Investors Alley

June 2015 Vol. 1 Issue 12

The Turnaround Stock Report

Finding Value Even as the Market Continues to Trade in a Narrow Range

Fellow Investor,

As we go to press, talks around Greece seem to be spiraling out of control. The so called "Grexit" might finally be happening but my money is still on one more last minute deal. The overall market is down over the past 30 days but the S&P 500 continues to churn along in one of its tightest trading ranges in recent memory.

It is very hard to get a feel on the market right now as it continues to feel equities are in a transitionary stage while investors wait for the Federal Reserve to take interest rates up for the first time since 2006. They took a pass at this last meeting. The consensus seems to be the economy and the markets are well-positioned to handle that eventuality when it occurs – most likely in September or December of this year. However, given it has been almost a decade since the last Fed interest rate hike I am more in a wait and see mode.

In This Issue

Domestic economic growth does seem to picking up from the slight contraction in the first quarter. Second quarter GDP numbers should show two to three percent growth when all is said and done. I also expect first quarter GDP levels to be revised up slightly to show perhaps flat growth in the opening stanza of the year. European growth projections have also started to be revised up mainly due to the impacts of the quantitative easing program by the European Central Bank. Hopefully, the situation in Greece is resolved so those growth projections can come to fruition.

Oil seems to have stabilized around $60 a barrel on West Texas Intermediate which has helped earnings prospects for the energy sector. However, where oil goes from here is anybody's guess. I would not be surprised if oil ended the year at either $80 or $40 a barrel given the complexity of the oil market. Where energy goes obviously has impacts to individual sectors of the market and it will be interesting to see how the energy market shakes out through year end.

It will also be interesting to see if the latest Greek drama boosts the greenback further against the Euro and other major currencies. This would not be a good thing for the profits of American multi-nationals who have seen earnings erode as the US dollar has rallied significantly since last summer. Additional dollar strength would boost consumers' buying power and provide a bulwark against any inflationary trends.

I would be surprised if the markets break out significantly to the upside this summer before the coming rate hike from the Federal Reserve, especially at current valuation levels. Probably the best that can be expected is stocks continue to trade in their recent range until earnings improve in the back of 2015. A possibility of a 5% to 10% pullback over summer cannot be discounted as it does feel like equities are at an inflection point at current levels.

That being said, we are still finding some pockets of value. This month we highlight two stocks that offer potential significant upside in an overbought value and should find success in the second half of the year barring any severe macroeconomic event.

I'm always here for you. If you have any questions about the strategy or the stocks in the portfolio please feel free to email me at bret.jensen@investorsalley.com.

Bret Jensen
Editor
The Turnaround Stock Report

P.S. In the coming weeks I plan to officially launch my new *Biotech Gems* service to the public. In mid-May we beta published our first issue and took on a few subscribers. There have been a few requests to open up the service to *Turnaround Stock Report* subcribers before going fully public with it. If you're interested in being a beta tester and early subscriber **just click here for a short description of the service and a link to sign up**.

P.P.S. The MoneyShow folks have asked me to return as a presenter at their conference. This time it's San Francisco from Thursday, July 16 through Saturday, July 18th. I'll be giving two presentations. Find out more about the show, how to register and my schedule, click here.

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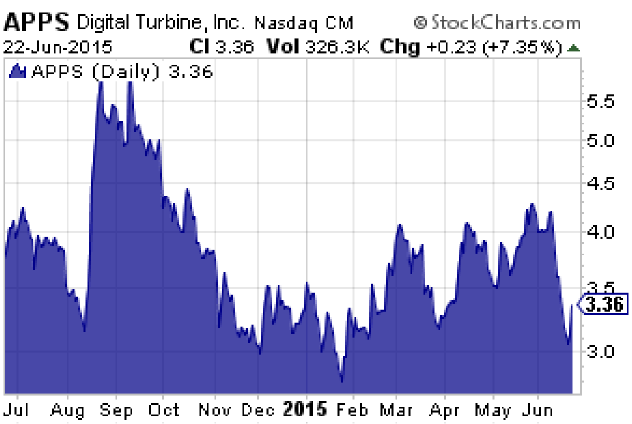
APPS: In the Middle of the Boom in Mobile

