocks. Recent performance even in what has been a flat if volatile market is also encouraging.

The next month or two is going to be critical for the market's direction at least through summer. After projections of over three percent GDP growth to start 2015, first quarter GDP growth is now expected to come in right around a paltry one percent. Whether the economy can reaccelerate quickly in the second quarter as winter fades, Europe can move Greece to the back burner one more time and whether investors will stick with equities on hopes earnings growth will return in the second half of the year; will all be questions that will need to be answered before markets can again resume their march higher in any meaningful way.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. Along with my colleague Tim Plaehn, our dividend and income expert, I'll be at our booth when I'm not presenting. It's #417. You can stop by to talk about the portfolio, the markets, or investing strategies in a relaxed setting.. 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.**

HDS: Poor Start, Outstanding Growth

This month's first portfolio addition is a company that has gone from an ill-timed spinoff from a retailing juggernaut to developing a compelling story of its own. The company is just starting to get real traction and has years of solid growth ahead of it.

The company and stock in question is **HD Supply Holding, Inc. (NYSE:HDS)**. The firm provides a range of products and value-add services to nearly 500,000 customers across North America. The firm possesses leadership positions in Maintenance, Repair and Operations (MRO), Infrastructure and Power, and in Specialty Construction.

Originally a business unit of Home Depot, the private equity firms Bain Capital, The Carlyle Group, and Clayton, Dubilier & Rice purchased HD Supply in 2007. The timing of the purchase could hardly have been more ill-timed coming just a year before the financial crisis especially for a company that was loaded with debt. However, the company managed to survive and has been whittling away at its debt load and improving operations for several years.

The company was on solid enough footing to again come public in 2013, in which a majority of the just over 53 million shares of common stock issued were purchased by those same private equity firms. After three separate secondary offerings, private equity ownership represents 13% of the overall float, down from 56% at the beginning of 2014.

The sectors the company operates in have a high degree of customer and supplier fragmentation, so customers typically require service and availability of a broad set of complex products from a range of suppliers. As the distributor, HD Supply holds a vital position in this value chain, and so far that's allowed it grow organically across the U.S. In addition, because of the fragmentation of the industry in which the company operates it is positioned to boost growth through strategic acquisitions, gaining market share as well as organic growth. It is just this type of strategy that has led its previous parent to be one of the most successful retailing stories of the last quarter century.

Let's jump into the individual divisions the company operates to provide a better idea of exactly how they conduct business.

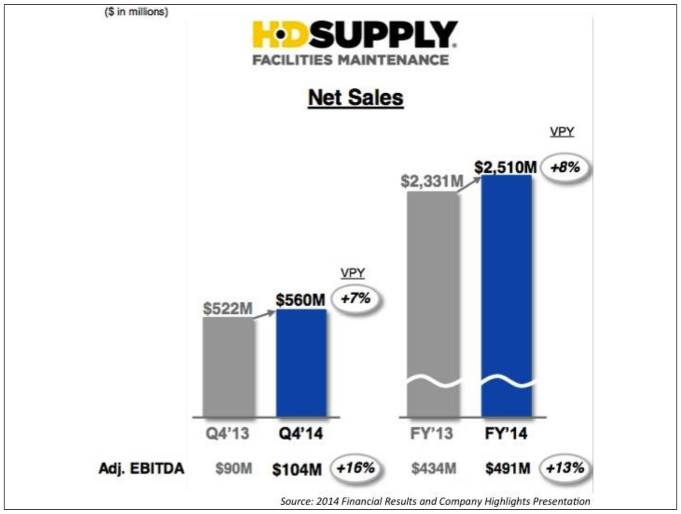
Maintenance, Repair and Operations:

Under its MRO division, HD Supply provides facilities maintenance and home improvement solutions. The firm's facilities maintenance segment is a major profit driver, supplying MRO products to owners and managers of multifamily, hospitality, educational and commercial properties; healthcare providers; and municipal government buildings.

Comprising about 60% of the firm's EBITDA, revenue from facilities maintenance increased approximately eight percent year over year from 2013. HD Supply estimates that its facilities maintenance division grew five percent in excess of the overall market. While the firm estimated that other divisions had also grown in excess of the market, I think it is particularly promising that the operations of the company's major source of revenue are improving. (See chart at top of next page.)

Infrastructure and Power:

Under the infrastructure and power market sector, HD Supply operates two primary business units: waterworks and power solutions. These provide critical supplies and services used to build and maintain water systems and electrical power generation and distribution infrastructure.



