Investors Alley

August 2015 Vol. 2 Issue 2

The Turnaround Stock Report

Capitalizing on Housing Sector Momentum

Fellow Investor,

My concerns continue to mount around the current levels of the market as I see more negatives than positives around the global economy. Commodity and energy prices continue to collapse, and even more concerning is that China has gone from a global growth engine for equities and currencies to a major headwind in the last month or so. Although the Chinese authorities continue to maintain the country is growing at or close to the "official" seven percent level, falling exports, imports and domestic auto sales bely that assertion. As well, their recent devaluation of their currency combined with the extraordinary measures they have taken to halt a stock market decline are not actions stemming from confidence in the economy.

In This Issue

It is not only China that is having growth issues right now. Domestically, GDP growth for the first half of the year posted a tepid reading of just under 1.5%. Growth should pick up in the second half of the year, but domestically we are looking forward to another below trend year of around two percent annual growth, continuing the weakest post war recovery on record.

Meanwhile in Europe, second quarter growth came in below expectations even as the continent tries to hammer out the latest "extend and pretend" bailout package for Greece. The Japanese Central Bank also just lowered their 2015 full year forecast for GDP growth to 1.7% from two percent previously. Korea just posted its lowest quarterly growth figures in a half dozen years. Neither of these export led economies will be helped by the recent devaluation of the Yuan.

The 2015 annual retail sales forecast by the National Retail Federation was also lowered to just 3.5% for the year from 4.1% previously. The extra spending from the continuing gasoline "tax cut" seems to be elusive for most of the consumer discretionary sector outside of improved restaurant sales and consumers moving up to trucks & SUVS from midsize cars.

Given the strong dollar, a collapsing commodity complex, and tepid global demand, the punk earnings reports in the first half of the year should be of no surprise. Both earnings and revenues for the S&P 500 in the second quarter have come in below year ago levels for the same period. Outside of healthcare, none of the other nine industry sectors within the market are showing double digit earnings growth.

On the brighter side, housing activity continues to be stronger than it has been in years as mortgage credit is finally starting to loosen. Domestic auto sales are also a bright spot as vehicle sales are back to where they were prior to the financial crisis.

In short, the global economy backdrop is extremely challenging at the moment. Hopefully the domestic economy will indeed pick up and no additional headwinds present themselves such as another debt ceiling debacle.

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 mid-September I'll be hosting a strategy session on getting profits from the red hot biotech sector. There will be a special emphasis on how to identify takeover targets and my four requirements every biotech stock must meet before even considering it for your portfolio. I'll be sending you an invitation in the coming weeks with more details and instructions on how to participate so watch you email inbox.

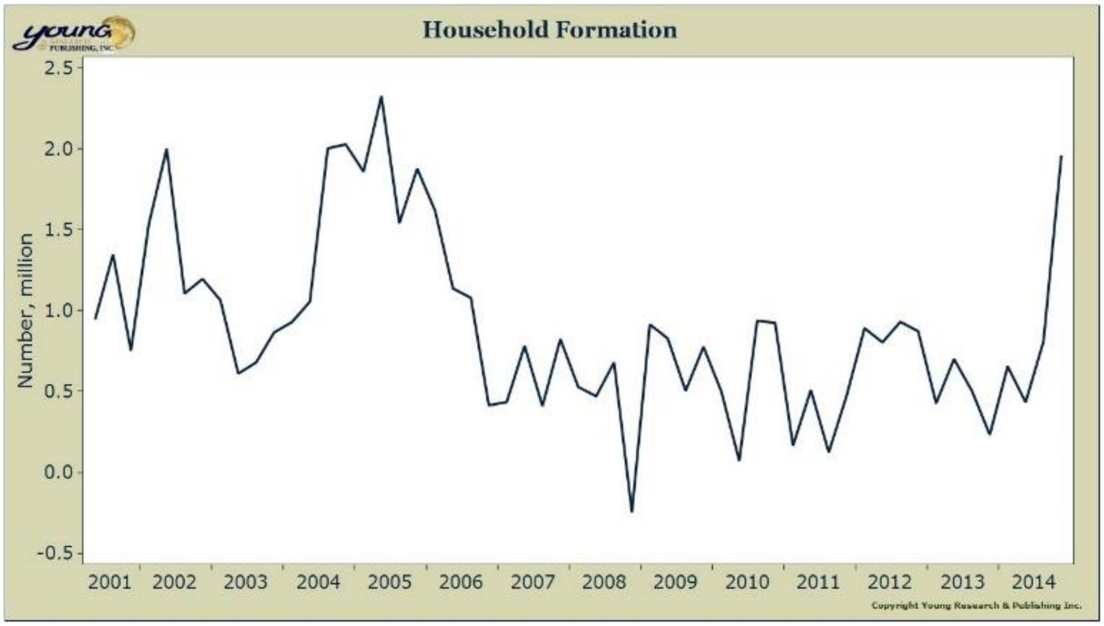
TRI Pointe Homes: Housing is too Hot to Pass Up