Our first addition for this month's issue of the Turnaround Stock Report is a foray into an evolving area of technology. The company is a small mobile tech company called **Digital Turbine (NASDAQ: APPS)** which has a market capitalization of under $200 million. The stock vaulted to almost $6.50 a share late last year but has spent the last six to eight months basing just above the $3.00 a share level. I believe the stock is poised to assault previous 52 week highs if everything falls into place over the next few quarters.



Company Overview:

Digital Turbine works at the convergence of media and mobile communications, delivering end-to-end products and solutions for mobile operators, app advertisers, device OEMs and other third parties to enable them to effectively monetize mobile content and acquire higher value user acquisition.

It is an interesting space with developing thousands of apps in the hopes of being installed on mobile devices. Mobile telecom operators are trying to get into this growing revenue stream by claiming a piece of each download.

Digital Turbine is creating systems to help both of these parties meet their goals and produce revenue. The company offers a complete ecosystem for distributing and managing mobile apps. Most of its revenue comes from two sets of customers: app developers and mobile carriers. Developers pay Digital Turbine to place their apps on devices distributed by its partner mobile carriers, who receive part of the revenue. Carriers in turn contract with Digital Turbine for products such as a private label app and content store (DT Marketplace), content management and mobile payment (DT Pay), app discovery tool (DT IQ), and device management and app distribution (DT Ignite):

Unlike the obvious example of **Apple (NASDAQ: AAPL),** mobile plays have traditionally captured little to none of the growing amount of money that is spent to market mobile apps, even though they provide both the data and the devices that enable them. Digital Turbine lets carriers finally capture a slice of application marketing budgets.

Just as Digital Turbine has two primary customers, so it has two reporting segments: advertising and content. The former, comprised of Appia Core and DT Media, provides content and billing services to wireless carriers. The latter, comprised of DT Marketplace and DT Pay, distributes apps for developers (aka advertisers) through "a network of publishers that include mobile websites, mobile applications and the carrier home screen."

Digital Turbine delivers apps to devices using Ignite, a software application designed to relieve manufacturers and carriers of time-consuming app-loading procedures. Unlike apps loaded by OEMs or carriers, apps delivered by Ignite are easy to delete. Carriers thus solve an important customer satisfaction problem, providing valuable functionality to their customers without saddling their devices with bloatware.

Appia Acquisition:

In March, Digital Turbine completed its acquisition of Appia, the leading network for mobile user acquisition. Appia's advertising clients include 60 of the top 100 grossing apps on Google Play and the App Store. Before the acquisition, Digital Turbine worked only with Android, so this marks its expansion into the Apple ecosystem. Some of the synergies are obvious. Appia has both expertise in app marketing and a large base of customers to whom Digital Turbine can cross-sell its app placement services. Integration is ahead of schedule.

In the past, Digital Turbine's relationships with carriers have been key to its success. Management believes relationships with advertisers will be just as important in the future. This is the strategic rationale behind its acquisition of Appia.

Recent Conference Call:

Digital Turbine recently submitted quarterly results. Revenue grew 46% sequentially, but the stock promptly plummeted, most likely because gross margins were lower than expected. The reaction was overdone. When a company beats on revenues but misses on earnings just after closing an acquisition, it is important to understand how the acquired company affected the numbers.

In this case, 26 days of Appia sales counted toward the quarter. Appia contributed more advertising revenue than DT Media, and its ad revenue carries lower margins. Further skewing the sales mix, Digital Turbine's carrier partners delayed the launch of several devices that would have contributed to higher-margin revenue.

Adjusted gross profit as a percentage of revenue accordingly fell from 34% to 18%. (Gross profit nonetheless grew in absolute terms by 33%.) GAAP gross profits fell from 28% to 9%, in part because of an investment the company made in its bidding platform.