HD Supply's waterworks is the nation's largest distributor of water, sewer, storm and fire protection products. It not only serves the needs of contractors in commercial and residential construction, but also delivers products that are crucial to the basic infrastructure of municipalities. Waterworks grew its revenues by 10% in the fourth quarter compared to the previous year, and by nine percent for all of 2014.

Ranging from product sales of transformers and fuses to services like tool application and repair, the power solutions sector generated almost $2 billion in revenue during 2014. This division serves public power, investor owned utilities, and the construction and industrial markets.

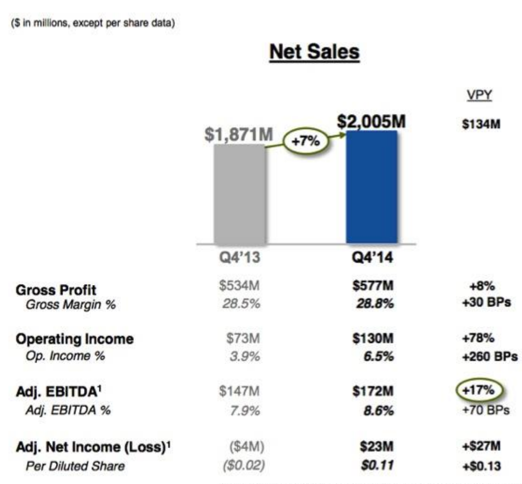
Specialty Construction:

HD Supply's specialty construction sector is composed of the construction and industrial division (C&I), as well as the interior solutions business. Both divisions are number one in their respective industry markets across the U.S. and operate in over 30 states. C&I has experienced promising revenue growth of 15% during 2014, boosting revenues to $1.5 billion.

I expect any uptick in commercial or residential construction across the U.S. to spur even more growth. Now that unemployment levels have fallen below six percent and more Americans are back to work, I am optimistic that construction will pick up. The following chart does a good job of breaking down the end markets of the main business unit and their expected 2015 growth.

Overall Financial Performance:

HD Supply generated $23 million in net income for the fourth quarter versus a loss of $4 million last year, and delivered 8% annual sales growth. Adjusted net income per diluted share improved from about $0.80 to just over $1.25 in 2014. Despite experiencing the early portion of a harsh winter in a good portion of North America during the fourth quarter, the firm performed well.



HD Supply managed to deliver sales growth in excess of its market estimate by about 4% in 2014. That growth was spread across its different business units and not tied strictly to one particular division. For the first quarter of 2015, the firm is expecting sales growth between four and seven percent. Sales for February, the first of month of HD Supply's fiscal year, grew by seven percent despite persistent winter weather. As the northeast region's economy continues to thaw out and rebound from the slew of heavy winter storms it experienced this year, construction will hopefully rebound along with it.

Management Goals and Debt Reduction:

Management at HD Supply focuses primarily on organic growth and internal cash redeployment. The firm has identified strategies it will execute to continue the impressive growth experienced over the past year, which include introducing new products and services; expanding channels to reach its customers via catalogue, internet, and mobile devices; and acquiring new customers and opening new locations. The company reduced its net debt to EBITDA ratio from just over seven times at the start of 2014 to about six times, and is hoping to bring that down to about three times over the long term.

I have been impressed with management and its ability to wisely utilize free cash flow of close to $180 million in 2014 to reduce long-term debt. The company also executed term loan repricing to save about $5 million dollars in annualized cost. In December 2014, they refinanced just over $1 billion dollars of secured first-lien notes, saving the firm $36 million per year in interest costs.

Secured and unsecured second-lien notes become callable in 2016, so HD Supply has quite a bit of flexibility to manage its capital structure and should continue reducing interest expenses in the future. The company also has net operating loss carryforwards of just over $2 billion dollars, which it expects will help significantly reduce future cash tax payments and boost earnings. Coupled with the firm's solid growth in sales, I see a promising upward trend in earnings going forward.

A Well-Rounded Long Term Play:

Given its diversified set of business units, steady growth in sales and anticipated reduction in debt costs as well as taxes, I think HD Supply is a solid investment. Although the firm operates many different divisions, there is a significant amount of overlap in the needs of the customers it serves. This should allow the firm to consolidate its business and cross-sell even more products and services nationwide while developing stronger ties with customers.

