THE MANUAL OF IDEAS ™

Value-oriented Equity Investment Ideas for Sophisticated Investors

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"If our efforts can further the goals of our members by giving them a discernible edge over other market participants, we have succeeded."

Investing in the Tradition of Graham, Buffett, Klarman

Year X, Volume I and II
January/February 2017

When asked how he became so successful, Buffett answered: "We read hundreds and hundreds of annual reports every year."

Top Ideas In This Report

Abercrombie & Fitch
(NYSE: ANF) 38

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(Nasdaq: FSLR) 66

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(NYSE: GES) 74

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BEST IDEAS 2017

- ► Screening Multi-Year Stock Market Losers
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- ► Proprietary Selection of Three Candidates for Investment
- ► Idea Highlights from the Best Ideas 2017 Conference
- ► Exclusive Interview with Jay Willoughby of TIFF
- ► Exclusive Interview with Shawn Kravetz of Esplanade Capital
- ► 10 Essential Screens for Value Investors

Companies analyzed in this issue include 21st Century Fox (FOXA), Abercrombie & Fitch (ANF), Avon Products (AVP), Bridgepoint Education (BPI), CGG (CGG), China Yuchai (CYD), Crocs (CROX), Ericsson (ERIC), First Solar (FSLR), Fossil (FOSL), Guess (GES), Jamba (JMBA), LSB Industries (LXU), Molson Coors (TAP), Morgan Stanley (MS), Movado (MOV), Och-Ziff Capital (OZM), Office Depot (ODP), White Mountains (WTM), and Wynn Resorts (WYNN).

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- ► Three In-Depth Idea Presentations from Best Ideas 2017
- ► Jim Roumell Shares Insights into Resilience
- ► *PREMIUM:* Alex Tsukernik on Value Creation in Metals & Mining

with minimal share dilution through the combination of share issuance and debt. Limbach is one of the largest commercial air conditioning contractors in the U.S. It is a fundamentally healthy business that is growing revenue and backlog by 30%. The company has the opportunity to grow organically, expand margins through increased service offerings, and opportunistic acquisitions. Both the common stock and long-dated warrants provide an interesting risk-reward proposition.

***PHIL ORDWAY**, MANAGING PRINCIPAL, ANABATIC INVESTMENT PARTNERS*

U.S. COMMUNITY BANKS: One key to understanding banks is the nature of their deposit base. The amount, cost and quality of these liabilities determine a bank's safety and soundness as well as its ultimate profitability. Deposits are the "raw material" for banks, and a good deposit-gathering franchise can make for a very valuable business. And while all banks are levered, many capital structures are actually quite stable. Total deposits in the U.S. have exhibited remarkable consistency, growing almost every year since the Great Depression and often outpacing GDP growth. At the same time, U.S. banks have purged their problem assets and retained much more equity capital. The quality of the U.S. banking sector's aggregate capital and liquidity make the industry as safe as it has been in decades. Another focus area for investors is the quality of a bank's assets. If deposits provide the "raw material" for a bank, it is up to management to then make intelligent capital-allocation decisions. The credit culture of a bank is crucial, and it must be judged both quantitatively and qualitatively. A few phone calls or meetings to find out which bank in a given market is stretching on terms or price will go a long way in avoiding future problems. In banking, an ounce of prevention really is worth a ton of cure. A third factor driving returns is consolidation. The number of commercial banks in the U.S. has declined almost linearly from more than 14,000 in 1985 to ~5,000 today. Across the broader industry, M&A has – with very few interruptions – continued every year for decades. In a typical year, 2-4% of the banks in America are acquired by other banks, and essentially zero new banks have entered the industry in the past decade.

Some particularly interesting opportunities are often found in the small "community" banks that comprise the vast majority of the 5,000 U.S. banks in existence today. Some of them are attractive businesses, some may have quantitatively cheap stock prices, and some might be candidates for acquisition; the combination of those factors can make for a sound and profitable investment.