Weak hands fold quickly when gross margins decline. But Digital Turbine had already told investors about the delayed launches. The skewed sales mix and attendant lower margins should have come as no surprise. Without the delay, DT Media revenue, along with gross margins, would have been higher. The company expects DT Media to contribute more in the future as new devices launch.

Management expressed confidence that gross margins would be 30% or better and EBITDA would be positive for the rest of 2016. It guided toward revenue of $110-130m. These benchmarks will help us gauge its success in the coming quarters.

Solid Balance Sheet:

Digital Turbine has $7 million in cash and $12 million in net receivables. Its cash burn for Q4 was $2.7m. Current liabilities outweigh current assets by nearly 20%. We expect to see this improve materially as new devices launch this quarter.

The company announced that its senior lender, Silicon Valley Bank, has increased its revolving credit to $5 million from $3.5 million and extended its maturity to June 30, 2016, all subject to increases in accounts receivable. Priorities for using the credit facility are:

- Funding working capital and fuel growth
- Refinancing subordinated debt
- Organic and non-organic growth

Regarding the third point, investors should be encouraged by the Appia acquisition, but of course any future acquisitions must be evaluated on their own merits. The company made a shelf filing as a co-requisite of the Appia deal. We consider this a prudent measure that may even prove to be advantageous should Digital Turbine find another good acquisition target.

Growth Opportunities:

In April, Digital Turbine announced Ignite deals with Verizon, US Cellular, Vodaphone Australia and other international carriers. Digital Turbine also has app delivery deals with OEMs such as HTC, Acer, Asus and Sony. These give its advertisers presence in markets where users bring their own SIMs to devices.

Over the next 90-120 days, management expects “numerous” new devices to launch with IQ, the app discovery tool that is already on several T-Mobile devices. Vodafone Australia is installing it on all of its Android devices.

The company is attracting new advertisers. This year it added Twitter, StarHub, Trivago, Airbnb, CBS and Lyft and renewed contracts with such brands as Pandora, Dominoes and Expedia.

Though modest in absolute terms, Ignite international revenue grew 900% between January and May. It should grow materially now that Deutsche Telekom and CloudFone have launched.

The company has agreed to distribute content for Electronic Arts and Disney in numerous South-East Asian markets. It intends to expand other partnerships and grow its presence in other international markets.

It is also expanding carriers' capabilities and driving new revenue by launching new products such as software that lets customers charge content subscriptions and in-app purchases to their mobile phone bills instead of paying Google Play or App Store.

Meanwhile, DT Pay is now offered by 82 content providers, up from 22 a year ago. At its recent conference call, management was firmly refused to guess either how many apps it would publish to each device or how much each would be worth. It will take a while to discern such patterns, in much part because the company is expanding so quickly. It acknowledges being “in the first inning” when it comes to “getting the model right for advertisers and carriers,” but says “demand is there.”

It is hard to argue with this claim. The nearly $30 billion app install market is expected to grow 30% annually. Early innings indeed. In April, Digital Turbine that the following devices would launch across various carriers and regions with Ignite installed:

Samsung Galaxy S6 and S6 Edge:

Verizon Wireless, US Cellular, Cellcom Israel, Globe Philippines, and Vodafone Australia

HTC One M9:

Verizon Wireless

LG Spirit (C70 or Logos):

US Cellular, Cellcom Israel, Vodafone Australia

Analyst Support:

Digital Turbine is currently by six analysts who have a median price target of $10.20, or more than three times the current level of the stock. Roth Capital initiated coverage with a price target of $12.00 a share in May, shortly after National Securities Corp initiated a price target of $10.00 a share on Digital Turbine.