This month we are making our first direct foray into housing within the Turnaround Stock Report. Our tertiary play on the market, **HD Supply (NYSE: HDS)** has held its own and the company is performing well. This month we add a homebuilder to our portfolio, and it might not be the last.

After being moribund since before the financial crisis, housing is starting to show major signs of life, and we could be at the beginning of many years of accelerating growth. New monthly housing starts are near eight year highs and homebuilder sentiment is at levels not seen in a decade. After running at one million housing starts annually or below, annual housing starts are running 20% above that one million level currently but is still far under the average of 1.5 million annual housing starts that has existed over the past three decades.

There are myriad reasons to believe we are in the early innings of an improved housing market. Obviously this would be hugely beneficial to not only the economy but for job growth and wages as well. Mortgage rates are historically low and credit conditions have started to loosen with the FHA recently bringing back the three percent down mortgage after it was yanked in the aftermath of the financial crisis.

More importantly, due to the tame amount of housing starts that have taken place over the past almost decade, there is huge pent up demand that will take years and years to work off. As can be seen in the "Housing Starts" chart, there would have been millions and millions more housing starts in recent years in an average environment. If it had not been for the dislocation caused by the financial crisis and its aftermath, housing activity would have been much stronger from 2007 – 2014.



In addition to pent up demand caused by the low levels of housing starts since 2007, household formation after the financial crisis plunged and has taken years to crawl back into normalized levels. Recent household formation figures show we are starting to see households form at levels similar to before the financial crisis. This creates its own demand for housing as household formation is one of the primary drivers for new housing starts.

It is against this increasingly positive backdrop that we add our first homebuilder to our Turnaround Stock Report.

Company Overview:

TRI Pointe Homes (NYSE: TPH) is the result of a November 2013 reverse merger between WRECO and TRI Pointe Homes, a homebuilder established in 2009 to capitalize on the housing recovery in California and other markets in the Southwest. The firm is one of the top ten homebuilders in the United States. The stock has a market capitalization just north of $2.5 billion and an enterprise value of just under $3.7 billion. The shares currently go for around $15.30 apiece.

The CEO, CFO and COO each have 20 years of experience in the California real estate market, which is home to the majority of the company's lots and communities. This management team began working together at William Lyon Homes about 16 years ago. The combination of great experience in their current market and a long personal history suggests a stable management team with a high degree of expertise.

Potential Margin Improvement: Tri Pointe Homes, much like many homebuilders, is feeling some pressure on margins due to rising costs of land and construction as well as the challenges in securing skilled labor in some regions of the country. The company should get some relief as home prices continue to rise. 60% of the company’s lots are in California and as of June 2015, the average price of a California home rose over six percent year-over-year.An improving job market in California should help drive home prices and mortgage availability as well. Within the company’s overall land portfolio, Washington D.C. ranks second to California, with just under 10% of the company overall lot supply. As long as California’s economy and job situation continues to improve, TRI Pointe is well positioned to benefit from these improving dynamics.

Strong Second Quarter Financial Performance:

You can see signs of a strengthening economy in the company’s last completed quarter. The company delivered earnings of 34 cents a share, significantly more than the consensus of 25 cents a share. New home orders were up 62% year-over-year which significantly outpaced new home deliveries that were up 27% year-over-year. This discrepancy boosted TRI Pointes' backlog significantly. Revenues were up over 40% year-over-year thanks to the uptick in home deliveries and a nine percent improvement in average sale price from the same period a year ago. The company reiterated conservative guidance calling for a 25% improvement in home deliveries in 2015, a level I expect the company to surpass when the year is closed. Homebuilding gross margin was 20% for the quarter and the company sees that figure growing to 21% for 2015 overall.