OCEANFIRST (OCFC) is a century-old community bank that has recently completed several acquisitions and may be a merger candidate itself. OceanFirst is now a mid-size community bank, with $5+ billion in assets. It is the largest community bank headquartered in Central and Southern New Jersey and the fourth-largest bank in New Jersey by deposit market share. The bank has an attractive deposit base (54% consumer, 46% commercial). Non-performing assets are ~0.5%, with zero non-performing commercial loans originated in the past five years. OceanFirst has an unusually deep and long-tenured management bench. ~20% of the shares are owned by insiders and employees. Management has been prudent in deploying capital via dividends, buybacks, and M&A. If OCFC is likely to earn 10-15% on equity, with a 35-40% payout ratio and 5-10% growth per year, is ~1.75x book value the right valuation?

WELLS FARGO (NYSE: WFC) is an amazingly resilient and predictable business, with massive scale and scope and low-cost deposits. A powerful core deposit franchise (+8.5% LTM 9/30/16) funds ~125% of loans, with total cost of deposits of ~11 bps. Fees are almost half of net interest income. Capital allocation includes a ~30% dividend payout and ~20% net share repurchase "payout". The fake accounts scandal reflected a colossal management failure but, financially, the entire issue was immaterial. A new incentive system is coming, reportedly emphasizing customer service and core account balances. TARP warrants offer very cheap, non-recourse leverage, but the dangers should not be ignored. If WFC is likely to earn 10-15% on equity, with a 30-40% payout ratio and a modest reduction in share count via buybacks, is ~1.5x book value the right valuation?

***CHRISTOPHER SWASBROOK**, MANAGING DIRECTOR, ELEVATION CAPITAL MANAGEMENT*

LUXOTTICA (Milan/NYSE: LUX) *(presented by Chris prior to Essilor merger announcement)* is the world's largest eyewear company and undisputed market leader. The group manufactures and distributes products across more than 150 countries, with 95 million prescription frames and sunglasses produced annually worldwide. As a category, Eyewear is benefiting from strong structural growth drivers and attractive socio-demographic factors while significantly underpenetrated markets provide opportunity for market-leading players. In this regard, Luxottica holds the dominant proprietary and licensed brand portfolio in the market, in addition to owning and operating several leading retail brands which similarly hold principal positions in their respective markets. Guided by founder Leonardo Del Vecchio, Luxottica has vertically integrated its business model with operations spanning all stages of the eyewear industry's value chain. Through these twin pillars (brand power and business model), Luxottica has created an extremely strong competitive advantage, enabling them to maximize efficiencies and extract value throughout all stages of their business. Furthermore, such qualitative factors are exceedingly hard to replicate and grant a defensible position against potential competitors as it increases barriers to entry. Looking forward, ongoing optimization of the group's vertical integration strategy and execution of current growth initiatives provide substantial headroom for long-term capital appreciation. Chris acknowledges that softness within the eyewear market may create volatile trading conditions in near term. However, he asserts that the quality of the business has been established such that it can endure short-term uncertainty and still thrive in the long run. In contrast to popular belief, Chris views the active involvement and leadership of Mr. Del Vecchio since 2014 as a positive for the Company and the other 33.5% of shareholders while concerns towards succession planning should be viewed as short-term "noise". Luxottica trades at ~€50 per share with an EV/EBITDA multiple of 13x which Chris believes to be attractive given the long-term growth outlook for the industry, the potential for further consolidation in the retail and wholesale segments, newly planned expansion into the lens market coupled with the possibility of a merger with global lens giant Essilor.

***STEVEN WOOD**, PORTFOLIO MANAGER, GREENWOOD INVESTORS*

BOLLORÉ (Paris: BOL) and **TELECOM ITALIA SAVINGS SHARES** (Italy: TITR) are two very timely ideas as we head into 2017. Both trade in markets which are hated by international investors. The world is underweight or short these markets, and Steven disagrees with this view. Yet, on their own, each company trades at historical trough valuation levels at the exact time the underlying businesses are showing tangible signs of near-term improvement. Bolloré is an investment holding company, trading at a roughly 60% discount to NAV, which consists of African ports and global logistics businesses, and controlling stakes in Vivendi and Havas, both media heavyweights in France. Run by an active value-creator with a terrific track record, Vincent Bolloré is transforming the weakest parts of Vivendi, with 2017 being a major year of stabilization and profit growth. Similarly, trade in Africa is beginning to stabilize with a stronger commodities environment, and is poised to grow significantly in the coming years of rebound. Steven believes NAV is poised to double in the coming years. Vincent is asserting similar control over Telecom Italia, through Vivendi's 25% stake in the company, and has accelerated cost-cutting efforts, taken positive pricing actions, and is working to increase the value proposition of the company's Telecom services. Because Telecom Italia is not only the cheapest Telecom in Europe, but also leveraged, high single-digit growth in cash flow will result in 25-30% compounded growth in Telecom Italia's fair value, holding its trough valuation steady. With Q3 results showing the first growth in revenue in a decade, 2017 results will be building on the solid progress achieved thus far, and handily exceed a sanguine consensus.