Risks:

The Appia integration may yet hit costly speed bumps. Digital Turbine is in the early stages of scaling globally. Its revenues depend on device launches. It has no control over their timing. A delayed launch may cause it to miss guidance. While it fine tunes its model and the engines and technology that support it, revenue may be lumpy. The company may fail to properly manage its business or its finances. It may make an ill-advised acquisition. At the moment we see no reason to expect worst case scenarios, and delayed device launches will have only temporary impact on the company's finances as long as it has sufficient working capital.

Outlook:

Digital Turbine's business sits at the intersection of mobile carriers and app developers. It helps carriers make money from the boom in mobile app advertising, and it helps developers acquire users for their apps. When a carrier launches a new device with Ignite on it, Digital Turbine has more slots to sell to app developers. As it signs up more carriers in more regions, its advertising business is likely to grow exponentially. As it offers carriers more means by which to capture revenue from their user base, it will become ever more indispensable to carriers and enjoy rapidly growing streams of revenue. If Digital Turbine lives up to its promise, it will deliver exceptional returns to the patient investor.

Recommendation: Buy APPS up to $3.50 a share. Initial price target of $7.00 a share.

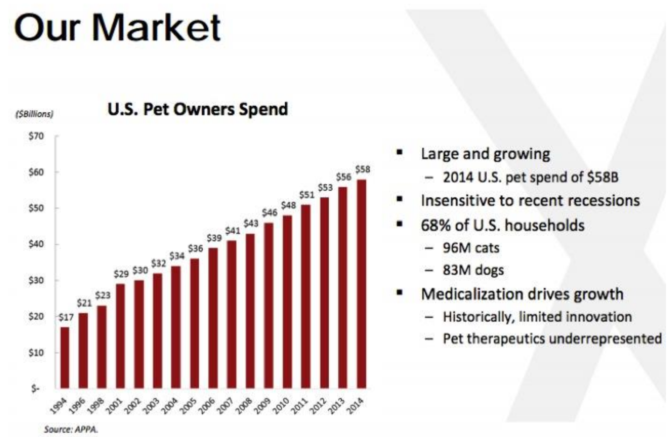
Position: Long APPS

PETX: Picking up the Pieces after the IPO Hype

Our second addition is a niche player in the growing field of pet medicine. The stock is also down some 30% from recent highs providing a nice entry point before awaiting sentiment to turnaround on this compelling player in an emerging market. The name of this company is **Aratana Therapeutics** which appropriately has the ticker symbol of **PETX** on the NASDAQ exchange.

The company came public just less than two years ago and sports a market capitalization of approximately $500 million. The stock had an offering price of $25.00 a share but now can be had for just over $14.00 now that the “IPO hype” has run its course. The promise and prospects of the company remain as good as or better than when Aratana debuted on the public markets in late July 2013.

The biotech landscape is full of companies tackling diseases and medical issues that plague humans. Aratana is taking a different approach to the pharmaceutical market by developing products to treat animals. U.S. pet owners spent nearly $60 billion on their animal companions in 2014, and that number will only rise as effective pet therapeutics hit the market.



2015 Corporate Presentation

Approximately two thirds of households in the U.S. own a cat or a dog. As the owner of a six year old Golden Retriever named Cooper I can tell you that American society increasingly views its pets as members of the family, and as a result pet owners are more willing to spend money on veterinarian care and just about anything else to make our “children” happy and healthy. Let’s take a look at Aratana’s development platform and how the firm leverages the human biopharmaceutical industry to create new therapeutics for animals.

Developing Its Portfolio:

Aratana’s business model centers on finding treatments that work for humans and retooling those therapies to address the needs of pets. Focused on cats and dogs, the company looks for human therapeutics that can demonstrate safety and effectiveness when reformulated for animals. Management also seeks to identify products already in development for pets so it can potentially license or acquire them.

The firm tries to de-risk its investment in products by only targeting those drugs for which toxicology data is readily available, manufacturing is scaled-up, and effectiveness is displayed in clinical trials. The medical issues Aratana aims to treat typically have an unmet medical need or high incidence rate in the pet market.