Industry Tailwinds:

New home sales are expected to rise approximately 30% in 2015 and should rise 20% to 25% in 2016. There is still a gulf between the prices of new homes and those of existing homes. The discount has been a factor in keeping the market for new homes from getting frothy. In fact, there is only half as much activity in new home sales as there was during the mid-2000s. National Association of Realtors Chief Economist Lawrence Yun says this suggests there is no bubble in homebuilding and that in fact there is room for growth. Given the dearth of housing starts over the past seven or eight years, this is a conclusion I share.

The building industry has lamented banks' inability to write more loans due to financial regulations over the past several years. However, mortgage credit is finally starting to loosen which should result in a larger population that is eligible to buy a home and should be a demand driver in coming years. Another demand driver will be that rental prices are rising nationwide at twice the rate of overall inflation which should encourage former renters to become buyers.

Significant Land Supply to Fuel Growth

TRI POINTE GROUP

Combined Lot Position

As of June 30, 2015

Market	Owned	Controlled	Total Lots	% Owned	Inventory Dollars	LTM Deliveries(2)	Years of Supply
California	17,834	533	18,367	97%	$1,466,267	1,343	13.7
Colorado	456	202	658	69%	$74,048	114	5.8
Washington, D.C. (1)	2,284	448	2,732	84%	$283,413	394	6.9
Arizona	1,485	327	1,812	82%	$189,036	380	4.8
Nevada	1,652	173	1,825	91%	$156,468	321	5.7
Texas	837	1,274	2,111	40%	$196,015	523	4.0
Washington	995	421	1,416	70%	$170,506	355	4.0
Total	**25,543**	**3,378**	**28,921**	**88%**	**$2,535,753**	**3,430**	**8.4**

(1) Includes lots in the greater Washington D.C. area.
(2) Includes legacy TRI Pointe Homes operations for the period prior to July 7, 2014, the closing date of the WRECO transaction. See "Reconciliation of Non-GAAP Financial Measures" in the appendix of this presentation.

26

Lot Inventory & Balance Sheet:

New home sales are rising quickly. Meanwhile supply is outmatched by demand such that the median time new construction stays on the market is near all-time lows. Builders that have substantial land inventory are in a good position to satisfy the growing demand for new homes. TRI Pointe has a nine years' supply of lots.

TPH has over $120 million in cash and a revolving credit facility with over $140 million available. The company has about $1.3B in long-term debt, for a net debt/capital ratio of 46%. $260M is due in one year. The debt is financed at reasonable rates (between 2.7% and 5.2%) and should continue to be manageable. In short, the company has solid financial flexibility

Valuation & Outlook:

TRI Pointe's backlog unit count grew by 48% year-over-year, and the value of its backlog jumped by 59% year-over-year. Note the implication that average price-per-unit is considerably higher year-over-year. The value of the company's backlog is $950 million, or nearly 40% of its market capitalization. The company's forward price earnings multiple (11.9) is significantly lower than its peers' average (15.2). The company should double the 58 cents a share it made in 2014 this fiscal year. The consensus has the company earning approximately $1.40 a share. This expectation may turn out to be significantly conservative if the housing market continues to improve at an accelerating rate. As it integrates WRECO, grows revenues, and stabilizes margins we would expect this discount to narrow and then disappear over time. At a peer valuation of 15 times forward earnings, the stock of TRI Pointe should sell at $21.00 a share and this will be our initial price target.

Recommendation: Buy TPH up to $16.50 a share.

Position: Long TPH

Portfolio Update

It continues to be a challenging environment for the turnaround stories that we focus on here. These types of stocks and sectors tend to shine when economic conditions are on the upswing such as the years 2010 through 2013 as the world recovered from the depths of the financial crisis, especially in the States.

Unfortunately, 2015 has not seen those types of positive conditions for our stocks and sectors to thrive in. The domestic markets are largely flat so far in 2015 as global growth is marching along at the slowest pace since the bad old days of 2009. In addition, most of the gains in the market have been accrued by the highflying momentum names that already sell at nosebleed valuations such as **Netflix (NASDAQ: NFLX)** and **Amazon (NASDAQ: AMZN)** both of which sell for hundreds of times their likely earnings in fiscal 2015.

The commodity and energy complexes continue to collapse thanks to a glut of supply, tepid global demand, and a strengthening dollar. Numerous small cap miners and exploration & production companies have already declared bankruptcy or have had significant restructurings. This unfortunately is just a start of a long shakeout if commodity and oil prices stay at current levels.

The Bloomberg Commodity Index is at lows not seen since 2002 and oil has not been this low since the tail end of the Great Recession in early 2009. This is causing havoc in commodity based economies such as Australia, Canada, and Brazil whose currencies and economies have eroded significantly over the past year. Valuations in emerging markets are at their lowest levels since April 2001.