Currently trading around $32.00 per share, the stock of HD Supply has done well over the past year. I like the company's prospects even with what has been approximate two percent annual GDP growth since the recession ended in 2009 with housing starts down some 500,000 units a year under the average of the past several decades. If the domestic economy could accelerate back to a more normal housing market and GDP growth of three percent growth earnings could significantly accelerate.

Earnings growth is hardly shabby at it is. The company had profits of $1.26 a share in the just concluded fiscal year. Consensus has it earning $1.80 to $2.00 a share this fiscal year and $2.40 to $2.60 a share next year. Given its revenue and earnings growth, the stock should at least be trading in line with overall market multiple which currently stands at just over 16 times forward earnings. Based on the mid-point of the current earnings range for next year that would be approximately $40.00 a share, a level I believe the stock can achieve over the next 12-18 months if not sooner.

Longer term as the HD Supply continues to de-lever, I expect some of its increasing cash flow to be allocated to initiating a dividend as well as to stock buybacks. I view this as a good long term play, and as long as the company continues to execute and its valuations do not get too excessive it should remain in the Turnaround Stock Report portfolio.

Recommendation: Buy HDS up to $34.00 a share

Position: Long HDS

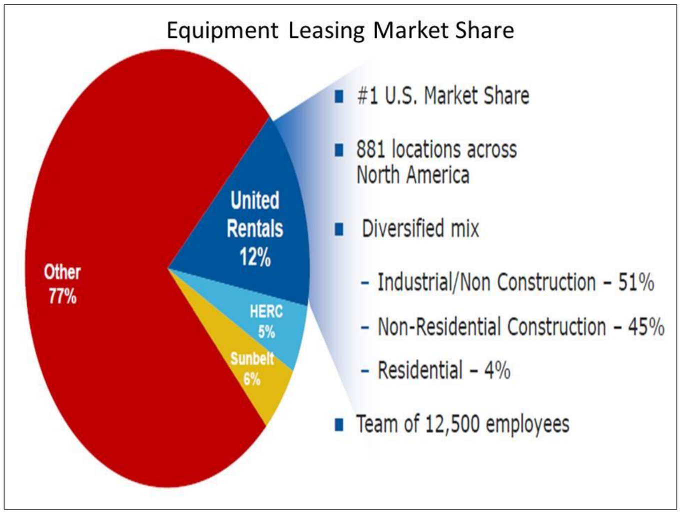
URI: Buying on the Recent Dip

Our second addition for this month has a common feature with our first pick of **HD Supply (NYSE: HDS)** in that it is a growing market leader in a very fragmented industry. It should therefore benefit from both organic growth within the sector as well as market share gains. In addition, it shares a trait with several other equities within our portfolio like **Greenbrier Companies (NYSE: GBX)** in that its stock has been unfairly beaten up due to the recent plunge in oil prices.

The name of the company is **United Rentals (NYSE: URI)** and the stock has a solid and compelling long term investment case.

Company Overview:

United Rentals, Inc. is an equipment rental company. It operates in two segments: General Rentals; and Trench Safety, Power and HVAC (heating, ventilating and air conditioning), and Pump Solutions. The company offers approximately 3,300 classes of equipment for rent to construction and industrial companies, manufacturers, utilities, municipalities, homeowners, government entities, and other customers. Its fleet of rental equipment includes general construction and industrial equipment, such as backhoes, skid-steer loaders, forklifts, earthmoving equipment, and material handling equipment, aerial work platforms consisting of boom lifts and scissor lifts, and general tools. The company has just under 900 facilities/stores in North America.

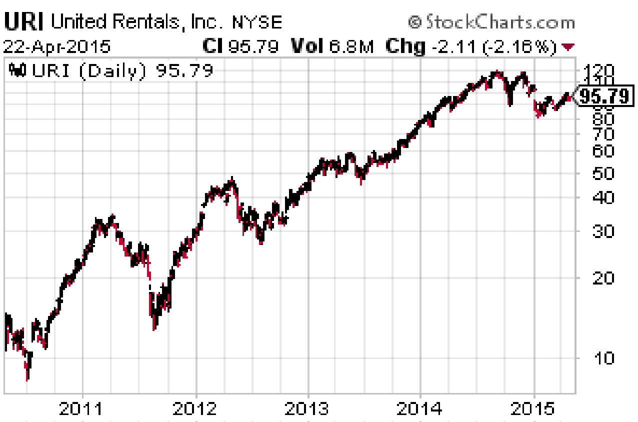


Just over 50% of the equipment owned by United Rentals is utilized for industrial purposed outside commercial or residential construction. Most of the rest is utilized for construction activity. The company is by far the largest equipment rental player within the industry but still has just 12% of the overall market share. The top three players in the segment control less than one quarter of overall sales. The company should benefit from both the just over eight percent annual growth the equipment rental market is expected to experience over 2014-2018 as well as buying out smaller competitors. In the last five years, the company has spent just over 10% of its capital budget on share buybacks, just over 30% on small acquisitions and the rest on capital equipment.