***KYLE MOWERY**, MANAGING PARTNER, GRIZZLYROCK CAPITAL*

TFS CORP. (Australia: TFC) has an effective monopoly on the world's supply of Indian sandalwood, used in cosmetic, religious, furniture, and pharmaceutical products. Based on Kyle's sum-of-the-parts analysis, he believes the shares of TFS have the potential to appreciate more than 100% over the next three years. TFS recently became FCF positive with visibility for FCF production for decades to come, which should catalyze the stock price higher in 2017 and beyond. TFS's internally owned Indian sandalwood plantations are worth more than the recent enterprise value of the company. Thus, an investor today is getting paid to own: 1) a profitable forestry business generating $60 million of annual EBITDA; 2) future performance fees worth $210 million fully taxed and discounted, and; 3) a pharmaceutical subsidiary in the U.S. with four candidates in FDA Phase II trials. TFS' marquee forestry customers include Harvard Endowment, GMO, and The Church of England, while its harvests are forward sold at pre-determined prices to international customers including Nestle and Young Living. This idea is timely given that Indian sandalwood takes 15 years to mature and TFS's first meaningful harvest represents a step-change in FCF beginning in fiscal 2017.

***JAMES ROUMELL**, PRESIDENT, ROUMELL ASSET MANAGEMENT*

ROSETTA STONE (NYSE: RST): Rosetta Stone provides technology-based language learning solutions. RST continues to execute on its plan to focus on three core business lines: enterprise and education (E&E) language, literacy (Lexia Learning) and serious consumer language learners. Led by John Hass and a strong board, the company is showing signs of a turnaround. Jim believes the company will continue to improve operations and will attract financial and strategic buyers. The company recently reported its seventh consecutive quarter of year-over-year opex reductions. Summing the company's net cash balance and the value of fast-growing Lexia Learning (year-end annual bookings run-rate of $40 million, coupled with 90% plus renewal rates and a 30% plus annual growth rate), implies little value for the company's consumer and E&E language businesses. Jim assigns a $100 million valuation to Lexia (2.5x year-end bookings run-rate), leaving the company's combined language businesses (consumer and E&E) valued at $52 million. Applying a modest 1x multiple to language revenue of about $150 million sums to a total RST valuation of roughly $285 million, or $13 per share.

PARATEK PHARMACEUTICALS (Nasdaq: PRTK): Since presenting PRTK at Best Ideas 2016, the news continues to exceed expectations. PRTK successfully reported its Phase 3 ABSSSI (skin) IV to oral trial results in May 2016. The company recently made other positive announcements. If the news on PRTK is so good, why did the stock drop ~30% last year? It is difficult to know, but at least two story lines are likely contributing to the sell-off. First, the NBI biotech index, comprised of the largest biotech companies, was down ~23% last year. PRTK is performing in-line with its smaller-cap biotech peers. This across-the-board selling seems to be the result of high-profile pharmaceutical price gauging cases leading to fears of legislative price restrictions on drugs. What does not seem to be well understood is that three years ago, Congress (with Democrats and Republicans joining together) passed the GAIN Act to increase the profitability in antibiotics in order to spur development given the dire need for new antibiotics articulated by the CDC and many world health organizations. Second, a PRTK competitor, Cempra recently experienced manufacturing problems and liver toxicity issues, sending CEMP stock down 60+% in one week. Jim continues to value PRTK at $1.5 billion (either 1.5x multiple to $1 billion in peak sales or 1x peak sales of $1.5 billion). On a per-share basis this translates to $65, compared to last year's number of $86 per share, accounting for the recently higher share count associated with raising capital to fund an oral-only skin trial.

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