Add to these challenges the obvious slowdown in the second largest market & economy in the world, China. The Chinese equity market has been in a freefall since mid-June which authorities seem unable to arrest despite taking extraordinary measures which have totaled north of $1 trillion to date. The decision last week by the Chinese to devalue the Yuan and delink it from the dollar for the first time since 2005 also signals weakening economic conditions. This brought a bout of volatility to global equity markets and is causing turmoil in the Asian currency markets.

Some of our turnaround stocks like **United Rentals (NYSE:URI)** and **Michael Kors (NASDAQ: KORS)** have gone from turnaround stories to downright value stories and are starting to draw the interest of well-known value fund managers like David Einhorn. Some of the picks are dirt cheap regardless of how you slice them. **General Motors (NYSE:GM)** is selling at seven times this year's profits, yields 4.6% and is having blowout domestic vehicle sales. Unfortunately, like **Ford (NYSE: F)** the stock is being held down by concerns around China.

On a brighter note, the second half of the year should show much stronger domestic GDP growth than the first half's tepid 1.5% level. Hopefully this will mean a much better environment for our portfolio through year end.

We are throwing in the towel on **Chesapeake Energy (NYSE: CHK).** The collapse of energy prices has caught most of the market looking the wrong way and it is time we admit like Carl Icahn, that we were just too early on this name. When energy prices eventually find a bottom and begin rising, this stock will have significant value. Unfortunately, when that might occur is just too hard to predict at the moment and things may get even worse before they better. We are replacing Chesapeake with a promising homebuilder that is benefitting from an accelerating housing market, one of the few parts of the economy that got significantly better in the first half of the year.

Effective with this issue CHK will no longer be a part of the portfolio or followed by me.

Current Portfolio

Company	Entry Date	Entry Price	Recent Price	Buy Up To	Target Price	Returns
Tri Pointe Homes (TPH)	08/18/15	$15.49	$15.49	$16.00	$21.00	N/A
GTx (GTXI)	07/17/15	$1.37	$0.97	$1.50		-29.2%
Aratana (PETX)	06/22/15	$14.71	$17.05	$16.00		15.9%
Digital Turbine (APPS)	06/22/15	$3.36	$2.29	$3.50	$7.00	-31.8%
Yahoo! (YHOO)	05/22/15	$43.49	$35.69	$47.00	$60.00	-17.9%
Delta Airlines (DAL)	05/22/15	$43.18	$47.36	$47.00	$60.00	9.7%
United Rentals (URI)	04/22/15	$97.90	$65.51	$105.00		-33.1%
HD Supply (HDS)	04/22/15	$33.14	$34.69	$34.00		4.7%
Michael Kors (KORS)	03/26/15	$66.97	$42.88	$75.00	$100.00	-36.0%
VEREIT (VER)	03/26/15	$9.90	$8.71	$10.75	$14.00	-12.0%
FelCor Lodging Trust (FCH)	02/20/15	$10.78	$8.61	$11.50		-20.1%
Cytori Therapeutics (CYTX)	02/20/15	$0.55	$0.40	$0.75		-27.3%
Sequential Brands (SQBG)	01/21/15	$11.09	$16.68	$12.00	$17.00	50.4%
Chicago Bridge & Iron (CBI)	01/21/15	$40.31	$48.96	$45.00	$60.00	21.5%
Greenbrier Cos. (GBX)	12/17/14	$46.51	$43.78	$50.00	$80.00	-5.9%
Halozyme Thera. (HALO)	12/17/14	$8.65	$19.03	$10.00	$18.00	120.0%
Zogenix (ZGNX)	11/18/14	$1.24	$18.79			89.4%
General Motors (GM)	11/18/14	$32.27	$31.71	$34.00	$47.50	-1.7%
Dynavax Technologies (DVAX)*	10/15/14	$14.30	$29.80	$17.50	$30.00	108.4%
AEGON N. V. (AEG)	08/14/14	$7.74	$6.83	$9.00	$15.00	-11.8%

Closed Positions

Company	Entry Date	Entry Price	Close Price	Close Date	Returns
Chesapeake Energy (CHK)	09/15/14	$25.05	$7.76	08/18/15	-69.0%
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: 08/18/15. 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.
** Zogenix did a 1/8 split on 06/01/15 thus the old buy up to and target prices have been removed.

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