Recent History:

Like most of the equipment rental companies; United Rentals had a near death experience during the financial crisis as demand for any sort of construction and most industrial activity shriveled up. The company

survived, implemented numerous operational improvements and delivered its balance sheet. Both United Rentals and its stock have thrived since the recession ended in June 2009. The shares have outperformed 99% of the equities within the market. The shares have pulled back some $20 a share due to the plunge in crude prices and a first quarter GDP slowdown.



This provides a good entry point for this turnaround story I wish I had actioned in 2009 or 2010 but still offers plenty of capital appreciation potential as it continues to grow its market share lead in an industry that has good growth opportunities. The oil and gas industry comprises only six percent of the company's overall demand, and most of that will remain intact as it is concentrated in the mid and downstream parts of the energy complex. Second quarter GDP should also accelerate as winter turns to spring and some pent up demand gets released.

Operational Improvements:

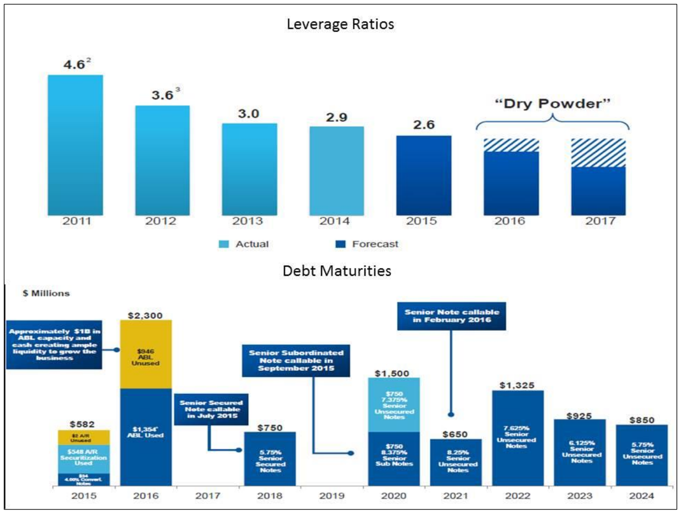
The company has initiated several key operational initiatives over the past year or so that should continue to boost earnings and margins down the road. United Rentals is about 30% toward identifying and taking an annual $100 million out of its operating expenses via cost reduction and productivity raising initiatives. The company is also moving strongly into specialty rentals like trench safety, power generation and pump solutions. These areas have higher margins and also provide much greater free cash flow over the life of the equipment asset. Specialty rentals now make up just under 20% of overall revenues and are growing faster than the overall product mix.

The company has also implemented what it calls "Total Solution" where it actually manages its equipment in the field for customers even keeping a field mechanic on hand for bigger projects. It even shares equipment across projects, utilizing scheduling software to improve utilization of the equipment. This means less downtime for customers as well as lower costs per hour, and higher margins for United Rentals as well. As of last quarter, revenue from this "Total Control" business grew over 40% year-over-year and now totals north of $200 million in sales a quarter.

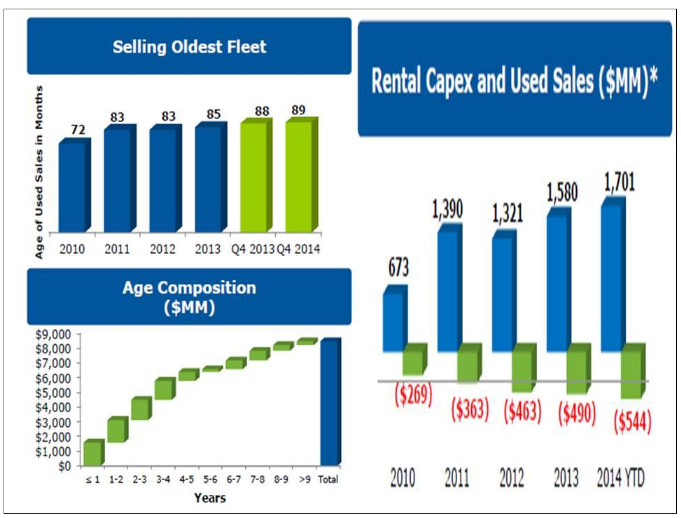
The company is also concentrating on growing the amount of sales that come from Key Accounts. These customers tend to more regional or national in nature, are stronger financially than mom & pop operators and present many more opportunities to cross-sell as well as cost synergies. Almost two thirds of United's accounts now fall into this category.