The process for achieving regulatory approval of pharmaceutical products for pets is less rigorous than the same process for human products. Where it can easily cost a company over one billion dollars to formulate, test and receive FDA approval of a new drug for humans, it costs approximately $10 million for Aratana to develop a new drug candidate. In addition, the timeline for developing a drug candidate for pets is shorter by about five years.

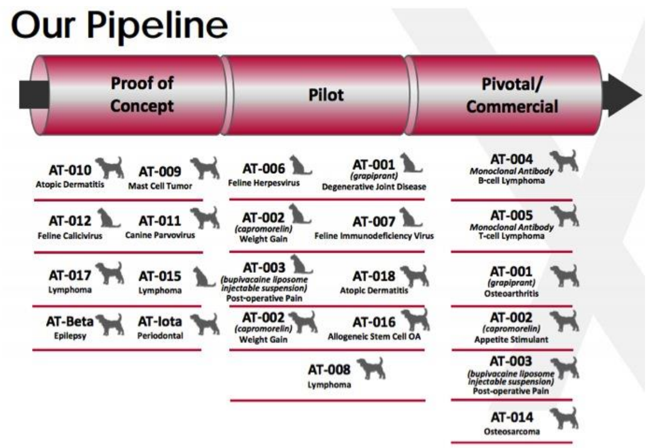
	Humans	Pets
Development	Multiple Species Steps	Direct to Species
	~$1.3B	~$10M
	~10 Years	~5 Years
Commercial	Third Party Payer	Private Pay
	Generic Pressure	Innovator Brand Loyalty
	Difficult & Indirect	Accessible & Direct

Source: 2015 Corporate Presentation

Pipeline:

Aratana owns over 15 novel therapeutic candidates in development that target cancer, pain, lack of appetite, viral diseases and allergy. Six of these treatments are approaching commercialization and have important approval milestones in the near future.

The firm's AT-003 is an extended-release injectable candidate designed to help relieve post-operative pain in both dogs and cats. The compound that comprises AT-003 is the key component of a product launched by Pacira in 2012 to help relieve pain in humans. A 2014 pilot study brought positive results regarding the candidate's effectiveness with animals, and topline results of an ongoing pivotal trial should be available in July.



Source: 2015 Corporate Presentation

Current pain relief products on the market for cats and dogs cause significant side effects and can damage an animal's liver or gastrointestinal system. So far AT-003 has demonstrated a favorable safety profile with a lower risk of toxicity. Veterinarians perform approximately 19 million dog surgeries and 14 million cat surgeries per year, so the size of the market for this product is large. Aratana anticipates receiving FDA approval of AT-003 in 2016.

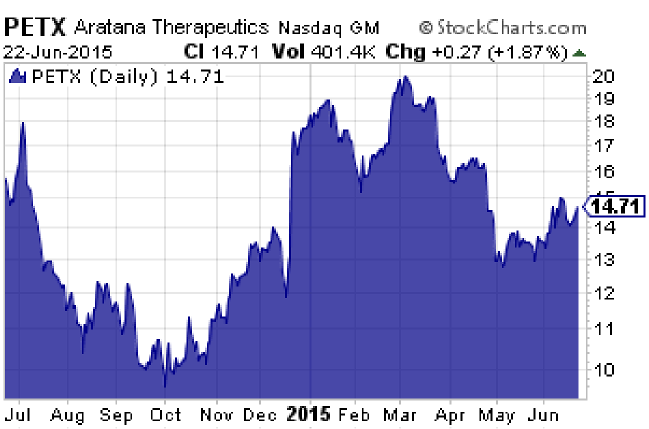
AT-002 is another candidate moving through the late stages of Aratana's pipeline. This product mimics a naturally occurring hormone to help stimulate appetite in cats and dogs. No currently approved products exist on the market to help tackle this problem, which is commonly seen in pets when they age or suffer from chronic illness. Animals typically must suffer through feeding tubes or face euthanasia if they struggle to eat and maintain muscle mass.