Balance Sheet:

The company has done a commendable job in reducing its leverage in recent years. Its balance sheet has staggered debt maturities and is well-managed as can be seen in chart below. The company has significant high interest rate debt coming due over the next several years which would be opportunity to refinance at lower interest rates if yields continue to stay at or near current levels.

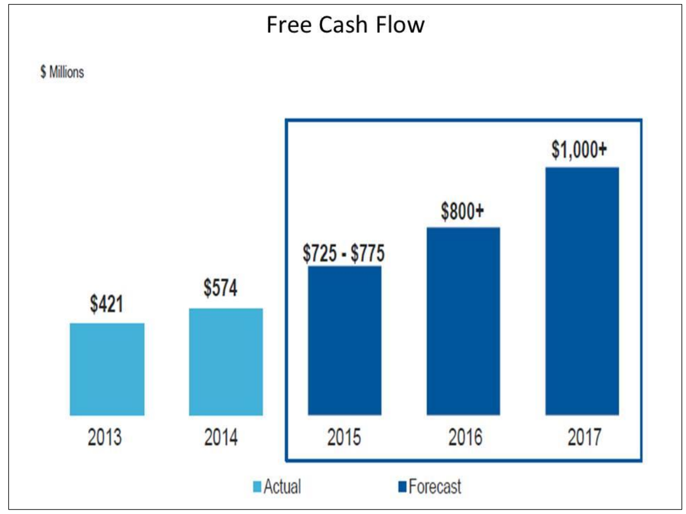


United Rentals does a good job of disposing of aged equipment at solid prices which not only reduces capital expenditure needs but also is resulting in a newer fleet over time.



Cash Flow Machine:

As can be seen from the chart below, United Rentals is becoming a free cash flow machine. At the midpoint of recent guidance, the company should throw off $750 million in free cash flow this fiscal year and $1 billion of free cash flow in FY2017. At the company's current market capitalization of just north of $9 billion, that is a free cash flow yield of 11% and impressive by any measure.



Opportunities for Growth:

As previous stated, the equipment rental business is expected to grow at approximately eight percent annually over the next few years. The company will add several percentage points of annual growth a year just by continuing to buy up smaller competitors. Foreign expansion is another opportunity that might be a new avenue of growth that is addressed at some point down the line as well.

What is impressive about United Rental's growth since the financial crisis is that it has happened despite a tepid commercial construction market which is slowly moving toward more normal levels. If commercial construction starts to trend higher, this would be a significant tailwind for United Rentals as would any kind of additional infrastructure spending bills coming from Congress; one of the few bipartisan efforts that can be imagined over the next two years.

Summary:

The company is experiencing revenue growth in the six to eight percent range annually on an organic basis. Earnings per share came in at just under $7.00 a share in FY2014 and the consensus has United earning just under $8.00 a share in FY2015 and over $9.00 a share in

FY2016. The stock sells for approximately $98.00 a share currently or twelve times next year's earnings. If the shares were priced at the overall market multiple, the shares would be 30% to 35% higher. Given the company's revenue and earnings growth as well as expanding free cash flow, that sort of capital appreciation should be in the cards over 12-18 months provided there is no recession is on the horizon, which seems doubtful at this time.

Recommendation: Buy URI up to $105.00 a share.

Position: Long URI

Portfolio Update

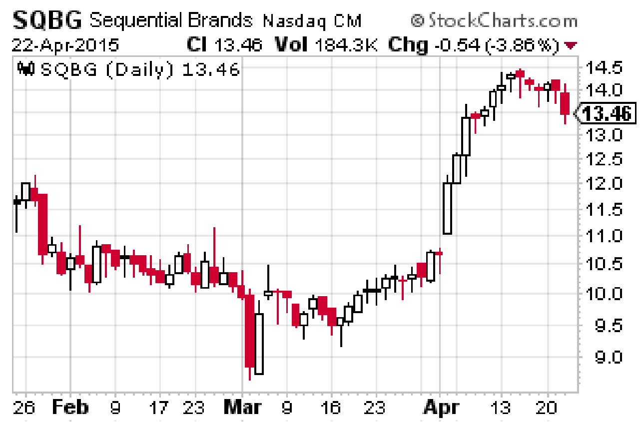
The Turnaround Stock Portfolio posted decent performance over the last month despite a flat and increasingly volatile market. A good portion of the equities in the portfolio stayed within a narrow range during the month. The big movers over the past few weeks have been on the upside which is encouraging.