AT-002 could be used daily at home by pet owners to safely stimulate appetite. The candidate demonstrated significant results on eating habits and weight gain in a pilot study, and more data will be presented over the coming month with an expected approval date sometime in 2016. I think the potential market for a product like this will be large because nearly every pet owner is familiar with the struggle to get an aging or sick animal to maintain a healthy diet. Positive news regarding AT-002's ongoing study or regulatory approval process could act as a catalyst for share price appreciation in the future.

Aratana possesses two therapies in the oncology market for canines that represent first-in-class products. AT-004 targets B-cell lymphoma and has been granted full licensing rights by the USDA, while AT-005 treats T-cell lymphoma and received a conditional license from the USDA. The firm intends to conduct more scientific studies to help place the products in cancer treatment protocols and expects to report on the results over the next 18 to 24 months.

Financial Profile:

Aratana holds a healthy $87 million in cash, about 15% of its market cap, which should last the firm about two years into the future given its current burn rate. If AT-004 and AT-005 are commercialized in the near future then they will provide a nice revenue stream and help the firm get closer to turning a profit. I see AT-002 and AT-003 as the heavier hitting products in the company's arsenal. Both candidates tackle a large market and could greatly improve the length and quality of life experienced by pets.



Commentary surrounding Aratana's future is bullish, and seven analysts have put an average target of about $27.00 per share on the company's stock. Analysts at Piper Jaffray recently affirmed its "Overweight" rating on PETX with a price target of $25.00 per share, representing a potential upside of just over 75% from its current price of around $14.70 per share. The analyst at Piper Jaffray cited the upcoming AT-002 and AT-003 clinical data as a possible driver of share price appreciation in the near future.

I am long Aratana and I think the company presents a unique play on an underserved pharmaceutical market. The firm's deep pipeline and upcoming milestones represent a good mixture of near to long term opportunities, and the pet therapeutics market will not fall off because Americans will always bring their pets to the veterinarian and get them the help they need.

Recommendation: Buy up to $16.00 a share.

Position: Long PETX

Portfolio Update

As noted in the Market Commentary, equities continue to trade in a narrow range even while investors wait on the latest news out of Greece and await the first interest rate hike by the Federal Reserve since 2006. It was a challenging month for the Turnaround Stock Report as we had some setbacks within the portfolio as well as some encouraging action from a couple of stocks in the portfolio.

First, let's start with **Warren Resources (NASDAQ: WRES)** which we are tossing out of the portfolio. Like most small exploration and production producers it has struggled mightily with the collapse in energy prices. The company should survive as it raised funds by selling some non-core assets but it is hard to see clear growth drivers unless energy prices snap back significantly. I am still holding within in my account but it is not worthy of a top 20 inclusion at this point in time.

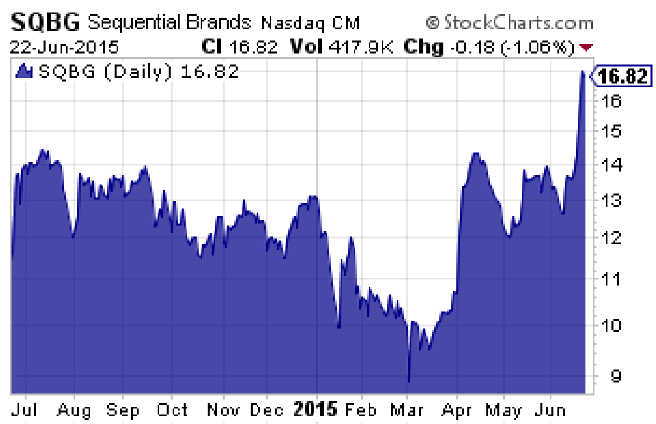
Just to be clear: this mean **WRES is now considered a Closed position and will no longer be covered in this newsletter**.

Michael Kors (NYSE: KORS) had a very tough month as growth is slowing and the company reported some disappointing results. I added to my core position on the decline as I still think this is a premier growth name in retailing and will right the ship in the next few quarters. The stock is definitely a full turnaround story now so we will probably have to wait a quarter or two to see better results which could ignite a rally.