Last month's selections of **Michael Kors (NASDAQ: KORS)** and **American Capital Realty Properties (NASDAQ: ARCP)** were down slightly but the investment thesis on both remains the same. Let's run down the rest of the movers within the portfolio this month.

Our star performer this month was **Sequential Brands Group (NASDAQ: SQBG)**. The stock is up some 35% since our last update. The retail play made an acquisition that made investors sit up and take notice buying a majority stake in the Jessica Simpson Brand.

The purchase included the Jessica Simpson Collection which is a growing lifestyle brand that offers more than two dozen product categories including footwear, apparel, fragrance, fashion accessories, maternity apparel, girls' clothing and a home line sold through department store chains.

Sequential made this purchase for approximately $250 million. This collection of business does some $1 billion in annual sales and Sequential believes the purchase will add approximately $80 million in royalty revenues and $50 million in adjusted EBITDA in FY2015 and will be immediately accretive to earnings. Over the past two weeks, four different analyst reiterated their "Buy" ratings. Their price targets on Sequential range from $16.00 to $20.00 a share.



We continue to get good performance from biotechs **Halozyme Therapeutics (NASDAQ: HALO)** and **Dynavax Technologies (NASDAQ: DVAX)**, as both continued their rallies over the past month. Subscribers who bought near the price the stocks were recommended at should be sitting on more than 50% gains and should have taken 10% off as profits implementing the culling strategy I have articulated numerous times in this newsletter service. **Zogenix (NASDAQ: ZGNX)** was up some 20% since our last update as investors got more comfortable with the price the company was able to get for selling off its Zohydro franchise.

Greenbrier Companies (NYSE: GBX) continues to reward its inclusion into the portfolio gaining almost another 15% during the month. Our two remaining energy sector investments, **Chesapeake Energy (NYSE: CHK)** and **Warren Resources (NASDAQ: WRES)** were both up 10% since our last update buoyed by the recent rise in crude prices. Hopefully this marks the start of a long overdue rebound for these beaten down exploration and production concerns.

Current Portfolio

Company	Entry Date	Entry Price	Recent Price	Buy Up To	Target Price	Returns
United Rentals (URI)	04/22/15	$97.90	$97.90	$105.00		N/A
HD Supply (HDS)	04/22/15	$33.14	$33.14	$34.00		N/A
Michael Kors (KORS)	03/26/15	$66.97	$62.22	$75.00	$100.00	-7.1%
American Cap. Realty (ARCP)	03/26/15	$9.90	$9.19	$10.75	$14.00	-7.2%
FelCor Lodging Trust (FCH)	02/20/15	$10.78	$11.42	$11.50		5.9%
Cytori Therapeutics (CYTX)	02/20/15	$0.55	$1.05	$0.75		90.9%
Sequential Brands (SQBG)	01/21/15	$11.09	$14.00	$12.00	$17.00	26.2%
Chicago Bridge & Iron (CBI)	01/21/15	$40.31	$51.24	$45.00	$60.00	27.1%
Greenbrier Cos. (GBX)	12/17/14	$46.51	$63.81	$50.00	$80.00	37.2%
Halozyme Thera. (HALO)	12/17/14	$8.65	$15.88	$10.00	$18.00	83.6%
Zogenix (ZGNX)	11/18/14	$1.24	$1.65	$1.75	$4.00	33.1%
General Motors (GM)	11/18/14	$32.27	$37.16	$34.00	$47.50	15.2%
Warren Resources (WRES)	10/15/14	$3.37	$1.17	$4.50	$7.00	-65.6%
Dynavax Technologies (DVAX)*	10/15/14	$14.30	$23.48	$17.50	$30.00	64.2%
Chesapeake Energy (CHK)	09/15/14	$25.05	$14.57	$27.00	$33.00	-41.8%
AEGON N. V. (AEG)	08/14/14	$7.74	$7.75	$9.00	$15.00	0.1%

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: 04/21/15. 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.