I also added some long exposure to **Greenbrier Companies (NYSE: GBX)** after it pulled back after being downgraded by Stifel Nicolaus on concerns around its order backlog. These are worries I do not share and take comfort that the analyst that provided downgrade hardly has a sterling investment record over the past year.

United Rentals (NYSE: URI) also reported some disappointing results and declined over the past month. However, coming economic growth in the second half of the year should boost the shares. In addition, noted activist investor Jana Partners just announced they have taken a six percent stake in United which is encouraging.

Turning to a brighter note, **Sequential Brands Group (NASDAQ: SQBG)** had a big month and as the brand management picked up **Martha Stewart Living Omnimedia (NYSE: MSO)** at an advantageous price. Sequential should be able to substantially boost merchandise sales through its vast licensing network should this deal close and investors bid up the stock



over 10% on Thursday when these rumors first surfaced.

In addition, **Halozyme Therapeutics (NASDAQ: HALO)** continues to be a star of the portfolio and posted another nice month with two analyst firms reiterating their Buy ratings over the past couple of weeks. Finally, **Zogenix (NASDAQ: ZGNX**) announced a reverse stock split. The market reacted favorably to announcement and Brean Capital reiterated their Buy rating on this small cap concern. Brean sees a "higher-than-average probability in successfully developing ZGX008 as a treatment for Dravet syndrome, which is a debilitating orphan disease." Phase III trials should start later this year.

Current Portfolio

Company	Entry Date	Entry Price	Recent Price	Buy Up To	Target Price	Returns
Aratana (PETX)	06/22/15	$14.71	$14.71	$16.00		N/A
Digital Turbine (APPS)	06/22/15	$3.36	$3.36	$3.50	$7.00	N/A
Yahoo! (YHOO)	05/22/15	$43.49	$40.73	$47.00	$60.00	-6.3%
Delta Airlines (DAL)	05/22/15	$43.18	$42.93	$47.00	$60.00	-0.6%
United Rentals (URI)	04/22/15	$97.90	$92.13	$105.00		-5.9%
HD Supply (HDS)	04/22/15	$33.14	$35.43	$34.00		6.9%
Michael Kors (KORS)	03/26/15	$66.97	$47.34	$75.00	$100.00	-29.3%
American Cap. Realty (ARCP)	03/26/15	$9.90	$8.46	$10.75	$14.00	-14.5%
FelCor Lodging Trust (FCH)	02/20/15	$10.78	$10.31	$11.50		-4.4%
Cytori Therapeutics (CYTX)	02/20/15	$0.55	$0.65	$0.75		18.2%
Sequential Brands (SQBG)	01/21/15	$11.09	$16.82	$12.00	$17.00	51.7%
Chicago Bridge & Iron (CBI)	01/21/15	$40.31	$54.25	$45.00	$60.00	34.6%
Greenbrier Cos. (GBX)	12/17/14	$46.51	$52.59	$50.00	$80.00	13.1%
Halozyme Thera. (HALO)	12/17/14	$8.65	$22.06	$10.00	$18.00	155.0%
Zogenix (ZGNX)	11/18/14	$1.24	$1.62	$1.75	$4.00	30.6%
General Motors (GM)	11/18/14	$32.27	$36.19	$34.00	$47.50	12.1%
Dynavax Technologies (DVAX)*	10/15/14	$14.30	$22.11	$17.50	$30.00	54.6%
Chesapeake Energy (CHK)	09/15/14	$25.05	$11.89	$27.00	$33.00	-52.5%
AEGON N. V. (AEG)	08/14/14	$7.74	$7.63	$9.00	$15.00	-1.4%

Closed Positions

Company	Entry Date	Entry Price	Close Price	Close Date	Returns
Warren Resources (WRES)	10/15/14	$3.40	$0.52	06/22/15	-84.7%
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: 06/22/15. 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.